The Insurance Policy Advisory Committee (IPAC)
Record of Meeting
October 25, 2023
Washington, District of Columbia

1. Opening Comments

The IPAC Chair opened the meeting, welcoming the members and thanking them for their continued dedication to the IPAC. The IPAC Secretary introduced Governor Bowman and Governor Cook to IPAC members, and each expressed their appreciation for the IPAC's work.

2. Roundtable Discussion with Governors Bowman and Cook

IPAC members participated in a roundtable discussion, facilitated by the IPAC Chair. Governors Bowman and Cook each attended and participated in part of the roundtable discussion. The roundtable covered trends and risks in the insurance sector. Members emphasized non-financial risks, including operational resilience, third party risks, privacy issues, model risk, and geopolitical risk. In some members' view, geopolitical risk, including the impact of deglobalization and possible sanctions, should also be included in scenario analyses. Sanctions could impact any company, regardless of the location of its operations. There have been some barriers to trading and problems in international capital flows, reflecting increased geopolitical risk.

Members also noted the importance of maintaining and updating assumptions used by insurers. The assumptions can never be perfect, but they are now more informed and efficient regarding lapses, surrenders, etc. Some members also highlighted the difficulty in quantifying climate and operational risk, although some non-financial risks like these may be more about enhancing resilience than about quantifying them.

For the life insurers, higher rates are generally viewed to be positive, although the speed of the rate increases have led to elevated disintermediation risk.

The potential impact of social media remains a concern, including for increased reputational risk, but the members' view is that there is less immediate risk for insurers than for banks because insurance policy surrenders typically happen over a longer period of time than the withdrawal of bank deposits.

Among credit risks, a member highlighted anticipated stress in commercial mortgages, commercial mortgage-backed securities, collateralized loan obligations, and other asset-backed securities. Higher interest rates could further exacerbate potential credit problems in these asset classes.

For property and casualty insurers (P&C), climate-related losses were cited as the prominent risk, which in one member's opinion may even have policy implications for financial stability. For insurers, there are dramatic increases in losses due to changing weather patterns leading to increased frequency and severity of wildfires, flooding, and storms in many areas. Hail has been the biggest recent weather event in the Midwest. Inflation and supply chain cost issues have also been headwinds for the P&C sector. There are concerns about concentration risk as some firms limit underwriting in certain states. Due to the higher cost and availability issues, some people are buying less insurance coverage. Reinsurance costs are also increasing. According to some IPAC members, the reinsurance sector is in near crisis, which may contribute to protection gaps for policyholders. The difficulty in getting timely and adequate rate increases approved by state regulators is also adding to P&C companies' need for cost cutting.

An IPAC member questioned the accuracy of part of the Board's October 2023 Financial Stability Report related to the liquidity of insurers' liabilities to the FHLB. Board staff agreed to research the matter.

3. What impact is the insurance industry currently seeing from the use of artificial intelligence (AI)?

In members' opinion, the emergence of AI is unavoidable and will have a significant impact on the insurance industry. Areas where the industry already uses AI include claims handling, marketing, fraud detection and prevention, customer service, and self-service. Members emphasized that the use of AI requires governance, guardrails, comprehensive model testing, and restrictions on usage. AI has the potential to speed up operations but may raise new issues regarding risk in areas such as protection of confidential information, privacy, data governance, people risk, and strategic risk. One member's view was that insurers' use of AI can be opaque, which may result in trust issues for consumers. He also questioned whether AI would improve coverage or create better products.

4. Report to IPAC members on the Insurance Capital Standard (ICS) working group's (ICS WG) ICS consultation response

The recent International Association of Insurance Supervisors (IAIS) ICS consultation was the third and final chance for public input on the design and function of the ICS. The IPAC ICS WG members made a presentation on the IPAC's submitted consultation response. This included responses to 58 questions. The main purpose of the consultation was to correct any remaining issues with the ICS. In one member's opinion, the responses help illustrate issues with comparing the ICS to the Aggregation Method. Conversely, in the members opinion, the treatment of internal models may need additional consideration by the IAIS. Members also suggested the process could benefit from greater transparency regarding the work being done on comparability.

5. What are IPAC members' thoughts on the work done by the ICS WG's Scalar workstream?

Members expressed a range of different opinions about the possible scaling methods. In support of simpler methods, one member noted that the more complex methods, such as one relying on probability of default estimates, may not be feasible. Another member noted that there have been very few actual defaults in other regulatory frameworks such that such default estimates may not be reliable as a basis for scaling. A third member commented that the use of judgment in the scalar method, such as through the broad assumptions in the simpler approaches, should not be viewed as problematic because the ICS uses judgement in areas like the correlation matrices. Conversely, a member responded that the more complicated methods generally can have value because they may use more reasonable assumptions. Another IPAC member commented that the approach of assuming all scalars were equal to one was not credible. Balancing these two perspectives, another member noted that the impact of the scaling method was unclear.

6. What are IPAC members' thoughts on the work done by the IPAC Climate Risk WG to date? Do IPAC members approve the draft charter of the IPAC Climate WG?

IPAC members expressed support for the work being done by the Climate Risk WG. One member stated that insurers need to maintain investment capacity in the energy sector for decades. Another member described the development of capital models and improvements in catastrophe bond market, where there has been a shift from indemnity products to index-based products. Members approved the draft charter of the IPAC Climate WG.

7. Additional Matters

Other IAIS Items: IPAC Secretariat staff shared a presentation covering the IAIS consultations on ICP 14 (Valuation), ICP 17 (Capital), the Stakeholder Engagement and Consultation Policy, the Targeted Jurisdictional Assessment (TJA) Aggregate Report and Report to the FSB, the 2025-2029 Strategic Plan and Financial Outlook, as well as the Roadmap for 2024. The Global Monitoring Exercise was mentioned, as well as the fact that the IAIS is expected to release two more consultations on climate risk.

One member asked if there is a list of firms subject to resolution planning, and whether the work is related to financial stability or Common Framework for the Supervision of Internationally Active Insurance Groups. Confidentiality issues were brought up as a reason for not making the list public.

The IPAC Chair announced that the 2024 IPAC meeting will include a virtual meeting on February 22 and in-person meetings on June 13 and November 11. The IPAC Chair then thanked members for their engagement and closed the meeting.