Box 3
Current issues facing Taiwan's life insurance companies and possible solutions

1. Current issues facing life insurance companies

1.1 Duration mismatch and negative interest rate spread

The fundamental issue facing life insurance companies in Taiwan is that long-term liabilities' share in total liabilities is persistently higher than long-term assets' share in total assets, owing to a lack of long-term investment instruments in the domestic market. This leads to a duration mismatch that may cause a higher risk of losses when market prices exhibit larger fluctuations. On the other hand, the assumed interest rates of life insurance policies issued in earlier periods are still higher than the current rates of investment return due to a worldwide downward trend of interest rates, resulting in the existence of a negative interest rate spread.

1.2 Average risk-based capital ratio needs to be improved

The return on investment of life insurance companies significantly declined in 2008 due to the deepening global financial crisis. In addition, operating losses during the same year further caused a decrease in their net worth. As a result, the average RBC ratio for life insurance companies dropped to 190.37% at the end of 2008, even though the Financial Supervisory Commission temporarily relaxed the regulation of risk-based capital (RBC) for the insurance industry. In the first half of 2009, unrealized gains and losses from domestic and foreign securities investments turned positive, but the average RBC ratio merely increased to 198.27% at the end of June 2009, still below the statutory minimum requirement of 200%. Among all insurance companies, there were six with RBC ratios below 200% where further improvement was needed.[1]

2. Possible solutions

The following measures may contribute to improving the performance of life insurance companies and lowering the potential unfavorable effects:

(1) If the government issues more long-term government bonds, it will help to provide sufficient long-term investment instruments for life insurance companies and, in turn, ease the mismatch problem of the asset-liability term structure;

(2) Life insurance companies are encouraged to focus on selling traditional life insurance

policies, but not investment-linked insurance policies, during low interest rate environments. Losses from negative interest rate spreads may be reduced accordingly;

(3) Insurance policies with high assumed interest rates should be closely monitored by supervisory agencies and be put under the risk control mechanism of insurance companies so as to reduce the risk arising from over competition in the life insurance industry; and

(4) Life insurance companies with RBC ratios lower than the statutory minimum standards should raise more capital within a certain time period. Furthermore, a 2% sales tax levied on life insurance companies may be considered by the government to be appropriated to the Insurance Stabilization Fund so as to expand the scale of the Fund and, in turn, contribute to adopting appropriate supervisory measures for problematic life insurance companies or implementing a market exit mechanism.

Note: As the profitability of life insurance companies improved markedly in the second half of 2009, the average RBC ratio is expected to increase at the end of 2009.