

Remarks of Jerry de St.Paer

Chairman

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Roundtable: Challenges in Asian emerging markets

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I'd like to thank the Chinese Insurance Regulatory Commission (CIRC) and the International Association of Insurance Supervisors (IAIS) for the opportunity to give this presentation today.

I am proud to have spent most of my career in insurance because of the impressive contribution that insurance makes to society.

However, I have sometimes found that this contribution is not always properly communicated by the industry or fully appreciated by our stakeholders and critics.

Life is uncertain. Exposure to risk is inherent in all aspects of daily life. Yet risk also offers opportunities to individuals, businesses and society as a whole. It allows us to lead fuller lives and makes life more interesting as well as more prosperous.

However for risk to work in our favour, we need to be able to understand and manage it effectively. Of course, insurance helps individuals and businesses manage risk. It provides security against damage and theft of property, protects health and well being, and gives business and individuals the freedom to prosper.

Today I'd like to discuss the contribution insurance makes to the individual, economy and wider society in China and in Asia and I would like to comment on the important role that will be played by the current efforts to develop international standards for insurance accounting and solvency in this contribution.

China now approaches the seventh year of its entry into the World Trade Organization (WTO). The Ministry of Commerce and related government authorities should be congratulated on their excellent efforts, accumulating in a tremendously successful implementation of the WTO agreement!

The initiatives in the Ten Point plan, proposed by CIRC Chairman Wu Dingfu approved by Premier Wen Jiabao tie well into my remarks today. As you are all aware “the Ten Point plan” was a crucial step taken by China to accelerate the development of the insurance industry. It will cast a profound effect on the development of the Chinese insurance industry, economy and society going forward. And, they represent a model for other economies.

Insurance is part of the 'hidden wiring' of society.

- It helps to make our homes, workplaces and roads safer places.
- It helps to drive up security standards for our homes, businesses and vehicles.
- It helps to promote good health and 'piece of mind'.

Because of insurance,

- Individuals and businesses do not need to retain high levels of liquid wealth as a hedge against risk. This wealth can therefore be used more productively.
- Individuals and business can purchase high-value items, which would otherwise simply carry too much risk.
- Those who have suffered an accident or illness, been victims of crime or experienced storm damage benefit from invaluable assistance.

However, although paying claims is often the most tangible effect that policyholders think insurance has on their daily lives this is only part of insurance's contribution.

Understanding and assessing risk is an important function of insurance. Taking positive action to mitigate or prevent a loss makes clear sense for insurers as it reduces the likelihood of a claim. It also works in the policyholder's favor as it may help them to avoid the stress and trauma of a burglary, illness or workplace accident. The added incentive for the policyholder is that insurers will take this into account when rating a risk and this is likely to result in a lower premium.

And insurance is evolving as risk evolves. Risks that were previously uninsurable can now be insured as insurers' understanding of risk, and how to price the appropriate protection, develops. Better risk pricing helps both insurers and customers by achieving fairer premiums.

As well as encouraging policyholders to take measures to mitigate losses or their severity, it enables some people to get insurance who could not previously do so. We see this with medical insurance where people with pre-existing conditions who would not previously have been able to obtain cover are now more likely to be able to. This is possible because insurers have more accurate information about these risks and can price them accordingly.

Insurers play an important role in the schemes co-sponsored by the government. At IAIS/CIRC/World Bank meeting this week, there will be a two-day conference describing the progress being made in the development of micro-insurance, or insurance for the rural poor.

Following twenty years of success in micro-finance, the insurance industry is working with governments and non-governmental organisations all over the world to bring its product to those who could not even consider it in the past. This is also being done with the participation of the World Bank in its effort to break the cycle of poverty by encouraging different approaches for different sectors of the economy.

This is consistent with the Chinese desire to come up with a “Chinese” solution for many of its problems, while interacting with international bodies and industries in their development.

These schemes benefit not only the insured farmer but also the community directly and indirectly in terms of maintaining agricultural production and rural employment and contribution to economic growth. All the rural insurance schemes, operated on a commercial basis, are designed ultimately to provide the same type of security for the rural families as is currently available for mainstream businesses and individuals able to participate in the traditional insurance system.

Working with governments and other participants, the insurance industry has devised special insurance schemes, at subsidized rates of premium, to cover cattle and other livestock for the beneficiaries of such schemes and various other government sponsored programmes and financial institutions.

These in turn have made our homes, vehicles, workplaces and our lives safer, less risky and more secure.

Insurers play a significant role in enhancing the efficiency of the economy.

They:

- Act as a major instrument for the mobilization of saving of people, particularly from the middle and lower income groups. These savings are channelled into investments for economic growth. The management of insurance assets has become an important factor in promoting healthy development of the Chinese industry.
- Reduce the transaction costs of bringing savers and borrowers together;
- Create liquidity through the use of income to provide long-term capital;
- Facilitate economies of scale in investment through their role as major institutional investors;

- Support banks and financial institutions on the basis of the collateral security of insurance when they lend money to industrial and commercial undertakings. No bank or financial institution would advance loans on property unless it is insured against loss or damage by insurable perils.
- Promote high standards of corporate governance in the firms in which they invest; and
- Support the property market in a variety of ways.

The system of insurance provides numerous direct and indirect benefits to the individual and his family as well as to industry and commerce and to the community and the nation as a whole.

But as well as these practical benefits, the insurance industry's assessment of risk can make it a 'messenger of change'. By this, I mean that the industry's expertise in risk assessment can act as an important barometer about the changing nature of risk itself. This in turn can be used to alert government to the need for social action in order to manage risk effectively.

If insurance didn't exist, the economy would look very different:

- Businesses would need to maintain larger liquid reserves to cover potential losses. This would divert capital from other projects and reduce money available for investment;
- Innovation in technologies and products would be stifled because the ability to spread risk would be diminished.

- Failure could result in bankruptcy; and
- Investors would tend towards safer investments. This would mean 'riskier' ventures, such as investments into Central and Western China, would be unlikely to find the financial backing they required.

Given the continuing evolution of international standards for insurance accounting and solvency, we need to debate the impact of these prospective standards on industry capital levels, rates of return, model driven earnings volatility, access to capital and thereby impact on the price and availability of insurance capacity and the impact on the demand for it.

For instance, proposals by the International Accounting Standards Board would require non-life insurance companies to discount claim reserves. Current Chinese standards for insurance company regulations do not permit non-life companies to discount their claim reserves. The recent appointment of Zhang Wei-Guo to the International Accounting Standards Board will help in allowing the international standard setting community to understand there is more to its consideration.

Similarly, the European Commission has proposed a Solvency Directive that would seriously impact the ability of insurance companies that are headquartered outside of Europe to compete for business in Europe. The North American industry strongly opposes these measures and we would encourage the Asian industry to review them and determine if they will have the same negative impact.

Solvency regulation and accounting regulation walk hand-in-hand – but they are not identical twins. The conventional wisdom is that general-purpose accounting expresses the condition of the company to support the needs of stockholders while solvency accounting expresses the financial condition of the company to support the needs of policyholders. But, shouldn't the stockholders see a view of the company that illustrates whether the company is able to meet its obligations to policyholders. What good is a statement that clouds or misrepresents that information?

Recognition of gains upon the issuance of an insurance contract is an item that is of serious concern to us and we believe should be to you. The IASB discussion paper suggests that it is acceptable to recognize a gain upon the issuance of an insurance contract.

Those familiar with recent accounting scandals might call this “ENRON accounting”. The IASB argues that these gains will be infrequent and insubstantial.

However, the European Chief Financial Officers Forum testified before the International Association of Insurance Supervisors Insurance Contracts Committee in August 2007 that this could amount to an initial figure of \$7.5 Billion and might be recurring in greater amounts.

The IASB further argues that the principle of allowing premium deficiency reserves upon issuance demands a parallel principle for allowing such day-one profit recognition. We believe this is not responsible regulation (principles based or otherwise).

GNAIE strongly opposes any gain on the issuance of an insurance contract. Not only does it misrepresent the financial performance, but it also misstates the solvency position of the company and could be extremely misleading to regulators.

If you are a stockholder of an insurance company, you want to get information on the financial performance of the company that is clear and expresses information based on the method that the insurer uses to do business. Not a form that may work for shoe manufacturers.

If you are a regulator of an insurance company, you want to get information that accurately expresses the financial condition of the company, not information that inappropriately puffs up the balance sheet.

We look forward to the upcoming discussions with the IASB and insurance regulators.

In many comments previous to this meeting, Chairman Wu Dingfu has mentioned CIRC's emphasis on four types of insurance: agriculture, private pensions, health and liability.

Despite great improvements in China's regulation of insurance, Chairman Wu in meetings with the NAIC last May noted the need for improvements necessary to adequately protect China's citizens.

We agree and know that these proposed Solvency and Accounting standards would not only increase the safety of insurance companies, but, in having safe companies, increase the capacity of the insurance industry to expand into these new markets.

One final note and one that can impact the ability of the average person in China to plan for the future.

At the recent OECD Conference in Beijing last November, Chairman Wu gave an opening speech on ‘Developing Insurance to Reinforce China’s Retirement Income System’, covering the following topics: radical economic and social changes in China; the important role of the insurance industry in China; the important role of insurance companies in pension provision in China; and challenges faced by China’s insurance companies.

Chairman Wu pointed out that the traditional pension system is not sustainable in the long run, largely caused by new challenges arising from industrialisation (e.g. the weakening role of informal family support), new challenges from urbanisation (e.g. 150 million migrant workers, most of them not covered by the urban pension system), challenges from marketization.

Again, we cannot solve all these problems today. A journey of one thousand miles starts with the first step. Today we take a step in bringing leaders together from around the world. With all of us working together, we will step forward to tomorrow.

In summary, insurance is an industry that is fundamental to the economy, both in terms of its contribution as a sector and the support it offers to business in general.

Insurance helps individuals to live through what are often some of the most difficult experiences of their lives and learns lessons which lead to continual improvements in people's daily lives.

Thanks again to the CIRC and the IAIS for this opportunity to present our views to you.

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