ASPECTS OF REINSURANCE IN THAILAND

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Abstract

Reinsurance is such an important part of the modern insurance market that without it economic development would be impeded. The vastness, volatility, newness and nature of so many contemporary risks are such that direct insurers alone could not cope, and the link between economic development and insurance (and reinsurance) has long been recognised.

Reinsurance is a necessity for insurers as they also need to transfer those risks which are beyond their capacity or otherwise undesirable. Reinsurance, operating internationally, can increase a market's capacity by spreading the risk globally, or through evading restrictive local laws in the country where the insurer is domiciled/registered. It is estimated that reinsurance volume worldwide is about 10% of total insurance volume.

Yet, despite the reinsurers' undeniable importance in insurance markets around the world, they seem to attract very few researchers and little is published about their activities. The same dearth of research and publications applies to insurance in Thailand. This paper, through exploratory and descriptive research, therefore attempts to shed some light on these twin topics, reinsurance and the Thai insurance market. Much of this article describes the success of the operations of the Thai Reinsurance Co. plc.

The Importance of Reinsurance

Reinsurance is a means by which an insurer can itself gain protection against the risk of losses, by transferring risks for which it would not otherwise have the capacity, and to protect itself against excessive losses, and thus smooth an insurer's results (www.Wikipedia.org, 2007).

Reinsurance is so vital to the operation of insurance markets, nationally and internationally, and thus to economic development, that it should be a regular theme for insurance research, conference papers, and publications. But it is not, apart from special Reinsurance Conferences. Thailand has a long-established thriving insurance market, including its own reinsurance company (Thai Re), yet it too suffers from being largely unknown to the world beyond its borders (and even within).

Reinsurance (and insurance) have been shown to have a symbiotic relationship to a nation's economy, both enabling its development and benefiting from it through premium growth (Skipper, 1997). Reinsurance acts as a form of capital for insurers, just as insurance is a form of capital for Insured (Weidemueller, 2006).

Furthermore, reinsurers tend to be the best skilled experts in many lines of business, simply because their dealings with many direct insurers involve them in research and data analysis, which they undertake continuously, in order to assess the cession offered by a direct insurer.

As this is exploratory and descriptive research it will be based on a literature review, including conference papers, journal articles, and published statistics. Subsequently (in a later paper) qualitative methodology will be used to capture facts and opinions from managers in the insurance industry in Thailand: Direct insurers, Reinsurers, and reinsurance Brokers.

The Direct Market in Thailand

The 1997 economic crisis was a severe blow for Thai insurers, resulting in decreased income, negative profit, and reduction in asset values. This produced significant changes. From being a mainly closed market, with limited foreign investment, the Ministry of Commerce, through its regulatory authority, the Department of Insurance, encouraged investment by foreign insurers to provide capital, experience, skills and systems (Cooper, 2003). This resulted in many joint ventures by local insurers and consolidation, local insurers preferring to join with foreign insurers rather than other Thai insurers (Lawrence, 2001). Business began to improve and was greater than pre-1997 levels by 2004, with growth estimated at 6% for both 2006 and 2007.

The general insurance sector is characterised by a large number of small- to mid-size insurers with over half of the 76 general insurers having less than a 1 per cent market share. This unnecessarily large number has produced intense competition. There is continuing pressure by the Office of the Insurance Commission (formerly the Department of Insurance) to reduce the number of these smaller companies through consolidation, and through an increase in the minimum paid-up capital requirement from the inadequate Thai Baht (THB)30 million to THB300 million (and it was estimated that more than half of Thailand's general insurers held less than THB300 million in capital funds). These measures, deliberately tough on small insurers, will benefit the overall strength and structure of the industry (Cooper, 2003). Local Life insurers are almost totally part-owned by foreign insurers.

Thailand is committed to liberalising its insurance market, having signed WTO agreements, although progress is slow (Lawrence, 2001). As with a number of other countries, Thailand has bound its multilateral obligations at less than status quo. This is a reflection of government's dual objectives of trying to encourage foreign investments in the financial sector but avoiding the instability which would follow premature and badly-sequenced liberalisation by providing some protection to the existing local suppliers from immediate competition. As with liberalisation of trade in goods, liberalization of trade in services could involve a painful short-term adjustment which needs to be appropriately managed. Liberalization of insurance requires that the regulatory environment is reviewed and modernised before and during the process. Liberalisation in a weak or ineffective regulatory supervision context could cause severe instability in the insurance sector and the overall economy in view of the important link between insurance and the economy (Rajan and Sen, 2002).

The Reinsurance Market in Thailand

The biggest reinsurer in Thailand is now CCR, the French State reinsurance company, which overtook Munich Re in Thailand after Munich increased its rates following the terrorist damage in New York in 2001. Munich Re still has a large presence, as does Swiss Re and Allianz Re, but mainly in Facultative reinsurance for huge infrastructure projects. Facultative Reinsurance is also a big premium earner for AIG, which although a direct insurer accepts it as inward business. Toa Re and Mitsui Re are big in Thailand, finding that the high reinsurance commission level here is an attractive inducement.

There is one local national reinsurer (Thai Re). It is a publicly listed company (with a limit on foreign ownership), to which all locally registered insurers, must cede at least 5% of their business on a quota share basis (and can cede more on a voluntary basis).. There are also active reinsurance brokers.

The total reinsurance business written in Thailand in 2006 is shown in the following table:

2006 Reinsurance Totals for Thailand (Source: Department of Insurance)

	Non-Life			Life		
	Million Baht	Proportion	%	Million Baht	Proportion	%
Direct Premium	93,314	100.0		176,426	100.0	
Reinsurance Premium	28,554	30.6	100.0	4,327	2.5	100
Domestic:						
Thai Re	3,719	4.0	13.0	304	0.2	7.0
Other Reinsurers	4,786	5.1	16.8			
International	20,049	21.5	70.2			

(Source: Department of Insurance)

Motor insurance has the highest domestic retention rate, while marine and transportation insurance have the lowest. Due to a lack of reinsurance expertise on the part of many Thai insurers, there is a significant reliance upon international insurers and an outflow of reinsurance premiums from Thailand (Cooper, 2003).

In Thailand, Fire treaties are almost all surplus treaties, larger insurers having first surplus treaties (typically with 20 lines) and second surplus treaties (typically with 10 lines), with either a surplus open cover (typically with 10-15 lines) or facultative obligatory arrangements. Risks are ceded on a sum insured basis (AXA, 2000). Engineering treaties are few because of the need for specialist underwriters, and are mostly placed with international insurers. Motor is usually either not reinsured, or there is excess of loss cover. Motor third party cover does not yet produce a long-tail effect in claims because of the local non-litigious culture (deeply Buddhist), but this is changing (Lawrence, 2003). Miscellaneous business, especially third party risks, is usually reinsured on a surplus basis, and the same cultural claims environment is also changing and will change further due to the new Products Liability law of 2006, which includes 'strict' liability, class actions, and contingency fees for lawyers (Lawrence, 2006). Marine Hull is a small specialist market, with few active companies, reinsurance being quota share, surplus, and facultative obligatory (AXCO, 2000). Marine Cargo is usually reinsured through surplus treaties. The Tsunami reinsurance risk rate has not changed because of December 2004, but direct insurers now want an increased layer in their excess of loss policies.

Reinsurers and brokers sometimes find that direct insurers are not sufficiently knowledgeable about the types of reinsurance product, and therefore are not skilled buyers. As the premium for treaty business is so relatively small, the small local insurers will find it increasingly difficult to buy this reinsurance.

The financial ability of insurers to pay claims and meet solvency requirements often depends to a large extent on the financial ability of its reinsures to meet claims when due. Yet in many countries reinsurers are not subject to the sort of stringent regulations applied to direct insurers, regarding solvency criteria, financial returns, and appropriate measures when financial difficulties affect a reinsurer (Insights, 2006).

Reinsurance regulation in Thailand is supervised by the Office of the Insurance Commission (OIC), within the Ministry of Commerce. The purposes of reinsurance supervision can be summarised as follows (Thanavarit, 1999):

1. To ensure that insurers do not assume risks of more than 10 per cent of their surplus, which is clearly stated and prohibited by the Non-life Insurance Act 1992;
2. To ensure that insurers have adequate reinsurance protection at reasonable cost;
3. To promote the local insurance industry and domestic retention, which help stabilise the country's foreign exchange reserve;
4. To prevent reinsurance from being used as a means to illegally transfer money

abroad or as a tool to avoid local taxes;

5. To ensure that reinsurance accounts are transacted with financially sound reinsurers. There is no specific requirement regarding choices of reinsurers. However, every insurance company is strictly required to submit copies of reinsurance treaties to the OIC within 30 days of the signing/renewal date.

The Founding of Thai Re

International reinsures had long operated in Thailand when the Thai Reinsurance Company Ltd. (Thai re) was formed in 1978. Thai Re is still the only registered local reinsurance company in Thailand. Its capital of 30 million Baht was jointly owned by the local Thai insurance companies, life and non-life, and the company had the support and co-operation of the private and government insurance sectors. It was registered as an insurer, authorised by the Ministry of Commerce through the Department of Insurance, to transact all types of life and non-life reinsurance.

The company's ownership structure was altered in 1993 to allow other than local insurers to participate. Its basic shareholders are still the Thai insurers: some have increased or decreased their holdings. Investment Funds now also participate. The balance is now about evenly divided between local insurers and other investors. The company's present registered and paid-up capital is 1,187 million Baht, and its capital fund at the end of 2007 was 2.474 million Baht.

The reason for establishing a local Thai-owned reinsurer was to reduce the outflow of insurance premiums to other countries, thus making such funds available to the local economy, and to limit the risk exposure of foreign exchange, and to strengthen the local insurance market.

As described by a former and highly effective Insurance Commissioner (Thanavarit, 1999), the primary objectives of incorporating Thai Re were to support and enhance the Thai insurance industry and the country's economy by:

1. Increasing domestic underwriting capacity;
2. Promoting the highest efficiency in underwriting domestic insurance;
3. Securing reinsurance from abroad to support the domestic insurance industry;
4. Extending co-operation and support to State insurance projects, to benefit the industry and society as a whole;
5. Arranging and managing Thailand's reinsurance sector at the highest level of efficiency;
6. Promoting knowledge and understanding of the industry by assisting in advisory and consultant capacities;
7. Promoting the growth and development of the insurance industry in Thailand to be in line with international trends;

8. Serving as a centre of information and statistics of the Thai insurance business;
9. Investing in businesses with emphasis on economic development of the country.

Apart from the aftermath of the 1997 economic crisis, local Thai insurers have had low loss ratios, which meant that they could improve their domestic retention level. As a result, starting on 1 January 1998, all insurers in Thailand were encouraged by the Department of Insurance to retain more risks, especially in fire and all-risk insurance policies. The guidelines to achieve higher retention can be summarised (Thanavit, 1999) as:

1. First-surplus treaties that historically illustrated low loss ratios and yielded profits to foreign reinsurers are subject to 20 to 25 per cent domestic retention;
2. Property fire policies (special tariff rates only) and property all-risk policies with sums insured of 300 million baht or more are subject to at least 30 per cent domestic retention;
3. Fire policies with sums insured of 30 million baht or more must reinsure 10 per cent of the premiums, but not exceeding 10 million baht per policy, with the Thailand Fire Pool (set up by the DOI and the General Insurance Association and managed by Thai Re).
4. Fire and all-risks insurance policies providing cover for losses or damages to finished buildings and properties and having sums insured not exceeding 5 million baht are subject to full self-retention or domestic reinsurance. For policies that have sums insured between 5 million and 30 million baht, insurers should retain the risks as much as their individual capacities allow.

Local Reinsurers in Some Neighbouring Countries

The creation of a local reinsurer is a feature of developing markets, and for similar reasons. Malaysian Re was established over 40 years ago by the Malaysian government as the national reinsurer, to maximise local premium retention and enhance the competitiveness and efficiency of local insurers, and has been active in treaty and facultative business for local insurers. It has reduced, through consolidation and increased capital requirements, the domination of the market by too many small insurers with low capitalisation. Through its market retrocession programme it assisted the writing of inwards retrocession business by insurers otherwise unable to compete for such business in the open market (although with increased capital requirements the programme was withdrawn in 2003). Malaysian Re also provides services to local insurers, such as a Central Administration Bureau for facultative reinsurance transactions within Malaysia. It is the administrative manager for the motor pool, the aviation pool, and the energy risks consortium, and has formed a rating committee to determine rates for special Fire and IAR risks. It owns 40% of the MRC, a centralised Database provider for motor spare parts and repair estimates (to reduce fraud and subjectivity). It provides training courses for insurers' staff (EAIC, 2006).

In Taiwan, Central Re was established by the Ministry of Finance in 1968 as the national reinsurer, with the aim of helping in the sound development of the domestic insurance industry. It was privatised in 2002, and 54.4% is owned by the Evergreen Group of Taiwan, a transportation conglomerate which includes one of the top 5 global container shipping companies. Central Re is a leading domestic reinsurer and has also expanded overseas, building close relationships with overseas strategic partners (EAIC, 2006).

In Cambodia, Cambodia Re was established in 2003 as the national reinsurer. It is a joint venture between the government and Asia Insurance International (Singapore). It has a registered capital of US$7 million, which is the minimum required by the 2002 Insurance Act (10% of which must be deposited with the National Bank of Cambodia). Almost half of its premium income derives from property insurance. Cambodia Re retains 45% of gross premiums received from local insurers (Asia Pacific Country Analysis, 2005).

Although in contradiction to strict capitalism and proponents of liberalised 'free' markets, the creation of a local reinsurer with special privileges is regarded as an acceptable step in the development of a national market which otherwise would be totally swamped by long-established foreign reinsurers with deep pockets, expert systems, skilled staff, and detailed data. The large international reinsures will still be big players. Swiss Re. Munich Re and others, offer not just reinsurance contracts but also a range of services.

Summary of Thai Re Results 1997- 2006

This Ten-Year Summary shows the decline after the 1997 economic crisis of southeast Asia and subsequent recovery, with a few setbacks as in 2003. The healthy situation in 2006 is despite a major fire and engineering loss at the Thai Airways catering depot at the new Bangkok airport in the first quarter. Thai Re has a special fluctuating loss reserve of 100 million Baht, extra to its normal loss reserves, and 30 million Baht of this was used, as intended by the creation of such a reserve, to smooth that year's loss exposure. Thai Re has long used a professional and conservative approach to reserving, and set up IBNR several years before required by the regulatory authority.

Fire business, which includes industrial all-risks, had a slightly reduced premium income in 2006 due to a softening of the market. Miscellaneous business, mainly engineering and personal & group accident, is a large and growing Thai Re segment, helped by its Customer Services division which has ventured into new distribution channels to reach niche markets, a bancassurance scheme, and innovative products such as Cancer Insurance, Household Package, SME Package, Health per Diem, Accident per Diem, and Loan Protection. Motor business fluctuates according to the level of car sales, and declined in 2006 mainly due to the cancellation of the Compulsory Motorcycle (Third Party) Pool.

Reinsurance from overseas is only a tiny proportion of Thai Re's income, less than 0.8% of non-life gross premiums in 2006. This was an increase over 2005, due to six treaties from connections in Hong Kong, Korea and Singapore. In 2007 the company began to explore facultative business opportunities from Indochina.

Almost half of Thai Re's business is Fire reinsurance from domestic insurers. Total non-life business is about 89% of the total, and life reinsurance about 11%. Details are in the following table:

Thai Re: Composition of its Reinsurance Business, 2006 and 2005

	2006	2005
	%	%
Non-Life Domestic		
Fire	48.8	52.1
Marine	7.5	7.9
Motor	3.9	4.9
Misc.	27.3	24.4
Total Non-Life	88.7	89.3
Life	11.3	10.7
	100%	100%

(Source: Thai Re, 2007)

The trend has been for the Fire proportion to diminish and Miscellaneous and Marine to increase, making it a more balanced account. The market agreement is that general insurers registered in Thailand cede 5% to Thai Re, mostly proportional contracts on a quota share basis. This is for Fire, Compulsory Motor, Marine, and some Miscellaneous lines. The agreement also includes some retrocession back to insurers. Life insurers have a similar agreement. Of course insurers can, and do make voluntary cessions above the 5%. The agreement cessions constitute about 30% of total reinsurance premium volume for Thai Re. For the other 70%, Thai Re has to compete with international insurers. It has successfully increased this 'voluntary' business from 45% in 2000 to 70% in 2006. In 2006, 29% of GWP was for Facultative reinsurance and 71% for Treaty business. Thai Re uses a single reinsurance broker to place its major retrocessions, excess of loss treaties, in London (and this broker agrees not to be otherwise active in the Thai market).

Financial Results, 2006 and 2005

	2006	2005
Loss Ratio	44.7%	45.0%
Commissions	36.9%	37.2%
Operating Expenses	4.7%	5.0%
Combined Ratio	86.3%	87.2%

(**Source**: Thai Re, 2007)

Subsidiaries and Affiliates of Thai Re

Thai Re has one affiliated company and five subsidiaries. Thai Re Life is the affiliated company, 100% owned by Thai Re. It covers all classes of ordinary and group life reinsurance (mostly the latter). Due to its nature, the amount of premiums ceded for life insurance is quite small and is ceded only for premium at risk.

Thai Re sees important future growth from life reinsurance, and has a strong business relationship with local and joint venture life insurers. Thai Re Life offers a full range of risk and security products. The income has grown over the last few years, and in 2006 the net premium income grew by 7.9%, with a substantial 117.8% increase in profit. The combined loss and expense ratio for 2006 was 70.6%. Life income is now 11.3% of Thai Re's total income, and the aim is to make that in excess of 15% in the next couple of years. As life business is usually less volatile than general business, this increased proportion would reduce the overall volatility of Thai Re's combined results.

Thai Re Life Results, 2006 and 2005

	2006	2005	Growth
Gross Premium Written*	304,399	286,171	6.7%
Net Premiums Written*	294,972	273,347	7.9%
Underwriting Profit*	80,258	36,857	117.8%
Combined Loss & Expense Ratio	70.6%	77.1%	

* in Thousand Baht

(**Source**: Thai Re, 2007)

There are five subsidiary companies, formed to provide expert assistance to smaller local insurers, and to diversify Thai Re's sources of income by becoming a service provider. Thai Insurer Datanet Co., Ltd. was the first subsidiary, established to develop computer software, and is 40% owned by Thai Re. The second subsidiary, EMCS Thai Co. Ltd. (37.5% owned by Thai Re) provides a computer system for motor claims, linking insurers and repairers and standardising repair prices. TR Training Co. Ltd, was the next subsidiary, wholly-owned, which provides a range of training programmes and a technical advisory service. In 2006 came the fourth subsidiary, First Tech Solution Co. Ltd. an 80%-owned company providing business process outsourcing to local insurers. Also in 2006, Thai Re Services Co. Ltd. was formed as a wholly-owned subsidiary providing claims management operations support and administrative support such as the printing of policies.

Conclusion

International reinsurers dominate the Thai market in terms of premium volume. Major construction projects, usually involve foreign finance or contractors, and the reinsurance is placed internationally. In 2006, 29.8% of general (non-life) reinsurance was placed in Thailand and thus 70.2% internationally. But Thai Re, the only local professional reinsurer, gained 13% of the general market and 11|% of the life market, in the face of this international competition, relying less and less on its market agreement cessions.

Thai Re undoubtedly has financial strength and is managed with skill, both strategically and operationally. In 2006, Standard & Poors uprated its Currency Counterpart Rating, and its Financial Strength Rating, from BBB+ (Good with Stable Outlook) to BBB+ (Good with Positive Outlook). In the last quarter of 2007 Standard & Poors again upgraded Thai Re's Currency Counterpart Rating and Financial Strength Rating, from BBB+ to A- (Stable Outlook). Thus Thai Re is among the highest rated of any insurance and financial services organisation in Thailand. The major factors for these upratings were the maintenance of the company's strong financial position, its professional management, and favourable market conditions. For its high corporate governance standards, also in 2006 Thai Re received yet another Stock Exchange of Thailand award for Distinction in Maintaining Excellent Corporate Governance Report and was nominated again for Best Performance - Financials.

Thai Re, like all organisations, faces internal and external threats. It is well aware of these, monitors them, makes necessary proactive changes and creates contingency plans. The increase worldwide in natural perils, which challenges insurers and reinsurers (Kitseree and Lawrence, 2006) affects Thailand. It is usually free of earthquakes but has experienced some minor quakes recently. Seasonal floods are a major problem. Internal threats, through operational and strategic management errors, are also continuously assessed by Thai Re, which in 2007 introduced an Enterprise Risks Management Guideline manual for all staff. Thailand's commitment to liberalisation of the insurance industry, following signature of WTO agreements, is a big competitive challenge, but has been known and planned for several years as the original timetable was lengthened (Lawrence, 2001). A challenge closer to home is that the Office of the Insurance Commission is considering issuing a licence for a second national Thai reinsurer.

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