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Life Insurance Development in Vietnam

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I spent the past three years working in Vietnam as the appointed actuary for a major life insurance company. During this time, I witnessed a lot of changes in the industry on regulation, distribution models and product development. In this article, I will briefly discuss the current life insurance development with a focus on the latest regulation change from an actuarial perspective and its possible impact to the industry.

LIFE INSURANCE IN VIETNAM

Vietnam has a population of over 93 million and the life insurance penetration rate is low at around 1.2 percent. There are currently 18 life insurers in Vietnam, with 17 of them foreign insurers and only one predominately local life insurer. The top five life insurers accounted for over 78 percent of sales in 2017. The CAGR for the last five years on annualized first year premium has been 29 percent with USD 760 million in 2016 (F/X rate is assumed at USD 1 = VND 0.000044). The preliminary 2017 annualized first year premium is recorded at over USD 980 million, sustaining a YOY 29 percent growth rate trend.

The Ministry of Finance (MOF) is responsible for supervising the insurance market in Vietnam. The MOF has the power to grant and withdraw licenses and has authority to issue legal documents (circulars/decisions) that provide guidelines for the operation and other activities of insurers, reinsurers, insurance agents and insurance brokers. The Insurance Supervisory Authority (ISA), which is part of the MOF, assists the MOF in supervising the insurance business and market in Vietnam.

All restrictions on the ability of foreign insurers to establish 100 percent foreign owned subsidiaries were removed on Jan. 1, 2008 according to Vietnam's WTO commitments. In 2016, we saw Aviva Vietnam become a 100 percent subsidiary by acquiring the balance of the shares from the joint venture of Vietin-Aviva. Sun Life Vietnam also acquired the balance of the shares of PVI-SunLife. A new entrant is MB Ageas Life, with share interests of: 61 percent with the Military Bank, 29 percent with Ageas and 10 percent with Muang Thai Life.

DISTRIBUTION AND PRODUCT OFFERING IN VIETNAM

Agencies represent the major distribution channel accounting for 85 percent of industry sales, while bancassurance represents close to 13 percent in 2017. A small percentage is distributed through alternative methods. The product offering continues to focus on universal life and endowment plans, which carry significant guaranteed interest rates. Riders have become popular, mostly importing product ideas such as accidental death and dismemberment, total and permanent disability, hospital income and critical illness from other countries or reinsurers. Term life and credit life represent a small part of life insurance sales.

RECENT REGULATORY CHANGE

The insurance regulation in Vietnam has been evolving, with significant changes introduced during 2016 and 2017. The last update in 2017 was the Circular (Cir) 50/2017 which was issued during the last week of May 2017. One change was to revise the maximum valuation interest rate formula partly in response to the single index to the 10-year bond auction rate and the movement of the interest rates. Figure 1 shows the movement of the primary auction rates of government bonds. Please note, certain months did not have an auction and this chart will show the same rate as the previous month.

Figure 1
Vietnam Recent Government Bond Primary Auction Rates

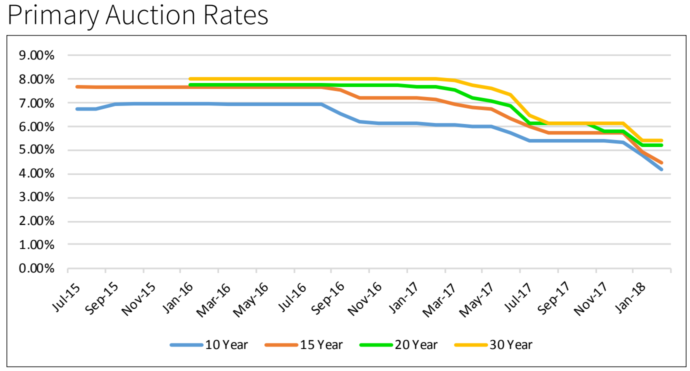

Table 1
Impact of Reserve Regulation on Methodologies and Assumptions

Reserve Regulations	Before	After
Primary regulatory documents	Dec 46/2007, Cir 125/2012 & Dec 96/2007	Dec 73/2016, Cir 52/2016, and Cir 50/2017
Reserve Methodology and Basis	Not permitted to change in the same fiscal year. Written approval from MOF is needed to change the method and basis for the following fiscal year.	Valuation interest rate can change (reduction only) within the fiscal year without notifying MOF but cannot be higher than the maximum valuation interest rate
Maximum Valuation Interest Rate (VIR)	80 percent of the 6-month average of 10-year government bond primary auction winning rates	70 percent of the 6-month average of 10-year and higher government bond primary auction winning rates. VIR cannot be higher than the average investment rates for the past four quarters. VIR cannot be higher than the pricing interest rate for each product.
Valuation mortality	80CSO	80CSO Other tables can be used but cannot be lower than the rates submitted for MOF product approval.
Minimum Valuation Methodology (contract term over 1 year)	Contract term > 1 year Zillmer with 3 percent expense allowance. Other methods are acceptable but cannot have lower reserves than the above prescribed methodology.	Contract term > 5 years Term products: 1 year FPT Others: Zillmer with 3 percent expense allowance Coverage term >1 year and =< 5 years Net Premium Valuation Other methods are acceptable but cannot have lower reserves than the above prescribed methodologies.
Unearned Cost of Insurance (COI) reserve	Not mentioned	100 percent of COI collected
Reserve for universal life	Surrender Value	Account value or surrender value
Reserve for minimum guaranteed interest rate	No detail	Equal to difference of investment result from insurance premium and guaranteed interest rate

Table 1 summarizes the impact of the most recent regulations on the reserve methodologies and assumptions. These regulations also resulted in a number of other changes but these are not discussed.

POTENTIAL IMPACT

The original idea of the changes in the VIR formula was to allow for a better representation of assets backing the liabilities and to reduce the sensitivity of a VIR reduction based on one tenor only. In this case, the MOF expands the VIR formula from a six month average of 10-year government rates to a six month average of government bond rates with tenor 10 years or higher. However, the MOF also increased the haircut factor from 20 percent to 30 percent as the interest rate was high at that point and thus the ISA was not comfortable with the significant jump of the VIR that would arise on 2017 data ending June, if the same haircut factor had been applied.

As illustrated below, the simple average yields were average of all winning auction rates for government bond rates 10-year or higher over the past six months. As an illustration, if over the past six months, there were three successful 10-year bond auctions with 6 percent each, one successful 20-year bond auction with 7 percent and one successful 30-year bond auction with 8 percent, then the VIR is $70\% \times (3 \times 6\% + 7\% + 8\%) / 5 = 4.62\%$. The VIR as of August 2017 was 11 basis points higher than would be determined using the replaced regulation.

Table 2
Valuation Interest Rates (VIR)

VIR	80% of Average 10-year yield*	70% Simple Average yields*
Jan-17	4.99%	5.26%
Feb-17	4.96%	5.22%
Mar-17	4.89%	5.20%
Apr-17	4.83%	5.15%
May-17	4.80%	5.05%
Jun-17	4.75%	4.97%
Jul-17	4.70%	4.83%
Aug-17	4.62%	4.73%
:	:	:
Dec-17	4.32%	4.01%

* The VIR calculation is based on Vietnam government bond winning auction rates.

Although the new regulation appears to support a higher VIR result, there are expectations of further declines in yield, driven by:

1. Moody's and Fitch upgrade on Vietnam's outlook from stable to positive,
2. Vietnam government targets and maintain inflation rate at around 5 percent,
3. Excess liquidity from financial companies such as banks and insurance companies.

In fact, the 10-year bond rates decreased around 67 bps YTD ending August while the 15, 20 and 30-year bond rates decreased around 145 bps, 188 bps and 188 bps respectively.

For example, suppose that the bond auction winning rates repeating the August rates only happen once a month between September and December for all four tenors on 10, 15, 20 and 30-year bonds, then

Table 3
VIR Scenario

VIR	80% of Average 10-year yield	70% Simple Average yields
Sep Projected Dec-17	4.30%	4.09%

In 2016, the maximum VIR wasn't known until the last week of December and then reduced to 4.99 percent from 2015's level of 5.10 percent. Most companies were able to absorb that last minute change due to the small difference. However, 2017 was a challenging year as the haircut factor was increased to 30 percent while rates continued to decrease. Applying the reduction of the maximum VIR from 4.99 percent to the 4.01 percent in Table 3 to the entire inforce block could mean an increase in the traditional reserve of around 10 percent. This increase in reserve coupled with the book value accounting of assets would also present a higher reduction in solvency margin. Based on a submission letter from the Vietnam Actuarial Work Group (comprising appointed actuaries within Vietnam) to the ISA dated Aug. 24, the total reserves for the whole industry would increase by VND 10,000 billion or USD 440 million at year end should the VIR drop to the 4 percent level, and it did.

CONCLUSION

The Aug. 24, 2017 submission letter to the ISA proposed a few solutions.

Short-term solution: Set the VIR to the higher of Cir 50 or 4.83 percent (VIR as of July 2017). This solution will expire either when a medium-term solution is agreed or by the end of 2018, whichever is sooner. Obviously, ISA didn't accept this proposal.

Long-term solution: IFRS 17 is mentioned but most companies may not have the proper capability for it as currently the valuation is simple and it is based on a net premium valuation with 3 percent Zillmer adjustment and 80CSO.

With the volatile interest rate environment and the continual evolution of regulation, it is very important for companies to understand the movement of interest rates and the impact to the financial statement by performing stress tests and/or stochastic test and make it a part of the appointed actuary report. Although most companies coped with the last minute change in the VIR in December 2016, this was not the case for 2017.

Disclaimer: The views expressed in this article are those of the author and are not necessarily those of Willis Towers Watson, the Society of Actuaries or the International Section. The content of this article is for general interest. No action should be taken on the basis of this article without seeking specific advice. ■

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