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It Is Politics

By Nian-Chih Yang

You heard a sigh of relief when the haggling in the U.S. Congress over the health care reform bills was over. A compromise was reached and majority ruled, as it ought to be in a democracy.

In another thriving democracy on the other side of the Pacific Ocean, theatrics as in the United States are also unfolding. Partisan politics played out in Taiwan is as intense, if not more! Watching political talk shows is a national pastime. These programs are broadcast live during the prime time and always receive high ratings. Interestingly, tourists from neighboring regions are known to choose staying in to watch these programs over going out on the town. The programs tend to have obvious political leanings and are blamed for fueling political polarization. They are full of conspiracy theories and false accusations. Objectivity is secondary to attaining high ratings.

It is difficult to have a constructive discussion on public issues in this charged environment. Policy debates quickly turn into finger pointing and mudslinging. Public officials on the island country govern with their eyes on the polls constantly and take the route of least resistance. Sadly sometimes the polls only reflect the shortsightedness of the public. The desire of staying in office results in quick reversals in decision and temporary fixes.

EPISODE I: HEALTH CARE SYSTEM DEBATE

In early March, Yaung Chih-Liang, the health minister in Taiwan, suddenly announced his resignation. It is because he would not go along with the premier's proposal where 75 percent of the people should be unaffected by the premium increase for the national health care plan and only the wealthiest 25 percent should be made to pay more.

Minister Yaung had previously been blamed within his own party for making blunt statements on rate increases at inopportune times that might have contributed to a few defeats in local elections.

He felt obligated to transform the program into a financially viable system. The system is under stress, with a projected US$3 billion shortfall by the end of 2010. The majority of the rising costs, similar to the United States, came from the aging of the population and demands for high quality care with the latest technological and medical advances. The deficits increase over time. The issue of fraud and drug pricing contribute only a minor part to the rising cost problems.

Minister Yaung blamed the issues on a short election cycle (yearly elections), which he claimed made so the government unable to put forward a sensible policy (e.g., delaying necessary rate increases). During his resignation press conference, he even offered to put up his own money for a referendum of election reform (fewer elections).

Minister Yaung's resignation announcement quickly turned public opinion to his favor. The premier modified his position. The government will now make up the funding shortfall, even though the rate adjustment is still limited to the wealthier group.

The minister had to deal with the pressure from the opposition party, which was in office for

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eight years prior to the current administration and had ignored the deficits. However, the prior administration's role in current problems has not stopped them from accusing the present administration of not having a consistent policy and lacking the backbone to take on difficult decisions.

Aside from the funding obstacle, the public regularly gives high marks to their health care system. The health care program is generally credited with providing freedom of selecting service providers, a high level of care, universal coverage, a broad range of services (including Western medicine, dental, traditional Chinese medicine and mental illness services,), easy access, short waiting period, and low costs. The single-payer, government-administered system, coupled with advances in data processing capability, provides a high administrative efficiency to the health insurance system in Taiwan. The adoption of the electronic identification card and the payment of fees directly to health care providers further improve the convenience of access.

Based on data at the end of 1999, health care spending in Taiwan is 6.1 percent of GDP, which was among the lowest of all the developed countries (United States 15.3 percent, Canada 10 percent).

Taiwanese were filled with pride when Nobel Laureate and New York Times columnist Paul Krugman hailed Taiwan's health care system in his column as a model of success. He pointed out that the savings from going with the single-payer system had expanded the coverage to a previously uninsured population without a major increase in health expenditures. Mr. Krugman was warmly received when he paid a visit to Taiwan in May 2009.

EPISODE II: SALE OF AIG ASSETS

Politics played a role in the sales of AIG/ Nan Shan in Taiwan. During the credit crisis last year, the U.S. government rescued New York-based AIG with a Troubled Asset Relief Program (TARP) loan bailout package worth up to US$182.5 billion in exchange for 79.9 percent ownership of the huge insurer.

AIG recently sold most of its Asian subsidiaries to pay back a portion of the TARP loans. Hong Kong-based AIA was sold to UK Prudential PLC for US$35.5 billion. ALICO, another subsidiary based in Delaware, was sold to MetLife for US$15.5 billion. A third subsidiary, Taiwan-based Nan Shan, was sold for US$2.15 billion to an investor group led by Hong Kong's Primus Consortium that also includes investment firm China Strategic Holdings Ltd. The investors are mostly the wealthiest businessmen in the region.

(Author's note: The AIA deal with Prudential U.K. ultimately failed to happen due to Prudential's inability to finance it. The Nan Shan deal was rejected by the regulators citing sensitivity/ suspicion of investors' Chinese connection. As

of October 2010, AIG is scheduled to make a public offering of AIA at the Hong Kong Stock Exchange, while Nan Shan employees' and customers' uncertainties continue to hurt Nan Shan's market presence.)

The Nan Shan deal is waiting for the local regulatory approval. Even though this deal was announced much earlier than the other two and has the least amount of investment fund involved, it has managed to drum up the most controversy. During this period of uncertainty, Nan Shan's market share in terms of the first year premium has dropped from the top to the eighth place.

Some of the terms of the deal are known. The acquirer agrees to maintain the Nan Shan brand. It also has agreed to retain existing compensation and benefit packages for Nan Shan's 4,000 employees. The agency organizational and commission structure will be kept for at least two years after the deal is closed. The current Nan Shan management team will stay put.

The employee union's demands include the full return of provident fund (retirement contribution made by the agents and employees). They also raised concerns with the lack of industry knowledge of the new owners and with their intention of staying for the long haul. The Hong Kong financial authority at one time censored China Strategic Holdings Ltd for improper stock manipulation. The union is concerned that the new investor may be a corporate raider.

However, the deal breaker turns out to be whether money from China is involved in the purchase. Even though cross strait relations with China have improved, people are still cautious. There are laws on the books prohibiting investment from China. The Economic Cooperation Framework Agreement (ECFA), a broad-based business agreement between China and Taiwan, is expected to be signed in June. The restrictions on investment from China will be greatly reduced. Yet, in the current political atmosphere, any matter involving China is an easy target that can be stirred up from all possible angles and manipulated by anyone for legitimate concerns or for hidden agendas. The regulators must be very deliberate in every step of the review process for fear of being challenged by any of the interested parties.

Taiwan Insurance Bureau (TW IB) has reviewed and agreed that there is no source funding from China based on the information provided by Primus and China Strategic Holdings Ltd. The investors pledge that there is no such funding involved and they are willing to forfeit their money if proved otherwise.

Nan Shan serves more than 4 million life insurance policyholders in Taiwan. It is the third-largest life insurer in the country in total premiums, with an asset of US$30 billion. The departure of AIG saddens many veterans in the industry. Nan Shan first successfully introduced the Western-style agency system into the island. Nan Shan alumni filled many key positions for insurance companies in Taiwan and other Asian countries.

EPISODE III: NEGATIVE INTEREST SPREAD BUSINESS

AIG's sale of Nan Shan is consistent with the exodus of other foreign life insurance companies in Taiwan. The timing was fortunate for AIG in the sense that there are many local carriers to bid for its business. Based on Fitch Ratings' report last November, life insurers in Taiwan have to provide an additional reserve of US$26.5 billion for negative interest spread.

The Taiwan Financial Supervisory Commission has scheduled the implementation of IFRS 4 (Phase I) next year. Insurers will have to phase

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in the larger liability reserve that reflects the interest rate loss. For those foreign insurers that have to comply with the more stringent fair value valuation requirements, the additional reserves required are many times larger than the new local requirement.

MetLife, Aegon, ING and UK Prudential have sold their respective life insurance businesses in Taiwan in the last couple of years. The key reason for the European insurers to get out of the Taiwan market was the coming Solvency II requirements, as well as Embedded Value and Market Consistent Embedded Value. By selling, they can recoup some of their loss by releasing the burden of the huge reserve liability. Their embedded values actually increased after these transactions.

UK Prudential sold its agency business to Taiwan's China Life for NT$1.00 (US$0.03). In this case, the acquirer put up the reserve and assumed all the liability. On the other hand, the seller walked away empty-handed but the lien on the seller's bank account of hundreds of million dollars was removed.

By acquiring the additional inforce businesses from the foreign carriers, the local companies gain market share to achieve certain economy of scale. Under statutory accounting rules, the local companies are required to establish a much smaller reserve. In the meantime, they hope the investment environment will turn around before long. Both parties expect to gain from these transactions. Only policyholders with a high guaranteed rate may lose out from the possible reduction of future benefit.

Even back in 2003, life insurers were facing a serious negative interest spread situation. The Taiwan regulators provided relief by lowering the valuation rate for new business to 2.5 percent and raising the oversea investment ceiling to 35 percent. Unfortunately, the investment rates have not risen and the insurers are in an even tighter bind.

In the deepest stagnation of a decade ago, Japanese regulators allowed the insurers to credit a lower interest than the guaranteed interest rate specified in the contracts. With many insurers having negative net worth and receiving dismal investment returns both locally and overseas, Taiwan's regulators may have to provide similar relief to the insurers. If the regulators choose to take this route, it would be hard for the policyholders to stomach.

For political expediency, it is easier for the regulators to allow for these benefit adjustments, if this negative interest spread business is held by domestic carriers rather than by foreign carriers. By design or not, after the recent transactions, the local insurers now hold most of these businesses.

FOOD FOR THOUGHT

Politics played out in a democracy often seems to be messy and ineffective. During Krugman's visit to Taiwan and on many other occasions, he made the rhetoric statement that he wishes the U.S. government could be like China's for a day. Reportedly, he was frustrated with the development of health care reform and addressing global warming climate change in the afterglow of the Chinese government's success with the 2008 Olympics. This fueled the debate of the virtues of democracy.

The possible benefit of more effective yet non-democratic government is pitted against the risk of deviation of public interest and political elites' desire. Does our actuarial insight of balancing risk and reward influence our personal opinions on this debate? □