PRIORITIES FOR THE INSURANCE SECTOR

ALBERTO CORINTI

Member of the Board of Directors – Italian Insurance Supervisory Authority (IVASS)

Evolving risk context calls for evolving supervisory practices

If we want to find one underlying feature that reflects the current risk context, I think we could say that it is characterized by a number of very dynamic, emerging trends that, in various ways, influence the materialization of more traditional, specific risks, both in terms of frequency and intensity of possible losses.

Current geopolitical trends could affect many types of market risks, for example in terms of increase in interest rates, pushed up by inflation, or credit and real estate risks, due to reduced growth or detrimental effects on trades or activities; but geopolitical trends could also have a number of other, less predictable effects on risks, such as cyber risk, that could significantly influence the business.

Also, climate change and, more generally, the transition to a more sustainable world, could -in many ways - affect the value of assets and liabilities of insurance companies and, at the same time, increase more qualitative risks, such as reputational or legal risks.

Again, the increasing use of IT innovations leads to the exacerbation of operational and cyber risks, but also to repercussions on business risks, in case of non-alignment with technological developments, and on legal and conduct risks, in relation to the way the relationship with policyholders is managed.

Overall, this landscape entails at least two main challenges for companies and supervisors. First of all, it reduces risk predictability, as it limits the capability of historic data to anticipate the future and increases the variety of ways in which certain risk factors could materialize. Secondly, due to the very nature of these risk trends and the consequent high correlation between the exposures in different firms and regions, it increases the probability of widespread, and therefore potentially systemic, impacts.

One could wonder if the current regulatory and supervisory framework in the EU is sufficiently equipped to face these challenges.

Without having the ambition to answer this question, in my view there are at least three areas to consider if one aims to reduce, in the current context, the probability of insolvencies as well as of systemic externalities, while reinforcing the social role of insurance in the economy.

Obviously, the first focus is on the approach of the prudential regulation. It should be sufficiently risk based and flexible to adapt to new risks; it should significantly rely on good and wide-ranging enterprise risk governance; and it should provide supervisors with tools and information that effectively help focussing on the real threats, early enough. I think that all these aspects are fundamental features of Solvency II. One could certainly question some elements of this framework, like its complexity, the volatility of its indicators or the calibration of some financial requirements, but I think it is apparent that its structure and forward looking approach constitute the preconditions to properly deal with an evolving and unpredictable risk context. It obviously remains to be seen how the framework is implemented in practice across jurisdictions.

Secondly, the ability of supervisors to promptly detect systemic threats at global, regional and national level and to intervene timely and effectively. Also in this case, I think that the insurance sector can rely on a framework that allows successfully achieving these objectives. The IAIS Holistic Framework, which also inspired the European macro-prudential framework, is indeed based on three key elements: on measures, to be applied on a proportional basis, that are aimed at mitigating the probability and intensity of the materialization of risks with systemic potential; on thorough monitoring of the main potential sources of systemic impacts, both at individual and market wide level; and finally on a toolkit of supervisory powers to be used as necessary. In this case too, however, the framework needs to be properly implemented in practice by national supervisors in order to be effective. The IAIS is committed to pursue this objective with its implementation assessment plan.

We need good supervisory practices applied consistently and effectively across jurisdictions.

Finally, and I think this is maybe the area with the most room for improvement, we need good supervisory practices applied consistently and effectively across jurisdictions. The ability of supervisors to understand new and complex risk sources and their potential transmission channels, to be timely, effective and balanced in their interventions, to concretely cooperate on common challenges, is certainly key. In this regard, the role of supranational institutions, like IAIS and EIOPA, is of utmost importance. It is essential, however, that in each jurisdiction, supervisors have sufficient resources, knowledge and powers to reinforce their supervisory approach and keep up with the evolution of the context.