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# Regulatory and Supervisory Developments: An International Perspective

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# Discussion Topics

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- International Developments
    - Too “something” to fail
    - Macro Prudential Supervision
    - Cooperation and exchange / crisis management / resolution
    - Other significant developments
      - Remuneration and Governance
      - Access
    - Implementation and Assessments
      - Assessments, FSAPs, FSB reviews, Self Assessment and Peer Review at the IAIS
  - Markets
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# G20 September, 2009

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- “It worked”. ...
  - but “A sense of normalcy should not lead to complacency. The process of recovery and repair remains incomplete”.
  - Several initiatives identified. Those relevant to regulation and supervision:
    - 16. *To make sure our regulatory system for banks and other financial firms reins in the excesses that led to the crisis.*
      - 17. ... raise capital standards, ...implement strong international compensation standards, ... improve over-the-counter derivatives market, and create more powerful tools to hold large global firms to account for the risks they take. Standards for large global financial firms should be commensurate with the cost of their failure.
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# Progress ...

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- 11. Since the onset of the global crisis, we have developed and begun implementing sweeping reforms ... Substantial progress has been made in **strengthening prudential oversight, improving risk management, strengthening transparency, promoting market integrity, establishing supervisory colleges, and reinforcing international cooperation**. We have enhanced and expanded the scope of regulation and oversight, ... tougher regulation of over-the-counter (OTC) derivatives, securitization markets, credit rating agencies, and hedge funds.
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**TOO "SOMETHING" TO FAIL**

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# Systemic institutions

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- 13. ... All firms whose failure could pose a risk to financial stability must be subject **to consistent, consolidated supervision and regulation** with high standards. ... at its core must be **stronger capital standards**, complemented by **clear incentives to mitigate excessive risk-taking practices** ... together with **more powerful tools for governments to wind down firms that fail ...:**
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# Higher capital singled out banks

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- *Building high quality capital and mitigating pro-cyclicality:* ... higher level and better quality capital requirements, counter-cyclical capital buffers, higher capital requirements for risky products and off-balance sheet activities, ... strengthened liquidity risk requirements and forward-looking provisioning, will reduce incentives for **banks** to take excessive risks and create a financial system better prepared to withstand adverse shocks. ... All major G-20 financial centers commit to have adopted the Basel II Capital Framework by 2011.
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- Too big, or interconnected, or systemic to fail
  - Too big to save
  - Capital charges for interconnectedness, systemic imposition, and other criteria.
  - For Australian institutions:
    - Are Australia's systemic institutions clearly identified? Are any too big to save?
    - Would capital charges for interconnectedness make sense given Australia's size and financial sector structure?
    - Are there cross border implications where institutions may not be systemic here but may be systemic elsewhere?
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# The problem with lists

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- Some resistance to public lists of TBTF Institutions
  - What is a sensible measure of systemic importance?
  - Would the next systemic failure be on the list (eg. Would AIG have been on usual lists? In Australia, was HIH systemic?)
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# MACRO PRUDENTIAL SUPERVISION

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# Macro and Micro Regulation

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- 12. ... It is important to ensure an adequate balance between macroprudential and microprudential regulation to control risks, and to develop the tools necessary to monitor and assess the buildup of macroprudential risks in the financial system.
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# What is Macroprudential Regulation & Supervision?

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Create Systemic Risk Oversight Function

Review and Report on Risks

Act on Emerging Risks

- The new cover of "Regulation" magazine.

Stress Testing

Studying interconnectedness

- What does it mean to "do" something?
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# Wider coverage

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- Sector rather than systemic institution focus
  - Full financial sector and real sector scope
  - EU and US models provide early templates but have to be interpreted in their local context.
  - What does macroprudential supervision mean for Australia and its institutions? ... and for regulation?
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# **COOPERATION, INFORMATION EXCHANGE, & CROSS BORDER RESOLUTION**

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# Addressing resolution and failure mechanisms

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- *Addressing cross-border resolutions and systemically important financial institutions by end-2010:* Systemically important financial firms should develop internationally-consistent **firm-specific contingency and resolution plans**. Our authorities should establish **crisis management groups for the major cross-border firms** and a **legal framework for crisis intervention** as well as **improve information sharing** in times of stress. We should develop **resolution tools and frameworks** for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in the future. Our prudential standards for systemically important institutions should be commensurate with the costs of their failure. The FSB should propose by the end of October 2010 possible measures including more intensive supervision and specific additional capital, liquidity, and other prudential requirements.
  - 16. We task the IMF to prepare a report for our next meeting with regard to the range of options countries have adopted or are considering as to how **the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions** to repair the banking system.
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- Living wills / stress testing
  - Supervisory colleges
  - FSB Review of cooperation
  - IMF and FSB both reviewing “More intensive supervision”
    - Additional capital, liquidity and other prudential requirements
    - Consolidated supervision where it is not currently practiced in full
    - But also more active oversight “just say no”.
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- Focus of resolution currently on operation of Financial System Support Schemes across borders but likely to expand.
  - Cross border resolution - substantially a work that remains ahead.
  - Intervention costs and financing
    - Pre or post funded levy based protection schemes
  - For Australian institutions, especially those that operate cross border, consider both local and international implications both for supervisory colleges etc, and resolution commitments.
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# REMUNERATION & GOVERNANCE

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# G20 on Remuneration

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- *Reforming compensation practices to support financial stability: ...*
    - avoiding multi-year guaranteed bonuses, etc etc
    - Increased review of remuneration against risk for financial supervisors
    - Greater disclosure / transparency
    - Linking variable compensation, net revenues, and capital
    - Independent compensation committees
    - Supervisory powers to intervene
  - FSB to monitor the implementation of FSB standards and propose additional measures.
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# ACCESS TO INSURANCE

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- G20 Initiative – origination and subgroup work
  - A2II and the IAIS
  - Key challenges for insurance in making MI work
    - Operational challenges
      - Rethink rather than simply downscale processes, products, etc
      - Deal with informality, leverage remittances,
    - Policy, Regulation and Supervision
  - Regional examples
    - Philippines, Thailand, PNG
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# **ASSESSMENTS TO SUPPORT IMPLEMENTATION**

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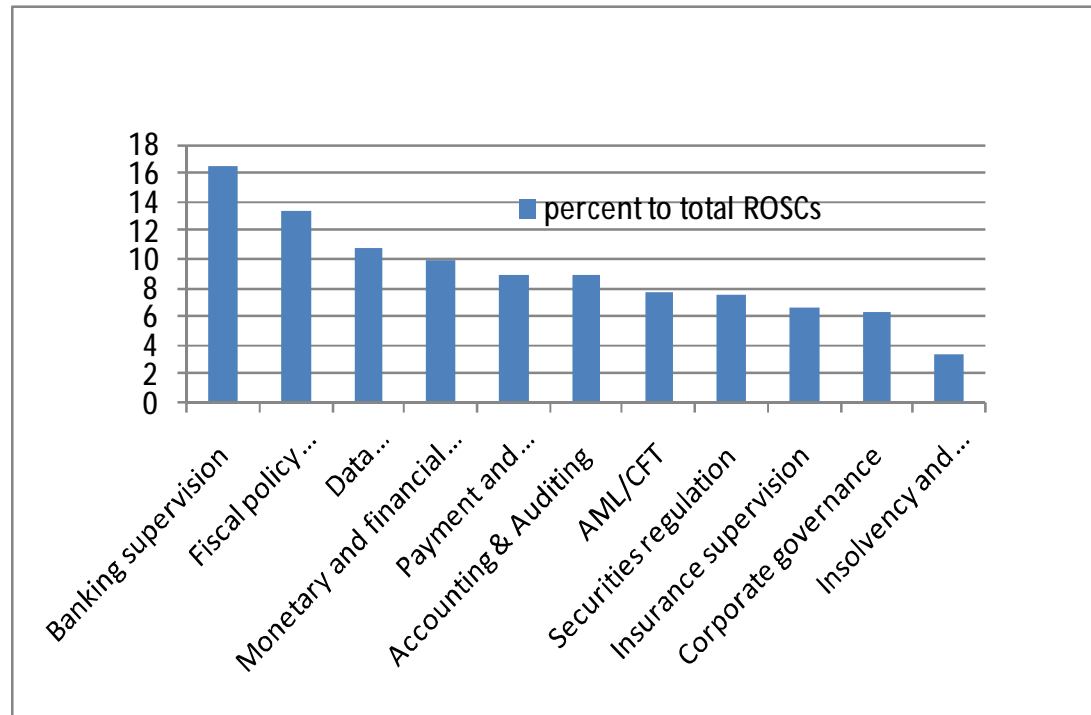
# Heavy reliance on World Bank & IMF delivered FSAPs

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- Financial Sector Assessment Program (FSAP) commenced 1999;
  - Increased international pressure for participation especially now through G20 and FSB.
    - All G20 members committed to completing and publishing FSAPs
    - FSB assessments for levels of observance below “observed” / “largely observed” will encourage implementation.
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# Assessments Completed

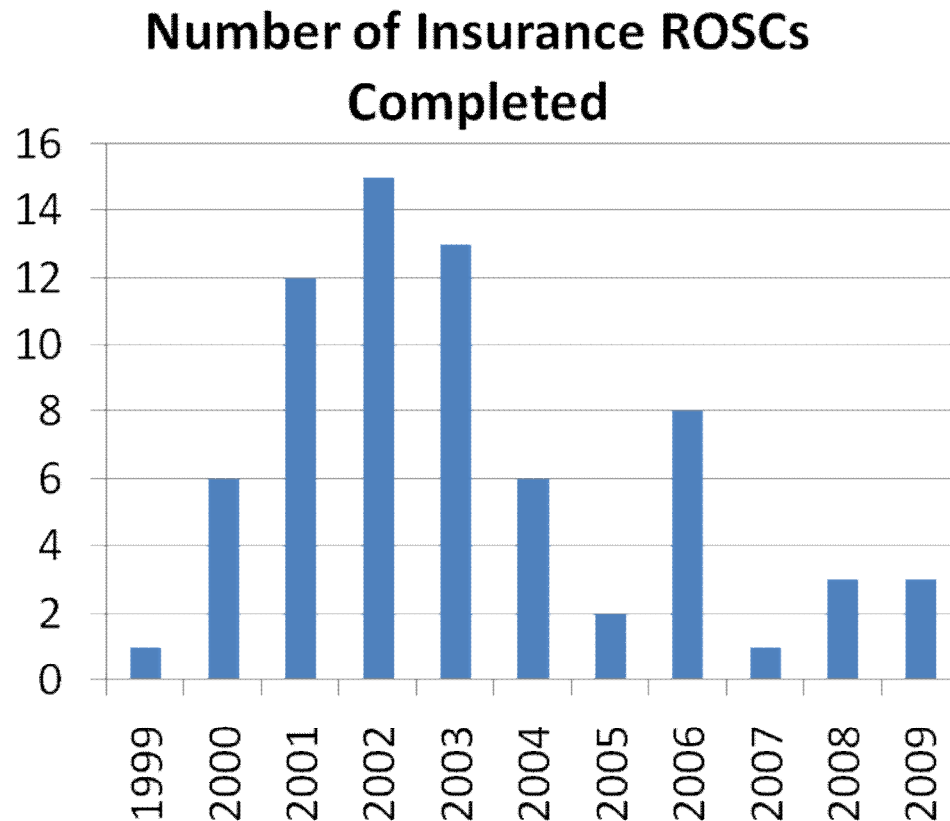


- To end 2009, Insurance Core Principle assessments are conducted less often, just over 6% of the total.



# After 2003 the Bank developed an alternative template

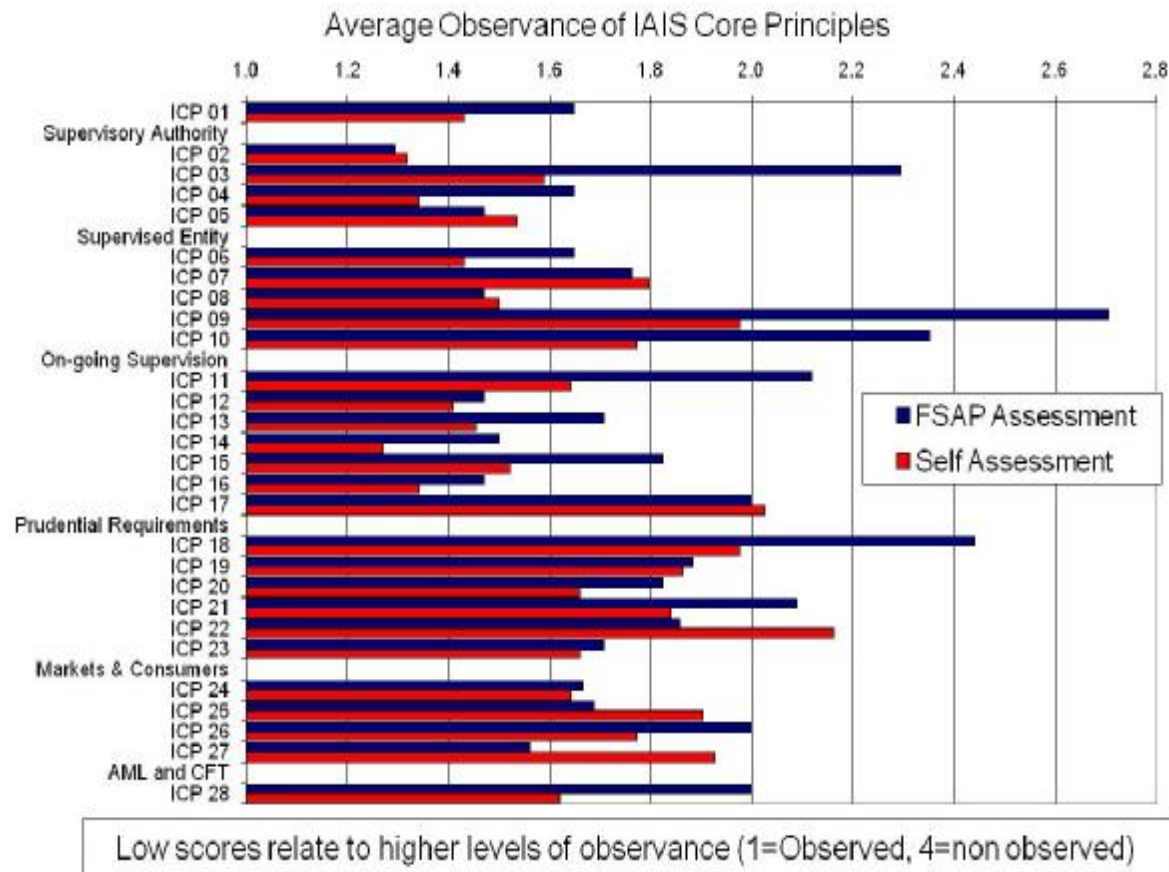
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- Most post 2003 ICP assessments have been Fund delivered, especially due to the off-shore centre initiative, although this has changed with requests in 2010
  - Now, Bank staff are relatively inexperienced compared to peers with respect to ICP reviews and more experienced compared to peers with respect to the developmental template based reviews.
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# Observance of ICPs



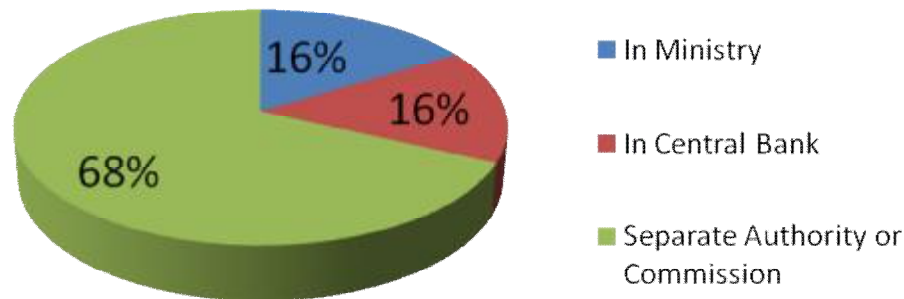
- ICP 3 The Supervisor
- ICPs 9 and 10 on Governance and Internal Controls
- ICP 11 Market Analysis
- ICP 18 Risk Management
- ICP 21 Investments



# Observations on Observance

- ICP 3: The Supervisor
  - Some think this is a function of many criteria but
  - Often poorly observed on supervisory structure and resourcing

Supervisory Agency Locations



***Call to action:***

In many cases, moving to an independent authority may not be the immediate priority, but improvements in independence, legal protection, and resourcing are priorities.



# Observations on Observance

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- ICPs 9 and 10 on Governance and Internal Controls still show limited progress
  - Despite topical nature of the issue since 2003 revisions post Enron etc. and reinforced through GFC.

***Call to action:***

- Efforts to implement standards are a key issue rather than defining new requirements at the international level, but significant challenges in countries due to political resistance by the sector and limited capacity in supervisory authorities to manage reform agenda.
  - Prioritizing reforms for emerging markets is needed and proportionality should be considered but little guidance for local supervisors exists on this issue.
  - International groups contribute positively in local markets as benchmark setters.
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# Observations on Observance

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- ICP 11 Market Analysis
  - Topical although still challenging
    - What did the IAIS mean when it proposed market analysis?
    - Analytical skills are in short supply in emerging market supervisors
    - Supervisory processes are not well advanced to include market analysis in a disciplined manner.

***Call to action:***

- Many supervisors need to develop a supervisory process and make greater use of IAIS Core Curriculum resources
  - Insurers will need to support improved content and timeliness of financial returns
  - Supervisors can contribute improved publications of market statistics and discussion of market analysis results but requires increase in confidence.
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# Observations on Observance

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- ICP 18 Risk management
  - Key issue is essential criteria a. “The supervisory authority requires and checks that insurers have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, assessing, reporting and controlling their risks”.

***Call to action:***

Supervisory powers and oversight is the key but is it the priority given other shortcomings?

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# Observations on Observance

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- ICP 21 Why are investments so poorly observed?
  - Many rules based systems have limited scope and do not address safekeeping of assets, appropriate matching, and liquidity directly.
  - Insurance supervisors have few rules on valuation particularly for real estate and related party assets
  - Rules act as a default and no requirement for an investment policy due to compliance based supervisory approach
  - Limitations of on-site inspection capacity
  - Lack of fitness and propriety extending to investment staff skills as required by ICP essential criterion g

***Call to action:***

Supervisors need to revisit outdated investment rules but should probably do so in concert with governance and solvency regulation.

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# **INSURANCE MARKETS IN THE REGION**

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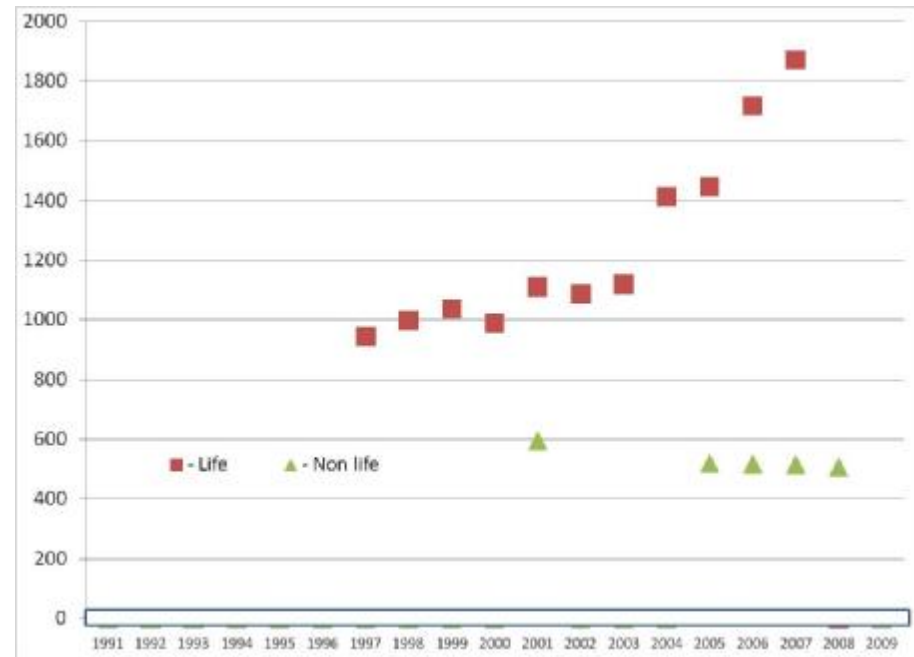
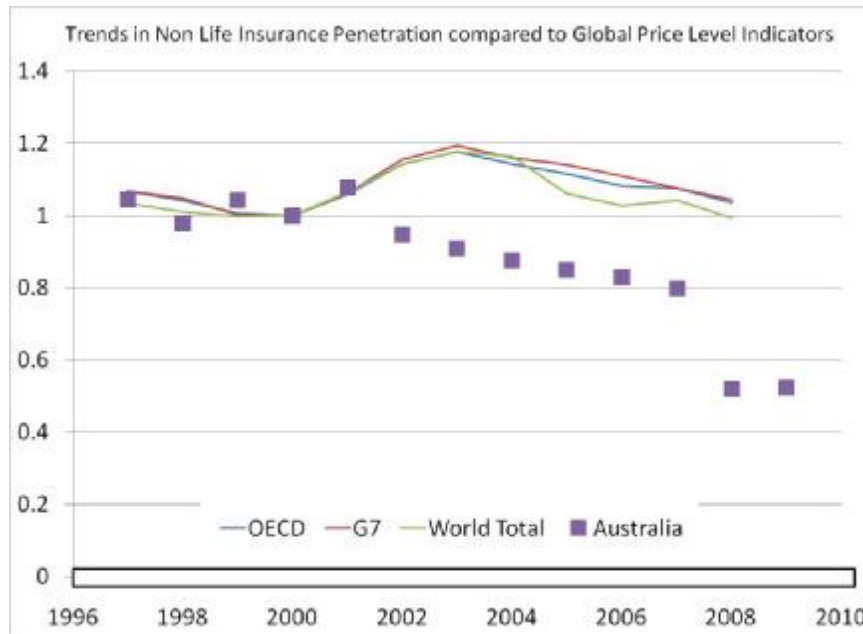


# Some Market Dynamics

Country	Insurance Penetration				Herfindahl	
	Life		Non life		Life	Non life
	%	5 yr real growth	%	5 yr real growth		
Australia	4.5	-1.3	2.1	-9.8	1,871 - normal	507 – very low
China Mainland	2.5	5.0	0.9	4.7	1,905 - normal	1,983 – high
Hong Kong SAR	9.5	4.5	1.4	-0.5	780 – very low	331 – very low
India	3.6	11.3	0.5	-1.1	5,627 – very high	
Thailand	2.4	2.2	1.2	-0.6	1,868 - normal	475 – very low
Cambodia			0.2	-0.6		2,552 - normal
Philippines	0.8	-4.0	0.4	-5.7	1,439 - low	522 – very low



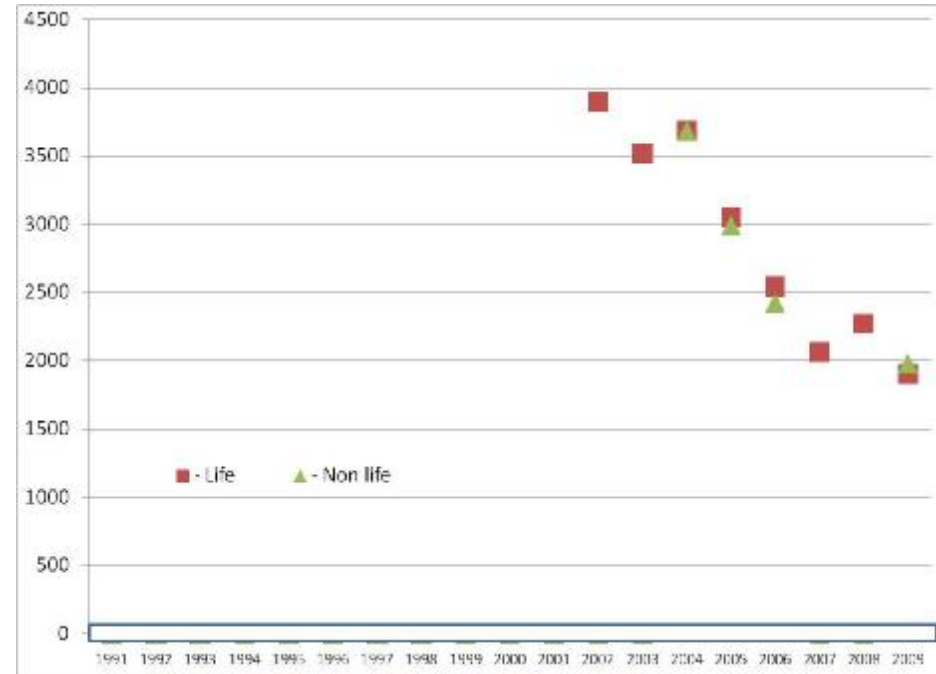
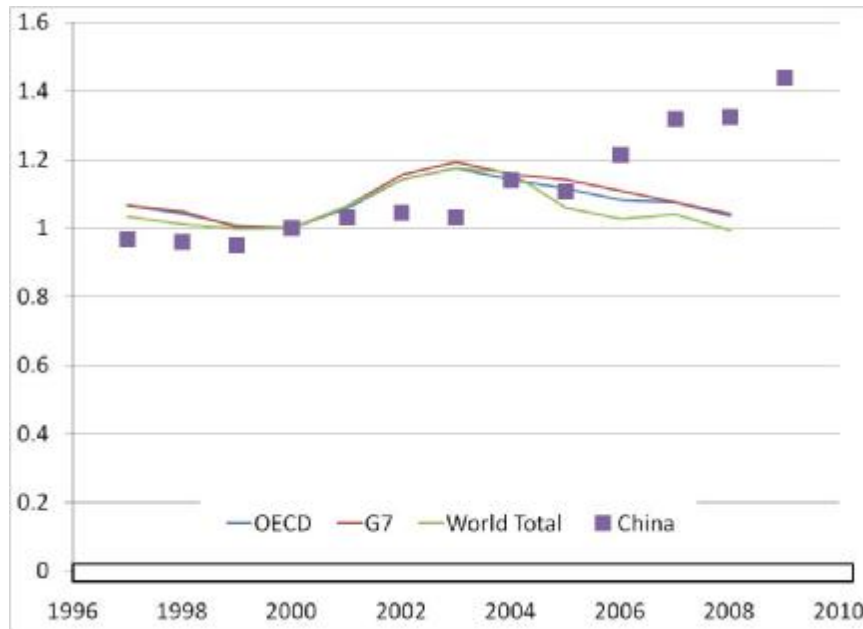
# Australia's competitive landscape



- Australia's non life market has been reducing and did not get the hard market effects it should have.
- Life markets have normalised but non life remains challenging.



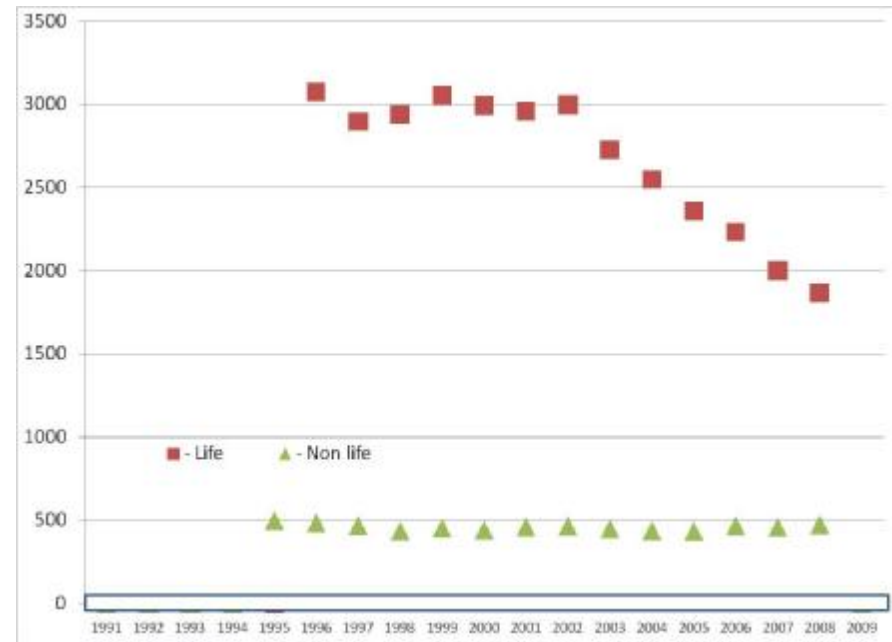
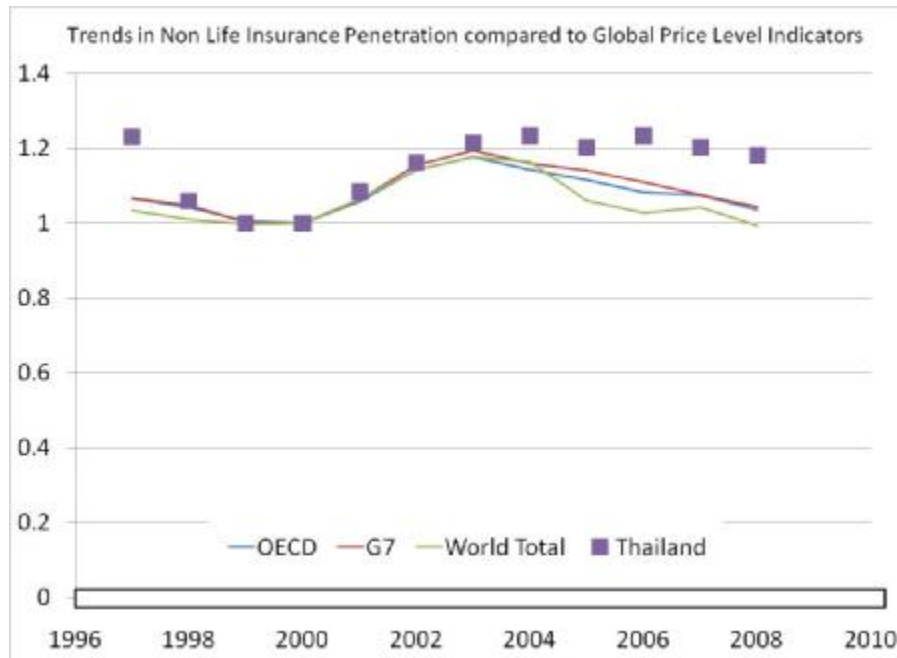
# China



- Non life is also growing especially since 2005.
- Both markets are becoming more competitive progressively.



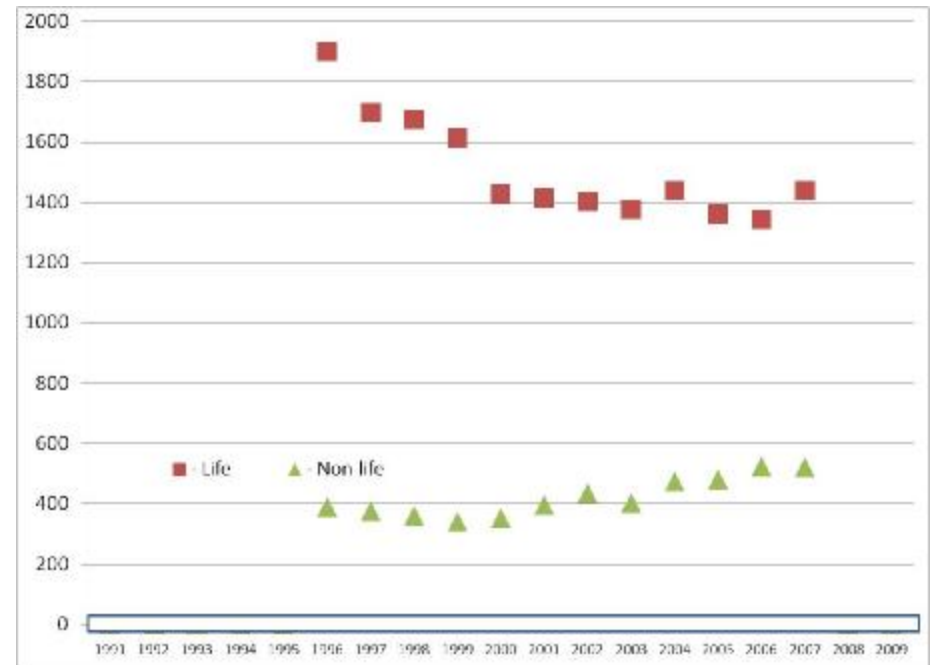
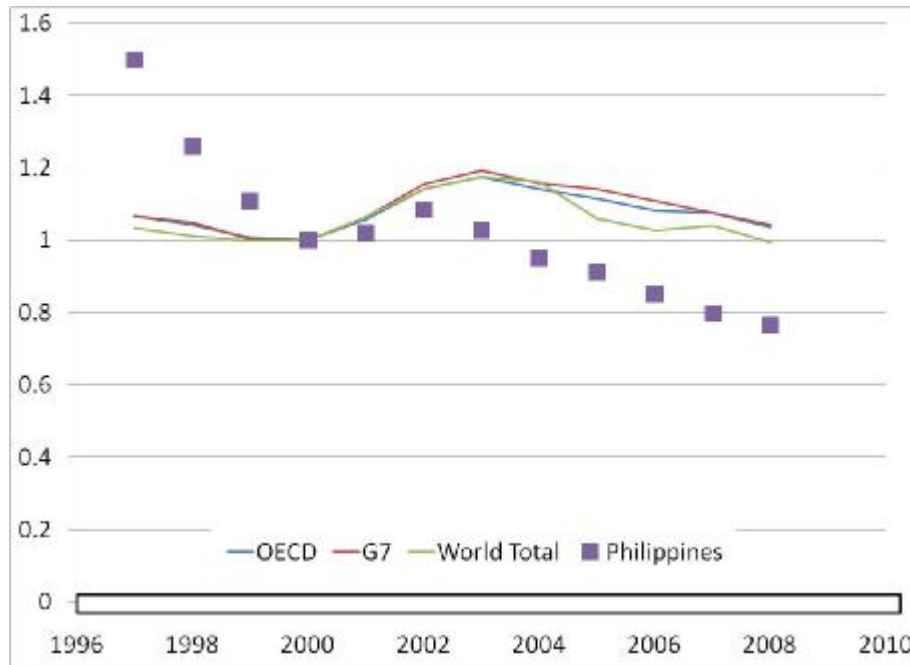
# Thailand



- Non life market has been improving of late but competition still too severe.
- Life markets have normalised with liberalisation.



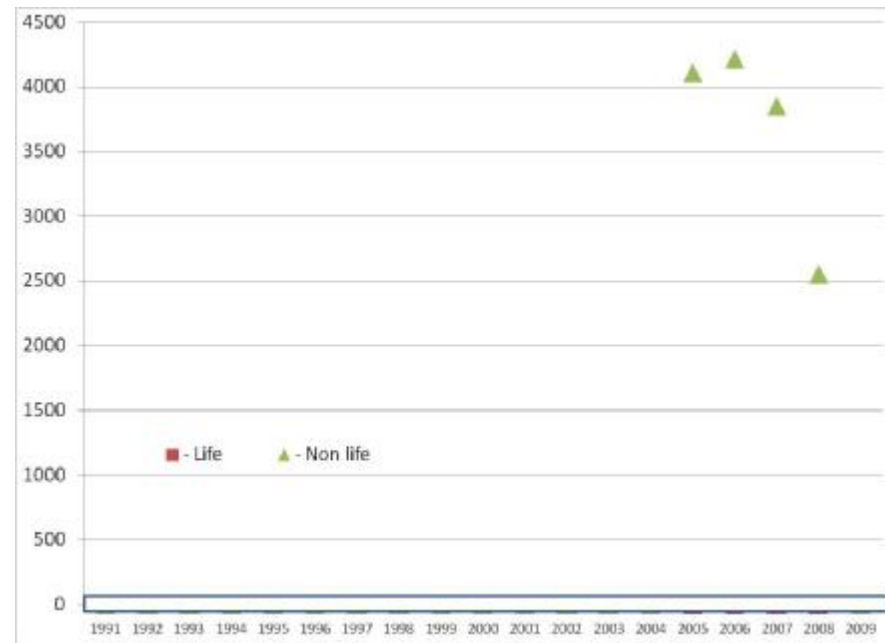
# Philippines



- Non life market has been heavily price discounting but offsets of penetration increases exist.
- Both Life and non life need some consolidation or new market penetration.



# Cambodia



- Non life market has been improving. Competition is stable but becoming more severe.
- Life markets are little more than an idea waiting for its time.



**END**

