Editorial

Rules of Engagement: Global Regulatory Reforms and the Insurance Industry

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As this editorial for the July 2011 issue of *The Geneva Papers on Risk and Insurance—Issues and Practice* is written, multiple, massively important regulation initiatives are hitting the insurance industry around the world at the same time. They range from changes in the financial services framework following the lessons from the most recent crisis, to new and more consumer protection initiatives, from further changes to international financial reporting standards to the profound solvency reforms, from modifications of the tax systems to transformations of old-age security arrangements. For any observer of the industry, it has become difficult to follow all of these reforms simultaneously and then trying to understand how they will affect the prospects of the insurance business in the longer term. It is a hallmark of *The Geneva Papers on Risk and Insurance—Issues and Practice* to discuss those issues that influence the insurance and risk management business in a strategic manner—and the massive regulatory changes in the works right now will change the industry profoundly and to long-lasting effect, which is why we decided to dedicate part of this issue to regulation.

In an additional and much more comprehensive effort, my colleague Jan Monkiewicz and I just published a book called *The Fundamentals of Future Insurance Regulation and Supervision—A Global Perspective*. Written by supervisors, leading academics, researchers and insurance industry experts, the book offers a diversified and holistic perspective on how the regulatory and supervisory framework for the insurance sector will develop in the future. In seven parts, the book contains articles on the global regulatory framework, the supervisory and market dimensions of insurance, stakeholder protection and international issues as well as perspectives from the developed and emerging market perspectives. From these contributions, as well as from the papers on regulation in this issue of *The Geneva Papers on Risk and Insurance—Issues and Practice*, it becomes clear how extremely challenging and busy these times are for all those concerned with financial regulation and supervision in insurance.

Suddenly, highly sophisticated and complex issues have become a subject matter of heated political debate in public as well as in private discussions, and the appetite for (above all readily comprehensible) analytics of our industry skyrocketed. Key actions taken in the midst of the financial crisis have gained in relevancy, especially where they are not only purposed for immediate fire-fighting, but meant to make a contribution

to more stable and resilient financial systems. And while it clearly is in the larger public interest that financial markets be stable and sustainable, it is equally desirable that they be efficient and effective in delivering their services.

Unfortunately, these aims are not always fully compatible and at times even directly opposed to each other. Good regulation ought to take care of this conflict. It is there to ensure competitive, solvent and fair markets in which all key stakeholders are adequately protected. It should also seek to ensure that quality, reasonably priced products and services are available from reliable sources when needed. The Chairman of The Geneva Association's Scientific Advisory Committee, Harold Skipper, and his colleague Robert Klein, both at Georgia State University, set out four key principles many years ago for proper insurance regulation: adequacy, impartiality, minimal intrusiveness and transparency.¹

While I fully agree with their work and the rationale leading to their principles, it is equally clear to me that the current processes defining the new regulatory framework for the insurance industry are unfortunately often enough not adhering to these standards. Whereas the issue of adequacy is one that can and is discussed heatedly by policy-makers and the industry and open to much subjectivity, the issues of minimal intrusiveness and transparency are easier to objectify. Unfortunately, there seems to be right now a general preference for speed and political expediency over analytical depth and proper research. Given the scope of the recent financial crisis and its consequences—which have of course inspired many of the systemic reforms undertaken and under discussion worldwide—it is not surprising that policy-makers would want to comprehensively deal with the perceived shortcomings of our current financial services systems—especially as regards systemic financial stability, the major concern during the crisis. Furthermore, an explosion of regulatory action always seems to appear after major failures in an existing financial infrastructure—so this is nothing new. And the usually proportional rule of the scope of new regulation mirroring the size of the crisis generally applies. So, the bigger the failure, the more sweeping the reforms will be that are proposed and subsequently implemented.

However, what is unsettling is that many reform projects apply a perceived urgency that appears to sacrifice too readily methodical analytics and careful investigation for quick action. In the quest for solving the problems at hand, rapid action is desired and the time for meticulous examination seems too long-winded and politically inopportune. This is a shame. Regulation, especially if it is comprehensive and meant to stand the test of time, needs a proper gestation period and enough time for appropriate consideration and thorough discussion.

Equally unsettling is the absence of much-requested transparency from some regulatory initiatives. It is more than just unfortunate that some regulatory bodies seem to regard outside comments of their work as distractions or, sometimes even worse, as inappropriate interference in their work. Since one of the key roles of The Geneva Association is to open up discussions and channel academic and industry intelligence into key debates, we are sensitive to any shortcomings in this respect. This has little to do with the advocacy of special positions and everything with trying to

¹ Skipper and Klein (2000).

make sure the right intelligence is available to the right groups, especially when they are about to take far-reaching decisions. Hopefully, *The Geneva Papers on Risk and Insurance—Issues and Practice* and other such journals and publications can help achieve this for insurance. Progress will be better, solutions more effective and any results should become more appropriate and more widely accepted as a result.

This is of particular interest due to an important new quality of many of the ongoing endeavours: the global reach of the current reforms. Never before have so many sweeping reforms been undertaken that do not only affect one industry in one or, at most, a handful of countries like in the past. Now many parts of our economic fabric around the globe are involved at the same time: banking, insurance, general finance, fiscal systems and even the social security systems of many different nations. This indicates a high degree of interdependence of various local solutions and a constant balancing act between what is happening at a national level and what happens at an international, that is global, one. As a result of this new quality, some new global institutions spring up, such as the G-20, wielding significant influence around the world. At the same time, some existing global institutions, such as the IMF, the BIS or the World Bank, are changing in response to the call for action, while other existing ones such as the Financial Stability Forum (FSF) not only acquire a new name (Financial Stability Board—FSB), but also a larger brief and more powers. All of these institutions need to have appropriate insurance expertise available to them—both inside as part of their institutional setup, as well as from the outside by means of ready access to external intelligence—if they are to take decisions properly that affect the insurance industry. An extensive production of such insurance intelligence is needed and *The Geneva Papers on Risk and Insurance—Issues and Practice* is one repository of knowledge that should help add quality. We encourage many others to do likewise for insurance as it seems that more often than not it is ignorance of (the sometimes intricate) insurance matters and not opposition to insurance solutions that preclude better decision-making.

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The following pages offer seven contributions in a wide variety of essential subjects in insurance and the economy by large. This volume starts with three articles dealing with the topics of insurance and regulation, with papers on lessons from the credit crisis with respect to risk management and regulation, insurers' financial and asset risks during the crisis, and risk disclosures in the European insurance industry. The first paper, by Simon Ashby, on *Risk Management and the Global Banking Crisis: Lessons for Insurance Solvency Regulation*, investigates the underlying causes of the banking crisis and considers the lessons to be learned for insurance regulation. It argues that the banking crisis was caused by human/cultural weakness, internal communication failures within certain banks, and weaknesses in regulation and supervision. Based on these findings, doubts are expressed about the direction of certain insurance regulatory reforms and it is recommended that regulators should pay closer attention to the management of insurance firms. The next paper, co-authored by

Etti Baranoff and Tom Sager, looks at *The Interplay between Insurers' Financial and Asset Risks during the Crisis of 2007–2009*. The study focuses on life and health insurance industries, partitioned into segments by product specialization, size and governance. The third paper, on *Investigating Risk Disclosure Practices in the European Insurance Industry*, by Dirk Höring and Helmut Gründl, explores the risk disclosure practices in annual reports of European primary insurers in light of the upcoming Solvency II Pillar 3. Based on a self-constructed risk disclosure index, the study examines the relation between the extent of risk disclosure and insurance companies' characteristics such as size, risk, profitability, ownership dispersion, cross-listing, home country and type of insurance sold to draw inferences regarding motives for enhanced risk disclosure, based on positive accounting theory.

The following section highlights the issues of the implementation of enterprise risk management in the property/liability insurance industry, the impact of career interruptions on pension rights, and life insurer solvency in the light of stochastic mortality and macroeconomic risk readings. The first paper deals with *Implementation of Enterprise Risk Management: Evidence from the German Property-Liability Insurance Industry* and is written by Muhammed Altuntas, Thomas R. Berry-Stölzle and Robert E. Hoyt. Implementing a properly functioning enterprise risk management (ERM) programme has become increasingly important for insurance companies. The goal of this paper is to examine the implementation of the ERM components by insurers, using the German property-liability insurance market as basis for the study. The next paper, *Career Interruptions: How Do They Impact Pension Rights?*, is by Nakat El Mekkaoui de Freitas, Cindy Duc, Karine Briard, Sabine Mage and Bérangère Legendre. The aim of the article is to analyse the question of career interruptions and to evaluate their impact on pension retirement for French private sector workers. It highlights the new trends in professional paths and determines how pension rights for French employees are affected by different career accidents. It shows how, by compensating for some career accidents, the French legislation allows individuals to receive, in some cases, the same level of social security pension that they would have received with a smooth professional path. The third paper in this section addresses the issue of *Stochastic Mortality, Macroeconomic Risks, and Life Insurer Solvency*. It is co-authored by Katja Hanewald, Thomas Post and Helmut Gründl. The paper analyses the impact of macroeconomic fluctuations on the solvency of a life insurance company.

The final section is a Special Contribution by Jean-François Outreville, *The Geneva Risk and Insurance Review 2010: We Have Learned Much since Willett and Knight*. It provides us with an extensive review of this journal's contribution to insurance economics research and illustrates the importance of risk and uncertainty in our modern economies and how it is still the starting point of economic research.

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We are indebted to all the authors who contributed to this volume and the many peer reviewers who have taken the time to work with us on this issue of *The Geneva Papers on Risk and Insurance—Issues and Practice*. We would like to express our deep

gratitude to all of them. We hope that you will have as much pleasure in reading these articles as we have had in editing this latest issue of *The Geneva Papers on Risk and Insurance—Issues and Practice*.

Reference

Skipper, H.D. and Klein, R.W (2000) 'Insurance regulation in the public interest: The path towards solvent, competitive markets', *The Geneva Papers on Risk and Insurance—Issues and Practice* 25(4): 482–504.