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Financial Stability and Insurance Supervision: The Future of Prudential Supervision

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1. Introduction

Recent years have seen an increased interest in the insurance sector and its role in financial stability, including from those outside insurance and insurance supervision. Early attention focused on the issues of credit risk transfer from the banking sector to the insurance sector, after it became apparent that the industry's exposure to banking risks was increasing. Concerns were raised about the lack of transparency in the insurance sector, potentially naïve risk-taking, particularly in the credit risk area, and possible linkages with the payment system through assumption of banking sector risks. More recently interest has focused on the potential systemic implications of reinsurance concentration and operational risk transfer from banks to insurers.[1]

In many respects, this increased scrutiny from those outside insurance supervision has been a healthy development. Senior policymakers – central bankers and finance ministers – are more likely today, particularly post-9/11, to recognize the critical role that insurance plays in economic activity. Banking supervisors are more likely to recognize some of the unique characteristics of the insurance sector.[2] Increased attention from those with a broader interest in global financial stability, and with a sometimes different supervisory perspective, has encouraged a critical analysis by insurance supervisors on what works well in insurance supervision and what can be done better. Insurance supervisors have been attempting to answer some very fundamental questions: what is the role of the insurance sector in financial stability; what are the significant issues that supervisors face today; and what should they do to continue improving regulatory processes in response to the changing environment?

The result has been a flurry of activity around the world, as insurance supervisors reengineer their supervisory systems to respond to the new demands. Major reforms are underway in the United Kingdom, the European Union, Australia, and The Netherlands, among others. Incremental reforms are underway in Canada and the United States. This paper examines current issues facing insurance supervisors and possible future directions for insurance supervision.

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* Iowa Insurance Commissioner, Past President of the National Association of Insurance Commissioners (NAIC). This paper reflects the views of the author and not of the National Association of Insurance Commissioners or U.S. insurance regulators, and is based on a speech given at the 19th PROGRES International Seminar of The Geneva Association in September 2003.

[1] See e.g, Crockett (2002, 2003); International Monetary Fund (2002, 2003); Large (2003).

[2] For an excellent description of differences in risk profiles and regulatory capital approaches in the banking, insurance and securities sectors, see Joint Forum (2001).

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