Life Industry Changes in Asia

Caroline Bennet, FIAA
Jeremy Porter, FIA

Presented to:
The Institute of Actuaries of Australia
2003 Biennial Convention
Shaping the Future: In a World of Uncertainty
18 – 21 May 2003

Life Industry Changes in Asia

Abstract

The Asian life insurance markets have long been seen as providing tremendous growth opportunities for market participants.

In recent years, events including continued global pressure on financial markets and in some cases major regulatory changes both in terms of capital requirements and distribution channels, has meant that the life insurers in many Asian markets have been operating in a rapidly changing market. At the same time, while historical sales growth rates in excess of 10% per annum were recorded for many markets for more than 10 years through traditional distribution channels, such growth rates have not been observed more recently.

This paper aims to address the commercial implications of the changing market environment in Asia for life insurers in a number of major markets, for both existing participants and potential new entrants.

It will be of interest to those practicing in Australia who do not deal with Asian markets as well as those currently involved.

1. Introduction

This paper focuses on four of the major Asian life insurance markets:

- Hong Kong
- South Korea
- Taiwan
- China

The Asian life insurance markets have long been seen as providing tremendous growth opportunities for market participants.

In recent years, events including continued global pressure on financial markets and in some cases major regulatory changes both in terms of capital requirements and distribution channels, has meant that the life insurers in many Asian markets have been operating in a rapidly changing market. At the same time, while historical sales growth rates in excess of 10% per annum were recorded for many markets for more than 10 years through traditional distribution channels, such growth rates have not been observed more recently.

This paper aims to address the commercial implications of the changing market environment in Asia for life insurers in a number of major markets, for both existing participants and potential new entrants.

The paper concludes with a discussion of the factors likely to be affecting markets in the coming years.

Acknowledgments

This paper is the result of research and information collated by various people beyond the authors as well as comments from other colleagues. To all, we thank you for your efforts and contribution. Specifically, we thank - Roger Steel, Bessy Ma, Hitesh Shah, Henry Yang, Doogie Noh and Miranda Wang.

We note that any opinions or points of view put forward in this paper are ours, and do not necessarily reflect those of our employer.

2. Update on operating environment

Difficult global economic conditions have impacted severely on Asian life insurance operations in recent years.

South Korea

Whilst economies in Asia have generally been experiencing low rates of growth, the South Korean economy has been remarkably resilient in recent years, with real GDP growth reaching just under 6% in 2002. It has avoided the destructive effects of deflation that have been felt by a number of its neighbours, and unemployment has remained at comparatively low levels.

Some reforms have been implemented, such as the introduction of a 5-day week, and measures to weaken the family control of the chaebols.

The international political scene faced by South Korea continues to be an extremely delicate one. In recent months North Korea has shown its willingness to defy the U.S. with its nuclear development programme. The popular support that led Roh Moo-hyun to victory in the December 2002 presidential election had an anti-US edge, and the current stand-off between the North and the US has certainly added to the tension felt between the South and its historical ally.

Interest rates have continued to fall in South Korea in recent years, eroding the profitability and financial strength of the life insurance market. The response to this in the market has been a move from savings products to risk products, increased emphasis on variable business, as well as a reduction in the pricing rate on traditional products.

China

Recent political events in China have been dominated by the nomination of Hu Jintao as general secretary of the Chinese Communist Party. Whilst a number of leadership changes have been announced, the former party chief, Jiang Zemin, has retained considerable influence within the new structure.

Whilst the new leadership is unlikely to reduce the role of the public sector in the domestic economy very significantly, there are signs of changes afoot. Continued efforts are being made to improve the efficiency of the public sector. In addition the outgoing general secretary Jiang Zemin outlined some tangible steps the government would take to support the growth of the private sector, amongst them interest-rate reform.

According to official figures GDP has continued to grow strongly, with real growth at around 7%-8% per annum in recent years. However rural income growth continues to lag the rise in urban incomes.

Price inflation has remained close to zero over the last few years, as foreign investment has increased capacity within the economy, in some sectors ahead of increases in demand.

Relations with the international community strengthened somewhat; in particular with the US immediately post the September 11th 2001 terrorist attacks. However, the war in Iraq has prevented a closer understanding developing between the two nations.

Taiwan

Following over 50 years of rule by the Nationalist Party, Taiwan returned an opposition president in the elections in 2001. The new president, Mr Chen Shui-bian, was elected on the back of a pro-independence campaign, and has effectively lead to Taiwan taking a step back from the "One China" principle. These events were viewed with some discomfort across the Taiwan Strait.

However calls from the island's strong political and business lobby for an end to restrictions on trade with the Mainland remain strong, particularly in view of economic weaknesses at home. Balancing these economic imperatives against domestic pressures to remain aloof from the Mainland will continue to pose the government a significant challenge. Trade with China increased rapidly in 2002 and the mainland now represents Taiwan's single largest export market.

The Central Bank of China (Taiwan's central bank) has allowed the Taiwan dollar to remain relatively weak over the period, in an effort to maintain its export market share in the face of increasing competition in particular from the Mainland.

Domestic demand remains sluggish, and continued low interest rates have failed to stimulate any real pick up in consumption. On top of this a lack of liquid domestic investments, coupled with severe restrictions on investing in overseas assets has contributed to very low yields on long-term bonds. This combination has resulted in a continued erosion in the returns available to Taiwanese insurers, and a corresponding impact on the profitability and financial strength of the industry as a whole.

Reforms are afoot however, and in the weeks prior to the publishing of this paper the government announced it would allow a number of the domestic players to increase their exposure to foreign assets to 35%. A number of other measures taken by the supervisory authority since June 2001 are expected to improve the financial condition of the insurance industry.

Hong Kong

The Hong Kong economy has been experiencing continued deflation since the start of the Asian Financial crisis. Particularly badly hit have been property owners, who have seen the value of their assets decline by as much as two thirds since the peak of the market in 1997, with no immediate sign of a respite.

The currency peg with the US dollar, and the strength of the US dollar before early 2003 also further eroded the competitivity of Hong Kong compared to its neighbours. This combined with a weak global economy has hit the domestic economy particularly hard.

Whilst the US dollar weakened in the early part of 2003, giving some hope of an externally lead recovery, the Hong Kong economy was then severely impacted by the SARS epidemic.

Unemployment has soared to levels well in excess of the historical average (which has been in the 2%-3% range), and seems set to reach 8% in 2003.

The incumbent chief executive, Tung Chee-Hwa, has struggled to improve his popularity ratings. In late 2002, the government began a highly controversial and at times badly managed process that will culminate in the passage of legislation to prohibit acts of treason, secession, sedition or subversion against the Chinese state. This generated concerns with regard to the freedom of information, the business environment and the freedom of the press.

Key Metrics for Insurance Markets

The table below summarises key metrics for a wide range of Asian life insurance markets:

Country	GDP (US$ bn)		GDP per capita US$		Population millions		Gross Savings % of GDP	
	1999	2001	1999	2001	1,999	2,001	1999	2001
Japan	4,166	4,254	32,985	33,399	126	127	30	35
China	975	1,159	780	908	1,250	1,276	39	40
India	415	478	421	463	987	1,032	22	23
South Korea	407	457	8,684	9,521	47	48	34	26
Australia	401	424	21,125	21,878	19	19	21	19
Taiwan	319	332	14,435	14,817	22	22	26	27
Hong Kong	154	164	21,977	24,164	7	7	30	33
Indonesia	101	145	485	680	209	214	26	27
Thailand	108	115	1,747	1,851	62	62	33	30
Singapore	79	88	20,108	21,201	4	4	50	52
Philippines	75	78	977	1,013	77	77	15	19
Malaysia	51	88	2,230	3,679	23	24	47	43
Vietnam	28	33	368	414	76	80	25	29
U.S.	9,300	10,171	34,053	36,718	273	277	17	19

Country	GDP (US$ bn)		Life Insurance Premium (US m)		Life Insurance Premiums % GDP	
	1999	2001	1999	2001	1999	2001
Japan	4,166	4,254	230,169	221,606	5.5	5.2
China	975	1,159	10,496	15,556	1.1	1.3
India	415	478	5,994	9,418	1.4	2.0
South Korea	407	457	35,161	39,699	8.6	8.7
Taiwan	319	332	18,542	20,945	5.8	6.3
Hong Kong	154	164	5,294	7,290	3.4	4.4
Indonesia	101	145	499	773	0.5	0.5
Thailand	108	115	1,475	2,127	1.4	1.9
Singapore	84	88	2,677	2,914	3.2	3.3
Philippines	75	78	485	493	0.6	0.6
Malaysia	51	88	1,773	3,082	3.5	3.5
Vietnam	28	33	79	169	0.3	0.5
U.S.	9,300	10,171	393,812	443,413	4.2	4.4

Sources:

1 *Primary Source: Sigma No. 6/2002*

2 *All GDP figures from World Development Indicators Database, WorldBank Aug 2002 except as indicated*

3 *Population from Swiss Re, sigma No.6/2002 (Sourced from Global Insight, WIIW, EIU)*

4 *Life Insurance Premiums from World Insurance 2001 - Sigma No. 6/2002 except where indicated*

5 *1999 figures are from IAA paper May 2001, at 3/3/03 exchange rate*

6 *Exchange Rate used as at 3/3/2003*

3. Overview of Factors Affecting Key Markets

There have been a number of key areas of continued development since the previous paper:

- Major regulatory changes
- Changes in distribution channels
- Market entry, exit and consolidation

3.1 Regulatory Changes

China

The key factor impacting China's corporate landscape at present is the impact of the WTO agreement signed last year. Under this agreement foreign insurers will enjoy much greater access to China's insurance markets.

For life insurers, generally at present foreign ownership of joint ventures may not exceed 50%, although this percentage will be increased to 51% in December 2004, and the limit will be removed entirely in December 2006. In addition, the restrictions placed on which cities foreign owned companies can operate in will also be lifted and foreign/joint venture insurers will be permitted to provide group insurance from December 2004. Compulsory reinsurance through the state owned reinsurer China Re will be removed by December 2005.

For investments in an existing Chinese domestic life insurance company, the total foreign ownership may not exceed 25 percent.

A new insurance law was enacted on January 1 2003, liberalising the insurance market in a number of areas. For example, many policy types no longer need the regulator's approval before they are released. Banks and security houses can now be the sales agent of more than one insurer. The reporting requirements were also strengthened in the new law, including the framework of an Appointed Actuary system. In addition, non-life insurers are allowed to offer accidental personal accident insurance and short-term health insurance business.

Other significant developments in recent years in the market include the authorisation to write both unit linked business (in 1999) and participating business (in 2000).

Furthermore, investment restrictions have been eased significantly over the period. In the past the only investment vehicles effectively available to life insurers were bank deposits, government bonds and corporate bonds (although there was a provision in the regulations which would allow other investment types to be approved by the State Council). In recent years insurers have been able to invest in certain closed end equity funds for their unit linked business, providing their policyholders with access to equity markets for the first time.

Hong Kong

The underlying philosophy to market regulation in Hong Kong is “freedom with publicity”. Companies enjoy considerable freedom in terms of product design and pricing, as compared to other Asian markets. As a result, in recent years product profitability has generally been higher in Hong Kong than in any other market in Asia, especially for traditional long-term products where the returns provided to policyholders are not transparent.

If and when the level of disclosure or transparency increases within the market, we expect that profitability levels will be affected. This is a particular risk as products such as unit-linked / variable life and universal life become increasingly popular.

The main changes in regulation within Hong Kong in recent years have centred on controlling agency force activities. The number of agents operating in the market started to drop from 2000, when new agent licensing exams were introduced, and a continuing professional development requirement for agents to retain their licenses was introduced in 2002.

In addition, measures designed at combating policy “twisting” activities have been recently introduced (this is the practice whereby an agent who switches employers persuades his client to surrender the previous employer’s policy and take out a new one). It is not yet clear how successful these new regulations will be in controlling agency practices in the market.

Korea

The Korean financial sector has been subject to major restructuring following the fall out from the Asian financial crisis of the late 1990s.

While there are multiple regulatory bodies and a high degree of regulatory activity, overall the transparency of financial reporting remains low and many Korean life insurers continue to struggle with the legacy of historical interest guarantees.

Major regulatory changes include:

- The allowance of sales through bancassurance from August 2003
- Introduction of variable life (2000)
- Reduction of minimum statutory valuation interest rates
- Introduction of asset adequacy analysis (similar to New York 7 requirements)
- Reduction in capital requirements for new entrants to insurance business

It is expected that there will be further changes to come, including:

- Reduction in the level of restriction over investments, in particular foreign investment requirements
- Increased disclosure, in particular around expense levels
- Potential independent actuarial reserve review
- Strengthening of reserving requirements, in particular focussing on premium deficiency reserves, and other reserves such as interest maintenance reserves and asset variation reserves
- In the longer term, the adoption of a risk based capital approach to solvency requirements

Taiwan

Market regulation in Taiwan has remained very "hands on" over the period since our last report. The regulator has generally taken a prescriptive approach, especially in the areas of product approval and participation in surplus. Participation in surplus has traditionally been through a cash dividend approach, with the factors for both mortality and interest surplus being provided by the Ministry of Finance. The result of this approach coupled with falling returns in the market has been poor product profitability.

The main factor that the regulator has used to restore profitability to the market is by progressively pushing the market to reprice on lower guaranteed interest rates. The inability to reduce the guarantees on in force business and the continual downward trend in returns however has resulted in the limited success of this approach.

As a result, in the early part of 2003, the regulator announced that companies would enjoy more liberal regulation of participating business. Under this new approach companies are free to set their own premium rates, and are subject to the sole constraint that they must distribute at least 70% of surplus arising to policyholders.

In conjunction with this, and faced with declining financial strength of many players in the market, the regulator is also in the process of introducing a US-style risk-based capital approach to measuring solvency. This replaces the previous method, which set the required minimum solvency margin at a fixed amount dependent only on the company's paid-up capital.

Furthermore, in the weeks prior to the publishing of this paper, the government announced that the ceiling on investment in overseas assets was to increase from 20% to 35% (subject to approval from the Ministry of Finance on a case by case basis). If this new ceiling were taken up in full by all companies in the industry, it would result in close to US$ 20 billion flowing into offshore assets.

In late 2001, the regulator paved the way for the formation of financial holding companies in Taiwan, in the hope of forming larger more diversified financial services groups in Taiwan. This was part of an overall drive to improve the financial strength of the financial services industry, and was later followed by changes in solvency regulations for the life insurance sector.

3.2 Distribution Channels

China

Tied agency forces continue to dominate the distribution landscape on the Mainland for individual life business. Recruiting and training high quality agents remains a challenge, and aggressive poaching activities remain common in the market.

The sheer scale of the agency forces of the larger domestic companies (for whom agent numbers run into the hundreds of thousands) poses a significant challenge to those companies to control the sales process and prevent mis-selling exposure. Agent certification requirements in China are not very onerous, and although a new more rigorous exam was introduced in 2002, to date only around one half of agents have passed it (the regulator has not yet enforced the need to pass this exam out of fear of the market disruption that would result).

Bancassurance distribution has been slowly growing in importance since its emergence in 2000. The current structure of the bancassurance agreements in place essentially allows individual branches of a bank to sign agreements with the life insurer and non-life insurer of their choice. As a result exclusive arrangements between a single bank and a single insurer have not yet come to fruition. The likelihood is for the bancassurance market share to continue to grow at the expense of agency over the coming years, as a number of players in the market look to expand aggressively in this area (Tai Ping in particular are making it a central part of their long-term growth strategy).

Other forms of distribution, such as direct mail, remain marginal.

Hong Kong

The Hong Kong market has also been one traditionally dominated by the agency sales force model. However in recent years this model has been challenged by a number of significant successes in bancassurance distribution. HSBC Group (encompassing HSBC Life and Hang Seng Life) showed a dramatic increase in new business volumes in 2001. Prudential UK also enjoyed a significant increase in sales in the same year, largely thanks to its distribution tie up with Standard & Chartered Bank.

Whilst this is a cause for concern for the major agency players in the market, agency is likely to remain the dominant distribution outlet in Hong Kong in the immediate future for a number of reasons. To date, much of the success of the bank channels has been with execution-only sales, and the banks still need to prove their proposition to customers that do not know what product they want or need. The major players in the market all have a significant interest in the continued success of the agency channel, as well as an immense amount of experience in managing their sales forces. Life insurance in Hong Kong, in common with the majority of Asian markets, remains a product, which is sold rather than bought, and the power of personal relationships in the sales process means that sales forces are likely to play a major role in the Hong Kong life insurance market for some time to come.

The Mandatory Provident Fund introduced in December 2000 is expected to have a continuing influence over the medium to long-term on the entire insurance market in Hong Kong. For the life industry, banks and insurers have formed alliances to capture the new market; however the very low margins and long pay back periods for this business have already resulted in some consolidation in this sector.

Korea

At present, the only non-life products that life insurance companies in Korea can sell are fixed benefit products (i.e. they can not provide indemnity basis cover). However, the Korean government plans to allow life insurers to sell more non-life insurance products including health insurance (conversely non-life insurers will also be able to sell life products such as variable life). It is expected that this will generate competition between life and non-life insurers and will draw global life and non-life insurers into the Korean market.

Product regulations have also been amended to include bancassurance in the market from August 2003. Many domestic insurers are now looking to form partnerships with banks to prepare entry into the new market. The bancassurance market will be highly regulated in the short to medium term, in particular with each bank allowed to sell no more than 50% of its total sales through one life insurer.

These restrictions prevent the introduction of integrated bancassurance observed in other markets and together with the other regulatory requirements, such as the phased introduction of products to bancassurance sales, will most likely impede the growth of the bancassurance market in the short to medium term and may well impact on its ultimate level of success.

A further example of the restrictions being considered was the recent announcement that lawmakers are planning to put further restrictions on bancassurance by limiting the number of sales agents in local banks that can sell insurance products to one per branch. This move is in response to concerns expressed by smaller insurers in the market that bancassurance will severely impact their ability to compete with the larger players.

Continued rationalization of the traditional solicitors channel is anticipated, as companies look to channels with higher productivity and lower average cost of distribution.

Taiwan

Taiwan has gone through several phases of development in distribution since the late 1990’s. The traditional agency system has been dominant since the foundation of the insurance industry, although more recently its market share has been on the decline. The independent brokerage system has also existed for some time, with significant growth only from the late 1990’s when insurers began looking more seriously for less costly distribution.

There are basically two types of brokerage; exclusive and non-exclusive.

Since the development of bancassurance began during the late 1990's, a number of brokerage operations have been established by the banks. These operations were generally wholly owned subsidiaries of the banks, and were set up to sell directly to the banks' customer databases.

In terms of market share by premium income, both independent brokers and bancassurance have shown strong growth from a low base in recent years. At present, business sold via each of these two channels accounts for just over 10% of total premium income in the market.

Other than the channel systems described above, other new sales methods have emerged since the early 1990's. This began with direct mailing, which was introduced by a number of specialized foreign insurers such as CIGNA, Zurich Life, and American Life, later other companies (both foreign and domestic) also followed the trend with mixed success. Telemarketing was also developed almost concurrently with direct mailing to support the sales process. The insurers have largely taken the initiative with the banks, and promoted business through the banks' credit card customer databases. The popularity of direct mailing has reduced somewhat during the last two years, due to declining response rates.

The development of direct mailing and telemarketing coincided with the development of bancassurance in the late 1990's. Like other markets, bancassurance was developed as:

- Banks are seeking additional sources of revenue due to the contraction of traditional banking business margins, caused by the downturn of the economy and falling interest rates
- Insurers are seeking alternative sales methods to reduce their distribution costs and at the same time to increase their sales volumes.

Since the passage of the Financial Holding Company Law in June 2001, bancassurance has stepped into a new era in terms of its operational model, with a number of longer-term agreements between banks and insurers under the same holding company structure.

The business goal of setting up financial holding companies centres on maximizing shareholder value through:

- Cross sales
- Sharing of resources
- Achieving scales of economy
- Diversification of risks

Since the passage of this Law, there have been 14 holding companies established. It is still too early to arrive at any conclusion on the degree of success of the holding companies, however, the common view is that the number of holding companies is too great in light of the relatively restricted size of the Taiwan market, and it is expected that there will be some consolidation in this area in the near future.

Agreements between banks and insurers that are not linked through a financial holding structure are built mostly through distribution agreements, although there are some joint venture arrangements emerging. There are pros and cons with this model from the perspective of both the bank and the insurer, however it is widely expected that they will come under increasing pressure due to competition from the entities within a financial holding structure (which can afford to make a longer term investment in the relationship).

3.3 Market Activity

Hong Kong

There has been relatively little merger and acquisition activity in the Hong Kong market over recent years. Low interest rates and poor profitability that have plagued many markets around the region have not impacted Hong Kong to the same extent. The laissez-faire regulatory regime has continued to allow life offices more freedom to operate than in neighbouring markets, and profitability has by and large been maintained throughout this difficult period.

A list of life insurance acquisitions since 1999 is provided in the table below:

Acquirer	**Target**	**Date**
MassMutual Financial Group	CRC Protective Life	March 2000
Swiss Re	China Insurance International Holdings	July 2000
MLC	CEF Lend Lease	June 2000
Standard Life	HIH Insurance	November 2000
ING Group	Aetna	Dec 2000
Great-West Life	Crown Life	February 2003

A number of these transactions occurred as part of larger regional or global acquisitions.

Taiwan

Merger and acquisition activity in the Taiwan market has remained somewhat subdued over the period since 1999.

The major acquisition impacting the market over this period was the purchase by ING group of the Asian subsidiaries of Aetna in July 2000. ING's previous operation, Life of Georgia, was merged into the newly purchased company, the combined new operation taking the Dutch group into the top four in Taiwan by market share.

A list of the significant life insurance acquisitions in the market over this period are shown in the table below.

Acquirer	**Target**	**Date**
ING Group	Aetna	June 2000
Citibank	Fubon	May 2000
Aegon[1]	AXA	October 2001
Prudential UK	Chinfon Life	November 1999
MassMutual Financial Group	Mercuries Life	March 2001
Union Insurance Co.	China Mariners Assurance	May 2002
Chiao Tung Financial Holding	Chung Kuo Insurance	May 2002
United World Chinese Commercial Bankd	Cathay	August 2002

[1] *Transfer of in force portfolio*

The large domestic players still dominate the market, although they have by and large seen their market shares slipping over this period.

China

Restrictions on foreign ownership in China since 1999 have limited any acquisitions within the market to strategic holdings. A number of such deals have however come to fruition, the key ones being:

- Winterthur took a 10% stake in Taikang Life
- Zurich Financial Services bought a 10% stake in New China Life
- Beiya Group took 7.51% share in New China Life
- Fortis took a 24.9% stake in the new Joint Venture, Tai Ping Life (October 2001)
- China International Re bought a 10% share in Tai Ping Life
- HSBC bought a 10% stake in Ping An Insurance Company
- Millea Holdings bought a 10% stake in Shanghai based Sino Life
- Asia General Holdings took a 5% share in Beijing based Minsheng Life

Far more entrants into the China market have occurred through joint venture partnerships between foreign insurance groups and domestic (largely non-insurance) partners. Whilst most of these joint venture partnerships are currently limited to selling in one or two cities on the mainland, such restrictions are scheduled to be lifted before the end of 2004, under the WTO agreement.

A list of joint venture partnerships which have obtained a China license since 2000, together with the geographical restrictions on the license are shown in the table below:

New Company Name	Partnership and ownership	Base in city
Haikang Life	50-50 joint venture between Aegon Insurance Group and China National Ocean Oil Corporation	Shanghai
Haier- New York Life	50-50 joint venture between New York Life and Haier Group	Shanghai
Nissay – Sva Life	50-50 joint venture between Nissay Life and Shanghai	Shanghai
Aviva – Cofco Life	50-50 joint venture between Aviva and China National Cereals, Oils and Foodstuffs Import and Export Corp.	Guangzhou
Generali China Life	50-50 joint venture between Assicurazioni Generali S.p.A and China National Petroleum Corporation	Guangzhou
ING – Cap Life	50-50 joint venture between ING and Beijing Capital Group	Dalian
Sunlife - Everbright	50-50 joint venture between Sunlife and China Everbright Group	Tianjin
Heng'an – Standard Life	50-50 joint venture between Standard Life and Heng'an Life	Tianjin
Sino-French Life	50-50 joint venture between CNP and China Post	Beijing
NA	50-50 joint venture between Sweden based Skandia and state-owned Assets Management Corporation Ltd.	Beijing

A small number of other companies have received licence, but not yet announced their local partner, as follows:

Company	Base in city
Metlife	Beijing
Cathay Life Insurance	NA

Swiss Re and Munich Re are the first two reinsurers to have received licences from CIRC. Cologne Re is expected to obtain the licence as well in June 2003.

Korea

There has been a relatively high degree of restructuring activity related to Korean life insurers with government authorities taking control of a number of financially distressed companies and then seeking purchasers.

A large number of local Korean life insurers were closed and transferred to other market participants in the period 1998-2000. There have also been a series of joint ventures, which have been dissolved over the same period, with one partner taking their holding to 100%.

Transactions that have been completed in recent years include:

Acquirer	Target	Date
Green Cross	Daishin Life	April 2003
Hanwha Group	Korea Life	2003
Allianz	First Life	August 1999
New York Life	Kookmin Life	January 2000
Hyundai Group	Chosun Life	January 2000
Allianz-First Life	France Life	March 2000
Tong Yang Life	Pacific Life	March 2000
Kumbo Life	Dong Ah Life	March 2000
SK Life	Kookmin Life	March 2000
Prudential	Youngpoong Life	October 2001

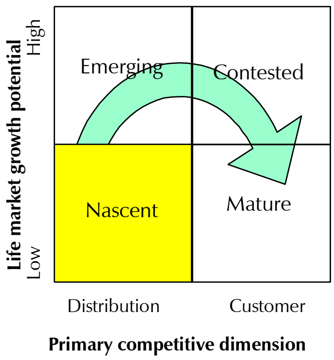
Further consolidation is to be expected as smaller insurers continue to struggle and with expectation of increased pressure with the introduction of bancassurance, continued falls in asset markets and additional focus on meeting solvency margin requirements. In particular, rumours continue of potential consolidation among medium sized life firms who hold 2 to 4 % of market share. There remains potential for another significant reduction in the number of life insurers in the market should the expected consolidation occur.

4. Key Markets Update

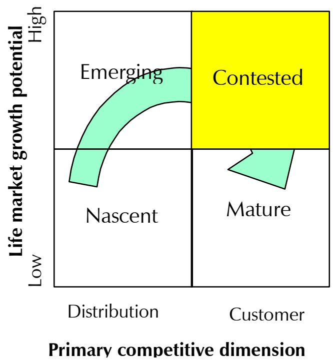
In 1999, the following views were formed on these markets using the following four categorisations:

- **Nascent** stage of development – life market in infancy, market is recently opened up to competition from private operators;
- **Emerging** stage of development – life market is a thriving sector, displays huge growth potential and is distribution driven. Individuals are not yet sophisticated in financial products awareness;
- **Contested** stage of development – life market continues to display growth potential, market is starting to be driven by what the consumer wants. The individual is becoming sophisticated in financial products awareness;
- **Mature** stage of development – life market growth potential slows down, the market is driven by consumers demanding transparency in disclosure of fees, charges and commission. Australia's life insurance sector falls in the category of a mature market.

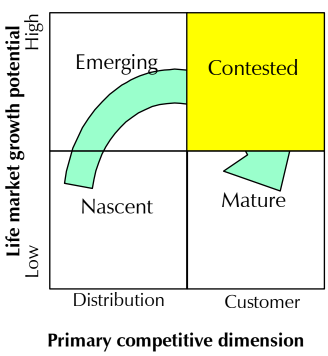
China



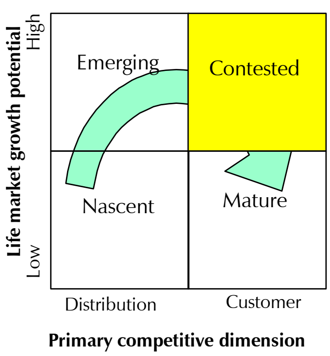
Hong Kong



South Korea

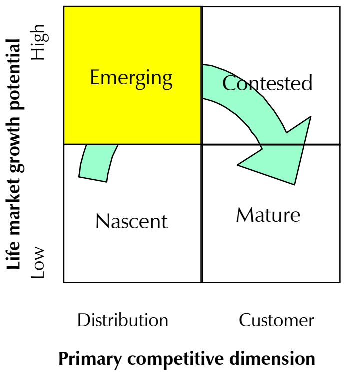


Taiwan

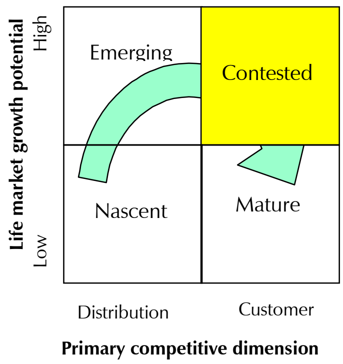


Today, we see the following:

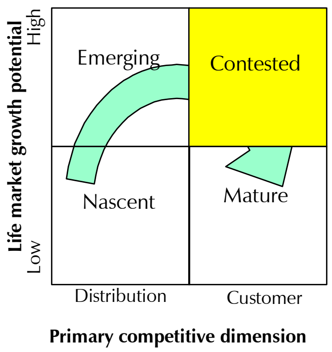
China



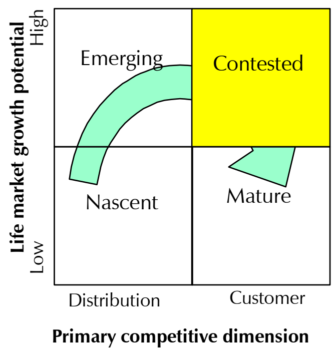
Hong Kong



South Korea



Taiwan



The largest changes have been seen in the China market, which has continued to show strong growth over the period since 1999, and has granted joint venture licenses to a large number of new entrants. The regulations have also evolved significantly over the period, for example both unit linked and participating products have been released and some.

A lot more development is expected in the coming years as the WTO agreement is implemented throughout the China insurance market.

As a result of these factors we have categorised China as an emerging market, rather than a nascent market.

We note that while the other markets are categorised the same as previously, we have seen increased competition in Taiwan and Hong Kong over the period together with ongoing consolidation in Korea, all markets showing the signs of moving toward the mature category.

5. Strategic Issues

The following section considers the impact of the following key strategic issues on the Asian markets:

- Future growth potential
- Trend to funds management
- M&A activity
- Asset liability issues
- Potential for future regulatory change

5.1 Future Growth Potential

Key factors likely to affect future sales growth are currently as follows:

- Bancassurance – deregulation
- Economic growth
- Competition from alternative forms of financial savings
- Agency force regulation

Deregulation of bancassurance continues to occur across Asian markets, both those discussed in this paper and also other markets. The question that remains however is whether bancassurance will succeed in these markets, with the evidence from some overseas markets being less than compelling. Further, the form in which bancassurance is being allowed in some markets is so restrictive that its prospects for success may be reduced to less than may otherwise have been the case.

The SARS epidemic has affected the global economy and many of the economies referred to in this paper severely. In the short to medium term it appears that SARS will severely impact economic growth in a number of Asian markets and most likely will lead to a continuing downward pressure on growth in insurance sales as a consequence. Further, it is yet to be seen what impact SARS or the prospect of other such large scale outbreaks of disease will have on mortality and morbidity experience and underwriting practices across the region.

Other forms of financial savings are expected to continue to grow and are discussed further in Section 5.2 below.

Finally, increased agency regulation is expected to result in a reduction in agent numbers, focus on training and agency quality and a reduction in part time members of sales forces, which have been historically a mainstay of Asian agency forces. This will also increase focus on other channels, including as previously discussed bancassurance and also other independent channels.

5.2 Trend to FM products

Although traditional products remain popular in Asian markets, it is to be expected that the international trend to unbundled savings products will ultimately be observed. In recent years, the penetration rates of mutual fund/unit trust style investments have increased rapidly.

In Hong Kong for example the penetration rate of mutual funds has increased from 3% in 1997 to nearly 10% in 2002.

Penetration rate of mutual trusts

Year	Penetration Rate (%)[1]
2002	9.5
2000	7.8
1997	3.2

1. Funds include 'retail unit trusts, mutual funds' and 'investment-linked assurance schemes' (Not TraHK or MPF)

This shift is believed to have occurred for a number of reasons:

- Low deposit rates
- Diversification of risks
- Referral by banks
- Increased awareness following launch of MPF scheme and tracker fund
- Greater transparency and lower charges of mutual funds compared to life insurance

Although not a focus of this paper, it is of interest also to consider the mix of financial assets currently held in Japan, currently the largest life insurance market in Asia. Results for the US are also shown for comparative purposes.

[1] Hong Kong Investment Funds Association Press Release "Over 500,000 HK adults invest in mutual funds", August 29, 2002.

Financial Asset Mix Comparison (%)

Financial Asset (%)	Japan		US	
	2002	**1999**	**2002**	**1999**
Currency and Deposits	54.9	55	12.2	10
Bonds	3.3	4	10.1	9
Shares and Equities	7.3	9	32.3	36
Investment Trusts	2.1	2	12.7	11
Insurance and Pension	28.5	27	29.9	32
Others	3.9	3	2.8	2
TOTAL	**100** **Value = 47 trillion yen**		**100** **Value = US$6.2 trillion**	

5.3 M&A Activity

Merger and acquisition activity will most likely have a number of key drivers in the forthcoming years:

- Exit of foreign insurers facing requirements for capital in their home markets due to sustained falls in investment markets or changes in their operating model such as consolidation of their back office functions and increased focus on a selected number of markets
- Consolidation of financially distressed entities as regulatory solvency standards are strengthened
- Existence of large number of below scale foreign owned operations around Asia, coupled with limited immediate growth prospects
- A number of regulators have acted to force smaller players to merge or be taken over

Recently, while there have been a significant number of potential transactions, few are actually reaching completion.

Also forthcoming are a number of potential landmark events in relation to the major players in the China market, including the privatisation of China Life and the listing of Ping An Insurance Company and New China Life.

5.4 Asset Liability Issues

There is a very wide range of approaches to asset allocation strategy currently being followed by companies around the region. At this stage it is still true that relatively few have engaged in any formal asset-liability management studies, although this situation is gradually changing.

Products

The majority of life insurance products offered in Asian markets are still traditional style products carrying relatively high levels of guarantee (both on maturity and on early surrender). Where products are participating in nature, in a number of markets current returns are not sufficient to support the payment of any discretionary bonus on the majority of the in force business (this is certainly the case in Japan, Korea and Taiwan).

In other markets whilst the products carry non-guaranteed bonuses, many companies do not have a clear methodology in place to adjust bonus scales with movements in investment markets. In some cases existing bonus scales have not been adjusted since the policies were written, and the products are sold as though the bonuses were guaranteed. As a result there is clearly the potential for groups of policyholders to take action against the insurers (as has already happened in many Western markets).

Investment Strategy

Generally speaking the domestic companies have followed the most aggressive investment strategies, investing up to 30% in non-guaranteed assets such as equity and property.

Foreign players have generally followed a more conservative strategy; particularly U.S. owned operations, in part due to risk based capital requirements in the U.S., which require substantial amounts of capital to be available to support non-guaranteed assets. The practice of other foreign owned entities is more diverse, reflecting the willingness of their parent companies to hold a wider range of assets than is typical in the U.S.

There are a number of additional investment issues facing life offices operating in most Asian markets, including:

- Lack of available appropriate long duration assets
- Relatively immature and volatile equity markets

- Investment restrictions in regulatory regimes, especially with overseas investments
- Exchange rate risk for overseas assets

The issue of a lack of availability of long duration assets presents a particularly acute problem. Whilst the long-term bond market in many Western markets is extremely well developed and liquid, many Asian markets have no long-term bonds and are severely restricted in their ability to invest in overseas markets due to local investment restrictions, and fears about exchange rate risk. It is not unusual as a result to find blocks of guaranteed regular premium business, with an average outstanding duration of 20 years or more, backed by short-term assets with a duration of less than 10 years.

This not only presents a problem from a matching perspective, but also given the sharply upward sloping yield curve that we have observed in many markets in recent years, is also preventing life offices achieving reasonable levels of return. This problem has been compounded by weaknesses in equity and property markets worldwide.

In Taiwan a number of companies looking to further diversify their asset portfolios, developed significant portfolios of residential mortgage loans in the 1990s. As the economy has continued to weaken, these companies have been further burdened with non-performing loan issues.

5.5 Potential Regulatory for future changes

It is to be expected that the current trends in regulation will continue to impact in particular the move toward US style Risk Based Capital requirements and the focus on agency force regulation.

We expect these changes, as discussed earlier to have a variety of effects:

- Emergence of solvency concerns on new bases
- Flow effects to product design and ranges
- Continued force for consolidation

Appendices

Appendix A – Exchange Rates as at 3/3/03

Country	US $1
Japan	118.16
China	8.2675
India	47.661
Korea	1,193.10
Australia	1.64474
Taiwan	34.8
Hong Kong	7.7992
Indonesia	8,885
Thailand	42.69
Singapore	1.7362
Philippines	54.805
Malaysia	3.7985
Vietnam	14865
U.S.	1

Appendix B – Regulatory Requirements and Supervisors

Insurance Law and Supervisory Body of Asian Markets

Country	Insurance Law	Supervisory Body
China	Insurance law 1995	China Insurance Regulatory Commission (CIRC)
Hong Kong	Insurance Companies Ordinance	Office of the Commissioner of Insurance
India	Insurance Act 1938 (amended 1999)	Insurance regulatory and Development Authority (IRDA)
Indonesia	Law No. 2(1992) concerning insurance business, Mof decrees	Ministry of Finance, Directorate of Insurance
Japan	Insurance Business Law 1996	Financial Services Agency (FSA)
Malaysia	Insurance Act 1996	Insurance Regulation Department within Bank Negara Malaysia
Philippines	Insurance Code 1978	Insurance Commission within the Ministry of Finance
Singapore	Insurance Act (Cap.142) - last amended Oct 2000	Insurance Commissioner's Department within the Monetary Authority of Singapore (MAS)
South Korea	Insurance Business Law 1962, 1998	Financial Supervisory Commission (FSC)
Taiwan	Insurance Laws and Regulations of the Republic of China 1997	Department of Insurance within Ministry of Finance
Thailand	Non-life and Life Insurance Act 1992	Department of Insurance within Ministry of Commerce
Vietnam		Insurance Division within Ministry of Finance