Global Research
& Analytics

CRISIL
An S&P Global Company

Insurance Industry

CRISIL Insights

2017

Through periodic updates CRISIL Insights Insurance Industry series, we offer incisive analysis of regulatory, macroeconomic, guidance and trends affecting the insurance industry. We focus on how various elements could influence the insurance industry landscape.

Navigating a complex environment

It is a critical moment for the insurance industry as various economic, regulatory and market guidelines are the driving forces of change in the industry. Since Solvency II came into effect in Europe in January 2016 insurance entities are now preparing for a fundamental review of their accounting practices under IFRS 9 and IFRS 17 and its implications in their business.

In addition, the adoption of Model Risk Management (MRM) practices has become more widespread among the insurers, particularly in the US market, as banking supervisory entities are advocating their implementation. This is likely to have a cascading effect on insurers because MRM practices are being actively adopted by insurers given this regulatory emphasis. Also in view of the advantages of embracing effective MRM frameworks by the banking sector, the insurance sector would follow the lead to adopt the best practices.

Banking and insurance entities located are under pressure due a prolonged low interest rate environment. Even nine years after the 2007-2008 economic crisis, the 10-year US Sovereign Yield rates continue to be low. In Switzerland and some European countries including Germany, Belgium and Netherlands, for example, have seen in negative rates average since 2016.

In an environment where one of the “too-big-to-fail” US insurance firms reported big losses in Q1 2017, supports implementation of MRM policies in the Insurance Industry. These policies will lead to added credibility and would facilitate scrutiny and examination of insurers by supervisory entities.

Hence, insurers will now have to rely on innovative solutions to overcome the challenging environment while continuing to strive to improve their performance and strictly adhere to regulatory guidance.

IFRS 17	CECL	Negative interest rates
New standard published in May 2017	Possible implications for insurers	Persisting environment in the industry

IFRS 17

- The new financial standard was published in mid-May 2017. It represents the biggest fundamental change in the way insurance companies conduct business and issue contracts.
- While some players are proactive in implementing the new standard, others have adopted a wait-and-watch approach. The effective implementation date is January 1, 2021 and early application is permitted.
- Many challenges have to be sorted out by insurers, including talent gaps, pace of implementation and proper transition.

CECL

- CECL is an evaluation method to assess the potential for credit-related losses on instruments that are not carried at fair value. GAAP reporting requires a look at the lifetime expected credit losses; IFRS requires bifurcation to 12 months and lifetime credit risks. According to paragraph 944-310-35-6 of the Accounting Standard Update (ASU) 2016-13, "An insurance entity shall measure expected credit losses relating to the premium receivable in accordance with Subtopic 326-20 on financial instruments measured at an amortized cost with a corresponding adjustment to earnings."
- US-based insurers need to comply with different reporting requirements, particularly those relevant to US GAAP. However, multinational insurers reporting under IFRS are also subject to CECL. The early adoption date for CECL is after December 15, 2018 and the effective date is after December 15, 2019.

Negative Interest Rates

- Insurers are facing low assets growth and long periods of low interest rates. This is an issue for the industry as a whole and some of the players are already calibrating models to cope with negative interest rates.
- A low interest rate environment not only affects capital requirements and margins, but also the price-to-earnings ratio of entities.
- Despite the absence of a formal study on the impact of low interest rates on the insurance industry, there are potential implications on product development and pricing and model risk management, including cash flow testing and asset adequacy and capital requirements.

CRISIL
An S&P Global Company

MRM	IFRS 9	Risk Transfer
Model Risk Management	Possible implications for insurers	Innovative portfolios for effective risk transfer

MRM

- In June 7, 2017, the Federal Deposit Insurance Corporation (FDIC) adopted the Supervisory Guidance on Model Risk Management previously issued by the Board of Governors of the Federal Reserve System (SR 11-7) and the Office of the Comptroller of the Currency (OCC Bulletin 2011-12).
- The burden on US-based insurers will increase due to more stringent Model Risk Management (MRM) requirements emanating from the banking industry and gradually cascading into the insurance industry through supervisory entities.
- Model inventory for insurers is typically split 50/50 between actuarial and non-actuarial models. Actuarial models are in general more compliant to MRM best practices, this is due to actuarial standards of practice issued by the relevant actuarial society. For example, in U.S. life actuaries have some guidance in section VM-G of the Valuation Manual guidance for governance for Principle Based Reserving (PBR) and other Federal Reserve issued documents, including SR11-7.

IFRS 9

- The standard comes into effect on January 1, 2019 and applies to derivatives that are embedded in a contract and also investment components that are separated from a contract within the scope of IFRS 17.
- Insurers must consider separation of components in their issued contracts under IFRS 9 to account for different investment components or embedded derivatives.
- Those insurers with guarantee contracts may make an irrevocable choice to use the appropriate disclosure, including opting for IFRS 9 or IFRS 17, for such financial guarantee contracts.

Risk Transfer

- Investments funds and insurers are exploring the possibility of issuing more bonds for risk transfer and this is a new asset class and investment strategy linked to insurance risks. The strategies, commonly referred as insurance-linked strategies (ILS), are attractive for certain investors as they provide diversification due to low correlation to market movements (low systematic risk).
- Traditional ILS products, such as CatBonds, are primarily used to hedge catastrophe risks, but these products have now been enhanced to include broader investment elements. Similarly, the industry is relying on Longevity Bonds as part of ILS products.
- Insurance companies reporting under US GAAP and having a high exposure to holdings that don't have typical characteristics (like those in the ILS products) may require a special review (in terms of segmentation) of these types of holdings under ASU 2016-13.

How CRISIL can help

Entities can leverage CRISIL's ample experience in Model Risk Management and its proprietary frameworks to overcome many of the challenges the insurance industry is facing. CRISIL collaborates with various entities in their first and second line of defense to enhance their approach to model controls and governance.

About CRISIL

CRISIL is a global, agile and innovative analytics company driven by its mission of making markets function better. We are India's foremost provider of ratings, data, research, analytics and solutions. A strong track record of growth, culture of innovation and global footprint sets us apart. We have delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

We are majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Global Research & Analytics

CRISIL Global Research & Analytics (GR&A) is the world's largest and top-ranked provider of high-end research, risk and analytics services. We are the world's largest provider of equity and fixed-income research support to banks and buy-side firms. We are also the foremost provider of end-to-end risk and analytics services that include quantitative support, front and middle office support, and regulatory and business process change management support to trading, risk management, regulatory and CFO functions at world's leading financial institutions. We also provide extensive support to banks in financial crime and compliance analytics. We are leaders in research support, and risk and analytics support, providing it to more than 75 global banks, 50 buy-side firms covering hedge funds, private equity, and asset management firms. Our research support enables coverage of over 3,300 stocks and 3,400 corporates and financial institutions globally. We support more than 15 bank holding companies in their regulatory requirements and submissions. We operate from 7 research centers in Argentina, China, India, and Poland, and across several time zones and languages.

CRISIL Privacy Notice

CRISIL respects your privacy. We use your contact information, such as your name, address, and email id, to fulfil your request and service your account and to provide you with additional information from CRISIL and other parts of S&P Global Inc. and its subsidiaries (collectively, the "Company") you may find of interest. For further information, or to let us know your preferences with respect to receiving marketing materials, please visit www.crisil.com/privacy . You can view the Company's Customer Privacy at www.spglobal.com/privacy.

Last updated: April 2016

Disclaimer

CRISIL has taken due care and caution in preparing this report. Information has been obtained by CRISIL from sources which it considers reliable. However, CRISIL does not guarantee the accuracy, adequacy or completeness of any information, and is not responsible for any errors in transmission; and especially states that it has no financial liability whatsoever to the subscribers / users / transmitters / distributors of this report.

No part of this report may be reproduced in any form or any means without permission of the publisher. Contents may be used by news media with due credit to CRISIL.

© CRISIL. All rights reserved.