Review & Preview
June 18, 2012

Growth Pauses in Asia-Pacific Life Markets as Insurers Seek New Routes to Expansion

Aging Populations, New Products Hold Opportunities.

Life insurers in Asia's largest markets have seen a slowdown in growth – with an outright decline in China – amid continued economic uncertainty. Meanwhile, low interest rates and volatile financial markets have cut into profitability. Still, life insurers are looking ahead to the opportunities arising from aging populations and new products and markets.

The four countries examined in this report underscore the diversity of the Asia-Pacific region's life markets, from the still developing potential of China and India, to the rising powerhouse of Korea, to the more mature, saturated business environment of Japan. Companies in the faster growing markets face the temptation to take excessive risk in pricing and underwriting, and the development of sales channels tends to be a work in progress.

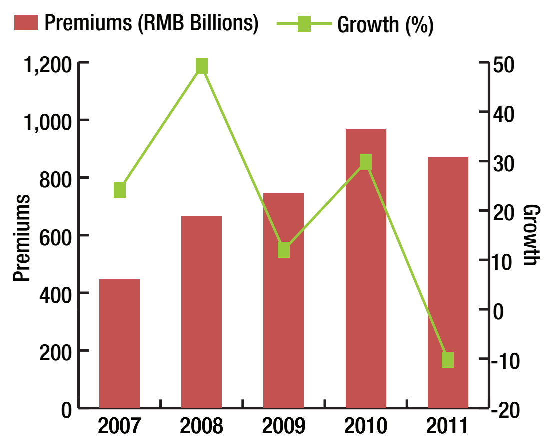
What these markets share is a promising outlook, despite short-term stumbles that may occur amid the global economic turmoil. More perils await, however, with domestic carriers facing foreign competition, and with regulation tightening to safeguard solvency and protect policyholders.

China: Life Sales Dip as Bancassurance Falters

The impressive premium growth in China's life insurance market faltered in 2011. Life insurance premiums, excluding accident and health businesses, recorded a 10% drop to RMB 870 billion in 2011 from RMB 968 billion in 2010. Apart from changes in reporting basis (which excluded most premiums from variable universal life investment-linked products in 2011), the trend reversal in growth of sales resulted from the decline of sales through bancassurance, which was the main channel, normally accounting for half of the life insurance market. The greater the reliance on sales from bancassurance, the lower was the company's premium growth in 2011.

There has been a structural change in the bancassurance model in China since 2011. The China Insurance Regulatory Commission (CIRC) and China Banking Regulatory Commission (CBRC) released new rules to impose stricter control. Insurance companies no longer could assign their agents to sell insurance products in bank branches. Instead, the insurance products must be promoted by licensed bank staff. Each bank, moreover, was only allowed to partner with at most three insurance companies to distribute their insurance products. The new rules also clearly stated

Exhibit 1
China Life - Premium Income (2007-2011)



Source: China Insurance Regulatory Commission (CIRC)

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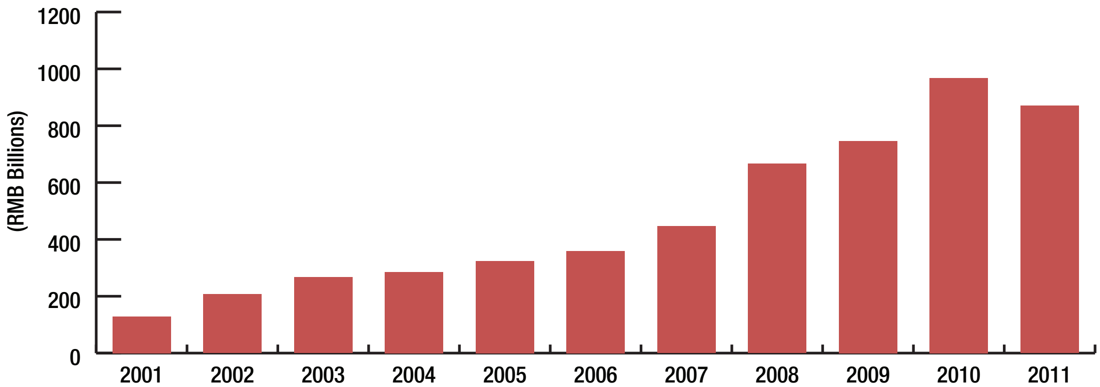
Exhibit 2
China Life – Premium (2001-2011)



Figures exclude health and personal accident premium.
Source: China Insurance Regulatory Commission (CIRC)

the appropriate sales process and business cooperation between banks and insurers.

Since emphasizing the aggressive expansion of their share of premium in the fast-growing bancassurance sector, insurers generally have paid less attention to product innovation and profitability. This resulted in various threats to the insurance companies from the bancassurance business. For instance, to acquire more bancassurance outlets for their products, insurance companies competed by offering higher commission rates and incentives to banks. The insurers stood at a disadvantage to the banks. The strong premium growth was accompanied by high expenses.

Exhibit 3
China Life – Bancassurance Share & Premium Growth (2010-2011)
For five largest life insurers in 2010.

Company	Premium Mix From Bancassurance 2010	Premium Mix From Bancassurance 2011	Total 2011 Premium Growth
China Life	50%	46%	0%
Ping An Life	11%	13%	28%
New China Life	67%	60%	3%
China Pacific Life	55%	48%	6%
Taikang Life	74%	68%	4%

Source: Company reports

To simplify promotion in the bank branches, most insurers developed similar saving products (e.g., single-premium participating endowment) for the bancassurance channel. The saving products with guaranteed yield to policyholders were capital intensive and exposed the insurance companies to losses from volatile interest rates. The growth in embedded value also greatly lagged behind premium growth from single-premium savings products.

The previous sales model that placed insurance companies' sales forces in the banks, meanwhile, led to numerous complaints from bank clients and policyholders. Without comprehensive monitoring of the sales teams, which strived to achieve high targets for growth in sales, it was not rare to find mis-selling cases. Misleading a bank customer that an insurance product was a type of bank deposit plan, or exaggerating the potential returns of insurance products, not only increased the number of complaints but also led to high surrender outflow.

Exhibit 4
China Life/Health – Lines of Business by Market Share (2010-H1 2011)

Product	Market Share 2010	Market Share 2011 H1
Participating life insurance	81.7%	91.6%
Traditional life insurance	9.7%	8.4%
Universal life insurance	1.0%	
Unit-linked insurance	0.1%	
Accident and health insurance	7.5%	
Total	**100.0%**	**100.0%**

Source: China Insurance Regulatory Commission (CIRC)

In 2011 these issues, together with the impact of declining crediting rates on insurance products and tightening liquidity in China's economy, drove the surrender outflow of most insurance companies to double-digit percentage increases. The lapse rates of short-term endowment and single premium products were generally higher. The outflow of some small insurers was even greater than their annual investment income. The fall in new business premium from bancassurance and the increase in surrender outflow reduced the net cash flow to the companies. In 2012, A.M. Best believes the sales environment for the bancassurance channel remains tough. Although there are signs that People's Bank of China is starting to ease the tightening monetary policy, reserve requirement ratios for banks remain high. Banks tend to absorb money as deposits or promote their own wealth management plans, rather than cross-selling insurance products. Unless the insurance company and the distributing bank belong to the same financial conglomerate, it is hard for the insurer to have control over the sales channel.

Exhibit 5
China Life – Surrender Payments (2010-Q1 2011)
For 5 largest life writers in 2010.
(RMB Millions)

	Surrender Payment(1)					
Top 5 Insurers in 2010	**2010**	**2011**	**% Chg**	**2011 Q1**	**2012 Q1**	**% Chg**
China Life	26,968	37,681	40%	8,177	9,916	21%
Ping An Life	3,816	4,407	15%	1,051	1,260	20%
New China Life	7,710	15,047	95%	3,032	4,741	56%
China Pacific Life	4,489	9,588	114%	1,634	3,202	96%
Taikang Life	2,516	4,960	97%	n.a.	n.a.	n.a.

(1): Surrender payment for life business
Source: Company reports

The high interest rates and weak momentum in the A-share equity market also hinder sales of saving products through bank channels. Currently, three-year and five-year RMB deposit rates are 4.65% and 5.10% respectively. Given the poor performance in investment markets, the thin interest income spread for insurance companies squeezes the profit margin. Short-term participating endowment products, which were the core type of product in the bancassurance channel in past years, become unattractive. The China A-share equity market, after losing more than 20% in 2011, remained trading in a range near the low point for the year to date. The sales of investment-linked and variable universal life insurance products are hit badly.

The strengthening regulatory supervision over bancassurance should continue in 2012. The local insurance regulatory commissions started to disclose more details in late 2011 for implementation of the bancassurance monitoring rules from CIRC and CBRC, such as the licensing requirements for bank branches selling insurance and penalties for violating the rules. Combined with the commercial factors already mentioned, the regulatory moves should restrain premium income from the bank channel in the short term.

However, over the long term, this should be a critical moment for China's insurance companies to transform the bancassurance channel in a sustainable and healthy way. The focus of the market's growth should be on the quality of business instead of the quantity. A.M. Best has seen that the proportion of new business from single-premium or three-year premium paying products gradually reduced, with premium-paying term lengthening to five to 10 years. If this trend persists, it will enhance the products' rates of profitability and persistency. The increase in renewal premium also will reduce the volatility of companies' cash flow caused by loss of new sales. Developing more life protection products for the bank channel also will diversify products and improve insurance companies' profitability. However, based on the experience of other developed insurance markets, it will take longer for the bank channel to significantly increase sales of long-term protection products.

The cooperation between banks and insurance companies also can be consolidated for greater efficiency. The banks own the strong customer network, which is useful for insurance companies to explore potential clients. With deeper collaboration, the banks and the insurers can expand the client groups by cross-selling, while sharing the costs in areas such as marketing and information systems.

The market of the high-net-worth group also can be developed jointly. Saving and protection plans are crucial in wealth management. The banks and insurance partners should work together to offer comprehensive packages of products, which will expand the business and profitability of both parties. Integration among financial institutions already has been observed (e.g., Ping An holding an equity stake in Shenzhen Development Bank). A.M. Best expects this type of financial conglomerate to be the pioneers in upgrading the bancassurance model in China.

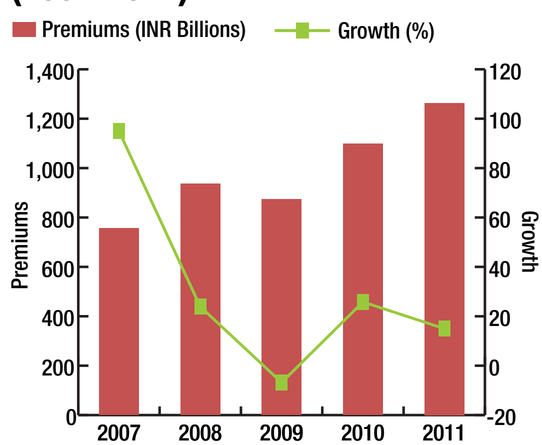
India: Group Life Sales Surge, Microinsurance Cultivated

Group life insurance has shown explosive growth in India in recent years, while individual sales have followed an unsteady trajectory. Group sales were up 56% and 57%, respectively, in the financial years ended March 31 2011 and 2010. But individual sales flattened to a scant 1% increase in the year ended March 2011, down from 18% the previous year.

Life Insurance Corporation of India, the state-owned life insurer, has benefited the most from the growth of group business, which was up 65% for LIC in the year through March 2011. But private life insurers also have fared well with these products, posting a 32% increase for the same period. Overall, LIC maintains a dominant position in the market, ceding little ground to the private competitors that have been growing in number after India's life insurance market was opened to competition in 1999 for the first time in 43 years.

Exhibit 6

India Life - First-Year Premium (2007-2011)



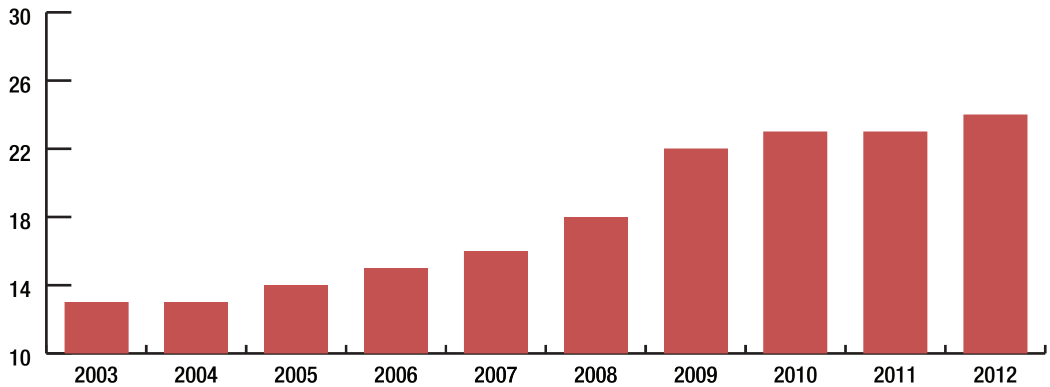
Source: Insurance Regulatory and Development Authority

Since competition returned to the market under the supervision of the Insurance Regulatory and Development Authority (IRDA), business has grown rapidly in step with the country's economy. India's life insurance penetration exceeded 4% in 2010, which is at the high end among Asia's developing insurance markets. India's life microinsurance market is expected to show increasing demand, supported by the economy, steady population growth and growing awareness of insurance protection among the low-income population in the country.

Life insurance in India was nationalized in 1956, and LIC was established with the goal

Exhibit 7
India Life – Number of Insurers (2003-2012)

Financial year ended March 31.



Source: BestLink, Best's Statement File – Global

of spreading the supply of life insurance products widely within India, in particular to the rural areas. The intent was to reach all insurable persons in the country, providing them adequate financial cover at a reasonable cost. This objective can be seen as the origin of microinsurance.

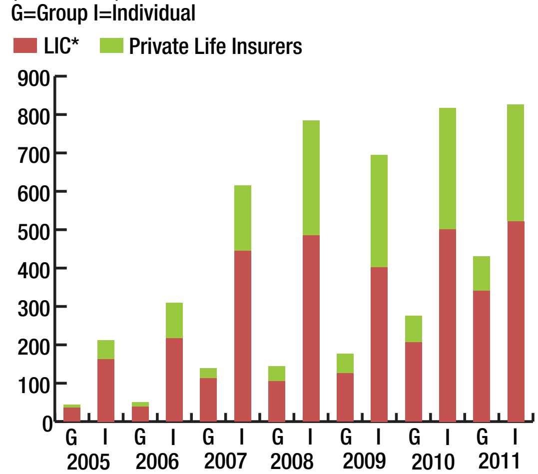
Microinsurance offers protection specifically addressing the needs of low-income people. The risks they face include death of a family member, serious illness, poor harvest and the like. Although low premium is the most common feature of microinsurance, designing such policies is not simply reducing the price and benefits of existing insurance policies, but addressing the needs of this group of insurance customers.

Exhibit 8
India Life – First-Year Premium (2005-2011)

Financial year ended March 31.

(INR Billions)

G=Group I=Individual



* Life Insurance Corporation of India

Source: BestLink, Best's Statement File – Global

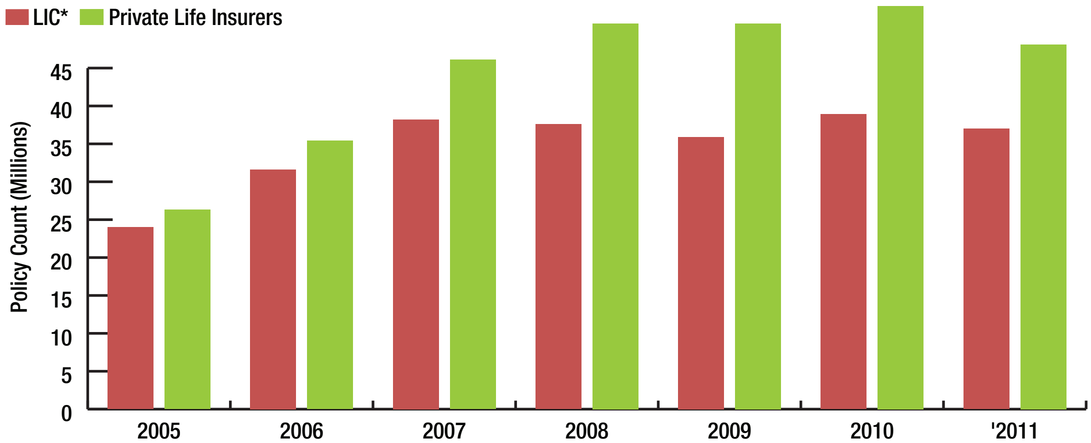
Life Microinsurance Product Features

Life insurance is the most common type of microinsurance. From the demand perspective, the financial distress arising from death of a family member has a significant impact for poor households. From the insurance provider's perspective, life microinsurance has the advantage of easy administration, because life insurance is less subject to fraud or moral hazard and has lower administrative cost than other types of insurance.

Examples of life microinsurance product features in India can be used to further explain how life insurance is a good fit to microinsurance, and how Indian life insurers design their products to address the specific nature of the microinsurance sector.

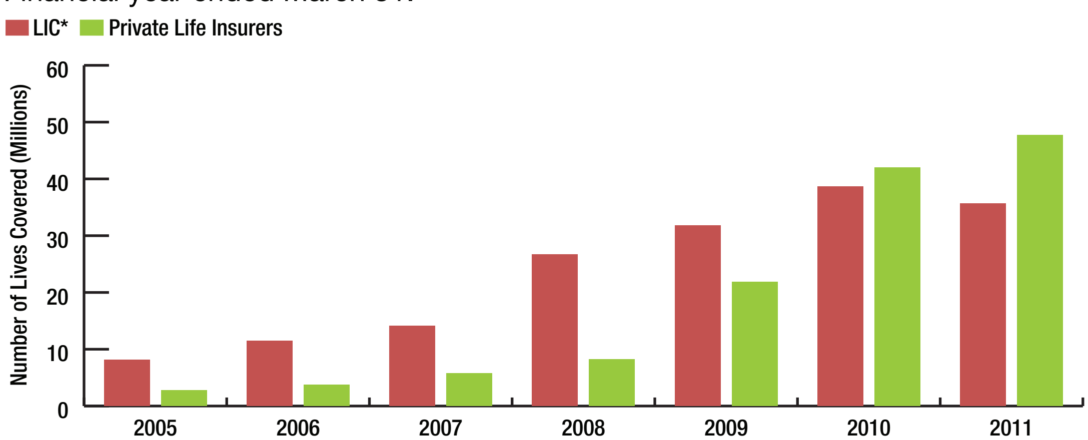
Surrender and withdrawal terms are often generous and flexible. For example, policyholders are allowed to surrender the policy right from or shortly after inception at very low charges, or even free of charge in special situations. These features address afford-

Exhibit 9
India Life – Number of Individual Policies (2005-2011)
Financial year ended March 31.



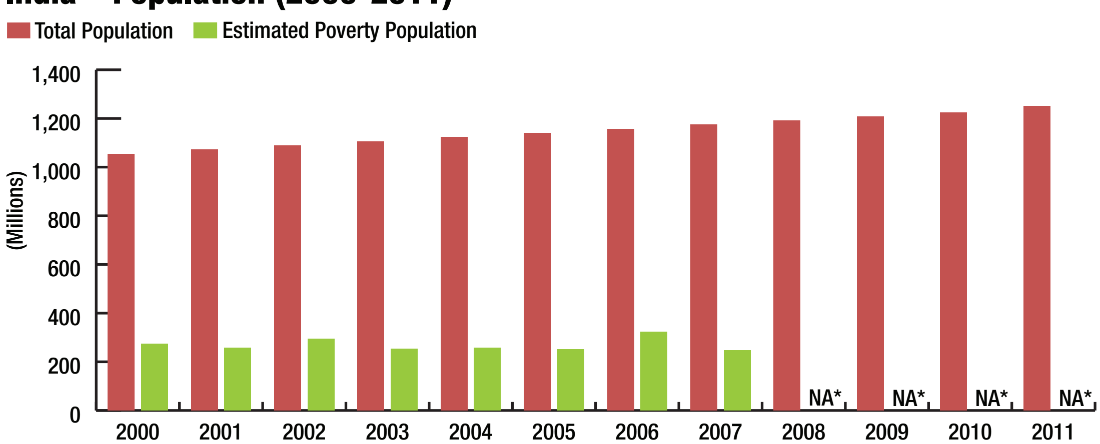
* Life Insurance Corporation of India
Source: BestLink, Best's Statement File – Global

Exhibit 10
India Life – Number of Lives Covered Under Group Policies (2005-2011)
Financial year ended March 31.



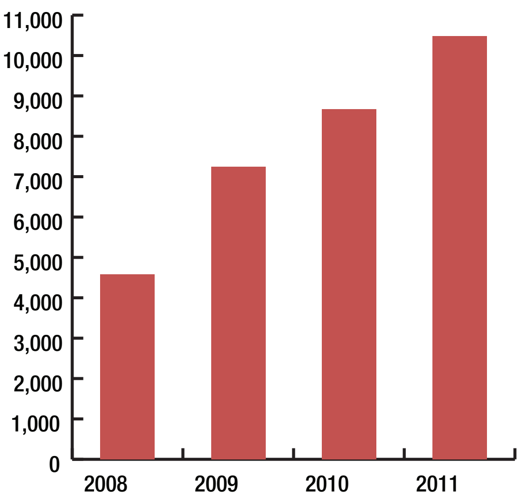
* Life Insurance Corporation of India
Source: BestLink, Best's Statement File – Global

Exhibit 11
India – Population (2000-2011)



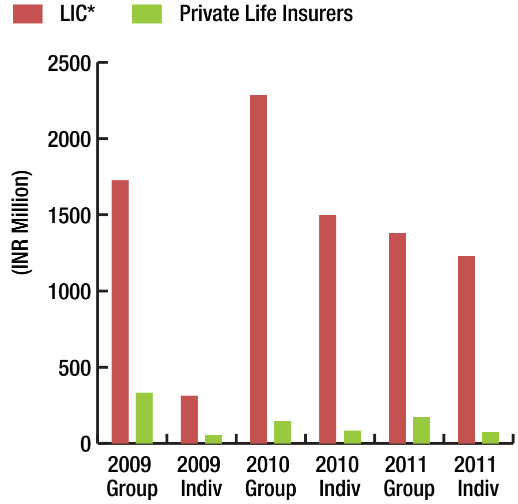
*Not Available.
Sources: World Bank, Development Research Group; United Nations, Population Division

Exhibit 12
India Life – Number of Microinsurance Agents (2008-2011)
Financial year ended March 31.



Source: Insurance Regulatory and Development Authority

Exhibit 13
India Life – New Business Microinsurance Premium (2009-2011)
Financial year ended March 31.



Source: Insurance Regulatory and Development Authority

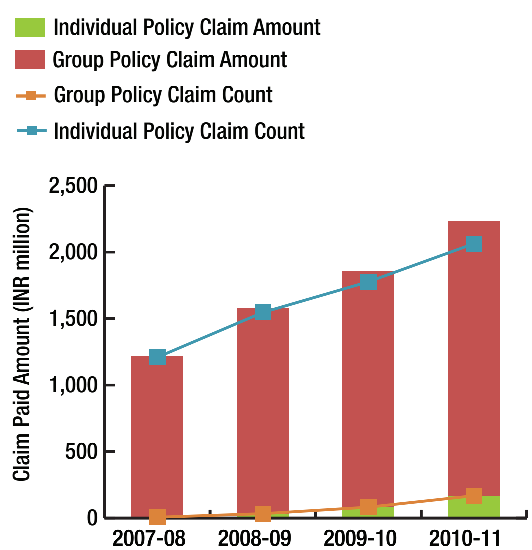
ability concerns and provide flexibility to microinsurance customers, whose sources of income are often irregular or seasonal.

Flexibility in contributions is another feature that addresses the affordability concern. After a one-off initial payment, the policyholder is free to make additional contribution to the account in later years.

Many microinsurance customers have low levels of education or often may be illiterate. They may not understand well the concepts and mechanisms of insurance. To address this, simplicity becomes important in designing microinsurance products. Insurance companies offer only limited choices of term – for example, only five- or 10-year terms may be available. Choice of death benefits and exclusions also are limited. Both microinsurance providers and customers benefit from this simplicity, because clarity of coverage promotes acceptance of the need for insurance and thus increase insurance penetration among the targeted customers.

Pure term life insurance often is less attractive to microinsurance customers. This is because microinsurance customers may not understand the value of term life insurance as a risk management tool to protect them from financial loss as a consequence of the insured's death. Policyholders may feel that the money they spent on the insurance policy has been

Exhibit 14
India Life – Microinsurance Claims Paid (2009-2011)
Financial year ended March 31.



Source: Insurance Regulatory and Development Authority wasted when the insured event does not occur, because the premiums paid do not return to the policyholder. As a result, products that combine savings and death benefit protections are much more popular in the life microinsurance sector in India.

Risk Management in Life Microinsurance

The growth in numbers of microinsurance agents attests to the promise insurers see in this market. In microinsurance as in other lines, LIC has made a strong showing, with market shares generally exceeding 80%. The pie shrank in the financial year through March 2011, however. Meanwhile, claims paid have increased steeply in number and amount.

As with any insurance business, the key to success in life microinsurance is managing risks. Following are examples of how risk management is incorporated in life microinsurance products in India.

Life insurance is long term and therefore inherently involves uncertainty in predicting insured events occurring long after a policy's inception. Instead of applying a significant uncertainty margin when setting premium rates, limiting the term of life policies to five or 10 years helps to reduce the risk arising from uncertainty in pricing parameters. Nonetheless, the low-income population generally has higher average mortality rates for various reasons, such as lack of access to health facilities, poor nutrition and the hazardous working environments of low-income jobs. Recognizing such differences in mortality, collecting appropriate data, and incorporating the differences into pricing and product design are crucial.

A health declaration is commonly used as a safeguard against adverse selection. In the microinsurance sector, the trade-off between costly health screening procedures and a straightforward declaration of health condition is obvious. Health declarations also help to exclude high-risk individuals from the insurer's pool of risks, which helps to reduce an insurer's expected total claim cost for its microinsurance policyholders. Keeping administrative costs and pooled claim costs low in microinsurance is important to ensure affordability for customers.

Insurance companies prefer charging premiums up front, because that helps to reduce problems with lapsed policies and keeps administrative costs low. Additional considerations specific to the microinsurance sector are the timing and method of premium collection. For example, payment should coincide with when the policyholder has surplus income: harvest time would be the best fit for policyholders who are farmers. Methods of payment should address the needs of microinsurance customers, as most of them live in rural areas. Traveling tens of kilometers to pay premiums can discourage policyholders from continuing their insurance policies.

Japan: Modest Life Sales Growth, Weak Profits Expected

In 2012, life insurance premium in Japan is expected to continue to grow, albeit at a moderate pace, while profitability is expected to remain weak because of continued unfavorable financial market conditions.

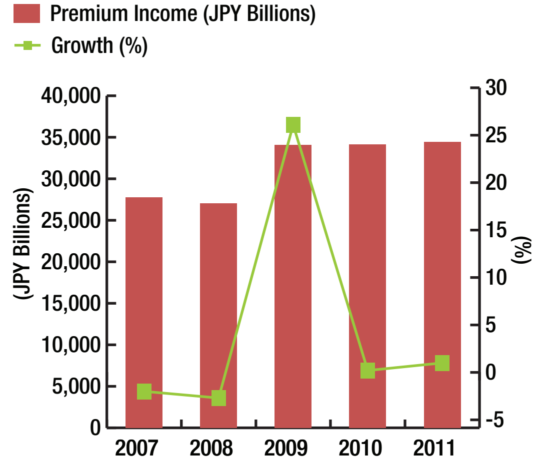
Major life insurers' financial results for fiscal year 2011 showed growth in premiums (based on annualized premium equivalent [APE]), mainly due to continued growth of sales in health insurance and annuities.

Demand for long-term care, accident and health products continues to increase as the population ages. But it is worth noting that the insured amounts of these products are relatively small compared with traditional, protection-type life insurance products, which means smaller premium income per contract. Overall policy amount in-force has continued to decline over the past 10 years.

As health products continue to gain traction, the life industry seeks to expand into the alternative distribution channels used by some foreign insurers. These include direct channels such as the Internet and telemarketing, as well as offline stores. Alternative distribution channels attract customers who voluntarily look for the insurance coverage with low prices. In addition, the bancassurance channel continued to build its presence in the market by expanding its mix of products from savings and annuities to whole life insurance.

Although the major life insurers are still in an early stage to earn meaningful amounts of premium income from the alternative distribution channels, some players apart from foreign life insurers have reported strong growth in these channels. Lifenet Insurance Co., the Internet-based life insurance company, started to sell life products in 2008. The company targets young customers with simple coverage and low prices through the Internet. Lifenet reported new sales (APE) of JPY 2,468 million in the first nine months of fiscal year 2011, compared with JPY 255 million in fiscal year 2008, implying roughly an average annual growth of 113% during the period. In contrast, new sales for the total life industry (APE) showed average annual growth of 10% during the same period. The life insurers owned by non-life insurance groups, sales of which are mainly based on non-life agency channels to promote cross-selling, continue to report stable growth in premium compared with the low single-digit growth of major life insurers.

Exhibit 15
Japan Life – Premium Income (2007-2011)



Source: Life Insurance Association of Japan

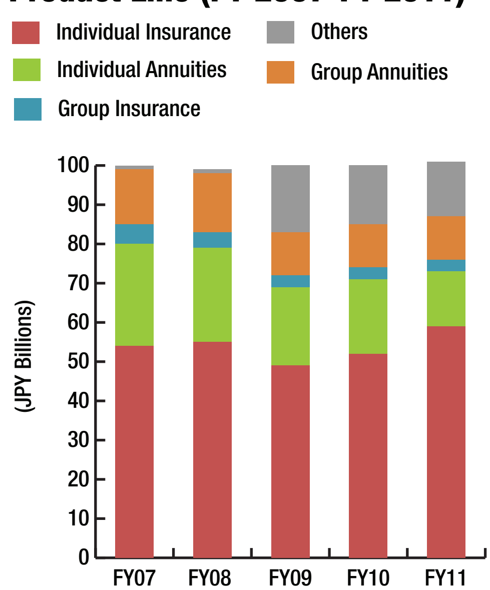
Exhibit 16
Japan Life – Annualized Premium Equivalent In Force (FY 2007-FY 2011)
Financial year ended March 31.

(JPY Billions)

	FY07	FY08	FY09	FY10	FY11
Life industry	19,422	19,698	21,378	21,782	n/a
- Major 4 life insurers	9,090	8,992	9,071	9,171	9,351
- Non-life subsidiaries	1,621	1,687	1,715	1,655	1,700

Sources: Life Insurance Association of Japan, company data

Exhibit 17
Japan Life – Market Share by Product Line (FY 2007-FY 2011)

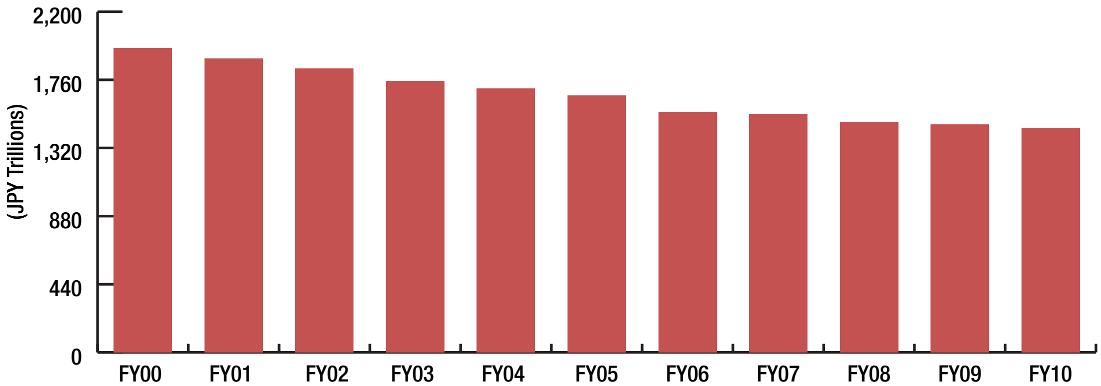


Source: Life Insurance Association of Japan

Exhibit 18

Japan Life – Policy Amount In Force (FY 2000-FY 2010)

Financial year ended March 31.



Sources: Life Insurance Association of Japan, Company reports of Toa Reinsurance Co. Ltd.

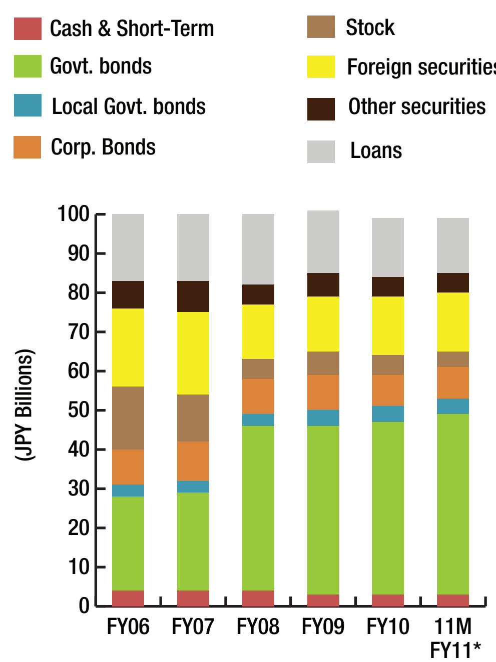
Major life insurers' sales of annuities continued to increase as variable annuities give way to fixed-rate annuities. The volatile stock market caused a surge in hedging costs against minimum guaranteed returns, which put life insurers under pressure to hold more capital against potential investment losses. This led most life insurers to curtail sales of variable annuities in the past two years. Sales of fixed-rate annuities grew favorably last year, although life insurers became more cautious on pricing under a low interest rate environment.

Overall, investment returns in fiscal year 2011 remained sluggish because of a volatile stock market and low interest rates. Ten-year government bond yields declined to 0.99% at the end of March 2012, which compares with 1.26% a year earlier. Persistent low interest rates, coupled with continued volatile stock markets led by a weakening global economy, are expected to continue to pose challenges to life insurers' investment management in 2012.

Life insurers increased their investments in government bonds in the past five years in an attempt to secure a capital buffer against tightening solvency rules under volatile financial market conditions. The proportion of government bonds, including municipal bonds, to total assets increased from 25% at the end of March 2008 to 46% as of February of fiscal year 2011. However, life insurers are expected to continue to increase investment in Japanese government bonds, as the Eurozone debt crisis has led life insurers to be more risk-averse. The risk of a surge in bond yields remains as the Japanese economy continues to grapple with high debt.

Exhibit 19

Japan Life – Invested Asset Distribution (FY 2007-11 Mos. FY 2011)



* 11M FY11 = as of February 2012.

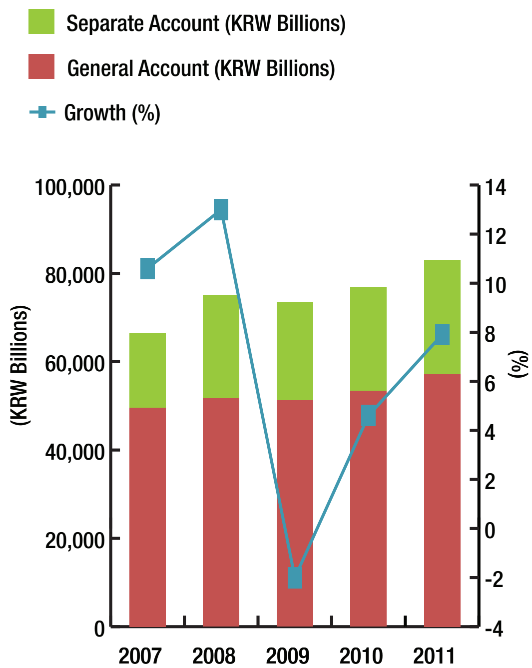
Sources: Life Insurance Association of Japan, company data

Korea: Life Insurers Look to Aging Population

The Korean life insurance market is expected to show mild growth for 2012 amid sluggish growth in gross domestic product (GDP), low interest rates and weak stock markets, accompanied by tightening consumer-protection regulations. However, the long-term outlook remains bright, given structural change in Korean demographics (i.e., an aging population) that suggests growing demand on retirement assets – which life insurers are uniquely positioned to manage for the increasing numbers of retired.

Exhibit 20

South Korea Life – Premium Income (2007-2011)



Source: Korea Life Insurance Association

The positive long-term outlook attracts various players to acquire life insurance businesses, which is likely to lead to fierce competition for growth in the near term. Bank-owned financial holding companies often indicate strong intentions to expand in the life insurance businesses, as they could diversify their sources of earnings and risk profile, and grow further by leveraging cross-selling. Bank-owned life insurers accounted for 13% of the market share in fiscal year 2011, up from 5% in earlier years. Life insurance business also attracts nonfinancial companies. For example, Hyundai Motor Group acquired Green Cross Life Insurance in February 2012 and renamed it as Hyundai Life, with an expectation of synergy with its group companies.

Life insurance premium grew by about 3% to KRW 10.8 trillion through 11 months of fiscal year 2011, as strong increases in sales of savings and annuity products offset the slower growth in protection-type products. Top-line growth for 2012 is expected to continue to slow on the back of sluggish GDP growth, especially for traditional, protection-type products. According to fiscal year 2012 business plans laid out by major life insurers, new sales of protection-type products are expected to slow to the low single digits based on annualized premium equivalents.

In addition, sales of variable life products, the key products to report strong growth in the past 10 years, are expected to fall, largely because of weak stock market conditions, coupled with the recent dispute about variable life insurance products between life insurers and the Korea Insurance Consumer Federation (KICF). The federation's report on potential misleading of consumers as to returns on variable life insurance led to tighter regulatory supervision in disclosure and sales processes. It is likely to slow growth of new sales with increasing pressure to educate customers about the products.

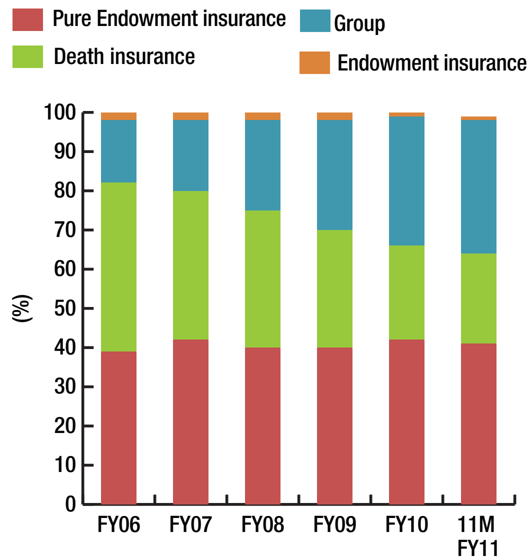
Sales of savings and annuity products are expected to slow in 2012, despite increasing demand for retirement asset management, because of tightening regulations. The sales volume of savings-type products increased strongly as life insurers offered favorable crediting rates in comparison with deposit products under a sustained low interest rate environment. The crediting rates in savings-type products of major life insurers remained relatively high at around 5% in May 2012, in contrast to both three-year government bond yields and deposit rates hovering at about 3%.

Regulators now are trying to stabilize the strong sales in savings products to reduce the potential risks of widening negative spreads under the current low interest rate environments. The regulators advised the insurers to reduce crediting rates on savings products early this year. Indeed, the regulators' introduction of additional provision for reserves to offset negative spreads in its Risk Based Capital (RBC) ratio is likely to restrain the sales of savings-type products. Furthermore, an increase in surrender values of such products, achieved by lowering commission payments to sales forces in the first year, was introduced in April 2012. This is likely to hit the insurers' earnings, as the insurers should compensate for the reductions in commission, caused by an increase in surrender value, to retain their sales forces.

Exhibit 21

South Korea Life – New Sales Market Share by Line (2006-11 Months 2011)

First year premium



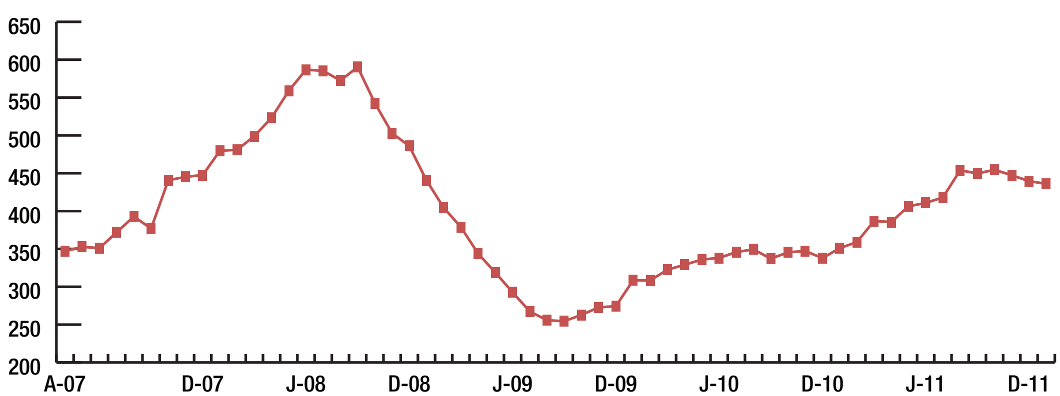
Sources: Korea Life Insurance Association

Investment returns also are expected to be weak in 2012, given the persistently volatile stock market and low interest rates. In addition, the returns on loan portfolios, which offer high returns relative to bond assets, are expected to be squeezed after the reduction of spreads (between lending rates and the crediting rates of the products) on policy loans. Insurers have aggressively increased loan portfolios in recent years as they benefited from tightening bank loans. However, this activity also triggered the regulators to tightly monitor insurers' loan portfolios with multiple measures to control the quality of loans. The regulator tightened the rules on provision for bad debt; increased the risk factors of loan portfolios in RBC calculations; and reduced the spreads on policy loans.

Exhibit 22

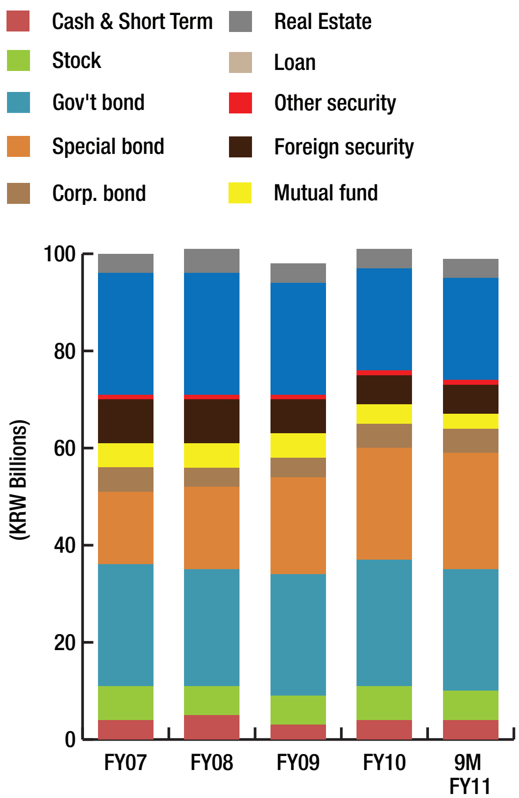
South Korea Life – New Variable Sales (Aug. 2007-Jan. 2012)

(KRW Billions)



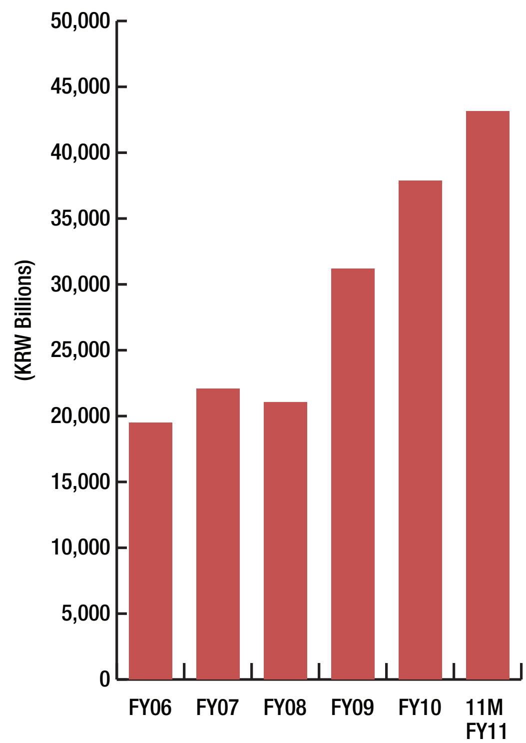
Source: Korea Insurance Research Institute

Exhibit 23
South Korea Life – Invested Assets (FY 2007-9 Mos. FY 2011)



Source: Financial Supervisory Service

Exhibit 24
South Korea Life – Net Asset Value of Insurers (FY 2006-11 Months FY 2011)



Source: Korea Life Insurance Association

On a more positive note, increases in life premium rates will be applied to new contracts from July 2012 as a result of the regulators' reduction of the standard rate in insurance products' pricing. The market expects premium rates to increase about 8% in life products, which would offset the sharp decline in both expense and interest margins. However, sales geared to low-margin savings and annuity products would weigh on the life industry's bottom line.

The life insurance industry's overall regulatory solvency margin in fiscal year 2011 remained adequate owing to capital raisings, in addition to increased investment in bond portfolios that reduce capital requirements in recent years to mitigate the adverse impact from the introduction of the RBC regime. However, the RBC scheme is tightening, with greater risk charges in investments and higher confidence levels to measure the risk requirements, which could weigh on the life insurers' capitalization. Indeed, the growth in capital is expected to slow for 2012, as life insurers' capital generation is geared more to market conditions. Thus capital generation is expected to weaken amid continued weak financial market conditions and prevailing pressure to provide returns to shareholders.

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