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.

Cambodia’s life insurance sector started formally

- 2012

- 2015

- 2018

- Future

India increased foreign investment limit from 26% to 49%

China will remove limits on foreign investment in four years

Myanmar?
Outline

• Motivation for entering new markets

• Framework for assessing key risks

• Implications for risk management

Motivation for entering new markets

Push and pull factors
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.

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.
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.
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

- What you are good at
- What you love
- What pays well

- Management experience with foreign businesses
- Home country’s relationship with new market
- First movers’ advantage
- Market potential
- Demographics
- Competition and incumbents

- Company’s mission and values
- Consistency with overall business strategy
- Language and cross-cultural communications
Framework for assessing key risks

Social, Technological, Economic, Political
Unknowns, Partnership

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.

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.
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

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
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

Unknows

"History is going to be dominated by an improbable event. I just don’t know what that event will be.” – Nassim Taleb
Partnership issues: two to tango

- 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.

<table>
<thead>
<tr>
<th>Country</th>
<th>Limit on foreign ownership</th>
<th>Additional requirement</th>
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<tbody>
<tr>
<td>Cambodia</td>
<td>100%</td>
<td></td>
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<tr>
<td>Laos</td>
<td>100%</td>
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<tr>
<td>Philippines</td>
<td>100%</td>
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<tr>
<td>Vietnam</td>
<td>80%</td>
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<td>Indonesia</td>
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<td>Listed locally</td>
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<td>Malaysia</td>
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<td>China</td>
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<tr>
<td>India</td>
<td>49%</td>
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</tr>
<tr>
<td>Thailand</td>
<td>49%</td>
<td></td>
</tr>
</tbody>
</table>

Case study: China

- Strength of local players
- Complex market
- Geographical constraints
- Lack of long-term bonds
- Regulation (CROSS) / Fraud (e.g. Anbang)
- Difficulty working with JV

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

- China
- UK

Sources: AsianBondsOnline, UK Debt Management Office
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

Implications for risk management

The 4Ps Model

Prepare  Protect

Pursue  Part Ways
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

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.

- Strong liquidity protects companies against sudden shocks.
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

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?
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.

The views expressed in this presentation are those of the presenter and do not represent the position of the employer.