LIFE INSURANCE

VIETNAM — A NEW STAR IN THE EAST

Vietnam offers foreign life insurers significant long-term growth opportunities as it enters a promising new phase of market development.

By Mark V.T. Saunders and Adrian Liu

Ask anyone to name the fastest-growing life insurance market in Asia over the last five years or so and most people will answer: China. In fact, although China has achieved impressive compound growth of around 30% per year, it has been outstripped by Vietnam, which has grown at an even faster 45%.

Of course, Vietnam's figures are from a much smaller base, and the market size is still only a small fraction of China's. Nevertheless, it is at a critical stage of development and is rapidly gaining the attention of foreign insurers seeking opportunities in Asia (see *Exhibit 1*).

EXHIBIT 1
Key comparative indicators in Asia

	Vietnam	Philippines	Singapore	Hong Kong	China	South Korea
Population (million)	82	83	4	7	1,300	48
GDP growth (in 2005)	8.4%	6.1%	6.4%	7.3%	9.9%	4.7%
Life insurance premium (US$millions)	500	800	6,500	13,000	35,500	48,500
Life insurance premium (as % of GDP)	1%	1%	6%	8%	2%	7%

ECONOMIC REFORMS GAINING MOMENTUM

Vietnam's growth story in recent years is in many ways as remarkable as those experienced by its larger neighbors China and India. It has a rapidly growing population of around 82 million people and a real GDP growth rate consistently around 7% for the last five years. Economic growth rates are forecast to remain around this level at least in the medium term.

In 1986 Vietnam began its *doi moi* program for economic liberalization. This has effectively become a five-year rolling series of government plans that have replaced the former state-controlled, closed economy in an all-out effort to encourage free enterprise and foreign investment.

Less than 10% of the population has any form of life insurance coverage. With a young population (over 60% of Vietnam's population is under age 30), and people accumulating wealth at an accelerated pace, Vietnam provides tremendous growth potential for life insurers to explore. With the right strategies and superior execution, there is plenty of room for new competitors.

In fact, the country is already seeing a new wave of entrants that came into the life insurance market in 2005, as well as a growing queue of foreign companies setting up representative offices in Vietnam. An important attraction is that there are no restrictions on the level of foreign ownership of life insurers.

LARGE POTENTIAL, BUT...

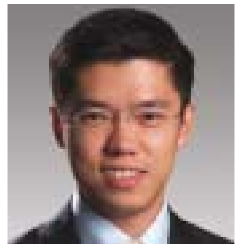
However, the challenges in capitalizing on the opportunities should not be underestimated. Lengthy bureaucratic processes, some corruption and fraud, lack of transparency and underdeveloped infrastructure make doing business problematic. Vietnam's judicial system is based on communist legal theory and the French civil law system. In practice, many foreigners find it difficult to understand how best to establish contractual relationships and arrange for acceptable operating facilities.

Still, these obstacles are similar to those experienced in the early stages of growth in China and other Asian markets that have developed with such success, and the Vietnamese are an enthusiastic people who welcome foreign know-how and have an astute business acumen. Government reforms now under way are helping to modernize and strengthen business processes, and the country's steps to prepare for WTO membership will add incentives to make the business environment more conducive to open competition.

A YOUNG ASIAN MARKET

Relative to most life insurance markets in the Asia/Pacific region, the life insurance market in Vietnam is extremely young. It did not really get going until 1996, when the state-owned Bao Viet insurance monopoly was converted into the Vietnam Insurance Corporation by the Ministry of Finance and granted a composite license (i.e., all life and non-life lines). Confusingly for some foreigners, Vietnam Insurance Corporation is still referred to as Bao Viet.

Mark V.T. Saunders is a managing principal of Towers Perrin in Hong Kong and managing director of Tillinghast's operations in Asia. He specializes in M&A and corporate restructuring, appraisal values, financial management, market strategy, partnerships, product development, sales, distribution, training and improving business performance.



Adrian Liu is a consulting actuary in Tillinghast's financial services consulting practice in Hong Kong. He specializes in M&A, financial reporting, embedded value determination, due diligence support and advice, market entry assessment and analysis, and capital management. He is a Fellow of the Institute of Actuaries of Australia.

Bao Viet was established in 1963 principally to cover marine cargo risk. Until then, in North Vietnam, all needs were provided for by the state. In South Vietnam, a number of insurers had operated until 1976 when the North took control. In 1993, Decree 100/CP was issued, leading to the creation of the government-owned Vietnam Insurance Corporation in 1996, the modern-day "Bao Viet." This effectively marked the birth of the life insurance industry.

Vietnam initially offered licenses to new entrants in 1999 with no limits on foreign ownership of life companies — unlike China, India and a number of other Asian markets. Four foreign and joint venture companies joined the market in 1999 and 2000: AIA (U.S.), Prudential (U.K.), Chinfon-Manulife (originally a Taiwanese-Canadian joint venture, now wholly owned by Manulife) and Bao Minh CMG (a Vietnamese-Australian joint venture). Three more life operating licenses were granted in 2005 by the Ministry of Finance to New York Life (U.S.), ACE (U.S.) and Prevoir (France).

Today, despite being so very young, the Vietnamese life insurance market has already overtaken Indonesia and the Philippines in penetration terms when measuring premium as a percentage of GDP.

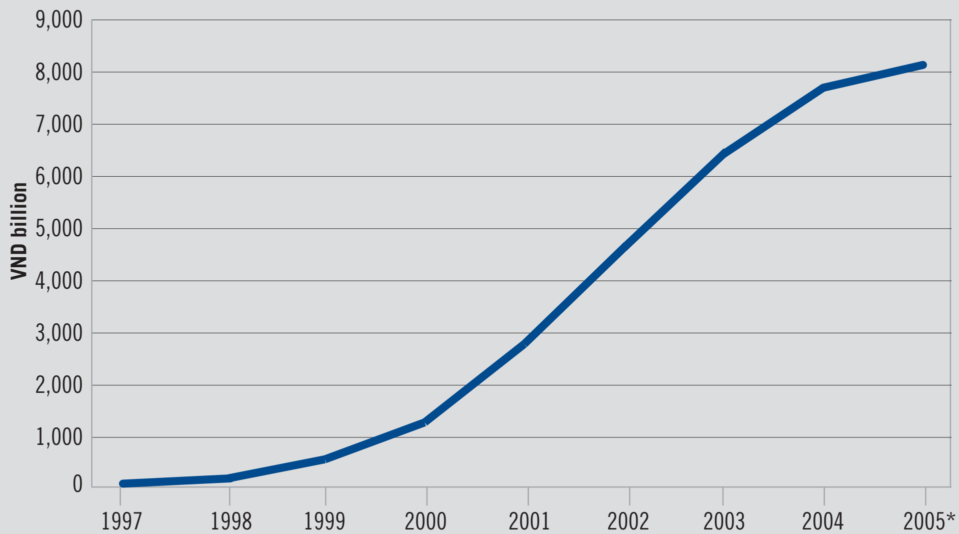
In addition, a range of foreign life insurers, including some large Asian-based life insurers (principally from Singapore, Taiwan, China and South Korea), have set up representative offices in Vietnam and are working toward gaining operating licenses.

It is also interesting to note the strong affinity developing with the Japanese and, in particular, the publicly stated desire to have strong economic cooperation with Japan. In all likelihood, Japanese insurers will be joining the market.

Bao Viet had an early lead at the start of this decade due to its monopolistic position when the industry got started. But this has changed considerably. In 2004, Bao Viet and Prudential each had around 40% market share by premium income. Adding Manulife, the top three companies command around 90% of the market share today.

EXHIBIT 2

Growth of the life insurance premium income in Vietnam



*Tillinghast estimate

HIGH GROWTH EXPECTED

Life insurance premium income grew at an annual rate of 67% in the five-year period ending in 2004 before taking a pause in 2005. From 1999, when the new foreign entrants arrived, to 2004, total life insurance premium grew from less than $20 million to just over $500 million (around VND 8 trillion) (see *Exhibit 2*).

Statistics for 2005 (not officially available at the time of writing) suggest that the market as a whole stayed flat during the year, with some decrease in new business. The slowdown can be attributable to a number of factors, including higher bank deposit rates that reduced the relative attractiveness of life policies and some

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negative sentiment toward insurance companies after payouts on policies that failed to meet customer expectations.

Furthermore, the "low-hanging fruit" has already been harvested, with many of the first wave of people who could afford life policies already having made purchases in recent years. Still, the low insurance penetration rate leads market participants to remain optimistic and expect strong growth for the remainder of the decade.

DISTRIBUTION

The tied agency channel is the backbone of the life insurance industry in Vietnam. It is estimated that at the end of 2005, the total number of tied agents was nearly 92,000 (a decline of some 4,000 over the year). However, the number of newly recruited agents for each of the last two years reached nearly 70,000, indicating an extremely high turnover with a very low length of service.

Given the nascent state of the industry, the lack of an experienced agency force has contributed to poor agency productivity and persistency. Business arising from agency sales has had relatively poor quality, with very small policies and fraud (resulting in a relatively high number of declined claims) as well as relatively high lapse experience. Companies' initial strategies were to build market share fast, getting as much out of a high-turnover agency staff as possible. Now that the industry is passing through its initial development phase, companies are looking to focus on improving the quality and professionalism of their agents.

In addition to the tied agency channel, some existing life insurers have already set up bancassurance arrangements with local and international banks, although this is not expected to gain dominance in the short term. Other channels are being developed, such as new entrant Prevoir's exclusive distribution arrangement to sell insurance through the network of Vietnam Post and Telecommunications.

To further tap new customers, insurers are moving quickly to distribute products outside the three major cities of Ho Chi Minh City, Hanoi and Danang. This is likely to be accompanied by lower policy size, as wealth is concentrated in major cities.

PRODUCTS

One ongoing challenge is that many people still prefer placing savings in more traditional and familiar assets such as real estate and bank deposits. Vietnamese banks currently offer a relatively high interest rate of 8.5% on one-year bank deposits. Moreover, the life insurance industry is still relatively unknown and there are cultural sensitivities about discussing death. Thus, selling insurance products has been very much a push rather than pull business, and sales are driven more by the personal relationships with agents than by policy benefits.

Traditional products with underlying guarantees, such as participating and non-participating endowment, education and whole life products, together with a range of term insurance and risk riders, are currently the mainstream products in Vietnam. Shorter-term single premium endowment products are also popular and typically easier to sell.

More sophisticated (e.g., investment-linked products) are being contemplated but the currently restrictive investment environment provides additional challenges for insurers to overcome.

REGULATIONS

The insurance market is regulated by the Department of Insurance under the Ministry of Finance. The department supports the insurance industry with a number of measures that include:

- promoting the network of professional agents and other distribution channels
- introducing greater flexibility to invest insurance funds by allowing the establishment of investment management fund companies
- allowing grants of additional licenses to foreign companies
- promoting self-regulation of the industry
- encouraging use of insurance funds to develop the country's economy.

In an attempt to better protect the interests of policyholders, the Ministry of Finance is introducing new rules that will specify the minimum amount of surplus distributable to policyholders under a formula that will link shareholders' dividends to a set fraction of payments to participating policyholders. The exact details of the proposed regulations are still under discussion. In addition, effective January 1, 2006, every

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life insurer in Vietnam is required to have a professionally recognized actuary approved by the Ministry of Finance to act as the appointed actuary. The requirements for actuaries are consistent with international standards.

INVESTMENTS

Investments by life insurers are limited by the underdeveloped nature of the Vietnamese capital markets. Currently, investments are practically limited to bonds issued by government authorities and state-owned enterprises, some infrastructure-related projects and bank deposits (both denominated in Vietnamese dong and foreign currencies). Investments in equities are severely limited by the size and liquidity of the stock market (the market only started in 2000 and has only 32 listed companies at year-end 2005). Investments in overseas assets are not currently permitted.

In 2005, Prudential and Manulife were authorized to set up fund management companies, allowing them to run their investment funds with greater precision and flexibility. Over time, the investment environment is expected to provide more opportunities as the Vietnamese government continues its effort to open up financial markets.

TRANSFORMATION AT BAO VIET

In 2005, state-owned Bao Viet announced plans to convert to a private stockholding company and to transform itself into Vietnam's first broader financial services group. Initially, the new structure is planned to consist of four wholly owned subsidiaries in life insurance, non-life insurance, insurance and reinsurance brokerage, and securities investment fund management. The company is expected to seek a strategic investor, following the model adopted by a number of the Chinese insurers. Bao Viet has also announced plans to set up a commercial bank later this year.

The changes under way at Bao Viet could mark the initial steps toward a broader and larger transformation of the entire financial sector in the near future.

LOOKING FORWARD

With the initial growth phase in the life insurance market coming to an end, company strategies will no longer rely on simply selling more policies in an attempt to gain market share. Customers will become more educated about life insurance and demand products and services more appropriate to their needs although, in the short term, the market will remain predominantly push rather than pull.

Competition, both for operating resources and customers, is set to intensify as existing players and new entrants build the market. It will be interesting to see which of the players moves forward to the next level of development most successfully. Life insurers that succeed will increasingly shift to building profitable businesses based on:

- creating new products and services suited to the Vietnamese culture
- improving quality and professionalism of the distribution forces and customer service
- developing risk, capital and financial management frameworks and new investment strategies as Vietnam's capital markets improve
- establishing efficient operations.

With less than 10% of the population having some form of life insurance coverage, the potential for growth is clearly one of the best in the Asia/Pacific region. The lack of experienced and qualified personnel and the need for capital offer foreign investors potentially attractive opportunities. As Vietnam is the latest sizable market to emerge in the Asia/Pacific region, investors with the right vision, strategies and execution capabilities will stand to gain significant rewards over the long term.

The question insurers should be asking is when the right time is to be in Vietnam. Some have investigated and decided not to proceed (or even to withdraw) while others are at varied stages of entry. The answer, of course, depends on individual company strategy and execution skills. One thing is certain: Vietnam will emerge as one of the important insurance markets in Asia.

For comments or questions, call or e-mail Mark Saunders at 852-2593-4535, mark.saunders@towersperrin.com or Adrian Liu at 852-2593-4537, adrian.liu@towersperrin.com.