RECORD OF SOCIETY OF ACTUARIES
1994 VOL. 20 NO. 2

THE FAR EAST MARKETS

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An examination of the Far East markets of interest in terms of size, growth, products, marketing and distribution, regulation and market entry, business strategies, and cultural issues will be discussed.

MR. STEPHEN H. CONWILL: Before I introduce the panel, I'd like to make a few introductory comments and, in particular, begin by giving three words of caution with respect to business dealings in the Far East. The first word of caution is to be somewhat cautious of dealing with presidents' children. When setting up an operation in a confusing country or new country, it's very tempting to seek out the people in power and try to, so to speak, jump start the operation. This can work in the short term, but it's somewhat naive in the longer term; your contacts will want to get paid for their efforts and this may have implications for either the long-term control or profitability of the operation. For the most part, establishing a life operation in the Far East is a very long-term, grass-roots-type affair, and it will be very hard to find shortcuts.

Second—and this is somewhat unfair, even though it is the view of some management—it's very important to keep in mind that business practice abroad differs very significantly from business practice in the United States or in North America. When dealing in a foreign country, you may not want to play the game on their terms, or you may be constrained by the laws of the United States and Canada. You at least have to understand what the game is. You should not count on your business rivals or, in some case, even your business partners being nice guys. You may finish last, or more likely you may not even finish at all.

Finally, a word of caution with some actuarial content. Life insurance is a very new business in many of the countries in the Far East, and you should not assume that your colleagues, associates or partners know the difference between cash flow and profit. In Japan, where there has been a highly developed life market for at least 100 years, the difference is well understood or at least is as well understood as it is in the United States. In many other places, there's still some rather basic actuarial education that may be required.

By making these three cautions, I definitely don't want to sound negative, because there are truly remarkable opportunities in the Far East. One of the real goals of the session is to talk about those opportunities, how to take advantage of them, and how to deal with some of the challenges.

Why pursue Far East opportunities? One big factor working in the favor of business people in North America is actually the trade deficit. If you look at the recent history of the trade deficit, and in fact the United States has not always had a trade deficit, you'll see that in the 1980s, as is fairly well publicized, the news has not been so good. The trade deficit grew to really remarkable proportions up through 1987, but began to turn around in 1987 following the Plaza Accords and the devaluation of the dollar. It improved until around 1990, and has begun to turn up again.

The important question is, what does all this red ink mean? It means that there's a great deal of money out there and the money has to be put back in circulation. Either it can be put back because our trading partners loan it back to us or because they buy our real estate, or, what's very important for our business, they buy our services. The key part of the picture is what has been happening on the services front. Since the mid-1980s, we've developed a very healthy trade surplus in the trade of services. Right now, it's approaching about $50 billion and it is really helping to counteract the deficit on the merchandise side.

The deficit grew dramatically in the 1980s, but has really turned around. The hook in the last couple of years is a little bit disconcerting, but there is reason for optimism. With a few more years of hindsight, we'll understand that hook better. I think most expectations are that it's going to turn back around in large part because of what's happening on the service side.

The trade deficit can really be cured in three ways. You can buy a few more American cars, or you can use a little bit less oil, or we can sell many more services.

Perhaps the most obvious reason to pursue opportunities in the Far East is the economic growth that is occurring there. The economic growth that is occurring now in Asia and that will occur over the next 10–20 years is staggering. The realignment of world economic power is of truly monumental proportions and will affect all of our lives. You really need to go there in order to believe it. This economic growth is creating remarkable opportunities for the insurance industry in Asia.

Let's back up and take a quick look at some world insurance statistics. I think some of the other panelists will have some greater detail later on, but I wanted to review the world's ten largest markets for life insurance and the growth in the Asian markets. The United States and Japan are clearly the two leading markets for life insurance; each has about the same premium income and both comprise about 60% of the world total. After that, the United Kingdom, France, and Germany are third, fourth and fifth, respectively.

I think the really significant country is number six, which is South Korea, with about $25 billion U.S. in premium income in 1991. This is really quite remarkable and a sign of things to come. I think in another 20 years, this ranking will be substantially rearranged, and we'll see several other countries from Asia moving way up on the list in terms of life insurance premium.

Finally, in almost all of the Asian markets there has been very dramatic growth. The size, of course, is quite small, but we're seeing 20–25% annualized growth. With the development of the industry itself and the parallel growth in the economies, we can expect growth of that nature for 10 or 15 or more years in many of these countries.

One exception to the growth is Japan, which has leveled off to some extent because it's already a huge market. Nonetheless, the size of the market in Japan creates an opportunity for foreign life insurers. In the Philippines, growth has lagged a little bit, in part because the political situation is more volatile than in the other countries listed here, but long term there are real opportunities there also.

With that brief introduction, I'd like to move on to the real panelists and make some introductions. I'm with Milliman & Robertson in Japan. I work out of M&R's Tokyo office. I'm very excited to have both Sam Sung and Chuck Von Fange on the panel. Sam will be the first speaker. He is the president of Kolon Met Life, which is Metropolitan's joint venture in Korea. He assumed that position after retiring as chief actuary of Mutual of New York a little over a year ago. Sam was born in Korea and moved to the U.S. about 35 years ago. In his talk, he's going to outline some of the actuarial, managerial and social insights that he has had as a result of moving back to Korea and operating in the business environment there.

Following Sam, we'll have Chuck Von Fange, who joined AIG in 1982. I think you're all familiar with AIG, which is almost certainly the most international of life insurance companies. In fact, its roots are in China. Chuck joined AIG on the domestic side as chief product development actuary and a few years later moved into the international operations. He is now vice-president of product development at Alico, AIG's life subsidiary. He spent about a year in Japan working on product development, in particular on dread disease and a female cancer product. His experiences in Japan form the basis of many of his remarks. With that, I'm very excited to be able to introduce Sam Sung.

MR. KIHONG SUNG: I want to cover the East Asian life insurance market. I said East Asian because the Far East usually implies China, Korea, and Japan. I am going to refer chiefly to other countries in East Asia. First, I will cover some past history of the Asian economy and the growth of the life insurance market, and then the current state of the market and foreign insurers in this market. Finally, I'll discuss the Korean insurance market in detail because that's where I have had experience the last year or so.

Let's discuss the economic growth rate between 1986 and 1990. Steve already discussed the rate from 1991 to 1993. The average annual growth rate in some of the countries is fairly large, with the exception of a few countries. The 1990 per-capita premiums income in these countries is much smaller than in Japan and the United States, but in terms of ratio to per capita income it's fairly high. For instance, Korea is 9.4%, which is the highest in the world and exceeds even Japan. There are many countries in which the ratio is very low, which means there is a potential for insurers to grow very fast in these countries.

I'm going to the next topic, which is the current status of market openings in these countries. I'm not going to talk about Japan, because Japan is well discussed and probably Steve can shed light better than I can. You can group these countries into four. The first one is where the market has always been open. The second category is where the market has become open in the last few years. The third one is where admission of a foreign insurer is very tightly regulated. The last one is where there are large market shares by foreign insurers, but lately they've implemented very tight restrictions against the foreign insurer. Finally, I want to discuss the market share by countries and foreign insurers.

Hong Kong was always a very open country. It's no different than say the United States, Canada, or the United Kingdom in terms of the degree of difficulty of getting into this market. Recently, Metropolitan has applied for admission to Hong Kong. We found out the insurance commissioner of Hong Kong is a British actuary and he is very tough; but the process is still going on. As long as you meet certain requirements, you can get admitted in Hong Kong.

The second group of countries in which the market has been closed for a number of years, but open lately under U.S. pressure, are Korea and Taiwan. In Korea, for 40 years there were only six companies operating under the protection of the government. In the mid-1980s, there was a tremendous political pressure by the U.S. to open up the market. Consequently, the market was opened to both new domestic and foreign insurers. Since the mid-1980s, 27 new companies have entered into the market. Fifteen of them are domestics and seven of them are joint ventures. They usually have foreign ownership of 49–51%. Finally, there are foreign branch offices or subsidiaries.

In Taiwan, there were no new life insurance companies from 1963 to 1986. Again, Taiwan was under U.S. pressure to open up the market, so it admitted U.S. branch offices in 1987. In 1992, new domestic and joint venture companies with a foreign insurer began to be allowed. Finally, in 1993 it opened up the market to foreign companies other than those from the United States. Beginning in 1993, any foreign company can operate in Taiwan, provided the insurer is one of the top 200 in the world.

The third group of countries, where the admission of foreign insurers is tightly regulated are Indonesia, the Philippines and China. In Indonesia, a foreign joint venture is limited to a maximum 80% share and it has allowed this since 1988. Philippine foreign joint ventures with a maximum share of 40% have been allowed since 1992.

In China, before the Communists took over in 1949, there were over 200 insurers. Since 1949, the insurance industry was not allowed to operate. There was no insurance between 1949 and 1982. In 1982, the state-owned Peoples Insurance Company of China was formed. In 1992, foreign insurers were allowed. AIG is now operating in Shanghai.

The last group of countries is where foreign insurers always had a large market share, but they have had tighter restrictions lately. In Singapore, no new insurer is allowed unless they address a special market niche. Malaysia, in 1971, implemented the Malaysian First Economic Policy. Under that policy, at least 30% of management must be held by Malaysians. Joint ventures are allowed, but the foreign insurance cannot have more than a 30% share. In Thailand, no new insurer, domestic or foreign, is allowed right now. Foreign insurers can gain entry only through acquiring shares of the existing company, with a maximum share of 40%.

The 1990 world market share of other countries are small in comparison to Japan and the United States. Korea by far has the largest market share of the remaining Asian countries, but the foreign share is very small. In China, as of 1991, there is no foreign insurer, but there's a great deal of potential in China in the future.

Now I'm going to talk about the Korean market in detail, because that's where I have experience. First, I'm going to talk about the number of companies and their market share, the products and the pricing, the distribution systems, the financial results of the new companies, the causes of the financial losses, and then prospects of the Korean life insurance industry.

In the 40 years prior to 1987, there were only six domestic companies that were very well protected by the government. As of 1993, their market share is still 82%. Six new domestic national companies entered since 1989 and their market share is about 8%. There are seven new joint venture companies since 1989. In 1993, market share is 4.6%. There are nine new local companies. They were initially allowed to operate only in the local province, but now that restriction is off and they have a 5.3% market share. Finally, there are five new foreign branches and subsidiaries. They have a very small market share.

Products and pricing are tightly regulated. Until last year, you had to get approval for any new product. Once products are approved, they become public knowledge and so you really cannot have a monopoly of some innovative products. If it's good, everybody will copy it. You cannot charge different premiums. The premium rate is exactly the same. Under pressure from the U.S. government, Korea initiated the deregulation process of pricing. By 1998 there will be significant liberalization of pricing.

There are basically five types of products being sold in Korea. The first, and by far the largest, are the short-term savings type of products. They typically have a maturity of five years or less. Probably 60–70% of premium volume comes from this category. Then there is an annuity with a term and accident indemnity rider. All products have term and accident indemnity riders. Finally, there are whole life, educational endowment, and cancer products. The cancer policy is a big seller. However, over 90% of premiums are from the savings annuity and the endowment products.

As I mentioned, pricing is tightly controlled by the Ministry of Finance (MOF), but there is a phase-in process of pricing deregulation beginning in 1993. There are solvency regulations, but they are very crude and unclear. The Korean distribution system is somewhat similar to Japan. They probably copied it from Japan, so about 95% of registered agents are females between the ages of 26 to 60. Most of them are married housewives. They are nominally full-time agents, but a number of them really work part-time. There are over 300,000 registered agents, which is a rather large number compared to the population. Each year there are about 250,000 new agents registered and a similar number drop out. In net numbers, the growth rate is probably less than 5% at the moment.

Productivity is low. Typically, there are about two sales per month. The agent retention rate is very low. Typically, after one year, 20% are left. Of course, if your retention rate is so low, your persistency rate goes with it. After the first year, the persistency rate is about 50%. Consequently, you never recover your acquisition costs. Distribution costs are high.

Excluding the three relatively new companies to the market, the total capital of the remaining 24 companies is $485 million. The accumulated loss through 1993 is $1.6 billion. The net worth before deferral, and I will explain to you what the deferral is, is a negative net worth of over $1.1 billion combined.

Under Korean accounting rules, start-up companies can defer 50% of expenses for the first five years. If you were to take that into account, according to Korean accounting rules, they are still solvent and their net worth is $375 million. However, deferral is limited to five years. After five years, you have to amortize 20% a year. It's a straight-line amortization, so that means the industry as a whole has amortized about $300 million a year. If I listed the 1993 fiscal year losses of these companies and if this pattern persists and you add another $300 million in losses, you know what's going to happen to the industry. They will be, even in Korean accounting, insolvent.

What do they do? Under current regulation, they have to infuse more capital. There are very few of these new insurers willing to put up capital. In case they don't put up the capital, what will the Ministry of Finance do? Nobody knows. The conjecture is either the Ministry of Finance will yield and postpone the implementation of solvency regulations, or there will be massive restructuring.

The foreign insurers have relatively small losses. They realize they cannot sustain the magnitude of losses incurred by the domestic or joint venture companies, so consequently their growth is very limited. Their market share is very limited. Also, for foreign branch offices there is some limitation on how much you can defer your additional capitalizations. For that reason, branch offices tend to be more conservative.

The causes of the financial losses are fairly obvious. There are very high acquisition costs because of the low persistency rate. Also, it is a carry-over from the cash-flow underwriting to provide funds for other business ventures. I always heard of the cash-flow underwriting on the property and casualty side, but I had never heard of cash-flow underwriting in a life insurance company until I got to Korea.

I have to explain why those kinds of practices are still prevalent. As I mentioned, six companies were well protected until 1987. During that period the interest rate was very high and there was tremendous interest leverage on investments. As long as you bring cash, regardless of the cost, we can make up by the interest leverage. There is fierce competition for life insurance agents. They go out there and they pound on their relatives and friends' doors. When they exhaust that list, they drop out and move to some other company and turn over your product. The companies didn't care because there is enough interest leverage. Also, some of these companies are controlled by a conglomerate and there was a tremendous cash-flow shortage for business investment. This is the way to get those needed funds to other ventures. These companies are operated as just a conduit to provide funds. Also, these companies invested heavily in real estate and the Korean real estate market really zoomed in the 1970 and 1980s. They reaped a tremendous amount of realized capital gains from real estate investments. As a result, the original six companies are in fairly good shape.

When the new companies started in 1987, the interest rate started to drop and so the interest leverage was not there any more. They are no longer protected from competition. In addition, enhanced policyholder dividends have been required, so any interest leverage they had, they had to distribute. Also, the people who managed these new companies came from the existing six companies. They don't know anything better than continuing with the kind of marketing they learned while they were in those existing companies. They continue this practice with tremendous financial losses. Of course, now there is insufficient capital to cover asset deficiencies over reserve requirements.

Finally, let's discuss the prospects for the Korean market. There are some positives. One is that the economic growth rate is still high. The savings rates are still somewhere around 20–30% a year. Despite high premium volume, the market penetration is not all that high. It's only 40%, because the low-income market and very high-income market is not well penetrated. There is room for more market penetrations. Inflation has come under control lately and the interest rate has stabilized, so there is a stable environment in which to operate a life insurance business.

Until last year when the civilian government took over, there was prevailing corruption among government officials and also the business ethics weren't there. Those things are now slowly changing; I hope, in the near future, business ethics will be up to or close to the North American standards. As I mentioned, we expect a large scale restructuring happening in the next five years. If you have enough capital, and if you have deep pockets and a risk-taking attitude, there can be great opportunities.

There are negatives. It's an expensive distribution system with high early lapse rates. All the companies realize that you cannot operate under such a high lapse rate environment, so they are trying to do something. Still, there are no visible effects. Then regulations are not predictable and sometimes irrational. Also, there is a lack of professionalism among management and even on the actuarial side the state of art is very primitive.

Of course, the result of high lapse rates is a negative image of life insurance companies. Of course, in the United States, the life insurance companies don't have a good image, but it's much worse in Korea. As I mentioned, Korea has the highest per-capita premiums relative to incomes. There is some question as to how far that number will grow.

MR. CHARLES VON FANGE: What I'm going to attempt to do is to give you a little bit of a feeling for what it was like to actually develop a product in Japan. I'm going to try to give context to that in terms of the political environment, the social environment, who the players were, what the process was like, what it's like to be an American operating in Tokyo and dealing with that culture, and how to conduct business in that environment. I'm going to try to put this into context, so it will be a short while before I get to the actual product development itself.

Let's start with the summer of 1989. I had been to Japan for one month, a short trip in the spring of that year, and I had been asked to take an assignment in Japan that fall. I suspect, but I do not know for certain, the one month tour was sort of a test to see whether or not I could accommodate to living in the Japanese environment and how well I interacted with the management team in our Tokyo office.

In the fall of 1989, I traveled to Tokyo and began living there. At that point in time, the living benefit as a product concept was getting a great deal of favorable trade press. It has been around as a product concept when it was developed since the early 1980s in South Africa. It was introduced in the United Kingdom at about the same time. It was receiving much favorable trade press. The NAIC at that point, seeing interest in the U.S. in this same kind of concept, had started working on a draft model regulation.

The Society of Actuaries began having presentations, workshops, and discussion on this. We began seeing it in various trade publications. American companies were beginning to develop their own plans to introduce such a product in the U.S. environment. American Life Insurance Company (Alico), which is a subsidiary of the American International Group, is the company that, on a day-to-day basis, I work for. It sells no business in the domestic U.S. market. It operates solely overseas and is in 60–70 different countries and territories around the world.

We already had products in two locations at that point in time. In the fall of 1988 and the spring of 1989, I worked on a product that was introduced in Canada. We also had another one of our actuarial people operating out of the Middle East that introduced a stand-alone rider-type contract, which became very popular.

Professional reinsurers had gotten themselves into the fray at that point in time. We began seeing white papers and articles. You were promoted by the reinsurance community to consider introducing this kind of product yourself. There were papers that were published by companies like Swiss Re, Munich, and Scandia. These papers were circulated. They gave information about the concept, claims processing, administration, and various aspects. They gave some limited information about how you would take what was typically population-level information and convert it into incidence rates, and how you would put that together and price a product.

At that time, the exchange rate was about 145 yen to the dollar. That compares with a current exchange rate of roughly 105 yen to the dollar. At that time, just as today, we had a large trade imbalance with Japan. There were frequent articles in the press and there was much pressure for change in regard to trade matters between the U.S. and Japan. You saw articles talking about possible trade sanctions.

In Japan, there is an advisory body called the Life Insurance Council. They have quite a bit of clout. Their recommendations command attention. They had recommended, at that time, that the process for bringing products to market and the insurance regulatory environment be deregulated. It had also given favorable mention to the living benefits concept at that time.

While I was there, there were two trade missions from the U.S. to Japan to talk about various trade matters. I think Dan Quayle headed one of those missions.

There was quite a bit of pressure on the trade side. In Japan, organ transplantation was a popular topic. It was being done with increasing frequency offshore. It was not done on shore. It was illegal. Frequently, organ transplants were done with Philippine donors and performed in the United Kingdom.

The medical community was quite divided about organ transplantation. It was dealing with the same subjects that the medical community in the U.S. had struggled with some years earlier, which is defining when death occurs. At that time, performing an organ transplant in Japan would have been illegal.

Cultural items. Japan is a very savings-oriented society, and it has a large insurance market. Japanese spend a meaningful portion of their expendable income on insurance. I read that the average Japanese household had about $50,000 U.S. stashed away in various forms of savings. In the U.S. context, that would sound like a significant amount, but it is necessary to put it in Japanese context, so I will give you some examples of the cost of living in Japan.

A fellow that I work closely with is an actuary in the product area. He lived about an hour and a half train ride from downtown Tokyo. He had three train changes on his way in the morning. He lived in a small house. It had about 900 square feet. In Japan, the space between houses is about a foot. You don't have a garage and you don't have a parking space near your house. If you have a place to park a car at all, it's typically on the sidewalk with two wheels out in the street.

That house cost the equivalent of about $400,000 U.S. Another quick item, just to give you some sense of cost. A watermelon that you might buy at the grocer, an average size watermelon, for unknown reasons is very expensive in Japan. That watermelon would cost you about $40.00. Another cultural item is Japan's preoccupation with cancer. They have a right to be somewhat preoccupied with cancer in the sense that it accounts for a very large percentage of their deaths; it's the leading cause of death between roughly the 30s and mid- to late-60s.

The denial that goes on with respect to that disease is very unusual. In the U.S., families of people who contract cancer are somewhat reluctant to talk about it, but usually the denial goes away after a period of time and you move into a phase where you try to give the family support. In Japan, the standard operating procedure for someone who is diagnosed as having cancer is that the attending physician informs the family members, but does not inform the person. Frequently, the patient does not know that he has cancer unless he suspects it or unless he demands an answer. Even then it's uncertain as to whether or not the attending physician would inform him of his disease.

It's interesting that in Japan the public understands the time value of money, but in my opinion does not necessarily understand the principle of insurance. Frequently, products are designed in Japan where the intention is to provide coverage and provide a no-claim bonus. Many of the products that are designed are intended to return some premium back to the customer. The average person on the street expects, when he puts a premium into a life insurance contract, to get his premiums back with interest without regard to the cost of the coverage that was provided in the interim.

The cancer coverage, which I mentioned a moment ago, also leads to some unusual situations. As I noted, it's common to provide coverages that have no claim bonuses in Japan, and cancer coverage is one of those. Many companies found themselves in an unusual situation where the family members had been advised that the insured had acquired cancer and they submitted a claim and collected under the policy. At the expiration of the policy, the insured himself would go to the insurance company expecting to receive payment for no claims and the insurance company was put in the very awkward position of explaining how it dealt with that issue. There were situations where the insurance companies literally paid the claim twice rather than embarrass the claimant.

Language barriers. It is difficult to operate as a foreigner in Japan. Even when you have very good interpreters, the information that you get is filtered. The Japanese are very polite. They do not want to embarrass you. If they interpret information that is to go back to you that's maybe negative or hostile, they're quite likely to filter that information before you receive it. So you may not always be getting the straight story, or you may not be hearing everything that was said. It's part of operating as a foreign in a Japanese environment.

I'm going to describe a little bit about what dealing with the Ministry of Finance is like. The physical plant that the MOF occupies is not far away from the Imperial Palace grounds in downtown Tokyo. If you thought of the Imperial Palace grounds as a face on a clock with the British Embassy at the one o'clock position, the Ministry of Finance is located at roughly nine o'clock, not too far away from the grounds themselves. The buildings themselves are somewhat unimpressive and institutional looking. I think there's a group of three or four buildings. There's the main building which is a five-story, gray, institutional-looking building. When you enter that building, it appears run down, antiquated, crowded, and messy.

One of the things that you're impressed with is the people who have jobs in the Ministry of Finance tend to be bright young people. They tend to have been outstanding achievers in some of the best universities in Japan. They take these jobs at the Ministry of Finance where the perks are not very great and the accommodations are very low scale, but they thrive on it.

Typically, the people you're dealing with at the Ministry of Finance are not actuaries. You will find that there will be one or two staff actuaries inside the department. Sam mentioned to me that it was his experience that, on occasion, when the MOF had a difficult product concept to deal with, they might not even use the staff actuaries; they might refer to another industry group known as the Life Insurance Association of Japan (LIAJ) and use the technical resources provided by that association.

There is a hierarchy of people that you deal with when you're going to the MOF. Most of the time you're going to be dealing with an examiner. At the early stage, you might be dealing with somebody who's called a window man who has nothing to do but accept information and papers that you supply. He has no authority. He can't make anything happen, but he's part of that machinery. There are also section managers and section chiefs. There is an actuary or actuaries that are in that department.

One of the other things you are impressed about in dealing with the Ministry of Finance is that there is essentially no error tolerance. When you're accustomed to doing filings in the domestic U.S. marketplace, there's sort of a proforma package that you prepare and submit, but you rarely get questioned on the calculations. In Japan, you're routinely going to be questioned on the calculations. If they can't reproduce your numbers to so many decimal places, you're going to be negotiating over it; they don't sign off on it until they're happy with it.

One of the other things that's unusual about filing and dealing with the Ministry of Finance is that everything is on an informal basis until all points of dispute have been settled. Personally, I think this has something to do with the cultural concept of saving face. People in Japan do not like to be presented with questions that they don't know the answers to. They don't like to be confronted. They don't like to be put into an argumentative position. So this process of negotiation is one where, on an informal basis, you come in and discuss a concept and an idea. When you have ironed out all the details, then you make a formal application. Rather surprisingly, approval happens quickly.

The number of companies operating in that environment is quite small. There are 20 domestic companies and ten so-called foreign companies. Of those 20 domestic companies, they are tiered into size groups. Probably half of those companies are of the magnitude of Prudential and Metropolitan. They're huge companies.

Another cultural item is something I would call etiquette. If you contact the Ministry of Finance with the intention of talking about a product concept and the person you reach says, "Well, at this point in time we're not ready to talk with you about this concept," then a polite Japanese actuary would go away and wait for the MOF to contact him at a later point in time when the MOF was willing to discuss the matter.

It's much different than in the United States. In the U.S., when you have a product that you want to file, you prepare a package and you submit it to your state insurance department. There may be some cuing in terms of when your product gets addressed, but nonetheless you do it at your own discretion when you want to. It doesn't work that way in Japan.

I would describe the process of dealing with the Ministry of Finance somewhat as a slow filtration process. They don't miss much. When you contact them and ask them to discuss some matter, whether it's brief or it's long, they don't forget very much. They may not act on it and it may take a long time before they come back to you, but they will come back to you.

Territorial prerogatives. In Japan, within the MOF there are three areas that deal with insurance. You have a life area, a nonlife area, and a fuzzy gray area called third-area products. These areas have their own agendas. They are not removed from the political scene. They are connected to politics and sometimes you find yourself in a situation where one of those units might have to cooperate and work with another unit. If there's been a conflict between personalities in those operating areas, you can find your filing being delayed until that matter gets sorted out.

MOF is extremely cautious about maintaining existing boundaries between these areas. They will analyze a product concept in great detail, and then they will massage and change the content of that product so that they do not change the boundaries that exist between those various areas.

For many years, the large mutual companies were prohibited from selling cancer coverages. The underlying rationale was that MOF wanted to protect newer, weaker companies that had introduced that product. I want to make one other quick note about cancer. American Family was the first company to introduce cancer coverage in Japan a long time ago. At the time, it did its ratemaking, and it used patient survey information that was taken on a regional basis.

Some years later when other companies were allowed to introduce cancer coverage—and, again, it was typically the American companies or foreign companies and not the domestic ones—they were required to use a broader scale nationwide patient survey, which coincidentally happened to produce higher incidence rates, which meant they had more expensive premiums for the same coverage. It is true that even AFLAC operates with its technical basis at a lower level than the other companies in Japan.

Granting of a hidden exclusive. On the record, exclusives don't exist, but in fact, they do. Japan's insurance market is a tariff rate environment. That means that the mortality or morbidity table that's being used in rate computations is going to be the same for everyone writing the same coverage. The interest rate, the premium formula, and the loads that are imbedded in that formula are statutory. If you develop an identical coverage to another nonparticipating company operating in Japan, your premium is going to be exactly the same. Mutual companies also are tariff driven. They have an opportunity to distinguish themselves on the basis of dividends.

MOF tends to take a narrow, literal interpretation of things when you're having discussions with them. We ran into that situation in the course of developing this particular product and we were attempting to use an analogy with the permanent and total disability benefit. They tried to follow that line of reasoning all the way out, and concluded that it couldn't be a life insurance coverage. The point that we were trying to make is that, in Japan, a person is paid the face amount on an ordinary life contract upon death or upon acquiring a permanent and total disability. We were trying to make the analogy that, in a sense, living benefits could cover another type of permanent and total disability in the sense that the person might acquire a serious, life threatening disease.

As I said, MOF took a very narrow interpretation of what permanent and total disability meant. We had initially thought about a design that would have paid out half the face amount at the time that the dread disease occurred, with the balance to be paid on subsequent death. They struggled with how you could have less than the full face amount paid upon the occurrence of the dread disease.

One other item and then we'll get into the product itself. Secrecy. When you go into the examination area at the MOF, one of the things that you notice is it's crowded and it's dirty. The desks are piled high with papers three and four feet high. There are people milling around. When you go in to have a conversation with an examiner, if it's considered to be a proprietary matter, they're quite likely to say, "We'll move this meeting to another location." They'll move to a conference room where you can have that discussion in private. It's not uncommon for other companies to visit the MOF and walk through the examination area just to see what other companies happen to have on the table at that time.

In July 1989, AIG's New York management had already decided that it wanted to pursue the living benefit product in Japan. At the local level, the local actuarial staff members had already done some preliminary work on this product. They had derived some methods for creating incidence rates using population data. They had actually generated some premiums for a couple of different benefit designs. One benefit design was they accelerated half of the face amount at the point that the event occurred. In another design, they suggested the entire amount to be paid when the event occurred.

They had thought about such things as in a situation where you paid out only a portion of the face amount of maybe reinstating or restoring the full face amount after the lapse of some period of time. Local management couldn't achieve a consensus on a number of the issues. Because of that, the decision was made to engage a professional market research group to go to the public, conduct focus group studies, and find out what the public's reaction was to this concept.

We wanted to find out such questions as should the death benefit be accelerated and to what extent. Do you pay the whole amount, some fraction of the amount, and does the client really care about death benefits after the occurrence of a dread disease? What's the list of covered conditions that the public is interested in seeing in this kind of a product? What's the public's sensitivity to price. The expectation was that this product was going to be a good bit more expensive than life insurance. Without knowing exactly how expensive, the question was, will the public be interested in that product and at what price? We also wanted to know what age and economic groups might be the most interested in this product concept.

One of the earliest obstacles that we dealt with was the agent's difficulty with benefit definitions. Although they had a history of having to deal with cancer coverages, cancer coverages make relatively low economic payments. The qualification was relatively simple. If you were hospitalized for a period of 20 days, you qualified. You have to understand that, in Japan, it's quite common for people to go to the hospital with relatively minor ailments, and stay for 20 days in a hospital. Nonetheless, the qualification requirement was very minor. The diagnosis could be made by a dentist as well, not necessarily a medical doctor.

One entire phase of this project was devoted to finding definitions in eligibility requirements in layman's terms that the agent would feel comfortable in explaining to prospective clients. It turned out to be mostly unsuccessful. In dealing with this kind of a product concept, if the triggering event is based upon a medical condition, you have to know whether or not that has occurred. In order to be able to know whether it has occurred, you have to make reference to medical terms and probably use various medical tests to be definitive.

Here is one of the funny stories that surrounded that process. The actuary whose house I visited and that I mentioned earlier had made arrangements for us to meet with ten of the largest brokers and producers for Alico. The purpose of the meeting was to go over the benefit definitions. In one way, we were attempting to educate them about the product, but we were also trying to get their input about what we could do to make those terms and definitions easier. My Japanese friend made the arrangements for this meeting. It was off site. It wasn't located in our building. It was arranged around a Japanese lunch. When I arrived there, I noticed that an interpreter had been provided, which wasn't uncommon. As the meeting began, I noticed that my Japanese associate spoke no English and for the entire duration of the meeting he spoke in Japanese and the interpreter related my comments back to the audience in Japanese. I don't know whether that was intended so that he was not put in the position of appearing to be siding with foreigners on this issue or whether it was another protocol item. It was an interesting experience.

The focus group results were very useful. The public was quite interested in this concept. It broke down somewhat between ages. Under age 40, they weren't all that interested. It was primarily the perception that they weren't really at risk. Once they got to age 40 and higher, people were interested. In terms of price sensitivity, they weren't all that concerned about the price per unit. They tended to have a family budget for how much they could spend on insurance, and that really tended to drive it.

When we started discussing alternate benefit designs such as this restoration of the death benefit or paying out the benefit in something other than a lump sum, they began to get very cautious and concerned. As was mentioned earlier, even in Japan, insurance is viewed with some suspicion by the public. They were not concerned about death benefits after the dread disease. They would buy the coverage for the dread disease by itself without regard to the death benefit itself.

Let me mention the covered conditions. When I arrived in Japan, seven conditions had been covered or imbedded in the rates that had been calculated—heart attack, cancer, stroke, coronary surgery, cirrhosis, which is an interesting one, renal failure, and organ transplant. By the time we reached the approval stage of this product, the covered conditions were narrowed down to three.

Our perspective of the concept was that a covered disease should be something that's recognizable by the public, something that they are concerned about, something that they are aware of, and something that they have some familiarity with. It should be life threatening. The onset should be capable of being objectively determined and should leave some permanent residual. It shouldn't be a situation where the person has this covered condition and receives a large economic benefit and recovers completely. That was not the intention. It should require a diagnosis by a qualified physician or practitioner. Our intention was to provide the large benefit, and a relatively large premium was associated with it.

On December 18, 1989, we began informal talks with the Ministry of Finance. I went to the MOF to make that original presentation. An interpreter went along and several staff members from the actuarial department. To the best of my knowledge, I'm the first non-Japanese to have gone to the MOF to do that sort of thing. It turns out that there are some advantages to that.

Over the first two weeks, we had several meetings with the MOF, all on an informal basis. They were intrigued with the concept. At the very earliest stage, they were already asking questions like is this product allowed in New York. Where else do you sell it? Does this product satisfy Article 673 of the Business Code, which means qualifying as life insurance? Why is the death benefit different for dread disease and death? One of our designs, as I said, was to take 50% of the face amount at the occurrence of the dread disease and take the remaining amount at the time that death occurred.

In February 1990, the papers included some articles on something that was described as an insurance scandal involving Nippon Life and Osaka University. It appeared that the insurance company and the university had conspired to grant insurance to a surgeon who worked at Osaka to (1) allow him insurance coverage and (2) pay the insurance benefit that was used to fund an organ transplant that was performed in the United Kingdom. The recipient became a crusader for transplantation.

The scandal broke because, after he returned to Japan and began proselytizing organ transplants, he became sick and died in a relatively short period of time. His wife published a book describing this whole series of events. The husband's family attempted to suppress publication of the book, which caused the scandal that appeared in the paper. It appeared to us that perhaps Nippon was attempting to create a climate that was favorable to dread disease products by having a coverage connected with providing the funds for this organ transplant and circumvent the transplant barrier, i.e., having the transplant performed abroad.

In February 1990, the NAIC Accelerated Benefit Guidelines became available and this turned out to be a favorable factor as far as we were concerned. We were in the relatively early stages of discussion with the MOF. They were looking for reasons why they should allow this product. The Accelerated Benefit Guidelines that were prepared by the NAIC gave at least an indication that one developed country, the United States, was headed in that direction and would perhaps allow that kind of a product.

In March 1990, MOF advised us that they wanted a formal argument. They recommended that we seek counsel from either a legal expert or an insurance law expert as to how this product fit under the confines of Article 673, which defines life insurance. At that time, they acknowledged the inevitability of accepting living benefits in some form in Japan. By the spring of 1990, it was apparent that MOF was dragging its feet. Progress was slow. We had periodic conversations with them, but we seemed to be going over the same ground again and again. We had started to work on promotional materials at that time.

In July 1990, MOF posed a list of questions to which they wanted a formal response. They were very perceptive. This one turned out to influence the product later on. How did you decide on the covered conditions? I mentioned that we started off with seven. When we got to the end of the line, we only had three. They wondered about whether or not we needed to have an elimination period.

Cancer coverages in Japan typically have a 60-day or a 90-day kind of elimination period to exclude preexisting conditions or moral risk, as they refer to it.

They were disturbed about organ transplants right off the bat. You can see the reference to permanent and total disability. As I said, they tried to follow that line of reasoning and got caught up in it. They never were able to satisfy themselves on that particular issue, so we ended up having to go in another direction to try to convince them that this qualified as life insurance. This one also popped up in the U.S. and other environments. Are the people who receive the death benefit going to be disappointed if you've already paid out some or all of the benefit to the insured person? If you look at the NAIC Guidelines, there is some discussion of that.

Tax regulations on living benefits. The objective or the anticipated result was that it would be treated the same way as proceeds paid out underneath a cancer benefit or hospital cash kind of benefit; i.e., not taxable income. What was innocuous at first, turned out to be significant later. In Japan, the Japan Medical Doctors Association is very influential. It is very connected politically. The MOF did not want to get into a debate with the Japan Medical Doctors Association. The burning issue was that currently there is a single claim form that is used to submit life and health claims in Japan. It's standardized and everybody understands it. The doctors are comfortable with it. They don't have to think about it when they're filling it out.

The claim forms that were going to be used for this coverage were different. In one area, they posed a particularly troublesome issue, which was test results that had been taken by another attending physician. They were concerned that they would put one doctor in the position of looking over another doctor's shoulder, and they did not want to deal with that issue. That became a major item which ultimately changed the course of the negotiations on this product.

In July 1990, MOF requested that we provide them with some materials. The examiner that we were working with, as I said, was intrigued with the concept from the very beginning. He was very supportive. He was looking for as many ways as possible to be able to carry this concept to the section chief for the insurance division and have it successfully approved. He did not want to put himself in a position where his senior would ask him an embarrassing question like why are you proposing this product for introduction in Japan but they don't have it in New York, or they don't have it in the United States, or they don't have it in other developed countries. He was looking for all the ammunition he could get.

We provided them at his request the NAIC Guidelines, both in English and Japanese. We gave him a paraphrased version of it. If you take the trouble to read that guideline, it is a bit difficult to understand. We gave him the paraphrased version in English and Japanese also. I contacted the New York Insurance Department to ask for the current status on living benefits and where that was going. As you probably know, ultimately the New York Insurance Department permitted the terminal illness variety of accelerated benefits, but has not permitted accelerated death benefits in the form that we're talking about here.

I did receive a letter back from the New York Department which sort of gave support to the argument that the concept was one that they were willing to accept. There was also a program bill which actually resulted in the New York regulation permitting the terminal illness variety. We gave them that in English and Japanese. We got a number of sample policy forms from domestic U.S. companies who were introducing the product here in the states. All this information was provided to them as support to deal with their superiors.

In June, July and August of 1990, it was time for MOF rotations. I think I neglected to mention that earlier. There is a regular process of having staff members of the MOF rotated among assignments. A typical examiner or other staff person in the MOF may be on an assignment as short as a year, but generally not longer than about three years. It is possible to find yourself in a situation, on a long development product cycle, to have gotten close or near to the end of the process and have the examiner changed and moved to a new assignment and have to reeducate somebody from scratch. You're talking about people who are nonactuaries. That makes it a difficult task.

In late August 1990, there was an article that was circulated in *The Japan Economic Journal*. An unidentified company circulated a report that several Japanese companies had approached the MOF and suggested that the living benefits product be submitted on an industry-wide basis—LIAJ. MOF rejected that. It appeared that this company was attempting to force MOF to consider combining all the companies and allowing them to go through at the same time.

We happened to be first. It happened to be a curiosity. Another area that I did not get into was this concept of turns of MOF. Most companies have about one opportunity a year to discuss a product with the MOF. If you miss that window of opportunity, it may be another year before you have an opportunity for discussion. It so happened that our window of opportunity popped up toward the end of 1989. As I said, we began informal discussions in December of that year. Had we not gotten it in until January or so, we could well have been sitting there for another year. There was another company that was prepared to talk with MOF about a living benefit concept. Because it was not that company's turn at the MOF, we had the lead on that concept.

In September 1990, we were still dealing with responding to MOF questions. Again, they were still trying to get themselves prepared for explaining this concept and defending it up the chain of command. Internally, they were struggling with some of these other issues, like the one I mentioned involving the Japan Medical Doctors Association.

In October, MOF suggested that we consider uniform payment definitions, and uniform claim forms. They mentioned their concern with the Japanese Medical Doctors Association. Our medical consultant in Japan, the doctor that reviews medical evidence on cases that require it, happens to be a well-known figure in the Japan Medical Doctors Association. He's a surgeon and well connected. He had already begun informal discussions with the Ministry of Welfare and the Japan Medical Doctors Association, so that ground had already been broken.

At about that same time, I was reassigned to come back to the states. I came back in late October 1990 and for the balance of the exercise I handled the negotiations by fax and telephone, and made an occasional trip. In the spring of 1991, it was clear that MOF was still wrestling with the politics of this situation. We later found out that they were really searching for a way out of what they felt was an untenable position.

In June 1991, at MOF insistence, Alico was requested to join an unidentified, large mutual company. It was identified to us. It was not to be disclosed to anyone else that we had joined forces with this large mutual company in a joint filing. This solved a number of problems as far as MOF was concerned. It required Alico and Company X to negotiate uniform benefit definitions and a claim form, which was something that they wanted all along. By having this large mutual company on board, it was not going to be difficult to have other players who entered the marketplace later on accept or buy into those standards.

It forced one statistical base that any subsequent company who was going to introduce the product would have to use. Because of this company's size and influence, it would be able to deal with the claims form issue in the Japan Medical Doctors Association, so they neatly solved all of those various problems by having us join forces with this company.

Informally, we were told that we would be granted a short period exclusive on the product as a trade-off for having allowed this other company to join with us. During the course of the summer and fall of 1991, there was a whole series of negotiation sessions between Company X and Alico. There were some substantive issues on this product from the perspective of those two companies.

Company X's position on it was it expected to sell the product in more of the mass marketed form, for lower dollar amounts (five million to ten million yen). It was not intending to sell it as a large, economic benefit policy. They would have been quite happy with that. They were not so concerned about being absolutely certain at point of entry that a medical condition did not already exist.

Alico's perspective was on the other end of the spectrum. We anticipated selling the product for perhaps as much as 50 million yen, which at that point in time was equivalent to about $400,000 U.S. We intended on medically underwriting every applicant. There was a major difference in perspective on this product. It took some time to negotiate the benefit definitions and the wording.

We wanted to be sure that, once the event occurred, it had left some permanent residual. One way of defining that was to use terms like sequela, lasting some period of time after the onset. We debated back and forth. Originally, we had wanted a three-month period. Company X didn't care about any residual on one of the covering conditions and wanted two months on another one. After a protracted period, we settled it out at two months for both the heart attack and stroke category. I think you can see why it is important, in a stroke category, that there be permanent damage or sequela for a period of time following the event.

We had wanted a maximum limited issue of 50 million yen. Company X was really interested in about 20 million yen. When it ultimately emerged, it came out as 30 million yen. Renal failure, which was mentioned, was eliminated not because it wasn't important, but because you must follow MOF's line of reasoning. Heart attack, cancer, and stroke were number one, two, and three. It was the cause of death for a broad range. Renal failure was only about number seven or eight. MOF's argument was if you don't include four, five and six, you can't have seven. Four, five and six happen to include suicide and accidental death. Ultimately, we decided renal failure was not worth the argument with the MOF.

Cirrhosis was also dropped out at a relatively early stage. As I mentioned, in the market focus group study that we had done, the public really didn't care about whether or not that condition was covered. No one considered it to be a major impairment to be concerned about.

In the month of December 1991, two years after the original discussions, we were having negotiations with the Japan Medical Doctors Association. The focus, as expected, was on the claim form. One in particular had to do with this viewing evidence that might have been collected by another attending physician. They were very reluctant to have that on the claim form.

As late as mid-December, we were still negotiating that. Ultimately, it was resolved by having a one- to two-page explanation of covered conditions that went to the attending physician and went a long way in describing to him what was necessary for his client to be covered under this benefit. Along with this two-page explanation was the claim form. The question regarding interpretation of the test was deleted. We did leave open the possibility that we might request copies of that information for our own medical doctor or consultant to examine.

As late as December 24, Company X was still asking one of the more bizarre questions. The product was going to be issued on both a whole life form and in some renewable term form. On the renewable term form, they asked the question, what if the term coverage expires before the completion of the 60-day elimination period or before the expiration of the 60-day sequela period? Our intention was if you hadn't qualified by the time the contract runs out, you don't get the benefit; ultimately, it came out that way.

Christmastime came. I was out for a week or so. When I came back from the holiday, I received a pleasant note through the mail that the product had been approved. It was almost anticlimactic at that point. There was such a long negotiation session on this product and there had been so many issues that when we were informed that the product had been approved, it was almost a disappointment because I was expecting at least another three, four or five months of negotiations and discussion.

I hope it gives you some insight as to what it's like to develop a product in the Japanese environment. The environment changes constantly. It's not static. There are some signs that deregulation is having an effect. I personally don't think it's substantial yet. There is one subtle difference that I've noticed in the last two years. The prior experience is that MOF does not approve anything until all the t's have been crossed and all the i's have been dotted. In the last year-and-a-half, we've had two products approved in Japan where we were down to the last 5% on the details. In the end, MOF approved the product with a contingent requirement that the senior

Japanese actuary would be responsible for any mistakes and correcting them. As you see, there is a change of attitude and a slight difference in the approval process.

MR. CONWILL: That last remark on the product approval really is significant. The MOF has committed itself to faster product approval and I think we are seeing slow, but nonetheless, real change in that regard.

FROM THE FLOOR: I have a few questions for Sam because I'm more interested in the management side. The first question, is how do you break down your time in terms of all kinds of major issues—regulatory or product?

MR. SUNG: Actually, as president, I can divide my time any way I want. My role now is not really on the technical side, because I have a staff that is technically competent to do technical work. I basically try to educate employees about the business ethics, how to think rationally, and the importance of telling the truth. That's really what I do. I've become kind of a missionary.

FROM THE FLOOR: What is the access, if any, to a capital market in Korea?

MR. SUNG: Life insurance companies are not allowed to borrow any capital. The only way you can have additional capital is through issuing additional shares or capital contributions.

FROM THE FLOOR: What about bribe and corruption related to insurance?

MR. SUNG: That really is going on to some extent, but it's much better now because the new president really instituted an anticorruption drive. That handicaps foreign insurance, especially U.S. companies; they have to be very careful. We have to be above the board, so that sometimes affects sales. Again, that's the name of the game we have to play. If you are not willing to do that, then perhaps you shouldn't be there.

FROM THE FLOOR: What about asset management?

MR. SUNG: Asset management is one of the areas that is not very sophisticated in Korea because of the investment media. You really don't have too much choice. There is no long-term investment available. Usually, your investment horizon is something like three years. Many corporations are not creditworthy, so that's another problem.

FROM THE FLOOR: Any major differences in terms of liability valuation?

MR. SUNG: Liability is basically setting the value for new companies.

FROM THE FLOOR: What are the international company's goals in the Korean market? Is it meeting a five-year breakeven point or is it just getting the positioning?

MR. SUNG: It depends on the company. Most companies, especially the 100% foreign-owned company, are trying to go slow. They are really building up very slowly and they are more concerned about the efficiency or quality of business than volume. With some of the joint ventures, the foreign company doesn't have control of that company, depending on the joint venture. For instance, there is one joint venture. They are operated just like a domestic company. Consequently, they have cumulative losses in excess of something like $140 million in five years and their capital base is only $15 million.

Other joint venture companies are going somewhere in between as a domestic company and a foreign company. They are growing at a reasonable pace, but they also try to control the growth so that they can concentrate on quality of business.

FROM THE FLOOR: My questions are for both of you. First, what is the product that's characteristic of Japan? What is the major product that Alico and all the other foreign companies are selling in Japan? What products are allowed and why? For instance, is universal life allowed or not. I'd like to know about variable products and whether they are allowed.

The second question pertains to the interest rate environment. CIGNA has been in Japan for many years, and the difficulty we are facing right now is the decreasing interest rate environment. How do you manage this interest risk when faced with this decreasing interest rate and limited investment opportunity vehicles?

MR. VON FANGE: He has multiple questions and I'm not sure I can respond to all of those in the time we have here. As far as Alico products, several years ago, the variable product was the largest selling product that we had. It's a narrow margin product. Some four or five years ago, we had large volumes of single-premium variable life being sold. Although the production figures and the premium figures continued to go up year by year, the profit margin or the bottom-line results went down and down by year. The answer was relatively simple. The profit margins in that product are very thin.

As I mentioned to you in the talk, the average Japanese is sophisticated when it comes to interest rates and the time value of money. They've made a practice out of finding situations in which you had an inappropriate interest rate risk and were doing things like buying single premium or full in-hospitalization (FIH) coverage, which is a cancer-type coverage and various other single premium forms of coverage even if they were on an advanced-premium basis where you gave them an inappropriate interest rate discount.

We have been managing that operation much more closely for the last four or five years. Periodically, we've had interest rates cycle up and down. Periodically, we have had to restrict product sales. We're currently restricting product sales on the endowment side. They're used for exactly the same thing—inappropriate interest rate and a technical rate versus what's available from banking institutions. We've had to restrict sales on it so that we didn't get too large a volume of this business.

Another whole area that we could spend a great deal of time talking about is rate change in Japan. It's something foreign to people operating in the domestic U.S. market. In the U.S. you have things like dynamic interest rates which change your technical basis periodically without stopping and negotiating. In Japan, that process is done on a stair-step basis. When the regulators recognize that interest rates in the products that are currently being marketed are inappropriate, they stop and make a change and the technical interest rates are adjusted for the entire industry.

Not only are they recalculated for new business, but in the case of nonparticipating business, they are modified for in-force business. There is an exercise that you go through where the customer will typically, if interest rates have gone up and improved, be presented with an opportunity to either have more face amount for the same premium or have a refund of cash out of the contract, or something along that line. It's always very one-sided. When interest rates change in the favor of the customer, he has a choice. When interest rates are not in the favor of the customer, you usually are locked into the same premium that you had before. It's a difficult environment.

FROM THE FLOOR: I have the same question about Korea on the decreasing interest rates and limited investment vehicles. How do you manage the long-term interest guarantee of 7.5% that the government dictates?

MR. SUNG: In the past, the average life of a product has been very short and so it wasn't a great concern. Also, the interest rate has been high compared with 7.5%. The prevailing interest rate came down to somewhere around 11–12%. Now the Korean government is allowing companies to market qualified retirement annuity products which are expected to have a long horizon. Consequently, the government now narrowed or lowered the guarantee rate to a range of 5–7.5%. Each company has the option of using a rate as low as 5%.

However, except for foreign companies, no domestic companies are using less than 7.5%, and that is going to cause some problems in the future in case the interest rate really goes down below 7.5%.

FROM THE FLOOR: Even if the 5% is used for guaranteed deferred annuities, at the end of the deferred period you're allowing the option to buy an annuity based on 5%. Is that going to be an allowable or manageable risk?

MR. SUNG: Yes, at the moment. Again, that product design specification is not finalized yet. It changes all the time, so I don't know. I wasn't there last week, so they may have changed again. The last I heard was that you can use a rate as low as 5%. My understanding is that CIGNA is using 6%. That's my understanding.

MR. CONWILL: Just one additional comment on Japan. You had asked if universal life was approved or would be approved in the near future. Universal life has been discussed on and off in Japan for at least five years. As of now and for the foreseeable future, it probably will not be approved, at least not in the very flexible form sold in the United States. More likely some sort of adjustable life product or indeterminate life product may get approved to enhance the flexibility with respect to interest rate changes and gross premium changes.

MR. VON FANGE: I'd like to make a quick comment on that. The issue is control. MOF does not wish to grant you the discretion of changing interest rates. It's one of the things that characterizes operating in that environment. In fact, you find yourself in situations where interest rates that are used for various product types, these technical interest rates, are derived on an industry basis, not on an individual-company basis.

We found ourselves, for a number of years, not being able to sell annuities because the market annuity rate was determined by companies that had been out there for years. These companies had investment portfolios with high aggregate interest rates that were not achievable by our own investment department. There was no hope of selling that kind of product.

MR. FRANCIS A. KIM: I have a question for Mr. Sung. I have a bit of an understanding of what the Korean market is like. There is a great deal of corruption. There are many political problems and all that. Listening to what you've said so far, you haven't really enhanced the hope of people who want to sell life insurance in Korea. You've also mentioned that you may want to do a few things in your own company to maybe increase the business ethics.

How would you increase the professional ethics of the people in Korea? What's more important than what you do in your own company is how the society as a whole reacts to the business coming in from the other country. After listening to what you've said so far, I must wonder why I should go over there. What's the point? Because the loss is accumulating, right? You keep saying that the market is there and the potential is there, but the loss is accumulating and there isn't a foreseeable hope of turning that loss around.

MR. SUNG: That's a good question. I ask myself why we are there every day. The point is that, as it is now, if you use the current or prevailing distribution system and with the same quality of business, there is no way you can make money in Korea. We are really looking for opportunity through education. Essentially, what my analysis indicates is that if we achieve a 13-month persistency of 65% and an efficiency of annual premium of over $25 million per branch office, and the total company volume of business of about $500 million a year, we can make money.

We are trying to strive for that goal. We have implemented a lot of small things to improve the quality of business. Again, I would mention to you that there will be significant restructuring of the industry. I think that there is a good opportunity, provided that you have a deep pocket.

MR. CONWILL: I think it's fairly clear that 20 years from now there will be a remarkably developed and prosperous life insurance industry in Korea. It's just getting from the present situation to that point that's going to be a real challenge. When to enter, how much capital to commit, and when to introduce certain strategies or changes are very challenging issues to deal with.

MR. PAUL F. TURNER: I have a question for Mr. Sung. Given the lack of public support or confidence in the insurance industry, I was wondering what your impression was of the banking industry in Korea. Is there a similar relationship there. What is the relationship between banks and life insurance companies in Korea? Finally, would another alternative distribution method such as direct response or bank assurance be of interest in Korea?

MR. SUNG: Well, the bank is actually a direct competitor of a life insurance company. As I mentioned, over 90% of the products are savings-type products that have a very short time horizon. Obviously, a bank is our major competitor. Again, the method the life insurance industry utilizes is based on the connection sale. Even though a bank offers much more favorable interest rates because they obviously have less acquisition costs than a life insurance company, the life insurance company has more influence in sales. So we can compete with the bank, even though we are not financially competitive. I think the same thing is true in the United States too.

You talked about alternate distribution. That's always a subject of discussion with many companies. We are exploring it. Direct response sale is now not legal in Korea. That's one of the problems. That's one of the trade issues. U.S. companies are pressuring the Ministry of Finance to allow those direct response sales, but whether they will be successful is another question. Nobody knows. Many companies are trying to utilize professional male agents who are college graduates. One example is the Prudential, but their sales force is not growing very fast. There is always a price to be paid in not using the conventional distribution system. If you are willing to wait to grow slowly, that's one strategy.