Addressing top-of-mind insurance issues

Current credit market

The credit markets in Q2 2024 faced a complex landscape shaped by rising economic uncertainty and evolving financial risks. **The Allowance for Credit Losses (ACL)** saw a significant shift, with 70% of companies anticipating an increase, a notable rise from 49% in Q1. Several factors contributed to this trend:

- **Macroeconomic pressures** – Unemployment rates and concerns surrounding the commercial real estate sector were primary drivers behind the anticipated increases in ACL. Companies cited these as key variables impacting their credit loss projections.
- **Economic forecasting challenges** – 68% of respondents identified forecasting, particularly around volatile interest rates and job markets, as a critical challenge in determining accurate ACL estimates. This uncertainty makes it difficult for companies to effectively assess credit risk, leading to higher allowances.
- **Rising delinquencies and net charge-offs** – According to the Current Expected Credit Losses (CECL) Pulse Check in Q2 2024, 67% of respondents saw an increase in delinquency rates, up from 56% of respondents in Q1. Additionally, 50% of respondents noted a rise in net charge-offs. This signals a broader trend of financial strain among borrowers, particularly in the face of elevated interest rates.
- **Non-performing Loans (NPLs)** – Commercial real estate loans, especially in the office space sector, emerged as the primary type of non-performing loans, with 63% of respondents reporting an increase in NPLs compared to the previous quarter. This highlights the vulnerability of the real estate market as it contends with high vacancy rates and changing work patterns.

Looking ahead, companies are focusing on risk management and scenario analysis to navigate the uncertainties posed by economic fluctuations. Many institutions have incorporated multiple economic scenarios, including downside risks, into their ACL frameworks, reflecting a cautious approach to credit loss estimation.

In conclusion, Q2 2024 saw growing pressures in the credit markets, with rising ACLs, delinquencies, and net charge-offs driven by macroeconomic instability. The commercial real estate sector, in particular, remains a critical area of concern as companies navigate ongoing economic challenges.

Thought leadership:

- CECL Pulse Check Q2 2024
- Credit Markets Update Q2 2024
- 2024 U.S. Banking Industry Outlook Survey

Economic update

Turbulence beneath:

On September 2, 1945, World War II officially came to an end. The so called “War to End All Wars” sparked a global desire for the nations to collaborate. This post-World War II era of economic and political integration is now being replaced with fragmentation. Diane C. Swonk, chief economist at KPMG LLP, provides a thorough analysis of the current global economic landscape and its underlying challenges, including geopolitical tensions, protectionism, and subdued global annual growth projections of just three percent for 2024 to 2026. Despite the challenges, there is hope for productivity gains driven by artificial intelligence (AI) and a reminder that cooperation is preferable than conflict.

Political and economic dissonance:

Consumers and chief executive officers often have vastly different perspectives on the economy, but why is that? It could be due to the sources of their news, but Swonk delves deeper into the underlying reasons for this divisiveness and what we can expect for the rest of this year and into 2025. At a quick glance, overall economic growth is expected to slow as the 2024 election approaches and continue into 2025. However, the Federal Open Market Committee (FOMC) voted to cut rates by one half percent in September 2024 and additional potential rate cuts in 2025 are anticipated to provide additional economic tailwind. The outcome of the election and the certainty it provides will be crucial for economic performance in 2025.

Top ten structural changes in the economy:

1. Worsening income and wealth inequalities
2. Rise in political extremism
3. Intensifying geopolitical tensions and fragmentation
4. Regional trade pacts are replacing global agreements
5. Accelerating disruptions due to extreme weather
6. Rapid technological innovation
7. Soaring energy demand
8. Aging demographics and growing opposition to immigration
9. Amplified risk of a debt crisis
10. Lingering legacy of COVID-19: The pandemic’s scars remain.

Thought leadership:

- Turbulence beneath the surface: A view from abroad
- Election year dissonance: Midyear economic outlook
- Groundhog day: Structural change watchlist
- Powell moves to seal his legacy: The Fed has started the rate-cutting cycle with an outsized move

GenAI

Generative AI (GenAI) continues to be an ever-changing landscape for insurers with new capabilities being implemented at a pace not seen before. GenAI adoption can provide valuable data insights for better decision-making in risk assessment and underwriting:

- **Personalization for customers** – GenAI provides the ability to leverage customer data to develop personalized products and services.
- **Legacy system solutions** – Use GenAI to extract the logic and data from legacy systems while Application Programming Interface (API) enabling them to feed into AI solutions.
- **Learning and development (L&D)** – With the use of GenAI, the future of L&D will involve constant reskilling, enabling learners to be more agile and responsive to change.

Expanding on the points above, property and casualty (P&C) insurers are exploring potential use cases that could further drive progress, including:

- **Underwriting** – Use GenAI to bring together relevant facts across various new business application documents to aid better underwriting decisions.
- **Claims** – GenAI allows for quick summarization of claims handing status and outstanding actions to speed up handling in a multistate claims team environment.
- **Antifraud** – Use GenAI to identify forged or inconsistent documents to reduce the probability of fraud in claims.

GenAI requires a strong data foundation and should be approached as a multiyear journey. The effective use of GenAI hinges on the proper foundation in data quality and cloud strategy. Additionally, effective adoption is highly dependent on robust change management practices.

Thought leadership:

- Advancing AI across insurance
- GenAI in P&C insurance
- Hot Topic: Artificial Intelligence in Financial Reporting
- The impact of artificial intelligence on the insurance industry

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Addressing top-of-mind insurance issues (continued)

Climate and ESG

The National Association of Insurance Commissioners (NAIC) issued a statement on environmental, social, and governance (ESG) policies in early February 2024. The NAIC statement provides guidance rather than mandatory requirements, and insurers are encouraged to do the following:

- **Consider social factors** such as human rights, labor standards, community engagement, diversity, and inclusion
- **Have strong corporate governance practices**, including transparent decision-making processes, effective risk management, and appropriate board oversight.

In early April 2024, the Securities and Exchange Commission (SEC) voluntarily stayed its recently finalized rules on climate-related disclosures pending the completion of judicial review by the US Court of Appeals for the Eighth Circuit. This court has been designated to handle all the challenges brought against the SEC's final disclosure rules. The SEC has indicated its intent to continue vigorously defending the final disclosure rules in court.

While the SEC's climate rules are argued in the courts, and the California climate bills have also come under legal challenge, registrants might still face increased pressure for climate-related disclosure from various sources. This includes Corporate Sustainability Reporting Directive (CSRD) requirements (if applicable), as well as insurance regulators, investors, analysts, customers, and others. As a result, insurers should:

- **Continue to assess current disclosures for compliance** with regulations applicable to the company
- **Consider the level of effort necessary to comply with such regulations** and, where appropriate, perform incremental activities such as conducting a materiality assessment, collecting and aggregating greenhouse gas emissions data, or enhancing risk management and internal control structure over such data.

Thought leadership:

- KPMG podcast: ESG reporting update
- Progress on amendments to California climate laws
- Impact of EU sustainability reporting on US companies

Regulatory

While 2023 marked a year of significant rulemaking, the uncertainty surrounding the 2024 election is shaping the regulatory landscape in a very different way. Key regulatory challenges include:

- **Regulatory intensity** – A shift away from "net-new" rulemakings and toward stringent supervision/enforcement of existing rules and frameworks; complexities/uncertainties from discord and legal challenge
- **Risk standards** – Regulatory expectations for robust (and demonstrable) risk management and governance; expanding focus on operational and compliance risk, protecting critical activities, role of third parties/nonbanks, and financial stability
- **Risk sustainability** – Regulatory expectations for adoption, functionality, continuous improvement and "sustainability" of risk processes and functions across governance, risk assessments, internal controls, issues management, and challenge
- **Growth and resiliency –** Ongoing and increasing regulatory focus on capabilities related to liquidity and interest rate risk management, contingency funding, and resolution planning
- **Capital and valuations** – Regulatory expectations to "level-up" on financial risk management practices; areas of focus include liquidity and interest rate risk, CRE and consumer credit, strategic planning, board oversight, reporting
- **"Threat actors"** – Supervisory focus on the expansion of perceived threats and vulnerabilities (e.g., AML/BSA/CFT, sanctions evasion, malware/ransomware, human rights, national security, fraud, and misconduct)
- **Fairness** – Legal challenges to rulemakings; a focus on fees and "product risk" (marketing and operational execution); expectations for robust analysis of customer impact/harm
- **Other areas** – These include responsible systems, security and privacy, and data

An administration change in 2025 may initiate shifts in the financial services regulatory environment, but the impact of change is not likely to be immediate regardless of the new administration's political party. Key takeaways in our administration scenario analysis (linked below) over three main areas are **agency leadership, rulemaking, and supervision and enforcement.**

Thought leadership:

- Ten Key Regulatory Challenges of 2024: Mid-year Look Forward
- SCOTUS Decisions: Year of Regulatory Anxiety
- Financial Services 2025 Regulatory Shifts

Tax outlook

As the election approaches, insurance tax leaders are facing a rapidly changing economic and political environment, complicating future projections. Additionally, the tax function is continuously implementing new tax guidance and focusing on transforming tax systems, responsibilities, and roles. Key tax issues for 2025 and beyond include:

- **2025 Fiscal Cliff**: The fiscal cliff refers to the expiration of significant tax provisions from the 2017 Tax Cuts and Jobs Act (TCJA) at the end of 2025, leading to potential tax increases unless Congress acts. With the election ahead and potential changes in Congress's composition and priorities, the provisions of the TCJA are difficult to predict but are expected to have a significant impact on future tax liabilities.
- **Minimum tax regimes:** The introduction of Pillar Two and Corporate Alternative Minium Tax (CAMT) introduced complexity in evaluating applicability, with more insurers being subject to the rules than originally anticipated or in assessing the impacts. Challenges are also emerging in determining taxable income. The Pillar Two and CAMT rules generally rely on the parent entity's consolidated financial statements, with adjustments, rather than a traditional calculation of taxable income. As such, different data than that traditionally gathered for the financial statements or tax returns may be needed, putting stress on finance staffs and company systems.
- **New income tax disclosures:** Under US generally accepted accounting principles (GAAP), annual income tax disclosures will be expanded to address investor requests for more information about how the tax risks, tax planning, and operational opportunities in an entity's worldwide operations impact the effective tax rate and future cash flows. Insurance companies need to start preparing for changes that may be required to systems, data, and controls to prepare the new expanded disclosures.
- **Technology and talent:** Similar to other areas in the insurance organization, the tax function is also facing similar challenges related to the deployment of new technology and GenAI, along with the talent implications that arise from an increasingly complex environment. insurers are reimagining staff roles and responsibilities as a result.

Thought leadership:

- New Income tax disclosures
- 2024 Chief Tax Officer Outlook: Tax meets tech to meet tomorrow
- Taxing Times: Navigating the evolving tax environment
- Navigating the new realities of Pillar Two compliance

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Additional insights and learning opportunities

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KPMG understands that staying at the forefront of innovation is critical for all insurance companies. We offer powerful insights and integrated solutions to help them navigate the dynamic world.

Featured insurance insight:

2024 Insurance Company Audit Committee Agenda

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Additional insights:

Financial reporting and controls:

- PCAOB seeks additional insight on proposed amendments
- PCAOB proposal on firm and engagement metrics
- ICFR and PCAOB updates: What leaders need to be aware of
- Trends in material weaknesses
- Insurance: Statutory Reporting – June 2024
- NAIC Bond Project
- Navigating Complexities in Assessing Securities as Bonds | LinkedIn
- Navigating the fallout: Lessons from the CrowdStrike outage
- Corporate Controller and CAO Hot Topics
- Staying in sync with internal audit and the chief audit executive

Risk and Compliance:

- Chief Risk Officer Survey – financial services perspectives
- CCO Insight: Planning Amidst Disruption & Operational Challenges
- *Watch now*: KPMG Audit Innovation in the Insurance Industry: Part 1

Webcasts + Events

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December 4–5, 2024

Las Vegas, Nevada

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Insurance Industry Symposium

Occurred June 18, 2024

Virtual event featured timely updates on insurance industry issues from KPMG subject matter professionals.

Watch Replay

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