



International Association for the
Study of Insurance Economics

Geneva Association Information Newsletter

Insurance and Finance

Research on Finance Issues in Insurance

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The Geneva Association

The Geneva Association is the leading international insurance think tank for strategically important insurance and risk management issues.

The Geneva Association identifies fundamental trends and strategic issues where insurance plays a substantial role or which influence the insurance sector. Through the development of research programmes, regular publications and the organisation of international meetings, The Geneva Association serves as a catalyst for progress in the understanding of risk and insurance matters and acts as an information creator and disseminator. It is the leading voice of the largest insurance groups worldwide in the dialogue with international institutions. In parallel, it advances—in economic and cultural terms—the development and application of risk management and the understanding of uncertainty in the modern economy.

The Geneva Association membership comprises a statutory maximum of 90 Chief Executive Officers (CEOs) from the world's top insurance and reinsurance companies. It organises international expert networks and manages discussion platforms for senior insurance executives and specialists as well as policy-makers, regulators and multilateral organisations. The Geneva Association's annual General Assembly is the most prestigious gathering of leading insurance CEOs worldwide.

Established in 1973, The Geneva Association, officially the "International Association for the Study of Insurance Economics", is based in Geneva, Switzerland and is a non-profit organisation funded by its members.

For more information please visit www.genevaassociation.org.

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The research programme on insurance and finance comprises academic and professional research activities in the fields of finance where they are relevant to the insurance and risk management sector.

The programme is dedicated to making an original contribution to the progress of insurance through different initiatives in the field of insurance and finance. It engages in: highlighting issues of key importance, promoting studies of the function of finance in insurance, discussing the relevance of financial concepts and instruments to the industry, detecting new and promising theoretical developments and diffusing knowledge and the results of research worldwide.

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The Geneva Association Newsletter—Insurance and Finance, N° 7, February 2011 Newsletter for Finance Directors and Researchers in Insurance

This newsletter for finance directors, senior financial managers in insurance companies and researchers in the field of finance is published by The Geneva Association as an information and liaison bulletin to promote knowledge and understanding of financial issues in insurance. It also fosters contacts between finance experts at insurance companies and at universities and other institutions with an interest in insurance. Any suggestions concerning the content or layout of the newsletter are welcome. Please notify us if you are interested in receiving this publication regularly.

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I. EDITORIAL

By Etti Baranoff*

As a newcomer to The Geneva Association and the new editor of this Newsletter, I will be writing about the hottest issues we have been working on since my joining on 1 October 2010. The systemic risks in insurance debate and how to highlight the major differences between the insurance model and the banking model have taken centre stage at The Geneva Association since the 2008-2009 global financial crisis. The two 2010 Geneva Association seminal reports on Systemic Risk in Insurance (SRI) delineate insurance activities from non-insurance activities or quasi-banking activities. These reports have jump-started the major work to assist supervisors worldwide in understanding the differences among financial institutions. Moreover, the reports and the continuing Geneva Association efforts in combination with the member's companies became a basis for finding methods to curtail future crises. Financial regulators are in the midst of efforts to shore up regulations in the systemic risk arena by designating Systemically Important Financial Institutions (SIFIs) and developing indicators for examining them. The AIG failure set the platform for supervisors to consider the inclusion of insurers in the SIFI screening process. Currently the Insurance and Finance programme at The Geneva Association is coordinating efforts to help global regulators with several work streams, as will be described in the next article by Daniel Haefeli, Head of Insurance and Finance. The sixth work stream in this effort generated a new report *An Analysis of the AIG Collapse—Understanding Systemic Risk and its Relation to Insurance*, I have been developing since November 2010. Its key message is that the AIG failure was not an insurance failure.

Now that you, my readers, are more familiar with the settings, I will move back to the content of my editorial, the structure of this Newsletter and our call to an open platform for exchange of ideas. The readers are invited to offer articles on current and future insurance and finance topics for the IF Newsletter.

As we have been working non-stop on the burning needs to help supervisors come up with sustainable solutions regarding systemic risks in insurance and curtailing future financial market disasters, we are reminded that the insurance model has shown tremendous resilience during these hard times. No policyholder's claim went unpaid. The foundation of an industry that is designed to foster stability and absorb risks has not been shaken to its core. Insurance has been and will continue to be the propeller of economic development and not economic hindrance. The AIG failure was not an insurance failure and should not be an example for the insurance industry worldwide, nor to the insurance model. It was the AIG Financial Products subsidiary (AIGFP) that took this stellar conglomerate down as noted in our new report, and in *The Financial Crisis Inquiry Report* released in January 2011 by the U.S. Financial Crisis Inquiry Commission investigating the causes of the financial crisis.¹ The U.S. 200-year old insurance regulation² has a proven record in safeguarding against systemic risks, fostering stability and propelling economic growth.³ The AIG story is not a characterization of insurers. The insurance part was solid. As quoted by the commission report, "*The AIG corporate empire held more than US\$1 trillion in assets, but most of the liquid assets, including cash, were held by regulated insurance subsidiaries whose regulators did not allow the cash to flow freely up to the holding company, much less out to troubled subsidiaries such as AIG Financial Products.*" It was the AIGFP that led to the demise. As noted in our AIG Report, the New York Times⁴ article describes the situation as "*AIG used its triple-A rating from the insurance part of its business to run a huge casino that then overwhelmed the entire business.*" Edward M. Liddy, who became AIG's Chief Executive after the bailout noted: "*It's an interesting structure where you have an insurance company that works really well and on top of it is a holding company and the holding company's biggest asset is this huge hedge fund.*"

* Research Director, Insurance and Finance, The Geneva Association (www.genevaassociation.org).

¹ *The Financial Crisis Inquiry Report* released in January 2011 by the U.S. Financial Crisis Inquiry Commission investigating the causes of the financial crisis.

² Etti G. Baranoff and Dalit Baranoff "Trends in Insurance Regulation", *Review of Business*, Fall 2003, pp. 11-20.

³ Additional explanation of the regulatory structure of insurance and the nature of insurance is provided in Chapters 6-8 of *Risk Management for Enterprises and Individuals* by Etti Baranoff, Patrick Lee Brockett and Yehuda Kahane, Flat World Knowledge, 2009.

⁴ "The Case for Saving AIG, by AIG" by Andrew Ross Sorkin, *New York Times*, 2 March 2009.

Now, in addition to helping global insurance regulators find a way to avoid another AIG on their watch despite the fact that the causes of the failure were non-insurance activities, we at The Geneva Association need to detail the true story of the insurance model. The model should include elements of the industry's resilience and stability, a model showing an industry that moves economies forward. It is a model of strength with solid regulation and major capital base. This story must clearly delineate the model from that of the banking model, and be told in the most transparent way. The public deserves to understand the differences and regain its trust in the one industry that has the tool kit to resolve some of the most pressing longevity risks looming on the horizon.

The AIG report to be released, which has occupied my attention since November, shows how the insurance model is resilient as long as it is not interfered with by the lax banking and thrift regulation model and/or deficient regulation in derivatives. The AIG Holding Company was not regulated by the insurance safety net and AIGFP did not operate under any efficient umbrella of regulation in the area of derivatives and credit default swaps—the main cause of the AIG liquidity catastrophe and near collapse which was averted by the Federal Government bailout. Insurance regulators were swept away from such products and from any doings with the AIG Holding company. Now, they are charged with shoring up the regulatory framework. Every catastrophic event in the past has led to evolution in insurance regulation. During the 200 years of insurance regulation history, every crisis resulted in strengthening the regulatory framework. This crisis will lead to such strengthening as well, as long as it is done in a form that does not hinder economic viability and does not leave gaps in regulation under non-insurance supervisory bodies. The question is: are these gaps really being closed by the new global efforts in the various countries? Is there a governing body with the power to eliminate regulatory gaps?

To help the global supervisors in their specific mission of finding SIFIs in insurance, we created a new academic working paper at The Geneva Association. Also, The Geneva Association Financial Stability Working Group and Steering Committee have been working at lightning speed to be of help at the International Association of Insurance Supervisors (IAIS) meeting on 17 February 2011. The next article delves into these efforts. The Geneva Association SRI reports and our working paper provide some of the foundations to this work and the models to identify SIFIs as well as indicators for regulation.

As you can see, these efforts can benefit from your contributions. We would like to foster open dialogue for innovation in ensuring the stability of the financial markets and of insurance in particular.

In this Newsletter we provide an overview of insurance and finance activities by Daniel Haefeli. Next is the feature success story of New York Life. It is an interview of the executive team hosted by Michael Sproule, New York Life CFO. This interview shows a truly successful insurance model. This exciting interview is followed by my summary of the Insurance and Finance (IF) seminar in London—a unique experience in the “discovery process” of the insurance model from industry leaders. The seminar is a weave of common themes and challenges for the insurance industry. This is balanced by a quilt of differences that are essential for success. Both extremes need to be balanced for uniformity in accounting standards and regulations. The seminar offered these views from the top down with the CEOs and CFOs panels' presentations, with a drill down into technical details. The second day of the IF London seminar featured Brian Shea from Merrill Lynch/BOA with an outlook of the industry. His message was uplifting and is provided in a separate article at the end of this newsletter (his full report is available via weblink). The Newsletter concludes with announcements. We hope the readers enjoy this new format and would like to see their names as contributors in the near future.

* * * * *

II. OVERVIEW OF INSURANCE AND FINANCE ACTIVITIES

By Daniel Haefeli*

Since joining The Geneva Association along with Etti Baranoff in early October last year, we have been thoroughly immersed in the Systemic Risk in Insurance (SRI) issues and the regulatory support efforts in the area of identification of Systemically Important Financial Institutions (SIFIs). This has dominated the Insurance and Finance programme almost exclusively.

The G-20 entrusted the Financial Stability Board (FSB) with developing methodologies to identify financial institutions that could generate systemic risks. More specifically, the FSB was asked to identify institutions that: (i) can cause impairment to all or parts of the financial system; and (ii) have potentially serious negative consequences for the real economy. Since the insurance industry is part of the financial services sector, the FSB asked the International Association of Insurance Supervisors (IAIS) to develop a process which would aid the FSB in designating SIFIs in insurance.

The issue of systemic risks in insurance became part of the financial crisis of 2008 chiefly because AIG was bailed out by the U.S. Federal Government to avert failure and deeper financial crisis. The Geneva Association produced two seminal reports in 2010: *Systemic Risk in Insurance—An analysis of insurance and financial stability* and *Key Financial Stability Issues in Insurance*. These reports have been the foundation for the current work of The Geneva Association. They delineate between activities that are core to the insurance business and those that are not or are more in line with quasi-banking activities. The main outcomes of the reports are that core insurance activities do not cause systemic failure of the economy. Only some very specific, well defined activities, carried out in large size, without strong risk management, and without efficient regulation can pose systemic risks. Along these lines, our current analytical efforts identified two main activities that may pose potential systemic risks in insurance:

- Derivatives speculation/ financial guarantees; and,
- Mis-managing short-term funding

In line with the two 2010 SRI reports and the current analytical results, The Geneva Association clearly shows that “an activity-based approach” is the technique to take for identifying critical potentially Systemically Risky Activities (pSRAs).

In November 2010 the FSB stated in a press release that they will determine by mid-2011 those institutions with a “G-SIFI” designation, as those with global impact. It was clear that insurers could not avoid discussions about possibly being included in a financial institutions list. Consequently, in the “observer meeting” of the IAIS’s FSC on 7 December 2010, Axel Lehmann of Zurich Financial Services, and Raj Singh of Swiss Re presented (on behalf of The Geneva Association) the foundation of the SRI studies. Their presentation reinforced again the SRI studies’ results regarding the industry’s activities.

The preparation for the IAIS Hearing in Basel on 17 February 2011 has taken an immense research and analysis effort under the guidance of the Financial Stability in Insurance (FSI) Steering Committee, coordinated by the IF programme of The Geneva Association.

The FSI working group had identified six work streams covering the key aspects of the efforts to assist the IAIS in its work. The objective was to have a strong and valid proposed methodology. The different work streams are as follows:

- scrutinizing and selection of pSRAs;
- measurements of indicators;
- resolvability/resolution in insurance;
- translation of risk assessment of indicators into supervisor methodology;
- reputational risk issues and market impact for the industry; and,
- AIG case study.

* Head of Insurance and Finance, The Geneva Association.

These efforts culminated in a comprehensive presentation for the February IAIS Hearing. This presentation is available on The Geneva Association website, as will be the AIG story written by Etti Baranoff, in order to provide a clear understanding of systemic risks in insurance based on the AIG situation. In a series of meetings and conference calls, we identified elements useful for the Financial Stability Committee of the IAIS. Along with the persons responsible for each of the six work streams, we agreed on a cooperation agreement with Oliver Wyman to pull the various analyses together in a cohesive way. Time has been a critical element in this extensive effort. Our work also became very dynamic and included moving targets, as information from the regulatory bodies evolved.

A case at hand is the mid-January released IAIS memo that included a preliminary proposal on how to identify SIFIs in insurance. The IAIS did acknowledge that the insurance industry as a whole is less systemically important than the banking industry. Nevertheless, they acknowledged that there might be some activities with interconnectedness and vulnerability with other areas of the finance industry.

Based on all the research so far, the message of The Geneva Association has been and remains: it is critical to distinguish between risk generator and risk receiver (the perpetrator and the victim). As an industry that is designed to absorb risk and provide stability, it is a somewhat surprising notion to regard it as the one that could pose systemic risk to the economy. This is particularly so as resolution mechanisms in insurance are specifically designed to minimise the impact on policyholders and the real economy. The mixed messages are extremely confusing. Therefore, it is obvious that the regulators of the insurance industry should recognise the crucial mission of insurers and that in their efforts to identify SIFIs, they do give credence to such activities. These activities receive the title of “traditional or core insurance business.” These are recognised as non-systemically risky activities. When these activities are not well managed, they can bring on insolvencies, but do not lead to systemic failures. The current insurance regulatory system does address the area of potential insolvency.

The following two exhibits from the presentation to the IAIS on 17 February 2011, delivered by Axel Lehmann, Chief Risk Officer, Zurich Financial Services and Stan Talbi, Chief Risk Officer, MetLife, provide the highlights of the methodology designed by The Geneva Association for SIFIs identification. Exhibit I illustrates the proposed two-phase approach. Phase I concentrates on identifying activities that potentially may be of systemic risk to the economy based on size, the interconnectedness, substitutability and timing. Phase II concentrates on the institutions that carry out these activities. We look at size relativities and again at interconnectedness, substitutability as well as timing. With Phase II, we ensure that only institutions carrying out the identified activities under Phase I are tested for possible SIFI identification and that no supervisory resources are squandered on institutions that have no SIFI potential. Further, there are aggravating or mitigating factors such as regulatory supervision, market conditions and internal risk management that need to be considered appropriately.

Exhibit II provides more details regarding the only two currently identified pSRAs: (1) derivatives speculation / financial guarantees; and, (2) mismanaging short-term funding. The Exhibit provides details.

Exhibit I

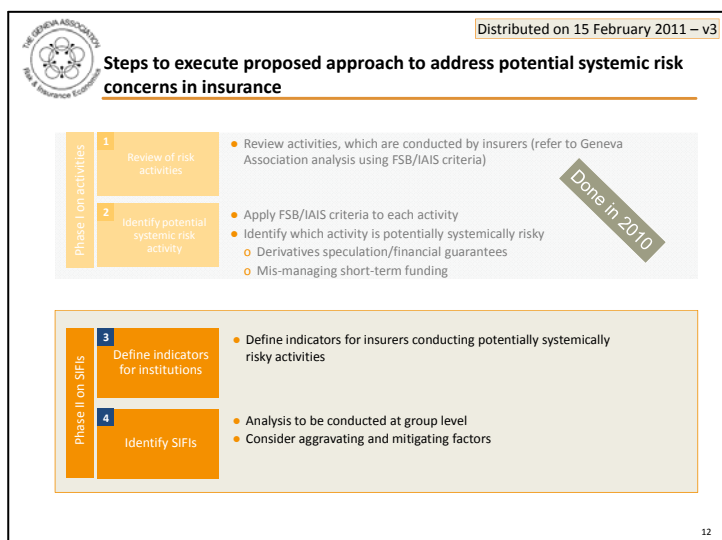
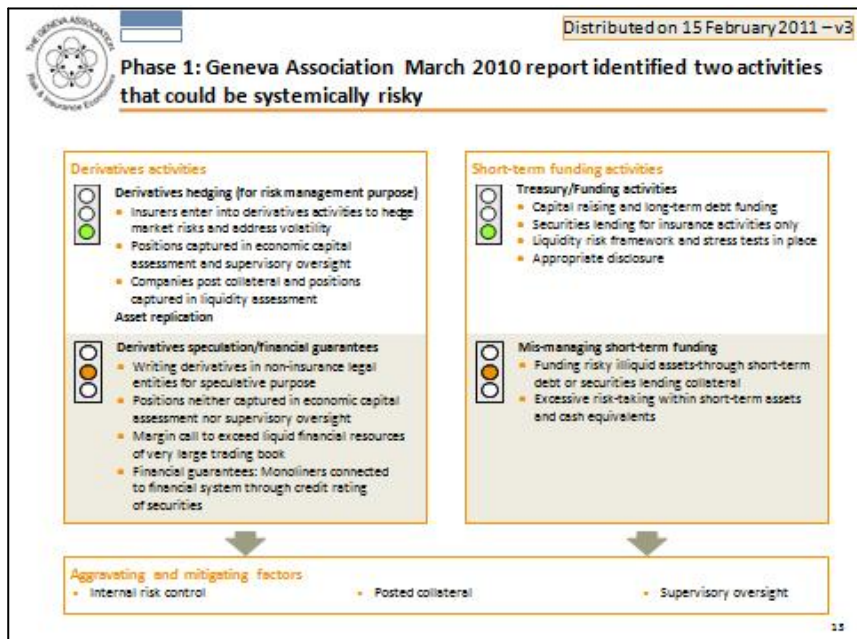


Exhibit II



III. FEATURE SUCCESS STORY: AN INTERVIEW WITH THE EXECUTIVE TEAM OF NEW YORK LIFE

By Etti Baranoff

The following Q&A is based on interviews conducted on 13 January 2011 in New York City, with New York Life executives. Interviewees were: Executive Vice President and Chief Financial Officer Michael Sproule, Senior Vice President and Chief Actuary Joel Steinberg, Senior Vice President and Chief Risk Officer Gideon Pell, First Vice President in charge of Corporate Communications Elizabeth McCarthy, and William Werfelman, First Vice President in charge of Media Relations. Daniel Haefeli, Head of Insurance and Finance at The Geneva Association, was also present.

Background

In 2010, New York Life Insurance Company was named the world’s most admired life insurance company by *Fortune* magazine in the publication’s annual industry survey conducted by the Hay Group. In nearly four decades of polling by *Fortune*, it was New York Life’s first time atop the survey. In the following pages of interviews I have explored the reasons—and they are many—as to why this accolade came now. The company points out, of course, that it doesn’t manage itself to score well on surveys, and that is clear. The *Fortune* survey is simply a validation of its strategies and the success it has had in executing them.

New York Life is the largest mutual life insurance company in the United States, currently ranking number 64 on the *Fortune* 500 list of America’s largest companies by revenue. New York Life credits mutuality as a core reason it has survived and thrived for 165 years, and that is explored at length here. Other factors crucial to the company’s success, it believes, are its unwavering focus in its core franchise, life insurance, and its primary distribution system, career agents. Of course, financial strength is the most essential measure of an insurance company, and of the 1,000 life insurance companies in the United States today, only three have the highest possible ratings from all four of the major rating agencies. New York Life is one of them.

But statistics aren't the reason New York Life came through the financial crisis a winner. Its success is rooted in decisions made years ago, in its "confidently humble" approach to management and in the actions it took in 2008 to seize the moment and distinguish the company from those firms suffering in the financial crisis.

Q&A:

Q1: Let's talk a little history to start off. In the late 1990s and early 2000s, a number of major U.S. insurers made the decision to become publicly traded companies. Was there a time when New York Life considered demutualizing?

Michael Sproule: New York Life was founded in 1845 as a mutual and remains committed to that form today. In fact, we discuss this decision with our Board of Directors each year, and it has consistently been reaffirmed unanimously. In modern history, the closest we've come to considering a change was during the booming stock market years of the 1990s, when Prudential and Metropolitan, two of our larger competitors, decided to demutualize. This was shocking to many people, as the life insurance industry had been led by the mutuals for so long—in size, in financial strength, and in other important ways. But when New York Life management and the Board did its analysis, it was clear that New York Life was a different case altogether.

Met and Pru had been moving away from their career agency distribution systems and were exploring alternate methods of distribution. With the demise of the Glass-Steagall Act (which effectively removed the separation that previously existed between Wall Street investment banks and depository banks, as well as other financial institutions), Met, Pru and others became enamored with the Citigroup model, becoming a financial services superstore with banking, insurance and brokerage all under one roof and offering—it was thought—better cross-selling opportunities.

New York Life was then and remains comfortable in its skin: we are a life insurance company through and through. We are well capitalised, so we don't need to tap the equity markets for capital to achieve our strategic objectives. We have a large block of in-force business that together with new business generates US\$18 billion to US\$20 billion in annual cash flow. We have the best agents; we've led the prestigious MDRT (formerly known as the Million Dollar Round Table) with the most qualifying agents for a remarkable 56 consecutive years. And we have an enviable reputation in the industry for delivering on our promises to policy-holders and being a responsible corporate citizen.

However, perhaps the most compelling aspect of all is that our products often represent a long-term promise to pay that might take 40 years, 50 years or even longer to come to fruition. The mutual form is aligned with the long-term nature of these promises. We're able to manage for the long term—even accept lower returns (or short-term losses) in the interest of safety and security for our policy-holders—rather than take imprudent risks. Subjecting a life insurer to the quarter-to-quarter pressures of Wall Street creates a disincentive to manage for the long term. Wall Street generally abhors companies that hold cushions of capital. But we do that deliberately, because if we have learned anything in 165 years of doing business, it is that bad things happen, and you must be prepared. We all saw how that played out over the past couple of years, with some of our public company colleagues applying for TARP funds when the financial crisis hit. In contrast, as we keep telling our policy-holders, New York Life was built for times like these.

Gideon Pell: Starting well before the financial crisis, we implemented a process of stress-testing the company's solvency position in the event of extreme scenarios. For example, we took the worst event in terms of death claims in the 165-year history of New York Life—the 1918 flu pandemic—and we scaled the estimate of potential claims to New York Life according to the current U.S. population of about three times the size. In addition to the impact that would have on our claims, we overlaid the additional credit and equity losses on our investment portfolio that would occur as a result of the economic downturn that in all likelihood would accompany such a flu pandemic. While no insurer would be entirely immune, we wanted to see if New York Life could withstand a 1918-type pandemic and still have very strong capital ratios. We passed easily. We also tested our resilience in the event of a "Japan scenario" of a decade-long period of very low interest rates, or of a stock market plunge of 40 per cent in the S&P 500. We demonstrated that New York Life's financial strength is quite resilient under a wide variety of extreme scenarios.

Q2: Let's talk about that resilience for a bit. What is your cushion of safety for policy-holders?

Sproule: It is substantial and is a key reason that we have the highest-possible ratings from all four of the major rating agencies. At year-end 2010, our Capital (which includes our statutory Surplus and Asset Valuation Reserves) stood at US\$16.8 billion, an all-time record for New York Life. In fact, we're coming off a year of records across the board—in sales, revenue and earnings. We view our Surplus like a water reservoir: it is there when we need it. During the financial crisis, the reservoir dropped by US\$2 billion but still remained at a robust level of US\$12.8 billion at the end of 2008. But that is what a reservoir is for. Because, frankly, if there were never a need to tap the reservoir, there would be no need to have one at all. By the way, we have since recovered all of that drop in capital and more.

Q3: How did your company react to the financial crisis, for example when Lehman Brothers went down and others soon followed?

Sproule: This is where the story really gets interesting. We knew we would be affected by the crisis; no insurer with a diversified portfolio of US\$150 billion in assets could avoid it. So we knew we would take some hits to our balance sheet. But there were some key investment principles that, under the leadership of Gary Wendlandt, our Chief Investment Officer, we had been using for many, many years. Those principles turned out to be the bedrock on which we stood. Gary played a key role in our communications both internally and externally, which we can discuss further in a moment. But those key principles included: 1) maintaining diversification; 2) conducting our own research; 3) insisting on getting paid for taking risk; 4) taking a long-term view; 5) maintaining ample liquidity; and, 6) not blindly following the crowd. None of these principles are complicated, but they are hard for many institutions to follow, especially those who are chasing next quarter's earnings. They know if they miss expectations by a penny, their stock price will be punished. It puts pressure on our competitors to reach beyond the safety zone. Sadly, the most damaging losses suffered by financial companies and individual investors could have been avoided through the application of these and other common-sense investment principles.

Based on these principles, Gary had made a tough call before the crisis even broke. Early in 2007, when credit spreads narrowed, he felt we were no longer getting paid to take the risk on corporate bonds compared with safe government bonds. He approached Ted Mathas, then our Chief Operating Officer and now our CEO, with the idea of increasing the allocation of our cash flows to Treasuries. We all knew that this decision would subtract from earnings in the short run, but we also knew it was the right thing to do. Chairman Sy Sternberg and the Board of Directors signed off on the plan, which came to be known as the company's "quality tilt" strategy.

Q4: Even with the quality tilt, were there ramifications beyond the US\$2 billion hit to surplus?

Sproule: Well, the crisis obviously rattled the rating agencies. The entire life insurance industry was placed on negative outlook. While most of our competitors were downgraded, often by several notches, New York Life retained its triple-A ratings throughout the crisis—a real testament to our financial strength. We owned some of the securities that were hit hard—residential and commercial mortgage-backed securities and the like. But since we do our own credit underwriting, we avoided the worst tranches of the various investments and, in some cases, avoided entire types of instruments that looked worrisome. Consequently, we were quickly on the mend. All four ratings agencies have affirmed us in the last year at the highest-possible levels.

Q5: While many other life insurance companies lost policy-holders in the crisis, you did not. How was this possible? How did policy-holders and agents react to the crisis?

Sproule: This is where the CEO and the management team really excelled, which was later recognised by *The Wall Street Journal* and others. CEO Ted Mathas quickly convened a series of meetings of our Executive Management Committee (EMC). The EMC comprises 14 of the most senior officers of the company, and its function is to assist the CEO in setting policy for the company. These meetings took place as Congress was debating a bank bailout plan. Among other agenda items, we talked about how some clients were worried about whether even the strongest life insurers could succumb to the crisis. Ted spoke with confidence, and he challenged us, noting that "*we're built for times like these*", a phrase that resonated throughout the company. Ted wanted us to tell the story of how we were different from

those in trouble—with three key factors in our favour: our mutual form of ownership, our superior financial strength and our disciplined and prudent investment approach.

Liz McCarthy: We also knew we had a great asset in our agent force—11,000 ambassadors to tell our story across the country; we just had to give them the right tools to excel in this unusual environment. From the first days of the crisis, Agency Head Mark Pfaff rallied the field force to call their clients, reminding agents that this was more than an opportunity to differentiate New York Life, it was the agents' moral responsibility to be there for their customers in a period of unprecedented turmoil. Few on Wall Street, it turned out, wanted to talk to their customers, because they had nothing positive to say.

Our agents accepted the challenge to contact their clients in record numbers and to reassure them that they couldn't be with a better company at this time of crisis. Although it was not our immediate goal, many of those calls resulted in new business, as clients sought the safety of guarantees and the comfort of working with a stable company.

We gave the agents materials to help them deliver the message, including a brochure called—what else—*Built for Times Like These* that provided data points that put things in perspective. For example, from 1 January 2007 to 30 June 2008, New York Life had US\$300 million in credit losses on its books—representing just 0.2 per cent of our cash and invested assets of more than US\$150 billion—which compared very favourably with the substantially bigger credit losses at many of the largest and best-known financial services firms. Our materials helped agents communicate clearly about what set New York Life apart, and it calmed our policy-holders to see such clear and concise messaging around our financial strength and resilience.

Conference calls with agents were a big part of the strategy. The leaders on the calls were CEO Ted Mathas, of course, along with Agency Head Mark Pfaff, who was a former agent himself and understood what it took to motivate the field force. And CIO Gary Wendlandt kept the field well informed about the financial crisis, the economy and the excellent state of our investment portfolio. The agency force looked forward to these conference calls as a way of learning more about the inner workings of the financial system and how long it might take to mend.

Bill Werfelman: Ted also decided to *increase* the advertising budget in 2009 to help us tell the story to the general public and support our agents and advisors in the field. And we shifted our message from protecting loved ones to ads that emphasized the company's financial strength and stability.

The success of all these efforts quickly became evident in our results. Sales took off, and market share increased. In fact, on 24 August 2009, *The Wall Street Journal* ran a front-page story about the handful of companies that were winning in the crisis. New York Life was prominently mentioned and Ted Mathas was extensively quoted.

It was a balanced communications plan. In addition to advertising and media relations, the plan included agent materials, newsletters and conference calls, annual report features that told the story to our policy-holders, employee Town Hall meetings and newsletters, and our websites and intranets for the public, agents and employees. Ted Mathas was personally very visible and engaged with all of the key audiences, including video messages on the websites. There was consistency of message and repetition to drive it home.

Q6: What was happening to your competitors all this time?

Sproule: Well, as we noted, a few took TARP funds to deal with liquidity pressures and get them through the storm. And most of our competitors were downgraded several ratings notches by the rating agencies. But by and large, the life insurance industry—especially the mutuals—came through in good shape. Some of the more adventurous in the industry had to re-price the risks they were taking on certain products such as variable annuities with equity market performance guarantees. But, once again, New York Life benefited from some of the contrarian decisions we had made over the prior decade. Just as we chose not to demutualize and not to move away from career agency distribution, we also made some contrarian decisions on the product front.

Joel Steinberg: We refused to make unsupportable lapse assumptions to justify unsustainable pricing of long-term care insurance and no-lapse guarantees on life insurance policies. And we did not offer variable annuity products with aggressive guaranteed minimum withdrawal benefits, because we questioned the viability of the hedging strategies that most companies were using. For a while, we heard that we were too conservative and unwilling to take risks, but we saw what was happening as a race to the bottom. I prefer to think we were simply being prudent and responsible in handling other people's money. As you might guess, we don't hear this characterization of our risk-avoidance much anymore.

Q7: So it sounds like the seeds of New York Life's success in weathering the storm were planted some time ago. Can you talk more about that?

Sproule: Yes, it is safe to say that we didn't discover financial discipline in 2009! Clearly, financially disciplined and often contrarian decisions were made consistently for many years before the crisis began, and this enabled us to come through in excellent shape. Remaining a mutual when others were demutualizing, staying focused on life insurance when others wanted to become financial superstores, staying with career agency as our primary distribution method when others were abandoning it—all these choices played an important part.

We have a healthy skepticism about following the pack. For example, our former CEO was once told by a reporter that, in effect, *"You must be hearing from the management consultants that if you don't demutualize you won't be able to compete with Met and Pru."* He responded, *"Let me tell you something about consultants. They are very good at telling you which way the herd is going. They aren't very good at telling you what is right for you."* That pretty much sums up how we operate at New York Life. To be as successful as we have been in what is a high-fixed-cost, low-growth industry, we have built on our differentiated strategy. We focus on life insurance, career agency distribution, and the underinsured middle market. We also do lots of other things, of course, but we know our strengths and we build our business from that foundation of strength.

Steinberg: We also price our products appropriately. We have a disciplined way of determining risk-adjusted targeted returns for each of our products, and we adequately capitalize our products to a very high confidence level. Our large block of in-force business—which is very stable even in stressful times—clearly allows us to say no to some activities that others feel they must engage in to meet shareholder earnings expectations.

Pell: Enterprise risk management (ERM) is another area of differentiation for New York Life, as the company's performance in the financial crisis reflected the strength of our risk management practices. Our ERM approach is driven by a risk culture that is aligned with our mission of permanence and communicated in our actions and in our words. Our business is geared to providing sustainable value for our policy-holders; it's not about chasing higher investment yields to improve short-term earnings for shareholders. Acceptable risks mean we have the expertise to price and manage them, and the markets compensate us sufficiently. Excessive risk-taking is avoided—and at New York Life we are careful to do our best to know the difference. We look at our finite risk capacity, both long- and short-term, across all of the businesses, building an aggregate picture of risk for the company. We've also been successful in raising the bar for our businesses in terms of evaluating risk/reward tradeoffs in a structured manner, and we have successfully embedded risk management in every facet of the operation.

Sproule: At some companies, the Chief Risk Officer unfortunately has morphed into the company's chief risk enabler. Sometimes it's the smartest people in the room that you need to worry about the most. Look at what happened at Long-Term Capital Management: it was run by one of the best traders on Wall Street and had two Nobel Prize-winning economists. They were probably the smartest people in any room, and so I like to tell people if you think you are smarter than Long-Term Capital Management, you should probably think again. But they not only brought down LTCM, they came close to taking the U.S. financial system with them at that time.

Our view is that we live in a "fat tail" world, and we are in a fat tail business. In life insurance you can make a decision today that won't come home to roost for 30, 40, 50 years or more. So the executives who made that decision may be long gone before the results come in. In the life insurance business sometimes it is the distribution—the advisors and agents—who are asking for products their competitors

are selling. We take the time to communicate our decisions to our distribution channels so they can fully understand the rationale. For example, we made a considered decision not to offer equity-indexed annuities and effectively communicated that position to our agents. It all comes back to our strategy. We know who we are.

Q8: Let's switch gears a bit to something very topical at the moment. Would you rather be on the list of systemically important financial institutions or be excluded from such a list? There are pros and cons, correct?

Sproule: There are lots of cons and very few pros. Initially it seemed that the Financial Stability Oversight Council (FSOC) was trying to design criteria that would be useful in determining a selection process for what constitutes "systemically important" institutions. However, Treasury Secretary Geithner was recently quoted as saying that he believes creating effective, purely objective criteria for evaluating systemic risk is not possible. He said it depends too much on the state of the world at the time, and you cannot make those judgments about which institutions are systemically important until you know the nature of the shock. I agree that allowing government some flexibility makes sense, because the actual situation will be an important part of the decision-making. Now it looks like the general criteria are being designed around systemically important **troubled** companies and large banks, and the criteria focus on size, interconnectedness with other financial firms, leverage, liquidity risk, maturity mismatch, and existing regulatory scrutiny. So despite the fact that New York Life is the largest mutual life insurer in the United States, our intent is to try to stay as far away as possible from any list with the word "troubled" in it. Given our low leverage, prudent risk profile, and commitment to staying with businesses we know, we should easily avoid making such lists.

We like to say we are a "confidently humble" company. We're confident because we know who we are, and we execute our plans very well. We're humble because we have been around for 165 years and have seen the best of times and the worst of times—just like the nation has—so we are very prudent about taking risks. We know that if we stay focused and execute well, we will be around for another 165 years. We've been successful by having a singular focus on the best interests of our one constituency—our customers. After all, that's what it's all about.

IV. REPORT FROM THE 7TH INTERNATIONAL INSURANCE AND FINANCE SEMINAR OF THE GENEVA ASSOCIATION, DECEMBER 2010, LONDON

By Etti Baranoff

Introduction

The 7th Insurance and Finance Seminar in London was my inaugural seminar with The Geneva Association. This seminar is distinctive in its structure and the opportunities available to the participants to learn from the top down about the challenges of the insurance industry. The format of moving from the "big picture" views offered by the CEOs down to the specialised, very detailed technical accounting issues discussed by the financial reporting executives has turned out to be very useful. It affords the audience an open and true glimpse into "the core concerns and aspirations" of the industry. It is obvious that there are common and separating themes among the players. Many of these are weaved throughout the various panel discussions, but at different levels of detail and perspective.

On a different note, I would like to thank our host, Nic Nicandrou, Chief Financial Officer of Prudential plc., for the wonderful hospitality and for giving the participants a great venue to take active part in the seminar. The organiser of the seminar, Jerry de St. Paer, Special Advisor and Seminar Director, Insurance and Finance, The Geneva Association, Barbara Botterill, Conference Coordinator, The Geneva Association and the team of The Geneva Association who coordinated the effort deserve the accolades for the success of the seminar. Their role is to be commended.

The box below summarises the main themes of the seminar. More detail is provided in the descriptions and summaries of panels' discussions.

Highlights of the 7th Insurance and Finance Seminar of The Geneva Association, 2010

A. A Weave of Common Threads

Insurance and Finance Issues and Challenges:

1. The message:
 - a. The industry's special position as a provider of stability had proved itself during the recent financial crisis.
 - b. The insurance model, when it is not interfered with non-insurance products, or quasi-banking products, has shown solidity.
 - c. The issue of systemic risk in insurance, or whether insurers are systemically important financial institutions (SIFIs).
2. The forward-looking view:
 - a. There needs to be a major educational effort undertaken to explain the insurance model to all stakeholders in the economy.
 - b. There needs to be a strong delineation between "the victims" and "the perpetrators" of the 2007-2009 financial crisis.
3. It was recognised that the insurance industry is in the best position to help in the largest looming challenge of longevity risk.
4. Specific current and future activities include: de-risking, dynamics products modifications, global issues, and more.

B. A Quilt of Essential Differences for Success

Insurance Financial Reporting & Regulation Issues and Challenges:

5. Issues in financial reporting for the group vs. single companies.
6. Non-uniformity in insurance accounting and regulation around the world is a challenging issue. Key questions surrounded two main topics:
 - a. Convergence towards uniformity.
 - b. Are accounting rules directing behaviour or responding to behaviour? There was no consistency in the opinions.
7. The issue of interest rates and their use in discounting for reserves, pensions and all insurance products became a weaving theme in many sessions.

C. Overall Overview

8. Optimism prevailed in the seminar. The presentation by Brian Shea (of Merrill Lynch/Bank of America): "Capstone Presentation: Insurance Industry's Appeal to Investors" provided a positive outlook. His message is of great importance and is afforded a special place in this Newsletter as a separate article following the description here.

It is worth noting that while we could see common threads weaving throughout the seminar, the special case studies of some of the companies have added depth to it. The unique attributes of some of the companies are the basis for the quilt that makes up the insurance industry. This quilt represents a safety net for consumers. Sections of the quilt represent competing insurers (ready to provide substitutes when necessary for exiting insurers). While there are many similarities, each has unique qualities and idiosyncratic characteristics. These insurers are not only different from banks, but are also dissimilar from each other.

The similarities and the differences were presented in the seminar to create a tapestry of issues and challenges with both common threads and separating themes. The balance between these two opposing themes is a key backdrop to the second day of the seminar when accounting issues took the centre stage. While the quilt of different insurers is a must for success, these dissimilarities become the core challenges in creating uniform global financial reporting and regulation. The objectives of the accounting regulators, the International Financial Reporting Standards (IFRS) and Financial Accounting Standards Board (FASB) were discussed in details. At the close of the seminar, a joint panel of the regulators and the industry debated openly the objective to achieve convergence among the various accounting standards. The main issues of discount rates and uniform reporting for all types of insurers—life and

property/casualty received deep technical consideration. These technical issues are beyond the scope of this overview. Nevertheless, a few highlights from the comprehensive presentations is featured briefly at the end.

Now, we move into the opening segment of the seminar which illustrates the common challenges along with the need for creativity and innovation to set competitors apart for success.

Opening Remarks

In his opening remarks, Nic Nicandrou, Chief Financial Officer of Prudential plc, noted the central role insurers played in human history and in economic development. This role has critical importance, especially in the period of the recent financial crisis. The fact that *“not a single insurance policy-holder lost money”* set the industry apart. The insurance industry provides *“a source of stability and ... it is central to the future prosperity of our society, providing the means for economic recovery with lending to businesses when normal (lending) was not available.”* In his concluding welcoming remarks, he reiterated that *“the sustenance and stability that the industry provides is a true testimony that insurance is not systematically risky.”*

The issue of systemic risk in insurance, or whether insurers are systemically important financial institutions (SIFIs) resonated throughout the seminar.

Patrick M. Liedtke, Secretary General and Managing Director of The Geneva Association also welcomed the participants to the seminar. He reinforced this overall theme that core insurance activities are not systemically risky. He described the major research projects undertaken by The Geneva Association in this area. Moreover, his message of *“not looking backwards, but forging forward into the future of delivery of goods and services.... with solutions to long-term care and old age”* was clearly resonated in this seminar.

Thus, Liedtke set up a foundation of two main common themes that flowed into the seminar: 1) forward-looking; and, 2) assisting the regulators in their efforts.

In the midst of the financial crisis issues, The Geneva Association has an accelerated role to play in explaining the insurance model to decision-makers who are out of the insurance sphere. The Geneva Association is a think tank with the ability to utilize major expertise in the insurance sector. Liedtke noted that for an industry with 11 per cent of the GDP, there is much for The Geneva Association to offer to policy-makers when debating SIFIs and regulatory issues on the local and global levels.

Special Address: Lessons of the Recent Decade and Insurance in the New Market Normal

The next presentation was a Special Address by Simen Vier Simensen, Director of the McKinsey Company. His talk was thought-provoking and centered on the “new normal” and a new world of “bubbles”, with more frequent financial crises. He began with intriguing statistics showing that, out of the top U.S. 100 companies in 1917, only seven were on the top in 2010.

In this new era, he introduced the “de-risking” terminology where *“insurance companies’ asset allocation reflects procyclical de-risking, at the potential expense of returns for policy—and shareholders”*. Other observations centered on the move to fee-based changes of the entire insurance system. *“The increasing share of third party and digital distribution channels is further eroding the insurance industry’s traditional profit pool... and the mid-back-office cost position of stand-alone insurers represents a serious strategic exposure in a low investment return environment.”*

The following box summarises the main points offered by Simensen:

Simen Vier Simensen posed two main questions and provided “thought-provoking” responses:

Question [common macro-themes for the industry]:

1. “Do current regulatory and macro-economic factors make the insurance industry more sustainable?”

Answers (Use Exhibit I):

1. Regulatory changes are sweeping with more transparency; stronger and more accurate risk-based capital requirements: no naïve provisions for guarantee; less cheap funding for low-grade sectors and transparency about the cost of regulation. Solvency II will become more stringent than Solvency I. Aggregate capital will go up relative to Solvency (See exhibit I below).
2. Rating agencies are expected to remain *de facto* regulators for overall capital requirements at entity level.
3. Current “structural increasing external systemic or tail-end risks are not addressed in the new regulatory and rating agency regimes...”, in the near future this is fast-changing with the major efforts by the FSB and IAIS along with the U.S. activities.

Question [separating success themes for the industry]:

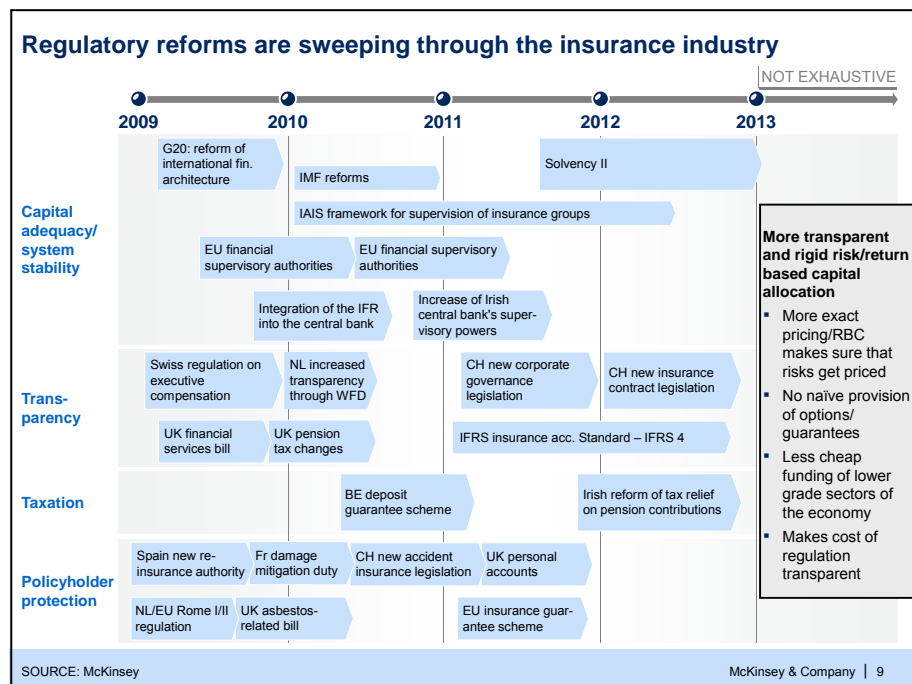
2. “Which are the key strategic issues for individual players in the new market normal?”

Answers (Use Exhibits II and III):

1. Developing a more robust risk-management framework, including building more robust business portfolios. Harvesting risk premiums through more targeted models, processes, and capabilities.
2. From participative life product to long-term savings and risk providers. Restructure the life business towards more customer- and shareholder-friendly solutions within pillars 2, 3 and 4.
3. Building innovative operational excellence. Need to win the “War for customers” in a sustainable way.
4. State and regulatory management. Collectively influence the regulator and the new market state to build customer and shareholder win-win solutions?

More detailed highlights are offered by examining the following exhibits Simensen offered. Exhibit I provides a quick view of the regulatory reforms the industry has faced and will fact from 2009-2013.

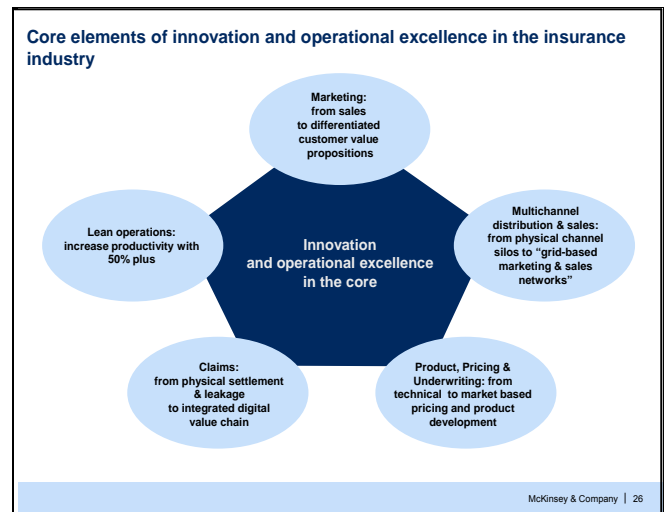
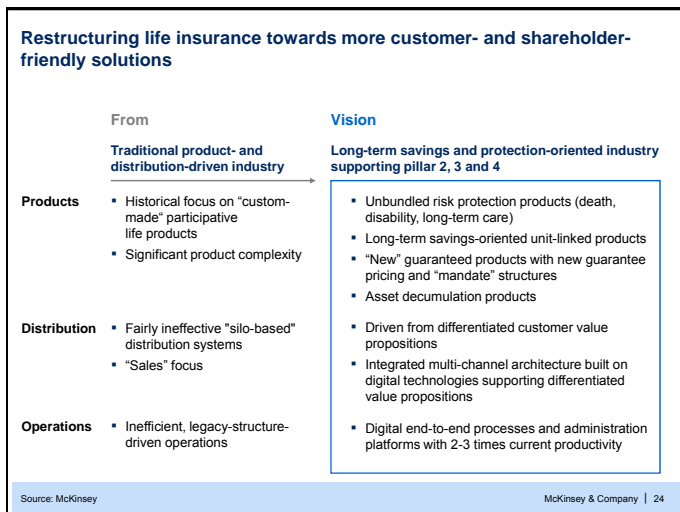
Exhibit I-The Macro Theme



With regulatory reforms come challenges, but they are only one part of the puzzle. The markets and how to survive in the competitive world is a major challenge for any business. Exhibits II and III are examples of only two of the “success themes”. Simensen emphasized more customer- and shareholder-friendly

solutions with heightened need for innovation, efficiencies that are second to none with high digital and technological content.

Exhibits II and III—Forward-Looking “for Success” Themes



His remarks provided a strong benchmark for forward-thinking and set the tone for high aspiration for the seminar.

Strategic Challenges in a Changed World—The CEO Perspective

This session began with comments from The Geneva Association Chairman and Munich Re CEO, Nikolaus von Bomhard. Key in his speech is the “*staying power and stamina*” in responding to the regulatory efforts in the post-financial crisis era. Exhibit I above underscores the depth of his comment.

von Bomhard questioned “can insurers be SIFIs?”. He pointed out that this question has been the result of lack of clarity about the insurance model coupled with lack of its delineation from the banking model. He added “*AIG collapse is mistakenly being used to muddle the picture of insurers*”, repeating that a non-insurance subsidiary of AIG was the cause of AIG’s failure, and that this fact needs to be explained repeatedly and well reflected in the major efforts of the industry to set the record straight. AIG was an insurance conglomerate. But, it went down because of its non-insurance unit and non-insurance products under a non-insurance model and its regulation. von Bomhard called for the following initiative:

“Instead of being on the defensive, this industry has a lot to show for itself and needs to promote itself and be promoted as the one financial industry that managed well through the crisis. It is amazing that instead of receiving accolades and the appropriate appreciation, the industry has to fight an image that was wrongfully imposed on it.”

von Bomhard reflected his disbelief that the insurance model has not been understood well enough and appears to be too complex and lacking in transparency to tell the industry’s positive and important story.

Following the Chairman, the presentation from David Fried, Group General Manager & Group Head of Insurance for HSBC Group eloquently demonstrated how AIG was an industry outlier rather than “*a point of comparison for the industry.*”

Fried’s presentation provided an interesting case study with distinct attributes. HSBC is an interesting example of the many different forms of insurance business. It is a huge conglomerate that stretches across the globe with insurers embedded in a banking conglomerate. He described his challenges as being “*between a rock and a hard place...*” He is not only an “*insurance expert, but also has to know everything about the banking environment and the new banking regulatory efforts such as Basel III and its impact not only on the banks, but also on HSBC insurers.*” His insurance team had to analyse the impact of Basel III on the insurance. Another factor unique to HSBC is the “*people impact.*” His insurance operations are functioning under the current negative environment surrounding pay, cash,

bonuses and salary. There is a fear about his insurance operations' disadvantages compared to other insurers in attracting qualified people. His main question was *"What will be the tail in all this?"*

Being in the global markets, HSBC sees faster growth and strong insurance penetration in Asia. This was a segue to a theme that appeared regularly throughout the seminar as an impending key issue: the growth of older populations. In Asia, 22 per cent of the population is over 60, up from only 7 per cent in 2000. One of the many key challenges that this creates is finding ways to manage mandatory and voluntary pensions and dealing with diverse governmental and population needs and expectations. This diversification was noted before and is a continued topic as shown in Exhibit I. Industry success will require *"time and patience"* he said. Fried raised an important point in the ongoing debate about *"too-big-to-fail"*. The debate should instead be about *"big vs. bad"*.

From the *"insurers in banking"* point of view, we were treated to the view from a large life insurer from Canada by Donald A. Stewart, CEO, Sun Life Financial Inc. This is our second case study. Stewart gave the future perspectives for the life, annuity and investment business as positioned for tomorrow. His outlook about the low interest rates weaved throughout the seminar. *"Interest rates are central in insurance and annuity operations. To use them in very longer-term products such as defined-benefit plans poses a central question."* Thus, no wonder there is major re-pricing of products. Stewart predicted *"shorter-term business, adjustable pricing, variable benefits, insurer-driven investment mix, and participating products with profits in the business."*

The CEO Panel concluded with a lively Q&A discussion that included some of the following topics and comments:

1. Consumer focus with product innovation and correct pricing of risks;
2. De-risking;
3. Transparencies that can help showing no systemic risk in insurance as long as the insurers stick to core insurance activities, and not getting into banking activities;
4. Helping to create regulation of the right operations vs. large;
5. Problems in asset/liability matching with comments depicting challenges such as *"subjecting 30 years promise to 90 days when you have mark-to-market"*;
6. Managerial initiatives rather than following the herd;
7. Back to basics—participating products;
8. *"Not chasing the guarantees"*;
9. *"Liquidity of insurers is second to none and rock solid"*;
10. Calls to enhance and illuminate clearly the insurance business model; and,
11. Moves to privatization of pensions for the ageing population and the opportunities for insurers with the unique model.

Responding to the Financial Challenges in a Changed World—The CFO Perspective

Chairman: Michael E. Sproule, Executive Vice President & CFO, New York Life Insurance Company

Sproule's presentation during the seminar became the basis for the New York Life success story interview featured earlier in this Newsletter. Please read the interview for the full details of the presentation. Briefly, the New York Life ideology is not to adopt a herd mentality and keep working with long-term objectives. During the financial crisis, this insurer did not lose customers; on the contrary the customer base has grown. Sproule touched upon accounting issues as well as strategic and operational issues.


Mr. Sproule's presentation was followed by the CFOs panel, Philip V. Bancroft, CFO, ACE George Quinn, CFO, Swiss RE, and Luke Savage, Director of Finance, Risk & Operations, Lloyd's.

The presentations provided insights into both common and individual issues in their companies, beginning with Bancroft, the CFO of ACE, who described his company as geographically diversified and in a few products. This diversification is a key factor his company's challenges and solutions: 1) currency volatility is dealt with using U.S. currency as the core currency and conducting asset/liability matching along with appropriate derivatives; 2) portfolio evaluation and risk management-in light of crisis-is dealt with through robust and cutting-edge governance and systems with zero tolerance for any guidelines breaches; 3) counterparty risks have been dealt with by robust ERM process and specially designed committees; 4) regulatory risks have been dealt with through major cooperation and dialogue with the

regulatory bodies; 5) globalisation led to sharing cost centers and outsourcing; and, 6) accounting issue risks have been monitored.

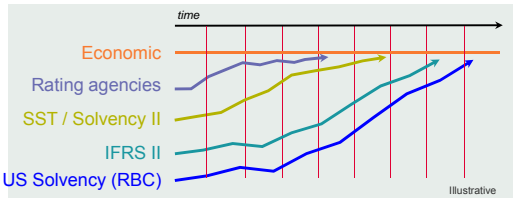
This presentation was followed by George Quinn, CFO of Swiss Re, who echoed some of the challenges and delved into the current interest rate issues, describing them as *“not what the industry ordered”*. It was interesting to learn more about the Swiss solvency testing. He shared the following Exhibit IV which compares the economic capital generated by various regulatory regimes. The convergence is of great interest. The Exhibit does speak for itself.

Exhibit IV



Convergence of frameworks

Economic view will prevail but at different speeds and 'economic' is not yet fully defined



Illustrative

Example of diverging capital ratios: regulatory capital (RBC) and SST for two US subsidiaries (Factual 2009)

Subsidiary	RBC ratio	SST Ratio
Swiss Re America Corp.	296%	738%
Swiss Re L&H America	766%	156%


- Swiss Re continues to be subject to local capital constraints
- Some local regulatory frameworks (e.g. US RBC) may give different answers compared to SST

➔ Despite the introduction of economic regulatory frameworks like SST or Solvency II, capital continues to be locked-up due to more conservative local capital constraints

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Quinn reiterated the regulatory challenges and noted, *“New stakeholders in insurance issues are gaining in importance (e.g. central banks) and new institutions are being created (e.g. FSOC, ESRB)”*. This is shown in Exhibit V.

Exhibit V



Key regulatory risks...

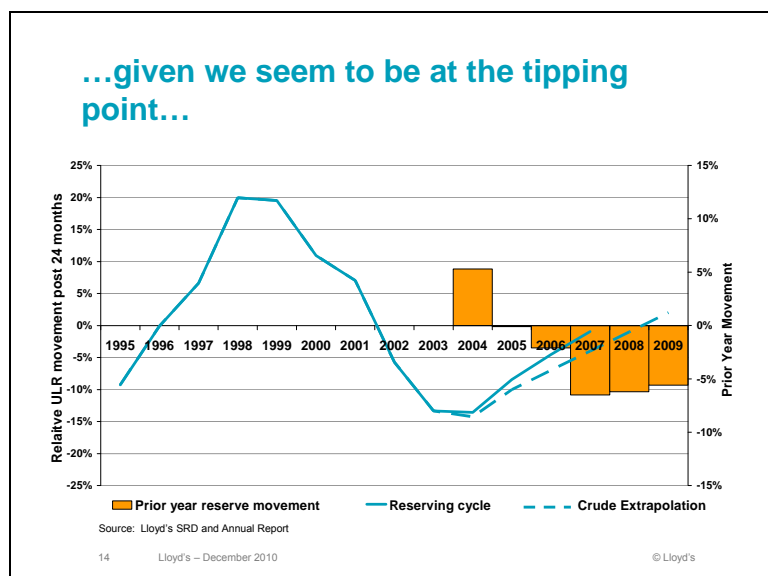
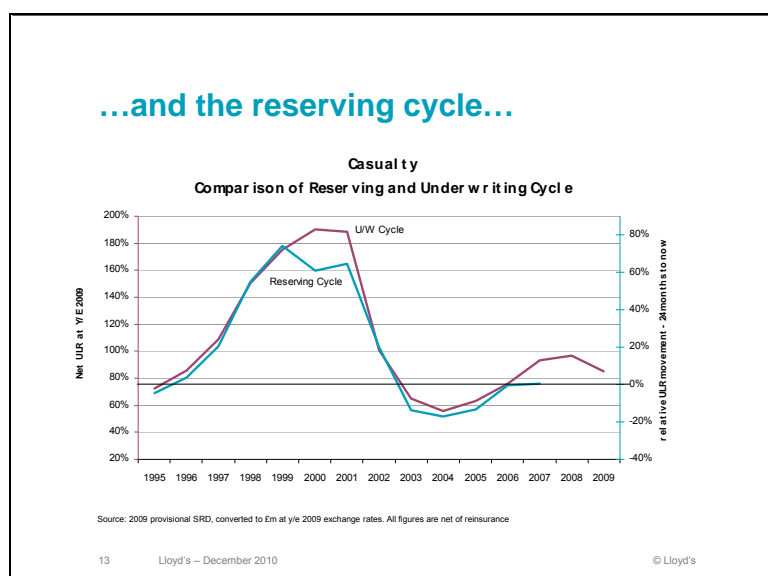
Region	Regulatory risk	Issue
European Union	Solvency II monitoring	Implementing measures
	New supervisory architecture	Creation of EIOPA and ESRB
	Fair risk assessment	European Court's decision pending
Switzerland	Swiss and EU equivalence	Switzerland's position
	TBTF and resolution	FINMA measures and focus on crisis management
United States	Systemic risk oversight (FSOC)	Potential systemic risk relevance of the industry
	Federal Insurance Office	Engage FIO in international agreements
	Collateral reform	State and NAIC efforts
	Affiliate reinsurance tax	Challenge to global risk diversification
International	SIFIs supervision	Criteria transparency
	IAIS ComFrame	Support IAIS efforts on group supervision

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Quinn’s presentation gave an optimistic outlook for the reinsurance industry which is echoed in Brian Shea’s article following this part of the Newsletter. He sees 6.5 per cent growth in the P&C market and only 3.7 per cent in the L&H markets. “Capital will remain an industry issue and whole consolidation among insurers will continue”. He concluded that insurers will remain focused on managing asset risk, linking it back to the “de-risking” aspect noted in the CEOs’ panel.

The last presenter in this session was Luke Savage from Lloyd’s with the 3 Rs’: 1) Repercussions of the crisis—the attractiveness of London; 2) Recession and its impact on business; and, 3) Regulatory environment. He echoed the frustration of being lumped up together with banks because of the crisis. He pointed out that not only the crisis, but also taxes drive capital offshore. On the R for Recession, he was not as optimistic about it being over despite seeing signs of better yields and rising equity prices. Skipping to his responses, it is interesting that underwriting is a key response and most importantly reversing the underwriting cycle as featured in Exhibit VI & VII. As interest rates have to go up, Lloyd’s is building the asset portfolios in anticipation.

Exhibits VI & VII

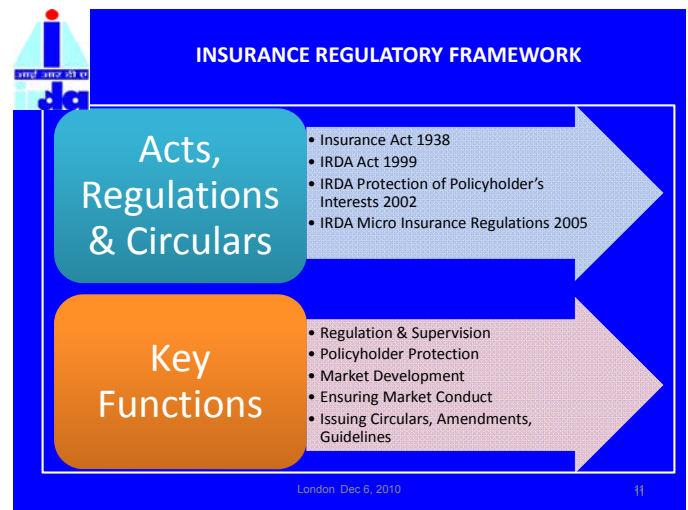
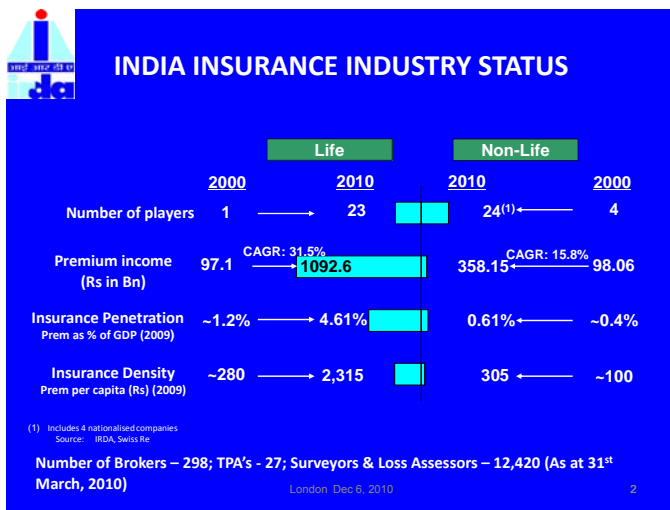


Global Insurance Regulation in a Changed World

This panel of supervisors presented a consistent system of tackling the risks “bit by bit”, with views on global regulatory framework. The first speaker was Kannan Ramalinga, Member (Actuary), Insurance Regulatory and Development Agency, India.

He gave a case study of the Indian insurance market and regulatory system. Exhibit VIII provides the main statistics on the size of the market. Exhibit IX provides an insight into the regulatory mechanism in India. The presentation was very comprehensive and will be soon available on The Geneva Association website.

Exhibits VIII & IX



The regulatory challenges for the emerging markets appeared similar to those of all insurance markets. However, in the newly developed insurance market in India, the regulators would not permit an insolvency.

Specifically for India, the challenges are: foreign equity in Indian insurance company to be raised from 26 per cent to 49 per cent; foreign re-insurers are to be permitted to open branches only for re-insurance business in India; increasing the penetration of health insurance business; obligatory underwriting of third party risks for motor vehicles; responsibility of appointing insurance agents shifted to insurers from IRDA, however IRDA to prescribe eligibility, qualifications and other norms; flexibility to raise capital through other forms instead of Equity only.

Ramalinga was followed by Susann E. Voss, Iowa Insurance Commissioner, President-Elect, National Association of Insurance Commissioners (NAIC) who extended an invitation to “face to face” talks with the insurance companies. She too believes that the insurance model is not clearly understood. The U.S. insurance regulators are of the opinion that insurers are not systemically risky. She reiterated other participants in the seminar in saying that “no insurance consumers were hurt” during the crisis and specifically noted that Federal regulators did not understand how AIG worked.

The NAIC’s five issues of top concern are: groups; reinsurance; accounting; capital; governance and risk management. On the groups, she used the “windows and walls” to explicitly emphasise the need for group supervision and corporate structure. She stressed the importance of working together to better understand structures like AIG and the strong need to get the “staff up to speed”.

In the area of Solvency and risk-based capital, Voss noted “Solvency modernization is not Solvency II” and that the U.S. risk-based capital is introducing internal models that include all risks.

In her concluding outlook, she discussed the challenges in supervising internationally active companies and again noted the challenges in group supervision.

Carlos Montalvo Rebuelta, Secretary General, Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) illuminated in the most eloquent way the fact that insurers do have choices in “What kind of house Insurance wants to live in?” He used a cartoon from the story of the “Three Little Pigs” with the wolf to drill a deep understanding into his perceptions—“it is up to insurers to decide if they want to live in a straw, wood or brick house. The “wolf” could not be harmful to the “pig”

who lives in the brick house.” His analogies were unique and provided in-depth “smart” insights into the understanding of the issues in the “Global Insurance Regulation in a Changed World”.

The Next Generation of Solvency—The Industry’s Next Steps

Chairman: Jean-Christophe Menioux, Chief Risk Officer, AXA Group

This Panel was structured in a Q&A format. The first question was on “building sensible solvency framework”. Jim Binder, Senior Vice President & Treasurer, Finance and Corporate Strategy, Jackson National Life, described the U.S. system as having had, “30 years of attempts to find harmonizing”. It appears that in the U.S. there is a common platform and that the exams are focused on risks. He noted that there is a look into international processes.

For Jackson it is very important to make the distinction that no matter “whatever the jurisdiction [is, it is important to] reflect the different products and customer demands”. Binder too called for simplification despite the differences.

Binder was followed by Makoto Okubo, General Manager, International Affairs, Planning and Research Department, Nippon Life Insurance Company. He provided a set of slides that centered on the differences between banks and insurance. He looked into how to justify the different treatment between banks and provided an in-depth presentation that will soon be available on The Geneva Association website. Of unique interest here is his observation that “insurance products are not part of the settlement system. Even under the financial crisis of 1990-2000 in Japan, no one observed any systemic events”. Further he noted “Another lesson from the Japanese experience was that banks and insurers had a different impact particularly with respect to a low interest rate”.

Robin Spencer, Chief Risk Officer, Aviva plc, stressed the need for market consistency.

As this panel closed the first day of the seminar, the CROs offered specific points of view on various technical issues. The technical aspects flowed into the second day with the complete focus on accounting issues.


Second Day, Financial Accounting Day

The second day was devoted to in-depth and comprehensive discussion of financial accounting issues. With SAP accounting in the U.S., GAAP accounting, FASB and IFRS, uniformity, consistencies and a move towards convergence became the objectives. The sessions looked into specific details under observation and comments, and were of a high technical value. The participants were: Elke König, Member, IASB; Hans Schoen, TEG Member & Inter Agency Working Group Chairman; Marc A. Siegel, Board Member, FASB; Tim Harris, Deputy Chief Financial Officer and Chief Capital Officer, Aviva Plc; Burkhard Keese, Executive Vice President, Head of Financial Reporting, Allianz; Kevin Spataro, Vice President, Accounting Policy & Research, GNAIE/Allstate Insurance Company; Lynda Sullivan, Executive Vice President & Controller, Manulife Financial.

Towards the end of the seminar, all the panelists sat together and discussed the issues with the audience. To give this day a broad overview, I chose slides with less technical complexities that can illuminate the issues discussed. These presentations will soon be available on The Geneva Association website (as part of the forthcoming Etudes et Dossiers).

I selected the first slide in order to provide the main questions. These were articulated eloquently by Keese in Exhibit X below. His first question appears to be a key question. Can it be conceivable that accounting rules dictate business behaviour? The panelists were not of the same opinion on this question. The next arching question was regarding the discount rates. This issue is a prevailing problem across many industries and especially in pensions. Key to accounting rules is the conclusion offered by Keese in Exhibit XI below.

Exhibit X


Allianz 

Cross-cutting questions
Cross-cutting questions


- 1 Should accounting follow the business model?
- 2 Accounting for duration mismatch?
- 3 What is the right discount rate?
- 4 How to deal with highly judgmental estimates?
- 5 How to deal with market inefficiencies?

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Exhibit XI

Allianz 

Conclusions
Conclusions



- A detailed technical discussion can never lead to a satisfactory result, since there are good arguments for both sides; without answering fundamental principles the insurance discussion will not be completed in the foreseeable future
- IFRS introduced a very important principle: the business model has to have an impact on accounting and not the other way around!

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I collected a few interesting additional exhibits from these morning sessions, especially in the area of discount rates and the differences between the U.S. and Europe, and the differences between P/C and Life accounting. As I looked into them, I found many technical terms and comprehensive issues and ideas worth exploring, too much to be included here. For more details, do not hesitate to contact us.

Conclusion

At the conclusion of the seminar, Jerry de St. Paer provided a one sentence summary for the “conflicts” in the accounting rules. He expressed the need to have “one voice.” As an academic observer of the seminar, I wonder if it is possible to have a uniform solution for such a tapestry of unique companies, each attempting to find its own niche and place in the market with innovation, creativity and efficiencies. Can the non-uniform pieces of the quilt that make up the insurance industry produce uniform accounting reports? Would such rules lead to inability to be very different? This is the type of “food for thought” that I gleaned from the intellectually exciting one and a half days at the seminar in London in early December.

V. PROJECTIONS FROM THE 7TH INSURANCE AND FINANCE SEMINAR OF THE GENEVA ASSOCIATION—IN DEFENCE OF THE INSURANCE SECTOR

By Brian Shea*

Introduction

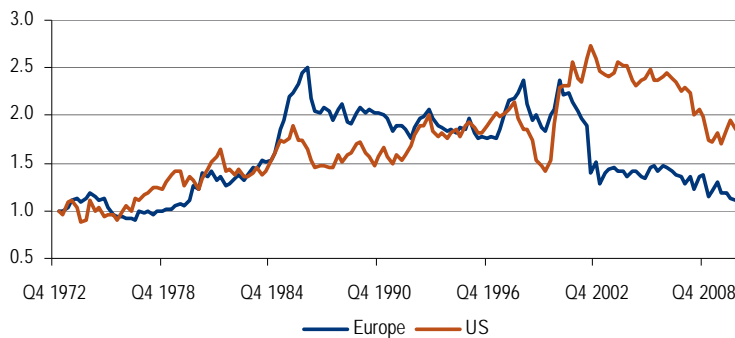
The European insurance sector has been a chronic underperformer for two decades and sentiment is at an all-time low. However, if you look at value creation and cash generation, the sector’s track record is actually respectable.

Key to the repair of reputation is better disclosure. The industry is at an important juncture in this respect. It is imperative that it works closely with the investment community and forms an effective lobby to achieve a new accounting standard that truly is an improvement and which helps to dispel the sector’s “black box” perception.

A graveyard for investors historically

The insurance sector was once an outperformer. And as the graph below shows, going back to the early 1970s both the European and U.S. sectors have eked out a cumulative outperformance over their local markets.

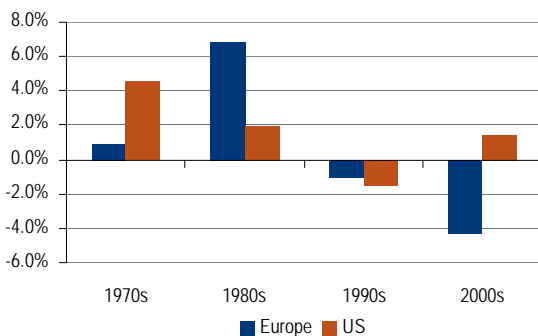
Chart 1: Relative share price performance



Source: Datastream

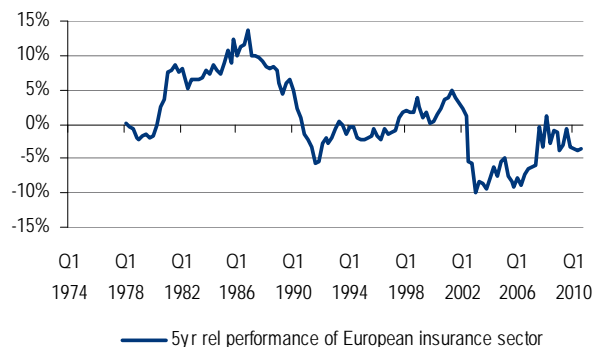
Unfortunately, all of that outperformance was achieved in the 1970s and 1980s. The past two decades have seen serial underperformance. You can see that in the bar chart below as well as in the rolling five year performance graph. Over the past 10 years, the sector is one of the worst performing in Europe. And its peers in this respect are the sectors which were most inflated by the TMT bubble at the start of the decade.

Chart 2: Annual relative share price performance



Source: Datastream, BofA Merrill Lynch Global Research.

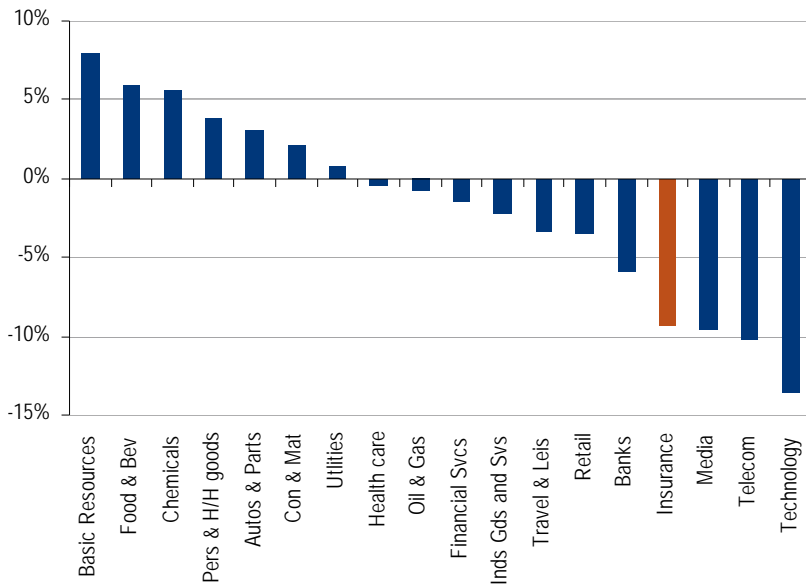
Chart 3: Rolling 5 year performance



Source: Datastream

* Managing Director, Global Research, Bank of America Merrill Lynch. The full report is available at http://research1.ml.com/C?q=U7TwFturJB-Rhtf1mtSk3A__&f=hussmo.

Chart 4: Sector price performance since January 2000

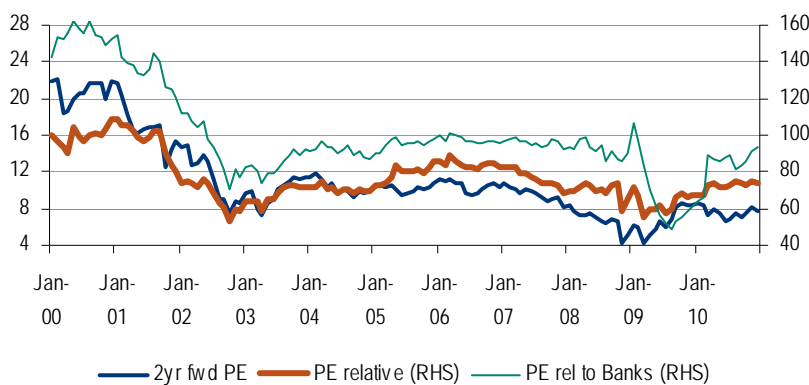


Source: Datastream

Valuations also point to long-term under-achievement, whether you look at:

- the chronic PE discount to the market (the relative PE is currently running at about 75 per cent of the market);

Chart 5: Historic PE



Source: Datastream

- the sector's implied cost of equity (which CFO would agree that his company's CoE currently measures 15 per cent?),

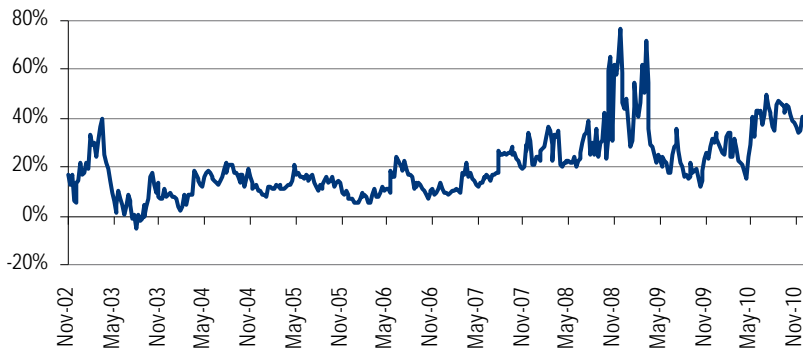
Chart 6: Implied CoE



Source: BofA Merrill Lynch Global Research.

- or the gap to our theoretical fair values (the long-run gap is not centred around zero, and the current gap is particularly large at about 40 per cent).

Chart 7: Gap to 12 month forward Fair Values

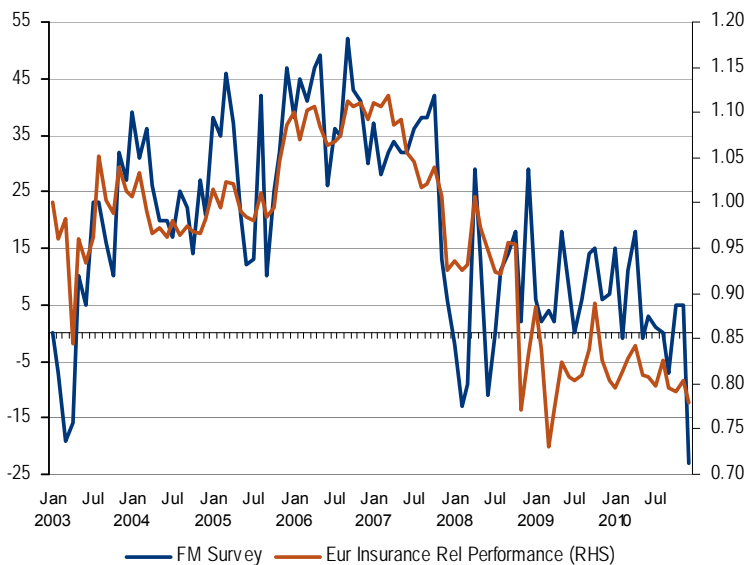


Source: BofA Merrill Lynch Global Research.

Sentiment at an all-time low

In the monthly *Fund Manager Survey* published at the end of last year, the European insurance sector scored its lowest-reading in survey history. A net 24 per cent of fund managers are now saying that they're overweight insurance. A net of 43 per cent of fund managers also see the sector as undervalued. Insurance, together with banks, is one of the most overweight and undervalued sectors.

Chart 8: BofAML Fund Manager Survey—Sector Sentiment vs Performance



Note: The *FM Survey* is a monthly survey of Eurozone fund managers. The line in this graph measures the percentage of fund managers who report they are overweight insurance minus those saying underweight.

Source: BofA Merrill Lynch *Fund Manager Survey* and Datastream.

But value creation has been good

In contrast to the above downbeat message, value creation in the European insurance sector has actually been good—at least over the past six years.

A simple, appealing metric

We think one of the simplest—and best—ways to track value creation in the European insurance sector is to look at growth in reported IFRS book value per share, with the dividend payment being added back to each year's growth rate. This measure is akin to an all-in ROE. This measure is fairly easy to track

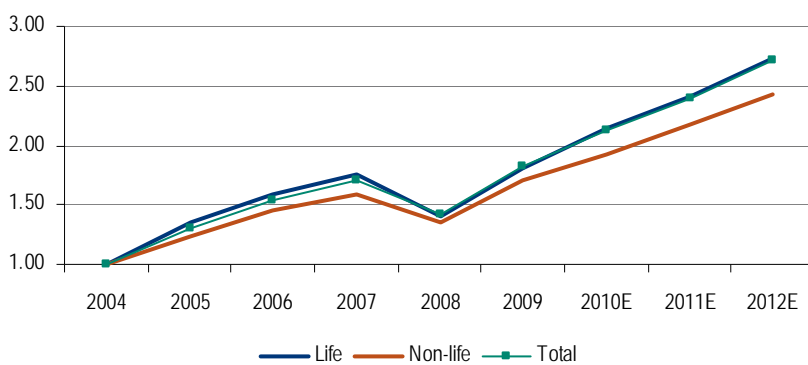
back to the end of 2004. We can track it back further for some companies, but it gets difficult as pre-2004 accounting regimes mean that you need to make a number of adjustments to reported book values. In the text that follows we use “book value growth” as shorthand for dividend-adjusted book value growth and synonymously with “all-in ROE”.

Upbeat message for the sector at large

The overall message is surprisingly upbeat. The overall sector has achieved an all-in ROE of 13 per cent over 2005-10E.⁵ This is comfortably in excess of our estimate of the sector’s cost of equity, which we put at roughly 9 per cent. As the graph below shows, volatility has also not been as big as you might think. In the 2008 financial markets melt-down, the sector’s book value fell by an average 16 per cent. So, just over one year’s valuation creation was erased by that crisis. The sector more than made up for the drop in 2009, with growth last year averaging 28 per cent, and the index of book values being 8 per cent higher at the end of 2009 than the end of 2007.

The patterns of life and non-life performances are also not that different, perhaps reflecting that many companies are composites (e.g. we put Allianz into non-life and Generali into life, although there is not a black and white difference in business mix). Life companies have averaged a higher return over 2005-10E—14 per cent versus 12 per cent. But they have shown greater volatility—life book values dropped 21 per cent in 2008 versus 14 per cent for non-life.

Chart 9: Robust, resilient progression of book values



Note: The graph tracks growth in book value, with dividends being added back to annual growth rates. Life and non-life do not average to total, as total also includes 'distributors' (ie Admiral and MLP).

Source: Company information, BofA Merrill Lynch Global Research.

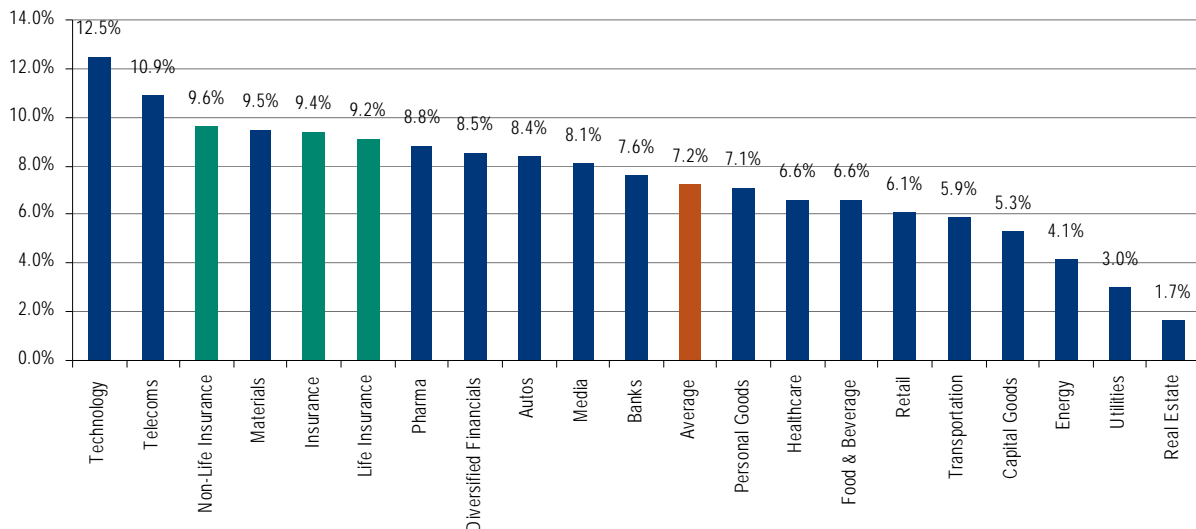
Sector is a strong cash generator

As well as good value creation, another defence of the European insurance sector is that a healthy amount of this “value” is being crystallised as distributable cash. The sector generates one of the strongest free cashflow yields in the market.

Disclosure on this topic is patchy at present, but we expect further visibility in the coming year. Better voluntary disclosure along the lines of FCF itself should be helpful in addressing the sector’s black box perception. But it’s not just the packaging—the content of the message is also good for many companies according to our estimates.

⁵ Our end-2010 estimates lock in market movements to date and assume that Q4 is normal in other respects.

Chart 10: Europe ex-emerging FCF yields by sector (2011 BofAML estimates)



Source: BofA Merrill Lynch Global Research.

Conclusion

The message we give to investors is that they should look at the sector with a fresh view and without prejudice. Peel away the opaque disclosure and you see a sector that has been a better than perceived value creator over time and a good generator of cash. And in our opinion there are some exceedingly cheap valuations at present.

The message for managements is, again, form an effective, cohesive lobby to get the right accounting standard. In our opinion, the problems of complexity and distance from cash haven't been solved by the IASB's Exposure Draft. On the other hand, the desire by some insurance companies to return to a cost-cost world is also not an option. In our view, a compromise could be for the top half of the P&L to consist of a simple cash-like "operating profit", with the connection to market values (with associated volatility) being made in the bottom half of the P&L or, better, in Other Comprehensive Income (OCI).

Key Message:

Set aside your prejudices, sector is a value-creator

This article takes a long-term look at the insurance sector. The sector has been a chronic underperformer for two decades and sentiment is at an all-time low. However, if you look at value creation according to the simple, intuitive metric of growth in IFRS book value (with dividends added back), the sector's track record is actually respectable. The annual growth rate (CAGR) in book value has been 13 per cent since the end of 2004, well above the sector's roughly 9 per cent cost of equity. FCF generation is also good, with insurance one of the highest yielding sectors in Europe. Key to the repair of reputation is better disclosure, and sadly we anticipate no quick fix. But we urge investors to look at the sector with a fresh view and without prejudice. In our opinion there are some exceedingly cheap valuations at present.

The outlook is attractive prospectively as well

Prospectively, it is still a reasonably rosy picture, despite the pressures of lower interest rates and less leverage. Overall, we look for an all-in ROE for the sector of 13 per cent over 2011-12E, coincidentally matching the 2005-10E period. This is comfortably in excess of where we see its cost of equity.

VI. CALL FOR PAPERS: CONVERGENCE, INTERCONNECTEDNESS AND CRISES— INSURANCE AND BANKING

CALL FOR PAPERS

Convergence, Interconnectedness, and Crises: Insurance and Banking

Conference, 9-10 December 2011
Temple University, Philadelphia, PA

The financial crisis of 2007-2010 revealed significant interrelationships both within and between the insurance and banking industries that contributed significantly to the magnitude of the crisis and the resulting government bailout. The need for additional research on interconnectedness provides the motivation for the Conference on Convergence, Interconnectedness, and Crises: Insurance and Banking. The Conference is co-sponsored by Temple University's Advanta Center for Research on Financial Institutions and The Canada Research Chair in Risk Management of HEC Montreal.

Researchers are invited to submit their research on topics related to the conference theme. We are seeking high quality papers from the U.S. and around the world. Selected papers presented at the conference will be published in a special issue of the *Journal of Risk and Insurance*. The topics considered will include but not be limited to the following:

- Convergence and/or divergence among the financial services firms (commercial banks, insurance companies, investment banks, and other financial firms);
- Interconnectedness among the financial services firms;
- Systemic risk;
- Implications of financial services mergers, acquisitions, and consolidation;
- Extreme correlations within the insurance industry;
- Banking and bank-related activities of insurance companies;
- Asset lending and financial guarantees by insurers;
- Interconnectedness through reinsurance within the insurance industry;
- Securitisation;
- Industry loss warranties;
- Collateralised debt obligations;
- Capital adequacy and capital allocation;
- Maturity mismatches between funding sources and investment portfolios;
- Shock transmission across financial industries (contagion, competitive effects);
- Effects of product diversification on industry stability/instability during crises;
- The role of derivatives in convergence of financial firms and crisis;
- Effect of the crisis on the financial industry at the firm-level and industry-level;
- Structural and regulatory changes in the financial industry in response to the crisis;
- Bailout and TARP funding effects on the financial firms and the industry; and,
- Implications for insurance regulation, including internal models, and Solvency II.

Papers should be submitted electronically to convergence@temple.edu. The deadline for submission is 2 May 2011. Authors will be notified on or before 1 June 2011. For further information about potential topics, please contact one of the conference organisers: J. David Cummins (cummins@temple.edu), Georges Dionne (Claire.boisvert@hec.ca), or Elyas Elyasiani (elyas@temple.edu).

VII. JOB OPPORTUNITY—HEAD OF INSTITUTIONAL RELATIONS



Head of Institutional Relations

Leading international insurance think tank, The Geneva Association, is looking for an expert to head a new Institutional Relations department, a key pillar of The Geneva Association's evolving activities aimed at delivering the political and public affairs outreach. The successful candidate will set up and lead the Institutional Relations Department. S/he will report directly to the Secretary General and Managing Director. The working language is English and the role will be based in Basel and Geneva and involve regular international travel.

Through research, regular publications and the organisation of international discussions and meetings, The Geneva Association is the leading voice of the largest insurance groups worldwide in the dialogue with international institutions. The Association's membership comprises a statutory maximum of 90 Chief Executive Officers from the world's top insurance and reinsurance companies.

Definition of Activity Portfolio

Lead and direct the institutional and public affairs outreach activities of The Geneva Association:

- Manage and oversee the institutional relations team and liaison functions and their key activities around the world
- Draft Geneva Association research-based position papers for international institutional interactions
- Represent world-leading insurance companies through The Geneva Association at events and meetings
- Develop positions for outreach and liaison work for The Geneva Association and its member companies and working groups
- Lead and develop relationships with target organisations internationally and liaise with trade associations

Qualifications of the candidate:

- Extensive, senior institutional relations experience in insurance/finance and/or having occupied a senior position in the insurance or wider financial services industry (banking, securities, or related organisations) with strategic outreach responsibilities
- Excellent credentials including higher academic education in a relevant field for the function
- Outstanding track record in organising and running institutional relations
- Exceptional organizational, writing, interpersonal and communications skills; skilled author of position papers
- English mother-tongue or near-perfect knowledge of English language; other languages a benefit
- Strong commitment to the insurance industry's role in the economy and society

Please send your submissions to Patricia Linstaedt at The Geneva Association via post, or email to: Applications@genevaassociation.org.

For more information on The Geneva Association, please visit our website: www.genevaassociation.org.

VIII. CONFERENCES ORGANISED AND/OR SPONSORED BY THE GENEVA ASSOCIATION

2011

March

- 11 Geneva **1st International Trade and Insurance Group Meeting**, hosted by The Geneva Association
- 20-22 Singapore **11th Asia CEO Insurance Summit**, co-organised by Asia Insurance Review and The Geneva Association
- 29 Zurich **7th Geneva Association Associates Meeting**, hosted by Swiss Re (*Associates only*)
- 31 London **5th Meeting of Chief Investment Officers in Insurance**, hosted by Aviva (*CIO members only*)

April

- 6-7 Vevey **The Geneva Association/IAIS Executive Committee High-Level Meeting** (*members only*), hosted by The Geneva Association
- 7-8 Vevey **27th PROGRES Seminar on Insurance Regulation and Supervision**
- 6-8 Rome **16th International Space Insurance Conference on “Space Activities Development – Risk Management and Insurance Aspects”**, organised by Pagnanelli Risk Solutions Ltd., co-sponsored by The Geneva Association

May

- 12-13 Basel **9th ART of CROs**, hosted by Baloise-Holding (*CROs of member companies only*)
- 25-28 Rio de Janeiro **38th General Assembly of The Geneva Association** (*members only*)

June

- 17 Beijing **7.5 Liability Regimes Conference**, hosted by Swiss Re
- 19-22 Toronto **The Geneva Association/IIS Research Award Partnership**

July

- 12-13 Bermuda **M.O.R.E. 25 on Mapping and Modelling Risks and Opportunities (MMR+O 2)**, hosted by the Bermuda Underwater Exploration Institute (BUEI), Bermuda

September

- 19-21 Vienna **38th Seminar of the European Group of Risk and Insurance Economists (EGRIE)**
- tba* Singapore **3rd CR+I Seminar on “Climate Risk: Opportunities for South-East Asian Insurers?”**

October

- 27-28 Munich **8th Annual Liability Regimes Conference**, hosted by Munich Re

November

- 16-17 Rüschiikon **7th CRO Assembly**, jointly organised with Swiss Re
- 7-8 Tokyo **8th Health & Ageing Conference of The Geneva Association on “Insurance and Dementia Diseases”**, hosted by Nippon Life Insurance Company