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State of Competition in the Insurance Industry: Selected Asian Countries

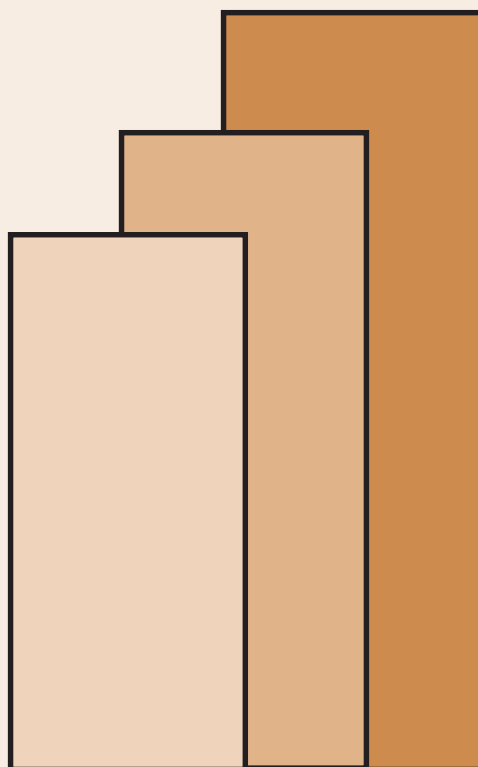
Melanie S. Milo

DISCUSSION PAPER SERIES NO. 2003-13

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September 2003

For comments, suggestions or further inquiries please contact:

The Research Information Staff, Philippine Institute for Development Studies
3rd Floor, NEDA sa Makati Building, 106 Amorsolo Street, Legaspi Village, Makati City, Philippines
Tel Nos: 8924059 and 8935705; Fax No: 8939589; E-mail: publications@pidsnet.pids.gov.ph
Or visit our website at <http://www.pids.gov.ph>

**State of Competition in the Insurance Industry:
Selected Asian Countriesⁱ**

Melanie S. Milo, Ph.D.ⁱⁱ

ⁱ Revised draft of the paper presented at the 28th Pacific Trade and Development (PAFTAD) Conference, 16-18 September 2002, Makati City, Philippines.

ⁱⁱ Research Fellow, Philippine Institute for Development Studies. The author would like to acknowledge the excellent research assistance of Ms. Alellie Sobreviñas. The usual caveat applies. Please send your comments to: mmilo@mail.pids.gov.ph.

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Abstract

This paper is a preliminary review of the state of competition in the insurance industry of selected Asian countries. In particular, it explores how competition has been affected by the market structure and the regulatory regime in the insurance industries of the ASEAN5 economies – Indonesia, Malaysia, Philippines, Singapore and Thailand. It has four main sections. Section II surveys the market structure and overall performance of the insurance industry in the ASEAN5 economies. The third section then looks at the regulatory framework, including the major financial sector reforms that have been undertaken and the factors driving these reforms. In particular, it shows how the regulatory framework in itself can be an important determinant of the structure and performance of the industry, particularly public policy towards entry and the critical role of the industry regulator. Finally, what competition policy implies for the industry is discussed in the fourth section.

Key words: Insurance industry, insurance regulation

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I. Introduction

The insurance industry has an important function in an economy. First, by offering various financial security products to individuals and businesses, it can provide extensive coverage at reasonable cost for a wide range of economic activities and spread the risk of loss throughout the economy. It can also play a major role in overall economic activity through its financial intermediation function (Skipper and Klein 1999). Especially in developing countries where traditional deposits are the main financial saving instruments, particularly life insurance can play a more important role in mobilizing savings because of its greater familiarity, acceptance and accessibility compared to money market instruments, for instance.

Furthermore, the 1997 Asian financial crisis highlighted the danger of firms' heavy reliance on bank financing and led to the conclusion that Asian countries should develop capital markets as alternative sources of financing. Given the dominance of commercial banking in Asia, the recommendation is that banks should also be encouraged to foster corporate bond market development and pursue a complementary role (Shirai 2001; Yoshitomi and Shirai 2001). The insurance industry can also help foster the development of capital markets.

Thus, a developed and competitive insurance industry is also important for economic development, along with developed and competitive banking and capital markets. The banking sector has typically been the focus of financial sector policy, development and reform in developing countries. More recently, the focus has somewhat shifted to the development of capital markets. In contrast, the insurance industry has remained largely untapped.

This paper looks at how competition in the insurance industry in selected Asian countries has been affected by the market structure and the regulatory regime. In particular, the paper looks at the ASEAN5 economies – Indonesia, Malaysia, Philippines, Singapore and Thailand. The next section surveys the market structure and performance of the insurance industry in the ASEAN5. The third section then looks at the regulatory framework, which in itself is an important determinant of the structure of the industry, particularly public policy towards entry and the role of the industry regulator. Finally, what competition policy implies for the industry and regulatory structure of the insurance sector is discussed in the fourth section.

II. Market Structure and Performance

Market structure. The insurance industry includes primary insurers, reinsurers, and agency and brokerage firms. Insurance companies fall in two general categories: life and

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nonlife or general insurers. Table 1 presents the number of insurance companies by type of business in the ASEAN5 economies. The table shows that there is a fairly large number of insurance companies, especially nonlife insurers in all five economies. The number of reinsurance companies in Singapore is also fairly large. The increase in the number of insurers in the 1990s was due to the deregulation of entry, including foreign entry. On the other hand, the decline in the number of insurers in Malaysia was due to consolidation.

Table 1 Number of insurance companies by type of business in the ASEAN5

Country (As of)	Life	Non-Life	Composite	Reinsurance	Total	As of 1994 ^a	
						Life	Nonlife
Indonesia (July 2001)	62	105	0	4	171	49	92
Malaysia (2002)	7	28	9	10	54	5	40
Philippines (2001)	41	109	3	4	157	26	98
Singapore (2002)	6	44	7	36	93 ^b	8	44
Thailand (2001)	25	78	0 ^c	1	104	12	62

Sources: The Indonesian Embassy, Philippines; Bank Negara Malaysia (2003); Insurance Commission, Philippines; Monetary Authority of Singapore; Ministry of Commerce (2001), Thailand; Swiss Re, Sigma No. 6/1996 for 1994 data.

Notes: ^aExcludes composite insurers.

^bIn addition, Singapore has around 50 captive insurance companies which include life, non-life and composite insurers.

^cComposite insurers were required to break up life and non-life business into separate companies by April 2000.

Table 2 shows the number of insurance companies by type of ownership and indicates that the insurance industry is principally private sector owned and operated. There are also a considerable number of foreign-controlled or owned companies in the sector. In fact, in contrast to the banking sector in these economies, there is dominant foreign participation in the insurance industry, particularly in the life insurance sector (Table 3). This was true even prior to the deregulation of foreign entry in the 1990s. In fact, foreign insurers played a major role during the formative years of the industry, before market access restrictions were imposed in the 1960s.

Table 2 Number of insurance companies by type of ownership in the ASEAN5

Country (As of)	State-Owned Companies ^a	National Private Companies ^b	Foreign-Controlled Companies ^c	Branches/Agencies of Foreign Companies	Total
Indonesia (July 2001)	4	122	45 ^d	0	171
Malaysia (1997)	1	45	7	14 ^e	67
Philippines (2001)	0	124	24	7	155
Singapore (2002)	0	17	24	52	93
Thailand (2001)	0	98	0	6	104

Sources: The Indonesian Embassy, Philippines; Insurance Commission, Philippines; Monetary Authority of Singapore; Ministry of Commerce (2001), Thailand; OECD (1999a).

Notes: ^aState-owned companies means companies whose majority (50% or more) of the controlling powers belongs to the state.

^bNational private companies means companies whose majority (50% or more) of the controlling powers belongs to national entities excluding State-owned companies.

^cForeign-controlled companies means companies whose majority (50% or more) of the controlling powers does not belong to national entities excluding branches and agencies of foreign companies.

^dJoint ventures.

^eBranches of foreign insurance companies were required to be locally incorporated by 1998.

Table 3 Foreign participation in the insurance industry in the ASEAN5, 1999

Country	Number of foreign non-life insurers			Number of foreign life insurers			Foreign share of total premiums	
	Domestic (majority) foreign-owned companies	Joint ventures ¹	Foreign branches	Domestic (majority) foreign-owned companies	Joint ventures ¹	Foreign branches	Non-life	Life
Indonesia	0	24	0	0	22	0	29%	46%
Malaysia	8	0	2	4	0	1	14%	65%
Philippines	8	0	6	19	0	0	19%	58%
Singapore	11	0	19	4	0	3	57%	55%
Thailand ²	1	0	5	0	0	1	8%	49%

Source: Sigma No. 5/1999 and No. 4/2001, Swiss Re.

Notes: ¹Joint ventures with foreign shares of 49% or above are included. This is to cater for markets where a foreign equity majority is not allowed although the foreign partner typically takes over operational control.

²For Thailand, a broader definition is sometimes attempted to also capture insurers with effective management control exercised by foreign shareholders. This approach would yield a foreign share of more than 15% in the non-life insurance sector.

With respect to the degree of concentration of the insurance industry, the Herfindahl index (HI) indicates that the nonlife insurance sector is highly fragmented, while the life insurance sector is significantly more concentrated (Table 4). The latter becomes even more evident when one looks at the share of the five largest life insurance companies in gross direct premiums, which ranged from 66 percent in Indonesia to over 90 percent in Singapore and Thailand in 1999. In contrast, the share of the five largest nonlife insurance companies in gross direct premiums was less than 40 percent. But the latter also signifies a high degree of concentration given the greater number of nonlife insurance companies. As in the banking sectors in these economies, there is also an oligopolistic market structure in their insurance industries. However, concentration particularly in the life insurance sector is not deemed a problem, and is noted to be common in developed countries as well.

Table 4 Degree of concentration in the insurance industry in the ASEAN5, 1999

	No. of companies ¹		Share of top 5 firms ²		Herfindahl Index ^{2,3}	
	Life	Nonlife	Life	Nonlife	Life	Nonlife
Indonesia	62	107	66.2%	34.3%	1,317	381
Malaysia	18	53	72.6%	30.3%	1,495	352
Philippines	40	110	76.0%	31.6%	1,615	335
Singapore	14	50	91.2%	32.6%	2,380	391
Thailand	25	73	90.2%	37.4%	2,975	462

Source: Sigma No. 4/2001, Swiss Re.

Notes: ¹Indicates all locally registered insurers.

²Measures in terms of gross direct premiums.

³The Herfindahl Index, which is a commonly used measure of industrial concentration, is calculated by squaring and summing the share of industry size accounted for by every firm in the industry, with a maximum value of 10,000 (where the market share is measured in percentage terms) indicating a monopoly. A value: below 1,000 often indicates that the market is not concentrated; between 1,000 and 1,800 indicates some degree of concentration; and above 1,800 indicates that a single insurer or a group of large insurers have the ability to exercise some control (e.g., price or distribution channel control) in the market (Kwon 2002).

By themselves, these numbers do not really mean much. The issue with respect to market structure is whether it is a market outcome or the result of government regulation. The fact

that there are a large number of firms in the industry does not mean that the market is automatically competitive. The question is whether it is contestable. The presence of foreign insurers also does not automatically mean that the market is more advanced in terms of product development. A high level of industry concentration is not necessarily bad. The concern with excessive concentration is that it is a potential source of monopoly power. Thus, there is a need to monitor the concentration process even in a deregulated environment to detect any further strengthening of the oligopolistic group, and ensure that it does not lead to misuse of market power.

In the absence of government restrictions, insurance markets are structurally competitive in most cases. The nature of entry and exit barriers, and economies of scale and scope is not such that would allow significant market power to be gained by a small number of insurers. Even in highly concentrated markets, the constant threat of new entry can impose competitive discipline. If insurers gain significant market power, it is usually due to restrictive government control over entry and competition (Skipper and Klein 1999). Thus, government policy or regulation is a significant factor affecting the state of competition in the industry, and ultimately the type, quality and price of the products offered to consumers and business users.

Performance. Insurance markets can be classified into three levels: fully mature, transitional and incipient. Among the ASEAN5 economies, only Singapore is classified as a transitional market. On the other hand, the insurance markets of Indonesia, Malaysia, Philippines and Thailand are classified as incipient markets. But there are also differences even among the latter group. In particular, Malaysia has a relatively more developed insurance market and shares some common characteristics with the Singaporean market. Indonesia, the Philippines and Thailand share fairly similar characteristics.

Key indicators of insurance consumption include insurance density and insurance penetration. Insurance density, defined as premiums per capita, represents the average spending on insurance by each person and shows the current state of the insurance industry. Insurance penetration, defined as the ratio of insurance premiums to GDP, measures the importance of insurance activity relative to the size of the economy. A high insurance density implies that the insurance market is fully actualized and therefore has less room to grow. Insurance penetration, on the other hand, can be used as a rough indicator of growth potential. It can be viewed as the relationship between insurance expenditures and economic production per household:

$$\frac{\text{Insurance premiums}}{\text{GDP}} = \frac{\text{Insurance premiums/capita}}{\text{GDP/capita}}$$

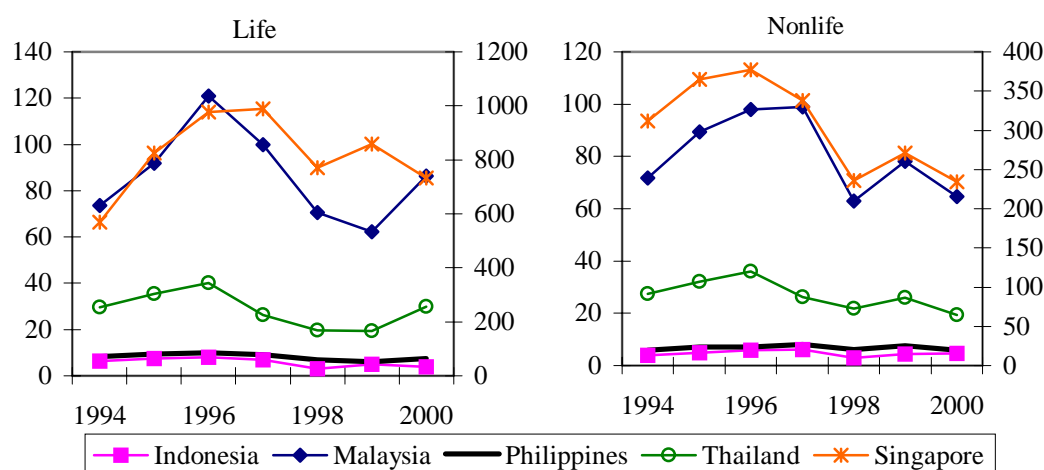
In particular, a positive relationship between insurance per capita and GDP per capita is posited: as production per household increases, household wealth also increases. Individuals can then afford to purchase more insurance. However, this relationship is also dependent on the level of GDP per capita. Both at low and high levels of GDP per capita, the demand for insurance is low. In the former case, it is because the level of wealth can only provide for basic needs. And in the latter case, a saturation point is likely to have been reached, with most insurable interests already insured. Thus, demand for insurance grows only marginally faster than wealth in both cases. In contrast, the demand for insurance is posited to grow significantly faster than wealth in transitional markets. As income rises above the minimal

level, people begin to accumulate personal assets including insurance. Thus, the highest potential for growth is in transitional markets (Chu 2001).

It should also be noted that insurance penetration is not a perfect measure of consumption. Because premium volume is a product of quantity and price, a higher premium volume may reflect a higher quantity, a higher price or a difference in the mix of mortality and savings element purchased. Lack of competition and costly/inefficient regulation may increase the price of insurance without implying a higher level of insurance consumption (Beck and Webb 2002).

Figures 1 shows the ASEAN5's insurance density in recent years. In particular, there has been significant growth in premiums per capita in Singapore and Malaysia in the years prior to the Asian crisis, particularly in the life insurance sector. Insurance density in Thailand also improved, while premiums per capita in Indonesia and the Philippines were stagnant.

Figure 1 **Insurance density: Premiums per capita in the ASEAN5, 1994-2000** (in US dollars)



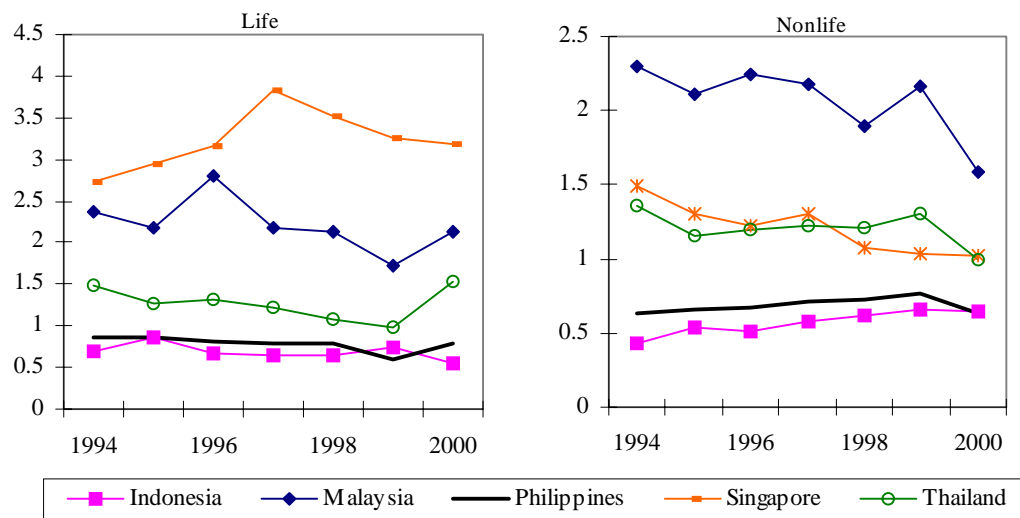
Source: Swiss Re Sigma (various years).

Note: Singapore is plotted on the right-hand scale.

Figure 2 also shows that growth of life insurance penetration has been relatively flat in the lower ranked economies in terms of GDP per capita (Indonesia, Philippines and Thailand), compared to Singapore and Malaysia. On the other hand, nonlife insurance penetration was relatively unchanged in all the ASEAN5 economies.

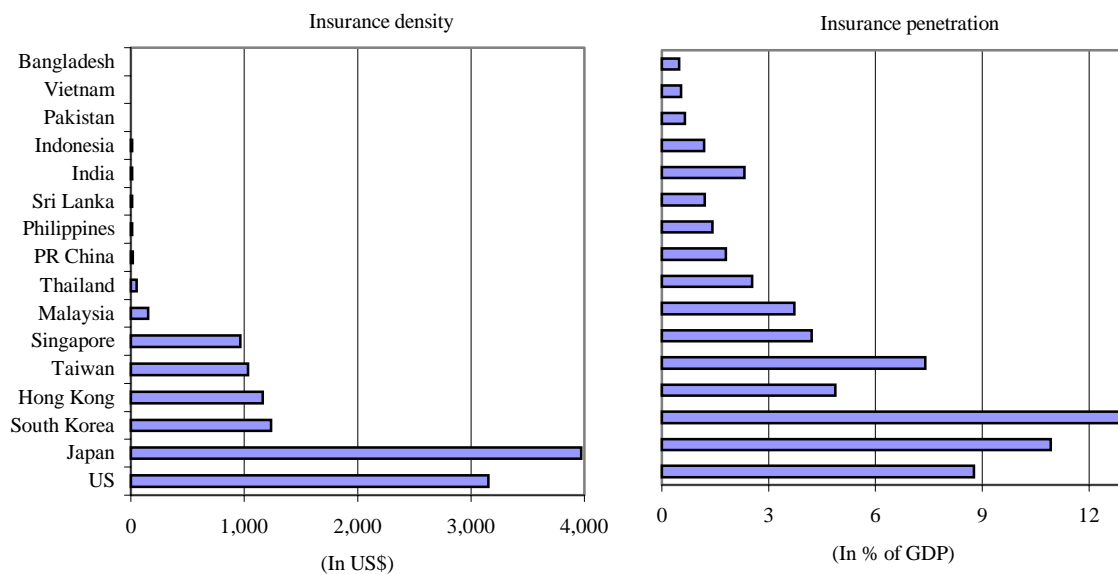
Figure 3 clearly shows the significant disparity in market development between 'mature' markets such as the US and Japan, the transitional markets such as the NIEs, and the incipient markets in the developing economies of Southeast and South Asia. Japan, which is the only mature market in Asia, and the US have the highest premium density ranking. On the other hand, transitional markets still have considerable room to grow, and even more so for the incipient markets.

Figure 2 **Insurance penetration: Premiums as percent of GDP in the ASEAN5, 1994-2000**



Source: Swiss Re Sigma (various years).

Figure 3 **Insurance density and insurance penetration in the US and Asia, 2000**

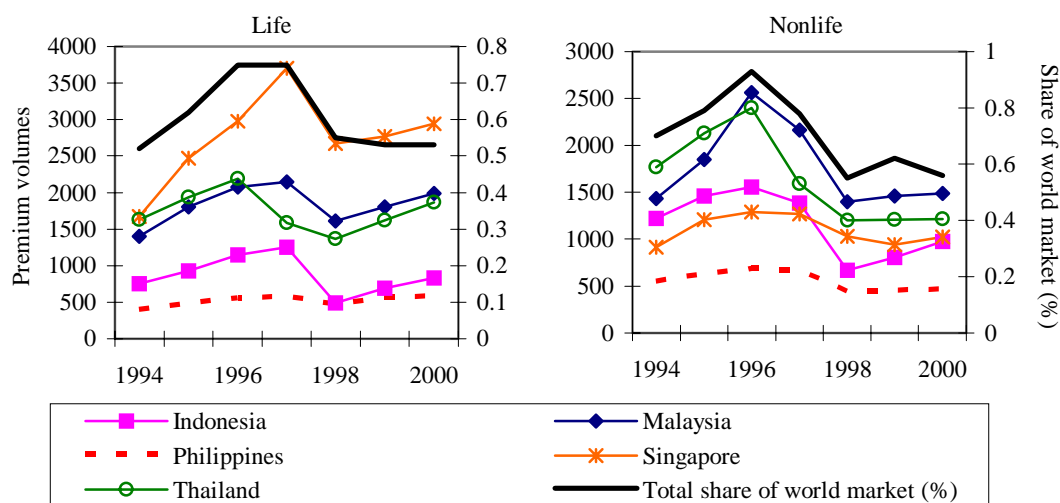


Source: Swiss Re, Sigma 6/2001.

Note: In the incipient markets, insurance density ranged from US\$1.40 in Bangladesh to US\$151 in Malaysia. Corresponding figures for Indonesia, the Philippines and Thailand were US\$9, US\$14 and US\$49, respectively.

In fact, the growth of the insurance industry in the ASEAN5 has been significantly faster in the 1990s relative to world life and nonlife markets, especially in the years prior to the Asian crisis. Figure 4 shows gross direct premium volumes for life and nonlife insurance in the ASEAN5.

Figure 4 **Life and nonlife insurance premium volumes in the ASEAN5, 1994-2000** (in million US dollars)



Source: Swiss Re Sigma (various years).

In the years prior to the Asian crisis from 1994-96, total insurance premium volumes in US dollars grew at an average annual rate of 28 percent in Singapore and Malaysia, 17 percent in Indonesia, 16 percent in Thailand, and 14 percent in the Philippines. In particular, life insurance business has been growing at faster rates than nonlife insurance. Insurance premiums then contracted in 1997 as a result of the Asian crisis, although there has been some recovery particularly in the life insurance sector. Overall, however, the ASEAN5 accounted for only less than 2 percent of the world market at most.

The rapid growth of the insurance industry in the ASEAN5 in recent years augurs well for the development of the sector, and its impact on capital markets and overall economic growth. In particular, life insurance is far more likely to add to long term capital growth than nonlife insurance or banks. Since the policies they sell are typically long term, life insurance firms can also lend their funds on a long term basis. It should also be noted that the insurance industry overall grew under a fairly restrictive regulatory framework.

The underdeveloped state of the insurance industry particularly in Indonesia, the Philippines and Thailand, has been primarily attributed to low levels of income and hence, low demand. But consumer demand is not the only factor affecting insurance consumption. Beck and Webb (2002) argue that important supply-side factors also affect the availability and price of insurance, including varying levels of urbanization, monetary stability, bureaucratic quality, rule of law, corruption, and banking sector development. In particular, a well functioning banking system can raise life insurance consumption by increasing overall confidence in financial institutions and providing an efficient payments system. An efficient financial system, marked by the absence of distortionary policies, can also help insurers invest more efficiently and thus provide more cost-effective insurance. A country's institutional framework or development is also a key factor for a dynamic insurance market, including efficient government bureaucracies and judiciaries. According to Ripoll (1996), insurance markets with fair and rigorous insurance legislation and regulatory bodies enjoy an important comparative advantage. Jenkins and Nuttal (2001) also argue that a favorable regulatory and tax structure for the industry is a key driver of insurance market development, in addition to

an adequate and growing GDP per capita (indicating the capacity of consumers to purchase insurance).

Historically, the regulatory approach applied to Asia's insurance industry was reliant on restrictive regulation of market forces. Limiting the extent of competition between insurers was effected through restrictions on entry, pricing, methods of calculating premiums, design of products, terms and conditions, and allowable investments. Not surprisingly, such regulatory approach had adverse effects on industry structure and performance. Table 5 gives a summary of the characteristics of the insurance industry in the four incipient markets.

Table 5 Characteristics of the four incipient insurance markets, 1997

Country	Characteristics of the insurance sector
Indonesia	Underdeveloped. 8 percent of population covered by insurance. Numerous small firms with limited range of products. Lack of expertise in insurance. 80 percent of risk reinsured overseas.
Malaysia	No new licenses since 1985. Auxiliary insurance services limited. Insurance companies required to place 80 percent of assets domestically and 25 percent in government bonds. Deposit insurance in the insurance sector.
Philippines	Sub-sectors strictly defined. Life market highly concentrated; two firms hold 60 percent of market. Nonlife premium rates set by government. Insurance funds subject to investment restrictions. Market highly dependent on reinsurance.
Thailand	Underdeveloped. 7.5 percent of population covered by life insurance. Life insurance market highly concentrated. Premium rates require government approval. Insurance funds subject to investment restrictions.

Source: Dobson and Jacquet (1998).

Overall, the focus of financial sector development policy and reform was the banking sector, and the insurance sector remained largely underdeveloped. Thus, the insurance industry is significantly smaller compared to the banking sector particularly in Indonesia, the Philippines and Thailand (Table 6).

Table 6 Comparative asset size of the financial sector in the ASEAN5 (in percent)

ASEAN5	Assets of deposit money banks Total financial assets			Assets of deposit money banks GDP			Assets of other financial institutions ¹ GDP			Assets of insurance companies GDP		
	1994	1997	2001	1994	1997	2001	1994	1997	2001	1994	1997	2001
Indonesia	89	Na	Na	51	58	49	Na	Na	Na	3.8	5.1	Na
Malaysia	65	64	69	79	115	117	39	52	44	10.9	12.4	17.9
Philippines	65	81	84	36	65	56	7	6	4	5.0	5.8	6.0
Singapore	Na	Na	Na	93	110	137	13	13	9	16.0	20.0	38.9
Thailand	89	79	73	89	118	99	10	15	24	5.3	5.3	Na

Sources: Database on Financial Structure and Economic Development, World Bank; OECD (1999b); Bank Negara Malaysia (2003); Insurance Commission, Philippines; Monetary Authority of Singapore.

Notes: ¹Excluding insurance companies.
Na means not available.

Commercial banks continue to dominate most developing countries' financial systems, with insurance companies and pension funds typically accounting for small and insignificant shares of total financial assets. Underdeveloped contractual savings institutions are due to

low income levels, the presence of pay-as-you-go public pension systems, the imposition of repressive regulations, and the use of insurance and pension reserves to finance public sector deficits at below market rates. Contractual savings institutions are more developed in economies where mandatory funded schemes for pensions are imposed, including Singapore and Malaysia. But again, another important factor is the regulation of insurance business, particularly life insurance (Vittas 1992).

The following section looks at the overall regulatory framework governing the insurance industry in the ASEAN5, as well as major reforms that have been undertaken and the factors driving them. In particular, the focus is on public policy on entry as a means of improving the competitiveness and efficiency of the insurance sector, and on the role of the industry regulator.

III. Regulatory Framework

The insurance industry in Asia has a long history, beginning with the establishment of some American, British and European nonlife insurance companies during the pre- and post-World War II period. After the war, local businessmen and family groups began to venture into the insurance industry. Historically, the regulatory approach was reliant on restrictive regulation of entry and competition (Emery 1970, Thomas 2000).

The period from the 1950s to the 1960s was a critical formative stage in the development of Asia's insurance industry. The rise of economic protectionism and nationalism at the time was carried over into the financial sector. Thus, market access and national treatment were denied or curtailed to foster the development of the domestic industry. Existing foreign insurers were grandfathered, and eventually became among the largest insurers. With the barriers to foreign entry put in place, the number of domestic insurance companies mushroomed. But the presence of many small firms led to some instability, causing regulators to also impose domestic entry restrictions and tightly regulate the industry. Restrictions on domestic entry were typically imposed due to "overcrowding". Given the small size of the market, the number of both local and foreign insurers already in operation was deemed more than adequate. But such closed door policy, by preventing new players with new products, more efficient distribution channels or better marketing from entering the market and removing the impetus among incumbent insurers to consolidate, innovate, and develop new products and distribution channels, ultimately led to least efficient and innovative insurance markets. Competition was further circumscribed through strict regulation of policy forms, prices and allowable investments. Overall, the presence of a large number of small, inadequately capitalized firms, particularly in the nonlife sector, is one of the principal causes of inefficiencies.

While market penetration by foreign brokers and underwriters was contained or restricted, foreign reinsurers played a more important role in the development of the insurance industry in Asia. They became a source of technology transfer in terms of product development, technical underwriting and management training, guidance on rate evaluation and construction on tariffs. Thus, it has been noted that foreign reinsurers actually enabled the small, inefficient domestic companies to survive, even thrive (Thomas 2000). This structure was also a key source of inefficiency because it only added an unnecessary layer in the underwriting chain.

In the 1980s and 1990s, many developed and developing countries began to undertake various financial liberalization programs to improve competitiveness and efficiency particularly in the banking sector. Reform of the other financials sectors, including the insurance sector, later followed. The following subsections briefly discuss policy reforms undertaken by the ASEAN5 economies with a view to improving the efficiency and functioning of financial institutions and markets, including public policy on entry and the role of the industry regulator.

Indonesia. Financial liberalization in Indonesia occurred in two stages. *Pakjun* came into effect in 1983, which deregulated interest rates and replaced all credit ceilings with reserve requirements. Banks were also allowed to engage in securities underwriting, brokerage, and trading beginning in 1985, although these activities had to be transferred to the banks' holding companies beginning in December 1991. *Pakto* came into effect in 1988, which focused on promoting competition in the financial sector by allowing domestic and foreign entry into the financial sector, although the latter was allowed generally through joint ventures with domestic partners. Previously, foreign participation was only allowed in the life insurance sector; from 1988, general insurance was also opened to foreign participation. Prudential regulations also began to be imposed in 1991 covering reporting requirements, and tightened throughout the 1990s. However, compliance was not strictly enforced until 1997. Minimum paid-up capital for banks and nonbanks were raised beginning in 1988 and throughout the 1990s. Minimum capital adequacy ratio for banks and solvency margins for insurance companies were set, and legal lending limits were also introduced (Dobson and Jacquet 1998).

The Insurance Law was promulgated in 1992. At the time, there were around 145 insurance companies. This rose to 171 by August 1997, mainly due to the increase in the number of foreign joint venture companies from 19 to 40. However, the minimum capital requirements for foreign companies were significantly higher. In 1998, the minimum paid up capital requirement for private national companies was Rp2 billion and Rp3 billion for life and nonlife, respectively. The corresponding requirements for foreign companies were Rp15 billion and Rp4.5 billion. However, in early 1997, 33 insurance companies, of which 19 were life insurers, were found to have failed solvency tests based on liquidity, risk management, profitability and legal aspects (Chou 1999).

Except for products not available in the Indonesian market, all insurance products can only be supplied through a locally incorporated insurance company that could either be Indonesian or foreign owned. Foreign commercial presence is through a joint venture with an Indonesian firm or through participation in the capital of a listed company, which was limited to 80 percent in a joint venture and 40 percent in a listed company. Indonesia's GATS commitments under the Financial Services Agreement (FSA) include the removal of ownership limits on foreign insurance companies and binding of up to 100 percent foreign ownership in domestic companies, as well as the removal of remaining discriminatory capital requirements (Rajan and Sen 2002).

The Directorate of Insurance under the Ministry of Finance is responsible for the general policy framework, supervision, regulation and licensing of all insurance companies. Following the Asian crisis, the focus of Bank Indonesia has been on amending and improving the banking supervision and regulation system to comply with international standards, and restructuring troubled financial institutions. In May 1999, Indonesia enacted a new Central Bank Act that conferred upon Bank Indonesia the status and position of an independent state

institution. An important provision of this Act is Article 34, which provides for the unification of financial sector supervision. In particular, the banking supervision function is to be transferred from the Central Bank to an independent Financial Services Supervisory Institution that was to be established before December 31, 2002ⁱⁱⁱ. Besides supervising the banking sector, this Institution will also supervise companies in other financial sectors including insurance, pension fund, securities, venture capital, and other financial institutions that manage public funds (Bapepam 2000). Changing the structure of regulation was deemed necessary to eliminate gaps in regulatory coverage, which resulted in the presence of a systematically significant unsupervised group of financial institutions (that is, finance companies, many of which were affiliated with commercial banks) that contributed to the crisis.

The insurance sector is smallest in Indonesia, considering that Indonesia also had the largest number of insurance companies among the ASEAN5. The industry is marked by the dominance of small-sized firms offering a narrow range of products. The large insurance companies are mostly state owned or part of family-owned business groups. The low capital base is also coupled with low retention - more than 70 percent of risk is reinsured with foreign firms. Thus, insurance companies were mostly commission earners rather than risk takers or carriers, which also limited the role of the industry as source of long term investment funds (AIR 2000; Dobson and Jacquet 1998). The top six life insurers in Indonesia, which included one state-owned company and three joint ventures, accounted for around 64 percent of gross premiums in 2001. Overall, joint ventures accounted for 48 percent of the market for life insurance. In the nonlife sector, the share of the five largest companies went up to over 50 percent of premiums in 2001. Joint ventures are deemed to have led to higher capacity and transfer of technology.

Malaysia. Financial sector reforms began in the mid-1980s following a financial crisis in the early 1980s. In particular, Bank Negara Malaysia (BNM) made the ringgit freely convertible in 1986. It also abolished deposit rate controls and made lending rates more flexible. In 1991, the basic lending rate (BLR), akin to the US prime rate, was freed from direct administrative control and was instead computed on a monthly basis using a four-element formula. In 1989, the Banking and Financial Institutions Act was adopted, which expanded the roles of financial institutions to foster market development. For instance, commercial banks were allowed to diversify into stock brokering and to hold equity in other stock brokering firms and insurance companies, although a license was required when diversifying into nontraditional areas. At the same time, prudential regulations were tightened and the legal framework was radically changed. In particular, the Act broadened central bank supervision to include all deposit-taking financial institutions, gave the central bank wide powers to pursue illegal deposit-taking institutions and act quickly in emergency situations. Prudential regulations on deposit-taking financial institutions and insurance companies addressed issues of shareholder diversification, risk diversification, reserve requirements, and foreign exchange exposure. Overall, Malaysia's financial services sector remains segmented and lacking in competition because domestic liberalization is incomplete and both domestic and foreign entry is restricted (Dobson and Jacquet 1998).

BNM had taken over supervision of the insurance industry in 1988. The Insurance Act of 1996 replaced the Insurance Act of 1963 as the legislative framework for regulation, and instituted more stringent requirements in terms of minimum solvency margins, asset quality

ⁱⁱⁱ The date was later moved to January 2004.

prescriptions, valuation standards, minimum capital requirements and reporting disclosures (BNM 1999, in OECD 1999b). The 1996 Insurance Act was amended in 1999, which further aimed to enhance the regulatory regime by strengthening insurers' financial positions, providing better protection to policyholders, and ensuring professionalism and sound insurance principles. Provisions dealt with: the licensing of insurers, insurance brokers adjusters and reinsurers; the setting up of subsidiary and offices, establishment of insurance fund, direction and control of defaulting insurers, the control on management of licensee, accounts of licensee, examination and investigation powers of the Central Bank, winding-up, transfer of business of licensee; and matters relating to policies, insurance guarantee scheme fund, enforcement powers of the Central Bank, offences and other general provisions. The growth of the sector in the 1990s has been attributed to improved consumer confidence as a result of these measures to strengthen the domestic insurance industry.

Another area of reform in the insurance industry was the fragmentation particularly of the nonlife or general insurance sector. A financial crisis in 1985-86 left a number of insurance companies unable to meet the minimum solvency requirement. Mergers were thus encouraged and no new license was issued. Thus, BNM provided various incentives to promote consolidation, including liberal branching policy, regional expansion, alternative distribution channels and tax exemptions. In particular, it envisioned a core of 10-15 well capitalized and managed insurers. It also increased minimum paid-up capital and solvency margin requirements, which proved more effective in promoting mergers and acquisitions (Nair 2001). As a result, the number of nonlife insurance companies declined from around 40 in 1994 to 28 in 2002.

In March 2001, BNM launched the Financial Sector Masterplan (FSMP), its ten-year road map for the country's banking and insurance sectors. The overall objective is to build an efficient, effective and stable financial sector, with strong domestic institutions serving as the core of the financial system. The FSMP is fairly extensive and includes specific recommendations that are to be implemented in phases over the ten-year period. The overall strategy is to manage the transition transition, and conduct regular reviews and assessments. In the insurance industry, the initial phase of the FSMP involves building the capabilities of domestic insurers through various deregulatory measures, including promoting bancassurance and deregulating pricing. Phase II will focus on promoting consolidation and strengthening incentives for improved performance, and includes raising minimum paid-up capital and enhancing prudential supervision. Stimulating innovation through progressive liberalization is the theme of the third and final phase, wherein restrictions on foreign entry will be liberalized. The challenge now is to operationalize these recommendations.

Malaysia's graduated and progressive liberalization of the financial services sector is also reflected in its GATS-FSA commitments, which generally limited foreign commercial presence to joint ventures in which the maximum foreign equity permitted is 15 percent by a single or grouped foreign interest or to an aggregate foreign interest of 30 percent. Holding of more than 30 percent foreign equity may be allowed on a case-by-case basis. In the insurance industry, entry of foreign insurers is currently allowed through investment in existing insurance companies, subject to an aggregate foreign shareholding limit of 30 percent. For existing joint venture companies, foreign shareholders that were the original owners of the companies are allowed to own up to 51 percent of the total shares. For the insurance sector as a whole, foreign equity ownership of up to 51 percent is permitted with at least 30 percent of Bumiputra held equity (Rajan and Sen 2002).

In Malaysia, the insurance industry is more developed and product development is relatively more advanced. For instance, the introduction of new annuity and investment-linked products spurred the growth of life insurance in 2000. The Malaysian general insurance sector also has a high retention rate. Malaysia also established the Insurance Guarantee Fund, which is financed by levies charged on all general insurers. More generally, Bank Negara has been actively involved in developing the insurance industry since it took over the supervision of the industry in 1988 in an effort to streamline financial sector supervision. In particular, it encouraged the sector to play a more prominent role in the capital markets (Dobson and Jacquet 1998).

Philippines^{iv}. The Philippines formally embarked on a financial liberalization program in the early 1980s, beginning with the gradual liberalization of interest rates from 1981-83 and the easing of restrictions on the range of operations financial institutions were allowed to conduct in the domestic markets, including the introduction of universal banking in 1980. But soon after the start of financial liberalization, the financial system underwent a series of crisis because of a combination of factors, which included an unstable macroeconomy, weak prudential regulation and supervision, concentrated lending and insider abuse of banks. Financial reforms resumed in 1986, which focused on effecting prudential bank management. Banking reforms implemented in the 1990s included the deregulation of entry of new domestic banks and of domestic bank branching in 1993, which were further rationalized in 1995, and the partial liberalization of entry of foreign banks in 1994. The government also moved to reduce its direct participation in the banking system by privatizing five of the six banks that it took over during the crises in the 1980s. However, entry restrictions on banks were again imposed as a result of the Asian crisis.

There was also an effort to expand the coverage of financial sector reforms in the second half of the 1990s. These included efforts to develop the equity markets and liberalize entry into the private insurance industry. A ban on the entry of new domestic and foreign insurance companies had been in place since 1966, although foreign companies that were already in operation were allowed to continue. With respect to foreign participation in the industry, this was limited to 40 percent equity and only in the nonlife insurance sector to help improve its weak capitalization. In 1992, the insurance industry was opened to new domestic entrants and allowed them to form joint ventures with foreign investors. The restriction on foreign equity in the life insurance sector was also removed, although the maximum 40 percent foreign equity remained. The repeal of the Uniform Currency Law, which required all money transactions in the Philippines to be conducted in the national currency, allowed the issuance of insurance products denominated in foreign currency.

In 1994, entry of new foreign insurance and reinsurance companies was partially liberalized, as part of the government's move to liberalize, deregulate and privatize critical economic sectors and activities including finance. This was in line with the government's decision to join the General Agreement on Trade in Services (GATS) and later on the World Trade Organization. A foreign insurance or reinsurance company or intermediary was allowed entry under (only) one of the following modes: (i) ownership of the voting stock of an existing domestic insurance or reinsurance incorporated in the Philippines; (ii) investment in new insurance or reinsurance company or intermediary incorporated in the Philippines; or (iii) establishment of a branch, but not for an intermediary. To qualify for entry, the companies had to belong to the top 200 foreign insurance or reinsurance or intermediaries in the world or

^{iv} This section draws on Milo (2000).

among the top 10 in their country of origin, and had been in business for at least ten years. A foreign insurance or reinsurance company that would operate as a branch, or where foreign equity in the company or intermediary was more than 40 percent, was allowed entry only for two years from the time the policy came into effect. During this period, the number of foreign insurance or reinsurance companies or intermediaries that would be allowed entry was five each, although this could be increased to ten upon the recommendation of the Department of Finance and the approval of the President. No composite license was to be issued to an insurance applicant under these guidelines. However, significantly higher minimum paid-up capital requirements were also set for new companies. In March 1996, Republic Act No. 8179 was enacted, which deleted the Negative “C” List from the Foreign Investment Act and allowed up to 100 percent foreign equity in key industries including insurance.

In contrast to the fairly rapid change in the policy on entry, other regulations remain stringent and outdated. Furthermore, the regulatory framework does not take into account the differences between the classes of insurance. It is noteworthy that only the Philippines has not issued an updated Insurance Code among the ASEAN5 economies. Changes to the Insurance Code of 1978 had been very few. Historically, the regulatory framework governing the insurance industry was marked by conservatism and risk aversion. Although this resulted in overall financial soundness, it was also deemed as overly cautious and thus constrained the growth and development of the industry. In particular, the requirements of the Insurance Code on investment policies and practices were quite restrictive, which resulted in very conservative investment choices by the insurance companies. Restrictions on the portfolio of assets that insurance companies could hold included limits on investments in stocks, bonds and other certificates of indebtedness, real estate investments, investment in a single enterprise, and investments in foreign currency. These restrictions, coupled with the required security deposits, led to a relatively high proportion of the industry’s portfolio in short term assets and government paper (World Bank 1992).

The insurance industry is the second largest financial sector in the Philippines. But it is also underdeveloped, and has lagged behind in terms of product development and innovation. The industry is also highly dependent on reinsurance. In particular, the nonlife insurance sector is characterized by a large number of very small, family-owned firms that are inadequately capitalized and operationally weak. Thus, significant amounts of risk premium are ceded offshore. This structure has been identified as a key source of inefficiency in the subsector because it only adds an unnecessary layer in the underwriting chain. On the other hand, the life insurance sector is deemed as adequately capitalized, albeit also overcrowded.

Although the insurance industry is largely private owned, it also includes five government insurance corporations: the Government Service Insurance System (GSIS), Social Security System (SSS), Philippine Crop Insurance Corporation (PCIC), Philippine Deposit Insurance Corporation (PDIC), and the Home Mortgage and Guarantee Fund (HMGF). These government corporations are governed by their respective charters and do not fall under the authority of the Insurance Commission. In particular, the SSS and the GSIS provide compulsory social security for employees in the private and public sectors, respectively, and have consistently been twice as large as the entire private insurance industry in terms of assets.

In the Philippines, another important impact of restrictive regulation in the industry was regulatory arbitrage. In particular, there was the growth of a parallel industry – the pre-need industry. The pre-need industry provided for the performance of future service or payment of

monetary considerations for health, education, pension or interment needs. Because pre-need plans are classified as securities, the pre-need industry fell under the jurisdiction of the Securities and Exchange Commission (and the Department of Health for HMOs), which was fairly liberal compared to the Insurance Commission. Thus, the pre-need industry grew significantly since it operated under a less restrictive regulatory environment relative to the life and nonlife insurance sectors (World Bank 1992). For instance, in 2000, total assets of the private insurance industry amounted to less than 212 billion pesos, while total assets of the pre-need industry amounted to around 148 billion pesos.

Singapore. Singapore's financial sector is well developed. In particular, it has become a sophisticated regional financial center as it focused on creating favorable conditions for domestic and foreign financial institutions to service nonresidents. Overall, the government's policies provide a moderate regulatory environment. However, domestic financial intermediation is fairly heavily regulated, and thus remains costly (Dobson and Jacquet 1998). For instance, no new direct general and life insurers have been admitted since 1984 and 1990, respectively. The only exceptions were direct general insurers underwriting specialized business that were deemed as beyond the expertise or capacity of existing insurers. In contrast, Singapore has an open admission policy for reinsurers and captive insurers. Thus, many of the world's top reinsurers operate in Singapore.

The rationale for the closed door policy on direct insurers was the same as in the other ASEAN5 economies - to prevent over competition, given the small size of the market and the adequate number of both local and foreign insurers already in operation. However, it was also recognized that such a closed door policy had adverse effects on the industry. Although a few of the local insurers had done well in Singapore and Malaysia, none had become significant regional players, which was not in line with Singapore's aim to become a world class financial center in Asia. Thus, creating a more competitive environment was considered necessary to raise standards to match international best practice, and thus turn Singapore into a leading center for insurance services in the Asia-Pacific. Freeing entry and ownership was seen as a necessary step towards achieving these aims. Thus, Singapore unilaterally liberalized entry into its direct insurance sector in March 2000, as well as lifted the 49 percent limit on foreign ownership of local insurers and adopted an open admission policy for insurance brokers (MAS 2000).

In tandem with its liberalization policy, Singapore will also undertake to pace the entry of new insurers to minimize the risk that greater competition will lead to unsound practices. In addition, corporate governance, market conduct, management practices and disclosure requirements will be strengthened to the standards of international best practices to protect policyholders' interests. Finally, a committee was also formed to study and recommend changes to improve the efficiency, transparency and quality of distribution of insurance products.

In contrast, Singapore did not address the issue of reforming and liberalizing the domestic banking sector, which remains protected. The rationale for wanting Singaporean banks to maintain a significant share of the market was their critical role in the conduct of monetary policy, the domestic payments system, and the entire process of intermediation in the economy. But similar reforms were deemed as essential to the positioning of Singapore banks in the broader international competitive environment.

Singapore's financial sector is well developed due to its explicit strategy to turn Singapore into a major regional and global financial center. Thus, its reinsurance industry is particularly strong in the region. Singapore also has the largest captive market in Asia, with around 50 captive insurers. In 1987, the Monetary Authority of Singapore established the Policyholders' Protection Fund to cover policyholders whose insurance companies have become bankrupt. It is maintained by a fee imposed on registered insurers. Singapore also has an Insurance Ombudsman Committee that handles policyholders' complaints and disputes. Finally, another key feature of the Singaporean market is its compulsory pension scheme, the Central Provident Fund, which led to its high rate of compulsory savings (Dobson and Jacquet 1998).

The Insurance Department, which forms part of the Financial Supervision Group in the Monetary Authority of Singapore, is responsible for the supervision and development of the industry. Its supervision philosophy has been described as one of "minimal control with responsibility". It also fosters close cooperation with the industry. Finally, regulation is constantly assessed and upgraded, such as the recent shift to a risk-focus supervisory approach (OECD 1999b).

Thailand. Thailand began to liberalize its financial markets in the early 1990s. The main components of the reforms included: liberalization of interest rates; easing of controls on foreign exchange transactions; widening the scope of business opportunities for financial institutions; developing and strengthening the system of prudential regulation and supervision; establishing an offshore banking system; and capital account liberalization particularly through financial institutions. The reforms resulted in tighter competition, especially between banks and finance companies, which led to imprudent management of assets and liabilities. Inadequate regulatory and supervisory frameworks, both for banks and even more so for finance companies, also contributed to the weakness of the financial system, which culminated in the financial crisis that triggered the Asian financial crisis in mid-1997 (Kawai and Takayasu 1999).

Under Thailand's 1997 IMF economic program, reforms planned for financial sector included: the adoption of international loan classification and provisioning standards, the introduction of a deposit insurance system, the implementation of new bankruptcy laws, and the commitment to remove restrictions on foreign equity ownership in banks and finance companies for the next 10 years. Similar to Indonesia and South Korea, the series of financial sector reforms that formed part of the support program that Thailand negotiated with the IMF also included reforming the institutional structure of financial regulation. But unlike South Korea and Indonesia, Thailand did not seek to establish an integrated regulator. Instead it drafted a new Financial Institutions Act that would give the Bank of Thailand the sole responsibility for supervising financial institutions (as opposed to sharing it with the Ministry of Finance under current laws) and will pave the way for universal banking in Thailand. It will also empower the BOT to supervise and monitor financial subsidiaries and conglomerates on a consolidated basis, and will specify steps for prompt corrective action and exit procedures for unviable financial institutions. The Act specifically aims to eliminate redundancies and discrepancies between different laws applicable to different types of financial institutions. Thailand has also drafted a new Bank of Thailand Act to strengthen the independence and accountability of the Bank of Thailand, and limits its objectives to maintaining price stability and safeguarding the stability of the financial system.

The regulatory body in charge of overseeing the insurance sector is the Department of Insurance under the Ministry of Commerce. The Insurance Act was revised in 1992 to

introduce better supervisory measures and to establish an insurance arbiter. Overall, regulations also remain stringent and outdated. In particular, foreign ownership remains highly restricted. Most insurance companies are local, with only one foreign life and five foreign nonlife branches in 2001. And as in the other markets in the region, foreign share in total life premiums was almost half. Although the 1992 revision of the Insurance Act allowed the Minister of Commerce to grant licenses to foreign companies without obtaining cabinet approval, it was not the government's policy to do so until 1995. The insurance market in Thailand shared similar characteristics as the markets in Indonesia and the Philippines. In addition to still fairly low income levels, lack of personnel trained in actuarial science was also an impediment to growth (Dobson and Jacquet 1998).

Thailand undertook to liberalize the insurance industry in three stages beginning in 1997. In the first stage, 25 percent of foreign equity participation in domestic insurance companies was allowed. Twenty-five new insurance licenses - 12 in life insurance and 13 in nonlife insurance, were also granted. In the second stage, foreign equity participation is expected to be raised to 49 percent of registered share capital. In the third stage, foreign equity will be allowed beyond the 49 percent limit once appropriate legal institutions are in place and have been in effect for five years (Rajan and Sen 2002).

In early 2001, the Bank of Thailand announced that it will come up with a master plan to increase the competitiveness of financial institutions, improve public access to financial services, ensure financial system sustainability, and correct remaining problems in the financial sector. However, the focus will be on commercial banks and other financial institutions under its supervision. It is envisioned that the proposed plan will provide a common framework for policymaking among the other supervisory authorities in Thailand.

In summary, the regulatory framework has been an important determinant of the structure and performance of the insurance sector in the ASEAN5, particularly state entry barriers. On the other hand, greater market access was facilitated by the WTO Financial Services Agreement (FSA), which was deemed as an important milestone in the evolution toward competitive financial markets. Although commitments made under the FSA were very modest and essentially formalized the status quo, it laid the legal foundation for market access (Skipper and Klein 1999; Dobson and Jacquet 1998). There were also unilateral liberalization efforts, such as in Singapore and the Philippines.

Finally, the critical role of the industry regulator was also highlighted in the cases of Malaysia and Singapore, which also recognized the importance of developing and strengthening insurance markets in the financial system albeit within a fairly protectionist regulatory framework. It is worth noting that insurance regulation and supervision in both Singapore and Malaysia are conducted by their respective central banks. In contrast, industry regulators in Indonesia, the Philippines and Thailand fall under the Ministry of Finance, Department of Finance and Ministry of Commerce, respectively. In the Philippines, it has been noted that the Department of Finance's role is not well defined and weak, especially with respect to its oversight functions (World Bank 1992). The same could be true of Indonesia and Thailand as well.

Das and Quintyn (2002) analyzed the initial outcome of the evaluation of good governance practices in financial sector regulatory agencies, based on the Financial Sector Assessment

Programs (FSAPs) jointly conducted by the World Bank and the IMF^v. Overall, compared to insurance and securities regulators, the results indicate that “...central bank governance practices are better established than good governance practices of other regulatory agencies” (p. 37). This is not surprising considering that the need for strong and independent central banks has been well studied and promoted in the past two decades. On the other hand, very little has been written on independent regulators and supervisors, and the call for good governance practices in regulatory agencies is fairly recent. Not surprisingly, Das and Quintyn (2002) found that insurance regulators were the weakest in overall regulatory governance. This was attributed to prolonged inadequate policy and institutional attention given to the insurance sectors in most countries. In particular, they also analyzed governance practices vis-à-vis insurance penetration as a proxy for the stage of development of the insurance industry. The results indicate that insurance regulators’ governance practices were significantly higher in countries with more developed insurance sectors.

Finally, Das and Quintyn (2002) noted that institutional factors, the underlying legal framework and country-specific characteristics also influence the governance framework. The regulatory agencies analyzed were either integrated (that is, they are responsible for more than one financial subsector^{vi}), independent or part of a larger government unit. These differences, in turn, led to differing regulatory governance approaches. For instance, they noted that in countries where integrated financial sector regulators were established, there was greater focus on the role and form of governance arrangements. In the case of Singapore and Malaysia, because their insurance regulators operated from within their central banks, they could capitalize on their central banks’ relative strength and independence.

Table 7 gives a summary of recent insurance regulation in the ASEAN5. Overall, protection of the local insurance industry is still being observed. Protectionism-oriented measures include imposing a needs test, higher paid-up capital for foreign insurers than for local insurers, putting a limit on foreign ownership share of local insurance companies, or imposing compulsory cession to the national reinsurer. In addition, some regulatory authorities maintain tariff-rating systems for selected lines of non-life insurance, and/or impose guidelines on insurance application forms and insurance contracts, either directly or through industry associations. Reform of the insurance industry is still in the initial stages and more market oriented reforms need to be done.

For Indonesia, the Philippines and Thailand, the task also includes the strengthening of the regulatory framework, including the institutional framework, in parallel with market oriented reforms. As such, these countries can learn a lot from the way reforms have been generally implemented in banking sectors and also in the insurance sectors of Malaysia and Singapore, especially with respect to prudential regulation and supervision. The latter is especially important with the entry of more foreign insurers, and the more competitive environment. As Kwon (2002) pointed out:

The insurance law, or administration of the law, should be clearer about market accessibility and the scopes of insurer operations; encourage insurers to diversify their risk and investment portfolios while requiring them to abide by well-defined accounting standards; address the supervisory roles of the regulator, and encourage self-regulation among insurers; promote fair competition in the market; and best protect policyholders’ interests (p.1).

^v Their analysis covered around 46 countries that participated in the FSAP effort between 1999 and 2001. Of the ASEAN5, only the Philippines was included in the analysis.

^{vi} The issue of institutional structure for financial sector regulation is discussed more fully in Milo (2002).

Table 7 Insurance regulation in the ASEAN5

Country	Insurance Law and Supervisory Body	Licensing Requirements	Supervisory Requirements	Market Access for Foreign Insurers ^a
Indonesia	Law No. 2 (1992) concerning insurance business and various amendments/ MoF decrees. Director of Insurance under the Ministry of Finance	Minimum capital for a new insurance company is IDR 100 bn	No government-set tariffs but self-regulation via the Insurance Association. A risk-based capital (RBC) system was implemented in 2000. The RBC ratio (adjusted capital to required capital funds) will be increased in stages to 120% by the end of 2004	Only in the form of joint ventures. The foreign partner can increase its equity share beyond the previous 80% limit provided the capital of the Indonesian partner is maintained WTO commitment: 100% foreign ownership of insurance subsidiaries but no branches
Malaysia	Insurance Act 1996. Insurance Regulation Department under the Bank Negara Malaysia (BNM).	Minimum paid-up capital of MYR 100 mn effective 30 June 2001	Motor and fire business subject to rate and form control. Insurers are not allowed to carry both life and non-life business. BNM has issued various incentives and guidelines to promote mergers and acquisitions.	51% ownership limit on existing foreign companies (WTO commitment). 30% limit if foreign insurers wish to acquire a stake in an existing locally incorporated company. No branching.
Philippines	Insurance Code 1978. Insurance Commission under the Department of Finance	Minimum paid-up capital of PHP 75 mn for new local insurers, plus a contributed surplus fund of PHP 25 mn. Minimum paid-up capital for (partially) foreign-owned insurers of PHP 250 mn, plus a contributed surplus fund of PHP 50 mn, where foreign equity is 60% or more; PHP 150 mn, plus a contributed surplus fund of PHP 50 mn, where foreign equity is between 40% and 60%; and PHP 75 mn, plus a contributed surplus fund of PHP 25 mn, where foreign equity is 40% or less.	Tariffs applicable for motor and surety lines. Margin of solvency for non-life insurers is a sum no less than PhP500,000 or 10% of net premiums written in the previous year, whichever is higher. For life insurers, the solvency margin is 0.2% of the preceding calendar year's in-force sums assured.	Branches, locally incorporated companies and joint ventures are allowed. Under the country's WTO commitment, foreign companies can take up to a 51% stake in new and existing domestic insurers. Subsidiaries are allowed but no branches.
Singapore	Insurance Act (Cap. 142) 1967 with subsequent amendments. Insurance Intermediaries Act 1999. The Insurance Department, as part of the Financial Supervision Group within the Monetary Authority of Singapore (MAS)	Minimum paid-up capital of SGD 25 mn for all insurers. Certain deposit requirements with MAS.	No rate control, but form approval required. For non-life insurers, the Singapore Insurance Fund (Offshore Insurance Fund ^b) solvency margin is the greater of SGD 5mn (SGD 1 mn), 50% (20%) of net premium income in the preceding accounting period, or 50% (20%) of loss reserves in the preceding accounting period. For life companies, the Fund's solvency margin is based either on policy reserves or the sum insured.	No foreign ownership limitations
Thailand	Non-Life and Life Insurance Act (1992). Department of Insurance under the Ministry of Commerce	Newly-established non-life companies should have not less than THB 300 mn paid-up capital, and THB 500 mn for life insurers ^c . There are proposals to raise the capital requirements of existing companies, but the decision has been put on hold.	Fire and motor business subject to tariffs. Tariff rates are also applicable to natural hazards like earthquakes, windstorm, flood and bush fires. For non-life insurers, the solvency margin is 10% of the preceding year's written premium, net of reinsurance and subject to a minimum surplus of assets over liabilities of THB 30mn. For life insurers, a capital fund should be maintained of not less than 2% of all reserves, or not less than THB 30mn.	Thailand has subscribed to a three-stage liberalization process, raising foreign ownership in steps to 25%, 49% and 100%. The current regime allows foreigners a 25% equity stake in existing domestic companies or higher if foreign insurers acquire shares from existing foreign investors in a Thai insurance company (but government approval is still required). Under the country's WTO commitment, Thailand will allow 25% foreign ownership.

Source: Swiss Re, Sigma No. 4/2001

Notes: ^aWTO commitments are included as some countries' current market access regimes are more liberal than their commitments. This means the host country can restrict market access to the level that it has committed, which implies some uncertainty for foreign insurers. ^bInsurers are required to set up separate funds for Singapore insurance business (Singapore Insurance Fund) and offshore insurance business (Offshore Insurance Fund). There are separate solvency margin requirements for each fund and for the insurance company as a whole. ^cApplication of financial regulations is non-retroactive.

IV. Competition Policy in the Insurance Industry

In most markets, enhancing competition typically involves the removal or easing of state-imposed regulations that inhibit the workings of the market. In the financial sector, it is also recognized that some form of regulation is necessary to protect the reputation and soundness of the financial system. Because asymmetric information and systemic risks are inherent in the financial sector, it remains closely regulated and supervised in most economies (Grimes 1999).

One common key lesson and policy prescription is that adequate prudential and regulatory provisions are essential to ensure the soundness of banking and insurance industries and the protection of consumers. In particular, prudential regulation and supervision should focus on solvency oversight, disclosure and consumer information, and market monitoring. Thus, while prudential regulations can be anti-competitive, some degree of prudential regulation can also promote competitive forces (Grimes 1999).

The strengthening of the regulatory and supervisory framework should be in parallel with market access and other market-oriented reforms, particularly competition and liberalization measures, to improve the efficiency of the insurance industry (Kawai 1997). Market access alone is not enough to ensure vigorous, fair competition. The insurance regulatory regime also has to be sound so that relaxing such constraints on competition will serve to enhance efficiency and innovation. (Skipper and Klein 1999). This also entails a regulatory and supervisory body that is capable of carrying out these tasks. In particular, a generally supportive policy attitude towards strengthening market elements and intensifying competition in the financial sector is considered as part of the scope of competition policy as well (Broker 1989).

Developed countries such as the members of the OECD also continue to heavily regulate their insurance sectors. However, there has been a shift from policy interventions designed to restrict competition, to deregulation of such restrictions and refocusing of regulation on prudential controls and consumer protection issues. There has also been a focusing of regulation on consumer product lines (OECD 1998). That is, better regulation does not necessarily call for the institution of more or stronger rules, but a different kind of rules.

Regulations that restrict market entry are among those that have the most direct impact on competition⁷. Such restrictions are typically imposed for public safety or efficiency reasons, including preventing over-investment or overcrowding in certain markets. But primary importance is often placed on the elimination or reduction of government barriers to market entry to enhance the contestability of markets and the competitive process (Grimes 1999). Thus, the over-arching theme of the competition principles identified by the Pacific Economic Co-operation Council (PECC) was "... the openness of markets to contest from all sources of supply", acknowledging that the ultimate goal of competition policy is to protect (or at least provide "minimum distortion" to) the *competitive process*, not *competitors or producers* (PECC 1998, in Grimes 1999).

On the other hand, open entry into the insurance sector (and the financial sector in general) is not practiced even in the most liberalized and deregulated financial sectors, for prudential and consumer protection purposes. That is, entry is typically subject to a strict licensing process.

⁷Aside from direct entry restrictions, there are other policy-induced barriers to entry such as fiscal incentives and credit subsidies, as well as structural (e.g., scale economies) and behavioral (e.g., predatory pricing) entry barriers. Barriers to entry serve to limit the number of producers or sellers, and thus stifle or restrict competition. In particular, they are factors that allow incumbent firms to raise and maintain prices above costs without fear that new firms would enter the market to contest it (Medalla 2000).

Although licensing requirements are technically entry barriers, such entry restrictions are necessary to ensure the financial soundness, and technical and managerial capabilities of insurance companies⁸. But in some developing countries, entry is not only regulated in this manner but outrightly banned, particularly the entry of foreign insurers. Others apply an economic needs test or require local equity participation (Skipper and Klein 1999). When the licensing process is not transparent, entry can then become discretionary and the prudential purpose is ultimately negated. Such restrictions are typically applied to protect and promote the domestic industry. But even if it is deemed worthwhile to purposely restrict competition to pursue wider social objectives, a national competition policy can then require the government to justify its interventions and restrictions in the market. That is, another aspect of competition policy would be to make such government interventions and restrictions transparent, and open to public scrutiny and assessment of their effectiveness (Cabalu *et al* 1999). Kwon (2002) argues that without a reasonable justification, differences in capital requirements and limited access to the local market should be eliminated because they can reduce insurer underwriting and large-line capacity, and discourage further foreign direct investment.

However, there will be further pressure to bring down state entry barriers, particularly under the GATS-FSA framework. In fact, it has been noted that a major proponent of the extension of US trade policy to services was its financial services industry led by the insurance sector (McCulloch 1990; in Dobson and Jacquet 1998). There are also some clear benefits of such a move, especially in incipient markets where regulation has served to protect industry players at the expense of consumers. It is worth emphasizing that governments should be concerned about total welfare and not just producer welfare. For Indonesia, the Philippines and Thailand, it would be useful to draw up a master plan for the entire financial sector similar to Malaysia and Singapore, which places domestic objectives and strategies and externally generated/directed deregulatory reforms in a consistent and coherent framework that includes clear targets, indicators and time frames. That is, liberalization should be guided by the domestic reform agenda/objectives, but kept in the context of an increasingly globalized and integrated financial services industry. Some policymakers are skeptical of the benefits of financial liberalization, in the light of the various financial crises that occurred especially in the 1990s. A balance needs to be struck between the potential costs and potential benefits of allowing greater competition. In particular, the potential adverse effects of enhancing competition through a lowering of barriers to entry can be addressed by properly applying prudential regulation.

Identifying the appropriate level and form of intervention is a serious challenge to government. Regulatory efficiency factors in overall economic performance. Inefficiency results in costs to the community through higher taxes and charges, poor service, uncompetitive pricing, or slower economic growth. In order to control costs and ensure effectiveness, regulation has to be placed within a consistent framework. To do this, it is necessary to establish clearly what needs to be regulated and why, as well as to define the principles for effective and efficient regulation (Wallis *et al* 1997). A corollary to this would be the identification of the appropriate regulatory structure. The development and application of a national competition policy is a necessary and useful step in this direction, and enhancing the role of competition in regulation may be one guiding principle⁹.

Ultimately, developing the insurance sector and deepening the reform process will rest on a clear understanding and appreciation of, and strong commitment to competitive insurance markets as being in the national interest.

⁸ Appendix 1 lists the provisions on entry of insurance companies in the ASEAN5

⁹ E.g., Skipper and Klein (1999) propose a set of pro-competitive principles in the design of insurance regulation.

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APPENDIX 1. PROVISIONS ON ENTRY OF INSURANCE COMPANIES

INTERNATIONAL STANDARDS	PHILIPPINES (Insurance Code P.D. 612)	SINGAPORE (Insurance Act, Cap. 142, last amended in October 2000)	INDONESIA (The Insurance Business Law No. 2 (1992) and MOF decrees)	MALAYSIA (Insurance Act 1996)	THAILAND (Life Insurance Act and Non-life Insurance Act of 1992)
<p>Companies wishing to underwrite insurance in the domestic insurance market should be licensed.</p> <p>Assessment of the suitability of owners, directors, and/or senior management, and the soundness of the business plan.</p> <p>In permitting access to the domestic market, the insurance supervisor may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent</p>	<p>No insurance company shall transact any insurance business until after it shall have obtained a <i>certificate of authority</i> from the Commissioner and payment of the fees prescribed. (Sec. 187)</p> <p>No insurance company may be authorized to transact in the Philippines the business of life and non-life insurance concurrently unless specifically authorized to do so. (P.D. 612, Sec. 187)</p> <p>The supervisor may require an insurance company to submit a business plan showing the company's estimated <i>receipts</i> and <i>disbursements</i>, as well as the basis, for the next succeeding 3 years. (As amended by P.D. 1455)</p> <p>Any person of good moral character, unquestioned integrity and recognized competence may be elected or appointed director or officer of insurance companies. (Sec. 187)</p> <p>No person shall concurrently be a director and/or officer of an insurance company and an adjustment company. (Sec. 187)</p> <p>All insurance companies and brokers are required to submit (every year) a certification on capital structure (name of stockholders, nationality, number of shares owned and amount paid a list of current directors and officers (IC Circular Letter 2-97)</p>	<p>No person shall carry on any class of insurance business as an insurer unless the person is registered by MAS. (Insurance Act, Rev 2000, Chapter 142, No. 3)</p> <p>MAS opened up entry to the direct insurance industry and lifted the 49% restriction on foreign ownership of local insurers (March 2000). Nevertheless, new applicants can be subject to needs test.</p> <p>Open market entry policy for insurance brokers. For reinsurers and captive insurers, the existing open admission policy will remain.</p> <p>Every registered insurer shall pay to the Authority such annual fees as may be prescribed but may exempt wholly or in part any registered insurer from the payment of the annual fees.</p> <p>No registered insurer shall appoint directors and principal officers unless the insurer satisfies the Authority that that person is a fit and proper person to be so appointed and has obtained the approval of the Authority. (Insurance Act, Rev 2000, Chapter 142, No. 31)</p> <p>Prospective applicants are encouraged to meet with the Insurance Department, MAS to discuss their business plans before submitting a formal application.</p> <p>In assessing an application for life and/or general reinsurance licenses, MAS takes into consideration the following factors: a) World ranking; b) Credit rating; c) Reputation, financial soundness and track records; d) Commitment to contribute to the development of Singapore as an important reinsurance center</p>	<p>An insurer must obtain prior approval from the regulator to open a branch office.</p> <p>The license holder can do business in only one class of insurance business, life or non-life.</p> <p>Only life insurance business was open to foreign participation before 1988; other insurers have been able to enter the market since then.</p> <p>The government has cut off a significant number of procedures to reduce the burden of high cost to a new insurance company that also channel to higher price for policyholders. A new established company is only obligated to provide all necessary documents to the <i>Minister of Finance</i>. If all requirements are completed the license will be issued not more than 30 days.</p> <p>Indonesia has committed itself to eliminating all market access restrictions and national treatment limitations for insurance companies by 2020, subject to similar commitments by other WTO members.</p>	<p>No person unless licensed shall carry insurance business, insurance broking business or adjusting business (Sec. 9)</p> <p>A licensed insurer, other than a licensed professional reinsurer, shall not carry on both life business and general business. (Sec. 12)</p> <p>The following should be considered in granting a license, with or without conditions, or refusing to grant a license: a) whether or not the issue of license would be conducive to a sound financial structure in Malaysia; b) whether or not the interests of the general public will be served if the license is issued. (Sec. 16)</p> <p>No licensee shall carry on its licensed business unless it is a member of an association. (Sec. 22)</p> <p>No licensee incorporated in Malaysia shall establish or acquire a subsidiary in or outside Malaysia without the prior written approval of the bank. (Sec. 35)</p> <p>No licensee incorporated in Malaysia shall open an office in or outside Malaysia, and no licensed foreign insurer shall open an office in Malaysia without prior written approval of BNM. (Sec. 36)</p> <p>No licensee, and no controller of a licensee, shall appoint a person as director or chief executive officer unless it has obtained the prior written approval of BNM for the proposed appointment. (Sec. 70)</p>	<p>The insurance business may be undertaken only by a limited company or a limited public company and has been granted a license to engage in the insurance business from the Minister with the approval of the Cabinet. (Life Insurance Act, Sec. 7 and Non-life Insurance Act, Sec. 6)</p> <p>License shall be granted only after the company has placed the security deposit and maintained the assets in Thailand (Life Insurance Act, Sec. 8 and Non-life Insurance Act, Sec. 7)</p> <p>A foreign insurance company may establish a branch for the undertaking of the insurance business after a license from the Minister with the approval of the cabinet has been obtained. (Life Insurance Act, Sec. 8 and Non-life Insurance Act, Sec. 7)</p> <p>A company which is a branch office of the foreign insurance company may not open a branch office anywhere. (Life Insurance Act, Sec. 8 and Non-life Insurance Act, Sec. 7)</p> <p>The government banned the insurers from concurrently operating life and non-life insurance businesses (1999).</p>

<p><i>Foreign Insurers:</i></p> <p>a. May operate in 2 ways:</p> <ol style="list-style-type: none"> 1. by a local branch 2. on a services basis <p>b. As an option, they may be allowed to operate only by setting up a branch in the domestic market.</p> <p>c. They may be allowed to operate, without an approval from the <i>host</i> supervisor where, for example, bilateral or multilateral agreements are in place.</p> <p>d. Companies which are incorporated in accordance with domestic law but which are partially or wholly foreign-owned subsidiaries should in principle meet the same licensing requirements as domestic insurers.</p>	<p>The total investment of a foreign insurance company in any registered enterprise shall not exceed 20% of the net worth of said foreign insurance company nor 20% of the capital of the registered enterprise, unless previously authorized in writing by the Commissioner. (Sec. 191)</p> <p>Every foreign company doing business in the Philippines shall set aside an amount corresponding to the legal reserves of the policies written in the Philippines and invest and keep the same therein (Sec. 193)</p> <p>Insurance industry was opened fully to foreign players (Foreign Investments Act)</p> <p>IC examines the ff. factors before it makes decision on application by foreign insurer:</p> <ol style="list-style-type: none"> a. geographic representation and complementation b. strategic trade and investment relationships between the Philippines and the country of incorporation of the applicant c. demonstrated capacity, global reputation in underwriting innovations and stability in a competitive environment of the applicant d. reciprocity rights that Philippine insurance or reinsurance companies or intermediaries can enjoy in the applicant's country. e. The applicant's willingness to fully share its technology. <p>A new foreign insurer is not allowed to hold a composite license but it may apply for a separate license for life and a separate license for non-life business.</p>	<p>The Authority may establish any foreign insurer scheme for the purpose of permitting any member of any class, society or association of foreign insurers specified in the scheme to carry on insurance business in Singapore. (Insurance Act, Rev Ed. 2000, Chapter 142, No. 35B)</p> <p>The Authority shall, in respect of any <i>foreign insurer scheme</i>, appoint an administrator who shall be resident in Singapore. (Insurance Act, Rev Ed. 2000, Chapter 142, No. 35C)</p> <p>Require the foreign insurers who wish to carry on insurance business in Singapore under any foreign insurer scheme to obtain such undertakings and guarantees by any person acceptable to the Authority.</p>	<p>Foreign firms may insure foreign nationals and foreign companies without having to form a joint venture.</p> <p>Foreign insurance firms are permitted to enter the market but face higher initial equity investment than do domestic insurance firms.</p> <p>A foreign insurance entity must satisfy several conditions before it is allowed to do insurance business:</p> <ol style="list-style-type: none"> a. Locate an Indonesian partner. b. Have its equity capital being at least 2x the amount of its investment in the joint venture. The local partner must have been operating for at least 2 years while satisfying the authority's requirement for solvency test. c. Submit a plan describing how the foreign partner's ownership in the joint venture will be reduced over a specified period of time. <p>A registered joint venture must limit its foreign ownership initially to 80% of its total share, and gradually, i.e., within 20 years, reduce it to no more than 49% of its total share.</p> <p>The joint venture must employ an adequate number of insurance professionals (commonly actuaries), whether Indonesian or foreigners, who have at least 5 years of experience in their specialty areas, and appoint Indonesians to its board of directors.</p>	<p>Foreign investors may hold up to 30% of ownership equity of any Malaysian insurance company. Foreign shareholders who had made their investment prior to the enactment of the Insurance Act of 1996 are exempted from this requirement, and may continue to hold equity up to 51% in aggregate. This exception is in pursuant to Malaysia's commitments under its WTO agreement.</p> <p>The insurance act made it mandatory for all branches of foreign insurers to be domesticated, i.e., locally incorporated as a subsidiary (by June 1998)</p>	<p>Foreign insurers are limited to holding a 25% stake in Thai insurers.</p> <p>The first stage of increasing the limit of foreign ownership in an insurance company from 25% to 49% is expected in 2003. The 49% limit is expected to remain fixed for 10 years, after which the Department of insurance has the power to increase it. The government intends to fully open the market well in advance of the WTO deadline of 2020.</p>
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