

# Insurance Forum: Key Discussion Points

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## Draft for Comments

Many thanks for participating in our insurance forum on the 25<sup>th</sup> of February. We realise that attending this meeting involved a considerable commitment in terms of time and preparation and for this we are extremely grateful. As sometimes happens at these events more questions arose than were answered. However we consider this to be a necessary step in the process by which the ICFR identifies key areas in which we should take our research and events agenda forward. It also helps us to come into contact with potential partners in on a range of projects associated with regulation in the insurance sector.

We are conscious that these discussions be productive, and are consistently trying to think of ways to improve both the agenda and the output. In this case, we identified one general theme: the need for a common understanding of what regulators and policy makers are seeking to achieve by way of regulation, particularly as it pertains to insurance. This is all the more important in a year in which the Financial Stability Board is under pressure to present comprehensive proposals on financial reform to the G20. The ICFR's non-partisan position offers a unique opportunity to bring regulators, practitioners and academics together in a constructive environment. Examining the "philosophy" of regulation is already a key component of the ICFR's research agenda. We are addressing this question at our annual event in Amsterdam on 20 April (see <http://www.icfr.org/Events/Regulation-without-Borders---From-Principles-to-Ac.aspx> for details of the event and programme), but will be doing more work on events and research related to the topic over the course of 2010. Do let us know if you would like to be involved in this project.

Below is a short summary of the event, and a list of the more specific issues which arose during the forum. We would welcome any comments you have on these notes plus any additional thoughts you may have for where we might follow up by Friday 12 March 2010. If there are specific follow-up issues in which you would like to be involved, an indication of this would also be useful.

### **Summary:**

While the insurance industry was largely unaffected by the financial crisis (AIG excepted), it is not clear that the industry will try to take advantage of difficulties in the banking industry to increase their own scope for several reasons. First, the insurance industry's history of departing from their core business has not been wildly successful, nor has the bancassurance model in the developed markets. Second, the capital constraints imposed by Solvency II mean that is as yet unclear how much capital will be available for expansion.

The attraction of the emerging world for insurance projects was discussed at some length.

Considerable discussion occurred on the issue of time horizons for strategy, investment and returns. This related to both the short-termism of many investors, the temptation to increase short-term profits by increasing risks if competitors are increasing their profitability by doing so, and the zero-50 year time horizon of insurance products. The discussion also touched on the unintended

consequences of regulation on the strategic time horizon of insurance companies and their investors.

Regulatory issues concerning participants included: agency issues, transparency, the allocation of capital, and technology constraints.

**Specific follow-up topics:**

- Will insurance become a more important component in the financial system in the wake of the financial crisis as a result of business restrictions imposed on banking institutions? Securitisation has been viewed with suspicion through this crisis but it will continue to form an important part of financial intermediation. What will be the role of the insurance sector in securitisation and credit products in the future?
- Although the bancassurance model in the developed world became heavily challenged, is there an argument to be made that it was not the model *per se* which is ill-founded but that it was not effectively applied? Could bancassurance models be an important part of financial structure in the emerging world? (*Potential topic for a follow up working group on insurance in the emerging world*)
- The fallacy of composition: is regulation encouraging homogeneity of risk and incentives, rather than diversification, thereby increasing risk in the system?
- Is there a danger of endogeneity in regulatory policies? (*This is already a core theme of the ICFR's research agenda*)
- Will over-capitalisation of insurance companies lead to under-capacity to innovate?
- How much risk-appetite is embedded in consensus/industry growth forecasts, leading to underestimation of risk and leverage?
- Shifting capital flows between countries and regions. How will these expose both the ability of financial systems in the emerging world to absorb these flows smoothly and what is the role of such capital flows in risk transfer? (*Potential follow up working group*) Would the picture look very different if measured on a cash flow instead of balances basis?
- The management of longevity risk.
- How to define financial stability?
- A general question arose during the debate over what mechanism is in place for monitoring the work of supervisors and regulators, how their work is to be assessed and more broadly how their objectives are defined and assessed. This can be considered the governance of regulators or 'who regulates the regulators?' This issue is also on the ICFR's broader research agenda.
- Are there risk management lessons and best practice to be shared between the insurance and banking industries?