

## The Impact of the Global Financial Crisis on the insurance industry

Some Food for Thought – an Asian perspective

A presentation for the Singapore Appointed Actuaries Symposium  
by Mark V T Saunders, FIA, FIAI, FSA, FSAS, FSAT

4 November 2010

# Mark Saunders, FIA, FIAI, FSA, FSAS, FSAT



## Snapshot of experience

Mark Saunders is a Managing Director of Towers Watson. He is the Managing Director of Towers Watson in Hong Kong and also Managing Director and Practice Leader of the Risk Consulting & Software Business for Asia Pacific.

He has been working in the insurance industry since the 1980's and in Asia since 1989. He moved to Hong Kong in 1994. Before joining Towers Watson (previously Tillinghast) in 1997 he was Asian Regional CEO and Executive Director Board Member of international life insurance operations ("CMI") of a UK-parented insurer ("Clerical Medical") including their joint venture in Korea ("Coryo-CM").

Mr Saunders has led more than 200 actuarial appraisal value assessments of Asian insurers spanning every major insurance market in Asia and is widely regarded as a leading practitioner in economic value determination and Mergers & Acquisitions of insurers in Asia. Mr Saunders has been involved in nearly every major M&A deal and capital raising exercise of insurers in Asia for more than the last decade.

High profile roles in the public domain where publicly named include:

- He provided the Actuarial Expert Opinion in the Prospectuses for the ground-breaking IPO of China Life (dual listing in New York and Hong Kong as well as the subsequent A-share listing in Shanghai).
- He was the lead actuarial consultant in the capital raising exercises for other leading state-owned insurers, Korea Life and Vietnam Life.
- He was the Expert Actuary for the Actuarial Consulting Report in relation to Great Eastern's Circular to Shareholders in relation to OCBC's voluntary unconditional offer.
- He provided the Actuarial Expert Opinion in the Prospectus for the inaugural domestic IPO of China Pacific in Shanghai as well as the recent subsequent listing in Hong Kong.
- He provided the Actuarial Expert Opinion in the Prospectus for AIA for its recent listing in Hong Kong

Mr Saunders has been the Appointed Actuary for ten insurers in Hong Kong, Singapore and Vietnam. He was the inaugural Appointed Actuary for the state-owned insurer, Vietnam Life ("BaoViet Life"). He also performs mentor roles for Appointed Actuaries new to the role in Asia. He also carries out Peer Review of Appointed Actuaries' duties for seven insurers in India. And he has provided Independent Actuary opinions for High Court sanctioned insurance business transfers and successful Expert Witness testimonials in the Court of First Instance.

Mr Saunders has undertaken memberships of numerous insurance-related, actuarial, regulatory and professional committees throughout Asia.

# Outline – The Crisis and Some Food for Thought

1. **Some views on CAUSES**
2. Some views on IMPACTS
3. Some REACTIONS to the economic downturn...
4. How to fare better...
5. Some experiences...
6. Lessons learned...
7. Three specific areas on which actuaries **MUST** have views...
  - M&A and AIA
  - Market-consistent valuations
  - Risk, Reward and Responsibility
8. And finally ...
  - Common sense and getting the basics right
  - Asian perspective and messages

## But first – “hot off the press” ASHK’s 10<sup>th</sup> Appointed Actuaries Symposium, 3 Nov 2010

- Observations to support view that GFC has affected the Hong Kong insurance industry:
  1. ASHK Circular on interpretation of valuation interest rate regulation
  2. MPFA reclassification of Class H (Pensions)
  3. AIG event, impact on AIA and market (also capital pressure for other mncs)
  4. Increased regulation around sales practices under the umbrella of “consumer protection”. And other related initiatives such as PPF, IIA, Commission Disclosure, RBC, ...
  5. Heavier hand from the SFC. Impact on product development...
- Other: Risk awareness, product demand, dividend cuts, capital issues, improved RM, expense focus, war for talent ...

## Asian perspective and messages

1. Asian Financial Institutions fared relatively well
2. Asia the future powerhouse
3. Where's our voice?
4. Actuaries in Asia
  - THE Risk Specialists ... "Opportunity Optimisers"
  - Let's grasp the opportunity!



*Weiji*

危机

- (Many westerners love assuming that the Chinese characters for CRISIS combine DANGER and OPPORTUNITY. As with many things this is an over-simplification and not quite correct or fanciful at best ... but is a compelling way to get an important message across...)

## Some views on CAUSES

- Fundamental cause
  - “...overextension of credit and mispricing of risk...”
- But why?
  - Regulatory regime shortcomings ???
    - Lack? Poor? Over-? ...?
- *Greed?*
- *Inappropriate reward systems?*
- *Cheap money?*
- *Poor risk assessment?*
- *Macro-economic imbalances*
- *Financial creativity?*
- *Over-complexity?*
- ***Lack of common sense!***

# Outline – The Crisis and Some Food for Thought

1. Some views on CAUSES
2. **Some views on IMPACTS**
3. Some REACTIONS to the economic downturn...
4. How to fare better...
5. Some experiences...
6. Lessons learned...
7. Three specific areas on which actuaries **MUST** have views...
  - M&A and AIA
  - Market-consistent valuations
  - Risk, Reward and Responsibility
8. And finally ...
  - Common sense and getting the basics right
  - Asian perspective and messages

## Some views on IMPACTS

- *Solvency?*
- *Profitability?*
- *Capital?*
- *Risk?*
- *Value?*
- *Assets?*
- *Liabilities?*
- *Liquidity?*
- *Revenue?*
- *Business?*

*PEOPLE...*  
*Insurance is a people business*



# Outline – The Crisis and Some Food for Thought

1. Some views on CAUSES
2. Some views on IMPACTS
3. **Some REACTIONS to the economic downturn...**
4. How to fare better...
5. Some experiences...
6. Lessons learned...
7. Three specific areas on which actuaries **MUST** have views...
  - M&A and AIA
  - Market-consistent valuations
  - Risk, Reward and Responsibility
8. And finally ...
  - Common sense and getting the basics right
  - Asian perspective and messages

## Some reactions... 1 of 2

- **CEA, November 2008: “Eight key messages on the financial turmoil”**
  1. The European insurance industry entered the crisis in a strong position and has shown resilience to the continuing shocks to the financial system.
  2. The business model of the insurance industry differs substantially from that of other financial services providers.
  3. Solvency II will ensure insurers and supervisors have better tools to resist financial crises.
  4. The financial turmoil demonstrates the need for appropriate supervision of financial institutions at group level.
  5. Risk management should be developed and strengthened in all financial institutions
  6. The market-consistent valuation of assets should remain the principle that underpins financial information and prudential oversight. At the same time, it is important to avoid pro-cyclicality in accounting and prudential rules.
  7. The current market turmoil should not lead to undue constraints on insurance-linked securitisation.
  8. Better information disclosure about complex products is essential.
- **The Geneva Association, 30 March 2009, Press Release. “51 CEOs of major global insurance companies call for effective and efficient industry regulation and supervision”**
  1. Insurance is vital to the economy; its business model has proven resilient
  2. Maintaining financial stability is of utmost importance
  3. Regulatory frameworks need to reflect the differences between insurers and banks
  4. The importance of strong corporate risk management has been clearly demonstrated
  5. Accounting systems need to be adapted in times of extreme illiquidity

## Some reactions... 2 of 2

- **CRO Forum, April 2009: “Insurance Risk Management Response to the Financial Crisis”**
  1. Integrated Risk Governance
  2. Risk Models
  3. Liquidity Risk Management
  4. Valuation and Risk Disclosure
  5. Group Supervision
- **Pan European Insurance Forum, Insurance View: “Regulatory Consequences of the Financial Crisis Insurance is vital to the economy; its business model has proven resilient**
  1. Financial Crisis and Regulation
  2. Specificity of Insurance...
  3. ...largely determines the impact of the financial crisis on insurers
  4. Policy Recommendations
    - Public policies should provide incentives for sound risk and capital management
    - Large complex financial institutions have to be supervised in their entirety
    - Regulators must step up their efforts to achieve convergence in accounting standards
    - Transparency regarding financial products has to be improved
    - Government interventions must not distort markets
  5. Conclusion: The Insurance Industry has to make its voice heard.

## Some actions taken ...

- **Some common solvency/capital response actions taken:**

- Bonus/dividend action
- Access reinsurance “on tap” to allow business to continue
- Capital raising (parent, external)
- Derisking
  - change mix
  - derivative protection
  - reinsurance
- Sales of (blocks of) business (or product line closure or emphasis change)
- Cost cutting
- Refocus on getting the fundamentals right ... value creation and optimisation
- ...

- **Some less common actions:**

- Attack the best form of defence? (Opportunity graspers)
- Position for recovery ...

# Outline – The Crisis and Some Food for Thought

1. Some views on CAUSES
2. Some views on IMPACTS
3. Some REACTIONS to the economic downturn...
4. **How to fare better...**
5. Some experiences...
6. Lessons learned...
7. Three specific areas on which actuaries **MUST** have views...
  - M&A and AIA
  - Market-consistent valuations
  - Risk, Reward and Responsibility
8. And finally ...
  - Common sense and getting the basics right
  - Asian perspective and messages

## How to fare better in practice ...

- Fire drill...
- Rather than trying to decide what to do in the heat of a crisis, clearly it's better to have thought through the situation and had a dry run through beforehand....
  - (But everyone's done it for real now, right !?!) 😊
- Australia: Figure it out ... Traffic lights ...
  - Simulation ... notify people ... call sub cttee meeting
  - Produce reports ... Actions ....
  - Governance, reporting, conflicts, ... which hat?
    - change procedures for such an extreme situation ...

# Outline – The Crisis and Some Food for Thought

1. Some views on CAUSES
2. Some views on IMPACTS
3. Some REACTIONS to the economic downturn...
4. How to fare better...
5. **Some experiences...**
6. **Lessons learned...**
7. Three specific areas on which actuaries **MUST** have views...
  - M&A and AIA
  - Market-consistent valuations
  - Risk, Reward and Responsibility
8. And finally ...
  - Common sense and getting the basics right
  - Asian perspective and messages

## Some experiences and lessons learned...

- Some “common” pearls of wisdom:
  - Appropriate disclosure can contribute to restoring stakeholders’ confidence
  - Insurers will give greater emphasis to credit risk analysis and increase their focus on liquidity risk
  - Insurers may lose their appetite for complex securities if required to use exit values which have a heavy adverse impact on their capitalisation. And could also reduce appetite for non-structured but illiquid assets
  - Sensitivity and stress testing will become more prevalent...
  - ...
- Some good ...
  - Greater awareness of risk and, eg, what a 1 in 200 event could mean and might look like...
  - In times of distressed markets, pragmatism required (and accepted)...
  - Accountancy rules can have undesired/unintended consequences
  - Models (and hedging/mitigation) cannot cover everything
  - Complex does not mean good ... common sense should prevail



## Some experiences and lessons learned...

- Some real-life experiences from hands-on practitioners:
  1. Regulatory capital becomes a key measure during a crisis – wake-up call !
  2. Regular processes were NOT
    - timely enough
    - sufficiently attuned to managing specifics of regulatory capital
  3. Quick and dirty measures and methods created. (Disappointing after so much expended!)
    - Better roadtests under pressure required
  4. Lack of detailed knowledge of and management under regulatory capital rules
  5. Wrong decisions around the bottom and miss the benefits of recovery
  6. Contagion risk is real !
  7. Supply of capital is equally important as demand
  8. Importance of ALM. Capability gap.
  9. Establish KPIs that let you see business problems early...
  10. Rather than being a lemming, consider being a contrarian...

# Outline – The Crisis and Some Food for Thought

1. Some views on CAUSES
2. Some views on IMPACTS
3. Some REACTIONS to the economic downturn...
4. How to fare better...
5. Some experiences...
6. Lessons learned...
7. **Three specific areas on which actuaries MUST have views...**
  - **M&A and AIA**
  - **Market-consistent valuations**
  - **Risk, Reward and Responsibility**
8. And finally ...
  - Common sense and getting the basics right
  - Asian perspective and messages

# M&A -- Some media headlines ... Reactions ?

- “Three European insurers exit Taiwan”
- “Prudential pays S\$428 million for UOB Life”
- “AXA to double the size of it’s Asian business”
- “ING to dispose of its insurance unit and Korea is the jewel in the Asian crown”
- “MaxNYL sheds 4% pie to Axis Bank”
- “AIA to IPO in Hong Kong”
- “Met to acquire ALICo for US\$15.5 billion”
- “AIG to sell Taiwanese operation Nanshan for US\$2.15billion”
- “Prudential to pay US\$35.5 billion for AIA”
- “Prudential to pay US\$1 billion in advisor’s fees”
- “New York Life to exit China”
- “Prudential offer reduced bid of US\$30.4billion for AIA but AIG reject it”
- “AIA IPO back on”
- “Chinese consortium to buy AIA”
- “Taiwanese regulators prohibit Nanshan US\$2.15billion sale”
- “AIA to raise US\$20billion in first IPO tranche”
- “Prudential Financial to pay US\$4.8billion for AIG’s Japanese units”
- “ACE said to be in talks for New York Life’s Asian units”
- “ACE buy NYL’s HK and Korean businesses for around US\$425 million”
- “AIA up 17% on first day of trading”
  
- In short, high activity and we will see many deals as the above headlines are the tip of the iceberg and a catalyst for action...
  - There has always been relatively high M&A activity in Asia over the last fifteen or so years but few exercises have resulted in deals...
  - A hinderance has been different perspectives and expectations of sellers and buyers...
    - And, candidly, not all actuaries and advisors involved have covered themselves in glory...

## M&A -- Key landscape changes:

- The relatively high number of recently completed deals and listings provides more transaction and valuation data points for Asian businesses than ever before
- The AIA listing provides more comprehensive disclosure and details relevant for Asian businesses than have been available in the public domain ever before and will likely continue to do so going forward
- All future transactions and assessments of economic value in Asia will be compared against these
- As an actuary you must gain as much intimate knowledge of the assessments of value as possible
  - **Must do: Read the AIA Prospectus**

## M&A -- Benchmarks? Help or hinder?

	AIA Australia	AIA China	AIA HK	AIA Indonesia (US\$ denominated)	AIA Indonesia (Rupiah denominated)	AIA Korea	AIA Malaysia
Risk discount rate	8.75%	10.00%	8.00%	12.50%	17.00%	11.00%	9.00%
Expected long term rate of inflation	3.25%	2.00%	2.00%	6.00%	6.00%	3.50%	3.00%
10 year Government bond yield	5.75%	3.74%	3.83%	--	8.94%	5.16%	4.46%
	AIA New Zealand	Philam Life	AIA Singapore & Brunei	AIA Taiwan	AIA Thailand	AIA Vietnam	
Risk discount rate	9.00%	14.00%	7.75%	8.00%	10.00%	16.00%	
Expected long term rate of inflation	2.00%	4.50%	2.00%	1.00%	2.00%	5.0%	
10 year Government bond yield	6.30%	7.47%	2.93%	1.73%	4.16%	9.25%	

**Useful ... but beware ... Many moving parts, components, and considerations  
Any measure in isolation is dangerous...**

**In addition to what is here, what is not here!?!?**

Source: AIA Prospectus 29 October 2010

# Market-Consistent Valuations

- “Market-Consistent Valuations and Solvency II: Implications of the Recent Financial Crisis” --
  - By Kamran Faroughi
  - Presented at the UK Actuarial Profession Open Forum, Staple Inn, 16 September 2010

Some conclusions of and insights from the paper...

- Mark-to-market accounting has been questioned
- Market-consistent valuation techniques use is likely to grow
- Designing and applying a fuller financial reporting information pack
- Need for capital-based metrics, cash flow projections, RoC, IRRs...
- Some difficult technical challenges
- Mitigating procyclicality

# Risk, Reward and Responsibility

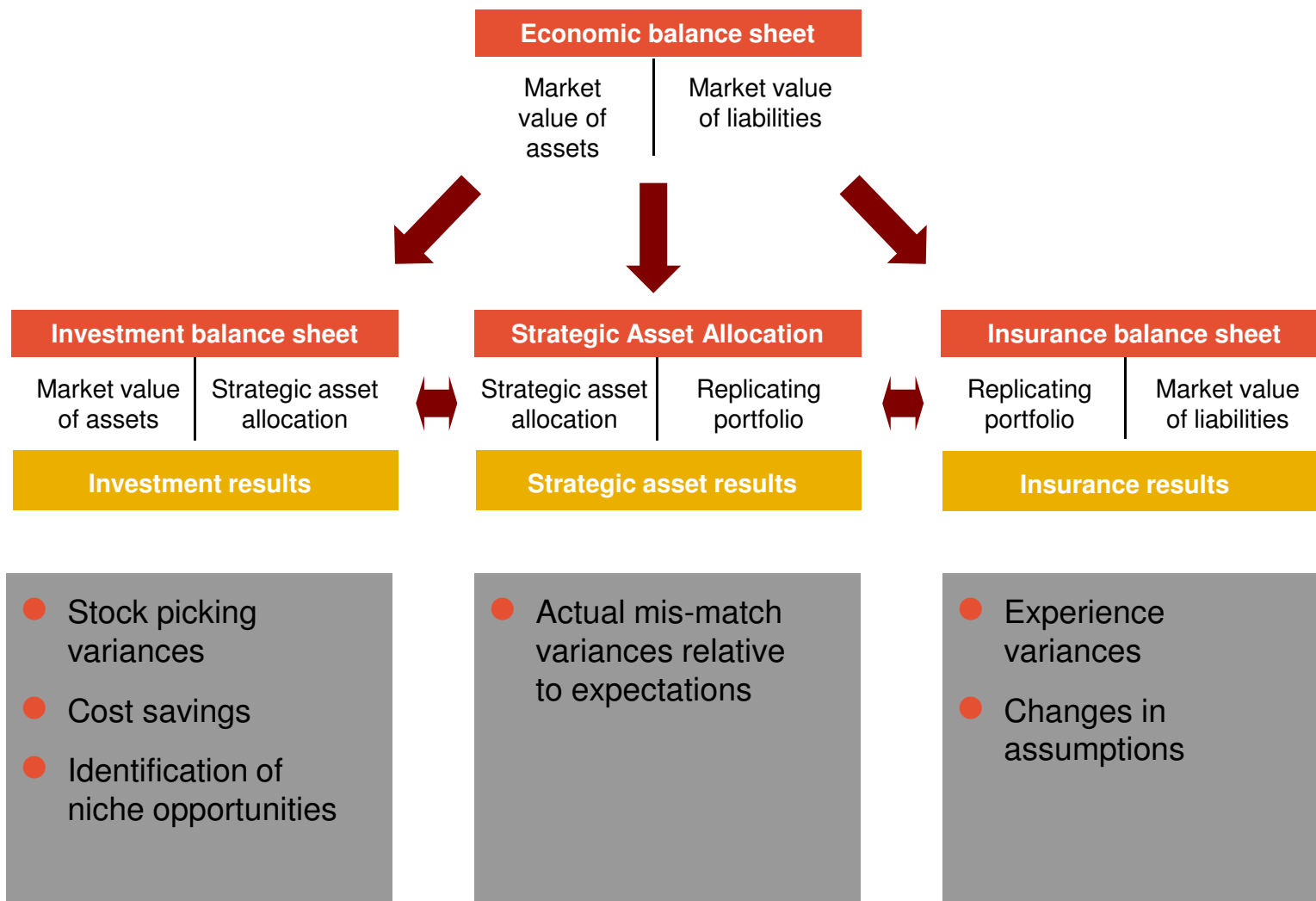
- Awareness – yes
- Understanding – hmmm...
- Fair Dealing (Singapore)?
- Sustainable Profitable Growth?
- Fair and reasonable returns for all stakeholders?
  - Eg. How (quantifiably) is risk and return of your currently best selling products being shared between manufacturer, distributor and customer?
    - Appointed Actuaries must assume responsibility to fully inform senior management and the Board such that they can properly balance the interests of the key stakeholders

# Outline – The Crisis and Some Food for Thought

1. Some views on CAUSES
2. Some views on IMPACTS
3. Some REACTIONS to the economic downturn...
4. How to fare better...
5. Some experiences...
6. Lessons learned...
7. Three specific areas on which actuaries **MUST** have views...
  - M&A and AIA
  - Market-consistent valuations
  - Risk, Reward and Responsibility
8. **And finally ...**
  - **Common sense and getting the basics right**
  - **Asian perspective and messages**



# Getting the basics right and splitting out more explicitly strategic and tactical investment results...To measure performance, insurers need to understand insurance and investment results



## And finally ...

# Common sense and getting the basics right

- Get the basics right ... Fundamentals of your core business ...
  - Are you creating the right amount of value?
  - Are the benefits (returns?) that are being provided fair and reasonable for all stakeholders?
    - Customer
    - Manufacturer
    - Distributor
  - Sustainability
    - Fair and reasonable for all parties
    - Grow your in-force block of business ...and manage the basics
    - “Top line is eye catching, bottom line is vital”
    - There is no substitute for common sense

# And finally ...

## Asian perspective and messages

1. Asian Financial Institutions fared relatively well
  - Learned from the AFC, greater conservatism, focus on fundamentals and getting the basics of the business right
  - But, one lesson not learned? Positioning for recovery?
2. Asia the future powerhouse
  - Balance of world power and influence shifting to the East
  - Look to be pioneers and leaders
  - No need to follow the West. Learn and do better... ?
3. Where's our voice?
  - Many industry bodies but where's our voice?
  - Asia Insurance Forum (CFO, CRO, etc.,.)?
  - Cultural barriers?
4. Actuaries in Asia
  - THE Risk Specialists ... "Opportunity Optimisers"
  - Asian Actuarial Association
    - Promote the profession. Support the professionals
    - Promote pro-activity, RESPONSIBILITY and accountability
      - Can lead to greater liberalisation, innovation, and professionalism in our marketplaces

• *Microinsurance*

• *Takaful...*



**And finally...**

**Asia is the leader of the future ... let's make our voice heard!**

# *Success and Fortune*



***Mark Saunders, FIA, FIAI, FSA, FSAS, FSAT***

***Managing Director, Hong Kong***

***& Risk Consulting Practice Leader, Asia Pacific***

***Telephone: +852 2593 4535***

***Fax: +852 2525 9706***

***E-mail: [mark.saunders@towerwatson.com](mailto:mark.saunders@towerwatson.com)***