Regulation matters

Ian Harper
Deloitte Access Economics

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Outline

• Overview of regulatory landscape

• Issues in prudential regulation

• Issues in non-prudential regulation

• Time for another Financial System Inquiry?
Overview of regulatory landscape

**Prudential regulation**
- International requirements for domestic insurers
- Bank-like capital controls imposed on insurers
- Systemically important insurers – G-SIIs & D-SIIs

**Non-prudential regulation**
- Appropriately priced insurance
- Adverse selection
- Affordability

**Time for another Financial System Inquiry**
- Balancing efficiency against stability in GI regulation
- Reviewing the role and performance of APRA
- Creeping expectations of public risk absorption - disasters

**APRA**

**Public policy**
Prudential regulation - international

- IAIS proposed policy measures for G-SII’s
  - enhanced supervision
  - effective resolution
  - higher loss absorption capacity

- Policy measures have roots in the FSB/Basel framework for G-SIB’s
  - but capital adequacy wasn’t a problem for local insurers during the GFC

- APRA seeks flexibility in applying international provisions to Australian G-SII’s and D-SII’s
Prudential regulation - banking

• Banking & insurance are similar … but the underlying risks are different
  • credit risk vs insurance risk

• APRA was organised to reflect these differences
  • the Wallis Inquiry established separate banking and insurance pillars – not putting insurance regulation under the RBA

• We should be wary of applying international bank-centric regulations to Australian insurers
  • risk of importing solutions designed for US insurers’ non-traditional, non-insurance business (e.g. CDSs)
Non-prudential regulation

• Tension between pricing and regulation
  • **affordability** vs **soundness**

• APRA requires prudential soundness and appropriately priced risk for different products

• Broader public policy focus is on affordability
  • **particularly for disadvantaged groups**

• Danger of adverse selection/market instability if insurance is deliberately underpriced
  • **private insurance can contribute to social outcomes but should not become an arm of social policy** …
What would an Inquiry examine?

• Lessons from the GFC –
  • *What role did our regulatory system really play?*

• Wallis “undercooked” its review of insurance regulation → HIH
  • *Do we have the right balance of competition & stability in insurance regulation? What about disclosure?*

• How has APRA performed as an “integrated” regulator of banking and insurance?
  • *Too bank-centric? Too powerful? Too risk-averse?*

• Implications of rising expectations of public risk absorption, e.g. natural disasters
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