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ASIAN DEVELOPMENT BANK
INSTITUTE
Kasumigaseki Bldg. 8F 3-2-5 Kasumigaseki
Chiyoda-ku, Tokyo 100-6008 Japan
Tel: 81 3 3593 5500, Fax: 81 3 3593 5571
Email: info@adbi.org http://www.adbi.org

Tokyo Executive Seminar on Insurance Regulation and Supervision

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Executive Summary of Proceedings

CONTENTS

Macroview

[¶] References are to paragraphs

The environment surrounding insurance regulators and supervisors is changing rapidly. As the business and markets evolve, regulation has to follow quickly in order to avoid becoming obsolete and irrelevant. **[¶ 22]**

Regulators now need to realize that the insurance sector is becoming a part of a broader industry, though it may retain some special aspects. This general trend should not necessarily end up with global financial conglomerates everywhere. Ultimately, corporate strategies on whether to be a conglomerate or instead focus on core business will be tested and judged by the market. When an institution does more than one line of business, cross-subsidy between the business lines should be an issue for financial supervisors. **[¶ 46]**

The establishment of an integrated financial supervisory body that covers different financial sectors, including insurance, has recently emerged as a global trend in such countries as the United Kingdom, Canada, Australia, Sweden, Norway, Denmark, Korea, and Singapore. In Japan, the Financial Supervisory Agency (FSA) was formed in 1998, as part of the Japanese financial "Big Bang" that intends to integrate the banking, securities, and insurance sectors. **[¶ 5]**

The Australian Prudential Regulation Authority (APRA) was established in July 1998 as that country's sole prudential regulator of banks, insurance companies, pension funds, and other credit institutions, and in the process merged 11 separate supervisory entities. In August 1999, the APRA's internal structure was reorganized to be more consistent with the trend towards convergence in the marketplace, and with the government's objective of regulating similar risks in a similar manner, irrespective of institutional boundaries. **[¶ 6]**

The challenges for **creating integrated supervisors** are :

- merging cultures
- training staff
- integrating systems
- cost cutting
- harmonizing prudential regimes
- establishing credibility in the marketplace
- minimizing disruption
- maintaining operations **[¶ 6]**

Regulatory reform is being implemented in the direction of removing administrative regulation that causes unnecessary costs to industry and limits managerial freedom, while at the same time strengthening solvency regulation to protect policyholder interests. Ruling bodies of supervisory authorities are increasingly constituted by both regulatory and private representatives from the financial sector. **[¶ 7]**

In order to have effective and efficient supervision, it is important that a supervisory authority has professional, competent, and dedicated staff. Selective recruitment has to be followed by appropriate training to ensure the staff is equipped with up-to-date knowledge and skills to supervise the fast evolving industry. In order to motivate and retain quality staff it is necessary to offer attractive remuneration packages, comparable to those in the financial sector, and flexible job rotation schemes. [¶ 9]

Only government institutions independent from the industry can inspire the public confidence on which insurance businesses rely. Adequate financing and attendant quality could be achieved by separating insurance supervision from the organization of the traditional administration, and by transferring it to an autonomous institution having an independent organization and budget. [¶ 10]

In order to avoid a situation in which the payer dictates the regulator's actions, various alternatives including a license charge, a levy based on annual gross premia and fines could be imposed so that the varied interests of different parties could be balanced. [¶ 11]

The solvency position of an insurance company depends at least on:

- sufficient technical provisions
- sound investment assets corresponding to the technical provisions
- a satisfactory solvency margin [¶ 13]

Adequate regulation of solvency capital is always necessary, because no matter how sophisticated, the technical provisions or investment regulations cannot eliminate the risk that the insurer becomes unable to meet its obligations. A variety of approaches are applied for stipulating statutory solvency requirements, including fixed ratio model, risk-based capital model, and the models based on risk or ruin theoretic considerations. [¶ 14]

The **risk-based capital formula** intends to establish a minimum capital level for each insurer, taking into consideration the actual risks it assumes, such as asset risk, insurance risk, interest rate risk, underwriting risk, and administrative risk. Four thresholds are established to trigger particular regulatory interventions, from requiring the insurer to submit a comprehensive financial plan to seizing control of the insurer by the authority. [¶ 15]

Pessimistic scenario testing also has various advantages, in that:

- it is forward-looking
- it can account for many adverse factors occurring concurrently
- it can be tailored to the risk profile inherent in each company's business mix [¶ 16, 17]

Market liberalization improves efficiency, quality, and diversity in the market through competition and innovation, and thereby enhances benefits for consumers and the economy as a whole. Greater efforts could, therefore, be made to eliminate limitations to market access and national treatment, and to review domestic regulations that effectively restrict the supply of services. A worthwhile strategy might be to place the initial emphasis on liberalization of commercial presence, followed by that of cross-border transactions and other modes of supplying insurance services. [¶ 19]

Worldwide harmonization of accounting principles for insurance companies will facilitate internationally comparable financial information to the benefit of not only supervisors but also consumers and investors. The increasing number of internationally-operating insurers would also welcome a single basis for their accounting. [¶ 20]

Similarly, disclosure requirements can be an important supervisory tool for the insurance sector as it encourages discipline, honesty, and efficiency in management, which also leads to more stability in the market as a whole. The information disclosed must be both verifiable and actually verified. The current process of demutualization of insurance companies would lead as a matter of course to more stringent disclosure requirements for publicly-traded insurance companies. [¶ 21]

Discussions are also underway at the international and intersectoral level concerning **supervision of financial conglomerates**. For instance, the International Association of Insurance Supervisors (IAIS) has been working with other international financial standard-setting bodies for the Joint Forum on Financial Conglomerates. [¶ 24]

The Joint Forum was established in 1996 as a formal group to discuss conglomerate supervision, consisting of regulators of the three sectors in 13 countries. Its mandate covers:

- exploring practical ways to share information,
- identifying the impediments to information sharing,
- establishing criteria for the lead supervisor and its role and responsibilities, and
- developing supervisory principles. [¶ 25]

While conglomeration may reduce the overall degree of vulnerability through risk diversification, it poses potential threats from a supervisor's viewpoint, such as capital inadequacy, contagion, intragroup exposures and transactions, large exposures at a group level, and especially where institutions supplying non-financial services also participate in the cooperation. At the institution level, the supervisors should pay attention to five aspects: ownership arrangements, compositions of management, credit relationships, distribution and outsourcing. [¶ 29, 30]

A **single regulator** has many advantages such as:

- a good overview of all financial businesses
- a common supervisory framework and methodology structure
- easy communication
- a coordinated supervisory approach with supervision of individual companies and group supervision [¶ 27]

Integration is now also crossing borders more frequently. For example, in the Nordic countries, Finansinspektionen will take lead responsibility for the overall supervision of a newly-merged transnational insurer, based on memoranda of understanding (MOU) to be negotiated among the supervisors in all three countries. [¶ 28]

G7 Ten Key Principles and the IAIS Model MOU envisage a greater level of **freedom of information exchange**. They include:

1. authorization to share and gather information
2. cross-sector information sharing
3. information about systems and controls
4. information about individuals
5. information sharing between exchanges (not applicable in the insurance context)
6. confidentiality
7. formal agreements and written requests
8. reciprocity requirements
9. cases which further supervisory purposes
10. removal of laws preventing supervisory information exchange [¶ 32]

Domestically, the U.S. National Association of Insurance Commissioners (NAIC) has developed a number of effective and innovative information systems and arrangements for information exchange among their 55 jurisdictions. [¶ 34]

Many insurers do business across borders in Europe in the form of cross-border transactions or via branches and subsidiaries. As a result of EC directives, confidentiality rules have been harmonized and certain "rules of the game" in a protocol on collaboration have been agreed upon among the European insurance supervisors. [¶ 35]

International insurance fraud could be significantly prevented by actions such as:

- coordinating international regulation
- giving more responsibilities to independents, auditors, actuaries and managers
- regulating reinsurers
- educating insurance consumers
- building effective systems for information exchanges [¶ 37]

Exchange of information in a winding-up situation is becoming increasingly important. Establishing relationships with other supervisors, whether formally through a memorandum of understanding, or informally, is essential to having an efficient flow of information when a crisis situation occurs. In such a situation, one needs to select key regulators with which to work. The selection could be based not only on the influence of the demise over a given jurisdiction but also on the relationship of trust developed through cooperation in the past. [¶ 38]

Financial convergence includes many different forms, ranging from simple cross-selling to integrated services, and from a sector-based structure to a functional, client-oriented organization. The current sectoral regulation and supervision, however, face difficulties in creating a level playing field to avoid hindering the innovation and expansion of the financial sector. [¶ 40]

The development of **bancassurance** seems to be driven by the various synergy effects raised from combining bank and insurance businesses (especially, life assurance). The development of bancassurance is beneficial for consumers by lowering the price of insurance products, as well as contributing to simplification and moralization in their supply. [¶ 41]

Commissioners of Insurance will continue to supervise the activity related to insurance products, but given the general trend towards financial sector convergence, deeper cooperation, especially exchange of confidential information, with banking supervisors is becoming necessary. [¶ 42]

Bancassurance arrangements are of two general forms: strategic alliances in which banks merely market insurance products using their customer bases, and full integration through merger and acquisition between banks and insurance companies in the post-Glass-Steagall world. [¶ 43]

Both pension fund administrators and insurance companies, who are active in the service of providing annuities after retirement, are subject to very similar investment regulation, though the latter have a greater degree of flexibility in investment. For example, insurance companies may invest, up to certain limits, in mortgages, mutual funds, and real estate abroad, which is not allowed for more conservative pension fund administrators. [¶ 44]

Due to their long-term nature, small changes in the real rate of return make a huge difference in pension funds. In order to help alleviate the future tax burden in the pension system, it is vitally important to invest the funds productively. Investment in the stock market should be preferable to that in government bonds as stocks are more profitable and less volatile over the long run. [¶ 45]

The protection of policyholders is essentially provided through financial supervision of insurance companies, first as prevention and subsequently as a cure if necessary and possible. The implementation of a recovery plan may be ensured by safeguard measures, such as restriction on asset disposals, to be taken if the company fails to achieve such implementation. The supervisor may further ask the company to seek external support in such forms as mergers and transfer of the portfolios of contracts. But generally, a guarantee fund usually does not command sufficient resources for coping with a systemic crisis. [¶ 48]

Winding-up or managing companies in crisis situations is an important issue for policyholders and claimants. Intervention by supervisors should be treated with respect and circumspection, because insurance is based on trust between the policyholder and insurance company. [¶ 49]

Prudent and effective crisis management starts with the setting up of an early warning system. Protection should also be provided to policyholders in winding-up through the preferential treatment of insurance claimants and assistance under insolvency funds. [¶ 50]

Protection fund scheme's key principles include:

- the design of the scheme must consider moral hazard, equity and administrative cost
- the scheme must come into operation not only when liquidation has taken place, but must allow for earlier action
- it should *only* benefit policyholders and third parties
- there will be a need for greater coordination between insurance protection schemes and protection schemes for the banking and securities industries [¶ 51]

INTRODUCTION

1. The Tokyo Executive Seminar on Insurance Regulation and Supervision was held at the Asian Development Bank Institute (ADBI) in Tokyo on 27-28 September 1999. It was hosted by the Financial Supervisory Agency (FSA) of Japan and ADB Institute in collaboration with the Organization for Economic Co-operation and Development (OECD), the International Association of Insurance Supervisors (IAIS), and the Ministry of Finance of Japan. Approximately 90 high-level officials and experts attended the seminar from the insurance authorities of 51 jurisdictions, as well as representatives of four international organizations (European Commission, OECD, IAIS and Joint Forum). The seminar provided a timely opportunity for these officials and experts to exchange views, and develop a better understanding of key issues on insurance regulation and supervision. Specifically, this seminar focused on:

- organization of insurance supervisory authorities
- prudential regulation
- supervision of financial conglomerates
- exchange of information among supervisors
- financial sector convergence
- supervision of insurance companies in difficulties

2. The seminar started with a welcome address by Mr. Masaharu Hino, Commissioner, FSA of Japan. The opening remarks were delivered by Mr. Hanley Clark, Chairman, Executive Committee, IAIS; Mr. Everette James, Vice Chairman, Insurance Committee, OECD; Mr. Makoto Fukuda, Director-General, Financial System Planning Bureau, Ministry of Finance, Japan; and Mr. S.B. Chua, Director, Capacity Building and Training, ADBI.

ORGANIZATION OF INSURANCE SUPERVISORY AUTHORITIES

3. This session was designed to explore issues related to the organizational arrangements of an insurance supervisory body, which vary considerably among jurisdictions. The session was divided into two parts: Part A dealt with the aspect of organizational structure, and Part B focused on operational arrangements such as recruitment and funding. Mr. Andre Swanepoel of South Africa moderated this session.

Part A: Organizational Structures

4. An overview presentation on the recent international phenomenon to establish an "integrated" financial supervisory body was followed by two country presentations.

5. **Mr. Sakura Shiga**, Counsellor of the Commissioner's Secretariat, Financial Supervisory Agency, Japan made a presentation on an *Overview of Organization Structure of an Insurance Supervisory Body*. The establishment of an "integrated" financial supervisory body that covers different financial sectors, including insurance, has emerged as a global trend in recent years. To date, an integrated supervisory body has been created in such countries as the United Kingdom, Canada, Australia, Sweden, Norway, Denmark, Korea, Singapore, and Japan. Representatives of these countries attended the meeting of Integrated Regulators hosted by the Australian authority in May 1999. The Japanese integrated supervisory body, the Financial Supervisory Agency (FSA), was formed in 1998, as part of the Japanese financial "Big Bang" that intends to lower the walls between the banking, securities, and insurance sectors. More financial conglomerates are expected to be active in the Japanese markets in the near future. How to cope with such conglomerates is an issue for the FSA, as its organization is structured on a mixed functional and institutional basis.

6. **Mr. Darryl Roberts**, General Manager, Policy Development, Australian Prudential Regulation Authority then explained the *Organization of Insurance Supervision in Australia*. The Australian Prudential Regulation Authority (APRA) was established in July 1998 as that country's sole prudential regulator of banks, insurance companies, pension funds, and other credit institutions, merging 11 separate supervisory entities. In its first year, it had a "silo" structure in which supervisory functions from different organizations simply sat side-by-side under the APRA banner. However, by August 1999, the APRA's internal structure was reorganized to be more consistent with the trend towards convergence in the marketplace, and with the government's objective of regulating similar risks in a similar manner, irrespective of institutional boundaries. Mr. Roberts pointed out that the **challenges for creating integrated supervisors are:**

- merging cultures
- training staff
- integrating systems
- cost cutting
- harmonizing prudential regimes
- establishing credibility in the marketplace
- minimizing disruption
- maintaining operations

7. **Mr. Manuel Aguilera**, President of the National Insurance and Surety Commission, Mexico, presented the *Organization Structure of an Insurance Supervisory Body: the Mexican Case*. The opening of the Mexican insurance industry to foreign competition in the early 1990s has brought about major changes in the market structure and consequently significant adjustments in the regulation and supervision of the insurance sector. Regulatory reform has been implemented in the direction of removing "administrative" regulation that causes unnecessary costs to the industry and limits its management freedom, while strengthening solvency regulation to protect policyholder interests. Since 1995, the CNSF, the Mexican insurance commission, has implemented a program to develop a new supervisory scheme. The new scheme focuses on three key aspects: financial, actuarial, and reinsurance supervisions. The ruling body of the CNSF is the Board of Governors, which is constituted by both regulatory and private representatives from the financial sector. The design of the organization of the CNSF is based on these key aspects of supervision, and is therefore structured on a functional basis.

Part B: Operational Arrangements

8. Part B dealt with issues related to professionalism and independence of an Insurance Supervisor. Among many issues, the key ones in this respect are recruitment and funding. Three presenters provided their respective experience with these difficult questions.

9. **Ms. Lim Shu Chiau**, Executive Director, Monetary Authority of Singapore (MAS) described MAS's policies on staff recruitment and training. In order to have effective and efficient supervision, it is important that a supervisory authority has professional, competent, and dedicated staff. Recruitment of the right people is the first determinant in ensuring competent staff. Selective recruitment has to be followed by appropriate training to ensure the staff is equipped with up-to-date knowledge and skills to supervise the industry. Apart from recruitment and training, the MAS must also do its best to motivate and retain quality staff. This can be done, for example, by offering attractive remuneration packages, comparable to those in the financial sector, and flexible job rotation schemes. Human-resource assets are important for the supervisory authorities, and the MAS is committed to providing well-rounded career development plans, and building a solid work environment and culture with which staff members can identity.

10. **Dr. Helmut Muller** from Germany discussed his view on the *Funding and Independence of an Insurance Supervisor*. He proposed five theses:

1. insurance supervision has to distinguish itself by high professional quality: effective supervision requires well-trained and experienced staff and technical equipment comparable to that of the industry.
2. insurance supervision has to be independent from the insurance industry: only government institutions independent from the industry can inspire the public confidence on which insurance businesses rely.
3. adequate financing is the basis for professional quality.
4. adequate financing encounters difficulties in the structure of traditional administration, in which the insurance supervisor suffers from limitations in staff, equipment, and budget in the same way as ministerial bureaucracy.
5. adequate financing and consequently the attendant quality could be achieved by separating the insurance supervision from the organization of the traditional administration and by transferring it to an autonomous institution having an independent organization and budget.

11. **Mr. Nambi Rangachary** from the Insurance Regulatory Authority, Ministry of Finance, India discussed their experience in *Funding and Independence of an Insurance Supervisor*. In line with a move to deregulate the Indian insurance industry, moving away from the monopoly of the state companies, the creation of a new regulatory body, the Insurance Regulatory and Development Authority is planned. This regulatory body is designed to be autonomous and independent in its functioning. It would consist of professional members who could make their decisions transparently and independently from political interference, though being appointed by the government. The funding of the authority would be provided by the industry. In order to avoid a situation in which the payer dictates the regulator's actions, various alternatives including the license charge, a levy based on annual gross premium and fines would be imposed so that the varied interests of different parties could be balanced. In the ultimate analysis, one could say that the independence of an insurance supervisor depends primarily on its credibility and commitment to professional competence.

CONCURRENT WORKSHOP MEETINGS

Workshop A: Prudential Regulation

12. This workshop covered a variety of classic regulatory issues, ranging from solvency regulation to liberalization of insurance services. During the first half of the workshop, three presenters spoke about the issues related to solvency regulation and its techniques. Three follow-up presenters discussed liberalization, disclosure, and accounting, respectively. Mr. Rinaldo Pecchioli of the OECD Secretariat moderated this workshop.

13. **Mr. Per Simonsen**, Assistant Director General, Kredit Tilsynet, Norway provided an *Overview of Solvency Regulations and Early Warning Systems*. The solvency position of an insurance company depends at least on:

- sufficient technical provisions
- sound investment assets corresponding to technical provisions
- a satisfactory solvency margin

14. These elements are considerably intertwined. The solvency margin requirement could therefore be relaxed if the other two are well satisfied. It should be noted, however, that adequate regulation of solvency capital is always necessary, because, no matter how sophisticated, the technical provisions or investment regulations cannot eliminate the risk that the insurer becomes unable to meet its obligations. There are a variety of approaches applied for stipulating statutory solvency requirements, including fixed ratio model, risk-based capital model, and the models based on risk or ruin theoretic considerations. In many jurisdictions, one or more control levels of solvency margin are set, which trigger certain supervisory interventions.

15. Mr. Alfred Gross, Commissioner, State Corporation Commission, Bureau of Insurance Commonwealth of Virginia, United States explained the ***Risk-Based Capital*** method. In the United States, the capital requirement for insurance companies is calculated according to the risk-based capital formula. This method has been introduced in response to a number of insolvency cases in the United States in the 1980s and 1990s, which highlighted the limitations of fixed minimum capital standards. The risk-based capital formula intends to establish a minimum capital level for each insurer, taking into consideration the actual risks it assumes, such as asset risk, insurance risk, interest rate risk, underwriting risk, and administrative risk. There are separate formulas for life, non-life, and health insurers. The risk-based capital ratio is not an indicator of the financial strength of an insurer, but a measure for granting insurance supervisors to take specific actions. Four levels are established to trigger particular regulatory interventions, from requiring the insurer to submit a comprehensive financial plan to seizing the control of the insurer by the authority.

16. Mr. Darryl Roberts from the Australian Prudential Regulation Authority presented the ***Pessimistic Scenario Testing in Australia***. The Australian supervisory regime for life insurers has a two-tier capital requirement:

- **Tier 1** the solvency standard to ensure the ability of a company to meet its current obligations.
- **Tier 2** the capital adequacy standard to contemplate sufficient capital as a going concern to accept new business.

17. Each capital requirement needs to be determined, taking into account the scenarios of adverse market movements that may affect the value of the liabilities or assets, so as to secure a certain level of capital even under adverse conditions. The scenario testing has various advantages:

- it is forward-looking
- it can account for many adverse factors occurring concurrently
- it can be tailored to the risk profile inherent in each company's business mix

18. Currently, only life insurers are required to undertake this pessimistic scenario testing that is prescribed by the standards, but Mr. Roberts sees that Australian regulatory regimes for insurers evolving in the direction from the blunt ratio model to stress testing and from the prescriptive approach to the internal model one.

19. Mr. Masamichi Kono, Director, Planning and Legal Affairs Division, Financial Supervisory Agency, Japan made a presentation on *Liberalization of Insurance Services*. Market liberalization improves efficiency, quality, and diversity in the market through competition and innovation, and thereby enhances benefits for the consumers and the economy as a whole. Efforts should be made, therefore, to eliminate limitations to market access and ensure national treatment and to review the domestic regulations that effectively restrict the supply of services. This general proposition can apply to the insurance market. It should be noted, however, that for the insurance market, the economic gains of liberalization must be underpinned by adequate prudential regulation to protect policyholders and to ensure the integrity and stability of the market. The millennium round of negotiations at the World Trade Organization should include liberalization of insurance services on its agenda. Indeed, many countries have already made encouraging commitments on insurance. Mr. Kono suggested a strategy in which the initial emphasis can be placed on liberalization of commercial presence, followed by that of cross-border transactions and other modes of supplying insurance services.

20. Ms. Florence Lustman, Commissaire Controleur, Commission de Controle des Assurances, France explained *International Accounting Rules for Insurance Companies*. There are many reasons to be in favor of movement towards worldwide harmonization of accounting principles for insurance companies. Internationally comparable financial information on insurance companies is beneficial not only for supervisors but also for consumers and investors. The increasing number of internationally operating insurers would also welcome a single basis for their accounting. From a practical point of view, however, harmonization is not at all an easy task, as special accounting practices and conventions are actually very close to the heart of the insurance business. Moreover, various factors related to insurance, such as pension and tax systems, are far from being harmonized. Since 1997, IASC has been running a project for developing international standards of insurance accounting, although this understandably will take time. Ms. Lustman therefore sees a need for an interim, practical solution catering to the immediate concerns of international insurance and reinsurance groups.

21. Finally, **Ms. Jane Lamb**, Senior Analyst, Office of the Superintendent of Financial Institutions, Capital Division, Canada discussed *Disclosure: The Good, The Bad and The Ugly*. Disclosure requirements can be an important supervisory tool for the insurance sector as it encourages discipline, honesty, and efficiency in management, which also leads to more stability in the market as a whole. In order to ensure effective disclosure, the quality of information is important. The information disclosed must be both verifiable and actually verified. Moreover, in Canada, it must also be approved by the board or "signed off" by a senior official of the company. Almost all information collected on the regulatory returns is now made public in Canada, with limited exceptions, such as details on particular investments or client transactions, proprietary information, and the evaluation of the company by the supervisor. The current process of demutualization of insurance companies would lead to the application of more stringent disclosure requirements for publicly-traded companies. Furthermore, Ms. Lamb regards it as important to improve the comparability of the disclosed information within a sector and, given the evolution of financial sector convergence, with other financial sectors.

22. Participants shared the sentiment that the environment surrounding insurance regulators and supervisors is changing rapidly. As businesses and markets evolve, regulation has to follow quickly in order to avoid becoming obsolete and irrelevant. Some regulators from emerging markets wonder whether the sophisticated regulatory tools presented, such as pessimistic scenario testing and the risk-based capital method may not be wholly relevant to regulating their markets. It may be true today, but probably will not be tomorrow. One of the general trends among the changes in the insurance markets is internationalization. Whether regulators like it or not, this trend will continue in line with advancing telecommunication technologies. In response, international coordination becomes increasingly important for insurance regulation and supervision. In this context, regulators should pay greater attention to the current efforts in harmonizing insurance accounting and disclosure as well as to those of market liberalization.

Workshop B: Supervision of Financial Conglomerates

23. Workshop B focused on the supervisory issues related to financial conglomerates, with which more than one financial supervisor is concerned. The first three presentations were intended to share the salient aspects of the discussions underway at the international and intersectoral level concerning supervision of financial conglomerates. They were followed by two speakers on supervisory challenges facing financial conglomerates from their country's experiences. Mr. Arend Vermaat from the Netherlands was the moderator of this workshop.

24. **Mr. Knut Hohlfeld from the IAIS Secretariat** made a presentation on *Global Cooperation among Supervisors of Different Financial Sectors*. The IAIS has been working with other international financial standard-setting bodies for the Joint Forum on Financial Conglomerates. The IAIS has also been actively involved in other international cooperation efforts such as the Coordination Group, the Joint Year 2000 Council, the Multidisciplinary Working Group on Enhanced Disclosure, the Financial Stability Forum (FSF), and the Working Group on Offshore Financial Centres. Moreover, cooperation has been achieved with other international organizations, such as the IMF on the Code of Good Practice, as well as the World Bank, the OECD and UNCTAD. In general, close cooperation between countries around the world is an indispensable foundation for international stability and prosperity. The IAIS plays an important role in global cooperation.

25. **Ms. Johanna Prevost from the Secretariat to the Joint Forum** explained the *work program of the Joint Forum*. Supervisory objectives and approaches vary among different financial sectors, i.e. banking, securities, and insurance. This variation creates complications for a group-wide approach in conglomerate supervision. The Joint Forum was established in 1996 as a formal group to discuss conglomerate supervision, consisting of regulators of the three sectors in 13 countries. Its mandate covers:

- exploring practical ways to share information
- identifying the impediments to information sharing
- establishing criteria for the lead supervisor and its role and responsibilities
- developing supervisory principles

26. In February 1999, the Forum issued a set of papers on capital adequacy principles, fit and proper principles, principles for supervisory information sharing, as well as a supervisory questionnaire. The intragroup transactions and exposures principles and the risk concentration principles are now under consultation. It will work on the issue of transparency of structures under the current mandate. Its new mandate is under consideration, which includes issues common to all three sectors.

27. **Mr. Jarl Symreng**, Head of Insurance Division, Insurance Market Department, the Swedish Financial Supervisory Authority made a presentation on *Supervision of Financial Conglomerates*. Finansinspektionen is the single financial supervisory authority that covers all Swedish financial sectors. In countries like Sweden, which have an integrated financial environment, a single regulator has many advantages:

- a good overview of all financial businesses
- a common supervisory framework and methodology structure
- easy communication
- a coordinated supervisory approach with supervision of individual companies and group supervision

28. Integration is in progress not only between the financial market segments but also across borders. In the Nordic countries, for example, a recent large merger has resulted in a Swedish insurer controlling half of the Norwegian and a third of Finnish insurance markets. Finansinspektionen will, therefore, be responsible for the overall supervision of the company, based on memoranda of understanding to be negotiated among the supervisors in all three countries.

29. **Mr. Arend Vermaat**, President, Verzekeringskamer, Netherlands discussed some core issues for *The Supervision of International Financial Conglomerates*. International financial conglomerates are becoming more important for international financial markets. While conglomeration may reduce the overall degree of vulnerability through risk diversification, it poses potential threats from a supervisor's viewpoint, such as capital inadequacy, contagion, intra-group exposures and transactions, and large exposures at a group level. Financial supervisors have to cope with these challenges across borders. Effective coordination arrangements among supervisors are essential for the supervision of international financial conglomerates. A list of such arrangements includes:

- realizing a level of familiarity between the supervisors involved
- agreeing on information exchange procedures
- attaining sufficient transparency of the reviewed group
- carrying out fit and proper tests for the relevant management levels
- defining basic financial parameters for a quick scan opinions
- applying tests to prevent multiple gearing

30. Finally, **Mr. László Asztalos**, President, State Supervising Authority of Insurance in Hungary presented *The Key Issues of Bank-Insurance's Regulation*. Bank-insurance is a fashionable expression nowadays, without any clear definitions available. In the narrowest interpretation, it means any form of cooperation between licensed insurers and banks. The "financial holdings" interpretation, which Mr. Asztalos recommends, generalizes it to indicate the cooperation between the institutions licensed to offer financial services. A broader definition can include the cases in which the institutions supplying non-financial services participate in the cooperation. Cooperation in bank-insurance may be classified at the product and institution levels. At the product level, the cooperation can be either combined or integrated, depending on whether the banking and insurance products preserve their independence or not. At the institution level, the supervisors should pay attention to five aspects: ownership arrangements, compositions of management, credit relationships, distribution and outsourcing.

Workshop C: Exchange of Information among Supervisors

31. This workshop examined issues of information exchange among insurance supervisors. The first three speakers presented models for information exchange arrangements among supervisors. They were followed by two presenters who discussed exchange of information among supervisors in specific situations. This workshop was moderated by Mr. Edward Forshaw from the United Kingdom.

32. **Mr. Edward Forshaw**, Manager, International Relations, Insurance and Friendly Societies Division, Financial Services Authority, United Kingdom started the workshop by his presentation on the *G7 Ten Key Principles and the IAIS Model MOU*. In May 1998, the Finance Ministers of the G7 countries endorsed their Ten Key Principles on information exchange and agreed to promote these internationally. The Ten Key Principles envisage a greater level of freedom for exchange of information than currently exists. They include:

1. authorization to share and gather information
2. cross-sector information sharing
3. information about systems and controls
4. information about individuals
5. information sharing between exchanges (not applicable in the insurance context)
6. confidentiality
7. formal agreements and written requests
8. reciprocity requirements
9. cases which further supervisory purposes
10. removal of laws preventing supervisory information exchange

33. Even before these principles were published, the IAIS had been seeking to encourage the exchange of information between its members. The IAIS model Memorandum of Understanding on exchange of information has been developed for this purpose.

34. **Mr. Alessandro Iuppa**, Superintendent, Department of Professional and Financial Regulation, Maine Bureau of Insurance, United States talked about the *Exchange of Information among United States Insurance Regulators* and briefly described the arrangements for information exchange between the 55 U.S. jurisdictions. The National Association of Insurance Commissioners (NAIC) has developed a number of effective and innovative information systems. For example, it has created a financial information database containing details of the annual financial statements of insurance companies. The companies are required to file this information through their states to the NAIC, using a common electronic format. The Special Activities Database (SAD) contains limited information on the individuals and companies that have caught the attention of regulators for potentially illegal action. It includes a contact person from whom further details can be obtained. The Regulatory Information Retrieval System (RIRS) holds information on all the individuals and companies that have been subject to enforcement action by any of the states. These U.S. schemes may not be appropriate for all jurisdictions, but they do illustrate the need for a multi-faceted approach to information sharing making full use of technology.

35. **Mr. Henke Bjerre-Nielsen**, Director General, Danish Financial Supervisory Authority presented the *Exchange of Information Among Supervisors in EU Countries*. Many insurers do business across borders in Europe in the form of cross-border transactions or via branches and subsidiaries. Therefore, the exchange of information among the supervisors and the coordination of their supervisory actions are of necessity in Europe. Formal impediments to cooperation and exchange of information have been removed, as, thanks to European directives, confidentiality rules have been harmonized and certain "rules of the game" in a protocol on the collaboration have been agreed upon among the European insurance supervisors. In fact, Danish supervisors, for example, meet with other European supervisors on a regular basis and exchange information both formally and informally. Some European supervisors make on-site inspections in foreign branches of their national insurers, which usually includes a visit to the host supervisor. The exchange of information is also important outside the EU, but the lack of a formal framework is a challenge.

36. **Mr. Steve Butterworth from the English Channel Isle of Guernsey** discussed *Insurance Fraud and Exchange of In-*

formation. The origins of the IAIS are rooted in a desire among certain insurance regulators to increase the exchange of information on fraud. Insurance fraud can be categorized into claims fraud, insurer fraud, money laundering, and fit-and-proper issues. Nowdays, it tends to be even more complicated and internationalized. In general, insurance fraud results from uncontrolled agents, unregulated reinsurers, bad management, poor insurance regulation and gullible customers. In this connection, the Insurance Fraud Subcommittee of the IAIS has made the following recommendations:

- monitor reinsurers and intermediaries, and intervene when necessary
- publish a list of reinsurers
- create an accessible database of established insurers, reinsurers and insurance brokers
- establish a standard for enforcement procedures
- establish fit and proper standards
- develop controls on web-sites

37. International insurance fraud could be significantly prevented by actions such as:

- coordinating international regulation
- giving more responsibilities to independents, auditors, actuaries and managers
- regulating reinsurers
- educating insurance consumers
- building effective systems for information exchanges

38. **Ms. Jane Lamb of Canada** made a presentation on *Exchange of Information in a Winding-Up Situation*. Establishing relationships with other supervisors, whether formally through a memorandum of understanding, or informally, is essential to having an efficient flow of information in a crisis situation. This is because in crisis situations the regulator must act quickly and therefore has no time to learn about another supervisory system or to find out whom to contact. When the OSFI faced the case of the collapse of a major Canadian insurance-led conglomerate, it cooperated particularly with regulators in the United Kingdom and the State of Michigan. In a crisis situation, one needs to select the key and relevant regulators to work with, because the information should be kept secret and there is little time to contact many other counterparts. The selection was based not only on the effects of the collapse over a given jurisdiction but also on the relationship of trust developed through cooperation in the past. As a result of such coordination, the OSFI was able to act timely and quickly and work the case out smoothly.

Workshop D: Regulatory Issues on Financial Sector Convergence

39. Workshop D discussed the regulatory issues on financial sector convergence. After an overview presentation, three speakers provided the experience in their respective countries as to the penetration of banks in the insurance market, or so-called **"bancassurance."** The following two speakers then addressed the regulation of private pension funds that are sometimes managed by insurance companies. The moderator of this workshop was Mr. Rinaldo Pecchioli.

40. **Prof. Lutgart Van Den Berghe**, Vlerick Lewen Gent Management School, Belgium presented an overview of *Convergence in the Financial Service Industry*. Looking at the market scene today, one can witness one or another form of financial convergence in many, if not all, developed markets. Financial convergence is a broader concept than the emergence of financial conglomerates. It includes many different forms, ranging from simple cross-selling to integrated services, and from a sector-based structure to a functional, client-oriented organization. Supervisors cannot prevent this convergence movement, as it is embedded in a much wider trend towards integrated, financial services in an effort to offer convenience, switching from mass production to customization and individualization. The current sectoral regulation and supervision, however, face difficulties in creating a level playing field to avoid hindering the innovation and expansion of the financial sector. Professor Van Den Berghe argues that the solo-plus supervision, which is currently discussed in relation to financial conglomerates, will probably be only a temporary solution in the broader convergence movement in which the distinction between "lead" and "plus" parts becomes more difficult to maintain. Further discussion is necessary as regards a need for a matrix approach, combining institutional and service/product typologies, and a need to go beyond the focus on legal entities in the financial sector.

41. **Mr. Bruno Bézard**, Head of Insurance Department, French Treasury outlined the development of *bancassurance* in France. The influence of banks in the insurance markets has grown remarkably in the last few decades. Especially in the life assurance market, the share of bancassurance has reached more than 60 percent today, while it remains not more than 6 percent in the non-life sector. The development of bancassurance seems to be driven by the various synergy effects raised from combining bank and insurance (especially, life) businesses and also the strategy of the banks against disintermediation in the French financial market of the 1980s. Mr. Bezard sees the development of bancassurance as beneficial for consumers by lowering the price of insurance products, as well as contributing to simplification and moralization in their supply. However, regulators also need to be aware of the risks associated with bancassurance. These include:

- risk concentration at the group level
- intra-group transactions and crisis contagion
- double use of capital, the opacity of group structure
- involvement of several supervisory authorities

He stressed that more work to address these risks should be done at both the national and international levels.

42. **Mr. George Reider**, President, National Association of Insurance Commissioners described the situation in the United

States concerning the activities of banks in the insurance sector. After the repeal of the Glass-Steagall Act, convergence and cross-ownership between the banking and insurance sectors can be expected to proceed apace. The selling of insurance products by banks had already been permitted by court decisions. The major merger of Travelers Insurance and Citicorp suggests the continued emergence of financial conglomerates as well. The Commissioners of Insurance will continue to supervise the activity related to insurance products, but given the general trend towards financial sector convergence, deeper cooperation, especially exchange of confidential information, with banking supervisors is necessary.

43. **Mr. Chee Siew Eng**, Senior Manager, Insurance Regulation Department, Central Bank of Malaysia discussed the *Regulatory and Supervisory Challenges for Bancassurance in Malaysia*. While the insurance industry has grown rapidly over the last decade in Malaysia, the market penetration of insurance products remains at a low level. This is partly because the industry, especially the life sector, is almost totally reliant on the agency channel for distribution, which involves a vast sales force with low productivity and quality. In response, Bank Negara Malaysia, which supervises both the banking and insurance sectors, is in favor of bancassurance. In Malaysia, bancassurance arrangements are of two forms: strategic alliance with which banks merely market insurance products using their customer bases, and full integration through merger and acquisition between banks and insurance companies. So far, the former model has been more popular but less successful. From Malaysia's experience, the main regulatory issues in the development of bancassurance include:

- financial and administrative responsibilities of the insurers
- appropriate passing-on of lower distribution costs to benefit customers
- training of the sales force
- protection against personal information abuses and pressure selling
- commitment by the management in promoting insurance products

44. **Ms. Mónica Cáceres Ubilla** of Intendente de Seguros of Chile explained the *Regulation of Insurance Companies and Pension Funds Administrators in Chile*. This decade, the social security sector has been strongly incorporated into the financial sector in Latin America, especially in Chile where the private pension system emerged in the early 1980s. Both pension fund administrators and insurance companies are active in the service of providing annuities after retirement. Being the major institutional investors in Chile, pension fund administrators and insurance companies are subject to very similar investment regulation, though the latter have a greater degree of flexibility in investment. For example, insurance companies may invest, up to certain limits, in mortgages, mutual funds, and real estate abroad, which is not allowed for pension fund administrators. Eighteen years after the introduction of the private pension system, efforts are continuing to improve its regulation. The legal changes currently proposed are:

- to allow discounts on commissions and creation of multiple funds by a pension fund administrator
- the extension of the measurement period for "minimum yield" required to pension funds administrators
- "early retirement discounts" so as to reduce high commissions charged by insurance brokers

45. **Mr. Matthew King**, Administrator, European Commission made a presentation on *Supplementary Pensions in the European Union: Funding Retirement through Private Savings*. Pensions attract considerable attention in Europe, as the society is aging rapidly: the number of workers per pensioner is expected to decrease sharply from the current four to two in 2020. Among the three pillars of pension structure, the EU debate focuses upon pillar two: pension funds linked to firms. The Commission intends to make these funds, where they are set up, more efficient through increased returns and security and through increased competition. Due to their long-term nature, small changes in the real rate of return make a huge difference in pension funds. In order to help alleviate the future tax burden in the pension system, it is vitally important to invest the funds productively. In this context, investment in the real economy, new technologies, and start-ups with great diversity including those in emerging market countries, is recommended. Mr. King also asserted that investment in the stock market should be preferable to that in government bonds as stocks are more profitable and less volatile over the long run.

46. In open discussion, participants reconfirmed that there is a general trend towards more convergence in the financial sector. Regulators now need to realize that the insurance sector is becoming a part of a broader industry, though it may retain some special aspects. A participant argued, however, that this general trend should not necessarily end up with global financial conglomerates everywhere. There was a case that the decision by management of a bank to acquire an insurance company was put in question by investors. Ultimately, corporate strategy on whether to be a conglomerate or instead focus on core business will be tested and judged by the market. Another participant pointed out that when an institution does more than one line of business, cross-subsidy between the business lines could be an issue for financial supervisors. The institution may distort competition in a financial market, using the profits gained from its operations in other sectors.

CRISIS MANAGEMENT: SUPERVISION OF INSURANCE COMPANIES IN DIFFICULTIES

47. This session centered on the issue of how supervisors should prepare and handle an insurance company in distress. Three speakers made presentations based on the respective experience in their countries, which was followed by a thematic presentation on policyholder protection schemes. The moderator of this session was Mr. Andre Swanepoel from South Africa.

48. Mr. Jean-Louis Bellando, Chef du Service du Controle des Assurances, Commission de Controle des Assurances of France presented *The Control of Insurance Companies in Difficulties*. The protection of policyholders is essentially provided through financial supervision of insurance companies, first as prevention and subsequently as a cure if necessary and possible. When the supervisor finds an ailing company, it asks the company to submit a recovery plan. The implementation of the plan may be ensured by safeguard measures, such as restriction on asset disposals, to be taken if the company fails the implementation. The supervisor may further ask the company to seek external support in such forms as mergers and transfer of the portfolios of contracts. If the company keeps deteriorating after all these efforts, the supervisor must put an end to its business, either by the compulsory transfer of its portfolio or by the withdrawal of its license. The latter should be the last resort, as in France it automatically leads to the liquidation of the company. A guarantee fund was introduced in France in 1999. In general, however, such a fund does not have sufficient resources for coping with a systemic crisis.

49. Mr. Andre Swanepoel, Deputy Executive Officer, Financial Services Board of South Africa explained the *Experience of South Africa in Supervising Insurance Companies in Difficulties*. Over the past fifteen years, eight insurance companies could be classified as those in crisis in the South African market. Out of them, two were managed back to financial soundness, three were wound up, and the remaining three were liquidated after transfer of their businesses to other insurers. In all cases, policyholders were well protected, though in those years the Insurance Registrar, South Africa's insurance supervisor, had very limited powers to rectify the situation. The new life and non-life insurance acts, promulgated in January 1999, give more options and powers to the Registrar, such as the authority to ask an insurer for a plan of action. Mr. Swanepoel concluded his presentation by mentioning:

- winding-up or managing companies in crisis situations is an important issue for policyholders and claimants, since there are no protection or guarantee funds in South Africa, and
- intervention of supervisors should be treated with respect and circumspection, because insurance is based on trust between the policyholder and insurance company.

50. Mr. Alan Wong, Commissioner of Insurance, Office of the Commissioner of Insurance, the Government of the Hong Kong Special Administrative Region shared his experience in *Crisis Management of Insurance Companies*. Crisis management starts with the setting up of an early warning system. The supervisor should find the early warning signals and assess the seriousness of situations through its supervisory work. Concurrently, the supervisor needs to ensure the implementation of preventive measures by companies, which include fit and proper management and adequate reinsurance arrangements. When necessary to safeguard the interests of policyholders, the supervisor should intervene by appropriate regulatory actions. In Hong Kong, China protection would also be provided to policyholders in winding-up through the preferential treatment of insurance claimants and assistance under insolvency funds. In a financial crisis, insurers face various problems. The regulator should be prepared against such a situation by an effective early warning system and preventive measures and adequate powers to handle crisis situations, as well as by greater market transparency and a reasonable balance between the market mechanism and regulation.

51. Finally, **Prof. Gerry Dickinson**, City University of London gave a presentation on *Policyholder Protection Funds and Guarantee Schemes: Some Theoretical and Practical Issues*. The protection fund/scheme concept was first developed for banking and then extended to other financial sectors. While there are pros and cons for the protection fund/scheme, it has been introduced in most of the advanced market countries. Professor Dickinson presented six key principles for developing protection schemes in insurance:

- the scheme must contain incentives to supervisory authorities to actively explore other solutions
- the design of the scheme must consider moral hazard, equity and administrative cost
- the scheme must not come into operation only when liquidation has taken place, but it must allow for earlier action
- the scheme should only benefit policyholders and third parties: it should not benefit managers, owners or other creditors of a failing insurance company
- the design of the scheme must carefully consider the international dimension
- within a country, there will be a need for greater coordination between insurance protection schemes and protection schemes for the banking and securities industries

CONCLUSION

52. The moderators summed up their respective workshops. Mr. Roberts also provided a summary for Session I and Mr. Wong for Session IV. The seminar was successfully concluded and participants expressed their appreciation to the ADB Institute, FSA of Japan and to the other organizers. The success of the seminar was also confirmed by the evaluation questionnaire in which most participants answered that the seminar was useful and well organized.

53. In the concluding session, several attendants expressed their desire that this kind of seminar should continue to be organized in the future. A variety of topics were suggested in the questionnaire for follow-up meetings, which include, among others, reinsurance, outsourcing of supervisory functions, crisis management, supervision of financial conglomerates, risk-based capital, emerging market issues. It was generally agreed that the continuation of this kind of effort in the future would be of the utmost importance.

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