Insurance Europe response to IAIS draft Issues Paper on structural shifts in the life insurance sector

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1. *General comments on the Issues Paper on structural shifts in the life insurance sector*

Insurance Europe welcomes the opportunity to provide comments to the IAIS draft Issues Paper on structural shifts in the life insurance sector.

Life insurers play a pivotal role in the provision of long-term savings and retirement products. In Europe, their ability to provide these much needed and valued products at a reasonable cost has been challenged by the introduction of Solvency II in 2016 and the period of ultra-low interest rates between 2012 and 2021. The shifts discussed in this paper are reflective of these challenges, although it is noted that asset-intensive reinsurance (AIR) transactions in continental Europe have been limited.

As noted in the paper, life insurers typically have long-term illiquid liabilities, allowing them to have long-term investment time horizons and act as long-term providers of capital. Making allocations to alternative assets enables insurers to diversify their portfolios and generate investment returns for their policyholders. Similarly, progress in refining the liquidity mix and attracting third-party capital and asset management expertise through AIR supports the availability and value of long-term life policies for consumers.

In addition, it should be recognised that an insurance company's purpose is to identify, price, assess and manage risks. Many of the concerns identified and discussed in the paper, such as valuation uncertainty, lack of data, and market dislocations, are issues that are dealt with by insurance companies on a daily basis, applicable to the liability side of the balance sheet as well as the investment side. And while understandable, it could also be reflected that there is significantly more data availability and understanding of investment risks than of some liability risks. In that regard, AIR transactions are B2B (business-to-business) arrangements between highly skilled risk professionals, structured to respond to the needs of the cedents. Cedents and brokers have the expertise and processes in place to make the necessary due diligence when selecting the pool of reinsurers with the financial strength to safely support their reinsurance programmes.

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While the paper offers a good overview of the pros and cons of investing in alternative assets and outlines a reasonable classification framework, Insurance Europe considers the existing supervisory material sufficient. The analysis presented in the report does not justify further changes to the Insurance Core Principles (ICPs).

Similarly, Insurance Europe considers that current ICPs are adequate to address any supervisory concerns arising from AIR.

Insurance Europe acknowledges that targeted clarifications could still add value without reopening core principles., For example, Insurance Europe considers that the IAIS should tighten its definition of AIR to be more targeted, and proportionate, in its analysis while recognising that it does not pose a global financial stability risk at present.

In general, an element of the strength and credibility of the ICPs should be that they are stable over time. The IAIS should assess the costs and benefits for consumers of any initiatives increasing the prudential cost of providing long-term life policies and its impact on the protection gap.

As an over-arching comment, Insurance Europe encourages early-stage engagement with trade associations ahead of IAIS initiatives, incorporating expert roundtables or technical workshops to facilitate meaningful dialogue. This is an area where trade associations are well-placed to ensure that consultations are fit for purpose and reflect market realities.

2. *General comments on section 1 Executive summary*

The sector requests changes to the wording regarding the use of internal models to calculate capital requirements. The executive summary states:

"Concerning capital requirements, approaches vary, with some jurisdictions using factor-based or formulaic methods, while others ***allow more discretion (eg internal models)*** *to calibrate capital requirements to the risk profile of the insurer. Jurisdictions also differ in their level of prescriptiveness regarding investment flexibility."*

However, (partial) internal models are not about discretion. The purpose is to adequately and accurately reflect the risk profile in the solvency assessment when a standard formula approach is not appropriate.

In regimes like in the EU, Switzerland, and the UK, it is not formulaic exclusively or internal models, but a coexistence.

1. Formulaic for simpler business models or where the formulaic (or standard model) approach works well; and
2. Internal models and partial internal models for more complex groups, or for instance to adequately capture the complexity of Nat Cat portfolios.

Therefore, Insurance Europe proposes the following alternative wording (with changes in red):

"Concerning capital requirements, approaches vary, with some jurisdictions using factor-based or formulaic methods, while others (eg internal models) allow ~~more discretion (eg internal models)~~ to calibrate capital requirements to the risk profile of the insurer."

Insurance Europe highlights that the following text in section 4.2.2 (page 45) is more accurate and requests that is also reflected in the executive summary for context:

"Insurers can apply to use a full or partial internal model for calculating capital requirements as ***a more tailored method*** *for measuring their specific risks. Internal models are subject to supervisory scrutiny and approval and need to be maintained continuously to a* ***very high standard".***

6. *Comments on section 3.2 Global trends in life insurers' investment in alternative assets*

IAIS analysis

While Insurance Europe recognises that some insurers have increased their allocations to "alternative assets", the analysis presented in the report does not fully support the narrative presented.

Section 3.2 starts by explaining that the trend of increasing allocation to "alternative assets" is difficult to quantify. It then goes on to clearly state that "*external data shows that the supply of alternative assets and allocations to these have increased over the past two decades*".

Furthermore, the median allocations presented on page 10 do not demonstrate significant increases in median allocation in absolute terms. Median allocations of 1% to securitisations, unlisted equity and infrastructure appear very moderate. The allocation to loans and mortgages at 7% is potentially an outlier but no data is presented to indicate what the historical allocation was.

In this respect, the industry welcomes the statement that allocations to "alternative assets" do not pose financial stability concerns.

In addition, some more mature analysis of how allocations have developed over time would be beneficial.

Non-banking financial intermediation (NBFI) definition

As outlined by the IAIS, when discussing the NBFI sector, it is important to recognise the fundamental business model differences and the regulatory oversight of each sector. As a highly-regulated and supervised sector, Insurance Europe does not support the inclusion of insurance in the wider NBFI-discussions.

In addition, Insurance Europe recommends further context to Footnote 20 is added.

Currently Footnote 20 states: *"…in the EU there are no capital requirements for liquidity risk and the supervisor assesses the portfolio liquidity in the context of the Prudent Principle of investments, with which insurers should comply".*

Capital requirements for liquidity risk do not make sense in an insurance context – this is similarly evidenced in the Insurance Capital Standards (ICS), which was approved by the IAIS as a global capital standard for Internationally Active Insurance Groups (IAIG)s.

In Europe, the management of liquidity risk is already a requirement of Solvency II (Article 44 2d) and is already very well managed, as evidenced through existing liquidity reporting, EIOPA liquidity stress tests, and IAIS liquidity metrics. Further introduction of liquidity risk management plans will apply from January 2027, as part of the Solvency II review.

Over the past few years, there have been a number of regulatory and supervisory initiatives to assess and monitor liquidity risk, beyond the Solvency II requirements of Article 44 2d. These include financial stability reporting, EIOPA liquidity stress tests, national ad-hoc liquidity reporting and the IAIS Global Monitoring Exercise including the IAIS ancillary liquidity risk indicators.

***7.** Comments on section 3.3 A principles-based classification*

Insurance Europe welcomes the IAIS's commitment to a principles-based approach for monitoring insurers' exposures, yet the benefit of classifying asset classes between "traditional" and "non-traditional" remains unclear.

The separation is imprecise, and bundles together instruments whose risk profiles and economic characteristics in a look-through view differ markedly.

Treating this heterogeneous set as a single risk bucket may obscure meaningful distinctions and could lead to supervisory responses that are not proportionate. This is especially the case as exposures must be assessed in the context of an insurer's overall balance-sheet, risk-management sophistication and liability structure.

***8.** Comments on section 3.4 Benefits associated with alternative assets*

The inclusion of the discussion of the potential benefits of investing in alternative assets is supported.

***9.** Comments on section 3.5 Supervisory concerns and areas of attention*

The comments on time horizon under section 3.5.4 are not very clear. In particular, it is unclear whether there would be supervisory concern if a life insurer with 10-20 year expected liability cashflows made investments with shorter time horizons.

***11.** General comments on section 4 Rising adoption of AIR in the life insurance sector*

The life insurance sector contends with the challenges posed by ageing societies while endeavouring to satisfy the needs of consumers. Addressing these challenges requires making continuous progress in ways to manage a finite amount of capital efficiently. Third-party capital, expertise and diversification benefits brought by AIR is one of the solutions.

The cross-border nature of reinsurance brings benefits including geographic diversification, access to specialised risk capacity, and global capital efficiency, which in turn helps mitigate concentration and systemic risks

Global reinsurers rely on intragroup retrocessions to achieve global diversification. The transferability of risks and capital through affiliated transactions is indispensable for the business of reinsurance. A global reinsurance group functions by moving risks where they diversify within the group and allocating capital where it's needed to support the growth of the activity and pay claims. Here again, affiliated retrocessions have everything to do with global diversification and fungibility of capital.

Reinsurers have highly skilled and knowledgeable risk professionals as clients. These B2B transactions are tailored at arm's length to respond to the needs of the cedents, which become long-term partners. Cedents and brokers have the expertise and processes in place to make the necessary due diligence when selecting the pool of reinsurers with the financial strength to safely support their reinsurance programmes.

Contrary to the impression that asset intensive reinsurance is only now attracting supervisory scrutiny, the jurisdictions that host the bulk of this business already apply stringent, front-loaded oversight. In both Bermuda and the United States, life AIR treaties generally require supervisory preapproval, are written through funds withheld or modified coinsurance structures that give ceding insurers full collateral visibility, and sit under solvency regimes whose capital coverage is well above IAIS minima (Bermuda Class E reinsurers, for example, reported a median Bermuda Solvency Capital Requirement (BSCR) ratio of roughly 259 per cent in 2023).

In addition to the examples cited from the US and Bermuda, the UK has also taken a clear and structured approach to AIR. The Prudential Regulation Authority's (PRA's) publication of policy statement PS13/24 and supervisory statement SS5/24, for example, set out the regulatory expectations in respect of insurers entering into or holding funded reinsurance arrangements as cedants.

AIR has developed into a well-established market tool, subject to structured oversight in key jurisdictions. Insurance Europe support continued supervisory engagement to ensure that oversight keeps pace with market evolution, for transferring long dated guarantees, releasing capital and helping to close the global retirement income gap.

The fact that a reinsurer is based in a jurisdiction using an economic prudential regime is not indicative of regulatory arbitrage. The IAIS itself adopted an economic International Capital Standard and determined that a non-economic US Aggregation Method provided a basis for a comparable outcome. This context does not support the argument of regulatory arbitrage.

However, the IAIS also raised important considerations relating to the need for supervisory authorities to have appropriate capabilities to keep abreast of market developments without stifling innovations in reinsurance solutions.

Another important consideration raised by the IAIS is about supervisory cooperation. Perception of regulatory arbitrage through external reinsurance can be dismissed through sustained dialogue between supervisors of the cedents and supervisors of the reinsurers. The IAIS provides a global platform for this dialogue, in addition to regional accords and bilateral Memorandum of Understanding. Regarding affiliated transactions, the group supervisor has a holistic view, and colleges of supervisors are allowing joint assessment of the functioning of the group. It is paramount that the supervisory community uses the levers of cooperation to address any specific issues instead of resorting to blanket regulatory restrictions.

The global diversification of risks through cross-border reinsurance benefits the resilience of societies and the stability of financial systems. It supports the provision of much needed long-term living benefits through capital efficiency. Barriers to cross-border reinsurance, such as mandatory collaterals, localisation of assets or pre-approval for third-country reinsurance, lead to market fragmentation and inefficiencies. It is essential that the IAIS promotes international convergence through the elimination of trade barriers, and in such a way that the life insurance sector can play its part in closing the protection gap in ageing societies.

As a result, Insurance Europe considers that the current ICPs are adequate to address issues arising from reinsurance arrangements in general and AIR in particular. An element of the strength of the ICPs should be that they are stable over time.

Insurance Europe acknowledges that targeted clarifications could still add value without reopening core principles. For example, Insurance Europe considers that the IAIS should tighten its definition of AIR to be more targeted, and proportionate, in its analysis.

A transfer of reserves should be considered asset-intensive when it gives rise to a significant transfer of assets (eg >5bn) and the allocation towards illiquid asset classes is very high compared to the allocation of assets backing a traditional block of business transfer. AIR should not include reinsurance structures that only transfer tail asset risk exposure of life blocks. These considerations should be a starting point for regulatory discussions, rather than a standard or ICP revision.

Application of proportionality and risk-based regulatory oversight is key. The definition of AIR proposed above would not be applicable in all cases. For example, any potential regulatory classification of AIR would also need to consider the context of the relevant regulatory regime, the materiality of the transaction on the reinsurer's balance sheet and asset mix.

12. *Comments on section 4.1 Understanding AIR*

As mentioned in the previous question, Insurance Europe considers that the IAIS should tighten its definition of AIR to be more targeted, and proportionate, in its analysis.

Transfer of life blocks of business is a traditional life reinsurance activity. It is performed routinely and contribute to the well-functioning of the life and health insurance market. Supervisors are well accustomed to this market practice and well equipped to oversee it.

However, Insurance Europe sees a risk that AIR could be loosely defined as a catch-all category that captures any long-term reserves cession.

A transfer of reserves should only be considered asset-intensive when it gives rise to a significant transfer of assets (e.g. >5bn) and the allocation towards illiquid asset classes is very high compared to the allocation of assets backing a traditional block of business transfer. AIR should not include reinsurance structures that only transfer very remote (tail) asset risk exposure of life blocks.

13. *Comments on section 4.2 Jurisdictional approaches to reserving, capital requirement and investment flexibility*

In Table 2, it is inappropriate to reference internal models in the column named "Discretionary". Please see the response to Q2 addressing this concern in the Executive Summary.

Additionally, the reference to investment flexibility should be updated. Investments are partly constrained by the standard formula/model and internal models themselves, as asset-liability management (ALM) mismatches and some asset charges are penalising. They are often complemented by investment guidelines.

14. *Comments on section 4.3 Supervisory concerns and responses*

Reporting: The European industry believes the Solvency II reporting at an EU-level is already sufficient regarding macroprudential risks. The jurisdiction-specific requests mentioned should be proportionate and risk-based.

Key statement: As mentioned above, Insurance Europe supports the key statement in this section:
"Within the EU, AIR does not pose material financial stability risks due to its limited use within the European Economic Area (EEA)."

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24. *General comments on section 8 Next steps*

As mentioned in the response to question 1, Insurance Europe recommends early-stage engagement with industry, and especially trade associations, before future IAIS work on structural shifts, or workstreams related to the contents of this paper.

For example, expert working groups or thematic roundtables. This would help ensure proportionality and relevance of the policies being considered from the outset.

Sufficient time should also be foreseen for public consultation.

Insurance Europe is the European insurance and reinsurance federation. Through its 39 member bodies — the national insurance associations — it represents insurance and reinsurance undertakings active in Europe and advocates for policies and conditions that support the sector in delivering value to individuals, businesses, and the broader economy.