Insurance Sector Regulations - Manoeuvring the Monitoring

Dr. G. Srinivasa Rao
M.Sc., MBA, M.Phil., Ph.D., PGDCA
Professor, Aditya Educational Institutions, Kakinada, Andhra Pradesh, India

***Abstract:* - With the globalisation of world economy the barriers of business boundaries are being erased. Hence there is a also a need for a cohesive effort at global level to synergise the efforts of each country's regulators. This Article talks about the concept of insurance and the need for its regulation it also insists the need for functional autonomy of the regulatory bodies and talks about various levels of regulation, their roles and finally the need for a global level coordination amongst the insurance supervisors for best supervision.**

I. INTRODUCTION

With the evolution of novel nomenclature, from the stage of 'controller' in early nineties to 'regulator' now and if we observe the usage of words like 'supervision'/'monitoring' as synonymous to 'regulation' it is interesting to see the changing paradigms of regulatory approaches. Stability of financial sector influences the stability of economy. For a nation to be on sound economic footing a stable financial sector is an essential prerequisite. Though, developmental factors like growth of agricultural, services and industrial sectors determine the pace of economic development, financial sector that purveys a stable financial infrastructure to these sectors, works like an umbilical cord in the overall growth of the economy.

Though, the regulated entities are aware of the fact that the functioning of the financial sector will be influenced by various external and internal factors, it is rare that they are hundred percent happy to accept the existence of a regulator. However, it is the presence of the regulator that promotes the growth of business and its sustenance. In its objective of ensuring self-sustainability, for ensuring continuous reposing of faith by the gullible public in the financial system, successive Governments preferred independent surveillance on the markets for regulating those sectors and institutions that are likely to be diversifying their networks across wide geographical areas reaching a wide gamut of population both directly and through new entities.

Insurance evolved as a branch of financial sciences, is in existence since time immemorial in the form of risk sharing and risk diversification in various clusters of social economy. Changing socio economic factors together with technological developments placed insurance in a prominent position in the financial sector. Insurance in the larger perspective is considered as a social security tool. As the costs incurred for insurance services are paid up-front, while the real benefits (of insurance) are contingent, the monies involved in certain classes like life insurance are paid over generations, it is essential that the business of Insurance is subject to the rules.

It is opined by economists that monopoly of any sector would be detrimental to the price and choice of the customers apart from restricting the flow of capital and generation of newer avenues. Accordingly, various sectors are opened to private participation, leading to ushering of multiple players competing one another to offer the best services with the best possible lower prices both to attract the customers and to capture a leading market share. In their attempt to capture the market share, some companies may be tempted to follow such market practices that may likely hamper sustainable growth thereby affecting the sustenance of the industry in the long run. As part of their obligation though Governments may monitor/ regulate the activities of these businesses, regulation being a complicated activity, managing the same within the overall framework of other executive activities may not receive the desired attention. Functional autonomy of regulatory bodies is recognised as one of the essential pre-requisites for an apt and sound regulatory regime. To ensure the autonomy of a regulatory body there is a deliberate action by legislations separating the task of regulations from the rest of its departments.

While the functioning of regulators is within the overall ambit of the legislative framework, this separation leads to grooming the regulatory bodies on professional lines with the main objective of protecting the interests of its respective stakeholders. A standalone regulatory activity also concentrates on the technical aspects of the regulated subjects leaving no scope for external influences on its decisions at various points of time. Given this valuable evolution, it is important that the regulated entities understand the intricacies of the regulation in order to appreciate the role of regulator.

II. REGULATORY LAYERS

Though, the statutory regulatory regime is in place with adequate regulatory framework, Regulators recognise, amongst others, the criticality of regulated entities' internal processes, their ability to administer the business, their credibility in terms of their Governance, which is referred as due diligence in regulatory parlance. While it is essential for the regulator to pay credence to these factors, it is more important to the regulated entities to adhere and continue with these values for their growth, stability and to maintain their unique identity. Sound operational systems, better market conduct, the best Governance practices are some of the important aspects that are expected and recognised by the Regulators. In order to adhere to and maintain these internal norms, regulated entities need to pay the same regard as how they regard the regulation, hence warrant treating them as their own internal regulations.

On the other hand, industry bodies have a role in chalking out a strategy for the entire industry, in putting in place the best practices / code of conduct and nudge the players of the industry to fall in line. For their critical role these industry bodies are historically referred as Self regulatory Organisations. All these different objectives, are different layers of Regulation of a regulated entity i.e., internal regulation, self regulation and statutory regulation. Internal regulation is the base on which the growth or evolution of the companies depend. As a next stage as how self-discipline is hailed as the best discipline, self-regulation of the industry by a body of association of its own members establishes the market discipline. At ultimate stage the statutory regulation has its own role as per the charter of statutes.

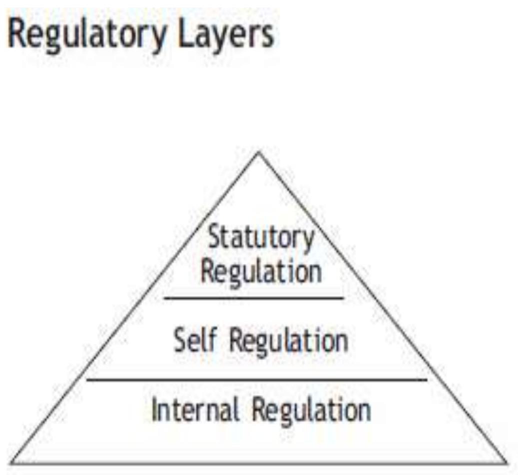

Diagram - 1

Internal regulation shall be self adopted concept encompassing the well-established internal controls, internal checks, governance norms and market conduct practices etc. While measures like internal controls and internal checks address the micro aspects of day to day transactions, issues like governance and business practices address the macro policies of the company for effective implementation. Practices adopted by the regulated entities work more on the lines of internal regulations, as these entities also monitor and rate their practices/ policies vis-à-vis their corporate objectives and industry growth. Certain issues like, issues relating to the self-sustainability of the products, market conduct practices, performance of investment could be better gauged by companies themselves before gaps, if any, are surfaced.

Self-regulation is the next stage wherein all the market players would come forward voluntarily and adhere to the best business practices across the industry. Self regulation though voluntary, occupies a prominent role in enforcing the discipline amongst the players. However, for its enforcement, markets need to be an established (read as matured) one. On the other hand statutory regulation, being the regulation imposed by the statute forces the insurers to demonstrate their adherence to regulatory framework during the conduct of the business and its operations. The intricacies involved and the objective of the statutory regulation are discussed in later stages of this article.

In the early 2000s, prior to the period of financial crisis, there was a school of thought that the Self Regulation of the industries shall be allowed to have a prominent role so that the markets determine their own course of action. However, post financial crisis the core of the regulation re-diverted and focussed on statutory regulation. The views of Dr Y V Reddy placed in the following box item bespeak itself on this approach.

Therefore, despite their respective strengths, when it comes to supervising / monitoring, the statutory regulation oversees the rest of two. While internal regulations framed are within the overall framework of self regulations and statutory regulations, statutory regulation also oversees if market players adhere to their own self regulations and internal regulations. And in turn the regulatory interventions would be based on their adherence to self regulation and internal regulation. As may be observed from Diagram – 1 the higher the importance to the internal regulation by the Insurers the lower the scope for the remaining and so on.

Overseeing Regulatory Tracks

The regulatory economics of insurance sector are quite dynamic with the nature of insurance business dealing with uncertain magnitudes of unknown risks. The need for extending the risk coverage to various sections of individuals in case of retail insurance and to various businesses in case of Group or Commercial risks opens a plethora of business avenues prodding them to breach various layers of the regulations referred

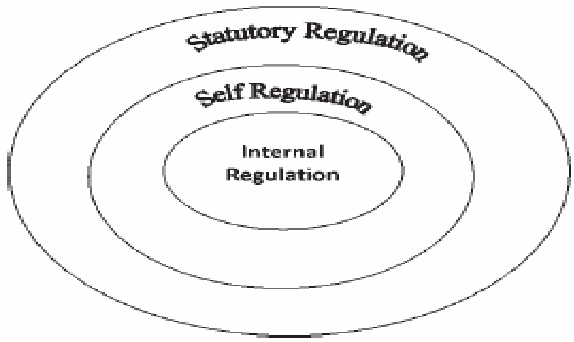

Diagram - 2

Diagram 2. Therefore, it is interesting to sense an overseeing mechanism where a well-established self regulatory framework is in place, it also oversees the internal regulatory framework of the players. Also as depicted at Diagram-2 the statutory regulation oversees the both. It is important for the regulated entities to prioritise adhering to their own internal norms (referred as regulation here) lest they may be subjected to oversight of the next layer. Where the self-regulation of the industry bodies is ineffective, the statutory regulation will have rebounding oversight.

III. EVOLUTION OF REGULATIONS

Of the regulatory concerns of insurance industry, continued financial soundness (termed as solvency) of insurers, the business practices (termed as market conduct) entities involved and prudential / operational practices that meet the expectations of policyholders are the prime ones. While statutes outline the broad framework empowering regulator to further intervene or prescribe the detailed regulations wherever warranted, prescribing regulations/guidelines is a continuous cyclical regulatory event. The operational and business practices of insurance companies may force business expansion which generally leads to product (e.g. ULIPs) and service (say online services) innovations. These innovations force the regulator to re-visit adequacy of regulatory framework to the prevailing business and operational environment. It is a wrong notion that regulations stifle the innovation. In fact the regulation that follows the innovation solidifies the business growth. Further, it is but for the regulator, the entities adopt the innovation. Thus, the regulatory circle, as depicted at diagram – 3, is a never ceasing process and is well understood by matured market players.

Regulatory Cycle

Enforcing Regulations as important as framing Regulations: The regulator has various regulatory tools at its disposal like market intelligence, international cooperation for sharing of information and inter regulatory coordination to regulate and supervise the markets, in brief it keeps monitoring the market conduct, prudential aspects and operational / governance practices through two main tools (i) offsite and (ii) onsite mechanisms.

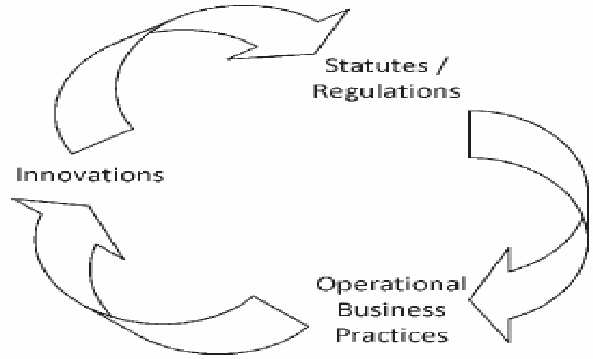

Diagram - 3

Offsite monitoring is the activity at the regulator's office, while onsite activity is the activity carried out at the premises / offices of insurers. A close off-site mechanism reveals, amongst others, early warnings, operational/systemic inadequacies and governance/business practices which may trigger an onsite inspection. By virtue of its role regulator carries out periodical onsite inspection of insurance companies which may bring out issues that have regulatory concerns leading to the tightening of offsite mechanism. Thus, onsite inspections complement offsite mechanism of regulatory bodies. The onsite and offsite supervisory tools may be aptly portrayed as the pedestals (Diagram – 4) on which monitoring of insurance sector actuates on an ongoing basis.

Regulatory Pedestals

As internal controls and checks that are in place with insurance companies constantly monitor the minuscule to majuscule transactions and policies of the company which are expected to be in accordance with statutory regulation; and self regulations, if any, the regulator develops such systems for an ongoing off-site monitoring like periodical reports/returns, preapproval procedures and grievances reporting etc. that provide flow of information. Every information, report / return received or application filed for prior approval offers opportunity for peeping into the possible conduct or the potential practices of insurers. These two pedestals also stand as a base for possible regulatory interventions.

Those regulated entities that closely follow the regulatory making process do appreciate that, quite often, it is because of the gaps that surfaced in the procedures / governance aspects of their offices, the regulator intervenes through a regulatory framework. Therefore, the better the conduct / operational procedures, the lesser (relatively) the role for repeated regulatory interventions.

IV. CONVERGENCE OF GLOBAL STANDARDS

With the globalisation of world economy the barriers of business boundaries are being erased. Further there is also a need on the other hand, for a cohesive effort at global level to synergise the efforts of each country's regulators. Be it Basel for banks or IOSCO for securities or IAIS (International Association of Insurance Supervisors) for insurance, the main objective of these global level apex bodies is to share the information on regulatory matters for strengthening the regulatory mechanisms. Of these three, IAIS provides guidance notes not only in supervisory matters but also on developmental roles of supervisory bodies of insurance sector.

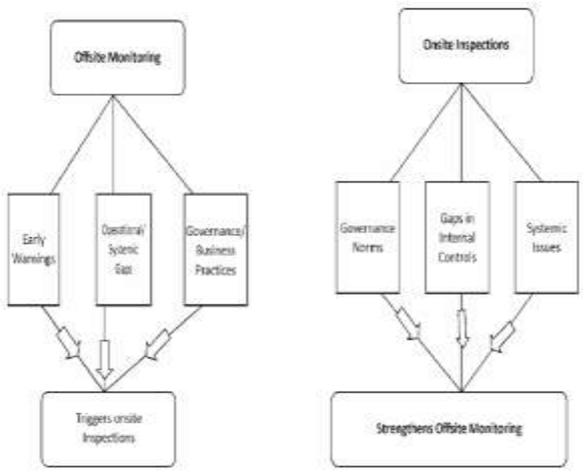

Diagram - 4

There is a virtual consensus that the regime of financial sector regulation in major developed countries needs a thorough overhaul. Several reports have taken this issue on board. The recommendations of all these reports is to: strengthen regulation; reverse the process of deregulation of recent years; increase the scope of regulation; make regulation countercyclical; emphasise macro-prudential regulations; take cognizance of liquidity risks; explore methods to tackle the 'too big to fail' institutions; alter the framework of managerial incentives; widen the range as well as scope of instruments of regulation consistent with the multiplicity of objectives and complexities in the market; enhance the scope for discretion of regulatory authorities while upgrading their skills; focus on structures and systems rather than only on mathematical models; and expand the obligation of financial instruments to be traded on exchanges.

V. CONCLUSION

The need for global level co-ordination is evident with the common concerns that exist in Insurance business like Solvency, Anti Money Laundering and Insurance Frauds which needs to be tracked continuously. Apart from this, global level coordination also facilitates exchange of information about the regulated entities for better supervision. Therefore, the regulated entities shall be always in their best attention, as the regulatory radars monitor their manoeuvres.

REFERENCES

[1]. www.irda.gov.in
[2]. Various issues of IRDA Journals.
[3]. Various Annual Reports of IRDA and LIC