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The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators, and assists in shaping financial systems globally. In particular, the IAIS is a member of the Financial Stability Board (FSB), member of the Standards Advisory Council of the International Accounting Standards Board (IASB), and partner in the Access to Insurance Initiative (A2ii). In recognition of its collective expertise, the IAIS also is routinely called upon by the G20 leaders and other international standard-setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

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The GIMAR reports on the outcomes of the IAIS’ Global Monitoring Exercise (GME). The GME is the IAIS’ framework for monitoring risks and trends in the global insurance sector and assessing the possible build-up of systemic risk. This is the mid-year update for GIMAR 2023.

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1. Introduction

This mid-year Global Insurance Market Report (GIMAR) update provides a summary of the interim outcomes of the 2023 IAIS’ Global Monitoring Exercise (GME) ahead of the publication of the final GIMAR at the end of the year. It covers key insurance sector financial stability topics analysed in the GME and discussed at the June IAIS Committee meetings and Global Seminar. It also addresses macroprudential themes that will form part of further analysis going forward.

Specifically, this mid-year GIMAR update contains preliminary statistics on solvency, profitability and liquidity positions of the global insurance sector; shares aggregate systemic risk scores; briefly discusses the interconnectedness of the insurance sector with banks; and elaborates on key areas of focus for the 2023 GME, namely (1) risks faced by insurers in light of the challenging macroeconomic backdrop and (2) structural shifts in the life insurance sector.

This mid-year update is based on preliminary GME 2023 data collected up to June 2023. Results may be subject to change in the 2023 GIMAR. Data collected consists of the 2023 individual insurer monitoring (IIM) applicable to insurance groups meeting the updated Insurer Pool criteria, consisting of approximately 60 of the largest international insurance groups from 18 jurisdictions, as well as the qualitative sector-wide monitoring (SWM) data covering aggregate insurance market data collected from IAIS members from 27 jurisdictions, comprising more than 90% of global gross written premiums. Quantitative SWM data will feature in the year-end GIMAR.

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1 The updated Insurer Pool criteria, as outlined in the recently published GME document, are: Total assets of more than USD 65 billion and a ratio of premiums from jurisdictions outside the home jurisdiction to total premiums of 5% or more, or total assets of more than USD 215 billion and a ratio of premiums from jurisdictions outside the home jurisdiction to total premiums greater than 0%, or jurisdictional discretion.
2. Solvency, liquidity and profitability

Aggregate participating insurers’ solvency and liquidity positions declined slightly from year-end 2021 to year-end 2022 while remaining well above 100%. Participating insurers’ aggregate return on assets also declined slightly.

The main drivers for the slight declines in solvency, liquidity and profitability include: lower asset valuations at year-end 2022, including declines in equities, widened credit spreads on corporate and sovereign debt, higher volatility of interest rates and weaker currencies in some jurisdictions. These declines were partially offset by increases in interest rates at year-end 2022 compared to year-end 2021.

The 2023 GIMAR will provide more insight into insurers’ solvency, profitability and liquidity developments, split by region and business model, including the qualitative outlook on the year ahead from the perspective of insurers and supervisors.

Main drivers for the slight declines in solvency, liquidity and profitability include lower asset valuations at year-end 2022.
3. Aggregate systemic risk scores

Aggregate IIM systemic risk scores for insurers that participated in the IIM 2020 to 2023 (year-end 2019 to year-end 2022 data) declined slightly compared to the year-end 2021 data. Key drivers for the decline are a decrease in the following indicators: short-term funding, liability liquidity, minimum guarantees on variable products and intra-financial assets. These decreases were, to some extent, offset by increases in indicators related to intra-financial liabilities, level 3 assets, derivatives, and premiums for specific business lines.

The 2023 GIMAR will provide more detail on the underlying drivers of changes in systemic risk indicators, as well as a cross-sectoral perspective comparing these developments to those in the banking sector.

At year-end 2022, a slight decline in aggregate systemic risk scores can be observed compared to year-end 2021.
4. Interconnectedness of insurance sector with banks

Overall, interim 2023 GME quantitative and qualitative data suggest no significant direct impact has been observed on the insurance sector from recent failures in the banking sector.

However, insurance supervisors are mindful of the lessons learnt in terms of the speed with which certain crisis events unfolded in an increasingly digitalised environment. Also, the potential second-round effects for insurers were flagged, recognising the important role of the banking sector in the overall financial system and real economy.

Insurance supervisors are mindful of the speed with which certain banking sector crisis events unfolded in an increasingly digitalised environment.
MANAGING INTEREST RATE, LIQUIDITY AND CREDIT RISKS IN A CHALLENGING MACROECONOMIC ENVIRONMENT

The current macroeconomic environment is characterised by persistently high inflation rates in several markets, leading to continued tightening of monetary policy and increased interest rates across many regions. Financial market sentiment remains fragile, with high degrees of volatility and uncertainty.

For the 2023 GIMAR, the IAIS will expand its analysis on how the insurance sector is managing this challenging combination of increased interest rate, credit and liquidity risks against this backdrop. Areas which will be assessed in more depth are: the lessons learnt from recent developments, the outlook going forward, key exposures and vulnerabilities, and measures that have been taken or are planned by insurers and supervisors to manage these risks.

On interest rate and liquidity risk, key areas of attention include:

- **Increased surrender risk:** The sharp increase in rates and inflation over the past year has increased surrender risk and the potential for additional liquidity needs. In the higher interest rate environment, policyholders may be incentivised to surrender policies early, thereby increasing cash flow obligations for insurers. In particular, policies with rate guarantees issued during the extended period of low interest rates may be susceptible to early surrenders.

- **Distribution channel:** Relatedly, the type of distribution channel through which insurance contracts are sold may have an impact on customer behaviour and lapse and surrender risk. The recent banking sector turmoil has shown the speed by which customers take collective action in the increasingly digitalised world. This needs to be taken into account in cash outflow modelling assumptions (collective lapses/surrenders).

The IAIS will expand its analysis on how the insurance sector is managing the challenging combination of increased interest rate, credit and liquidity risks.
Funding: Rising rates may also lead to additional liquidity pressures. Insurers with reliance on short-term funding or those with significant outstanding short-term debt may face pressures when refinancing or rolling over debt.

Derivatives and margin calls: Insurers who had hedged interest rate decreases during the low interest rate period using, for instance, derivatives and interest rate swaps may now face collateral calls in variation margin that must be settled in cash for centrally cleared contracts.

Ownership: Shareholder disengagement may impact the reputation and trust in an insurer, potentially amplifying market and policyholder behaviour with the risk of triggering increased surrenders.

Importance of asset-liability matching (ALM) and liquidity risk stress testing: Higher interest rates benefit insurers by allowing them to reinvest at higher rates. Insurers’ capital positions may improve if the value of their liabilities declines by more than the value of their assets (ie if their asset duration is shorter). However, increased interest rates also lead to declines in the value of fixed-income investments, which may lead to notable increases in insurers’ realised losses in certain accounting regimes. Un realised losses may need to be realised to meet unexpected or unmatched liquidity needs, highlighting the importance of ALM and liquidity risk stress testing. Also, the impact of the shape of yield curves on solvency and liquidity positions may warrant further monitoring, in particular in those jurisdictions characterised by an inverted yield curve.

On credit risk, areas of focus include:

Debt sustainability: Rising interest rates increase the debt funding costs of fixed-income securities. The insurance sector has substantial exposures to fixed-income assets, including sovereign debt, corporate debt and real estate, all of which warrant increased monitoring going forward as debt sustainability pressures rise.

Corporate and sovereign debt: During 2022, corporate defaults and downgrades significantly increased. Sovereign risk has risen over past years, illustrated by high sovereign debt to gross domestic product ratios. Should sovereign risks materialise, this could pose systemic risk given the materiality of the insurance sector’s exposures to these assets, the financial sector’s exposures to sovereign debt and the impact on the real economy.

Real estate: Office real estate is under particular stress due to the remote working trend. The impact on real estate valuations in general will be monitored. In aggregate, insurers’ commercial real estate exposures are assessed to be limited; however, second-order effects could materialise. The market for securitisations of real estate assets is also under pressure.

Leverage: Insurers’ leverage, for instance, through investing in structured products or derivatives (held directly or in funds) or through debt funding, may impact its ability to sustain volatility on financial markets and will therefore be monitored going forward.
STRUCTURAL SHIFTS IN THE LIFE INSURANCE SECTOR

As highlighted in the 2022 GIMAR, the life insurance sector is undergoing structural changes that could potentially impact the sector, policyholders, financial stability and supervisory practices.

For the 2023 GIMAR, this theme specifically identifies two key structural changes in the life sector that are closely intertwined: the utilisation of cross-border asset-intensive reinsurance and the increased allocation of capital to alternative assets.

The asset-intensive reinsurance model relies on a higher allocation to alternative assets with the aim of generating additional yield, which is a significant economic driver for these transactions. Moreover, asset originators rely on (re)insurance as an important part of their investor base.

Supervisors note a growing market trend in the life insurance sector to reinsure not only liabilities (e.g. longevity risks) but also assets (e.g. investment risks). These reinsurance treaties offer some advantages, such as improved capital management, potential tax and cost efficiencies, and the ability to centralise risk (positive network externalities). Differences in solvency regimes and accounting rules may incentivise the use of these reinsurance treaties, leading to changing risk profiles and complex multi-dimensional risk structures. This triggers questions about concentration, herding and recapture risk. Additionally, these reinsurance structures can limit the analysis of risks specific to individual insurance entities, making it more challenging to assess potential implications for financial stability.

As part of this theme, analysis of potential risks and their impact on financial stability will be conducted, encompassing an evaluation of supervisory responses to ensure effective risk management and oversight.

Secondly, the persistently low interest rate environment in prior years had prompted many life insurers to seek higher-yielding investments. As a result, insurers have allocated a greater portion of their investments to assets that exhibit higher illiquidity, more challenging valuation processes, and less transparent structures. As part of this theme, potential risks associated with alternative investments will be evaluated (such as model risk and valuation risk). Potential financial stability implications will be assessed, including a focus on transparency, oversight, and supervisory responses to this ongoing trend.

The life insurance sector is undergoing structural changes that could potentially impact the sector, policyholders, financial stability and supervisory practices.
6. Next steps

The final 2023 GIMAR publication is expected to be published by the end of the year.

The report will elaborate in more detail on key potential systemic risk developments in the insurance sector, how this compares to the banking sector, the outlook with respect to solvency, profitability and liquidity positions and a deep-dive into the themes outlined in section 5 (Key themes in the 2023 GME), which will be discussed by global insurance supervisors in more detail in September.

In September, global insurance supervisors will hold deep-dive discussions on the key themes highlighted in this report. Outcomes from those discussion will feed into the GIMAR 2023 to be published in December.