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TOWARD FREE TRADE IN SERVICES: THE ASEAN INSURANCE MARKET

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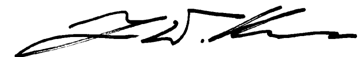

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Introduction

The Association of Southeast Asian Nations (ASEAN) comprises Brunei Darussalam, Cambodia, Indonesia, Laos, Myanmar, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. These ten countries have a total population of about 500 million, a total area of 4.5 million square kilometers, a combined gross national product of US$ 685 billion, and a total trade of US$ 720 billion.

They have agreed to create the ASEAN Free Trade Area (AFTA), with the ultimate objective of increasing ASEAN's competitive edge as a production base geared for the world market. A critical step in this direction is the liberalization of trade, eliminating intra-regional tariffs and nontariff barriers, which will reduce production costs and encourage manufacturing industries to become more efficient and more competitive in the global market.

As a complement to the liberalization of trade, ASEAN has adopted a Framework Agreement on Services. The agreement seeks to integrate the ASEAN market for services by eliminating restrictions on trade in services among member countries. This integration involves liberalizing trade in services beyond the commitments undertaken by member countries under the General Agreement on Trade in Services. The final goal of the Framework Agreement is to realize a free-trade area in services.

While ASEAN leaders have clearly stated their vision of "a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities," achieving this vision will not be easy.[1]

Southeast Asian countries display immense diversity in ethnicity, culture, and religion. Every country in the region comprises more than one ethnic group, each carrying a unique culture from one generation to the next. There are Christians, Catholics, Buddhists, Muslims, Hindus, and those following indigenous religions. The legal systems of southeast Asia also vary widely. Some countries follow European legal systems, while others are modeled after North American systems. Political systems also run the gamut from monarchism to socialism.

Insurance Market Characteristics

In Southeast Asia, there are economically advanced countries as well as countries where the population struggles to overcome poverty. Except for Brunei, Malaysia, Singapore, and Thailand, Southeast Asian countries still generate less than US$5,000 GDP per capita.[2] This low level of income suggests that current consumption of insurance pales compared to the insurance markets of Japan, Europe, or North America.

According to the Swiss Re survey of insurance consumption—measured by per capita premiums in US dollars—ASEAN countries spent only US$28 per capita for insurance in 1999, compared to US$1,950 in OECD countries. Within ASEAN there is considerable variation. Singapore, Malaysia,

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[1]*ASEAN Vision 2020*, ASEAN (December 15, 1997) Kuala Lumpur, Malaysia.

[2]Per capita GDP is purchasing power parity adjusted. See the statistical appendix for further explanation of this adjustment.

and Thailand ranked at the 19th, the 37th, and the 54th, respectively, among the 84 countries surveyed.[3] Indonesia, the fourth most populous country in the world, ranked 76th.

These rankings reflect more than simply the relatively low incomes of ASEAN countries. The insurance markets in the region are also comparatively underdeveloped. In 1999 insurance premiums represented only 3% of GDP, compared to 8.6% in OECD countries. By this measure Singapore ranked 27th, Malaysia 29th, and Thailand 47th.

Insurance products available in many ASEAN countries are rather simple. Term life and whole life insurance products prevail in the life insurance business. Investment-oriented products, better known in Southeast Asia as unit-linked insurance products, exist in only a few countries, and they are relatively new there. As for non-life insurance, basic fire insurance and compulsory insurance, such as motor liability and workers' compensation insurance, predominate.

The economic integration of ASEAN will encourage the development of the insurance industry as the advantages of insurance become better known and new products enter the market. Given the population of the region, the ASEAN insurance market has great potential for growth in the future.

What will then be the necessary elements for the market to mature, while preserving financial soundness, so that the policyholders' interests can be best protected? Such development calls for regulation and supervision according to international standards. The market must be served by financially healthy insurance entities—direct insurers, reinsurers, and insurance intermediaries all working together. Well-developed infrastructure should exist in the economy, particularly in the financial services industry, for insurance to function smoothly. Governments must impose fair and transparent regulatory measures for the insurance market while applying prudent supervisory approaches to insurance players. Concurrently, all the players in the market should maximize their operating efficiencies while striving to satisfy the insurance needs of individuals and businesses in the market. When all these efforts are made, policyholders' interests can be best protected and sustained growth of the insurance industry will follow.

Regulation, Deregulation, and Liberalization

The insurance industry, whether in Asia or elsewhere, tends to be one of the most closely monitored, if not heavily regulated, industries in the country. The industry plays a pivotal role in protecting individuals and businesses from unforeseen, financially devastating events. It performs this duty by making both short- and long-term promises to policyholders. Hence, the success of the insurance industry depends on the insurer's ability to meet its contractual obligations, and the government is obliged to preserve this security. For this purpose, most governments operate a special regulatory body, commonly known as the insurance department, which may belong to a government ministry or may operate autonously.

The government regulates the insurance industry using various approaches. It may use *ex ante* approaches by setting (often stringent) standards and rules that new and incumbent insurance players must abide by. Examples are market entry requirements, permitted ownership structures, prior approval of

[3]Swiss Re, "World Insurance in 1999: Soaring Life Insurance Business," *Sigma* (9/2000).

premium rates and product designs, and solvency (margin) requirements. A government may adopt *ex post* approaches that are expected to correct any distortion in the market once the distortion has been identified. Review, as opposed to prior approval, of premium rates and examination of insurers' financial statements are examples of *ex post* approaches. Most governments use a combination of these two approaches. Additionally, self-regulatory approaches such as corporate governance and monitoring of member activities by industry associations are increasingly important in many countries.

The recent worldwide trend has been toward deregulation of the insurance industry. Deregulation in this sense means shifting from *ex ante* approaches to *ex post* and self-regulatory approaches. Many countries, especially economically developing countries, also liberalize the insurance market, allowing multiple entities to compete for business. With such liberalization, private firms, including foreign entities, are becoming the dominant suppliers of insurance. Countries generally deregulate and liberalize their markets to make their insurance industry more efficient. In selected cases, these actions are also in response to the standards set by inter-governmental organizations.

Nonetheless, few countries have, or are likely to have, a completely deregulated or liberalized insurance market. Some governments strongly believe that the government, which is not a profit seeking entity and is assumed to be bankruptcy free, should provide certain social insurance protections. In other countries, certain risks are too large for local insurers to underwrite (for example, nuclear hazard or environmental pollution-related risks) or are avoided by most insurers due to a high probability of loss (for example, flood insurance), thus requiring the government to be the insurer for those risks.

Other reasons for strong regulation exist. In economically underdeveloped or developing countries, the government may treat premiums as an important source of capital for economic development and try to reduce the flow of premiums out of the country. Or, it may believe that the industry should be protected until the local insurers develop sufficient financial capacity and insurance expertise to compete with foreign insurers. How far a government deregulates and liberalizes the insurance industry depends not only on market forces but also on external factors.

This paper investigates where Southeast Asian countries stand when it comes to deregulation and liberalization of the insurance industry. The next section examines the development and the current status of the insurance market in each of the ASEAN countries. An analysis of regulatory and supervisory approaches found in ASEAN countries follows. The concluding section presents recommendations for improvement of the Southeast Asian insurance market.

Country Studies

This section describes the regulatory and supervisory environment surrounding the insurance industry in Southeast Asian countries, with a summary of the economic infrastructure and history of the insurance industry of each country. For some countries, particularly Brunei, Cambodia, Laos, Myanmar, and Vietnam, only a limited amount of information is available and the discussion is rather brief. In contrast, the more extensive discussion of Malaysia includes a detailed explanation of its offshore insurance market as well as its relatively developed domestic market. In addition, an appendix to this paper discusses the application of Islamic socio-economic principles to Islamic insurance, better known as *takaful* insurance, of which products are marketed in Brunei, Indonesia, Malaysia, and Singapore.

Where possible, the following section describes four aspects of each country's regulation and supervision of its insurance industry. Licensing regulation indicates the freedom of local private and foreign investors to enter the insurance market, as well as the initial capital requirement and other conditions that the local government authority imposes. Solvency requirements specify the financial conditions that licensed insurers in the country must abide by. Investment guidelines and accounting principles determine the financial information that licensed insurers in the country must provide to the regulatory authority. Market conduct regulation covers insurers' pricing, product designs, reinsurance arrangements, and corporate governance.

Brunei Darussalam

Brunei Darussalam is a small country with a population of a little over 300,000. It is situated on the island of Kalimantan, also known as Borneo. In this Islamic, oil rich sultanate, the government is the largest employer. The Brunei government provides all medical services for the people.

There are more than 100 registered insurers in the country, but as of January 2001, only 22 companies actively offer conventional and Islamic-based *takaful* insurance products: 16 non-life insurers, three life insurers, and three *takaful* insurers.[4] Brunei allows only *takaful* insurers to operate in both classes of insurance business.

With the exception of the Motor Vehicles (Third-Party Risks) Act of 1998, there appears to be no specific legislation relating to the insurance industry in Brunei Darussalam. The government is expected to introduce an insurance act in the near future. Once introduced, this insurance law will govern both conventional and *takaful* insurance matters.

The Financial Institutions Division (FID) of the Ministry of Finance currently monitors and supervises activities of insurance companies operating in Brunei. Its major

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[4]For its Muslim residents, the Islamic Bank of Brunei Berhad and the Islamic Trust Fund of Brunei established in 1993 two takaful insurance companies: Tabung Amanah Islam Brunei and Takaful IBB Berhad. See the discussion about takaful insurance in the appendix. In Brunei, Takaful insurers are strong both in life and non-life insurance. In fact, their Islamic-based motor insurance products have become attractive to non-Muslim motorists.

activities include granting licenses to prospective insurers—although no new insurer has been registered since 1984—and issuing regulatory guidelines. Those guidelines specify that an applicant in non-life insurance business must meet the minimum paid-up capital of B$1 million.[5] Once admitted, it must maintain a solvency margin of 20% based on premium income, net of reinsurance, of the previous year. For insurers writing motor insurance business, the ministry requires a deposit of B$1 million with the government.

The FID has also issued administrative measures, applicable mainly to non-life insurance business, and guidelines regarding the appointment of motor insurance agents.[6] The Insurance Association of Brunei Darussalam currently administers the guidelines. The regulator uses moral suasion when necessary, and holds meetings periodically with the Insurance Association of Brunei Darussalam, which includes all licensed non-life insurers in the country.

The FID does not strictly direct how non-life insurers should price their products or maintain their insurance funds for most lines of insurance. Instead, the regulator, through its guidelines on the accounting procedures, requires non-life insurers to calculate unearned premium reserves pro-rated to the period of insurance coverage, to estimate IBNR losses based on past experience, and not to discount their outstanding claims. Non-life insurers must use the lower of the book value or market value when valuing their investments.

All licensed insurers in Brunei must submit the following statements to the Financial Institutions Division: audited accounts (annually), ASEAN unified statistics (annually), and premium data (quarterly). Branches of foreign insurers, of which there are three currently operating in Brunei, are free to transfer out their capital or profits.

Cambodia

Its admission to ASEAN delayed until 1999 because of its political turmoil, Cambodia is yet to see significant improvement in its economic status. Its small economy has not attracted much foreign investment. Cambodia lacks a clearing house or an interbank fund transfer system for local financial institutions. Neither can a foreign exchange market be found in the country. Besides, only few financial institutions are financially or operationally competent.

The Cambodian government drafted an insurance law in 1994, but it was only in June 2000 that the National Assembly passed the final version. The bylaws will be available in the near future. The insurance law requires approval from the Ministry of Finance before an entity commences insurance business. It makes motor third party liability insurance, construction all risks (CAR) insurance, and passenger transportation insurance compulsory. Before the enactment of the law, certain projects and assets were insured overseas. The insurance law no longer allows such exceptions, and all projects and assets located in Cambodia must be insured locally and by a licensed insurer. This provision was added to the law to prevent the outflow of

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[5]The official currency of Brunei, the Brunei dollar, is pegged to Singapore dollars on a one-to-one basis.

[6]The insurance industry was under the supervision of the State Secretariat between 1976 and 1983 and of the Economic Development Board of the Ministry of Finance until 1993. Chua Pheng Siong, "An Overview of the Insurance Industry in Brunei Darussalam," in *Insurance Regulation and Supervision in Asia* (OECD: Paris, 1999), pp. 115-19.

premiums from the country.

The insurance industry in Cambodia is in its infancy with only one insurance company, Caminco. This government-owned insurer sells mainly non-life (motor insurance in particular) and personal accident insurance products. There are four insurance brokerage firms—including Indochine Insurance, established in 1993, and Asia Insurance (Cambodia)—operating in Cambodia. If they wish, these firms can become licensed insurance companies, subject to meeting the capital requirement as well as other terms and conditions stipulated in the insurance law.

Insurers in Cambodia are also subject to special provisions of the country's tax law, which was amended in 1997. The law levies a 5% income tax on an insurer residing in Cambodia, based on its gross premiums for risks in Cambodia. If an offshore insurer underwrites risks in Cambodia, the government may withhold 15% of the premiums for such risks for income tax purposes. For income from non-insurance activities, insurers generally are subject to income taxes of 20% of their profits.

Indonesia

Prior to the Asian financial crisis in 1997, Indonesia had been enjoying rapid economic growth. The crisis devastated the economy and rekindled political instability. The on-going saga of ethnic disputes also continues to cover its future with dark clouds. Nevertheless, the Indonesian government has made numerous attempts, with financial and other aid from international organizations such as the IMF, the World Bank, and the Asian Development Bank, to improve its economic condition. The government, particularly the Indonesian Debt Restructuring Agency, has closed banks with large portfolios of non-performing loans and arranged mergers and acquisitions of many other banks.

This recent economic and political instability in Indonesia has affected the performance of its insurance industry. All insurers experienced reduction in premium income, and non-life insurers had to absorb the burden of increasing claims arising from recurring riots in major cities. Reduction, if not elimination, of this political risk would be critical for the restoration of a healthy insurance industry.

In Indonesia, the Directorate General for Financial Institutions with the Ministry of Finance has been regulating and supervising the Indonesian insurance market, which is served by a large number of life and non-life insurers, totaling 178 in 1998. State-owned insurers—such as Asuransi Kiwasraya and Asuransi Jasa Indonesia—and the insurance subsidiaries of local conglomerates dominate the market.

Licensing Regulation

The regulator requires that all licensed insurers in Indonesia meet the minimum paid-up capital requirement, the amount of which varies depending on the class of insurance

business and ownership structure. In life insurance, the minimum paid-up capital is Indonesian 2 billion rupiah for domestic insurers and 4.5 billion rupiah for joint ventures. In non-life insurance, it is 3 billion rupiah for domestic insurers and 15 billion rupiah for joint ventures. A reinsurer operating in Indonesia is required to have a minimum paid-up capital of 10 billion rupiah if it is a local company; otherwise, the amount increases to 30 billion rupiah.[7]

The authority also requires that the insurer place 20% of its capital in the form of a deposit at a commercial bank in Indonesia. The deposit increases annually by 1% of the increase in premiums if it is in non-life insurance business or 5% in the increase in premium reserves if in life insurance business.[8]

A foreign entity must satisfy several conditions before it is allowed to do insurance business in Indonesia. First, it must locate an Indonesian company willing to be its joint venture partner, and the joint venture must be incorporated as a limited liability company. Second, the foreign partner must be of good reputation and have its equity capital being at least twice the amount of its investment in the joint venture. Third, the local partner must have been operating for at least the previous two years while satisfying the authority's solvency test. Fourth, the applicant must submit a plan describing how the foreign partner's ownership in the joint venture will be reduced over a specified period of time. In particular, a registered joint venture must limit its foreign ownership initially to 80% of its total share and gradually (within 20 years) reduce it to no more than 49% of its total share. Fifth, the joint-venture must employ an adequate number of insurance professionals (commonly actuaries), whether Indonesian or foreigners, who have at least five years of experience in their specialty areas, and appoint Indonesians to its board of directors usually in proportion to the share of foreign-local ownerships. Finally, the license holder can do business in only one class of insurance business, life or non-life.

Solvency Regulation

The Indonesian government announced in 1993 that life insurers must maintain a solvency margin of at least 1% of premium reserves for life insurance and 10% of net premium for health and accident insurance. Non-life insurers should meet a solvency margin—expressed as "the excess permissible assets over liabilities"—which is at least the sum of the initial minimum capital and 10% of net premiums.

Non-life insurers are not permitted to assume any risk if the coverage amount exceeds 10% of their equity. The total amount of premiums, net of reinsurance, that non-life insurers can write is limited to 300% of their equity.

In 1999 the Ministry of Finance started to employ risk-based capital (RBC) models to determine solvency requirements of insurance companies operating in Indonesia. These RBC models cover differences among the insurers with respect to their exposures to asset default risk, cash flow mismatch risk, foreign exchange risk, claims experience-related risk, investment performance-related pricing risk, and reinsurance risk.

Financial and Accounting Regulation

Several regulatory measures related to investments and accounting standards exist in

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[7]*Government Regulation No. 73/1992*, Ministry of Finance, Indonesia.

[8]The government, upon obtaining approval from the Ministry of Finance, may use those deposits to cover liquidity crisis in the insurance market.

Indonesia. In the case of a life insurer, its total investments, excluding investment in mortgage loans, must be at least equal to its technical reserves. It must maintain a premium reserve of the amount determined in accordance with the Ministry of Finance guideline—that is, an estimate based on an actuarial calculation— as well as a liability provision for future policy benefits as approved by a registered actuary.

In the case of non-life insurers, the total investments, excluding investment in mortgage loans, should be at least equal to the sum of the technical reserves and 25% of equity. Non-life insurers must estimate their unearned premiums using one of the two prescribed methods: per policy estimation on a daily basis, or in aggregate of all policies in the line based on a percentage basis. For the valuation of invested assets, both life and non-life insurers must use either book value or market value, depending on the type of invested asset.

Market Conduct Regulation

The Ministry of Finance has issued several guidelines governing the scopes of insurer business and reinsurance transactions. For example, an insurer must obtain prior approval from the regulator to open a branch office. However, it is not allowed to hold equity ownership in insurance brokerage firms or agencies.[9] Besides, the Indonesian Insurance Council, an industry association, publishes tariffs for various non-life lines of insurance that insurers must abide by. Non-life insurers are also subject to commission limits of 15% for brokers and 10% for agents.

Regarding reinsurance transactions, the ministry requires direct insurers, especially those in non-life insurance business, to have a treaty reinsurance arrangement with at least one reinsurer and to retain at least 30% of the original risks based on premiums. The authority permits direct insurers to cede their risks to offshore (non-admitted) reinsurers, provided that those reinsurers are of good reputation in the country of domicile, have a treaty (reciprocal) agreement with at least one domestic reinsurer in Indonesia, and have their paid-up capital being at least equal to the minimum capital required for domestic joint venture reinsurance companies, which is 30 billion rupiah.

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[9]Insurance agents in the country are tied (exclusive) agents; that is, they can represent only one insurance company.

Laos

Laos, which was under a six-century old monarchy until 1975, is another small economy in Southeast Asia. It was not until the mid-1980s that this officially communist state adopted an economic reform and began to encourage private enterprise. Only in 1990 did the government implement the first, albeit uncomplicated, insurance law and create the Insurance Directorate within the Ministry of Finance. In 1995, the ministry abolished this position and transferred the responsibility to the State Property Directorate within the same ministry.

Neither did Laos have an insurer until the government established in 1992 a joint venture insurance company, Assurances Generales du Laos (AGL), with Assurances Generales du France.[10] AGL was given a three-year monopoly, and has even after 1995 been a *de facto* monopoly as no other insurer has been licensed in the country. The Laotian government increased its ownership share of this joint venture from initial 20% to 49% in 1997.

AGL generates about 99% of its premiums from underwriting non-life insurance risks. Life insurance is not popular in the country because of a cultural impediment: it is commonly believed that insurance is "tantamount to calling down misfortune to one's head."[11]

The existing insurance law does not limit the types of insurance products that an insurer can sell, but requires it to obtain prior approval for premium rates and policy conditions from the ministry. No specific accounting principle for the insurance industry exists, and AGL uses generally accepted accounting principles in its financial statements.

The Laotian government wishes to admit another joint venture or a subsidiary of a foreign insurer. However, the 1994 Law on the Promotion and Management of Foreign Investment in Laos, PDR, is unclear whether foreign investment in the financial services industry would be permitted. Besides, it states that the Foreign Investment Management Committee licenses and screens all foreign investment projects, big or small, in Laos. The lack of government initiatives for its economic development and weak economic infrastructure, notably underdeveloped financial services markets, may continue to delay the emergence of a private-sector driven insurance market and the inflow of foreign insurers to the country.

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[10]Ministry of Finance, "Country Note: Laos," in *Insurance Regulation and Supervision in Asia* (OECD: Paris, 1999), pp. 143-44.

[11]*Ibid.*

Malaysia

Malaysia is a constitutional monarchy where state monarchs take turns serving as the country's monarch, but without any political power. Malaysia is a member of the British Commonwealth, and its legal system follows primarily the British system. The Malaysian economy has developed quite impressively since its independence in 1957. It has attracted a large number of foreign investors, including insurance companies. Malaysia is also known for its 1998 foreign investment and exchange control, which the incumbent Mahatir administration imposed to weather the 1997 Asian economic crisis.

Malaysia has a relatively well-developed insurance industry. Early in the 20th century branches of foreign insurers began to offer insurance services in the country. In 1948 the Life Assurance Companies Ordinance and the Fire Insurance Companies Ordinance attempted to regulate the insurance business. However, since these ordinances did not contain clear provisions regarding premium adequacy and capital or solvency requirements of insurers, numerous insurers mushroomed. Many of those insurers were small, financially insecure, had little expertise in insurance business, and exhibited widespread malpractices.

The government attempted to correct this problem by amending the Life Assurance Companies Ordinance in 1961. It also introduced the Insurance Act in 1963 that comprehensively covers major issues in insurance regulation.[12] Finally, Malaysia introduced the latest act governing the industry, the Insurance Act of 1996, as well as the Insurance Regulations of 1996.

The Ministry of Finance is the *de facto* regulator and supervisor of the Malaysian insurance industry, but has long delegated the duty of administering the insurance law to Bank Negara Malaysia (BNM), the central bank of Malaysia. BNM also administers special directives issued by the Ministry of Finance, issues its own guidelines, circulars, notices and codes, and works very closely with major industry associations.[13]

The main objectives of insurance supervision in Malaysia are to protect public interest, to see that insurers serve their policyholders and claimants fairly and equitably, to foster competence among insurers, and to encourage development of the industry. Important milestones in Malaysian regulation include the Takaful Insurance Act of 1984, which permits insurer operations based on Islamic principles, the Labuan offshore insurance center opened in 1990, and recently introduced guidelines for the increase in operational efficiency and distribution of insurance products in life business.[14]

BNM has also introduced new solvency measures, including risk-based capital requirements, and created the Customer

[12]The contents of this act was based on "the Caffin Report upon Insurance Legislation for the Federation of Malaya," prepared by S. W. Caffin, the then insurance commissioner of Australia.

[13]This duty was initially delegated to the Office of the Director General of Insurance within the Ministry of Treasury until BNM took over the responsibility in 1988.

[14]The first takaful insurer, Syarikat Takaful Malaysia Sendirian Berhad, commenced business in 1985, followed by MNI Takaful Sendirian Berhad in 1993. Bank Negara Malaysia periodically updates the list of investments (selected equities from the Kuala Lumpur Stock Exchange) to which takaful insurers can invest. In 2000, Prudential Assurance Malaysia Berhad announced its intention to offer takaful insurance products.

Services Bureau that oversees complaints and inquiries from policyholders and claimants. A new challenge facing most Malaysian insurers is the government's plan for mergers and acquisitions within the industry, either voluntarily or following government orders. In fact, seven mergers were initiated in 2000 and more insurers are currently considering a merger. In March 2000 BNM expressed the view that there would be only 10 to 15 insurers left after completing the consolidation of the industry by 2003.[15] By way of comparison, there were 58 direct insurers and 10 reinsurers, including one life reinsurer, in Malaysia in 1999.

Licensing Regulation

An entity wishing to do insurance business in Malaysia may file an application to the central bank, which has the authority to review such an application. Bank Negara Malaysia may then make a recommendation on the application to the Ministry of Finance, which has the power to license new insurance companies. BNM has only the power to license insurance brokers and adjusters.

As per minimum paid-up capital, BNM requires RM50 million for local direct insurers and local professional life reinsurers, and RM100 million for local professional non-life reinsurers.[16] In the case of foreign direct insurers and reinsurers, they must generate an equivalent minimum capital—RM50 million and RM20 million, respectively—in the form of net working capital held in Malaysia. Responding to the 1997 Asian economic crisis, however, BNM introduced a temporary relief of this requirement such that direct insurers needed a minimum capital of RM35 million for financial year 1998. Reinsurers were not given such a relief. This minimum was increased to RM40 million by year-end 1999 and restored to RM50 million by year-end 2000. BNM may soon raise the minimum capital amount for direct insurers—and presumably for local professional life reinsurers—to RM100 million as an attempt to eliminate small insurance companies.[17]

There are two specific provisions regarding foreign investment in the Malaysian insurance market. For one, BNM allows foreign investors to hold up to 30% of ownership equity of any Malaysian insurance company. Foreign shareholders who had made their investment prior to the enactment of the Insurance Act of 1996 are exempted from this requirement and may continue to hold equity up to 51% in aggregate.[18] For the other, the insurance act made it mandatory for all branches of foreign insurers to be domesticated; that is, locally incorporated as a subsidiary, by June 1998.

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[15]For eligible merging insurers, BNM may offer some incentives such as takaful licensure, a grace period to meet the required level of admitted assets, freedom to rationalize the branch network and an exemption from the cost control limits for the expenses associated with the merger exercise "Capital, Solvency Margin Rulings Reinstated," *Business Times*, Malaysia (July 20,1999), pp 1, 18.

[16]For branches of foreign insurers, the minimum capital is calculated as the surplus of assets over liabilities.

[17]R. G. Candiah, "Focus on Insurance Mergers Next," *Star Online*, Malaysia (March 21, 2000). Sulong Wong and Yap Leng Kuen, "Paid-up Capital of Insurance Companies Likely to Double," *Star Online*, Malaysia (April 17, 2000).

[18]This exception is in pursuant to Malaysia's commitments under the WTO agreement. Hisaya Ishii, "Insurance Regulation and Supervision in Asia," in *Insurance Regulation and Supervision in Asia* (OECD: Paris, 1999), p. 37.

Solvency Regulation

The Insurance Act of 1996 covers the establishment of insurance funds and empowers Bank Negara Malaysia to prescribe solvency requirements. According to BNM requirements, licensed insurers and reinsurers in Malaysia must maintain an insurance fund for each class of insurance business they write. Thus an insurer underwriting substantial risks in both life and non-life classes must maintain segregated life insurance and non-life insurance funds, and cannot co-mingle its premiums, claims, and other expenses across the funds. Effective on January 1, 2001, a licensed direct insurer and reinsurer must maintain at all times a fund margin of solvency of RM50 million and RM10 million, respectively, for each class of business. For direct insurers, this solvency requirement is a substantial increase from the RM40 million that was required for the year 2000 and the RM30 million required previously.[19]

The Insurance Act of 1996 additionally prescribes that all licensed insurers maintain admitted assets of no less than the sum of the liabilities of the insurance fund and the fund margin of solvency.[20] However, the central bank issued in 1998 temporary measures that insurers would be allowed to maintain a minimum of 70% for financial year ending 1998, 80% for 1999, and 90% for 2000 of the required amount in the form of admitted assets and the remaining percentage being supported by other assets.

Financial and Accounting Regulation

Insurers operating in Malaysia are subject to several regulatory measures with respect to their investment activities and accounting standards. Among the measures is the *Bumiputra* investment recommendation that the Malaysian government made in its 1996-2000 National Development Plan. To abide by this recommendation, all insurers in Malaysia must maintain, unless a relief is granted, at least 30% of their investment in *Bumiputra* share, ownership share by ethnic Malay.[21] Additionally, licensed insurers must obtain prior approval from Bank Negara Malaysia for any changes in their ownership share. If, however, the change is regarding an acquisition or sale of an interest in excess of 5% of the shares of a licensed insurer, the insurer must obtain prior approval directly from the Ministry of Finance.

All life insurers in Malaysia must submit annually to BNM an actuarial certification of their liabilities prepared by an appointed actuary of the company. The central bank may require non-life insurers to submit an actuarial valuation of the company's IBNR claims and any inadequacy in loss reserving for outstanding claims.

Market Conduct Regulation

The Malaysian government has implemented a guaranty fund system to protect policyholders from financially troubled or insolvent insurers. Known as the Insurance Guarantee Scheme Fund, this fund provides some compensation—benefits for bodily injury only—to those policyholders and claimants who have a third party liability or workers' compensation-related claim with a

[19]These higher solvency requirements already resulted in total capitalization of insurers rising to RM 4 billion as of December 31, 1999. *1999 Insurance Annual Report,* Bank Negara Malaysia, 2000.

[20]Of this, at least 20% must be invested in securities, bills and certificates issued by the federal government.

[21]This recommendation does not apply to Malaysian reinsurance branches of foreign companies.

financially troubled insurer. All non-life insurers participate in the fund and pay a levy of not less than 1% of their direct premiums earned during the preceding financial year.

All insurance companies, including newly licensed ones, in Malaysia must be a member of an industry association. For example, all direct non-life insurers are members of the General Insurance Association of Malaysia (*Persatuan Insurans Am Malaysia*), and all life insurers are members of the Life Insurance Association of Malaysia (*Persatuan Insurans Hayat Malaysia*, formerly *Persatuan Insurans Nyawa Malaysia*). The General Insurance Association of Malaysia sets premium rates for fire and motor insurance businesses, and its member non-life insurers must abide by the tariff rates.

The 1996 Insurance Act and the Insurance Regulations of 1996 have provisions regarding pricing insurance products, insurer expenses, and premium rates. BNM also issued two guidelines on insurers' operating costs: one for non-life insurers in 1991 and another for life insurers in 1996.

All insurers must comply with the act when designing their insurance application forms, contracts, and marketing brochures.

Life insurers in Malaysia depend on independent agency systems, allowing an agent to represent multiple insurers. As a measure to contain agency commissions, BNM has set the maximum percentage of agency commissions on a life insurance policy (except term life policies with less than 20 years of coverage) to not more than 171% of the annual premiums payable over 10 years. For policies with a shorter duration, the maximum commissions payable are reduced on a pro rata basis. Commissions payable on yearly renewable term insurance and single premium mortgage term insurance are limited to 10% of the premium. Further, insurers must contain their agency-related expenses to 3.5% on the first RM5 million of first year aggregate premiums (excluding single premiums) and 2.25% on the balance of the first year premiums and 3% of the single premiums. Regarding management expenses (all expenses relative to insurance business other than claims and agency commissions), all life insurers must abide by the maximum allowed expenses of 28% of their first year premiums, 10% of their single premiums and 1-19% of their renewal premiums.

Non-life insurers operating in Malaysia are subject to a 10-25% ceiling of their gross direct premiums for their gross commissions and agency-related expenses. Regarding management expenses, non-life insurers are subject to a 15% limit of gross direct premiums, 7.5% of premiums for facultative reinsurance assumed, and 2.5% of premiums for treaty reinsurance assumed. The insurers may use any savings in commission costs to cover management expenses; however, the reverse is not permitted.

The Insurance Act of 1996 requires every insurer to obtain the central bank's prior approval for the appointment of a person as a director or chief executive. The act also makes the insurer be responsible for meeting the "fit and proper" person criteria of the act.

At the time of writing this paper, BNM was formulating a framework of corporate governance based on the Malaysian Code of Corporate Governance. This framework would establish basic principles for the insurance industry and include guidelines such as management accountability, corporate independence, internal control, operational risk management, public accountability, and financial and management reporting.[22]

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[22] Mohd Nasir Hasni, "Good Governance Guide for Insurance," *Star Online*, Malaysia (April 5, 2000).

Capital Requirements at Labuan Offshore Financial Center

	Minimum Capital	*Minimum Solvency Margin Requirements*
Non-life insurer	RM7.5 million	The greater of: RM7.5 million; or 20% of preceding year's net premium income
Life insurer		The greater of: RM7.5 million; or 3% of latest actuarial valuation
Composite insurer		The greater of: RM7.5 million; or Aggregate of 20% of net premium income of preceding year for non-life insurance and 3% of latest actuarial valuation for life insurance
Reinsurer	RM10 million	RM10 million
Captive insurer	RM300,000	RM300,000

Labuan Offshore Insurance Center

As a means to attract foreign capital, Malaysia created in October 1990 the Labuan International Offshore Financial Center (OIFC) in an island west of mainland Malaysia. Later in 1996, the government established the Labuan Offshore Financial Services Authority. For offshore insurance business in particular, it adopted the Offshore Insurance Act of 1990 permitting foreign entities to do offshore captive insurance, reinsurance and other insurance brokerage businesses in the island. By yearend 1997, the island hosted 64 offshore banks, 38 insurance and related companies, 21 trust companies as well as around 1,700 local and foreign non-financial firms.[23] This authority generated an income of RM7.5 million in 1997.

A foreign entity wishing to do offshore insurance business in the island may file an application to the Labuan Offshore Financial Services Authority and subsequently get approval from the Ministry of Finance. The applicant must meet the minimum capital requirement and, once admitted, minimum solvency margin requirements. These requirements are shown in the table above. Admitted offshore insurers and related firms in Labuan may have access to large and specialized Malaysian risks, including some limited access to liability risks, and offer investment/unit-linked investments products to wealthy Malaysians.

[23]Labuan Offshore Financial Services Authority, 1998.

Myanmar

Myanmar, formerly known as Burma, had about 100 insurance companies prior to its independence in 1948. Fewer insurers continued to operate in this economically underdeveloped country after its independence. Following the establishment of the Union Insurance Board in 1952, all private insurers eventually disappeared. This state-owned composite insurer, which was renamed later as Myanmar Insurance, had been the monopoly insurer in the country until another composite insurer, owned primarily by Myanmar Economic Corporation, was incorporated in 1997.[24]

The regulatory body of the Myanmar insurance industry is the Insurance Business Supervisory Board, formed in 1996. Not surprisingly, this body is with Myanmar Insurance and its members are drawn mainly from Myanmar Insurance, Central Bank of Myanmar, and other government authorities.

After the adoption of the Insurance Business Law of 1996 and the Insurance Business Rules of June 26, 1997, the government announced opening its insurance market to foreign investors. It later granted three foreign insurers—Yasuda Fire and Marine and Mitsui Fire and Marine from Japan, as well as Overseas Union Insurance from Singapore—permission to open a representative office. However, it has not yet granted operating licenses to any foreign entities, whether their applications were for joint venture, branch, or subsidiary.

According to the law, an applicant of insurance business must file an application to the Insurance Business Supervisory Board. Separately, it must obtain approval of its investment plan from the Myanmar Investment Commission before it can commence insurance operation. The regulator requires all insurers to maintain a capital of at least 20 million kyats for life insurance business and 200 million kyats for non-life insurance business.[25]

Myanmar currently does not have either solvency requirement guidelines or investment guidelines for the licensed insurers in the country. However, all insurers are required to use only the insurance application and policy forms approved by the Insurance Business Supervisory Board. Life insurers must also obtain prior approval from the board for any changes in life insurance surrender values, premium rates, and commission structures. Finally, insurers operating in Myanmar must establish a policyholders' protection fund to protect mainly owners of life insurance policies.

[24]In addition, Myanmar International Insurance Services Corporation provides insurance and reinsurance brokerage services in the country.

[25]An insurance brokerage firm is required to maintain a minimum capital of 300,000 kyats.

The Philippines

The Philippines emphasizes the role of the private sector in its economic development. The strong influence of the U.S. legal and economic systems reinforces the principles of free enterprise. The Philippine economy grew rapidly during the 1970s and was a model for other Asian countries. However, a long period of stagnation followed under the Marcos administration, and the Asian economic crisis of 1997 interrupted a renewed expansion. Recent political instability surrounding the removal of President Estrada casts a continuing shadow over the country's economic prospects.

The Insurance Commission (*Komisyon ng Seguro*) of the Philippines regulates and supervises the insurance industry in accordance with the Insurance Code. It also issues circulars and guidelines that govern insurer activities. Below is a list of selected circulars and guidelines in chronological order:

- *Department Order No. 115-93 and 116-93* – Requirements, rules, and regulations relative to the increase of paid-up capital of all insurers doing business in the Philippines;
- *Circular Letter No. 23-94* – Guidelines on investments placed by insurers that require or do not require prior approval of the Insurance Commission;
- *Insurance Memorandum Circular No. 1-96 and its addendum on December 27, 1996* – Revision of the limits of liability, schedule of indemnities and premium rates for the compulsory motor vehicle liability insurance policies; and
- *Department Order No. 49-96* – Maximum writing authority of any one risk for non-life insurers in relation to paid-up capital.

Licensing Regulation

The Department of Finance announced in 1994 a licensing guideline for foreign companies wishing to conduct insurance business in the Philippines. The chart on the next page summarizes the minimum paid-up capital and contributed surplus requirements stated in this guideline.

The Insurance Commission, upon receiving an application, examines the following factors before it makes a decision:

- geographic representation and complementation;
- strategic trade and investment relationships between the Philippines and the country of incorporation of the applicant;
- demonstrated capacity, global reputation in underwriting innovations, and stability in a competitive environment of the applicant;
- reciprocity rights that Philippine insurance or reinsurance companies or intermediaries can enjoy in the applicant's country; and
- the applicant's willingness to fully share its technology.

As per the third criterion, the commission has specified that it would accept applications from those listed in the top 200 insurers, reinsurers or intermediaries in the world or the top 10 in their country of origin. The applicant must also have at least 10 years of experience as of the date of application. To qualify as a branch or as a new company incorporated in the Philippines, the applicant must also be widely owned or publicly listed in its country of origin, unless it is majority-owned by the government. A new foreign insurer is not allowed to hold a composite license. It may, however, apply for separate licenses for life and for non-life business.

Minimum Paid-up Capital and Surplus Requirements in the Philippines

	Minimum paid-up capital is	Contributed surplus is
Direct insurers, if foreign ownership is:		
• less than 40%	P75 million	P25 million
• more than 40% but less than 60%	P150 million	P50 million
• more than 60%	P250 million	P50 million
Reinsurers: if foreign ownership is:		
• less than 40%	P150 million	
• more than 40% but less than 60%	P300 million	
• more than 60%	P500 million	

The Insurance Commission requires any foreign insurer or reinsurer seeking entry as a branch to deposit with the commission securities satisfactory to the commission. The required minimum paid-up capital, at actual market value, is 300 million pesos for a direct insurer and 500 million pesos for a reinsurer. Fifty percent of said security deposit must be in the form of government securities and the rest in other acceptable Philippine securities.

In the Philippines, direct insurers and reinsurers as well as insurance intermediaries may conduct insurance business in one of three ways. They may own voting stock of an existing domestic insurer, invest in a new insurance or reinsurance company or intermediary incorporated in the country, or establish a branch. The Insurance Commission does not allow a foreign intermediary to enter the market as a branch. The *Republic Act No. 8179*, which was passed on March 26, 1996, permits up to 100% foreign ownership of local insurance and reinsurance companies.

Solvency Regulation

All insurers operating in the Philippines must maintain the margin of solvency prescribed in the Insurance Code. For the life insurer, the total admitted assets must be greater than the sum of the total liabilities plus paid-up capital plus revaluation reserves. The life insurer must also meet the requirement that the difference be the greater of 500,000 pesos or 0.2% of the total amount of all policies (except term life insurance) for the preceding year.

In the case of a non-life insurer, the amount should be the greater of 500,000 pesos or 10% of the total amount of net premiums written during the preceding year. In the case of a foreign branch insurer or reinsurer, its head office must guarantee prompt payments of all liabilities of the Philippine branch.

Market Conduct Regulation

An insurer must obtain approval from the Insurance Commission before it commences

marketing an insurance product. In regard to pricing, life insurers are required to obtain approval from the commission of the premium rates for their insurance products. In contrast, the Philippines Insurance Rating Association recommends premium rates for non-life insurance tariff lines, notably motor insurance and surety bonds. All non-life insurers are a member of this association and must abide by the recommended premium rates. Insurers in the Philippines have since 1996 allowed to market insurance products where the premiums and benefits are expressed in foreign currencies.

As for management control matters, the existing regulatory measures in the Philippines state that non-Philippine nationals may become members of the board of directors of a joint venture insurance or reinsurance company to the extent of the foreign participation in the equity of such company.

Singapore

Singapore, an island state located south of Peninsular Malaysia, has been a regional center for commerce and trade since it was established as a trading station for the British East India Company in 1819. Now it is also a regional center for financial services. Its economy, albeit small, is based on a free enterprise system with few restrictions on foreign ownership or capital inflows and outflows. Not surprisingly, the insurance market in Singapore is very competitive, with about 50 players in each of the direct, reinsurance, and captive insurance markets.

The insurance business in Singapore began in the mid-19th century when branches of foreign insurers started to underwrite risks in Singapore and in Malaysia as well. Locally incorporated insurers evolved early in the 20th century. Until the 1960s, the market was loosely regulated. Small insurers with inadequate capital mushroomed, damaging the image of the industry. To eradicate those undercapitalized firms, mainly small life insurers, the government introduced the Life Insurance Companies (Compulsory Liquidation) Act in 1962. The Insurance Company Act of 1963 provided for a more comprehensive control and supervision of both life and non-life insurance business. Following independence in 1965, Singapore passed its own insurance act of 1966, which came into effect in the following year. Recently, it introduced the Insurance Intermediaries Act of 1999 to regulate the activities of insurance agents and brokers in life and non-life insurance businesses.[26]

[26]The government plans in the near future to standardize regulatory and supervisory measures governing activities of all intermediaries in the financial services industry, including the insurance, banking, and investment sectors.

The Insurance Department of the Monetary Authority of Singapore (MAS), Singapore's *de facto* central bank, is responsible for the regulation, supervision, and sound development of the insurance industry. The Insurance Act and the Insurance Regulations, both amended in 1999, empower the MAS to monitor insurer operations, in particular insurers' ability to meet their obligations to policyholders and claimants and their compliance with prudential standards. The department issues notices and directives to insurers and other players in the Singapore insurance market. It also maintains a close relationship with various insurance industry organizations to foster self-regulation.

Licensing Regulation

The door to the Singapore insurance market had been closed since the mid-1980s for direct non-life insurers, unless a new insurer had expertise in a specialized line of insurance that the incumbent insurers lacked, and since 1990 for direct life insurers. It was only in March 2000 that Singapore liberalized access to the direct insurance market and lifted its 49% restriction on foreign ownership of locally incorporated insurers. For reinsurers and captive insurers, the open admission policy remains.[27] Nevertheless, new applicants are subject to a needs test —commitment to Singapore's development as a regional insurance hub and international financial center.[28] This practice still falls short of full liberalization of the insurance market.

The Insurance Department has the power to grant licenses to qualified applicants wishing to do insurance business in Singapore. The MAS requires a minimum paid-up capital of S$25 million for applicants in direct insurance and reinsurance business.[29] The minimum paid-up capital applied to captive insurers is S$400,000.

The Insurance Department commonly gives a full license to a qualified applicant, which can then do business in all lines of life insurance or non-life insurance class, or both, depending on its licensing status. After the opening of the market in 2000, it also issues specialized licenses, allowing holders to operate in selected lines of insurance such as ocean marine insurance and financial guaranty insurance. The department may apply different initial minimum paid-up requirements to those specialized licensees. In Singapore all local and foreign insurance companies in each license class are treated equally and are subject to the same regulatory and supervisory process. The MAS regulates reinsurers in a similar, albeit not exactly the same, way that it does direct insurers.[30]

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[27]It has also adopted an open market entry policy for insurance brokers.

[28]The other criteria for entry of new direct insurers would be their (i) domestic and international rankings, (ii) present and past credit ratings, and (iii) track record and reputation with regard to compliance with regulations and the strength of internal control systems.

[29]This is an increase from S$5 million for direct insurers and S$10 million for reinsurers that was effective until October 1997. Those companies which were already licensed prior to the effective date were given until January 2000 to meet the new capital requirement.

[30]The MAS places greater reliance on the financial soundness of the reinsurers on a global basis and therefore some requirements, for example fund solvency margins, placed on reinsurers are slightly lower.

Solvency Regulation

The existing solvency margin requirement in Singapore is based primarily on the size of insurance business and liability reserves. The Insurance Department plans to introduce in 2001 more comprehensive risk-based solvency requirement models: one for life insurers and the other for non-life insurers. These new measures are expected to reflect differences in not only insurance business risk and reserve risk but also asset and pricing risks among all licensed insurers in each class of insurance. As the final framework of the models is yet known, the discussion in this paper is about the existing solvency margin requirements to which all insurers in direct, reinsurance, and captive insurance business are subject.

The solvency margin requirement comprises two requisites: the fund margin of solvency and the company margin of solvency.

First, the Insurance Act requires insurers to set up and maintain a separate insurance fund for each class of insurance business, which is further segmented into the Singapore Insurance Fund (SIF) for domestic businesses and the Offshore Insurance Fund (OIF) for offshore businesses. In managing these funds, the insurers must make sure that all transactions of premiums, expenses and liabilities of one class of insurance business are recorded in the fund related to the business. For example, a non-life insurer must record all such transactions for risks situated in Singapore in its Singapore Insurance Fund (SIF). Insurers are then subject to the following fund margin requirements:

- A direct life insurer must maintain its SIF margin of solvency not less than the higher of S$5 million or the amount calculated based on a formula that takes into account each insurer's actuarial liabilities, the sum insured at risks as well as net premiums from accident and health policies. In order to meet the OIF margin of solvency, the insurer must maintain its assets not be less than its liabilities.
- A direct non-life insurer must maintain its SIF margin of solvency so that it is the highest of S$5 million, 50% of net premiums in the preceding accounting period, or 50% of loss reserves at the end of the preceding accounting period. To meet the OIF margin of solvency, the insurers must maintain the highest of S$1 million, 20% of net premiums in preceding accounting period, or 20% of loss reserves at end of the preceding accounting period.
- A life reinsurer or a captive life insurer must maintain its assets not less than its liabilities of the fund in order to meet its fund margin of solvency. This applies to both SIF and OIF.
- In the case of a non-life reinsurer or captive non-life insurer, the SIF margin of solvency is the highest of S$1 million for a reinsurer (S$400,000 for captive insurer), 20% of net premiums in the preceding accounting period, or 20% of loss reserves at end of the preceding accounting period. It must also maintain its assets not less than its liabilities of the fund to meet the OIF margin of solvency.

The second requisite is meeting the company margin of solvency. To comply with this requirement, all insurers other than captive insurers doing business in one class of insurance must maintain S$5 million. In the case of composite insurers, the margin is doubled to S$10 million. Captive insurers are subject to a company fund margin of S$400,000.

Financial and Accounting Regulation

The Insurance Regulations of 1999 lay out statutory accounting principles for insurance companies.[31] In particular, they require direct non-life insurers to use at least a 1/24th method for the valuation of unearned premium reserves.[32] For their direct business in cargo insurance, however, they may maintain a reserve of not less than 25% of the related premiums. In the case of non-life reinsurance business, the reinsurer must maintain an amount not less than 25% of the premiums of marine and aviation policies, or 40% of the premiums in other policies. Non-life insurers must estimate their claims liabilities based on their claims statistics. The Insurance Department does not allow them any discounting of their loss reserves and may soon require them to have their estimates certified by a qualified professional.

Direct life insurers are subject to the statutory minimum valuation basis for computing their actuarial reserves. The statutory basis is a net premium valuation assuming 4% interest and mortality rates according to the Commissioner's Valuation Table 92 for life business. For annuities, insurers may assume 5% interest rate and mortality rates of Table a(90) rated down 2 years.

The Insurance Regulations prescribe investment limits of the SIF by asset type and exposure. For example, the current limit is 45% for equities, 30% for overseas assets and 25% for real properties. Insurers may invest beyond the prescribed limits, but part or whole of the assets in excess of the maximum limits will not be admitted for the purposes of meeting the fund margin of solvency. There is no specific investment requirement for offshore business, but insurers are expected to exercise prudence in their investments. The existing guidelines are expected to be revised once risk-based solvency requirement models are introduced.

Market Conduct Regulation

The Insurance Department requires that direct insurers have suitable reinsurance arrangements at all times and that the reinsurers be of good security. If their reinsurance arrangement has been or is likely to be rendered inadequate or ineffective, they are required to inform the MAS immediately. The department checks soundness of insurers' retention limits and reinsurance securities. It issued in August 1999 a MAS notice on financial reinsurance that governs the scope of financial reinsurance transactions that licensed direct insurers in Singapore may engage in.

Insurers operating in Singapore must obtain approval of their principal officers and directors from the Insurance Department. In cases of life insurers, they must also seek approval for the appointment of the appointed actuary, who will be responsible for certifying the adequacy of premium rates and reserves of the life insurer as well as submitting reports to the MAS on the financial condition of the insurer.

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[31] In areas where the regulations are silent, insurers may use a generally accepted accounting principle.

[32] The premium base used is basically net of reinsurance or retrocession premiums ceded to or assumed from outside Singapore. When the 1/24th method or another more accurate method is used, the premium base may be reduced by the actual commissions payable, up to a maximum of 20% of premiums, or commissions at an assumed rate of 20% of premiums.

Thailand

Thailand is a constitutional monarchy heavily populated with Buddhists. Its pro-market government promotes economic development and invites foreign investors to the country. Thailand is also known as the country that triggered the Asian economic crisis of 1997. One of the outcomes of the crisis was closure of 11 insurers, including two life insurers, which had failed to meet the required liquidity standards in 1997.[33]

The Thai government continues to revive and reform its economy. In particular, to discourage financial institutions from continuing to practice poor management, including rendering loans and credits to risky businesses without proper collateral or arbitrarily to their related firms, the government revised the Commercial, Bank, Financial and Credit Foncier Businesses Act—better known as the Financial Institutions Act. Implemented in October 2000, this act is expected to make financial dealings more transparent and permit subsidiaries of financial institutions to engage only in financial services business.[34] The government also plans to set up the Retirement Mutual Fund (RMF), to which working individuals can contribute part of their earnings with some tax privileges.

The Life Insurance and Non-life Insurance Acts of 1992 empower the Department of Insurance of the Ministry of Commerce to be the regulator and supervisor of the insurance industry. To be specific, the ministry is responsible for broad policy matters, including licensing and setting investment policies, and the department administers other less strategic matters.[35] In October 2002 the Insurance Department will be separated from the Ministry of Commerce and become an autonomous agency free from government intervention. The Thai government's regulatory philosophy emphasizes stable growth and security of the insurance industry, regulating and supervising the performance of insurers to make them efficient and reliable risk-taking financial institutions, and protecting the interest of the policyholders and the general public.

Access to the Thai insurance market was blocked for decades until the government adopted in the late 1990s a three-stage development plan for the industry. As a result, as of January 2000, there were 100 insurance companies operating in the country—20 in life insurance, 68 in non-life insurance, 5 in both life and non-life insurance, 6 in health

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[33]The Department of Insurance decided not to make public the list of the failed insurers. According to speculation, one factor in the failure of non-life insurers was a sharp decline in car sales, a 75% reduction from the previous year. Motor insurance is the main non-life business line in Thailand, and banks and other financial institutions, which extend loans to motor buyers, control the distribution for motor insurance. Obviously, many of those closed finance companies owed a huge amount of funds to related non-life insurers. Brian Lawrence, "Developments in Motor Insurance in Thailand," *The Fourth Annual Conference Proceedings of the Asia-Pacific Risk and Insurance Association*, July 16-19, 2000, Perth, Australia. Another factor was the collapse of the stock market as a result of 1997 Asian economic crisis.

[34]Suvicha Pouaree, "To catch a Corporate Cheat," *Bangkok Post* (August 6, 2000), p. 1.

[35]Thailand adopted the Protection for Motor Vehicle Accident Victims Act in 1992 to make purchase of motor insurance coverage compulsory to motorists.

insurance, and one in reinsurance.[36] Of the 100 companies, five are branches of foreign life insurers and four are of foreign non-life insurers.[37] Insurance business in Thailand is relatively liberal as national treatment is generally observed.

Insurance companies will soon be subject to more stringent regulatory requirements. The Department of Insurance is reviewing loss reserve requirements that take incurred but not reported (IBNR) losses into account. Further, the government authority is reviewing its investment guidelines to allow insurance companies to engage in more flexible and wide ranges of investment activities. Also being reviewed are motor insurance premium rating plans and the construction of separate mortality tables for males and females. The department encourages insurance companies to be more responsible for their intra-company activities via corporate governance and for their inter-company activities via self-regulatory bodies such as the Thai Life Insurance Association and the General Insurance Association.

Licensing Regulation

The Thai government is liberalizing its insurance market in three phases. In the first phase, the government amended its 1992 life and non-life insurance acts, permitting new domestic insurers to form a joint venture with up to 25% foreign ownership. This resulted in licensing 28 new firms, 16 of which were in non-life business, by year-end 1998.[38] The Department is now planning to allow foreign equity participation up to 49% once the existing insurance laws have been amended. After another five years from the date the new laws take effect, the foreign ownership restriction will be eliminated. Newly licensed life and non-life insurers are now required to raise a minimum paid-up capital of 500 million baht and 300 million baht, respectively.

Solvency Regulation

All insurers operating in Thailand must maintain a prescribed solvency margin. Life insurers must maintain a capital fund of not less than 4% of the insurance reserve or not less than 500 million baht, whichever is greater. However, the government has placed an interim measure that allows them to meet within three years a capital fund of not less than 300 million baht and then increase the fund to Thai 500 million baht within five years from the date of implementation of this new capital requirement.

In the case of non-life insurance companies, the department requires them to maintain a capital fund of not less than 20% of net premiums written in the previous year. Non-life insurers are also given a relief that they meet only 200 million baht within the first three years and 300 million baht within five years from the date of implementation of this new capital requirement. The Insurance Department may impose additional requirements on Thai branches of foreign insurers.

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[36]Those insurers doing business in both life and non-life classes were asked to split into separate companies by April 2000.

[37]Insurance companies in Thailand have over 1,700 branches in aggregate across the country, and depend primarily on agency distribution systems. As of January, there were approximately 15,000 life agents and 4,000 non-life agents and brokers.

[38]A number of these new companies are related to established business conglomerates, well-known families, and banks or other financial institutions.

Financial and Accounting Regulation

The Thai government believes that the success of supervision of insurance companies depends on the success in monitoring their investments, which can be achieved by regulating the amount and the quality of investment.[39] In line with this philosophy, the Ministry of Commerce introduced in 1993 a guideline that basically requires insurers to invest within Thailand. Insurers may invest outside Thailand in shares and debentures of reinsurance companies incorporated under ASEAN or Economic and Social Commission for Asia and Pacific (ESCAP) agreements. For other investments outside the country, insurers must obtain approval from the authority.

Market Conduct Regulation

Several regulatory and supervisory measures regarding insurer operation have been in place in Thailand. First, the government banned in 1999 insurers from simultaneously operating life and non-life insurance businesses. All five then composite insurers were asked to split their life insurance business from non-life business by April 2000.

Second, non-life insurers have long been subject to tariff rates for their motor insurance business. The Thai government introduced in 2000 a new tariff rating structure which is based on a wider range of risk categories than the previous one.[40] Fire insurance premiums are also subject to tariff rates.

Third, all direct insurers entered into gentleman's agreement to cede on a quota share basis at least 5% of their assumed risks —based on premiums—in fire, marine, transportation, and miscellaneous insurance to Thai Reinsurance Public Company. Besides, they must abide by the current regulation that they maintain a proper reinsurance arrangement if the aggregate fire risk they have assumed in a geographical zone exceeds 10% of the solvency margin, or the total risk in their motor business portfolio exceeds 10% of the solvency margin, or the risk of any individual policy exceeds 10% of its surplus.

The Insurance Department is revising its fire insurance retention guidelines. Under the new guidelines, non-life insurers would be required to retain fully fire risks up to Thai 5 million baht per policy or cede part of the risks only to local reinsurers. For fire risks up to Thai 30 million baht, they would be asked to retain up to their retention capacity.[41]

Other key guidelines imposed by the department include obtaining approval of insurance policy application forms and policy documents, appointment of individuals to the board of directors, and appointment and remuneration of intermediaries.

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[39] Potjanee Thanavaranit, "The Thai Insurance Market and Supervision," in *Insurance Regulation and Supervision in Asia* (OECD: Paris, 1999), pp. 181-86.

[40] Brian Lawrence, "Developments in Motor Insurance in Thailand," *The Fourth Annual Conference Proceedings of the Asia-Pacific Risk and Insurance Association*, July 16-19, 2000, Perth, Australia.

[41] Thanavaranit, "The Thai Insurance Market and Supervision," pp. 181-86.

Vietnam

Following the global trend of deregulation and liberalization, socialist Vietnam implemented in 1989 the *doi moi* (renovation) plan to transform the economy to a market-oriented one. Its economy has grown rapidly, especially after the mid-1990s, and the country has attracted several foreign financial entities to its local market. The country must still overcome significant obstacles to develop the economy further. Those obstacles include weak economic structure, low production efficiency, low labor force skills, and an incomplete legal system.

As a part of the *doi moi* plan, the Vietnamese government ended its decade long monopoly operation of the state-owned Baoviet and invited four foreign insurers to open a representative office in the country.[42] Those insurers, hoping to operate in Vietnam soon, assisted the national insurer to develop its manpower and underwriting skills, commented on drafts of an insurance law, agreed to deposit up to US$1 million with the government to cover any future claims disputes arising out of their eventual insurance business, and submitted their commission rates and products to the government authority.[43] However, the government postponed licensing those invited foreign firms to give Baoviet a head start. Additionally, the government established two more wholly state-owned insurers, namely, the Ho Chi Minh Insurance Company (Baominh) and the Petro Vietnam Insurance Company (PVIC). It also created three partially state-owned local insurance companies.[44]

The government finally granted licenses to two of those foreign insurers in 1999 and the remaining two in 2000.[45] It also set up a national reinsurer, the Vietnam National Reinsurance Company, and granted licenses to two joint ventures, each having a state-owned insurer as a partner, to underwrite non-life risks. At present, 16 insurers operate in Vietnam and approximately another 30 foreign insurers have a representative office in Vietnam. The Ministry of Finance is responsible for regulating the insurance industry, issues licenses to new insurance companies and brokers, and deals with other matters related to insurance business and insurer operations.[46]

Until recently, the insurance industry was subject to numerous circulars, decisions, and decrees issued by the Ministry of Finance as well as other government agencies. For example, the *Government Decree No. 100/CP* issued in 1993 prescribed rules governing the activities of insurers and insurance

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[42]Baoviet was initially created as a non-life insurer. It commenced life insurance business in 1996. This national insurer still dominates the market and generates about 2/3 of the total premiums in Vietnam.

[43]Margot Cohen, "Foreign Cover," *Far Eastern Economic Review* (August 3, 2000), pp. 46-47.

[44]Quang Binh Le, "Vietnam's Newly Developing Insurance Market," in *Insurance Regulation and Supervision in Asia* (OECD: Paris, 1999), pp. 187-92.

[45]They are Chinfon-Manulife (established in 1999 by Chinfon Global of Taiwan and Manulife of Canada), Prudential (1999), Bao Minh CMG (2000 by Vietnam's second largest insurer and the Colonial Group of Australia) and AIA Vietnam (2000).

[46]In addition, Vietnam National Reinsurance Company (VinaRe) gathers statistical data from the insurance market and makes them available to all local insurers. This national insurer also functions as a training center of the Vietnamese insurance industry.

intermediaries.[47] The Insurance Law approved by the National Assembly of Vietnam in December 2000 and enacted on April 1, 2001, supercedes the regulations issued over the past decade.

This new law is rather comprehensive and addresses fundamental aspects of prudent regulation and supervision. However, it states clearly that the government will compete with the private sector in providing insurance coverage and that direct insurers are subject to compulsory reinsurance cession. The insurance law does not apply to social security, health insurance, deposit insurance, and other types of insurance that are provided by the state and are of non-commercial nature. The Insurance Law of 2000 defines the following lines of compulsory insurance: motor owner's civil liability insurance, air carrier's civil liability insurance to passengers, professional indemnity insurance against risks arising from providing legal services, professional indemnity insurance for insurance brokers, and fire and explosion insurance.

Licensing Regulation

An entity wishing to do insurance business may apply to the Ministry of Finance for a license.[48] At the time of application, the entity must pay a 50% of the certificate fee of Vietnam 10 million dong or 0.2% of its initial capital, whichever is greater, to the ministry. The remaining 50% must be paid when the certificate is issued. Other documents, such as a five-year business plan, are also required.

A new insurance company, as well as a brokerage firm, may be formed as a mutual company, a joint stock insurer, a joint venture insurer, or a wholly-owned subsidiary. Insurers are not allowed to operate concurrently in both life and non-life classes. An exception exists when a life insurer offers health and personal accident insurance as auxiliary products of its life products.

In the case of a foreign applicant, it must additionally submit evidence of its licensing status and financial soundness in insurance operation in the country of domicile. The insurance law no longer requires a foreign applicant to apply to the Ministry of Planning and Investment for an investment license. Upon receiving a license application from a foreign insurer or brokerage firm, the ministry examines the mode of incorporation —whether the application is for a joint venture with a Vietnamese company or a wholly-owned subsidiary of a foreign insurer —and the size as well as reputation of the applicant company. It also examines whether the applicant maintains a representative office in Vietnam at the time of application, whether

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[47]Other previously issued government procurements include *Circular 73 TAT/LB* (November 1992)–Establishment and operation of representative offices of foreign insurers in Vietnam; *Circular 45/TC/CDTC* (December 1993, Ministry of Finance)–Financial management of insurance business; *Circular 05 TC/TCNH* (January 1996, Ministry of Finance)–Insurance commission rates; *Decision No. 1296 TC/QD/CDKT* (December 1996)–Implementation of accounting system for insurance enterprises; *Decision No. 60 TC/QD/TCNH* (January 1997)–Compulsory reinsurance; *Circular 26 TT/BTC* (March 1998, Ministry of Finance)–Certificate of sufficiency of criteria and conditions to engage in insurance business; *Circular 27 TT/BTC* (March 1998, Ministry of Finance)–Insurance development activities and management of insurance premiums; and *Circular 174/TT/BTC* (December 1998, Ministry of Finance)–Application of value added tax and corporate income tax for the insurance industry.

[48]The license is also known as a "certificate of sufficiency of criteria and conditions to engage in insurance business."

the clients of the applicant are large investors in Vietnam, and how much the applicant's country of domicile has invested in Vietnam.

The minimum paid-up capital required for non-life insurers is VDN70 billion for Vietnamese entities or US$5 million for foreign firms. For life insurers the minimum required is VDN140 billion for Vietnamese insurers or US$10 million for foreign-owned insurers. In the case of brokerage firms, the minimum capital required is VND4 billion for Vietnamese firms and US$300,000 for branches or subsidiaries of foreign insurance brokerage firms.

Solvency Regulation

The Ministry of Finance requires all insurers in Vietnam to make a security deposit with a licensed bank in Vietnam. The amount required is 5 percent of the required capital.

All insurers in Vietnam must also maintain assets in excess of liabilities by an amount of no less than the sum of the paid-up capital, compulsory reserve funds, and retained profits.[49] In addition, they must meet the following requirement:

- for non-life insurers, 20% of the total premiums for the risks they retained from the previous financial year;
- for life insurers, 0.1% of the aggregate coverage (sum assured) of all policies in force during the previous financial year; or
- for composite insurers, the aggregate of the above two requirements.

The pending implementing regulations state new solvency requirements for life insurers. Policies with terms of 10 years or less will require a solvency margin of 4 percent of technical provisions plus 0.1 percent of the net amount at risk. For policies with longer terms, the required margin will be 4 percent of technical provisions plus 0.3 percent of the net amount at risk.

Market Conduct Regulation

Vietnam imposes several restrictions regarding insurer operation and market conduct. For example, insurers may not open more than one branch in a city. Non-life insurers are subject to compulsory session —presumably 20% of their assumed risks on a quota share basis—to the Vietnamese National Reinsurance Company. The Ministry of Finance plans to phase out this cession requirement over the next five years.

In the case of foreign insurers, they are committed to investing all premium revenue in Vietnam and must contend with public doubts over the stability of Vietnam's official currency. Wholly foreign-owned insurers may remit overseas their retained profits after meeting all reserve requirements. Foreign parties of joint venture insurance companies may also remit overseas the amount of distributed profits after meeting all reserve requirements.

The financial year of insurance companies, including brokerage firms, must coincide with the calendar year. After the end of each financial year, all insurers must submit their financial statements to the Ministry of Finance and make public those financial statements. Finally, insurance agents can be licensed by an insurance company or an insurance industry association. The law is silent regarding the licensing examination for insurance agents.

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[49]Insurers and insurance brokerage firms must deduct 5% from the net profits annually to be deposited into a compulsory reserve fund until the balance of the fund reaches 10% of the entity's capital.

Regulatory and Supervisory Structures

Although there are some common elements, the insurance regulatory and supervisory approaches found in ASEAN countries vary considerably. In Brunei, Cambodia, Indonesia, Laos, and Vietnam, the finance ministry directly or indirectly —commonly through its insurance department—administers the insurance law or equivalent. It is the commerce ministry in Thailand that plays such a role currently, whereas the central bank is the regulator and supervisor in Malaysia and Singapore. In Myanmar and the Philippines, the insurance department, as an independent government agency, carries out the duty. In Myanmar, however, this regulatory body is not clearly separated from Myanmar Insurance, a state-owned insurer.

For ASEAN free trade in services to function smoothly, some harmonization of these regulatory structures will be required. The key issues are market access regulation, investment regulation, and solvency regulation.

Market Access Regulation

The fact that insurance regulators in most Southeast Asian countries are an integral part of the government implies strong government interest in the insurance industry. Indeed, it is often the government, particularly its ministry, that sets key policies regarding licensing and ownership structure, pricing, product design, investment activities, and reinsurance cessions in the insurance industry. Concurrently, the insurance regulator issues directives or notices to give specific guidelines, arrange dialogs with selected insurance industry associations, to which insurers in the country must be members, or exercise moral suasion to direct insurer operations. In Brunei, Malaysia, and Singapore, the government signals the need for or leads mergers and acquisitions among insurers.

ASEAN governments, especially those of economically developing countries, view insurance premiums a vital source of capital for building and strengthening their economies. As such, they encourage individuals to purchase not only protection-oriented insurance products but also other insurance products with a strong savings element. Savings-oriented insurance policies also supplement the country's weak social security system.

Relatively strong protection of the local insurance industry is also common in many Southeast Asian countries. State-owned insurers were the sole suppliers of insurance coverage in Cambodia, Laos, and Myanmar until recently.

In less extreme cases, economic needs tests restrict access to the domestic insurance market to the local private sector or only to selected foreign insurers. Other protectionist measures still found in the region include requiring a higher paid-up capital for foreign insurers than for local insurers (Indonesia and Vietnam), limiting the foreign ownership share of local insurance companies (Malaysia and Thailand), and imposing a compulsory cession (Indonesia, Malaysia, and Vietnam)—or asking for gentlemen's agreement for cession (Thailand)—to the national reinsurer.

Such protectionism, on one hand, might protect the local industry during its infancy and give local insurers time to build up their financial capacity and expertise in insurance business. On the other, prolonged protection of the local insurance industry, with a possible

exception of using the approach truly to protect policyholders' interests as those found in social insurance, could distort the market from operating efficiently and delay the development of a sound insurance industry led by insurers equipped not only with expertise in insurance pricing, marketing, underwriting, and claims handling, but also with financial capacity to underwrite large risks and compete in the regional and international markets. In fact, Indonesia, which requires local applicants of insurance business to raise as little as 20% of the capital that foreign-local joint-venture applicants must meet, has seen its local market served by a large number of small insurers that are weakly capitalized and less competitive in underwriting large risks.

Insurance Associations in Southeast Asia

Country	Associations
Brunei	Insurance Association of Brunei Darussalam (for all insurers except for takaful and life insurers)
Indonesia	Society of Actuaries Indonesia (*Persatuan Aktuaris Indonesia*) Insurance Council of Indonesia (*Dewan Asuransi Indonesia*) Indonesian Insurance Brokers Association (*Asosiasi Broker Asuransi Indonesia*)
Malaysia	Actuarial Society of Malaysia (*Persatuan Aktuari Malaysia*) National Insurance Association of Malaysia (*Persatuan Insuran Kebangsaan Malaysia*) General Insurance Association of Malaysia (*Persatuan Insuran Am Malaysia*) Life Insurance Association of Malaysia (*Persatuan Insurans Hayat Malaysia* – formerly, *Persatuan Insurans Nyawa Malaysia*) Insurance Brokers Association of Malaysia (*Persatuan Broker Insurans Malaysia*) National Association of Malaysian Life Insurance Agents Fire Protection Association Malaysia Bhd. Motor Insurers' Bureau of West Malaysia Association of Malaysian Loss Adjusters (*Persatuan Penyelaras Kerugian Malaysia*)
Philippines	Philippine Life Insurance Association ISAP Inc. (formerly Insurance and Surety Association of the Philippines) PIRA Inc. (formerly Philippine Insurance Rating Association) Philippine Insurers Club Reinsurance Exchange Club of the Philippines 8 other associations
Singapore	Singapore Actuarial Society General Insurance Association of Singapore Life Insurance Association of Singapore Singapore Reinsurers' Association Singapore Insurance Brokers' Association Life Underwriters Association of Singapore Reinsurance Brokers' Association
Thailand	General Insurance Association Thai Life Assurance Association Underwriters Association of Thailand Thai Insurance Brokers Association
Vietnam	To be created

Except for Cambodia, which still maintains a state monopoly in the insurance market, all ASEAN countries have opened the insurance industry, at least the direct insurance sector, to private firms. Countries with traditionally private-sector-led markets have also expanded access to the local insurance market. They expect that when the industry is capable of self-regulation, the regulator will function more as a supervisor than a regulator. In line with this philosophy, the Philippines admitted 11 new insurers in 1997, Thailand licensed 28 new insurers by year-end 1998, and Singapore announced in 1999 a near-full market liberalization plan. Vietnam has just started to admit local and foreign insurers. The chart below shows the estimated number of insurance companies currently operating in ASEAN countries.

There are several other indications that *ex ante* regulation prevails in Southeast Asia. Economically unjustified regulatory measures in a country can increase the cost of business, and it is primarily the country's policyholders that bear this increased cost of insurance. Conversely, as long as strong supervision is in place to encourage prudent operations and financial soundness of insurance players in an open, competitive market environment, market forces tend to lower the cost of insurance.

Licensed Insurers in Southeast Asia

	Life	Non-life	Composite	Reinsurance	
Brunei, *2001*	3	16	3	0	Only takaful insurers are composite About 70 more insurers registered, but inactive
Cambodia	- - - -	1	- - - -		4 insurance agents operate under Caminco
Indonesia, *1998*	62	107	0	4	Also 2 insurers for social insurance, 3 for civil servants; 178 brokers, adjusters, and consultants
Laos	0	1	0	0	
Malaysia, *1999*	7	40	11	10	Government directed consolidation in progress
Myanmar	0	0	2	0	
Philippines, *1997*	34	105	2	4	11 new insurers admitted in 1997
Singapore, *1998*	8	47	6	50	Also 52 captive insurers
Thailand, *1998*	20	68	5	1	Also 6 health insurers; composites must separate businesses by April 2000
Vietnam, *2000*	10	4	1	1	Life insurers are local; non-life are joint ventures Composite insurer and reinsurer are state-owned

As the table below shows, significant regulatory impediments to an open market still exist in the ASEAN region. Regulatory authorities in Indonesia, Malaysia, the Philippines, and Vietnam maintain tariff-rating systems for selected non-life lines of insurance such as motor and workers' compensation insurance. Although it is not confirmed, Myanmar might also have similar measures. Thailand requires non-life insurers to obtain prior approval for their premium rates, while Brunei, Laos, and Singapore do not have such a regulation.

Most governments in the region maintain additional guidelines regarding the contents in insurance application forms and wordings in insurance contracts. For example, Myanmar requires insurers to use government-approved forms, whereas Laos and Thailand ask insurers to obtain prior approval of such forms and contracts. Finally, with an exception of Brunei, all other countries in Southeast Asia seem to have stringent investment guidelines for insurers, which warrant close examination.

Summary of Insurance Regulation in ASEAN Countries

	Licensing Requirements			Required solvency margin	Regulation of:		
	Foreign ownership limits	Minimum capital	Economic needs test		Pricing	Forms	Investment
Brunei	●	●		●			
Cambodia	?	?	?	?	?	?	?
Indonesia	●	●		●	●	●	●
Laos		●	?	?		●	?
Malaysia	●	●	●	●	●	●	●
Myanmar		●	?		?	●	?
Philippines		○		●	●	●	○
Singapore		●	●	●			○
Thailand	●	●		●	●	●	●
Vietnam		●	●	●	●	●	●

○ = partial or varying requirement

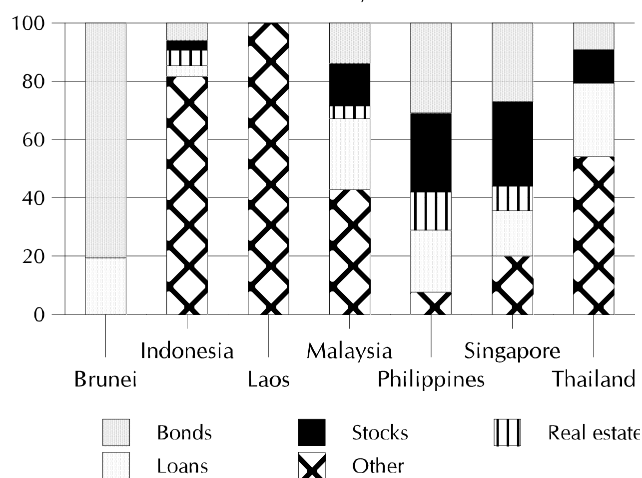
Investment Regulation

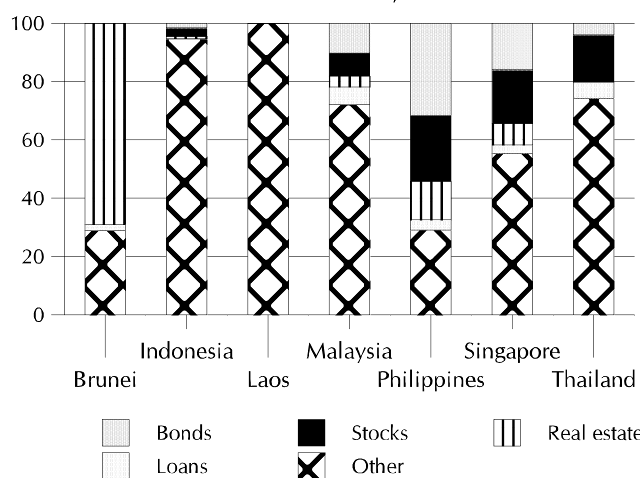
Regulators in the region commonly prescribe specific investments as well as the percentage of their assets that insurers are permitted to invest in each. Some countries require insurers to invest a certain percentage of their capital, including premiums, in government securities or designated sectors of the economy. In particular, the Malaysian regulator makes it compulsory, unless it has granted a relief, that insurers maintain at least 30% of their investment in *Bumiputra* shares. These stringent investment guidelines, especially when they limit insurers' investment to the local economy, may not only hinder insurers in the region from investing prudently consistent with their risk portfolios and business philosophy, but also affect the cost of insurance that their policyholders end up paying.

A few inferences can be drawn from the accompanying charts showing the composition of insurer investment portfolios in selected Southeast Asian countries. It appears that insurers in the region often do not have diversified investment portfolios. Insurers in Brunei, Indonesia, Laos, Malaysia, and Thailand hold most of their assets away from bonds and stocks and park them in other types of investments such as cash and time deposits. In Indonesia, for example, time deposits comprise 47.35% of total investments for life insurers, and 73.06% for non-life insurers.

These inefficient investments can take place when a country does not have a well-developed financial market or when insurers offer mainly simple insurance products that expose them to a limited amount of investment risk. In fact, the most popular insurance products in the region are term life, whole life, and endowment insurance policies,

Investment Portfolios





as well as fire and motor insurance policies.[50] A non-diversified investment portfolio, especially the one heavily skewed toward low-risk investment vehicles, could also be a result of a government's policy to safeguard policyholders' funds against volatile

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[50]Motor insurance is one of the dominating non-life insurance businesses in those countries which require motor vehicle owners to purchase compulsory third party motor liability coverage.

investment results of their insurers. Regulators in those countries may need to review the existing investment guidelines so that more diversified investment choices are available to insurers, while promoting development of new insurance products that respond to the growing needs of insurance protection by individuals and businesses. Otherwise, the local industry may become or remain less attractive both to the private sector and to foreign insurers.

Solvency Regulation

The table on the next page summarizes solvency and liability reserve requirements in the region. The solvency margin requirements of most ASEAN countries subject insurers to a solvency margin formula based primarily on their premiums—commonly earned premiums —as well as the difference between their assets and liabilities, subject to a minimum amount stipulated in the relevant law. Such formulas do not fully reflect differences among insurers operating in the same class. Individual insurers can have very different risk and investment portfolios and other insurance business-related risks. Thus these solvency margin formulas result in potentially inadequately assessed capital requirements for those insurers operating in volatile lines of insurance business.

To correct this problem, Indonesia, Malaysia, and Singapore have introduced or are in the process of introducing risk-based capital models in lieu of the existing solvency margin requirement guidelines. Well-articulated liability reserving methods should also exist for better measurement of insurer solvency. It appears that a number of governments in the region need to amend their laws regarding insurers' unearned premium reserves and loss reserves, including IBNR claims and loss adjustment expense reserves.

Solvency and Reserve Requirements

	Solvency requirements	*Reserve requirements*
Brunei	20% of previous year's net premium income	No regulation for life insurance For non-life insurance, unearned premium reserves on a pro rata basis and IBNRs on past experience
Cambodia	Not known	Not known
Indonesia	For life insurance, 1% of premium reserves For non-life insurance, initial minimum paid-up capital + 10% of premiums	Statutory accounting principle adopted and used for solvency margin analysis For life and non-life insurance, actuarial basis for unearned premium calculations
Laos	20% of actual premiums	Provisions regarding unearned premiums and outstanding claims exist
Malaysia	For life insurance, based on the actual valuation of liability, aggregate insurance coverage, etc. subject to a minimum amount For non-life insurance, based on premium income or incurred claims subject to a minimum amount	Statutory accounting principle adopted For life insurance, provisions related to the valuation of liabilities exist For non-life insurance, unearned premiums are based on a 1/24th method. For aviation and marine, the unearned premium is 25% of the net premium. IBNR estimation required.
Myanmar	Does not exist	For life insurance, liability estimation based on actuarial calculations For non-life insurance, no provision for unearned premium and IBNR loss reserves
Philippines	For life insurance, based on aggregate insurance coverage in force, subject to a minimum amount. For non-life insurance, 10% of net premium, subject to a minimum amount	Statutory accounting principle adopted and is complemented by GAAP No requirement for life insurance For non-life insurance, unearned premium reserve required of which reserve amount varies by line
Singapore	Fund solvency margin and company solvency margin currently exist. However, it is expected that existing requirements will be replaced with risk-based capital requirements	Statutory accounting principle adopted; when SAP is silent, GAAP is used. Reserve requirements related to unearned premiums, outstanding and IBNR claims exist for life and non-life insurance. However, requirements and valuation methods are to be revised.
Thailand	For life insurance, 2% of reserve fund subject to a minimum amount For non-life insurance, 10% net premiums received the previous year subject to a minimum amount	Statutory accounting principle adopted For life insurance, actuary's report on valuation of mathematical reserve For non-life insurance, unearned premium reserve based on a 1/24th method
Vietnam	Exist	Statutory accounting principle adopted For life insurance, liabilities valued on actuarial basis For non-life insurance, unearned premium estimated by the method approved by the regulator; IBNR on a statistical method

Conclusions and Recommendations

This examination of the current status of insurance regulation and supervision, along with the socio-economic structure, in Southeast Asian countries reveals that ASEAN countries are not only at different stages of economic development, but also show wide variations in their regulatory and supervisory approaches to the insurance industry. For example, access to the Cambodian insurance market is very restricted, while Singapore has recently adopted a policy offering much greater access to its insurance market. Singapore is also known for its transparency in regulatory measures, while little is known about the insurance industry in some countries of the region. Laos still does not have an insurance law and is served by a single state-owned insurer, while Vietnam has been successful in developing its insurance market nearly from scratch in a relatively short period. ASEAN countries also differ in their investment control, accounting standards, compulsory reinsurance requirements, corporate governance, and other market conduct regulations.

Still some similarities in regulatory and supervisory approaches do exist in these countries. Most governments in the region are deeply involved in regulating the insurance industry not only for the protection of policyholders' interests, but also for the healthier growth of the economy, the latter objective receiving more emphasis in economically developing countries than in others. Most Southeast Asian countries welcome foreign capital and expertise to further develop their insurance markets. Many ASEAN countries have re-opened, or are in the process of re-opening, their formerly nationalized insurance markets.

Nevertheless, the insurance industry in most countries in the region is far from full development. This underdevelopment is not limited to the insurance industry in those countries. It is an issue calling for presence of stronger infrastructure of the financial services industry and of the economy of the country. The comparatively low level of insurance consumption in Southeast Asian countries indicates a great potential for growth, especially when well-defined regulatory and supervisory guidelines are introduced, if they do not exist already. Thus it is important to consider the following requisites for the furtherance of the insurance industry in Southeast Asia.[51]

Well-defined Regulatory and Supervisory Guidelines

With an insurance law, the regulator can set the appropriate level of regulation, and the insurer can identify the scope of operation that best meets its stakeholders' interests. Through supplementary guidelines to the law, the regulator imposes specific regulatory measures, and the insurer can find ways to maximize its operating efficiency within the regulatory constraints.

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[51]The International Association of Insurance Supervisors also identified similar common problems facing insurance markets in emerging economies. Those identified problems are: lax management within insurance companies; weaknesses in the legislative framework; weak corporate governance; ineffective market discipline; and inadequate information flows due to a lack of transparency or undeveloped accounting systems.

Mere presence of a law or guideline is, however, necessary but not sufficient for the development of a financially sound insurance market. The law should be clear about market accessibility and the scope of insurer operations. It should encourage insurers to diversify their risk and investment portfolios while requiring insurers to abide by well-defined accounting standards. It should address the supervisory roles of the regulator, and encourage self-regulation among insurers. It should promote fair competition in the market. Lastly, the law should protect policyholders and claimants from insurer insolvency by requiring insurers to establish and maintain a policyholder protection fund mechanism.

Solid Economic Infrastructure

Insurers in several Southeast Asian countries are subject not only to stringent investment regulation, but also to limited choices of investment vehicles permitted or available. Some common reasons for the limited investment choices exist. Like the insurance industry, the banking industry is under strict government control. The majority of banks operating in Southeast Asia are weakly capitalized and lack expertise. Bond and securities markets are yet to develop. Capital movements into and out of the country are closely monitored. And, regulators tend to control reinsurance transactions, especially when direct insurers wish to cede parts of their risks to overseas reinsurers.

As a result, insurers in those countries have difficulty in diversifying their investment risks. They are less willing to offer new insurance products when they cannot closely relate the duration, risk, and investment return of their assets to those of matching liabilities from offering insurance products. Thus, presence of financially sound and strong capital markets is a requisite for the development and growth of the insurance industry. Otherwise, it might take long until insurers actively offer other sophisticated insurance products.

Human Resource and Expertise Development

There is a widespread shortage of qualified insurance professionals in most Southeast Asian countries. Only Thailand has universities offering degree programs in insurance and actuarial science, and a few more countries have training institutes for industry personnel (Malaysia, the Philippines, Singapore, and Thailand).[52]

Most Southeast Asian regulators acknowledge the urgency of having more qualified insurance professionals. According to the regulators in Vietnam, for example, business management, personnel qualifications, technology, and the reputations of insurers are still poor.[53]

As the insurance industry develops, it certainly needs more local expertise in insurance business. These needs could not be met effectively via skills-oriented training programs only. The insurance industry is undoubtedly in the need of well-educated

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[52]On the current status of collegiate insurance and actuarial science education as well as training institutes in Asia, see W. Jean Kwon, "Collegiate Insurance and Actuarial Science Education in Asia," *1999 American Risk and Insurance Association meeting*, August 10-12, 1999, Vancouver; and W. Jean Kwon, "Insurance Training Programs in Asia Insurance Industry," *The Third Annual Conference Proceedings of the Asia-Pacific Risk and Insurance Association*, July 19-21, 1999, Hong Kong.

[53]Le, "Vietnam's Newly Developing Insurance Market," pp. 191-92.

professionals specializing in insurance and actuarial science. The convergence of financial services industries also points out that such expertise should include other areas of financial services industry, such as banking and investment services. Fortunately, stronger interest in collegiate education in insurance and actuarial science is now observed in several Southeast Asian countries, although Singapore has recently abolished its only insurance program at the university level. For insurance personnel, several international organizations have initiated or plan to initiate training programs in the Asia-Pacific region. The Hanoi Plan of Action of 1998 mandated the establishment of ASEAN Insurance Training and Research Institute by 2003. The APEC Asian Studies Center in Australia has since 1999 offered two annual training programs in life insurance and pension. The IAIS and Singapore are about to embark a similar 5-year program in broader areas. A proposal for a training program for Asian insurance regulators was also accepted during the Asian Insurance Regulators' Meeting in 2000.

Deregulation and Liberalization of the Insurance Market

For further development of the insurance market, the regulatory authorities should consider deregulation of the market. The entire spectrum of insurance products need not be deregulated, as a perfectly competitive market could only be observed in theory. No countries, including OECD member countries, let the insurance market run free of any regulatory measures. However, the regulator must minimize, unless it can eliminate, any unnecessary constraints in the insurance market, while it closely monitors all the activities in the market, especially financial soundness of licensed insurers, for the development of a healthy insurance industry.

A deregulated and liberalized market environment in Southeast Asia may also pressure insurers to increase their efficiency and become more competitive, while such a competition does not necessarily lead to market distortion.[54] Insurers in a deregulated market would not focus their *modus operandi* on marketing a few, simple products that are already available from other insurers. They will develop their expertise in product design, pricing, underwriting, claims adjusting, and investment activities in order to gain a competitive edge. When the market is liberalized, even if not fully, foreign capital and expertise will flow in to the local market, generating more of the scale- and scope-economies of insurance operations for all the participants in the market.

Few local insurers in Southeast Asia currently operate outside the country or the region. This can be a result of those insurers being small in size or lacking expertise in handling specialized or non-traditional insurance risks. Once they have acquired more expertise in insurance operations, they will attempt to expand their scale and scope of business by entering the insurance market of other countries in the region.

Such expansion fits the broader objectives of ASEAN. The Hanoi Plan of Action, which ASEAN adopted in 1998, made several proposals for financial market reform. Those proposals include developing liquid financial markets, adopting standards of disclosure and dissemination of economic and financial

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[54]Thitivadee Boonyasai, "The Effect of Liberalization and Deregulation on Life Insurer Efficiency," *The Fourth Annual Conference Proceedings of the Asia-Pacific Risk and Insurance Association*, July 16-19, 2000, Perth, Australia.

information, intensifying deregulation of the financial services industry, and intensifying negotiations of financial sector liberalization under the ASEAN Framework Agreement on Services (AFAS). They also agreed to enhance the role of ASEAN Reinsurance Corporation as a vehicle to further promote regional cooperation in reinsurance business, accelerate the implementation of the ASEAN Free Trade Area (AFTA), and implement the framework agreement on the ASEAN Investment Area (AIA).[55]

The regulatory and supervisory environment in Southeast Asia has changed significantly over the past decade. More governments have adopted, or are seriously considering, an open insurance market system with less regulatory involvement. Many domestic insurers and other financial institutions in the region have become financially and managerially strong, owing in part to recent government initiatives and voluntary mergers and acquisitions among financial institutions. International insurers are showing a great interest in several Southeast Asian markets which are open or about to be open.

Southeast Asia can and will play a larger role in the world insurance market. There is another, and probably most important, regional issue that must be resolved. Recurrence of political threats along with economic instability in some Southeast Asian countries can create another crisis in the region and put insurers into insolvency. To avoid such a calamity, all insurers in Southeast Asia must enhance their expertise in insurance operations, spread their insurance risks more widely geographically and through reinsurance, strengthen their financial capacity, and diversify their investment portfolios. The regulators in the region must also keep their policies transparent, encourage healthy competition among insurers, and continue to monitor insurer operations to protect policyholders' interests.

[55]The fate of ASEAN Reinsurance Corporation, domiciled in Singapore, is currently unknown. It has not been used as an active regional reinsurance pool among member countries, and it is required to increase its capital substantially to meet the new guidelines that the Singapore government imposed in 1999.

Appendix: Islamic Socio-economic Principles and Takaful Insurance[56]

In Islam, all that happens in this world is by the will of Allah and all activities of Muslims must conform to the Quran, the Muslim Holy book. The Quran exhorts Muslims to accept all misfortunes as predestined but not to passively endure their fortunes. They must take necessary steps to minimize losses from unfortunate events. Muslims are also taught to abide by the Shariah—the code of social conduct that Islamic scholars built based on the Quran.

The Shariah classifies all matters into either *halal* (those permitted) or *haram* (those prohibited). For example, it permits *takaful* (meaning "joint venture" or "shared responsibility") and strongly encourages such practice among Muslims. It also permits *zakat*, which obliges the rich to help the destitute and weaker members of society. In contrast, the Shariah prohibits exploitation and risky investments because Muslim jurists generally view that these activities are *ghara* (contracts in which results are unknown, hidden, or speculative in nature)[57] and the market must be a place for exchange of products and services where all parties in each contract explicitly know the prices. *Riba* (charging predetermined interest) is also forbidden in Islam regardless of the purpose for which such a loan is made and the rates at which interest is charged. As a result, Islamic financial transactions are, at least in principle, interest-free.[58]

The application of *riba* principle does not mean that capital is costless.[59] Islam permits making a predetermined claim on the surplus from using capital for production. Hence, a profit-sharing arrangement where the profit-sharing ratio is predetermined, not the rate of return, is allowed in Islam. This arrangement can technically replace its Western counterpart interest rate and allow capital to flow into the arrangement that offers the highest profit-sharing ratio to investors, *ceteris peribus*. The Shariah also permits shareholding as Islam encourages movements of capital for the benefit of individuals and society as a whole.

Understanding the Islamic *mudaraba* and *musharaka* modes of financing is also important. Under the *mudaraba* principal, an owner of capital may let an entrepreneur use his or her capital within Islamic guidelines and share in the profits with the entrepreneur. Both the owner and the entrepreneur are free to determine the extent of their profit-sharing ratio. However, only the owner of the capital will be responsible for all losses as a related principle (*sharakah*) rules that losses are to be shared strictly in proportion to their capital contributions. The *musharaka* mode of financing, in contrast, refers to an agreement in which two or more partners use their capitals jointly for investment and share in both profits and losses in proportion to their capital contribution or any

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[56]The discussion in this section is drawn from Kwon and Maysami, "An Analysis of Islamic Takaful Insurance: A Cooperative Insurance Mechanism," *Journal of Insurance Regulation* (Winter 1999), pp. 109-32.

[57]Azman Ismail, "Insurance and Shari'ah: Part I," *The Call of Islam*, 19 (July-August 1997), pp. 22-23.

[58]Mahmud Ahmad, "Semantics of Theory of Interest," *Islamic Studies* (Rawalpindi), 6 (June 1967), pp. 171-96.

[59]Mohamed Ariff, "Islamic Banking," *Asia Pacific Economic Literature*, 2 (September 1988), pp. 46-62.

other ratio they have agreed. In practice, these two concepts can be applied to Islamic insurance such that an insured (acting as an owner of capital) enters into a *mudaraba* contract with an insurer (acting as an investor of the capital). The insurer may then enter into a *musharaka* reinsurance arrangement on a profit/loss-sharing basis.

Whether or not conventional (non-*takaful*) insurance concept is permitted is still debated. Strictly applying the Shariah, Muslim jurists argue that there is a prohibited element whenever a difference exists in time, quantity, or amount of exchange in a contract.[60] When a conventional insurance contract is created, neither the insurer nor the insured knows with certainty the outcome of *each* contract. In term life insurance, the insurer does not know, *ex ante*, the outcome of the insurance exchange because the total premiums paid by an insured varies according to the time of the death of that insured. In whole life insurance, the protection period is known only *ex post*.

They also argue that conventional insurers either loan their funds for interest income (*riba*) or invest the funds for uncertain returns (*ghara*). Conventional life insurance is also considered *haram* because life insurance pays for a loss of human life that cannot be valued.[61] Further, others (such as the Faisal Islamic Bank of Sudan) contend that conventional insurers, especially stock insurance companies, are in business to generate maximum profits not for their insureds but for their other stakeholders. For this purpose, conventional insurers would engage in investments where the level of risk is higher than the default risk assumed in the market. Muslim jurists claim that these types of activities even contain the element of gambling or *maisir*.[62]

Others Muslim jurists view conventional insurance differently. For example, the Council of the Academy of Canonists of Muslims World League elaborates that the original legal position on any matter is permitted until there is evidence that it should be prohibited. Insurance is then allowed because there is no specific injunction in the Shariah against it, and a mere presumption is insufficient to declare insurance as unlawful. They further suggest that insurance benefits society as it helps alleviate the losses of the unfortunate through pooling individual contributions, which is consistent with the Shariah. Accordingly, they view that insurance is accepted as long as it is intended for a good cause.

In conventional insurance, no new risk is created and, at least in theory, there is no gain for the insured from having insurance coverage. The principles of indemnity, subrogation, and utmost good faith in conventional insurance minimize the problems of moral hazard and clearly separate it from gambling. Nevertheless, due to the presence of uncertainty and other forbidden characteristics, Muslim jurists have not yet resolved their differences in opinions regarding conventional insurance.

Takaful insurance refers to an Islamic way of joint guarantee in which a group of societal members pool their financial resources together against certain loss exposures. In particular, *takaful* life insurance works both as a savings instrument where participants set their own target amount to

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[60]Azman Ismail, "Insurance and Shari'ah: Part I," pp. 22-23. "Insurance and Shari'ah: Part II," *The Call of Islam*, 23 (April-May 1998), p. 17.

[61]Kasi Md. Mortuza Ali, "Principles and Practices of Insurance under Islamic Framework," *Insurance Journal*, (December 1989), pp. 29-38.

[62]Ismail, "Insurance and Shari'ah: Part I," pp. 22-23.

accumulate over a certain period, and as a protection mechanism in which all participants guarantee each other against certain events that would alter their financial status. A typical *takaful* insurance policy has a defined period of maturity, and the insured pays level premiums regularly that will be used primarily for meeting his or her savings target and in part for assisting financially the bereaved families of decreased insureds.[63] The premium amounts vary from insured to insured depending primarily on the sum (face amount) that each insured targets to accumulate at the end of the coverage period and on the age, gender, and health condition of that insured. The insurer may set the minimum face amount for this purpose. It may also set minimum and maximum age limits for participating in this type of policy, accept standard risks only, and maintain separate classes of insureds of the same age but with different year of entry to the plan.

Takaful life insurance is also used for other purposes, including generating a fund for children's education, securing a fund in case of mortgagor's premature death, and protecting business interest against key-employee's death. Several *takaful* policies now come with hospitalization and disability benefit riders. In fact, there is a counterpart *takaful* life insurance policy for virtually each major type of conventional life insurance policy. The difference lies in how premiums are allocated.

Takaful non-life insurance works more like a joint guarantee in which all participants contribute their own shares of premiums into a pool and mutually agree to indemnify those participants who suffer from an insured peril. Muslim jurists generally agree that *takaful* insurance is in accord with the Shariah, as *halal* concepts of *tabarru* (meaning "donation" or "contribution") and *takaful* are deeply embedded in it. *Takaful* insurers offer coverages, commonly on an annual renewal basis, for fire insurance and allied lines, automobile insurance, liability insurance, marine insurance, workers' compensation, fidelity, and even crop insurance. As in *takaful* life insurance, the *mudaraba* mode of financing is employed in *takaful* non-life insurance. In other words, each insurer manages a *takaful* fund funded mainly by premium payments. The insurer acts as trustee, invests the fund in Islamic ways, and channels the investment income, less investment expenses, back to the fund. The insurer then settles all outstanding claims, deducts its operating expenses, and transfers part of the fund to relevant reserves. If there is any balance in the fund after all these adjustments, the balance will be shared by the insurer and its insureds in accordance with an agreed ratio basis, such as 50 percent each. This surplus is normally distributed on expiry of each insured's insurance policy. If, however, the sum of the premiums and investment income is insufficient to meet these adjustments, those affected insureds could be assessed for additional contributions. Accordingly, *takaful* non-life insurance resembles, albeit not exactly, assessable mutual insurance arrangements in the conventional insurance context.

For risk-sharing and pricing purposes, reinsurance transfers are commonly classified into proportional and non-proportional arrangements. In *takaful* reinsurance (also known as *retakaful*), non-proportional arrangements such as excess of loss or stop-loss arrangements may not be suitable because there exists uncertainty with respect to the assessment of losses in those arrangements, whereas Islamic principles demand clearly defined joint responsibility throughout the coverage period. Hence, *takaful* reinsurance is likely to be arranged on a pro-rata basis—quota share or surplus

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[63]The beneficiaries, in turn, must not seek any gains from the insurance compensation or indulge in any activities which can be detrimental to the interests of existing insureds. Kasi Md. Mortuza Ali, "Principles and Practices of Insurance under Islamic Framework," pp. 29-38.

share reinsurance—where the reinsurer becomes technically a coinsurer of the original risks. If, however, a non-proportional reinsurance arrangement is selected, it could be based on a strict profit commission plan or on a reciprocal basis. In this regard, it matters little whether the reinsurance transfer is on a facultative or treaty basis.

With the increase in complexity and variety of products, *takaful* insurance has become popular among Muslims in many countries. The world's pioneer *takaful* insurer, the Islamic Insurance Company of Sudan, established in 1979, was followed by Islamic Insurance Company of Saudi Arabia in the same year. *Takaful* insurance is popular in Asian countries with a sizable Muslim population. For example, Syarikat Takaful Malaysia was established by Islamic Bank of Malaysia in 1984. This was followed by the establishment of Takaful IBB Berhad and Takaful Taib Serndirian in Brunei in 1993, PT Syarikat Takaful Keluarga (life) and PT Syarikat Takaful (non-life) in Indonesia both in 1994, and Syarikat Takaful Singapore in 1995. *Takaful* insurance began to operate in Switzerland and Belgium as early as in 1983 and now exists in many countries of Europe and North America as well as Asia and Africa.

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