COST-EFFECTIVE AND FIT FOR PURPOSE

Darren Maher, partner at Matheson, explores the burgeoning regulatory demands on the sector and the importance of innovation for the insurance industry

Increased levels of regulation and compliance are the new realities facing financial institutions in the post-financial crisis world. This is of course necessary and inevitable to ensure the public interest is protected given past failures. Indeed, during his speech to the European Insurance Forum last year, Matthew Elderfield reminded us that not so long ago a "now notorious banker" complained about regulation saying: "It's time to shout stop: the tide of regulation has gone far enough."

That said, in the same speech Elderfield conceded that debates about regulation are healthy and reasonable, once they are transparent and grounded in specifics. With that in mind, we should now consider recommencing a measured and balanced dialogue about what is necessary to achieve appropriate levels of regulation post-financial crisis. It should not be seen as a contradiction to emphasise the importance of properly regulating our financial sector to protect the common good, while at the same time asking questions about the cost that regulation is having on insurers. Manpower and capital which insurers could previously have used for investment or product development are now being diverted towards compliance, as insurers struggle to keep up with the introduction of new regulations. We should consider whether this trend will lead to a weakening of the sector which may in turn require further capital thereby creating a potential downward spiral.

The economic crisis highlighted the failings that were prevalent in the financial sector's corporate governance practices, with boards of directors being unable to ensure that financial institutions were sufficiently solvent and liquid and adequately insulated from credit risk. It is for this reason that the introduction of codes of conduct such as the Central Bank's Corporate Governance Code for Credit Institutions and Insurance Undertakings and the overhaul of the Central Bank's Fitness and Probity Regime are welcome. While such initiatives are positive, the concern is that a tendency to over-regulate will take hold.

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Regulation has become increasingly intrusive and time consuming for regulated financial institutions. Global figures from the third quarter of 2013 show that some 10,000 new jobs were created in the financial sector since the financial crisis, the majority of these in the areas of compliance, risk and regulatory functions. The creation of employment is positive. However, as valuable manpower and resources are injected into insurers' compliance departments, business aspirations and product development will be correspondingly scaled back.

European insurers have also had to invest significant resources in the implementation of the Solvency II Directive, in addition to the International Association of Insurance Supervisors' Insurance Core Principles. The tidal wave of regulation is unlikely to abate in the near future. Insurers are struggling to keep abreast of changing capital and corporate governance requirements, while seeing their premium income declining year-on-year. This is against a backdrop of financial regulators who are ever-more willing to commence enforcement proceedings for compliance failures.

While the pace of global recovery appears to be gaining momentum, it remains fragile and uncertain. Trading conditions continue to be challenging for many insurers: consumer demand is low and overall unemployment remains at historically high levels.

Although insurers' profitability has suffered, the overall result is a more stable, transparent insurance industry and renewed – albeit tentative – faith in the financial sector. In the post-financial crisis world the insurance industry must seek ways to continue to innovate and remain profitable, while simultaneously responding to the pressures imposed by an increased compliance burden. This is a matter of balance. The financial sector plays a major role in protecting the common good. Compliance is a key factor in this role. However, regulators also need to ensure that regulation is cost-effective and fit for purpose. Above all, they must ensure that over-regulation does not irreparably damage the financial sector, and consequently the common good that they are charged to protect.

> **"Regulators need to ensure that regulation is cost-effective and fit for purpose"**