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Recovery and Regulatory Changes in Indonesia

by Richard Holloway

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Following one of the worst periods in the history of Indonesian life insurance industry, it has been showing signs of recovery. This, coupled with some regulatory changes designed to improve the financial condition of companies, provides encouraging signs for an industry that has been severely battered and bruised through the recent economic and political problems.

Recovery

Prior to the economic crisis, the life insurance industry had been growing strongly. Total premium income more than quadrupled in size over a 6-year period, growing from Rupiah 0.8 trillion in 1992 to Rupiah 3.6 trillion in 1997, implying a nominal average growth rate of 35% and a real growth of 25%. The collapse of the Rupiah at the end of 1997 and the ensuing economic and political upheaval have both caused a variety of problems within the industry. Many policies were surrendered and new U.S. dollar-denominated business all but disappeared.

Many commentators were skeptical about the pace of recovery in 1999, particularly with the prospect of the Presidential elections hanging over the country. In practice though, 1999 was a good year for the industry. Total premium income was Rupiah 5.4 trillion, based on data submitted by 49 of the 58 companies in the market, as compared to Rupiah 4.9 trillion for the entire industry in 1998.

Although the whole industry has recovered to an extent, it is the foreign joint venture companies that have been experiencing much of the growth. The financial crisis badly affected the image of many domestic conglomerates and banks. This has resulted in a "flight to quality and security" from which the joint venture life insurance companies have benefited.

Regulatory Changes

A summary of the major regulatory changes introduced post-crisis is provided below:

- ***Foreign Equity Cap***

Prior to the economic crisis, foreigners could hold up to 80% of the equity in an insurance joint venture. The recent economic environment has made it impossible for the majority of the domestic partners in the joint venture to raise additional capital.

There have been several situations where foreign joint venture companies have not been able to inject much needed capital without contravening the limits on foreign equity. As a result, the regulator has relaxed the foreign shareholder maximum of 80%. However, although a foreigner can dilute the domestic equity, it cannot buy existing shares owned by the domestic partner. New companies do still need a domestic shareholder; at the time of establishment the foreign shareholding is still capped at 80%.

- ***Capital Requirement***

After much discussion about the inadequate level of capitalization of the industry, the Government finally issued a ruling on July 2, 1999, stating that new insurance companies will be required to have a minimum paid-in capital level of Rp100 billion. Previously the regulations had required minimum paid-in capital levels of Rp2 billion and Rp4.5 billion for domestic and foreign joint venture life insurance companies, respectively. Existing insurance companies are, however, unaffected and are still governed by the previous low levels.

- ***Solvency Margins - Risk Based Capital***

Following much debate among the industry, the regulator has formally introduced more onerous solvency margin requirements. These are based on a risk-based capital (RBC) approach, similar to that which is found in Canada. Each insurer has to meet solvency margin requirements in a stated proportion to various risks.

The solvency margin is being phased-in over a five year period. Initially insurers are required to hold 5% of the calculated solvency margin by the first quarter of 2000 increasing to the ultimate level of 120% of the calculated solvency margin by the end of 2004.

Possible Implications For Insurers

Each of these changes are designed to improve the financial soundness of the industry. If the regulations are strictly enforced, the new solvency margin requirements will focus more attention on the capital requirements of the business. This is likely to affect many of the smaller companies, with a likelihood of industry consolidation in the short to medium term.

In addition to understanding how to calculate the new solvency margin, it will also be important for companies to project the solvency margin and capital requirements in the medium term. The requirement to hold more onerous solvency margins may also impact on product profitability and prompt consideration of alternative product designs.

Other Changes

Other recent changes include the approval of investment linked business (which was previously considered to be

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indirectly prohibited by the reserving regulations) and a relaxation on the rules for foreign investment whereby up to 20% of an insurer's total assets can now be invested overseas. Companies have already started to successfully introduce single and regular premium unit linked plans, several of which are linked to funds in a variety of currencies. Matching of US dollar liabilities with overseas assets is also becoming more prevalent.

The Future

Despite the well-publicized economic and political problems, there are signs that the life insurance industry in Indonesia is recovering. Prospects for growth in the short term are good. Although we expect some consolidation within the industry, the absence of an array of attractive acquisitions means that growth will be largely organic in nature.

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International Sessions at the Annual Meeting

by Michael Gabon

Following are summaries of sessions and events sponsored by the International Section at the upcoming Annual Meeting. Plan to attend the sessions and join us for a Tuesday early evening reception at Chicago's Cultural Center and breakfast on Wednesday, Oct. 16-18.

Who Wants To Be an Offshore Reinsurer? IF 34, Monday, Oct. 16

This session provides reinsurer, regulator, and rating agency perspectives on the use of reinsurance with offshore entities. In doing so, onshore ceding companies will be better informed, as will those firms considering entry into the offshore market place.

Penetrating the Great Wall of China PD 53, Tuesday, Oct. 17

For several years only a few foreign insurers were permitted to provide life and health insurance in China. In recent years, regulators have been more receptive to the entry of foreign insurers to service the population of over one billion. This session will provide you with a better understanding of the opportunities and obstacles of the insurance marketplace in China.

International Nontraditional Marketing CS 69, Tuesday, Oct. 17

As companies seek profitable growth, international expansion and utilization of nontraditional marketing methods are often given consideration. This session allows you to participate in a case study discussion of a company developing its strategy for entering a foreign market place, using alternate marketing methods.

Critical Illness: Surviving 5 Continents PD 85, Tuesday, Oct. 17

Critical Illness, introduced in the early 1980s, made its way around the globe in insurer product portfolios in a little over a decade. Attend this session to gain a background and basics. Attend the follow-up session to discuss experience, issues, and opportunities in offering the product in markets outside North America.

Savings and Retirement Plans in Developing Countries PD 86, Tuesday, Oct. 17

Latin America, Southeast Asia, and Eastern Europe are recognized as regions with relatively untapped private insurance markets. However, recent changes in social security systems have dramatically changed the playing fields. This session presents opportunities insurers are exploring in the public and private savings and retirement market segments of the above regions.

Early Evening Reception FT 102, Tuesday, Oct. 17

Join friends and colleagues while savoring the food, entertainment, ambiance, and taking a guided tour of the Cultural Center, one of Chicago's most historic buildings.

International Section Breakfast SM/PD 111, Wednesday, Oct. 18

Join Section members to hear more about the Ambassador Program and briefings from our SOA Ambassadors. In addition, participate in discussions about issues facing the International Section.