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Breaking Boundaries in New Markets: A Risk Management Perspective

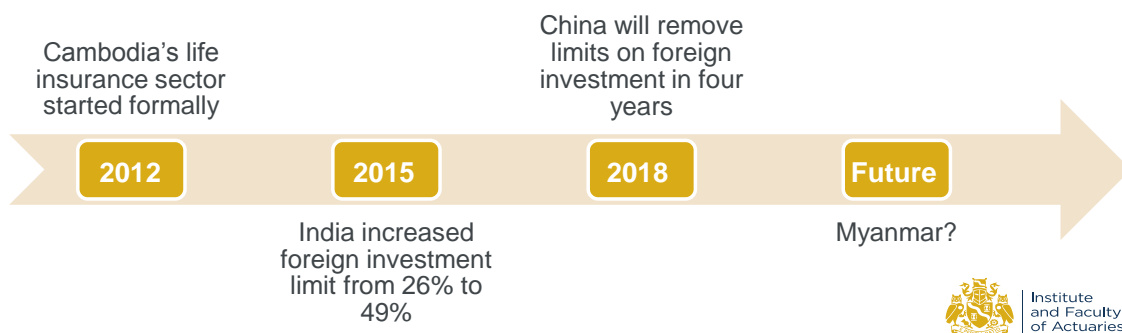
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11 May 2018



Expansion into new foreign markets

- Insurance markets that were once dominated by state monopolies are opening up to domestic private firms and then to foreign companies.



Outline

- Motivation for entering new markets
- Framework for assessing key risks
- Implications for risk management

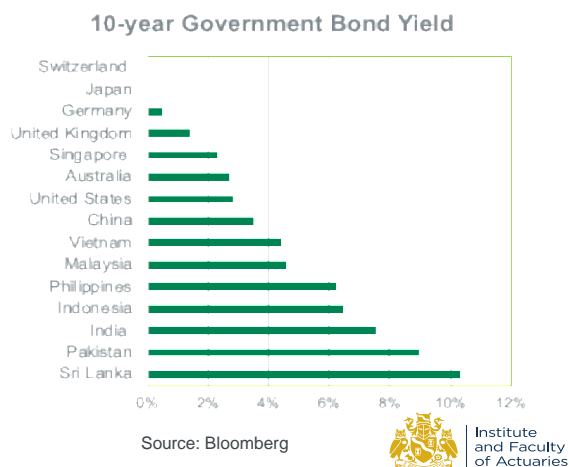
Motivation for entering new markets

Push and pull factors

Enterprise
 Sponsorship
 Thought leadership
 Progress
 Community
 Seasonal Meetings
 Education
 Working parties
 Volunteering
 Research
 Shaping the future
 Networking
 Professional support
 Enterprise and risk
 Learned society
 Opportunity
 International profile
 Journals
 Support

Interest rates are greener on the other side

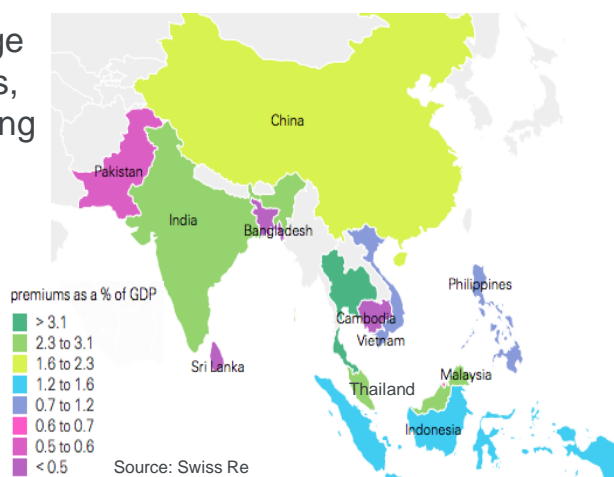
- Quantitative easing in major economies have reduced interest rates to record-low levels.
- Yield pickup is possible via emerging market investments.



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From overgrazed pastures to underinsured markets

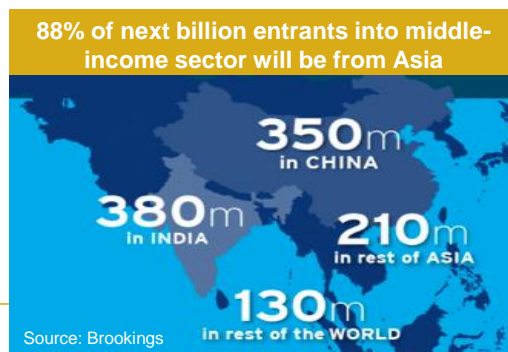
- While penetration rates average about 5% in advanced markets, they are much lower in emerging Asia
- Likely to increase with future demographic and economic potential



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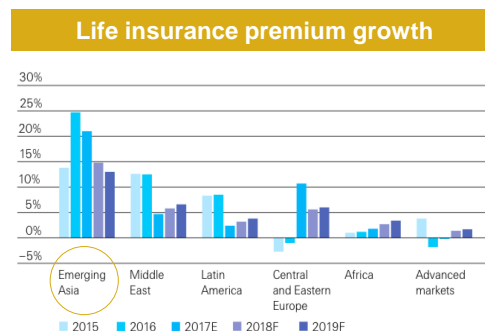
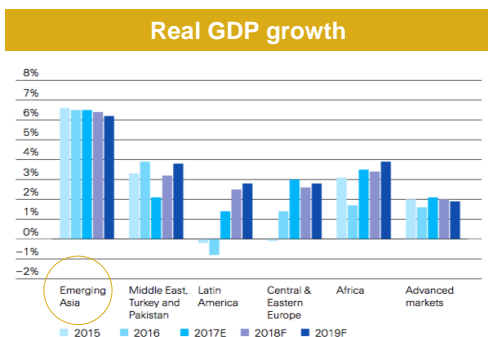
Excellent demographics

- As opposed to ageing populations in advanced markets, significant population growth increases demand for insurance.
- Affordability also improves with expansion of middle-income sector.



Macro-economic growth fuels insurance sector

- Insurance sector growth tends to match GDP growth and emerging Asia offer huge potential.



Source: Swiss Re Institute

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Insurance as a form of social good

- Beyond commercial reasons, companies may have a sense of social responsibility towards new markets.
- Insurance has social protection value and is a pre-requisite for economic prosperity.
- Foreign insurers serve new markets by:
 - Applying best practices learnt from other markets
 - Insuring risks avoided by local insurers, given more experience
 - Providing healthy competition

Deciding to expand into new markets is analogous to choosing careers





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Framework for assessing key risks

Social, Technological, Economic, Political
Unknowns, Partnership



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ponsorship
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Progress
Community
Sessional Meet
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Social perspectives



- Macro: Profound social instability (e.g. street riots) and polarization in societies



- Micro: Consumers' financial literacy and insurance awareness is more basic, giving rise to potential mis-selling.



- Stakeholders' trust towards foreign insurers needs to be built gradually.



Technological perspectives

- Weak banking infrastructure compels companies to use cash transactions, which can lead to fraud as large sums of money exchange hands.
- Future economic growth hinges on speed of establishing effective transport network and utilities sector.



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Economic perspectives: macro

- Delicate balance between inflation, growth, fiscal deficit and debt
- Failure of a major financial institution
- To overcome subjective quantification issues, we may consider comprehensive indices such as Index of Economic Freedom.
- Exchange rate risks:
 - Highly dollarized economies such as Cambodia and Myanmar are susceptible to external shocks.
 - During economic crises, devaluation of local currencies result in double whammy to foreign investors.



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Economic perspectives: micro

- Insufficiently developed market for long-term bonds and derivatives results in asset and liability mismatches.
- When life insurance sector growth outpaces development in local capital market, sizeable assets compete for long-term bonds, leading to excessive market volatility and overvaluation of bonds.
- Manage liability duration by repricing or changing product mix:
 - Example: Unit-linked products are popular in Southeast Asia



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Political perspectives: macro

- Interstate conflict can have economic (trade/currency wars, resource nationalization), cyber and societal consequences.
- Failure of national governance: corruption, political deadlock, coup etc
- Potential catastrophic losses result from political instability, civil unrest and terrorism.
- Government may discriminatorily change laws, regulations, or contracts governing foreign investments—or will fail to enforce them.
 - Example: Preference may be given to local companies during disputes



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Political perspectives: micro

- Regulatory standards for insurance companies remain basic, may change unexpectedly or become more complex to protect consumers
- E.g. RBC 2, IFRS 17, ORSA increase compliance costs
- Myanmar:
 - Private insurers can underwrite business in only 6 of the 48 insurance categories while the rest are monopolised by state-owned Myanma Insurance.
 - Guidelines on solvency or reporting requirements are still evolving
- Lack of tax transparency



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Unknowns

"History is going to be dominated by an improbable event. I just don't know what that event will be." – Nassim Taleb



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Partnership issues: two to tango

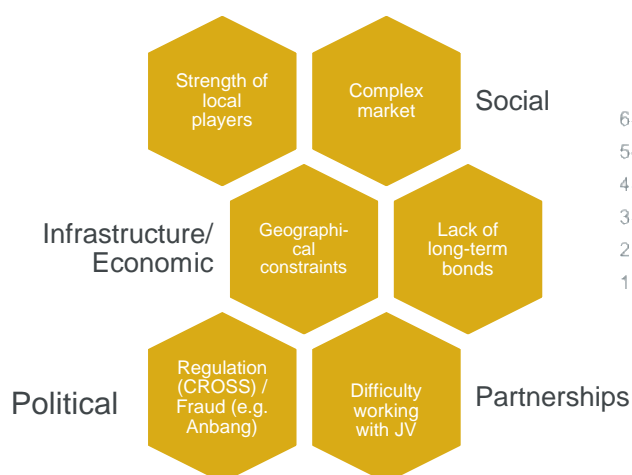
Country	Limit on foreign ownership	Additional requirement
Cambodia	100%	
Laos		
Philippines		
Vietnam		
Indonesia	80%	Joint venture
Malaysia	70%	Listed locally
China	51%	
India	49%	
Thailand	49%	

- Trade barriers partially restrict insurers' market entry, requiring cooperation with local companies.
- Challenges in vetting partners:
 - Compliance and integrity-related issues
 - Incorrect or insufficient information from partners or third parties
- JV may not meet the initially high expectations
- Over time, partnership weakens with management changes, etc

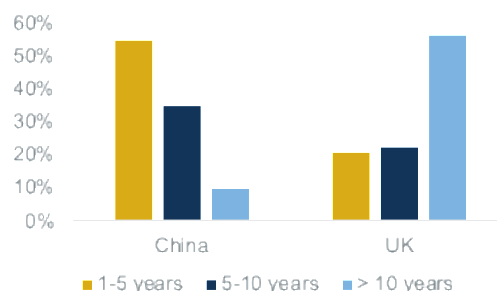


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Case study: China



Local Currency Government Securities Maturity Profile as Share of Total (%)



Sources: AsianBondsOnline, UK Debt Management Office



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Case study: Vietnam

Social

- Shortage of talent
- Low risk awareness
- Intense competition among foreign insurers

Economic

- Low income means lower affordability
- Higher commission expense-to-premium compared to region

Regulatory

- MoF's scrutiny on price wars
- Stringent requirements:
- (1) Total assets of >USD 2 billion
- (2) Minimum credit rating of BBB+
- (3) Consistent profitability in 3 FYs

Unknowns

- Frequent floods and droughts
- Agents' incompliance and reputational risks

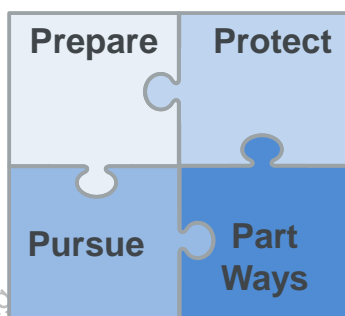


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Implications for risk management

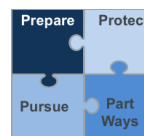
The 4Ps Model



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Preparation: look before you leap

- Diversify investments across countries.
 - Strikers / Midfielders: high-growth, high-risk markets
 - Defenders: stable markets and cash cows
 - Goalkeeper: cash
- Perform due diligence
 - Key difference from domestic M&A: lack of information
 - Assess the integrity and eligibility of potential business partners
- Maintain the strength of long-term partnership

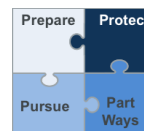


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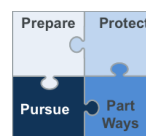
Protecting the local business

- Political and social risks are hard to hedge with legal contracts, insurance or financial instruments.
- Strengthen corporate governance and internal controls, beyond standards in advanced markets.
- Ensure the business meets all regulatory requirements, imposed by local regulator and home country.
 - Example: US Foreign Corrupt Practices Act (FCPA) applies to any U.S. company doing business overseas.
- Strong liquidity protects companies against sudden shocks.



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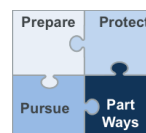


Pursuing the growth strategy

- Build trust in community with sound business practices
- Invest in goodwill and corporate social responsibility.
- Adopt pro-active political management strategies legally.
 - Show how insurer can create jobs and help regulators to ensure proper development of local industry
 - Engage politicians as network of relationships influences policy outcomes
- Local knowledge is critical for investing in new markets.
 - Understand the native business cultures
 - Complement with mature market practices



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Parting ways: begin with the end in mind

- While insurers generally take a long term view and commit to the local business, an exit strategy should be considered.
- Scenario planning:
 - What event will trigger a certain response?
 - What happens if the response fails?
 - Under what circumstances will we withdraw investment?
 - How can we divest stake in order to reduce losses?



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Conclusions

- New markets present a wide range of opportunities and risks.
- They are not created equal, making “one size fits all” approach elusive
- Success depends on actively acknowledging, anticipating and mitigating the unique risks.



Questions



Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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