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Insurance Product Regulation— A World Tour

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Editor's Note: This is part I of a four-part series on insurance product regulations around the world. This topic was presented in a panel discussion at the 2001 Society of Actuaries Annual Meeting in New Orleans.

PART I – SELECTED ASIAN MARKETS

Summary

There may be common features among the Asian markets, but it is difficult to make generalized statements about the regulations in Asian markets. Each country is unique and therefore the regulation is unique.

How strict the rules are vary by the need or the philosophy of the government to regulate the market. It also varies by the experience level of the market. There is often little regulation on illustration or sales conduct.

Little regulation means more freedom for companies and perhaps a more competitive market. However, it may also be easier for companies or the industry to make costly mistakes. More regulation may prevent some costly mistakes but may take away innovation. Only time will tell which approach is better.

However, no matter what is written on the paper, the rules of the game are dictated by what is endorsed via enforcement. In some markets, rules may not be well documented or multiple government agencies issue conflicting regulations. So it would be prudent for a company to obtain specific approvals from all appropriate agencies.

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A summary of regulations impacting product design are discussed for selected Asian markets.

Tax

Before getting into the regulations, I'd like to address tax regulation and its impact on product design.

Many products in the U.S. are driven by the U.S. tax regulation. For example, the tax deferral feature of the insurance products drives some of the product innovation in the United States. Often these products will not necessarily have a marketplace in Asian countries where there is no similar tax advantage. On the other hand, products that are not sold in this country due to tax regulation may have a marketplace in these Asian countries. For example, there are very few endowment products sold in this country because they fail to meet IRS definition of "insurance" products but are very common in Asian markets.

Singapore

Singapore was founded by Sir Raffles and was a British Colony for many years. Not surprisingly, there is a lot of British influence on this island. Since its independence, the island city has been ruled quite strictly by the government. The economy has developed tremendously over the last 30 years. The island country has a culture of strict rules and obeying these rules. This is reflected in insurance regulation.

Summary of Regulations

Every product must be filed

- Investment-linked products must be approved

No specific requirements on premiums

Minimum reserve is CVT92 at 4%

Whole life and endowment products must have cash value from year 3+ at 95% (life) or 80% (endowment) of reserves

Participating Products

- Segregated Funds
- Must pass Bonus Reserve Valuation
- 10% to shareholders (1/9 of the dividends)
- Signed by Appointed Actuary
- Reversionary bonus and/or terminal bonus may be paid

Maximum agency compensation set at 160% for recurring premium and 5% for single premium

Illustration

- Investment linked must be illustrated at 5% and 9%
- Non-investment linked at 4.5% and 7.5%
- Appointed Actuary must certify that bonuses are supportable on best estimate assumptions (maximum 6% and no shareholder transfer)
- Must distinguish between guaranteed and non-guaranteed benefits
- Must disclose distribution costs and reduction in yield due to expenses, commission, mortality costs, etc.

Investment-linked product, a British style product, is very popular here. It typically has a fixed premium and is front-end loaded. Some allow dump-in or partial withdrawals.

Participating products also follow the British style. A separate fund is kept for the product. Every year the bonus scale declared must pass the Bonus Reserve Valuation test. The Appointed Actuary must certify that the amount of assets in the fund is sufficient to support the business under the proposed scale using realistic assumptions. The ability to transfer money out of the participating fund is limited. Typically shareholders are allowed to receive 10% of the profit from this block of business. This is measured by 1/9 of the dividends declared. This structure creates some challenges for the actuary in the product design and dividend recommendation to make sure the "blocked" surplus is minimized while ensuring adequate surplus to support the business. The dividends are paid in the forms of reversionary bonus and terminal bonus.

Singapore may have the most developed and sophisticated regulation on illustration in Asia. The regulation is designed to protect the policyholders. It also encourages the companies to operate efficiently by making the companies disclose the impact of expenses on policyholders' yield.

Malaysia

Malaysia, Singapore's neighbor, has a lot of similarities to Singapore.

Summary of Regulations

Products must be filed and certified by the Appointed Actuary

- Annuity certain and investment-linked products must be approved

Minimum gross premium is 90% of M83-88 at 8.5% plus FY loading of 12%/160 and RY loading of 3%/40

Must have non-forfeiture values for most policies

Minimum reserve is SVT96 at 4.5% (4% for single premium) which may be modified using FPT

Maximum agency compensation plus overrides cannot exceed 171% over five years

- Segregated Funds
- Must pass Bonus Reserve Valuation
- 10% to shareholders (some companies at 20%)
- Signed by Appointed Actuary
- Reversionary bonus and/or terminal bonus may be paid
- Limits on amount and incidence of bonus

Illustration

- Each participating life sale must have an illustration
- May not illustrate rider with base
- Must distinguish between guaranteed and non-guaranteed elements

2000 was the first year of pension privatization. Annuity products were introduced to serve this market. These annuity products are old-fashioned annuities where the contracts specify the number of premium payments and the amount of annuity payments at the time of issue. The accumulation and payout phase are all part of the same contract. The Malaysian government has stopped this business in the middle of 2001 amidst concerns about the contracts not providing good value to consumers. It is unclear when this market may open again.

Thailand

Thailand's insurance market is still developing. The government has very strict rules which limit the amount of gross premiums as well as sets the minimum reserves. The minimum interest rate used in the gross premium calculation was 6% despite the fact that the bank deposit rates fell to the range of 1%. The government was slow to lower this rate but finally lowered it to 5% in early 2001 and 4% in late 2001.

Amidst all the discussion on interest rates, the official mortality table also changed. All products sold after January 1, 2002 will have

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to be priced on the new mortality table. As a result, there was a backlog of products to be approved in late 2001.

Summary of Regulations

Products must be filed and approved
Maximum gross premium is TMO 97 at 4, 5 or 6% plus specific expense loading
Minimum reserve is TMO 97 at 6%, 5%, or 4% with FPT or Zillmer modification
Estimated dividends are filed but no need to inform to insurance department of dividends

Since gross premiums are tightly regulated, actuaries often face the difficult task of designing products that meet corporate profitability requirements.

The main distribution channel in Thailand is agency force. The activity and productivity rates in agency force are quite low. As a result, the key to growth is the number of agents. New entrants to the market are offering lucrative golden hellos to agency leaders. The resulting price war is making it a difficult and expensive market to develop agency force. The actuaries are given the unenviable task of making sure the distribution costs are covered by the expense loading dictated by the regulators.

Indonesia

Indonesia, one of the most populous countries in the world together with easy entry and little regulation, brought many foreign players to this market. However, the country is still undergoing turmoil making the operating environment very difficult.

The Chinese population in Indonesia is affluent and is a natural target market by the insurers. Specific products such as education and savings may be designed to attract the Chinese market. Insurers may also have programs to recruit Chinese agents in order to penetrate the Chinese market.

Summary of Regulations

Products must be filed and are assumed to be approved after two weeks unless told otherwise
No specific requirements on gross premiums
Minimum reserve is 1980 CSO at 9% (Rupiah products) and 5% (USD products) with Zillmer modification
No requirements on minimum cash values
No regulation on dividends or illustrations

Philippines

Unlike many other Southeast Asian countries where there is a strong British influence, Philippines has been heavily influenced by the United States. The regulations are therefore quite similar to that of the United States.

Summary of Regulations

Products must be filed and approved
No specific requirements on gross premiums but Insurance Commissioner makes sure expense loading is unfair to policyholders
Minimum reserve is a standard table (e.g. 1958 or 1980 CSO) at 6%. FPT, CRVM and NLP are acceptable.
Minimum cash value is 80% of reserves or reserves less 25 per mil (smaller of the two for Peso products and larger of the two for USD products)
Initial dividends are filed and approved
No specific regulation on illustration

Greater China—Mainland

Insurance and financial services industry is quite new to China. China has held a tight leash on the market by limiting entrance to the market as well as regulation to control the market. The goal is to control market liberalization so the local players can adapt to the competition over time.

The regulatory body has also changed over the past few years. People's Bank of China (PBOC) was the central bank as well as the regulator for the financial services industry. Newly created China Insurance Regulatory Commission (CIRC) is now in charge. CIRC is likely to continue the tight control on the market in the near feature.

Summary of Regulations

Products must be filed and approved
Maximum pricing interest rate limited and expense loading is subject to specific limits
Minimum cash value must be calculated using gross premium assumption plus 2% of interest rate
Minimum reserving rate is the pricing rate or a yearly specified rate by CIRC

Participating products and investment-linked products are two new innovations in the market. It is unclear what the regulation may be on these two products. Recent negative publicity over high growth return illustrated in investment-linked products may accelerate development of more stringent regulation on illustrations.

Greater China—Hong Kong

Hong Kong is known for its friendly environment towards business. This is evidenced by the fact that many multi-nationals choose to set up regional offices in Hong Kong. Insurance regulation is no exception.

Summary of Regulations

Product filing is not required as long as insurers have obtained the license for specific class of business but investment-linked products need approval from the Securities and Futures Commission
No specific requirements on gross premiums
Minimum reserve is 1.5 year FPT subject to Zillmer of 3.5% sum assured
Valuation interest rate must be at most the prudent asset yields less 2.5%
Participating Products

- No regulation on dividend and cash value scales
- No regulation on surplus split between policyholders and shareholders

Illustration

- Must clearly define guaranteed and non-guaranteed benefits

Greater China—Taiwan

The market is quite regulated in Taiwan. Many foreign players have branches rather than subsidiaries in Taiwan due to a past regulation that foreign entrants must be a branch of a stock company.

Summary of Regulations

Products must be approved
Minimum reserve is 1989 TSO at lower of the pricing rate or MOF declared rate
Minimum cash value required on long-term life insurance products is a percentage of reserve with percentage grading to 100% over time
Participating Products

- Policyholder dividends are based on the difference between pricing and MOF declared experience
- Recent changes in regulation allow companies to choose their own policyholder dividend formula

Illustration

- Currently under study by MOF working group

Dividends on participating products were paid based on the difference between pricing and industry experience as declared by the Minister of Finance (MOF). This has been the case until recently when the companies were allowed to choose their own dividend formula. Additional changes are expected on illustration once the MOF working group makes their recommendation. □

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