MARKET CONDUCT IN THE INSURANCE INDUSTRY AND CONVERGENCE OF INTERNATIONAL SUPERVISION[ι]

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Abstract

The increasing regulatory, supervisory and academic debate on the assessment and supervision of insurance companies is not a homogenous process: discussions are concentrating heavily on solvency capital requirements, risk management and supervisory review, disregarding market conduct and the risks associated.

Analysing the main experiences of market conduct regulation and supervision in the financial sector, the international standards and principles and the related academic contributions, we aim at proposing a comprehensive definition, identifying components included and links with other supervisory fields. Our research stresses the importance of appraising international market conduct regulation more in detail, considering comprehensively and equally all aspects of regulation to achieve a thorough assessment, and the need for greater convergence of supervisory frameworks to enhance the exchange of information and avoid costly compliance processes by the industry.

Keywords: insurance regulation and supervision, market conduct, reputational risk, market discipline, consumer protection

Introduction

In the light of the debate surrounding the forthcoming European Solvency II framework for insurance supervision, and following the ongoing discussion around the Basel II Accord for the banking sector, regulators, supervisors and the industry are now contributing in developing a

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comprehensive model that involves all major aspects of supervision. Its structure is based on three pillars: quantitative requirements, supervisory activities, reporting and disclosure.

In a more general model developed by the International Association of Insurance Supervisors (IAIS), the common structure of insurance supervision should comprise financial, governance and market conduct requirements; the preconditions for the effective functioning of supervisory authorities, the insurance sector and supervision; and supervisory assessment and intervention activities. Given the complexity of the subject and the extent of aspects involved, different approaches have been adopted in these areas world-wide, complementary to solvency supervision which together enforce efficacy and accuracy of assessment activities.

Unfortunately it could be seen that, despite this organic architecture, the international debate as well as relevant literature, are focusing heavily on quantitative aspects of capital requirements, with limited (if any) efforts in enhancing at the same time the correlated and mutually enforcing profiles underlined by the three-pillar approach.

The purpose of this paper is to highlight the risks of this narrow focus of the international agenda. Regulation of market conduct issues is present in almost all countries, despite a high degree of heterogeneity. Above all, we are strongly convinced that market conduct requirements are an integral part of regulatory frameworks, but at the same time we observe little (but growing) attention to this field. We note that interest in this field is expressed both by developing and developed countries, but for divergent underlying reasons: the former are mainly driven by the need to establish a higher degree of confidence among potential and actual policyholders and to promote the growth of the sector, whereas the latter seem more interested in providing a complementary and qualitative element of customer protection and enhancing risk management activities of insurers.

We aim at suggesting a proposed definition and morphology for market conduct that could be applied to an international level of supervision. This contribution could be seen as a further step towards the convergence of insurance regulation world-wide, to avoid the development of systems that are not comparable or require excessive costs of interrelation. It should be noted, however, that this paper examines a subject broader than solvency supervision itself. We support the idea that financial requirements should represent only one set of provisions towards insurance solvency. Therefore, unless otherwise stated, we refer to solvency supervision in its broadest sense considering also aspects other than financial requirements.

Moreover, the discussion mainly deals with market discipline (transparency and disclosure of company-wide financial and risk information) and consumer protection (information and provisions addressed to customers). Therefore, we are not using the terms "market discipline" and "market conduct" as synonyms: in our view the latter comprises the former.

To achieve our objective, we examine the most recent experiences emerging in the United States and the European Union, that are currently facing the issue of a cross-border harmonisation of market conduct principles. We consider also recent developments in the banking sector and the securities industry world-wide, to provide a comprehensive picture of financial intermediaries, where borders are vague and internationalisation is a common issue.

Research Methodology

A business relationship involves knowledge and trust, and these intangible assets require time and resources to be established. Knowledge and trust are closely related to reputation, which is an important element in maintaining a profitable set of relationships with market participants and, therefore, to conduct business. Loss of reputation has proved to have significant direct and indirect consequences for firms: in a regulated sector (like financial intermediation) costs could derive directly from supervisory intervention or other legal actions, or indirectly, as loss of new business opportunities or deterioration of existing ones. Moreover, reputation and trust influence also cross-border supervisory relationships, referring to sets of different provisions applicable to national or foreign entities.

In the field of knowledge and trust, the conduct of financial intermediaries towards market participants represents one of the main issues that should be dealt with by supervisory assessment frameworks. Even if its main outlines are known and present in many countries, at the moment there is no commonly agreed international definition that includes all relevant elements and avoids overlapping with other topics. Potential adverse effects are excessive costs due to duplication of compliance processes, both for supervisors and insurers, that are ultimately borne by customers and other market participants.

In the light of these issues, we aim at proposing a comprehensive morphologic picture of market conduct and a definition useful to develop a greater level of convergence of international insurance supervision world-wide. At the same time, we are aware that specialties in regulation, supervision and practices of each country suggest that we start this process from a general framework and from high-level principles.

To achieve this, we have adopted a qualitative and inductive approach based on the following steps:

- we examine the academic contributions on market conduct issues to identify approaches already adopted, focusing on the insurance field but considering also the overall financial sector, to keep consistency with other international developments;
- to identify areas of overlapping or missing international regulation, we examine the international standards and guidelines applicable to market conduct issues across the financial sector, especially focusing on the work of the IAIS.

A second part of our research adopted a more deductive approach: we summarise, as guiding examples, recent developments in countries particularly relevant for insurance business, where regulation and supervision of market conduct on a cross-border basis emerged more strongly (i.e. the United States and the European Union).

From these sources, we identify common and discordant views to clarify connections between elements of market conduct regulation: the structure of international frameworks comprises implicitly or explicitly a three-pillars approach with thin borders between them.

After having collected this information, we construct a morphological picture of market conduct regulatory issues, grounded on reputational risk and classes of market participants, from which we derive a proposed definition.

Finally, we employ the proposed definition to define connections with financial requirements and corporate governance supervisory issues, focusing on areas of potentially overlapping regulation and relevant fields for convergence of international effective supervision.

Literature Review

The review of the literature represented the first important phase of our research. We have identified three main sources in the available literature to ground our contribution:

- academic literature, referred mainly to the banking sector and the insurance industry,
- contributions by international organisations active in the financial sector,
- regional-specific experiences accrued in the United States and in the European Union.

We have not reviewed market conduct practices on the industry side: our focus is towards regulatory and supervisory high-level principles, rather than day-by-day compliance. Moreover, as explained below, the Organisation for Economic Co-operation and Development is already involved in this side of the research. Nevertheless, it should be noted that to develop further our general framework, industry's best practices will be a precious source for a more effective regulation, as well as a main indicator to understand common pitfalls in market conduct processes and the risks associated.

Academic Literature

To our knowledge, focus on market conduct in the insurance academic literature is very limited. Therefore, and to keep our picture consistent, we have investigated contributions related also to the banking sector, that shares some common issues with the insurance business.

Banking sector. In the banking sector we found a significant amount of contributions, unfortunately focused mainly on measuring and describing abstractly market discipline and related effects; in other words, transparency and disclosure towards financial markets, that represents only a limited set of provisions within our view of market conduct issues. Scott (2004, [42]) underlines how reliance on market discipline is not sufficient in presence of moral hazard and safety-nets systems and that regulatory restrictions could produce adverse effects on firms. Hoenig (1999, [15]) suggests that increased amount and complexity of disclosure do not necessarily increase their quality for market participants and emphasises the positive role of international standardisation towards risk-based supervision. Other authors highlight that the relevance of information disclosed could be misleading for the decisionmaking process of market participants (Kwan, 2002, [32]), as well as for supervisory purposes (Pop, 2004, [41]). Finally, Sironi (2003, [43]) has investigated the presence of market discipline in the European banking industry through subordinated debt issues.

Market discipline, therefore, means the extent to which markets influence the risk-taking activities of entities, through the use of information available to affect the pricing of traded securities. It should be noted, however, that enhanced disclosure does not automatically imply an enhancement of transparency and, as a last consequence, a more informed decision process from market participants.

Insurance sector. In the insurance sector some authors have verified the hypothesis that market participants influence the risk-taking activity of firms, often examining the life and non-life business separately, and how this process is influenced by regulatory behaviour. This issue is closely linked with the sensitivity of market participants to the insolvency risk of insurers (Harrington, in Borio et al, 2004, [3]). Sommer (1996, [44]) concludes that insolvency risk of non-life insurers is reflected in the prices of their policies. Epermanis and Harrington (2001, [5] and 2006, [6]) provide evidence of a negative relationship between premium growth and rating downgrades for non-life insurers, i.e. the existence of market discipline (although investigated for rated insurers only). Zanjani (2002, [45]), examining life insurers, supports the existence of market discipline by ordinary life policyholders, finding only weak evidence of adverse effects by guaranty funds. Finally, Harrington (in Borio et al., 2004, [3]) provided useful considerations about factors that can reduce the sensitivity of market participants to insurers' quality (like guaranty funds), whereas Bliss (in Borio et al., 2004, [3]) underlines those that might enhance this perception and related reactions (like systems of monitoring and incentives across market participants).

At this stage, academic literature has not improved our knowledge of market conduct issues comprehensively. Despite the useful evidence of these studies, their focus on market discipline and on measurable effects (only on rated insurers) are only partly of interest for our purposes and recommends the examination of other sources.

International supervision on market conduct

Contributions of international bodies have been examined to identify the main activities developed or under development on a cross-border and cross-sectoral basis.

OECD. The OECD provided a study on corporate codes of conduct across several countries and industries (1998, [35] and 2001, [36]) and related principles (2004a, [38]), with a general definition that is not fully satisfactory for our purposes. Moreover, the OECD, dealt in greater detail with a particular aspect of market conduct for insurance companies, issuing guidelines for best practices in claims management (2004b, [39]). Finally, the OECD is currently undertaking a project on consumer education, developing the contents of a previous document (OECD, 2005, [40]), and more recently explicitly on financial education (OECD, 2004, [37]).

Joint Forum. The Joint Forum provided a cross-sectoral comparison of principles developed by international bodies (Joint Forum [31]) and is developing further on the conduct of business issues. The picture provided, despite a trend towards convergence of supervision in banking, insurance and the securities industry, depicts a significant degree of heterogeneity, especially for market conduct (i.e., in the Joint Forum paper, market integrity and financial crime; customer protection; information, disclosure and transparency; and issuers of securities).

IOCSO, BCBS and IAIS. The International Organization of Securities Commissions issued principles on financial crime, disclosure, transparency and consumer protection that are applicable to the overall financial sector (IOSCO [30]). The Basel Committee on Banking Supervision, through its Basel II Accord (BCBS [2]), focused on market discipline and transparency issues. The IAIS issued several papers based on Insurance Core Principles (IAIS [19]) on market conduct aspects:

- public and enhanced disclosure (2002, [17]; 2004a, [20]; 2005b, [23]; 2006b, [27]);
- conduct of business (2003a, [18]);
- fraud, anti-money laundering, combating the financing of terrorism and the misuse of insurers for illicit purposes (2004b, [21]; 2005a, [22]; 2006c, [28]); and
- overarching standard setting papers (2005c, [24]; 2005d, [25]; 2006a, [26]; 2007, [29]).

Given the purpose of this paper, we avoid a detailed review of these contributions (only a limited discussion is presented later). However, it should be noted that the consistency of the work of the IAIS has influenced significantly the results of our research.

Regional specific experiences of market conduct

The experiences of the United States and the European Union have been examined to review their practices and to understand how they approached cross-border issues in market conduct regulation.

United States. In recent years, a broad discussion of market conduct issues has taken place in the US, especially because of the particular regulatory structure of their insurance market. Many organisations have underlined the potential benefits of common standards across States, both on the supervisory and the industry sides (for instance, IMSA, 2000, [16] and NAMIC, 2001, [34]). Despite the recent achievement of a model law for market conduct by the National Conference of Insurance Legislators (NCOIL), State regulators have paid limited support to its full adoption (NAIC, 2005, [33]). However, a greater degree of convergence in this field is under achievement and its growth is foreseeable for the near future.

European Union. In the EU, the framework on market conduct and its enforcement are fragmented and continuously developing (EC, 2005a, [9] and 2005b, [10]), with consumer protection as a primary objective (EC, 2001b, [8]). A clearer framework is foreseeable for the insurance sector after the completion of the Solvency II Project: market mechanisms play an important role for supervisory assessment (EC and and KPMG, 2002, [11]), but debate is heavily concentrated on capital requirements and supervisory review. Even recognising that sound market conduct should be part of good risk management frameworks, CEIOPS is currently not addressing directly this issue (CEIOPS, 2005, [4]) and regulation is left to individual jurisdictions (e.g., policyholders' protection in the UK, as part of the project named "Treating Customers Fairly": FSA, 2006a, [12] and 2006b, [13]).

Finally, it could be seen that the main concern under the third pillar is towards the relationship with the forthcoming Phase II of insurance contracts' accounting framework, to be developed by IASB (concerning, above all, disclosure and market discipline).

Market Discipline and Risk Sensitivity of Market Participants

From our literature review one could note that the most investigated market conduct issues are market discipline and sensitivity to risk of market participants (especially, the effects of safety nets such as guaranty funds).

Safety nets, guaranty funds and their effects on depositors' and policyholders' behaviour represent an issue shared by the banking and the insurance sectors. Guaranty funds prevent destabilising systemic effects but mitigate incentives for market participants to monitor their counterparts. However, in the insurance sector these effects are limited: such schemes, if present,

are often incomplete (i.e. not all lines of insurance are covered; deductibles, upper limits of cover and a significant time delay before the final settlement are often present).

Sensitivity to risk of market participants could be affected by other factors, such as their ability to assess the insolvency risk (mainly transparency opaqueness and costly search for information issues) and compulsory insurance requirements (that could push some policyholders to buy insurance regardless of the insurer's risk profile).

Market discipline, despite the focus in the literature, is only one of the elements of market conduct. Enhancing transparency has benefits for financial stability and provides an incentive to sound management, but it also affects the costs borne by entities, in terms of resources needed to respond to disclosure requirements (direct costs - amount and complexity of forms required; and indirect cost - potential competitive disadvantage in disclosing proprietary data). Moreover, the potential for benefits varies, depending on stakeholders' knowledge and skills on one hand, and the development and functioning structure of the capital markets on the other. Disclosure about capital adequacy, risk management and risk assessment does not exclude the need for other relevant information to market participants, especially from the point of view of customers. Financial assessment skills, as well as the lack of risk sensitivity, could negatively affect the usefulness of this information for customers.

Disclosure is a necessary tool of communication with external stakeholders for all institutions. The solvency assessment itself is part of the regulatory objective of protecting customers. But safeguarding of economic and financial interests of policyholders constitutes only a portion of their need for protection: unfair treatment, fraudulent activities and mis-selling, for instance, could take place even in a financially sound and transparent company. As such it will affect consumers' confidence in their counterpart. One could also say that perfect fairness towards market participants and corporate governance of entities could reduce the need for financial capital requirements. Therefore, oversight of the relationships between entities and markets is an integral part of prudential regulation and supervision.

Main Regulatory Practices in Market Conduct

The experiences of the US and the EU are useful in expanding our view on market conduct. In the former, the purposes of the ongoing process are mainly towards convergence in market conduct practices: lack of common standards across States produces duplication of work (for both the supervisor and the regulated entity) and difficulties in communication. The recent model law would require State regulators to examine a wide range of company practices (sales, underwriting, claims handling, etc.) to protect consumers from unfair conduct. Particularly, it addresses issues such as:

- establishing methods for collecting marketplace data consistently (market analysis);
- enhancing State collaboration (coordination and minimisation of resources absorbed);
- allowing domiciliary States to have responsibility to perform market conduct surveillance and setting forth a structure for performing targeted inspections (e.g. reviews of rates, forms and internal policies);
- setting forth a continuum of market conduct actions to be considered prior to undertaking targeted market conduct inspections (e.g. processing consumer complaints practices and revising licensing processes);
- enhancing measures of consumer education.

This experience underlines how inconsistencies, inefficiencies and costs associated with diverging standards could and should be eliminated: similar conclusions would be relevant also for global insurance markets, where regulation differs significantly and raises costs that are finally borne by customers, but affect supervisors and insurers as well.

As noted above, a common and understandable framework on market conduct in the EU is far from being achieved. Nevertheless, this issue should be resolved with the completion of the Solvency II Project. Without exceeding the scope of this paper, it should be noted that the regulatory framework in place focuses on business-customer commercial practices, not covering other areas with harmonised rules (such as marketing practices, design of contracts, payment and after-sale services). Moreover, specific directives addressing particular issues proved to be obsolete, because of the evolution of business practices, and are excessively fragmented. Developing the Solvency II Project, it has been underlined that disclosure is even more important for policyholders, if compared with the banking sector, since insurance companies are not dependent on one another as banks and insurers only have a marginal need for financing through external parties (other than policyholders). However, current developments of the Solvency II framework mainly focus on Pillar I and Pillar II requirements, and on disclosure issues under Pillar III.

It should be underlined how an enhanced disclosure does not imply necessarily an enhanced transparency, especially in the lack of proper education among customers, and provisions in this sense could therefore prove to be ineffective.

Proposed Definition and Morphology of Insurance Market Conduct

The starting point for our definition of market conduct is represented by the work of the OECD summarised earlier. The reference in their review of codes of conduct is to "*commitments* [...], *which put forth standards and principles for the conduct of business activi-*

ties in the marketplace", in other words sets of ethics (either internal to the company or set by national regulation or international standards) that regulate the behaviour of a company (in a broad sense, including employees and third parties acting on its behalf) while interacting with the market (again, in a broad sense, including all external parties, such as actual and potential investors, customers or, generally, stakeholders).

Despite other tentative definitions, expressed as lists (as emerged in many regulatory frameworks world-wide), this definition has taken a different approach leading to an extremely general terminology. Both types of definition do not work for our purposes, because they do not directly address connections with other fields of regulation and supervision, such as corporate governance, public disclosure, consumer protection, contracts' law, accounting and auditing. Secondly, the concept of behaviour is used in a broad sense, involving activities that fall under several regulatory headlines and possibly under the competence of more than one supervisor. Finally, the inclusion of reference to all stakeholders could involve also internal interested parties such as employees, moving into corporate governance rather than market conduct issues.

The most comprehensive picture of market conduct arises from the Insurance Core Principles issued by the IAIS (2003b, [19]), where the section on "Markets and consumers" deals with principles in four areas, closely linked with reputational risk and relevant for their prudential impact on markets:

- Intermediaries: given their role of connecting consumers and insurers, direct or indirect supervision of their conduct of business is necessary, aiming at protecting policyholders and promoting their confidence towards the industry;
- Consumer protection: minimum requirements in dealing with consumers (applicable also to foreign insurers) are required, especially regarding timely, complete and relevant provision of information;
- Information, disclosure and transparency towards the market: disclosure of timely and relevant information to stakeholders on insurers' business activities, financial position and risks assumed should be required;
- Fraud: provisions to prevent, detect and remedy insurance fraud at all levels, also on a cross-border basis;
- Specific issues: provisions towards insurance policies with significant investment components, anti-money laundering and combating the financing of terrorism.

The explanatory notes, as well as the essential and advanced criteria accompanying the principles, illustrate them in further detail. The IAIS developed further its Insurance Core Principles by issuing Principles, Standards, Guidance papers and their recent Overarching standard setting papers.

Focusing on reputational risk, for which no financial or capital requirement is actually forsee-

able, underlines the importance of other sets of provisions to protect customers and to promote their confidence towards the insurance markets (hence the interest of many emerging markets).

According to IAIS (2004b, [21]) and BCBS (2001, [1]), reputational risk is "*the potential that adverse publicity regarding an insurer's business practices and associations, whether accurate or not, will cause a loss of confidence in the integrity of the institution. Reputational risk could arise from other risks inherent in an organisation's activities. The risk of loss of confidence relates to stakeholders, which include, inter alia, existing and potential customers, investors, suppliers, and supervisors*". Accordingly, to IAIS, in our view this risk represents the liaison between the apparently heterogenous aspects of market conduct.

Especially in a business based on trust and confidence, reputation has primal relevance for corporate risk management. However, reputational issues may arise also due to poor management of other risks. Moreover, companies may suffer from a potential loss of market confidence due to adverse behaviour of other entities. Therefore, the quantification and management of reputational risk represents a difficult task for companies. At the same time, it represents an issue also for supervisors, that may experience the failure of the regulation in protecting policyholders, despite its soundness, only due to the disruptive effects of reputational risks.

The link between market conduct and reputational risks highlights how poor market discipline and consumer protection may increase the risk borne by the company, therefore influencing also the management and control of other risks, ultimately changing the solvency profile of the firm. This is mainly the reason underlying our strong support to the inclusion of market conduct, in its broad sense, as one of the main aspects of insurance supervision. Despite this inclusion, however, more research should be carried out to understand how reputational risks arise and are spread in the marketplace and the potential measuring and managing tools that could be effectively adopted by firms.

Summarising the previous discussion, the main components of market conduct regulation could be illustrated as follows, classified with reference to classes of market participants:

- acutal and potential policyholders (the most important recipients of this protection): involving, above all, aspects such as advertising activities, collection and supply of information, advice services, sale of insurance products, claims/disputes handling procedures;
- shareholders and other investors (financial markets): mainly, dissemination and contents of internal information to financial markets (public and confidential);
- partners, intermediaries and competitors (insurance market): primarily, fair competition and transparency of relationships, with particular reference to group transactions and reinsurance;

- supervisors and regulators: mostly, disclosure of confidential information and cross-border cooperation and exchange of information between authorities.

Despite the fact that disclosure towards financial markets, customers and supervisors often represents a legal requirement, behaviour of insurers might affect its accuracy and efficacy (timing, contents, co-operation, etc.). An international common set of provisions would enhance cross-border exchange of information between supervisors and comparability across firms.

These concepts and the main issues arising are summarised in the following Table 1.

Table 1: Market Conduct Morphology

STAKEHOLDERS	MAIN ISSUES
Customers Current and potential policy-holders	Customer protection Customer suitability Customer education Customer informatuion Claims handing systems Rules for particular products (with-profits, pensions, long-term care) Fair conduct of business Conflicts of interest Due skill, care and diligence (corporate policies) Privacy Protection Particular issues (fraud, money laundering, financing of terrorism)
Financial markets Shareholders, bondholders, rating agencies,...	Disclosure (market discipline: business, financial position, management, corporate governance and risks) Fair conduct of business Conflicts of interest Particular issues (fraud, money laundering, financing of terrorism)
Insurance market (Re)insurance companies, inter-mediaries, partners and competitors	Disclosure (market discipline: relationships and affiliations) Fair conduct of business Conflicts of interest Licensing/registering, Assessment of profesional knowledge, ability and reputation Reinsurance treaties Particular issues (fraud, money laundering, financing of terrorism)
Regulators/Supervisors Home-country and foreign regulators and /or supervisors	Disclosure (market discipline) Cross-border cooperation and exchange of information Paricular issues (fraud, money laundering, financing of terrorism)

From this morphological picture, we developed our proposed definition:

Market conduct: *involves the behaviour of an insurer and of those that act on its behalf towards stakeholders (potential and current policyholders, investors, other market participants), when its inappropriateness could impact their reputation, potentially affecting the confidence of market participants also towards other entities. Market conduct comprises market discipline (transparency and disclosure of company-wide financial information, corporate governance and risk management) and consumer protection (information and provisions addressed to customers).*

Not all the above aspects could be subject to effective international standardisation, other than high-level principles. Comparing several countries world-wide, insurmountable basic differences exist in country-specific regulatory frameworks. However, a common basis among supervisors and the industry to behave with regard to these issues could be a starting platform for building trust and benefits for both, and ultimately for policyholders.

The diversity of topics involved should be subject to further examinations of elements that could be regulated and others that should be left to general guidelines or high-level principles.

Some aspects included in our view of market conduct could have already been part of provisions related with other aspects of supervisory assessment and regulation. On one side, disclosure of financial information, corporate governance and risk management should be part of an enhanced disclosure system: in this way they would be able to enforce the level and quality of information provided to market participants. Moreover, provisions on internal policies, addressing aspects such as fair conduct of business, claims handling systems and conflicts of interest, may overlap with corporate governance regulation. This duplication should be avoided through the achievement of a structured and comprehensive solvency assessment framework, to minimise the resources needed by both supervisors and insurers.

Finally, many aspects of market conduct should be further examined in order to achieve a greater awareness and convergence of international insurance supervision. We underline the following:

- trade-off between applicable qualitative and quantitative provisions in managing reputational risks;
- incentives systems to enhance insurers' capability and willingness in dealing with these issues;
- separation of issues between the three blocks of supervisory assessment of market conduct provisions.

As far as our knowledge of reputational and contagion risks, of their effects and the cause-effect chain is limited, it is not feasible to employ financial or capital requirements to address the quantitative implications of market conduct, and focus should be kept to supervision of internal policies and diffusion of best practices.

Conclusions

In this paper we examined the aspects of market conduct regulation in the solvency assessment framework. Our aim is to achieve a definition and morphology applicable on a cross-border basis, in order to promote a greater international convergence of insurance supervision.

Examining the relevant literature and some significant regulatory experiences, we found that there is no common definition for market conduct and that provisions in this field vary widely across jurisdictions and business activities. Moreover, international standards and principles in the financial sector cover only some of the aspects involved. Insurance regulation, developed or under development in many countries, focuses heavily on solvency capital requirements and disclosure of information: apparently, there is little debate on the joint effects of all provisions related to solvency assessment.

Despite this fragmentation, we are strongly convinced that a common framework on insurance market conduct, in a business qualified by increasing cross-border and cross-sector operations, would have significant benefits:

- supervisors would benefit in terms of mutual exchange of information and limited duplication of work;
- insurers would benefit from an increased efficiency in complying with regulation in different countries;
- regulators and insurers would benefit from external experiences and best practices;
- consumers and other market participants would benefit from higher standards of protection, both quantitative and qualitative, and an improved quality of insurance products and services.

Therefore, we propose a comprehensive and specific definition of market conduct that is based on reputational risk towards market participants, avoiding open-end itemisation of hardly comparable issues. We aimed at including all relevant aspects of market conduct, allowing the establishment of clear links with the other fields of supervisory assessment, and enhancing the understanding of their joint effects.

We are aware that only part of the issues identified as relevant could be a target for international convergence, especially where country-specific aspects, such as contract law, differ

strongly. However, we underline that to achieve a thorough assessment all the joint effects of solvency regulation should be examined at the same time.

Finally, further research, in our view, is needed in the following areas:

- internal policies and procedures relevant for market conduct;
- the activities of advertising and advising insurance products, quantitative and qualitative information to be collected from customers, and to be provided to them, during all phases of the underwriting process;
- measures to prevent and remedy mis-selling of products, both from insurers and intermediaries;
- the fairness of claims and disputes handling systems;
- contractual rights of policyholders, requirements and guidelines suggested to enhance their disclosure and transparency;
- the fair conduct of business towards other market participants;
- guidelines for supervisory authorities to enhance policyholders' education efficiently;
- possibly, identify if more guidance for disclosure, internal procedures and policies should be developed for specific products, such as participating and with-profit policies, pensions or long-term care insurance schemes.

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