

CREATING LONG-TERM CONFIDENCE

A report on the first year of the
Managing Regulatory Change in Life Insurance
& Pensions Program

FIRST ANNUAL SYMPOSIUM

Manila • 23 – 24 November 2000

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Australian APEC Study Centre – Monash University City Campus
Level 12, 30 Collins Street Melbourne Victoria 3000 Australia
www.apec-finsecreg.org

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Foreword

Life insurance and pensions play an important role in the financial markets in the Asian region. The funds invested are an important source of capital and hence of growth in the economies in the region. Life insurance and private pensions also have an important social role to play in securing people's living standards in their retirement.

The long-term nature of these industries has always called for regulation of life insurance and pensions. Yet the Asian financial crisis has shown that regulatory arrangements in the region were weak and in need of reform.

The Managing Regulatory Change (MRC) in Life Insurance and Pensions program was developed to address the issue of reform. The aim of the program is to create long-term confidence in the life insurance and pension industries in regional economies through the establishment of sound supervision and regulation.

Long-term confidence is essential to the ongoing success of the industries and in the provision of retirement incomes to the aging population. All the major stakeholders need to feel confident.

Regulatory agencies must have confidence that companies:

- are well run, with strong corporate governance regimes;
- manage operational risk well; and
- utilise efficient and effective systems to run their businesses.

Industry must have confidence that:

- they will be able to operate in a fair regulatory environment free from arbitrary or unnecessarily burdensome restrictions;
- they will be able to introduce innovative products and practices in response to changing consumer needs; and
- they will be consulted on regulatory changes that impact on how they operate.

Similarly, policyholders and shareholders must have confidence that:

- in the long-term, the industry is a secure one in which to invest, and to continue to invest.

In turn, other stakeholders such as government and industry professionals will gain confidence from an industry that operates in this manner.

Yet these expectations have large areas of potential conflict that need to be fairly balanced. A move away from prescriptive regulatory systems to prudential regulation is a major objective of the MRC program.

Acknowledgments

The Managing Regulatory Change (MRC) in Life Insurance and Pensions program has been made possible by funding from the Australian Agency for International Development (AusAID), the Asian Development Bank (ADB), the Commonwealth Bank of Australia, AXA Asia Pacific Holdings, and the Australian APEC Study Centre.

The First Annual Symposium in Manila was opened by Mr Tadao Chino, President of the Asian Development Bank, and Mr John Lockhart, Director, Asian Development Bank delivered the dinner speech during the program.

Mr Paul McCarthy, General Manager Group Planning and Development, Commonwealth Bank of Australia and Mr François de Méneval, Chief Executive of AXA Asia Pacific Holdings International, delivered opening and closing addresses at the Symposium in Manila and the first and second training courses, and their support of the program is greatly appreciated.

The Australian APEC Study Centre, as the managing organisation of the program, is grateful for the informative contributions made by all presenters and respondents in the Symposium.

Key speakers in the Symposium included: Mr Sean Hughes, Director, Deposit Taking Institutions, the Australian Securities and Investment Commission; Prof Kevin Davis, University of Melbourne, Mr Don McIsaac, Adviser Financial Sector Development, the World Bank, Mr Tan Hak Leh, Monetary Authority of Singapore; Ms Julie Rogers, Financial Analyst, Asian Development Bank; Ms Shamshad Akhtar, Asian Development Bank, Mr Senthamangalam Venkatramani, the Australian Prudential Regulation Authority; and Mr Benjamin Tang, Insurance Commission, SAR Hong Kong.

In particular, the Australian APEC Study Centre, AXA, and the Commonwealth Bank would like to thank the senior regional regulators from the People's Republic of China, Fiji, SAR Hong Kong, India, Malaysia, the Philippines, Papua New Guinea, Singapore, Thailand and Vietnam. The contribution of their expertise and experience has been invaluable to the success of this program.

The training courses would not have been possible without the generous support of AXA Asia Pacific Holdings and the Commonwealth Bank of Australia who both made the expertise of their staff freely available throughout the training courses. In addition, the Australian Prudential Regulation Authority and the Australian Securities and Investment Commission, and the Department of Treasury made their staff available as presenters during the training courses and their generosity is appreciated.

The MRC program has been overseen by its Advisory Committee which included:

Ms Julie Rogers, Senior Banking Sector Specialist, Asian Development Bank; **Ms Jo Bosben**, Assistant Director, Australian APEC Study Centre; **Mr Kevin Ryan**, Project Manager, Australian APEC Study Centre; **Mr Senthamangalam Venkatramani**, Australian Prudential Regulation Authority; **Mr Andrew Milford**, Australian Prudential Regulation Authority; **Mr Sean Hughes**, Australian Securities and Investment Commission; **Ms Kim Holmes**, Australian Securities and Investment Commission; **Mr Bjorn Baklien**, AXA Asia Pacific Holdings; **Mr Andrew Brown**, AXA Asia Pacific Holdings; **Dr Robert Christie**, AusAID; **Mr Lindsay Chan**, AusAID; **Mr Andrew Collins**, AusAID; **Mr Ken Waller**, Group Senior Economic Advisor, CBA Group; **Mr Jules Gribble**, Actuarial Consultant to CBA Group; **Mr Bob Glading**, Consultant, Ernst and Young; **Dr David Knox**, Director, PricewaterhouseCoopers Actuarial; **Mr Stephen Joske**, Department of Treasury; **Mr Tony Simovski**, Department of Treasury; and **Prof Kevin Davis**, Colonial Chair of Finance, The University of Melbourne.

MRC Program Overview

A stable and vibrant financial system that enforces sound standards and practices while encouraging competition and innovation is fundamental to sustainable economic growth. Recent experience in the Asia Pacific region has demonstrated that even countries with high domestic savings rates and increased trends of liberalisation cannot escape economic breakdown if their financial systems lack strong prudential regulation.

Between 1990 and 1997, life insurance markets in eleven Asian economies expanded by an average real growth rate of 13%. In China and Indonesia, growth in this period exceeded 20% annually.

The future value of policyholder's claims and investor confidence in the life insurance area is dependent on profitable investment of this resource base. Unfortunately, the lack of effective and efficient regulation in many Asian economies at the time of economic crisis has undermined the security of consumers, investors and the financial system. Since 1997, many life insurance companies have faced severe contraction in the value of their portfolios, and in the case of company failures, long term savings have been put at risk.

To address these difficulties, existing regulatory weakness must be overcome and new standards and practices developed and adhered to. Individuals responsible for management and supervision of life insurance industries in Asia must be equipped with the necessary knowledge, skills and support to overcome domestic and regional challenges.

The *Managing Regulatory Change (MRC) in the Life Insurance Industry* program will support the process of safeguarding the life insurance and pension industries in China, Fiji, India, Indonesia, Malaysia, Papua New Guinea, Philippines, Thailand, and Vietnam, by helping to establishment systems of sound supervision and regulation.

The MRC Program has been developed based on the outcomes of the *Enhancing Life Insurance Regulatory Regimes in Asia* program mounted by the Australian APEC Study Centre and funded by the Australian Government, Colonial and AXA Asia Pacific Holdings. Senior regulators from throughout the Asian Pacific region took part in the symposium. They stressed that effective regulatory reform of Asia's life insurance industry will require the input and cooperation of public, private, academic and regulatory institutions in industrialised and developing economies alike.

To encourage the long-term objective of regulatory reform through capacity building, the MRC Program will take place over a three-year time period and will be applied at two distinct levels – High Level International Symposia and Specialised Short Training Courses.

International Symposia – Regulator to Regulator and Regulator to Industry Discussions

The MRC Program will mount 3 major annual international symposia. Each symposium will bring together senior life insurance regulators from all participating economies. Symposium organisers will invite the participation of representatives from industry groups, the ADB, the International Association of Insurance Supervisors (IAIS), and the World Bank.

The location of the symposia will rotate between three different capital cities in Asia: the first symposium was held in Manila in November 2000, the second will be held in Beijing in November this year, and the third will be held in New Delhi in 2002. Speakers and observers from governments, private sector companies, and international financial and economic institutions will be invited to contribute to proceedings.

The main objective of the symposia will be to provide regulators with the opportunity to meet on a regular basis with representatives from industry and compare processes of economic and financial system reform. Differences in the stages reached in regulatory development will be recognised as will the processes of transition in the development of regulatory systems in various countries.

The symposia will enable life insurance regulators to examine and assess innovative developments

that have been applied in other financial jurisdictions, such as new methods of operational controls, risk management procedures, rating agency transparency, and standards of market discipline.

Participants also will be able to draw on the experience of others in the design of new products, including for example, the development of unit-linked products. The symposia will explain developments in the areas of consumer protection and the role of consumer preferences and public policy changes in the development of new products. The program also will outline concepts relating to the protection of shareholders as well as policyholders in the life insurance industry.

As a principle outcome of each annual MRC Symposium, participating regulators will be asked to consider the on-going training requirements of officials in their regulatory institutions, and to make recommendations of topics for inclusion in the MRC Training Courses. In this way, discussions that take place in each high level symposium will have vital and on-going influence in promoting long-term economic growth and stability in the Asian region, through capacity building and higher education initiatives.

Training and Capacity Building

The MRC program has been designed out of recognition that one of the most important factors supporting sustainable economic development, including effective management of reform processes, is continued investment in the human capital of a country. The MRC program has a specific aim to help underpin financial stability through the provision of skills and knowledge to individuals who will formulate and implement life insurance regulation and who will have responsibility for protecting the interests of investors and consumers in the area.

Based on the outcomes of each annual international MRC Symposium, and in consideration of the on-going work done by the World Bank, the ADB and the IAIS on insurance system reform, six two-week training programs will be mounted over the course of three years. Courses will be taught by Australian business practitioners, academics, and regulators currently working in the area. The training programs will be held for middle level supervisory and regulatory officials who will one day assume responsibility for the overall management of life insurance system operations throughout Asia. Three participants from each economy will be invited to attend each course.

In total, the MRC training courses will provided specialty training for up to 162 middle level supervisory and regulatory officials.

Overview – First Annual Symposium, Manila, November 2000

Existing regulatory arrangements in Asia tend to be weak and overly prescriptive, and vulnerable in a financial and business environment that is rapidly evolving and becoming increasingly global. The Asian crisis seriously exposed the industry in some economies.

There is therefore a crucial need for a transition to regulatory arrangements that can better handle the major changes now impacting on financial sectors.

Consequently, the theme for the First Annual Symposium was *Transition*.

As Regulatory Agencies have specific national obligations, the rate at which transition may occur, the way in which transition may be implemented, and particular impediments to regulatory evolution and transition vary between regulatory jurisdictions.

Accordingly, the focus of the symposium was the many common factors that can be absorbed by most regulatory regimes and the international best practices that are evolving and shaping new regulatory arrangements.

International practice and regulatory evolution appears to be heading toward a prudential management approach. This approach focuses on establishing and maintaining the financial strength and integrity of the business institutions at a 'macro' level, recognising that this, and a fair competitive business environment, will best ensure that 'micro' issues will be adequately handled. To paraphrase, there is a focus on 'managing the managers', in contrast to enforcing management directly. In such an environment, the importance of good corporate governance and the strength of professional bodies, together with strong financial management, are of great importance.

Each session in the symposium was chosen to highlight a particular issue of importance to regulation within the region. The first day's sessions looked at: the overall philosophy of regulation, and how it will shape the mission statement of a Regulatory Agency; and governance from the perspective of a Regulatory Agency, Industry, and Consumers. The final session of the day closed with concluding remarks that summarised the days discussion.

The second day of the symposium covered: the role of prudential management in a changing environment; regulatory enforcement and investigative capacity; and regulatory infrastructure needs. The final session of the symposium looked at the way in which regulatory reform can be advanced.

The following section contains abstracts of the formal presentations that formed the basis for discussion of these issues both among regulators and between regulators and industry representatives.

SESSION I

Philosophy of Regulation – Mission Statement for a Regulatory Agency

This session focused on the purpose and role of regulators. The clear identification of the various stakeholders is needed to clarify a mission statement for a regulatory agency, as are their obligations and needs, and the manner in which regulation is implemented.

PRESENTER: SENTHAMANGALAM VENKATRAMANI, GENERAL MANAGER, DIVERSIFIED INSTITUTIONS DIVISION, AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

Regulators must take into account the needs of all stakeholders: the government, industry, industry professionals, the international community, consumers, and the public.

Regulators have several roles to play: establishing and enforcing prudential standards; fostering stable, efficient and competitive financial systems; providing policy input to the government; and liaising with other regulators.

Effective regulation seeks to achieve a favourable climate for sound practices. It does not attempt to provide guarantees of performance. Accordingly, it must foster best practice in risk management control, but be willing to step in and enforce standards when necessary.

The regulatory style implemented will be affected by existing industrial economic conditions within the country. While styles may vary, the aim should be to move to a consultative approach as industry is well placed to assess the impact of regulatory policies. The regulator's interest lies in fixing problems rather than taking a punitive approach to breaches.

For effective prudential regulation, a well-developed risk-focused supervisory methodology is called for. The supervisory process should be aimed at identifying major risks to the security of policyholders' and fundmembers' entitlements. The regulatory challenge is to ensure that the process is followed, but not in an overly mechanical fashion. Staff need to be trained in analysis and judgment so that major risks are identified.

Measuring the success of regulatory outcomes can be difficult. The business and economic cycle may well mask the true state of play with a particular organisation. A competitive and well-capitalised industry able to respond with innovation to its clients' needs is a useful guide. Similarly, the interest with which Industry involves itself in regulatory issues is indicative of the state of the industry.

From an internal perspective, quality assurance reviews provide feedback on which practices have worked. Consistency between supervisory approaches is a benefit to all stakeholders and review of procedures can help to achieve this.

In the transition to a robust and transparent regulatory system, the regulators vision, mission and values are foundations that must be translated into action through consultation, visits and enforcement. This requires the commitment of the authorities, cooperation of institutions and dedication of supervisory personnel, coupled with a well-developed dispute resolution system and skilled professional firms.

In the final analysis, the real test of effective prudential regulation will be the development and sustenance of viable and competitive industry that attracts financial and human capital. The achievement of this aim should be the regulator's mission.

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SESSION II

Governance – Regulatory Agency Perspective

Regulatory agencies need to have comprehensive statutory and procedural bases from which to work. Such processes need to be open, timely and equitable to all stakeholders. Globalisation and the growth of international organisations bring an international flavour to these bases.

PRESENTER: BENJAMIN TANG, COMMISSIONER OF INSURANCE, HONG KONG SAR

In his presentation, Mr Tang spoke of how a sound and effective regulatory regime will not only insure a healthy insurance industry, but also will strengthen public confidence and facilitate continual market growth. The mission of regulators is to protect the interest of existing and potential policyholders and to maintain the systemic stability of the market.

In Hong Kong the regulatory process has been based on the principles of transparency, flexibility, accountability, competitive neutrality, and cost effectiveness.

- **Transparency**

When decisions and actions are made accessible and visible it promotes understanding, as the reasoning behind decisions becomes known. In turn, this makes decision-makers accountable for their actions and decisions.

- **Flexibility**

The regulatory framework must be swift and proactive to cope with changing market environment and product features to ensure continued effectiveness.

- **Accountability**

Regulators must operate independently, accountable for the exercise of their functions and powers, but not subject to political influence or sectional interest. The regulatory standards must be clear and consistent and supported by competent staff committed to high professional and ethical standards.

- **Competitive neutrality**

Competitive neutrality requires that regulatory measures apply equally to all that make the same commitments. It also requires minimal barriers to entry and exit from the market, no undue restrictions on institutions or products offered, and a market which is open to the widest possible range of participants.

- **Cost-effectiveness**

Government regulation imposes costs on insurers that ultimately are borne by insurers and the public. A cost-effective regulatory system requires a presumption in favour of minimal regulation. Intervention must be justified on social and economic grounds and, most of all, in the interests of the public.

As regulators, we should be committed to modernising our insurance regulation to meet the challenges of an increasingly dynamic and internationally competitive financial services marketplace. International coordination and cooperation are not just desirable but necessary.

The mission of regulators is to protect the interest of existing and potential policyholders and to maintain the systemic stability of the market.

SESSION III

Governance – Industry Perspective

The regulatory environment needs to foster a competitive, innovative and robust industry. Encouraging flexibility, innovation and attractiveness from the business perspective needs to be balanced by providing appropriate levels of regulation.

PRESENTER: ALLAN RONEY, CHIEF OPERATING OFFICER, INTERNATIONAL FINANCIAL SERVICES, CBA-CMG ASIA (AUSTRALIA)

Balancing the conflicting objectives of stakeholders is the key to appropriate governance.

Mr Roney stated that he believed that the regulator's principal objective should be the creation and maintenance of efficient, fair and stable markets within a stable financial system while delivering reasonable benefits and protection to policyholders.

An appropriate balance of respective stakeholder interests will be met through:

- providing the necessary industry security to ensure policyholder reasonable expectations are met;
- fostering an environment where shareholders make acceptable returns and continue to invest in the industry;
- the management and sharing of risk so there is a balance between risk and reward for policyholders and shareholders.

As financial markets internationalise the lines between various players in financial services will disappear. An increase in cross border trading and new forms of insurance providers, not necessarily from conventional financial backgrounds will emerge.

Appropriate regulation should provide a level playing field for the industry. The most productive long-term outcome for the industry is to err firmly on the side of markets determining outcomes.

Regulators should focus on ensuring that:

- companies are able to demonstrate they run a strong corporate governance regime, manage operational risks well and utilise efficient and effective systems.
- an ongoing low probability of insolvency exists within companies, as regulating with the aim of zero insolvency is not realistic.
- companies are conducting their affairs in such a way as to be prudent risk managers.

We have a very good chance of attaining the appropriate regulatory framework, if the regulator can see that companies are meeting their own governance responsibilities; driven by professionals who are qualified to international standards, operate according to a Code of Ethics, and are appropriately independent.

Regulators need to: think globally; work cooperatively with industry to canvas issues; reach agreement with all parties on each other's role; develop an ongoing role for education in the market place; and make it a priority to pro-actively prepare for the New World of globalisation in our financial markets.

RESPONDENT: ISA RACHMATARWATA, DIRECTORATE OF PENSION FUNDS, MINISTRY OF FINANCE, INDONESIA

Mr Rachmatarwata gave an overview of the pension industry in Indonesia. While there is wide-scale support for the existence of the Mandatory Provident Fund program, monopoly management by the government is constantly challenged. It is widely believed that Indonesian life insurance companies, banks, investment managers, and pension funds would be better administrators and achieve higher investment yields on a competitive basis.

Formal pension schemes will become more important as the economy progresses and social values change. The idea of allowing life insurance companies, banks or investment managers to administer the mandatory program is met with much enthusiasm.

The regulator's principal objectives should be the creation and maintenance of efficient, fair and stable insurance markets within a stable financial system that delivers reasonable benefits and protection to policy holders.

SESSION IV

Governance – Distribution and Consumers

The provision of insurance and pensions is a relatively complex business, and one consequence of this is a disparity of knowledge between providers and users. There needs to be a balance between consumer protection, disclosure and consumer responsibility.

PRESENTER: SEAN HUGHES, DIRECTOR, D.I.S.C., AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

ASIC's responsibilities as market integrity and consumer protection regulator entail, in the main, focussing on the interaction between consumers and financial service providers through:

- The disclosure of information provided to consumers by financial services providers; and
- The conduct of financial services providers and intermediaries when dealing with consumers.

ASIC brings to its regulation and supervision of the financial services industries, some years of experience with regulation and supervision of the corporate sector more generally. Not surprisingly, its experience and desire for regulatory harmony between all commercial sectors it regulates, is an important driver of its regulatory approach. Such consistency of approach is reflected by the recent extension of our policy regarding electronic applications for securities, to the proposed policy allowing electronic applications for life insurance and superannuation products.

The range of activities ASIC regulates, the size of the market and the finite nature of public resources means that its approach to regulation – be it enforcement of the law or policy guidance – needs to be structured, focussed and based on a balanced assessment of competing risks and emerging trends.

Consistently with that risk-based strategic approach, ASIC adopts a proactive approach to e-commerce. While it is technology neutral on the delivery of information by either traditional or electronic means, it works with consumers and industry to ensure that consumers are not disadvantaged by new methods of delivery of information, while providers can maintain their drive towards greater cost efficiency and international competitiveness.

RESPONDENT: JULES GRIBBLE, ACTUARIAL CONSULTANT TO THE COMMONWEALTH BANK OF AUSTRALIA

The issues facing regulators and industry from the perspective of governance regarding distributors and consumers are well established and important.

The impact of the new technology, the internet in particular, and globalisation brings some of the issues and principles to the forefront. While the advent of new and rapidly evolving technologies provides both opportunities and threats to various stakeholders, it is important to recognise that the underlying principles remain unchanged.

There are both direct and indirect consequences to consider. In each area there are opportunities for stakeholders – consumers, distributors, business and the regulator.

However, the pace of change and evolution of electronic technology in general, as well as its potential application in the domains of insurance and pensions, means new and significant issues will continue to emerge. In assessing, utilising and regulating the implementation of these changes it will be important to retain a balanced and flexible approach rooted in a focus on the underlying principles and objectives.

It is possible that ultimately the greatest challenges and opportunities will come from the indirect consequences of the technology rather than the immediate direct impacts. That is, the business-to-business impacts will be stronger and more pervasive than the direct business-to-consumer impacts.

The regulatory challenge is to facilitate the use of the tools and opportunities the internet provides, while at the same time ensuring consumers are protected and business retains appropriate flexibility and incentive.

While the advent of new and rapidly evolving technologies provides both opportunities and threats to various stakeholders, it is important to recognise that the underlying principles remain unchanged.

SESSION V

Concluding Remarks – Day 1

This concluding session summarised the discussions and issues raised during Day 1 and placed them within the context of the Symposium theme of 'Transition'. The scene was set for moving into the second day and discussions on how to achieve such an environment.

KEN WALLER, GROUP ECONOMIC ADVISER, COMMONWEALTH BANK OF AUSTRALIA

Mr Waller observed that while Industry and regulators have different views of what an enhanced regulatory regime may mean, the day's discussion had shown that both were moving to common understandings.

While Industry and regulators have different views of what an enhanced regulatory regime may mean, the day's discussion had shown that both were moving to common understandings.

Regulators were encouraged to give thought on how they may best take this endeavour forward. Mr Waller expressed the opinion that the next Symposium should be about "Implementation" and he hoped that the focus then could be on issues faced in reforming the regulatory arrangement.

Mr Waller made the point that some introspection may be useful in assessing how to go forward. Clearly regulators have not done enough in the enforcement of regulations, while governance is weak in agencies and many firms in the region, and effective accountability is lacking.

Change in the region is being driven by globalisation, deregulation, demographics, the development of conglomerate businesses, e-commerce, and changing consumer preferences

In the Pensions area, there is very low private pension take up in Indonesia and probably other developing economies. Serious problems have arisen with mandatory schemes under the monopoly management of governments.

In responding to change, consumer advocacy is increasingly crucial, and enforcement powers need to be effective. In addition, the funding of regulatory agencies is an issue, as is the need to ensure regulations keep abreast of business and consumer trends.

SESSION VI

Prudential Management in a Changing Environment

With globalisation and technology driving changes in the business environment at an increasing pace, Regulatory Agencies need to have the capacity to adapt to, and reflect, change. This session explored the appropriate characteristics of regulatory approaches, including interaction with other regulators; and the role of other professional bodies, both nationally and internationally.

PRESENTER: HANS WAGNER, CHIEF ACTUARY INTERNATIONAL, AXA ASIA PACIFIC HOLDINGS

In the long run, following a static approach will not work in an environment that is one of change, and the 'hard' or 'easy' tests that we may set have limitations. Instead, an active and flexible approach, maybe incorporating some dynamic scenario testing may prepare the industry for future shocks, and create a more stable regulatory environment, which will be desirable for all.

It is also important to realise the balance of solvency and fair selling, and that while some regulatory approaches may appear conservative on the surface, dynamic testing can help highlight the hidden risks. It is critical to understand the implications of the regulations we set especially in a dynamic environment.

Setting regulations in a changing environment is not a simple task. As we move from a static approach to management that is more active there will be a need to rely on professionalism of actuaries and agents.

PRESENTER: SHAMSHAD AKHTAR, MANAGER, FINANCIAL SECTOR + INDUSTRY DIVISION (EAST), ASIAN DEVELOPMENT BANK

Ms Akhtar highlighted some essentials of prudential regulation and supervision and pointed to emerging trends and debate in the area. There are worldwide emerging pressures with growing competition, globalisation and technological innovations which will, if it has not, compelled insurance, like other segments of financial industry, to change. In the process, the ADB hopes for more collaboration and coordination among regulators to jointly improve consistency in regulation and supervision practices to allow for more harmonisation – which though a difficult goal will help capital access and mobility.

This presentation attempted to draw the attention of regulators to some key issues in developing countries in Asia that need urgent attention and we hope the regulators gathered here will play a key role in generating reforms in this area. The ADB has assigned high priority to the capacity building of regulators and industry and has a number of initiatives in this area and, accordingly, would be glad to work more intensively with all regional regulators.

The ADB has assigned high priority to the capacity building of regulators and industry.

SESSION VII

Regulatory Enforcement and Investigative Capacity

Regulatory Agencies need appropriate powers and independence, as well as the ability and will to utilise these powers. This session focused on ensuring Regulatory Agencies have the appropriate powers in the context of licensing, monitoring, investigation and intervention. This requires appropriate legislative and judicial support.

PRESENTER: THE HON EDUARDO MALINIS, INSURANCE COMMISSIONER, PHILIPPINES

Since the Philippines Insurance Code was implemented, no life company has ever been declared insolvent. Even in 1997, when the Asian region was hit by devastating financial crisis, the life insurance sector managed to maintain its strength.

Despite its effectiveness, however, new trends in the industry scene have been evolving, and a closer look at the Code's provisions reveals a need for reviews and updates, to keep pace with the changing market conditions.

The Code is basically effective, but contains provisions that are outmoded and so can somehow be restrictive and debilitating to companies. The ADB has noted the need and proposed that the legal framework for the supervision of the Philippine insurance market be made prudential in nature.

In the words of the ADB, "A prudential legal framework places emphasis on the need for insurance companies to be under sound management, on their being in a healthy financial condition commensurate with risks undertaken, and on the supervisory authority being able to monitor and timely intervene should there be any significant cause for concern. It also aims to give the necessary flexibility for the insurance company's management to take responsibility, within established parameters, for prudent decision-making; together with the statutory responsibility to conduct its affairs in accordance with sound and prudent insurance management and business practices."

Both the Insurance Commission and the life insurance sector believe that prudential supervision is a key to ensuring a visible and well-run business. But the change could only be felt if and when the Code finally gets amended, and hopefully, in the direction that the ADB has indicated.

Lastly, it is worth mentioning that the government fully supports the Insurance Commission in its execution of powers over the insurance industry. It is set to pass an Administrative Order on Corporate Governance Reforms seeking to strengthen the supervisory capabilities of the Insurance Commission along with those of the Central Bank of the Philippines and the Securities and Exchange Commission. Foremost in its directives is the immediate review of their respective charters, focusing on scope of supervisory authority, institutional strengthening and capacity building to achieve high levels of professionalism and secure institutional independence.

A prudential legal framework places emphasis on the need for insurance companies to be under sound management, on their being in a healthy financial condition commensurate with risks undertaken, and on the supervisory authority being able to monitor and timely intervene.

SESSION VIII

Regulatory Infrastructure Needs and Issues

Once a view of how regulation should be carried out has been developed, the appropriate infrastructure is required. This session focussed on identifying regulatory infrastructure needs, current impediments to improvements, and strategies that could be implemented to make a transition through these impediments.

PRESENTER: SENTHAMANGALAM VENKATRAMANI, GENERAL MANAGER, DIVERSIFIED INSTITUTIONS DIVISION, AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

In developing a regulatory system which balances the requirements of the various stakeholders it is necessary to put in place a robust structure which will facilitate the process.

The basis of regulation should derive from legislative instruments. Consultation is the key to successful legislative reform, as this facilitates the perspectives of participants to be integrated into the process. Typically, the proposals will have to take account of political, industry, professional and international regulatory practices in the light of the existing state of industry, and an analysis of the perceived problems.

Once an acceptable broad framework has been set in legislation, further details need to be worked out that provide guidance on how it will be implemented. This involves two distinct parts: professional standards on aspects of regulated industries and regulatory process guidelines.

The former will have a significant degree of input by the relevant professional bodies and industry. For example, actuarial and accounting standards may have already evolved in response to existing regulations and would need to be adapted to the new framework.

The second aspect relates to the regulator outlining its own internal supervisory methodology. This involves details of off and on-site inspections, statistical collections, approvals of specific transactions conducted by the regulated entities, escalation of significant prudential issues within the regulatory agency and enforcement action against breaches of regulations.

Even where the regulatory framework has been bedded down, the regulator is interested in identifying emerging issues which signal prudential risks. In undertaking research and policy development, it should be possible to avoid duplication by drawing on the existing processes. Central banks have traditionally developed strong economic research capabilities, while national statistical bureaus collate and interpret trends.

Prudential supervision of complex institutions is increasingly risk-based, not lending itself to a simple checklist approach. Nevertheless, consistent application of regulatory practices across similar instances and different locations is important in maintaining public confidence in the regulatory process. Similarly, regular interaction with industry bodies allows the regulator to keep in touch with issues of importance to the industry, and makes the consultative process easier.

Effective regulation relies on a well-developed professional community. Regulators rely on institutions taking appropriate professional advice in relation to product design, reporting of financial results and taking corrective action to restore solvency.

There is increasing recognition that uniform regulatory practices in accordance with accepted core principles serve to increase regulatory efficiency and minimise information gaps. Where local institutions have international parentage, it is necessary to know of any concerns that an overseas regulator might have in regard to the parent.

Regulatory agencies have a low-key public presence, which is unfortunately heightened only in times of crisis. They need to communicate their mission and approach to supervision and be able to defend their actions, particularly when they are in spotlight.

Prudential supervision of complex institutions is increasingly risk-based, not lending itself to a simple checklist approach.

SESSION IX

Moving Forward

The concluding session explored mechanisms to move forward, in relation to the overall 3 year MRC Program.

PRESENTER: PROF KEVIN DAVIS, COLONIAL CHAIR OF FINANCE, UNIVERSITY OF MELBOURNE

It is clear that all stakeholders share a common goal of improving the regulatory architecture and enabling regulators to best adapt to ongoing financial and economic change. The question we face at this stage is how to build on the progress made in regulatory reform and initiate further desirable developments.

That question can be posed at the levels of: political influence; organisational development; staff development; and life office development and education.

First, how can the political agendas within APEC and its member nations be influenced to mobilise further support and achieve lasting gains for regulatory reform and development?

Second, how can the needs of national regulatory bodies for assistance in influencing legislation, implementing supervisory practices, and developing their own regulatory cultures best be met?

Third, what is the appropriate framework for training, education, and development of staff?

Fourth, how can continuing progress towards best practice and good governance in life insurance companies in the region be ensured?

PRESENTER: BOB GLADING, CONSULTANT, ERNST & YOUNG

There are wide differences in the regulatory environment in jurisdictions of the eleven regulators who have taken part in the symposium. If the up coming Training Programs are to be useful to their participants, the desired regulatory environment needs to be agreed.

The sponsors and those providing endorsement and financial support of the initiative do have a clear idea of the goal. It is equally clear, that many of the regulators in the region have a similar basic regime in mind and indeed a few are a substantial way forward to achieving it.

Some individual issues deserve to be highlighted:

- regulation must be justified on the grounds that the cost of market failure is greater than the cost of regulation and we need to use measures that best resolve the causes.
- a consistent concept – across jurisdictions – of corporate governance must be grasped.
- the need for consultation by regulators with industry received overwhelming consensus from the participants. It is important that it is real consultation, explaining proposals and listening to observations. The component of self-interest involved be identified and attempts made to eliminate it.
- In looking at the structure of the supervisory agency, the environment and culture of the jurisdiction must not be over looked. Regulatory structures in their entirety are unlikely to be suitable elsewhere.
- The environment for growth, innovation and competition changes. Markets are available to all; borderless, with no time constraints. There is both disintermediation (cutting out the middle man) and re-intermediation (new intermediaries).

Regulation must be justified on the grounds that the cost of market failure is greater than the costs incurred by of that regulation.

Training Courses

The training courses form an important part of the MRC program. By training the middle level regulators – who are currently responsible for industry supervision and who will assume senior policy roles within Regulatory Agencies in the future – the regulatory capacity of organisations is greatly enhanced.

The first training course for the 3-year MRC program was held in Melbourne from 3-16 March 2001.

The training course involved 3 participants from each of the nine participating economies: the People's Republic of China, Fiji, India, Indonesia, Malaysia, Papua New Guinea, Philippines, Thailand and Vietnam. Two life insurance regulators and one pension regulator attended from each country.

Each day of the 9-day course had a particular theme and covered a number of topics within that theme. Within the first day's theme of *The Need for Financial Regulation*, the topics included: the IAIS prudential regulation principles; pension regulation issues; and a panel discussion on current regulatory positions and issues.

The second day had the theme of *Emerging Trends* and included topics on: future trends and issues; e-commerce; and financial statements analysis.

Day 3 focussed on *Business Financial Risk* and included sessions on: macro environmental financial and structural risks; inflation risk; and asset management and risks.

The theme of the fourth day was *Regulatory Capacity and Risk Management* and topics included: regulatory risk assessment techniques; regulatory capacities; and a panel discussion on impediments and how to address them.

The first week ended with a morning session on *Consumers and Disclosure* and included topics, such as: sales and product disclosure; policyholder reasonable expectations and consumer responsibilities; Australian consumer protection principles; and consumer protection – issues and the future. In the afternoon, a site visit was made to AXA Asia Pacific Holdings.

The second week started with a focus on *Financial Risk and Prudential Management* and topics included: minimum valuation bases; alternate capital adequacy models; regulatory prudential standards; and assessing financial condition. A site visit was also made to Colonial/Commonwealth Bank of Australia.

The theme of the 7th day was *Operational Risk and Management* and topics included: regulatory assessment of operational risk; and a panel discussion on assessing operational risk.

The theme for day 8 was Management Structures and *Corporate Governance* and topics included: principles of corporate governance; managing financial services firms; and the role of the independent professional. The chairman of the Australian Prudential Regulation Authority, Mr Jeff Carmichael also addressed the participants.

The final day looked at the *Future of Best Practice Regulation* and included a review of the training course, a panel session on *Moving Forward* and the presentation of the Case Studies that the participants had worked on during the course.

Presenters for the course included representatives from: Australian and international regulators; industry representatives from the sponsors, AXA Asia Pacific Holdings and the Commonwealth Bank of Australia; the University of Melbourne; and industry consultants. The particular experience and expertise of individual participants was also used in the panel discussions.

The second training course was held from 16-27 July 2001 and was based on the successful first training course.

The themes for each of the days used in the first training course were again utilised. Changes were made to individual sessions to draw upon the expertise of certain presenters and to reflect current issues in regulation in the region.

Formal papers presented at the training course have been added to the MRC program website (<http://www.apec-finsecreg.org>).

FIRST TRAINING COURSE • 3 – 16 MARCH 2001

MONDAY 5 MARCH 2001

NEED FOR FINANCIAL REGULATION

- Opening Address
- The Need for Financial Services Regulation
- Life Insurance: IAIS Prudential Regulation Principles
- Pensions: Regulation and Issues
- Panel Discussion: Current Regulatory Positions and Issues

TUESDAY 6 MARCH 2001

EMERGING TRENDS

- Future Trends and Issues
- Panel Discussion: Issues, Impediments and How to Address Them
- E-Commerce
- Financial Statements Analysis

WEDNESDAY 7 MARCH 2001

BUSINESS FINANCIAL RISK

- Macro Environmental Financial and Structural Risks
- Guarantees and Life Insurance
- Inflation Risk
- Asset Management and Risks
- Case Study

THURSDAY 8 MARCH 2001

REGULATORY CAPACITY AND RISK MANAGEMENT

- Regulatory Risk Assessment Techniques
- A Business Perspective on Risk Management
- Regulatory Capacities
- Panel Discussion: Future Trends and Issues
- Case Study

FRIDAY 9 MARCH 2001

CONSUMERS AND DISCLOSURE

- Workshop – Sales and Product Disclosure
- Policyholder Reasonable Expectations and Consumer Responsibilities
- Australian Consumer Protection Principles
- Panel Discussion: Consumer Protection – Issues and the Future
- Site Visit: AXA Asia Pacific Holdings

TUESDAY 13 MARCH 2001

FINANCIAL RISK AND PRUDENTIAL MANAGEMENT

- Minimum Valuation Bases
- Alternate Capital Adequacy Models
- Regulatory Prudential Standards
- Panel Discussion: Assessing Financial Condition
- Site Visit: Commonwealth Bank of Australia

WEDNESDAY 14 MARCH 2001

OPERATIONAL RISK AND MANAGEMENT

- Regulatory Assessment of Operational Risk
- An Industry Perspective
- Regulatory Assessment of Operational Risk
- Panel Discussion: Assessing Operational Risk
- Case Study

THURSDAY 15 MARCH 2001

MANAGEMENT STRUCTURES AND CORPORATE GOVERNANCE

- Principles of Corporate Governance
- Managing Financial Services Firms
- Role of the Independent Professional
- Panel Discussion: How to Achieve Appropriate Corporate Governance
- Case Study

FRIDAY 16 MARCH 2001

THE FUTURE OF BEST PRACTICE REGULATION

- Future of Best Practice Regulation
- Case Study Presentations
- Case Study Presentations (cont)
- Symposium Review
- Panel Session: Moving Forward
- Graduation Ceremony & Presentation of Certificates

SECOND TRAINING COURSE • 16 – 27 JULY 2001

MONDAY 16 JULY 2001

NEED FOR FINANCIAL REGULATION

- Opening Address
- The Need for Financial Services Regulation
- Life Insurance: IAIS Prudential Regulation Principles
- Pensions: Regulation and Issues
- Panel Discussion: Current Regulatory Positions and Issues

TUESDAY 17 JULY 2001

EMERGING TRENDS

- Future Trends and Issues
- Panel Discussion: Future Trends and Issues
- Market Forces vs Regulation
- E-Commerce
- Financial Statements Analysis

WEDNESDAY 18 JULY 2001

BUSINESS FINANCIAL RISK

- Macro Environmental Financial and Structural Risks
- Guarantees and Life Insurance
- Inflation Risk
- Asset Management and Risks
- Case Study

THURSDAY 19 JULY 2001

CONSUMERS AND DISCLOSURE

- Policyholder Reasonable Expectations and Consumer Responsibilities
- A Regional View on Disclosure
- Australian Consumer Protection Principles
- Panel Discussion: Consumer Protection – Issues and the Future
- United Linked Products

FRIDAY 20 JULY 2001

REGULATORY CAPACITY AND RISK MANAGEMENT

- Regulatory Risk Assessment Techniques
- A Business Perspective on Risk Management
- Regulatory Capacities
- Panel Discussion: Issues, Impediments and How to Address Them
- Site Visit: Commonwealth Bank of Australia

TUESDAY 24 JULY 2001

FINANCIAL RISK AND PRUDENTIAL MANAGEMENT

- Minimum Valuation Bases
- Asset Liability Management Principles
- Regulatory Prudential Standards
- Capital Adequacy for Pensions
- Panel Discussion: Assessing Financial Condition
- Site Visit: AXA Asia Pacific Holdings

WEDNESDAY 25 JULY 2001

OPERATIONAL RISK AND MANAGEMENT

- Regulatory Assessment of Operational Risk
- Reinsurance – a Management Tool
- Panel Discussion: Assessing and Managing Risk
- Case Study

THURSDAY 26 JULY 2001

MANAGEMENT STRUCTURES AND CORPORATE GOVERNANCE

- Principles of Corporate Governance
- Managing An Exit
- Role of the Independent Professional
- Panel Discussion: Achieving Appropriate Corporate Governance
- Case Study

FRIDAY 27 JULY 2001

THE FUTURE OF BEST PRACTICE REGULATION

- Future of Best Practice Regulation
- Case Study Presentations
- Case Study Presentations (cont)
- Symposium Review
- Panel Session: Moving Forward
- Graduation Ceremony & Presentation of Certificates

The Year Ahead

The second year of the MRC program will again include a Symposium for senior life insurance and pension regulators, and two Training Courses for middle level regulators and supervisors.

2nd Annual Symposium – Beijing 8 – 9 November 2001

The overall theme of the Symposium will be 'Implementation'.

There are a number of specific issues to be recognised in the development of the Symposium:

- The need to address both Life Insurance and Pensions issues;
- To promote international best standards/principles of relevance to private pensions, drawing as appropriate from those applying in the life insurance sector;
- In the context of Life Insurance, this is the third Symposium and so there is a need to move forward from discussion of issues to how more concrete steps are being and to be taken to address issues; and
- Regulatory regimes for Pensions vary more widely than is the case for Life Insurance, and in some cases the stage of development of Pension regulatory systems is not as well established as is the case for Life Insurance.

In the context of 'Implementation', there are a number of more specific objectives:

Overall Objectives

- Prepare a brief outline of key issues arising from the symposium for review/endorsement before its conclusion.
- To determine any changes to Training Programs over 2002 – identify any new key areas and confirm central areas of course; and
- Consider measures to support some 'train the trainer' initiatives.

Life Insurance Objectives

- To assess whether agencies have implemented regulatory reforms in the recent period and to detail those reforms;
- To assess whether any reforms are planned in near term and to detail them;
- To identify the key obstacles to proceeding with reform and to discuss measures to help deal with them; and
- To discuss one or two central issues which deal with agency structures and relationships with the bureaucracy and industry;

Pension Objectives

- The focus of the MRC Program with respect to Pensions is on the involvement of private industry with Pensions; and
- To foster and implement existing regulatory standards and principles to underpin private sector pensions.

Third and Fourth Training Courses – March and July 2002

The third and fourth training courses will build on the model of the successful first and second training courses. Feedback on the training courses from both regulators and participants has been positive. As with the First and Second training courses, the input of regional regulators will be sought at the symposium to ensure that the courses are meeting the evolving needs of regulators.

In addition, the course structure and content will be reviewed by the MRC Advisory Committee to ensure that emerging issues are appropriately addressed within the courses.

FIRST ANNUAL SYMPOSIUM

REGULATORS

PEOPLES REPUBLIC OF CHINA

Mr Shi Ming Cai

Director General,
Department Social Insurance Fund Supervision,
Ministry of Labour and Social Security

Mr Chai Zhi Jian

Department of International Cooperation,
Ministry of Labour and Social Security

FIJI

Mr Inia Naiyaga

Chief Manager, Financial Institutions, Reserve Bank of Fiji

HONG KONG, SAR CHINA

Mr Benjamin Tang

Commissioner of Insurance

INDIA

Mr H O Sonig

Member, Insurance Regulatory and Development Authority,
Ministry of Finance

Mr Harbhajan Singh

Member, Insurance Regulatory and Development Authority,
Ministry of Finance

INDONESIA

Ms Dayana Sasmito

Insurance Directorate, Ministry of Finance

Mr Isa Rachmatarwarta

Directorate of Pension Funds, Ministry of Finance

MALAYSIA

Mr Zakaria bin Ismail

Director, Insurance Regulation,
Bank Negara (Central Bank of Malaysia)

Ms Robiah Abu Bakar

Manager, Investment & Economic Research Department,
Employees' Provident Fund

PAPUA NEW GUINEA

Mr James Sea

Assistant Commissioner (Life),
Office of Insurance Commissioner

PHILIPPINES

The Hon Eduardo T Malinis

Insurance Commissioner

Mr Ernesto E Reyes

Deputy Executive Director,
Presidential Retirement Income Commission

SINGAPORE

Mr Tan Hak Leh

Head, Life & Composite Division,
Insurance Department, Monetary Authority of Singapore

Ms Lau Mei Fong Sophia

Manager, Life & Composite Division,
Insurance Department, Monetary Authority of Singapore

CHINESE TAIPEI

Mr Kaiyuan Chern

Head, Life Section, Department of Insurance

Ms Chen

Department of Insurance

THAILAND

Mr Montree Vipunwarapong

Deputy Director General, Department of Insurance,
Ministry of Commerce

Mr Paisan Chotipaibulpan

Director, Policy and Information System Division,
Department of Insurance, Ministry of Commerce

Ms Rutnati Padmasuta

Senior Analyst,
Securities & Exchange Commission

VIETNAM

Mr Nguyen Van Thanh

Official, Insurance Supervisory Division,
Department for Banking and Financial Institutions,
Ministry of Finance

SPONSORING ORGANISATIONS

ASIAN DEVELOPMENT BANK

Mr John S. Lockhart

Director, Asian Development Bank

Ms Shamshad Akhtar

Manager, Financial Sector & Industry Division East,
Asian Development Bank

Ms Julie Rogers

Senior Banking Sector Specialist,
Asian Development Bank

AXA ASIA PACIFIC HOLDINGS

Mr Les Owen

Group Chief Executive,
AXA Asia Pacific Holdings (Australia)

Mr François de Méneval

Chief Executive, International Operations,
AXA Asia Pacific Holdings (Australia)

Mr Hans Wagner

Chief Actuary, International,
AXA Asia Pacific Holdings (Australia)

Mr Andrew Brown

Actuary, Asian Development, AXA Asia Pacific (Australia)

Ms Daniella Urbino

Actuarial Analyst, Asian Development,
AXA Asia Pacific Holdings (Australia)

COMMONWEALTH
BANK GROUP**Mr Alan Roney**

Chief Operating Officer, International Services,
CBA-CMG Asia (Australia)

Mr Paul McCarthy

General Manager, Group Planning and Development,
Commonwealth Bank of Australia (Australia)

Mr Ken Waller

Group Senior Economic Advisor,
Commonwealth Bank Group

Mr Jules Gribble

Actuary, IFS, Colonial

Mr Mike Patterson

CBA-CMG Asia, (Australia)

Mr Shane McNally

CBA-CMG Asia, (Philippines)

ORGANISERS

AUSTRALIAN APEC STUDY CENTRE

Ms Jo Bosben
Australian APEC Study Centre
Mr Kevin Ryan
Australian APEC Study Centre

PRESENTERS

Mr Craig Thorburn
International Association of Insurance Supervisors
Mr Sean Hughes
Director, D.I.S.C.
Australian Securities and Investment Commission

Mr Senthamangalam Venkatramani

General Manager, Diversified Institutions Division,
Australian Prudential Regulation Authority

Prof Kevin Davis

Colonial Chair of Finance, The University of Melbourne

Mr Bob Glading

Consultant, Ernst and Young

Mr Don McIsaac

Adviser, Financial Sector Development Department,
World Bank

OBSERVERS

Mr Mark S Worrall

Asia-Pacific Economist, Export Development Corporation

PRESENTERS – TRAINING COURSES 1 AND 2

AUSTRALIAN REGULATORS

Mr Jeff Carmichael
Chairman, Australian Prudential Regulation Authority
Mr Craig Thorburn
General Manager, Diversified Institutions Division,
Australian Prudential Regulation Authority
Mr Senthamangalam Venkatramani
General Manager, Diversified Institutions Division,
Australian Prudential Regulation Authority
Mr Andrew Milford
Senior Manager,
Diversified Institutions,
Australian Prudential Regulation Authority
Mr Robert Thomson
Australian Prudential Regulation Authority
Ms Clare O'Reilly
Australian Securities and Investments Commission
Ms Sharman Grant
Australian Securities and Investment Commission
Mr Darren Williams
Australian Securities and Investments Commission
Mr Phil Gallagher
Commonwealth Treasury
Ms Amanda Goodban
Commonwealth Treasury

INTERNATIONAL REGULATORS

Mr Edward Sin
Senior Insurance Officer,
Office of the Commissioner of Insurance,
Hong Kong, SAR China

Ms Chien Wai Sum Nancy

Senior Insurance Officer,
Office of the Commissioner of Insurance,
Hong Kong, SAR China

Mr Tan Hak Leh

Head, Life & Composite Division,
Monetary Authority of Singapore

INDUSTRY

Mr François de Méneval

Chief Executive,
International Operations,
AXA Asia Pacific Holdings

Mr Hans Wagner

Chief Actuary, International, AXA Asia Pacific Holdings

Mr Andrew Brown

Actuary Asian Development, AXA Asia Pacific Holdings

Mr Bjorn Baklien

Marketing Development Director,
AXA Asia Pacific Holdings

Mr Rob Baillie

AXA Asia Pacific Holdings

Mr Daniel Craine

AXA Asia Pacific Holdings

Mr Kent Griffin

Appointed Actuary, AXA Asia Pacific Holdings

Mr Murray Jones

AXA Asia Pacific Holdings

Mr Kevin Le Plastrier

AXA Asia Pacific Holdings

Mr Andrew Raftis

AXA Asia Pacific Holdings

Mr Vincent Regnier

AXA Asia Pacific Holdings

Mr Ken Robinson

AXA Asia Pacific Holdings

Mr Hitesh Shah

AXA Asia Pacific Holdings

Mr Paul McCarthy

General Manager,
Group Planning and Development,
Commonwealth Bank of Australia

Mr Allan Roney

Chief Operating Officer,
International Services, Colonial Mutual Group

Mr Gary Mackrell

Head Office of CEO/Group Planning and Development
Commonwealth Bank of Australia

Mr Gary Ray

Solicitor – Victoria,
Commonwealth Bank of Australia

Mr Joseph Law

Deputy Solicitor – Victoria,
Commonwealth Bank of Australia

Mr Jules Gribble

Consulting Actuary to Commonwealth Bank of Australia,
CMG Asia

Mr Ken Waller

Group Senior Economic Advisor, CBA Group

Mr Mark Rebuck

Deputy Regional Actuary,
Commonwealth Bank of Australia

Mr Mike Paterson

Regional Actuary, CBA-CMG Asia

Mr Patrick Edwards

Head, Capital Management,
Commonwealth Bank of Australia

Mr Paul Davis

General Manager, Operational Risk Manager,
Commonwealth Bank of Australia

Ms Michelene Hart

General Manager, Group Business Systems,
Commonwealth Bank of Australia

Ms Vanessa Beenders

Executive Manager,
Commonwealth Bank of Australia

Mr Rob Donaghy

Actuary,
Commonwealth Bank of Australia

Mr Steve Varney

Head of International Products,
CMG Asia

Mr Warwick Young

Vice-President,
Regional Business Development, RGA

CONSULTANTS

Mr Bob Glading

Consultant,
Ernst and Young

Dr David Knox

Director,
PricewaterhouseCoopers Actuarial

ACADEMICS

Prof Kevin Davis

Commonwealth Bank of Australia Chair of Finance,
University of Melbourne

Prof Rob Brown

Department of Finance, University of Melbourne