Ravi Menon: Smart regulation and sustainable insurance growth

Speech by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the Insurance Institute of London, London, 12 May 2015.

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Mr Stephen Riley, President of the Insurance Institute of London

Mr John Nelson, Chairman, Lloyd's of London

Ladies and gentlemen, good afternoon.

I wish to thank John for inviting me to speak to you today. It is a privilege to address members of this esteemed Institute, and a pleasure to do so in a heritage building of such architectural and historic interest.

I have been to this building before. And my first thought as Lloyd's Building came into view, along with its plumbing, stairways and lift shafts, was transparency. So it is apt that in the same spirit of transparency, I should make a couple of disclosures:

- one, I am not an actuary or an accountant, and
- two, I am not responsible for Solvency II.

But John has kindly assured me that the musings of a central banker and regulator from the Far East counts towards fulfilling your continuing professional development requirements. So for my speech today, I will offer an overview of MAS' roles as central bank and integrated supervisor, our approach to regulating and developing the financial sector, and prospects for the insurance industry in Asia.

MAS as central bank, integrated supervisor, and financial sector promoter

Those of you who have visited Singapore might have come across one of the highlights of our architectural heritage – the black and white colonial bungalows. Combining British aesthetic sensibilities with local adaptations to a tropical climate, these former colonial residences exude stately elegance while offering cool, airy comfort come monsoon rain or equatorial shine.

The Monetary Authority of Singapore (MAS) itself operates out of a decidedly functional office block. Thankfully, the work that the MAS does is rather more interesting.

- MAS houses under one roof central banking, financial surveillance, and integrated supervision.
- MAS is also responsible for developing a sound and progressive financial centre.

MAS' single agency model sets us apart from other financial regulators. Many jurisdictions operate on what is commonly known as the twin peaks model of regulation. Under this model, separate agencies have responsibilities for prudential oversight and market conduct respectively. Prudential oversight is concerned principally with the safety and soundness of institutions while market conduct is focused on effective functioning of markets and consumer protection. Australia, Canada, and the UK are among the leading jurisdictions with twin peaks regulators.

Like the black and white bungalows, MAS' unique mandate of central bank, integrated supervisor, and promoter of financial sector development, was born partly out of circumstance. For a small country like Singapore with limited human capital, the single agency model allows MAS to more effectively utilise available expertise and exploit synergies to achieve our objectives for the financial sector and wider economy.

And like the blending of British and tropical themes in the bungalows, bringing together central banking, integrated supervision, and developmental functions serves important practical purposes.

First, being an integrated supervisor gives us better insights into the full range of activities that a financial institution engages in and hence facilitates more holistic financial supervision.

Integrated supervision is consistent with the broad range of services that financial institutions provide as well as the blurring of distinctions across financial products that we see today.

- Banks offer their clients a suite of financial services, including investment and insurance products.
- Insurance companies offer financial planning solutions that incorporate elements of savings deposits and investments, in addition to protection.

There are synergies across prudential regulation and market conduct regulation. Market conduct issues provide useful perspectives on the prudential safety and soundness of individual firms. How financial institutions treat their customers speaks a great deal about their corporate values, ethical standards, and quality of risk management and internal controls.

Second, being a central bank and a financial regulator allows us to harness synergies between macroeconomic analysis and financial stability oversight.

During the Global Financial Crisis and subsequent Eurozone crisis, macroeconomic shocks, financial market stresses, and institution-specific vulnerabilities interacted in complex ways with consequences for both systemic stability and the safety of individual institutions.

The two-way flow of information and sharing of perspectives between the central banking and supervisory arms of MAS proved invaluable in helping us assess a rapidly evolving situation and co-ordinate appropriate policy responses in a timely manner.

Having central banking and financial supervision within one organisation is not the only way to achieve better financial stability outcomes. It makes sense in a small country like Singapore. Larger jurisdictions have sought the same outcomes through strengthened co-ordination mechanisms among the various agencies whose work contributes to financial stability. The Financial Stability Oversight Council in the US and the Financial Policy Committee in the UK are two good examples.

Third, being a financial regulator as well as promoter of financial sector development helps ensure that regulation is not only robust but sensitive to the broader needs of the economy.

Lest there be any doubt, financial stability is our overriding objective. But a safe financial sector that does not help to meet the needs of businesses and individuals or support economic growth and development misses its purpose. Sound regulation is about promoting a robust yet vibrant financial sector that supports the wider needs of the economy.

Our experience has been we can achieve better stability and development outcomes within one organisation with a shared purpose rather than separate agencies with possibly conflicting goals.

Smart regulation – sound but purposeful

I would describe our approach – or at least our goal – as smart regulation: regulation that is sound yet purposeful.

MAS seeks to do this in three ways.

- First, regulation is aligned with the best international standards but is also appropriate to the risks in domestic markets.

- Second, regulation is complemented with intensive supervision that calibrates responses according to the risk profile and impact of individual institutions.
- Third, regulation is focused on outcomes rather than prescribed checklists and is implemented in a way that seeks to minimise compliance burden.

Aligned with international standards and appropriate to domestic risks

MAS' regulatory framework is aligned with global standards and principles. Indeed, we play an active role in developing many of these standards through active participation in various international standard setting bodies, including the IAIS. Global standards promote financial stability by providing a more level playing field for financial institutions and minimising regulatory arbitrage.

But financial markets are not homogeneous in their risk profiles. It is necessary to apply regulatory standards in a manner that is sensitive and appropriate to the risks associated with particular markets and activities.

Take for example our risk-based capital (RBC) framework for insurance. Insurance companies in Singapore have been subject to RBC requirements since 2005, predating Solvency II. At that time, there was no international capital standard for insurers, let alone one that is risk-based. But we assessed that maintaining capital buffers to cushion against potential losses was relevant to insurance companies as it was to banks. So, we proceeded to put in place capital requirements for insurers operating in Singapore, even when most other jurisdictions did not.

At the same time, we were conscious of the need to apply the capital framework in a manner commensurate with the risks posed by different types of insurance activities.

- For example, Lloyd's Asia syndicates are not subject to the RBC framework. This is because the Lloyd's market is approved and regulated by the UK regulator, and premiums are booked in the UK and protected by Lloyd's central fund.
- Likewise, captives and marine mutuals are not subject to RBC. They are restricted to writing business principally for their parent and related corporations, and of their own members respectively. The risk they pose to the broader financial system is low.

Complementing regulation with supervision

Close, and if necessary intrusive, supervision of financial institutions is an important complement to industry-wide regulation. Frequent and in-depth monitoring of the institutions we supervise helps us calibrate our supervisory approach to the particular circumstances of each institution.

An important aspect of supervision is surveillance, which seeks to identify and assess risks and vulnerabilities that may affect the financial system, including insurance companies. A critical component of surveillance is stress testing.

- Since 2005, MAS has been conducting annual stress tests to assess the insurance industry's preparedness against both macroeconomic stress scenarios and more insurance-specific scenarios.

The more we can rely on risk-focused supervision and ongoing surveillance informed by periodic stress tests, the less we need to design one-size-fits-all rules and regulations that seek to cover all risks.

Outcome-focused regulation and minimising compliance burden

The third aspect of smart regulation is to focus on desired outcomes. This means articulating and communicating clearly the desired outcomes of regulation and allowing financial institutions the latitude to achieve these outcomes in ways that make business sense and minimise compliance burden.

Consultation on proposed rules and even co-creation of new rules together with industry is therefore an important aspect of MAS' regulatory approach.

- Consultation helps MAS better understand the likely impact of new regulation and how it might best be implemented.
- By involving industry and stakeholders in co-creating regulatory requirements, we are able to minimise unintended consequences and foster better industry understanding and support.

Singapore as an Asian insurance hub

Even as we strengthen and update our regulation and supervision of the insurance industry, MAS has been promoting Singapore's development as an Asian insurance hub.

Emerging Asia as an insurance growth market

The demand for insurance services is growing rapidly in Emerging Asia. For a long time, insurance growth lagged economic growth in Emerging Asia. But this is changing, and changing fast.

- Munich Re projects that Asia will account for 40% of the global insurance market by 2020.
- Five of the top 10 primary growth markets will be in the Asia-Pacific; this includes China, India, and Indonesia.

There are three structural factors driving demand for insurance in Emerging Asia.

First, Asia is getting richer. Projections by the IMF show that Emerging Asia will remain the fastest growing region in the world over the next decade. As incomes rise in Asia, governments, corporates, and individuals will increasingly seek insurance to protect their growing economic assets.

- Burgeoning urbanisation, infrastructure development, and cross-border trade will drive demand for commercial and specialty insurance.
- A growing middle class and rising affluence will underpin a steady increase in life and health insurance penetration rates.

Second, Asia is getting older. Asia is facing declining fertility rates, increasing life expectancy, and a rapidly ageing population.

- The United Nations projects that, by 2030, Asia's old age dependency ratio will be 16%, up from today's 11%.
- Against this demographic backdrop, public retirement and pension systems in Asia remain inadequate. The retirement gap between savings and retirement needs can be as high as 13 years.
- This will spur greater demand for private health insurance, annuity and other retirement security products.

Third, Asia is becoming more aware of catastrophic risk.

- Over the last 30 years, Asia has borne the brunt of natural catastrophe losses, accounting for almost half of the world's estimated economic losses from natural disasters. Yet less than 5% of the losses were insured, compared to 40% in advanced economies.

- At the same time, rapid urbanisation is concentrating ever higher economic wealth in exposed areas. Eight out of the ten global mega-cities most at risk from natural perils are located in Asia. They include Jakarta, Kolkata, Manila, and Shanghai.

This large protection gap in Emerging Asia presents the global insurance industry, confronting mature markets and excess capacity, with a significant opportunity to deploy capital for better returns.

London and Singapore as complementary insurance centres

International financial centres in Asia, like Hong Kong and Singapore, as well as domestic financial centres in China and Korea are well-placed to meet this growing demand for insurance in Asia. But international financial centres outside Asia – such as London – with the enormous breadth of their markets, depth of financial expertise, and connectivity with other financial centres – also stand to gain from Asia's rise.

On occasion one hears stories of London losing ground as an international insurance centre due to tightening regulatory standards and a shift in the global economic centre of gravity to emerging markets. But polls and expert opinion also predicted the recent UK election race would be neck and neck. On both counts, the numbers prove otherwise.

- London is the undisputed global insurance market for specialty commercial risks – insuring highly exotic and bespoke risks from Formula 1 drivers to Cristiano Ronaldo's legs.
- London controls more than 60 billion pounds in premiums, which makes the London market twice the size of Bermuda, three times that of Switzerland, and more than 10 times bigger than Singapore.

With its wealth of insurance and specialist risk capacity, London insurance is well positioned to ride the growth in Asian demand. But insurers will benefit from closer proximity to markets, information, and talents. Global insurers and brokers are responding to a growing preference for local placements by setting up local offices in high growth markets to understand their clients better and to be more responsive to their needs.

This is where Singapore and London can play complementary roles. London with its unparalleled insurance expertise and experience, and Singapore, with its market proximity and client knowledge can collaborate on providing insurance and risk management solutions that are, relevant, appropriate and responsive to Asian needs.

Conclusion

The fascinating origins of Lloyds, over 300 years ago – in a coffee house where seafarers gathered to swap intelligence on their trade – illustrates the enduring power of information, networking and the centrality of markets.

As with Lloyd's coffee house, the essence of financial centres lies in connecting markets and people to provide innovative solutions to further economic prosperity. The rising demand for financial services in Asia offers tremendous opportunities for London and Singapore to strengthen our connections for sustainable insurance growth.

Thank you.