

The Insurance Industry in the ASEAN5 Economies: *Tapping its Potential*

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The insurance industry has an important function in an economy. By offering financial security products to individuals and businesses, it can provide extensive coverage of a wide range of economic activities at reasonable cost 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. In developing countries where bank deposit is the main method of saving, insurance, particularly life insurance, can further increase savings because the public finds it a more familiar and accessible route than, for instance, the money market. The development of life insurance is also far more likely to add to long-term capital since the policies are long term.

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 to provide alternative sources of financing. The insurance industry can help foster the development of capital markets.

How well can the insurance industry play this role? Is it established enough? And how does the government regulatory framework affect its performance?

This *Policy Notes* gives an overview of the state of the insurance industry in the ASEAN5 economies of Indonesia, Malaysia, Philippines, Thailand and Singapore. Overall, the finding is that the industry is relatively underdeveloped. Its strong performance, though, particularly in the years prior to the 1997 Asian crisis, augurs well for its growth and impact on capital markets and economic development.

Market structure

The insurance industry includes primary insurers, reinsurers, and agency and brokerage firms. Primary insurance companies fall into two main categories: life and nonlife (or general) insurers. Table 1 shows that there are a fairly large number of insurance companies, especially nonlife insurers, in all five economies. The number of reinsurance companies in Singapore is also quite large.

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The increase in the number of insurers was a response to the deregulation of entry, including foreign entry, into these markets in the 1990s. On the other hand, the decline in the number of nonlife insurers in Malaysia was due to an active policy to consolidate small companies in the late 1990s.

Although the insurance industry in the ASEAN5 economies is still principally made up of domestic private firms, there are now more foreign-controlled and foreign-owned

companies in the sector (Table 2). Foreign participation in the insurance industry, particularly the life insurance sector, was significant even before the deregulation of foreign entry in the 1990s. In fact, in contrast to the banking sector in these economies, foreign firms have dominated the share, particularly of total life insurance premiums.

In terms of concentration, the nonlife insurance sector is highly fragmented in the ASEAN5 economies while the

life insurance sector is significantly more concentrated. The share of the five largest life insurance companies in gross direct premiums 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. Given the greater number of nonlife insurance companies, however, this share still indicated a significant degree of concentration.

Is this market structure of the insurance industry a market outcome or the result of

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

ASEAN 5 (As of)	Life	Nonlife	Composite	Reinsurance	Total	As of 1994	
						Life	Nonlife
Indonesia (2001)	62	105	0	4	171	49	92
Malaysia (2002)	7	28	9	10	54	5	40
Philippines (2001)	40	110	3	4	157	25	97
Singapore (2002)	6	44	7	36	93 ^a	8	44
Thailand (2001)	25	78	0 ^b	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.

Notes: ^aIn addition, Singapore has around 50 captive insurance companies, including life, nonlife and composite insurers.
^bComposite insurers were required to break up life and nonlife business into separate companies by April 2000.

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

ASEAN5 (As of)	State-owned ^a	National private ^b	Foreign-controlled ^c	Foreign branches and agencies	Total	Foreign share of total premiums (1999, in %)		Share of top 5 firms in total premiums (1999, in %)	
						Life	Nonlife	Life	Nonlife
Indonesia (2001)	4	122	45 ^d	0	171	46	29	66	34
Malaysia (1997)	1	45	7	14 ^e	67	65	14	73	30
Philippines (2001)	0	125	25	7	157	58	19	76	32
Singapore (2002)	0	17	24	52	93	55	57	91	33
Thailand (2001)	0	98	0	6	104	49	8	90	37

Sources: The Indonesian Embassy, Philippines; Insurance Commission, Philippines; Monetary Authority of Singapore; Ministry of Commerce (2001), Thailand; OECD (1999a); Swiss Re, *sigma* Nos. 5/1999 and 4/2001.

Notes: ^aState-owned companies are defined as companies where the majority (50% or more) of the controlling power belongs to the state.
^bNational private companies are defined as companies where the majority (50% or more) of the controlling power belongs to national entities excluding state-owned companies.
^cForeign-controlled companies are defined as companies where the majority (50% or more) of the controlling power 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.

government regulation? The fact that there are a large number of firms in the industry does not mean that the market is automatically competitive. And the dominance of foreign firms does not mean that the market is advanced in terms of product development. The question is whether the market is contestable.

In the absence of government restrictions, insurance markets are structurally competitive in most cases. The nature of entry and exit barriers, and of economies of scale and scope are 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. Thus, if and when insurers gain significant market power, it is usually due to restrictive government control over entry and competition. As such, government policy or regulation may be considered as 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.

Overall performance

Insurance markets can be classified into three levels of development: (a) fully mature, (b) transitional, and (c) incipient. Of the ASEAN5, only Singapore is classified as a transitional market while the insurance markets of Indonesia, Malaysia, the Philippines and Thailand are all classified as incipient markets. But even among this group, there are differences. In particular, Malaysia has a more developed insurance market and shares some common characteristics with the Singapore market.

To determine the state of the industry and its contribution to the overall economy, one can look at key indicators of insurance consumption, namely, insurance density and insurance penetration. Insurance density, defined as the amount of premiums per capita, represents the average spent on insurance by each person and shows the current state of the insurance industry. Insurance penetration, meanwhile, which is defined as the ratio of insurance premiums to GDP, measures the importance of insurance activity relative to the size of the economy.

Insurance penetration is also a rough indicator of growth potential. As GDP per capita rises, it is expected that individuals will purchase more insurance. However, the demand for insurance grows only marginally faster than wealth in cases of both low and high levels of per capita GDP. This is because in the case where per capita GDP is low, the amount or level of wealth can only afford for basic needs while in the case where there is a high level of per capita GDP, the tendency is to reach a saturation point where most insurable interests are already insured.

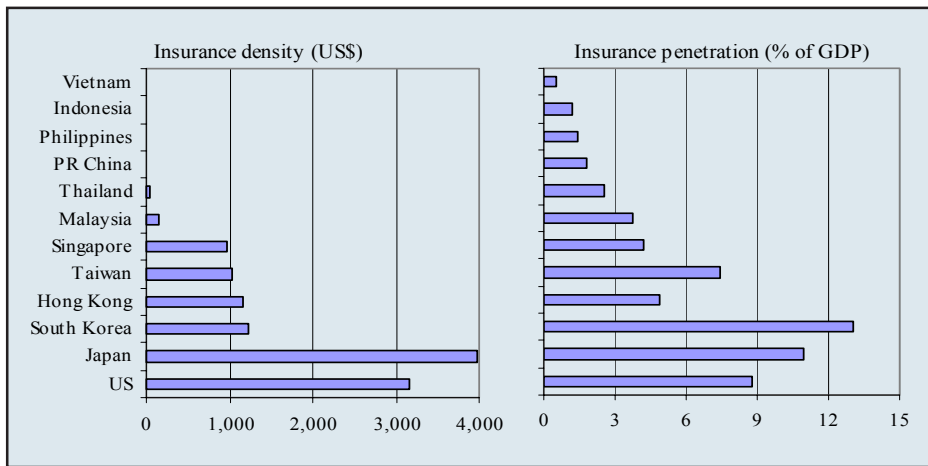
In view of this, the demand for insurance is seen more to grow significantly faster than wealth in transitional markets. As income rises above a certain minimum, people begin to accumulate personal assets, including insurance. The highest potential for growth is therefore in transitional markets.

It should be noted, however, that these measures of consumption are not perfect. 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. And again, lack of competition and costly/inefficient regulation may increase the price of insurance without implying a higher level of insurance consumption.

Figure 1 shows the significant difference in terms of insurance density and penetration between mature markets such as the United States and Japan, transitional markets such as Singapore, Taiwan, Hong Kong and South Korea, and the incipient markets in Southeast Asia. Japan, which is the only mature market in Asia, and the United States already have very high levels of insurance density and insurance penetration. On the other hand, transitional markets still have considerable room to grow, and incipient markets are even further behind.

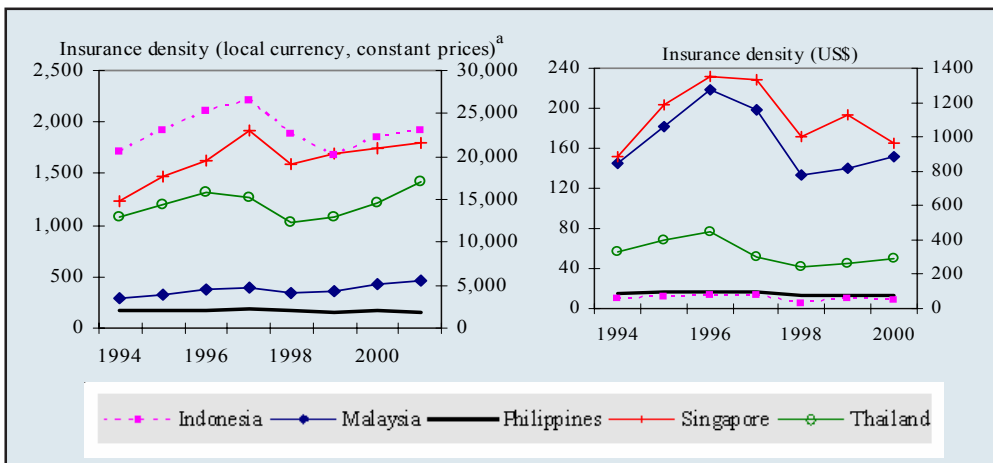
Meanwhile, in terms of insurance density in the ASEAN5 between 1994 and 2000, one notes a significant growth in insurance premiums per capita prior to the 1997 Asian crisis, except in the Philippines, as shown in Figure 2. In particular, insurance premiums per capita in local cur-

Figure 1. Insurance density and insurance penetration in the United States and East Asia, 2000



Source of basic data: Swiss Re, *sigma* No. 6/2001.
 Note: In the incipient markets, insurance density ranged from US\$2.10 in Vietnam to US\$151 in Malaysia. Corresponding figures for Indonesia, the Philippines and Thailand were US\$9, US\$14 and US\$49, respectively.

Figure 2. Insurance density in the ASEAN5, 1994–2000



Source of basic data: Swiss Re, *sigma* Nos. 4/1996, 4/1997, 4/1998, 3/1999, 7/1999, 9/2000, 6/2001;
 Notes: Indonesia’s insurance density in local currency and Singapore’s insurance density in US dollars are plotted on the right-hand scales. ^aThe deflator used was the respective economy’s GDP deflator.

rency registered average real growth rates of 11 percent in Indonesia and Thailand, 13 percent in Malaysia and 15 percent in Singapore from 1994-96. In contrast, the Philippines’ average real growth rate for the same period was only three percent.

On the other hand, insurance penetration in 1994-2000 was relatively unchanged, although there was some in-

crease in Singapore and Malaysia before the Asian crisis hit.

The prospects for further growth in the industry seem good. When looking at the growth in premium volumes, the ASEAN5 insurance markets registered significantly faster growth in the 1990s than world markets, especially in the years prior to the Asian crisis. Between 1994 and 1996, the volume of total insurance premiums 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. Life insurance premiums have been growing at a faster rate than non-life insurance premiums. Overall, however, the ASEAN5 accounted for only less than two percent of the total world market premiums.

Relative to the banking sector, the insurance industry is significantly smaller, especially in Indonesia, the Philippines and Thailand (Table 3). Commercial banks dominate most de-

veloping countries’ financial systems, with insurance companies and pension funds typically accounting for insignificant shares of total financial assets. Underdeveloped contractual savings institutions are the result of 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. Again, an

Table 3 Comparative asset size of the financial sector in the ASEAN5 (in percent)

ASEAN5	Assets of deposit money banks			Assets of deposit money banks			Assets of insurance companies		
	Total financial assets			GDP			GDP		
	1994	1997	2001	1994	1997	2001	1994	1997	2001
Indonesia	89	Na	Na	51	58	49	3.8	5.1	Na
Malaysia	65	64	69	79	115	117	10.9	12.4	17.9
Philippines	65	81	84	36	65	56	5.0	5.8	6.0
Singapore	Na	Na	Na	93	110	137	16.0	20.0	38.9
Thailand	89	79	73	89	118	99	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.
Note: Na means not available.

important factor here is the regulation of the insurance sector, in particular, life insurance.

Regulatory framework: the ASEAN5 experience

As noted in the previous discussion, the insurance industry has been underdeveloped in most of the ASEAN5 countries, in particular, Indonesia, the Philippines and Thailand. The state of underdevelopment has been primarily attributed to low demand as a result of low levels of income. However, besides consumer demand, other factors like the varying levels of urbanization, monetary stability, bureaucratic quality, the rule of law, corruption and banking sector development influence the availability and price of insurance.

Another key factor behind a dynamic insurance market is a country's institutional framework or development, 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. 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 protectionist and relied on restric-

tive regulation of entry and competition. Not surprisingly, such a regulatory approach had adverse effects on industry structure and performance.

Restrictions on domestic entry were typically backed by arguments that markets were small and that the number of local and foreign insurers already in operation was more than adequate. Foreign entry was restricted to promote the domestic industry. Such closed-door policies prevented the entry of new players with new products, more efficient distribution channels or better marketing, and removed the impetus for incumbents to consolidate, innovate or develop new products and distribution channels, ultimately creating insurance markets that were inefficient and lacked innovation. Competition was further circumscribed through the strict regulation of policy forms, prices, allowable investments and other restrictions. Overall, the presence of a large number of small, inadequately capitalized firms that relied heavily on foreign reinsurers, particularly in the nonlife sector, has been a principal cause of inefficiencies.


Many developed and developing countries including the ASEAN5 economies began to undertake financial liberalization programs in the 1980s and 1990s to improve competitiveness and efficiency, particularly in the banking sector. Reform of the other financial sectors, including the insurance sector, later followed. In particular, there was an easing of restrictions on both domestic and foreign entry in the ASEAN5 in the second half of the 1990s. The latter was facilitated by the commitments that the five economies made under the Financial Services Agreement (FSA) of the General Agreement on Trade in Services, which was deemed 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, the FSA laid the legal foundation for market access. There were also unilateral liberalization efforts such as in

Singapore and the Philippines. There are 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.

Rx: strengthening regulatory framework in tandem with market reforms

Market access alone, of course, is not enough to ensure vigorous and 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. This requires a regulatory and supervisory body that is capable of carrying out these tasks. The critical role of a strong and proactive industry regulator in developing and strengthening the industry was evident in the cases of Singapore and Malaysia. The strengthening of the regulatory and supervisory framework should occur in tandem with market access and other market-oriented reforms, particularly competition and liberalization measures, to improve the efficiency of the insurance industry. In particular, the possible adverse effects from enhancing competition through lowering the barriers to entry can be addressed by properly applying prudential regulation.

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. 

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