# Over-regulation in the insurance industry

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***Abstract***:
French insurance companies are faced with a “regulatory avalanche”, an unprecedented accumulation of uncoordinated standards. This over-regulation, at national, European and international levels, is somewhat of a tribute to the key role this industry plays in contemporary society. However useless regulations can hamper both growth and innovation. It is essential that regulatory authorities better coordinate their actions and that the main stakeholders to be more widely consulted on regulations.

*“This must be said: There are too many “great” men in the world — legislators, organisers, do-gooders, leaders of the people, fathers of nations, and so on, and so on. Too many persons place themselves above mankind; they make a career of organising it, patronising it, and ruling it”.*

Frédéric Bastiat (1801-1850)

This quote from the free-market economist Bastiat shows that the impression of overregulation is nothing new. However, it is only during the last twenty years that French insurance companies have been feeling smothered by a “regulatory avalanche” that I will define as an accumulation of uncoordinated standards. The latter may be “hard” (French legislation, EU regulations, which are directly applicable) or “soft” (recommendations, guidelines, etc. constituting soft law which appears, on the face of it, relatively unrestrictive whilst, in fact, representing an additional regulatory layer).

This soft law derives from disparate sources such as international public (OECD, Financial Stability Board, etc.) or private (IASB[1]), European (Commission, EIOPA, etc.) or national fora – with increasing numbers of independent administrative authorities.

[1] The International Accounting Standards Board (IASB) is the body tasked with developing international accounting standards. It is a private organisation managed by a foundation based in Delaware (United States).

## **Rationale behind this over-regulation**

Many sectors (banking, agri-food, etc.) claim to feel strictly regulated, supervised and even obstructed as regards their actions and innovation. This situation is justified by customer-protection issues. The insurance sector considers itself to be especially affected by this phenomenon and even wonders, at times, whether the essence of the profession, namely to underwrite risk, is not being compromised. If we look at supplementary health insurance, French insurance companies are unable to assess the relevance of the healthcare that they reimburse, cannot select the risk as part of solidarity-based contracts and are not at liberty to set their prices, etc.

### Who regulates insurance companies?

The regulators' focus on the profession comes from national fora (government and Parliament naturally, as well as the prudential supervisory authorities, the Prudential Supervision and Resolution Authority (ACPR), the French Data Protection Authority (CNIL) which upholds civil liberties, Tracfin, the French Financial Intelligence Unit (FIU), which fights money laundering, the *Autorité des Marchés financiers* (AMF) for initial public offerings, the Accounting Standards Authority (ANC) which defines the rules for making provisions, etc.), European bodies (Council, Commission, Parliament for directives and regulations,[2] the EIOPA which oversees the sector to specify legislation at the Commission's request or to make recommendations), or even international structures (Financial Stability Board, G20, IASB for international accounting standards), although insurance markets are still highly fragmented and national-centric. In one sense, being the subject of so much attention from the various regulators is a tribute to the sector and proof that it is central to the daily concerns of all of us.

Obviously, that amount of diverse and uncoordinated attention leads to paradoxical, or even contradictory, requirements.

### Why is there so much regulation?

There are clearly reasons connected with the very profession of insurance companies. We underwrite risk – that is the essence of our business – sometimes over the long-term (construction insurance, loan insurance, long-term care insurance, etc.). Moreover, life insurance is still French citizens' favourite investment medium with outstandings of €1,700 billion. There is therefore an entire prudential framework for the insurance sector both nationally[3] and at European level (Solvency II Directive and its Delegated and Implementing Regulations, which aim, inter alia, to protect insurees by ensuring that the insurance company has a probability of insolvency of less than 0.5% within one year and that the company's governance allows it to properly manage its risks). Certain features of these

[2] Examples of EU legislation of major importance for the sector: the Solvency II Directive which sets out the prudential regime; the Directive on Insurance Distribution; the numerous anti-money laundering directives, etc.

[3] Example of the Sapin 2 Act which broadened the powers of the government and the ACPR through the High Council for Financial Stability in the event of extraordinary circumstances requiring life insurance redemptions to be blocked.

regulations are open to criticism, in particular the fact that as a result of the strategy to protect insurees, insurance companies have been driven to excessive conservatism in their investments by shying away from those in shares or infrastructure, at the expense of economic growth in Europe. We do, nevertheless, understand the need for this "standard" supervision which is geared towards ensuring the financial robustness of the stakeholders.

There are also other sources of regulations tied in with the fact that insurance companies carry out many quasi-public service assignments:

- Tax collectors. One example is the fixed annual contribution on all non-life insurance policies of €5.9 per policy. This provides financing for the FGTI, the fund which compensates victims of acts of terrorism and serious crimes. Over the last decade, there has also been a sharp increase in taxes on supplementary healthcare policies. These now account for 13.27% of premiums and contribute €4.5 billion to tax revenue.

- As a result of their anti-fraud initiatives, insurance companies cooperate with government departments. Often, as part of an insurance fraud case, it is discovered that individuals are also defrauding the tax authorities or are involved in money laundering or terrorist financing.

- At the request of lawmakers and the government, insurance companies keep files. One example is the future Insured Vehicles File which will come into force in early 2019 and which will provide details on persons holding automobile insurance.

- We help ease the case backlog at courts through the out-of-court settlement of minor disputes using legal protection insurance.

- We issue statistics of public interest on the frequency of accidents, theft or the savings habits of French citizens.

- And, generally speaking, insurance companies and the government have similar interests and their actions complement each other as regards increasing road safety or tackling the effects of climate change.

In light of the foregoing, it might therefore be concluded that the insurance sector should be strictly regulated especially in a French society in which distrust is rife,[4] and whilst we are navigating in uncharted waters with, for instance, advances in digital technologies which are shaking up the insurance industry in the same way as they previously disrupted other sectors. There are also unprecedentedly low interest rates which put a drag on insurance companies' financial revenue.

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[4] In this respect, refer to the works of the economists Algan, Cahuc and Zylberberg called "*La société de defiance*" and "*La Fabrique de la defiance*"; and the highly informative annual Cevipof analyses ("political confidence indicator") which reveal, for instance, that 69% of French citizens think that "you can never be careful enough when dealing with others".

As the senior academic Francis Fukuyama has shown,[5] in a distrustful society in which the stakeholders find it difficult to sign agreements and forge contractual relations, the government takes up the slack and over-regulates.

Although the need for government intervention to oversee such a strategic sector cannot be denied, I would like to now posit that the precautionary principle has been taken too far and that stakeholders should be given headroom and breathing space.

Like all obsessions, an excess of conservatism can end up by becoming crippling. There needs to be an urgent shift in the framework in order to show that, if insurance companies had greater freedom to act, they would be better placed than all the dispersed regulators to reconcile protection of their insurees with economic momentum.

## The "regulatory avalanche" compromises growth

Compliance functions[6] are becoming increasingly important in the insurance sector.

### An abundant and disorderly regulation process

These functions are becoming crucial in light of the huge increase in the number of standards laid down by administrative authorities, whether independent or not. Rightly or wrongly, insurance companies sometimes feel like ships buffeted by a storm when the standards they have to apply are contradictory and overlap, without anyone within the state apparatus being able to impose coordination. This is partly due to the fact that the sources of regulation now extend beyond the national framework.

Each authority is legitimate, each has its role to play and their managers cannot be criticised for failing to apply themselves. Nevertheless, there is no longer anyone to coordinate them, even at national level. One example is consumer protection, the remit of both the ACPR and the Directorate General for Competition Policy, Consumer Affairs and Fraud Control (DGCCRF) at the Ministry for the Economy and Finance, which do not coordinate their verification work.

Furthermore, the term "soft law" is a misnomer. It is an actual regulatory layer as the authorities are authorised to conduct controls in businesses and hand down administrative and financial sanctions if they consider that regulations and their interpretation, via their recommendations, have not been, or are not being adequately, complied with.

[5] *Political Order and Political Decay: From the Industrial Revolution to the Globalization of Democracy*, 2015.

[6] The four key functions defined in the Solvency II Directive are compliance, internal audit, risk management and actuarial. Their goal is to ensure that insurance companies control risks. The "four-eyes" principle has also been introduced under which there must be two effective managers who take the most important decisions in a company. Lastly, more than twenty written policies setting out the company's risks and strategies have to be approved by the board of directors.

What is surprising is that this ratcheting up of compliance is taking place against a backdrop in which no major insurance company has failed in Europe in recent years. As regards the near-disappearance of AIG, which was the world leader, during the 2008 financial crisis, this had more to do with reckless risk-taking on credit derivatives than the conducting of its core business.

There is a real danger of discouraging internal innovation and of moving towards standardised practices in order “to be compliant”. As rules currently stand, would certain essential stakeholders in the French market have been able to set up shop and expand?[7] Would their managers and directors have been seen as fit and proper? Would their underwriting and financial investment policies have been deemed sufficiently conservative?

Compliance and control constraints also come at a cost. Unlike in the banking sector, there are currently a large number of small insurance companies in France. These are most often affinity-based general mutual insurance companies or mutual health funds. There are still around one hundred and twenty players offering non-life insurance (automobile, housing). Expenditure on compliance can lead to consolidation of the sector which reduces the diversity of the offering. This would appear to have been the case for a number of years in both the mutual health fund industry and for insurance companies governed by the French Insurance Code.[8]

## Are there any positive aspects?

Obviously, these stricter reporting obligations do include some positive aspects. They force directors and teams to act professionally and steer due and proper risk monitoring.

The potential consolidation brought about by stricter standards may lead to the emergence of more robust stakeholders and a more diversified customer base.

Lastly, this over-regulation creates a solid barrier preventing the arrival of new players. As matters stand, up to the present day, GAFA have not begun operating in the sector although it is regularly rumoured that Google or Amazon, which know so much about us, are contemplating becoming insurance companies or, at least, insurance brokers. Similarly, no Chinese or American companies have significantly penetrated the major European markets which are still national in terms of individual insurance cover.

[7] We could mention the “affinity-based” (at least at the outset) mutual insurance companies such as Maif (French Teachers’ Mutual Insurance Company), MAPA (Food Professions’ Mutual Insurance Company), *Mutuelle des Motards* (Motorcyclists’ Mutual Insurance Company), etc. For all these companies, the founding directors were not insurance experts.

[8] We could mention the setting up of the VYV Group, the market leader in health insurance, which emerged from the partnership between, inter alia, MGEN and Harmonie Mutuelle; and the imminent mergers of AG2R La Mondiale with Matmut and Macif with Aesio.

# Conclusion: What should be done?

There needs to be a better balance between regulation and the leeway afforded to stakeholders. Clearly, new regulations could be considered on the basis of the emergence of new risks (cyber-risk and the fresh issues it raises such as whether ransoms can be indemnified, as does this not amount to financing terrorism?). Nevertheless, everyone considers that the pendulum has swung too far towards regulation that can be both discouraging and disempowering.

An insurance company is a risk taker. The risks are calculated and measured and therein lies the social utility of insurance. Moreover, insurance requirements show no signs of abating whether this concerns the impact of climate change or the ageing population with the risks attendant with longer lifespans and long-term care.

I have three points by way of conclusion:

## 1. Over-regulation may put a drag on growth and innovation

New technologies (big data, machine learning, blockchain, etc.) may shake up insurance practices with information that is more accurate, personal and relevant, and ensure more effective prevention policies, smoother relations with insurees, improved responsiveness, etc. It is clearly crucial to have safeguards for privacy and, in this respect, Europe's regulations are ahead of the United States. However, these regulations should not be stricter for "old industries" that are upgrading than for GAFA.

The ability of incumbent stakeholders to make commitments in terms of best practices and ethics that prevent excesses (such as risk segmentation which may be excessive and which would prevent certain people from taking out insurance for an accessible price) must also be factored in.

To ultimately aim for radical streamlining measures (*choc de simplification*), which have been much heralded yet little seen, distrust of stakeholders must be replaced by confidence. Here is a straightforward example: insurance companies should have access to social security numbers so as to better identify beneficiaries during searches concerning unclaimed life insurance policies so as to pay them the benefits.

## 2. The precautionary principle has been taken too far

Below are two examples.

A French example: France is often prone to over-enact directives with an eye to always being "top of the European class". In respect of anti-money laundering, there is no obligation to apply the rules to non-life insurance which, incidentally, is probably not a very effective way of laundering money but we have done it. French industry is put at a disadvantage when we go further than the stipulations of EU legislation.

A European example: the Solvency II Directive. Mere years after its application, many are already calling for the revision of this legislative package in light of the cumbersome constraints laid down. Admittedly, insurance companies have little chance of failing within a year in view of the amount of regulation to which they are now subject. However, how many of us can say that these mass constraints weighing on long-term investors foster growth in Europe?

## 3. The need for improved coordination of regulators

Below are another two examples.

There is a need for improved coordination of regulators in France. The fact that they are independent should not block dialogue and coordination between them, as well as with the insurance companies themselves. We can but call for heightened consultation well in advance of any new regulations so that the relevant stakeholders are able to play a tangible role in developing them. Work conducted in conjunction with the CNIL as part of the "insurance compliance package" (data processing standards tailored to the sector) provide a shining example of such cooperation, that we could call co-regulation.

Matters can also be improved at European level: What are the EIOPA's responsibilities? Who is it accountable to? The EIOPA should primarily focus on ensuring that the freedom to provide services in the EU is upheld in the face of the existence of "prudential havens" (Gibraltar, Liechtenstein, etc.) in the very heart of the Union.