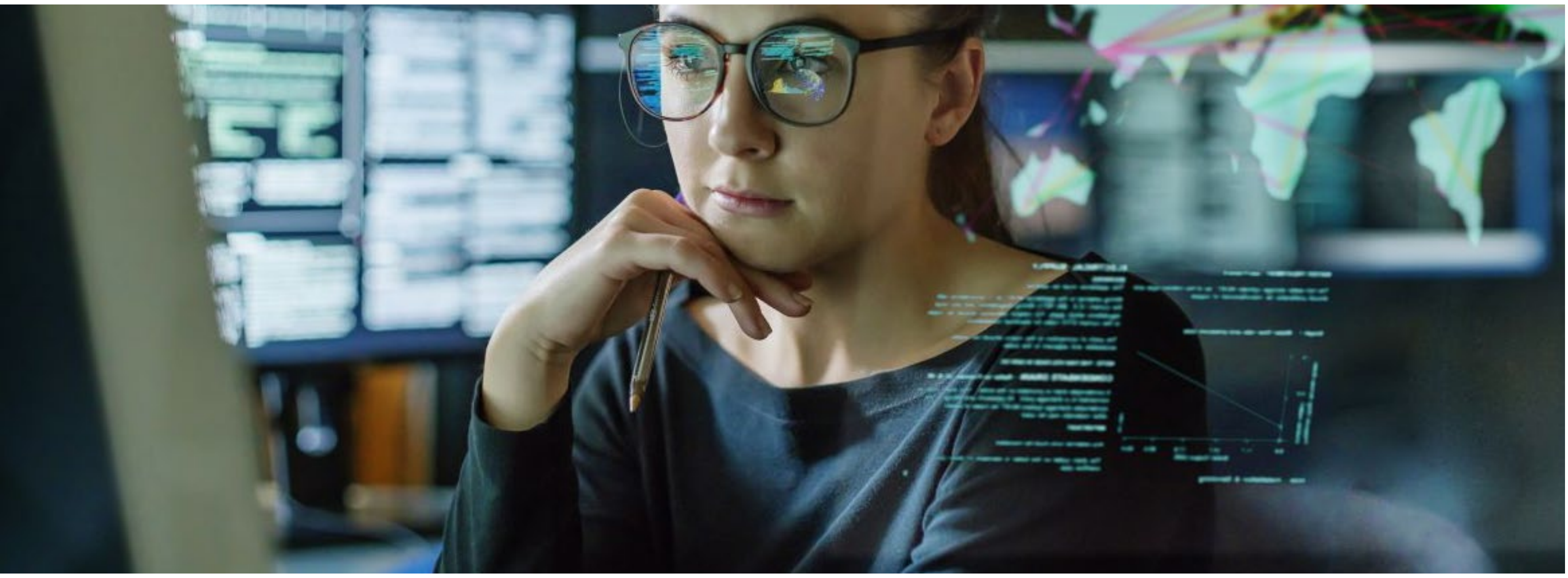

Insurance regulation newsletter

Issue 4 – January 2023

As we enter 2023, if there is a single word to summarise the current focus of regulators, that word is 'resilience'. Between climate change, digitalisation, macroeconomic volatility, geo-political developments, and the post-COVID-19 'new-normal', both the CBI and EIOPA are placing high demands on the (re)insurance industry to ensure it remains resilient in the face of unprecedented challenges.

Elsewhere, consumer protection maintains its fair share of the spotlight with value for money, switching patterns, policy literature, and personal injury awards all remaining topical.

The Mazars insurance regulation newsletter provides a flavour of the latest developments that insurers should be aware of.

At the turn of a new year, it is timely to reflect on what a turbulent start it has been for the 2020s. As 2020 dawned, few would have predicted how the first three years of the decade would pan out. At that point, Britain's exit from the EU looked set to be the defining moment for the future decade. But three years later, we are reflecting on the impact of a global pandemic, a worsening climate crisis, and war once again on the continent of Europe. Aside from the clear and devastating human turmoil, the second-order consequences include near double-digit inflation, economic volatility, increased cyber threats and significant changes to our work. From an insurance regulation perspective, this activity has also influenced the supervisory agenda for both the CBI and EIOPA.

Recovery and resolution planning activities continue to be developed at the Irish and European levels. At the same time, we finally have confirmation of the Digital Operational Resilience Act being adopted by the EU. More generally, cyber and outsourcing risks are still under scrutiny as remote working patterns change considerably. This comes as insurers grapple with the short-to-medium-term challenge of four-decade-high inflation rates and volatile yield curves. The medium-to-long-term agenda remains dominated by the escalating climate crisis.

Another common theme across our industry engagements is a scarcity of talented resources. With a growing to-do list and limited personnel, many insurers have become increasingly required to develop risk-based prioritisation to ensure the key issues get dealt with.

But despite many challenges, we remain confident that the Irish insurance industry can continue to respond as it has done so well in recent years.

The Mazars insurance team looks forward to continuing working with all of our clients in navigating whatever comes next. Most of all, we wish all our clients and contacts a happy and prosperous 2023.

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CBI assessment of key sectoral risks

The Central Bank's latest quarterly newsletter provides an insightful overview of what the regulator perceives as the key risks facing the (re)insurance industry. Hence the following areas should be expected to be central to the supervisory process during 2023:

Macroeconomic risks

2022 was a volatile year for financial markets, not least because of rapid inflation and an increasingly unstable geo-political environment. Most insurers will be exposed to increased assets valuation, foreign exchange, liquidity, and counterparty default risks. Ensuring ALM strategies remain resilient should be a priority for risk, finance and actuarial functions.

The possibility of an economic downturn could also expose insurers to increased lapses and reduced sales activity. High inflation clearly poses threats to pricing, reserving, and expense management.

Operational risks

The CBI continues to perceive outsourcing as a prominent risk area for many insurers. This should already be evident from the recent Cross-Industry Guidance papers issued on outsourcing and operational resilience, along with the insurance-specific paper on the use of service companies for staffing solutions and the thematic inspection of the use of MGAs. Appropriate oversight and governance arrangements are expected at a minimum.

Digitalisation risks

The pace at which the financial services sector has embraced new technologies has brought many advantages for firms and consumers. However, the pace of change can also pose many threats. There is a significant challenge for insurers to develop systems of governance that remain knowledgeable of changing business models and product offerings.

The use of Big Data and AI technologies poses both prudential and conduct of business threats, particularly for more vulnerable customers.

The industry must appropriately address the management of cyber risks, underwriting and operational. The CBI and EIOPA have issued warnings on the importance of unambiguous policy wordings where cyber-related risks may be covered within (re)insurance contracts.

Climate change

Climate remains the dominant long-term challenge facing insurers. The CBI will remain committed to addressing both physical and transition risks. The industry also looks forward to the Bank's next steps after concluding its CP151 consultation paper in 2022.

Regulatory and legislative change

Legislative changes, domestic and from other jurisdictions, remain a notable risk to (re)insurer's strategic and operational objectives.

Maintaining a robust process to identify and respond to changes in a complex legislative landscape is a minimum expectation for all (re)insurers.

Resilience, recovery and resolution

CBI thematic review of (re)insurance Recovery Plans

Following the introduction of Recovery Plan Requirements for Insurers Regulations 2021, insurance and reinsurance undertakings were required to have documented Pre-Emptive Recovery Plans in place from 31 March 2022.

On the back of the first round of completed Recovery Plans, the CBI conducted a thematic review, the observations of which were recently communicated to insurers.

Many of the observations drawn by the CBI are consistent with the industry-wide survey conducted by our survey earlier in 2022. Read the Pre-emptive recovery planning – 2022 Industry benchmarking survey report to find out more.

Similar to our observations, the Central Bank commented on the wide variance in the quality of plans submitted to date, with some insurers at a far greater stage of preparedness than others. Some firms did not clearly understand that the plan's purpose was to provide feasible recovery plans in the event of a crisis, not to assess the likelihood of such a crisis which, of course, can be accessed via the ORSA.

Some other common observations made by the CBI include:

- Many insurers relied too heavily on stress and scenario tests used within their ORSA. So, in some cases, they were not severe enough to adequately challenge the effectiveness of recovery options.
- Some plans did not set out formal and urgent recovery roadmaps, instead providing management with too much discretion in the event of a crisis.
- The Overall Recovery Capacity ("ORC") section was generally poorly developed by insurers.
- Group capital, reinsurance, de-risking and restructuring solutions were all common recovery options. However, firms could do more to consider how operations would continue during such actions and what alternative options would be available if group support failed to materialise.
- Developing an appropriate Recovery Indicator Framework will be an expectation for many insurers, particularly with reference to forward-looking indicators.
- A significant number of insurers failed to duly consider liquidity indicators.
- Other firms failed to consider solvent run-off as a potential recovery option.

With many High and Medium-High impact firms required to update their plans at least once every 12 months, many insurers will find themselves revamping their documents in the first half of 2023.

EIOPA focus on the Insurance Recovery and Resolution Directive (IRRD)

EIOPA continued its agenda in forming a Member State-wide Insurance Recovery and Resolution Directive (IRRD) by issuing two new staff papers in November.

The first paper is an FAQ document which addresses some common queries including those in the area of recovery actions, exemptions, cross-border considerations and funding.

The second paper draws comparisons with the already operational Banking Recovery and Resolution Directive (BRRD). This makes for an interesting read, providing insurers with learnings from a very comparable existing EU regime.

Council of the European Union adopts the Digital Operational Resilience Act

On 28 November 2022, the Council of the European Union adopted the Digital Operational Resilience Act ("DORA"). DORA has been designed to help address the risk arising from an increasingly digitalised and technology dependent financial services sector in Europe.

DORA creates a regulatory framework for all EU financial service providers (including insurers) to ensure they can withstand and recover from various forms of IT disruptions and threats.

DORA is now expected to be fully effective within two years, with the European Supervisory Authorities (including EIOPA) expected to develop the technical standards over that time.

With operational resilience already a key focus of the CBI following its Cross-Industry Guidance last year, insurers would be well advised to conduct their readiness assessment and gap analysis during 2023. All financial service providers will be expected to demonstrate that their ICT risk management frameworks are up to date and fit for purpose.

EIOPA's discussion paper on cyber stress testing

In November 2022, EIOPA published a discussion paper on methodological principles of insurance stress testing focusing on cyber risk.

The paper considers the ability of insurers to withstand cyber underwriting risk events, but also the resilience of an insurer's own organisational capacity if exposed to a cyber-attack.

The discussion paper remains open for feedback until 28 February 2023.

Inflation

CBI newsletter – inflation

The Central Bank of Ireland released its latest quarterly newsletter in December 2022, with inflation as the headline topic in sharp focus of the regulator.

The Bank highlights that the low inflation levels over the past 20 years may mean that the current high levels will come as a shock for many insurers and the manner in which they run their businesses. A change in risk management systems is expected to analyse and monitor inflation across different lines of business, segments and geographical areas. Increased consideration of methodology, assumptions and communication of risks has been called for. Secondary impacts also need to be considered.

Firms are required to perform more granular monitoring and analysis of inflation and its drivers. Both current and future ranges of inflation should be considered, including economic, excess and social inflation.

Economic inflation is often captured through economic indices such as CPI, RPI and wage indices. But excess inflation includes factors specific to insurers' business. It includes social inflation, changes in technology and medicine, changes in the legal or political environment and attitudes towards claiming. Social Inflation results from societal trends, e.g. increasing cost of claims from increased litigation, higher court awards and social movements.

Insurers should model the types of inflation that are relevant to their business. Some insurers may have previously had a single inflation assumption; however, the emerging trend is for insurers to split inflation into different components. For example, non-life insurers can split inflation into general economic and excess inflation. Life insurers can split inflation into price inflation and expense inflation, e.g. salaries, rents, and IT.

Past data is unlikely representative of the future, requiring modelling methodologies to evolve. Implications on reserve risk volatility and on correlations between risks in capital models and in the ORSA should also be considered. HoAFs should communicate appropriately and quantify inflation assumptions in the base scenario, including the materiality of downside risks. Uncertainty around future inflation can materially impact reserve adequacy.

EIOPA supervisory statement on inflation

Of course, the CBI is not the only supervisory authority currently concerned with inflation. EIOPA published a supervisory statement on inflation in December 2022, addressing inflation in (re)insurance and raising awareness of the relevant SII provisions.

Striking a very similar tone to the CBI, EIOPA also highlights that two decades of low inflation levels may have caused insurers to become complacent with managing the risks associated with a less stable economic environment. Over-reliance on past data may lead to inappropriate methodologies and hence underestimation of Technical Provisions. Insurers are therefore expected to assess whether inflation assumed in calculating Technical Provisions is realistic, considering the nature, scale and complexity of risks.

Inflation can also erode real asset values. Insurers should assess whether valuation methods and assumptions used for investments exposed to inflation should be adjusted accordingly.

Potential impact on capital requirements, including appropriateness of the Standard Formula, are expected to be assessed.

Direct or indirect inflationary impacts on other elements, such as risk management systems, should also be assessed and reflected in the ORSA.

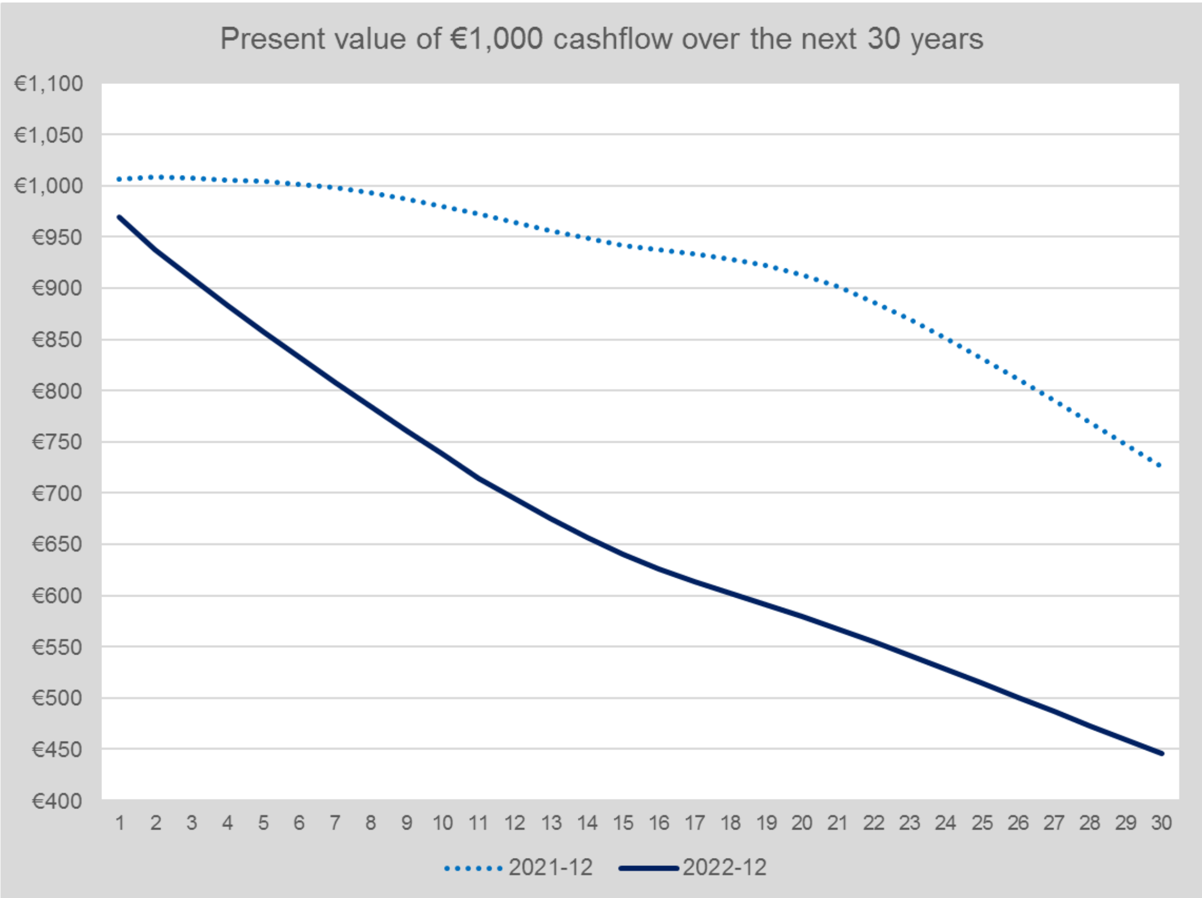
EIOPA risk-free interest rate term structures: A year of dramatic transformation

(Re)insurers, particularly those with longer-term liabilities, will enter the Solvency II 2022 year-end reporting cycle with a set of risk-free interest rate term structures that are barely recognisable from those seen just 12 months ago.

The graphic below considers the impact on the present value of a €1,000 future cash flow due at various points over the next 30 years.

A €1,000 cashflow 20 years from now would have been valued at €913 using the end December 2021 term structures. However, using the 2022 equivalent values, the same cash flow at just €580 – an extraordinary movement in just one year.

The recent changes will undoubtedly have put the effectiveness of asset-liability matching strategies to the test. For some entities, the balance sheet will be almost incomparable from year to year. Nevertheless, due to the stark movements, insurers will be required to explain and articulate the impact on their business.



Climate change

EIOPA discussion paper – Prudential Treatment of Sustainability Risks

In December 2022, EIOPA launched a discussion paper on the prudential treatment of sustainability risks as the regulator seeks to ensure that the Solvency II regime appropriately reflects such features.

EIOPA assesses whether a dedicated prudential treatment is merited. The discussion paper outlines the scope and methodologies for the assessment and includes an analysis of the following:

- Assets and transition risk.
- Underwriting risk and climate change adaption.
- Social risks and objectives.

EIOPA's stakeholder feedback period runs until 5 March 2023.

EIOPA's natural catastrophe insurance protection gap dashboard released

EIOPA's interactive tool presents the drivers of climate-related insurance protection gaps.

Historically, around a quarter of losses caused by extreme weather events across Europe were not insured. But with the increased prevalence of climate events, the price of insurance is expected to increase; hence, it is feared the insurance protection gap could widen.

The interactive dashboard makes for interesting consumption for directly affected insurers and casual readers alike. It provides insights on specific perils at a country level and over time dating back to the 1980s.

From an Irish perspective, the local levels of risk of flood and windstorm perils are estimated to be above the EEA average. Coastal flood risk, in particular, was identified as a potential area of under insurance.

The cost of Insurance: domestic focus

Private Motor Insurance Report 4 – National Claims Information Database (NCID)

The Central Bank of Ireland published its fourth Private Motor Insurance report in November 2022.

The report revealed that the average earned premium per motor policy decreased by 2% from 2020 to 2021. Claims cost per policy & claim frequency increased by 1% and 11%, respectively, but remained well down on pre-COVID levels, with 2021 impacted by various periods of lockdowns.

In encouraging news for motorists, the average premium in Q4 2021 decreased by 17% from its Q4 2017 high point. An average loss ratio of 67% was observed in 2021, well down from the 92% peak in 2014.

The document also highlights that operating profit for motor insurers was just 4% over the period 2009-2021, albeit profitability has improved over the past four years.

Regarding motor-related injury claims in 2021, 16% settled under the new Personal Injury Guidelines. Claims settling through PIAB under the new guidelines had average award values 34% lower than those comparable to the old Book of Quantum equivalents.

But despite the PIAB reductions, it should be borne in mind that 36% of all claims are settled through litigation, and such cases are typically higher costs and more complex in nature. So, while Personal Injury Guidelines will no doubt reduce costs overall, there remains some way to go before a clear picture emerges. Indeed, some insurers will be concerned by the recent Supreme Court agreement to hear an appeal over the constitutionality of the award guidelines.

PIAB Personal Injures Award Values report

The latest PIAB report, which was released in November 2022, covered data up to the end of June 2022. It shows average 2022 awards under the new guidelines (effective from April 2021) are 38% lower than the average 2020 award under the old Book of Quantum.

The drop in award values was observed consistently across PIAB's three categories of Motor, Public, and Employer's Liability classes.

Acceptance rates post-guidelines increased steadily from 36% in May 2021 to 48% in June 2022, nearing the pre-guidelines rate of 51%.

It should be noted that applications received in 2020 and 2021 were heavily impacted by COVID-19. Applications received in the first half of 2022 continue to remain at low levels.

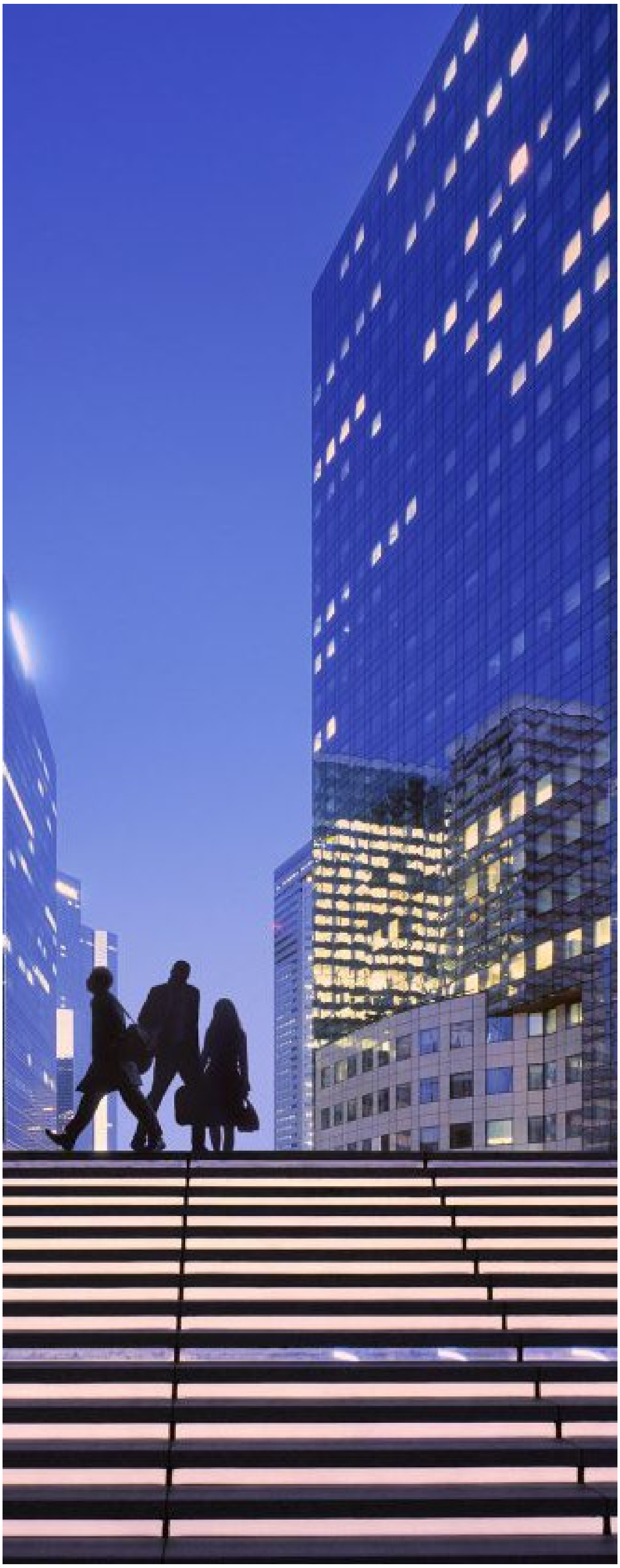
Overall, there is evidence that PIAB has successfully implemented the new guidelines to bring down average award values. However, many insurers will be more concerned by the low level of applications and acceptance rates. The extent to which the guidelines can be enforced on more complex cases going through litigation will be a key focus for 2023.

Central Bank research on insurance engagement and switching

The recent CBI publication delved into consumer engagement habits within the domestic market. Insights generated from the wide-ranging survey include:

- Eight out of ten car and home insurance customers engage with their provider on renewal.
- About one in four switch providers annually.
- Behavioural characteristics varied markedly between different groups of consumers. Some were highly reluctant to switch, even where financially beneficial to do so, and up to one in four believed that loyalty to their current provider would be rewarded.
- Unsurprisingly, time-poor consumers were the least likely to switch.
- More than half of all consumers now use digital platforms as part of their engagement, but one in five still report difficulties with internet-based insurance engagements.
- Policyholders less comfortable with digital channels, which are often older or less educated consumers, are less likely to engage in switching.

While the results of the survey are not overly surprising, it does highlight what the CBI's key priorities are. The report follows the implementation of [the differential pricing rules] during the summer of 2022. It should indicate the CBI's continued intention to level the playing field for less digitally sophisticated and time-poor consumers.



Consumer protection: cross-border focus

EIOPA calls for better value for money in bancassurance

In October 2022, EIOPA issued a stark warning to banks and insurers, noting concerns around consumer protection on Credit Protection Insurance products. The warning comes on the back of the regulator concluding its recent thematic review on insurance products sold with mortgages, credit cards and other consumer credit arrangements. EIOPA specifically references the following key issues:

- Limited choices and barriers to shopping around.
- Challenges to consumers in comparing a diverse range of products, often with widely varying terms and conditions.
- Issues with cancellation and switching.
- High remuneration and hence conflicts of interest of insurers and banks on a product line that often generates high commission and profitability levels.

EIOPA reminds all insurers and banks of their obligations under the Insurance Distribution Directive (IDD), including the Product Oversight and Governance (POG) requirements.

EIOPA issues its methodology for assessing value for money in the unit-linked market

EIOPA's spotlight on consumer protection continued with a focus on assessing value for money within the unit-linked market.

EIOPA's methodology document provides local authorities more clarity on the responsibilities of insurance manufacturers and distributors on their Product Oversight and Governance (POG) requirements.

EIOPA's overarching aim is to achieve a consistent standard of supervision across all European markets. The document outlines a three "layer" approach to identifying high-risk products, applying enhanced supervision, and assessing POG documentation.

EIOPA's annual report on IDD sanctions

In December 2022, EIOPA published its third report on administrative sanctions under the Insurance Distribution Directive (IDD).

Over 1,600 sanctions were issued across all Member States, a slight decrease from the previous year. Over 70% of sanctions were for breaches of the professional and organisation requirements under Article 10 of the IDD.

At an individual member state level, just one sanction was issued in Ireland in 2021. Indeed, the experience across member states varied markedly. Germany continues to stand out as the leader, with over 1,100 sanctions issued during the year. Undoubtedly, as IDD becomes more embedded, EIOPA will expect to see a more convergent approach adopted by Member States.

Other updates

Changes to Russia-Ukraine regulations

On 16 December 2022, the EU adopted its ninth package of sanctions since the Ukraine conflict began. The package, in this case, includes amendments to some existing sanctions.

The CBI has a dedicated page setting out details of the restrictive measures/sanctions.

All firms are expected to take steps to ensure they remain compliant with the restrictions and sanctions.

NST taxonomy updates

The CBI will introduce changes to several National Specific Templates (NSTs) in early 2023. Templates NST.01, NST.02 and NST.07 come within the scope for the planned changes.

The revised taxonomy is to be published on 16 January 2023 and implemented with effect from 28 February 2023.

Mazars insurance services

Our local team of insurance professionals have the knowledge and expertise to meet your organisation's needs. Click the hyperlinks below for more information or get in touch.

Actuarial

- Outsourced actuarial function services;
- Peer reviews;
- Pricing & underwriting;
- Data analytics;
- Portfolio transfers, mergers and acquisitions.

Assurance

- External audit;
- Internal audit support;
- Outsourced Head of Internal Audit;
- Tax;
- IT.

IFRS 17

- Transition support;
- Systems development;
- PAA eligibility testing;
- Yield curve assessment;
- Disclosures advice;
- Training programmes.

Regulatory

- Board training and governance;
- IAF & SEAR preparation;
- GDPR compliance;
- ESG gap analysis;
- CBI licence applications.

Risk management

- Risk framework and internal control reviews;
- ORSA support;
- Recovery & Resolution;
- Outsourced risk function services.

Solvency II

- Capital management;
- Pillar II governance;
- Pillar III support (QRTs, NSTs, SFCR, RSR);
- Third-country branch services.

Mazars insurance regulation newsletter

Our team are here to keep you abreast of all the latest regulatory developments via our insurance newsletter. Have you missed a previous issue? Check out past publications right here: Insurance regulation newsletter archive

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