BILA COLLOQUIUM: REGULATION

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Introduction

The inclusion of a session on Regulation in the programme for BILA's 50th Anniversary Colloquium was an interesting one for an association that is concerned with insurance law. The fact that it was included and that its inclusion did not raise any questions perhaps shows both the rise in importance of regulation for the industry and the extent to which law and regulation are now accepted as interlinked.

The session was chaired by Sean McGovern, Chief Risk Officer & General Counsel at Lloyd's. On his panel were two industry representatives and two representatives from the UK regulators. For the industry was Olav Jones, Deputy Director General of Insurance Europe, the body that represents insurers in Europe, and Hugh Savill, Director of Regulation at the Association of British Insurers (ABI). On the other side of Mr McGovern sat Chis Moulder, Director, General Insurance for the Prudential Regulation Authority (PRA) and Mike O'Hagan, Manager, Lloyd's & London Market Supervision from the Financial Conduct Authority (FCA). Panel members were only allowed the briefest of presentations with the rest of the session given to a panel discussion. What follows, therefore reflects the themes discussed rather than the chronological order of points made.

Getting the regulatory balance right

An important theme that ran through the session was the question of whether the regulatory balance is right. Hugh Savill made the point trenchantly in his opening comments. As he put it, as the economy begins to grow, there will be a need for insurance capacity and for insurers to be able to offer attractive insurance products to families whose finances are improving. Against that background, he asked, are the regulators playing their role in getting the level of regulation and supervision right so as not to hold up growth? He noted industry concerns, for example, at the number of FCA thematic reviews undertaken and the FCA's growing interest in conduct regulation for wholesale insurers. For his part, Mr Jones seemed more optimistic that at least at the European level, the Commission will wish to support growth and development and that insurers will see the benefit of this in the regulatory agenda adopted.

Responding for the regulators, Mr Moulder recognised that the past four to five years had been busy years for regulation and he doubted that the next few years would be any different but much of that was outside of the control of the regulators. He accepted that the UK regulators are focussed on stability and do not have economic growth as an objective. Nevertheless, Mr Moulder said that at the heart of their assessments is whether firms have a stake in the future and remain viable businesses and this is fundamental to the protection of policyholders.

With the UK having adopted a twin peak regulatory model, an early fear of the industry was that the two regulators would struggle to work together. The fear was that this could increase the burden on the industry. Mr McGovern therefore invited the panel's view on this and the consensus seemed to be that the arrangement was working as well as could be expected. Mr Moulder was clear that the regulators understood that to succeed they needed to cooperate and this was reflected in the formal memoranda of cooperation agreed between the PRA and FCA and in the quarterly senior meetings between them. Mr O'Hagan echoed the same view and said that he saw good evidence of cooperation on the ground, although he warned that the FCA and PRA would not always have the same agenda and therefore they would not always be wholly aligned. For his part, Mr Savill agreed that the PRA and FCA were receptive to feedback on how their actions were affecting the industry and they seemed willing to take those points on board.

Solvency II

Solvency II is the European initiative to introduce a new Europe-wide, harmonised framework for prudential regulation. Mr Jones said that after 13 years in the making, the industry is more relieved than overjoyed that a

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firm date for implementation – 1st January 2016 – has at last been set. The industry sees Solvency II as imperfect but the uncertainty caused by its delay was becoming more damaging than any perceived imperfections. More broadly, he highlighted that the industry had been supportive of Solvency II at the outset and, while there are fears of unintended consequences in its implementation, insurers remain of the view that a strong risk-based, harmonised regime is the right way to go.

Mr Moulder similarly shared Mr Jones' view that having an implementation date for Solvency II is good news but he saw as less positive the fact that many of the detailed provisions are still to be finalised, making implementation challenging on the present timetable.

With regard to the UK's readiness Mr Jones said that in Europe, the UK is perceived as being well prepared for Solvency II, as UK insurance regulation already reflects many Solvency II principles. Other countries, moving directly from Solvency I to Solvency II, will have a bigger leap to make. Mr Moulder warned, however, that UK insurers should not be lulled into thinking that the transition from ICAS to Solvency II is an easy one. Although ICAS, the current UK capital setting regime, gives the UK a head start, Solvency II is still quite different and more rules-based. He also noted the challenges for the PRA itself in building the systems needed for Solvency II, including the IT system it will need to gather the Pillar 3 disclosure data insurers are required to provide.

Conduct Regulation

Mr O'Hagan said that while the FCA sometimes felt a little like the "new kid on the block" it was looking to develop its own regulatory style, appropriate to a conduct regulator, based on judgement-based early intervention. Mr O'Hagan hoped that there would be less "paralysis by analysis", meaning the FCA would not delay tackling problems just because it had not completed the full analysis that may previously have been demanded. The FCA's basic aim is to get firms to put consumer interests and the integrity of the market at the heart of their business models. This will be implemented through firm-by-firm reviews, with deeper reviews of the greatest risks and thematic reviews where appropriate. He acknowledged that there had been a lot of reviews commenced in the early days of the FCA, a point noted by Mr Savill as a concern for insurers, but Mr O'Hagan said the FCA would be looking to communicate its agenda better with the market.

Mr Savill also raised a concern about the FCA involving itself in the wholesale market. He said the unique cover provided by the London Market needed to be recognised as different and unless there is evidence of market abuse, the FCA should assume that the market can look after itself. In response, Mr O'Hagan stressed that the FCA is not trying to import retail concepts into supervision of the wholesale market but the FCA does not believe that the divide between the wholesale and retail market is quite so clear. The FCA's reviews had shown that many insurers that saw themselves as wholesale insurers were writing significant books of consumer business.

At the European level, Mr Jones said that while the focus to date had been on prudential regulation, there was an interest in conduct regulation as well (including MiFiD and IMD2). EIOPA has also indicated it intended to focus on this issue. Mr Jones said that European policymakers need to be sensitive to diversity in the European insurance industry; they should not ban practices just because they are different. Asked by Mr McGovern as to whether he thought there was a tendency in Europe to assume that it must legislate or regulate, Mr Savill said he believed that was the case. Generally, he thought, there is plenty of satisfactory conduct regulation at national level and his fear was that intervention at a European level will only make this more onerous and burdensome, with, in his view, little overall benefit.

ComFrame

In addition to the busy regulatory agenda at the UK and European level, the panel also discussed some of the more important international initiatives.

One of the most significant of these is ComFrame, an initiative of the International Association of Insurance Supervisors (IAIS) to provide an agreed framework for the supervision of internationally active insurance firms. Mr Jones noted the origins of this initiative, as a reaction to the financial crisis and in particular the difficulties experienced by AIG, which lead to calls to have better arrangements in place for supervisory co-ordination. However, if the origins of the idea were in supervisory co-ordination, that was no longer the only focus and increasingly ComFrame had become about international comparability, including of capital standards. At

present, Mr Jones said, the industry remained supportive of the ComFrame objectives. It supported the group approach in Europe and believes that it makes sense as a global approach. Many supervisors are seeking more information about groups and there is a logic to them working together. This was a point reflected by Mr Moulder who believed that ComFrame was helping provide structure to the formation of regulatory colleges. Mr Jones, however, expressed the concern that ComFrame has developed into a detailed set of rules, particularly in areas such as risk management and the fear for European insurers was that it could require further changes to Solvency II. In Mr Jones' view, ComFrame should remain as a high-level regime.

International Capital Standards

One area that has developed out of ComFrame is the proposal to create international capital standards (ICSs). On this, both Mr Jones and Mr Savill were clear, setting out the position of the insurance industry. In their views, however the ICS programme may develop, it is crucial that it does not distract attention away from the implementation of Solvency II. Solvency II is a rigorous system for prudential regulation and if it is to be implemented on time, the timetable is extremely tight. The fear for the industry is that the ICSs, once agreed, could require changes to Solvency II but this should not be a reason for delaying Solvency II further and regulators should not allow themselves to be distracted. Mr Savill in particular pointed to the IAIS announcement that it was looking at the ICSs when European insurers were trying to implement Solvency II as evidence of the difficulties insurers can sometimes face. He likened the situation to an ice-hockey match where all the players are focussed on the game at one end of the rink, only to see another puck thrown in at the other end!

Mr Moulder noted that the PRA did not yet have a fully-developed in-house position on ICSs but he noted the challenges that would lie ahead. He noted that the project to harmonise insurance accounting standards started in the 1980s and that the parties had only recently ended discussions, having failed to reach a final agreement.

Global Systemic Risk

In July 2013, the Financial Stability Board (which was established under the auspices of the G20) announced its first list of global systemically important insurers (G-SIIs) (the list will be updated annually). It is expected that these G-SIIs will become subject to the enhanced policy measures developed by the IAIS published alongside the FSB's list. These policy measures require G-SIIs to be subject to enhanced supervision, have effective resolution arrangements in place and greater capacity for loss absorption.

When asked what this would mean for supervision in the UK Mr Moulder noted that significant firms have always been subject to close scrutiny by the PRA. In the case of Recovery and Resolution, this was also on the PRA's agenda but he noted that the publication of the FSB list and the IAIS standards meant this would likely receive additional focus from the PRA on progressing this work.

Responding for the industry, Mr Jones said Insurance Europe had always strongly argued that insurance does not pose the same systemic risk as banks. The issue was what activities were being undertaken. If the activities were risky in nature, as had been the case with AIG, then the focus should be on those, but just because insurers were big did not mean they posed a particular systemic threat.