MINISTRY OF PLANNING AND INVESTMENT
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Studies on the Competitiveness and Impact of Liberalization in Financial Services: The Case of Insurance services

Final Report

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INVESTCONSULT GROUP

Foreword

This is one of a series of studies on *Competitiveness and the Impact of Trade in Services Liberalization in Vietnam*, conducted in the framework of the project “Capacity Strengthening to Manage and Promote Trade in Services in Vietnam in the Context of Integration” (or “Trade in Services” Project - VIE/02/009), which is currently being funded by the United Nations Development Programme (UNDP), and implemented by the Department of Trade and Services of the Ministry of Planning and Investment (MPI).

This study presents an overview of the insurance sector in Vietnam. It provides an analysis of the competitiveness of Vietnam’s insurance services in the context of recent global sector integration developments; and the possible impact of further liberalization of insurance services from two different angles: impact on the sector itself, and on the economy, including social impacts. The report also presents a set of recommendations, including recommendations for improving the legal and policy framework; developing a strategy for the sector; and improving governance and insurance operations.

The study was conducted by INVESTCONSULT GROUP, under the directions, with assistance and supports of many individuals, authorities, organizations and enterprises.

We would like to sincerely thank Mr. Truong Van Doan, Vice Minister of MPI, Mr. Ho Quang Minh, General Director of the MPI Foreign Economic Relations Department; and Mr. Thai Doan Tuu, Deputy General Director of the MPI Trade and Services Department. Dr. María Cristina Hernández, Senior Technical Advisor to the Project, conceived the study and assisted the team at various stages of the research.

We would also like to send our sincere thanks to Mr. Rodney Lester, insurance specialist, Mr. Le Song Lai, Deputy Head of Department of Insurance of Ministry of Finance, Mr. Phung Dac Loc, General Secretary of Vietnam Insurance Association, Mr. Nguyen Thieu, senior consultant of Research Committee of the Prime Minister, Mr. Nguyen Duc Binh, Deputy General Director of Post Joint Stock Insurance Company, and Mr. Mac Van Tien, visiting professor of National Economics University for their constructive comments, which have significantly improved the quality of the report.

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Acronym

1. AFAS: ASEAN Framework Agreement on Services
2. AFTA: ASEAN Free Trade Area
3. ASEAN: Association of South East Asian Nations
4. ATM: Automatic Telling Machine
5. BTA: Bilateral Trade Agreement
6. CPC: Central Product Classification
7. CPIC: China Pacific Insurance (Group) Co., Ltd
8. GATS: General Agreement on Trade and Services
9. GATT: General Agreement on Tariffs and Trade
10. GDP: Gross Domestic Product
11. GIC: General Insurance Company
12. IMF: International Monetary Fund
13. IBNR: Incurred but not reported
14. IRDA: Insurance Regulatory and Development Authority
15. IT: Information Technology
16. MFN: Most Favoured Nations
17. MOF: Ministry of Finance
18. MOJ: Ministry of Justice
19. ODA: Official Development Assistance
20. OECD: Organisation for Economic Co-operation and Development
21. OTC: Over the Counter
22. PICC: People's Insurance Company of China
23. SOCB: State owned commercial bank
24. SOE: State Owned Enterprise
25. SWOT: Strengths, Weaknesses, Opportunities, Threats
26. TAC: Tariff Advisory Committee
27. UNDP: United Nations Development Programme
28. USD: United States Dollars
29. VAT: Value added tax
30. VIA: Vietnam Insurance Association
31. VND: Vietnamese Dong
32. WB: World Bank
33. WTO: World Trade Organization

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1 Introduction

1.1 Background of the Study

The liberalization of financial services, including insurance and insurance related services has actively been taking place over the past decade in both industrialized and emerging countries. The negotiations on financial services were introduced in the Uruguay Round of trade negotiations. Specific commitments to provide market access and national treatment were made for the sector, but they were not considered enough to conclude the negotiations and as a result negotiations continued to the end of 1997, when the 1997 Financial Services Agreement was reached. This was an important first step in achieving trade liberalization and market access in financial services. The agreement includes commitments from more than 100 countries, which account for more than 95 percent of world trade in financial services. By the end of the extension for the financial services agreement, 70 countries had improved their offers.

Financial services are one of the most active areas in WTO negotiations. By 2000, financial services ranked second to Tourism in terms of number of GATS commitments made. This is also the area where industrialized countries have put a lot of pressure on developing countries, requesting greater market access and a level playing field with domestic firms. In response to this, the governments of emerging markets and developing countries began privatizing state monopolies, deregulating industries and liberalizing markets by bringing down barriers to foreign entry.

In Vietnam, the liberalization of the insurance sector started in 1993 with Decree 100/1993/ND-CP, allowing different economic sectors to engage in insurance business. The need for liberalizing and deregulation of the Vietnamese insurance market did not arise under the pressure of WTO accession negotiations, but also from a demand for the economic development of Vietnam. A well-functioning insurance market plays an important role in economic development. Theoretically, insurance supports economic development through promoting financial stability and reducing anxiety, more efficient allocation of societal resources, facilitating trade and commerce, mobilizing national savings, and more efficiently managing risks etc. In turn, the participation of foreign insurers brings benefits to the local market by improving customer service and value, increasing domestic savings, transferring technological and managerial know how, channelling in external financial capital, improving the quality of insurance regulations, creating domestic spill-overs[1].

There is empirical evidence favouring liberalization of the insurance sector in developing countries. Dr. Boonyasai, in her doctoral dissertation[2], found that liberalisation and deregulation of the Korean and Philippine life insurance industries seems to have stimulated increases and improvements in productivity. In addition, liberalisation and deregulation of these markets created more competitive markets as witnessed by life insurers' improving efficiency; e.g., achieving cost savings and adjusting their scale of operations[3]. However, this does not mean that liberalization does not cause any negative impacts on the economy. Theoretically, foreign insurers might dominate the domestic market and thereby precipitate adverse microeconomic (less consumer choice and value) or macroeconomic (failure to contribute adequately to economic development) effects. Foreign insurers may also provoke a greater foreign exchange outflow. And most importantly, if there is not adequate prudential supervision, competition regulation and market conduct oversight, liberalization may cause micro or macroeconomic disruptions[4].

[1] Skipper, H. 1997
[2] *The Effect of Liberalization and Deregulation on Life Insurer Efficiency* examined the effects on life insurer efficiency of insurance market opening and deregulation efforts undertaken by Korea, the Philippines, Taiwan, and Thailand.
[3] Skipper, H. 1997
[4] Skipper, H. 1997

To prepare for a new phase of liberalization as a result of the approaching accession of Vietnam to WTO, it is essential to understand how the Vietnamese insurance sector is currently performing in comparison with that of other countries, to see how open the market is, to what extent the market has been deregulated, to what extent regulatory regimes have been reformed in accordance with best practices. It is also important to understand the past impact of liberalization on the insurance sector and future impact must be predicted so that measures can be taken to promote the positive effects and bring attention to negative ones.

1.2 Introduction of the study

The Vietnamese Government recognised the important role of the insurance sector to Vietnam's economic development as well as the pressures of the liberalization process, and in conjunction with UNDP and a number of ministries selected the insurance sector as one of several key service sectors to conduct studies on competitiveness and impact of services liberalization (Project VIE/02/009).

This study covers potential impacts and required changes to the legal and regulatory framework, administrative procedures and competitiveness of insurers in the Vietnam insurance market. This has implications across the board in terms of consumers choices and possible benefits; the adaptability of domestic insurers to increased foreign competition and the extent to which liberalisation (or internationalisation) of the economy is beneficial to macro economic growth and stability. Though quality of growth (jobs and equity) issues also arise they are not looked at in detail in this study.

1.3 Objectives of the Study

The study conducted analytical research to assess the competitiveness of the insurance sector, as well as the impact of liberalization on the sector itself, on user industries, on the population and on the economy as a whole.

The main objectives of study are therefore to:

- Assess the competitiveness of the sector at the present time, taking into account trends in the international market;
- Assess the impacts of Vietnam's market reforms and trade liberalization commitments in the insurance sector itself, on the economy of Vietnam as a whole and on consumers;
- Understand the readiness of insurance services for liberalization, opportunities and challenges;
- Identify and understand relevant regulatory issues and developments at stake in the country in insurance;
- Assist Vietnam's policy makers in formulating appropriate domestic policies to ensure the implementation of commitments and to achieve Vietnam's development goals;
- Strengthen the research and policy analysis capacities of Vietnam in the area of services in general and in trade service in particular.

1.4 Scope of the Study

The study focuses on two areas:

- Evaluating the current competitiveness of Vietnam's insurance sector
- Assessing the impact of liberalization in the insurance sector on the economy, enterprises in this sector and insurance consumers.

The study covers all commercial insurance services, supplied by commercial insurance firms. They are:

- Life insurance

- Non-life insurance
- Reinsurance
- Insurance Brokerage

Obligatory social and health insurance, which is supplied by and under the control and supervision of Vietnam Insurance, is not the subject of this study.

Liberalization in the insurance sector is analyzed from two perspectives:

- Improving market access to the private sector of Vietnam; and
- Improving market access and national treatment to the foreign investors.

1.5 Structure of the Report

The report is covers 6 chapters as follows:

Introduction: background and purpose of the study.

Chapter 1 – International Benchmarks: The key issue of this section is to identify international benchmarks, against which the performance of the Vietnamese insurance sector and regulatory regimes will be compared to determine the competitiveness of the Vietnamese insurance sector.

Chapter 2 - Current status of the Vietnamese insurance sector, which describes the **Development and contribution of the insurance sector to the socio-economic development**, market structure and characteristics (characteristics of suppliers, role of foreign direct investment to the sector).

Chapter 3 - Legal Framework of the insurance sector, where both the general laws and specific laws governing the insurance sector are presented with a special focus on the International standards and the inappropriateness or inadequacies of regulations in some specific areas. The comparison between existing laws and Vietnamese commitments under BTA, GATS and AFAS will be brief as this is discussed in more detail in the report.

Chapter 4 - Competitiveness analysis of the Vietnam insurance sector: The analysis is based on two analysis models, the Diamond model of Michael Porter and a SWOT analyses. Following the Diamond model, the competitiveness of the insurance sector of Vietnam is analyzed from 4 perspectives: (i) Firm strategy, structure and rivalry; (ii) Demand conditions; (iii) Factor conditions (human resource, capital source), (iv) Related and supporting industries (stock market, information technology, bank system). The competitiveness analysis will be based mainly on a comparison between the current situation of the sector and International and regional benchmarks and best practices and between 100% wholly Vietnamese-owned insurance firms and foreign owned insurance firms in Vietnam. The analysis will be carried out in light of the Government legal framework and Vietnam's commitments, which are described in detail in earlier sections of this report. The SWOT model will then be used to draw conclusions on the strengths and weaknesses of the Vietnam insurance sector, opportunities and threats in the integration process.

Chapter 5 – Impacts of liberalization in the Vietnamese insurance sector: This chapter has 2 sections:

Section 1: Assessment of the impacts to-date which liberalization has made. The two major reforms in the sector are the allowance of the domestic private sector in 1993 and foreign organizations in 1996, to operate in the insurance service sector. Impacts will be assessed in terms of both economic and social aspects on the economy, the insurance sector and consumers.

Section 2: Projections of possible impacts of further liberalization when the commitments of Vietnam under BTA (commitments which have not taken effect yet and shall take effect in the future) and GATS, become effective. China's experience in opening this market will be integrated in this chapter for reference.

Chapter 6 - Recommendations: This section will present recommendations on policies to support the Vietnamese insurance sector to achieve International and regional benchmarks and best practices; to take advantage of foreign investment and to minimize possible negative impacts. The section will also outline the role that the insurance sector should be playing in achieving goals in economic growth and human development.

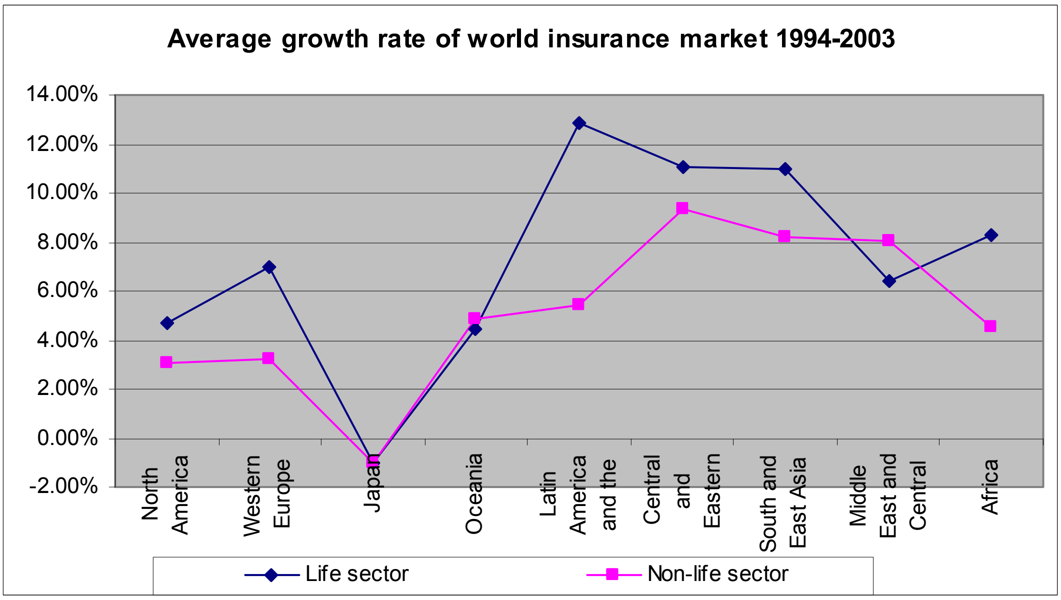
2 International Benchmarks

This chapter describes International benchmarks in terms of market performance, market deregulation, recent trends and pro-competition regulatory regimes, which are derived from the operation of the insurance sector of Asian countries. These will be used as a basis for some comparative analysis in Chapter II, which looks at the performance of the insurance sector in Vietnam over the past decade, Chapter III, which looks at the regulatory framework governing the insurance sector of Vietnam and Chapter IV, which looks at the competitiveness of the insurance sector of Vietnam.

2.1 Market Performance

World market share and premium growth: In terms of scale of activity it is the major industrialized nations that dominate the insurance sector. As of 2004 Western Europe and the USA accounted for approximately 37% each of the World Market whilst Japan accounted for just over 15%. Overall emerging markets (mainly ASEAN, Latin American, Eastern European countries) accounted for just 9% of global premium volume with ASEAN member states accounting for a very small portion 0.85%. However, over the past 10 years, emerging markets have recorded high growth rates in premiums in the life and non-life sectors, compared to the mature markets of industrialized countries.

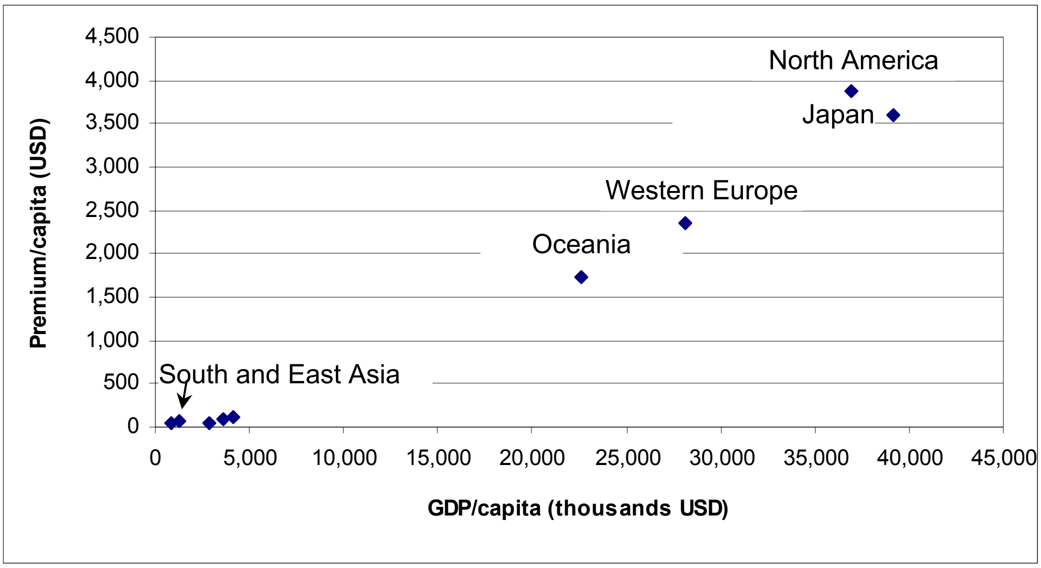
Figure 1: Average growth rate of the world insurance market, 1994-2003



Source: WTO Statistics

Insurance penetration: As of 2004, premiums as a percentage of GDP amounted to 9.2% in North America, 8.4% in Western Europe and 10.5% in Japan. Figures for South and East Asian countries showed a low penetration of 5.2%. In 2004 (compared to 2000) China had a ratio of 3.26% (1.79%), Malaysia, 5.40% (3.72%), Thailand, 3.52% (2.53%) and Vietnam just 2.02% (0.53%).

Figure 2: Premium/Capital vs GDP/Capita in the world



Source: Swiss Re 2/2005

Insurance penetration is a rough indicator of growth potential. It can be viewed as the relationship between insurance expenditures (premium/capita) and economic production per household (GDP/capita). Household wealth increases as the production per household increases, in turn motivating individuals to purchase more insurance. This illustrates the positive relationship between insurance per capita and GDP per capita. However, this relationship changes substantially at different levels of GDP per capita. When GDP per capita is very low (as in least developed countries), the level of wealth can only provide for basic needs and the demand for insurance is low. Consequently insurance demand grows only slightly faster than wealth. When GDP per capita increases (as in developing countries such as China, India or Vietnam), the growth in insurance is much faster than the growth in wealth. In recent years, the average annual growth rate in these countries has been twice as high as for industrialised economies. Conversely, when GDP per capita is high (as in developed countries in North America, Western Europe or Japan), a point of saturation has been reached, with a large portion of the insurable interests already insured. Here, demand for insurance grows only marginally faster than wealth[5]. However, the market performance of Asian emerging countries has tended to fluctuate far more widely since 1997/1998, compared to OECD countries.

Insurance density: Industrialized countries have significantly higher insurance densities than emerging countries. While North America, Western Europe and Japan recorded an insurance density range between US$ 2,300 to 3,800, emerging markets have a very modest density of less than US$100. Different regions also have very different behaviour in terms of life and non-life insurance.

Compared to other regions - Non-life insurance in emerging Asian markets under performs: With the exception of South Korea and Malaysia, non-life insurance penetration in emerging Asian markets is lower than the global average. This reflects the under-insurance of industry and risk of natural catastrophes against a backdrop of a relatively weak corporate risk management culture. By contrast, life insurance outperforms other areas.

2.2 Market deregulation and Increasing foreign participation in Asian countries

2.2.1 Market deregulation

Market deregulation and liberalization has actively been taking place in Asia over the last 10 years. The main areas of deregulation include deregulation for market participation,

[5] Milliman USA 2001

deregulation of distribution systems, deregulation to link demand with supply and deregulation for insurance products and prices.

Deregulation for market participation: Most developing countries have allowed foreign participation to a certain degree. As of 2000, all countries allowed foreign insurers to participate in local markets. However, many still restrict foreign participation to minority shareholdings.

Table 1: Market access options for foreign insurers

	Joint ventures with foreign minority participation	Joint ventures with foreign majority participation	100% participation/ subsidiary	Agencies/branch offices
China	( )	**x**	**x**	( )
Indonesia			( )	**x**
Malaysia	max 30%	(**x**) (51% for existing JVs)	**x**	**x**
Philippines		(max 51%)	**x**	**x**
South Korea				
Taiwan				
Thailand	(max 25%)	**x**	**x**	**x**
India	(max 26%)	**x**	**x**	**x**

Source: Swiss Re Economic Research & Consulting
Note: : is permitted, ( ): with certain restrictions, **x**: is not permitted, (**x**): with exceptions

In China, upon accession to the WTO, foreign life insurers were allowed to hold 50 percent ownership in joint ventures and may choose their own joint venture partners. For non-life insurance, China will allow branching or 51 percent foreign ownership upon accession and wholly owned subsidiaries two years after entry to the WTO (i.e., no restriction on the form of enterprise establishment). Licenses will be granted solely on the basis of a prudential criterion with no economic needs tests or quantitative limits on the number of licenses granted.

Deregulation of the Distribution system: Governments of developing countries started encouraging insurance companies to formulate their own strategies for agencies, compiling their own agency's commission table, replacing uniform ones that insurance companies unanimously used before. In addition, the introduction of tele-marketing has been allowed in many markets, especially for automobile and personal accident businesses. Brokers have also been recognized as market players.

Another important achievement in the deregulation of distribution systems is the removal of restrictions to the establishment of branches of foreign insurers. Upon accession to WTO, the Government of China committed to removing all geographic restrictions three years after the entry.

Deregulation of Insurance products and prices: Most countries have gradually removed obligatory tariffs applied to various kinds of products. Most countries have allowed life insurers to set their own prices. Some countries such as Thailand and the Philippines still regulate the prices of some non-life classes of insurance such as motor, fire, etc. India is the only one which still regulates the price of most non-life businesses.

Table 2: Obligatory tariffs

Country (2003)	Obligatory tariffs
South Korea	None
China	"file and use" for all lines except mandatory statutory classes, new life products and insurance affecting public interests which are subject to tariffs
Taiwan	None
India	Most non-life lines
Hong Kong	None
Singapore	None
Malaysia	Motor and fire
Thailand	Fire, earthquake, motor, marine cargo, personal accident
Indonesia	None
Philippines	Motor, bond and surety

Source: Compiled from different sources

2.3 Increasing foreign participation

Governments in emerging countries are responding to the World Trade Organization's (WTO's) call for increased liberalization by moving towards greater openness of foreign investment in the financial services sector[6]. The market share of insurers who were either partly or fully foreign owned tripled in Latin America between 1990-1999, and rose to 47% and 41% in Central and Eastern Europe. The average in Asia was 12%, which may indicate a more cautious stance on market liberalisation compared to other emerging regions Evidence suggests that Eastern Europe, followed by Africa, was the most open with regards to cross border investment, although Asia was higher than Latin America.

Table 3: Foreign participation in Life and Non-life markets of Asian countries

	Life			Non-life			
	1997	**1999**	**2003**	**1997**	**1999**	**2001**	**2003**
China	0.80%	1.70%	2.00%	0.40%	0.70%	0.70%	1.00%
India	0%	0%		0%	0%	3%	
Indonesia	23.40%	46%	48.00%	20.30%	28.90%	27.00%	25.00%
Japan	3.80%	8.90%		4.70%	3.80%	6.00%	
Malaysia	57.60%	64.60%	71.00%	9.60%	14.20%	23.00%	25.00%
Philippines	32.60%	58.30%	61.00%	13.60%	18.80%	20.00%	29.00%
Singapore	52.50%	54.60%	58.00%	57.30%	56.70%	52.00%	53.00%
South Korea	0.30%	6.70%	10.00%	0.30%	2.20%	0.60%	1.00%
Taiwan	24.90%	29.90%	33.00%	7.80%	9.30%	11.00%	12.00%
Thailand	48.90%	48.60%	41.00%	17.70%	8.30%	7.00%	7.00%
Vietnam	0%		56.00%	0.00%	3.70%	8.00%	6.00%

Source: WTO Statistics

6 Oetzel, 2005

The market share of the foreign sector has increased between 1997 and 2003 for most countries in both life and non-life sector. In addition, consistently in all emerging markets, the foreign sector has had a deeper participation in the life sector.

2.4 Consolidation, Integration and Market Concentration

2.4.1 The Trend Towards Consolidation and Market Concentration

As of early 2004, the top 8% of companies in Asia commanded some 68% of all non-life premiums in Asia. The remaining 92% of companies shared just 32% of premiums. The recent trend in consolidation in the Asian market place is exerting increasing pressure on smaller operators. In the aftermath of the Asian Financial Crises, some weakened companies had to merge to survive.

This trend is also fuelled by the desire of a number of governments to nurture strong domestic players to compete with foreign competitors. This is particularly the case in Thailand and Korea where, in the wake of company insolvencies and distress caused by the Asian Financial Crises, governments have made a conscious effort to rebuild the sector with larger firms.

Many smaller companies are holding out on small premiums. For example, 79 out of 104 insurers in Indonesia's fragmented market have a share of less than 1%. The increasingly polarised market is forcing second tier players to concentrate on niche sectors.

Table 4: Market Concentration in Asia

	No. of insurers		**Market share of 5 largest insurers**		**Herfindahl Index**	
	Non-life	Life	Non-life	Life	Non-life	Life
India	5	1	100%	100%	2524	10000
China	14	12	98.1%	99.1%	6398	5180
South Korea	15	27	73.4%	82.1%	1368	2126
Japan	60	45	53.1%	61.2%	828	1009
Taiwan	28	31	47.6%	78.5%	805	1771
Indonesia	107	62	34.3%	66.2%	381	1317
Thailand	73	25	37.4%	90.2%	462	2975
Singapore	50	14	32.6%	91.2%	391	2380
Philippines	110	40	31.6%	76%	335	1615
Malaysia	53	18	30.3%	72.6%	352	1495
Hong Kong	137	55	24.8%	61.5%	251	963

Source: Swiss Re 2001

* A Herfindahl index below 1000 indicates that the market is not concentrated; between 1000-1800 indicates that a single insurer or group of large insurers has the ability to exercise some control (price or distribution channel).

Hong Kong, which maintains a liberal regulatory environment, has a relatively competitive insurance market. By contrast, in Singapore, again with a developed insurance market, shows a high Herfindahl index and an extremely high five firm concentration. Similar results are found in Thailand. The findings for China and Vietnam indicate that their insurance markets are highly concentrated, and a few insurers probably exerting a good deal of influence on the market. However, when compared to life insurance markets, non-life markets in most Asian countries, except for China and Vietnam, show a relatively low index and concentration ratio.

A country with a high firm concentration ratio and a high Herfindahl index, may need some corrective measures to minimise, if not eliminate, any competitive threat. Admitting more financially sound insurers with a strong financial capacity and good expertise in insurance is another solution. Alternatively, creating an environment that encourages mergers and acquisitions between small insurers or between firms in financial services (including the expansion of bank assurance) is a remedy.

2.5 The Trend Towards Integration of Financial Services

In parallel with the consolidation trend has been the integration of financial services, which has seen the formation of big financial corporations in Asian countries such as South Korea, Taiwan, and Japan. The close linkages and inter-support amongst insurance, banking and other financial services has led to the merger of banks, insurance firms and investment funds, producing mutual benefits for all companies in the same group.

2.6 Pro-competitive regulatory framework

Liberalization and deregulation of the market does not necessarily mean laisser-faire. In today's globally competitive financial services world, the nature and specific features of each government's intervention into its insurance market should be reassessed to ensure that every aspect is essential and is accomplishing its goal with minimum market disruption in light of the country's economic, political, and social situation. The most common rationale for government intervention into insurance markets is to protect buyers — in economic terms, to rectify market imperfections. To do this, insurance regulation should seek to ensure that quality, reasonably-priced products are available from reliable insurers. Hence, an important role of government is to promote fair competition to achieve these goals, while protecting buyers from misleading, collusive, and other anti-competitive practices. At the same time, arguably the most important governmental role is to ensure that insurers are reliable[7].

The following are the best regulatory regimes to create a competitive, solvent insurance market, which are extracted from the paper Liberalization of Insurance Markets: Issues and Concerns published by the OECD.

2.6.1 Regulations should be adequate:

- ***Competition Law:*** Government should enact and enforce laws that provide an effective framework for competitive insurance markets.

- ***Prudential Regulations:*** Government should enact and enforce laws that establish reasonable solvency standards and regulation as the primary means of protecting the public. As a part of reasonable solvency regulation, government should establish, make public, and enforce appropriate and consistent rules and procedures for identifying and dealing with financially troubled insurers.

- ***Regulatory Effectiveness:*** Government should establish an insurance regulatory agency that operates in society's interest and has sufficient resources to efficiently, effectively, and impartially enforce the nation's insurance laws and regulations.

- ***Phased-In Liberalisation:*** Government should develop and implement pro-competitive insurance regulation in a way and at a pace that ensures adequate protection of the public but that proceeds without undue delay and is subject to a reasonable implementation timetable.

2.6.2 Regulation Should be Impartial

[7] Skipper, 2000

The Government should ensure that insurance regulation and enforcement are applied with consistency and impartiality between competitors, irrespective of the nationality.

2.6.3 Regulation Should be Minimally Intrusive

- ***The Limits of Regulation:*** Insurance regulation should be limited to that which is (1) justified as providing meaningful protection and (2) minimally intrusive to accomplish its purpose.

- ***Distribution and Product Regulation:*** Subject only to that regulatory oversight essential to protect the public, government should allow the market to determine (1) what financial services products should be developed and sold, (2) the methods by which they will be sold, and (3) the prices at which they will be sold.

- ***Disclosure and Consumer Information:*** Government should ensure that insurance customers have access to information sufficient to enable them to make informed, independent judgements as to (1) an insurer's financial condition and (2) the benefits and value of its products.

2.6.4 The Regulatory Process Should be Transparent

The Government should make existing insurance laws and regulations easily available to the public, including to consumers and businesses and to insurers and other financial services providers.

In drafting proposed insurance laws and regulations, government should (1) make such proposals easily available to the public, including to consumers and businesses and to insurers and other financial service providers; (2) invite comment on the proposals; (3) allow sufficient time for interested parties to provide comment; (4) provide justifications for decisions to accept and reject comments; and (5) establish and communicate a fair process by which decisions considered arbitrary or unjust can be challenged.

These best practice regulatory regimes should be used as benchmarks, against which the regulatory framework of Vietnam can be compared to see to what extent the existing legal framework of Vietnam facilitates the development of a competitive and solvent insurance market.

2.7 Summary of Findings

In brief, opening insurance and financial services markets in general fits within the overall trend towards macro-economic reform, privatisation and the liberalization that has been taking place in many developing countries (particularly Asian) over the past decade or so.

Whilst relatively strong protection of local insurance markets may still be observed the momentum towards market opening has been gathering pace, particularly in response to the negative impacts associated with the Asian Financial Crises, since the late 1990's. In recent years, many Asian Governments have restructured the way they regulate the insurance industry and most are in the process of moving away from a government monopoly of the business. This has allowed for an increasing role of the private sector in the domestic insurance market. The liberalization process has, to varying degrees, allowed foreign competitors an entrance to the local market.

Except where markets are heavily concentrated and dominated by a small number of large firms this ought to lead to increased competitiveness and benefits for consumers.
Liberalisation is encouraging multi-national entrants into the market place, who operate both independently and in strategic alliances with large, often privatised local companies. They are bringing new products and new means of distribution that significantly reduce transactions costs.

From a policy perspective many governments are reinforcing the tendency of industry concentration by encouraging the formation and strengthening of local companies in order to compete with new entrants, or to enter into joint ventures with them.

3 Current status of the insurance sector in Vietnam

3.1 Development of the Vietnam insurance sector

Before 1975, there were only a few insurance firms in Southern Vietnam. In the North, the Vietnam Insurance Corporation (Bao Viet) was established on 15 January 1965 and in early years, Bao Viet only supplied import-export cargo insurance and shipping insurance. After 1975, Bao Viet expanded into the South, applying the same business style across Vietnam and became the biggest insurance firm, dominating the market.

Decree No. 100/CP dated 18 December 1993 governing insurance businesses was a significant milestone and brought about significant changes in Vietnam's insurance market. 1999 another key year with the foundation of 5 foreign insurers. Since 2003 there have been great changes and arrangements for domestic insurers:

- Bao Viet was restructured into a financial group with independent accounting members: Bao Viet Vietnam specialized in non-life insurance business and Bao Viet Life Insurance specializing in the life insurance business.
- A number of state-owned insurance and reinsurance firms were transformed into joint stock companies.
- Some joint stock companies and brokers were established.

By early 2005, there were 31 firms of diversified legal form and scale operating in life insurance, non-life insurance, reinsurance and brokerage. There were also over 30 representative offices of foreign insurers present in the market.

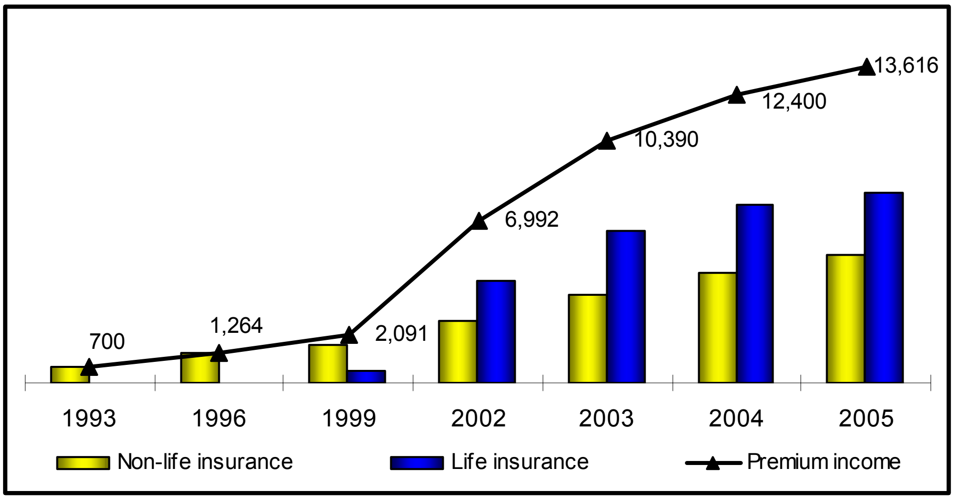
Table 5: Structure of the insurance sector, 1993 – 2005

	1993	1996	1999	2002	2003	2004	2005
Life insurers			3	4	4	5	8
Non-life insurers	1	6	10	13	14	14	15
Reinsurance firms		1	1	1	1	1	1
Brokers	1	1	1	2	5	6	7
Total	**2**	**8**	**15**	**20**	**24**	**26**	**31**

Source: Vietnam Association of Insurers

Over ten years, the insurance market has grown rapidly with average growth in income premiums of around 38% a year, between 1993 – 2004. The non-life sector recorded an average growth rate of 23% a year. Life insurance started in 1996 and began to grow significantly from 1999 when large foreign insurers joined the market. Over the period 1999-2004, the life sector recorded a remarkable average growth of 81% a year, much higher than average growth in the South and East Asia region during the same period, which was 11% for life and 8.2% for non-life. However, the growth of the life sector in Vietnam has slowed significantly, approaching regional levels, 16% in Vietnam compared to 9% for South and East Asia between 2003 and 2004.

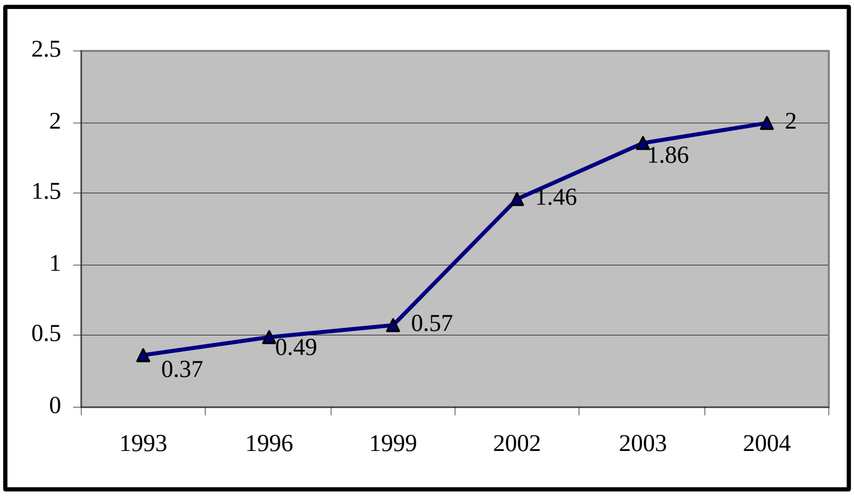
Figure 3: Income Premiums of the insurance market, 1993 – 2005, *Unit: VND billion*



Source: Vietnam Association of Insurers

Insurance penetration increased sharply, especially between 1993 and 2004. Insurance penetration increased from 0.37% in 1993 to 2% in 2004 and was nearly 1% of GDP between 1999 and 2002. It is estimated by the end of 2005, the insurance sector would contribute 2.5% of GDP.

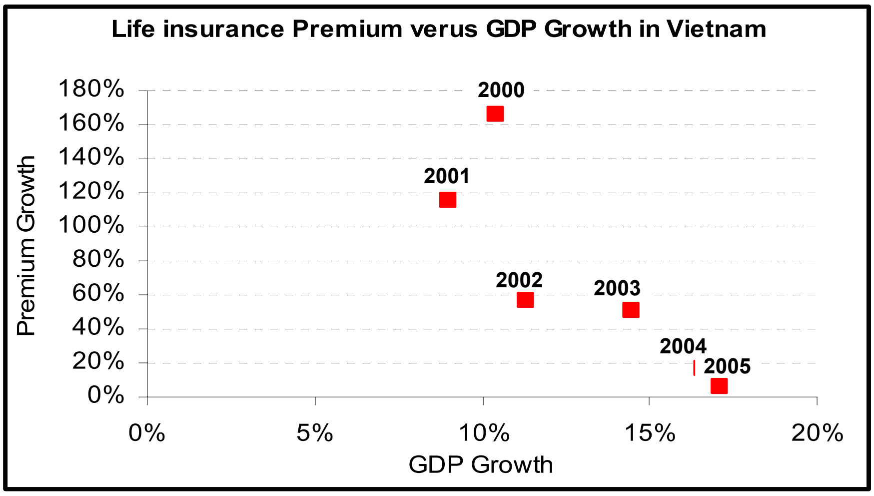
Figure 4: Insurance penetration in Vietnam over the past decade, *Unit: %*



Source: Vietnam Insurance Market 2004 (MOF)

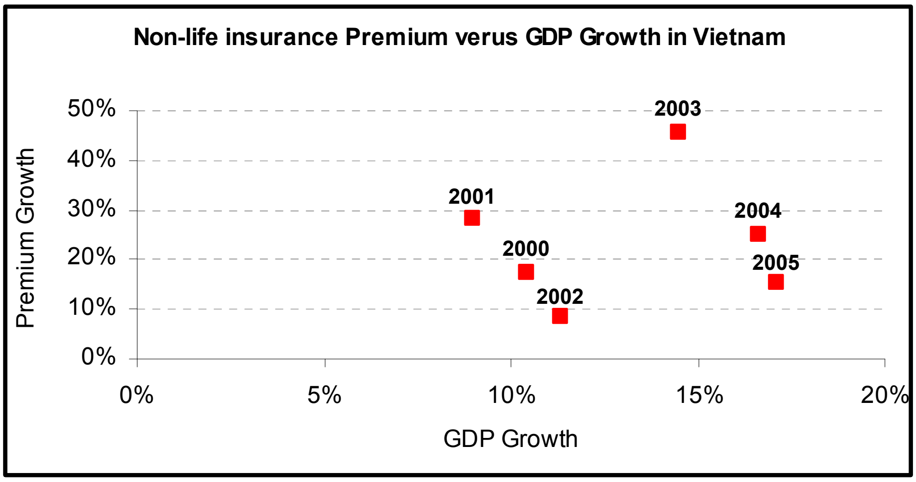
The annual increase in penetration shows that the take up of insurance has grown faster than economic production. As discussed previously, in developing countries such as Vietnam, the demand for insurance grows faster than wealth. Figures below clearly illustrate this scenario. In the life sector the growth in premiums have outpaced the growth in GDP. However, from 2004, the take up of life insurance has been decreasing, especially in 2005 when growth was only a half of GDP growth. This signals a saturation in the life insurance sector. In the non-life sector, the annual increase in penetration was more stable than the life sector except during 2002. In 2005, premium growth decreased and was lower than GDP growth.

Figure 5: Life insurance premium growth versus GDP growth



Source: Vietnam Association of Insurers

Figure 6: Non-life insurance premium growth vs GDP growth

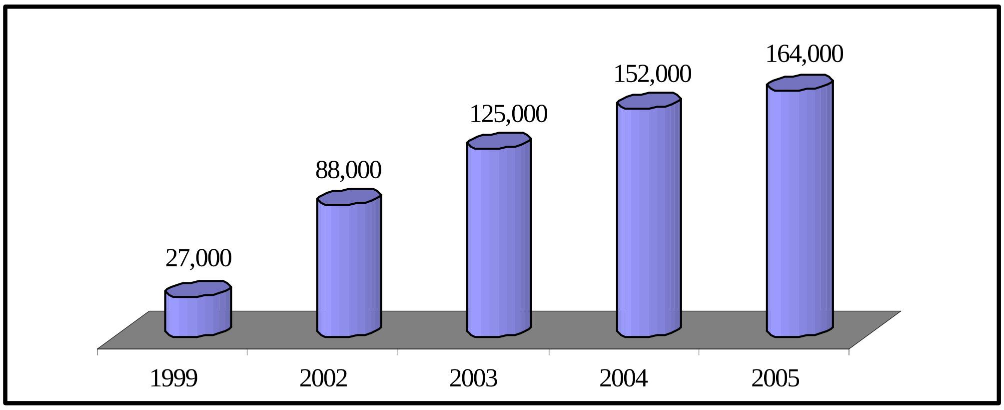


Source: Vietnam Association of Insurers

Although this is a significant development in the insurance sector of Vietnam, penetration rates are still low compared with ASEAN averages,, where penetration rates were 3.31% in 2004.

There have also been big changes in insurance densities across the years, where premium/capita increased more than 16 times between 1993 and 2005. However, again Vietnam's insurance densities of around US$11 are still behind when compared with the ASEAN averages, where the density was US$54.4 in 2004.

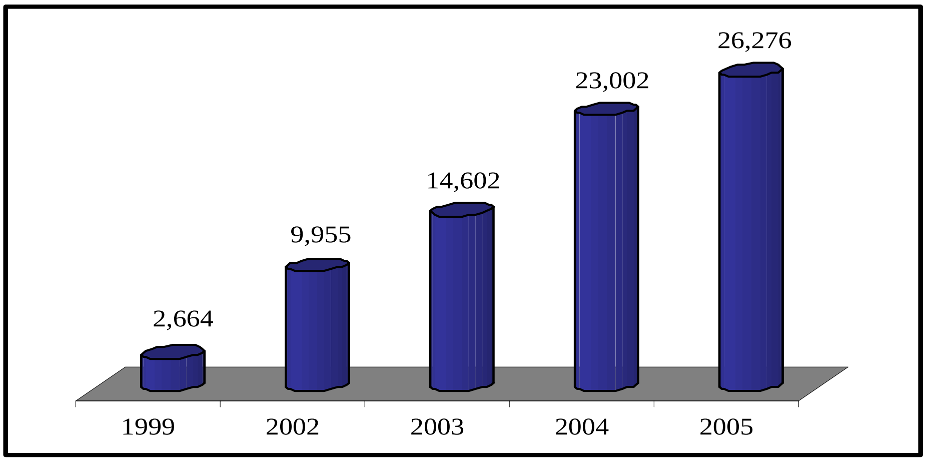
Figure 7: Insurance density, *Unit: VND*



Source: Vietnam Association of Insurers

In investment, insurers have increasingly affirmed their role in mobilizing savings for Vietnam's development. Total investment of the insurance sector in 1999 was VND 2,662 billion, and rose to VND 9,995 billion in 2002, 3.8 times higher. Short term investment has changed to long term investment in the form of Government bonds, direct investment into infrastructure and developing business.

Figure 8: Total investment capital of insurance sector, *Unit: VND billion*



Source: Vietnam Association of Insurers

A large number of labour has been attracted to the insurance sector. Growth in the number of insurers and their operations has led to an increase in employment in the insurance sector. In 1993, there were 1,000 insurance employees and agents by 1999 this was 30,000, and by 2004 he sector was employing 136,900 employees and agents; 136.9 times higher than in 1993.

3.2 Current status of the Vietnam Insurance Sector

Decree No. 100/1993/ND-CP, December 1993, governing insurance business operations, marked a significant milestone for the Vietnam insurance market allowing different economic sectors and foreign investors to carryout insurance operations in Vietnam. Since 1995, the establishment of new insurers, especially foreign owned ones, has accelerated the markets development.

By December 2005, there were 29 insurers doing business in life insurance, non-life insurance, reinsurance and brokerage sub-sectors.

Table 6: Structure of Vietnam's insurance market in 2005

Insurers	State owned company	Joint stock company	Joint-venture company	Wholly foreign owned company	Total
Life insurance	1		1	6	**8**
Non-life insurance	3	6	4	2	**15**
Reinsurance	1				**1**
Brokerage		4		3	**7**
Total	**5**	**10**	**5**	**11**	**31**

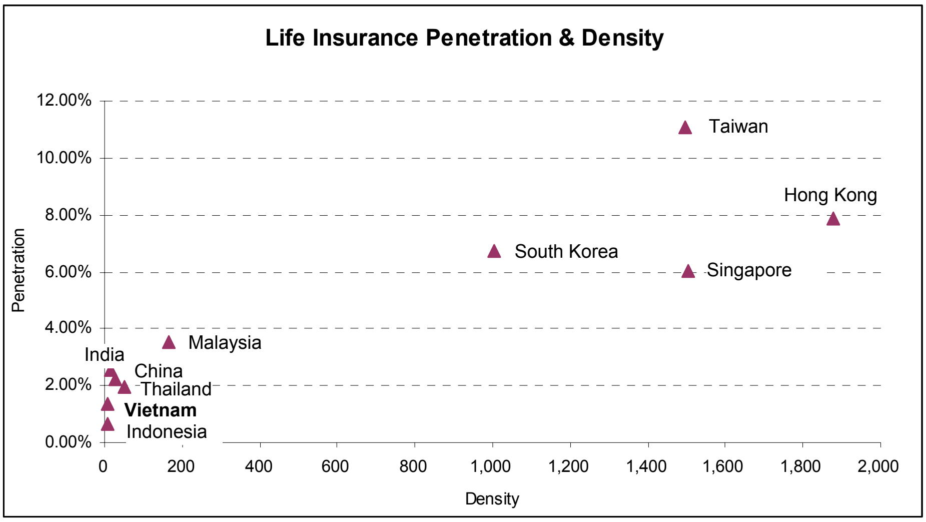
Source: Vietnam Association of Insurers

3.2.1 Life insurance

Performance

Despite the high growth rate of the life sector in Vietnam over the past 5 years, the penetration and density rates of the sector is very low compared to other countries in the region. According to Swiss Re data in 2004, Vietnam was in the mid range in terms of penetration, but the third lowest in terms of density in Asia.

Figure 9: Life Penetration and Density in Asian markets, 2004



Source: Swiss Re 2/2005

Market share

Vietnam's life insurance market is dominated by foreign insurers in both number of suppliers and market share. So far, Bao Viet Life Insurance is the only domestic life insurance firm, the other 7 life insurers are foreign companies.

By the end of 2005, the share of life insurers in the market were:

- State owned insurance companies: 37.5%
- Joint venture insurance companies: 3.5%
- Wholly foreign owned companies: 59.0%

Life insurance products

Amongst insurance products, life insurance is the most attractive products for individual customers. Foreign insurers with advantages in capital, design technique and actual supply of diversified products have premium rates that meet the demands of customers, helping them to raise their market share in the life insurance sub-sector.

Between 2001 and 2005 newly founded foreign insurers concentrated on supplying new products of customers' interest. As a result the number of new contracts in this period increased. At the same time, there were a number of changes in life insurance purchasing with riders purchased increasingly by customers. Since 2004, the number of new policies has decreased as the market saturated. However, the proportion of riders is higher than that of basic products.

Table 7: Number of new contracts, 2001 – 2005

	Basic products					Riders				
	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Number of new contract	792.672	1.001.318	1.024.802	808.514	590.429	514.708	769.214	1.046.014	997.275	607.571
Proportion in product structure	60,63 %	56,55 %	49,49 %	44,85 %	49.28 %	39,37 %	43,45 %	50,51 %	55,15 %	50.72 %
Growth rate		26,27 %	2,35%	-21,11 %	-26.97 %		51,25 %	35,98 %	-4,66%	-39.08 %

Source: Vietnam Association of Insurers

In premium income terms, endowment insurance makes up the largest ratio, other products such as whole life policies, pure endowment insurance, term insurance and annuity insurance accounts for a low proportion. However, since 2004, the number of new contracts, face value and premiums has decreased, indicating a period of stability after significant market development.

Table 8: Structure of premium income and face value of new contracts in classification

Classification	**Premium (%)**		**Face value (%)**	
	2004	**2005**	**2004**	**2005**
Whole life insurance	2.09	0.63	1.87	1.40
Pure endowment insurance	2.79	0.26	0.4	0.12
Term insurance	0.46	1.32	3.08	6.57
Endowment insurance	89.21	90.70	75.87	58.22
Annuity insurance	2.69	3.73	0.06	1.19
Rider	2.76	3.36	18.72	32.50

Source: Vietnam Association of Insurers

Employment

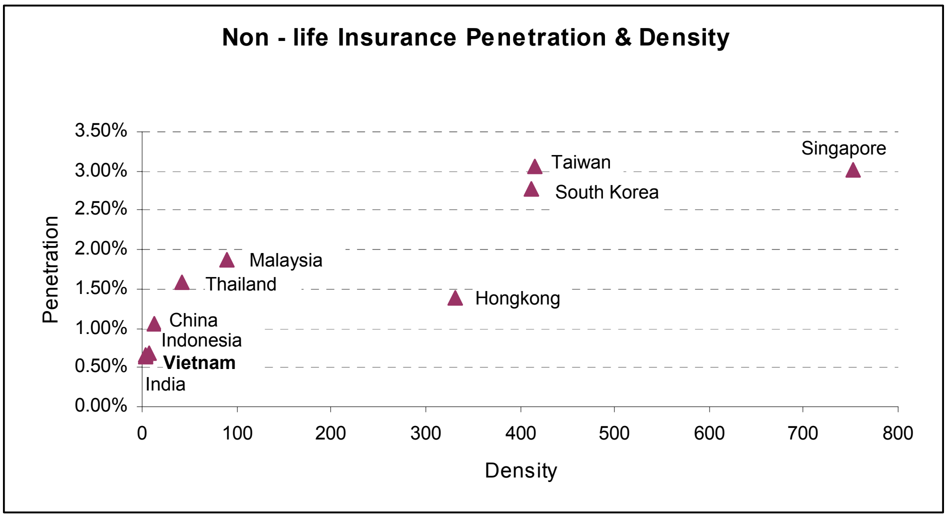
Employment in the insurance sector increased from 125,700 people in 2003 to 136,900 people in 2004. The growth rate of agents also increased between 2000 and 2002, especially for foreign insurers. However, since 2003, this has been gradually decreasing. In 2004, the growth rate of agents was only 1.38% in comparison with 35.22% in 2003. In 2005, the growth rate was –4.05%.

3.2.2 Non-life insurance

Performance

After the promulgation of Decree 100/1993, several non-life insurers were established. Foreign insurers had also joined the Vietnamese non-life market as early as 1996. The penetration and density of the non-life sector is the lowest in comparison to that of other countries in the region. In addition they are significantly lower than those of the life sector. Nevertheless, this follows the general trend in emerging countries, where the non-insurance sector underperforms the life sector. In these countries where on one hand GDP per capita is low, people cannot afford to pay for insurance of their properties, and on the other, they do not have many valuable assets which need to be insured.

Figure 10: Non-life Penetration and Density in Asian markets



Source: Swiss Re 2/2005

Market share

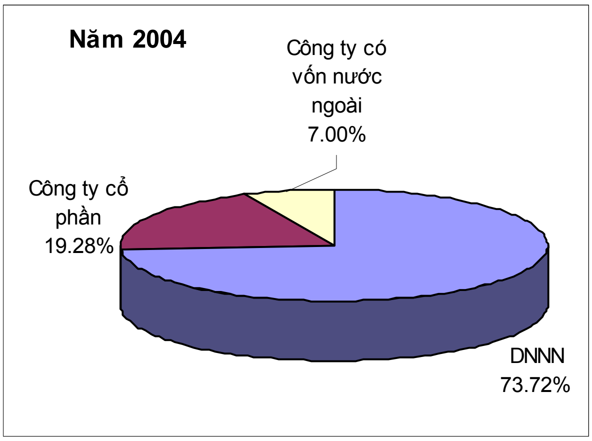
While the life insurance market is dominated by foreign insurers, the non-life insurance is dominated by domestic insurers. At the end of 2005, there were 15 non-life insurers with half being foreign insurers. However, domestic insurers made up 95% of the market share while foreign insurers accounted for only 5%. This is in line with trends in other Asian countries, where domestic firms account for up to 90% of the non-life market.

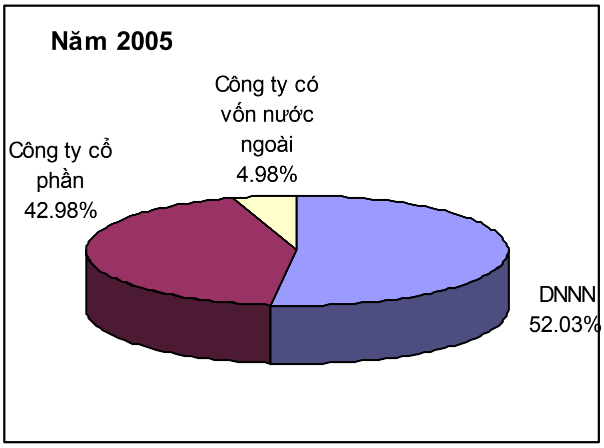
Table 9: Structure and market share of non-life insurers, 2005

Non-life insurers	Number	Market share
State own company	3	52.03%
Joint stock company	6	42.98%
Foreign company	6	4.98%

Source: Vietnam Association of Insurers

Figure 11: Market share of non-life insurance, 2004 – 2005





Source: Vietnam Association of Insurers

Structure of product class and non-life insurance premium income

Non-life insurance products includes 11 product classes: personal accident and health insurance, property and casualty insurance, cargo insurance, aviation insurance, motor vehicle insurance, fire and explosion insurance, hull and P & I insurance, public liability insurance, financial risk insurance, business interruption insurance and agriculture insurance. However, the proportion of premiums mostly comes from traditional areas including motor vehicle insurance, property and casualty insurance, cargo insurance, hull and P & I insurance, aviation insurance.

In 2005, motor vehicle insurance made up the largest proportion (31.05%), property and casualty insurance ranked second (19.98%), personal accident and health insurance (16.25%), fire and explosion insurance (11.16%), hull and P & I insurance (10.21%). Some classes accounted for only a small rate and some products had a decreasing level, such as agriculture insurance (0.01%), financial risk insurance (0.00%); and especially, the aviation insurance which decreased from 7.20% to 0.06%.

In the growth of premiums, public liability insurance had the highest growth rate (164.28%), then business interruption insurance (35.54%), motor vehicle insurance (18.07%), personal accident, health insurance (15.28%), hull and P & I insurance (14.78%). Financial risk insurance, agriculture insurance and aviation insurance were all decreasing gradually.

Mutual insurance

A mutual insurance organization is the distinct characteristic of an insurance sector in a modern economy, where insurers move from specific insurance products, such as in agriculture, forestry, or the fishing sector which were not met by non-life insurers. Though there has not been any mutual insurance organization in Vietnam, the promulgation of regulations[8] created a legal framework for Vietnam's mutual insurance development in the future.

3.3 Reinsurance

In 2004, net premiums retained in the country were 86.19% of total direct premiums written. Reinsurance premiums assumed from overseas increased from VND 38 billion in 2003 to VND 61 billion in 2004. This was the result of the improvement of financial capacity, business capacity as well as risk evaluation and management of insurers that has increased the premium and the net premiums written retained in the market. At present, there is only one enterprise that specializes in reinsurance, Vietnam National Reinsurance Joint Stock Corporation (Vinare), a

[8] Decree No.18/2005/ND-CP stipulates the establishment and operation of mutual insurance organizations, Circular No. 52/2005/TT-BTC guiding establishment on mutual insurance organizations in supplying agriculture – forestry – fishing insurance products

state owned company that was transformed into a joint stock company in 2004. It assumes life and non-life reinsurance from insurers.

Table 10: Reinsurance operations, 2004

Unit: VND billion

Indicator	2003	2004
Total direct premiums written	10.390	12.400
Reinsurance premium assumed from overseas	38	61
Reinsurance premium ceded to overseas	1.448	1.773
Total net premiums written	8.980	10.688

Source: Ministry of Finance

3.4 Brokerage

The first broker in Vietnam's insurance market was founded in 1993. The role of brokerage in the development of the insurance sector had not been promoted. The main reasons were an erroneous understanding of broker's roles in insurance business, the unclear relationships between rights and obligations of insurers and brokers.

In recent years, insurers and insurance customers have become more aware of broker's roles and have gotten used to purchasing insurance through brokers. This has helped develop the brokerage service. 2003 marked the establishment of several domestic brokers and foreign brokers. In addition, foreign direct investment was very good in 2004, which facilitated the work of brokers, especially foreign owned ones.

Table 11: Types of Brokers

Types of Brokers	2004	2005
Domestic Brokers	3	4
Foreign Brokers	3	3
Total	**6**	**7**

Table 12: Broker's operations, 2003 – 2004

	Total premium income through brokers (VND billion)	Proportion to Non-life insurance premium (%)
Year of 2003	196	5.14
Year of 2004	580	12.18

3.5 Conclusion

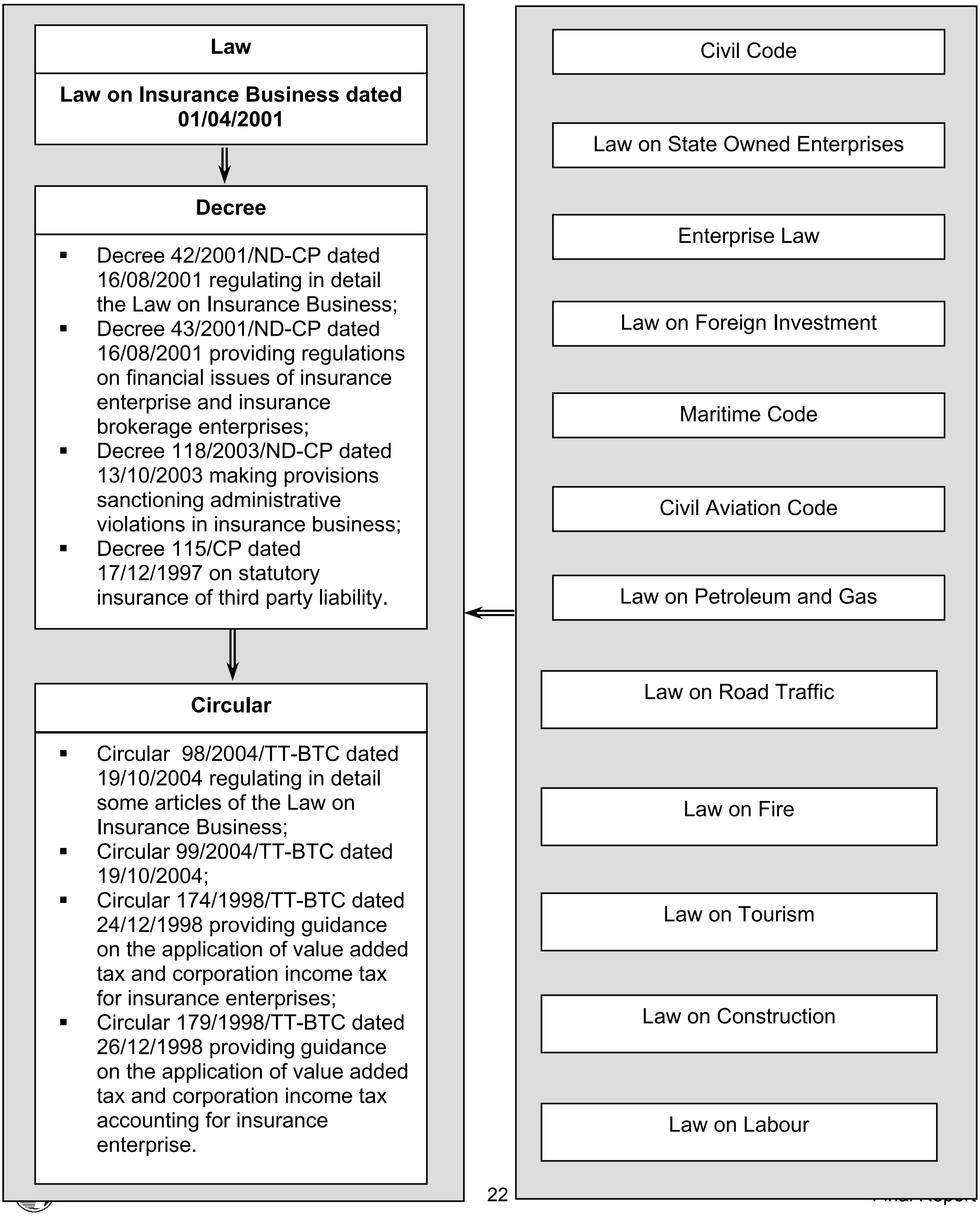
The development of the insurance sector in Vietnam was facilitated by the Law on Insurance Business, 2000. The average growth of both life and non-life sectors between 1993 and 2004 was higher than the rest of the region. However, the growth rate has been slowing, especially in the life sector and it is now approaching regional averages. Despite high growth, the penetration and density of both life and non-life sectors in Vietnam is very low in comparison with that of the region. Brokers are now recognized as market players, but their contribution to the development of the industry is still very limited. The following chapter will analyze the alignment of the Vietnamese legal framework with best regulatory regimes and will look closely at several provisions which are either inappropriate, inadequate or unclear.

4 Legal framework governing the insurance sector in Vietnam

This chapter will briefly describe deregulation in the insurance sector of Vietnam and discuss how the existing insurance legal framework of Vietnam satisfies the best practice of regulatory regimes recommended by the OECD for emerging countries. It will then examine, existing inappropriate or unclear provisions, which should be addressed to create a pro-competitive environment in order for insurance sector to develop. The chapter will end with a comparison of existing provisions and commitments under BTA and GATS to show areas of inconsistency, which will need to be removed in the future.

At present Vietnam's insurance sector activities are regulated under a number of laws and implementing decress including:

Figure 12: Vietnam's legal framework for the insurance sector



4.1 Market Deregulation in Vietnam

4.1.1 Deregulation for Market access

Compared to other developing countries, Vietnam has significantly deregulated access to the insurance market in both life and non-life sectors. While many countries still restrict foreign participation to joint ventures (with minority or majority foreign shareholding), Vietnam has for some time allowed 100% foreign owned insurers and brokers. In its schedule of commitments under GATS, mode 3 fully liberalizes all insurance and insurance related services.

4.1.2 Deregulation of Distribution systems

Insurers in Vietnam, both life and non-life, have the freedom to develop their distribution systems. The Government allows insurers to formulate their own strategies for agencies and compile their own agency's commission tables. However, the opening branches in other provinces are still restricted for foreign insurers. There is no minimum registered capital requirement when a new branch is established, as in China, but there is a restriction in the number of branches that can be opened every year after a company has been established.

4.1.3 Deregulation of Insurance products and prices

As in other countries insurers operating in Vietnam are free to create insurance products that meet clients' demands and also determine prices through market competition, though not for compulsory lines. Products and rates do have to be filed with the Department of Insurance under the Ministry of Finance for approval, though the procedure is felt to be transparent.

4.2 Vietnam legal regulations compared to best practice regulatory regimes

The legal framework governing the insurance sector in Vietnam was significantly improved under the Law on Insurance Business, 2000, and guiding decrees and circulars. Compared to OECD best practices recommended for emerging countries the framework is rather complete. The following section briefly discusses how the existing Vietnamese legislation aligns with OECD best practice. Detailed comparisons to OECD best practice suggestions are provided in the annex.

4.2.1 Important regulations

The Department of Insurance under the Ministry of Finance acts as an independent regulatory body, monitoring and supervising all the activities in the insurance market. Important issues of prudential solvency, healthy competition and codes of conduct are regulated in detail through legislation and guiding decrees and circulars.

With regards prudential regulation, the Government provides detailed requirements to ensure the solvency of insurers, including minimum registered capital, deposits, reserves, solvency margins etc. Most insurers, both local and foreign, feel that solvency margins requested under the law are appropriate given the level of development of the sector and the economy as a whole. However, concrete provisions for the management of insolvent and troubled insurance firms have not yet been put in place. The rights and benefits of policyholders in cases of insolvencies are not yet adequately regulated.

The Competition Law, July 2005, introduced comprehensive legislation regulating a competitive regime. The Competition Law covers two broad categories of competitive practices:

- Practices that may restrain competition (e.g. agreements on the restraint of competition, abuse of dominant market position, economic concentration); and\

- Unfair competitive practices (coercion, defamation, advertisement and promotion aimed at unhealthy competition etc.)

The Competition Law also established a framework of exemptions from the competition regulations and for competition enforcement proceedings. This law governs the insurance sector in 2 ways:

- Through the general application of the law's principles, insurers cannot misrepresent the terms of the cover of policies to potential buyers. While these principles are straightforward, international experience has shown that they can have a wide application in day to day practices of any business.

- Through the specific application of issues unique to the insurance industry. International experience has shown that while, technically, particular aspects of the insurance industry breach competition laws, limited exemptions are provided for the sharing of loss information, pooling arrangements and agreements relating to uniform or standard policy terms and agreements[9].

4.2.2 Impartial regulations

Both local and foreign insurers are governed by the same legal framework. Market access requirements such as minimum capital, deposits, application procedures and solvency requirements are the same for both local and foreign investors. However, there remain several areas where the playing field has not been levelled. The biggest restriction for foreign insurers is that they have not been allowed to sell products to state owned companies or state financed projects. This has significantly affected the performance of foreign insurers and protected the benefits of local insurers, detailed in the following chapters. However, this restriction will certainly be removed upon Vietnam's accession to WTO as this protection is not provided in the existing offer of Vietnam.

4.2.3 Disclosure and Consumer Information

Although insurers are required to have their financial statements audited, they are not obliged to make their financial conditions public. As a result consumers do not have access to information enabling them to evaluate the financial conditions of insurers. However, the Government does set out financial indicators, which must be calculated and submitted to the regulator by insurers so that the Government can regularly monitor and supervise the solvency of insurers.

4.2.4 Transparent regulatory process

Law making transparency in Vietnam has been increasingly improved. Most insurers interviewed had been asked for their opinion and comment on most important draft laws and supporting documents. The Vietnam Insurance Association has played an active role in advising the Government in the formulation of the regulatory framework for the sector.

4.3 Existing inadequacies and inconsistencies in Vietnamese insurance legislation

4.3.1 Inappropriate regulations

Many insurers commented on and recommended changes to the current VAT system affecting insurance. Current legislation states only reinsurance abroad is not subject to VAT, which is felt to be irrational. 0% VAT should also apply to reinsurance ceded to both domestic and overseas re-insurers.

[9] Phillips Fox, 2005

As for marketing costs, the current limit of payable expenses is 10% of total expenses, this is again felt to be irrational. Insurers felt that their expenses are mainly compensation. As a result a cap of 10% of total expenses will lead to bigger compensation expenses when marketing expenses are bigger. A more appropriate approach would be to base marketing costs on business results.

4.3.2 Conditions to enter the market

The regulation on the management capacity of managers when entering the market, are too general. No clarification has been made as to which positions require professional management capacity/skills.

4.3.3 Standard insurance terminologies

In Vietnam, the terms and conditions of insurance policies are formed, based on parties' agreements which are in compliance with legal regulations. There is controversy on the necessity of standardizing insurance policy agreements. In many OECD countries, the terms and conditions of insurance policies are explicitly regulated by the state. In some countries, insurers are granted an exemption from competition laws in order to facilitate agreement on common terms and conditions of insurance contracts. Consumers often lack information on insurance services and are unable to compare the insurance policies offered by competing insurers to determine which policies are better or whether a new product introduced to the market offers better value than an existing product. This hinders competition is to some extent. Standard agreements assist the comparison of agreements by consumers.

However, such agreements may also facilitate collusion. Standardized contracts not only facilitate price comparison by consumers, but also by competitors. In addition, a successful cartel agreement which fixes prices will typically simply re-direct competition into non-price areas. Standardizing contracts can also hinder competition.

However, although it may not be necessary to regulate a standard agreement, covering all terms and conditions, it is extremely important to regulate the terminologies used in all such agreements and supporting documents. At present, Vietnam has no legal regulation on the use of insurance terms, which are complicated and incomprehensible to most policyholders. Insurers should have the freedom in determine their own terms and conditions as this is an important tool of competition tool, but they must also be bound to the same insurance terminology, so that consumers can clearly understand their meaning, helping to avoid future misunderstandings and misinterpretations. So far, the Vietnam Insurance Association has developed 29 terminologies. While not all terminology has been covered, this is a very encouraging effort by the Association. Legal regulation should be developed obliging insurance firms to use such terminology.

4.3.4 Investment regulations

Currently legislation allows insurance firms to make investments in bonds, deposits, real estate, purchase shares and make loans. However, the majority of capital has been put into Government bonds and bank deposits. Amongst the many causes hindering insurance firms from putting their capital into investments is an inadequate legal framework.

4.3.4.1 Investment in lending activities

According to the Insurance Law, insurance enterprises can use idle capital to invest in lending activities, under the Law on Credit Organizations. Under this law, lending permits for insurance enterprises are given by the State Bank of Vietnam. The State Bank of Vietnam is yet to provide instructions allowing an insurance enterprise to conduct lending activities. As a result, insurance enterprises do not yet have a legal framework to carry out lending activities.

4.3.4.2 Investment in real estate

While there are legal regulations governing real estate investment in by domestic investors and foreign investors, but no legal regulations governing such investments by foreign owned companies, which have been established in Vietnam and have resources for investments such as insurance firms. Although the law on insurance allows foreign owned insurance firms to make such investments, there is no clear legal framework to guide foreign insurance firms to carry out these investments.

4.3.4.3 Investment in shares

At present there are no clear regulations guiding whether foreign owned companies established and operating in Vietnam should be treated as domestic firms or foreign investors when they buy stakes in domestic firms. If they are treated as domestic firms, then there would be no restrictions in purchasing a stake of any firm, no matter of what the legal form or business area of operation. If they are treated as foreign investors, they would only be allowed to purchase up to 30% of registered capital of a domestic firm, which is operating in specific areas regulated by the law and up to 49% of registered capital of listed firms. Although this has, to date, not been the main cause of low investments in shares of foreign insurance firms, adequate and clear regulations must be in place to remove all ambiguity or different application of laws in different localities.

More importantly, legislation on corporate governance and the financial transparency of domestic firms are inadequate and supervision of compliance with legislation is neglected. At present there are no mechanisms for authorities to monitor and supervise compliance with legislation on corporate governance and the protection of shareholders. Firms are requested to prepare and submit financial statements to authorities, but this is for tax purposes rather than for the protection of shareholders. This reduced the confidence of insurance firms in domestic businesses resulting in few daring to take a risk and investment in such businesses.

4.3.5 Reinsurance

Accounting requirements for reinsurance in Vietnam is currently limited. Only ceded premiums and claims received on reinsurance are required to be disclosed in operation reports. Profit and loss on reinsurance should be disclosed separately as well as the impact of reinsurance on premium income, reserves and claims.

Internationally disclosure requirements are more stringent as companies must disclose their strategy on reinsurance in a note to their financial statements as well as the kind of risks, types of product that are reinsured and the accounting policies. This information enhances the readers understanding of the financial situation and risk profiles of insurance companies.

4.3.6 Deferred acquisition costs (DAC)

According to current regulations in Vietnam, there is no requirement for recording DAC (for payment of commission, advertisement, etc) for insurance companies, while this is obligatory internationally. This causes financial results of insurance companies to be misleading, particularly in the first few years of operation.

4.3.7 Statutory insurance

The Insurance Law regulates 4 statutory insurance services, though the Government does submit others for supplementation. At present there is only implementing documentation for motor car owner third party liability insurance. Fire insurance is regulated by the Law on Fire Prevention. Specific regulations on professional indemnity insurance against risks arising from the provision of legal consulting services and insurance brokerage services are not yet in place. As a result from the perspective of service suppliers, those who buy insurance to comply with the law bear a higher cost than others. From the perspective of customers, there is no standard to compare which service is better guaranteed.

According to Decision No. 128/1999/QD-BTC dated 25/10/1999, ship owners licensed to do offshore fishing are obliged have their ship body insured. Those who do transportation business by registered transportation means in inland water areas are also subject to third party liability insurance. Besides, oil and gas projects, construction and installation, projects and construction works of a high danger to public security and the environment are also subject to statutory insurance, but not regulated in Insurance Law.

Insurers who want to provide statutory insurance products must apply for approval from the Insurance Authority – the Ministry of Finance. The Law on Insurance Business generally regulates that foreign owned insurers and insurance brokerage enterprises are allowed to provide professional indemnity insurance, but do not detail in what areas. However, to date, no insurer in this sector has been approved to provide statutory insurance products.

4.3.8 Withdrawal of an insurance enterprise from the market and management of troubled firms

Another further area lacking detailed regulation is how the rights and benefits of customers are protected when an insurance firm stops its operations on purpose or becomes insolvent. The exit of an insurance firm from the market cannot is not as simple as firms in other industries as customers have paid for but have not received anything except for promises. The transfer of a promise from one firm to another is not as simple as the transfer of tangible properties. In the worse case, a firm does not intentionally withdraw from the market, but it becomes insolvent. Although to date no insurance firm has fallen into insolvency, the issue of insolvency cannot be neglected by the law as unlike other industries, the bankruptcy of one insurance firm will affect the entire sector, if not the entire economy. Existing law and subordinate documents do regulate solvency margins and list measures to recover solvency margins, but do not regulate in details how to manage the insolvent and troubled insurance firms and how such recovery measures are conducted.

4.3.9 Private investigation and civil investigation

This is a major gap in the legal framework for the insurance sector. This makes it impossible for insurers to keep control of insurance fraud before signing policies. A present, the Ordinance on Investigation only provides legal regulations for investigation activities of competent State investigation agencies in criminal related events which mostly appear at the time of insured events, while insurers have a demand for investigated information of civil related events before signing insurance policies. Private investigation is now allowed, but is allowed only in the private sector. Many other factors are awaiting legalization such as investigation procedures, rights and legal status of investigators, as well as legal validity of such investigated results.

4.3.10 Other issues

There are various other items that are not covered under current regulations. For example there is no guidance on the accounting treatment for special lines of business such as investment products, annuities, group insurance and human related insurance services. These normally require different accounting treatment compared with traditional products.

4.4 Unclear provisions

4.4.1 Contract termination

Insurance policy related issues are regulated under Chapter II of the Law on Insurance Business. However, some rights and benefits of consumers have not been assured under existing regulation. Typically there remains inconsistency among the Law on Insurance

Business and some other regulations, especially regulations on termination of insurance policies, where much discussion has been raised.

In terms of terminating insurance contracts, according to Article 19 of the Law on Insurance Business an insurance enterprise has the right to unilaterally suspend contracts and collect insurance premiums up to the time of contract suspension when a policyholder has intentionally provided false information in order to enter an insurance contract to earn the insurance payment or compensation. In the case where an insurance enterprise intentionally provides false information to enter an insurance contract, the policyholder has the right to unilaterally suspend contract and insurance enterprise has to pay arisen loss for policyholder for the misinformation provided.

Meanwhile, according to **Article 22** of the law one area invalidating an insurance contract is where a policyholder or insurance enterprise plays tricks when entering an insurance contract.

As a result the provision of false information to enter an insurance contract may lead to either unilateral termination of a contract or annuls the contract. Nevertheless, the legal consequences of unilateral termination and these invalid contracts are completely different. Such unclear provisions of the law might lead to misinterpretations or disputes between the insurers and the policyholders.

4.5 Compliance of the Vietnam legal framework on insurance business with international agreements

Vietnam has been an official member of ASEAN since 7/1995, concluded the Bilateral Trade Agreement with the USA on 7/2000 and began negotiations for accession to the WTO around 10 years ago. In order to successfully negotiate accession to the WTO, Vietnam had to provide a schedule of commitments in market access and national treatment in line with the principles of GATS including horizontal commitments and specific commitments in each service.

From the perspective of the legal framework, the Vietnam insurance industry is basically “open” compared with BTA and GATS. In fact, the insurance market was openned quite early due to characteristics of reinsurance activities, which are regulated by International practices rather than domestic regulations. There are concerns that undue attention was paid to to the insurance industry and as a result has been liberalized too much and too fast compared with other industries, while this industry is very sensitive. However, if it was not opened so soon, the Vietnam insurance market would have not been as effervescent and attractive to investors as it is now.

4.5.1 Vietnam’s commitment under BTA and GATS

The conclusion of BTA has facilitated Vietnam’s accession to WTO. Under the BTA, Vietnam has had time to review and readjust its legal regulations to make them more and more consistent with International standards so that the commitments of Vietnam under BTA could take full effect in 2006. BTA is the floor for Vietnam’s commitment under GATS, that forces Vietnam to undertake higher commitments under GATS.

Given the above mentioned commitments, the comparison between Vietnam’s legal framework and each individual commitment of Vietnam under BTA is as follows:

	Vietnam’s commitment under BTA		**Vietnam’s current regulations**
Market access	(1) (2) (3) (4)		(1) (2) (3) (4)
National	(1) None		(1) None

treatment	(2) None (3) None except statutory insurance services (4) Unbound except horizontal commitments.		(2) None (3) Foreign owned insurers are still limited: Lines and operation location is limited in the provision of services to state owned enterprises and state budget based works; A specific number of branches are allowed to be established after a specific operation duration. (4) Work permit is required.

Note: ⟷ *: consistent*

(1): Cross-border (2): Consumption-abroad

(3): Commercial presence (4): Personal presence

Vietnam is now in the process of negotiation for accession to WTO and its offers are yet to become official commitments. However, it is possible to foresee that this offer is similar to Vietnam's commitments under BTA in which Vietnam's effort in acceding to WTO by 2006 is also considered.

4.6 Conclusion

Vietnam's legal framework on insurance business covers broadly all necessary issues relating to management of the industry. Most regulatory issues recommended by the OECD to emerging countries have been incorporated in the laws and supporting documents governing the insurance business.

However regulations exist which are not appropriate for real application (e.g. regulations on VAT, marketing costs etc.), are inadequate (statutory insurance, reinsurance) or unclear (e.g. contract early termination).

Several regulatory bodies are involved in preparing legislation governing insurance issues (e.g. regulations on fire insurance are developed by Public Security, regulations on ship insurance are developed by Ministry of Transport etc.), which makes the application of laws complicated for both insurers and consumers.

In light of the legal framework the competitiveness of the insurance sector of Vietnam will be analyzed from 4 perspectives (i) Firm strategy, structure and rivalry, (ii) Demand conditions, (iii) Factor conditions (human resource, financial sources), (iv) Related and supporting industries (stock market, information technology, banking system), which are the 4 determinants of national advantage in the Diamond model.

5 Competitiveness analysis of Vietnam's insurance sector

5.1 Economic and business competition

Competition is seen as the pillar of capitalism in that it stimulates innovation, encourages efficiency, drives down prices, and is seen as the foundation upon which capitalism is justified. According to micro-economic theory, no system of resource allocation is more efficient than pure competition. Competition causes commercial firms to develop new products, services, and technologies. This gives consumers greater choice and better products. A greater choice typically causes lower prices for products compared if there was no competition (monopoly) or a little competition (oligopoly). However, competition may also lead to wasted (duplicated) efforts and to increased costs (and prices) in some circumstances.

Three levels of economic competition have been classified. The most narrow form is direct competition (also called category competition or brand competition), where products that perform the same function compete against each other. The next form is substitute competition, where products that are close substitutes for one another compete. The broadest form of competition is typically called budget competition. Included in this category is anything that the consumer might want to spend their available money on. Competition does not necessarily have to be between companies but ban be within companies, either between divisions or individual employees.

It should also be noted that business and economic competition in most countries is often limited or restricted. Competition is often subject to legal restrictions, which usually provide for fair and equal business competition. Such laws may include the banning of monopolies and price gouging. Depending on the respective economic policy, pure competition is to a greater or lesser extent regulated by competition policy and competition law. Competition between countries is quite subtle to detect, but is quite evident in the World economy, where countries like the US, Japan, the European Union and the East Asian Tigers each try to outdo the other in the quest for economic supremacy in the global market.

The above concept of economic and business competition is considered to be a leading premise and is extended in the following section to further understand the competitiveness of Vietnam's insurance sector, through Michael Porter's Diamond model.

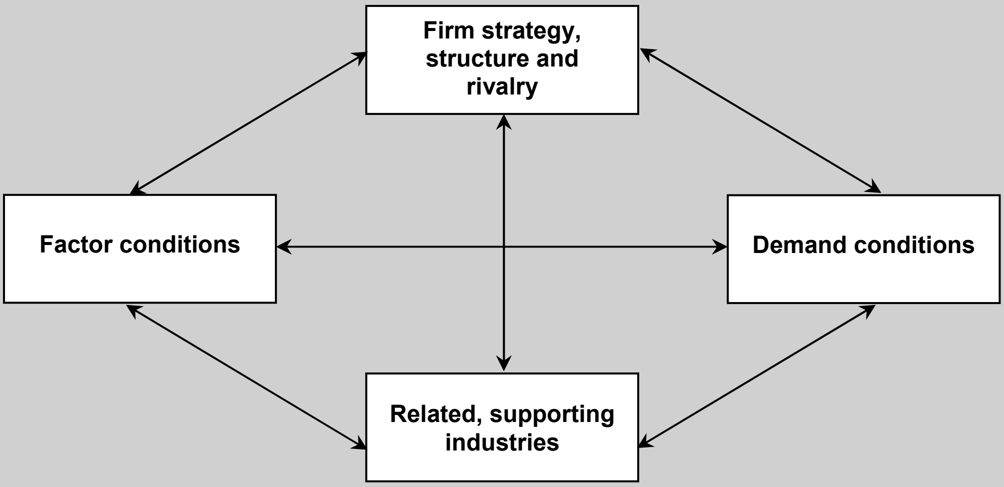
5.2 Analysis of Competitiveness using the Diamond model

In the previous chapter, the legal environment of Vietnam was compared to OECD regulatory regime best practice. This chapter will look at 4 competitiveness determinants (i) Firm strategy, structure and rivalry, (ii) Demand conditions, (iii) Factor conditions (human resource, financial sources), (iv) Related and supporting industries (stock market, information technology, banking system) and how they affect the competitiveness of the insurance sector in Vietnam. Firm strategy, structure and rivalry affect local and foreign insurers' competitive advantages and disadvantages. The demand conditions will explore the development potential of the insurance sector from the perspective of buyers, where awareness level and density are key determinants. Human resources, financial capacities, the development of supporting industries such as stock markets, statistics sector etc. will also are analyzed to show how such determinants will promote/inhibit the competitiveness of the insurance sector of Vietnam.

These determinants create the national environment in which companies are born and learn how to compete. Each point on the diamond – and the diamond as a system – are essential ingredients for achieving international competitive success: the availability of resources and skills necessary for competitive advantage in an industry; the information that shapes the opportunities that companies perceive and the directions in which they deploy their resources and skills; the goals of the owners; managers; and individuals in companies, and most important, the pressures on companies to invest and innovate.

Box 1: The Diamond model of Michael Porter

Determinants of National Competitive Advantage



- Factor conditions: A country's factors of production, such as skilled labour or infrastructure, necessary to compete in a given industry.
- Demand conditions: The nature of home-market demand for the industry's product or service.
- Related and Supporting industries: The presence or absence in a country of supplier industries and other related industries that are internationally competitive.
- Firm strategy, structure and rivalry: The conditions in a country governing how companies are created, organized, and managed, as well as the nature of domestic rivalry.

5.3 Strategy, structure and rivalry

5.3.1 Factors affecting the competitiveness of an insurance company

5.3.1.1 Long term development strategy

The insurance sector of Vietnam is now in a similar position to China in its pre-opening phase of 1996-2001, and the first years after WTO accession, where most companies, especially domestic ones focused on increasing premiums. In the life sector, Chinese domestic insurers employed a tactic of "people ocean", recruiting a lot and having a high turnover. By the end of 2001, the number of sales agents in the life sector in China exceeded 1 million. Similarly in the life sector in Vietnam insurers compete by recruiting many sales agents, and in the non-life sector, insurers compete by reducing premium rates. It is quite obvious that this is not the way insurers can exist and prosper. Price cuts to attract customers are good but it must be conducted as part of a clear development strategy, otherwise in the long run, insurers will be left with no resources to develop.

5.3.1.2 Reputation of insurance institutions

It is apparent that state enterprises in a command economy do not operate by the rules and principles of a market economy. It is common for enterprises not to operate to primarily serve customers, but to implement political goals. Their operational goals and constraints were different from those in a market economy. Scarcity of products and services was also common. Service providers did not need to reach the customer. On the contrary, the customer had to look for goods and services. This and other reasons led to a low level of customer satisfaction. In fact, insurance and banking, along with other sectors, were known for their bureaucracy, where it is easy to pay the insurance premium but it is very difficult to get claims paid in full.

Since the introduction of the market economy, competition has helped to improve the situation and approach. However, it remains an obstacle when persuading customers to buy insurance. The current market economy also has its own weaknesses adding to the reputation problems. The improper training of insurance agents easily leads to unrealistic expectations for inexperienced customers. When a customer realizes that he or she does not get the benefits expected, the image of the whole industry is seriously undermined.

Our survey results show that 21.2% of individuals interviewed rated life insurance companies (both foreign and domestic) as "very reputable" and other 67.0% of them rated insurance companies as "reputable". The total number of respondents rating life insurance companies as "very reputable" and "reputable" was 88.2%. The same percentage applies for non-life insurance companies. This is rather encouraging.

Table 13: Proportion of interviewees who feel that insurance companies are prestigious

Legal forms of interviewed companies	%
State owned	64.4%
Domestic joint stock	62.1%
100% foreign owned	75.0%
Joint venture	55.6%

Source: Survey data

5.3.1.3 Customer service culture

"Reputation" should not be confused with customer satisfaction. Customers may confuse reputation with visibility which has more to do with the level of advertisement or presence of a company. This is especially so in this initial period of insurance in Vietnam where customers has little experience with the services of each company and only know companies through their advertisements.

Box 2: Convenient premium payments

A customer may want to look for a convenient way to pay insurance premiums. A helpful sales staff may offer to come and collect the cash. This is an initiative at an individual level. The helpful staff can not help all other customers the same way.

Alternatively, the customer may want to pay by bank transfer. He finds it more secure and more convenient this way. In this case the insurance company must understand that its customer's convenience does not stop when the premium has been paid. It goes further. The company must make it convenient for the customer to track his payment and must issue receipts accurately within a short time frame. If the customer has no trust in the company's capability of recording and acknowledging his bank transfer payment properly he will go back to cash payments. This initiative to receive premiums via bank transfer must be made at a company level. The company's computer and accounting system must be able to handle it; agreements with different banks must be reached to make this possible; and so on.

This is not only a question of helpfulness of sales staff, but a whole new service culture and system.

In the long term customer satisfaction should be a better indicator of competitiveness. It is obvious that insurance companies should make efforts to improve customer satisfaction. Foreign companies have a competitive advantage in this regard. They have a corporate culture of putting customers first. This is realized by implementing appropriate strategies at all levels. Foreign companies are more knowledgeable in making transactions convenient for clients, especially in dealing with inquiries, to pay premiums, to request for information, to file a claim, and so on. Domestic companies, on the other hand, understand that this is important, but they do not have comprehensive strategies and procedures to implement it. Sales staff of domestic companies learn quickly how to help their customers, though this is usually limited to the individual level. A specific sales staff member can be helpful to his or her customers, but can not help all customers. Domestic companies should take immediate actions in this regard and adopt a company-wide policy with considerable back office support.

Our survey indicated that domestic companies seem to provide better customer service than their foreign competitors. The survey shows that around 82% respondents rate the customer service of domestic companies as "very good" and "good" while only 68% of respondents rate the customer service of foreign companies at the same level. This seems to contradict the above analysis. However, foreign companies do have a clear strategy on customer services while domestic companies may have good customer services and sales staff but need to improve the system and back office to support staff.

5.3.1.4 Managerial expertise in insurance

Dorfmann and Ennsfelner observed the above regarding insurance sector in an economy in transition[10] which is valid for Vietnam also. The short history of insurance in Vietnam explains the above partly. The basic skills at a working staff level can be learnt quickly and this has been done, however, managerial skills at higher levels require longer periods of learning and exposure. This is true for both the managerial side and the insurance side.

Managers at domestic insurance companies may have been in their position for a long time, but they lack experience within a market economy. The socialist management style still has its root in domestic companies. Decision making is slow; responsibility is not well defined; pay and promotion are not performance-related; little authority is granted to lower levels and so on. This is common to every industry in the Vietnam.

Besides general managerial skills, insurance managers also need a range of insurance specific skills. While it is usual for managers, especially leaders, not to have specific technical skills, their focus should be on leadership and strategic thinking. However, they should understand their industry and its driving forces, trends, competitive advantages. All this is based on knowledge and experience. The less competitive environment in the past offered little opportunity for the leadership of domestic companies to practice and learn these skills.

The participation of foreign companies not only brings about increased competition, but develops competition. Vietnam is currently in the process of integrating into the world and must play by established rules. Vietnamese companies must start over again and insurance is no exemption.

There have been attempts in the past to acquire "technology" (the way of running an insurance business) from foreign insurers by giving market access to joint-ventures only. It was hoped that while a joint venture is jointly run by both Vietnamese and foreign managers, it offers the quickest way to acquire insurance technology. It is unknown how successful this strategy has been so far, though success may be limited as each joint venture partner usually follows its own objectives.

When the market is fully opened to foreign competitors domestic companies should consider recruiting foreign experts to manage their companies as competition will become more western. The nationality of a CEO or a manager should be less important than the success of the company. After the foreign expatriate leaves, the knowledge, systems and procedures they create remain in the company. This is an unusual proposal, but it is one of the few ways to compete in new and increased competition.

[10] Dorfmann M. & Ennsfelner K., p8.

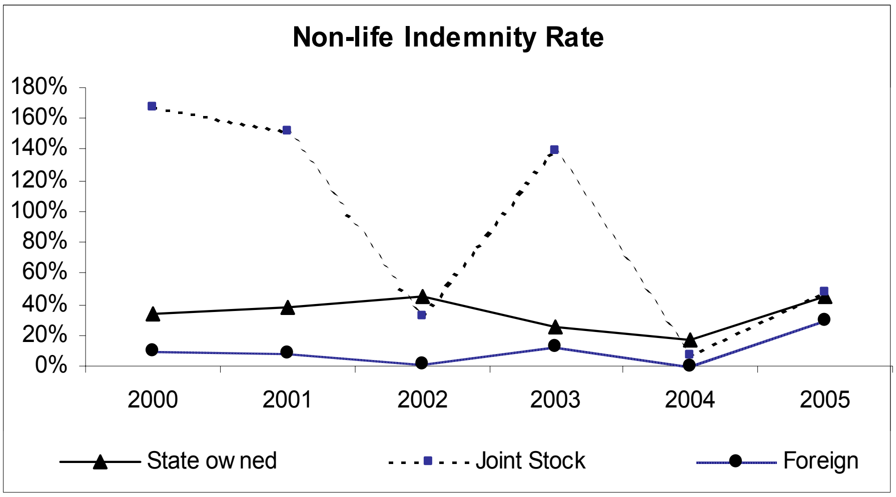
One should also bear in mind two questions: one -- if one wants to improve one's competitiveness only, some skills are enough, and two -- if one wants to compete and outdo competitors one must be more skilful.

5.3.1.5 Actuarial data

One weakness of domestic insurance companies is a lack of actuarial skills. Actuaries possess specific mathematical expertise related specifically to insurance. Amongst other things, actuaries determine premium rates and calculate reserves. Without their help no insurance company can operate competitively. Insurance companies must price their products accurately. It is obvious that if they price their products too low, they will not make money, and if they price their products too high, they will find it difficult to sell them. In order to price insurance products accurately and fairly insurance companies need a vast amount of data, often collected over decades or even centuries. There must be a well designed system to collect, store and process needed information. It is not known if any domestic company possesses such a system to record statistical data. Normally firms only collect financial and record data such as total premiums, total claim payments broken down by year, geographical location and line of business. Much more is needed. For instance in motor vehicle insurance data should be recorded that tells the frequency and severity of car accidents broken down by age, sex, profession, car type, and so on. Car owners will then be charged a premium commensurate with all the aforementioned factors. It is also an aspect of fair pricing. The riskier the driving, the higher the premium. This way of pricing, differentiating customers by their level of risk, also encourages them to take measures to minimize risks and with that the premiums chargeable.

The business of insurance is based on probability derived from a large number of homogenous risks. Bigger companies such as Bao Viet, Bao Minh and Prudential have a customer base that is big enough to provide reliable statistics. This is their competitive advantage. They may see no incentive in sharing their statistics with others who are their competitors. Smaller companies will find it more difficult to collect reliable data over a short time period. It would be beneficial to the whole market if statistical data is collected and shared amongst all companies.

Figure 13: Compensation ratios in the non-life sub-sector



Source: Association of Vietnamese Insurers

Foreign insurers begin gathering statistical data as soon as they sell insurance products and pay claims And they have systems designed to do this. This function is either neglected by domestic companies, in the worst case, or improperly done, in the best case.

Although levels of compensation depend on many objective and subjective factors, they to some extent, depend on the risk assessment and management of insurance companies.

Statistics show that, domestic companies, especially joint stock ones always have higher and more volatile compensation ratios than their foreign competitors.

5.3.1.6 Information technology

Domestic insurers fall far behind foreign competitors in this respect. At present, no domestic company owns insurance software, although they have become aware of this important factor. Bao Viet has been hiring a local information technology firm to write its software for several years, but the project is not finished yet. Bao Minh is also only now looking for an information technology firm to assist its IT development. Foreign insurers, on the other hand, always come with advanced information technology systems. Not only do they have financial means to purchase and develop IT, but they also enjoy technical support from their head offices in choosing the right software and its implementation.

This is a real problem for domestic companies of a smaller size. First and foremost is the huge cost. The problem is two folds. First, smaller domestic companies might not have enough cash for the initial investment. Secondly, such a huge investment is only justified if the volume of business to come is big enough. In other words, smaller companies will find it more difficult to achieve economies of scale. For instance, an information technology system might cost US$1.5 million. If a company knows that it will write 1.5 million policies during the next 3 years, it can charge $1 to each policy. If the company knows that it is going to write only 300,000 policies over the next 3 years, it will have to charge $5 to each new policy.

However difficult it is, domestic companies must find affordable ways to develop IT systems to support their operations. In today’s competitive environment technology not only helps provide good customer service, it also helps increase operational efficiency.

Box 3: Information technology in insurance

Information technology is the backbone of a company’s operations. However, let’s consider the following in insurance:

- insurance companies collect, store and process a vast amount of customer and risk information;
- policy issuance, response to customer inquiries, record policy changes, etc. must be prompt and accurate;
- loss information and other statistics must be processed to aid product pricing and reserve building;
- huge amounts of other underwriting information such as flood history, volcanic history, average rain fall, construction type, car type, driver’s age, etc. must be available and processed quickly to aid underwriting decisions;
- An agencies workforce can be in the range of tens of thousand of people selling different policy types and earning commission on different scheme. Their sales and commission must be recorded accurately;

5.3.2 The two faces of competition

Presently domestic non-life insurance companies compete mostly on two sides – personal relationships and low price.

5.3.2.1 Large and complex risks

Examples of large and complex risks are power plants, oil rigs, airlines, etc. There are smaller risks such as product liability risk, professional indemnity, but they are also complex. The underwriting of these risks can be predicted by foreign insurers While domestic companies do not have the needed expertise, statistical data and financial capacity to bear the risks. Due to current regulations, an insurance policy must still be issued by a domestic company. After issuing the policy the domestic company looks for re-insurance capacity overseas. That is when the entire insurance premium amount goes overseas. The domestic company only retains a symbolic share and earns re-insurance commission. For this kind of risk, domestic companies compete for the right to issue a policy. They are in fact, acting like an insurance broker rather than an underwriter. Here personal relationship marketing dominates over professionalism. Personal relationships are not a bad thing, but over time professional underwriting must become the competitive edge. Cross-border trade under the BTA is already effective. Over time, when Vietnam joins the WTO, government procurement clauses and national treatment will also apply. The clauses will prohibit giving preferences to state or domestic companies. If domestic companies do not take action now, they will loose this important segment of business.

On top of this it is common to pay kick-backs to a customer, especially in the case of a state company, to win contracts. Many companies that loose business in this kind of competition complain about it. Paying kick-backs occurs not only in the insurance sector and is a common phenomenon of the economy and culture in general.

Under pressure to report high premium income figures some domestic companies are keen on reducing prices to get business. By doing so they loose the re-insurance back up of international re-insurers. They usually end up holding excessive risks themselves or are re-insured by lower-grade overseas re-insurers. This is a very dangerous situation, not only for the companies in questions, but for the whole industry. Foreign companies usually have a list of approved re-insurers. If such a list is available and made binding for domestic companies they will be forced to abide by underwriting disciplines. However, to fix this problem, domestic companies should have long term plans to improve their underwriting skills, recruiting and training of personnel, gathering statistical data and increasing financial capacities.

5.3.2.2 Smaller and less complex risks

This includes mostly risks such as motor vehicles, personal accidents, small offices, etc. This type of risk does not require overseas re-insurance capacity. Domestic insurers retain all the risk in the country.

Box 4: Loss ratio, combined ratio and profit

Loss ratio = Claims cost / Total premium.
Expense ratio = Other operating expenses / Total premium.
Combined ratio = Loss ratio + Expense ratio

If the combined ratio is below 100% the insurance company would make an underwriting profit.

Beside the underwriting profit insurance companies also earn investment profit by investing unused premium amounts. In other, more competitive markets companies charge low premium rates so that their combined ratio is in the range of 100%. In other words, they do not earn much money on the underwriting side, but it is compensated by the investment profit. We do not have the combined ratio of domestic companies, but a loss ratio of 28% seems low.

According to data released by the Association of Vietnamese Insurers, the loss ratio measured as claims payments divided by total premiums, in 2004 was 28%. This seems low by international standards. In other words, the underwriting profit is seems large and it may explain why companies do and can afford to reduce prices which is very common. For the moment this price cutting seems in order. Competition is bringing benefits for customers. However, it is unknown how long this will last. Also here professional underwriting skills are required. At present domestic companies seem to focus more on sales rather than underwriting. It is common to reduce prices to win a customer. Even when staff consider risks it is primarily based on his experience and personal feelings rather than on established underwriting guides and rules.

5.4 Demand conditions

Demand conditions are evaluated based on criteria such as: the awareness of policy holders on the importance of insurance and the insurance companies operating in the insurance market, experiences of policy holders, the real insurance business and the potential for exploiting insurance in the future.

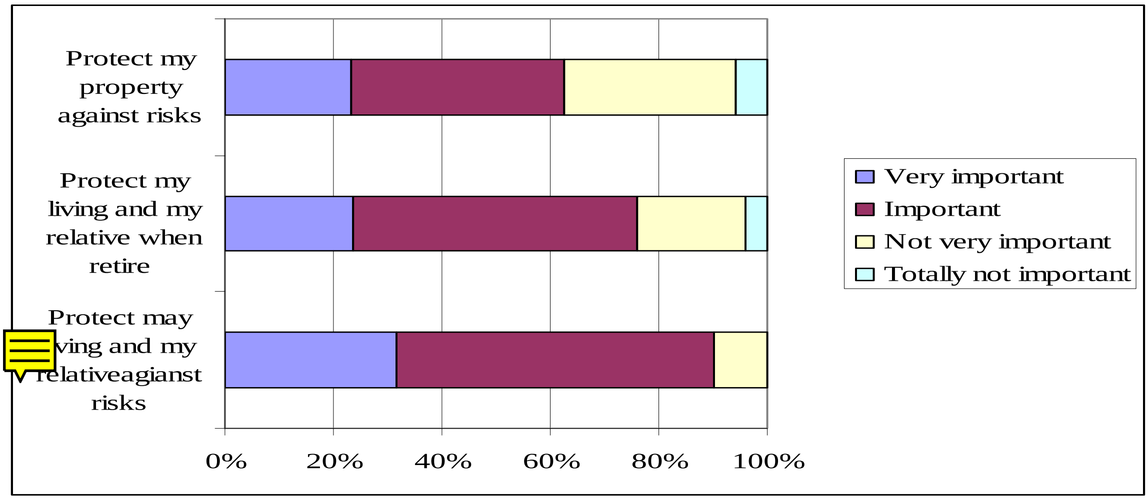
5.4.1 Individual policy holders

5.4.1.1 Individual policy holders are well aware of life insurance policies but pay less attention to non-life insurance policies

Along with the increase in income and living standards there has also been an improvement in people's awareness of the importance of insurance. However, this can also be attributed to competition amongst insurance companies.

Our survey asked policy holders how important insurance was to them as a risk prevention measure under different circumstances. The findings of the study indicate that individual policy holders pay more attention to their own and their families lives rather than their assets. Those who are employed in government authorities and enterprises are more aware of the importance of insurance than those who are peasants, workers or self- employed.

Figure 14: Awareness of the importance of insurance



Source: Survey data

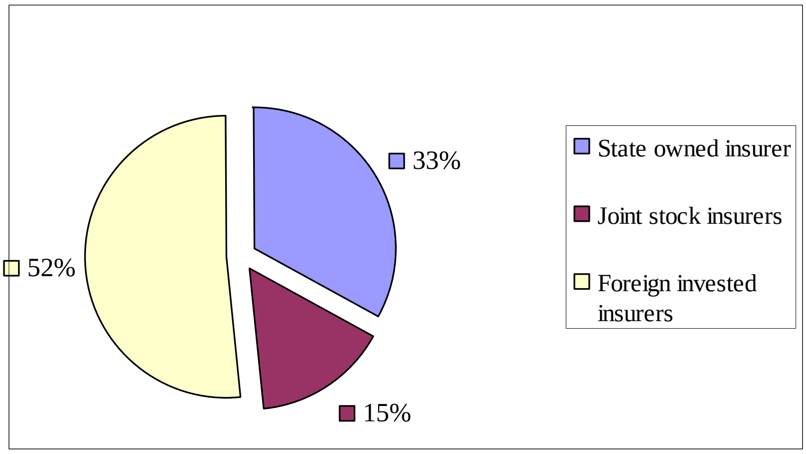
There are two extremes of awareness of interviewees. Most interviewees are aware of life insurance while only 6% of peasants interviewed knew about agricultural insurance. This, to some extent, reflects the current situation of the insurance market where there is fierce competition in the life insurance sub-sector with the participation of many life insurers launching regular and broad marketing campaigns. Meanwhile, non-life insurers focus on corporate users. Additionally, individual users are not really interested in other non-life insurance products rather than third party liability of vehicles' owners, which is compulsory.

As for agricultural insurance, this kind of insurance is essential and beneficial for both society and the economy. However, due to both subjective and objective reasons, there a market for agricultural insurance does not yet exist. On the demand side, peasants are not really aware of the role and the operation of agricultural insurance. Agriculture activities are conducted mainly at a household scale with limited financial capacity. Therefore, peasants often cannot afford agricultural insurance even if they are well aware of the necessity of insurance. On the supply side, technical difficulties in verification and prevention of risks, loss evaluation, and premium collection etc. have significantly prevented insurers from being successful in this sector.

5.4.1.2 Individual policy holders

The current balance in the insurance market is accurately interpreted in the awareness of interviewees. State owned and foreign owned insurers are most familiar for (i) having been operating for a long time as a monopoly or (ii) having spent much on promotion campaigns etc. Joint-stock insurers are less popular as they non-life insurers. On the one hand individual users are not really aware of the importance of non-life insurance, and on the other hand, non-life insurers have not focused their business on individual users.

Figure 15: Survey Awareness of insurers



Source: Survey data

5.4.1.3 Individual policy holders are inexperienced in purchasing insurance products

The findings of the survey show that policy holders had not carefully studied terms and conditions of insurance policies. For those who did, most of them focused on terms and conditions regarding the responsibilities of insurers and early termination of policies. In theory, these are the two most important terms of an insurance policy as all users are concerned about (i) what the responsibilities of the insurers are and (ii) what the possible losses are in case the contract is terminated prior to its expiry. The term of a life insurance policy is quite long and not everybody can be sure if he/she can follow it until its expiry. In fact, there are other more important terms on responsibility exemption or the compensation procedures. Many individuals have purchased insurance policies for savings rather than for risk prevention, as they feel that they would not have many risks in the future, and therefore they pay less attention to responsibility exemption and compensation procedures. This has sometimes resulted in disputes between policy holders and insurers when there is a loss. Additionally, policy holders pay less attention to the terms of their responsibility and do not comply with them accordingly and consequently were not compensated.

5.4.1.4 Exploitation of insurance is low

Statistics show that exploitation of insurance is low. Life insurance premiums account for only 3.1% of total savings and human accident insurance covered only 12% of labor (MOF 2002). The findings of the survey also showed that each individual bought an average of 1 policy.

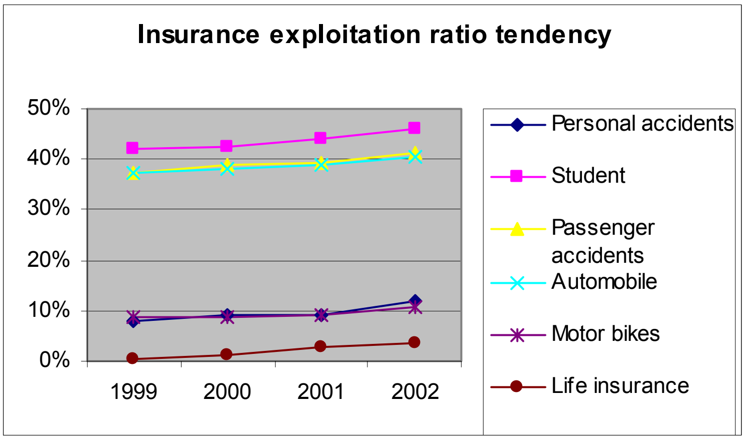
Table 14: Exploitation insurance products

Kind of insurance	Ratio of use
Life insurance	3.61% total saving
Human accident	12% of labour
Pupil accident	45.86% of pupils
Passenger accident	41.15% of passengers
Property insurance	40.4% of automobiles and 10.53% motorbikes

Source: Vietnamese insurance market development strategy by 2010

However, the exploitation ratio has increased gradually.

Figure 16: Increase in the exploitation ratio of insurance products



Source: Strategy to develop Vietnam Insurance Market 2003-2010

The increase in the exploitation ratio contributed to an increase in insurance density. This figure nearly doubled between 2002 and 2004, increasing from VND88,000 to VND152,000. However, Vietnamese insurance density is low in comparison to other countries in the region.

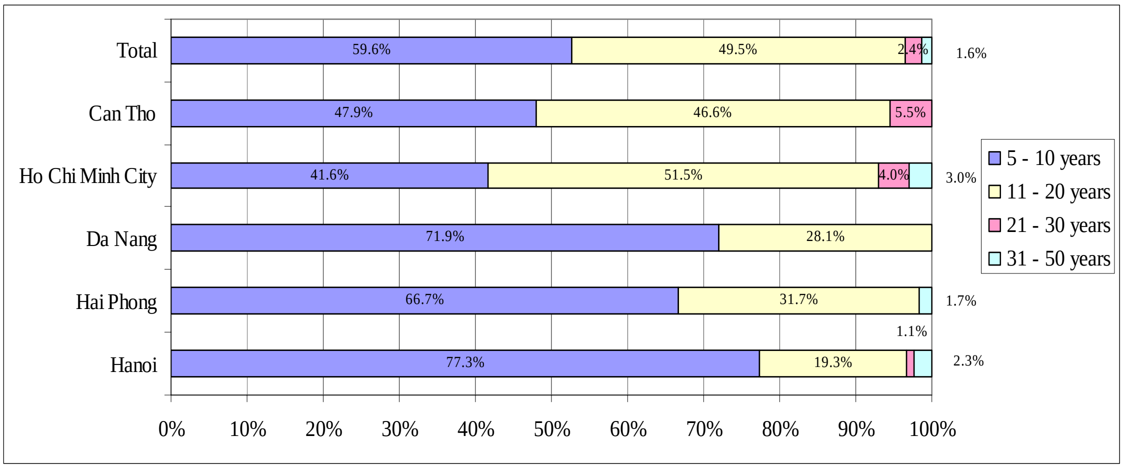
Table 15: Average insurance densities across Asia , US$

Country	Premium per capita	Life insurance premium per capita	Non- Life insurance premium per capita
Japan	3.874,8	3044,0	830,8
Singapore	1849,3	1483,9	365,5
Korea	1419,3	1006,8	412,5
Malaysia	256,5	167,3	89,2
Thailand	92,1	50,8	41,3
China	40,2	27,3	12,9
Philippines	15,6	9,4	6,2
Indonesia	15,5	7,4	8,1
Viet Nam	11	7,3	3,7

Source: Swiss Re Sigma No. 2/2005

Parallel to the increase in exploitation ratios, there has also been an increase in cover duration of life insurance policies. Although the current duration of life insurance policy is mainly between 5-10 years, the number of longer policies has increased, accounting for 36% of insurance policies covered in the survey.

Figure 17: Cover duration of life insurance policies

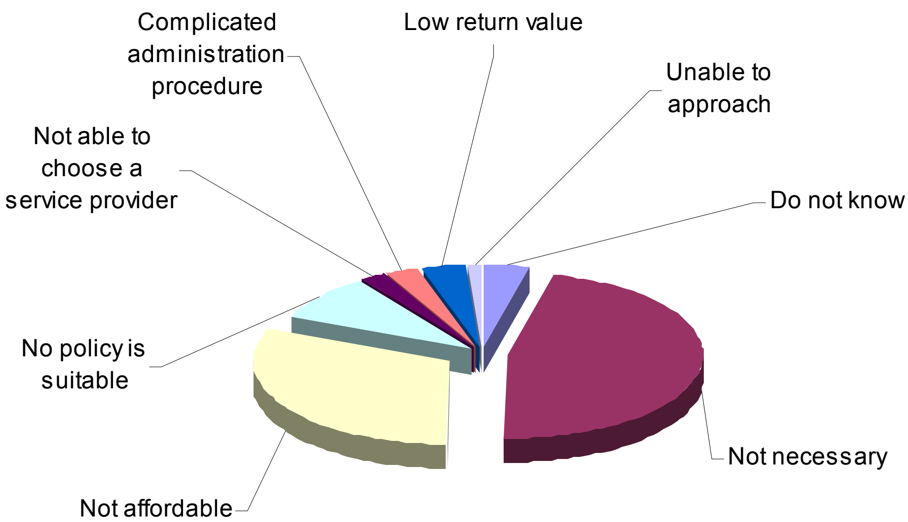


Source: survey data

5.4.1.5 Potential in the Vietnamese insurance market

Statistics show that after the rapid development in the life insurance market between 2000-2003, the market leveled off followed by a downward trend. The number of new life insurance policies decreased from 1,024,802 in 2003 to 808,514 in 2004. The ratio of new life insurance policies over the total number of policies has decreased from 60.63% in 2001 down to 44.85% in 2004. Foreign insurers, such as Prudential, AIA and Manulife, mushroomed from 1999 and contributed to a development wave in the Vietnamese life insurance market between 2000-2003. The entrance of Prevoir, ACE and New York Life in the first half of 2005 may result in a new development wave for the Vietnamese life insurance market. However, such a wave, if any, will be much different from the first one. High income earners were the first to use insurance services and most of them purchased from one of the insurers which were established before. The survey found that only 12% of interviewed policy holders were willing to purchase more policies. Therefore, such policy holders will not be potential users in the coming years. The survey found that interviewees would not be purchasing new policy as they are (i) not really necessary or (ii) not affordable, in which the later is the most popular among average income individuals.

Figure 18: The reason for not purchasing policies



Source: survey data

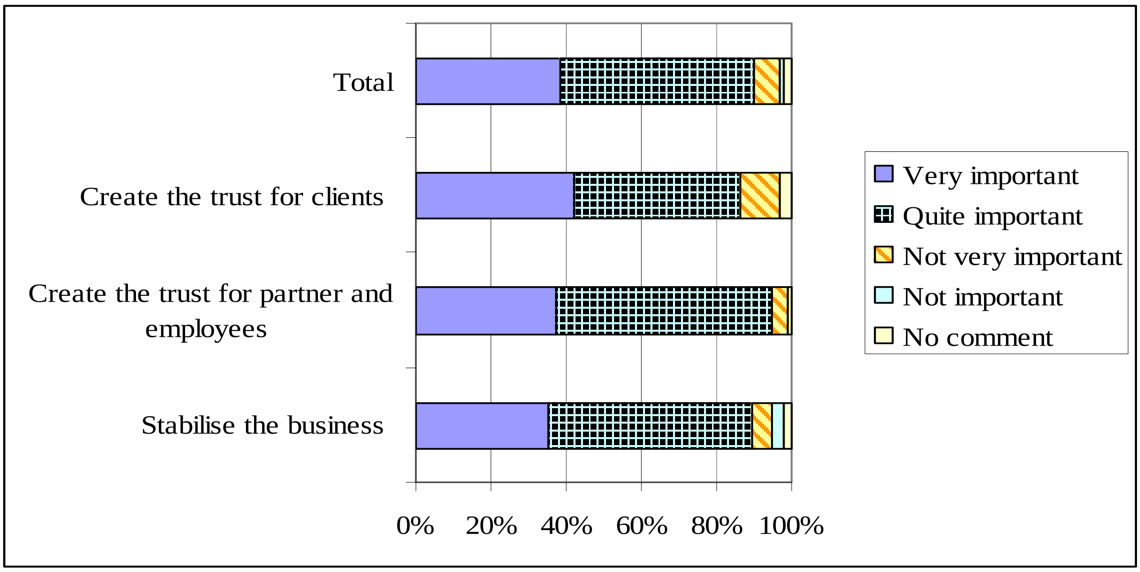
Therefore, there should be a renovation in the service supply of insurers especially in determining target clients.

5.4.2 Corporate users

5.4.2.1 Most of enterprises are aware of the importance of insurance for their business

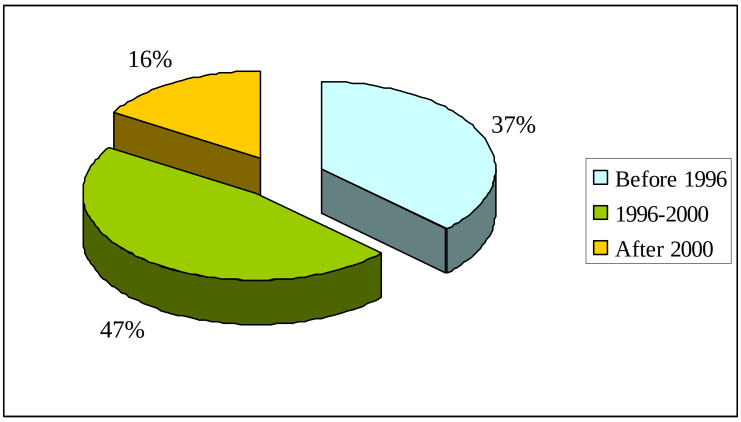
Most surveyed enterprises are aware of the importance of insurance in three areas: (i) stabilizing the business, (ii) gaining trust from their clients and (iii) gaining trust from their partners and employees. Of the surveyed enterprises, only 9.9% felt that insurance was not important or simply did not know.

Figure 19: Enterprise awareness of the importance of insurance



Source: Survey data

Figure 20: First year of purchasing insurance products



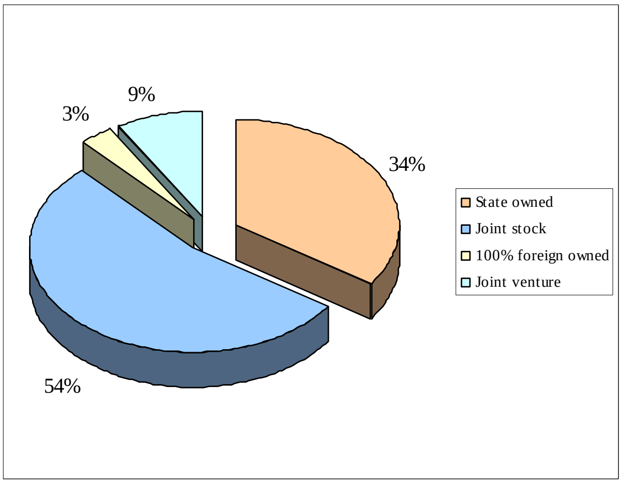
Source: survey data

The awareness of the importance of insurance for business is also reflected in the increasing number of enterprises purchasing insurance services (excluding social insurance and health insurance) soon after their establishment. Survey findings show that most surveyed enterprises purchased insurance before 2000 (37.2% before 1996 and 46.8% before 1992-2000). Comparing the first purchase of insurance with the year of establishment reveals that the number of enterprises, which are aware of the importance of insurance, is increasing. Though 58.6% of enterprises in our survey were established before 1996 only 37.2% of them purchased insurance products. Meanwhile, 31% of surveyed enterprises were established between 1996-2000 and 46.8% of them purchased insurance products.

5.4.2.2 Domestic insurers are more popular

The awareness of surveyed enterprises reflects the current balance in the non-life insurance market in Vietnam. State owned and joint stock non-life insurers are the most popular. Surveyed enterprises had little information on foreign alternatives. Correspondingly, surveyed enterprises assessed state owned and joint stock non-life insurers higher than foreign insurers in terms of prestige, financial security and the ability to approach clients

Figure 21: Awareness of non-life insurers



Source: survey data

There are many reasons for this, mainly due to existing legal restrictions on business fields and on target customers imposed on foreign non-life insurers. In terms of business fields, the number of enterprises purchasing vehicle insurance and fire insurance is quite large as they are compulsory. Domestic non-life insurers are major insurance service suppliers in this segment. Consequently, it is apparent that clients know domestics insurers best. Additionally, foreign insurers are unable to provide insurance services for either SOEs or projects that are financed by the state budge. This is a very lucrative market segment dominated by domestic insurers, especial state owned insurers. The fact that foreign insurers are not able to penetrate this area explains why they were less popular in the insurance market, even to foreign invested companies in Vietnam.

5.4.2.3 Insurance exploitation is low

In general, the level of non-life insurance exploitation is low, especially in the construction, exports and agricultural sectors Statistics on the exploitation of insurance in construction shows that most construction financed by domestic funds are not insured, with only 7.17% insured. It is estimated that over 90% of investment in construction financed by foreign funds is insured. This is worrying not because it adversely affects insurance business but because the risk to society has not been properly hedged. Most domestic investment in major construction and infrastructure is financed by the government budget or ODA. The fact that such projects are not insured or are improperly insured is a considerable risk for both the economy and social stability.

Table 16: Exploitation of insurance, 2002

Kind of insurance	Ratio of use
Construction	7.17% of investment financed by domestic funds and

	90.91% for foreign
Petroleum	41.27% of investment in petroleum
Exports	6.55% of export value
Imports	30.67% of import value
Agriculture	1% of plant and animal

Source: Vietnamese insurance market development strategy by 2010

The low rate of insurance exploitation in import and export is because imports and exports are insured by foreign insurers overseas. Vietnamese traders often sign import and export agreements with CIF and FOB terms respectively, which leaves the responsibility to buy insurance services to foreign partners, especially in the case of exports. Additionally, domestic insurance is just developing. In the past, as domestic insurers were unable to provide insurance services for import and export goods, the consigner, both Vietnamese and foreign did not award insurance agreements to Vietnamese insurers

5.5 Factor conditions

5.5.1 Mechanism and Way of thinking of state authorities

The mechanism, awareness and way of thinking of state authorities regarding their responsibilities in assisting enterprises to overcome difficulties and develop is not the issue of the insurance sector alone, but the issue of the entire economy. In the insurance sector, insurance firms are not only working with and under the supervision of authorities in charge of the insurance sector, but also other related authorities (such as health, security, transport, customs, construction etc.) when they underwrite risks in different sectors, and especially when they assess damages for claims. Although legal and administrative reform in Vietnam has, to some extent, improved the business environment for enterprises, many officials in state authorities still have an attitude of “asking – giving” regards enterprises. Their awareness of their responsibility to assist enterprises to overcome difficulties is very limited. This has causes many obstacles for insurance firms in their operations.

To be able to determine insurance premiums, assess the damage for claims, insurance firms are in great need of statistics, health treatment dossiers, transport accident dossiers etc. However, insurance firms have not yet been able to access such information in an official way. This partly due to the lack of a mechanism, partly due to the way of thinking of state authorities, with the provision of information for these enterprises still not designed to “help enterprises”, and are not really “fulfilling their responsibilities”.

5.5.2 Human resources

Bao Viet was established in 1965, though the market for insurance did not come into existence until 1993. Actual competition in the insurance market did not develop until 1999-2000. Consequently, the capacity of employees in domestic insurance companies has not fully met the requirements of the profession in terms of both expertise and management.

Recently, domestic insurers have paid more attention to human resource development and have begun to send their employees on domestic and foreign training courses. Domestic insurers have also faced a brain drain due to restrictions in administration management, salary systems and promotion etc. which makes foreign insurers more attractive.

Foreign insurance companies in Vietnam often set up management system in which positions are clearly defined in terms of standards and ability etc. Senior positions are occupied by expatriates, Vietnamese overseas or senior Vietnamese experts. Foreign insurance companies have a salary policy and other support for employees which are more attractive than those of domestic insurance companies. As a result foreign insurers in Vietnam are able to attract senior domestic human resources, including those from domestic insurers. Additionally, foreign insurers have a clear human resource development strategy providing their employees with good opportunities to participate in short term or long term training courses on expertise and management. As well as global training programs following their parent company's systems. The purpose of such a policy is to build a stable human resource and to enable employees to exercise their full capacity.

Similar to other newly developed insurance markets, the human resource movement is not only from domestic insurers to foreign insurers in Vietnam but also among foreign insurers themselves. In order to control this situation, the 5 foreign insurers have agreed not to implement measures to attract each others' employees. However, such an agreement seems inadequate as there are now 29 insurers, re-insurers and intermediaries. In addition new insurers who have just entered the Vietnamese market are not bound by this commitment.

A common problem for domestic insurers in human resources is dealing with a shortage of experts in specific insurance areas such as actuary. Actuaries are responsible for calculating risks, reserves and reinsurance for insurance products. An actuary also contributes to verifying the position of the insurer in the market and formulating business strategies for the insurer. Despite this areas importance, there are few experts who have gone through basic actuary training . Furthermore, they have little chance to practice what they have learnt as they need the support of an adequate database on insurance.

5.5.3 Training activities

Academic training on commercial insurance is implemented in a number of universities and institutes which offer financial training courses. The training capacity is roughly 300-400 students per year, most of whom graduate from the National Economics University (Hanoi), the University of Economics Ho Chi Minh City and the Financial Institute. However, the number of hours, in which less relevant curricula is taught, still accounts for 70-75% of the total training duration. For curricula on commercial insurance, the content provides only basic, theoretical and outdated knowledge. Consequently, the insurance industry feels university graduates are of moderate capacity and need further education and training to meet the industry's requirements. For other areas of expertise supporting the development of insurance such as informatics, accounting, business administration, university graduates are also felt to be of a moderate capacity. In general, domestic academic training has only satisfied the industry to the average extent.

In order to meet the demand for specific expertise in insurance, there has been training courses on actuary in Vietnam since October 2002 with a training capacity of 15-20 students a year. This is in cooperation between University of Economics Ho Chi Minh City (Mathematics faculty), Université Claude Bernard Lyon 1, Institut de Science Financière et d'Assurances (ISFA), Association Diffusion Internationale de l'Actuariat Français (DIAF), Fédération Française des Sociétés d'Assurances (F.F.S.A) and other French insurance and financial corporations such as Prévoir and Groupama. After 2 years training in Vietnam, students continue their study in I.S.F.A for 9 months and prepare their graduation thesis within 6 months in an insurance company in order to be equipped with as much necessary knowledge and skills after their graduation.

In addition, in order to improve the capacity of the insurance system, develop a sustainable insurance market and improve the quality of the insurance business, a project on Insurance Training Center was approved and was implemented between 2004-2007. The budget for the project is EUR2,260,000 of which AFD financed EUR 2,100,000. The purpose of the project is to improve institutional capacity and organize training courses for human resource development. There will be an Insurance Training Center in Vietnam with senior professors, comprehensive curricula, and modern teaching equipment. The training center will introduce regional and international standards to Vietnam and provide an example to be replicated in other universities and institutes. The Insurance Training Center continues its training course after the project ends and will have a long term impact on the supply of human resources for the Vietnamese insurance industry.

5.6 Supporting industries

5.6.1 Financial Market

Together with the development of the economy, there have been reforms and improvements in the Vietnamese financial market. This began with the transition from a mono-tier to a two-tier banking system in 1990 in order to separate the role of the State Bank and commercial banks. Further reforms in the banking system, monetary system, securities and insurance have also contributed to the formation of a fully-constituted financial market. Along with insurers, other notable financial institutions in the Vietnamese financial market include credit institutions and institutions in the security market.

5.6.2 Credit institutions

By 2005, credit institutions in Vietnam included state owned commercial banks (6), joint stock commercial banks (37), foreign bank branches (28), joint venture banks (5), financial companies (5), leasing companies (9), representatives of foreign banks (43) and people's credit funds (901). This structure is considered to have approached to an analogue structure of newly emerged market or countries.

The credit institution system is the backbone of the Vietnamese financial market, occupying over 80% of assets of the entire financial system. State owned commercial banks have taken a controlling role in the banking system, accounting for over 75% of lending in the economy in recent years. Though foreign banks in Vietnam have a sound financial capacity, the boundaries in their fields of activities mean they can only provide 10% of credit in the economy. The clients of state owned commercial banks are mainly SOEs while those of others are the emerging private sector, foreign invested companies and individuals

Table 17: Market share of credit institutions

Unit: %

Year	2000	2001	2002	2003	2004
Credit operations					
State owned commercial banks	77	80.1	79.3	78.1	75.2
Joint stock commercial banks	11.3	9.2	10.1	11.2	13.2
Foreign invested commercial banks	10.3	10	9.4	9.3	9.7
Other institutions	1.4	0.7	1.2	1.4	1.9
Lending					
State owned commercial banks	76.7	79	79.9	78.6	76.9
Joint stock commercial banks	9.2	9.3	9.5	10.8	11.6
Foreign invested commercial banks	12.3	10.5	8.8	8.9	9.5
Other institutions	1.8	1.2	1.8	1.7	2

Source: State Bank of Vietnam

The financial capacity of Vietnamese banks is considered to be quite weak. The combined registered capital of state owned commercial banks, which are the largest, is only VND 21,000 billion (USD 1.32 billion), though this figure has increased by 3.5 times since 2001. With their current registered capital, state owned commercial banks of Vietnam are of the same size as medium scale banks in the South East Asia region. Other joint stock commercial banks are running at a lower registered capital, approximately VND 200-300 billion (USD 15-20 million) on average. A low registered capital has had an adverse impact on banks ability to lend due to the mandatory 15% ceiling set by the Law on credit institutions and banks. According to the law credit institutions are not allowed to lend more than 15% of their registered capital to a single borrower. Foreign invested banks in Vietnam have enormous financial support from their parent banks and do not suffer from such limitations.

The second phase of the project of modernisation the banking system has been approved and is being implemented between 2005-2008. The first phase of the project has been completed, with the operation of an inter bank payment system. In addition, commercial banks now offer modern services such as e-banking and ATMs. There are now as many as 1,100 ATMs and 6,000 POS serving 1.5 million people in card payments. The application of modern technology in banking system has paved the way for cooperation between banking and other industries such as telecommunication, power and insurance in payment activities.

5.6.3 Security Market

The security market has been in operation since 2000 and there have been 29 listed stocks, 1 investment fund certificate and 237 bonds traded in the security market. The security market consists of 13 securities companies, 5 fund management companies and 5 custodian banks. The total value of listed securities is approximately VND32,000 billion, of which VND29,000 is in bonds, VND1,500 in stocks and VND300 billion in investment fund certificates. Investors have opened around 24,000 accounts of which 250 are for corporate investors. Together with the increase in the number of securities and investors, services offered to investors have also been improved and diversified. Investors have more choices of investment options thanks to the development of new kinds of investment such as investment funds, forward agreements in ceding bonds and stocks An OTC market was established in Hanoi in July 2005 with the involvement of 6 stock companies.

Despite its notable development, the Vietnamese securities market has not fulfilled its role as medium and long-term capital mobilizer for the economy. The total value of listed securities was only 0.9% of GDP in 2005 while projections saw this ratio as 2-3%. The average registered capital of listed companies is roughly VND 51.7 billion and few companies in lucrative industries are listed.

The development of the securities market heavily relies on the diversification of securities for the market, of which the stocks of joint stock companies and government bonds account for the majority. By 2004 2,307 SOE have been equitized a combined registered capital of VND 22,000 billion. 1,224 equitized companies meet the requirements for listing in the securities market or are suitable to be traded OTC. As for bonds, the combined value of bonds issued by 2004 reached VND48.027 billion. The projected value of bonds to be issued in 2005 is VND38,000 billion of which 50% will be via the securities market. Consequently, the total value of bonds in the securities market may reach VND40,000 billion. By 2010 the Vietnamese security market development strategy projects that the total value of listed securities will reach VND150,000-160,000, which is equivalent to 10% of GDP.

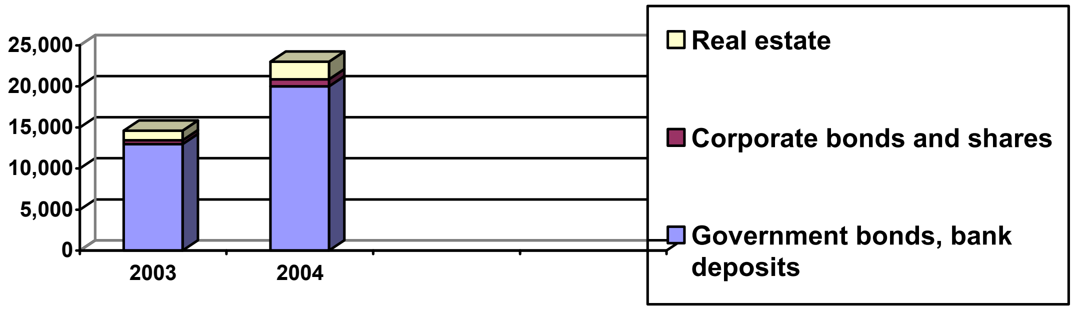
The development of Vietnamese security market is closely related to credit institutions. Credit institutions not only have established securities companies (7 out of 13 current stock companies) to facilitate the trading of securities but have also established fund management companies. The securities market has, to some extent, shared the burden of credit institutions in raising medium and long term fund for the economy.

5.6.4 The impact of the securities market on the investment of insurers

Investment by insurers in 2004 was VND8,400 billion, raising the accumulated investment to VND23,002 billion, a 60% increase in comparison with that of 2003. The portfolio of the insurers included government bonds and bank deposit accounts for the bulk of the investment. Other investments in stocks, corporate bonds and real estate accounted for only 12% of investment.

Though this is an highly secured and liquid portfolio, it is criticised for not being the most efficient.

Figure 22: Portfolio of insurers



Source: MOF

State owned and joint stock insurers have a more diversified portfolio than those of foreign insurers. Foreign insurers mainly invest in government bonds and bank deposits. The reasons for this, especially for foreign invested insurers, are as follows:

- The securities market has not been attractive for investment. There are few securities in the market and few joint stock companies in lucrative industries are listed. A number of cases relating to information disclosure of several listed companies have raised questions on the reliability and transparency of the whole market. Around 1,000 accounts regularly transact (out of the 24,000 accounts opened). By 9/2005 there were only 2 fund management companies established by 2 insurers with a limited investment in comparison to the capacity of the insurer.

- Inconsistency of legal regulations has hindered insurers" ability to lend money directly. According to the Insurance Law, insurers are allowed to invest their idle capital in various activities including lending in conformity with the Law on credit institutions. However, as regulated in the Law on credit institutions, enterprises which are allowed to lend must be a credit institution and allowed by the State Bank to lend money. Currently, the government has not promulgated a decree providing guidelines for the lending activities of insurers. As a result, the State Bank is unable to allow insurers to implement lending operations.

- Though both domestic and foreign insurers mobilise domestic funds, discrimination on the basis of legal entity between foreign and domestic investors poses many difficulties for foreign invested insurers in their investments in Vietnam.

5.6.5 Statistics and informatics

5.6.5.1 Statistics

At present insurance industry statistics only track the internal operations of an insurance company and key indicators such as premiums, compensation and market share are compiled in order to have an overall picture of the market. Such statistics are provided in publications of the MOF and Association of Vietnamese Insurers. Regulatory authorities are responsible for many other tasks in the insurance market and with current resources, more comprehensive and detailed statistics seem to be beyond their capacity. The shortage of statistics on risk and insurance fraud results in certain difficulties for insurers in business strategy formulation and decision making processes.

MOF is currently planning to cooperate with the Association of Vietnamese Insurers in preparing united report forms, from which a database for the Vietnamese insurance market would be developed. However, this initiative requires the joint force of insurers as well as resources

5.6.5.2 Information technology

The application of information technology in the insurance sector is not just the development of a web-site to introduce insurers and their services etc. Information technology must also be applied in company management, such as internal management, agent management, files management via image copy technology, customer relations management, accounting and financial management and Enterprise Resource Planning.

The application of information technology in insurance companies has the following notable features:

- Information technology has been initially applied in highly standardised areas such as accounting and financial management and then in other areas to improve management capacity and competitiveness, such as file management and online management.

- Insurers with a large number of policy holders and agents such as Bao Viet, Prudential and Manulife have adopted IT significantly in their management systems due to management task requirements.

- Foreign invested insurers have applied information technology sooner and to a greater extent in their management activities than their domestic competitors thanks to inheritance from their parent company. For instance, Manulife was the first to build a web-site and Samsung sent their experts to Vietnam to develop a management software when they set up a joint venture with Vinare in Vietnam. The application of information technology has enabled foreign invested insurers to access to up to date information faster and more accurately than domestic insurers.

5.7 SWOT analysis

5.7.1 Strength

5.7.1.1 Political and macroeconomic environment

The stability of the political environment of Vietnam has continued to be sustained and the economy has been growing continuously at a high pace in recent years. This is a very important condition for the development of the insurance sector, which is very sensitive to political, economic and social instability.

5.7.1.2 More transparent and standardized legal environment

Decree 100/ND-CP,1993, marks the beginning of Vietnam's insurance sector. Since then the legal framework governing insurance activities has been amended many times and has come closer to International benchmarks. An assessment of Vietnam's legal framework for insurance reveals that it covers nearly all areas which need the management of state authorities, especially in licensing, supervision, solvency, investment, reinsurance, competition and contracts. The insurance law passed in 2000 and supporting documents have created a transparent legal framework, which is fair to all market stakeholders. This is the result of the efforts of policy makers, associations, companies, consumers, partly for the development of a healthy insurance market and partly to satisfy the requirements of International agreements, to which Vietnam has committed to.

5.7.1.3 Insurance companies have, to some extent, satisfied the needs of consumers and have increased their prestige

5.7.1.4

Research indicates that existing insurance companies are highly valued in terms of prestige, financial security and service quality. In general, insurance companies, especially life insurance ones, have satisfied the needs of consumers by offering many different products with different features and premium rates, which are affordable for different groups of people. This is a very important factor which has helped the development of the insurance sector in Vietnam.

5.7.1.5 Each group of insurance companies has their own competitive advantages

State owned insurance companies

- Being in the market for a long time, all state owned companies are known to consumers. This is a very advantageous strength and an important condition for their development.
- In addition, state owned insurance companies also receive support from the Government. This is gives them a large advantage as it helps to make consumers more secure when buying insurance services.
- The network of branches of state owned insurance companies now covers all provinces and is the widest network of branches and agents. This is a good condition for their business expansion.
- Another advantage of state owned companies is that they have a good understanding of the habits and culture of consumers throughout the country. This bears a great meaning in product design and marketing strategy development.

Foreign owned insurance companies

- Customer services is standardized at various levels of foreign insurance companies. Foreign owned insurance companies, especially in life insurance, are highly valued in terms of customer approach and service. This is very important as it takes time to establish such a system.
- Most 100% foreign owned companies have had a very long operation in the insurance industry and possess very good expertise and experience.
- Foreign owned insurance companies efficiently applied information technology in their management and operations, making information processing and exploitation much better, which has created many important advantages in competition

.
- With a long development history, foreign owned insurance companies are better at developing distribution channels, especially in the life sector. Bancassurance has been introduced by Prudential to Vietnam, and to some extent this new channel of distribution has gained some successes. Prevoir has introduced the idea of distributing insurance products through post offices. Although there needs time for Prevoir to implement their plan and to get results. All such new distribution channels have proven the competitive advantage of foreign insurance firms over domestic ones.

Box 5: Why Bancassurance

- ❖ Increasing competition, reducing interest margins => new product development/diversification and important way of enhancing profitability and productivity.
- ❖ Customer investment preference is changing, moving away from simple deposits towards insurance and more structured products => banks must be able to offer a wider range of services to clients.
- ❖ Banks's customer database, long-term relationship with customers, existing branch networks etc. are advantages in distributing insurance products profitably, compared with other channels.
- ❖ Combined bank and insurance products provide more complete solutions than traditional standalone banking or insurance products.
- ❖ For insurance companies: bancassurance provides new sources of customers, opportunities for new products and cost savings from economies of scale.

Source: Vietcombank

Box 6: Prudential with bancassurance in Vietnam

Bancassurance in Vietnam
- 2 deals with 2 banks, both making profits
- Set up 4 operating models
- Acquired over 2000 customers through bancassurance
- Developed sales people into management roles
- Minimal infrastructure giving a lower cost base
- A working Direct Marketing hybrid

Prudential Vietnam success with bancassurance
- Productivity is higher than agency force
  FSCs aproximately 15% more efficient than agents
  TMRs approximately 200% more efficient than agents
- Now producing about 1% of Prudential Vietnam business
  Effectively 0.5% of market share
  Confident of hitting 5% of Prudential Vietnam business in 2005

Challenges in Vietnam
- Customers are not used to buying insurance in banks
- Banks not used to a sales culture
- Need to be sensitive to branch dynamics
- Neet to get a signature, which makes DM/TM complex
- Language difficulties have led to some interesting dialogues
- It is never quite clear what the legal position is

Source: Prudential Vietnam

Joint stock insurance companies

Joint stock companies strength are their good understanding of the habit and culture of customers. Their sales network has been established for many years. In addition, they are very flexible and have good relations with Vietnamese corporations.

5.7.1.6 There is potential for development of the insurance market in Vietnam

The Vietnamese insurance market has recorded breakthroughs in its development since 2000, especially life insurance. This has partly resulted from the enactment of the Insurance Law, creating a more transparent legal framework, and partly from the establishment of several foreign owned insurance firms (including Prudential, AIA, Manulife and CMG). This illustrates the growth potential of the Vietnamese insurance market. Consumers have quickly recognized the importance of insurance and are willing to pay to be protected. Existing insurance companies have been successful in converting market potential into development, but have not been able to fully exploit the potential of a market with over 80 million people and 100 thousand businesses. Statistics show that the ratio of savings over GDP for Vietnam in 2002 was 22.5%. This low when compared to other Asians countries such as China (40.1%), South Korea (33.6%), Singapore (51.7%), Malaysia (47.3%)[11], but similar to developed insurance markets such as the UK, Belgium, Canada, Australia. The Strategy to develop the insurance sector of Vietnam 2003-2010 see the potential for life insurance as follows:

Table 18: Predicted life insurance market exploitation to 2010

Assessment indicators	2006	2007	2008	2009	2010
Savings over GDP (%)	27%	28%	28%	29%	30%
Potential market % savings	11.50%	13%	13.50%	14%	15%
Potential premium (billion VND)	22.560	28.009	31.791	36.478	43.250

[11] Swiss Re Sigma No 9/2000

Potential exploited premium (% potential premium)	69%	68%	72%	73%	71%
Life insurance premium per capita (US$)	10.85	13.16	15.60	18.05	20.65
Life insurance premium/person (thousand VND)	184.41	223.69	265.24	306.93	351.00
Exploited premium/savings	7.89%	8.82%	9.68%	10.25%	10.72%

Source: Strategy to develop insurance market of Vietnam 2003-2010

5.7.2 Weaknesses

5.7.2.1 Legal regulations are inadequate, overlapping, conflicting and do not keep pace with the development of the insurance sector

The regulatory system guiding the insurance sector incomplete and inconsistent. There exists overlaps and conflicts between different documents. Issues such as obligatory insurance, competition and contracts are both regulated through insurance laws and other sectoral laws, with no clear regulation on application principles, making both the execution of laws and the supervision of laws difficult. Important issues in insurance such as obligatory insurance, agent management, statistics gathering, storing and reporting, supervision of reinsurance overseas and the protection of customers' rights, are not regulated in detail and there is no specific mechanism to supervise compliance of the law.

5.7.2.2 The mechanism of providing information for insurance firms by state authorities is unclear and the awareness of state authorities of their responsibilities in assisting enterprises remains limited

One of the most important factors affecting the healthy development of the insurance market is the adequacy and accuracy of information. Inadequate and inaccurate information is likely to lead to misconduct in insurance, inaccuracy in damage assessments and claims settlement. At present the mechanism for state authorities to provide information to insurance enterprises is unclear. At the same time state authority officials continue to have an attitude of "asking – giving" towards enterprises, are unaware of their responsibilities in assisting enterprises. This has, to some extent, caused difficulties to enterprises in assessing risks, assessing damage and claims.

5.7.2.3 Asymmetric market development and high market concentration

The insurance market of Vietnam, despite great developments in recent years, has asymmetric development and high concentration levels. In the life insurance sector, there 7 providers, 6 of which are foreign owned, while market share is controlled by Bao Viet Life Insurance (40%) and Prudential (over 40%). The remaining 5 companies share 20% of the market.

The same situation is found in the non-life sub-sector. While the market is not asymmetric in terms of the number of companies of different legal forms, it is asymmetric in terms of market share. At the end of 2004, 3 state owned non-life companies had 70% of market share, while 7 foreign owned companies had only a 7% market share. At the beginning of 2005, Ho Chi Minh insurance company (Bao Minh) was equitized, which transferred its share (22%) from the state sector to the domestic private sector. This lowered the share of the state sector to over 50%, while Bao Viet Vietnam controls 40% of the market.

Compared with other countries in the region market concentration in Vietnam is still high.

Table 19: Market Concentration in Vietnam

	No. of insurers		Market share of 5 largest insurers		Herfindahl Index	
	Non-life	Life	Non-life	Life	Non-life	Life
India	5	1	100%	100%	2524	10000
China	14	12	98.1%	99.1%	6398	5180
Vietnam (1999)	10	4	94.8%	100%	3908	10000
Vietnam (2004)	14	5	90.4%	100%		
South Korea	15	27	73.4%	82.1%	1368	2126
Japan	60	45	53.1%	61.2%	828	1009
Taiwan	28	31	47.6%	78.5%	805	1771
Indonesia	107	62	34.3%	66.2%	381	1317
Thailand	73	25	37.4%	90.2%	462	2975
Singapore	50	14	32.6%	91.2%	391	2380
Philippines	110	40	31.6%	76%	335	1615
Malaysia	53	18	30.3%	72.6%	352	1495
Hong Kong	137	55	24.8%	61.5%	251	963

Source: Swiss Re 2001

Note: A Herfindahl index below 1000 indicates that the market is not concentrated; between 1000-1800 indicates that a single insurer or group of large insurers has the ability to exercise some control (price or distribution channel).

Statistics show that Vietnam has the highest Herfindahl index in the life insurance sub-sector, 2 times higher than that of China, which is ranked the market of second highest concentration. In the non-life sub-sector, Vietnam ranks after China, but its Herfindahl is still 5 times higher than that of Thailand, which ranks after Vietnam.

In addition, a number of insurance companies provide insurance services in specific industries such as oil and gas, telecommunications and petroleum which has limited competition amongst insurance companies in these industries. Insurance companies in these industries are still entitled to some level of monopoly in supplying services for companies in their industry.

5.7.2.4 Domestic insurance companies lack clear development strategies, management experience, professional expertise and information technology application capacity

Development strategy: A clear long term development strategy is not yet in place, especially for local non-life insurers. Except for Bao Viet, which the Government has earmarked to be developed as a large financial corporation, other local insurers are still competing on an ad-hoc basis, relying more on personal relationships than on long term strategies. Not enough effort has been made to improve human resources and infrastructure for long run development.

Organization and management: In general domestic insurance companies, both life and non-life, have a complex structure and backward management technology in comparison with foreign owned insurance companies. In addition to the lack of job descriptions, scope of responsibilities, performance based salary and promotions, most domestic companies have not established a customer service culture, and rely mainly on the helpfulness of individual staff members. This not only affects service quality, but also the operational efficiency of the companies themselves.

Human resources: Domestic insurance companies lack managers and technician staff with expertise and experiences in insurance. Domestic companies, especially state owned ones, are facing an outflow of qualified staff to competitors due, to some extent, to strict legal regulations on salary and promotion. In addition, staff with expertise in some special areas such as actuary, risk management and loss assessment are too few in number and not really capable of handling complicated transactions.

Information technology application: the application of information technology is very limited in most domestic insurance companies, especially medium ones. Information technology has been mainly applied to the management of customers only. Its application to other important areas such as actuary, reserve determination and agent management is very limited. No domestic companies have succeeded in obtaining software tailored to their own operations and management.

5.7.2.5 The Financial capacity of domestic insurance companies is limited

Domestic insurance companies', existing financial capacity and ability to mobilize further capital is limited especially in joint stock companies. The financial capacity of state owned insurance companies is large compared to competitors but average to that in the region. Experience has shown that to ensure the market develops sustainably, development capital, including 40% of retained premium in the non-life sub-sector and a 10% reserves in the life sub-sector, must be higher than minimum capital. It has been estimated that the minimum capital required in Vietnam's insurance market for 2005 and 2010 was around VND2,600 billion and VND9,100 billion respectively. Corresponding development capital was around VND4,187 billion and VND13,970 billion. Meanwhile, real capital mobilized to 2002 was only VND1,515 billion.

In addition, data on the registered capital of non-life insurance firms reveals that most firms only just satisfy minimum capital requirements under the law. Except for Bao Viet and Bao Minh, the two largest state owned and equitized state owned insurance firms, which have registered capital of over VND1,000 billion, most others have a registered capital of between VND70 and 100 billion. Foreign owned non-life insurance firms also have quite modest levels of registered capital, though this may be due to a restricted scope of business in Vietnam (which does not lead to a demand for increasing capital) rather than the weak financial capacity of the investor. In coming years, when all existing restrictions to their businesses are removed, their ability to increase capital levels to become more competitive on the market is beyond question.

Table 20: Registered capital of insurance firms on the market by the end of 2004

	State owned	Joint stock	Foreign owned	Total
Life sector				
Over 50 million USD	1		1	**2**
10 – 12 million USD			3	**3**
Non-life sector				
Over 50 million USD	1	1		**2**
5 – 7 million USD	1	3	7	**11**
12 – 15 million USD		1		**1**

Source: Vietnam Insurance Market 2004 – Ministry of Finance

5.7.2.6 Relationships and competition

Relationships have always played an important part in competition, especially where risks are complicated and financed by the state budget. Domestic insurance companies, with flexible structures are more advantageous in this area than their foreign competitors. Relationships can be considered as a competitive advantage, but if this competitive factor does not go along with a high quality service, it will be unhealthy competition. It has been shown that newly-established insurance companies with limited financial capacity, expertise and experiences, have been able to win contracts to underwrite large and complicated risks thanks to special relationships, while insurance companies with strong financial capacities, expertise and experiences are not given such contracts. This on one hand, generates unfair competition in the market, and on the other causes a large amount of premiums ceded overseas.

In addition, from the long term perspective of insurance companies if such insurance companies relied only on their relationships, they would face two risks: (i) losing markets because of losing personal relationships, or (ii) breaching the law because of their anti competitive activities.

5.7.2.7 Inexperienced Individual consumers

In any country, no matter how developed the insurance market is, the protection of customers is always the first priority of policy markers and market regulators. In emerging markets such as Vietnam's insurance market, the protection of customers is much more essential, as consumers, especially individual, are very inexperienced. In addition, insurance is a special industry where asymmetrical information is more evident than other industries. Individual customers do not have the resources to acquire information while insurance companies do.

The Vietnamese insurance market was established in 1993, though life insurance products were first offered in 1996, with further development beginning only since 2000, when several foreign insurers joined the market. In the non-life sub-sector, most individuals buy only obligatory insurance, which is the third party liability of vehicles' owners. Obligatory insurance is subject to strict regulations on premium rates and compensation, as a result there are few disputes. The more important issue is life insurance. With the distribution channel of agents, life insurance companies have been very successful in developing their customer networks. However, this has also led to disputes with agents, trying to sell products without fully explaining details such as exemption of responsibilities, claim procedures and early termination of policies. Consumers are inexperienced and often totally trust the agents and do not carefully review policies or are unclear on terms and conditions because of complicated terminology. All insurance companies have regulations for agents, but in reality, supervision of agents is not simple. In addition when disputes arise, the agent involved might no longer work for the company, or the customer may not remember exactly what the agent had explained.

5.7.2.8 Low stock market contribution to the development of the insurance industry

For the insurance industry, the stock market plays both the role of capital mobilization channel and a role of offering investment opportunities. To date no insurance company has listed on Vietnamese stock exchange. This is partly due to legal restrictions and partly due to limited financial capacity and transparency of companies.. As a result the Vietnamese stock market has not performed its role of a capital mobilization channel. Regarding investment, a stock market with too few products, weak information updating and limited transparency is not very attractive to insurance companies, especially foreign ones. Most insurance companies focus their portfolio on Government bonds and deposits with credit institutions. Although these are the safest investments, they do not bring high returns which restricts the operational efficiency of insurance companies and restrains them from performing their role of financial intermediary.

5.7.2.9 Human resource problems

Despite the long existence of insurance in Vietnam, market based insurance was only introduced to Vietnam from 1993. Though the education and training sector of Vietnam has made efforts to supply a labour force for the development of the insurance sector, it has only made an average contribution. In fact, the close linkage between training and industrial practice is essential. This has not happened and is restrained by a education sector that has weaknesses in its teaching and is theoretically based. Coupled with this most domestic insurance companies are not financially able to make long term investments in the development of their human resources. Most insurance staff in these companies are learning by doing and must rely on their experience in similar situations. Without basic training on expertise, insurance staff can still manage the daily work, but are unable to handle more complicated tasks. To cope with the lack of professional staff, most domestic companies try to learn and follow what their foreign competitors do in the market in areas such as product design and premium determination. Such measures can help companies to exist, but cannot create a sound foundation for them to develop.

5.7.2.10 Statistics collection, storing and processing has not been standardized at both enterprise and industry levels

The insurance industry can not develop sustainably without support from statistics. To collect and store statistics to serve the entire industry, there needs to be greater joint effort by all involved insurance companies, associations, policy markers and market regulators. Big companies such as Bao Viet and Prudential may be reluctant to share information with other companies. However, the collection, storing and sharing of information will not only benefit companies but is an obligation of all companies. Of course, statistics is an important factor giving some companies a competitive advantage. As a result using laws and administrative measures to force companies to share all their statistics would affect competition amongst companies. For this reason, the collection, storing and sharing of information must be standardized. There needs to be clear regulations on the scope of responsibilities for each stakeholder to ensure that statistics are adequate for the safe and sustainable development of the entire market.

5.7.3 Opportunities

5.7.3.1 Improving financial stability for individuals, business and the entire economy

More often than not, life and economic activities are disrupted by unforeseen events. To flatten out the magnitude of negative impacts various types of reserves are established. There are strategic oil reserves, hard currency reserves, and food and medicine reserves. Individuals also build their own reserves by saving their income for planned and unplanned spending in the future. Each reserve fulfils a specific purpose and is most effectively funded in a specific way. For instance, food and necessary medicine reserves should be built by the Government for disaster relief, while some spare capacity should be built by companies to avoid disruption in case of unexpected high demand or failure of supply. Insurance is one kind of financial reserve. It has a specific purpose to provide financial means in case of accidental mishap. Experience in developed economies show that, when the economy develops to a certain extent, all business activities of individuals and corporations will be properly insured. The development of the insurance market of Vietnam is the foundation for the development of other economic sectors.

5.7.3.2 Better mobilization of savings for investment

The main function of insurance is to hedge risk, but life insurance is also a savings tool. Research results reveal that many life insurance customers buy insurance for the purpose of savings more than the purpose of risk hedging. Many life insurance products become attractive because buyers can achieve two goals through one activity (i) their lives are insured against risk and (ii) they get the money with interest back on the expiry of the policy if risk has not happened. Of course, many people, if not buying insurance, would deposit money in banks to earn interest. In such a case, total savings mobilized for investment remains unchanged. However, there are also people, who would reduce their monthly spending to pay premiums. In such a case, savings are increased, which increases investments for the economy.

5.7.3.3 More efficient allocation of investment capital

Insurance companies, as with securities companies or securities investment funds are better at collecting and analyzing information, and as a result can make better decisions than individual investors. Insurance companies often have a division responsible for making investments, and who follow investment portfolios daily. This makes companies carry out timely adjustments and interventions to maximize investment profits and increase capital exploitation efficiency. Despite current legal restrictions on the investments of insurance companies, especially foreign owned, making their investments inefficient, most insurance companies have paid attention to establishing a division in charge of making investments. With the development of the securities market, more practical legal regulations on investments, more professional insurance companies and greater participation of the foreign owned companies, it is sure that investment capital channelled through insurance companies is better allocated and managed.

5.7.4 Threats

5.7.4.1 Strong development of the insurance market might surpass the control of market regulators

Foreign owned insurance companies operating in developed markets over a long period of time become more experienced not only than domestic companies, but also regulators. To be able to predict the development tendency of the market so that relevant regulations could be developed to regulate and protect the market's stakeholders, the capacity of regulators must be built up in correspondence with the requirements of the market. If the market develops beyond the controlling capability of regulators, or regulators were unable to assess and supervise the business operations of insurance companies, the market could be distorted or unhealthy competition may develop. The fact that the foreign owned companies introduce International business practice and products, in which Vietnamese consumers are totally inexperienced, or apply business models which are not in line with Vietnamese culture, could lead to market distortion or unhealthy competition. The capacity of regulators must be actively built up so that they not only keep pace with market developments, but also target market development to national socio-economic goals.

5.7.4.2 Greater integration of the Vietnamese insurance market into regional markets makes Vietnam more exposed to regional crisis risk

Open insurance markets such as Thailand and South Korea suffered the most during Asian Financial Crisis and needed a longer time to recover. Countries which, to an extent, maintained restrictions on the participation of foreign insurers such as China and Vietnam were better protected during the crisis.

This is the two faces of market opening and integration. Insurance in a very sensitive sector, in which companies run their business based on the trust of customers. As a result, similar to banking sector, when all customers (mainly life ones) rush to get back the money, the entire industry suffers. In addition, as the insurance sector plays a risk hedging role when a crisis happens, the loss of any industry would lead to a loss in the insurance industry. Being in the same boat as other insurance markets, the market of Vietnam would be more vulnerable to International and regional risks.

5.7.4.3 High market concentration might lead to collusion between large insurance companies, affecting the healthiness of the market

As analyzed above, Vietnam is one of the leading countries in terms of market concentration. State monopoly has been eliminated, but there is a risk that some large companies which are able to control the market, could collude. Although this has not happened in Vietnam, this is a very likely risk, which could happen if there was no close supervision of the market by regulators and as competition becomes fiercer with new entrants. Normal agreements amongst insurance companies in such areas as policy forms, premium rates, information sharing and cooperation in the insuring of large risks could restrict competition to the detriment of customers.

5.7.4.4 Widening gap between rich and poor

This is one of the biggest concerns of most economies in transition. As the main function of insurance is to hedge risks, the poorer people are, the greater demand for protection they have. However, the objective of commercial insurance is profit and, not charity, and as a result cannot play a role in hedging risks for poor people. In a developing country such as Vietnam, with GDP per capita of over US$400 per year, commercial insurance can only hedge risks for those people with average or high incomes. The irony is that the good income earners are better protected than low income earners and vulnerable groups. The more commercial insurance develops, the higher the degree of insurance is. Good income earners would be able to buy more insurance products with higher premiums, and are better protected. On the other hand, low income earners do not have the financial capacity, and are unprotected. Although this is an unchangeable principle of the market economy, this social issue must receive attention.

A typical example of this is the development of agricultural insurance in Vietnam. To date, Bao Viet Vietnam and Groupama offer agricultural insurance to farmers. Both companies incurred serious losses when they tried to develop into this area. Nobody suspected the importance of agricultural insurance to the Vietnamese economy, in which over 70% of the population live in rural areas and work in the agricultural sector and over 30% of GDP is from agricultural production. In theory, there is great potential for agricultural insurance to develop, in reality, supply and demand factors are inadequate for the establishment of a market. Farmers have a great demand for their products to be protected, but have very limited financial capacity and are reluctant to pay premiums. From the suppliers' point of view, Bao Viet Viet Nam and Groupama have not fully assessed the difficulties in this type of business, which arise in very simple areas such as identifying the insured objects or collecting premiums. It will be very difficult for agricultural insurance to develop in Vietnam as an unusual non-life insurance.

5.8 Conclusion

The Vietnamese insurance market was established in 1993 following the issuance of the Decree 100/1993/ND-CP. Immediately after its establishment, the market was opened to foreign insurers. Aon was the first foreign broker to enter the Vietnamese market. The establishment of the International Vietnam Insurance Joint Venture Company followed in 1996. From 1993 to 1999, all foreign insurers coming to Vietnam were non-life insurers. From 1999 several new foreign establishments, in both life and non-life sub-sectors (3 life and 2 non-life insurance companies) entered the market. The life insurance market developed especially fast after 2000, partly because of the participation of well-known life insurance companies such as Prudential, Manulife and AIA, and partly because of the enactment of the Insurance Law. After 5 years' development, the Vietnamese market has gained considerable socio-economic achievements, confirming its role of risk hedger and investment capital mobilizer.

That the insurance industry of Vietnam has made such bold steps is backed up by its political and macroeconomic stability, increased transparency and standardized legal frameworks. All insurance companies, both life and non-life, have used their competitive advantages well confirming their position in the market. Individual and corporate customers highly value the prestige of insurance companies. The growth of the insurance market, especially in life have started to slow down after the development wave of 2000-2003, but development potential exists. The participation of new names in the life market is promising to create new development waves. The growing insurance market is, on one hand, improving the financial stability for individuals, businesses and the entire economy, and on the other, mobilizing savings for investment and improving the efficiency in resource allocation.

Despite remarkable breakthroughs, the insurance sector of Vietnam still has many weaknesses:

- Legal regulations are inadequate, overlapping, conflicting, and do not keep pace with the development of the insurance sector;
- The mechanism for state authorities to provide information for insurance firms is not clear, many officials still have an attitude of "asking – giving" towards enterprises, and are not really aware of their responsibilities in assisting insurance firms.

- Asymmetric development and high market concentration;
- Domestic companies lack long term development strategies, management experience, technical expertise and information technology application capacity;
- Domestic insurance companies do not have strong financial potential;
- Relationship based Competition is common;
- Inexperienced individual consumers;
- The stock market has not contributed much to the development of the insurance market;
- Human resource has not satisfied the sector
- The collection, storing and processing of statistics has not been standardized at both industry and company levels.

The market might develop beyond the controlling capability of regulators. The regulators might not be able to assess and supervise business operation of insurance companies, especially the foreign owned companies. Greater integration of Vietnamese insurance markets into the regional market will makes Vietnam more exposed to International and regional crisis. Current high market concentration might lead to the collusion between large insurance companies, which will affect the market. Finally, a developed insurance industry might also widen the gap between rich and poor.

6 Impacts of the liberalization in the Vietnamese insurance sector

6.1 Assessment of the impacts of market liberalization to date

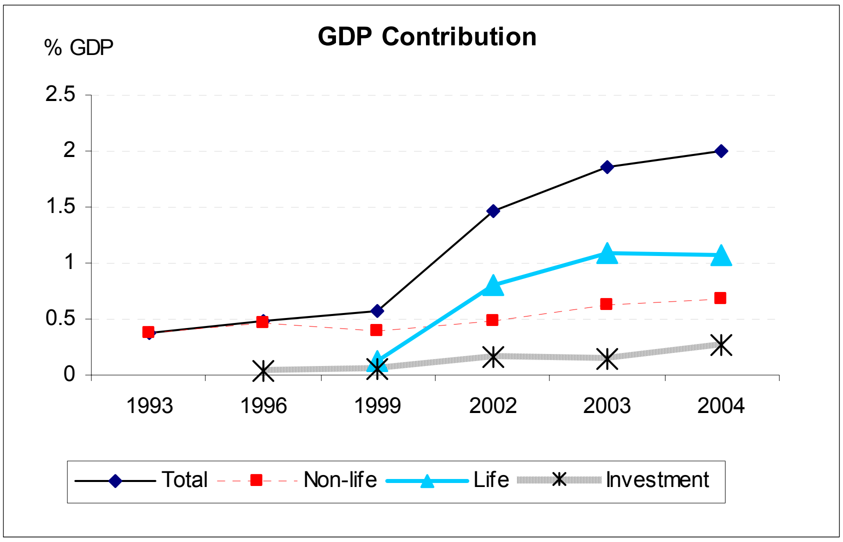
This section presents an overview of the Vietnam insurance market's process of opening and its impacts on the economy in general, the insurance sector, and service users. Analysis and evaluation of impacts will be closely considered in connection with new entries and expansion.

6.1.1 Impact on the economy

6.1.1.1 Contribution to economic development

In 1993, Bao Viet was the only insurer in the market and held a monopoly position. The insurance sector, at this time, contributed 0.37% to GDP, though this increased steadily up to 1999 with 15 insurers operating in the market. Since 2000, the market has had considerable changes in terms of market size and number of insurers. The contribution to GDP of the insurance sector increased dramatically thanks mainly to the growth of the life sector and investment activities of insurers. The graph below shows this fact: while the rate of GDP contribution of non-life sector increased steadily from 0.37% in 1993 to 0.67% in 2004, the life sector increased from 0.12% in 1999 to 1.07% in 2004. Noticeably three out of four newly established life insurers (including Manulife-1999, Prudential-1999, and AIA-2000) are wholly foreign owned, and Bao Minh CMG is the only joint venture.

Figure 23: Insurance penetration, 1993 to 2004



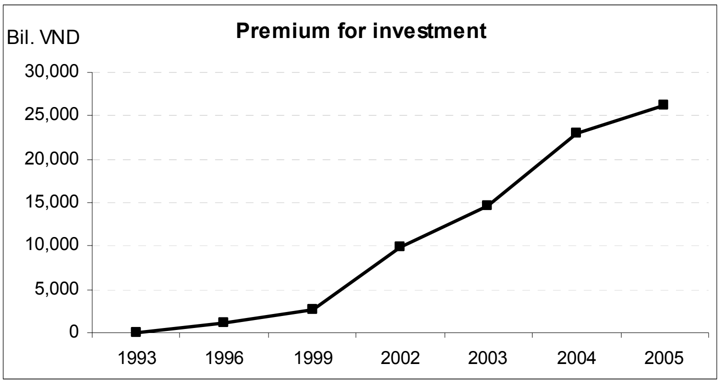
Sources: Vietnam Association of Insurers

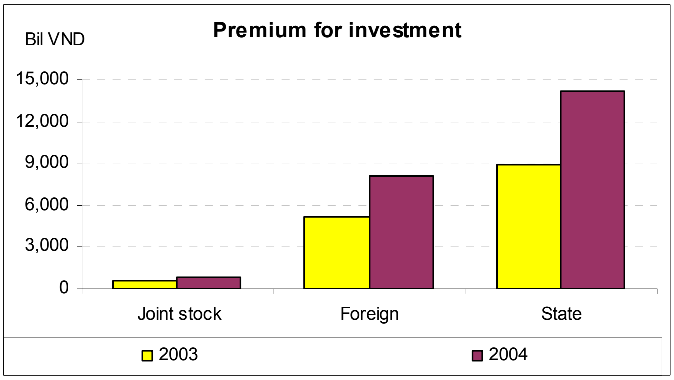
6.1.1.2 Insurance as a mobilizer of capital for the economy

The graph below illustrates the role of the insurance sector as an effective channel for capital mobilization. The rapid growth is owed partly to the contribution of foreign invested insurers.

Figure 24: Insurance premiums

Figure 25: Comparison of investment premium





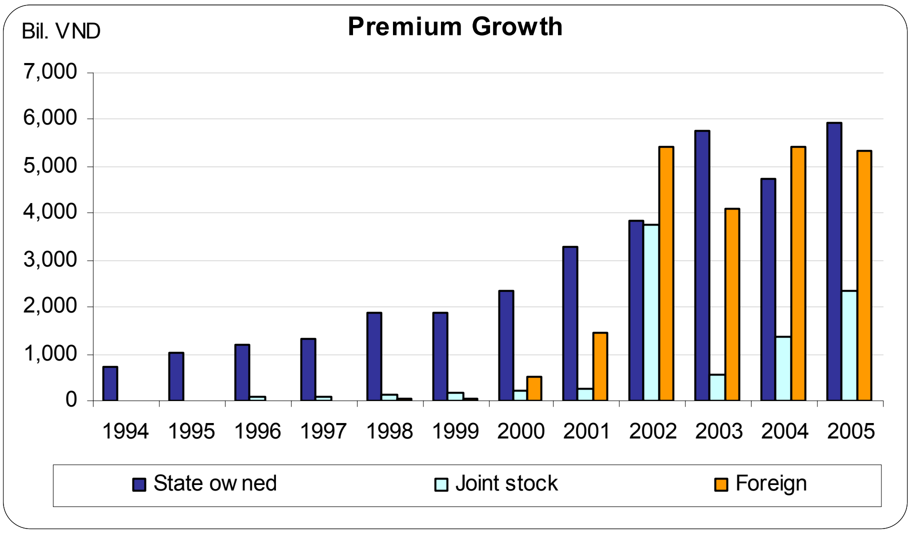
Sources: Vietnam Association of Insurers

In terms of investment structure, foreign invested companies accounted for 35.35% in 2003 and 34.91% in 2004.

6.1.2 Contribution to socio-economic stability

Functioning as a socio-economic stabilizer, the insurance sector has, in the past ten years, made remarkable steps increasing premiums by 14.59 times during the period 1994-2000. This growth rate was especially high since 1999.

Figure 26: Premium growth

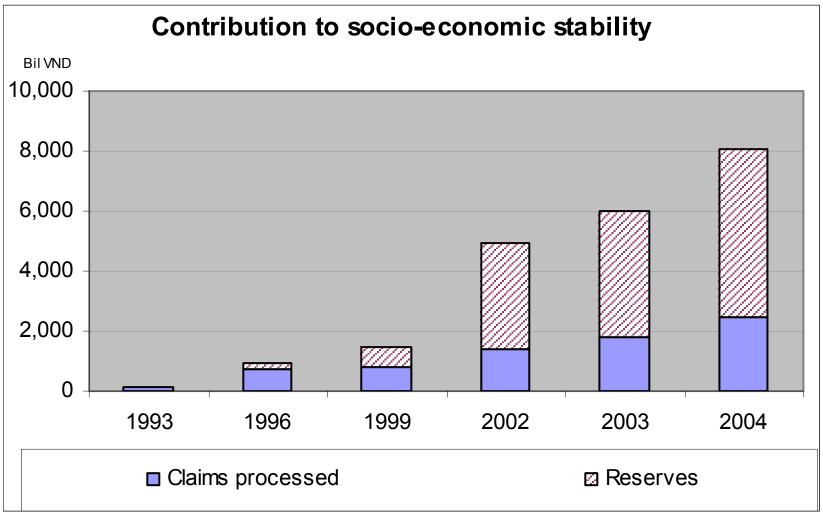


Sources: Vietnam Association of Insurers

By the end of 2004, the country had 6.549.905 life insurance users, 8.09% of the population. Between 2000 and 2004, life insurance premiums increased 40% annually, reaching VND 7,710.4 billions in 2004, 1.25% of GDP. However, between 2004 and 2005, the growth rate decreased, and was only 6.5% in 2005. At present, there are more than 100 life insurance products in the market, which better satisfy the demands of customers.

Indemnity value and reserve building has expanded rapidly between 1999 and 2004, while premium levels have change little, indemnity increased by VND 1,676 billions with an average growth rate of 62.48%. This illustrates that individuals and businesses are better protected against risks.

Figure 27: Contribution to socio-economic stability



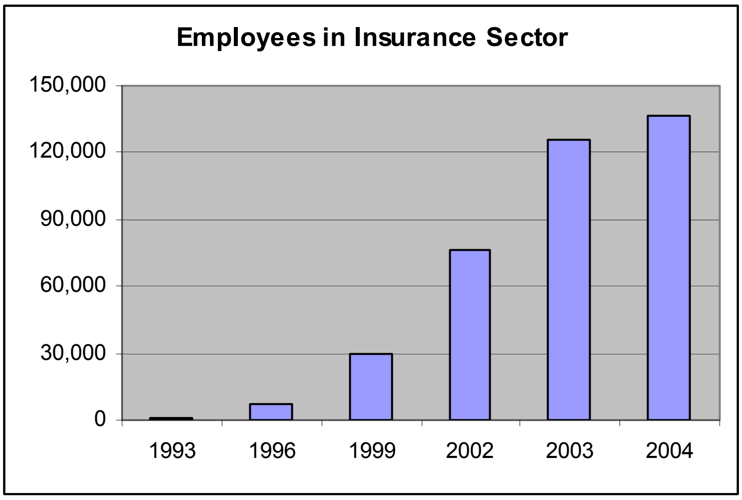
Sources: Association of Vietnamese Insurers

Reserve also increased between 1999 and 2004 thanks to participation of new insurers, especially foreign life insurers. Within only 5 years, total reserves increased 698,58% to VND 4,925 billions.

6.1.3 Employment Generation

Following the entry and expansion of insurers, employees working in the insurance sector increased dramatically. By the end of 2004, employment in the insurance sector increased 137 times compared to 1993.

Figure 28: Employees in the insurance sector



Sources: Vietnam Association of Insurers

6.1.4 Regulatory regime is more transparent, fair and closer to international standards

There have been a number of changes in the legal system that has strengthened the insurance sector considerably. The Insurance Law replaced Decree 100/CP 1993 and now uniformly administers insurance activities. Supporting documents regulate the Law in greater detail and are increasingly in line with International standards.

6.1.5 Unfair competition between insurers

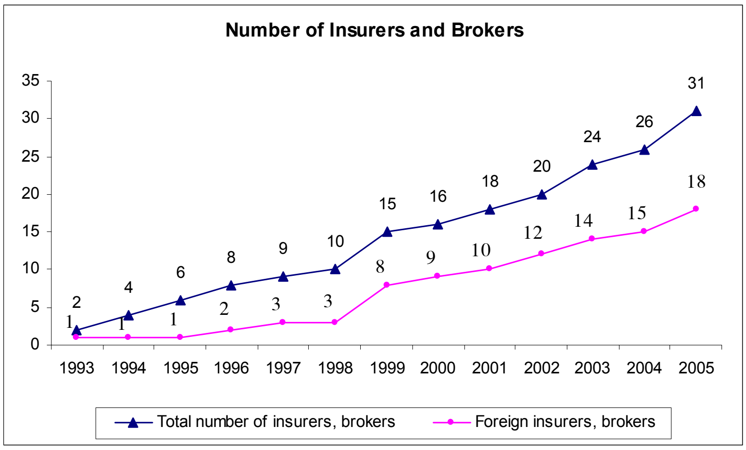
The participation of new insurers has made the insurance market busier with greater contribution to socio-economic development. However, such severe competition has led to some of insurers using unfair competition measures, such as price dumping and enticing employees and agents from other insurers, using personal relations to win contracts. These activities have not yet become too serious and have, to some extent, been stopped by both administrative tools and agreements amongst insurers. However, policy makers, should keep closer track of the market to watch for signs of unfair competition. In the future, with the participation of more companies, these unhealthy measures will probably be seen again causing more serious impacts, not only in the insurance sector, but also the entire financial sector and the socio-economic stability of Vietnam.

6.2 Impacts on insurance sector

6.2.1 Increased business in the insurance market

Since the market opened the number of insurance companies has increased quickly. The most noticeable increase was in the number of foreign owned insurance companies, especially in 1999 with the participation of 5 companies

Figure 29: The number of Insurers and Brokers



Sources: Vietnam Association of Insurers

This is the first and most noticeable impact of liberalization, which has also been seen in other countries such as China. The number of life insurance companies in China more than tripled within 10 years since the end of the monopoly period in 1995.

Box 7: Number of life insurance companies in China

	1980-1995 Phase I	1996-2001 Phase II	2002-2004 Phase III	2005- Phase IV
New	**4**	**10**	**14**	**19**
Domestic	3	3	3	15
Foreign owned	1	7	11	4
Total number	**4**	**14**	**28**	**47**
Domestic	3	6	9	24
Foreign owned	1	8	19	23

Source: Ping An Insurance Company - China

The participation of new insurers, especially foreign, has increased activity in the market, with insurance premiums increasing continuously and quickly. The most remarkable premium growth was recorded by foreign life insurers. The success of these companies illustrates the high potential of the market.

One of the most important elements of opening the market is the breaking of the monopoly situation by quickly increasing insurance suppliers. In fact, the opening process of the Vietnam insurance market has achieved this objective. A market of more suppliers will motivate the process of expanding product range, and hence, facilitate the insurance sector to perform its function of mobilizing capital and protect individuals and businesses from risks.

6.2.2 Strengthening knowledge and expertise transfer

Domestic insurance companies are now in a better condition to acquire knowledge and professional skills from foreign companies. Changes in the market over recent years reveals that foreign insurers are in a more advantageous position than domestic insurers in terms of risk assessment and management, contract management, and marketing strategies.

Higher competition pressures have forced domestic insurers to actively adjust their management structures and policies, train their employees and apply information technology to increase their competitiveness.

6.2.3 Personnel movement among insurance companies

As the number of new insurance companies entering the market grew faster than the number of qualified personnel working in the insurance sector, there has been significant movement of qualified personnel amongst insurance companies. New insurance companies, especially those in life insurance offer attractive policies to entice employees from other companies.. This not only affects the personnel structure of domestic insurers but also helps other companies to get sensitive information about their competitors.

Domestic insurers, if they do not adjust their personnel policies, will lose advantages against their foreign competitors. In senior personnel, foreign insurers have an absolute advantage thanks to their traditional development and complete training systems. Lower ranked employees are enticed by offering attractive policies and employment packages.

In order to prevent serious employee movement amongst insurers, several insurers have signed an agreement, in which insurers agree not to take measures to entice employees from each other. The agreement, however, is just an agreement and not very binding.

6.2.4 Restructuring State Owned Enterprises to improve the competitiveness

To implement the SOE reform programme of the Government and improve competitiveness, most state owned insurance firms have been transformed into joint-stock companies, such as Bao Minh, PTI or have become holding companies as with Bao Viet. Most companies have developed to become strong financial corporations working in different fields, most other state owned companies have been equitized to create a better mechanism for capital raising and management. Though this is not the case for Bao Viet, which is still a state owned company.

6.2.5 Market share of state owned enterprises is shrinking

The decrease in the market share of domestic enterprises was the most obvious impact of the liberalization process in all countries. Insurance markets are not an exception. Statistics show that the market share of Bao Viet Life Insurance decreased from over 70% in 2000 to 40% in 2004. In parallel with this decrease was the rapid increase in the market share of foreign insurers, especially Prudential.

Figure 30: Trend of life insurance market share

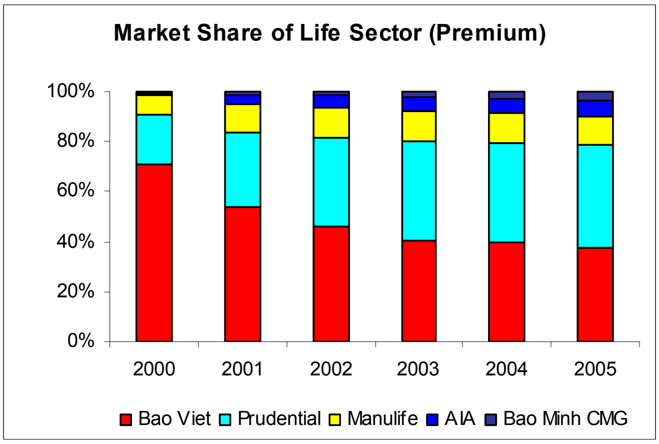
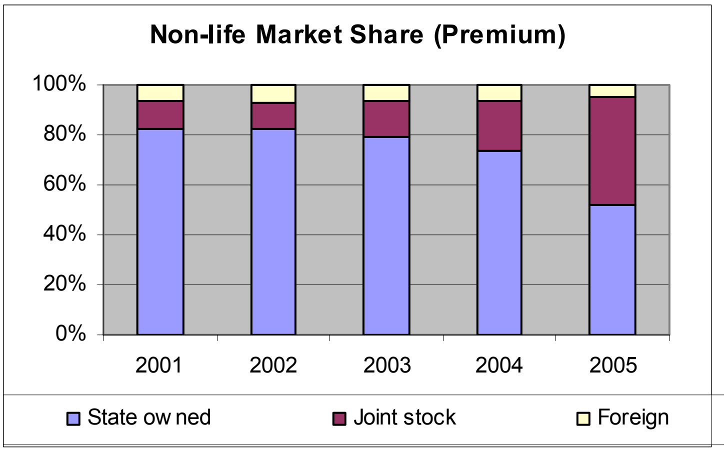


Figure 31: Tendency of non-life insurance market share



Sources: Vietnam Association of Insurers

6.3 Impact on service users

6.3.1 Wider choice of products

By 2004, the Vietnam insurance market had over 650 products. The process of geographical expansion and product diversification has helped insurers to reach their target of stable development.

6.3.2 Improved service quality

Our survey of 95 corporate users shows that service quality has improved significantly. The procedures relating to contract signing have been significantly improved to the convenience of customers with 82% of users feeling processes are now convenient. The proportion of interviewees which see process as "very convenient" is 13.4%.

80.8% of customers felt that customer care was "good" and "very good", while the proportion assessing "not good" accounted for less than 5%. Current products in Vietnam insurance market are evaluated as "good" (78.5%) and "very good" (7.6%). Therefore, most of products (86.1%) satisfy customers' needs, to some extent.

6.3.3 More affordable insurance premiums

The Vietnam insurance market has recently experienced great fluctuations in premium rates. Rapid increases in the number of insurers and the continual geographical and product expansion have put increased competition pressure on insurers. This has forced some insurers to use premium rates as their main competition tools, a sensitive but effective tool. Survey results, however, show that low insurance premiums are not the most important factor affecting the decision making processes of customers.

Table 21: Factors affecting insurance supplier choice

High financial safety	29,0%
Good customer service	12,6%
Introduced by acquaintances and/or partners	11,0%
Long working history	10,5%

High professional characteristics	10,5%
Competitive premium	9,5%
Vietnamese insurance firm	9,0%
High reputation	5,3%
Foreign invested firm	1,1%
Working in different countries	1,1%

Source: Survey result

6.3.4 Improved awareness of insurance

Together with the opening of the market, the operation of insurance companies has made a good contribution to increasing peoples awareness of the role and function of insurance. Good awareness and knowledge of insurance and insurance activities will help achieve the targets set out by the sector.

6.3.5 Inexperienced users will be affected

Individual users have very little experience in using insurance, especially life insurance. This has been significantly affected by the introduction of new products and concepts into the market. Though there is yet to be a in the life insurance market, the number of customers, which have been disappointed on notification of their benefits could be large.

6.4 Impacts on market regulators

6.4.1 Establishment of an independent insurance market regulator

During the 1975-1989 period, Vietnam’s Insurance Corporation held monopoly control of insurance services and also acted as state management and regulator of the insurance market. By the beginning of the 1990s, and after the enactment of Decree 100/1993/ND-CP, the state management role was removed from the Vietnam Insurance Corporation and given to the Ministry of Finance (Department of Finance and Banking).

In 2003, the Department of Insurance under Ministry of Finance was established as an independent insurance market regulator, responsible for assisting the Ministry of Finance to supervise the establishment and operation of insurance, brokerage and reinsurance firms and all insurance activities in the market. With the establishment of an independent insurance market regulator, the legal framework governing insurance activities has been gradually improved with the turning point being the Law on Insurance Business in 2000 and its guiding documents.

6.4.2 Application of International standards in supervising market performance

In parallel with the establishment of the Insurance Department as an independent insurance market regulator, many efforts have been made to build the capacity of insurance officials, studying International standards and experiences of other countries in regulating the insurance market. As a result, regulators have gradually shifted from the regulation of the market through administrative procedures to regulating through prudential standards and indicators to ensure solvency and fair competition. Legal regulations governing insurance activities are more and more in line with the world’s best practice, which has facilitated the operation of insurance companies and protected the public.

6.5 Possible impact of further liberalization

6.5.1 General impact

6.5.1.1 The insurance market and insurance legal system of Vietnam has come closer to the International benchmarks

Integration requires Vietnam to improve its legal framework to bring it more in line with WTO and BTA regulations. Improvements are not only carried out in the insurance sector, but also all other financial sectors. The greater participation of foreign insurers in the market and increased flexibility in reinsurance overseas will help to maintain premiums close to world levels. This will generate benefits for both customers and insurance companies. For customers, they will benefit from better services and more affordable premiums, while insurance companies, will find it easier to be reinsurers.

6.5.1.2 External capital mobilization

For the market to sustainably develop, it must have enough capital capability. Under current circumstances, domestic insurance companies, both state owned and joint stock, are encountering difficulties in raising their capital levels. State owned companies are dependent on the state budget plan. Newly equitized companies such as Bao Minh and Vinare may list on the stock exchange soon, which will help them to better mobilize capital. Privately owned joint stock insurance companies will find more difficulties in raising large amounts of capital. The introduction of external capital is one solution, which will lead to an increase in investment capital for the economy through foreign owned insurance companies investments.

6.5.1.3 Better managed risk and increased market attractiveness

Well established foreign owned insurance companies have significant experience in assessing and managing risk. Risk assessment and management is carried out not only at the beginning of the policy, but throughout the policy term and when the company makes investments. Statistics also reveal that foreign owned insurance companies have quite low and stable loss ratio, while Vietnamese companies, especially joint stock companies, have higher and more volatile loss ratios. The participation of big names in the Vietnamese market will bring in effective risk hedging tools. Should risks be managed effectively, both individual investors and businesses will find it more secure to increase their investments.

6.5.1.4 Neglect of market segment(s)[12]

In 2000, the economic research and consulting service of Swiss Re released a report “Emerging markets: insurance industry in the face of globalization”. The report states “There are worries that selective marketing by foreign insurers could result in the neglect of some customer groups. Foreign insurers, which are generally more focused on high-value clients, could fail to provide insurance covers to certain customer sectors, particularly to low-income groups”.

This is one arguments that many countries use to counter the participation of foreign insurers in their markets. Market segment neglect is really a threat to the development of the entire market and is not only due to the impact of the participation of foreign insurers only. Except for state owned insurance companies, which might be assigned to provide services for specific groups for social objectives rather than economic profits, privately owned insurance companies do not take such groups as target markets as they do not see profit potentials.

Fair treatment within all economic sectors is a two way action and is not only down to the removal of Government protection to the state sector. The state sector should also have social responsibilities removed in order to compete fairly with other companies. Therefore, in insurance, it is necessary to separate commercial insurance from social insurance. A company with too many objectives to achieve, will not fully achieve any objective.

[12] Skipper H.

6.5.1.5 Market share and dominance of foreign companies

This seems to be the biggest concern of liberalization. While domestic companies see the benefit of having foreign competitors in the market, they still feel uncomfortable seeing their market share shrinking. The market has grown and every company has also grown. However, it seems that companies prefer to grow both in absolute size and market share. The government also shares the concern that market share might go to foreign competitors.

Foreign insurers are looking for new markets and emerging markets need insurance service providers. It is inevitable that domestic insurers share their markets with foreign competitors. This should be seen as a natural development of international division of labour. While developing countries export garment, agricultural products to developed countries, they import high tech products such as airplanes, mainframe computers, banking and insurance products.

Will foreign insurers dominate the domestic market? Right now foreign insurers only have 7% of the non-life sector. This is partly due to the fact that until recently foreign insurers were only permitted to serve FDI projects. When restrictions are removed, the situation will change. However, domestic companies will continue to dominate in future because few foreign insurers will be interested in the motorbike insurance market which accounted for 28% of total market premium income in 2004[13]. The life insurance sector is different, with 4 foreign insurers and 1 domestic company. Prudential alone has surpassed Bao Viet Life in market share. At the end of the 2nd Quarter 2005 domestic companies only had a 40%share[14]. Recent trends show that this will decrease.

6.5.1.6 Increasing Mergers and Acquisitions, and Financial Integration

Mergers and Acquisitions and Financial Integration of financial corporations have been increasing over recent years. In Vietnam, this has increased over the last 2 years. In the banking sector there have been several cases where small joint stock commercial banks have merged or joint stock commercial banks have merged with corporations in other sectors to form bigger banks, foreign banks have acquired shares of existing local joint stock commercial banks etc. In the insurance sector, Bao Viet has been restructured into a large Financial Corporation, of which its subsidiaries are operating in different financial sectors of life insurance, non-life insurance, fund management, banking etc. Recently, foreign investors in the BIDV-QBE insurance company also sold off its share to BIDV to transform the joint venture into a 100% domestic insurance company. At the same time this foreign investor acquired Allianz insurance from its German investor. In future, in addition to the establishment of new insurers and brokers, there may also be a number mergers and acquisitions involving foreign participation. This will require coordination between different authorities to ensure the close supervision of the various activities.

6.5.1.7 Non-traditional distribution channels

Over the long run, more non-traditional distribution channels will be developed. Bancassurance and selling insurance through post offices have been introduced to Vietnam by Prudential and Prevoir. Bancassurance has gained positive results in recent years and will become more popular as financial integration increases. E-commerce and tele-marketing will also develop as the Internet becomes more popular and users become more familiar with and aware of insurance.

6.5.2 Specific impacts of the Vietnam–United States Bilateral Trade Agreement

[13] See Association of Vietnamese Insurers, No. 04/2004. This figure of motor vehicle insurance includes insurance of motorbikes, cars, vans, trucks and other special class of vehicles.
[14] See Association of Vietnamese Insurers, No. 01/2005

The BTA and the offer of Vietnam under GATS are the highest commitments of the Government of Vietnam in opening up its insurance market. The following analysis looks at the commitments of Vietnam under BTA with some reference to offers made by Vietnam under GATS. As Vietnam is not yet an official member of WTO, Vietnams offer is not a final commitment. However, according to MFN principles, what Vietnam has committed to under BTA shall also be applied to other WTO members. In addition, to date, the offer of Vietnam under GATS are very similar to its commitments under BTA.

Compared to a number of countries in the region, the Government of Vietnam is quite flexible in allowing foreign insurers to enter the Vietnamese market. Even before the signing of BTA or its offer under GATS, the Government of Vietnam had allowed foreign insurers to establish 100% foreign owned insurance companies in Vietnam, the highest liberalization under Mode 3. In national treatment, there remain some legal restrictions to foreign insurers in the non-life sub sector.

This analysis focuses on commitments of Vietnam, which remove existing restrictions in both market access and national treatment.

6.5.3 Commitment of Vietnam under Mode 1: Cross border

Foreign insurers overseas are allowed:

- To supply insurance services for foreign owned insurance companies in Vietnam
- To supply insurance services in international transport

The Vietnamese Insurance Law states that individuals and organizations, which wish to be insured, can only purchase insurance services from insurance companies operating in Vietnam. The commitment of the Government of Vietnam allows foreign insurers overseas to participate to these market segments. Commitments in the international transport sector will not have too much impact on insurance companies in Vietnam, as so far, the majority of Vietnam's imports and exports are insured by foreign insurers overseas (as most imports are imported by CIF and exports are exported by FOB). However, allowing foreign owned companies in Vietnam to buy insurance from foreign insurers overseas would significantly affect insurance companies operating in Vietnam, and foreign owned insurance companies are most likely to be affected. If foreign owned companies, especially those of transnational companies, are allowed to freely select insurers, they would tend to use the services of foreign providers, who supply services for their parent company. Currently, foreign owned companies are the target customers of foreign owned insurance companies in Vietnam, thus if a large number of foreign owned companies shift to foreign providers, foreign owned non-life insurance companies operating in Vietnam would be greatly affected.

Under liberalization foreign owned companies would have increased choices. Many companies would be able to save insurance costs as they would be entitled to special premiums offered by service providers when they use joint group services with their parent company or other companies in the group. However, the purchase of services from foreign providers is not that simple, especially with large and complicated risks. For such risks, the process of risk assessment and claims would be much more complicated than that of an insurance company operating in Vietnam, costing foreign providers more to send their expatriates to Vietnam to assess the risks and losses.

The opening up of the market will generate more development opportunities for insurance brokerage companies, especially foreign owned ones as they have a wide network of relationships, knowledge and experience with foreign insurers overseas, thus they would better approach foreign owned companies in Vietnam to introduce and offer services.

Foreign brokerage companies overseas are allowed to supply insurance brokerage services and reinsurance services for insurance companies in Vietnam. The current law does not restrict Vietnamese insurance companies from ceding their premiums overseas (of course, the obligatory ratio of ceded premiums to Vinare must be satisfied), thus the supply of reinsurance brokerage services through mode 1 has not been restricted. Thus, this commitment would not have much impact on the market of the insurance brokerage companies regarding the insurance brokerage activities, although there is currently no restriction to the supply of insurance brokerage services through mode 1, individuals and organizations of Vietnam are not allowed to buy services from foreign providers overseas. As a result the supply of insurance brokerage services through mode 1 has not been feasible. The market, which shall be opened up for insurance services for international transport and foreign owned companies, would facilitate foreign brokerage companies overseas to approach foreign owned companies in Vietnam to have their services introduced and offered. This would be a big challenge to domestic brokerage companies as they do not have such a wide network, bulk of knowledge and experience with foreign insurers overseas as their foreign competitors.

6.5.4 Commitments of Vietnam under Mode 3: Commercial presence

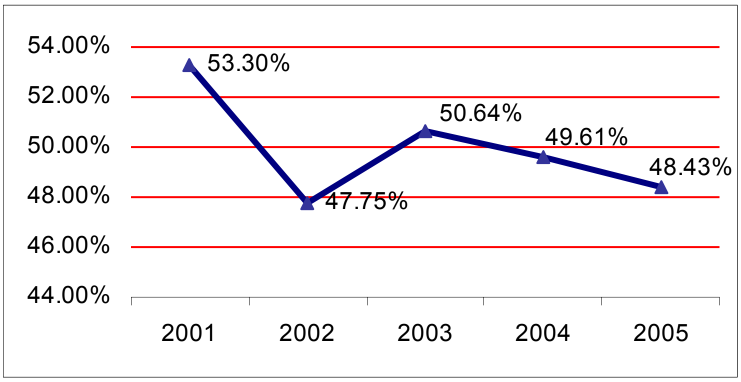
Existing restrictions in national treatment shall be removed, which means that restrictions in terms of fields of operation, target customers shall be removed. Foreign owned insurance companies shall be allowed:

- To supply insurance services for state owned companies or projects financed by the state budget.
- To supply obligatory insurance including third party liability of vehicles' owners, construction and installation, oil and gas, projects and constructions of high danger to the public and environment.

In the short term, the elimination of such legal restrictions will not cause much impact on domestic insurance companies, as in most of these insurance classes, the wining of contracts depends on the relationship with the project investors. Foreign owned insurance companies, which have just entered this market, would not be able to set up as wide network of relations as their domestic competitors. However, this competitive advantage of domestic companies will gradually diminish if it is not backed up with service quality improvements.

Foreign owned insurance companies have to cede a minimum of 20% of their contracted liability to Vinare. However, this obligation shall be removed in 2006 under BTA, and 1 year after Vietnam's accession to WTO under the existing offer of Vietnam under GATS. This obligatory cession will ensure premiums for Vinare and minimize the transfer of premiums overseas by cession contracts, which will help to increase insurance penetration and investments back to the economy. However, this is also a big pressure for Vinare. In order to accept all these obligatory reinsurances, Vinare must be improved in both financial capacity, expertise and management. Should Vinare not be capable of retaining all such ceded premiums, it would have to recede the premiums overseas. In such a case premiums will not be retained in the Vietnamese economy. When obligatory cession regulation is removed, Vinare will face large losses in obligatory premiums. To cope with this challenge, Vinare was restructured in 2004 to have a more flexible mechanism to raise capital and structure its management. Over recent years, the ratio of obligatory premiums over the total premiums of Vinare has decreased, leaving more room for voluntary reinsurance.

Figure 32: Obligatory reinsurance premiums



Source: Association of Vietnamese Insurers

6.6 Conclusion

The Vietnamese insurance market opened to foreign participation very early. Compared to some countries in the region, the Government of Vietnam is quite flexible in allowing foreign insurers to enter the Vietnamese market. Even before the signing of BTA and its offer under GATS, the Government of Vietnam had allowed foreign insurers to establish 100% foreign owned insurance companies in Vietnam, the highest liberalization under Mode 3. In national treatment, there remains some legal restrictions to foreign insurers in non-life sub sector.

Statistics show that thanks to the participation of foreign owned life insurance companies in the market since 1999, the life insurance market has become busier. The establishment of several insurance companies has increased insurance premiums, insurance density, insurance penetration and investment back to the economy. Socially, insurance has generated a large number of jobs (over 130 thousands) by recruiting many insurance agents. Under pressure of integration commitments in trade agreements and strong market growth the Government of Vietnam has made great efforts in completing the insurance legal framework that is transparent and fair to all market stakeholders, and ensure the sustainable and healthy development of the market. Although competition pressure has given rise to some unhealthy competition actions such as a decrease in premium rates and the enticement of each others' customers and agents. Insurance fraud has also happened, however, regulators, in coordination with the Association of Vietnamese Insurers and insurance companies themselves have managed to control this situation.

The development of the market has helped all companies to develop in terms of premium volumes. However, the share of domestic companies, especially state owned companies in the life sub sector has been reducing and moving toward foreign owned insurance companies. Prudential, after 6 years' operation in Vietnam, has won 40% of the market from Life Insurance company Bao Viet. The non-life sub sector is very different, with a controlling share in the hands of state and state equitized companies. After nearly 10 years in Vietnam, foreign owned non-life insurance companies (7 of 14 non-life insurance companies) now account for around 7% of the market. Legal restrictions are currently attributed to the moderate development of this group.

The appearance of foreign owned insurance companies in the market has improved technology and expertise transfer, but has, on the other hand, given rise to a big movement of human resources amongst insurance companies resulting in many disadvantage for domestic companies. The flow of qualified staff from domestic to foreign owned companies is very common and is a problem for domestic managers.

Due to market changes, state owned companies have been restructured to increase their competitiveness. Vietnam Insurance General Corporation has been restructured as a holding company. Other state owned companies were equitized. The first operational results of restructured companies has shown good performance.

The main beneficiaries of liberalization are insurance customers, both individual and corporate as products have become more diversified, service quality has been improved and premium rates have become more affordable. However, individual customers have, also been affected by their inexperience in insurance. Many agents, for the sake of premiums, have made misinterpreted the policy terms and conditions to customers.

When insurance commitments of Vietnam under BTA take effect and Vietnam joins WTO, positive impacts may increase while negative ones may become more serious, as a result of the greater participation of foreign insurers to the Vietnamese market. In addition to such positive impacts as better legal framework, external capital mobilization, better risk management, there are also negative impacts including neglect of market segments (e.g. insurance for low income earners) and market dominance by foreign insurers.

7 Recommendations

7.1 Recommendations to policy makers and market regulators

7.1.1 Completion of the insurance legal framework

The insurance legal framework must be reviewed carefully and amended so that **inappropriate and unclear provisions are revised and inadequate regulations are amended,** specifically:

7.1.2 Revise inappropriate and unclear provisions

Consideration should be given to the issue of VAT. The insurance sector is aiming not only to increase total premiums, but more important to increase the portion of premiums retained in the country, which will be channelled back to the economy through investments. The application of VAT of 0% to reinsurance ceded domestically could be a good incentive to encourage insurers to retain premiums in the country.

Consideration should also be given to the issue of marketing costs. Capping marketing costs of insurance firms at 10% over total expenses, which is applied to all firms in all other industries, may not be reasonable. An insurance firm with good risk assessment and management expertise would normally have lower compensation expenses. If the cap of 10% of total expenses applies, such firms will be placed at a competitive disadvantage as they would not be allowed to spend as much as their competitors on marketing activities.

The provisions on contract termination and contract annulling should be reviewed carefully to ensure that clear interpretations and guidance is provided. The legal consequences of the unilateral termination of a contract and those of an annulled contract are completely different, thus the provision of wrong information to enter an insurance contract should not misleadingly lead to either unilateral termination or annulled contracts.

7.1.3 Supplementing inadequate regulations

Regulations on the expertise and experiences of managers of an insurance firm should be made greater detail. There must be provisions on what qualifications and experience that key specific positions (e.g. CEO, actuary) should meet.

A uniform application of the same insurance terminologies in all insurance policies and supporting documents is beyond a question. Insurers must be asked to use such terminology (which might be developed and defined by the Vietnam Association of Insurers) under law so that the interpretation and comparison of such documents by policyholders is facilitated and future misunderstandings and misinterpretations can be avoided.

Guiding documents relating to lending activities, making investments in real estate, the share of insurance firms, especially foreign owned ones, should be provided to facilitate the investment activities of insurance firms. This will promote the channelling of capital to the economy, and will bring in greater returns to insurance firms and policyholders. In addition, legislation regarding corporate governance and the financial transparency of firms should be more in line with International practice. Compliance with such legislation must be monitored and supervised more closely by the authorities so that insurance firms can have better confidence when buying stakes in specific companies, especially non-listed ones.

There should be more stringent requirements on reinsurance activities of insurers. The existing legislation regulates the criteria which should be met by a reinsurance firm overseas, but there is no concrete requirement for insurance firms to disclose information of their reinsurers. The provision of information on reinsurance activities of insurance firms will not only help to protect policyholders, but also help regulators to detect cases, where insurance firms issue an insurance policy just for an overseas ceding purpose, which is called fronting business.

Although fronting business is not forbidden in Vietnam, it must be under tight control and supervision of authorities as this is not a normal insurance business. It does provide necessary insurance to the economy, especially in cases where domestic firms are incapable, but it might also harm the rights and benefits of the insured as the insurance firm, which legally bears the underwriting responsibilities, does not have enough resources to underwrite such risks. If such business goes beyond a limit, the healthiness of the sector will be affected.

All statutory insurance should be clearly regulated in one single legal document. There must be a joint force of different authorities so that all legal documents governing insurance activities of specific sectors (e.g. construction, maritime, fire etc.) are more comprehensive and transparent and the enforcement of laws is enhanced.

Where an insurance firm withdraws from the market or becomes insolvent must be regulated in greater detail. Existing legislation does refer to the transference of insurance policies, but does not specifically address the issue of an insurance firm intentionally stopping their operations. The law also lists measures to recover the solvency of an insurance firm, the establishment of a supervision committee to monitor troubled companies, but does not go into detail on how each measure is carried out, how the committee is established and functions. The law does refer to the Bankruptcy Law, but an insurance firm is not like any other firm. The protection of the rights and benefits of policyholders must be the top priority. The application of normal bankruptcy procedures and orders of priority in receiving payments does not guarantee the best protection for policyholders. Greater efforts should be given to the revision of all such laws so that the principles of the Bankruptcy Law are observed, while the rights and benefits of policyholders are protected.

There should be adequate a legal framework for private and civil investigation so that insurers can be more active in the market. The results of private and civil investigations should be regulated and legalized in detail so that they have a legal validity for insurers to base insurance fraud assessments before they are regarded as crime. The development of this mechanism will help insurers to avoid insurance fraud and will help insurers to deal with such insurance fraud and enter policies with such clients.

7.1.4 Neglected market segments

The Government must be responsible for attending to neglected market segments. In the existing market the provision of services for some special groups such as farmers and poor people will not bring insurers profits. In the case of agricultural insurance, which had been tailored to farmers, Bao Viet Vietnam and Groupama have not been successful due to various technical and economic difficulties, of which the affordability by farmers is still a big concern.

In order to ensure that poor and disadvantaged groups are well protected, Government funded insurance, such as obligatory health insurance, social insurance or other types of insurance such as mutual insurance should be strengthened to become more effective. The Government should have researched in greater detail, initiate pilot projects so that appropriate forms of service supply could be identified in agricultural insurance,. The Government could also oblige farming households, which borrow from the state budget or ODA, to buy agricultural insurance.

7.1.5 Improving the law building, inspection and the supervision capacity of state regulators

As we discussed above the strong development of the insurance market may surpass the control of market regulators. It has been shown that the development of the market, growing competition between insurers, the introduction of new products, new terminologies, and a new way of doing insurance business has made a strong contribution to the economy, the sector and consumers. However, this has also given rise to the appearance of unhealthy competition in the market and conflicts between insurers and the policy holders.

In order to effectively regulate the market and protect rights and benefits of inexperienced customers, in addition to the organization of training courses or sending officials to overseas training, the regulatory authority should work with regulators in other countries and encourage dialog within the insurance association and between the industry and the regulator. Today this job has been done satisfactorily and should continue. The recruitment of the former staff of foreign companies to work in regulatory authorities should be encouraged. In addition, attention must also be paid to investment in infrastructure and the application of information technology to state management to ensure the updating and processing of market activities.

7.1.6 Building a system to collect, store, process and share insurance statistics

The insurance sector operates successfully based on a pool of statistics which are accumulated over a long history. While an insurance sector with a short development history may not built up such a good statistical database.. The statistics collection activities in Vietnam have not been well carried out compared with other countries as there is no clear mechanism for state authorities to provide information for insurance firms.

This is an urgent need of Vietnam's insurance industry. This is not a simple task, not only from the financial point of view, but also from the willingness of insurance companies. The Ministry of Finance could assign the Association of Vietnamese Insurers to initiate this project. It is necessary to determine which information and statistics must be collected, stored, processed and shared between different stakeholders. The responsibility to collect, store, provide information and the statistics of insurance companies should be regulated in related legal documents. It is necessary to have a clear mechanism for state authorities to supply information for insurance firms. It is also necessary to separate the role of state management from the role of public service. There are many kinds of information, which can be collected by state authorities (country statistics, transport accident dossiers, fire dossiers etc.) and insurance firms are willing to pay for such information. The separation of state management from public service will ensure that state authorities have budgets to collect information, and will build up a mechanism for state authorities to officially supply information to insurance firms so insurance firms have an official source of information.

7.1.7 Continue to develop financial markets, especially the stock market

The insurance sector has integrated links with the stock market. In most economies with developed insurance sector, insurers are listed on the stock exchanges. To the insurance industry, the stock market plays both a duel role of capital mobilization channel, and offers investment opportunities. In Vietnam, due partly to legal restrictions and partly due to limited financial capacity and transparency of companies, no insurance companies are listed on Vietnam's stock exchanges. As a result the stock market has not performed its role as a capital mobilization channel. With regards investment, the stock market has too few products, weak information updating operations and limited transparency which is not very attractive to insurance companies, especially foreign companies. This leads insurance companies to direct their focus on Government bonds and bank deposits. Many other studies have shown that in the future Vietnamese banks will no longer be able to satisfy the capital demands of firms, and the capital market will have to be strengthened to ensure there is sufficient capital for the economy to grow.

7.1.8 Training human resources

Human resources in the insurance industry still have a long way to go to ensure the sector continues to develop. Analysis shows that there is still a big gap between what students are taught in universities and what they do in practice. It is not feasible to expect graduates to be able to handle their work right from the beginning. However, research reveals that the academic training in universities is still not close enough to the industry with too much weight spent on supplementary subjects or statutory insurance, not commercial insurance, where the demand for human resource is much bigger.

Training of insurance professionals must be reformed in all universities and institutes which offer such courses. The Government (through the Ministry of Education and Training, Ministry of Finance) must instruct training organizations to actively seek cooperation opportunities with the insurance industry so that students can have more opportunities to practice what they learn. At the same time the teaching curricula but satisfy the industry's requirements to a greater degree. Training cooperation with foreign training organization or insurance associations should also be encouraged.

7.2 Recommendations to insurance companies

7.2.1 Developing long term development strategies

The insurance sector of Vietnam is now experiencing a similar situation to China during its pre-opening phase (1996-2001) and the first years of its WTO accession, where most companies, especially domestic ones focused on increasing premiums. In the life sector, Chinese domestic insurers employed the tactic of "people ocean", recruiting a lot and increasing turnover. By the end of 2001, the number of sales agents in the life sector of China exceeded 1 million. Vietnam has developed similarly in the life sector, with insurers competing though the recruitment of sales agents. In the non-life sector insurers compete with each other by reducing premium rates. Realizing this is a problem, large Chinese domestic insurers started to focus on the basic construction of recruitment, selection and training of staff from 2003.Since 2005, when the market fully opened, Chinese insurers started to "change their operational guidelines, orienting to the long-term development, instead of pursuing the amounts of premium blindly. On one hand, they emphasized the new business embedded value, and on the other, they made great efforts to realize stable annual growth of profit and earning[15]".

Learning from the experience of Chinese domestic insurers, Vietnamese domestic insurers should develop a long term development strategy. Premiums are a very good indicator of growth, but in the current context of for domestic Vietnamese insurers, it might not be as important as human resource development indicators (e.g. retention rates, persistency rates, improvement in professional expertise and managerial skills) or operation efficiency indicators (standardized procedures and time savings for each), as these areas offer good foundations for future development. Of course, without good premiums, no company can make investments, either in their human resources or in other areas, but companies should find a good balance to ensure that they will not be exhausted when the new phase of competition comes.

7.2.2 Building a customer service culture

Analysis shows that many domestic insurance firms have not built up a customer service culture, while the foreign firms, inheriting such culture from their parent companies, are strong in customer services. While foreign firms standardize all work procedures, making inquiries convenient for their clients, to pay the premiums, to request information and to file a claims, domestic firms, though understanding that this is important, do not have comprehensive strategies and procedures to implement customer services. Foreign firms keep employees in specific procedures to serve customers, while domestic firms rely on the helpfulness of individual employees in dealing with customers. This causes problems as it is impossible to expect that all employees are helpful. As a result if there are some unhelpful ones, and there is no strict procedure for them to follow, customer service will be neglected.

Domestic companies need to improve their systems and training, to provide good customer services. While sales staff can be helpful to the customer more is needed. Companies must review the work flow from a customer's point of view to identify areas for improvement. The aim is not to provide good customer service only, but at the same time to increase operational efficiency.

[15] Ping An Insurance Company – Presentation delivered in Vietnam Insurance Outlook 2005

7.2.3 Improving managerial skills

Managers in domestic insurance companies might have been in their positions for a significant time, but lack experience of the market economy. The socialist management style still has its root in domestic companies. Decision making is slow; responsibility is not well defined; pay and promotion are not performance-related and little authority is granted to lower level. This phenomenon is common to every industry in Vietnam. In the insurance sector, beside general managerial skills, managers also need some specific to insurance skills. Although they do not need specific technical skills, they must understand their industry, its driving forces and competitive advantages.

Domestic companies should focus on long term training schemes. Promotion should be performance oriented and recruiting foreign expertise should be an option. Foreign managerial expertise can also be introduced to domestic firms through the involvement of foreign parties to the management board when foreign firms buy a stake of a domestic company. Domestic firms should take this into serious consideration when designing strategic development plans to determine whether the involvement of foreign parties to the management of the company will bring benefits. If so, domestic firms should actively search for compatible foreign insurers and reinsurers to work closely with and which might also strengthen their capital base though the purchase of an equity stake in the company.

7.2.4 Improving skills to underwrite complicated risks

At the moment domestic companies rely on foreign re-insurers and foreign competitors to underwrite large and complex risks such as power plants, oil rigs, air lines and professional indemnity. To date, without the skill to underwrite such risks, domestic firms are still able to win contracts as most of these projects are financed by the State budget and insurance cannot be provided by foreign owned companies in Vietnam. After issuing a policy the domestic company looks for re-insurance capacity overseas, when the entire insurance premium goes overseas. The domestic company only retains a symbolic share and earns re-insurance commission.

When restrictions on foreign insurers are removed as a result of market liberalization, domestic firms will probably loose this segment. As a result they need to acquire skills (training, recruiting of foreign expertise) and collect statistical data immediately to prepare for the future as this is going to be a long process.

7.2.5 Databases for actuarial activities

Although statistical activities must be carried out as a joint initiative at all levels, from the Government, sectorial and down to firm level, there should also be an organization to chair and coordinate the activities of various stakeholders at all levels. Insurance firms must be active in this because statistics are essential to their daily operations.

7.2.6 Information Technology

Domestic insurers are far behind foreign competitors in this respect. At the moment, no domestic company owns insurance software although they have are increasingly aware of this gap. Domestic companies need to address this issue immediately. There must be a clear Information technology strategy open to adaptation to changes in the future. In today's business environment, Information technology is the backbone of any operation, helping to reduce labour costs, making operations more efficient and helping to improve customer services. Information technology costs can be in the millions of dollars And implementation is a challenge for smaller companies, but they need to find more affordable way to implement it.

7.2.7 Developing a network of traditional customers

To date domestic non-life insurance companies outperform their foreign competitors partly thanks to the protection of the Government, and partly to the relations that they have built up with customers. It is important for domestic firms to now aactively exploit local market knowledge and local market connections to develop a network of customers, which will help them to have more resources to implement strategic development plans to compete with large foreign competitors.

7.2.8 Strengthening financial capacities

The first impact of the liberalization of any insurance market will be the increase in the number of insurers. Vietnam's market is not an exception. Although the increase in insurers might help to increase competition, many small scale companies will not help to improve the strength and healthiness of the industry. In the life sector, all foreign owned insurance companies belong to very big financial groups with very strong financial capacities. To face this competition, Bao Viet Group will go through a restructuring process to become a financial group. In some respects the decision to restructure Bao Viet appears to represent a similar attempt to develop a strong local market presence. However, Bao Viet is a special case, which receives great support from the Government to develop into a financial group. Other state owned insurance firms, equitized state owned firms or 100% privately owned firms will not receive similar support, thus they must have their own strategy to become more financially secure, not just to cope with market challenges, but also to expand and develop. However, there is also world evidence that smaller companies are being squeezed out of the market or are simply holding out on small premiums. For example, 79 out of 104 insurers in the fragmented market of Indonesia have a share of less than 1%. The increasingly polarised market is forcing second tier players to concentrate on niche sectors[16].

Over the past several years, after the Asian financial crisis, there has been a tendency that different financial services are integrated and big financial corporations are formed. This has been seen in many countries such as Taiwan, Japan and South Korea. The close linkages and inter-support amongst insurance, banking and other financial services have led to the merger of banks, insurance firms and investment funds, which will produce mutual benefits for all companies in the same group.

Domestic Vietnamese insurance firms should take into a serious consideration the possibility of merging or establishing alliances with privately owned banks, which are also facing greater competition from foreign banks. Experience from China's alliances between domestic insurance companies and banks, through mergers and alliances will, on one hand, help to improve the financial capacity of both banks and insurance firms, and on the other facilitate the integration of financial services, which make both banking and insurance products more attractive to customers. This is also a good way to develop bancassurance in Vietnam, which has been successfully implemented in other countries such as Singapore and China. In addition, this is the only way for Vietnam to have big financial corporations, which can be listed on the stock exchange. In Vietnam, equitized state owned companies such as Bao Minh or Vinare will not encounter any difficulties in going listed and effectively operate on the stock exchange, but this is not always the case for smaller insurance companies.

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Appendix 1: Vietnamese legal regulations versus OECD's suggestions

In 1997, the Insurance Committee Secretariat issued "Detailed principles for the regulation and Supervision of insurance markets in emerging Economies". The following matrix describes the consistency and gap between such recommendations and legal regulations governing the insurance business in Vietnam.

	OECD' suggestions	Vietnam's Legislation
Licensing procedures	**Legal requirements**: ▪ Business forms ▪ Filing of by-laws ▪ Filing of general terms and conditions of policies ▪ Filing of insurance specialization	▪ Enterprise forms include: state-owned enterprise, joint-stock enterprise, joint-venture, 100% foreign owned enterprise and mutual insurance organization; ▪ By-laws must be in line with legal regulations (State-owned Enterprise Law, Enterprise Law, Law on Foreign Investment) and submitted to authorities for approval; ▪ Law on Insurance Business does not provide terms and conditions in detail of an insurance policy; however, it must abide by Civil Code and Commercial Law; ▪ Insurers must also submit sample insurance policies and detailed terms and conditions for approval ▪ Applicants must specify insurance specialization that they will be involved in the application dossiers.
	Accounting requirements ▪ Filing of opening balance sheet, budget and income statement, proof that the company has required minimum capital.	▪ Financial status of applicants is strictly examined through financial statements. Insurance firms have to satisfy the minimum capital requirements and also have to pay deposits.
	Technical requirements ▪ Filing of premium rates for information/approval ▪ Filing of technical bases used in ratification and planned technical provisions and of reinsurance contracts	▪ Insurance firms must submit to authorities premium rates for approval. However, there is no legal requirement on the explanation on how premiums rates are calculated.
	Managerial requirements ▪ Demonstration that officers are fit and proper and shareholders are reputable	▪ Laws on Insurance Business do require justification of technical competence of significant officials, but does not specify in detail which positions. ▪ When evaluating applications for the license of foreign insurers, the credibility, reputation of investors is carefully examined, but this does not apply when applications of domestic investors are examined.

OECD' suggestions		Vietnam's Legislation
Examining, supervising activities of Insurance Enterprises	***Supervising legal obligations:*** compliance with existing legal regulations, by-laws of the companies, general terms and conditions of insurance policies.	Ministry of Finance exercises the right and function of supervising insurance enterprises through periodical reports and site inspection (inspection is no more than once a year in each enterprise).
	Financial supervision: own funds, technical provisions, assets, monitoring of business activities;	In addition to the annual financial statements that all firms in Vietnam have to submit to authorities, insurance firms have to prepare special reports with specific indicators regulated by the Ministry of Finance that better reflect their financial health, compliance with regulations on technical provisions etc. However, there are still a few matters that are not standardized to be declared, which leads to reports not accurately reflecting the financial status of the enterprise; e.g. accounts are not to referred, re-insurance loss and gains and reinsurance's effects on insurance income, reserves and compensations are not stated separately.
	Auditing of mid-term and annual financial statements	The obligation of recording annual financial statements is applied to all insurers and must be audited by an independent audit organization.
	Actuarial supervision: tariffs, technical or mathematical provisions	Decree 99/2004/TT-BTC determines in detail methods to build reserves but does not indicate methods of calculating insurance fees.
Investment	***Diversification, spread and liquidity*** ▪ Ceilings may be set on admitted investments, by type of investment and in percentage terms ▪ There must be a distinction between the treatment of investments representing technical reserves and that of investments of the capital base, and between the minimum required capital and the free capital.	The law specifies the ceiling applied to each type of investment by free capital.

	OECD' suggestions	Vietnam's Legislation
Insolvency and management of trouble companies	Clear instructions should exist regarding what is to be done about insolvent insurers through legislation covering all matters connected with the management of troubled companies, including standards used to establish insolvency, the basis for choosing between rehabilitation and liquidation, recovery measures available, the revocation of licenses, conditions under which policies may be transferred to a sound company (often resulting in the rights of policyholders being safeguarded), the role of the liquidator and the ranking of creditors' claims.	The existing law and subordinate documents regulate the solvency margin and list measures to recover solvency margins, but does not regulate in detail how to manage insolvent and troubled insurance firms and how such recovery measures are conducted. In addition, the protection of rights and the benefits of policyholders in cases where insurance firms become insolvent is not regulated in detail.
Distribution of insurance products	In many cases only intermediaries have contact with consumers, therefore regulations on intermediaries should be adopted. These regulations would cover issues such as registration, required business qualifications and ethical standards, along with financial security (including the need for professional liability coverage).	The Law on Insurance Business provides regulations on insurance agents which covers issues such as: conditions to act as insurance agents, areas of agent activities and agent contract and agents' responsibilities. Insurance brokerage activities are also governed by the Law on Insurance Business. The insurance brokerage business is subject to approval by the Ministry of Finance, has to satisfy minimum capital levels and contains some requirements on the terms of qualifications and experience of managers in insurance firms. In addition, insurance brokerage firms must buy professional indemnity.

	OECD' suggestions	Vietnam's Legislation
Contract Law	▪ The distinction between policies providing indemnities and those paying flat sums should be clear, including the various legal consequences thereof (differences in the amount of compensation in the event of a loss in particular). ▪ The importance of establishing the exact time at which contracts are executed and go into effect, their life, as well as the issue of proof of contract, should also be underscored. ▪ Regulations on intentional losses or wrongful conduct, which constitute grounds for exclusion from coverage. ▪ Refer to the rights of third parties to compensation or with respect to the insurer. ▪ Modalities of disputes settlement.	The Law on Insurance Business regulates different types of insurance contracts and proof of contracts, but does not go into detail on intentional losses or wrongful conduct, which constitutes the ground for exclusion from coverage. Insurance contracts are also governed by the Civil Code and the Maritime Code.
Obligatory Insurance	Obligatory insurance should be applied in the following cases: ▪ More closely related to the social sector than to private insurance ▪ In specific areas where compulsory insurance is justified by the seriousness of risk exposure and/or by its generalised nature (automobile liability or occupational accidents for instance); ▪ In areas where premium payments should be divided on an equitable basis among the policyholders groups under consideration.	Obligatory insurance includes: the Law on Insurance Business which indicates 4 types of obligatory insurance; depending on each period, the Government refers to the establishment of other obligatory insurance types. At present, obligatory insurance is enforced on the following groups: ▪ Boat or ship owners with boats operating under far-from-land fishing permits have a duty to follow obligatory insurance for boats and ships. ▪ Enterprises who conduct business in marine transportation by registered domestic marine vehicles are subjected to obligatory insurance as civil duties. ▪ In addition, gasoline, construction and instalment projects, construction works and projects with high risks to social security and environment are also subjected to obligatory insurance.
Actuaries	Insurance companies are required by law to appoint actuaries.	The law does require life insurance firms to appoint an actuary.

	OECD' suggestions	Vietnam's Legislation
Reinsurance	▪ Compulsory cession of reinsurance. ▪ An audit of the financial statements and notes thereto (in particular reinsurance agreements) of ceding companies. ▪ Compile as much information as possible on reinsurers, their solvency and liquidity (including through rating agencies), as well as, more generally, on the overall impact of ceding risks, taking into consideration all significant transactions with respect to claims, commissions and brokers' fees.	▪ The law does specify the cases of compulsory cession ▪ The law does set out criteria which should be met by overseas reinsurance firms, but does not have concrete requirements for insurance firms to disclose information of their reinsurers.

Appendix 2: Vietnam's offer under GATS in comparison with commitments under GATS of some ASEAN countries

Generally, Vietnam's offer under GATS is open compared to commitments under the GATS of other ASEAN countries. The following table summarizes the offer of Vietnam (1) and the commitments of Indonesia (2), Thailand (3) and Singapore (4).

	Insurance and insurance related services	**Market Access**				**National Treatment**			
		Vietnam	Indonesia	Thailand	Singapore	Vietnam	Indonesia	Thailand	Singapore
Vietnam	All insurance and insurance related services, excluding health insurance services and insurance agent services	None for: - insurance services provided to enterprises with foreign invested capital, foreigners working in Vietnam; – reinsurance services; – insurance services in international transportation; – insurance broking and reinsurance broking services; – advisory, claim settlement and risk assessment services.	None	- Foreign ownership in JV is limited to a maximum of 70%. - 01 year after accession, 100% foreign owned companies are permitted. - 100% foreign owned companies are not allowed to engage in statutory insurance business. 02 years after accession, this limit is abolished.	Unbound, except as indicated in the horizontal section	None	None	None	Unbound, except as indicated in the horizontal section.

	Insurance and insurance related services	**Market Access**				**National Treatment**			
		Vietnam	Indonesia	Thailand	Singapore	Vietnam	Indonesia	Thailand	Singapore
Indonesia	All insurance and insurance related services. For services auxiliary to insurance include only insurance brokerage services and reinsurance brokerage services	Unbound, except as reinsurance services (reinsurance service suppliers from other member must be rated a minimum BBB by Standard and Poor or equivalent)	Depending on insurance and insurance related services	As specified in the Horizontal Measures and General Conditions. (E.g.: Foreign ownership limited to a maximum of 80%)	Unbound except for director and technical advisor/expert .	Unbound except for Insurance Brokerage Services and Reinsurance Brokerage Services	Unbound except for Insurance Brokerage Services and Reinsurance Brokerage Services	As specified in General Conditions	As specified in the Horizontal Measures.

	Insurance and insurance related services	Market Access				National Treatment			
		Vietnam	Indonesia	Thailand	Singapore	Vietnam	Indonesia	Thailand	Singapore
Singapore	All insurance and insurance related services	Unbound, except for reinsurance and retrocession, insurance intermediation and services auxiliary to insurance	None, except for Non-life insurance services (compulsory insurance of Motor Third Party Liability and Workmen's Compensation which can be purchased only from licensed insurance companies in Singapore) and Insurance intermediation (Agents are not allowed to act for unregistered insurers)	Depending on insurance and insurance related services (Foreign parties can only acquire equity stakes of up to a limited rate)	Unbound except as indicated in the horizontal section.	Unbound, except for reinsurance and retrocession.	None	None, except for insurance intermediation is unbound	Unbound except as indicated in the horizontal section.

	Insurance and insurance related services	Market Access				National Treatment			
		Vietnam	Indonesia	Thailand	Singapore	Vietnam	Indonesia	Thailand	Singapore
Thailand	All insurance and insurance related services. For services auxiliary to insurance (excluding pension funding services)	None, except for services auxiliary to insurance (excluding pension funding services) is unbound.	None, except for auxiliary to insurance (excluding pension funding services) is unbound.	Depending on insurance and insurance related services. (E.g.: for life insurance services and services auxiliary to insurance: foreign equity participation is limited to 25% of registered share capital.	Only senior managerial personnel, specialists and technical assistants with the approval of the Insurance Commissioner	None	Depending on insurance and insurance related services. (E.g: Life insurance premium is tax deductible up to a certain amount while non-life insurance services are unbound.	Depending on insurance and insurance related services. (E.g.: Life insurance services: None; Services auxiliary to insurance: No limitations as long as foreign equity participation does not exceed 49%).	None

Appendix 3. Case study of the liberalization of the insurance sector in China

Introduction

This short case study provides an explanation of the history of insurance operations in China, the role of insurance in the WTO negotiation process and the effect that membership in the WTO will have on insurance operations in China.

Insurance emerged as one of the most hotly debated issues regarding China's entry into the World Trade Organization as a result of both historical precedents and the potential for significant market growth. The new rules for insurance operations in China under the WTO will allow insurers more freedom to enter and operate in this market.

After 15 years of arduous negotiations between China and members of the World Trade Organization (WTO), on November 12, 2001, at the Trade Ministerial meeting in Doha, Qatar, trade ministers from 142 member countries at the WTO summit unanimously approved membership for China. China's entry into the WTO occurred after lengthy negotiations in which China had to satisfy its trading partners, most notably the United States and the European Union, that it was doing enough to open its economy to international competition.

Since its WTO entry, China's insurance industry has experienced significant changes and has moved from a predominantly closed market in the early 1990s, to one in which foreign insurers now account for more than half of all insurance companies. The market has grown significantly, encouraged by legislative reform, restructuring of the social security system and high levels of saving and low penetration rates. However, in comparison to Western countries the actual market size remains small and is a fairly low source of revenue.

Changes Tacking Place Through WTO Membership

As a member of the WTO, several changes are in the process of taking place.

- China will permit foreign property and casualty firms to insure large-scale risks nationwide immediately upon accession;
- China will expand the scope of activities for foreign insurers to include group health and pension lines of insurance, which represent about 85 percent of total premiums, phased in over five years after joining the WTO;
- China will allow 50 percent foreign ownership and remove joint-venture requirements on foreign life insurers, and phase out internal branching restrictions;
- For nonlife insurance, China will allow 51 percent foreign ownership upon accession to WTO, and;
- China will award licenses for insurance business solely on the basis of prudential criteria, with no economic needs test or quantitative limits on the number of licenses issued. China has market opening commitments in the US-China Bilateral WTO Accession Agreement and the EU-China Bilateral WTO Accession Agreement. Market access barriers such as restrictive licensing have been addressed in these agreements. Companies will be able to obtain a license if they have more than 30 years of experience in a WTO member country; a representative office established in China for two consecutive years; and global assets of more than US$5 billion.

Additional WTO commitments include: internal branching is permitted, consistent with the phase-out of geographic restrictions; reinsurance, master policy insurance and large-scale commercial risk insurance provided nationwide upon accession; health, pension and group products can be sold two and three years from accession, respectively; and brokerage services are permitted.

Shanghai and Guangzhou are the first two cities fully opened to foreign life insurers upon accession. A dozen other cities will be opened up within two years of accession. These are

Beijing, Chengdu, Dalian, Chongqing, Shenzhen, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. A year later, all geographic restrictions are to be lifted.

Depending upon experience, it is possible China will accelerate this timetable, but the decision could hinge on the activities of the new foreign companies allowed into the market.

At present, non-Chinese insurance firms do not enjoy the same means of access to the market as Chinese firms do. For example, the government requires foreign insurance companies to follow a strict timetable before they may enter the market. Prior to full operations, an outside firm must first establish a representative office. Under Chinese law, these are strictly limited to offering consultations and market-study services. Then, only after operating as a representative office for two years, insurers may conduct full business operations if they receive approval to upgrade to full-service branches.

The rules were originally intended to protect the domestic insurance industry and will be repealed to comply with the openness and equality required of a WTO member.

Market Overview

China's insurance market is currently small. It is underdeveloped, not only in terms of size but also in terms of products offered and basic infrastructure, with many places in China not having insurance institutions.

Insurance generally is not a concept largely understood or adopted by the Chinese people, which explains the low insurance depth. However, in comparison to broader China, trends in urban centres are promising, with Shanghai enjoying an increase of around 42 per cent for insurance premium income in 2001 to 2002. Foreign insurers play an increasingly important role in Shanghai's insurance industry, in 2001 taking up 13.6 per cent of the city's total premium and 12 per cent of the life insurance premium.

China's insurance market has experienced consistently high rates of growth, averaging between 10-25% since the early 1990’s, which is largely driven by the lack of a social security safety net. Total premiums amounted to US$9.6 billion in 1996, almost US$20 billion in 2000 and had increased to US$47 billion in 2003. China’s share of world insurance now amounts to 2.03%, almost doubling from 1.03% in 2000.

Premium’s per capita (insurance density) amounted to US$36 in 2003 (life US$25.1 and non-life US$11.2). This compares to US$15.2 in 2003. Total premiums as a percentage of GDP amounted to 1.93%. This compares to 11 percent in Japan, 8% in the United States, 2.03% in ASEAN and a world average of 8.8%.

Participation of Foreign Insurers

Although foreign insurers now account for more than half of all insurers in China, they take up only a small market share. Their growth has been hindered by geographic and product restrictions, as well as the requirement that each branch be capitalised at RMB 200,000,000 (US$24 million). This capital requirement has been a particular issue, because it reduces operational efficiencies in comparison to domestic insurers, who are able to get a national licence with a one-off capital payment.

Even with China's commitment to market opening, the fact remains that the current legal framework restricts foreign insurers' rights to underwrite in particular areas. This is all part of the phasing-in process of reform. However, at present, the legal framework contributes to protecting state and domestic companies' position in the market.

Historical Evolution of the Insurance Industry

China's insurance industry was nationalised in the 1950s and virtually closed for a decade during the Cultural Revolution. When it reopened in 1978, the state-owned People's Insurance Company of China (PICC) monopolised the industry. The PICC's dominance began to break down in 1988 when two domestic insurance companies, Ping An Insurance Company of China Ltd (PAIC) and China Pacific Insurance Company (CPIC) were granted regional licences. Today, there are a number of these regional domestic insurance companies competing for market share.

In 1990, China's Government, keen to participate in the General Agreement on Tariffs and Trade (GATT) announced it would open its insurance market to foreigners. AIG was the first to benefit, with a licence issued in 1992. From then on, foreign insurers continued to be licensed in limited numbers; however, the process of getting a licence was slow, and foreign insurers were permitted only to establish branches or joint ventures in specific regions.

The reinsurance field was also dominated by a state-owned insurer, the China Reinsurance Company, which held its monopoly until as late as mid-2002, when a foreign insurer was licensed.

Legal and regulatory environment

On the 18 November 1998, the State Council established the China Insurance Regulatory Commission (CIRC). Directly under the State Council, the CIRC is the sole regulator of China's insurance industry and meets China's WTO commitment to provide separate regulation for each service sector. The Insurance Association of China was established at the end of 2000 in Beijing. Although its strength as an industry association is still uncertain, its intended purpose is to coordinate and discipline the insurance sector.

The main contribution to insurance reform in China is the Insurance Law 1995. The Law provides a broad legal framework, which was intended to foster growth by providing rules relating to the formation and operation of insurance companies on the mainland. It was updated in 2002; with amendments effective January 2003 that mark a significant step forward in fully opening the market.

The Insurance Law focuses on two prime areas: contract and regulatory control. The contract aspect of the law details the rights and privileges of the consumer and insurer. The regulatory control aspect details the powers, responsibilities and accountability of insurers and industry bodies.

The Insurance Law 1995 and its amendment do not deal with foreign insurers in a substantial manner. The Law does, however, apply to them, with article 148 stipulating that the establishment of joint ventures, wholly foreign-owned enterprises and branches of foreign insurance companies will be governed by the Insurance Law, except where specifically provided for in other laws and regulations.

The recent amendments to the Insurance Law represent a shift to a more market-oriented and policy-based regulation. For example, companies can now write their own clauses and decide premiums, whereas in the past CIRC dictated these conditions. The amendments enable CIRC to monitor the solvency capability of companies according to set standards, and provide better protection for the insured by placing legal obligations on companies to train and administer their agents.

To complement and provide detail for the Insurance Law, various regulations have been promulgated, including rules for the absorption of foreign equity by domestic companies, insurance brokers, insurance agents and foreign-invested insurance companies.

The Regulations of the People's Republic of China on Administration of Foreign-Invested Insurance Companies is the primary regulation foreign investors should look to when establishing an insurance company in China. The Regulations set out the criteria for foreign insurers seeking to operate in China and empower the CIRC to supervise, administer and grant licences for insurance companies.

Under the Regulations, a foreign insurer who intends to set up a joint venture, wholly foreign-owned enterprise or branch of an insurance company should have:

- At least 30 years of experience in the insurance industry;
- Established a representative office in China for at least two years preceding the application; and
- At least US$5 billion in assets in the year preceding its application.

The minimum registered capital for a joint venture or wholly foreign-owned enterprise is RMB 200,000,000 (US$24,150,000), or the equivalent in a freely convertible currency. This minimum amount must be actually paid in. Branches of foreign invested insurance companies must have operating funds of at least RMB 200,000,000 or the equivalent amount in a freely convertible currency as operational capital for the parent company. These capital requirements are costly by international standards, effectively limiting the market in China to large, well-established international companies. Reinsurance companies have even steeper capital requirements, needing RMB 300,000,000 or roughly US$35 million in capital.

Foreign-invested insurance companies are prohibited from operating both property and life insurance businesses at the same time in China. However, an exception to this rule has been created by a recent amendment, which allows property insurance companies to engage in cross-class operations in short-term health and casualty insurance products if permitted by CIRC.

Insurance licenses

In addition to the substantial capital and experience requirements described above, the foreign investor must also:

- Be from a country or region that has a sound insurance regulatory system and where the company is already subject to effective regulation by the authorities of that country or region;
- Meet the solvency standards of the country or region where it is located;
- Have evidence that the authorities of its home country or region have agreed to its licence application in the People's Republic of China; and
- Meet other prudential conditions required by CIRC.

The application process to gain an insurance licence has a number of stages. Initially, a preliminary examination of the application is undertaken, with CIRC deciding to accept or deny it within six months of receipt. If the preliminary application is accepted, a formal application form will be issued, which the applicant must complete and submit within one year, together with the relevant documents. Once the formal application is submitted, it will be assessed and approved or denied within 60 days. If it is approved, a permit is issued. If either the preliminary or formal application is denied, CIRC must notify the applicant in writing and provide reasons.

Once the formal application is approved, the applicant must then register at the industry and commerce administration for a business licence. If the application is denied, however, an applicant may not reapply for six months.

For both foreign and domestic insurers, China's entry into the WTO has had a significant impact on CIRC's licensing practices in relation to them. Recent licensing trends reflect China's commitment to opening up the insurance sector; however, the significant increase in the number of licences being granted has left some unsettled. For foreign insurers, the primary concern is market saturation by their domestic counterparts, whose establishment costs are lower.

Barriers to market development

Until recently, insurance companies were only allowed to channel their funds into severely restricted investment options, choking off sustainable growth. These restrictions have resulted in a significant proportion of insurance premiums being invested in either cash or bank savings. In comparison in the West, funds are commonly invested in stocks, which generate the returns necessary to cover pay-outs on premiums, as well as costs and profits.

In an attempt to rectify this problem, the China Security Regulatory Committee (CSRC) has taken steps to allow insurance funds to enter share markets. However, these markets are unsophisticated and volatile, with few solid companies to invest in. They therefore have a limited attractiveness to insurers.

Company solvency is a major issue in China's insurance industry, with the current level of capital funds held by domestic insurers being low. The lack of solvency has been exacerbated by insurers' restricted investment options. Recent changes in the law require greater transparency in regard to holdings and permit greater diversity of investment.

As competition in the market increased, domestic insurers quickly expanded their market share without much regard to quality and, in some cases, by using improper means, such as government interference. A lack of insurance professionals with knowledge and experience in insurance markets has further contributed to the problem; as has the history of state company monopoly, which has left a legacy of non-competitive services. However, as foreign insurers, with their customer-driven service mentality, enter the market, domestic insurers are being forced to lift their standards.

The low quality of services and lack of understanding by the general population of the role of insurance has led to a credibility crisis for China's insurance industry. Many have been reluctant to purchase policies, their scepticism encouraged by damaging reports in the news on the difficulty of receiving reimbursement. This reputation potentially affects foreign insurers, both positively and negatively: positively, in that they may be differentiated by their reliability, and negatively if they are perceived as being the same.

Also hindering market growth has been a delay in the development of a comprehensive legal environment for insurers. The drafting of insurance laws and regulations has lagged behind, with The Regulations of the PRC on Administration of Foreign-Invested Insurance Companies only released in 2002. Prior to this, the Insurance Law 1995 was the primary legislation regulating the industry; however, it does not deal comprehensively with foreign insurers, and was not updated till 2002.

Conclusion

China's commitment to comply with its WTO obligations is genuine, with many reforms in the insurance industry having taken place since its accession. However, despite these reforms, the market remains underdeveloped and insufficiently regulated. The market remains dominated by state and domestic companies, which have the advantage of fewer restrictions on their operation.

Regardless of these challenges, foreign insurers continue to enter the market with the knowledge that reform is ongoing and industry growth of 12 per cent annually presents opportunities. New amendments to the Insurance Law that allow insurers more freedom to enter and conduct business in the market, and which allow property insurance companies to offer short-term health and casualty insurance products, are an indication the sector is moving towards international norms. However, some foreign insurers may prefer these norms to be realised before investing in China.

Strategy of China's life insurance sub sector through different periods of liberalization

Phase	Strategy
Phase I: Monopoly 1980-1995	❖ The three domestic companies began to transform from multi-line mixed operation to P&C-life separate operation ❖ Widely set up branches from littoral cities to inland cities ❖ The individual life insurance products were mainly endowment and juvenile products with 7,5% assumed interest rate ❖ Except Ping An and AIA, the other companies sold mainly single premium products
Phase II: Pre-open 1996-2001	❖ Speed up the development of individual life insurance business. Domestic companies excessively recruited under the "people ocean" tactics. By the end of 2001, the number of sales agent exceeded one million. The business scale greatly exceeded the group business. ❖ PICC, Ping An and CPIC completed founding the branches in cities all around China ❖ Serious poaching appeared with the foundation of new companies ❖ Individual life insurance products gradually turned to be long-term products. Ping An and CPIC promoted unit linked and universal products to penetrate the high income market. ❖ Group business began to emphasize on one-year accident insurance and health insurance business.
Phase III: Prophase after WTO 2002-2004	**Individual Life Insurance:** ❖ The large domestic insurers employed the tactics of "people ocean" – recruit a lot and turnover a lot. The growth of portfolio and manpower slowed down. Thus they started to emphasize the basic construction of recruiting, selection and training. ❖ Foreign insurers have taken up their position in metropolis, especially in Shanghai, Guangzhou and Shenzhen, where they have got great market shares. Among them AIA stood out particularly. ❖ Participated product was focused first, and critical illness product took the second. Universal insurance became hot sale gradually. ❖ Cross-selling has taken initial success **Group Life Insurance:** ❖ Control the volume of short-term single premium policies. Develop one-year accident insurance and health insurance. ❖ Develop cross-selling, brokerage and general agency channel **Bancassurance:** ❖ Bancassurance business grew rapidly in virtue of bloomy bank network in China. ❖ Focused on short-term single premium saving products. For the poor profit, recently controlled the scale and started to emphasize the product transformation.
Phase IV: Full-scale open 2005-	❖ Domestic insurers: under the influence of the listed companies (China Life & Ping An) and will-be listed companies, domestic insurers change their operation guidelines, orienting to the long-term continual development, instead of pursuing the amount of premium blindly. On one hand, they emphasize the new business embedded value, on the other hand, they make great effort to realize stable annual growth of profit and earnings. ❖ Foreign insurers: their branches will be spread to set up in the littoral big and medium cities as well as mainland big cities. Meanwhile making full

	use of their advantages, they will penetrate foreign firms in China to provide employee benefits. ❖ On the premise of broadening investing channels, a great lot of investment-linked products will come out. ❖ Cross-selling will be widely employed, and come into large scale. **Individual Life Insurance:** ❖ Strengthen selection and training to new agents. Improve productivity, retention rate and persistency rate. Emphasize customer service and brand building. Improve sales representative's public image. ❖ Promote long-term life insurance business. Push the development of one year accident insurance and heath insurance business by means of supplementary contracts. ❖ Investment-linked products will become hot sale gradually. ❖ Medium and small companies will use broker and general agency channels. **Group Insurance:** ❖ Employee benefit will be the mainstream of group insurance. ❖ Brokerage, general agency and pooling business will have great growth. **Bancassurance** ❖ Seek breakthrough in the mode of cooperation with banks ❖ Make the products transform gradually.

Source: Ping An Insurance Company – China