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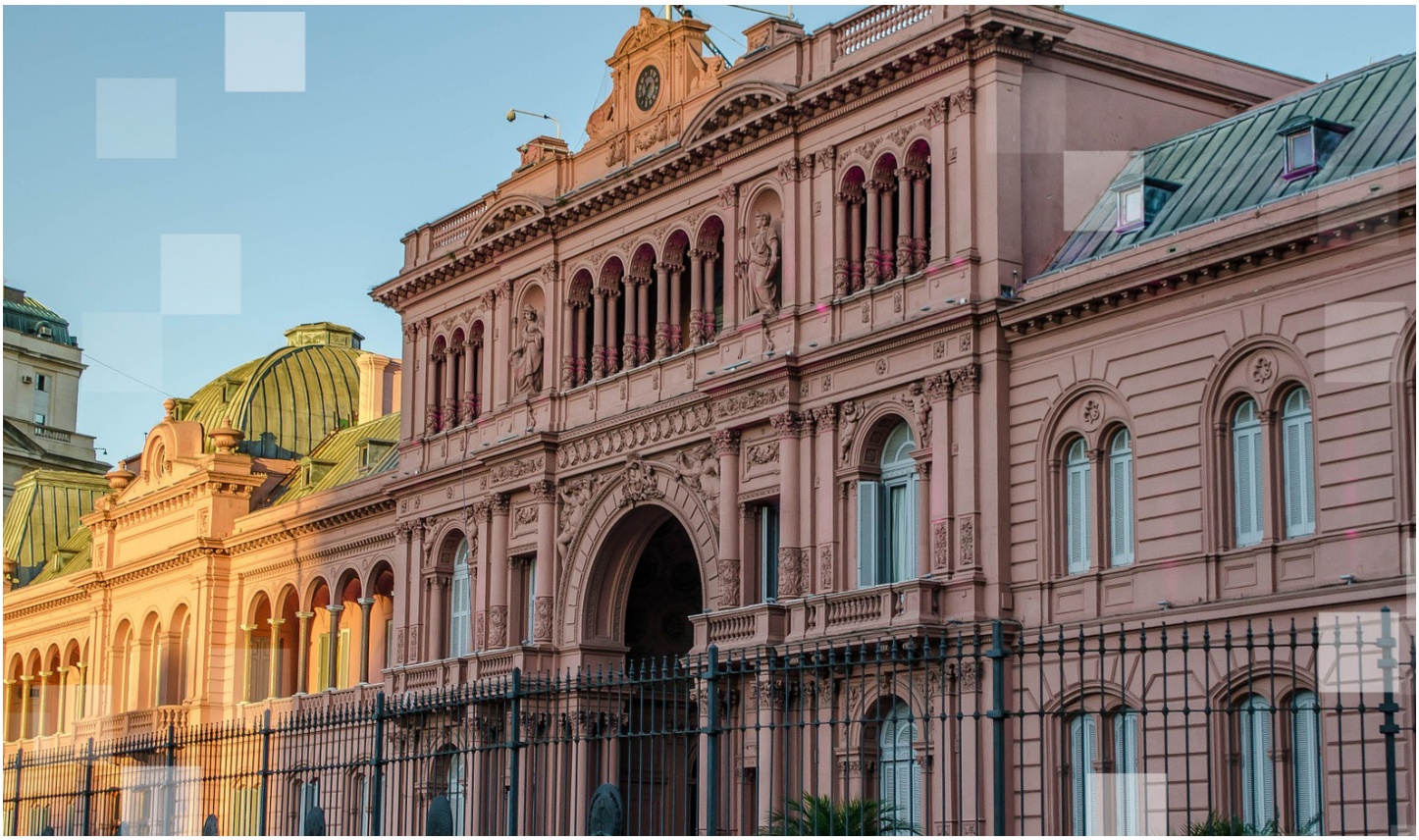

IAIS update—2019 Global Seminar

International insurance supervisors set out their new strategic direction—pivoting their focus from capital to risk management

Buenos Aires, Argentina – Hosted by the Superintendence of Insurance Argentina (SSN), the 12th annual International Association of Insurance Supervisors (IAIS) global seminar was held June 13–14, 2019, in the beautiful city of Buenos Aires, now more than 400 years old and famous for its European-styled architecture and cultural life. The IAIS was celebrating its own milestone—25 years since the first meeting of the IAIS was held in Baltimore, Maryland, US. The focus of the meeting was not the quarter of a century birthday celebration, but rather the full agenda of the two-day seminar.

At the 11th IAIS global seminar held in Moscow in 2018, 10 years since the financial crisis, the IAIS sought to put a stake in the ground that the work on post-crisis macroprudential initiatives to reduce systemic risk was largely complete. However, a number of these initiatives remain, including systemic risk and its an impact on insurance, establishing the common framework (ComFrame) for internationally active insurance Groups (IAIGs) and its major component—the design and implementation of a global insurance capital standard (ICS).

The IAIS attempted to set a new strategic direction during the 2019 seminar, which provided a detailed overview of the *The IAIS Strategic Plan 2020–2024*. However, with so much of the macroprudential initiatives still in flight, will the strategic plan be overshadowed by the continued efforts to complete past initiatives? In Argentina, as the birthplace of the famous tango dance,

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the question was raised: how would the IAIS dance of setting a new strategic direction and completing in-flight macroprudential initiatives at the 12th annual seminar play out?

Welcoming regulators and industry stakeholders from around the world, the IAIS Secretary General Jonathan Dixon thanked the hosts from the SSN and conveyed his appreciation of all stakeholders, noting how this had fed into the IAIS's own strategic discussions and planning. He further spoke of the changing risk landscape, with pressing societal challenges, and that there should be consideration of both the challenges and opportunities this brings to the insurance sector.

The IAIS Executive Committee (ExCo) Chair Victoria Saporta reiterated the IAIS was looking to finalize aspects of the financial crisis reform agenda, and while the dialogue was at times intense, the discussion was productive. She noted that the IAIS is embarking on a new strategic direction and is setting out a plan for the next five years. This new direction was described as a pivot from the work to implement past reforms toward emerging industry risks and trends. Saporta called for a more collaborative response to issues such as operational and cyber resilience, with the common goal of recognizing these initiatives as more aligned across stakeholders than previous reforms such as the ICS.

Santiago Bausili, secretary of finance, Ministry of the Treasury, Republic of Argentina, reminded the audience of the reforms introduced by Argentina's president, one of which was the reinsertion of Argentina into the global financial services market. Argentina has identified a regulatory opportunity to bring its standards up to those of the international community. In viewing this as a long-term objective, Argentina wants to make sure both industry and regulators work together.

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The IAIS strategic plan 2020–2024 —the new strategic direction

The strategic plan was approved by the entire IAIS membership at the time of the 2019 IAIS Global Seminar, and it is available on the IAIS website. Described as a watershed moment for IAIS, the 2020–2024 strategic plan will see the association continue to support and implement existing standards contributing to global financial stability, as well as pivot in ways to help IAIS members from more than 200 jurisdictions respond to a new risk environment. Going forward, the IAIS's core functions are defined as the following:

1. **Assessing and responding to market developments** – Monitoring and scanning key risks and opportunities by leveraging the membership base of more than 200 supervisors.
2. **Standard setting** – The IAIS has spent many years developing and agreeing to supervisory standards and will continue to maintain this effort as needed. However, the focus will be on monitoring and assessing implementation of current standards. The IAIS will pilot a deep dive and conduct comprehensive member assessments to evaluate compliance with the adoption of standards. This will help IAIS members understand how well they have met the minimum standards.
3. **Supporting supervisory practices** – Supporting the implementation of supervisory material and helping supervisors adopt best practices.
4. **Supporting observance of standards** – Partnering to enhance supervisory capacity to improve the insurance market and to enable supervisors to better supervise their local markets. For example, IAIS Executive Committee Member (ex officio) Peter Braumüller noted discussions with the International Actuarial Association (IAA) concerning building actuarial capacity, particularly in markets that are challenged in this area.
5. **Effective operations and transparency** – Improving internal efficiency of IAIS by creating a sustainable financial model that no longer relies on industry contributions.

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Strategic themes

IAIS activities will focus heavily on certain key themes over the period of the 2020–2024 strategic plan, many of which are areas of common interest with other standard setting bodies, but also have a particular insurance sector perspective, including:

- Technological innovation – FinTech presents significant opportunities for financial inclusion and policyholder value, but also poses operational and underwriting risks. The rapid expansion in alternative data sources and advanced data analytics has the potential to disrupt the insurance market;
- Cyber resilience – insurers are not only exposed to cyber risks but are also active takers of cyber risk through their cyber underwriting activities;
- Climate risk – insurers are exposed to both transition risk as institutional investors and physical risk from natural disasters through their underwriting, but can also be key agents in the mitigation and management of climate risk;
- Conduct and culture – technological changes to the insurance business model present new conduct challenges. A holistic approach to market conduct and prudential supervision is called for, recognizing that conduct and culture issues could lead to financial soundness and stability concerns; and
- Financial inclusion and sustainable economic development – insurance supervision has an important role to play in insurance market and economic development. Policyholder protection and contributing to financial stability are fundamental to ensuring the sustainable involvement of the insurance sector in closing the protection gap.

Insurance capital standard

The ICS v2.0 will be approved at the end of November. Once approved, the ICS will go into a five-year monitoring period that will not be a prescribed capital requirement (PCR) but will be used by supervisors to monitor the performance of the ICS. The design of ICS v2.0 will not change over the period, but any unintended design flaws will be addressed through a consultative process. It was noted that the Kuala Lumpur agreement includes the delivery of ICS 2.0 during the five-year period (2020–2024) as well as the review of the group capital calculation (GCC) being developed in the United States.

Pivoting focus to risk management

The IAIS's intention is to monitor risk trends as part of the strategic plan, and it will be active in performing this role. Risk topics include: digitalization, cyber resilience, data privacy, third-party risk, climate risk (including the role of sustainable investment), conduct and culture (noting the recent Australian commission report into conduct), and financial inclusion, against a backdrop of societal challenge and changing demographics.

The IAIS noted that many of these risks cut across both the conduct and prudential agenda, for example, machine learning and artificial intelligence, in which underwriting programs could be discriminatory. Algorithms and model risk also present challenges for many supervisors. It's worth noting that some countries have begun to address this through consultation work and the issuing of new standards. Additionally, the IAIS would like to improve accountability at the board level and seeks to improve the risk culture within companies. IAIS further noted that a holistic view needs to be taken of these new risks, and, if existing standards are not sufficient, new standards would be developed.

Stakeholder engagement

The IAIS indicated a desire to explore new ways to engage with industry. Stakeholders asked the question, "Would IAIS matters remain a hot topic for insurance companies going forward?" The IAIS confirmed that insurance companies should continue to stay engaged, especially around topics such as climate change, cyber security, and AI. A polling question held during the session indicated that stakeholders were supportive of the pivot in the IAIS's focus to the strategic plan. Additionally, stakeholders at the seminar indicated their preference for communication through stakeholder-engagement sessions.

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ComFrame and the ICS—moving toward implementation

One year ago, ComFrame was issued for consultation along with ICS version 1.0. Except for the holistic framework comments, ComFrame is considered close to being finalized. The IAIS 2019 focus for ComFrame development will include:

- Identification of IAIGs by group-wide supervisors; and
- Increased supervisory cooperation and coordination with supervisory colleges.

On April 30, 2019, ICS field testing commenced, with submissions due by the end of July 2019. This year, 50 volunteer groups are participating. The public field-testing package was released at the end of June 2019, and a public call followed for the IAIS to provide context to stakeholders.

The objective of the ICS continues to be a common language, along with comparable outcomes for insurance company regulatory capital. Stakeholders noted that the industry is concerned about confidentiality during field testing. The IAIS leadership responded that it is mindful of confidentiality during the upcoming five-year monitoring period and feels appropriate controls are in place. The monitoring period is not intended to be used by supervisors to review capital adequacy, but rather to review the ongoing development and performance of the ICS design. It will not be used as a PCR, and IAIGs are not expected to manage their business to a PCR-capital constraint. This assessment by the group-wide supervisor and supervisory colleges should include four components:

1. A comparison of the ICS to existing capital requirements (or those under development). For example, work will continue in parallel to review the aggregation being developed in the United States to understand if it is comparable to the ICS, and if it could in the future be used as a PCR.
2. The extent to which material risks are captured by the ICS.
3. The appropriateness of the ICS calculation and how practical it is.
4. Understanding any difficulties in implementing the ICS by the IAIG or the IAIG's supervisor.

It was noted that, during the monitoring period, significant design flaws are unlikely to be identified since previous field testing should have identified these. However, if design flaws are discovered, then they will be considered. It is anticipated that, prior to the adoption of the ICS as a PCR, there will be a further public consultation.

Stakeholder feedback included:

- Potential tension between the local supervisory and group-wide views, in which companies may be challenged to manage both jurisdictional and group needs.
- The ICS capital measure may not always be the right measure of financial risk. For example, liquidity risk may be better assessed through other tools such as asset and liability management (ALM)/liquidity measures.
- Recovery and resolution planning are perhaps the toughest part of ComFrame that will be required for all IAIGs. While efforts have been focused on risk management and capital, the recovery-plan components are new, and supervisors will need time to consider and adopt them.
- The time line for adoption continues to be tight, and more time may be required. However, it is recognized that some deadlines for adoption are rigid to help drive faster decisions.
- Currently, the ICS is performed on a best-effort basis. To improve reliance on the ICS, consideration will need to be given to how the required quality standards for ICS are put into production in 2025.

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The holistic framework for systemic risk in the insurance sector

After the financial crisis, work was performed to deal with the issue of systemic risk in the financial services industry, including work in the insurance sector. The IAIS supported the FSB with the development of a framework and process to identify globally systemically important insurers (G-SIIs). Nine G-SIIs were initially identified using an assessment methodology developed by the IAIS, along with policy measures that should apply. This work has been subject to continued refinement, which included the decision to move to an activities-based assessment approach. Work on the holistic framework commenced in 2017 with the publishing of an activities-based approach to assess systemic risk. Over time, the IAIS also reviewed several approaches and brought them together in the publishing of a holistic framework consultation document in November 2018.

The IAIS team expects to finalize its work on the holistic framework by November 2019, and a consultation process to aid finalization is set to close August 15, 2019. Key elements of the framework include:

1. An enhanced set of supervisory policy measures.
2. A global-monitoring exercise by the IAIS.
3. Supervisory powers of intervention.
4. Mechanisms that help to ensure the global consistent application of the framework.
5. The IAIS assessment of implementation of supervisory material.

The goal is that this work will be completed in time for the 26th annual conference in Abu Dhabi with implementation taking place in 2020. This would be consistent with expectations set with the FSB. Implementation of the holistic framework will require:

- Adoption of policy measures by supervisors.
- The IAIS coordination of the annual global-monitoring exercise and data collection.
- An assessment of implementation by the IAIS of the supervisory material contained within both the insurance core principles (ICPs) and ComFrame.

In 2022, the FSB will review the holistic framework to consider the IAIS recommendation to suspend the G-SII identification process. It was noted that, for now, the annual data-collection exercise will continue but will be adapted based upon the November 2018 consultation.

Development of the holistic framework

2017

February:

Announcement of the IAIS Systemic Risk Assessment & Policy Workplan

December:

Release of interim public consultation on Activity-Based Approach

2018

February:

Stakeholder event

November:

Release of public consultation document on the Holistic Framework for Systemic Risk in the Insurance Sector

2019

January:

Stakeholder event

Mid-June – Mid-August:

Public consultation revised ICPs and ComFrame related to Holistic Framework

November:

Adoption of the Holistic Framework by the IAIS AGM

2020

Implementation starts, including:

- Global monitoring exercise by the IAIS
- Implementation of revised ICPs and ComFrame

2022

November:

FSB review of the holistic framework and the role of an annual identification of G-SIIs

Source: Holistic Framework for Systemic Risk in the Insurance Sector, IAIS Global Seminar – June 13, 2019, Buenos Aires.

IAIS Executive Committee dialogue

Led by Jonathan Dixon, IAIS secretary general, an update was provided on IAIS strategy. It was also noted that the ExCo had said goodbye to its current vice chair, Julie McPeak, during the week of the global seminar, and seamlessly appointed a new vice chair, David Altmaier, from the state of Florida.

Stakeholders at the global seminar welcomed the IAIS strategic plan with the change in focus to emerging risks and local-market supervisory developments. The IAIS paper on climate change in 2018 was provided as an example of this pivot to engage with global stakeholders in emerging risks. The ExCo noted that it is difficult to develop international standards in some of these areas because not all supervisors have developed their points of view concerning these new emerging risks. With that said, the emerging risks do present common areas of interest that can be coordinated to develop points of view on how best to support the broader regulatory community.

For example, the IAIS will undertake a joint workshop with the FSB to discuss emerging risk areas and how these can be addressed. The approach to these emerging risks is not to jump to standards, but instead to support members in their understanding of best practices. Given some of these risks apply across the financial system, IAIS noted it is important to coordinate with other standard setters to avoid duplication and overcomplicating matters through uncoordinated approaches.

The ExCo highlighted that the new strategic plan will provide an opportunity for a further change in approach to stakeholder engagement, given the emerging risks involved. The IAIS has discussed how the new model might work. For example, with FinTech, the ExCo met with several developers in Silicon Valley to understand how regulations might be applied.
The ExCo also meets at least once per year with insurance company CEOs to understand their points of view. Stakeholder engagement will be extended to investors, financiers, and rating agencies. In addition, others could be added to this collaborative model, including chief risk officers of insurance companies.

Geoff Summerhayes, who is leading work on climate change, noted that industry will continue to be consulted. Many companies agree that climate change poses a material risk to their assets and liabilities, but it may be that fewer firms are disclosing this fact. Given that the past is not considered a good predictor of the future, more work can and should be done on climate risk. Questions were raised about asset portfolios that have higher carbon-related investments, and there is a move toward more sustainable investing. The IAIS leadership discussed, under the ICS, whether an asset that is sustainable based upon evidence should attract a different capital treatment.
IAIS leadership stated they are currently developing a work plan to look at these types of issues. It was noted the first step will be to look at existing data.

The ExCo is focused on the pivot in direction under the new strategic plan and will be working with supervisors and other stakeholders as they start to look at new and emerging risks. The need for stakeholders to continue to provide input into the work of the IAIS remains important.

The role of insurance in promoting economic development and resilient communities, including sustainable infrastructure development

IAIS opening remarks noted that an insurance protection gap does not just solely exist in developing countries. Reducing the gap between economic loss and insured loss is a responsibility of the insurance industry. The protection gap poses a significant risk to consumers and economies in general, which often carries the burden of uninsured losses. While this protection gap poses significant risk, it also offers an upside opportunity for the insurance industry. US panelist Gary Anderson, commissioner of Massachusetts, Division of Insurance, used the example of flood insurance in the United States and the work to develop a framework that will lead to private carriers entering the market.

Manuela Zweimueller, as representative of the European Insurance and Occupational Pensions Authority (EIOPA), noted a significant protection gap within Europe, citing the aging population and the widening gap in the areas of both personal pensions and health insurance.

Juan Pazo, superintendent of insurance, Republic of Argentina, recognized the protection gap in many areas, including pensions. The government is working to develop a framework to improve coverage through consumer education as well as develop life and retirement markets through tax changes to encourage market growth.

All panelists agreed that these protection gaps are risks to consumers that also present an opportunity for insurance carriers to develop new markets and further expand into current markets. In the absence of private insurance, large-scale catastrophes often require governments to step in and look to bridge the gap.

Panelists noted related topics of how closing the protection gap and developing local insurance markets will help countries build resilient economies, providing funding for infrastructure projects. It was generally agreed that more should be done by both the IAIS and local supervisors to address protection gaps and look for opportunities to develop local insurance markets.

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Climate risk: "You can't do business on a dead planet."—Kajetan Czyz

Perhaps the most passionate panel discussion of the two-day seminar was on climate risk. The panel was set to discuss the challenges and opportunities for implementation of climate-related financial disclosures. However, the discussions soon moved to other related issues.

Kajetan Czyz of the Cambridge Institute for Sustainability Leadership set the stage, noting that historically climate change had been more about ethical investment. Following the 2009 Copenhagen summit, the development of the carbon market in the EU was initiated, which allowed an assessment of the climate change risk for companies. The next milestone was the Paris agreement and the move to a low carbon environment. Throughout this time, the approach has become less about the monitoring of the risk and more about the mitigation or problem-solving for the risk. He noted that the data were in place to demonstrate climate risk is an issue and does pose financial risk.

Concerning the issue of climate risk and company disclosures, the audience was polled on the question, "How would you rate your organization on its maturity of understanding climate-related financial disclosures?" The majority of respondents answered that their organizations were not mature. Panelist Suzette Vogelsang of the Prudential Authority for the South African Reserve Bank noted that the "insurance sector lags other sectors when it comes to climate-related financial disclosures."

It was noted that regulators are considering climate risk and that many of them require material financial risks to be disclosed. There was an open question as to whether enough companies were disclosing and correctly addressing the risk. It was stated that in Europe, insurance companies have started to disclose climate risk within their Own Risk and Solvency Assessment (ORSA) filings. The audience was also polled on the question, "Should mandatory disclosure of climate change risk information be required by legislation?" The general view was that it should be mandatory.

The discussion soon shifted from disclosures to the challenge of managing the risk and the opportunities for insurance companies to provide protection and become champions of climate risk. The difficulties of managing, quantifying, and assessing the impact of climate risk were discussed. Insurance is about anticipating and managing risk, and thus understanding the exposure provides a better position from which to understand and respond to the risk on both the assets and liability side of a company's balance sheet. A European insurer noted that they are taking a full assessment of climate risk across their business and see responding to climate risk as a key component of being a responsible insurer. It was noted that insurers are well placed to invest in long-term low carbon assets given their liability profiles, although there is a question as to whether there are sufficient green assets available for investment.

Climate risk poses many secondary risk events that need to be considered by insurers as basic components of good risk management, including:

- Understanding the potential effects of different climate change scenarios on their business, as measured through modeling a temperature change of 1.5 percent.
- Overall asset-portfolio performance should green assets become more favorable in the market than non-green assets.
- The physical risk that needs to be considered during rainfall, flooding, and extreme heat that may cause disease, mortality, and property damage. These risks are not limited to just property; thus, casualty insurers and life insurance companies also need to be focused on this risk.
- The impact of climate risk relative to political, societal, economic, and transition risks.
- Both the risk to existing products and services and future opportunities.
- Legal risk given what is known about climate change and how companies will respond to potential challenges from consumers across their business.

The overarching message from the panel discussion was that climate change is a top risk that companies should respond to and it is viewed as a significant opportunity for the sector, which is well positioned to make an important societal contribution.

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New technologies—trends, developments, and implications for policyholders and supervisors

Panelists discussed new technologies, trends and developments, and the market implications for policyholders and supervisors. The audience was surveyed using a polling question that asked the level of preparedness of the global insurance regulatory community for FinTech. The majority response was the community is generally not prepared. It was noted that regulators need to engage in this topic. A panelist noted that, recently, the Bermuda Monetary Authority had reviewed its own level of preparedness for FinTech and identified two areas for improvement: in cybersecurity and supervisory capabilities.

The panel discussed the challenge of the FinTech culture, which is perceived to gravitate toward an innovation model that allows for the making of mistakes to advance progress. This philosophy, while understood, does not always sit well with regulators, particularly when it relates to consumer protection. With that said, several benefits were recognized by the panel, with FinTech being able to support consumer inclusion, lowering of the cost of insurance, 24/7 access, and sales capabilities. Recent examples include the use of blockchain to promote process efficiencies, smart contracts, and pay-as-you-go driving.

As regulators seek to keep pace with FinTech developments, regulations are being developed to help frame FinTech. Recent examples include work undertaken relating to consumer data privacy and cybersecurity. Future regulatory developments may include consideration of regulations concerning artificial intelligence, as being developed in the European Union, and increased transparency into the technology used to make decisions, which is currently being reviewed by both New York and California.

Ethics, bias, and data protection raise big questions, and consumers have natural concerns about how their data are being used. Regulators noted that the ethical challenges will have to be tackled. Consumers will need assurance to help them understand whether their digital identity is reflective of their physical reality.

There was general agreement by panel members that regulators should support the development of FinTech but that the regulatory challenges do need to be addressed. Consumer education will be important to aid protection. Oversight by regulators of insurers will be an important tool, with insurance companies being challenged to consider which skill sets they need in the delivery of FinTech solutions, along with the necessary FinTech oversight, starting from the board down.

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This publication is a summary of the common themes expressed by the participants during the 12th annual Global Seminar of the IAIS. The notes were taken informally and were based on discussions heard and were not validated or confirmed by Deloitte.