Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms

Consultation document on main elements

The International Cooperative and Mutual Insurance Federation (ICMIF) thanks the Financial Stability Board (FSB) for the opportunity to comment on its proposed structured framework for the post-implementation evaluation of the effects of the G20 financial regulatory reforms.

The objectives of our following response are to provide:

• overall comments on the methodology used to evaluate the effects of the regulatory reforms

• views from the mutual and cooperative insurance sector on the material regarding unintended consequences.

ICMIF is a federation of 290 organizations based in 74 countries, representing 6.8% of the global insurance market (by premium income)[1]. In 2014, ICMIF members collectively wrote USD 268 billion in insurance premiums, split 50:50 between life and non-life insurance. ICMIF members serve over 285 million members/policyholders and employ over 230,000 people worldwide.

The members of ICMIF range from large market leaders to niche, affinity-based insurers, and most are small/medium-size. Mutual insurers constitute an important element of the insurance industry, contributing in particular to consumer choice, product and service innovation, fair pricing and consumer trust. The principle of insurance – the pooling of risk – is inherently a mutual concept: the earliest forms of insurance were based on a mutual model and new mutual insurers are still being established in both emerging and developed markets, in response to evolving market demands and emerging risk needs.

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Our comments

'If regulation is to remain effective, it must be reassessed frequently and made consistent with evolving market and financial structures' Minsky and Campbell, 1987

[1] ICMIF Members: Key Statistics 2015, https://www.icmif.org/icmif-members-key-statistics-2015

In Minsky's spirit, we welcome this Proposed Framework for the Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms.

The insurance business model

We share the general view that the reputation of both the financial services industry and of regulation has been tarnished in the past by the failure to adequately punish those senior executives in the financial services industry with a clear responsibility for the financial crisis. It should be noted, however, that the risk of systemic failure within banking does not have a direct parallel risk in insurance. We are therefore concerned about the suggestion that insurance could be considered in the same way and evaluated in the same manner as banking and securities.

More broadly, the current draft shows limited consideration for the insurance business model and industry, which provides a range of vital services to the real economy and society. Current regulation aiming to reduce systemic risk lacks consideration of the long-term nature that is inherent in the insurance business model

Maintaining corporate diversity as part of the process of rule-making

Ensuring diversity of ownership structures and business models generally relies upon a balance between public and private ownership, with the private sector comprising external shareholder-owned firms other private ownership such as private equity, and a range of 'stakeholder ownership' models including co-operative banks, mutuals and credit unions

The Centre for European Policy Studies (CEPS) has produced two major, comprehensive research studies of diversity in European banking (CEPS, 2009 and 2010)[2], both of which emphasise the advantages of having diversity in banking structures and models, and illustrate this with case studies of several countries. The purpose of these reports is not to argue that one model is superior to others, but precisely that advantages accrue through diversity. The most important conclusion is that the current crisis has made it even more evident than before how valuable it is to promote a pluralistic market concept in Europe and, to this end, to protect and support all types of ownership structures'.

In a situation of uncertainty and unpredictability, and a complex global economic system, we cannot know which model will prove to be superior in all possible future circumstances, so there is a call for caution against destroying any successful model. Importantly, the functioning of complex systems can be intrinsically unpredictable, even if we know everything else about them. Thus, the problem is not just that the economic future is uncertain, but that it is fundamentally unpredictable. As The Economist notes: "Just as an ecosystem benefits from diversity, so the world is better off with a multitude of corporate forms". (The Economist, 2010, p. 58) [3]

Most rules are created for oversight of the shareholder-owned firms, but also because for regulators and supervisors alike the objectives explicitly are to consider how to facilitate competition, and the nurturing of different business forms would in no way be incompatible with that.

Actions by regulators and supervisors that constrain corporate diversity may not allow for the capability of the mutual business model to be apparent in a future downcycle. Examples of these constraining actions include: disproportionate capital requirements, governance arrangements

[2] http://aei.pitt.edu/32647/1/70._Investigating_Diversity_in_the_Banking_Sector_in_Europe.pdf

[3] **Fostering diversity: promoting mutuals,** The All-Party Parliamentary Group for Building Societies & Financial Mutuals, July 2011

imported from the PLC world, and a misunderstanding of ownership rights in mutuals. In our view, an approach to policy-making that takes issues like competition and corporate diversity into consideration during the development of policy, rather than part of the post-production justification, would help avoid this failure.

To this end, we would like to propose that the FSB and its relevant standard-setting bodies follow the UK Parliament in recognising that mutual and cooperative societies are worthy of consideration, which in practice would mean analysing whether new rules impose any significantly different consequences for mutual businesses.)[4].
This should also mean that FSB policy evaluation considers the diversity of corporate forms element in its approach.

Adverse effects of regulation/prioritisation of topics

The new financial framework to ensure global stability was designed with a systemic logic, flagging up market or individual events that affected capital markets. More fundamentally, the nature of insurance and insurance regulation is different: insurers are heavily regulated, with significant capital requirements that are designed to ensure they can survive a one-in-200-year event.

As a result, the costs of the introduction of Solvency II for European mutuals have been largely spent on compliance and not in securing extra capital. We do not suggest that these compliance costs have not been valuable: they have certainly raised standards of governance and internal control and helped improve overall risk management. However, for mutuals with strong capital buffers, the work required to implement Solvency II has led to: significant internal costs; highly inflated external actuarial and audit costs; massive commitments of management time; and very large opportunity costs, as mutuals have had to focus on additional compliance work rather than on growing the business.

In fact, it is estimated by UK Treasury that insurers have spent £2.6 billion complying with Solvency II and have enormous reserves of capital. This provides a very effective form of consumer protection.

The same requirements imposed on (nearly) all insurance undertakings do not however generate the same direct and indirect costs on all undertakings as the concept of proportionality, while accepted in theory, is not instrumental in practice. It should also be noted that the accumulation of Tier 1 capital within a mutual insurer relies almost exclusively on the growth of retained earnings (as they cannot access the capital markets as a share-holding company would). This creates specific outcomes for mutuals, for example the ability of a health insurer with standard risks, which provides short-term contracts and bears short-term liabilities, to accumulate this capital is distinctly different from that of a life insurer, which provides long-term contracts for long-term liabilities.

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[4] (Financial Services Act 2012) http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted
In addition, the Bank of England and Financial Services Act 2016 now provides an additional Diversity clause for FiSMA, to require the PRA and FCA to take account of corporate diversity and the mutual business model in all aspects of their work. http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted

Agencies and administrative authorities

In many jurisdictions, as a result of the increasing complexity of regulation, policymakers are shifting their responsibility to independent technical authorities, at both national and international levels, but their purpose and powers are not always clear. These agencies are inclined to then compete among each other, adding extra layers of requirements and possible sanctions which create a climate of tension for companies.

Material unintended consequences of the regulatory reforms

As noted in the proposed Framework, time is of essence in the evaluation process of the monitoring, and policy evaluations require the articulation of measurable outcomes (operationalisation) that can be compared against benchmarks distilled from these objectives.

We fear that the evaluation will merely register the changes as they take place, but do not provide an opportunity for reviewing and restructuring the regulatory reforms.

Many mono-line insurers, including a considerable number of SME mutual insurers with a very low technical margin, will not be able to absorb the cost of compliance. They will be required to merge, be absorbed into a large group or build partnerships. This means they will no longer exist in their current form. This risks the loss from the marketplace of some mutual insurers which are specialist providers of coverages which the rest of the insurance industry is unable or unwilling to provide, thus creating the potential for market failure and/or consumer exclusion/detriment.

A concentration of the market will also bring about the following socio-economic consequences: a rise in overheads (non-recurrent), tied to the operational implementation of reforms (new recruitment, training, system adaptation, etc.), a rise in overheads (recurrent), tied to the assimilation /acquisition by the companies (wage costs and extra activities).

The cost of compliance will have to be passed onto consumers, raising the prices of insurance or reducing the benefits which, the particular case of health and providence insurance, could have dire repercussions.

But more importantly, the diversity of corporate forms in the market will have been impacted and the systemic character of the markets will be amplified.

Conclusion

To the question whether or not financial regulation can prevent the next financial crisis, we would like to evoke Minsky again for whom "*any system of regulation that succeeds in producing stability will eventually be undermined by its success in producing stability.*"

The wider economy benefits from a reduced risk of failure of large organisations, but it should not be forgotten that evidence suggests that organisations with a focus on serving the best interests of their customers produce better outcomes for consumers and society as a whole. Our experiences as mutual insurers support this.

We therefore urge the FSB and its SSBs to consider taking account of corporate diversity and the mutual business model in all aspects of their work.

Responses to the FSB's questions

Main elements of the framework:

1. Do you have any comments or suggestions on the main elements of the evaluation framework (eg are there other elements that should be considered for inclusion in the framework)?

   The scope of this framework is on post-implementation, we would however like to emphasize the need for the next evaluation to be ex- ante as well, i.e. commencing at the very beginning of the policy change.

2. **Are** the objectives and scope of the framework appropriately set out?

   ICMIF supports both objectives of the framework:

   - To guide the analysis of whether G20 financial reforms are achieving their intended outcomes
   - To help identify any material unintended consequences that must be addressed within the reform,

   and particularly welcomes the latter, hoping however that the scope will include the insurance sector as a whole, and not limit itself to the actors that have been identified as systemic.

3. Would you suggest any refinements or additions to the concepts and terms?

   We would like to propose that the FSB and its relevant standard-setting bodies recognise that mutual and cooperative societies are worthy of separate consideration, which in practice would mean analysing whether new rules impose any significantly different consequences for mutual businesses. This would also mean that policy evaluation would consider the proportionate application of rules and standards.

No further comments to the remaining questions.

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