The Enlightenment to the Chinese Insurance Business by analysis on the U.S. Government's Takeover of American International Group

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Abstract: - Since the American sub-debt crisis has erupted, has caused US's entity economy and even the whole world capital market fluctuation, Its influence effect does not allow to look down upon. The American International Group (AIG) takes the world insurance and the financial service leader, also has paid the huge price. Regarding China, the immediate influence which the crisis brings is limited The insurance business as the financial service industry's important composition department, This article thought that has the necessity to study it to our country insurance business enlightenment.

Key-Words: Sub-debt crisis, American Group International, Chinese insurance business, CDS, CDOs, Financial supervision

1 U.S. government seized control of AIG

With the deteriorating of the U.S. sub-debt crisis, the world's top finance and insurance group, American International Group (AIG) , which has up to 89 years of operating history and more than 1,000 billion dollars of total assets, is on the verge of bankruptcy. By the end of June this year, AIG has loss 25 billion dollars in the Credit Default Swaps (CDS) business and 15 billion dollars in other business.

At the same time, many holders of senior bonds issued by AIG, AIG shares and subordinated bonds and other insurance companies also suffered heavy losses. The Prudential plc which holds the fair value of 195,000,000 U.S. dollars of bonds AIG, show that this part of the assets of as much as 43% have been eliminated in the files to the U.S. Securities and Exchange Commission while the company also holds a fair value of 9,000,000 U.S. dollars of bonds AIG, is reduced by 7% only in the third quarter. AIG in times of crisis loan losses to the inevitable spread to other global insurance giant, the global insurance industry suffered heavy losses.

Members of the House Committee on Oversight and Government Reform. weren't buying it, not that lawmakers were necessarily well-versed in the rule in question, known as mark-to-market. But they seemed to know a half truth when they heard one.

Former chief executives Martin Sullivan, who resigned under pressure in June and Robert Willumstad, a former president of Citigroup who headed AIG until the government bailed out the company last month with an $85 billion loan, attributed the bulk of the insurer's problems to forces beyond their control.

Both men cited the unintended consequences of mark-to-market accounting, a practice that forced AIG to book unrealized losses on its book of mortgage-backed securities and credit default swaps - a type of contract which can insure everything from plain-vanilla corporate and municipal debt to esoteric products like collateralized debt obligations, or CDOs. AIG was a big player in both the default swap and mortgage-backed debt markets.

By Sept..30, AIG has used the 61 billion dollars of the transition bandwidth 85 billion promised by the Federal Reserve. On Oct. 8, the Fed announced another injection of 37.8 billion dollars. On Sept. 16, the Federal Reserve provide a 85 billion emergence loan to AIG though the NY Federal Reserve Bank, and hence the U.S. government will effectively get a 79.9% equity stake in the insurer in the form of warrants called equity participation notes. In other words, the U.S. government has seized control of AIG. Since the main victims of the sub-loan crisis are investment banks, AIG is the only bust insurance company. Why does it happen?

2 Analysis of the loss of AIG in the sub-debt crisis

2.1 Introductions to Sub- Prime Mortgage

In order to stimulate economic growth in 2001 U.S. Federal Reserve began to use active monetary policy so as to the achievements of the U.S. real estate market in 2001 - 2005 years of prosperity. During this period, buyers will of the people of the United States rose, financial institutions were driven by real estate interests, the provision of loans have also become more relaxed. Those who can not apply for the original mortgage groups, that is a credit score in the 6, 601 points below (the United States account for about 25% of the proportion of the population) people, but also to be included in the mortgage customer resources, and can ALT-A2 and sub-loans Loan-level access to financial support. The objects of Sub-Prime Mortgage, refers to a credit score below 620 points and do not have to provide proof of income customers. The two types of loan interest rates were higher about 2-3 percent than the good-quality credit. Subsequently, a number of new mortgage products came into being, such as the principal of the loan (Interest Only Loan), 2 / (N-2) adjustable rate loans (Adjustable Rate Mortgage, ARM), selective adjustable rate loans (Option ARM) and so on. These innovative mortgage products have a common characteristic, that is, in the early repayment burden, the latter part of the repayment will be a sharp increase in pressure.

In order to improve the liquidity of assets, real estate and financial institutions create mortgage-backed securities MBS (Mortgage Backed Securities), and its essence is to make a large number of mortgage assets to form a pool of assets, and the pool of assets generated by cash flow (That is, buyers pay on a regular basis for the month) as the basis for payment of principal and interest MBS. In order to further enhance the types of financial products, the mobility of the MBS market, enhance the secondary bond credit rating, financial institutions, real estate investment bank in the help of credit enhancement through a series of measures to develop a new type of debt security certificate - CDO (Collateralized Debt Obligation). The core of the product is to highlight the outstanding credit risk classification of the different concepts, that is, in accordance with the distribution of cash flow or debt default in the order of its evaluation of the credit default risk, and then re-divided according to three different levels: High-level, mid-level, the equity level: from the first to the third is priority class, the middle class, the class shares. The lower the credit ratings of CDOs of their products the higher level of income in that to attract a large number of investors, CDO is one of the fastest-growing products in recent years MBS market, In particular, in the years from 2004 to 2006, has grown rapidly, CDO market size of the issue reached the 1, 57,000,000,000 U.S. dollars, 2, 49,000,000,000 U.S. dollars and 4, 89,000,000,000 U.S. dollars. Due to the different risk preferences, commercial banks, insurance companies, mutual funds, pension funds, such as relatively risk-averse institutional investors tend to hold priority CDO; Middle-class level CDO equity is held by investment banks. American Standard is the amount of the mortgage down payment of 20%, but in recent years has dropped to zero or even negative down payment. U.S. housing loans down payment rate decreased year by year, together with credit loans to lower the threshold to be, resulting in CDO products to credit risk and continue to accumulate reserves.

CDS is a so-called buyers and sellers of the agreement, in which the buyer commitments on a regular basis in accordance with a fixed price to the seller must pay the cost, in return for a third party (such as housing loans in the home), breach of contract case to be compensated by the seller. From the point of view of the nature of the product ,CDS is similar to the credit guarantee insurance, if the housing loan default rate at a level of stability, then the CDS seller is really able to bring about greater benefits. AIGFP find the business opportunities in the market to sell a large number of super-called credit default swaps (Super Senior Credit Default Swaps) products on the market for the CDOs to provide massive security. As by the end of June, AIG also for 440,000,000,000 U.S. dollars worth of products to provide such guarantees CDOs. AIGFP from AIG has a ready source of money into a bottomless black hole.

2.2 From the point of micro-analysis:

Participants in the market have paved the way for the crisis. The borrowers' loan-to-super-act stimulates the mortgage market supply. Concerning more profits, banks and credit companies relax the credit rating review on borrowers and reduce the amount of down payment radio. These acts result in the increase credit risk of low-income borrowers. In the term of mortgage securitization, investment banks use lower sub bonds to support the asset quality to meet demand of high-yield customers. Moreover, investors overestimated the quality of the assets of sub bonds and put too much of them in their portfolio.

2.3 From the point of macro-analysis:

The low interest rates and relaxed lending standards in U.S lead a constantly increase in the sub bond issuance. However, many borrowers –especially those low-income borrowers, made their decision recklessly. The economic bubble doesn't show up when the real estate market is booming. However, since the Federal Reserve has risen the interest rates 17 times in a row (from 1% to 5.25%), the costs are too huge for the borrowers to bear. Besides, such situation is unexpected by the investment banks.

2.4 From the point of the management of AIG

2.4.1 The monitoring mechanism in AGI didn't play its role.

After the accounting crisis in 2005, AIG established two committees (Complex Structured Finance Transaction Committee and Transaction Review Committee) to estimate its transaction. Although Bernard Connolly, a global strategist who works for AIG warned the danger of CDOs and CDS the two committees didn't pay adequate attention.

In 2007, at a time when increasing loan crisis, AIG has exposed some signs of damage. Despite that the fourth quarter of 2007 has created the largest quarterly loss record since 1919 at that time, the market is still widely felt in the loss of control. However, on February 11, 2008, AIG to the U.S. Securities and Exchange Commission (SEC) filings made in Yukui amendment to change the credit default swap products, the method of valuation, according to a security meeting by the previously announced loss of 1.1 billion U.S. Yuan, the amendment to 4,880,000,000 U.S. dollars. Upon disclosure of the information, AIG immediately drop the market value of 15,000,000,000 U.S. dollars, AIG This is a turning point in the issue began to deteriorate. Since then, due to increased impairment losses, AIG's book losses continue to grow. It was therefore of the opinion that: AIG will incident as their business issues, it would be better under the accounting issues. Credit default swaps to change the method of valuation of the products has greatly increased the amount of losses AIG, AIG is to promote the troubled accelerator. It should be noted that, AIG is not the initiative to adjust the valuation method, but by independent external auditors PricewaterhouseCoopers views. AIG's original valuation methods obviously over-estimated the credit default swap contract value, and underestimated the potential loss. According to the U.S. accounting standards, the valuation of derivatives use the fair value measurement. The fair value of the so-called core meaning "mark to market", the market price of financial assets recorded in the statements on the amount. But for those involved in small, liquidity is not so strong, not even the market price of the transaction, the fair value of the cash flow projections on the basis of relying on complex mathematical models of calculated. No one knows, the complex geometry of the product value in the end, even if AIG listen to the views of auditors changed the method of valuation, there are also over-estimated the existing methods of the possibility of actual loss, In other words, the market may be over-reacted on the existing accounting of the number . In any case, AIG did not start in a more cautious approach to the valuation of derivatives transactions, leading to today's Board.

2.4.2 Over-involved in derivatives trading

AIG has unacceptable flaws in the valuation of CDS. Pricewaterhouse Coopers, AIG's external accountant believed that AIG used Market-to-Market to value the CDS business, which inflated the value of CDS. Contracts in AIG's CDS contained various credit levels, those contracts may devalue rapidly when the U.S economy drops. If value those assets through the opening market, the valuation could hardly catch up with the devaluation. Indeed, AIG's profits will be over-estimated and thus affect the fairness of the financial report.

The loss in AIG current book, a large part of the credit default came from the CDS. Credit default swaps are similar to a guarantee insurance business; the operators are not limited to insurance companies. When investors buy a credit default swap, the equivalent of its investment securities purchased insurance. When the securities were credit rating agencies to lower ratings, any risk of default will be clammed by the investors themselves not by the sale of credit default swaps of the sector. AIG provide a great deal of credit default swaps to CDOs, which lead in a huge risk exposure.

Many people accused AIG into the CDO/CDS, and other complex financial derivatives is the main reason for now bogged down in a quagmire. This is not unreasonable. AIG on a large number of CDOs into the business, in the final crisis has been before the parties (including credit rating agencies) as a high credit rating business, risks are close to 0.For the benefit of the same credit rating higher than traditional asset-backed securities, AIG to invest heavily, as well as security can not be said to be the company's rational decision-making. It also makes a significant contribution for the growth of the company's performance. After all, the investment policy is relatively conservative and radical, and there is no absolute right or wrong of points, we can't carry out an active advocate of innovation when the market is good and blamed "aggressive" when the market is bad, The root of the problem is not that AIG is involved in this type of complex derivatives, is only "excessive" involvement. First, because of the special nature of insurance compensation, the second reason is that the relatively low-cost insurance funds are particularly vulnerable to lead to impulsive investment. As a result, both the operating insurance agencies and insurance regulators in the treatment of insurance investment activities should uphold the special caution. Insurance funds for the proceeds of the factors to consider, of course, be careful risk assessment based on high-risk asset allocation. However, we must first and foremost for the safety considerations, the investment impulse control strictly the proportion of such assets. AIG over foots in high-risk assets, yield to the temptation of the proceeds blindly, and forget about the potential risk, it is the first reason which leaded in today's situation.

Despite the risks from the final attribution of view, CDS and bonds are basically the same security, but CDS, in particular the high-level CDS, provider of mobility requirements are more stringent. AIGFP its counterparty provided by the so-called high-level CDS, and the need for the CDO arbitrage portfolio of credit derivatives to provide the majority of mortgage assets. The amount depends on the mortgage assets of the credit derivatives of the replacement value or market value of the bonds. At the same time, the amount of mortgage assets with AIG credit rating and credit rating relating to Bonds. As a result, the CDS once the effect of price changes or the subject of CDOs of asset price changes, as well as AIG's own credit rating change, AIG must provide more liquidity assets as collateral. The worst scenario is inevitable emergence of the second loan crisis broke out, so that almost all of the above conditions have been triggered: In the first half of last year and this year there are a considerable number of CDO's credit rating was reduced, AIG is on a substantial loss in the credit default swap business, 3 major rating agencies lowered their ratings, led to AIG increase tens of billions of dollars to the collateral. As of July 31, 2008, as a result of the deterioration of the CDO rating AIGFP provide a total of some 165 billion dollars in mortgage assets for its senior credit derivatives.

In addition, AIGFP has also provided a lot of hidden security products which have the characteristics of credit derivatives. For example, 2a-7 puts from AIG. These products are allowed CDO when it has no breach of contract, but is difficult to sell, included in AIG's balance sheet. In the second quarter of this year, AIG was the name of a total value of 18,800,000,000 U.S. dollars of CDO products 2a-7puts. This greatly increased the company's products CDO exposure.

2.4.3 Real estate related to the excessive concentration of risk

To diversify the risk of spread of the use of insurance funds is the basic guiding principles. However, AIG is contrary to the principles of its business into the area of real estate finance at all levels, leading to the real estate market and the risks associated with excessive concentration. Specifically, not only AIG insurance and financial services sector to invest in direct support of the mortgage securities and CDOs (On the basis of which all or part of the collateral by the housing mortgage loans). And many of the subsidiaries AIG Group specialize in a certain category of real estate finance business. For instance, AGF purchase housing for all and to issue loans in the first level; UGC for high loan / price ratio of housing mortgage guarantee insurance to provide mortgage services; AIGFP provide credit protection through CDS for some ultra-high-level CDOs. It can be said, AIG comprehensive set foot in the real estate finance in various fields. Once the real estate prices, rising mortgage default rates, a risk in the area quickly spread to another area, resulting in the loss was the geometric growth of the base.

Similarly, the risk of real estate can not be over-concentrated simple reason attributed to AIG executives in decision-making errors. In fact, AIG involved in all aspects of real estate finance and not contrary to the existing regulatory framework, and also have measure for the risk of isolation. For example, to engage in mortgage insurance subsidiary has adopted a single-line mode of operation, there is no other business operators at the same time. However, there still comes a problem. This tells us that the existing regulatory system, the existence of the gap, the current risk of isolation is not enough.

2.4.4 Too many parts of AIG's business lines are encroached on the bond sub-products

AIG as a Financial Group sets foot in business insurance, banking, leasing and other fields. However, a number of AIG's business lines, a number of subsidiaries have to set foot in sub-sub-credit and bonds, thus meeting the overall loan-to-high risk of exposure drag its financial position.

1st- security operations bonds. We can see that AIG provided a security bond of close to 30% of the credit rating under AA. This has led to AIG in the security business in 2007 from a net profit of 1 million -7800 quarter of the rapid growth in 2008 to the mid-million -51800.

2nd- mortgage insurance. The AIG's business is provided by the UGC, in order to have a different order of the right to claim credit for insurance.

3rd- senior credit derivatives, mainly refers to the CDS products provided by the AIGFP. As of June 30, 2008, AIGFP's senior credit derivatives net exposure to 441,000,000,000 U.S. dollars, involving a total of 208 transactions. CDO for which the subject of credit derivatives totalled 57,800,000,000 U.S. dollars, Among these 65%, or about 36,400,000,000 U.S. dollars of CDO has been downgraded, there are 33,900,000,000 U.S. dollars in CDO's on the brink of relegation and therefore lead to the mark-to-market losses amounted to a total of about 24.8 billion.

4th- the real estate loans provided by AGF (American General Finance).

5th- the sub-loan assets in the insurance portfolio held by AIG Investment. As of June 30, 2008, AIG's insurance 261,800,000,000 portfolio, 24% RMBS, 1% of the CDO, as well as 5% of the CMBS. The first two sub-loans are a great association. For example, AIG's investments in RMBS, there were almost 200 million are sub-loan RMBS.

Multi-line business is in a different way into the loan-to-time, AIG is facing not only the high risk of exposure, but also to the entire group of risk measurement and management very difficult. In addition, AIG's complex structure is difficult to lead to a comprehensive risk management, reflecting the important reasons behind.

3 Lessons for China's insurance industry

As the capital markets and banking open late, the influence of Sub-debt crisis on China's insurance market is extremely limited. However, through careful analysis of the crisis on the U.S. insurance industry and the government, regulators response, China can still have a very useful inspiration:

3.1 AIG insurance crisis revealed the risk of new features

With the second loan from the subprime mortgage spread to the of Alt-A loans, from private to public securities spread to the securitization, the crisis is on further escalation, more problem financial institutions were exposed. Local time, the United States on September 15, AIG's stock price plummeted 61% to 4.76 U.S. dollars, so that the market value of AIG has shrunk nearly 200 million. This year, the stock fell a total of 93% for the Dow stocks performed the worst one.

Since the U.S. sub-loan crisis, AIG has suffered a three-quarter net loss. Net loss of 5,290,000,000 U.S. dollars in 2007 fourth quarter, In the first quarter of this year, a loss of 7,800,000,000 U.S. dollars and 5,360,000,000 U.S. dollars in the second. As of the second quarter of AIG's CDS business had a loss of up to a total of 25,000,000,000 U.S. dollars. The night of 16th, the U.S. government agreed to authorize the New York Federal Reserve Bank of AIG to provide emergency loans 85,000,000,000 U.S. dollars in exchange for 79.9 percent controlling stake in the way of taking over AIG. The loan window will be valid for 24 months, the interest rate for the period March London Inter-bank Offered Rate (LIBOR) plus 850 basis points. AIG has been took over by the U.S. government and avoided the immediate closure of the fate of 85,000,000,000 U.S. dollars, but high-interest-bearing loan is actually a winding-up program, ordinary shareholders are likely to lose all the last, AIG still have to through the sale of assets to pay off the loan as soon as possible .

Re-examine the insurance companies in the sub-loan crisis in the role, not only can help us to clarify the context of the financial turmoil and toward, and contribute to an in-depth assessment of the insurance industry has a new identity and new risks.

3.1.1 Financial risk has shown a new way to the insurance market.

Decrease in capital market investment will not only affect the solvency of the net assets of the insurance companies and could also make insurance company liquidity problems. The AIG is adequate solvency, as a result of lack of liquidity crisis.

3.1.2 The insurance industry on financial markets, the depth of intervention, increased its cyclical characteristics.

Traditional thought, the insurance industry that is not sensitive to economic cycles, in particular the life insurance industry. However, nearly 20 years of experience in the international insurance market, insurance influenced by the depth of financial markets, the characteristics of the cycle is increasingly clear in insurance industry. Collapse of the wave of Japanese insurance companies in 1997-2001, as well as global stock markets fell by insurance companies to weaken the power of capital in 2000-2002, both of these indicate that the insurance industry's business cycle fluctuations of the sensitivity enhanced.

3.1.3 In the macroeconomic, financial market volatility conditions, smoothing the business cycle fluctuations in China's insurance industry is of practical significance.

From the perspective of the balance, it is necessary to strengthen the management, attention to product pricing and underwriting profits. From the perspective of assets, it will have to widen the investment channels through the diversification of risk and the risk cycle.

3.2 The important role of Insurance Company in the sub-loan crisis transmission risk chain.

Over the past 20 years, financial assets expanded rapidly, Bank credit as being paid to the importance of continuous decline. Large international banks to gradually buy from the traditional holders (buy-and-hold) to launch the distribution of profits model (originate-to-distribute) profit model. That is, through the Bank of securitization and credit derivatives will be issued credit for his re-assigned to the capital markets, more transactions become the main type. Bank business model changes brought about an important change is to reduce the bank's credit risk vulnerability; risk is widely distributed in addition to the banking system. In the originate-to-distribute model, the credit enhancement has become the most important.

From a global point of view, the credit enhancement has penetrated into the bond issue, including the traditional financial services in many areas of the field. The insurance companies involved in credit risk transfer is the most important non-bank financial companies, and through the CDS and other products to be the second to bear the ultimate risk of loan-to-one. Since early 2008, including bonds and financial guarantee insurance companies, including insurance companies throughout the evolution of the crisis at the beginning of an important fact. From the beginning of the year MBIA, AGC bond insurance companies such as the recent financial crises of AIG have caused serious market turmoil.

3.3 Improve the corporate governance structure is a fundamental and crucial work

It can’t be denied that AIG is under Greenberg management and control for more than 40 years of have made outstanding achievements, but also exposed a number of obvious problems. Greenberg, through a special structure of the company, the company's long-term operational and management control, He took advantage of AIG executives in the hands of the original stock has registered a 3 - Starr International, CV Starr, Starr Foundation, He is the company's three largest shareholders, and the three companies are major shareholders of AIG. As a result, his use of the three companies control not only firmly in control of AIG, but AIG took control of the senior management, led to the supremacy of the individual over the authority of the established, the role of individuals is often greater than the system, making corporate governance Failure. Although the company's governance structure integrity and complete system, but in practice because of the large shareholders can not be manipulated to play a real role. Lack of sufficient checks and balances of rights, is often a breeding ground for potential risks.

Since the resumption of business in 1980, China's insurance industry experienced two decades of rapid development, has made remarkable achievements. However, the development of the long-term accumulation of a number of issues have gradually become apparent that corporate governance is one of the problems, If we do not effectively be addressed not only vulnerable to the insurance industry's enormous potential systemic risk, but also constraints of the insurance industry will be sustained, rapid and sound development of the bottleneck.

At present, China's insurance industry is still in its initial stage, insurance companies, construction management structure is still in its initial stage, inevitably there are some problems, Outstanding performance as follows: First, the equity structure, shareholder rights of asymmetry. At present, although investors to diversify, there have been state-owned shares, legal person shares, foreign stocks, stocks mixed private property rights structure, Corporate governance structure and emerging into a new orbit, but focus on equity, stock and shares of the main structure of the type of structure is irrational, the proportion of state-owned shares is too large and the lack of personification of the main property, and "lack of owners", resulting in Shareholders have control, management and control of external intervention, and other issues still exist, principal-agent problem is more prominent, making it difficult corporate governance realize their full potential. Second, we do not fully play the role of the board of supervisors. Although the restructuring of state-owned companies made considerable achievements in the new "three" system set up, most of the other joint-stock companies to set up a board of supervisors, but in actual operation, the board of supervisors has not really expected to play a substantive role in the supervision. Third, the independent directors can not really play a role in the building of the Board of Directors is not sufficient. Although a small number of companies set up the independent director system, the introduction of independent directors, but the effect was not obvious. Of course these problems not only reflected in the insurance industry, which is our corporate governance in various sectors of common problems. Recently, a major media of China's listed companies in all industries sample survey shows that the board of directors to vote in 33.3 percent of the independent directors have never voted against and abstained from voting, 35% of the independent directors of listed companies and has never made a major shareholder differences The independent views. Fourth, China's insurance laws and regulations and operating practice, there are still lagging behind and do not fully match. For example, the "Company Law", "Insurance Law" and the management of insurance companies, all of the corporate governance structure of the general meeting of shareholders, board of directors, board of supervisors, managers have a clear terms of reference, but in practice, there are many companies in the industry and Approved by the executive does not refer explicitly to the system; Also on the corporate governance structure of the incentive mechanism, there is no principle, no taxation policies, leading companies and executives for the stability of the pay comparison, increased corporate governance costs.

As a result, based on China's insurance industry in corporate governance problems and their deep-seated reasons for a gradual manner, through deepening reform and industry characteristics of the new corporate governance structure, improve internal and external governance mechanisms to fully mobilize the enthusiasm of all sides, stimulate and enhance internal Vitality and external competitiveness, and gradually establish a standardized modern corporate governance structure and internal operation mechanism.

3.4 Always adhere to the principle of insurance investment security

The principle of security is the necessary condition to achieve the full amount of insurance funds, for returning reliable and the guarantee of payment, which is decided by the nature of the insurance funds. The majority of countries conduct more stringent supervision over the investment activities of the insurance companies, For example, to set the specific investment ratio of specific capital, to make higher requirements of high-risk investments, and so on. The security of return is the prerequisite for the usage of Insurance funds otherwise they will affect the insurance function of the realization of economic compensation, thus affecting the stability of insurance companies operating as well as social stability. Therefore, in the insurance investment management, to ensure the safety of the funds are often placed on the first of many factors.

Since we are increasing channels to expand the use of insurance funds in China, security is the first principle when the insurance companies develop their own investment strategy so that they can control investment risks.

It is the only way to guarantee sustainable and smooth development of the insurance investment activities.

3.5 To broaden the field of insurance business

To promote the insurance industry and capital market integration and make Insurance funds to operate efficiently is an inevitable choice for the development of China's insurance industry’s innovation. Learn from the experience of the Western insurance business, combined with China's realities, with improvement the solvency as the core, ensuring the efficiency of the use of insurance funds as the target, risk-management techniques as a means, the operation and administration of the funds which is made according to the structure and characteristics of the Insurance capital and under help to form a virtuous circle of operation and promote sustainable and innovative development, is a major strategic choice in the new period of development of China's insurance industry.

There is no bond insurance in China yet, however, there are a lot of business such as liability insurance, agricultural insurance, banking insurance which are all of new business areas. The regulatory bodies must address these new business developments of the special nature of the special regulatory rules, track and analysis of new business market and take the appropriate adjustment measures to solve them in time. Only in this way, small problems will not be accumulated to form the system risk, the insurance market be able to develop healthily.

It is true that new financial products' appearance can increase the operating efficiency of financial markets. But financial innovation is a double-edged sword. In the process of innovation we can not ignore the financial security, it is necessary to grasp the balance between safety and efficiency. If not handled properly, the financial instruments for prevention of financial risks of are also likely to bring new financial risks. During the innovation in the insurance business, we should consider not only its own products and systems for insurance risk, but also take into account that its real economy may be risk factors. If we only pursuit of innovation and efficiency and ignore the safety, in the event of a crisis, not only reduce the efficiency of financial innovation, but also may have hurt the economic entities and effect the efficiency of economic operation.

The sub-debt crisis show that, today , financial markets globalized increasingly, financial innovations have become increasingly popular, financial products are increasingly complex. Traditional financial-market has been to play down the boundaries between, cross-market financial products become increasingly common. The financial institution and the number of which innovative products related have been increased.

3.6 About the establishment of a deposit insurance system in China

The so-called deposit insurance system means that for the absorption of funds from the public to engage in the business of financial institutions to establish an insurance agency, the members of the financial institutions pay premiums to insurance agencies, financial institutions, members of the payments crisis or facing bankruptcy to operate, the insurance institutions by protection of the deposit accounts of principal and interest payments to give all or part of the security system. In the sub-debt crisis in the U.S, traditional deposit insurance system has played a limited role.

In our country we have been operating implicit deposit insurance system, it is unrealistic to introduced a deposit insurance system immediately.The deposit insurance system in the banking system is the last line of firewalls, from the current situation of the affected financial institutions, our country did not hurry to introduce this system, we can learn from the experience of the crisis, to improve the system more rational.

Now the world economy is in a financial panic, China's economy is entering a downward track, big ups and downs in the stock market, real estate is full of stormy uncertainties of the current rush the introduction of a deposit insurance system, it may be counter-productive. If you have to be introduced, at least a few years of grace period to allow banks and depositors of the system to have a step-by-step process of digestion and adapt in order to give better play to the functions of a deposit insurance system to safeguard the security of the financial system.

3.7 Insurance information disclosure system should be run through the whole process of insurance business

AIG's accounting and control the quality of information disclosure led Wall Street investment analysts questioned the broad, but also seriously affected the confidence of investors. At present, China's insurance information system is not sound credit evaluation system, lack of insurance, policyholders asymmetric information, Insurance market information distribution and transmission of the irrational behaviour exists to a greater extent, insurance companies, information disclosure, whether in the form or content is still in its initial stage, the motive for the disclosure of information is not very strong, which is not comprehensive enough, in the form of a single comparison, the lack of time Rapid way to be normative. Now, the WTO transition period ended, In the opening round and faces new pressure to open the new situation, the insurance industry to disclose information is industry practice to operate and theoretical research should be of concern, Explore the establishment of China's insurance industry to disclose information system, strengthening supervision to protect the legitimate rights and interests of all sides to maintain a fair market, systemic risk and improve internal management and rational allocation of resources, insurance and so on, have an important realistic significance and far-reaching implications.

3.8 To establish a flexible, comprehensive coverage of the monitoring system

The fact of the U.S. loan crisis in the bond insurance market, shows that the capital market in the chain of financial institutions have close ties, the market is not omnipotent, supervision is particularly important.

In the loan crisis, although many of the mature market, insurance companies suffered more adverse effects, but because of its good risk management system, make the loss in the maximum control. It goes without question, these companies a good risk management system and the establishment of regulatory agencies to implement risk-sensitive solvency regulation great relationship. With the sub-loan crisis of the in-depth reflection and assessment, is expected in the future solvency of the insurance industry in China will be more strict supervision. In the United States, New York state has planned to increase the bond insurance and capital adequacy requirements; In Europe, in the process of being prepared to establish a "solvency II system" will be based on recent market developments, some European insurance companies to re-evaluate the risk management capability, In particular focus on insurance companies to study the balance sheet assets of the party to determine whether they can withstand the volatility of market risk in the near future. To achieve seamless monitoring is extremely difficult. To this end, the regulator should not have been as much as possible to improve the current regulatory system should also pay attention to "monitor the border" to make it more flexible and more comprehensive.

Shang Fulin, chairman of the SFC pointed out that the financial system; financial security can not be ignored forever. The financial supervision should be adjusted and optimized according to the development of the market. Modern financial system, the regulatory function and supervision in advance should be strengthened. To enhance the uniformity of international regulatory standards is also needed. Different regulatory standards will lead to regulatory arbitrage market emerged. China's banking, insurance, securities regulatory standards are gradually walking to the international line.

At present, the financial supervision and monetary policy authorities and the majority of cases are distinguished from, so our country and other countries in addition to the attention of monetary policy co-ordination between, we also have to pay attention to the domestic regulatory information, communication, and the central bank's cooperation.

Through the sub-debt crisis in the U.S, it should be noted that in China's financial industry actively and steadily push forward the opening to the outside world at the same time, the risk of the global financial system can not be ignored. Of particular importance is that China's banking financial institutions must be deeply reformed, improve risk management capacity and enhance overall competitiveness. China's financial regulators should draw lessons from similar circumstances should have early warning capability. In short, China should learn something from the sub-debt crisis in the United States to promote China's economics' sustainable development.

3.9 Learn the way of U.S. government's action in the crisis

Most of the money that U.S. government puts into the capital market is short-term loan. The 85b dollars which AIG received are not free lunch but have a 12% interest rate. In other words, on surface, the U.S. government is trying to save the insurance giant; however, AIG's stockholders will lost their benefit in order to save the taxpayers and the capital market.

Moral hazard, which means the safe of the taxpayers' money is top priority, is the most concerned by U.S. government. If the lost in the crisis are committed by the government and taxpayers finally, speculators will continue their risky investments since they will lose nothing. This also provides reasons why U.S. government saves Fannie Mae, Freddie Mac and AIG in a row, but let the Lehman Brothers go break.

China's government, however, reacts by just putting money into the nationalized banks and using the state foreign exchange reserve. Indeed, citizens in China finally pay the bill of the banks' lost.

China should learn the way that U.S government did in the crisis.

3.10 establish a national credit rating system

So far, China does not have a unified credit rating system. Every bank and insurance company has its own one. However, such credit rating system is often invalid since companies are tending to get round the system for their own profits.

The China Construction Bank (CCB), one of the country's four largest State-owned commercial banks, is to establish its first national individual credit rating system, in a bid to ward off possible bad-loan risk in the booming personal loan market.

"The rating system, which is expected to be able to provide the bank with more objective understanding of its clients' credit status, will be a crucial step in enabling the bank to gain a larger stake in the retail banking market," Xin Shusen, general manager of the bank's retail banking department..

By linking all the bank's computer networks together, the rating system will contain all of CCB's credit records, for around 200 million clients nationwide, and a set of rating standards that will be used to evaluate the credit status of individual clients who apply for loans from CCB.

The move is believed to be another breakthrough in safeguarding the banking sector form possible lending risks and improving the objectiveness of ratings following the establishment of the country's first regional individual credit rating system in Shanghai.

The bank's retail services for individual consumers have undergone a sharp increase in recent years in the country's developed areas.

CCB will be able to decide whether to lend and how much to lend to individual clients based on historical consumer records and CCB's rating standards.

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