The Makings of Imminent Insurance Markets in Asia

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Abstract

With China's imminent entry into the World Trade Organization, the deregulation of the Japanese insurance market, and the liberalization of Indian insurance regulations, Asia is poised to become a major insurance magnet over the next decade Foreign companies able to capitalize on the recent increased openness of the Asian markets stand to reap substantial profits However, companies entering these largely uncharted waters will encounter various navigational obstacles The roadblocks and risks facing eager insurers are both political and psychological in nature, with many linked to cultural differences This paper will broadly survey the motivations (of both foreign insurers and Asian governments) underlying the ongoing market deregulations in several countries, the obstacles to foreign entry, and the potential risks that must be considered Also outlined herein are insurance models which may be appropriate for specific markets

About the Author

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Introduction

With China's imminent entry into the World Trade Organization, the deregulation of the Japanese insurance market, and the liberalization of Indian insurance regulations, there is much speculation and anticipation as to how the formerly stringently-regulated Asian insurance markets will be relaxed to permit the entry of foreign insurers. At stake for non-life insurers is a potentially immense economic opportunity. For Asian countries there are potential gains in technology and work force skills, as well as the stabilization of financial economies. However, few foresee the ongoing process of deregulation and foreign entry as uncomplicated. Many obstacles and possible risks await eager insurers, not only from the Asian governments but also from the ingrained attitudes of the various distinct cultures.

Current Insurance Markets in Asia

The premium distribution and maturity of Asian insurance markets vary considerably by country. Broadly, Asian insurance markets can be stratified into three levels. fully mature, transitional, and incipient. Japan is the only fully mature market, accounting for over 75% of the insurance premiums in Asia. Transitional markets include South Korea, Taiwan, Singapore, and Hong Kong. The two major incipient markets are China and India, which are the world's two most populated countries.

Two indicators help to distinguish the current and potential states of an insurance market insurance density (premiums per capita) and insurance penetration (percentage of

insurance premiums in GDP (gross domestic product)) Insurance density indicates the current state of the market; this indication is highest in industrialized nations For example, as shown in Table 1, both the United States (US) and Japan, the world's most industrialized countries, have the highest premium density ranking, with over $800 per capita China and India, in contrast, are represented by single-digit figures To some extent, this relationship can be explained by the maturity of the tort system and the overall wealth of the country. The two premises of insurance are protection on properties owned and protection against intangible liability. US citizens possess more assets and are exposed to a greater likelihood of litigation, necessitating higher levels of insurance, both property and liability The high insurance density implies that the insurance market is fully actualized and therefore has less room to grow

Insurance penetration, on the other hand, can be used as a rough indicator of growth potential Consider insurance penetration as follows,

$$\frac{\text{Insurance Premiums}}{\text{GDP}} = \frac{\text{Insurance Premiums / capita}}{\text{GDP / capita}}$$

The numerator of the right hand side of the equation, insurance premiums/capita, can be described as the insurance expenditure per household. The denominator of the right hand side of the equation, GDP/capita, can be described as the production per household When combining the two parts, insurance penetration can be viewed as the relationship between insurance expenditures and economic production per household.

Household wealth increases as the production per household increases, in turn motivating individuals to purchase more insurance This illustrates a positive relationship between insurance per capita and GDP per capita However, this relationship changes substantially at different levels of GDP per capita When GDP per capita is low (i e , China and India), the level of wealth can only provide for basic needs and the demand for insurance is low Consequently, insurance demand grows only slightly faster than wealth Conversely, when GDP per capita is high, a point of saturation has been reached; a large portion of the insurable interests are already insured. Here again, demand for insurance grows only marginally faster than wealth.

In contrast to the relatively flat rate of growth exhibited at the low and high ends of the GDP spectrum, the demand for insurance grows significantly faster than wealth in transitional markets (South Korea, Taiwan, Singapore and Hong Kong). When income rises above the minimal level, people begin to accumulate personal assets and an awareness of the value of insurance develops Insurance consumption then rises rapidly to fill gaps of need Transitional markets thus demonstrate highest growth potential.

Note for example the insurance penetration figures for Japan (3 42%) and South Korea (2 23%) as shown in Table 1 The above-average non-life insurance penetrations can be partially explained by savings-type policies in non-life insurance These policies provide for substantial premium refunds if no claims are made With the inclusion of savings-type policies, the non-life insurance expenditure may appear to be a larger percentage of

GDP in Japan than in the US, even though Japan has a less litigious environment than the US.

Table 1
Comparison of Insurance Density and Insurance Penetration

	(1) Non-Life Insurance Premiums (US$M)	(2) Population (Million)	(3) Insurance Density: Premiums per Capita (US$)	(4) GDP (US$M)	(5) Insurance Penetration: Non-Life Insurance % of GDP
US	$280,000	270	$1,037.0	$9,255,000	3.03%
Japan	101,277	126	803.7	2,950,000	3.43%
South Korea	13,959	47	297.0	625,700	2.23%
Taiwan	4,790	22	217.7	357,000	1.34%
Hong Kong	1,943	6.8	286.0	158,200	1.23%
Singapore	1,265	3.5	361.4	98,000	1.29%
China	5,873	1,247	4.[illegible]	4,800,000	0.12%
India	2,074	1,001	2.2	1,805,000	0.11%

NOTES:
1. (3) Insurance density = (1) Non-Life Insurance Premiums / (2) Population
2. (5) Insurance penetration = (1) Non-Life Insurance Premiums / (4) GDP

Reasons for Expansion into Asian Insurance Markets

The most obvious motivation for foreign expansion into Asia is the opportunity to access immense, largely untapped markets. Aside from Japan, most Asian countries have extremely underserved insurance markets when compared to highly industrialized nations such as the United States. In addition to the sizeable potential markets, expansion into Asia serves several other aims of foreign non-life insurers: 1) diversification of risk, 2) servicing existing international clienteles, and 3) more efficient use of capital.

1) **Diversification of risk.** Insurance is based on the spread of risk. Therefore, insurers are perennially looking for ways to diversify their risks or to add less-correlated risks to their books of business. For many exposures (e g., natural catastrophes, weather related risks, etc), the probability of incurring losses of the same nature simultaneously in the US and in Asia is less likely than when both risks are in the same market. Foreign insurers can significantly widen their risk base by expanding into disparate markets such as those in Asia.

2) **Servicing existing international clienteles.** The expansion of large North American and European corporations into Asia necessitates appropriate insurance to cover such foreign investments. The coverage required for these firms often exceeds the local insurers' capacities, hence foreign insurers, with their greater resources, are indispensable.

3) **More efficient use of capital.** Given the currently very high level of capitalization and the competitive nature of US markets, little or no profits are left to insurers Instead of competing for US business that will produce only modest returns, expansion into Asia may provide a higher return over an extended timeline

Benefits to Asian Countries

The recent regional economic crisis and several major natural catastrophes have induced Asian governments to reassess their insurance structures. The result has been a rise in the level of awareness of the need for protection against various risks. Throughout Asia,

liberalization plans have been introduced which will allow for greater foreign ownership and increased licensing.

- **Financial stability.** The regional financial crisis and the subsequent damage to financial infrastructures have made Asian governments much more receptive to foreign partnerships and investments. An influx of foreign capital will help to stabilize the local economies.

- **Knowledge transfer**. Foreign insurers tend to have more sophisticated risk classification systems, forcing domestic insurers to advance their practices in a competitive market. Local markets and workers benefit greatly from improved technology and other advanced work skills introduced by foreign companies.

- **Employment opportunity.** New foreign insurance companies will need to hire from local work forces. These companies tend to pay well in comparison to the existing job markets, and the skills acquired by the local workers add to the overall pool of skilled personnel.

Obstacles to Entering Asian Markets

Historically, whenever a corporation has expanded into a foreign market, various difficulties have arisen, ranging from unfamiliar regulatory practices to dissimilar ways of thinking.

- **Regulatory environment.** In1998, Japan began relaxing its non-life insurance market, which previously had been heavily regulated India chose to privatize its insurance markets at the end of 1999 And China, as a precondition for entry into the World Trade Organization, has agreed to relax its stringently regulated insurance market to permit the entry of foreign insurers Since deregulation in these countries is still at the early stages, their business infrastructures remain relatively undeveloped, and thus continuing to impede the entry of foreign insurers. Nevertheless, some insurers are already in the process of entering Asia, but their experience shows that much requires further definition before efficient access can take place.

- **Sizable investments.** Besides the minimum capital required by each country, the cost of establishing an insurance company in Asia can be significant, including the financial requirements to set up branch offices, develop new distribution systems, establish underwriting guidelines, and arrange for claims services. Table 2 shows the start-up capital requirement for an insurance company by country.

Table 2
Capital Requirement by Country (US$M)

Country	Capital Requirement
Japan	$7.69
South Korea	$18.75
Taiwan	$57.3[1]
Hong Kong	$1.28 or $2.56[2]
Singapore	$14.53
China	$60.4
India	50% of written premiums

NOTES:
1. $57.3 million for domestic insurers, including foreign joint-ventures.
2. $1.28 million for life and non-life companies, $2.56 million for composite or non-life companies writing compulsory lines of business.

- **Localization.** Localization is the adaptation of existing insurance products to a new market. Restated, this is the modification of existing products or services to account for differences in distinct markets. Localization can include language translation, conformation of accounting procedures to local taxation, and even tailoring a web site to achieve a local look and feel.

Risks and Barriers

The adage taught in basic finance— "the greater the expected profit, the greater the risk"—is especially true in the case of Asia's insurance markets. Although there is great potential for financial gain, foreign insurers must be aware of and prepared for a variety of risks that can combine to derail any start-up effort. Among the more significant risks are:

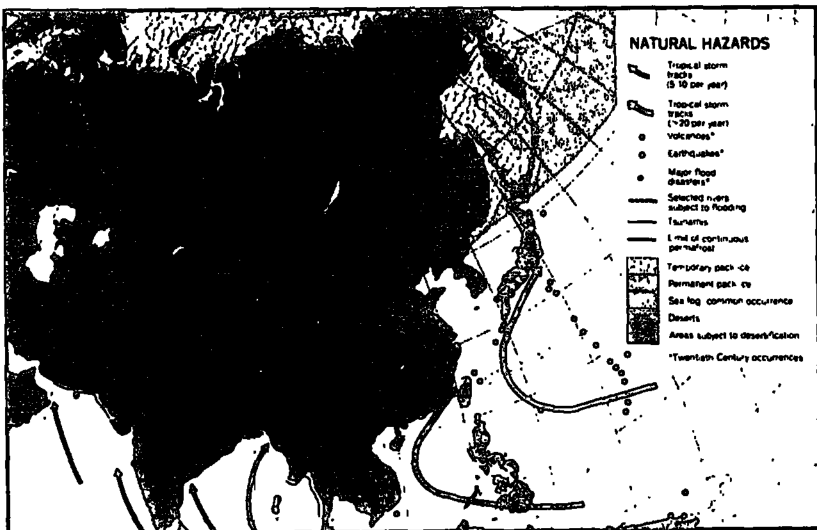
- **Political and regulatory risks.** Many countries in Asia have virtually no non-life insurance history To further complicate matters, the few judicial rulings that have been passed on non-life insurance issues have been erratic All of this could lead to an extremely unpredictable liability insurance cycle, since pricing, liability estimates and other economic considerations are dependent on a fully developed tort system Other political risks include the possibility of expropriation of assets, changes in tax policy, or other changes in a given country's business climate

- **Exchange rate risk.** The dollar return from foreign investments depends not only on the returns on the foreign currency, but also on the exchange rate between the dollar and that currency If the local economy collapses, a foreign company's assets could be seriously jeopardized Currently, foreign currencies are not allowed in China, all business is carried out in the Chinese yuan The yuan is especially complicated because it is only partially convertible and is not completely tied to a flexible exchange system.

- **Natural catastrophes.** The majority of residents in Asia live close to major rivers (i e , the Yantze and the Huang He in China, the Ganges in India) These rivers historically have been the cause of multiple severe floods that affected millions of people In addition, Asia is prone to earthquakes (China, Japan, Taiwan, India), windstorms, hail, typhoons (southeastern coast of China, Japan, Taiwan, Malaysia, and the coastal regions of India), and volcanic eruptions (four volcanic fields in western China and six in the eastern portion of China that borders Korea,

all of Japan). The region's susceptibility to these natural hazards is illustrated in the map below.

Recently, catastrophe simulation models have been used to assist in the pricing of catastrophe property insurance. However, due to the scarcity and unreliability of historical data for this region, the simulation models may not be dependable. Writing property risks in Asia will thus be a major challenge for foreign insurers.



- **Cultural barriers** Many Asian countries highly value relationships, even if certain of these relationships may be viewed by Americans as merely contractual obligations Because of this respect for relationships, lawsuits are uncommon, whether business or personal. This behavior impedes the need of liability

insurance to have an established, highly developed tort system upon which to rely It remains to be seen how Asia's gradual relaxation of its economic and social systems will affect the perceptions and behaviors of its citizens.

Another cultural disparity is the inclination of Asians toward saving. This is a long-held ethic in Asia, one that could lead to that public's view of insurance as atrophy Further, in those Asian countries historically observant of superstitions, purchasing insurance may be considered as cursing oneself and asking for misfortune.

- **Distribution systems.** Although the demand for insurance may be growing in Asian countries, coverage may not be accessible due to the poor distribution systems in place. For example, in the past Japanese insurers distributed life insurance policies through "seiho ladies" (seiho is the Japanese word for life insurers). These representatives, often housewives, sold life policies in the workplace, sometimes pressuring workers to purchase coverage with little or no explanation of the policies.

- **Target markets.** Often times, insurers tend to target existing segments of the insurance business rather than expanding the market. For example, 50% of the current demand for general insurance in India comes from corporations However, the corporate segment as whole is not likely to grow rapidly, so when the market expands, the competition for these same corporate risks will drive

down potential insurance premiums Thus, new entrants should both target the existing market and develop specific niches in the currently under-served lines of business

Forecasting Models for Asian Insurance Markets

The following outlines insurance models which may be appropriate for the specific markets targeted and their respective levels of economic development.

- **Fully mature.** (Japan) - Sophisticated liability insurance for protection of personal wealth and advanced risk management structure for large commercial firms. Japan's well-developed economy can sustain the full range of modern insurance products.

- **Transitional.** (South Korea, Taiwan, Hong Kong, and Singapore) - Auto insurance and some forms of liability insurance. People in these developing economies are becoming aware of the importance of protecting personal wealth, but may not have the full appreciation to warrant an ultra-sophisticated approach.

- **Incipient.** (China, India, Vietnam) - Property and fire insurance, or some type of savings policies. People in these countries are mainly concerned with preserving what they have acquired through hard work. Insurance policies with a savings mechanism will attract people by offering an accumulation of wealth rather than an expenditure.

Conclusion

Asia's non-life insurance market contains enormous potential profit, with both domestic and foreign insurers standing to reap the expected rewards of insurance deregulation and financial restructuring Even with these countries' stringent and often ambiguous laws, the general absence of established tort systems and the myriad of cultural barriers, foreign companies continue to exhibit a great eagerness to take the plunge. These interested parties have obvious reasons to look ahead, but they should take caution to carefully consider and prepare for the many risks that may be realized

1. This article first appeared in Best's Review, April 2001 It is reprinted by permission of Best's Review

2. Discussion related to China first appeared in Best's Review, August 2000

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