Right-sizing Insurance Regulation
At International Insurance Society seminar, insurers, regulators and academics consider how best to balance the rules under which the industry operates.

June 22, 2011
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The rapidly evolving regulatory environment was a central topic of discussion this week at the International Insurance Society Annual Seminar in Toronto.

Delivering the keynote address, Canada’s top financial regulator, Julie Dickson, superintendent of Canada’s Office of the Superintendent of Financial Institutions, said insurers and regulators alike had learned a great deal since the financial crisis about what constitutes an effective regulatory environment. Among these lessons, Dickson said, was that insurers need to move risk management efforts to the forefront by equipping chief risk officers with sufficient clout and engaging in stress testing. Furthermore, she called for better governance and information management practices and more clearly stated risk management practices from insurers. “Insurers must be more agile in assessing how they would do in another crisis,” she said.

Despite the praise Dickson garnered for the performance of Canadian firms during financial crisis, she acknowledged that regulators also have their work cut out for them. “It’s important that we don’t get complacent,” she said. “Past success is no guarantee of future success.”

Dickson said insurance regulators would benefit greatly from a global capital standard. She said that while the Solvency II initiative in the European Union was an improvement, it is still incomplete and probably insufficient for the task. She also said the lack of harmonization on group supervision was another key detriment to effective regulating an increasingly global industry. While she praised the ongoing convergence efforts of the International Accounting Standards Board and Financial Accounting Standards Board, she said much work remained before a single set of accounting rules that accurately reflected the realities of the insurance industry were in place. “A global standard is worthwhile but the challenge is daunting,” she said.

Presenting the findings of his newly released research paper, Robert Klein, associate professor of risk management and insurance, and director of the Center for Risk Management and Insurance Research at Georgia State University, argued for a more modern regulatory regime in the U.S. Klein noted that U.S. solvency regulations are still mostly rules-based. Likewise, he said, U.S. capital standards are “antiquated” and recommended adoption of a more sophisticated, model-based approach.

Klein’s work also addresses the question of what is the proper role of regulators in the insurance market. He acknowledged that the insurance market is largely more “workably competitive” that “perfectly competitive.” Klein also said that a distinction must be made between market problems (i.e. high rates in certain localities) and market failures (i.e. widespread insolvency). “Regulators can’t really remedy market problems,” he said. “Only market failures deserve regulatory intervention.”

Dr. Volker Deville, EVP, of Allianz also argued that the unique business model of insurers warranted a lighter regulatory footprint compared to other parts of the financial services industry. Deville noted that two of the primary causes of the financial crisis, leverage and interconnectivity, are largely absent from the insurance market. “Insurers are not leveraged,” he said, adding that with insurers typically reinsuring less than 5% of their business, interconnectivity is relatively low. “The contagion chain for insurers is tiny compared to banks.”
Rolf-Peter Hoenen, president of the German Insurance Association acknowledged the need for regulatory reform, especially in areas such as cross-border and across sector groups, but said regulators must find a way to protect consumers without placing undue burdens on the industry. "The cost aspect of regulation is often neglected in the public discussion," he said. "Capital requirements must be reasonable and data requests can’t be excessive. Over-regulation has become a major risk for the insurance industry."