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Life Insurance: The Philippine Modification

by Mabini L. Juan

It was in 1966 that an industry was born that would provide the public with an alternative product that could address their insurance needs. The beginning was in the area of memorial or life plans which would answer for their funeral expenses. Given the scope of coverage, the amounts involved were modest. The product differed from a life insurance policy in three aspects: (1) the benefit was the delivery of services regardless of the actual cost at the time of delivery (hence, not fixed at issue); (2) the mortality risk was passed on to a selected life insurance company that provided creditors life and term insurance coverage on the life of the contract buyer under a group insurance; and (3) the contract was transferable. Furthermore, the product was registered with the Securities and Exchange Commission as a security. Given that this initial product focused on a specific need, they were labeled as "Pre-Need Plans" and the companies offering

such contract as "Pre-Need Companies".

Then in 1977 another product line was introduced: Pension Plans. This reference appeared inappropriate in as much as the benefit at maturity is usually paid in lump sum. These plans were sold to address individual financial needs at retirement. In reality, the plans sold had shorter maturity periods and could be considered as savings plans with substantial life insurance coverage up to their maturity dates. Although comparable to endowment plans, these contracts passed on the mortality risks to an insurance company.

In 1980 when the pre-need concept was applied to future payment of college tuition fees, a strong market acceptance was recorded. Given the Asian tradition that parents provide their children the best education possible (at least better than what they themselves went through), sales resistance was nominal. The ensuing sales success was triggered by the concern (which still currently prevails) that tuition fees can increase significantly. It then made sense to pay such future need with current financial resources. The payment period was usually for five years. These contracts were referred to as traditional education plans where, at maturity, (usually at age 17, when the child is assumed to enter college) benefit payments will cover the full tuition fees of the particular course/college chosen. This plan differs from the first two types in that there are two lives involved: the "planholder" (usually a parent paying the contract price) and the "scholar" (the child who would avail of the benefits).

Other factors that contributed to the sales growth include:

1. Product simplicity and features led to the hiring of a large number of sales counselors that, in most cases, needed only a half day of training to start selling.

2. In the beginning, there was no regulatory body to supervise the marketing or operations of the industry. This "free environment" led to a number of aggressive sales campaigns and product promotions.

3. Insurance coverages were extended on liberal terms since group insurance underwriting rules were adopted. There was extended insurance protection for the other family members and some companies even offered certain hospitalization benefits.

With the unexpected Asian financial crisis in 1997, the viability of the pre-need plans came under heavy fire. The increases in tuition fees significantly exceeded expectations/assumptions and market values of real estate. Stock portfolio also deteriorated and earnings of other investments plummeted to single-digit rate (a lot lower than the 12 to 15 percent used in the pricing model).

To counter the adverse financial situation, contract price increases were filed and adopted. The industry players adjusted their prices using a more conservative (and achievable) interest assumption and generally stopped offering traditional education plans. Contract change to fix the amount of tuition fees payable at maturity was introduced in the new plans.

The financial issue centered on fully-paid plans that provided for increasing liabilities beyond the actuarial assumptions used while the assets that have been accumulated were earning much less than the interest used in the pricing model. How does one strike a viable balance between these items?

An immediate need was the actual measurement of such mismatch with the use of realistic assumptions. The identified variance must be addressed by a number of initiatives that the company concerned should immediately undertake.

An infusion of additional capital was the initial option considered. Allocating more corporate assets or capital infusion by stockholders should help bridge the gap. Unfortunately, there is a short supply of surplus funds.

While other solutions are still being explored, time may not be on the side of the industry given that the related liquidity requirements arising from the payment of benefits may not be covered by installments paid and short-term investments. In addition, 2003 sales have been modest while 2002 registered a decline over 2001.

Actuaries of these pre-need companies face formidable challenges not only in the proper measurement of the liabilities but also in the formulation of action plans to address the asset/liability mismatch.

It is expected that a clearer financial picture will emerge by the end of this year.

Will this industry, which recorded strong and sustained growth up to year 2001, survive?

Hopefully, I will be able to submit a rosier picture in early 2004. ☐

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The 4th China Congress of Actuaries

by August C. Chow

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This 4th Congress was attended by over 200 actuaries, insurance professional and industry representatives from China and overseas. Invited guests representing overseas and international actuarial bodies included Yves Guerard (International Actuarial Association), David Lewis (United Kingdom Institute of Actuaries), Shu-yen Liu (Society of Actuaries), Alex Zu (Casualty Actuarial Society), Won How Lo (Actuarial Institute of Taiwan), Peter Luk (Actuarial Society of Hong Kong) and August Chow (Canadian Institute of Actuaries). The meeting was held in a resort hotel in Chengdu, a major inner city in China with a population of 10 million.

The main theme of the conference was "Actuarial Professionalism—Mission and Responsibility." Mr. Yves Guerard, the secretary general of the International Actuarial Association, gave an opening address, which was followed by a welcome address by Ms. Yao Hezhen, vice president of China Reinsurance Company, the sponsor of the Congress. Mr. Wei Yingning, the vice chairman of the China Insurance Regulatory Commission (CIRC), delivered the keynote speech.

The two-and-a-half day meeting covered a variety of topics on the roles and responsibilities of actuaries from the regulatory, industry and professional point of view; the challenges to actuaries; the life, pension and casualty insurance in China; the proposed IAS international accounting standard; and the insurance agency and the supervision of market conduct.

During the meeting, the CIRC released three draft regulations on the interim measure of (1) the administration of practicing actuaries in China, (2) the professional code of conduct of actuaries in China and (3) the continuing professional development of actuaries in China.

At the end of the conference, a number of delegates joined the scenic tour that was organized by the conference committee. ☐

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