Regulation matters

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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
- Systemically import insurance institutions
- International requirements for domestic banking
- Banking requirements imposed on insurance institutions

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

Time for another Financial System Inquiry
- Insurance prudential standards
- Inefficient taxes and levies
- State stamp duties

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

- Banks and insurers 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 under the RBA
- We should be wary of applying international bank-centric regulations to Australian insurers
Future challenges

- Scope and interpretation of systemic risk has moved on since Wallis Inquiry
  - HIH – Australia’s largest corporate failure had far reaching consequences
  - GFC – highlighted an increasingly interconnected global financial system
- Inappropriate to impose solutions designed for conditions outside Australia
  - risk of importing solutions designed for US insurers’ non-traditional, non-insurance business (e.g. CDSs)
  - banking and insurance are related but “one regulatory size does not fit all”
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
• But private insurance should not become an arm of social policy
Non-prudential regulation cont.

- Inefficient taxes on insurance raise its price
- Underpricing risk leads to adverse selection
- Inquiry into residential strata title insurance
  - Residential strata title disaster insurance in Far North Queensland was not appropriately priced.
  - Prices have had to increase significantly – playing catch-up.
  - Rising costs have adversely affected the community in FNQ.
  - Symptomatic of the tension between soundness and affordability.
Future challenges

• Governments’ regulatory focus is on both prudential soundness and equity
• Prudential regulation appropriate for insurers’ exposures
• Public policy aims for affordable insurance
  • governments can help by helping reduce insurers’ cost base
  • e.g., fire services levy review in Victoria and NSW
  • removing State stamp duties – this will need to be balanced in the budget
• Avoid what happened in health insurance!
What would an Inquiry examine?

- Review Wallis Committee approach to regulation of insurance
- Lessons from the GFC
- How to avoid conflict/tension between prudential and non-prudential regulation
- Review the role of private insurance in light of creeping expectations of public risk absorption, e.g., bushfires, floods, cyclones
- Has “integrated” regulation worked?
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