Transparent Insurance Markets:
Supervisors, Professional Bodies, and All

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Presentation to the 18th Conference of European Insurance Supervisory Services
Prague, May 19, 2005

The U.S. insurance market has been in the news of late. Contingent commissions, finite reinsurance, and corporate governance have stolen headlines from Michael Jackson, Scott Peterson, and the runaway bride. It is hard to know what to make of all this attention.

This barrage of headlines might leave the impression that the U.S. insurance market is full of problems, and perhaps lacks sufficient oversight. In fact the headlines demonstrate a particular strength of the supervisory environment in the U.S. To be sure, that environment is far from perfect. None of us would claim to have established the Utopia of insurance supervision. That is exactly why we come together here to learn from each other and improve our insurance supervisory systems.

At the International Insurance Foundation I have the freedom to engage in Utopian thinking, pondering the ideal system of insurance supervision. Thus when emerging market supervisors ask for help, we are prepared with some sensible suggestions.

We start with the premise that insurance markets must be supervised for the sake of consumer confidence. Markets are voluntary. If people don't trust them, they don't participate. Then when disaster strikes, the victims become charity cases because they have no insurance. Governments divert resources to address these emergencies. How much better when risks are shared efficiently, priced appropriately, and resources allocated to their best use. We all benefit from the safer, more prosperous world that results.

To achieve those benefits of a free market, the insurance market must actually be free. Both consumers and producers must have alternatives, and the ability to choose the best alternative among them. Then competition drives the market toward the most efficient outcomes. However, in business just as in sports, the more intense the competition, the greater the temptation for someone to cheat. For markets to work well, we need rules that everyone knows, accepts, and follows.

Supervisors both promulgate and enforce those rules. They make the competition fair; market forces then lead to the most efficient outcomes. Most competitors, and certainly the best prepared, seek only fair competition.

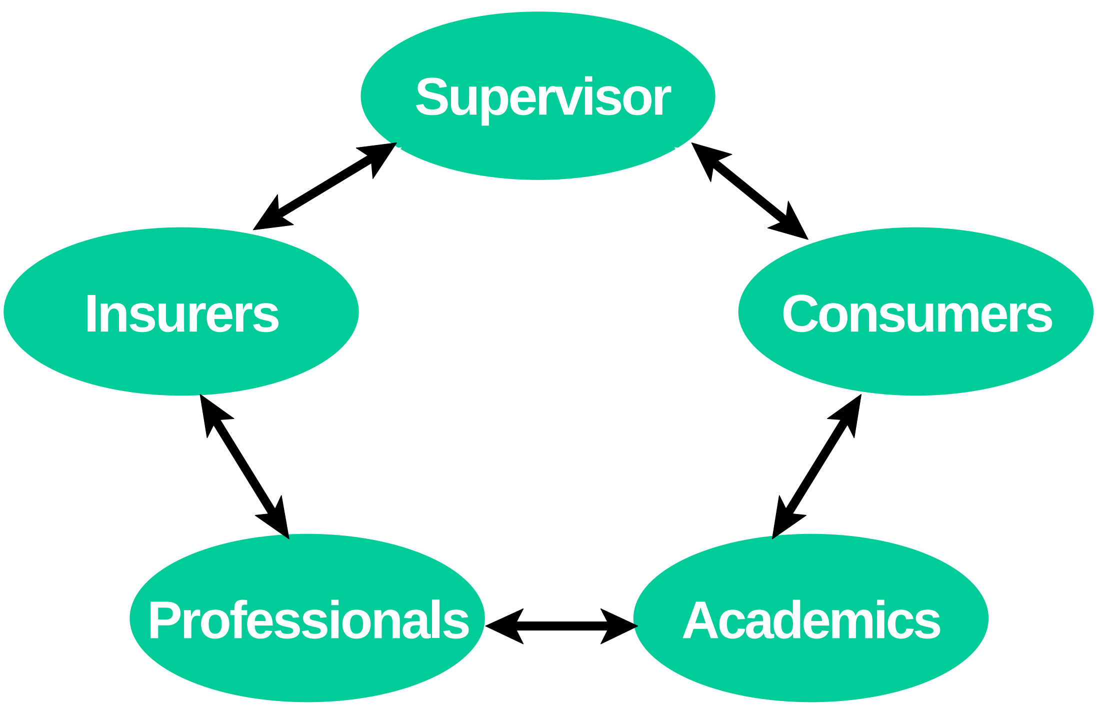
Because the rules define the market, they serve everyone's interest. In the largest sense, insurers, consumers, and supervisors have the same objective. All of them want insurance entities to survive. In Utopia at least they should be able to agree on the rules most likely to sustain a healthy market within a framework of fair competition.

Establishing the rules should be a collaborative process. As medieval kings learned, those who participate in making the rules are more willing to abide by them. They might also know better where to look in enforcing the rules. And consultation lessens the risk of making rules that are not practical, not understood, or that distort the market.

For supervisors, consultation and collaboration makes their job easier, for they are not alone in safeguarding the soundness and integrity of the market. Not only consumers, but also intermediaries, insurers, reinsurers, and retrocessionaires constantly evaluate the reliability of potential contracting partners. Potential investors evaluate the prospects of insurance firms. Industry associations concerned about the public perception of the group often impose expectations upon their members.

Given the complexity of the insurance business, a further layer of knowledge and professionalism undergirds the insurance market. Academic and research institutions contribute significantly to the analysis and understanding of complex issues of insurance,

Collaborative Supervision



as well as preparing future professionals. And when it comes to promulgating and enforcing rules, professional bodies play a major supporting role through the standards they set for their own professions.

Professions involve a high degree of specialized training and skill. Thus, educational qualifications and proficiency testing assume great importance in professional accreditation procedures. Actuaries and accountants establish rigorous standards of competence and ethical behavior maintained by formal examination procedures for new members and by peer review for present members of the profession. Similarly, the U.S non-life insurance industry recognizes the Chartered Property Casualty Underwriter (CPCU) designation as the symbol of professional competence, educational attainment, and ethical behavior. In general a profession displays such characteristics as:

- High ethical standards
- A commitment to public service
- Educational qualifications
- Mandatory continuing education
- Professional independence
- A professional standard-setting body
- A disciplinary code

Strong professions, measured by these characteristics, provide important support for insurance supervisors in maintaining the integrity of the market.

Finally international cooperation also makes supervision more effective. Universal rules are stronger than parochial ones when they come closer to expressing the essential principle. They also carry more weight because they are recognized more widely.

So in devising the ideal system of insurance supervision, I would want to incorporate these other sources of norms and standards as much as possible. The more people talk about what is right, the harder it becomes to do wrong. Trust has always been central in the insurance business, and there are many people working to enhance it, including our partners in this Conference, the IAIS and the OECD. Risk-based supervision, professional conduct, regulatory compliance, corporate governance, social responsibility, customer service, and good business are all about doing the right thing, and encouraging others to do likewise.

The strength of U.S. financial regulation is the interaction of these forces, each reinforcing the other. While the news seems to say that one ambitious and energetic state attorney general is giving the U.S. insurance industry a difficult time, a closer look at the headlines reveals an amazingly diverse array of voices sounding alarms.

It was the Risk and Insurance Management Society that made an issue of undisclosed contingent commissions. The subsequent revelation of hopefully isolated cases of bid-rigging generated many confusing and conflicting responses about accepted industry practices of broker compensation. But members of the CPCU Society, who pledge to place the client's interest above their own, responded by unequivocally reiterating their commitment to their ethical code. Such clear messages help to set expectations, and major brokers are abandoning questionable compensation arrangements. It is now possible that the market will resolve this issue before the regulators have completed their fact-finding.

Equal clarity is hardly possible with the transfer of risk rules for reinsurance accounting. Still those rules emanate from the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, and the National Association of Insurance Commissioners, and they have evolved through 30 years of discussion. It takes professional accountants and actuaries to discern improper application of those rules. The Casualty Actuarial Society had already devised tools to test the transfer of risk, and a new project is underway to clarify the rules. The issue of finite reinsurance was new only to outsiders and to the popular press.

Similarly corporate governance has engaged the legal, accounting, and regulatory communities for some time. The OECD has been a leader on this subject, as its recently published Guidelines show. The Guidelines articulate best practices that are widely accepted among experts and that corporations are now rushing to adopt before their public image suffers. Despite concerns about the expense of complying with the Sarbanes-Oxley requirements, most experts now support them. Where internal control weaknesses have permitted questionable transactions, the independent auditor's evaluation of internal controls will usually eliminate the weaknesses faster than regulatory action.

Some ask why New York's Superintendent of Insurance had not discovered these problems sooner. The answer I think is that insurance is a complex business that requires expertise from many quarters: actuaries, accountants, lawyers, analysts, underwriters, reinsurers, risk managers. No one can possibly know everything. It takes a variety of gifts, all working together for the common good. In the end it matters not who detects abuses, only that they are detected and stopped. Transparency makes that possible.

Compared to a Utopian insurance supervisory system, U.S. financial regulation has many shortcomings. It is cumbersome, and it has too many overlapping jurisdictions. On the other hand, the recent events have illustrated the value of transparency better than any theoretical discussion ever could. When many eyes inspect the same cloth, there is less chance of overlooking a flaw. And in extreme cases, when many searchlights fall on the same ground, there is no place to hide.

As I said at the beginning, we have not yet found Utopia, and we need to help each other look for it. No matter how big or small the mess may be, no one can clean it up by himself. We are all in it together, and it is all about ethics. For consumers, insurers, and supervisors alike, the task is to find rules for the market that you would willingly follow if you were on the other side.