Article from:

International Section News

June 2003 – Issue No. 30

The Mysterious East, Part One

A Review Of Asian Life Insurance Markets — Issues & Challenges

by David Rosier

Editor's Note: the following article is reprinted with permission. It last ran in Vol. 18, No. 4 of On The Risk.

Executive Summary: Asian insurance markets generally possess enormous growth potential and insurers from around the world are continuously being tempted to enter the region. From a risk management perspective, much misconception exists concerning the nature of the markets, the approach to risk evaluation and management and the issues and challenges that are being encountered.

This article attempts to dispel some of the "myths" around the perceived unique nature of Asian markets. Part I addresses the nature of the markets, the business drivers and the issues and challenges being encountered. Then, in Part II, from a risk management perspective, the current situation is reviewed, issues identified concerning the future development of appropriate skills to tackle the inevitable rapid growth in customers under management and the anticipated diversification in terms of product coverage and distribution approaches.

The world continues to "shrink" and our customers will become increasingly more mobile. Appreciation of international markets will be a key requirement for risk managers in the future.

Introduction

I can hardly believe how many years have gone by since I last wrote on Risk Assessment in Asian Markets—at least six years! Another article is arguably long overdue. This may be particularly relevant as many leading risk managers are currently pursuing objectives of seeking to link underwriters around the world in common development pursuits. Greater awareness of the nature and differences of the environments in which our industry operates is hopefully beneficial as is the reality that we all operate by principles/practices, and deal with issues, that are fundamentally the same the world over. If this article helps dispel some of the "myths" as to the perceived alien nature of markets in Asia compared to the markets of the "West" then I will have achieved my objective. If this assists in the process of creating a global underwriting community linked by events such as the International Underwriting Conference, I will deem the effort more than worthwhile.

My last article took the form of a "Great Train Journey" around Asia and I have resisted the temptation to simply update you on latest developments. This time, I want to take a different approach. I am working on the assumption that if you do not understand the fundamentals of the markets, then it is difficult to fully appreciate the challenges of those involved in operational risk management (underwriting and claims).

Given the majority of the readership reside outside of Asia, I felt it important to provide an insight into the market fundamentals within Asia which, despite the diversity of the countries involved, prove to be the core driving forces in the evolution of the life and health insurance industry.

Why would any of this be of relevance to an underwriter in North America or Europe? Firstly, the world is a shrinking "market" where national boundaries are less of a barrier to our business. Secondly, so many of us are part of multinational organizations, which either currently operate in Asia or have ambitions to do so. Finally, we all deal in essentially the same principles and practices, which drive our business—appreciation of these similarities will hopefully support the linkage of markets and professional associations around the world in common pursuits for enhancing our understanding of risk and its management. As I look back, one of the strongest impressions is the amazing speed at which Asian markets have developed and, to a degree, matured in response to competitive pressures. In recent years, most markets have had to face up to the challenges created by rapid growth in distribution capabilities (agents). From an operational viewpoint, companies have struggled to deal with business efficiently while managing risk effectively. The challenges have been compounded by an explosion of product diversity and coverage features. Profit margins continue to be challenged as companies struggle to absorb operating costs.

My final comment in this preamble is that my observations, while drawn from a long period of being involved in risk management in Asia, are by no means just my own views.

In seeking to compile this article, I have spoken with many underwriters, operational heads and claims assessors around Asia, both from within my own organization and beyond, and whose opinions I respect and value. To all these people who were so willing to share their experiences and wisdom, a sincere thanks.

Life Insurance Markets in Asia

Firstly, let's consider the issues and challenges, which currently face life insurers in Asia and then relate that to the process of risk evaluation and management. For the purposes of this article, I have excluded Japan and Korea from the review as they represent markets, which are virtually impossible to compare with the rest of the region, and possibly warrant their own separate article.

Preamble

Arguably, I am in a somewhat unique position to comment on where the markets are today—where they have come from—and where they may be leading. During the years spent in Asia, I have been involved with virtually all Asian countries as a direct insurer and/or reinsurer.

While you may rightly conclude the issues highlighted are no different, at least in nature, to your own markets, I would suggest that very few areas of the world have experienced such rapid growth in terms of new markets opening and new players gravitating to those markets. Development cycles, particularly related to products, have shortened dramatically such that new products in North America and Europe experience virtually no "lag" time before entering the Asian markets. Critical Illness being a good example of that phenomena.

Market Development

Having resisted the temptation to provide a country-to-country "potted" history; it is suffice to say life insurance in Asia has been around a long time. Multinationals such as American International Group (AIG) and Manulife have been operational close to or in excess of 100 years.

It would be true to say, however, that until the last 10-20 years, development has been rather slow with only "limited" competition both from local companies and the leading multinationals. Japan and Korea developed virtually with no foreign interest and many markets simply developed on the back of old colonial influences together with a number of true pioneering companies. As growth slowed in mature Western markets and wealth increased (in absolute terms and in distribution) in certain Asian countries, the time has been ripe for rapid expansion.

As countries generally seek to remove "trade barriers" and virtually all governments embrace the global economy, this trend of growth in both number and diversity of providers in Asian countries will continue, slowed only periodically by economic slowdowns and reality checks to insurers in terms of the cost: benefit analysis of operating in certain markets.

Generally, however, the outlook remains positive with, collectively, huge untapped potential across the region with "consumers" apparently keen to save and interested in protecting their families.

As a possible counter to these positive demographics is the uncertainty as to the speed at which markets should develop, and the wisdom in forcing new and complex forms of distribution and products into unknown environments in the pursuit of accumulative growth, which may or may not turn out to be profitable.

...the outlook remains positive with, collectively, huge untapped potential across the region with "consumers" apparently keen to save and interested in protecting their families.

Market "Players"

It would be wrong to give the impression that all markets are totally dominated by multinationals—the reality is there are some very credible local companies in most markets, although one has to speculate what the future will be for these entities without joining the global "rush" to consolidate and therefore partner with a multinational. The nature and size of local players have been strongly influenced by the regulations, which have permitted or restricted foreign entry to the market. In recent years, barriers have generally dropped regarding market entry, be that in terms of absolute new licenses or through acquisition or partnering with a local company. This has led to a surge of new entrants from around the world. Recently, however, economic realities have seen several of these organizations retreat from markets such as Philippines, Thailand and Indonesia.

China leads the "interest stakes" when it comes to market entry, with in excess of 50 companies queuing up for licenses and a handful already operational, but with licenses that are highly localized from a geographical perspective.

While we are, therefore, in a period of rationalization and consolidation in many markets in terms of absolute number of players, this should lead to stronger entities with a desirable mix of foreign and local expertise in the management team.

Joint venture operations were at one time seen as the "ideal" model, bringing together the appropriate mix of local and foreign expertise and influence. Certain governments

continued on page 6

insisted this be the only model to pursue and "protected" local interests such that they always retained a controlling interest—China still operates this model for life companies.

Sadly, so many joint ventures failed to work, as both parties had probably taken inadequate time to learn about each other during the "courtship" period. All too often inequity in the relationship existed at outset and good intentions failed to close the gaps. Economic problems including insolvencies for local J-V partners have also been a problem in recent years for certain countries.

The reality appears that the most successful companies have a strong management team with an appropriate mix of expertise (foreign and local) and which pursue a long term strategy of profitable growth built upon certain core competencies related to financial and risk management, plus product and distribution development expertise. Their ownership structure is somewhat academic, although some form of affiliation for a local entity with a multinational does allow access to the knowledge and skills of other markets and so reduces an unrealistic dependence upon a reinsurance relationship.

Ownership structures are most definitely relevant to risk management, as they determine the level of growth and success that is expected and the time frame. Internal battles between partners can destroy companies, due to inconsistent and inappropriate strategies reflecting the ongoing power struggles around management control.

In summary, I see markets being led generally by the large and established multinationals, who will become stronger as they build on sizeable inforce blocks of business (and inherent profitability), plus already successful and financially strong local companies who form equitable partnerships or alliances with a foreign entity.

For all such companies, the focus and challenge will remain on creating essentially local management teams and skills irrespective of the ownership structure.

Many companies are arguably chasing unrealistic growth and profitability targets driven by overly optimistic assumptions regarding the market potential.

Market Diversity

It is very difficult to discuss Asia as a single entity given the diversity of the region from a cultural, political and economic viewpoint. For life insurers, there is just as much diversity with countries with NO life insurance industry through to "mature" markets. As mentioned previously, all are challenged by a number of common issues.

For the sake of simplicity, I would categorize markets in the shaded box above.

Market Categories

Mature

- Reasonably high product penetration
- Focus on customer retention and increased relationship value
- Emergence of alternative distribution

e.g. Japan/Korea, Hong Kong and Singapore

Developing

- Still considerable potential for new customer sales
- Predominantly ties agent distribution

e.g. China, Vietnam, Indonesia, Pakistan and Bangladesh

Closed

- Laos, Cambodia and Myanmar...

I will refer to differences in approach for risk management later in this article based on its categorization.

Market "Realities"

Let us now tackle the issues, which are exerting the strongest influence on the way markets are evolving and directly impact upon how risks are evaluated and managed.

Competitive Pressures

It is generally agreed most markets have more than enough players for the current market size and potential (with possibly the exception of India and China). Many companies are arguably chasing unrealistic growth and profitability targets driven by overly optimistic assumptions regarding the market potential.

In such an environment, a few will thrive—many will retreat. Those that remain will ultimately benefit from the consolidation. Pressure will remain on growth (and assumed profitability), but with an anticipated economic revival, the risk is there will be a repeat of the cycle with surge of entrants and an unhealthy intensification in competition.

Competitive pressures will see all companies seeking to maximize distribution capabilities, focus on operational efficiencies and develop ever-increasing product diversification, together with "streamlined" risk management. This scenario represents a tremendous challenge from a risk management perspective.

For risk managers, the challenge will also be around managing products, which have a much shorter life cycle, as new variants rapidly emerge in response to competitor activity. Distribution capabilities will increase numerically and expand into new areas, particularly in seeking to serve the customer better and to increase the value of that relationship to both insurer and policyholder.

Regulators may at times be overwhelmed at the pace of change. Most are and will seek additional controls, which will go beyond just financial strength of the insurer and focus on ensuring "value" for customers. While these issues are not unique to Asia, it is the speed of underlying business growth in Asia, which makes this such a challenge to manage.

Consumers

Our policyholders and target consumer groups are becoming far better informed given increasing media interest in our industry and the emergence in many markets of consumer protection organizations. There is nothing inherently wrong in this and arguably a better-informed consumer should make a better customer, so long as they receive good service and perceived/real value in the products they purchase.

Here lies a challenge to the established players who have grown on a business model of simple products—"fat" margins—basic service. No longer will this be acceptable to the new Asian consumer and is not the strategy adopted by new entrants.

A by-product of greater consumer awareness in companies with weak risk management is an increase in fraud and this should not be underestimated.

Products

As mentioned earlier, virtually all markets are characterized by the introduction of increasingly complex and diverse products whose "shelf life" is often very short (compared to five-10 years ago).

Price has tended not to be a driver in a tied agency dominated market and breadth of coverage and the risk selection approach has been the main driver.

Another phenomenon is the shortening product development cycle where historically products developed in Western markets have taken several years to find their way into Asia. No longer is this the case, as multinationals introduce products they believe will prove attractive. Critical illness has been a good example of this aspect of the business. The lack of experience in mature markets has obvious risk management implications in the less developed markets.

In many product areas, risk management expertise lags sales and this is a major concern for both direct insurers and reinsurers.

Distribution

The traditional "tied agency model" is alive and well and in virtually all markets in Asia forms the dominant method of distribution. This creates certain perceived advantages concerning a company's ability to train and educate and perhaps even control the sales environment. Sadly, reality is far from that vision of "Shangri La." Pressure to obtain sales has resulted in limited initial training. Attrition rates for agents are high in the early years and those that succeed are regularly courted by new companies (as are their customers). Agent poaching and "twisting" of business are major concerns in many markets.

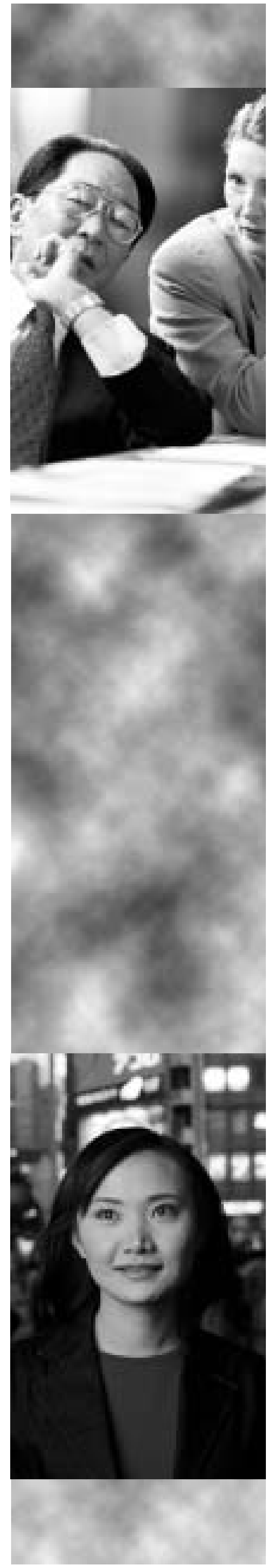
None of this is good for the industry and its reputation. Regulators in some markets have, more recently, sought to impose minimum education/training standards for agents and protection for policyholders tempted to switch coverage to the new company of their agent. All credible responses to these dubious practices.

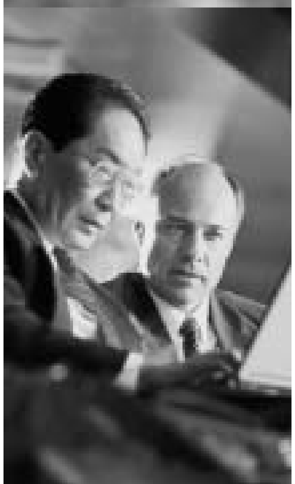
At ready markets, such as Singapore, have taken on regulation from UK and Australia, which requires hard disclosure of commission with related sales practice controls. The tied agent is arguably starting to become an endangered species.

Banks are also awakening to the potential of selling insurance to their customer base. In Hong Kong, this has come to challenge the direct insurers for market leadership. Elsewhere, progress is slower but models are emerging that indicate the validity of banks selling a full range of financial services to their customers.

From a risk management perspective, the nature of distribution should determine an appropriate approach to risk selection. The highly competitive environment, however, will determine the need to be cautious concerning the completeness and accuracy of the disclosures made. Tied agents are often only marginally better informed than the applicants concerning materiality of information. As field force size increases, the problem will be compounded. Rarely does the nature of risk

continued on page 8





and its evaluation receive appropriate coverage in agent training programs.

Customers

The "customer is king" phenomenon is certainly trying to establish itself in many parts of Asia, driven by the increasing awareness and expectations of consumers regarding service and value. Insurers are coming to accept that, as markets mature, the need is to not only acquire customers but to retain them longer and increase their spending and therefore value.

Historically, this has not been a market driver as rapid growth of new customers was achieved on relatively low acquisition costs. Today, the model is changing and companies must retain customers longer and enhance the value they represent.

Customers will demand services and products, which will recognize their status and value. As part of this phenomenon, new risk management/evaluation approaches will have to be created. All customers are not "born equal" and companies will need to recognize and respond to that reality not only in the products offered but also in the way in which risk is perceived and quantified.

All of this will challenge the traditional tied agency model where service to existing customers has been generally limited and provided normally by the original or servicing agent. Insurers will need to become more directly involved in this relationship.

Technology

There is no doubting for the major players, at least, a technology revolution is under way, driven primarily by a need to increase capacity, enhance efficiency and extend the service model. Growth potential supports the need to invest in technology. Increasing staff costs in many markets means the once plentiful supply of human resources is now recognized not to be the ultimate solution to production needs, although most companies understand that we remain very much a "people orientated" industry.

The emphasis has been on enhancing the ability to capture and manage policyholder data, although more lately there is a move to extend into the quantifying of risk and managing the customer relationship. Finally, and perhaps most importantly, is the expansion of a range of "Point of Sale" tools, which will enhance the agent's ability to prospect and then conclude a sale.

Risk management process will need to adapt to this new reality, recognizing that a large percentage of business needs to be handled automatically with emerging gains regarding efficiency and consistency. A reduced percentage of cases will continue to need individual risk management. There is an increasing appreciation as to where so-called "expert" systems should be applied, i.e., to handle the bulk of the business, typically well over 90 percent that will be accepted at standard rates, much on application disclosures only.

As mentioned, point of sale delivery, in an online or offline environment, will be a critical area of development. Risk managers can and must control the rule base, but delivery can and should be as close to the point of sale as possible. This will "empower agents," reduce the typical 15-20 percent incomplete application rate, enhance efficiencies and, most importantly, provide customers with a considerably enhanced service.

Regulation

Clearly, the potential and real impact a regulator can exert should never be under-estimated. This is particularly true in Asia where country regulators meet regularly, share concerns and experiences. While rarely following uniform approaches, they do draw heavily from each other on deciding market approaches as well as linking with the international regulator community.

While mature market approaches exert considerable influence, they are not the sole driving force in defining appropriate regulation. Regulator understanding of the business and the workings of the market environments is increasing rapidly, although often the government departments lack the necessary experience in depth and struggle to recruit appropriate skills.

While financial viability of an insurer remains a core responsibility, most regulators see their role to also ensure appropriate value for the consumer, and this has seen a focus and involvement in areas of distribution increase significantly.

Risk management is only starting to receive significant attention prompted by the terrible events of 9/11 and a realization companies should be able to quantify risk and ensure they are managed adequately.

Beyond the insurance regulator, certainly in the developed markets, other areas of government are taking can increasing interest in issues such as privacy, data protection and discrimination, such that the insurers will inevitably have to join the worldwide crusade to preserve the "right to underwrite."

The "People" Factor

This has deliberately been left until the last of the general aspects because it underpins the whole industry. Despite all the potential advances in our ability to evaluate, process and manage our business and serve our distributors and customers via automated solutions, we will, I believe, remain essentially a "people business." The business models being developed and employed in Asia necessitate enhanced skills both technical and interpersonal. Despite automation, inter-personal skills remains vital to create strong and durable relationships with customers (and agents), as does the expertise to make informed decisions as to appropriate responses to growth opportunities and competitive pressures.

There is a critical shortage of the skills and expertise needed by the industry to realistically capitalize on the growth potential, and this is particularly true when it comes to risk management.

In the past, our needs in terms of skills were reasonably easy to define and, to a degree, train and develop. Then retention of those skills was the greatest challenge. Today, the same issues apply but are compounded by the need for multi-disciplined staff that need, not only technical expertise, but also the communication skills to service agents and customers. There is an increased need to be fully conversant in the overall complexities of the business rather than specialization in a single function.

Lessons are being learned regarding the reality that strong technicians do not necessarily make good operational managers. Career paths have to evolve for technical specialization in addition to the traditional management model.

Companies create self-inflicted problems when political bias or supposedly cultural sensitivities cloud the issue of developing and appointing the appropriate individuals. Surely it is inherently wrong to select the best person available, as defined by some artificially created requirement to recruit "locally?" Some markets still have to come to terms with this issue. This is not an argument for "expats" but a recognition that skills take time to create and companies have to invest in this process and consider the movement of expertise to where it is needed to create a "skill transfer." This needs incentives to create that mobility of expertise and careful selection of the appropriate people. In the end, this has to be preferable to a local salary war.

The costs of local vs. foreign staff weighs heavy on management, but in the end the supply and demand equation must prevail. New markets lack local expertise—an indisputable fact. Skill development takes time and requires investment and involvement of "external" resources. Skill development is a cost of new market entry and growth, but often overlooked in a belief a detailed enough process guide and rule book will suffice. Finally, any career development plan must deal with reward and recognition leading to the required retention of the skills created.

Localization of authority and management is clearly the ultimate objective and the business model should work toward this, but it takes considerable time and investment to achieve and assumes key staff can and will be appropriately retained.

To conclude this review of Asian market conditions and issues, it is clear that the perceived potential of the region will ensure it remains the focus for virtually all leading multinationals as they seek to obtain growth and profitability levels which are not possible in "home" markets.

While competition continues to intensify, the business model will also evolve and do so more rapidly than in the past. The expense of market entry and the assumptions as to business targets on growth and profitability will have to be realistic—unlike the recent past—otherwise operations will rapidly become unviable and exit the market (as is happening currently in Philippines/Indonesia/Thailand).

Insurance will remain essentially a "people business" from the tied agents through to those who serve and support the customer relationship. Technology will only support the business objectives through efficiency and enhanced service, but should never replace the human contact in what should be a long-term relationship. The consumer, "aided and abetted" by the regulator and the media, will truly become "king" in determining what he wants, how much he is willing to pay and how he expects to be serviced. Companies who ignore that reality will eventually lose market share in the developing countries. The question to be addressed in the second part of this article is how well are those in risk management coping with this new and rapidly evolving environment? Where are the strengths to build on and the weaknesses to eradicate? ☐

David Rosier, FSA, MAAA, is vice president for risk management, Asia for Manulife Financial. He can be reached at david_rosier@ manulife.com.