THE TAIWAN INSURANCE INDUSTRY

Warren W. J. Tseng*
Taiwan Insurance Institute, Taipei

INTRODUCTION

This report examines the development of the insurance business in Taiwan, mainly in 2011, but by comparison with 2010 and with the first half of 2012. It consist of many figures and percentages, as would be expected, but it also includes important information on changes in the Regulatory measures, It concludes with a review of the challenges facing the Taiwan life industry, together with a future outlook, which includes some recommendations for the Taiwan insurance community.

บทนำ

รายงานฉบับนี้วิเคราะห์เกี่ยวกับการเติบโตของธุรกิจประกันภัยในประเทศไต้หวันในปี 2011 โดยเปรียบเทียบกับปี2010และช่วงครึ่งปีแรกของปี 2012 รายงานนี้ ประกอบด้วยตัวเลขต่าง ๆ และอัตราร้อยละ รวมถึงข้อมูลสำคัญในเรื่องของการเปลี่ยนแปลงทางด้านมาตรการทางด้านกฎหมายและยังรวมไปถึงปัญหาและอุปสรรคที่ธุรกิจประกันภัยในประเทศไต้หวันประสบอยู่ รวมถึงอนาคตของธุรกิจประกันภัยและคำแนะนำให้แก่ธุรกิจประกันภัย ในประเทศไต้หวัน

AN ECONOMIC OVERVIEW OF TAIWAN

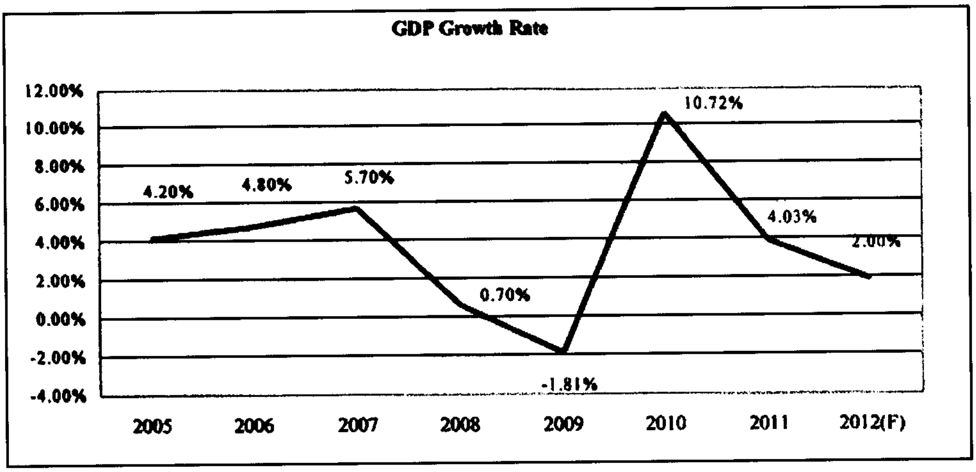
Under the severe impact of the global financial crisis, Taiwan's economy slowed down in 2008 and 2009. In 2010, thanks to continuing increase in export trade and domestic demand, Taiwan's economy recovered and experienced a double-digit growth.

In 2011 the world economy saw a slowdown again, mainly due to the influence of the European sovereign debt crisis, which is still simmering. As an export-oriented island, Taiwan's economy was inevitably affected by stagnant economic growth as well as diminishing exports, and therefore the overall economic growth fell to 4.03%.

---

*Mr. Tseng, BA MBA, is President of the Institute, a Board Member of the Insurance Guarantee Fund and also of the Central Reinsurance Corporation, and is Chairman of the Risk Management Society of Taiwan. His career has included senior positions in insurance, including Deputy Insurance Commissioner. As Chief Delegate for Taipei, he presented this paper at the 26th East Asian Insurance Congress in Kuala Lumpur, October-November 2012.

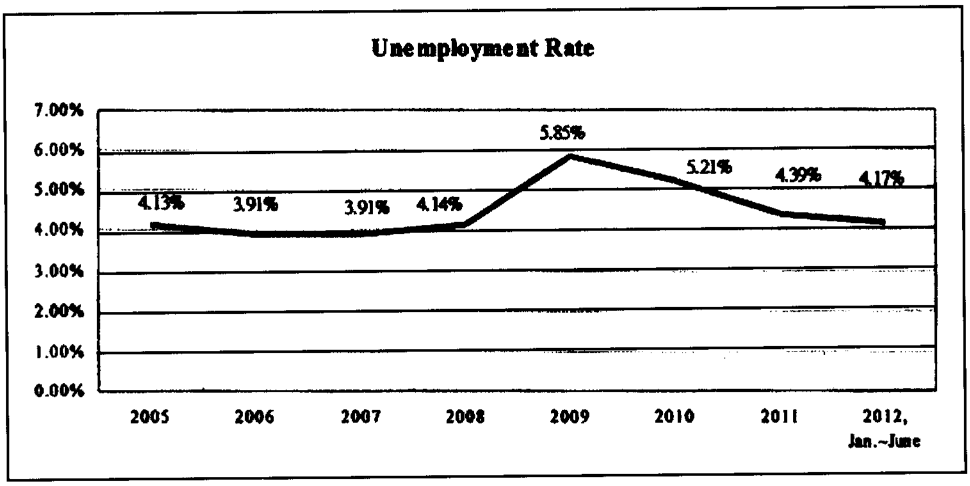
Furthermore, due to continued weakness of exports and sluggish domestic investments in the first half of 2012, the economic growth rate of 2012 is forecasted at around 2% by the government and other research institutes.



Resource: Directorate-General of Budget, Accounting & Statistics, Executive Yuan, R.O.C. (Taiwan): Website: www.dgbas.gov.tw

In the first half of 2009, the financial crisis severely damaged the labour market in which involuntary unemployment saw significant increases and all segments across ages and education demographics were influenced. The annual unemployment rate in 2009 was 5.85%. Due to the momentum of the recovery of economic conditions and a series of labour force development programmes carried out by the government, the unemployment rate in 29010 was 5.17%.

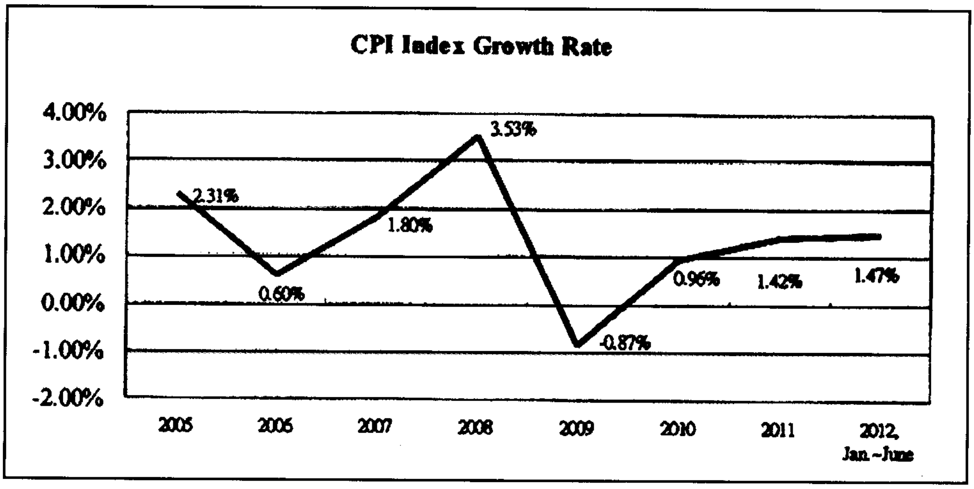
In 2011, the average amount of employed was almost 10,709,000 persons, with a growth rate of 2.06% compared with the previous year, and the unemployment rate decreased to 4.1%. As these indicators illustrated, the unemployment rate is improving with a steady pace.



Resource: Directorate-General of Budget, Accounting & Statistics, Executive Yuan, R.O.C. (Taiwan): Website: www.dgbas.gov.tw

In 2009, on account of the economic downturn, weakness of private consumption and significant decrease of the oil price, the consumer price index (CPI) growth rate dropped to -0.87%. With the economic growth rate hitting a record high in 2010, CPI growth rate increased to 0.96%.

Following the unstable outlook of the Taiwan economy, the CPI in 2011 rose to 1.42% compared with the previous year. The major categories were food and clothing with growth rates of 2.26% and 3.29% respectively. In the first half of 2012, the CPI growth rate climbed to 1.47% and the pressure of CPI will continue as the utilities prices will be adjusted upward in the second half.



Resource: Directorate-General of Budget, Accounting & Statistics, Executive Yuan, R.O.C. (Taiwan): Website: www.dgbas.gov.tw

THE TAIWAN INSURANCE MARKET STRUCTURE

The Taiwan insurance market was completely open to foreign insurers in 1994. Since then, the number of insurance and reinsurance companies increased gradually and the market became more competitive. At the end of 2011, there were 57 insurers operating business in Taiwan, which includes 23 non-life insurers (6 foreign insurers), 31 life insurers (7 foreign insurers) and 3 reinsurers (2 foreign reinsurers).

The proportion of the premium income of domestic non-life insurers accounted for 97.77% of the non-life insurance industry. As regards life insurance, the proportion of the domestic life insurers' premium income accounted for 97.01% of the total life premium income. The market shares of foreign non-life and life insurers were both less than 3%. In terms of insurance intermediaries, there were 316 insurance agents, 502 insurance brokers, and 81 insurance surveyors at the end of 2011.

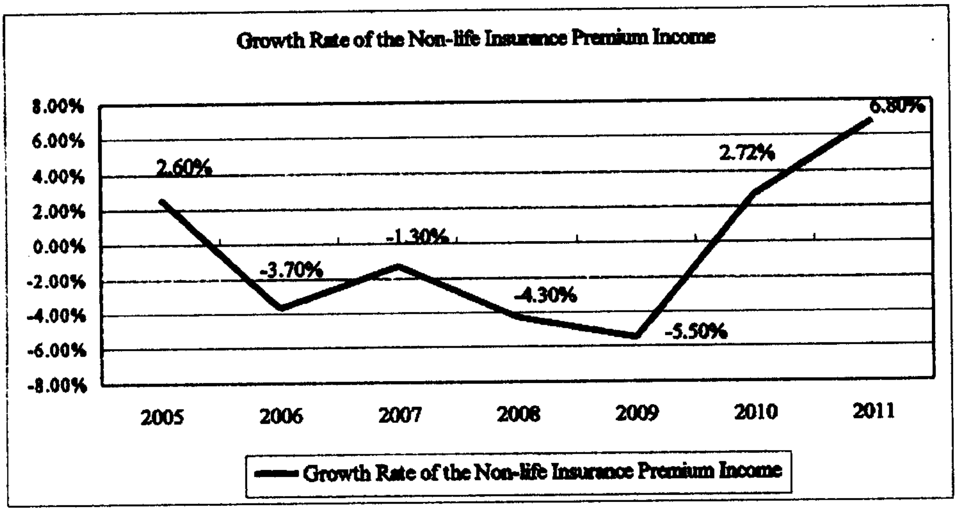
THE INSURANCE INDUSTRY PERFORMANCE

Non-Life Premium Growth

In 2010, the premium income of non-life insurance had registered a growth of 3.88% thanks mainly to the reviving of motor and marine insurance following the recovery of the economy. In addition, the rapid growth of personal accident insurance also contributed to the positive growth of non-life income in 2010.

In 2011, the written premium income of the non-life insurance companies in Taiwan was NT$ 113 billion, and increase of NT$ 7.2 billion or 6.83% over the previous year. The bulk of growth came from motor, commercial fire, personal accident and health insurances, among which commercial fire insurance experienced a 10% growth.

In the first half of 2012, the written premium income was NT$ 62.3 billon, with a growth of 5.9% over the same period of 2011.



Resource: Taiwan Insurance Institute

Premium Breakdown by Line

The written premium of motor insurance was NT$ 55.8billion in 2011, an increase of 6% compared with 2010. The premium income of motor insurance was 49.4% of the entire premium of non-life insurance in 2011. In the first half of 2012, the premiums of motor insurance increased 5.6% due to stronger sales of new cars.

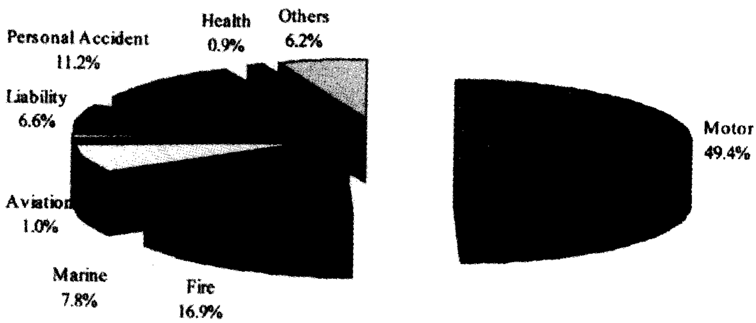
As influenced by the implementation of new natural disaster premium rates, the premium income of fire insurance was NT$ 19 billion in 2011, an increase of 9.7% in comparison with 2010. In 2011 the market share of fire insurance accounted for 18.9%, which was 16.4% in 2010. In the first half of 2012, fire premium income increased at 11.5% and its market share rose to 19,9% of the total non-life insurance. In 2011, the premium income of marine insurance was NT$ 77 billion, a growth of 3.4%. The market share of marine insurance was 7.8%. For aviation insurance, the premium income was NT$ 1.09 billion, a decrease of 13%.

Liability insurance premium in 2011 expanded continuously to reach NT$ 7.5 billion, an increase of 14.4% from the previous year. It accounted for 6.6% of the total non-life premium income.

Personal accident (PA) insurance grew fast since non-life companies were permitted to operate in 2005. The premium income of PA written by non-life insurers in 2011 reached NT$ 12.7 billion. Now it is the third largest line, next to motor and fire insurance. The market share of this line in 2011 was 11.2%, increased from 10.7% in 2010.

As for health insurance, non-life insurers were permitted to write it in 2008. In 2011 the premium income was NT$ 1.07 billion. In the first half of 2012 health insurance increased by 19.8% It is expected that it has great potential for growth in the non-life insurance sector in which traditional lines are highly competitive.

Premium Breakdown by Line(2011)



Resource: Taiwan Insurance Institute

Underwriting Results and Profit-Loss

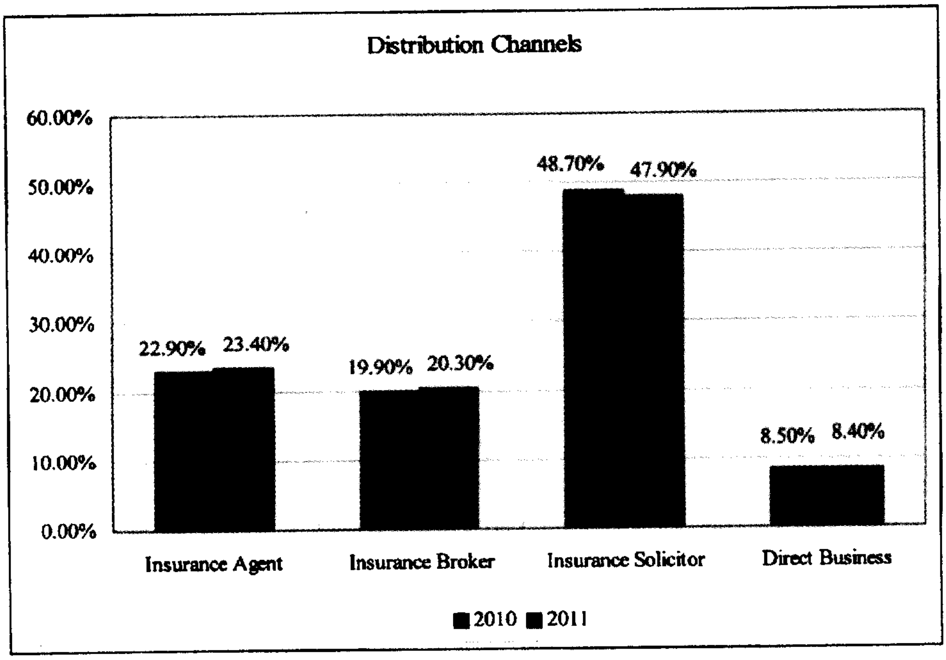
The loss ratio of non-life insurance was 55.1% on average in 2011, dropping by 1.7% compared to 56.8% in 2010. This decrease in 2011 was mainly attributed to the non-occurrence of major losses. The loss ratio of compulsory motor liability insurance was 67.7%, a 7.4% increase from the previous year due to decrease in premium rates and increase in traffic accidents.

The expense ratio in 2011 was 38.8%m an increase from 30.2% in 2010. The combined ratio in 2011 was 93.4%, dropping from 96% in the previous year. In the first half of 2012 the combined ratio was 90.7% as no major losses happened. But the ratio is likely to rise given the fact that natural disasters such as typhoons normally hit the island in the second half.

The net profit after tax of the non-life sector reached NT$ 11 billion in 2011. In the first half of 2012, the net profit before tax declined 12.9% due to the shrinking of investment income.

Distribution Channels

The written premium income of the non-life sector mainly came from two channels: solicitors and agents. Compared with 2010, the proportion of solicitors slightly decreased and the proportion of agents and brokers increased in 2011. Direct business for this sector continued to play an important part over the last two years.



LIFE INSURANCE IN TAIWAN: PREMIUM GROWTH

In 2011, total premium income for this sector was NT$ 2,198.2 billion, down by 4.96% when compared to NT$ 2,312.9 billion in 2010. The overall first year premium income was NT$ 995 billion, which accounted for 45.26% of the total premium in 2011, a decline of 14.34% in comparison with 2010. On the other hand, renewal premium income in 2011 was NT$ 1,203.3 billion, making up 54.74% of the total, an increase of 4.53%. These figures mean that the decline in overall premium income was mainly due to the decrease of first-year premium income.

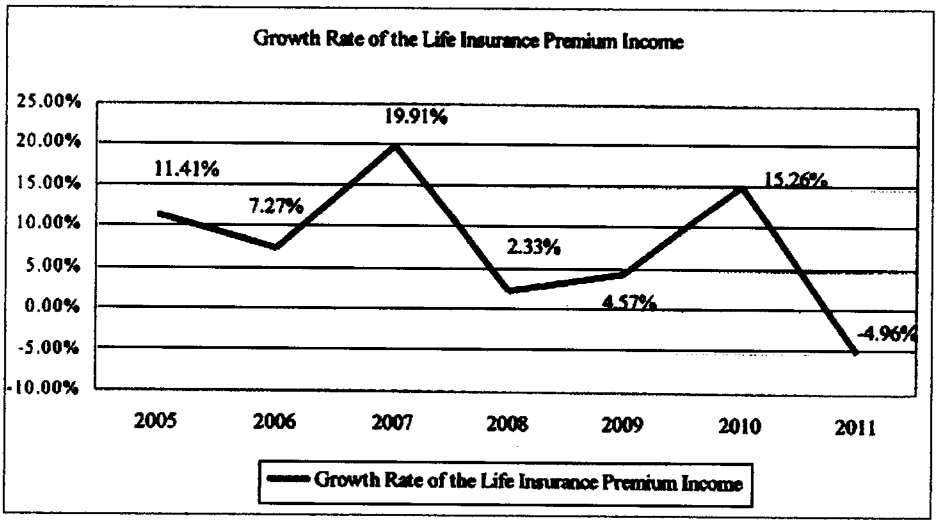
In the first half of 2012, the total premium income of life insurance increased by 14.9%, affected by revision of the liability reserve interest rate and the implementation of new mortality tables.

Further analyzing the first-year premium income, traditional life insurance was NT$ 642.1 billion, an increase of 15.53% compared to 2010, and accounted for 64.53% of the total first-year premium in 2011, a boost from 47.84% in 2010. The tremendous increase of traditional life insurance was mainly led by the repercussion of structured notes, which alarmed consumers to turn their interests to risk-aversion products.

The premium income of traditional annuity products was NT$ 123.2 billion in 2011, showing a remarkable drop of 70.17% and accounting for 12.38% of first-year premium income. Again, this large decline was the result of the extension of surrender charges period for short-term interest-sensitive annuities insurance, thus reducing the policy-holders' willingness to purchase such products.

Investment-linked products increased to 21.07% of the total first-year premium income in the wake of a low-interest market, which gave favourable advantage to investment-linked products with principal-guaranteed or a loss-resistant feature amongst conservative policyholders. In 2011, investment-linked products accounted for 18.94% of the total first-year premium income.

Single-payment premium income accounted for 63.25% of the total first-year premium income, a decrease from 65.74% in 2010. It indicated that the single-payment premium insurance contributed greatly to the first-year premium income. The top two products which dominated the single-payment premium in 2011 were variable life insurance and traditional endowment insurance. The growth rates were 158.80% and 8.06% respectively.



Resource: Taiwan Insurance Institute

Premium Breakdown by Line

In terms of product types, the premium income of traditional products amounted to NT$ 1,867.1 billion, which accounted for 84.94% of the total life premium income, among which NT$ 1,427.8 billion was traditional life insurance, NT$ 131.4 billion was traditional annuity, NT$ 250.8 billion was heath insurance, and NT$ 57.1 billion was accident insurance. Despite annuity insurance declining by 68.51%, most traditional products continued to show a growing trend.

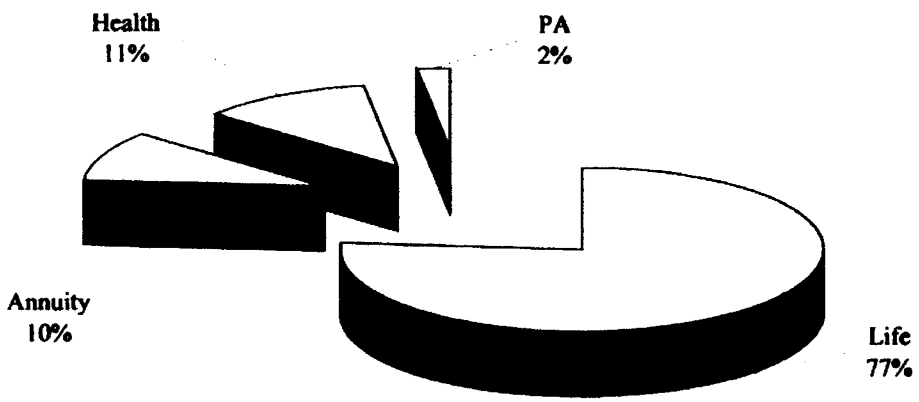
In terms of market share, life insurance accounted for 76.28% in 2011, rising from 64.67% in 2010, annuity accounted for 9.72%, a sharp decrease from 22.79% in 2010. Health insurance accounted for 11.41%, rising from 10.11% in 2010, and PA accounting for 2.28%, a slight rise from 2.12% in 2010.

Life insurance and annuity are major parts of the portfolio, accounting for about 86%. Life insurance and annuity products featured with a principal guarantee are viewed as less risky investments and hence become one of the major options in asset allocation to cope with demographic change, low interest, and the increasingly complicated financial environment in Taiwan.

In 2011, the premium income of investment-linked products was NT$ 331.1 billion, an improvement of 9.20%, which made up 15.06% of the total life premium income, up from 13.11% in 2010. Investment-linked life insurance made up 11.32% of the total premium income, a remarkable increase from 8.37% in 2010.

Among investment-linked products, in 2011 the premium income of investment-linked life insurance was NT$ 248.9 billion, up by 28.63%, and investment-linked annuity was NT$ 82.2 billion, a decline to 25.07%. Premium income of investment-linked life insurance accounted for 13.96% of the total first-year premium income, up from 6.52% in 2010. Meanwhile investment-linked annuity accounted for 4.98% of the total first-year premium income, a decrease from 6.25% in 2010. From the above data, it could be concluded that the growth of premium from investment-linked insurance products was meanly led by the rebounding of sales of the investment-linked life insurance products.

Premium Breakdown by Line(2011)



Resource: Taiwan Insurance Institute

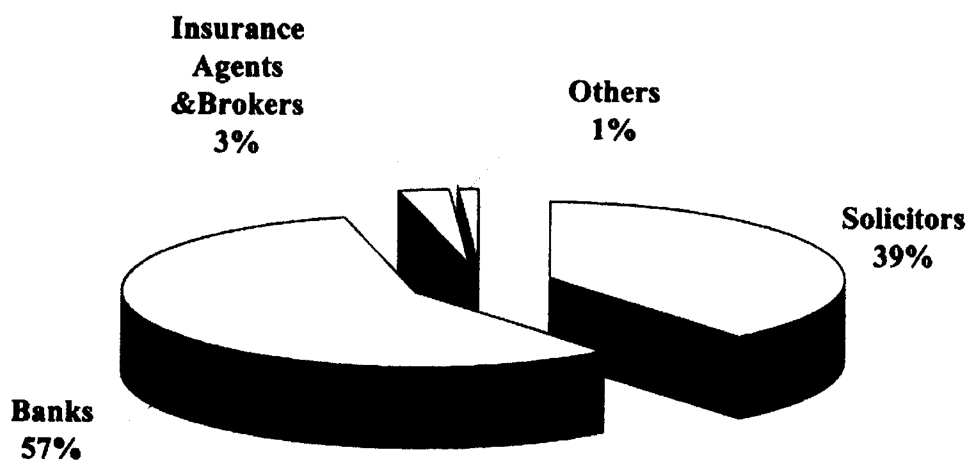
DISTRIBUTION CHANNELS

The premium income mainly comes from two channels: solicitors and bancassurance. In past years, solicitors dominated the life insurance market. Since investment-linked products were introduced in 2002, the distribution channels have undergone structural change. Bancassurance has developed rapidly; on the other hand, the role of traditional solicitors declined significantly.

In 2011 bancassurance was the main contributor of first-year income, and accounted for 57.07%, dropping from 65.25% in 2010. It was due to significant reduction of interest-sensitive annuities affected by new regulation in 2011 impacting on interest-sensitive annuities and six-year single-payment insurance. This diminished the policyholders' purchases of savings-alike insurance products from the bank channel. On the other hand, the market share of solicitors was 38.76% in 2011, an increase from 31.5%. The combination of the two channels represented a dominant 95.83% market share. Other distribution channels merely accounted for 4.17%.

In 2010, life insurance companies launched the endowment type of products, which became one of the best tools for banks to manage liquidity. Under the powerful promotion of bancassurance, the first-year premium income hit a new record high. However, a new stipulation was imposed in 2011 on interest-sensitive annuities and six-year single-payment products, which diminished the policyholders' purchase of savings-like insurance products.

Premium Breakdown by Channel(2011)



The global trend of financial market integration led to change of distribution channels for Taiwan life insurance. The selling of life insurance products no longer depends on traditional solicitors since investment-linked products were introduced, indicating that the distribution channels are becoming more diversified. Other distribution channels such as insurance agents, brokers, and direct sales, although only representing 4.17% of first-year premiums in 2011, a steady growing trend is anticipated.

ASSET ALLOCATION AND NET PROFIT

In 2011, total assets of the insurance industry were NT$ 13.05 trillion, a rise of 7.7% due mainly to the rebound of financial portfolios following recovery from the financial crisis. The top three forms of asset allocation were foreign investments, which accounted for 37.8%, domestic government and treasury bonds (21.5%), and financial bonds and other securities (19.4%).

The financial results of the life insurance industry were improved in comparison with 2010. In terms of net gain from investment, life insurers posted an interest income of NT$ 331 billion, and return on securities bounced from 23.8 billion in 2010 to 27.6 billion. However, as the exchange rate risk was greater than securities investment profit, the net profit after tax for the industry was negative NT$ 0.9 billion, but this was far better than the negative NT$ 1.9 billion in 2010.

RECENT REGULATORY MEASURES

Financial Consumer Protection Act

In the past, financial disputes in Taiwan were handled by separate organizations. For instance, the Banking Association was responsible for bank-related cases; and the Taiwan Insurance Institute (TII) was assigned to deal with insurance claim disputes.

In 2011, the Financial Consumer Act (FCPA) was enacted to consolidate the proceedings of financial-related disputes, including banking, securities, and insurance, in the hope that the interests of financial consumers can be fairly protected.

The Financial Ombudsman Institution (FOI) was established in January 2012 under the FCPA as an independent incorporated foundation, to deal with disputes between consumers and financial sectors. In the first quarter of 2012, 85% of the disputes were insurance-related cases.

Applying new mortality tables

In response to Taiwan's changing demographics, the FSC approved the use of three mortality tables as the minimum statutory valuation standard effective from July 2012. These tables are the 2011 Taiwan standard ordinary experience mortality tables, the 2011

Taiwan individual annuity mortality tables, and the 2011 Taiwan non-smoker and smoker mortality tables for preferred life products.

It is expected that insurers may lower premiums of traditional protection-type life insurance due to the lower mortality rates of the new tables, but premium premiums for new products with more savings elements may be increased.

Increase of Insured Amount for Compulsory Automobile Liability

Since the implementation of the new compulsory automobile liability insurance in 1998, this scheme has performed successfully for 14 years. According to the surveys conducted by a well known magazine in Taiwan for the past years, consumer satisfaction with this scheme has always been over 90%. To provide more for traffic victims, the insured amount for death or disability was increased in March 2012 from NT$1.6 million to NT$ 2 million. At the end of 2011 the cumulative special reserve was over NT$ 25.5 billion, and can only be used to reduce premiums or increase the insured amount.

Increase of Insured Amount for Residential Earthquake Insurance

By the end of 2011, the take-up rate of residential earthquake insurance had reached 29.27% and the total number of policies in force was 2.39 million. The cumulative special reserve for this insurance amounted to NT$ 13.305 billion. In July 2012, the maximum sun insured per policy was adjusted upward from NT$ 1.2 million to NT$ 1.5 million, and contingent living expenses from NT% 180,000 to NT$ 200,000.

Whether the coverage of this insurance should be extended from total losses only to include partial losses has been under review by the Residential Earthquake Insurance Fund.

Regulation of Natural Disaster Premium Rates

The third stage of rate deregulation was implemented in April 2009. Intensive price competition arising form this deregulation generated impacts on the premium levels of non-life insurers. The premium rates of fire insurance had dropped 17.2% in 2011.

The increasing threat of natural catastrophes, and the under-pricing of premium rates, led in July 2011 to the re-regulation of rates for natural disaster fire insurance, to ensure premium adequacy. Insurers are now only allowed to use rates based on loss models that are submitted for approval. Insurers who have not developed their own models have to use the reference rates provided by the Taiwan Insurance Institute. After implementing these regulatory measures, the premiums for typhoon & flood insurance increased by 16.9%, and by 20.3% for flood insurance.

Risk-Based Capital (RBC)

Insurance companies in Taiwan are required to maintain the RBC ratio above a 200% level. As the net worth of many life insures dropped sharply due to substantial unrealised losses for stock investment when the EU debt crisis occurred, and continued to affect stock prices around the world, the Taiwan FSC adopted temporary measures at the end of 2011 to mitigate the impact on those companies under the regulatory capital requirements due to declined market value of stock investments. These measures allowed insurers to choose recognizing the unrealized loss from their stock investments as the basis of the past 6-month average prices of the stocks to replace the current market value basis. It is recognized that these tentative measures have helped life insurers to relieve financial pressures of cash injection.

Furthermore, Taiwan's FSC keeps monitoring the development of international insurance supervisory trends (e.g. the EU Solvency II and USA NAIC SMI), and advises the calculations of Total Adjusted Capital (TAC) and Risk Capital in Taiwan's insurance RBC system.

Implementation of IFRS 4

Phase 1 of IFRS 4 was implemented in Taiwan in 2011. To address phase 1, Taiwan had adopted 'Statement of Financial Accounting Standards No. 40 Insurance Contracts', based on which the life insurance companies have to perform the Liability Adequacy Test to ensure the adequacy of reserves. In addition, in order to meet the requirements in respect of information disclosure, insurance companies have to disclose their accounting policies, significant assumptions and methods, and material qualitative and quantitative information.

The main purpose of these measures is to improve the transparency of the company's financial status. The insurance companies who a sold life insurance products with high assured interest rate before 2001 will face higher reserving levels based on risk free interest rates. Considering the interest rate risk, it is expected that the sale of long-term life products will decline in the long run.

Regulatory Reform for Insurance Intermediaries

In order to enhance the protection of consumers' rights, and to strengthen market discipline, the FSC amended the Insurance Act in 2010 to strengthen the supervision of intermediaries.

The amendments include requiring agents, brokers and surveyors to post bonds and obtain related liability insurance, and requiring intermediaries of certain sizes to build internal control and audit systems, as well as business solicitation structures and procedures. If an agent, broker or surveyor violates laws or regulations, the FSC may take regulatory action against them.

Implementation of Market Exit Mechanism

Due to financial difficulties, Walsun Insurance Company was ordered by FSC to terminate operations in January 2009. It became the second insolvent non-life insurance in history. The first insolvent non-life insurer was Kuchwa Insurance Company, which was ordered by the Regulator to terminate operations in November 2005. The Taiwan Insurance Institute was assigned by the FSC as rehabilitator of those two companies.

In addition, one life insurer, Kuchwa Life Insurance Company, was taken over by FSC in 2009. Due to the deterioration of its financial position, Kuchwa Life failed to meet the statutory RBS requirement and no capital injection was made within the requested period. Therefore, under the instruction of FSC, the Insurance Guarantee Fund stepped in and took over the company in July 2009.

Revision of Regulations of Some Funds

With insurers facing a gloomy investment environment, the FSC considered increasing the total amount an insurer can invest in any one investment, from 25% to 35% of the paid-in capital for infrastructures and public utilities. Insurers or their representatives may also become directors or supervisors of the invested company.

CHALLENGES AND FUTURE OUTLOOK

As a result of no major natural disasters occurring in Taiwan in 2011, the non-life insurance industry achieved a net profit before tax of NT$ 10.86 billion, the highest amount since 2006. Nevertheless, the Taiwan non-life sector has to deal carefully with potential natural disaster risks that are increasing, and therefore adequacy of premium rates should be corrected.

In addition to introducing loss models which reasonably reflect the non-life sector's exposure to natural catastrophes, reinsurance arrangements of insurers should also be strengthened and examined to ensure that the financial position of insurers should not be hit when natural disasters occur.

Boosting solvency and strengthening insurers' liability reserves remains a top priority in this market. The FSC will continue to consider complementary measures for IFRS Phase II which remains under discussion, and has urged life insurers to develop plans to strengthen their liability reserves. A research project examining the transformation of the current solvency system to encompass international standards like Solvency II and the IAS principles has been conducted by the Taiwan Insurance Institute.

Negative spread and maintaining sufficient capital remain critical issues for all insurance companies in Taiwan. In 2011 some measures helped reduce the negative spread. Insurers were focusing on protection-oriented and foreign currency insurance policies as well as selling interest-variable policies and non-guaranteed investment policies to minimize the interest rate risk. As for asset allocations, insurers are increasing their allocation to high-yielding instruments to avoid asset-liability mismatch.

The Regulators have also modified the supervisory framework to assist insurers, such as loosening investment targets and opening up overseas investment, excluding the amount of foreign currency insurance policies from that of the total overseas investment limit.

Meanwhile, Taiwan continues its strong cross-strait cooperation with China, and by May 2012 the FSC had approved nine applications for equity investments in joint ventures in China, with six of them already approved by the China Insurance Regulatory Commisssion (CIRC). 12 Taiwanese insurers have set up 14 representative offices in mainland China. In 2012, CIRC announced the opening of its compulsory motor liability insurance business to foreign insurers. Taiwanese insurers, such as Fubon and Cattry have to submit applications for operating this insurance. If permitted, Taiwan non-life insurers will have the opportunity of further expanding their business in China. Regulators have also recently relaxed investment rules, including allowing insurers to invest in yuan-denominated securities and bonds issued in Hong Kong. Insurers in Taiwan are also allowed to invest in stocks, bonds and real estate in China, but only for their own use and not to earn rental income.

Given the difficulties of operating in an environment of low interest rates, and to cope with an ageing population, the life sector needs to change its strategies by increasing sales of low-interest policies and developing product innovation in areas of medical insurance, nursing care, and retirement insurances.

Lastly, to ensure insurers' capital adequacy and solvency, insurers have to implement enterprise risk management (ERM) and strengthen capital management. Therefore, quantitative techniques of economic capital and Own Risk and Solvency Assessment (ORSA) should be developed.