Q&A

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Building a more resilient economy: a robust insurance sector and sustainability

What are the key risks, trends facing the global insurance sector and the related priorities for the IAIS for the coming years?

The IAIS assesses emerging risks and trends in the insurance sector through the annual Global Monitoring Exercise (GME). In July, the IAIS published preliminary findings of the 2024 GME in a mid-year Global Insurance Market Report (GIMAR). The interim results show stability in the insurance sector.

The 2024 GME will cover two risk themes that are top-of-mind for supervisors:

- The first theme is on interest rates, liquidity and credit risks. The global economic growth could be negatively affected by factors such as prolonged high interest rates and high level of debt. We will look at transmission channels from geopolitical risks, second round effects from commercial real estate exposures, debt sustainability of fixed-income assets and the impact of digitalisation and AI on the insurance sector.
- The second theme is on structural shifts in the life insurance sector and covers two elements: First, the impact of growing investments by insurers in alternative assets. Supervisory concerns could include: discretionary valuation of assets; liquidity risks; hidden leverage; credit risk; and transactions with affiliated parties. Second, the growth in cross-border asset-intensive reinsurance, whereby a material part of an insurer's investment risk is transferred to the reinsurer. Supervisory concerns could include knowledge gaps regarding non-domestic prudential frameworks, limited information exchange and potential conflicts of interest within corporate structures. Possible financial stability risks include concentration risks at the jurisdictional and reinsurer-level, as well as potential herd behaviour amongst insurers.
- A more comprehensive update will be included in our December 2024 GIMAR and in an Issues Paper that we aim to receive public consultation on in the first half of next year.
- Additional focus areas for the 2024 GME are operational resilience to cyber risk and climate-related risks. In August, the IAIS published for consultation an Application Paper on objectives for supervisors to support insurers' operational resilience, including cyber resilience. The IAIS will also publish a GIMAR special topic edition next year on the potential financial stability implications of natural catastrophe protection gaps.

For the period 2025-2029, the IAIS will remain vigilant in its assessment of key risks and trends impacting the global insurance sector and will continue to enhance its GME and strengthen the link between its risk assessment and globally coordinated supervisory responses.

What are the main challenges for the adoption of IAIS standards (ICS) at the global level and the outcome of the IAIS process to achieve an effective consistency in this area?

The IAIS is currently finalising the global solvency standard for internationally-active insurance groups, the Insurance Capital Standard (ICS). We remain on track with respect to the timelines for finalization. With the ICS clearly in sight for adoption in December, the IAIS set high-level timelines to assess the comprehensive and consistent implementation of the ICS across jurisdictions. These timelines recognise that it will take some time for jurisdictions to finalise necessary regulatory and supervisory changes to align with the ICS, taking into account jurisdictional circumstances. For the IAIS to prepare for implementation assessment:

- The ICS implementation assessment will follow a two-step approach. In 2026, the IAIS will coordinate a baseline self-assessment by IAIS members of their progress in implementing the ICS, which will be a foundation for future implementation progress monitoring. The IAIS will aim to start in-depth targeted jurisdictional assessments in 2027.

- In preparation, the IAIS will begin developing an ICS implementation assessment methodology in 2025, leveraging the IAIS' general principles and methodologies for assessing its standards, while considering the quantitative nature of the ICS. It will specify an appropriate level of granularity and articulate the quantitative and qualitative analyses to be used in the assessment.
- The IAIS is beginning work to define the need for and scope of any future ICS-related data collection from insurance groups and group-wide supervisors that may be needed to facilitate the consistent implementation of the ICS. Any such data collection would be more targeted than the data collection undertaken during the monitoring period, which supported the development of the ICS. It would continue to be voluntary, and coordinated with the data requests made in other areas of IAIS work, to avoid any duplication.

What are the views at the international level on the transition path and the balance between market-driven transition and formal transition policies? How is Japan managing these dynamics?

- While transition finance, which Japan has advocated from the very beginning at the G20, has gained broad support globally, its operationalization remains a challenge.
- This is particularly because transition paths could vary depending on the policy frameworks the government puts in place reflecting the national net-zero target, while benchmark pathways, through which the credibility of each corporate transition plan would be assessed, are often framed on a global basis.
- Simply put, we need to be ambitious in our aspiration but practical in our approaches. In this regard, market-driven transition and formal transition policies should work in tandem, complementing each other.
- As such, formal transition policies should anchor the direction of market-driven transition with certain safeguards. The government can demonstrate its commitment with a high-level of ambition through formal transition policies, including regulations, tax incentives and subsidies. A market-driven approach can also be a powerful tool, using the private sector's appetite for innovating energy and industrial processes towards net-zero.
- The view within the Japanese government is that collaboration among stakeholders provides a useful basis for a sustainable path towards achieving net-zero. The government has published the Green Transformation Strategy and sectoral road maps, thereby providing national benchmark transition pathways for industries. It not only outlines future transition paths but also includes necessary public support, even for SMEs, for easier transition planning. The FSA has issued guidance encouraging financial firms to engage with clients to better support them in achieving their climate goals. These multi-faceted, on-the-ground, practical approaches will help create a fusion of formal transition policies and market-driven transition approaches.
- In addition, Japan has started to exchange views with ASEAN countries on how to operationalize transition finance, for example, by identifying good use cases. Given Asia's large GHG emissions, such regional approaches can help to consider Public Private Partnerships and to reflect on targeted flexible approaches of regulatory frameworks on climate-related risks.
- We should steadily advance efforts even against geopolitical tensions and inflationary pressures. However, we also must be mindful how it fits into our overall macroeconomic policy management. Ambitious targets but practical approaches will be needed to achieve a sustainable path towards net-zero while avoiding sustainability fatigue.

How is Japan addressing the challenges posed by the lack of definition of financial sector climate change transition plans and the need to align them with the national transition plan?

- Financial institutions (FIs) can play a pivotal role in encouraging real economy corporations to transition to net zero, even though direct GHG emissions from FIs might be insubstantial. This important role of the financial sector could be well supported by the deployment of transition finance.
- Japan has developed its national transition finance framework in line with its commitment to net zero by 2050 and consistent with its NDC and other policies. The framework is comprised of guidelines and sectoral roadmaps, as described in Q3.
- These efforts are expected to help reach a closer alignment of private sector transition plans (TPs) with the national TP.
- In this regard, for real economy corporations, TPs are often a strategy document. But, while TPs are used for various purposes, for FIs, ensuring the implementation of a credible TP by their clients may also lead to their management of climate-related risks. This will not only reduce immediate transition and physical risks at their portfolios but also ultimately bring down risks for the whole system.
- One of the candidates for FIs' TP metrics is financed emissions. Given its backward-looking characteristics, however, we need to find a set of forward-looking metrics that can measure how financial activities, ranging from provision of finance to engagement with clients, contribute to emissions reduction and alignment of clients' TPs with net zero goals.
- Building on the above-mentioned guidance, the FSA aims to develop an effective monitoring framework for climate-related risk. This framework will emphasize the dialogue with FIs to identify the progress on how they manage climate-related risk through supporting clients' alignment of its TPs, ultimately reducing climate related risks for the whole financial system.