Asset Structures for Insurers

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Insurance differs from most businesses, in that consumers do not receive an immediate tangible good or service in exchange for their payment, but rather a promise of future benefits if and when specific conditions occur. The assets held by insurance companies provide the backbone to the ultimate security offered to policyholders. The amount, type and valuation of assets have a very significant role in the calculation of capital, management of liquidity and the ongoing ability of an insurer to meet its liabilities to policyholders and creditors.

Often an insurance company's success will be driven by the success of its investment policy. Because insurers hold premiums (money) for some time before the moneys are paid out, it is important that they make good investment returns from the use of that money. One way of measuring success is by the damage claim ratios of an insurance company. Success will be driven by the success of management in managing capital, and the overall quality of an insurer's balance sheet. The quality of an insurer's balance sheet is determined by its financial strength and overall solvency, which is a measure of its ability to meet its obligations. The assets held by insurance companies provide the security for the future benefits promised to policyholders.

Requirements related to assets are a key element of insurance regulation and supervision. Such requirements generally deal with the quality, liquidity, and valuation of assets, and the need to select a diversified investment portfolio that can provide a hedge against inflation and expectations of future returns. Good investment returns allow an insurer to be more competitive and to produce higher profits for their shareholders, bonuses for their managers, and better opportunities for their staff. Conversely, if a risky investment produces losses, an insurer may have to raise more capital to continue in business. In such circumstances, there are really only two sources of capital—new investments or funds, but shareholders, and better opportunities for their staff, can only be provided with higher profits from their business. Good investment returns show an insurer to be more competitive.

Counterparty risk is another key element of insurance regulation and supervision. This risk is the possibility that a counterparty (such as a reinsurer) may default on its obligations. The quality of a reinsurer's balance sheet is determined by its financial strength and overall solvency, which is a measure of its ability to meet its obligations. The assets held by reinsurers provide the security for the future benefits promised to policyholders.
assets that are consistent with the nature of the liabilities of an insurer to its policyholders. Capital adequacy requirements often depend on assets, with an insurer being required to hold more capital in respect of riskier types of assets. The International Association of Insurance Supervisors has established principles and standards in these areas, which most jurisdictions seek to observe. There should be a balance between the need for security by policyholders and the need for profit by shareholders.

The types of assets available and their liquidity depend on local economic and investment market conditions. In most developed economies there is a wide variety of assets available, including some with high liquidity. This is not the case in developing markets, where there is usually a limited choice of assets in which to invest. Foreign investments are sometimes permitted, but such investments pose a currency risk in addition to any inherent riskiness in the type of asset held, and it take assets outside of the immediate jurisdiction of the supervisor. Also, because insurers are typically among the largest investors, governments sometimes require that they invest locally in order to help develop the local investment markets.

The asset structure of an insurer must take local market conditions and regulatory requirements into account. It will also depend on other factors, such as the types of insurance business being written, the financial position of the company, the company’s business objectives, taxation rules, and financial reporting requirements.

The following sections discuss the cash flows that affect an insurer’s investments, the various types of assets and the risks associated with them, restrictions that might need to be considered in developing an investment strategy, and the manner in which assets might be managed.

Cash flows

Insurance companies exist to pay benefits to claimants, and their assets must provide security for these benefit promises and liquidity to enable the promises to be met promptly when due. Cash flow and possible variations in cash flow are important when an insurer is considering the types of assets it should own.

An insurance company can consider cash flow as being derived from two distinct sections of its business: funds backing liabilities to policyholders (policyholders’ funds); and funds relating to capital (shareholders’ funds). Sometimes insurers are required to hold poli-

cyholders’ funds in a manner which demonstrates that ownership is clearly and legally distinct from shareholders’ funds.

Cash flow in a policyholders’ fund is composed of:

- Premiums (positive)
- Premiums paid to reinsurers (negative)
- Claims payments (negative)
- Cash dividends or bonuses paid to policyholders (negative)
- Reinsurance recoveries (positive)
- General expenses and commissions (negative)
- Investment income from policyholders’ funds less expenses (a net positive)
- Asset purchases (negative)
- Asset sales and redemptions (positive)
- Transfers to or from the shareholders’ fund (could be positive or negative).

Cash flow in a shareholders’ fund is composed of:

- Fees, if any, for management of insurance funds (positive)
- Expenses (negative)
- Investment income from shareholders’ funds less expenses (a net positive)
- Asset purchases (negative)
- Asset sales and redemptions (positive)
- Transfers to or from the shareholders’ fund (could be positive or negative)
- Dividend payments to shareholders (negative)
- Capital paid in by shareholders (positive).

The principle of separating out cash flow attributable to different funds in an insurance company is a good discipline. It is through this mechanism that management can identify the elements that belong to shareholders and different classes of policyholders. Ultimately a better picture can be developed indicating the relative contributions to the company of the different participants (shareholders and groups of policyholders).

An insurance company will usually have positive cash flow, which helps to provide the liquidity needed to pay claims. However, there are different types of insurance, whose different characteristics can affect the timing and variability of cash flows, and therefore the types of assets in which the insurer should invest.
Life insurance policies often cover long periods of time and some types of life insurance and annuities have a significant savings component. There are three basic types of life insurance contracts:

- Investment-linked, in which the investment return and risk is entirely passed along to the policyholder;
- Participating (or with profits), in which the policyholder has a minimal return guarantee and shares in some proportion the excess return, and
- Nonparticipating, in which the policyholder has a fixed guaranteed return and the insurance company bears the investment risk.

Each type of policy may require a life insurer to adopt a different asset structure. Usually, the assets backing investment-linked policies need to be held in a segregated fund, so that the value of investments and investment income can be systematically determined. Similarly, the assets for participating policies must often be held separately from those for nonparticipating policies.

The policies issued by a nonlife insurer are generally nonparticipating policies. They are often short term in nature, but claims on nonlife insurance tend to be more variable than those on life insurance, which makes the projection of cash flows more difficult. Nonlife insurance does not include a savings element, so some jurisdictions might not require separation of policyholders’ and shareholders’ funds, even if they do so for life insurance.

Cash flows could be seasonal, because of factors such as:

- Timing of receipt of premiums (it is quite common for some insurers to receive a high proportion of premiums towards the end of or at the beginning of a year);
- Payment of reinsurance (if an insurer is a big buyer of reinsurance, it may have large payments being made at, say, the end of each quarter); and
- Payment of dividends to shareholders (normally they are paid twice a year).

Cash flows could also vary for other reasons, such as:

- Timing of investment opportunities (a life insurance company may want to take an opportunity in an investment market because, for example, interest rates have increased); and
- Repayments of any non-insurance liabilities, such as borrowing or tax liability (such payments would normally be anticipated in cash flow management).

There are often different rules applying to the assets of life insurers and those of nonlife insurers, because of the differences in the nature of their obligations and the variability of their cash flows. In some countries, composite insurers (those that write both life insurance and nonlife insurance) are allowed to operate. The application of rules related to asset structures can be complicated for composite insurers.

Cash flow management is a driving force of asset management. Cash flow should be projected periodically and monitored closely, to ensure that investment opportunities are maximized while at the same time regulatory requirements are observed.

**Assets and asset risks**

It is not always possible for insurers to structure their assets to closely correspond with the nature of their cash flows, because they need to select investments from among the types of assets actually available to them. The types of investments most commonly available to insurers include the following:

- Cash and cash at bank;
- Short-term deposits (or their equivalents), usually with a bank;
- Debt instruments (bonds), usually issued by Government or major corporations. They have a longer duration than short term deposits and usually carry a higher interest rate;
- Equities (shares), representing ownership in a company. There are different classes of equities, such as common or preferred shares. Usually the shares would be traded on a stock exchange. Income from an investment in common shares would be expected to come from two sources—dividends and capital appreciation;
- Property investments, which can be categorized as follows:
  - Property used by an insurer in the conduct of its business;
  - Property rented to another party. The insurer would obtain rents and also have to meet the costs to upkeep the property;
  - Development property, where an insurer buys a property to construct a building or buildings and then sell.

Insurers may have other types of assets in their balance sheet, such as premiums receivable from policyholders, derivative securities (which should be used only for hedging purposes), and goodwill (from the acquisition of another insurer). Some of these assets may be discounted or disregarded by supervisors when assessing the financial strength of an insurer. Life insurers usually also have policy loan assets (loans to life insurance policyholders, on the security of the cash values).
Insurers are subject to risks inherent in their insurance business as well as to the general risks applicable to any business. The risks—some of which are directly related to assets—affect the determination of the appropriate asset structure, and can be classified in the following broad categories:

- **Underwriting** (related to the risks underwritten by the insurer);
- **Credit** (the possibility that a counterparty will default on its obligations);
- **Market** (exposure to changes in equity prices and investment yields; exposure to changes in investment yields is also known as interest rate risk);
- **Liquidity** (the risk that events will require the insurer to attempt to liquidate assets prematurely on short notice and under unfavorable terms);
- **Operational** (risks related to operational problems of all sorts, such as fraud and computer problems); and
- **Strategic** (business risk from poor management decisions).

Because insurers may get unexpected claims and because asset values can fluctuate, liquidity is an important consideration. Examples of very liquid assets are cash at bank and government bonds (especially in developed economies). Examples of very illiquid assets are investments in associated companies, non-listed shares and properties.

Shares in a company related to the insurer or shareholders of the insurer and significant investments in other insurers or banks are treated with caution by supervisors, because of the risk that assets can be diverted and thus unavailable to meet obligations to policyholders. Investments in another insurer or financial institution may be disregarded by the supervisor to prevent the assets effectively supporting two financial institutions.

Property used by an insurer in the conduct of its business is generally considered an appropriate investment, although limits on the amount of such investments are sometimes imposed. Property that is rented to another party could be an appropriate investment for an insurer, but would generally be treated with caution as it is an illiquid investment. Development property is often not considered a good type of investment for an insurer, especially a non-life insurer, because it lacks a regular flow of income and is illiquid.

As noted earlier, the types of assets available and their liquidity depend on local economic and investment market conditions. In most developed economies there is a wide variety of assets available, including some with high liquidity. In such economies there are usually what is referred to as “deep” markets in areas such as government bonds and shares traded on a stock exchange. The expression “deep” means a market is sophisticated and highly liquid. It is easy to buy and sell without having a significant impact on the price of the asset at the time of a transaction.

This is not the case in most developing markets, where there is usually a limited choice of assets in which to invest. Developing economies usually have very “thin” markets in government bonds and shares, if indeed there is a formal stock exchange at all. “Thin” means that there is not an active market where the securities can be traded. One of the main implications of a “thin” market is the existing high volatility since there can be significant movements in the values of assets based on the timing of a purchase or sale and the level of demand at that time.

Choice of assets by insurers in “thin” markets is much more difficult than in “deep” markets. Government regulations in countries with “thin” markets often place particular emphasis on security and liquidity, because “thin” markets contribute to increased market risk and liquidity risk. In most economies investments in properties and privately issued shares are thinly traded. Investments in such assets by insurance companies are often restricted even in the most well developed economies.

An insurer needs to prevent the possibility of assets being taken. Assets can be subject to operational risks such as fraud or failure of safekeeping. Safekeeping means to keep ownership secure, maintaining physical possession or title to assets at all times. Although there are legal differences between countries, title to assets can change hands where they are used as security to borrow money. Such assets that have been offered as security may not be fully available to policyholders should they be needed, hence their value should be discounted when measuring assets available to meet insurance liabilities or capital adequacy requirements.

**Constraints**

In addition to the market and risk considerations discussed above, there are other factors that constrain insurers in the determination of their asset structures. These factors include regulations on the investments of insurers, taxation of different types of investments, and the valuation of assets for both shareholder and regulatory reporting.

The assets backing policyholder liabilities are a key focus of insurance regulation. Insurance laws and regulations typically impose several types of constraints on the investments of insurers, to ensure that the
assets are adequate in amount, secure, and liquid to enable insurers to meet their obligations to policyholders. Constraints can include:

- Prohibitions on certain types of investments;
- Limits on the maximum proportions of an insurer’s assets that can be invested in various types of assets;
- Limits on the maximum proportion of an insurer’s assets that can be invested with a particular counterparty (or related group of counterparties);
- A minimum proportion of an insurer’s assets that must be invested in highly liquid assets, such as cash or short-term government bonds; and
- Prohibitions on the use of derivatives, even for hedging purposes.

The constraints may vary depending on the type of insurance being accepted. For example, different limits may apply for life insurance than for nonlife insurance. Life insurance policies are often very long term and include a savings element. Therefore, asset security is particularly important. Life insurance companies may be restricted in their asset choices, to limit credit and market risks and thus create a level of security comparable to what a bank provides when taking deposits.

Although nonlife insurance does not include a savings element, the claims experience may be volatile. Therefore, nonlife insurers may be required to invest a higher proportion of their assets in highly liquid investments than would be required of life insurers.

The need for balance is essential. There is an inherent conflict as higher interest earnings theoretically mean lower premiums, and policyholders are attracted to low-cost, high-return products. Aggressive investment practices can increase an insurer’s market share and profitability. However, they also increase the risk that an insurer will fail—thus being unable to meet its obligations.

In some countries, insurers are legally required to manage their investments in manner that would be considered prudent with reference to their particular circumstances. In countries that take this “prudent person” approach, specific regulatory constraints would still need to be observed, but such constraints are typically less detailed and prescriptive than they would be in countries that do not follow this approach.

Sometimes insurers are required to hold policyholders’ funds in a manner which demonstrates that ownership is clearly and legally distinct from shareholders’ funds. Such separation is intended to provide more security for policyholders, by restricting the use of policyholders’ funds. In the event the insurer fails, the insurance law might also protect such funds from the claims of an insurer’s general creditors. Separation of funds is more commonly required for life insurance than for nonlife insurance, because of the long-term savings element of many products.

Insurance liabilities are only estimates, so to increase the likelihood that an insurer will be able to meet its obligations even under adverse circumstances, capital adequacy requirements are established. Capital (also referred to as shareholders’ funds, net worth, or net assets) represents the net assets of an insurance company after deducting the value of both policyholder liabilities and any other liabilities.

Minimum levels of capital required to be retained by insurers are often a fixed amount specified in local currency terms, an amount calculated based on premiums (and/or claims), an amount calculated relative to policy liabilities or an amount calculated based on an assessment of the riskiness of assets and liabilities held. Under the risk-based approach, the amount of capital required depends on the risk profile of the insurer, with insurers being required to hold more capital in respect of riskier types of assets. Asset riskiness will increase as its term to redemption increases, the credit behind the issuer of the asset reduces and the perceived liquidity of an asset reduces. Most of these risks are reflected in the interest rate payable on (or the economic rent derived from) the asset.

Many countries impose constraints on investments that can be held in the shareholders’ funds. In some countries, such constraints are less stringent than those applicable to policyholders’ funds. However, some assets, such as goodwill, may be inadmissible when calculating the amount of assets available to meet capital adequacy requirements.

Taxation and other laws may also influence the composition of assets. Taxation rates may differ between capital gains and income gains, such as interest and dividends. For example, in Australia most dividend income from share investments is, in effect, not taxable. The taxation of dividends paid on shares may also differ from that applied to interest income. Within a country, the taxation of life insurance companies might differ from that of nonlife insurance companies, for example, because the government wishes to encourage savings or life insurance.

The manners in which assets are valued and the values are reported can also affect asset structures. In some countries there may be differences in how companies report to shareholders and to supervisors. Supervisors often prefer that assets be valued and reported conservatively, for example, by prohibiting the recognition of unrealized capital gains. Reporting to shareholders might be done on a different basis, for example, in accordance with International Financial Reporting Standards (IFRS). IFRS requires that most assets be valued on a “fair value”
basis, which makes the reported values subject to market fluctuations. Many countries are converging to IFRS for shareholder reporting, and a growing number of jurisdictions are also using IFRS for regulatory reporting purposes (perhaps with adjustments to asset values when assessing capital adequacy). It is important that both insurers and supervisors understand any accounting differences that might exist.

**Asset management**

Regardless of the situation in a market or with respect to a particular insurer, the basic principles behind successfully managing an insurance portfolio, cash flows and assets should be the same. The board of directors (supervisory board, in a dual-board system) should establish an investment policy that is appropriate to the business of the insurer and meets regulatory requirements. Management should manage the assets in accordance with the investment policy. The board of directors should require that adequate controls are in place to ensure that this happens, and assess the results of the investment program.

In many countries, regulations require that a formal investment policy be adopted and set out the items that it must be address. They would typically include:

- The objectives of the investment program, which should be in accordance with the overall risk philosophy of the insurer as outlined in its strategic plan and take into account its ability to absorb potential losses;
- The expected composition of the portfolio by type, term and liquidity, and detail permissible investments, including details of any restrictions as to markets (e.g., only securities listed on specified stock exchanges), minimum rating requirements, and so forth;
- Limits to prevent excessive concentrations and ensure sufficient diversification of the investment portfolio, which may be based on ratings, markets, currency, industries and sectors. Limits should also be established for investments with the same counterparty (or related counterparties) and with parties related to the insurer. Where applicable, regulatory limits and/or restrictions should be noted; and
- Authorization procedures, limits and accountabilities for investment activities. The framework of accountability for all investment transactions should include details on who is authorized to undertake investment transactions and procedures for approval of new investment instruments. The approval process for investments should also include the review and approval of legal documentation prior to the execution of the transaction;
- The circumstances in which derivative instruments—or structured products that have the economic effect of derivatives—can be used. Limits should be established by type of instrument (e.g., swaps, options, and futures) and by counterparty.

Many factors must be considered by an insurer when it develops or updates its investment policy. Some of these factors are specific to the insurer, including:

- Risk appetite—the level of risk the board of directors is prepared to accept;
- Capital position—an insurer with a lot of excess capital may be able to follow a riskier strategy, while one with capital close to the minimum required by a supervisor should have a relatively low-risk asset strategy;
- Capital structure—capital may include subordinated debt or preference shares, which may not be permanent capital;
- Ownership and access to capital—a strong owner that is willing to provide additional capital if the need arises might mean a riskier asset strategy can be followed;
- Types of business—some types of insurance are very long-term in nature and some are relatively short-term;
- Exposure to claims fluctuations—the quality and quantity of reinsurance and a company’s exposure to catastrophes such as storms and earthquake;
- Currency—some policies might be written in different currencies, and holding assets in a different currency than corresponding liabilities creates a potential risk if the currency value changes;
- Mix of policyholders—if business comes predominantly from big corporations or is concentrated in a particular industry, the insurer may diversify its assets away from its clients and their industries, in order to reduce the risk that adverse circumstances could affect both insurance liabilities and asset values;
- Strength of cash flow—an insurer with strong positive cash flow may be able to invest a higher proportion of its funds in illiquid assets;
- Existing assets—the investment policy should take into account the mix, liquidity and return on existing assets;
Other factors that must be considered are generally relevant to all insurers in a jurisdiction, such as the following:

- Regulatory constraints on assets;
- Capital adequacy and solvency requirements, such as the admissibility of assets and the risk weightings of different types of assets in a risk-based capital adequacy system;
- Valuation requirements, for both shareholder and regulatory reporting;
- Taxation—differences in the taxation of different types of investment gains;
- Government incentives—for various types of investments;
- The state of investment markets—as markets become more or less confident, investments in assets will usually be longer- or shorter-term in nature, respectively;
- General economy—investments might be directed to areas of the economy where growth appears more likely to occur or asset classes that might be expected to benefit from exogenous factors, such as higher oil prices; and
- Inflation expectations—debt instruments can lose real value in a high inflation environment.

As mentioned earlier, cash flow management—both short-term and long-term—is an important element of asset management. Often, the investments of insurers have different maturity and liquidity characteristics than their insurance liabilities. This mismatch in assets and liabilities exposes the insurer to interest rate risk. Many insurers, particularly life insurers, employ a range of techniques to address possible mismatches. This is referred to as asset-liability management (ALM), which has been defined by the Society of Actuaries as “the ongoing process of formulating, implementing, monitoring, and revising strategies related to assets and liabilities to achieve an organization’s financial objectives, given the organization’s risk tolerances and other constraints.”

It is best practice to have a risk management plan. The objective is to ensure that companies consider all material risks that could do harm to the company. The investment policy and investment management procedures are important elements of a risk management plan. Some examples of risk management techniques used as part of the asset management process are:

- Diversification of assets by market, to limit the effects of sudden changes to markets caused by an outside event;
- Careful evaluation of the quality of counterparties and diversification of investments among counterparties, to limit credit risk;
- Cash flow projection, to ensure adequate liquidity;
- ALM, to limit the exposure to interest rate risk; and
- The use of a third-party custodian to strengthen the safe keeping of assets.

In conclusion, it is clear that an appropriate asset structure is a key to the success of an insurer and the security of its policyholders. Many factors must be considered to determine an appropriate asset structure. In doing so, a balance achieved between the advantages of the high investment returns that might be produced by an aggressive investment policy and the increased threat to policyholder security that would accompany such an approach.
In life insurance companies there are three types of liabilities for which assets are held:

i. Shareholders’ funds in what is referred to as a General Fund where assets are held separately from Policyholders’ funds. There is a minimum amount of capital required for this fund of AUD10 million. Additional capital (assets) is required if needed if there are risks to be supported from this capital in addition to life insurance business.

ii. Shareholders’ funds representing the surplus in the Policyholders’ funds

iii. Policyholders’ funds—the assets represented by this amount and ii above are held in a fund or funds where ownership is quite clear and distinct from Shareholders’ assets.

Valuations of assets and the amount of assets needed in a fund take into consideration:

i. The state of the markets for assets

ii. The costs of turning an asset to cash and its liquidity.

iii. Whether an insurer is too exposed to one asset or a group of related assets

iv. The credit risk of an asset

There are limitations on assets that can be held in a Policyholders’ fund. For example:

i. No limit if asset guaranteed by Australian State or Federal government.

ii. If secured by bank deposits the greatest of 50% of value of fund assets (less the value of the assets of the fund (VASF) secured by bank bills); and 25% of VASF; and AUD 20 million.

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**Case Study 1:**
**Developed Market—Australia**

**TYPE OF GOVERNMENT AND ECONOMY**
Democratic, mature and open economy

**POPULATION**
Over 20 million

**INSURANCE PREMIUMS PER CAPITA**
USD 2569.9 (Swiss Re Sigma 2005)

**CAPITAL MARKETS**
“Deep” with a well developed stock exchange and active markets in government bonds and other securities.

**INSURANCE ACCOUNTING, PROFESSION & INSURANCE ACCOUNTING STANDARDS**
Profession is well developed & well trained. International accounting standards have been recently introduced with the “fair” value concept for valuing assets. In essence this means that most assets are at market value.

**ACTUARIAL PROFESSION**
Required under life insurance law since 1945.
Required under non life insurance law since 2002.

**CORPORATIONS LAW**
Very well developed

**LIFE INSURANCE LAW**
In existence since 1945, actuarial involvement extensive. Separate from Non Life law.
In non life insurance there has to be a minimum of shareholders' funds of A$5 million (generally speaking). Assets do not have to be held in a legally separate fund. Generally speaking assets are at "fair value" as required by accounting standards (effectively market value) with the supervisor making some adjustments.

Some assets are not allowed. eg goodwill.

**Valuing assets must keep in mind:**

i. Credit risk
ii. Market or mismatch risk
iii. Liquidity

The more risky an asset the more capital in the form of assets required by an insurer. For example:

i. 0.5% more assets for cash (notes and coins); obligations of the Australian Government; an Australian State or Territory government.
ii. 4.0% more for unpaid premiums due less than 6 months
iii. 8.0% listed equity instruments
iv. 10.0% more for direct holdings of real estate
100.0% more for loans to directors of the insurer or directors of related bodies corporate and where an asset is charged or used to support other Policyholders' funds.

APRA has significant discretion on what valuations it will accept.

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**Case Study 2:**

**Developing Market—Vietnam**

Socialist Republic that is seeking economic growth and development

Almost 90 million

USD 10.1 (Swiss Re Sigma 2005) but growing rapidly. Life premiums grew by 12% and non life by 30% in 2007.

“Thin” with a rapidly developing stock market and share trading centre in HCM and Hanoi respectively. “Thin” markets in other securities such as government bonds.

There is a developing industry that does not as yet have the capacity to adopt international accounting standards in insurance.

Developing with actuarial sign off required in life insurance from January 2006.

Enterprise law implemented in the 1990's to implement a basis for the development of a multi-sector commodity economy, encourage investment and business, protect the lawful interests of private entrepreneurs, and enhance the efficiency of State management in respect of all business activities.
Law on Insurance Business introduced in 2000—applies to life and non-life. Legal regulations issued in 2008 to make the industry more transparent, more favourable to the interests of the insured and in line with international rules. Government Decree 45 dated March 27, 2007, says that non-life insurance companies and life insurance companies must have respectively at least VND300bil in legal capital (previously VND70bil) and at least VND600bil (VND140bil).

Pham Quang Tung, BIDV Insurance Company Director, said that “the required capital levels might be high for local companies, but they proved to be relatively low compared to those of companies in regional countries. Insurers need to increase their capital in order to become financially stronger.”

**Splitting owner’s capital fund and premium fund in life insurance**

Life insurers must split into separate accounts owner’s capital from premium collected from purchasers of insurance in accordance with guidelines of the MOF.

Insurance enterprises are leading investor. Total investments were estimated in 2007 to be USD$2.5bil of which nearly 90% was invested in government bonds or deposited in banks.

**Investment capital sources of an insurer:**

i. Owner’s capital.
ii. Idle capital from insurance reserves.
iii. Other legal sources as stipulated by law

**Investments from owner’s capital**

i. Investments from owner’s capital must be safe, effective and of a liquid nature in accordance with guidelines of the MOF.
ii. Insurers shall be permitted to make offshore investments in accordance with law of that part of owner’s capital which exceeds the legal capital level or the minimum solvency margin, whichever is the greater.

**Idle capital from insurance reserves of an insurer means:**

the total insurance reserves less (-) sums of money used by the insurer for regular payments of non-life insurance claims in a period and for regular payments of life insurance proceeds in a period.
In the case of life insurers, sums of money for regular payments of insurance proceeds in a period shall be:
not lower than 5% of the total insurance reserves and shall be deposited with credit institutions operating in Vietnam.
Idle capital from insurance reserves of an insurer:
  i. No limit—Purchase of Government bonds or guaranteed bonds of enterprises, or deposits with credit institutions.
  ii. Not greater than 50% shares, unsecured bonds of enterprises, and capital contribution in other enterprises.
  iii. Not greater than 40% of real estate business and lending.

Sums of money for regular payments of compensation for claims in a period shall be:
not be lower than 25% of the total insurance reserves and shall be deposited with credit institutions operating in Vietnam.

Idle capital from insurance reserves of an insurer:
  i. No limit—Purchase of Government bonds or guaranteed bonds of enterprises, or deposits with credit institutions.
  ii. Not greater than 35% shares, unsecured bonds of enterprises, and capital contribution in other enterprises.
  iii. Not greater than 40% of real estate business and lending.

There is a draft circular that has as examples for solvency:
  i. Fully admitted assets: Cash on hand, cash at bank and government bonds.
  ii. Assets that are wholly excluded: Investment in other insurers, bad debts, office equipments, inter-companies receivables, premium receivables outstanding more than 2 years, loans, investments in affiliates, partnerships, shareholders and related parties.
  iii. Assets that are partly excluded: Guaranteed corporate bonds (1%), listed shares (15%), unlisted shares (20%), own use real estate (8%), investment real estate (15%), premium receivables outstanding from 90 days to 1 year (30%), outstanding from 1 year to 2 years (50%)

Note: Source of most of above is MOF Vietnam website and various laws, decrees (especially Decree 46) and circulars of Vietnam.
Suggested further reading

2. Valuation Bases of Different Types of Assets:
   a. Australian Accounting Standard AASB 5 “Non-Current Assets Held For Sale And Discontinued Operations”—July 2004
   c. Australian Accounting Standard AASB 128 "Investments in Associates”—July 2004
   e. Australian Accounting Standard AASB 138 "Intangible Assets”—January 2005
   g. Australian Accounting Standard AASB 140 “Investment Property”—July 2004


