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The Development of Life Insurance Companies in Emerging Asian Markets

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"Try not to become a man of success, but rather try to be a man of value"
Albert Einstein

Introduction:

When discussing the topic for my presentation with the President, we agreed that I should try to present something on the "*Path to Success for India*".

In the meantime I am rather overawed at what I have let myself in for. Those of you who are expecting a "five point plan" which will guarantee success will be badly disappointed. However, being an intelligent audience, you will know that if I was this fount of knowledge, my fee would make this a costly conference.

Rather, I will attempt to identify where India is in its development and consider some of the issues from my Asian experience. My intention is that this provides some food for thought, that it probably reminds you of some things you already know, and ultimately provides a platform for further debate on which environmental changes could enhance the chances of success for life insurance in India.

Where is India Now?

I think it is a useful starting point to step back and see where the India life insurance industry is both compared to other countries in Asia, as well as on a more global scale.

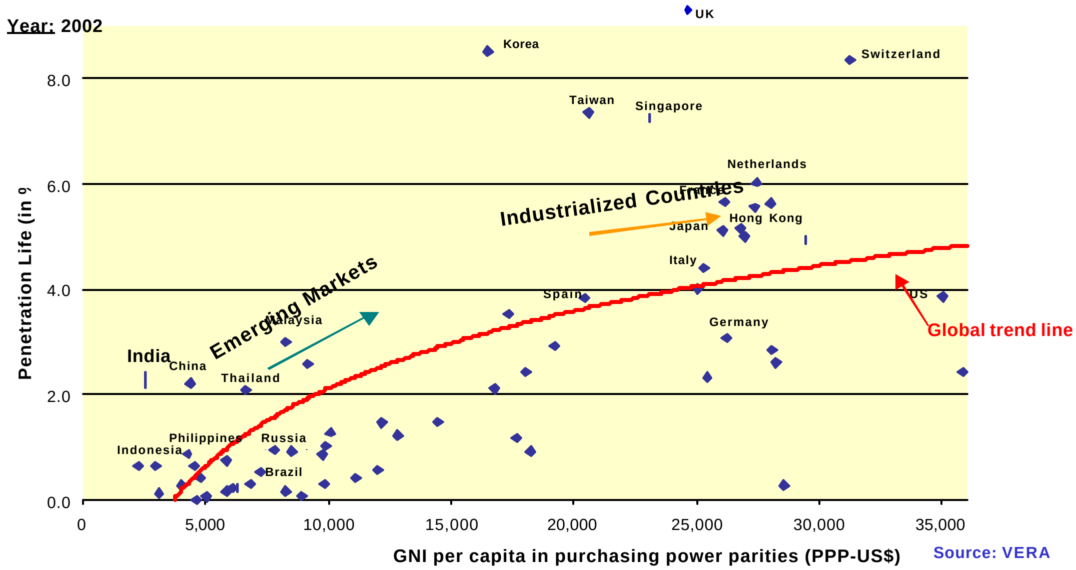
The Munich Re Economic Research Unit prepared me the results of a study into Economic Wealth and Life Insurance Penetration. Naturally, there is a special focus on Asia, but I have also depicted Germany, UK and USA and some other countries as comparative benchmarks.

Comparison of Asian life insurance markets in 2002

Life insurance market	GNI per capita at PPP-US$	Penetration (in %)
China	4.390	2,22
India	2.570	2,28
Indonesia	2.990	0,66
Japan	26.070	5,12
Korea	16.480	8,52
Malaysia	8.280	3,00
Philippines	4.280	0,88
Singapore	23.090	7,25
Taiwan	20.597	7,36
Thailand	6.680	2,09
Germany	26.220	3,09
UK	25.870	10,27
USA	35.060	3,87

If we put this into a graph one gets a nice picture of position and trend:

Relation between wealth and Life insurance penetration in 2002



The position of India is firmly positioned in the emerging market sector, alongside a number of other Asian countries, notably China.

Instinctively, this is as it should be:

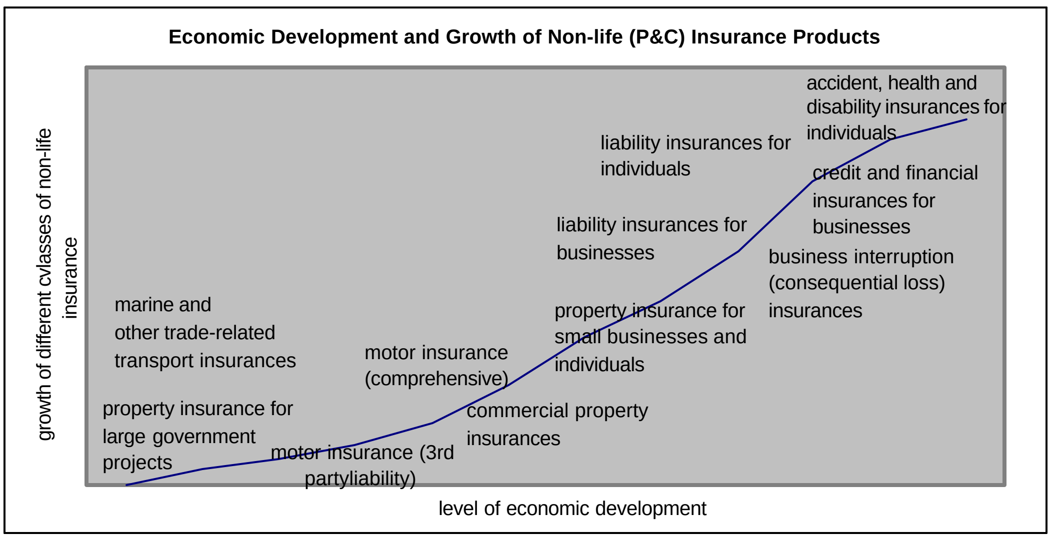
- There is a positive relationship between wealth (measured as gross national income per capita in purchasing power parities) and a country's insurance penetration; higher wealth tends to result in a rising penetration in Life as well as in Non-Life (i.e. the insurance market is growing faster than the overall economy). In general, the increase is stronger in emerging markets than in industrialized countries.

- Existing deviations of individual countries from the "Global trend line" shown in the graph are due to differences in Life insurance market environments across countries (e.g. degree of old-age pension systems being based on social security), i.e. wealth alone does not explain the state of a country's Life insurance market.

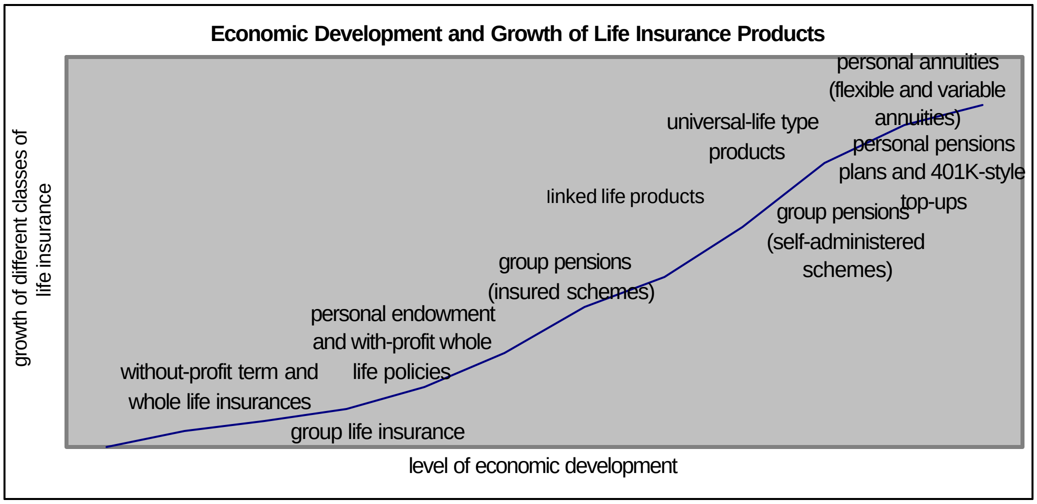
- Based on the overall global trend, growth potential in Life business in general exists in emerging markets (catching up) as well as in industrialized countries (reform of social security systems, ageing society).

- Non-Life: Growth potential particularly in the emerging markets, growth in the industrialized countries expected only in line with the economic development (i.e. with GDP growth).

In a presentation by Professor Gerry Dickson at a conference in Malaysia he followed the same approach. He extrapolated this on the types of products one could expect to find in markets at different development stages.



There is the trend over time for non-life market to broaden from the protection of physical assets to the protection of income and financial assets (e.g. liability, business interruption, credit etc.)



Life insurance markets start more slowly than non-life markets due to lower consumer awareness and individual income constraints. There is a trend over time from products emphasising life insurance (death benefits) towards those emphasising saving, especially retirement saving. One can also observe a trend over time towards unbundling of protection and saving and for less investment guarantees to be offered by life insurers.

Clearly, such developments will not simply happen in isolation, but will be dependent on the legal and regulatory environment, covering areas such as

- Distribution
- Consumer protection
- Solvency and Capital Adequacy
- Investment restrictions
- Co-operation between different players in the financial services sector
- Restrictions on the shareholders and foreign investment.

One could thus build up a profile of development covering economic, regulatory, distribution and other aspects to reflect the current state and assess how the future is likely to look, based on other markets' experiences.

Let us look at China, which we saw earlier was at the same economic development stage as India. Its key features are:

- Very low insurance penetration
- Low awareness of insurance by general public
- Strong economic growth
- A few large national companies
- Gradual entry of foreign players with severe operational and investment restrictions
- Regulations and legal framework still under construction and little experience within the authorities
- Relatively simple products marketed
- Strong drive for market shares
- Agency distribution systems dominate
- A nascent actuarial profession

This probably applies to many so-called developing industries.

India is rather unique and does not, on this broader basis, typically fit in. It has a fascinating mix of developing and sophistication.

It was before my time, but I understand that India had a vigorously competitive life insurance market prior to the formation of the Life Insurance Corporation. Certainly, there exists a body of legislation with which the industry is regulated though some of it will relate to an industry as it was some decades ago. The LIC is synonymous with insurance in many of the remote villages in India, demonstrating the fulfillment of its brief to bring these services to the nation as a whole. So life insurance is not unknown. So far, most products are fairly standard as is distribution (along agency lines). As in China, entry into the market is severely restricted, but there are quite a few new players, primarily foreign. Unlike China, there is a long actuarial tradition. Thus, using one measure does not give one a complete picture of the state of development.

So, where is India heading and what can be expected? And how can you prepare yourself for success? India will be broadly subject to a number of pressures. Individual companies will have their own specific issues, so there is not “one size that fits all” in my analysis.

<u>The Future:</u>

I think the following issues will be increasingly occupying the minds of insurance company executives in India.

- Moving from volume-driven to profit-orientated business
- Consumer and regulatory interest in ethical sales behaviour and marketing literature
- Improving the financial effectiveness and productivity of the organisation as a whole to meet shareholders' demand for adequate returns on capital invested
- Greater focus by regulators on solvency, financial soundness and risk adequate reserving
- Impact of new international accounting standards
- Greater professionalism.

Distribution:

The massive distribution system built up by LIC will not be duplicated. The new entrants will not be seeking to compete head-on, but will be attempting to develop new markets. To this extent, a totally new market is being reached with different needs and expectations, in addition to that already formed through the LIC network.

However, all companies will need to generate sufficient volumes of good quality business to cover their costs and to provide shareholders with their required returns. I therefore see the agency system with its ability to market more complex products to a more sophisticated client as being the route chosen. But it will have to do a much better job overall to justify the high costs.

Alternative channels will be developed, in particular where the joint venture partner is another financial institution, such as via bank branches. There are some serious attempts in Asia to develop so-called bancassurance as a profitable form of distribution in its own right.

An example would be Mayban Life in Malaysia, a venture with Maybank. This is considered successful, but no one expects it to become the biggest life insurer. If it is sufficiently profitable then why should it want size at the cost of profit.

In Singapore Aviva has a co-operation with DBS Bank one of the large local banks. It sold off its agency force and is exclusively selling via the bank. The jury is still out as to its success.

In India there are also bancassurance products, but in general this is for most players a niche. It is notoriously difficult to make bank/insurance relationships work successfully, and I would advise anyone wishing to go this route to do their homework very thoroughly – in close union with their prospective partner.

There will be other pressures brought to bear on the industry, that of ethical sales and providing qualified, reliable advise to prospective policyholders.

Licencing of agents is but one step. Consumer interest groups and also interest by Regulators in sales will bring a great deal of pressure to bear on companies to provide quality training before letting agents loose on the general public. The question asked will be, have the reasonable expectations of policyholders been met, based on what was done at the time of sale.

In Europe companies have paid dearly for misselling.

There will be the internal needs of companies to improve business quality as well e.g. lower lapse rates, as one moves from a volume to profit driven organisation.

I thus see two areas of interest: Firstly, improving the professionality of the agency force, which will continue to be a key source of business. Secondly, looking to cost effective alternatives, probably in close co-operation with other financial service providers, such as banks. I do not see this (latter route) as being an exclusive (or even primary) source of business for most players.

<u>Shareholders' Demands</u>:

Investors will be following the use of their capital with increasing interest. Following the bursting of the stock market bubble in most countries in 2000, insurance companies everywhere are facing one of their severest tests, probably since the Second World War. Capital has become a rare commodity and now competes for the most financially effective returns. This will apply also to markets such as China and India, which are universally still considered to be the most attractive for investment. Significant global players have reconsidered investments and if results and prospects do not match aims, they have withdrawn from markets.

This has been observed in Philippines and Indonesia, where the economic promise disappointed, resulting in mergers and acquisitions. And not all players have decided that China has the potential to satisfy the extraordinarily high investments. Events on international post 9/11 capital markets, which have affected insurance groups, have forced some players to reassess their business strategy and this will no doubt have been a further important factor for rationalising business activities.

India is clearly not immune to external factors, given that the vast majority of new players are connected to the major global groups; albeit with majority stakes still in the hands of the local partners. The WTO agreements and generally political pressure being brought to bear on India both internally and externally will, I believe, continue the trend to expanding foreign ownership. The banking sector has led the way in this respect and the insurance sector will surely follow. Such Indian companies will be under the scrutiny of their overseas investors. These Indian companies will as a result be required to match the demands of these shareholders, both strategically and, as mentioned earlier, in the returns these investments provide, bearing in mind the competing needs of capital. Companies will need to demonstrate that they are creating value, rather than purely volume.

Solvency and Capital Adequacy:

Notwithstanding the fact that some legislation in India may be dated, the regulators have not been idle. If anything, regulators have been scrutinising every aspect of the business in great detail. I would even suggest in too much detail. There has been much debate in Asia about micromanagement vs. macromanagement in respect of regulating life insurers. In Korea, for example, every single detail of a new product application is subject to regulatory approval. The statistical basis used to derive the actuarial basis has to be “proven” to the satisfaction of the regulators. And they are one of the most difficult regulators to satisfy!

This means that introducing a new product such as Critical Illness requires enormous efforts and research. Naturally this stifles new developments or flexibility and leads to a “follow the leader” approach: identical products with identical terms and conditions. Unfortunately, it has been no protection to insurers and consumers alike. The enormous problems still confronting Japan, notorious for regulation by “micromanagement”, is a telling example. But others have moved on. Regulators in the meantime have also globalised and meet regularly to exchange views. It is thus no coincidence that countries such as Singapore have embraced the Appointed Actuary approach better known in the UK or Canada. Risk-based capital (RBC) is now being introduced. Even Indonesia introduced RBC methodologies, though they have encountered difficulties in fully implementing it.

The solvency and capital approach to regulation is, of course, well-known to actuaries with roots in the British and North American actuarial organisation. Such actuaries abound in Asia and their influence is significant. You will not be surprised to know that Singapore and Hong Kong is home to a great number of expatriate actuaries and local actuaries are inevitably educated through the aforementioned actuarial organisations. The influence of Australian actuaries is increasing and they, I understand, have done much work, for example, in Indonesia.

India's long traditional links especially to the UK Institute of Actuaries has ensured that actuaries here are fully aware of the mainstream of actuarial developments internationally.

A cursory scan of the papers presented at last year's 5th Global Conference of Actuaries held here in Delhi shows how open India is to examining and considering what actuaries outside of India are doing and thinking. Indeed the visit and presentation last year by Jeremy Goford, the encumbent President of the Institute of Actuaries, London, underlines this.

I am sure that the Indian regulators will be very carefully considering their next steps and the questions of solvency and capital adequacy will surely become one of the key factors for satisfying them that policyholders' reasonable expectations are being protected. I therefore see an increasingly important role for actuaries to support the regulators in responsible management of policyholder interest, a move to macro issues, leaving the micro issues to the individual actuaries within their respective companies.

Actuaries will be expected to carry out their various responsibilities matching the highest professional standards. This is welcome and will ensure that the high ethical and professional regard held for actuaries globally is properly reflected also in India.

This will put tremendous demands on the India Actuarial Society, but I will comment on this later.

<u>International Accounting Standards:</u>

There is a large amount of, sometimes acrimonious, debate on new international accounting standards: Fair value accounting. So far, activity is centred on the international groups and forums driven by European and North American organisations. Asia seems to me to be in an observer mode at this point in time. However, this is no protection from change. The preponderance of foreign investors in the Indian life market will guarantee the exposure of Indian professionals in dealing with issues outside of their borders. Reporting requirements outside of India will have to be met, regardless of and in addition to the local accounting and statutory reporting practices. The concepts of fair value, embedded value, appraisal values and so on will need to be fully understood here too.

<u>The Actuarial Profession In India:</u>

India is one of the few countries in Asia that has chosen to develop its own independent society which also sets education standards and examines its students for qualification. It has been built on the UK traditions which many of its members share. The Philippines do the same, but lean towards the US approach. Korea, Japan and Taiwan also arrange their affairs independently, but follow their own education programme, which tends to be narrower and more focussed on theoretical aspects of pricing and reserving.

China has started its own system of education having initially depended heavily on programmes supported by the Society of Actuaries at Nankai University in Tjanjin and Institute of Actuaries at University of Beijing. China has also seen in influx of Chinese actuaries who were educated and gained experience outside of China. This latter development has been and continues to be of fundamental importance, since China prior to opening its market had no actuarial society of any kind and hardly any actuarial knowledge or experience of any sort. Today Chinese actuarial students belong to one of the most successful, which a short glance at the pass lists of the US or UK actuarial organisation will confirm. Notwithstanding the new Chinese Actuarial Society and exam system, Chinese students still tend to favour being trained by and attaining the qualifications of recognised international actuarial organisations.

The primary problem is not the shortage of actuarial staff, but the lack of experience actuaries to guide newly qualified actuaries in the early stages of their careers. The central role of actuaries in insurance is slowly being recognised in China. If one of the younger actuaries through inexperience makes some wrong decisions, this could have a significantly detrimental effect on their role thereafter, as I am sure you will appreciate.

The reason for this discourse on China is that I see some parallels for India. Yes, you do have a long and proud tradition for actuaries in India and of course there are quite a number of highly experienced practitioners. Furthermore, the global actuarial community abounds with extremely competent actuaries, who play leading roles in the profession. Some of these actuaries are happy to play a new role in the emerging Indian insurance industry. But the challenges facing the Indian Actuarial Society can best be described in the following statistics:

Membership Statistics of the Indian Actuarial Society:

	March					**July**
Membership Class	**1999**	**2000**	**2001**	**2002**	**2003**	**2003**
Fellow	146	143	218	204	200	198
Affiliate	0	0	4	19	23	24
Associate	87	106	122	122	118	118
Student	442	471	604	1494	1905	2102
Total	**675**	**720**	**948**	**1839**	**2246**	**2442**

I am quoting figures published in the Economic Times Mumbai on 29th December 2003.

The number of Fellow members jumped from around 140 to just over 200 (ca. 50% increase) in 2001 and has remained more or less there since then. Similar trends can be observed with Affiliate and Associates. The growth in Students on the other hand, has been quite remarkable, an increase from 442 to 2102 (475%).

In the same edition of the Economic Times a headline announced that actuaries earn Rs 45 lakh per year. I hope you can process all the new membership applications!

But jokes aside, this staggering growth has similar problems to those encountered in China. I would raise the following questions:

- How does one manage to effectively control the education of such large student numbers?

- How does one ensure a satisfactory level of peer review and guidance for the large number of new qualifying members given the comparatively small number of Fellows?

With such a dramatic change, it is inevitable that the whole character of the Society must change. The difficulty will be to ensure that the positive features are maintained and that one can also recognise and absorb those new ideas that will enhance the profession in India.

Success will be measured not in numbers, but in the standard, ethics and professionality that the Indian Actuarial Society requires of its members. The will and determination to achieve excellence is there. It can only be achieved by continuing with the hard work and high standards set. Most importantly it depends on us all. I, personally, am immensely proud to be associated in a very small way with this exciting development. There is still a lot to do, so I take heart in the words of another famous personality:

"*Indolence is a delightful but distressing state; we must be doing something to be happy*".

Mahatma Gandhi

About the Author

Edward Reiche, Head of Department, Divisional Unit Life

Edward Reiche was born and educated in South Africa. He obtained a Bachelor of Science degree (Mathematics, Economics) at the University of Natal, Durban, South Africa. He started his career in South Africa with SANLAM, one of the largest life companies in the country. After 4 years he moved to England, where he spent three years with Phoenix Assurance, based in Bristol.

In 1983 he joined Munich Re in Munich initially supporting the UK and South African markets. As from 1991 he became involved in representing Munich Re's life reinsurance business in Asia, in particular the Indian sub-continent and some South East Asian markets, as well as China. This involved frequent travel to the region. In 1998 he was delegated to Munich Re's Singapore office where he built up a local team to service life insurance clients in the ASEAN region.

He returned to Munich at the start of 2002 where he took up the position of Head of Department responsible for Munich Re's life reinsurance business throughout Asia.

He is a qualified actuary (Fellow of the Institute of Actuaries, London) and has presented several papers at actuarial conferences, such as the East Asian Actuarial Conference and most recently at the International Congress of Actuaries in Cancun, Mexico. He is a member of the Deutsche Aktuarvereinigung (German Actuarial Association) and the Actuarial Society of South Africa.

Edward is also an Affiliate Member of the Indian Actuarial Society.