

Taiwan Non-Life Insurance 2004 - Market Report

I. Market Overview

Based on data published by Taiwan Insurance Institute, insurance penetration of Taiwan in 2004 was 13.95% and insurance density reached NT\$ 62,760 (US\$ 1,881.29¹). However, when comparing to life premium income, the ratio of non-life premium income versus life was only 1:11.33, implicating a remarkable potential for expansion on non-life premium.

Economic recuperation in the first-half year of 2004 helped ease the tension of Taiwan's insurance market. Low loss ratio in 2003 and improvement on overall investment environment further enhanced the non-life insurance industry. However, the over-reliance on reinsurance and the lack of market discipline aggravated market uncertainty and abated business profitability.

II. Economic Environment

According to TII's prior research, economic growth has a delayed, but positive, striking effect on insurance premium income. Growing non-life insurance premium income, moreover, impels advancement on price index. The overall economic growth rate of Taiwan in 2004 was 5.71%, a result higher than expected. The total export of first three quarters equaled to US\$ 128.3bn, an upsurge of 24.2% comparing to 2003. In general, growth of external trade compels a positive influence on the marine cargo insurance.

Last year (2004), the wholesale price index had a significant annual average increase of 7.17%. It is expected to grow continuously. Consumer price index growth rate reached 1.6%. It is believed that the appreciation of property value would stimulate enterprises' or individuals' willingness to purchase insurance although it could take a while to reflect the effect. It can be concluded that the climbing rate of price index will eventually benefit the development of non-life market in the country.

III. Non-Life Business Overview

As of end of 2004, there were a total of 23 non-life insurance companies in Taiwan: 16 local and seven foreign companies. There was an apparent trend of increasing business locations following Financial Supervisory Commission's (FSC) amendment in February over the "Directions Governing Review of Establishment of Domestic Branch Units by Insurance Enterprises," which relaxed the qualifications² and removed restriction on the number of

¹ All currency rate conversion to USD in this paper is based on the exchange rate (NT\$ 33.36 / USD) published in "World Insurance in 2004", *Sigma* No.2/2005, Swiss Reinsurance Company, 2005.

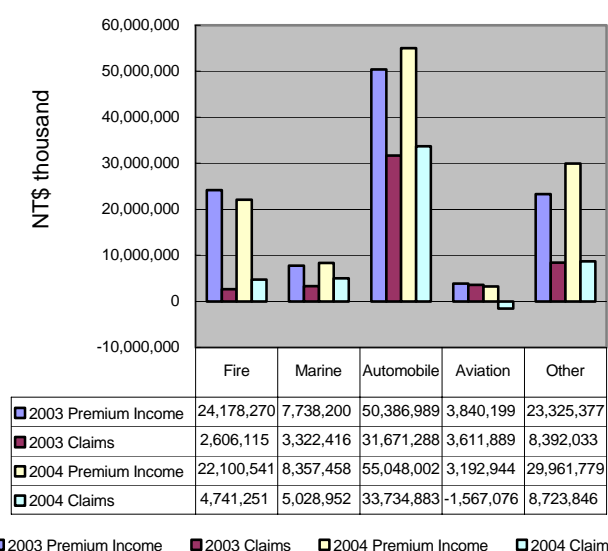
² Insurance enterprise with no cumulative loss and no violation of law and regulation could submit its application to establish domestic branch units following the approval by the board of the directors of the insurance enterprise.

branches allowed. Also, the proportion of sales representative among internal staff (3.99%) was higher than the average of past few years, indicating less reliance on insurance auxiliary and more emphasis on the development of in-house sales representatives.

A. Non-life Operation

In 2004, the non-life gross premium income, including direct written premium (NT\$ 115.4bn) and reinsurance premium income (NT\$ 9.4bn), was NT\$ 124.8bn (US\$ 3.74bn) in which direct written premium grew 5.48% from last year. Fire insurance fell by 8.59% mainly due to substantial premium discount which averaged to about 40%-50% on huge sum insured³ commercial fire insurance in the first half-year. Zero catastrophe loss further drove the general fire premium to drop around 10% ~ 20%. Fortunately, the fierce price war on fire insurance was

Graph 1: Non-Life Insurance Operation, 2003 vs. 2004



alleviated in second-half of the year with the completion of "Self-Discipline Agreement on Fire Insurance⁴," which was coordinated by the Non-Life Insurance Association (NLIA) and signed by non-life insurers after regulator's intervention. Meanwhile, other property insurance (including personal accident insurance) thrived 14.76% in 2004, consequently to the Insurance Bureau's encouragement to develop new products and liability insurance.

The retention ratio in 2004 climbed to 52.02%, the highest comparing to records of recent years. The retained premium growth rates for domestic insurers and foreign insurers in Taiwan were 15.3% and 25.9%, respectively, reflecting the strengthening of insurers' capacity. To improve retention capacity, insurers should enhance and adjust their underwriting skills, risk assessment, and reinsurance strategy.

B. Cost-Profit Analysis

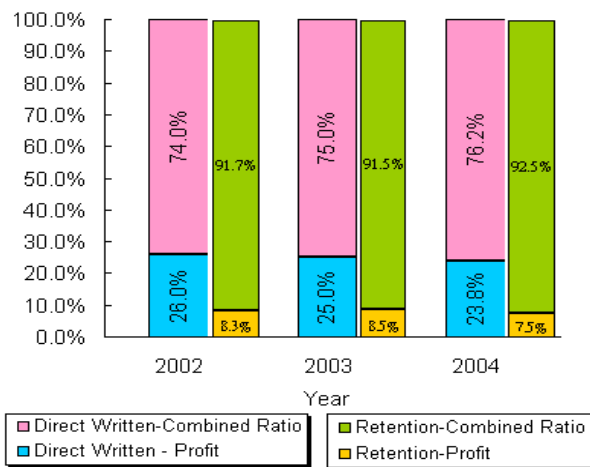
The overall underwriting profit reduced slightly in 2004 regardless of the climbing

³ Fire insurance policy with insured amount above NT\$ 3 billion.

⁴ NLIA has began commencing the « Self-Discipline Agreement on Fire Insurance» since September 2004, restricting the rate of discount on renewal for huge sum assured commercial fire insurance to 30% of the rates for previous year; when small and medium sum assured fire insurance policy changes into huge sum assured fire policy, the discount for the policy premium cannot be lower than 50% of the basic risk premium set for the previous year. Violation of the Agreement would be fined NT\$ 100,000~600,000; fines could cumulative.

retention ratio (52.02%). One of the main reasons was the NT\$ 240mn fire damage of He-Ping Power Plant in which seven written companies absorbed the loss. Also, the chart of non-life combined ratio below conveyed that the combined ratio of direct written business attained 76.2% and that of retained business was only 92.5%. In either situations, the business gains were descending, implying the necessity to rectify reinsurance strategy for the entire non-life industry. Besides, the retained combined ratio of domestic insurance (92.5%) was much higher than that of foreign insurers (68%). Alleged reasons for the distinction were foreign insurers' superiority in underwriting skills and reinsurance strategies, and domestic firms' inappropriate rebate practice.

Graph 2: Combined Ratio, 2002-2004



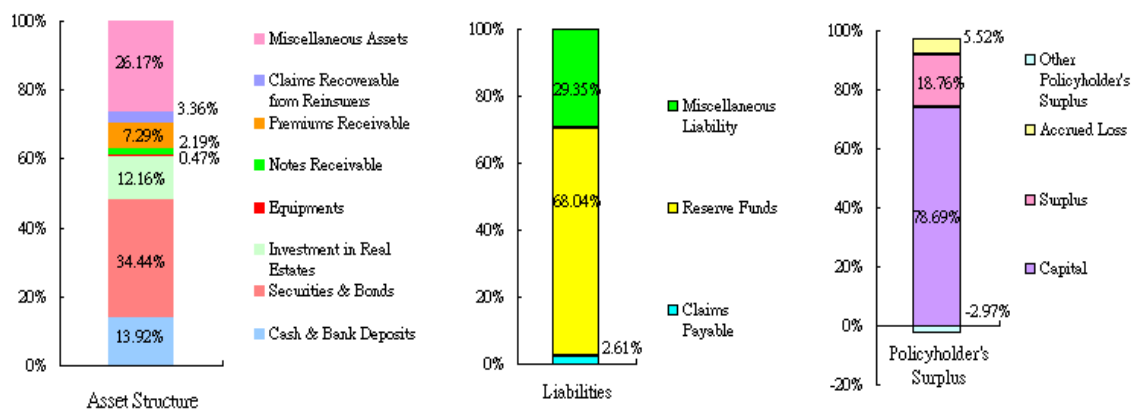
In sum, low frequency of catastrophe loss in recent years had kept underwriting profit at a stable rate. Nevertheless, under the trend of non-proportional reinsurance, former practice of taking reinsurance commission to cover operating expense would be unsustainable. Again, enhancing excellent actuarial and underwriting skills would be essential ways to improve combined ratio.

IV. Financial Overview

A. Asset-Liability

The total assets of non-life insurance companies in 2004 added up to NT\$ 208bn (US\$ 6.24bn), which was merely 3.95% of the assets of the country's entire insurance industry (NT\$ 5,709.0bn). The total liability of non-life insurance came to NT\$ 130.9bn, and policyholder's surplus was NT\$ 77.0bn. The liability to asset ratio of the non-life industry averaged to 63%.

Graph 3: Assets, Liability and Policyholder's Surplus, 2004



Since securities and real estate attained as high as 46.6% of the asset structure of non-life insurers, the implementation of the SFAS 34 “Accounting for Financial Instruments” and SFAS 35 “Accounting for Impairment of Assets” in 2005 and 2006, respectively, are predestined to cause significant impact on the policyholder’s surplus as well as on the capital adequacy of non-life insurers.

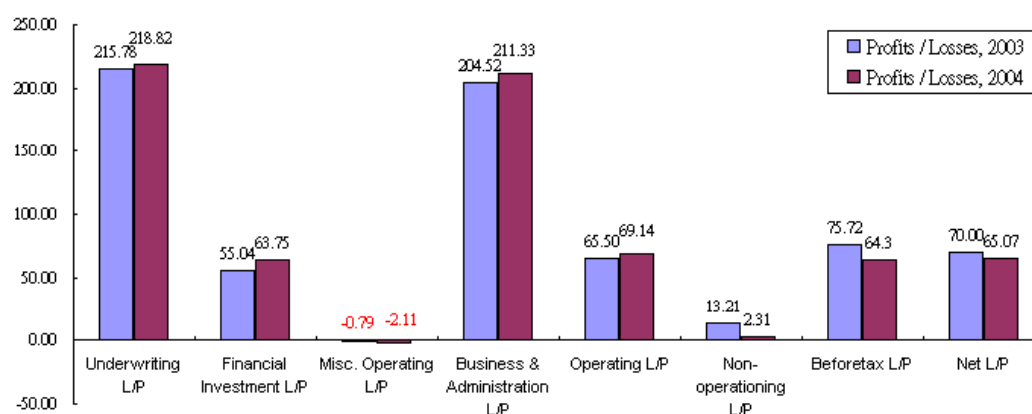
Furthermore, the higher policyholder’s surplus to asset ratio and the low net premium to policyholder’s surplus ratio might have indicated low capital utilization efficiency. A few insurers had in fact expressed their consideration on capital reduction.

B. Profit and Loss

The total pre-tax profit of the industry in 2004 was NT\$ 6.43bn (US\$ 189.12mn), decreasing 17.76% from 2003. The main reason of the decline was the difference of NT\$ 131mn found in miscellaneous operating revenue between 2003 and 2004. Soaring financial market in 2002 caused a large adjustment in allowance for loss on investment in the following year, leading to abnormally high net miscellaneous operating revenue for 2003 (NT\$ 1.31bn).

Besides the plunge of net miscellaneous operating revenue, underwriting profit declined by 3.77%, and financial investment profit rose 8.71%. Overall speaking, financial revenue for non-life insurers improved, but operating expense increased simultaneously. Consequently, finding new marketing channels and cost control continued to be major elements affecting the profitability of the industry.

Graph 4: Profits / Losses 2004



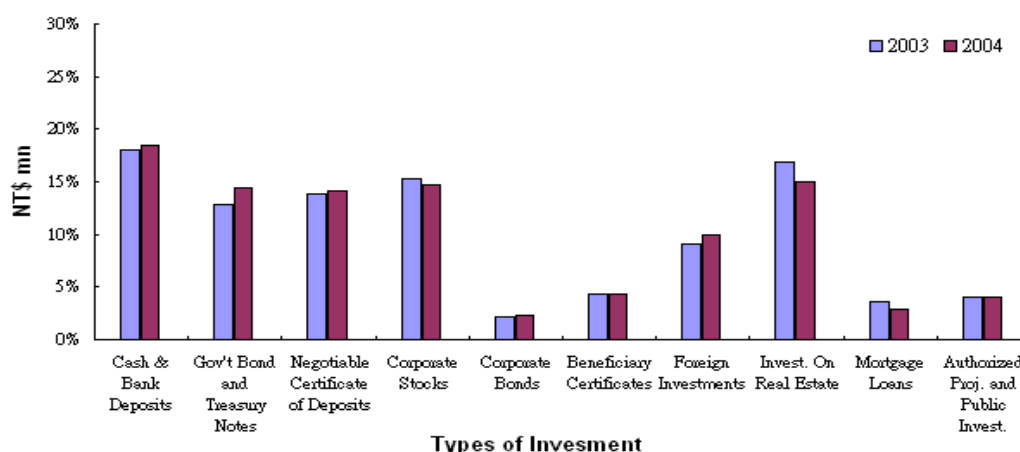
C. Fund Utilization

In 2004, total fund available of the non-life insurance industry was NT\$ 165.0bn (US\$ 494.60mn). Fund utilization ratio was 95.5%, higher than that of 85.46% in the previous year. Higher proportion of fund was invested in government bonds and treasury notes and corporate bonds; allocation to corporate stocks was moderately decreased both in real numbers and in proportion to other investment items. Meanwhile, the prosperous real estate market compelled

non-life insurers to sell off their property. Furthermore, a few non-life insurers advanced into mortgage-backed securities to induce more income.

In the segment of foreign investments, relaxation of regulation and depreciation of the NT dollar stimulated greater investments overseas. An automatic approval system for insurers to increase the foreign investments was commenced in May to benefit those that had kept their investment amount under the ceiling. Moreover, currency depreciation in 2004 helped increase insurers' returns on foreign investments. The returns⁵ on foreign investment, indeed, resulted in 3.6% as opposed to 3% derived from domestic investments.

Graph 5: Fund Utilization of Non-Life Insurance Industry, 2003 and 2004



V. Future Outlook

Next year (2005), non-life insurance companies will face up to the challenge from the second stage of rate liberalization. Non-life insurers should first search for a profitable market, implement stricter underwriting policy, and develop a complete and accurate information system. Furthermore, non-life insurers should equip themselves with more matured skills in order to underwrite huge sum assured products successfully. And as customized policy becomes more favorable in the market, insurers must be highly alert to the changes of loss ratio and develop reinsurance strategy based on the characteristics of individual business lines. Last, but not least, establishing a more healthy competition and market order for the overall business environment should be the goal of all the players in the non-life industry.

(All statistics used in this report are based on data provided by non-life insurance companies before accounting audit.)

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⁵ Investment return = net investment revenue / average investment asset. Net investment revenue = interest (revenue – expense)+(beneficiary certificate net profit + real estate net profit + foreign investment net profit); Average investment assets = (Asset (Beginning + Ending) – Net investment revenue) / 2