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Go for Gold

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**At the Coal Face
Global Insurers – The Future**

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What went wrong?

What will happen next?

How will the industry change?

Some final thoughts



What went wrong?

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The press have identified many culprits..

ALAN GREENSPAN

Securitisation

Regulators

FECKLESS AMERICAN BORROWERS

Chinese Savers

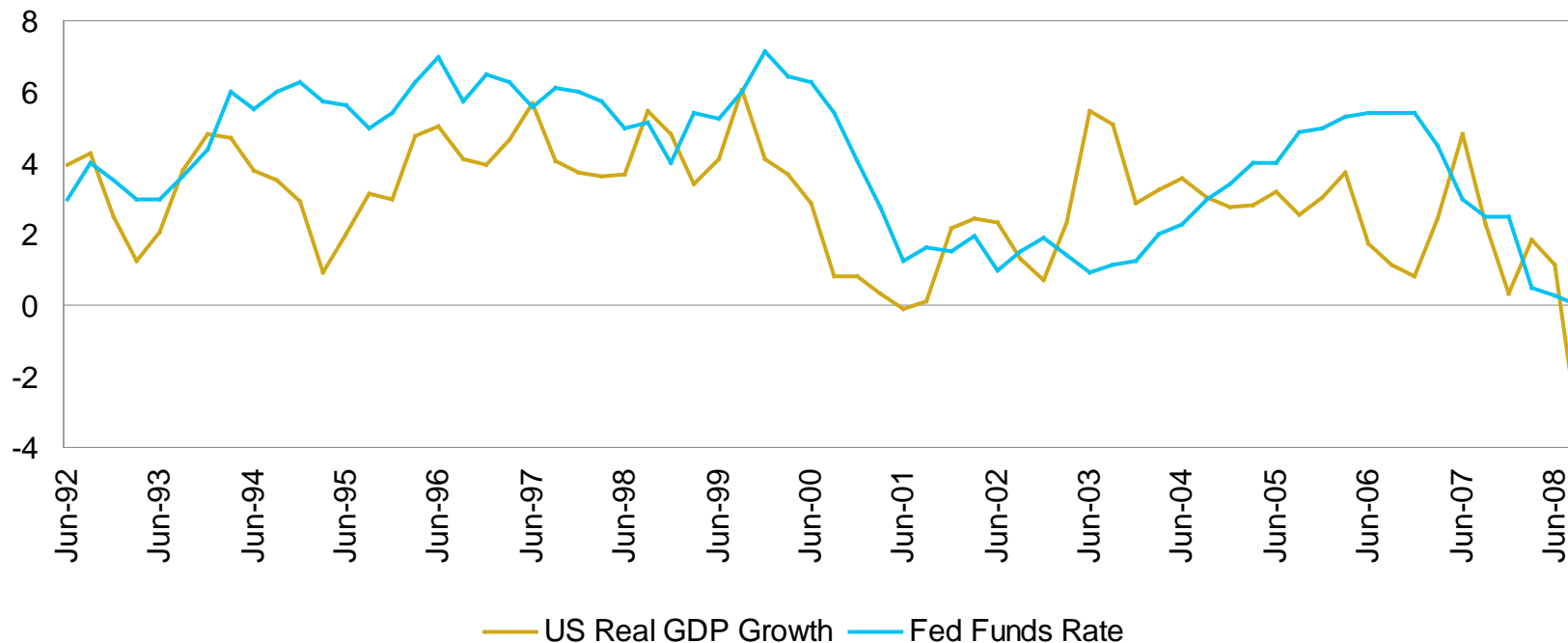
Greedy bankers
— and their bonuses



A Perfect Storm

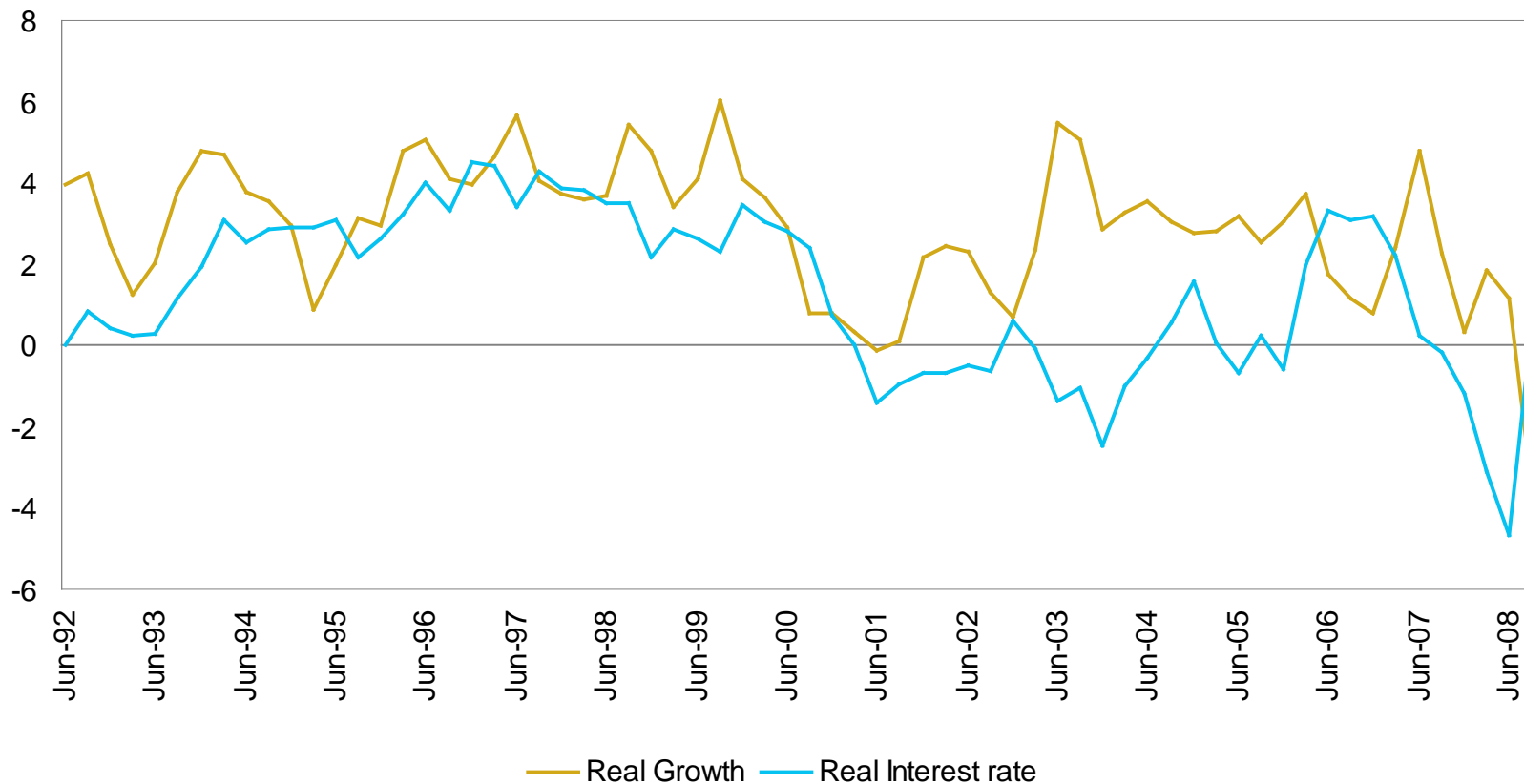
An Extraordinary Confluence of Events

- Globalisation – deflationary pressure
- Fixed Asian exchange rates
- Willingness to finance growing US deficits





A Perfect Storm An Extraordinary Confluence of Events



Source: Bloomberg, US Department of Labour

FF rate – 1yr avge CPI growth
shifted 6 months

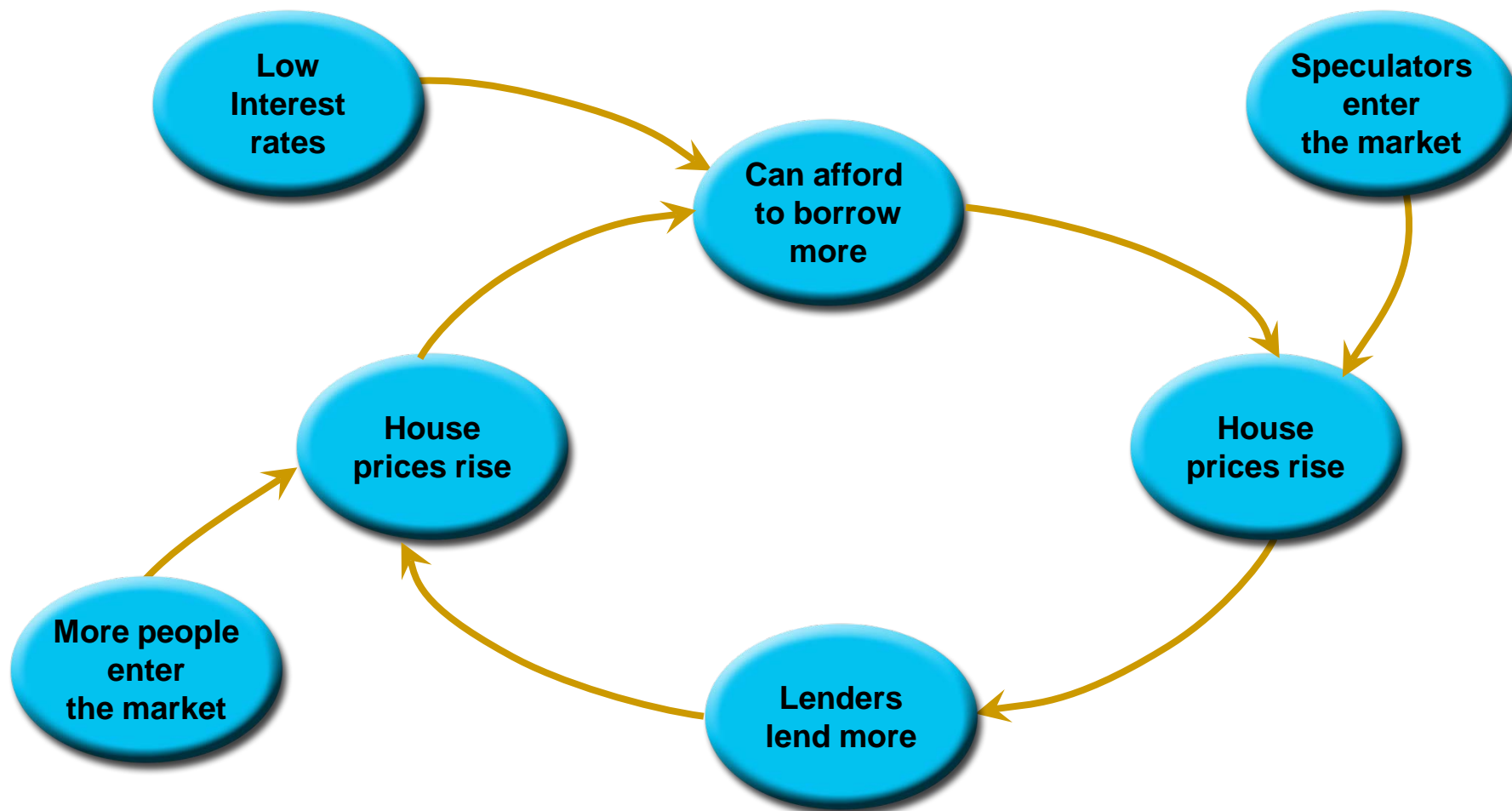


An extended period of low interest rates and low inflation changed behaviour and attitudes

- Immediate consequences
 - Strong economic growth
 - Asset price inflation
- Attitudinal changes:
 - A new paradigm
 - “No more boom and bust”
 - Gearing is good



“Virtuous circles” become self-reinforcing





Similar effects pervade the whole economy

- Equity markets
 - Hedge funds
- Company values
 - Private equity
- Commodities
 - Specialist investment funds



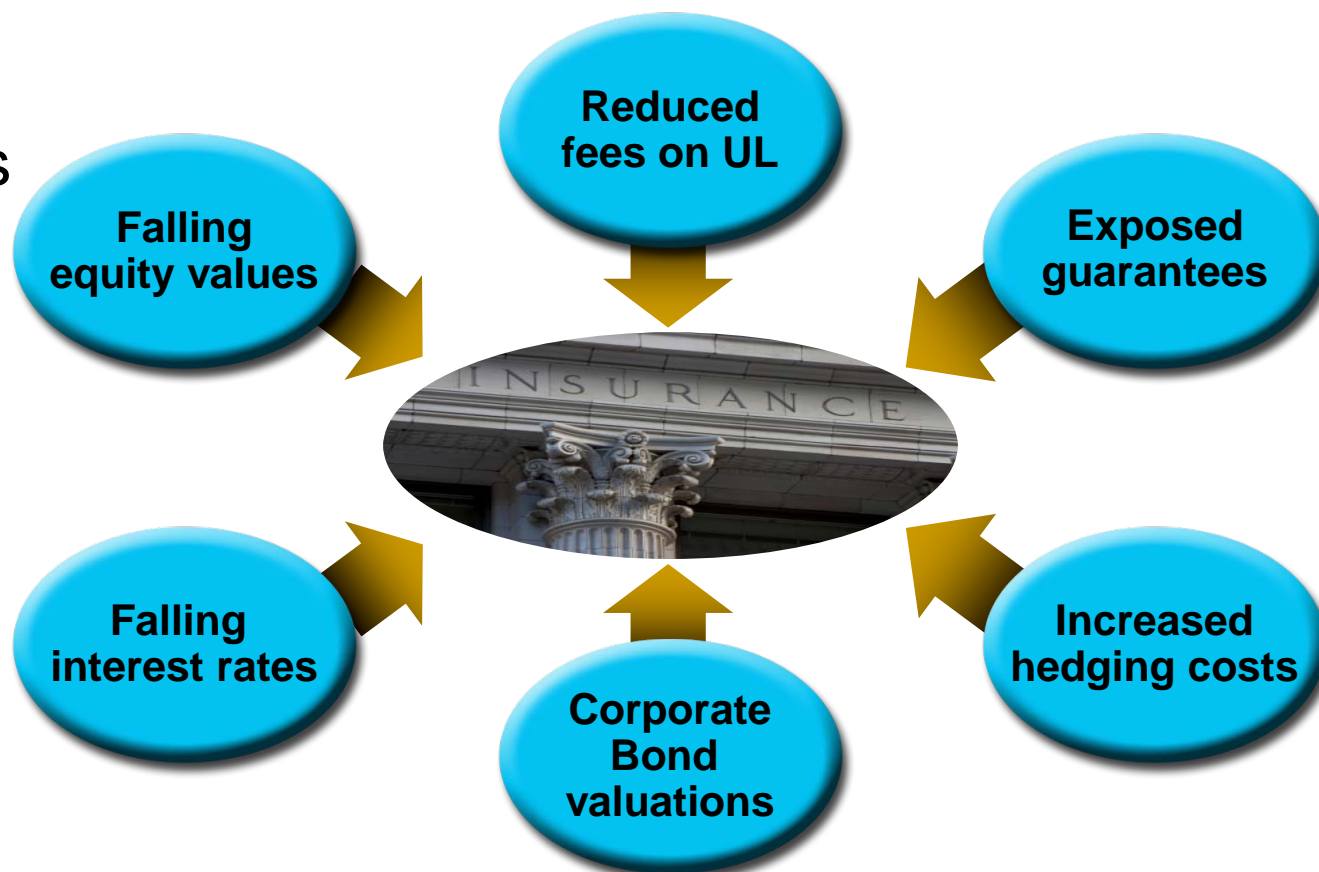
The bust – at first only specialist insurers were affected

- Monolines
 - MBIA, AMBAC etc, writing MBS insurance
- Some reinsurers
 - Swiss Re, XL Re, Scottish Re



The second wave affected most, but some more than others

Life insurers
attacked on
several fronts



Non-life insurers are relatively well placed



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Anyone who says they know what will happen next is wrong

- Similar to Japanese banking crisis
 - This time the whole world is in recession
- Similar to the Great Depression
 - We can avoid the mistakes they made
 - Will we find new and different mistakes?



We can speculate on possible outcomes

A benign outcome

- The worst affected governments (US, UK) will take radical measures to prevent banking system failure
- Rapid monetary expansion will avoid deflationary traps
- Asset prices will stabilise at a point consistent with economic activity
 - Mild inflation will shrink debts



We can speculate on possible outcomes

However:

- Monetary expansion must then reverse
- Government debt must be reduced
- Confidence in lending will be lower
- Private spending will be lower



We can speculate on possible outcomes

Bad Outcomes

- Asset prices keep falling, leading to bank nationalisations
- Corporate defaults lead to insurer insolvencies
- Currency crises limit government action
 - Some countries will default
- Deflation traps increase indebtedness or, alternatively:
- Hyperinflation may appear in some countries



Achieving the benign outcome is not easy

- Small countries have less room for manoeuvre than the US
- No-one knows how big the losses will be
 - or when confidence will return
- Inflation is unstable



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Regulators are unwilling to increase the burden on the industry right now

Capital charges for default risk have been low



Providing incentives to increase credit risk



Insurers are the main holders of corporate bonds (mostly bank debt)



Capital charges cannot be increased for now



Regulators are exploring widespread changes – not just for banks

More regulation

- remuneration
- credit rating agencies

Different business models

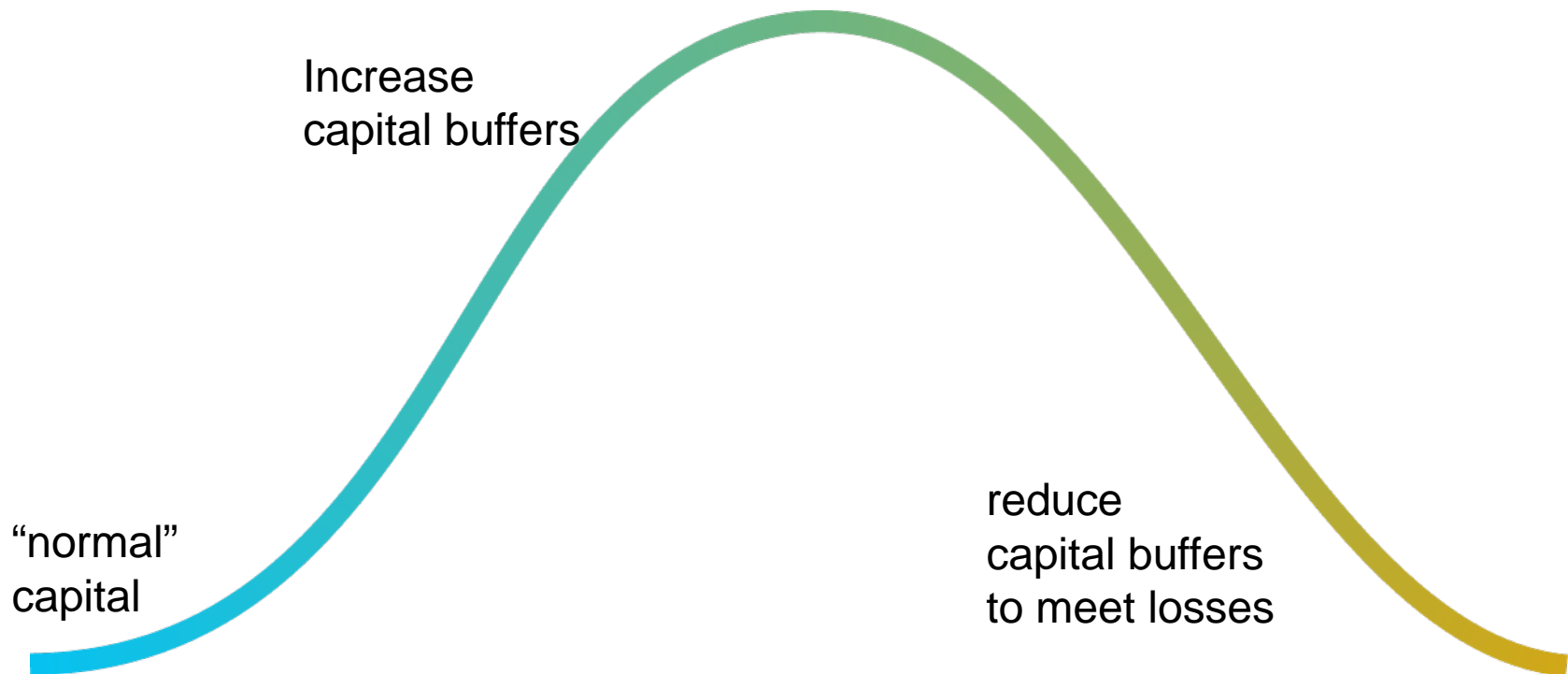
- limits on leverage
- limits on securitisation
- product regulations?

Capital

- more and better quality
- phased in over time



Counter-cyclical capital requirements are being proposed



Easier in theory than in practice



Will Market Value Accounting survive?

Against



Causes failures of “sound” companies



Will Market Value Accounting survive?

For

**The
Transparency
Argument**

- The market gives the best available view of value
 - Who can give a better one?
- If a company is insolvent on MV basis
 - Do investors deserve to know?
 - Do customers deserve to know?

Avoids perverse incentives to buy risk



Solvency II is proceeding through Parliament

- The basic framework is unchanged. However, expect...
 - higher approval standards for models
 - including independent governance
 - tougher calibrations
 - higher correlations of tail events



The aftershocks will extend further

- Pension lifeboats will sink
 - Expect more regulation on funding
- As markets stabilise and recover
 - stronger companies will raise capital
 - to acquire weaker companies



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When the immediate crisis is over

- US, UK government deficits will be large
- Will Asian and Middle Eastern funds want \$\$\$?



The difficult government actions are still to come

- So far governments have acted well to ease the crisis
 - However, handing out money is easy....
 - Taking it back will be harder
- Will politicians really take the tough decisions?



Anger has been suppressed by necessity

- The public are strongly against bailouts
 - Why should taxpayers subsidise rich bankers?
- Politicians will be looking for revenge
- Future regulation may not be entirely rational
 - Will the insurance industry escape unscathed?