Keynote Address for MultaQa Qatar, 2012

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Dear colleagues, ladies and gentleman,

It's a great pleasure for me to have the opportunity of attending the MULTAQA QATAR 2013. During these days' discussions on how the insurance can cope with the current environmental challenges and maintain the momentum of growth at the same time, here I would like to share with you a personal assessment of the key strategic corporate implications of current regulatory trends.

Since the outbreak of the Global Financial Crisis, governments around the world have repositioned themselves with various fiscal policies, monetary policies and financial reform bills in attempts to regain the financial stability. International organizations such as the World Bank, IMF, the BCBS (Basel Committee on Banking Supervision), the IOSCO (International Organization of Securities Commission), and the IAIS (International Association of Insurance Supervisors) have also been vigorously exploring the future directions of their supervisions. A wave of regulatory reforms is unavoidable, in the light of the increasing interconnectedness of the macro and micro economics, diminishing barriers amongst financial sectors, globalized financial system, and more complicated financial tools.

David Cameron, Prime Minister of the United Kingdom, presented a report named "Governance for Growth: Building Consensus for the Future" at the G20 Cannes Summit in November last year. In this report, he urged the world leaders to generate political consensus through G20, strengthen the role of the Financial Stability Board, and reinforce the World Trade Organization in the multilateral trading system; and make the economic policy coordination more effective. In addition, he also proposed to make global governance more focused on delivering global growth.

In addition, German Chancellor Angela Merkel stressed in her opening address at the 42nd World Economic Forum Annual Meeting that, tightening fiscal policy will not resolve the European sovereign debt crisis. She suggested, if Europe wants to restore confidence in its viability, it needs a more aggressive employment policy and structural political reforms. She also indicated that reinforce supervision over large banks will not be sufficient enough to stabilize the financial system.

From the aforementioned points, we may conclude that while the supervisors commit to strengthening financial supervisory regulations, they need to simultaneously consider the overall economic growth and the development of the financial sectors in their countries.

Today, I would like to first take you through recent trends of international financial regulation reform and then propose a recommendation, which could effectively take into account both the industrial development and solvency while undergoing reforms.

Trends of international financial supervision reform in the recent years

The trends of international financial supervision reform may be divided into the following four aspects:

From solo-supervision to group-wide supervision:

As financial institutions expand and internationalize, the traditional principles of solo supervision could not oversee the risks that are associated with the wider group of which companies are part, either due to the level of group connectivity or interdependency. Therefore, the strengthening of group-wide supervision is taken as one of the key elements in the 2011 IAIS Insurance Core Principles, and the Solvency Modernisation Initiatives by the NAIC as well. In addition, the Joint Forum also released a consultative paper on Principles for the supervision of financial conglomerates.

From micro-prudential supervision to macro-prudential supervision:

The basic concept of micro-prudential supervision is that for the financial system be sound, it is necessary and sufficient that each individual institute is sound, based on the assumption that the problem occurred in an individual company would not spillover to other companies, let along the industry.

However, in the wake of the Financial Crisis in 2008, we learned that a spillover could be inevitable under some extreme conditions. Therefore, much of the attention has been shifted to macro-prudential supervision, which aims to diminish the problems caused by financial instability and prevent negative impacts on economic development. For examples, the IAIS established Financial Stability Committee in 2009, the United States founded Financial Stability Oversight Council in 2010, European Union created the European Systemic Risk Board in 2011, to identify systemic risks in the market and make recommendation to strengthen supervision.

From single-sectoral supervision to cross-sectoral supervision:

Most supervisors and insurance companies agree that traditional insurance business does not pose a systemic risk and was not the cause for the financial crisis. Geneva Association, NAIC and IAIS have all put forth similar views. However, in additional to the catastrophic losses of certain large financial institutions, the financial crisis also brought tremendous impact to real estate market, loan market, stock market, foreign exchange market, interest rates, and global economies, thus affecting the insurance company's investment return, asset allocation performance, and the consumer's purchasing power. This is an implication that, a tight collaboration amongst banking, insurance and securities supervisors should be the key to determining the effectiveness of the overall financial supervisory system. A good example of cross-sector financial supervisory cooperation could be the Joint Forum, which is formed by three international supervisory organizations - BCBS, IOSCO, and IAIS – to work on cross-sectoral issues.

From individual jurisdiction supervision to cross-border supervision:

Due to the diversification of risk features and the globalization of the insurance business, it has become impossible for a supervisory authority of a single country to effectively monitor the transnational institutions. CEO of NAIC Dr. Theresa Vaughan, pointed out in a presentation in September 2011 that, "--- there are different regulatory systems and approaches around the globe, so regulatory convergence must involve arriving at common outcomes and not necessarily at universal standards or structures. Moreover, global convergence should heavily focus on information sharing." Thus, strengthening international information exchange and cooperation becomes an important issue to financial supervisors.

In response to this issue, IAIS adopted three measures: first, established related ICP (Insurance Core Principles). For example: ICP 3 Information Exchange and Confidentiality Requirements, ICP 25 Supervisory

Cooperation and Coordination, and ICP 25 Cross-border Cooperation and Coordination on Crisis Management enhance supervisory cooperation among jurisdictions. Secondly, IAIS encouraged supervisors or authorities of different jurisdiction areas to sign the MMoU (Multilateral Memorandum of Understanding) to foster information exchange. Thirdly, IAIS initiated the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) on July 1, 2010, through which it aims to supervise the business structure, activities and specific risks of IAIGs from the perspective of risk management, establish qualitative and quantitative supervisory requirements for IAIGs, and furthermore set grounds for better international supervisory cooperation and interaction.

ICP 1 states that the objectives of supervision promote the maintenance of fair, safe and stable insurance markets for the benefit and protection of policyholders. And the regulation trends that I just mentioned were supervisory authorities' endeavor to correct the insufficient governance over group-risks, solvency, capital adequacy and protection of policyholder rights. As regulation requirements become stricter than ever, what do you think would be the reactions of insurers?

Insurance Industry's reactions to regulatory reforms

I would like to share with you recent reports by three international consulting firms:

The first report came from Ernst & Young. Ernst & Young began publishing the Business Risk Report in 2008. According to the Business Risk Report 2010, "Regulation and Compliance" was listed as number 1 threat to financial service sector. They expressed concerns that this could result in an over-regulated sector and greater protectionism, preventing global firms from effectively operating across borders.

The second report is the bi-annual Global Risk Management Survey published by AON in 2011. In this report, the regulatory or legislative changes ranked number 2 of the top 10 risks, trailed behind only that of Economic slowdown. It is worth mentioning that, survey respondents from financial industry indicated they have invested significantly high cost in response to the regulatory and legislative reforms. Taking the example of European insurance industry, it will cost estimatedly 3 billion Euro to implement Solvency II.

The third survey report is the PwC's Insurance Banana Skins published in 2011. According to the survey result, Regulation and Capital are listed as number 1 and 2 risks facing the insurance industry, respectively. Survey respondents indicated that they are concerned about the burden of regulation, which is being placed by a wave of regulatory reforms in particular the EU's Solvency II. Furthermore, the scale of the new capital requirements is such that the industry could end up being hindered by them rather than helped.

These three reports consistently reflected the financial or insurance respondents concerns on the impact that may arise from this wave of regulation reforms.

I would like to also share my experience at the 3rd CEA International Insurance Conference in 2011. From the survey on the biggest concern of the insurance industry on regulation and supervision reforms, the higher capital requirement ranked the highest concern.

As set out in the Financial Services and Markets Act 2000 (FSMA), the FSA-UK proposed a few principles that would deploy a good regulatory and supervisory system:

- The supervision is based on a cost-benefit analysis so that the resources can be used in the most efficient and economic way;
- A firm's senior management is given clear management functions of risk management and control;
- The supervision is applied with proportionality taking into account the insurers' nature, scale and complexity;
- The goals of the supervision and measures are transparent and understood by the insurers;
- The supervision is in an ever-evolving process so as to cope with the market dynamics;
- A good regulatory and supervisory system should help develop a competitive and fair insurance market that the consumer's right is well covered.
- The international characters of the business are taken into consideration by the supervisor and the supervisor cooperates with involved supervisors closely, and both agree the international

supervisory standards.

However, the outbreak of financial crisis has shaken the public and supervisory authorities' confidence in financial industry. Additional regulation measures are thus imposed. But on the other hand, financial institutions including insurers are concerned that these regulations may burden their operation and hinder future growth. I believe the first step towards establishing regulations that balances both the growth of industry and maintaining solvency is to rebuild the mutual trust between insurers and supervisory authority.

Insurance is a form of risk management primarily used to hedge against the risk of a contingent, uncertain loss, by pooling funds of many insured of the same policy. Insurers thus have commitments of future liabilities to policyholders. The operations of insurers will involve the principal-agent risks found between management teams and stockholders as well as between the insurers and the insured.

In addition, it takes more than a single supervisory authority to maintain financial stability of a country. It requires certain preconditions, including the existence of an effective market discipline. For example, the insurer should provide sufficient disclosure of information.

Therefore, the sound development of the insurance market relies heavily on the integrity of each insurer on top of the regulations imposed by supervisory authority. In other words, the soundness of the industry can only be maintained through insurers' good practice of self-discipline and market conduct. For instances, design fair and justifiable insurance products, strengthen company's financial soundness and capital adequacy, establish a good corporate governance and risk management mechanism, disclose sufficient financial information, and protect consumer rights.

As previously mentioned, the objectives of supervision promote the maintenance of fair, safe and stable insurance markets for the benefit and protection of policyholders. The key to deepening mutual respect between insurers and supervisory authorities is that insurers must first develop a good self-discipline policy and practice it, so that an effective communication channel could be built based on this mutual trust.

It has always been a supervisory authority's best interest to develop a sound and stable environment for insurers to grow. I believe we can close the gap in understanding the regulations through the process of communication that is based on mutual trust. Hence, we can construct supervisory regulations that are based on the globally-consistent ICPs yet aligned with the societal, economic and cultural characteristic of the local, and lead us to a win-win situation where both soundness of the industrial development and solvency can therefore be achieved.