INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

INSURANCE CORE PRINCIPLES, STANDARDS, GUIDANCE AND ASSESSMENT METHODOLOGY

ICP24

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ICP 24 Macroprudential Surveillance and Insurance Supervision

The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information to have a macroprudential perspective in the supervision of individual insurers.

Introductory guidance

24.0.1 Macroprudential surveillance aims to minimise the incidence and impact of disruptions in the provision of key financial products and services that can have adverse consequences for the real economy and broader implications for economic growth. In that respect, macroprudential surveillance may help to identify vulnerabilities in the insurance sector resulting from both internal dislocations and external shocks.

24.0.2 Systemic risk may be defined as the risk of disruption to financial services that: 1) is caused by an impairment of all or parts of the financial system; and 2) has the potential to have serious negative consequences for the real economy.

24.0.3 Macroprudential surveillance is predicated on:

- the assessment of system-wide vulnerabilities and the identification of threats arising to and from the insurance sector from the build-up and unwinding of financial risks;
- common exposures to macro-financial shocks; and

possible contagion or spillover effects from individual institutions and markets due to direct or indirect connectedness to the financial sector and the real economy.

24.0.4 Macroprudential surveillance relating to insurance has regard to insurers being potential originators, recipients of and possible amplifiers to systemic risk.

24.0.5 In its macroprudential surveillance, the supervisor should also take into account the risks that non-insurance entities may pose to insurance legal entities, insurance groups and the wider financial system.

24.0.6 Acknowledging the increase in the need for cooperation and coordination between jurisdictions, this ICP does not specifically distinguish between local, regional and worldwide shocks and corresponding policies.

24.1. The supervisor identifies underlying trends within the insurance sector by collecting microeconomic, macroeconomic and cross-sectoral data.

24.1.1 The supervisor collects information in a manner proportionate to the nature, scale and complexity of insurers to limit systemic risk. The supervisor should identify:

- ***microeconomic data***, which may but need not include items, such as insurance pricing, underwriting, transaction costs, expenses, claims inflation, reinsurance, intra-group transactions, and general developments in the insurance market (for example, the development of claims, reserves, pandemics, and changes in morbidity and mortality, longevity, changes in the frequency and severity of natural and man-made catastrophes, changes in medical inflation and changes in law). In addition, the supervisor may collect data on both the asset and the liability structure of undertakings. On the liability side, particular attention should be given to those products and features that have a greater potential to pose systemic risk. The supervisor should consider having established processes and communication channels on microeconomic data collection with other involved supervisors when an insurer operates in multiple jurisdictions.
- ***macroeconomic data*** to complement microeconomic data to allow the supervisor to assess the vulnerability of the insurer to systemic risk and to assess the potential of the insurer to act as a transmitter of systemic risk. Data can include general domestic and international macroeconomic variables (such as interest rates, exchange rates, inflation or balance of payments) which could identify macroeconomic instabilities and sources of risk both in the domestic and the global economy. Macroeconomic data may be used to assess the exposure of insurers' portfolios of both assets and liabilities to economy-wide factors. For insurers operating in multiple jurisdictions, the supervisor should consider collecting macroeconomic data relevant for material jurisdictions.
- ***cross sectoral data,*** which can include information on the exposure of insurers to other financial institutions (such as other insurers, banks or asset management funds) or significant concentrations of assets and liabilities to specific sectors of the domestic or the global economy. Cross sectoral data should be used to assess channels of mitigation, transmission or amplification of systemic risk.

24.1.2 The supervisor may either collect the relevant data itself or make use of data and analysis as provided by other sources.

24.2 The supervisor performs market analysis that considers current and historical trends as well as the current risk environment. The supervisor uses market analysis to inform its considerations in developing prospective scenarios.

24.2.1 Macroprudential surveillance requires the supervisor to have a structure and processes in place that allow for the monitoring of data, with a specific emphasis on data on the insurance market and sector trends that could potentially result in shocks to the wider financial system. Such a structure and processes should cross disciplines and sectors, recognising that shifts in in the economic values of exposures of the insurers can potentially have implications to macroprudential risks.

24.2.2 Consultation with stakeholders, including the public and private sector, is critical in enabling the supervisor to perform its market analysis. The supervisor should identify key sources of market and industry information as described in 24.1, have a communication strategy in place with respect to those sources to obtain information, and take into account all relevant factors when assessing that information.

24.2.3 The supervisor should ensure that there is an appropriate connection between the macroprudential surveillance done and the microprudential supervision of domestic insurers. Macroprudential surveillance may impact the micro prudential supervision of insurers.

24.2.4 Outcomes of market analysis should be considered in the development of adverse but plausible forward-looking scenarios that may be applied in stress test exercises to help determine potential vulnerabilities within individual insurers where such exercises are deemed necessary and appropriate. Adverse scenarios should reflect the current market environment and potential volatilities taking into account the specific institutional characteristics of the supervisory framework and the structure of the insurer's assets and liabilities. When stress test exercises are done, the supervisor should discuss any potential vulnerabilities with senior management of relevant insurers.

24.2.5 Those prospective stress scenarios should take into account ways market dynamics have changed, making historical data potentially less relevant. Prospective stress scenarios may be used to determine whether there are potential risks for the insurance sector and for individual insurers by paying special attention to unfavourable future scenarios.

24.2.6 In the development of adverse future scenarios, extreme circumstances can be taken into account, as long as those circumstances and the resulting scenarios are still plausible. Scenarios that are extreme to the point of being implausible do not provide information that is useful in determining when additional supervisory oversight or action may be required.

24.3. The supervisor performs both qualitative and quantitative analysis on the data so that macroprudential risks are properly assessed as part of the overall supervisory process.

24.3.1 Quantitative analysis includes, but is not limited to, identifying trends, outliers, interconnectedness and/or risk concentrations of existing or newly identified sources of uncertainty that amplify and facilitate the transmission of systemic risk when the insurer acts as an originator, receiver or transmitter of systemic risk. Qualitative analysis includes, but it is not limited to, performing subjective assessments based on judgement, experience, information and any other factors that either cannot be measured or quantified with typical methods

24.3.2 Typical quantitative methods of analysis can include, but are not limited to:

- horizontal review;
- descriptive statistics such as mean, median, standard deviation, percentiles;
- trend analysis with the use of linear and/or non-linear regression and filtering; and
- statistical modelling using past data.

Events, which are, by nature, high impact-low probability, but cannot be quantified due to lack of past experience, can be qualitatively assessed but should be used as inputs to quantitative assessments.

24.3.3 The supervisor may conduct a horizontal review to reveal the range of practices among the insurers relevant to a common subject. An insurer-by-insurer review may provide a relative ranking to determine which insurers are outliers, whether to bring those insurers back in line with their peers, and, if so, what areas need to be addressed. A horizontal review may also help determine whether industry practice as a whole is strong enough to address the risks embedded in the activity.

24.3.4 To make horizontal reviews effective, the following parameters may be taken into account:

- where peer groups are utilised, the choice of the peer group can have an impact on the quality of the outcome of the review. The supervisor should carefully consider the criteria for inclusion in the peer group.
- the sequential execution of reviews over a long period of time reduces the effectiveness of horizontal, or peer, comparison. Reviews should be performed within as short a period of time as practical.
- when reviewing an insurer operating in multiple jurisdictions, the group-wide supervisor should seek out a global perspective. Such a perspective can come from a peer authority or a third party (including international financial institutions such as, but not limited to, the IAIS, IMF and World Bank) which might have a broader perspective on the state of global practice.
- an established communication strategy should be in place for horizontal reviews, which addresses the need for assessments to go to the insurer's Board and Senior Management. Where appropriate, some higher level aggregated peer group information

- may be provided to insurers, who may or may not have participated in the review, so that they can gain from the lessons learned.
- the results of horizontal reviews performed within a single jurisdiction can be beneficial to the global supervisory community as a whole, especially as they may relate to systemic risk to the insurance sector. The supervisor may also consider suitable forums for the communication of information that is not necessarily insurance or firm specific.
- horizontal reviews need not always be sizeable undertakings. Simple horizontal outlier analysis on readily available insurer reports can often provide helpful supervisory insight. Simple analysis of some of these reports, including trends and peer comparisons, can help the supervisor to identify areas of potential risk and help it to target future work.

24.3.5 The supervisor should evaluate its data needs and data processing capabilities in order to determine whether it is able to accommodate additional requirements arising from the supervision of more complex insurers. The supervisor should address deficiencies in:

- the type of data collected;
- its ability to process data in a timely and/or complete way; or
- its ability to collect ad-hoc data in a timely manner.

24.4 The supervisor aggregates data and publishes aggregated data on the insurance market when this is necessary and feasible.

24.4.1 The publication of aggregated data by the supervisor may enhance market efficiency by allowing market participants to make more informed decisions related to their specific needs and reduce the cost to policyholders of acquiring insurance market information. Moreover, the publication of aggregated data may serve as a market disciplining mechanism by facilitating comparisons of an individual insurer to the market as a whole.

24.4.2 The supervisor may provide access to sufficiently detailed aggregate data either by publishing data itself or by providing others with adequate means for publishing data. This could be achieved by engaging a government statistical office or cooperating with the local insurance sector; provided the supervisor is satisfied with content, frequency and timeliness of such publication.

24.4.3 Feasibility pertains to the ability of the supervisor to publish aggregated data when there is no breach of confidentiality or data quality limitations, which would distort the actual financial condition of the sector that could lead to loss of market confidence from market participants.

24.4.4 Necessity pertains to publication of data that have not already been made available by industry itself as part of enhanced disclosure or could come from other sources, such as rating agencies or market analysis.

24.5 The supervisor assesses the extent to which macro-economic vulnerabilities and financial and non-financial risks impinge on prudential safeguards for insurers or the financial stability of the insurance sector.

24.5.1 The supervisor should assess insurers' connections, such as counterparty or macroeconomic exposures, with financial markets and the real economy in order to identify potential or existing build-up of risks in other sectors that could adversely impact the insurance sector.

24.5.2 When necessary, the supervisor should cooperate with other financial market supervisors (such as banking, securities and pension supervisors, central banks and government ministries).

24.5.3 The supervisor should monitor the liquidity of an insurer's invested assets relative to its insurance liabilities and analyse the potential that an insurer's operations could require that insurer to engage in asset sales of a significant size.

24.5.4 The supervisor should identify, assess and mitigate financial stability risks to the insurance sector. The supervisor should communicate the findings of its assessment as appropriate to either insurers or the industry and require insurers to take action necessary to mitigate any particular vulnerabilities that have the potential to affect financial stability. The supervisor uses its analysis to determine follow-up work required, if any.

24.5.5 The supervisor should have a toolkit of supervisory measures available for the mitigation of financial stability risks. For example, such measures may include:

- enhanced reporting;
- enhanced confidential and/or public disclosure;
- application of supervisory measures with respect to all relevant insurers ; and
- proposing regulations, such as limitations on double gearing, dividend pay-outs and large exposures.

24.6 The supervisor has an established process, which it uses to assess the potential systemic importance of insurers.

24.6.1 The supervisor should take a holistic perspective of an insurer's assets and liabilities when considering the potential systemic importance of an insurer.

24.6.2 In addition to the policies underwritten by the insurer, the supervisor should consider other activities the insurer is engaged in, such as the degree of engagement in derivatives activity and reliance on short-term market activity, as well as overall interconnectedness with other financial institutions.

24.6.3 The supervisor should give specific consideration to recent developments that might affect the insurance sector's risk factors.

24.7 If the supervisor identifies an insurer as systemically important, it develops an appropriate supervisory response commensurate with the nature and degree of the risk.

24.7.1 In jurisdictions where one or several insurers have been identified as systemically important, the supervisor should have available a framework of policy measures concerning such insurers to mitigate systemic risk.

24.7.2 The framework for systemically important insurers could include tools such as:

- enhanced supervision - more intensive and coordinated supervision and supplementary prudential, as well as other requirements;
- effective resolution - measures for resolution in an orderly manner without destabilising the financial system and exposing the taxpayer to the risk of loss; and
- enhanced capital regimes to reflect the that the relevance of these institutions for financial stability;
- liquidity management and planning.

24.7.3 Supervisors should act to reduce systemic risk, when identified within the jurisdiction through heightened supervisory oversight and globally through increased communication and cooperation with other jurisdictions.