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New Lease on Life for Korea?

by Paul Sinnott

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Any reader of the world's economic press in the last few months cannot fail to have noticed the widespread reporting of Korea's unprecedented comeback from financial disaster. The country's stock market has rebounded above pre-crisis levels; GDP growth for 1999 is predicted to be around 10%; and the Won continues to strengthen. How has the country's beleaguered life insurance industry fared within this encouraging recovery environment?

The short answer is — not very well. Although the insurers' equity portfolios have soared and they are probably less worried about their property assets, non-performing loans remain a big problem and, most importantly, the low interest environment is worsening an already dire financial picture (given the guarantees offered within their existing portfolios). On the positive side, the industry's problems are prompting regulatory change in a variety of areas such as products, distribution and financial reporting/solvency.

The Main Problems

It is wrong to solely attribute the insurance sector's predicament to asset deterioration around the Asian crisis. The problems really center around the lack of financial management in an industry that has historically been driven by business volumes; this being a direct consequence of the strict "tariff" based regulatory environment. Companies were not encouraged to consider the profitability of the products they sold and product development was commonly based on taking a competitor's product and adding a further benefit or two. After many years of these practices, we are left with probably the most complex product landscape in the world.

On the distribution side, the majority of life insurance sales in Korea are made by part-time housewives ("solicitors"). Although not in itself necessarily a bad

A Brief History

Late 1940's/ early 1950's	❑ the "Big Six" are born and have an oligopoly until…..
1987	❑ Market is liberalized with new licenses offered to domestic and foreign players. The following few years saw 27 new licences issued in total.
1995	❑ Aetna withdraws from joint venture with Dongbu to be replaced by AXA.
1997	❑ Clerical Medical backs out of joint venture with Coryo. ❑ MetLife reported to have paid 23 billion Won for the remaining 49% stake in its joint venture with Kolon.
1998	❑ 18 of 33 companies are instructed by regulators to submit "rehabilitation plans." ❑ First attempts at selling some of these companies by local shareholders founder on an inability to persuade the Financial Supervisory Commission ("FSC"), who were grappling with bigger problems in the banking sector at the time, to: (i) inject public funds to fill some/all of the asset "hole" and (ii) allow conversion of portfolios from participating to non-participating in nature, in return for certain additional future "dividend" payments. ❑ Reported that MetLife and New York Life commence due diligence on Korea Life and Kookmin Life, respectively. ❑ 4 of the 18 (BYC, Coryo, Kukje and Tacyong) are suspended and larger insurers are instructed to take them over (Kyobo, First, Samsung and Hungkuk, respectively). ❑ 7 of the 18 (Dong Ah, Doowon, Handuk, Hankuk, Chosun, Kookmin and Pacific) were directed to provide more comprehensive plans to correct their financial situation.

thing, persistency is actually amongst the worst in the world; mainly a consequence of relationship selling and a significant proportion of “phantom sales.” First year persistency rates as low as 30% can be readily found, with even the better performers only achieving 50% to 60%. Over-complex solicitor remuneration arrangements make the tracking of distribution costs very difficult. A general lack of control of both distribution and operational costs, on top of the poor persistency has meant that product expense loadings are rarely reached.

The other main contributor to the industry’s financial plight has been the regulation that allowed new start-ups to write-off up to 50% of their expenses as a “deferred acquisition asset” on their balance sheets for a period of five years. This resulted in companies writing significant volumes of new business without putting up the required capital. This deferred acquisition asset was then to be amortized over a subsequent 5-year period.

Of course when shareholders looked at the “bills” of hundreds of billions of Won racked up, most balked at the prospect of paying. Typically insufficient levels of capital were injected, deferred assets were written down and, not surprisingly, liabilities were significantly higher than assets. The “portfolio drag” on investment income caused by such asset deficiencies, along with little or no profit margins on their products (given the tariff and typical companies’ operating experience) has meant that most are falling further and further into the red.

The Future

More consolidation is expected in the near future, as many of the middle tier local companies are recognized to be in much the same position as those already designated to be “financially impaired.” With interest rates remaining low, as the government has dictated, financial problems are likely to emerge quickly, especially with the vesting of some of the high guarantee single premium policies written during the crisis, during a desperate scramble for cash flow.

Regulatory changes to the product and distribution regimes are on the way, led by pricing deregulation in April 2000. This, along with increasing recognition of the causes of the industry’s problems, will result in much improved focus on financial management for many. The long overdue introduction of modern actuarial profit-testing/financial projection techniques has begun.

The IPOs of Samsung and Kyobob Life are widely predicted, although recent reports suggest that Samsung’s plans for a first quarter listing this year may be postponed due to disputes with the FSC.

The Korean market is certainly an important one with much to offer,

1999	❑ The FSC takes over Korea Life, agrees to an injection of public funds but demands an auction rather than MetLife acquisition exclusivity. ❑ The FSC takes over the 7 abovementioned “financially impaired” companies, appoints advisers, agrees to public fund injections and attempts to sell them. ❑ Problems emerge with jailed major shareholder of Korea Life and first auction is unsuccessful. Second and third have similar results under massive press coverage. Court challenges are eventually overturned and Korea Life is “nationalized” in September along with a large injection of public funds. ❑ Allianz acquires 100% of First Life in August. ❑ Manulife withdraws from its joint venture with Youngpoong with a “small book gain on sale” in October. ❑ The sale of the distressed 7 reported to be proceeding as follows: - Hyundai Group to take over Chosun and Hankuk - Kumho to take over Dong Ah - Youngpoong to take over Handuk - Tongyang and Rothschild to take over Pacific ❑ Talks with Hartford for the sale of Dong-Ah and Kumho reported to have failed. ❑ LG Insurance is reported to be taking over Hansung Life. ❑ ING announces joint ventures in life insurance and funds management with large local bank, H&CB, along with a minority shareholding in the bank itself. ❑ Press reports suggest negotiations with New York Life over the acquisition of Kookmin Life have stalled.

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although the often-cited "sixth biggest" title does not hold when looking at a measure such as assets managed. Some of the foreign players are expected to continue their impressive recent growth rates (Prudential and ING the most cited examples). It will be interesting to be see whether other foreign life insurers will be attracted by the economic recovery, deregulation, high propensity to save and relatively poor penetration of true life insurance, or whether it will remain in the "too difficult" box.

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Meeting Members' PD Requirement in Asia

by Pat Kum, SOA International Outreach Coordinator

With the implementation of the professional development (PD) requirement for Fellowship candidates under the new SOA education and examination system this year, the SOA China Region Committee (CRC) recognizes it has an important role in helping SOA members in the China region meet the PD requirement. As part of its effort to provide support to members, CRC Chairman Kin-Chung Chan said that the CRC would organize continuing education seminars that qualify for SOA-approved PD credit, assist SOA in identifying appropriate professional examinations organized by the other bodies in the region as fitting for PD credit and help apply for SOA-approved PD credit for other regional events upon recommendation or request from organizations or students.

Last November, the CRC and the Actuarial Society of Hong Kong, for the first time, jointly sponsored a one-day seminar on "Healthcare Reform — Current Issues and Preparation for the 21st Century." Chaired by Estella Chiu, a CRC member, the seminar qualified for five units of SOA-approved PD credit and was well attended by actuaries and practitioners. The seminar featured speakers from the United States, the People's Republic of China, Taiwan, and Hong Kong. The objective of the organizers' was to provide a platform for the sharing of the different perspectives, issues and concerns on health care reform in Asia. The presentations aimed to give the participants a better understanding of the current situation of health care reforms and health care systems in the Asian region, the roles of the public and private sectors, and the direction and opportunities for the future. Each presentation was followed by a flurry of questions from the attentive audience.

(Left to right) Speaker Dr. Lai Mei-Shu is presented with a gift of appreciation by Kin-Chung Chan, CRC Chairman.

Most of the morning sessions were devoted to a discussion of the healthcare concerns in Hong Kong. The Harvard Team's Consultancy Study, a study commissioned by the Hong Kong SAR Government, was highlighted. Speaking on the study, Amy Kwok, a member of the Harvard Consultancy Team, described the issues and recommendations addressed