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Doing Business in the East Asian Life Insurance Market

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Recorder: LEO J. HERBERS

Summary: This session profiles each market in terms of size, characteristics, experiences, and potential and then looks into the following areas:

- *capital and other entry requirements, the trend to liberalization and deregulation*
- *East Asian culture and business practice impacting insurance business, and*
- *how to succeed in East Asia; examples and critical success factors*

Mr. Chiu-Cheng Chang: I am currently a professor and the director of the graduate school of management, at the Chang Gung College of Medicine and Technology, in Taiwan. What's more important to this session is that I have been a consulting actuary in East Asia for a number of years.

Steve Conwill is with the Tokyo office of Milliman & Robertson, Inc. His area of expertise is consulting to Asian life insurance companies, primarily in Japan and Korea on financial and capital management issues, product design, agent compensation, and strategic planning. He has also consulted with North American and European companies on market entry issues, including green fields operations, establishment of joint ventures, and mergers and acquisitions. A graduate of Haverford College, Steve earned a master's degree from Princeton University. He is

† Note: Steve Conwill's presentation was not captured on audiotape and is not able to be reproduced here, except for a copy of his slides. Please contact Mr. Conwill at his directory address for more information.

also a Fellow of the Society of Actuaries (FSA). Steve joined Milliman & Robertson in September 1988 in its Seattle office. In February 1992, Steve moved to Japan to help establish Milliman & Robertson Japan. Today Steve is managing director and senior consultant in the Japan office. Steve has published a number of articles on Japanese and Korean life insurance markets. He will review the East Asian life insurance market generally and then will focus on Japanese and Korean life insurance markets, particularly because these are currently the two largest life insurance markets in East Asia.

Kermitt Cox is vice president and assistant corporate actuary for American Family Life Assurance Company (AFLAC). AFLAC's major product line is supplemental health insurance with nearly 85% of its premium income coming from its branch operation in Japan. AFLAC's second major market is the U.S. It also has several other very small foreign operations, principally in Canada and Taiwan. Kermitt has been with AFLAC for nearly ten years and has worked almost exclusively with their international business. Prior to joining AFLAC, he was associated with Mutual of Omaha Insurance Company for 14 years and was involved with the initial business planning for their entry into the Japanese life insurance market. Kermitt is a member of the International Relations Committee of the Society of Actuaries and also a member of the Futurism Section Council of the Society of Actuaries. Kermitt will speak on capital and entry requirements for Japan, Taiwan, and Korea and will also discuss AFLAC-Japan as a case study of how to succeed in Asia.

I will cover some of the most recent developments in some East Asian countries which are of interest. Then, I will concentrate on "Doing Life Insurance Business in China." I will then answer the general question, Why Should You Be Doing Business in the East Asian Life Insurance Market? Finally, I will summarize the critical success factors for foreign insurers doing business in East Asia.

The recorder for our session is Leo Herbert. Leo is an FSA and assistant actuary for The Principal Financial Group in Des Moines, Iowa.

RECENT DEVELOPMENTS IN THE PHILIPPINES AND THAILAND

In October 1994, the Philippine government amended its Foreign Investment Act to allow the granting of up to ten new life insurance and ten new general insurance licenses to foreign insurance companies within a two-year period. Until the issuance of the new licenses, the life insurance industry in the Philippines comprised 25 companies, six of which captured around 80% of the market. The remaining companies operated predominantly in niche markets, often by concentrating in rural areas or marketing to certain ethnic groups.

In contrast to many other emerging markets in Asia, such as Thailand and Indonesia, where foreign insurers may only operate on a joint venture basis, the Philippines allows foreign insurers to apply for a license as a wholly owned subsidiary or branch operation if they meet certain qualifications. These qualifications are: (1) The foreign insurer must be one of the top 200 foreign insurance companies in the world or one of the top ten in their country of origin and (2) the insurer must have been doing business for ten years.

The application process involved the following three stages:

1. The insurer should submit a letter of intent to the Insurance Commissioner together with specified documentation. If satisfied, the Commissioner will issue a letter of no objection.
2. The insurer should register with the Securities and Exchange Commission.
3. The insurer should submit its formal business plan. Product submissions could be done in parallel but the formal approval will only be given once the license has been granted.

The paid-up capital requirements for new companies vary from 100 million pesos to 300 million pesos depending on the level of foreign investment. If the ten licenses are granted, other foreign insurers can still enter the market by forming joint ventures with existing local companies, as long as their shareholding is 40% or lower. Furthermore, a review of the developments will take place after October 1996, the deadline for the two-year period. It is expected that the Philippine government will state its intention to grant further licenses.

In June 1995, the Thai government announced that it would issue new insurance licenses. Until the issuance of the new licenses, the life insurance industry comprised 12 companies. Since the announcement, the government has received 44 applications for life insurance licenses and 43 applications for general insurance licenses by the closing date of October 9, 1995. Since then, 66 applications (35 life and 31 nonlife) have passed the scrutiny of government selectors and have been forwarded to the Cabinet for approval. The Cabinet will have the final say over how many licenses to grant; however, it is likely that most will be approved since a study suggested that the Thai market can support this number of additional companies.

DOING LIFE INSURANCE BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA (PRC)

With its 1.2 billion population and robust economic growth since 1978 when the economic reform movement started, China is unquestionably one of the fastest growing insurance markets with the potential to become the largest market in the world. At the end of 1995, total premium income written by all domestic and foreign insurers in China was $7.1 billion (U.S.), an increase of about 35% over 1994. According to China's latest Five-Year Plan (1996–2000), annual premium income is expected to reach $23 billion (U.S.) in 2000 and $58.8 billion (U.S.) in 2010. The plan also calls for gradual opening of coastal cities to foreign insurance companies and approval for one to two foreign companies a year in 1996–2000 and two to three foreign companies a year in 2001–2010, reaching a total of about 30 foreign insurers by 2010. As expected, the international insurance industry is turning increasingly to the vast potential of the market in China.

At the end of 1995, there were 26 domestic and foreign insurance companies in China. Three of these were domestic national companies, three were independent regional insurance companies, 17 were regional or local insurers that were affiliated either with the People's Insurance Company of China (PICC) and/or with local governments, and three were foreign companies. PICC is by far the largest insurance company in China, controlling about 84% of the market with premiums of $4.4 billion (U.S.) in 1994. It has nearly 5,000 branches, about 120,000 employees and 200,000 full-time and part-time agents in China. In an effort to comply with the new insurance law and streamline its operations, PICC has recently undergone a restructuring. A new holding company, The People's Insurance Company of China (Group), was established on July 23, 1996. It has the following subsidiaries:

1. The People's Life Insurance Company of China, PICC (Life)
2. The People General Insurance Company of China, PICC (General)
3. The People's Reinsurance Company of China, PICC (Reinsurance)
4. Overseas PICC Insurance Companies
5. Noninsurance commercial companies

American Insurance Association (AIA) was the first foreign insurer allowed to set up operation in China. It established a branch office in Shanghai in 1992 handing both life and nonlife business. In July 1995, AIA received permission to open two separate branches in Guangzhou, one for life and the other for nonlife business. Both started their business in January 1996. AIA is the wholly-owned subsidiary of American International Group (AIG). The subsidiary started its business in Shanghai in 1931. It is now incorporated in Hong Kong and has branch offices and affiliated companies in a dozen countries in Asia-Pacific.

According to the AIA Shanghai operation it is going to be on target to reach its goal of breaking even after five years. The Shanghai branch is expected to be a great success mainly because it quickly builds up a large group of highly motivated, well-qualified and, perhaps, most highly-educated agents in the world. The branch now has 6,000 agents, most of them good university graduates. AIA agents currently earn an average of about $200 (U.S.) per month with top agents making around $5,000 (U.S.) in a single month. Being an old China hand, AIA has maintained its good relations with PICC by concentrating on individual life policies, an area largely ignored by PICC. The most popular AIA products in Shanghai are endowment insurance, personal accident insurance, and medical insurance.

Japan's oldest and largest nonlife insurer, Tokyo Marine, became the second foreign insurer to receive approval for a branch in Shanghai in July 1994. It was restricted to handling nonlife business for non-Chinese companies in Shanghai. It provides marine and cargo, property, fire, construction, machinery, liability, and personal accident insurance. Tokyo Marine was permitted to write personal accident policies, even though they are within the scope of business of life insurance licenses.

China's economic reforms started in 1978. They have helped stimulate strong economic growth by moving the old planning economy to a new market economy. The "open door" policy, implemented to bolster reforms, provides an opportunity to learn from professional foreign insurers. Moreover, some reforms themselves directly supported the growth of the insurance industry. The economic reforms have indirectly helped produce other factors that influence the insurance industry favorably. These factors include drastic change in public attitude toward insurance, the recognition and acceptance of risks and rewards by all parties concerned, the use of insurance as a vehicle to transfer risk, the change in family structure, the gradual increase in reliance on self-planning for retirement, and the impact of the aging of the population.

Despite all these powerful factors contributing to the growth of the insurance industry, there are some problems that might impede its progress. These can be summarized as follows:

1. Political uncertainty. Leadership succession could create problems. A relatively new market economy has been prone to boom-and-bust cycles with sharp downturns and high inflation; it could lead to social unrest. More importantly, political and military powers could overwhelm the gray areas where the rules and regulations are not clearly in place.

2. Lack of regulations. Although the new insurance law went into effect on October 1, 1995, many of the necessary regulations have not been promulgated. This could lead to the problem that a fair play on a level-playing field may become questionable.

3. Lack of investment channels. This is partly due to the statutory restrictions on the investment of insurance funds and to the fact that China's financial market is still underdeveloped. The number and degree of sophistication of investment vehicles should increase as China's economy becomes more advanced.

4. Lack of professional personnel. This is to be expected due to the short history of a free market economy in China. The lack of professionalism and ethical standards could lead to serious problems in the development of the insurance industry.

5. Chinese government's dilemma. China wants to open its door so that they can learn from experienced, professional, foreign insurers. However, it does not want to see its market being dominated by foreign insurers someday. China's bad historical memories are still vivid when Western powers divided China exclusively for their own economic benefits. It cannot tolerate enduring a similar repetition of history if the insurance market is divided by a few foreign giants. Therefore, foreign insurers cannot grow too prominently. They must be patient and maintain a low-profile. As an example, AIA's rapid growth in recruiting agents in Shanghai was slowed down by the Chinese authority with an unconvincing reason that their agents are not properly trained due to too fast growth. Foreign insurers must learn how to walk a fine line to balance their growth with that of China's own insurers.

One aspect of the economic reform that will have a major impact on the insurance industry is the abolition of the old welfare system for state-run enterprises. The proposed new social security system consists of three parts of which the three-tier Social Insurance System is most important for insurance companies. It covers retirement, medical care, work-related injury or illness, and unemployment. It is supported by (1) government plans that are designed to meet basic needs with contributions from the employer and employee, (2) company plans as supplements, and (3) individual plans, also, as supplements. Insurance companies will be able to participate in both company and individual plans.

Before the granting of a license to AIA to establish its Shanghai branch, Chinese insurers had concentrated mostly on nonlife insurance and group life insurance. The individual life insurance was generally ignored. In 1992, AIA entered the Shanghai market with a focus on individual life insurance sold through an agency distribution system. The products marketed by AIA in Shanghai were similar to but simpler than, those sold by AIA in other Asian counties. Due to their marketing expertise, AIA products became very popular in Shanghai.

In contrast to AIA's products, Chinese life insurance companies generally offer simple and rigid products such as basic personal life insurance, basic personal retirement insurance, accidental death and dismemberment insurance, industrial life insurance, group life and dismemberment insurance, group medical hospital insurance, major illness insurance, etc. For comparison purposes, I've listed here a few sample AIA products:

1. Special Participating Endowment Life-Saving Policy
2. Twenty-year Payment Nonparticipating Whole Life Insurance
3. Income Protection Full Cover Policy
4. Group Employee Comprehensive Coverage Insurance
5. Whole Life Policy for Children in Kindergarten, Primary, and Secondary School

On June 30, 1995, China's new insurance law was approved and become effective on October 1995. The law covers all commercial insurance activities within China. It stipulated that the financial supervision and regulation department of the People's Bank of China (PBOC) shall be responsible for the supervision of insurance business and insurance companies. The law's main provisions are briefly considered below:

1. General provisions. Articles 1–8 cover these provisions of the law.

2. Insurance contracts. Articles 9–68 cover the principles of insurance contracts including insurable interest, disclosure, notification and payment of claims, obligations and rights of the applicant, the insured, and the insurer.

3. Establishment and financial control of insurance company. Articles 69–90 cover this, including the minimum amount of registered capital, organizational structure, the management system, and so on. For insurers wishing to establish a foreign company in Shanghai, some additional conditions such as insurance experience, maintenance of a representative office, and minimum total assets must be met. The application procedure, including detailed steps (six in total) and rules of winding-up, is also prescribed.

4. Operational rules governing insurance business. Articles 91–105 cover these, including scope of business, reinsurance, reserves, and insurance fund and investment.

5. Supervision and regulation of insurance companies. Articles 106–121 cover these, including insurance clauses and premium rate approval by PBOC, monthly and annual filing, actuaries, and actuarial reporting systems.

6. Insurance agents and brokers. Articles 122–130 cover these, including single company representation, broker's liability for negligence, conditions for becoming an agent, and annual filing.

7. Legal liability. Articles 131–146 cover this, including insurance fraud and violation of the insurance law.

8. Supplementary provision. Articles 147–152 deal with these.

To implement the new insurance law, PBOC released the first set of regulations in February 1996, covering the administration of insurance agents. The second set of regulations was released in August 1996. It has a total of 11 chapters, 90 articles and one appendix, giving detailed provisions to be applied to insurance companies—both domestic and foreign, and life and general insurance companies. The highlights of the second set of regulations follow:

1. Chapter 1: General (three articles)

2. Chapter 2: Establishment, Change, and Closure of an Insurance Company (16 articles)

3. Chapter 3: Scope of Business for an Insurance Company (four articles). This chapter emphasizes the importance of separating life and general insurance business.

4. Chapter 4: Administration and Investment of the Capital (ten articles). This chapter stipulated the amount and type of funds and the reserves that an insurance company needs to set up. It restricts the investment to bank deposits and government and financial bonds.

5. Chapter 5: Administration and the Business License (six articles).

6. Chapter 6: Insurance Clauses and Insurance Premium Rates (eight articles). The insurance clauses and premium rates of major insurance types should be determined and published by PBOC. Insurers may apply for a protection period of six months during which other insurers may not issue similar products.

7. Chapter 7: Solvency Requirements for an Insurance Company (five articles).

8. Chapter 8: Administration of Insurance Operation (12 articles).

9. Chapter 9: Supervision (eight articles).

10. Chapter 10: Penalty (15 articles).

To enter the Chinese insurance market, a foreign insurer must set up a representative office as required by PBOC for at least two years before applying for a license to carry on insurance business in China. Although the representative offices are restricted to liaison work, they serve an important purpose as a sign of the foreign insurer's commitment. This commitment is reflected in the time and expense of setting up and maintaining an office and in the office's work on projects which help the Chinese domestic insurance industry. Moreover, the offices may be needed to enable foreign companies to learn about the Chinese insurance market.

Foreign insurers should use representative offices as a base to proactively engage in all activities conducive to their objective of establishing an insurance company in China. These activities could include surveying the insurance market, collecting data and information in preparation for entry into the market, creating ties with the insurance community, building a good relationship with central and local governments at all levels, and with Chinese insurers, business leaders and educational institutions. Other more positive activities, such as training staff of Chinese insurers and officials of PBOC, sponsoring seminars and conferences, establishing funds such as scholarship, buying textbooks and computers for universities, sponsoring university students to write actuarial examinations, lecturing for actuarial science programs, at universities, and so on, all enhance an office's chance of gaining a license in the future.

Currently, there are more than 100 representative offices in China, representing more than 70 foreign insurers, reinsurers, and brokers from more than a dozen countries. To establish a representative office, foreign insurers must first obtain approval from PBOC according to Article 80 of the insurance law. Procedures for obtaining approval for a representative office are set down in the PBOC's Administration of the Establishment of Resident Offices in China by Foreign Investment Financial Institutions Procedures. The highlights of the procedures follow:

1. Article 5: Insurers applying for a representative office shall first apply to a local PBOC branch that scrutinizes their application and passes it to the PBOC head office in Beijing for final approval. This article also specifies documents to be submitted with the application.

2. Article 6: PBOC will decide within three months whether to accept the application. If it accepts the application, it will issue an application form for

the establishment institution. The foreign applicant must fill out the form within two months and submit it to PBOC along with additional documents. Upon approval by the PBOC head office, an approval certificate will be issued.

3. Article 7: Once the approval certificate has been obtained, the foreign insurer must complete a registration and residence procedure, open an account at a designated bank, and complete taxation registration procedures at the local taxation bureau.

A foreign insurer can enter the Chinese insurance market by establishing a branch operation or a joint venture with a local company. PBOC would prefer insurers to enter via a joint venture while foreign companies prefer branch operations because they offer more autonomy. Joint ventures would give local companies direct access to foreign capital and expertise. Local partners would learn from foreigners how to manage an insurance company professionally, they would learn about things from product design and pricing to underwriting and marketing, from training and education of an agency force to accounting and management information systems, from reserving and financial reporting to profitability and experience studies, and so on. All these areas have been long neglected by local insurers because of the lack of competition and contact with foreign insurers.

In addition to more autonomy offered to foreign insurers in branch operations, foreigners consider sharing management control with local partners unacceptable, especially because Chinese partners prefer a 51% share. Some foreign insurers also worry that Chinese partners may not be able to contribute their share of capital and expertise for expansion. However, some foreign insurers like the attractions offered in joint ventures. The main advantage is that it may be faster to get into the market through a joint venture because PBOC favors them and there is a long waiting list applying for approval of insurance license. Another advantage is that local partners may be able to contribute a client base and also knowledge of local conditions.

I would like to point out that it is widely believed that Chinese authority takes into account the applicant’s nationality in granting a license. This belief is generally based on the fact that the Chinese government adopts different policies toward different countries and this will inevitably influence the PBOC’s decision to grant an insurance license. The Chinese authority first chose an American company, AIA, then a Japanese company, Tokyo Marine, and then a Canadian company ManuLife. It is believed that the next company will likely be from Europe or Australia.

It is advisable to briefly touch upon AIA’s experience in China to illustrate how a foreign insurer can be expected to operate successfully in China. AIA has its roots planted in Shanghai bank in 1919. It started negotiating for re-entry into China as early as the 1970s. The key to its success as the first foreign insurer to enter China is its ability to convince the Chinese government that an important priority for AIA is to help China develop its economy, not just to make money. To that end, AIA invested heavily in Shanghai and promised to reinvest all profits received in the first ten years back into its business in China. AIA also contributes to China's insurance industry through training programs for PICC and PBOC staff members.

AIA's other strong selling points are its record for services, financial strength in other markets, and its foreign experiences. It is either the largest or one of the largest foreign insurers in each of the countries in Southeast Asia. AIA's reserve bases are generally more conservative than the statutory requirements of the local governments in these markets. Once entering the market, AIA has avoided direct competition with PICC by focusing on individual life insurance which has been ignored by PICC. As a result, AIA has become very successful in the individual life insurance market, and PICC's profits and premium income grow strongly, in Shanghai. Finally, AIA has also introduced the agency system to the Chinese insurance market. By recruiting and professionally training highly qualified insurance agents, AIA can claim that is has improved the reputation of the Chinese insurance industry and changed public attitude toward insurance.

WHY SHOULD YOU BE DOING BUSINESS IN THE EAST ASIAN LIFE INSURANCE MARKET?

There are many reasons why foreign insurers should consider doing business in the East Asian life insurance market. The most important among those reasons are: strong and sustainable economic growth, very high savings rates, high and persistent premium growth rates, favorable effects of industrialization and Westernization on insurance purchase, and with the exception of Japan, East Asian countries are grossly underinsured. In addition to these, the existence of the following multiple sources of profit should be considered:

Mortality

The mortality tables used in pricing life insurance products are generally very conservative in East Asia. Moreover, these tables are mandated by the regulatory authorities to be used for pricing life insurance policies. Clearly, this is a guaranteed source of profit. There are talks about updating the mortality tables more frequently than in the past. Updating would reduce the degree of conservatism, thereby decreasing the profit margin. However, as long as the pricing tables are the same as the valuation tables which are an aggregate (versus select-and-ultimate) mortality table, this source of profit can be assured. Foreign insurers can do even better in this regard. Generally, foreign insurers target to the professionals, managerial, and supervisory people who are more educated and belong to higher social and economic status. This segment should have seen better mortality rates based on the results of many mortality studies by education and economic status.

Morbidity

In general, there has not been an industry-wide morbidity experience study done on the insured population in East Asian countries. There also is not any industry-wide actual-to-expected morbidity experience published. However, we can closely estimate the loss ratios of accident and health business of both individual and group lines for most of the East Asian countries. Compared to the American market, the loss ratios for individual lines of business are lower than the minimum loss ratio requirements of the U.S. This means that if this business were conducted in the U.S., the insurers would have to reduce their premiums so as to raise the loss ratios above the minimum requirements. Similarly, the loss ratios for group lines of business are far lower than the prevailing expected loss ratios used in pricing group accident and health products in the U.S. This means that East Asia's morbidity assumptions used in pricing accident and health insurance products are conservative. This practice is expected to continue, thereby assuring another source of profit.

Persistency Rates

Foreign insurers generally use fairly conservative lapse assumptions in pricing. These lapse rates are generally lower than those actually experienced by local companies. Since foreign insurer's lapse experience has emerged and is, in general, significantly better than that of local insurers, higher persistency rates should be another important source of profit for foreign insurers.

Investment Yield

For foreign insurers operating in East Asia, the investment strategy for the first few years may not be important because of negative cash flow, unless they decide to acquire their own office building to be used as their headquarters in some East Asian countries. Some East Asian governments do allow foreign insurers to own their home office building. Historically, investment in real estate has had the highest rate of return among all the investment in East Asia. Since the price for real estate now is generally considered low, the capital gains from real estate investments can be extraordinary. Once a foreign insurer has established its foothold in East Asia and experienced positive cash flow, its normal investment operations other than real estate and stock should be able to generate enough investment return to more than cover the interest assumption used in pricing. The interest spread between interest earned and that used in pricing will provide another important source of profit.

Expense Ratios

An important reason for foreign insurers to decide to enter the East Asian market is the inefficiency of most local companies. Generally, the ratios of business and administrative expenses to the amount of premiums received have been between 20% and 25% for the industry in the most recent five years. In sharp contrast, the corresponding ratios for established North American insurers range from 9% to 13%. There is such a disparity in efficiency that once a foreign insurer is established in East Asia, this source of profit resulting from expense savings due to efficient operations could became one of the most important profit sources. As an example, Nan Shan (owned by AIG) has the lowest expense ratio of 8% which is lower than even the most efficient North American insurer. Simply imagine how much profit is generated for Nan Shan from this source alone if Nan Shan prices its products by using, say, a 20% expense assumption!

Profit Margin

Needless to say this is the bona fide source of profit if all the actuarial assumptions used in pricing are realized or the actual experience is better than the assumed.

CRITICAL SUCCESS FACTORS FOR FOREIGN INSURERS DOING BUSINESS IN EAST ASIA

Based on our experience in observing how foreign insurers succeeded or are going to succeed in various countries such as America, Canada, Japan, Taiwan, Singapore and Hong Kong, we firmly believe that the following success factors are all critical and should be duly pursued.

1. A strong long-term commitment to a very worthy corporate vision.
2. A strong long-term commitment to a set of respectable corporate values.
3. A well-researched and executable business strategy created to achieve both corporate vision and values.
4. A strong and experienced country manager who is most effective and competent for (a) leadership, (b) strategic vision and planning, and (c) building the business.
5. A capable and dynamic alignment of management structure with the executive of business strategy.
6. A solid and sound distribution system.

We will discuss only items three and six above. A business strategy for a foreign life insurer should start with the identification of the insurer’s corporate vision and values for its East Asian operation. They can then be used to define the insurers’s mission and set the business objectives and direction in East Asia. The strategy should describe the life insurance market, market trends, and current and anticipated future competitors. It should analyze the insurer’s own and its competitors' strengths and weaknesses. Also, the strategy should identify, to the extent possible, all the competitive gaps. It should then identify the insurer's target market and its customers' insurance needs.

The key strategies should then be clearly identified, defined, and described. These should include, among other things, the distribution system, superior service, customer satisfaction, professional management, transfer of the insurer's strengths to East Asia, product innovation, price, and how to become a low-cost provider.

The entire business strategy should also include various financial projections based on an optimal product portfolio and various scenarios. It should clearly identify all the critical issues the insurer expects to encounter such as a computer system, human resources, marketing, and customer service.

A solid and sound distribution system includes a competitive agent compensation plan. This is a comprehensive scheme requiring an enormous amount of time and effort to iron out all the details. It should be so designed that its underlying philosophy is consistent with corporate vision and values. The plan should be selected only after thorough comparison research has been done among all possible choices and only if it is believed to be the most suitable one for East Asia's life insurance market. It should best facilitate the execution of the insurer's business strategy.

The agent compensation plan defines the structure of the entire marketing organization, the production requirements of each level of the sales force and their compensations and various incentive bonuses. It sets out all the rules to measure performance and gives detailed validation schedules. The plan also describes sales management's responsibilities including recruitment, training, education, and leadership. It also specifies requirements for promotion, special awards, and recognition. There may be as many agent compensation plans as there are insurance companies. The most difficult part in designing the most suitable plan for a foreign insurer lies in identifying the plan that can best facilitate the execution of the insurer's business strategy.

A solid and sound distribution system should include a good screening process for selecting capable, educated, and highly motivated agents. It should also include excellent training programs and continuing education plans for the following objectives:

1. To continuously update the skill and knowledge of the sales force.
2. To keep the sales force at the highest professional level.
3. To keep the sales force constantly motivated.
4. To make an insurance sales career an attractive and respectable one.

Mr. Kermitt L. Cox: I am going to describe some specific experiences my company has had doing business in East Asia. First, I will talk about the process of obtaining a license to do business in a particular country, and then I want to discuss some specifics about our success in the Japanese marketplace.

I would first like to give you a little background about American Family Life Assurance Company. It was founded in 1955 and it primarily sold cancer insurance. It was located in Georgia. By the late 1960s, the chairman was having thoughts about some type of international expansion. He would eventually find in Japan an opportunity to bring some innovation to another market. I'll have more to say about that later.

AFLAC has also had some small ventures in other foreign countries but none of them has come close to the success of the Japan operation.

When a company decides to enter a foreign market, it must file for a license to do business. This can be a laborious and slow process. I'm going to describe to you the experience that we had with one particular East Asian country. We actually went through the filing process twice. The first time we were given a license to sell cancer insurance only; we later applied for a license to sell life and health insurance (the same type of license already given to the other foreign insurers in that country.) The second application took longer than the first. The documentation required to supplement the formal application for license can be substantial. The process can be frustrating. In our experience all of the requests for documentation did not come at once and there didn't seem to be any formal requirements. Everything was ad hoc. The list of documents that eventually were requested included:

- A copy of the company charter,
- A copy of the by-laws of the parent company,
- A copy of the license to do business in the state of domicile,
- Documentation showing compliance with the insurance laws and regulations of the state of domicile,
- A board resolution authorizing the company to pursue a license in this foreign country,
- Naming of a local representative,
- Granting of a power of attorney to this local representative,
- A copy of the company's annual statement,
- A report by an independent auditor for that same reporting year and the annual statement,
- Copies of all reinsurance treaties to which the U.S. insurance company was a party,
- Verification from the state of Georgia on our capital and surplus account, and

- A copy of our license to do business in every other foreign country in which we were operating.

I suspect that different companies have different experiences with the same country, and the experiences from country to country probably differ significantly also. In any event, this was the way the process emerged for AFLAC and you need to be prepared for the possibility of a similar experience.

As you can infer from my previous comments, a significant factor in the filing process is the time frame involved. This can test your patience, at least that has been our experience. Our license expansion request took three-and-one-half years.

If you are going to operate in a foreign country, you will probably have to deposit into or maintain some specified amount of capital in that country. I have some information on capital requirements for Japan, Taiwan, and Korea. For all three countries the capital requirements vary according to the type of operation you plan to operate. In Japan, if your operation is a branch operation, the current requirements for foreign capital is ¥200 million (yen), roughly equivalent to $2 million (U.S.).

Alternatively, if you want to set up a subsidiary of your company or participate in a joint venture, the minimum capital requirement is ¥1 billion, or roughly about $10 million (U.S.). If you are going to sell insurance in Korea, the branch operation will require a capital contribution of ₩(won) 2 billion, a little less than $2.5 million (U.S.). If you are going to participate in a subsidiary or a joint venture in Korea, then the capital requirement becomes ₩(won) 6 billion or about $7.5 million (U.S.). It is my understanding that the capital requirement is reduced to ₩(won) 5 billion if your company is located outside the metropolitan area. I don’t know the reason for this differentiation in capital based upon location. Perhaps it is to encourage establishment in some of the lesser developed, lesser populated areas in Korea. In Taiwan, for a branch operation a capital deposit of NT(yuan) $50 million is required. This is also about $2 million (U.S.) so the requirements for Japan, Taiwan, and Korea are about the same for a branch operation. The marked departure comes if you want to establish a joint venture in Taiwan. It is only in recent years that a foreign company could operate in Taiwan other than as a branch. The foreign investment is limited to, at most, 49%. If you wanted to participate in Taiwan via a joint venture, then the capital requirement becomes NT(yuan) $2 billion or about $80 million (U.S.); a sizeable investment.

Next I would like to take some time and talk about AFLAC’s entry into the Japanese insurance market. In about 1970, our chairman, Mr. Amos, approached the Japanese government, specifically the Ministry of Finance (MOF) about allowing him to sell cancer insurance in Japan. The MOF basically rejected this request at that time. Two years later Japan was being encouraged to open their life insurance market to foreign companies, Mr. Amos's idea was again presented and this time it was received with interest by the MOF. AFLAC made formal application with the MOF in 1972. In October 1974, about two-and-one-half years after application, we finally received our license to do business.

The Japanese MOF felt that a cancer insurance product would fit their situation quite well. This was a turn-around from their earlier position. The Japanese government, while opening their market, also did not want to create a situation of direct competition for their domestic insurers. This is somewhat characteristic of the Japanese way of doing business. That is, look for a solution that is as close to a win/win solution as possible. Therefore, they were interested in finding a U.S. company that could introduce a new product to Japan. It may be true they were also interested in a smaller U.S. company that would not provide too much of a threat to the existing domestic insurers. It just happened that AFLAC fit this criteria quite well. At that time our asset base was about $28 million.

The cancer product did not exist in Japan. We were able to modify our U.S. cancer product to fit the requirements or expectations of the Japanese people and the MOF. Being a life insurance operation in Japan, we needed to add a death benefit to the product. We offered a death benefit for death due to cancer and for death due to other causes but with a lower benefit amount. The death benefit was not the major benefit, however. The in-hospital benefit was the largest benefit in the product. Our product was going to be a level-premium whole life product, and therefore, another necessary modification was to provide cash surrender values as part of the product. Benefits were selected that would provide a meaningful supplement to the national health insurance in Japan.

With the product design completed, there was a need to select a distribution mechanism to sell the product. In the U.S., AFLAC had utilized what the company calls "cluster selling" or marketing to employees of a common employer. The agent will make a presentation to the employees, and they will individually elect whether to purchase a policy. The policy sold is an individual policy and a payroll deduction mechanism is utilized whereby the employer can deduct the premiums from the employee paychecks and remit them to the insurer.

Something similar to this existed in Japan and is known as a corporate agency. A corporate agency is a subsidiary of another company, and this subsidiary is established for the purpose of selling insurance to the employees of the conglomerate. This concept was not introduced by AFLAC into Japan, it preceded our entry but the corporate agency concept was previously utilized only on the nonlife (property and casualty) side of the industry. Domestic life insurers sold their business through the captive agency type of distribution. The life company agents were mainly housewives who went door-to-door selling their product. AFLAC introduced the utilization of the corporate agency for a life insurance product (or in current terminology, a third-sector product). Automatic paycheck deduction was also supported by the employer.

AFLAC was fortunate that it had what amounted to an exclusive right to sell the cancer insurance for about eight years after the product was introduced. There was no formal statement to this affect, but in essence, that is what happened. AFLAC was able to establish a significant market penetration with the cancer product. We entered Japan late in November 1974. By the end of 1975, we had approximately 400,000 policies in force. Growth has continued and today were have nearly 13 million cancer policies in force, plus of course, other lines of business.

In summary, the significant factors of our success in Japan are:

- First is favorable regulatory environment. I think this is not usually found today to the extent that we experienced it in the mid-1970s in Japan. Sometimes the environment may, in fact, be adversarial. There are countries that have opened up their market to foreign insurers, but in my opinion, this opening was somewhat of a facade. Foreign insurers were allowed to enter and set up an operation, but the working environment is very difficult and success is difficult. Also, I would like to say that regardless of where you are, I think that strong attempts to maintain a good relationship with your regulator is critical to your success. This can often be very difficult because the regulator may be difficult to work with. The regulations and the laws themselves may be vague or in need of modification to meet the needs of the changing environment. A great deal of patience is required as is much coordination and close contact with the applicable regulatory body. Language difference can so make the situation more difficult. One principal that I have always tried to observe and keep in mind sounds very basic but my impression is that it is sometimes overlooked; always treat the foreign regulators with professional courtesy and respect. I think it will pay you dividends in the long run.

- The second major factor in our success was a favorable competitive environment. As I mentioned, we were basically allowed to have the market niche to ourselves for a number of years and this can be extremely helpful in getting your feet on the ground and getting a base of business established. Our presence did not create a threat to the markets of the domestic companies, and this was a significant contributing factor as well.

A distribution system that works for you is extremely important. We were able to find a concept in Japan that matched our corporate culture in terms of the type of distribution that we were accustomed to in the U.S. Basically we took a system already existing in Japan and moved it from the nonlife side of business to the life insurance side.

Our product became immensely popular in Japan. Cancer was and is the number one cause of death in Japan and there was a great deal of concern about the cost associated with a diagnosis and treatment of cancer. Back in the 1970s the average stay in the hospital approached 70 days. With over two months of hospitalization on average for the treatment of cancer, the ancillary cost associated with treatment was quite high, and the offering of a product that would defray some of those costs met with much acceptance in the population. You can see how fast our in force volume grew. By the end of 1977, we had over one million units of insurance in force.

- Finally, another significant factor is finding the right people to do the job for you.

Following are contributions from Stephen Conwill.

DOING BUSINESS IN EAST ASIA
FOCUS: JAPAN AND KOREA
ASIAN MARKET OVERVIEW
CHART 1
ASIAN INSURANCE MARKET PREMIUMS

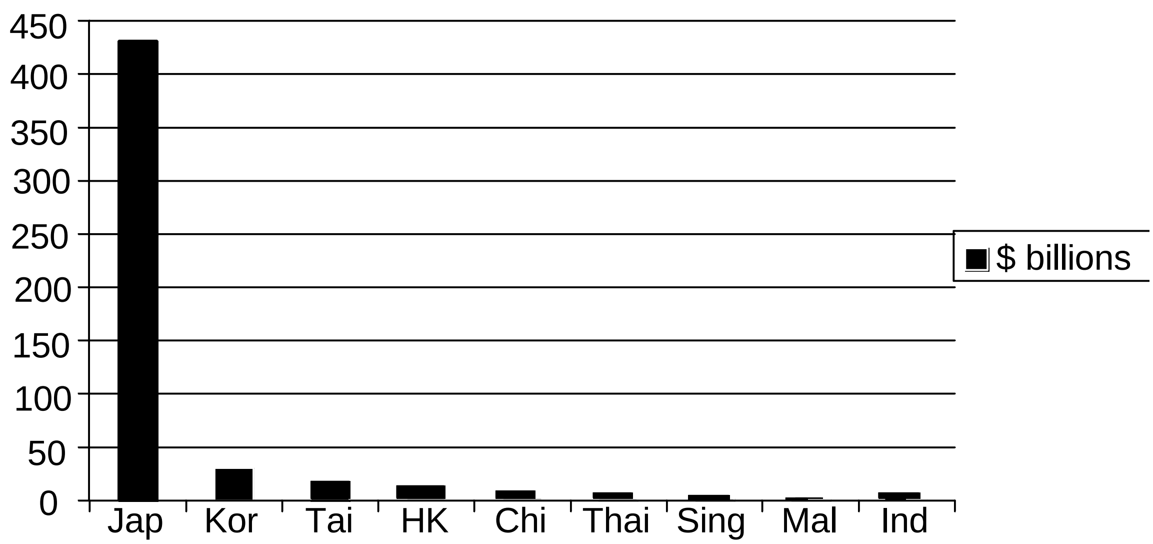


CHART 2
ASIAN INSURANCE MARKET PREMIUMS - EX JAPAN

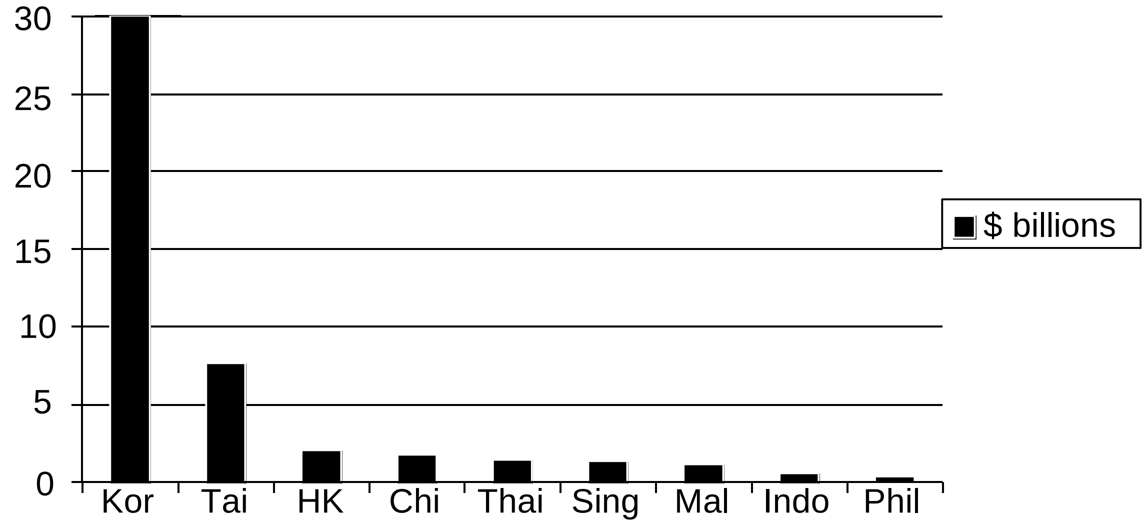


CHART 3
PER CAPITA LIFE PREMIUMS

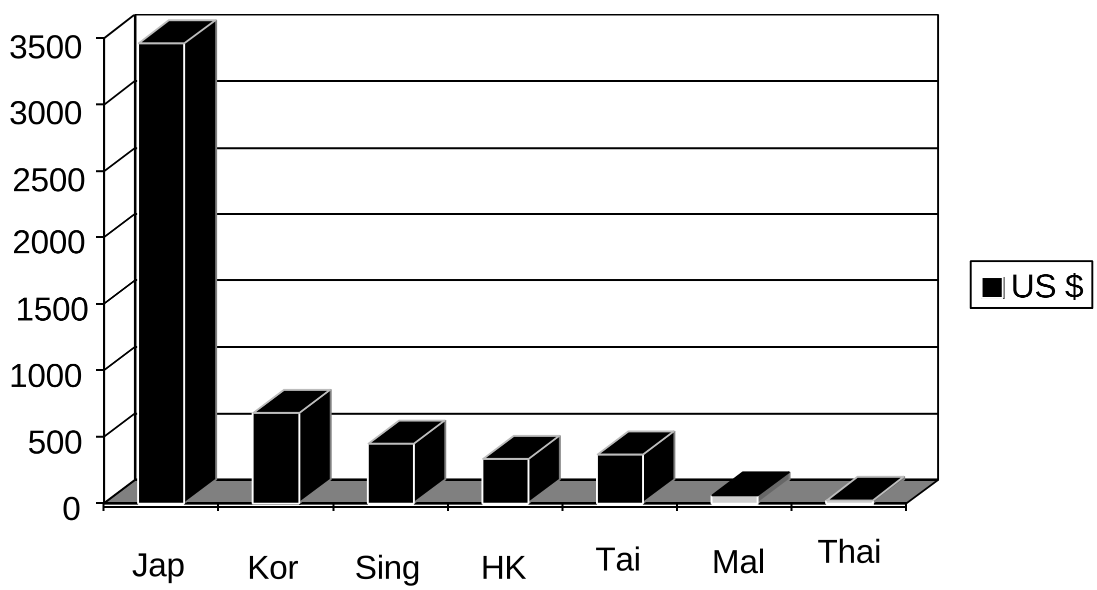


CHART 4
HISTORY OF LIFE COMPANY PREMIUM—JAPAN

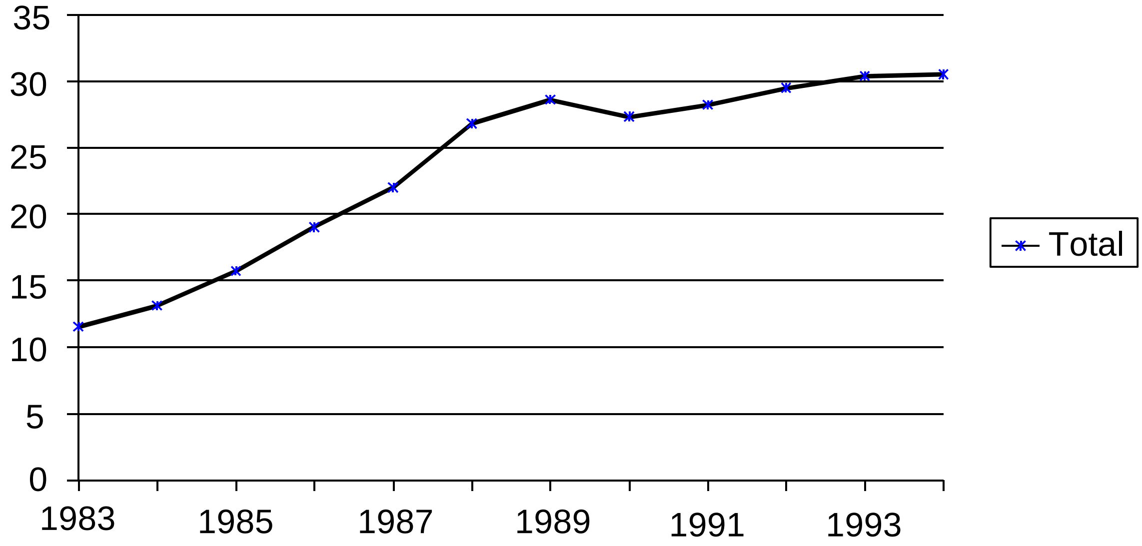
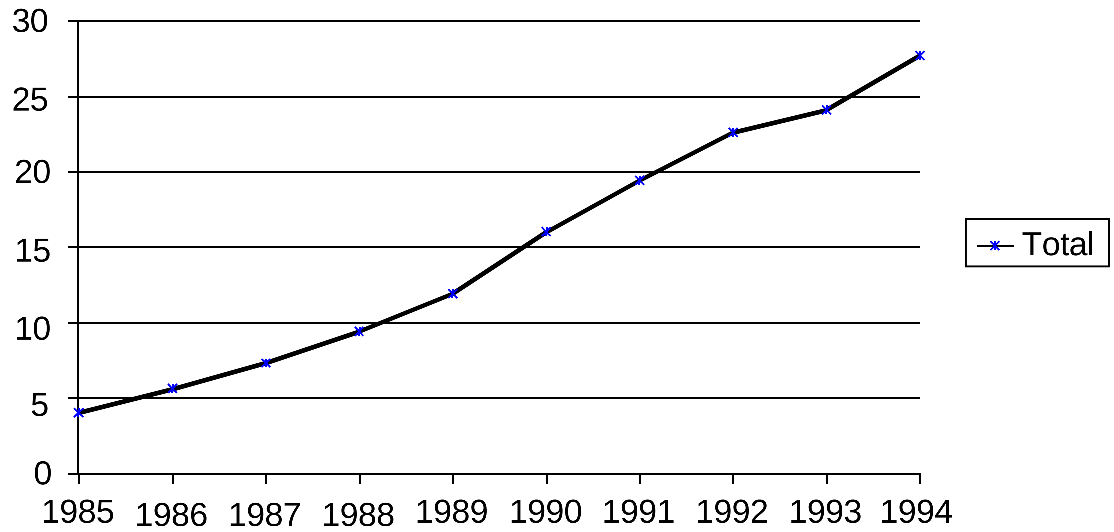


CHART 5
HISTORY OF LIFE COMPANY PREMIUM—KOREA



WHAT IS EAST ASIA?
ARE GENERALIZATIONS POSSIBLE?

EAST ASIA:

- More than 2 billion people
- Hundreds of languages and dialects
- Widely varying culture
- Widely varying economic development
- The per capita life insurance premium of Japan exceeds the per capital GDP of Indonesia.

THERE ARE COMMON TRENDS:
- Competition
- Shift in distribution
- Product evolution
- New solvency/financial regulation
- Lower barriers between financial institutions

COMPETITION TRENDS

COMPETITIVE SITUATION 10 YEARS AGO
- Very high concentration of business in a few leading companies
- Controlled competition—“convoy”
- Few foreign players

CURRENT COMPETITIVE SITUATION
- Many new entrants in most markets
- Fierce competition for distribution and home office staff
- Some product and price competition

COMPETITIVE TRENDS
- Customer will become the focus of competition
- Increase in the pace of product development
- Increasing price competition

DISTRIBUTION TRENDS

DISTRIBUTION SITUATION 10 YEARS AGO
- Distribution dominated by tied agents
- Relationship sales
- High agent turnover in many markets

CURRENT DISTRIBUTION SYSTEM
- Increasing professionalism
- More examples of companies employing several distribution channels
- More examples of cross selling of products with other financial institutions (or non-financial organizations)

DISTRIBUTION TRENDS
- Stage One—continued growth of professional distribution/financial planning; competitive advantage to companies with strong tied agency systems
- Stage Two—move away from tied agents to brokerage and alternate channels

PRODUCT TRENDS

PRODUCT SITUATION 10 YEARS AGO
- Primary focus on short-term investment-oriented products

CURRENT PRODUCT SITUATION
- Growth in risk-oriented products
- Dread disease, hospital cash
- Greater acceptance of term life
- Continued expansion of medical products

- Coordination of life coverage with financial need—growth of term insurance in connection with unbundling
- Longer-term investment products; both fixed guarantee and equity linked

FINANCIAL REGULATORY TRENDS

FINANCIAL REGULATION SITUATION 10 YEARS AGO
- “Statutory” accounting intended to be a conservative basis
- Reserve levels specified by formula
- Mortality and interest assumptions fixed

FINANCIAL REGULATORY TRENDS
- Solvency margin or target surplus formulas stipulated by regulators
- Appointed actuary required to give opinion on financial health
- Cash-flow testing, dynamic-solvency testing, or other techniques are specified
- Growth and development of the actuarial profession

BROADER FINANCIAL SERVICES TRENDS

FINANCIAL SERVICES COMPETITIVE SITUATION—10 YEARS AGO
- Well-defined walls between banks, brokerage firms, insurers
- Life and non-life operations usually conducted through separate entities

FINANCIAL SERVICES TRENDS
- Reduction in barriers between financial services providers
- Bancassurance
- Growth in insurer equity products and equity management
- Cross marketing

KEYS TO SUCCESS
- Distribution
- Differentiation of Operations
- Hiring Key Staff
- Understanding the Regulatory Situation
- Communication with the Home Office
- Capital Commitment
- Risk Management—balance of discipline and growth

CLOSING THOUGHTS
- Cross border operations
- The internalization of ideas