

Strong case for uniform regulation

NIKOLAUS VON BOMHARD, the president of the Geneva Association, begins a new monthly contribution by investigating the advantages of a global solvency standard



GLOBAL insurers and reinsurers provide their risk-taking capacity not only in their home markets, but also in many other territories and jurisdictions.

They operate in heterogeneous supervisory environments, characterised by a variety of quantitative and qualitative requirements for risk capital, risk management and disclosure. Despite the existence of mutual recognition of regulatory regimes that aim to ease these burdens, there is a need for a global solvency standard. Its introduction would let insurers reduce their resources in complying with often duplicative regulatory reporting requirements; it would make local regulatory capital requirements comparable and thus further pave the way for a level playing field among insurers.

Further integral steps towards a more homogeneous supervisory landscape would be a group solvency regulation approach, together with the introduction of a lead supervisor concept, including the set-up of colleges of supervisors for insurance and reinsurance groups.

Finally, all the issues mentioned would benefit the policyholder in the form of more attractive offers and conditions.

The financial crisis drew the world's attention not only to the banking sector, but also to the insurance industry.

A global supervisory system capable of detecting future dislocations of financial markets earlier or to mitigate the adverse impact of such situations is lacking at present. The regulatory landscape is fragmented and supervisors have preferred to elaborate country-specific solutions.

Policymakers, supervisors, investors and other stakeholders are seeking a system which might be the role model for the future solvency standard. Europe, with its Solvency II approach scheduled for implementation in 2012, is well positioned in this respect, as it presents one of the most advanced supervisory frameworks, both in terms of quantitative requirements (eg, setting of the solvency capital requirements and principles for determining technical provisions) and qualitative prerequisites (eg, duties and powers of supervisory authorities and requirements regarding companies' risk-management systems).

Not only the industry and supervisors worldwide but also politicians are now advocating and demanding improvements in the supervisory landscape. The G20, for example, stated in light of the recent dislocations in the financial markets: "We will take action to build a stronger, more globally-consistent supervisory and regulatory framework for the future financial sector, which will support sustainable global growth and serve the needs of business and citizens."¹

The focus of this article is not on the overall establishment of a level playing field in financial sector supervision, but on changes in the insurance and reinsurance industry.

Although there are certain similarities between the financial industries (eg, banking, insurance and securities trading) which would justify the introduction of an integrated global approach, the differences are far from negligible. It therefore seems preferable to start with a common approach towards insurance regulation, an issue also dealt with in the Geneva Papers to a certain extent and from a supervisory point of view by Elderfield.²

Advantages for supervisors

Without doubt, a global approach to insurance supervision would have several advantages for supervisors, insurance and reinsurance companies and their policyholders.

Many countries already have, or are in the process of, revising their regulatory systems to give them a more risk-based approach. These isolated endeavours, however, disregard an important point: increasing globalisation and internationally operating insurance and reinsurance companies with a wide-ranging network of branches and subsidiaries require a global supervisory standard.

Harmonisation of quantitative and qualitative regulatory standards is advantageous for all parties involved. The industry will benefit from the fact only one standard has to be followed and resources do not need to be allocated to comply with numerous regulatory systems.

This is of particular importance for companies which intend to expand into new markets abroad. The cost and resources issue should not be neglected on the regulatory side either. Having a uniform supervisory standard will save regulators money, as their staff can concentrate on one set of rules and requirements.

Focusing on a single regime is also appealing in the light of regulatory standards and models that are becoming more complex and challenging and will require people with special skill-sets. The war for talent – ie, the search for people with actuarial and risk-management expertise – has already begun and demand is still rising.

Policyholders and other intermediaries will also benefit from lower prices as a result of the emerging level playing field and thus increased competition between insurers and reinsurers and their lower spending for compliance with various supervisory frameworks. If policyholders were to be asked, they would almost certainly advocate a globally consistent standard precisely for these reasons.

Transparency is another keyword in debate. Adherence to the same set of standards by companies worldwide minimises the risk of regulatory arbitrage. And a new standard geared towards the latest findings in the industry will avoid inefficiencies going forward.

Global insurance and reinsurance companies play an important role in the development of national economies by assuming and disseminating risks and making entrepreneurial decisions. A global regulatory regime for insurers would demonstrate more effectively the existence of efficient and stable insur-

ance markets against the background of the volatile financial markets and a looming worldwide recession scenario. Supervisors will be better prepared for the occurrence of future crisis situations (eg, the increasing probability of pandemics, the rising severity of natural catastrophes and terrorism alerts, to mention just a few).

IAIS as global authority

The creation of a global supervisory standard for insurance is an ambitious but worthwhile undertaking. Apart from the availability of the regulatory standards and the readiness of the insurance and reinsurance companies, there remains the question of whether or not a regulatory authority with sufficient and adequate competencies and powers exists to ensure compliance with global standards.

The International Association of Insurance Supervisors (IAIS), which represents insurance regulators and supervisors worldwide, appears to be the best-suited candidate. The organisation was set up in 1994, and its main objective is the release of insurance core principles (ICPs), other principles and regulatory standards. The ICPs present fundamental principles for proper regulation and deal, for example, with the supervisory system, prudential requirements or questions relating to the ongoing supervisory process.

The ICPs have been accepted by IAIS members as an appropriate supervisory standard, but in practice companies must still comply with the local regulatory standards and requirements. IAIS principles, standards and guidance papers are non-binding (ie, they are not directly applicable to (re)insurers but have to be implemented by IAIS members).

While there seems to be general agreement among stakeholders the IAIS needs to be strengthened in order to achieve a global solvency standard in the mid to long term, there is still uncertainty about how exactly this could be accomplished.

One option would be to restructure the IAIS into a World Trade Organisation-like organisation with the power to issue binding guidelines and conduct appropriate dispute settlement procedures. It is also conceivable the Organisation for Economic Co-operation and Development's insurance committee might play a more prominent role.

Many believe, though, the most promising idea for insurance is to adopt a process similar to the one developed for the Basel committee on banking supervision, established by the central bank governors of the G10 countries in 1974.

The committee does not possess any



formal supranational supervisory authority; its conclusions do not – and were never intended to – have legal force. Like the IAIS, the Basel committee formulates supervisory standards, guidelines and best practices. But usually banking supervisory rules are endorsed by the central bank governors and heads of banking supervision of the G10 countries.

Conclusion

It has become evident international approaches towards common insurance regulation are an important undertaking. Policymakers and supervisors should therefore not miss the opportunity now to raise the issue of a global standard for the supervision and regulation of the insurance and reinsurance business.

Promising developments are especially observable in Europe, with the scheduled implementation of the Solvency II regime by late 2012 – and, to a lesser degree, also in the US. Supervisors in several countries have shown their interest in Solvency II features and some have launched the implementation of similar requirements to ensure mutual recognition of the supervisory regimes (eg, Bermuda).

A new global approach must definitely involve the two main markets, the US and the European Union. Only then can the undertakings evolve into global efforts to adopt a worldwide supervisory standard in which insurance and reinsurance companies are subject to similar supervisory conditions and requirements, no matter where they come from or where they intend to do business.

The objective must be to revise the supervisory landscape, which is uneven and impedes the functioning of globally operating insurers' and reinsurers' business models. The resultant lack of a level playing field for regulation results in higher costs and inefficiencies for insurers, supervisors and policyholders alike. The IAIS, which has been working for several years on standards and principles for a new global supervisory framework, might be a good starting point for a new and effective supervisory authority.

• This article is based on a contribution to the Geneva Association's journal, the Geneva Papers on Risk and Insurance – Issues and Practice, 35(1) by Dr Nikolaus von Bomhard, president of the Geneva Association and chief executive of Munich Re.

For further information on The Geneva Association and the Geneva Papers, please visit www.genevaassociation.org.

1) G20 (2009)
2) Elderfield (2009)

Structure risk in UK election

Scott Vincent

STABILITY within the UK regulatory environment is crucial for the insurance industry as it continues to prepare for the implementation of Solvency II in 2012. Yet this stability could be threatened in the coming months, with a change of government likely to bring a change in regulatory structure in the UK.

While a Conservative victory in the general election – widely believed to be taking place on May 6 – is by no means certain, the Tories are still ahead in the polls as both parties prepare to embark on their election campaigns.

The Conservatives have said they will abolish the Financial Services Authority (FSA) if they come to power, in favour of a regulatory system consisting of the Bank of England (BoE) and a new Consumer Protection Agency (CPA). How soon this would occur is unclear – the Conservatives have not offered a timeline as to when the changes will be made.

How the insurance sector as a whole will fit into this new regulatory system is also still subject to some debate.

At a British Insurance Law Association lecture, held at Lloyd's Old Library last week, Mark Hoban MP, shadow Treasury minister, said there were arguments to give the BoE supervision of the whole insurance sector. "We believe it is a good fit for the Bank of England to become a macro-prudential regulator," he said.

When questioned about the future for brokers under the Conservative regulatory regime, Hoban was less certain. "We haven't finalised the dividing line between the CPA's remit and the Bank of England's remit," he said. "My guess... as a lower balance-sheet risk, brokers will be regulated by the CPA." This will mean brokers avoid becoming embroiled in the capital requirements likely to be enforced by the BoE for the risks it regulates.

"Both the Bank of England and the CPA will have to go out into the market and recruit people with relevant experience," Hoban continued. "The bank will need to make sure it has adequate tools to monitor the solvency of insurers."

The insurance sector has given a subdued response to plans to scrap the FSA, although privately many have voiced concern over the proposals. A survey of in-house lawyers in the insurance sector, published late last year by Pinsent Masons, showed only 7% of respondents supported Conservative proposals to abolish the FSA and replace it with the BoE/CPA set-up. More than two-thirds of respondents favoured a single regulator rather than a split between prudential and conduct of business regulation.

"The FSA at the moment deals with prudential supervision and conduct of business," Hoban said. "Up until the financial crisis, the FSA's main area was conduct of business. This took centre stage in the FSA approach, with insufficient attention being paid to prudential supervision. The challenge we face is how do we provide a framework for financial services that assures people lessons have been learned from the economic crisis?"

Last week saw the Financial Services Bill pass its third reading in the House of Commons. In it, the Labour government proposes to increase the FSA's powers to introduce tougher rules governing pay and bonuses, as well as set up a Council for Financial Stability, bringing together the BoE, HM Treasury and the FSA.



Unmasking issues: a global regulatory regime for insurers would mean supervisors were better prepared for pandemics