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Life Insurance in Asia

New Realities and Emerging Opportunities

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In the years leading up to the global financial crisis, multinational life insurers converged on Asia.¹ They were drawn to the region's strong economies and rising household wealth, as well as to the low penetration of life insurance products among wide swaths of the population. The opportunity for growth seemed vast.

Yet today, many of these insurers are facing a reality check. The recession has hit virtually all industries in Asia—including financial services—and has altered the competitive dynamics of the life insurance sector.

On the positive side, markets in the region have begun to recover, revealing the structural effects of the crisis on the insurance landscape and clarifying the opportunities. Still, there is much work to be done. The anticipated postcrisis environment should motivate life insurers, particularly multinational companies, to retool their strategies for Asia. The same factors that made the region's life-insurance sector so attractive before the crisis can play a large role in the sector's continuing recovery—provided insurers move nimbly and take bold action.

Obviously, strengthening the fundamentals of the business—such as capital management, product portfolios, and distribution channels—will be critical to a successful rebound and to ensuring stability. But the imperatives for action are not all defensive. Some insurers will find new chances for growth as their rivals downsize or abandon positions in an effort to focus on core markets and mend balance sheets.

In order to move forward effectively and efficiently in Asia, however, insurers must first fully grasp the evolution of the market—in particular, how it has fared since the last time the region was rocked with a major financial upheaval.

A Growth Trend Interrupted

During the Asian financial crisis of the late 1990s, household purchasing power declined in many regional markets. So did life insurance premiums. In 1998, for example, life insurers in Thailand suffered not only from declining new business—which fell by 29 percent—but also from a threefold rise in contract cancellations. A similar pattern was seen in Indonesia, where sales of new life-insurance policies fell by 12.6 percent in 1998 and cancellation rates rose from 2.6 percent in 1997 to 12.8 percent in 1999.

Following these trying years, Asia's life-insurance sector recovered gradually, slowly developing into an engine of steady growth. From 2004 through 2007, Asia generated \$185 billion in new life-insurance premiums—about one-fourth of the global total—with regional markets growing by 23 percent per year on average. Six markets accounted for 90 percent of this growth. (See Exhibit 1.) Profitability was high, although it varied widely from market to market. Of course, the region was hit hard in 2008 and the first half of 2009. The market value of Asia's life-insurance sector fell by 51 percent in 2008, and spending per new policy dropped steeply. Consumer demand for life insurance products, after years of steady growth, plummeted.

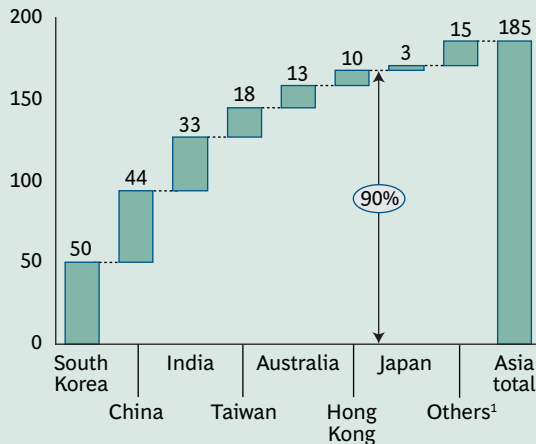
Nonetheless, the long-term future of life insurance in Asia remains bright. Most markets in the region returned to strong growth—if not fully back to precrisis levels—in the second half of 2009. This was largely due to the positive macroeconomic fundamentals that still underpin demand for life insurance in Asia:

1. Asia includes Australia, Greater China, New Zealand, North Asia, South Asia, and Southeast Asia.

Exhibit 1. Precrisis, Six Markets Accounted for 90 Percent of Life Insurance Premium Growth in Asia

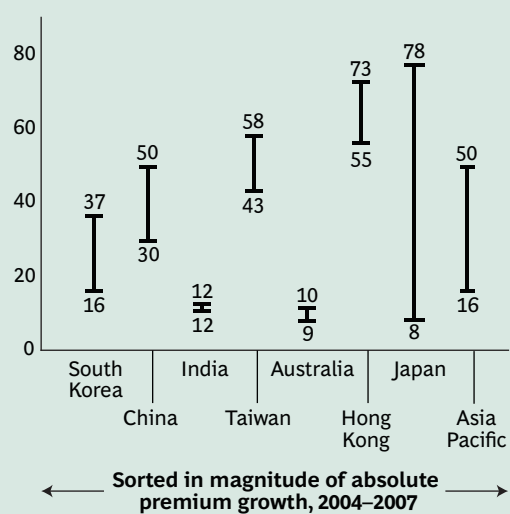
South Korea, China, and India led the growth trend

Life-insurance premium growth, 2004–2007 (\$billions)



New-business profitability varied widely

Survey of maximum/minimum NBV margin across regional companies, 2007 (%)²



Sources: BCG Insurance Database; regulatory Web sites; Swiss Re Sigma World Insurance Report 2008; BCG analysis.

Note: Column totals have been rounded.

¹Others include Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

²New-business value (NBV) margin is defined as a percentage of absolute premium growth.

- ◇ Strong economic expansion
- ◇ Increasing affluence and the emergence of the middle class²
- ◇ Consumers' propensity to save
- ◇ Limited credible alternatives to life insurance as a savings vehicle
- ◇ Relatively low penetration of life insurance products, creating headroom for further growth

Over time, the attractive long-term growth prospects in Asia will soften the impact of the crisis. In fact, we estimate that by 2017 four of the top seven global growth markets for life insurance will be in Asia—China, India, Japan, and South Korea. (See Exhibit 2.)

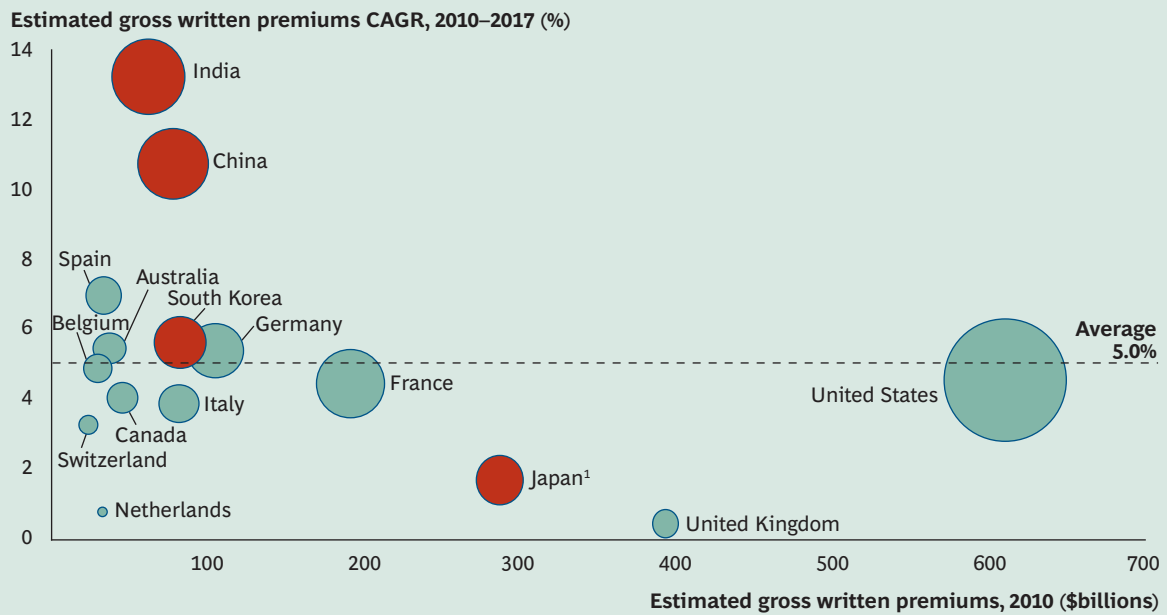
But two key questions remain: How much structural change did the crisis really bring about, and how will precrisis strategies need to be updated?

The New Realities of Life Insurance in Asia

The financial crisis has given rise to a whole new set of conditions that life insurers will be forced to cope with. At the same time, opportunities to leapfrog the competition will be plentiful for those insurers that have both sufficient resources and a relatively strong appetite for risk. What are some of these new realities? In our view, they include the following: the days of easy growth for multinationals are over; consumers have become more risk-conscious; consumer confidence and trust in insurance

2. See *Delivering on the Client Promise: Global Wealth 2009*, BCG report, September 2009.

Exhibit 2. Four of the Seven Top Global Growth Markets Will Be in Asia



Bubble size represents estimated total change in GWP in \$, 2010–2017

● \$30 billion (Asian countries) ● \$30 billion (other countries)

Sources: Economist Intelligence Unit; Euromonitor International; Organisation for Economic Co-operation and Development; Swiss Re; BCG analysis.

Note: Countries analyzed include mature life-insurance markets as well as the largest emerging markets.

¹The Japanese life-insurance market has been experiencing a longer period of decline due to an economic downturn; its growth potential depends upon a future economic recovery.

distribution have eroded; efficiency matters as much as growth; capital has (again) become a major source of competitive advantage; the competitive landscape is shifting; and the role of banks continues to evolve.

The Days of Easy Growth for Multinationals Are Over

From 2002 through 2005, multinationals increased their market share of Asia's life-insurance premiums from 18 percent to 25 percent. But then their share stagnated as it became increasingly difficult to encroach on territory held by local incumbents. (See Exhibit 3.) During the same period, multinationals began to compete more intensely against one another. In 2003, the top five multinationals accounted for nearly three-quarters of life insurance premiums generated by international competitors. By 2008, the market share of these same five companies had dropped to 63 percent.

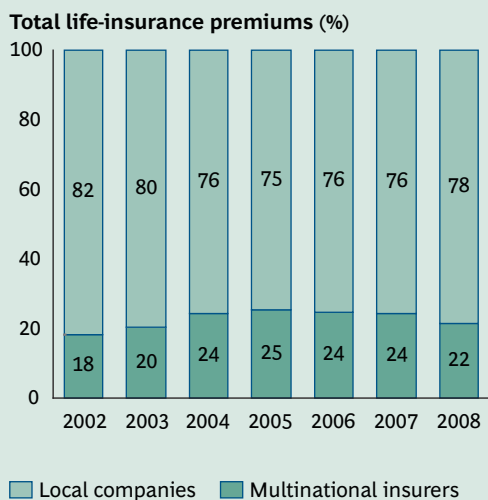
Consumers Have Become More Risk-Conscious

In the years leading up to the crisis, sales of investment-linked products (ILPs) flourished. These products allowed insurers to transfer the risk associated with an underlying investment—usually a mutual fund—to the consumer. In better times, consumers favored ILPs because these products harnessed the energy of strong investment markets. Insurers liked them because they were capital-light.

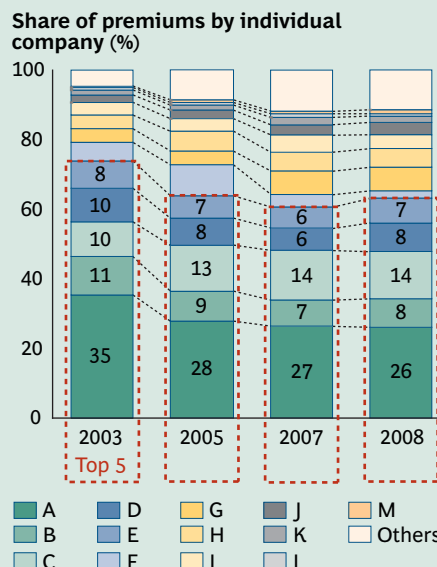
But the sharp downturn in investment markets has taken a heavy toll on ILPs. Unnerved customers have gravitated toward more traditional, capital-intensive life products, which typically provide explicit or implicit guarantees. In Taiwan, for example, ILP premiums as a percentage of total life premiums fell from 71 percent in January 2008 to 11 percent in March 2009. With the rebound of capital markets in Asia, we have seen some risk tolerance return to the life insurance market, but ILP sales in most countries are still well below their precrisis peaks.

Exhibit 3. Multinationals' Share Is Declining amid Fiercer Competition from Local Insurers

Dominant locals are gaining momentum



Competition among multinational insurers is rising



Sources: Axco Insurance Information Services; BCG analysis.

Note: Affiliates are counted in total premium calculation only if their share reached the regulatory limit (for example, 26 percent in India) or if they had a controlling stake; mergers are backtracked in premium calculation.

Consumer Confidence and Trust in Insurance Distribution Have Eroded

Looking back, as markets have evolved and consumer needs grown more complex, the distribution model for life insurance has tended to shift gradually from a product-push to an advisory model. The ripple effects of the crisis will accelerate this process. Consumers will avoid agents who seem more concerned with pushing products than with providing advice. An advisory approach based on a clear understanding of investors' individual needs and risk appetites will be critical to success.

Banks, too, will need to change their distribution models. The crisis has revealed that many customers had little understanding of the complex structured products they purchased. Indeed, the street protests that still persist outside some banks in Hong Kong are a vocal reminder of consumers' anger and loss of confidence. In the future, clarity and product transparency will be more important than ever. Regulators are moving swiftly in that direction, mandating greater transparency on commissions and tightening supervision of sales practices.

Efficiency Matters as Much as Growth

Faced with increased pressure on earnings, insurers have been scrambling to cut costs. But a more deliberate, sustainable approach to managing costs is required—one that includes adopting new disciplines and revising incentives. Insurers will also need to foster a different mix of capabilities among senior executives whose primary aim should be efficient growth rather than growth at any cost.

Indeed, before the crisis, many companies had operating models designed to support growth without sufficient regard for costs. And the capabilities for managing costs and cash flow at numerous institutions remain relatively underdeveloped. Achieving efficient growth will therefore be a major undertaking for many insurers.

Capital Has (Again) Become a Major Source of Competitive Advantage

In the high-growth years leading up to the financial crisis, capital strength rarely made it to the top of insurers' strategic agendas. Organizations were geared for growth—period. Today several factors

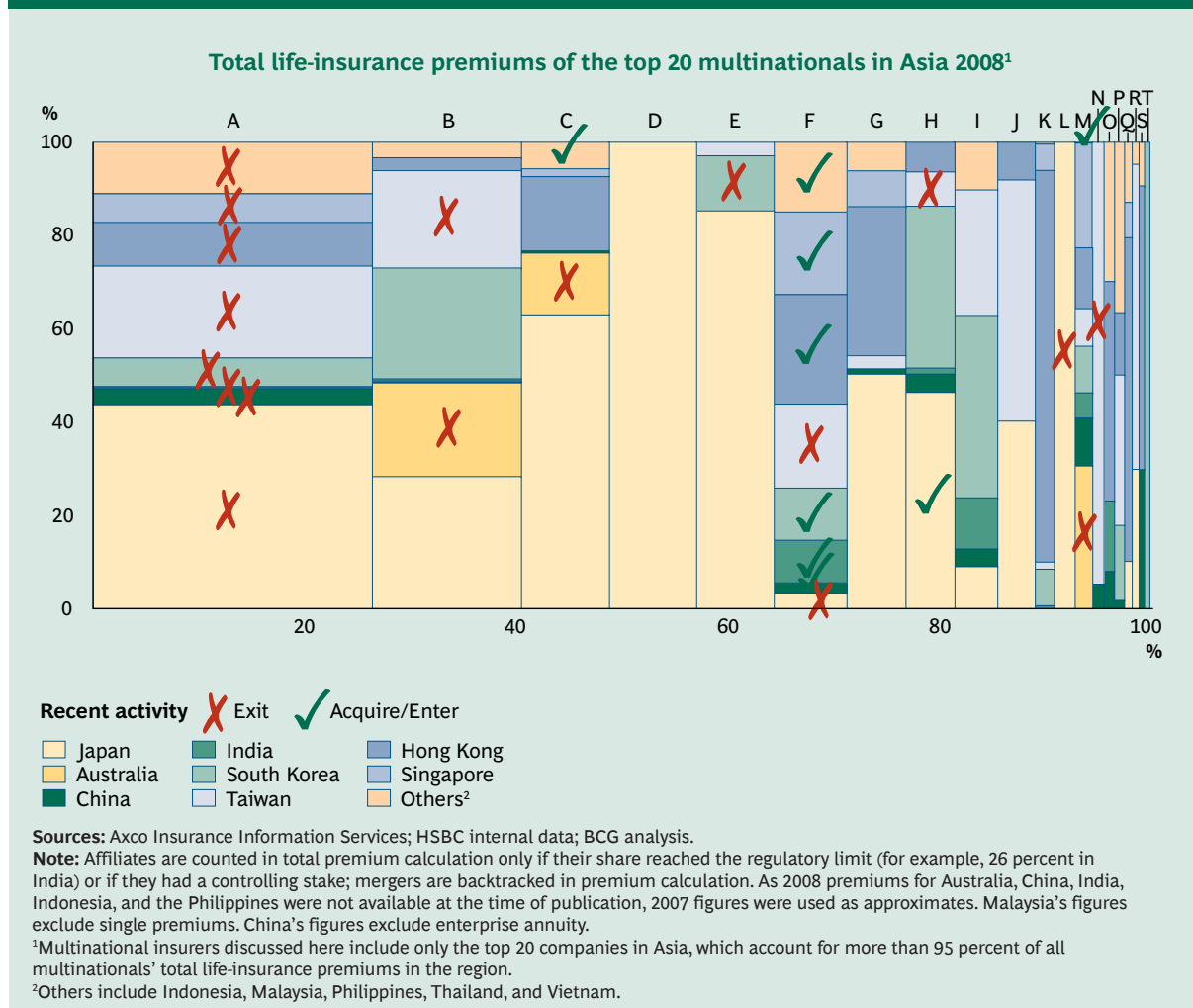
have combined to make capital strength not only a major concern but also a source of competitive advantage:

- ◇ *Capital Depletion.* Declining investment markets and a surge of write-offs have taken a heavy toll on insurers' capital.
- ◇ *Capital Scarcity.* Increased risk aversion is stemming the flow of money into debt and equity instruments throughout the financial services industry, including the life insurance sector. As a result, capital has become scarcer and more expensive.
- ◇ *Capital Intensity.* Capital requirements are likely to increase significantly owing to several factors: the shift from capital-light ILPs to capital-heavy guaranteed products, the rising costs of distribution, and tighter capital standards under Solvency II regulations.

The Competitive Landscape Is Shifting

Asia's life-insurance sector is becoming polarized. There is a distinct difference between the haves—insurers that possess adequate capital—and the have-nots. The latter will need to focus on preserving and somehow growing their capital. The former will possess the wherewithal to pursue new opportunities as some multinationals scale back or abandon their positions. We have already seen a significant outflow of foreign capital from Japan, Australia, and Taiwan as some multinationals exit Asian markets in order to minimize their exposure to capital-intensive back books and lower-margin businesses. (See Exhibit 4.)

Exhibit 4. Many Multinational Insurers Are Reconfiguring Their Portfolios in Asia



At the same time, local competitors are becoming increasingly aggressive both at home and in the search for growth across borders. They are picking up domestic assets and customers as multinationals exit certain markets. The rush to raise capital in Japan and South Korea through IPOs has led to a more intensive search for new growth markets in the region. Although local Chinese insurers, cautious from past forays abroad, have not yet made major moves, we expect this attitude to change in the coming years.

The Role of Banks Continues to Evolve

Financial institutions in Asia, as in other parts of the world, are focused on stabilizing their balance sheets. In some cases, banks are encouraging customers to transfer their money away from life insurers—for example, from variable annuities to bank products. Insurers are at a disadvantage in markets where bank deposits are backed by government guarantees and insurance products are not.

In addition, in some markets, banks are making a direct push into the life insurance sector. In China, for example, deregulation is allowing banks to invest in insurance companies. Many of the major local banks have already made (or are considering) moves into the life insurance space.³

Seizing Opportunities in the New Normal

Multinational life insurers must recognize that Asia presents challenges that extend beyond the turmoil created by the financial crisis. In many markets, their focus has shifted from “growing with the flow” to increasing market share. Insurers should expect to fight hard for the gains they achieve. The new realities stemming from the crisis, coupled with the evolving competitive environment, will force multinational insurers to take a more critical view of how and where they compete in Asia. In our view, multinationals should take the following steps: continue to focus on the fundamentals, act decisively while competitors are distracted, use the crisis as a catalyst to transform the business, review portfolios to manage tradeoffs between growth and profitability, and take advantage of the window for inorganic growth.

Continue to Focus on the Fundamentals

Life insurers must heed the lessons of the crisis and protect the financial fundamentals of their businesses. They must control costs, review and update their product portfolios, strengthen their risk-management and capital-management capabilities, and keep their sales forces engaged. With the recent rally in insurance markets in Asia, some institutions might be tempted to loosen controls that they put in place in 2008 and 2009. This would be a mistake. Even if the global economic outlook were more upbeat, insurers still need to embed new disciplines into the operating fabric of their companies. If they do not, they will never fully regain the trust of regulators, business partners, customers, and distributors.

Act Decisively While Competitors Are Distracted

Some insurers may be able to gain ground while their competitors are tied up with complex postmerger integration projects. These companies may, for example, find ways to invest in innovation and product development while others are immersed in melding processes and overcoming organizational conflicts with M&A partners.

Other insurers might find opportunities to poach talent if their competitors are caught up in M&A deals, especially if the integration plans lack focus. The employees and agents of both an acquirer and a target may be apprehensive about their roles in the combined entity. They might also be frustrated or intimidated by the complexity of an uncoordinated integration and by uncertainty over the company’s strategic direction.

Use the Crisis as a Catalyst to Transform the Business

By putting sustained pressure on profitability, the crisis has provided life insurers with a mandate to transform parts of their businesses long considered off-limits or too difficult to change. Insurers in Asia have a unique opportunity to transform compensation, distribution, and back-office costs by taking the following actions:

3. See *Bancassurance in China: Reaching the Next Level*, BCG and Swiss Re report, December 2009.

- ◇ *Review the structure and compensation of the agency workforce.* Managing the agency workforce has always been a sensitive issue given the powerful role of agents. In some markets, life insurers are beholden to their agency networks, not in control of them. As a result, many insurers have been hesitant to review the fairness of agent compensation or revisit the best way to structure compensation to create value.

Yet the crisis has partly shifted the balance of power from agents to life insurers, and the overall decline in demand could make agents more receptive to changes in the compensation scheme. In fact, there has never been a better time to ask tough questions about the long-term sustainability of the agency structure, especially in markets such as China and India where the anticipated economics of agency distribution have yet to materialize.

- ◇ *Change the nature of the conversation with bank distributors.* In some markets, life insurers will need to revisit their distribution arrangements with banks. In China, for example, banks and insurers have a many-to-many model. A bank might sell insurance products originating from as many as 20 institutions, and an insurance company might have distribution deals with as many as 20 banks. This super-market-like approach is not in the best interest of insurers—which are forced to compete on price—or banks themselves. Moreover, customers can end up with products that are ill suited to their needs, and the best offerings can be lost among the wide range of products available.

In our experience, close partnerships with a small number of providers on both sides can lead to higher sales and better penetration of the bank's customer base. Life insurers, therefore, can use the crisis to initiate a conversation with banks about the current distribution model, posing questions such as: How can the model better serve customer needs and lead to better customer retention? Wouldn't banks and insurers benefit from having a more selective approach to distribution? Could such a *modus operandi* pave the way for an advisory model, which in turn might deepen customer relationships in the long term?

- ◇ *Transform back-office costs.* The crisis should provide the impetus for changing the underlying cost structure of the back office. Such efforts are not without risk, however. Most insurers face a vexing tradeoff between efficiency and quality. Large cost-cutting initiatives, such as reducing the number of back-office staff or call-center employees, can undermine the quality of service. Conversely, efforts to improve quality can lead to higher costs and therefore higher prices.

Insurers can overcome this problem by focusing on improving their processes and operations rather than just cutting costs. Insurers can increase efficiency and quality by using lean processes and organizational structures, along with new and innovative technologies, to industrialize their operations. In our experience, industrialized insurers have much more vigorous productivity—as much as 35 percent higher than their nonindustrialized peers in some cases.

Lean practices include both separation and specialization. In claims, for example, an insurer can improve both efficiency and quality by separating simple claims from complex ones and routing the latter to specialized divisions. This leads to faster processing for simple claims and more attention for complicated claims.

Review Portfolios to Manage Tradeoffs Between Growth and Profitability

Before the crisis, many life insurers devised growth strategies that were unencumbered by concerns about capital reserves. Moreover, profitability could be delayed if that was the price of building a presence in a new market. But capital has since become a determining factor in how and where insurers compete. Institutions cannot afford to allocate capital to efforts that do not immediately contribute to competitive advantage.

For a strategic review that encompasses insurers' customer segmentation, product portfolios, and regional coverage, capital needs to be an input—not an output. Insurers skilled at managing capital will find new opportunities for growth, even as they pare back their positions to concentrate on the customers, products, and markets that best suit their strengths. Particularly in China and India, insurers should take a critical look at whether the tradeoff between growth and profitability is still worthwhile. Many multinationals have spent years building a presence in these countries, but few if any are turning a profit. Now is the time

to question whether these investments are justified and decide what needs to change to improve their value potential.

Take Advantage of the Window for Inorganic Growth

M&A activity will continue to rise as life insurers focus on core markets, take steps to boost capital, and look for opportunities to build market share and strengthen strategic positioning. An increase in activity is already evident. From 2006 through 2008, the number of M&A deals involving Asian insurance companies increased from 26 to 37, and the total value of the deals jumped from \$2.1 billion to \$6.1 billion. After a hiatus in 2009, we expect renewed activity over the next 12 to 18 months. Insurers must decide quickly how and where to take action. Most important, they need to have an approach that will lead to successful deals.

First, insurers need to be extremely judicious when it comes to finding potential targets. With so many attractive assets either on offer or potentially for sale, insurers must have a clear view of the deals that would best fit their capabilities and plans for growth. They should be preemptive and go after the assets they want, determining in advance the price they want to pay. Second, insurers should have a plan to rapidly integrate their acquisitions and retain talent. A focused approach will be critical. The strategic rationale for the deal should help the acquirer decide which parts of the asset it wants to keep and which should be divested. Third, insurers should think creatively about ways to make the M&A deal capital-light—for example, through asset swaps.⁴

Moving Ahead

Growth has already returned to Asia's life-insurance industry, where it will be stronger and more resilient than in many other regions. But multinationals still face a challenging environment. Unable simply to grow with the flow, they will need to develop strategies that enable them to expand market share. Achieving this will not be easy, as local insurers are becoming more competitive and profitability remains under pressure.

In our view, succeeding in Asia will require not only a leaner and stronger business model but also a clear focus on specific markets. To this end, multinational insurers should ask themselves three questions as they decide whether and how to compete in the region:

- ◇ *Is our company truly committed to growing in Asia?* If so, we must be willing to make the necessary tradeoffs between near-term earnings and long-term investments in growth opportunities.
- ◇ *How can our current portfolio be adjusted to take advantage of growth in Asia?* We may need to exit some markets and enter others, possibly through M&A deals.
- ◇ *Which parts of our operating model can be used to drive profitable growth?* Depending on the market, there may be opportunities to unlock growth by revamping the agency model, reassessing the role of bank channels, developing a new product portfolio, and reconfiguring the back office.

Ultimately those multinational insurers that take swift and bold action to position themselves for the postcrisis era in Asia will reap strong benefits in the years to come, both in terms of market share and overall profitability. Those that hesitate or take a wait-and-see approach may find themselves out of the game before it really begins.

4. For more on the fundamentals of M&A, see *Value Creation in Insurance: Laying a Foundation for Successful M&A*, BCG White Paper, September 2009.

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