Priorities for the insurance sector

1. At the global level, insurance standard setters are finalising common quantitative and supervisory standards and monitoring the risks to the insurance sector, and their implications for financial stability

A regulator explained that the International Association of Insurance Supervisors' (IAIS) five-year plan emphasises the importance of monitoring, identifying and addressing emerging risks to ensure macroprudential soundness in the insurance sector. The qualitative element of the IAIS' Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) was adopted in 2019, with the Insurance Capital Standard (ICS), the quantitative element of the ComFrame, to be finalised by the end of the year.

The Holistic Framework for the assessment and mitigation of systemic risk in the global insurance sector was also adopted in 2019 as the IAIS' monitoring framework. As part of the Holistic Framework, the IAIS' annual Global Monitoring Exercise (GME) collects data from supervisors and industry and provides a robust framework that presents the basis for global supervisory discussions. In 2024, the GME will focus on two areas: first, interest rates, liquidity and credit risks, including the transmission channels for geopolitical risks, second round effects from commercial real estate exposures, the debt sustainability of fixed-income assets, the impact of digitalisation and AI, and secondly, structural shifts in the life insurance sector, including increasing investment in alternative assets and growth in asset-intensive reinsurance, with an IAIS issues paper to be published in H1 2025.

A special topic in the Global Insurance Market Report (GIMAR) next year will be dedicated to the financial stability implications of natural catastrophe (NatCat) protection gaps.

The IAIS remains vigilant in monitoring emerging risks, and collaborates with all relevant stakeholders, including policymakers, other standard-setting bodies, the Financial Stability Board (FSB) and industry, in order to contribute to global financial stability. In this context, the IAIS' Targeted Jurisdictional Assessments (TJAs) of the Holistic Framework supervisory material have also demonstrated that there has been consistent and strong implementation of the Holistic Framework supervisory standards, which is the evidence that enhanced macroprudential supervisory practices have been seen in the insurance sector in recent years.

On the way forward of the implementation assessment of supervisory standards, the ICS will be finalised by the end of 2024. In 2026, IAIS will coordinate a baseline self-assessment process. In 2027, the aim will be to start an in-depth TJA on ICS implementation.

2. In the EU, at the start of a political cycle, many challenges for the insurance sector exist

The Chair noted the value of seeking the views of experts at the start of a new political cycle on the positives and negatives of the current framework, as well as priorities for the future in terms of regulation and political initiatives. The risk and business context for insurance must also be considered, alongside demographic and geopolitical trends and the sustainability and digital transitions underway. The fundamentals of the insurance process may be impacted, as the sector is asked to play an enhanced role supporting the economy and filling protection gaps.

3. The current EU regulatory framework for the insurance sector, which is world-leading, is an asset for the sector

An industry representative characterised Europe's regulatory framework as world leading. Solvency II has provided insight into how the ICS might impact the insurance market. In Japan, insurance companies are already calculating their internal economic solvency ratio (ESR) in preparation for ICS implementation, to ensure financial soundness and to consider how companies might best benefit policyholders and society.

Europe's climate risk disclosure requirements had a global impact. Insurance companies must engage with investment and funding partners to encourage behaviour change, despite the difficulties and costs required by EU regulations. It is impossible to address every issue with a one-size-fits-all approach, which may cause a significant challenge such as widening protection gap.

3.1 Recent adjustments facilitate long-term investment by insurance companies

A policymaker suggested that the framework, which is solid and respected, delivers on its objectives and ensures insurance sector stability through economic and geopolitical challenges. Nevertheless, a stocktake following first years of application showed a need to fine tune certain aspects. The new rules agreed end of last year can help the sector to deliver in more general terms. They address gaps in the framework in terms of investor and policyholder protection and the role of the European Insurance and Occupational Pensions Authority (EIOPA). They create the conditions by which investment capacity can be boosted, though preferential treatment for long-term investments in equity. This has relevance for the capital markets union (CMU). The finetuning of the long-term guarantee measures, including the volatility adjustments are another welcome change.

These rules can also be used in service of the Green Deal, including through the introduction of prudential transition plans. The European Commission wishes to see more made of the cooperation between home and host in terms of cross-border service provision and the strengthened power of EIOPA.

3.2 Covering new risks (technology, cyber and climate) requires swift implementation of the revised framework and enhanced insurance undertakings contribution to the CMU, envisaging additional adjustments

A regulator warned against complacency, despite the robustness of the framework. Regulation has expanded over the past five years to cover new technology, cyber and climate risks. The measures agreed by the European Parliament are yet to be implemented. Pragmatic implementation after levels 2 and 3 will be essential.

An official highlighted that the Solvency II review will give insurers leeway to invest in the European economy and green transition. In this regard the specific prudential treatment for long-term equity investment is most welcome. Along the same lines, adapting the prudential treatment of securitisation, a cornerstone of the CMU, will be key. France is eager to work closely with the European Commission during level 2 deliberations to deliver on these issues. Competitiveness was one of the objectives of the Solvency II review and must also be put at the heart of upcoming ICS discussions.

An industry representative emphasised that the Solvency II is a robust prudential framework as well as a good economic risk management tool for companies that should be protected, particularly with regard to the ICS discussions. The ongoing review is going in the right direction following the line of the political agreement of December 2023, wherein welcome changes were introduced to facilitate investment in Europe. However, the practical impact will depend on the level 2 measures currently under discussion These discussions should not overrule the previous political agreement on level 1. In this context it is important for regulators and the insurance sector to work together on level 2 and 3 measures. Another objective recognised by the European Commission is that the unnecessary regulatory burden must be reduced. This latter point is not only about Solvency II.

4. Supervisors in the EU have a strong role to play

4.1 The actual relaxation of capital requirements requires supervisors to exercise greater caution in a number of areas, in order to evenly ensure the protection and confidence of policyholders throughout the EU

A regulator explained that the nature of regulation has changed. The easing of capital requirements within Solvency II in practice meant billions of euros less capital to protect policyholders. While EIOPA advised that some easing is necessary to recognise the long-term investment part of insurance, this has gone too far, straying into mid-term and short-term investments. Supervision has changed to consider beyond only the prudential.

Europe has created a single market for insurers, but not consumers. Inequal protection for consumers across European member states is a risk. Consumers are being asked to move money protected by a deposit guarantee scheme into an insurance product where there is generally no insurance guarantee scheme. EIOPA does not have the power to resolve every issue. The Chair observed that there is still significant work to be done on the supervisory side.

4.2 Supervisors still have to clarify certain issues and optimise the balance between customer protection, insurers' contribution to EU investment needs and EU insurance companies' competitiveness

A regulator noted that regulators seek to inform and advise, with no commercial interest. There are misconceptions, for example, about the level of investment by EU insurers in Europe. Supervisors can use their reputation to inform debate and challenge the industry. The industry must balance consumer protection with the need for investment in Europe. The retail investment strategy will be a key consideration in this regard, as will the European competitiveness debate. Supervisors view the current conversation as unbalanced. Competing elements must be brought together to provide simple products with the same protection for every European.

4.3 Developing sustainability risks require supervisors' caution

An official remarked that the insurance sector has successfully dealt with challenging situations. The robustness of the prudential framework is the cornerstone of its resilience. The prudential transition plans introduced in Solvency II will be useful tools, provided that they are made fully consistent with the Corporate Sustainability Reporting Directive (CSRD). EIOPA's work on climate-related risk and climate protection gaps is welcome, as is the 2024 stress test conducted by Autorité de Contrôle Prudentiel et de Résolution (ACPR) at the French national level, but more work is needed.

4.4 Attention is paid to balancing the regulatory framework and limiting regulatory burden

An industry representative reported that European confidence in the non-life insurance sector is strong. There is a question of whether the right balance is being struck. The fundamental goal of broader insurance at an affordable cost is sometimes forgotten and here the insurance sector can contribute to European competitiveness and the wellbeing of the European citizen. There is a positive direction of travel in the prudential field, but perhaps less so in other areas of regulation.

A regulator commented that, in practice, there is a lot of supervisors must deal with. Reducing the regulatory burden would be helpful. For example, EIOPA has reduced the datapoints required from small- and medium-sized enterprises implementing reporting

technical standards (ITS) and is reviewing the Solvency II guidelines. Revised versions have thus far reduced the number of articles by at least 20%.

A policymaker noted that Solvency II level 2 measures are under discussion, with a view to balancing competitiveness with financial stability and consumer protection. Moreover, work on the retail investment strategy would not end with matters currently before the legislature, as the retail investor must be put at the heart of the CMU. In the new political cycle, there will be a focus on implementation, enforcement and consistency, including cutting red tape and reducing duplicated reporting requirements. The question of why the insurance sector is kept away from securitisation will be reviewed.

The debate on the European Securities and Markets Authority (ESMA) might also apply to EIOPA. Centralising of supervision is a possibility, but strong political commitment will be needed to engage with the notion of an investor guarantee scheme. There is optimism that political will of this nature will develop.

4.5 Sustainability challenges also require complementary approaches and focus points

An industry representative recommended that artificial intelligence (AI) be considered an opportunity to improve productivity and understanding of risk first before it is considered a risk. The main contribution insurers can make to the green agenda is prevention of and adaptation to climate change. There is insufficient focus on liability and how the regulatory framework might foster preventative action on the part of the insured. However, the insurance sector must have the humility to admit that it cannot do everything. Collaboration is key.

The Chair concurred that the insurance sector can contribute both to the transfer of risk and to prevention, to the benefit of the policyholder and society. It is uncertain whether there are regulatory obstacles. Insurers are being asked to do more, beyond their traditional role.

An industry representative added that the reasons behind the decline in affordability must be considered. It is possible that a regulatory framework aimed at stabilising insurance companies might reduce the availability of insurance services. It remains unclear how agreement can be reached on climate risk between developing and developed nations.

5. In the EU and globally, economies are facing additional challenges – cybersecurity, climate-related threats, solvency of social security schemes, development of fintech – and both should leverage the insurance sector as these challenges might impact the risk pooling that traditionally underpins insurance

An industry representative recognised the issues at play, including climate and cyber risk. There are three key elements to consider. First is progress in medical technology, which might reverse the informational asymmetry between insurers and consumers, leading to adverse selection issues or the emergence of a group no longer requiring insurance. Second is the management of the health of individual citizens by the government as social security systems reach their limit. Third is a radical reorganisation of the financial industry, as a result of reduced transaction costs. Reliance on traditional risk pooling models will become increasingly difficult. The division of roles between the public and private sectors in terms of regulation may require review.

5.1 Addressing the negative impact of demographic shifts on the pension and health system, as well as cyber risk

The Chair highlighted the challenge of balancing different objectives. There is work to do and a role for the insurance sector play in terms of filling the demographic gap.

An industry representative supported the idea that a pensions dashboard as promoted by EIOPA is a step in the right direction to foster awareness by citizens. On health, more can be done on the public private partnership (PPP), particularly in terms of prevention and data sharing. Insurance companies can be part of the solution. The sector is engaged to contribute to bridge the pensions gap while ensuring sustainability and promotion of long-term investments in Europe, through further development of collective and individual savings and pension products. However, promoting private collective pensions will require political courage.

An industry representative noted that insurers and reinsurers are eager to develop coverage for digitalisation and cyber risks. It is a key issue covered by the Draghi report, though the precise definition of cyber warfare remains unclear. This may become problematic in the future.

5.2 Insurance digitalisation raises regulatory challenges for the sector, notably because of horizontal regulations on insurance mechanisms

The Chair observed that technological innovation creates risk but can also provide opportunities for the insurance sector to take up its ever-evolving role. An industry representative added that new technologies are likely to be the main tools by which the insurance sector can increase productivity. One use case might be the tailoring of products for clients, using client data. However, this would require specific regulation. Horizontal regulation raises some concern. Any regulation must also be tailor-made and both horizontal and specific.

The Chair suggested that digitalisation, while helping the insurance sector price better, might also limit the mutualisation principle behind insurance. An official was of the view that enhanced cyber security is the key to better balancing innovation, customer protection and sound insurance markets. France strongly supports the development and enforcement of cyber risk governance in the European financial sector. Innovation fostered through regulation must be pragmatic. The Financial

Data Access Act (FIDA), for example, aims to develop personalised products, but will also impact the economic model of European actors.

If there is no caution, data sharing might negatively impact mutualisation, the principle at the heart of the insurance sector. Indeed, generalising data sharing through FIDA might result in a much more targeted and heightened selection of risks, which would increase financial exclusion and widen protection gaps. The Chair agreed that it is a matter of balancing different objectives.

A regulator explained that AI is already supervised under Solvency II. An AI Act is additional, has overlap with Solvency II and adds complexity. Supervisors seek to build a final, single set of regulation where the source, AI Act or Solvency II or both is irrelevant to insurers.