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## Necessary Reform of Insurance Business Law in Vietnam After Its Accession to the World Trade Organization: Prudential Regulatory Aspects

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## ARTICLE

### NECESSARY REFORM OF INSURANCE BUSINESS LAW IN VIETNAM AFTER ITS ACCESSION TO THE WORLD TRADE ORGANIZATION: PRUDENTIAL REGULATORY ASPECTS

*Vu Nhu Thang\**

#### I. INTRODUCTION

In 1986 during the Sixth Congress of the Communist Party, Vietnam launched a fundamental economic reform program, called *doi moi* (Renovation), a turning point that marked the country's transition from a centrally-planned economy to a market-driven economy with a socialist orientation. Key elements of this reform include (i) state-owned enterprise reform and private sector development, (ii) external trade and foreign investment, and (iii) liberalization of financial market. Along with the domestic economic reform, at the bilateral level, Vietnam has established and fostered economic relationships with other countries with a view to facilitating foreign trade relations and integration into the world economy. By 2003, Vietnam had entered into seventy-two bilateral trade agreements and set up trade relations with 165 countries.<sup>1</sup> At the regional level, an important landmark in Vietnam's integration was joining the Association of Southeast Asian Nations in 1995 and the Asia-Pacific Economic Co-operation Forum in 1998. The road toward membership in the World Trade Organization (WTO) has been marked by observatory status in the General Agreement on Tariffs and Trade since June 1994. Vietnam became the 150th member of the WTO in 2007.

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1. Symposium, *Opportunities and Challenges for Vietnam in WTO Accession*, (2003), available at [http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/vietnamaccession\\_nam.pdf](http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/vietnamaccession_nam.pdf).

Concerning Vietnam's insurance services sector, commitments to liberalization of the domestic market under the market access and national treatment principles of the General Agreement on Trade in Services (GATS) require Vietnam to treat foreign insurance services and suppliers no less favorably than domestic counterparts.<sup>2</sup> Consequently, equal treatment between domestic and foreign insurers in the provision of services will put domestic insurers under pressure to restructure and innovate corporate governance in order to enhance their efficiency. On the other hand, the national treatment probably makes it difficult for regulators to protect domestic insurance companies. This regulatory equity also restrains administrative intervention in the domestic insurance sector. In other words, it would eliminate regulatory discretion and arbitrariness.

Literature review shows that liberalization of services in general and insurance services in particular require regulation, including increasing the strength and quality of certain regulations, as well as introducing new rules that facilitate transition to a more open system.<sup>3</sup> A more liberal insurance sector, therefore, will require a more complex and effective regulatory and supervisory framework. Under GATS, Vietnam, nevertheless, is not limited in introducing prudential measures for consumer protection and systemic concerns.<sup>4</sup>

Accordingly, this paper presents the necessity of enhancing prudential regulation and supervision on insurance business operations in Vietnam in order to protect the interests of consumers in the domestic insurance market. Comparative analysis provides an appropriate methodology. Experiences of the European Union (EU), the United States (US), and Japan are employed to analyze current solvency regulations in Vietnam because the US is the world largest insurance market.<sup>5</sup> The EU and Japan are the second largest insurance markets in

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2. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1B, Legal Instrument Result of the Uruguay Round [hereinafter GATS], art. XVI and XVII.

3. See MARKUS KRAJEWSKI, NATIONAL REGULATION AND TRADE LIBERALIZATION IN SERVICES: THE LEGAL IMPACT OF THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS) ON NATIONAL REGULATORY AUTONOMY 5 (2003); Carlo Gamberale & Aaditya Mattoo, *Development, Trade and the WTO - A Handbook*, xi (Bernard Hoekman et al. eds., World Bank, 2002); HAROLD D SKIPPER, JR., HARMONIZATION VERSUS COMPETITION: INTERNATIONAL FINANCIAL MARKETS 3 (Claude E. Barfield ed., AEI Press, 1996).

4. GATS, *supra* note 2, at Annex on Financial Services, para. 2.

5. WTO Secretariat, *Trade Policy Review - The United States*,

the world, just behind the US.<sup>6</sup> In the case of the US, because the insurance industry is regulated at the state level but not at the federal level, model laws, which are developed by the National Association of Insurance Commissioners (NAIC)<sup>7</sup> and can be adopted by states, shall be examined. Part II will provide a brief history of Vietnam's insurance services market and its regulations. Part III will present Vietnam's obligations and commitments in the field of insurance services under the multilateral framework. The review of compliance with commitments will be analyzed in Part IV. The necessity of future reforms of prudential regulations in the insurance sector is discussed in detail in Part V. Finally, with Part VI, this paper will conclude.

## II. VIETNAM'S INSURANCE SECTOR AND REGULATORY DEVELOPMENT

### *A. Brief History of the Insurance Market*

In the insurance sector, there are two important landmarks in the legal environment after *doi moi*. The first is the governmental decree on insurance, introduced in late 1993. The second legal landmark is the first Law on Insurance Business (the "Vietnam Insurance Law") passed in 2000. Therefore, the trend of development of the insurance services market in Vietnam might be divided into three stages: pre-1993, 1994-2000, and post-2001.

Three characteristics of Vietnam's insurance sector before 1993 were (i) the state monopoly in supplying insurance services; (ii) the modest role of the sector in the economy as a whole; and (iii) no separate regulator and supervisor. The state-owned insurance company, Vietnam Insurance Corporation, was established in 1964 in the North under the Ministry of Finance (MOF) to provide cargo insurance, marine hull insurance, and personal accident insurance.<sup>8</sup> After the country's

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WT/TPR/S/160/Rev.1, at 95 ( Jun. 20, 2006).

6. WTO Secretariat, *Trade Policy Review – European Communities*, WT/TPR/S/136, at 120 (Jun. 23, 2004).

7. NAIC, which was established in 1871, is an organization of the chief state insurance regulatory officials with a view to coordinating supervision and regulation. The coordinated activities include maintenance of database, analysis of financial conditions of insurers, design of uniform statutory financial statements and accounting rules for insurers. See INSURANCE SOLVENCY SUPERVISION: OECD COUNTRY PROFILES 295-96 (OECD, 2002).

8. Decision 179/CP dated Dec. 17, 1964 of the Prime Minister (Vietnam).

reunification, fifty-two insurance and reinsurance companies operating in the South merged with the Vietnam Insurance Corporation in 1976-1977.<sup>9</sup> Along with the economic development of the 1980s, several new insurance services were supplied, such as personal accident, aviation insurance, agriculture insurance, and insurance services to foreign direct investment projects.<sup>10</sup> In terms of foreign participation into the domestic insurance market, there was only one insurance brokerage company, which was set up in 1993 with wholly foreign ownership. There were no life insurance services in this period. According to Seibel, this was due to the high inflation rate and the scarcity of long-term investment opportunities.<sup>11</sup> The total insurance premiums written accounted for 0.37 percent of the Gross Domestic Product (GDP) in 1993.<sup>12</sup> Concerning the regulatory and supervisory body, the Vietnam Insurance Corporation conducted both insurance business activities and the state management function over the sector until 1992. The Insurance Division under the MOF was established in 1992 and separated from the Vietnam Insurance Corporation in order to conduct regulatory and supervisory functions over the insurance market.

The second period, from 1994 until 2000, experienced fundamental changes in the domestic insurance market. The total insurance premiums written in 2000 increased seven times since 1993. During this period, the non-life insurance premiums doubled.<sup>13</sup> The insurance sector, therefore, played a clearer and more important role in economic growth during this period. Compared to 1993, the total investment capital from the insurance sector into the economy in 1999 increased considerably by fifty-eight times.<sup>14</sup> Life insurance services have been supplied since 1996. Private sector and foreign access to the domestic insurance market were permitted. By the end of 2000, there were three domestic joint-stock, four state-owned, and nine foreign insurers in Vietnam.<sup>15</sup> Among foreign counterparts, Japanese insurers were the

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9. Truong Moc Lam, *Nganh kinh doanh bao hiem o Vietnam – Mot chang duong* [Vietnam Insurance Sector – A History], 2 TAP CHI BAO HIEM 1, 1 (2003).

10. *Id.*

11. HANS DIETER SEIBEL, THE MAKING OF A MARKET ECONOMY: MONETARY REFORM, ECONOMIC TRANSFORMATION AND RURAL FINANCE IN VIETNAM 67 (1992).

12. Ministry of Finance, *Thi Truong Bao Hiem Viet Nam Nam 2004* [Vietnam Insurance Market 2004] at 6 (2005).

13. *Id.*

14. *Id.*

15. *Id.* at 19.

main players in 1996-1997, while European and American insurers were dominant in 1999-2000.

In the third period, from 2001 to the present, Vietnam's insurance sector has recorded significant growth and expansion. The total insurance premiums written amounted to 1.76 percent of GDP in 2005.<sup>16</sup> As of the end of 2005, thirty-two insurance companies participated in the domestic insurance market. In terms of ownership, there were twelve companies with wholly foreign-owned capital, six joint-venture companies, eleven domestically joint-stock companies, and three state-owned insurers. The number of foreign insurers has doubled since 2000. One of the main reasons for this growth is the implementation of trade agreements between Vietnam and the US and EU.<sup>17</sup> While foreign insurers play an insignificant role in the non-life insurance market with market shares less than ten percent, their share in the life insurance market accounts for approximately two thirds.<sup>18</sup> Capital investment in the economy increased tenfold between 1999 and 2005.<sup>19</sup> Foreign insurers climbed gradually from thirty-five percent of the total capital investment from the insurance sector in 2003 up to forty percent and forty-seven percent in 2004 and 2005, respectively.<sup>20</sup>

However, the insurance sector is still characterized by its small size and the limited variety of insurance products available, as well as lower competitiveness of domestic insurers. As noted earlier, the total value of insurance premiums in Vietnam accounted for less than two percent of GDP in 2005.<sup>21</sup> In 2004, premiums per GDP of the US were 9.44 percent, and that of the EU and Japan were 8.64 and 10.47 percent,

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16. Ministry of Finance, *Thi Truong Bao Hiem Viet Nam Nam 2005* [*Vietnam Insurance Market 2005*] at 6, (2006).

17. The Bilateral Trade Agreement between the US and Vietnam, which was concluded in 2001, is the most comprehensive and the first agreement to encompass trade in services, which significantly influences the development of the domestic insurance market. In addition, Under the EU-Vietnam Agreement on Mutually Beneficial Trade Liberalization, concluded in February 2003, Vietnam committed to grant an additional insurance brokerage license to an EU-origin company, among other things, as a condition for an increased quota in the EU textile market.

18. Ministry of Finance, *supra* note 16, at 6.

19. *Id.* at 5.

20. *Id.* at 5; see also, Ministry of Finance, *Vietnam's Economic and Social Statistic Data in the First Quarter of 2005* (Jun. 26, 2005), available at [http://www.mofa.gov.vn/en/tt\\_baochi/nr041126171753/ns050628153332](http://www.mofa.gov.vn/en/tt_baochi/nr041126171753/ns050628153332).

21. Ministry of Finance, *supra* note 16.

respectively.<sup>22</sup> While the number of insurance products increased sharply to around six hundred by the early years of this decade, because of the lack of adequate governance by the existing legal framework there are still many areas which have not yet been adequately covered, such as credit insurance, business risk insurance, and professional liability insurance.<sup>23</sup> Investment portfolios of insurers were not diversified. Investment in corporate bonds and shares as well as loans and real estate accounted for less than fifteen percent of the total investment capital of insurers in Vietnam, while this figure was eighty percent in the EU.<sup>24</sup>

*B. Insurance regulations before Vietnam Insurance Law*

As described earlier, before 1993, there was only one insurance company operating in the insurance market. The supply of insurance services was governed by rules of the MOF, which was designated exclusively to the Vietnam Insurance Corporation. Those rules included insurance products, insurance contracts, terms and conditions, premium rates, and dispute settlements.<sup>25</sup> However, there was no regulation on new entrance and exit of insurers. In addition to rules of the MOF, certain insurance services were regulated by different laws, such as marine insurance contracts under Marine Code 1990 and civil liabilities of carriers under Law on Aviation 1992.

The governmental decree in 1993 on business insurance, as the sole regulation guiding the industry, was considered an initial step for

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22. SwissRe Sigma, *World Insurance in 2004: Growing Premiums and Stronger Balance Sheets* 17 (Feb. 2005), available at [http://www.swissre.com/INTERNET/pwswilpr.nsf/vwFilebyIDKEYLu/MPDL-6DM8Y4/\\$FILE/sigma2\\_2005\\_e.pdf](http://www.swissre.com/INTERNET/pwswilpr.nsf/vwFilebyIDKEYLu/MPDL-6DM8Y4/$FILE/sigma2_2005_e.pdf).

23. Nguyen Trong Nghia, *Thuc trang va Giai phap Hoan thien He thong Phap luat Phat trien Thi truong Tai chinh va Dich vu Tai chinh* [Current Situation and Solutions for Improving Legal System on the Development of Financial Markets and Financial Services] at 46 (2004) (academic research paper, Ministry of Finance, Vietnam) (on file with the Financial Scientific Institute).

24. Le Song Lai, *Thuc trang va Giai phap nang cao hieu qua hoat dong dau tu cua cac doanh nghiep tren thi truong bao hiem Viet Nam* [Current situation and Solutions on improving investment efficiency by companies in Vietnam's Insurance Market] 22-23 (2005), (Symposium on Solutions for facilitating efficient investments by insurers into the economy) (on file with the Association of Vietnamese Insurers).

25. See, e.g., Decision 254-TC/QD-BH dated May 25, 1990 of the Finance Minister (Vietnam) (permitting Vietnam Insurance Corporation to supply marine insurance services).

opening the insurance market.<sup>26</sup> It was a landmark for diversifying insurance services in Vietnam, including direct insurance, both life and non-life; reinsurance; brokerage; and agency.<sup>27</sup> Apart from those insurance services, an insurance company was also permitted to conduct assessment, inspection, calculation for loss distribution, and act as agent in assessment and settlement of compensation.<sup>28</sup> Parallel to the policy on promotion of private sector and encouragement of foreign direct investment in Vietnam, the monopoly in the insurance sector has been replaced by diversifying players.<sup>29</sup> The opening of this sector, however, was subject to various licensing criteria, including clear objectives and areas of business activity, and proposed insurance services necessary for the national economy.<sup>30</sup> The implementation of these procedures allowed for the speed at which the insurance sector opened to be better managed.

### *C. Vietnam Insurance Law*

Vietnam Insurance Law, effective April 1, 2001, reinforces the safety and soundness of the domestic insurance market, strengthens the financial capacity of insurance companies, and protects interests of policyholders.<sup>31</sup> The law consists of 129 articles, which are divided into nine chapters. Chapter One covers general principles, including the application of law, terms and definitions, and classes of insurance services. This Chapter also asserts that consumers may only purchase insurance services from insurers authorized to operate in Vietnam.<sup>32</sup> Chapter Two covers forty-six articles governing insurance contracts, including categories of insurance contracts, their contents, rights and obligations of insurers and insured. Chapters Three through Five provide rules for market entry and operations of domestic insurance

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26. Vietnam Decree 100/CP of the Government on Insurance Business (Dec. 18, 1993).

27. *Id.* art. 3, 7.

28. *Id.* art. 8.

29. *Id.* art. 2. Forms of insurance companies include state owned company, joint stock company, mutual insurance company, joint venture company, branch of foreign insurance company, and insurance company with 100 percent foreign owned capital.

30. *Id.* art. 17.

31. Law on Insurance Business (Vietnam), at XIV-1221, 8th Sess. (Dec. 9, 2000).

32. *Id.* art. 6.



companies, insurance brokers and agents, including licensing procedures, transfer of insurance contracts, recovery of solvency, dissolution, bankruptcy, as well as accounting and financial statements. There are five categories of insurance companies, which are classified by ownership: (1) state-owned, (2) joint-stock, (3) mutual-aid, (4) joint-venture, and (5) wholly foreign-owned capital.<sup>33</sup> Chapter Six deals with specific requirements for licensing and operations of foreign invested insurance companies and foreign invested insurance brokers in Vietnam. Chapter Seven gives rules for the state administration of the insurance industry, including regulatory and supervisory functions. While Chapter Eight includes provisions on rewards and handling of breaches of the law, the final chapter is comprised of implementing provisions.

### III. VIETNAM'S OBLIGATIONS AND COMMITMENTS UNDER THE MULTILATERAL FRAMEWORK

#### A. General Obligations

While the WTO agreement addresses institutional and operational matters of this organization extensively, it also sets out fundamental obligations of its members. As a member of the WTO, Vietnam is required to ensure conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed agreements, including GATS.<sup>34</sup> It indicates that as a general obligation under the multilateral trading system, Vietnam shall promulgate new legislations or amend existing laws in accordance with WTO obligations. Accordingly, any provision in Vietnam Insurance Law and other related regulations, which is inconsistent with the multilateral rules and principles, must be revised in conformity with GATS, unless exceptions are provided.

#### B. Obligations Under GATS

The GATS framework provides a set of principles and rules that require Vietnam to remove both discriminatory and non-discriminatory restrictions on trade in insurance services. While a number of principles address exclusively either discriminatory or non-discriminatory restrictions, some others concern both types of restrictions. There are

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33. *Id.* art. 59.

34. WTO Agreement, *supra* note 2, at art. XVI(4).

two fundamental general principles in Part Two of GATS, addressing the problem of non-discriminatory restrictions on the trade in services, namely regulatory transparency (Article III) and domestic regulation (Article VI). Although discriminatory restrictions are dealt with by most-favored-nation treatment (MFN) and national treatment in Articles II and XVII, respectively, only the MFN is the general principle.

Under the regulatory transparency obligation, Vietnam is required, firstly, to publish all relevant measures “of general application” relating to trade in services.<sup>35</sup> Second, Vietnam also is required to annually notify the WTO on new or changed laws, regulations, or administrative guidelines which significantly affect trade in services, and thirdly, to respond promptly to all requests by any other Member for specific information on any of measures of general application.<sup>36</sup> The purpose of this Article is call for the removal of unnecessary restrictions on trade in services as a result of a lack of clarity, unfairness, as well as to assure compliance with specific commitments in national treatment and market access.<sup>37</sup> Regulatory transparency involves not only designing but also applying regulations by requiring WTO Members to establish “enquiry points” in order to provide information to other Members.<sup>38</sup>

GATS Article VI on domestic regulation provides a framework for minimizing the distortions of trade created by domestic regulations. It requires that any measure of general application affecting trade in services is to be administered in a reasonable, objective and impartial manner.<sup>39</sup> Domestic regulation involving qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services.<sup>40</sup> Such disciplines are to be: (a) based on objective and transparent criteria, (b) not more burdensome than necessary to ensure the quality of the services, and (c) in the case of licensing procedure, not in themselves a restriction on the supply of the services. Moreover, in scheduled sectors, for example, Vietnam is required to restrain from applying licensing and qualification

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35. *Id.* at GATS art. III:1

36. GATS, *supra* note 2, at art. III:3, III:4

37. SYDNEY J. KEY, *THE DOHA ROUND AND FINANCIAL SERVICES NEGOTIATIONS* 44 (2003).

38. RACHEL THOMPSON AND KEIYA IIDA, *TRADE IN SERVICES: NEGOTIATING ISSUES AND APPROACHES* 105-110 (OECD, 2001).

39. GATS, *supra* note 2, at art. VI:1.

40. *Id.* art. VI:4.

requirements as well as technical standards that cause nullification or impairment of such commitments on the market access and national treatment on insurance and insurance-related services.<sup>41</sup>

Under the MFN obligation of GATS, Vietnam must accord immediately and unconditionally to services and service suppliers of any other WTO Member “no less favourable” treatment than it provides to “like” services and service suppliers of other Members.<sup>42</sup> The “no less favourable” treatment encompasses both *de jure* and *de facto* discrimination.<sup>43</sup> GATS allows an exemption to the MFN obligation whereby Vietnam is not prohibited from granting advantageous treatment to “adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.”<sup>44</sup> Another exemption from the MFN obligation is the economic integration, whereby Vietnam is not prohibited from being a party or entering into an agreement liberalizing trade in services between or among parties to such an agreement.<sup>45</sup>

Article XVI on market access extends to all measures that restrict either domestic or foreign services and service suppliers from getting access to Vietnam’s insurance market, regardless of discriminatory or non-discriminatory basis.<sup>46</sup> There are six types of limitations which are prohibited by this Article, namely: (a) limitations on the number of suppliers; (b) limitations on the total value of service transactions or assets; (c) limitations on the total number of service operations or on the total quantity of service output; (d) limitations on the total number of natural persons that may be employed; (e) measures which restrict or require specific types of legal entity or joint venture; and (f) limitations on the participation of foreign capital, either in terms of a percentage limit on foreign shareholding or on the total value of foreign investment, either in the aggregate or by a single entity.<sup>47</sup> Under Article XVII on

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41. *Id.*

42. *Id.* art. II:1.

43. WTO Dispute Appellate Body Report, *European Community—Regime for the Importation, Sale and Distribution of Bananas*, para. 234, WT/DS27/AB/R (adopted on Sep. 25, 1997).

44. GATS, *supra* note 2, at art. II:3.

45. GATS, *supra* note 2, at art. V.

46. GATS, *supra* note 2, at art. XVI:2.

47. The Appellate Body found that in the context of Article XVI:2 (a) and (c), any measure prohibiting supply of services that constitutes a zero quota is quantitative limitation. See WTO Dispute Appellate Body Report, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, para. 214, 238,

national treatment, Vietnam is required to treat foreign services and service suppliers of any other Member no less favorably than it does its own “like” services and service suppliers.<sup>48</sup> However, the application of the market access and national treatment principles is conditional upon the schedule of specific commitments by Vietnam regarding insurance and insurance-related services.

*C. Vietnam’s Commitments in Insurance and Insurance-Related Services*

*1. Scope of Business*

For liberalization under the multilateral framework, Vietnam schedules direct insurance, excluding health insurance services; re-insurance and retrocession; insurance intermediation, such as brokerage and agency; and services auxiliary to insurance, such as consultancy, actuarial risk assessment and claim settlement.<sup>49</sup> Market access on the cross-border supply (Mode 1) of insurance services is applicable to certain insurance services, namely insurance services in international transportation; reinsurance services; insurance brokerage and reinsurance brokerage services; and consultancy, claim settlement and risk assessment services.<sup>50</sup> In addition, foreign insurers are permitted to engage in cross-border transactions with foreign invested companies or foreigners working in Vietnam.<sup>51</sup> Vietnam has agreed to ensure no limitations on market access with respect to consumption abroad (Mode 2).<sup>52</sup> Statutory insurance services are permitted to be supplied by a wholly foreign-owned insurance company from 2008.<sup>53</sup>

With regard to commercial presence (Mode 3), foreign insurers are

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251, WT/DS285/AB/R, (*adopted* on April 20, 2005).

48. GATS Article XVII on national treatment would enjoy a broad scope of obligation due to the uncertainty in determination of “like” services and service suppliers, and the broad coverage of “no less favourable” treatment between domestic and foreign services and services suppliers. For further discussion, see Vu Nhu Thang, *Interpreting GATS national treatment principle: Possibilities and problems of transplant from GATT*, 32 FORUM OF INT’L DEV. STUD. 173 (2006).

49. WTO, *Vietnam—Schedule of Specific Commitments*, GATS/SC/142, at 42-43, (Mar. 19, 2007).

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

permitted to establish either joint-venture or wholly foreign-owned company from the date of accession, i.e. as of 2007. The form of branches of foreign non-life insurers shall be allowed after five years from the date of accession, i.e. by 2012 in accordance with prudential regulations.<sup>54</sup>

### 2. Movement of Natural Persons

Limitations on market access in supplying insurance services under Mode 4 are consistent with the horizontal commitments that apply to all services, including insurance services, provided through the presence of foreign natural persons in Vietnam. Vietnam inscribed no commitments on the market access, except for measures relating to entry and temporary stay of five categories of natural persons, namely intra-corporate transferees, other personnel, service sales persons, persons responsible for setting up a commercial presence, and contractual service suppliers.<sup>55</sup>

### 3. National Treatment

Full national treatment is granted to Modes 1, 2, and 3. With respect to Mode 4, Vietnam undertakes commitments with limitations, whereby only five categories of natural persons shall enjoy full national treatment when supplying insurance services in Vietnam. In other words, Vietnam may impose restrictions on the national treatment with regard to the movement of natural persons other than the five above-said categories of natural persons.

In general, it may be observed that Vietnam's commitments to liberalization of insurance services at the multilateral level are relatively liberal compared to competition by foreign insurance services and service suppliers.

## IV. REVIEW OF COMPLIANCE WITH WTO COMMITMENTS

As Vietnam acceded to the WTO, its commitments in the Protocol on the Accession<sup>56</sup> and other multilateral agreements, including GATS,

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54. *Id.*

55. WTO. *supra* note 49, at 4-8. The entry of "contractual service suppliers" is allowed for computer and related services, and engineering services.

56. Protocol, *Accession of the Socialist Republic of Vietnam*, WT/L/662 (Nov. 15,

became international treaties, to which Vietnam is a party.<sup>57</sup> According to the Constitution, the National Assembly has the power to ratify an international treaty, which is directly signed by or upon the proposal of the President of State.<sup>58</sup> The ratification of international treaties by the National Assembly shall be made in the following circumstances: (i) as provided in the international treaties, (ii) as signed on behalf of the State, and (iii) as signed on behalf of the Government but containing provisions contrary to domestic laws.<sup>59</sup> As several commitments of Vietnam on the accession to the WTO are inconsistent with its current legislation,<sup>60</sup> the Protocol on the Accession was ratified by the National Assembly on November 29, 2006.<sup>61</sup>

International treaties bind Vietnam in accordance with provisions stated in those treaties.<sup>62</sup> In theory, international treaties might be applied directly or implemented by legislative and other measures.<sup>63</sup> In Vietnam, for the purpose of application of WTO obligations and commitments, an implementation plan is required which consists of proposals on amendment of and addition to or repeal of current legislations, or enactment of new laws.<sup>64</sup> Accordingly, the National Assembly has power to incorporate international treaties into domestic laws and the government may provide administrative regulations and rules for such implementation. On the other hand, direct application of WTO commitments in the insurance sector is permitted, whereby

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57. *Law on Signing, Acceding to, and Implementing International Treaties* (Jun. 14, 2005) (Vietnam) [hereinafter *Law on Treaties*], art. 2.1.

58. Resolution of the National Assembly No. 51/2001/QH10 (Dec. 25, 2001), on amendment of and addition to the 1992 Constitution of the Socialist Republic of Vietnam (Vietnam), para. 17.

59. *Law on Treaties*, *supra* note 57, at art. 31.

60. For example, in insurance services, Vietnam commits to open market access for foreign non-life insurance companies to supply insurance services in Vietnam in the form of branches, while this form is prohibited in Vietnam Insurance Law.

61. Resolution of the National Assembly No. 71/2006/NQ-QH11 (Nov. 29, 2006), on ratifying the Protocol of Accession to the WTO Agreement (Vietnam) [hereinafter *Resolution 71*].

62. *Law on Treaties*, *supra* note 57, at art. 71.2(c).

63. Qingjiang Kong, *China's WTO Accession: Commitments and Implications*, *J. OF INT'L ECO. L.* 655, 679 (2000).

64. *Law on Treaties*, *supra* note 57, at art. 31. See also *Resolution 71*, *supra* note 61, at para. 3.

insurers are not required to cede a compulsory amount of non-life insurance liabilities to the Vietnam Reinsurance Corporation in case of ceding to foreign insurers abroad.<sup>65</sup> Moreover, in cases where there might be conflict between international treaties and domestic laws, the multilateral agreements and commitments shall prevail.<sup>66</sup> It would suggest a clear legal basis of direct effect of WTO obligations and commitments in Vietnam.

With regard to insurance service sub-sectors, both life and non-life insurance are permitted to be supplied in Vietnam.<sup>67</sup> The scope of reinsurance comprises: (1) ceding part of the risk assumed to one or more other insurance companies; and (2) assuming part or the entire risk insured by other insurance companies.<sup>68</sup> Concerning insurance intermediation, Vietnam has permitted insurance companies to supply insurance agency services and brokerage services.<sup>69</sup> Therefore, it is submitted that the scope of life and non-life insurance, reinsurance services, and insurance intermediation in Vietnam Insurance Law are consistent with Vietnam's commitments.

The scope of services auxiliary to insurance includes: (i) prevention and mitigation of risks and losses; (ii) loss surveys; (iii) acting as loss survey and claim settlement agents and/or third party claim agents; (iv) fund management and investment; and (v) other operations as provided by laws.<sup>70</sup> However, compared to Vietnam's commitments on services auxiliary to insurance, there is no provision on insurance consultancy services and actuarial services in Vietnam Insurance Law. Although one may argue that those two auxiliary services could be included in "other operations as provided by laws," a clear provision on consultancy and actuarial services is necessary to ensure transparency and consistency with Vietnam's commitments.

An article on favorable conditions towards state-owned insurers may raise concern over the possibility of violating GATS obligations on

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65. Resolution 71, *supra* note 61, at para. 2. Law on Insurance Business, *supra* note 31, at art. 9.2, stipulates that in case of reinsurance abroad, all insurers are obliged to reinsure a portion of the liability under reinsurance contracts to a domestic enterprise, which is engaging in reinsurance business in conformity with governmental regulations.

66. Resolution 71, *supra* note 62, at para. 2. Vietnam Insurance Law, *supra* note 30, at art. 2.2.

67. Law on Insurance Business, *supra* note 31, at art. 7.

68. *Id.* art. 61.

69. *Id.* art. 85, 90.

70. *Id.* art. 60.1.

the national treatment. According to Vietnam Insurance Law, the State shall invest capital and other resources in those enterprises to bolster their development and safeguard their dominant role in the insurance market.<sup>71</sup> This suggests discrimination against both foreign participation and the domestic private sector. However, until the end of 2006, all three state-owned insurers had been subjected to privatization – the so-called equitization in Vietnam.<sup>72</sup> This evidence indicates that there will be no more state-owned insurers in the domestic insurance market. Meanwhile, the government has decided to refrain from establishing new state-owned insurance brokerage enterprises, as well as new insurers wholly owned by other state-owned enterprises.<sup>73</sup> As a result, the dominant role of state-owned insurers will not *de facto* exist in the insurance services market. As far as foreign insurance service suppliers are concerned, this article would constitute *de jure* discrimination in favor of domestic state-owned insurers under the meaning of GATS Article XVII. It is submitted that this measure, which safeguards the dominant role of state-owned insurers is irrelevant to prudential reasons, and accordingly could not be justified by the prudential exception under the Annex on Financial Services.<sup>74</sup>

In addition, other commitments on the market access and national treatment shall require the revision of Vietnam Insurance Law, including

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71. *Id.* art. 4.2.

72. Decision 310/2005/QĐ-TTg dated November 26, 2005 of the Prime Minister on the equitization plan and pilot establishment of Baoviet Financial-Insurance Conglomerate (Vietnam), art. 1.1; *see also* Decision 175/2003/QĐ-TTg dated August 29, 2003 of the Prime Minister on approving the Strategy on Development of Vietnam Insurance Market 2003–2010 (Vietnam) [hereinafter Decision 175].

73. Decision 175, *supra* note 72, at art. 1.3.a, 1.3.b.

74. Literature has provided several interpretative discussions on three factors of the prudential exception applicable to financial services, including insurance services, in the Annex on Financial Services of GATS, namely the concept of “prudential reasons” connection between the prudential objectives and measures, and anti-avoidance provision. *See Key, supra* note 37, at 37, 51. *See also* Eric H. Leroux, *Trade in Financial Services under the World Trade Organization*, 36(3) J. WORLD TRADE 413, 430-31 (2002); Aaditya Mattoo, *Financial Services and the WTO: Liberalization Commitments of the Developing and Transitional Economies*, 23(3) THE WORLD ECONOMY 251, 254 (2000); KALYPSO NICOLAIDIS & JOEL P. TRACHTMAN, GATS 2000 – NEW DIRECTIONS IN SERVICES TRADE LIBERALIZATION 255-56 (Pierre Sauve and Robert M. Stern eds., The Brookings Institution, 2000); Joel P. Trachtman, *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis*, 34 COLUM. J. TRANSNAT’L L. 37, 71-72 (1995).



permission of across-border supply of certain insurance services, and acceptance of branch form of foreign insurers.

V. NECESSITY FOR FUTURE REFORM: PRUDENTIAL  
REGULATORY CONCERNS

While it is indispensable to amend Vietnam Insurance Law consistent with commitments in the multilateral trading system, further enhancements of this law are necessary in order to ensure the safety and soundness of the insurance market and to pursue consumer protection. Under GATS, Vietnam is allowed to introduce prudential measures with respect to “the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier” and “to ensure the integrity and stability of the financial system.”<sup>75</sup> Introduction of such prudential regulations, nevertheless, is not employed as a means of avoiding Vietnam’s obligations under the multilateral framework as well as its commitments on insurance and insurance-related services.

Experiences of Japan, the EU, and China show evidence that enhancement of prudential regulations is considered as one of crucial measures when implementing commitments on liberalization of insurance services. In the case of Japan, parallel with implementing commitments on ensuring the national treatment between domestic and foreign insurance companies, Japan amended certain insurance enforcement regulations with a view to introducing more stringent solvency margin standards and disclosure requirements.<sup>76</sup> While undertaking commitments on the national treatment with regard to trade in insurance services, the EU introduced new legislation in order to increase solvency requirements of life and non-life insurers, especially in the areas of maritime, aviation and general liability business.<sup>77</sup> With regard to China, as observed by Chen and Shih, the level of competition became more intense due to the implementation of WTO commitments on China’s insurance services.<sup>78</sup> This includes abolition of

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75. GATS, *supra* note 2, at Annex on Financial Services, para. 2.

76. WTO Secretariat, *Trade Policy Review – Japan*, WT/TPR/S/107 at 62-63 (Oct. 9, 2002).

77. WTO Secretariat, *supra* note 6, at 121.

78. CHIEN-HSUN CHEN AND HUI-TZU SHIH, BANKING AND INSURANCE IN THE NEW CHINA: COMPETITION AND THE CHALLENGE OF ACCESSION TO THE WTO 146-148 (2004).

discriminatory measures.<sup>79</sup> Accordingly, the supervision of insurance companies has been strengthened, including monitoring minimum solvency requirements, regulating allocations of technical provisions and raising capitalization.<sup>80</sup>

The prudential regulations, which address the solvency situation of insurers, broadly cover requirements on technical provisions, solvency margin, and investment rules.<sup>81</sup> Accordingly, the following section shall examine prudential regulations under Vietnam Insurance Law in details.

#### *A. Establishment of Technical Provisions*

In Vietnam, with regard to liabilities, insurers are required to set up technical provisions, which must be calculated from insurance premiums separately for each class of insurance.<sup>82</sup> There are different types of technical provisions, namely (i) provision for unearned premiums; (ii) provision for claims outstanding; (iii) equalization provision; (iv) mathematical provision (life insurance); and (v) reserve for dividend to policyholders (life insurance).<sup>83</sup> The fundamental purpose of setting up technical provisions is to ensure that insurers are capable of meeting the commitment towards policyholders at all times.<sup>84</sup> In the words of the International Association of Insurance Supervisors (IAIS),<sup>85</sup> “the

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79. *Id.*

80. *Id.*

81. International Association of Insurance Supervisors, Sub-Committee on Solvency and Actuarial Issues, Issues Paper on Solvency, Solvency Assessments and Actuarial Issues 7 (Mar. 15, 2000), available at <http://www.iaisweb.org>.

82. Law on Insurance Business, *supra* note 311, at art. 96.2.

83. Decree 46/2007/ND-CP dated Mar. 27 2007 of the Government regulating financial issues of insurance enterprises and insurance brokerage enterprises (Vietnam), art. 8 and 9.

84. Jorg Vollbrecht, *Insurance Regulation and Supervision*, POLICY ISSUES IN INSURANCE: INSURANCE REGULATION AND SUPERVISION IN THE OECD.

85. The International Association of Insurance Supervisors (the “IAIS”), established in 1994, represents insurance regulators and supervisors of some 180 jurisdictions in more than 130 countries, as well as more than 100 observers representing industry associations, professional associations, insurers and re-insurers, consultants and international financial institutions. The IAIS was formed to promote cooperation between insurance regulators and supervisors in improved supervision of insurance industry on domestic and international levels. In doing so, the IAIS issues global insurance principles, standards and guidance papers. For more information, visit the IAIS’s homepage, at <http://www.iaisweb.org>.

establishment of sufficient technical provisions is . . . a cornerstone of a sound capital adequacy and solvency regime”<sup>86</sup>

Nevertheless, the regulations on establishing technical provisions are based on sound accounting and actuarial principles.<sup>87</sup> Specifically, the importance of auditors is to verify the correctness of the annual accounts.<sup>88</sup> In addition, the actuary plays a critical role in maintenance of the financial soundness of insurers.<sup>89</sup> In Vietnam, every company is required to prepare four financial statements: (i) balance sheet; (ii) profit and loss statement; (iii) cash flow statement; and (iv) explanatory notes for the financial statements.<sup>90</sup> Insurers are required to make these financial statements public.<sup>91</sup> However, the scope of information disclosure does not cover a requirement on disclosure of risks to which insurers are subject. As guided by the IAIS, public information should include financial position, financial performance, risk exposure, and management by insurers.<sup>92</sup> Risks relevant to public disclosure might include technical risks and investment risks.<sup>93</sup> The main objective of disclosure of those financial statements is to give the public a clear view of the insurer’s business activities as well as financial position, and also ensure a smooth functioning of the insurance market.<sup>94</sup> Moreover, these requirements would be important for public confidence, especially because they would enable policyholders to monitor what categories of assets support their insurance contracts.<sup>95</sup>

In the insurance sector, in addition to accounting requirements, financial statements of insurers must be certified by an independent auditor, one authorized to conduct business in Vietnam.<sup>96</sup> However, there are no requirements in Vietnam Insurance Law and its regulations

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86. International Association of Insurance Supervisors, *Insurance Core Principles and Methodology* 34 (Oct. 30, 2003).

87. *Id.*

88. Viviane Leflaive, *Comparative Analysis, INSURANCE SOLVENCY SUPERVISION: OECD COUNTRY PROFILES* 45 (OECD, 2002).

89. International Association of Insurance Supervisors, *supra* note 81, at 25.

90. Accounting Law (Jun. 17, 2003) (Vietnam), art. 29.3.

91. Law on Insurance Business, *supra* note 31, at art. 104.

92. International Association of Insurance Supervisors, Task Force on Enhanced Disclosure, *Guidance Paper No. 4 on Public Disclosure by Insurers* 7 (Jan. 2002).

93. International Association of Insurance Supervisors, *supra* note 81, at 9.

94. International Association of Insurance Supervisors, *supra* note 86, at 42-43.

95. Chris O’Brien, *The Regulation of Life Assurers in a Law Solvency Environment: The UK Experience*, 23(3) *ECON. AFF.* 16, 19 (Sept. 2003).

96. Law on Insurance Business, *supra* note 31, at art. 102.

for what kind of information or comments must be produced by an independent auditor. Auditors play a crucial role in expressing their opinions on the compliance of financial statements with the financial reporting regime.<sup>97</sup> For example, in EU approved balance sheets, profit and loss statements, annual reports, and reports by the persons responsible for auditing accounts must be published.<sup>98</sup> In addition, auditors have the duty to report promptly to the supervisory authority any fact or decision, which based on their awareness, would constitute a material breach of laws and regulations, affect the continuous functioning of the life insurer, or lead to refusal to certify the accounts or to the expression of reservations.<sup>99</sup>

As noted earlier, Vietnam Insurance Law has no provision regarding actuaries. However, under the MOF rules, appointment of an actuary in life insurers is obligatory in Vietnam.<sup>100</sup> This means that the use of an actuary is irrelevant to non-life insurance companies. Duties of an actuary include setting up mathematical provisions, appraising the financial conditions of the life insurer and estimating future performance.<sup>101</sup> There is, nevertheless, a lack of requirements on the actuary to report financial conditions of insurers to the supervisory authority. Appointed actuaries are common in both life and non-life insurance in several countries, such as the US, United Kingdom, Canada, and Belgium.<sup>102</sup> Actuarial skills are important to assess risks exposed by insurers as well as to set up technical provisions for both life and non-life insurance.<sup>103</sup> In Japan, all insurers are required by law to appoint an actuary by board of management. An appointed actuary is

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97. International Association of Insurance Supervisors, *Guidance Paper No. 7 on The Use of actuaries as part of a supervisory model 5* (Oct. 2003).

98. Council Directive 91/674, On the Annual Accounts and Consolidated Accounts of Insurance Undertakings, 1991 O.J. (L 374) (EC).

99. Council Directive 2002/83/EC, art. 17.1 (a), 2002 O.J. (L 345) 1, (*concerning life assurance*); Council Directive 2005/68/EC, art. 31.1 2005 O.J. (L 323) 1, (*on reinsurance*).

100. Ministry of Finance, Circular on Insurance Business, *Providing guidelines for implementation of Decree 42-2001-ND-CP of the Government dated 1 August 2001 providing detailed regulations for implementation of a number of articles of the Law on Insurance Business*, § I.1.1.2 (19 October 2004) (Vietnam).

101. *Id.* § I.1.1.1.

102. Chris Dykin, *The Role of the Actuary in the Supervision of Insurance*, INSURANCE REGULATION AND SUPERVISION IN ASIA 272 (OECD 1999).

103. International Association of Insurance Supervisors, *supra* note 97.

required to submit a statement of opinions to the board of management on: (i) underwriting reserves; (ii) fair and equitable distribution with regard to policyholder dividend or surplus; and (iii) other matters specified by a Cabinet Office ordinance.<sup>104</sup> Moreover, an actuary must concurrently submit a copy of his or her statement of opinions to the Prime Minister.<sup>105</sup> This means that an actuary is required to submit reports to both the insurer's board of management as well as the insurance supervisors. By this provision, the supervisory authority shall simultaneously be able to monitor the appropriateness of financial conditions of life insurers as well as rightly conduct an intervention if the underwriting reserves prove to be insufficient in the light of prudential regulations.<sup>106</sup>

In the case of the US, every life and non-life insurance company is required to submit an actuarial opinion on an annual basis.<sup>107</sup> The opinion given by an actuary must cover the adequacy of reserves, which are in compliance with requirements of insurance laws and regulations.<sup>108</sup> If an insurance company fails to provide actuarial opinions, the supervisory authority has the power to assign another actuary to prepare a report at the expense of that insurance company.<sup>109</sup>

### B. Assets Representing Solvency Margin

In Vietnam, in order to start a business, the insurance company must have chartered capital higher than the legal capital as stipulated by governmental regulations.<sup>110</sup> In the on-going business, the insurer is required to have sufficient funds or assets to cover future insurance contracts. This requirement is called the "solvency margin", which is

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104. Japan Insurance Business Law art. 121.1 (2001),

105. *Id.*, art. 121.2.

106. KOJI KINOSHITA, ECONOMIC REGULATION AND COMPETITION: REGULATION OF SERVICES IN THE EU, GERMANY AND JAPAN 200-01 (Jurgen Basedow et al. eds., Kluwer Law International, 2002).

107. Model Laws, Regulations and Guidelines 822-1 § 5.A, Actuarial Opinion and Memorandum Regulation (Nat'l Ass'n of Insurance Commissioners 2006); Model Laws, Regulations and Guidelines 745-1 § 2.A, Property and Casualty Actuarial Opinion Model Law (Nat'l Ass'n of Insurance Commissioners 2006).

108. Model Laws, Regulations and Guidelines 822-1 § 4.A, Actuarial Opinion and Memorandum Regulation (Nat'l Ass'n of Insurance Commissioners 2006).

109. Model Laws, Regulations and Guidelines 745-1 § 2.C, Property and Casualty Actuarial Opinion Model Law (Nat'l Ass'n of Insurance Commissioners 2006).

110. Law on Insurance Business, *supra* note 31, at art. 63.1.

defined by the difference between the value of the insurer's assets and its outstanding liabilities.<sup>111</sup> This buffering capital ensures that insurers are capable of absorbing financial losses.<sup>112</sup> However, what appears to be missing here is the lack of a provision on categories of assets that can represent solvency margin. Vietnam's approach towards identifying assets eligible for the solvency margin would suggest that all assets are acceptable. This approach seems to simplify the credit risks associated with insurers' assets, such as loans and securities. Moreover, it does not take into consideration the liquidity of assets. In principle, capital adequacy requirements must be correspondent to the size, complexity and risks of an insurer's operations.<sup>113</sup> As noted by Leflaive, different categories of assets must be weighed for the purpose of examining the solvency margin according to the nature, degree of liquidity and class of credit risks.<sup>114</sup> To be more specific, the solvency position of an insurance company must reflect the "ultimate collectability" of all income under assets.<sup>115</sup>

In contrast, the approach of both the EU and US is to adopt a positive list of assets that are acceptable for solvency margin. In the EU, the solvency margin shall consist of the following assets: (i) the paid-up share capital; (ii) statutory and free reserves; (iii) profit or loss brought forward after deduction of dividends to be paid, profit reserves; (iv) cumulative preferential share capital and subordinated loan capital up to fifty percent of the lesser of the available solvency margin and the required solvency margin; and (v) securities with no specified maturity date and other instruments up to fifty percent of the lesser of the available solvency margin and the required solvency margin.<sup>116</sup> In the same approach, New York Insurance Law lists twenty-two admitted

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111. *Id.* art. 77.3.

112. Vollbrecht, *supra* note 84, at 37.

113. International Association of Insurance Supervisors, *supra* note 86, at 39.

114. Leflaive, *supra* note 88, at 28.

115. Gerry Dickinson, *The Changing Focus in the Supervision of Insurance Company Investment*, INSURANCE REGULATION AND SUPERVISION IN ASIA 340 (OECD, 1999).

116. Directive 2002/83/EC, *supra* note 99, at art. 27.2 and 3; Directive 2002/13/EC of the European Parliament and the Council of Mar. 5, 2002 amending Council Directive 73/239/EEC as regards the solvency margin requirements for non-life insurance undertaking, art. 1.2; Directive 2005/68/EC, *supra* note 99, at art. 36.1, 36.3. The available solvency margin, however, shall be reduced by the amount of own shares directly held by the insurers/re-insurers.

assets owned by insurers for the purpose of determining solvency margin, including cash, investment, interests, and insurance premiums.<sup>117</sup> In addition, rules for valuation of those assets are also clearly stipulated. For example, investment in securities may be valued at market value, appraised value, or at price set by the supervisory authority.<sup>118</sup> Similarly, Japan also specifies assets, which are eligible for determining the solvency margin of insurers. In particular, solvency margin consists of: (i) capital; (ii) price fluctuation reserve; (iii) risk reserve; (iv) general bad debt reserve; (iii) unrealized gains/losses on securities and real estates; and (iv) any other amounts determined by the Financial Service Agency, such as subordinated debts, margin contained in statutory provision.<sup>119</sup> In the case of unrealized gains/losses on securities and real estates, for example, ninety percent of latent profit on stocks and eighty-five percent on latent profit on land are calculated for determination of solvency margin, but one hundred percent of unrealized losses.<sup>120</sup>

### C. Investment Rules

Investment regimes have been widely recognized as a main function of insurers. As the nature of liabilities of an insurance company decide the nature of assets in the investment portfolio, the primary consideration of the investment regime is security of capital and liquidity in order to convert those assets to cash to pay out claims or satisfy unexpected claims.<sup>121</sup> In most OECD countries, including the EU, US, and Japan, the investment regulations only relate to the funds that constitute the contractual liabilities to policyholders, i.e. technical provisions, rather than the capital base of insurers because if investment regulations extend to and restrict investment of the capital base, they may discourage insurers to hold high level of capital, and thus weaken the financial conditions of insurers.<sup>122</sup>

In the case of Vietnam, investment portfolios of insurers may cover

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117. N.Y. INS. LAW § 1301 (McKinney 2007).

118. *Id.*, § 1414 b(1).

119. The General Insurance Association of Japan, *Fact book 2004-2005 General Insurance in Japan* 70 (2006).

120. *Id.*

121. J. FRANCOIS OUTREVILLE, *THEORY AND PRACTICE OF INSURANCE* 248 (1998).

122. See Vollbrecht, *supra* note 84, at 44; see also Dickinson, *supra* note 115, at 311.

government bonds, corporate shares and bonds, real estate, equity in other companies, loans, and bank deposits.<sup>123</sup> Specifically, quantitative restrictions have been set out to limit categories of assets to be included in the investment portfolio of an insurance company, and they differ between life and non-life insurance.<sup>124</sup> First, there is no ceiling restriction for both life and non-life insurers with regard to government bonds, secured corporate bonds, and deposits in credit institutions. Second, investment in unsecured corporate bonds and shares, and capital contributions to other enterprises shall not exceed thirty-five percent for non-life insurers, and fifty percent for life insurers, of permitted funds from technical provisions. Third, investment in real estate, loans, and other authorized investments through financial institutions shall not exceed twenty percent for non-life insurers, and forty percent for life insurers, of permitted funds from technical provisions.

As noted by the IAIS, different investment-related risks are embedded in an investment portfolio, and might affect the coverage of technical provisions and the solvency margin.<sup>125</sup> Moreover, there is strong correlation between credit risks of investment from the same issuer, and consequently an insurance company may be over indebted or insolvent.<sup>126</sup> In examining the effect of life insurer insolvency in the US-First Executive Corporation on the value of other life insurers, Fields et al. concluded that the failure of an insurer may lead to losses in investment portfolios of other insurers, substantially for weak insurance companies, and those that engaged in more risky investment portfolios, junk bonds, and real estates.<sup>127</sup> However, under Vietnam's current regulations, while an insurer is allowed to invest a maximum amount in each category, there is no restriction on a single investment. In other words, insurers may invest all permitted capital (i.e. twenty percent and forty percent regarding non-life and life insurance, respectively) from technical provisions into one piece of land or building, or provide loans to one borrower. Such regulation may provide incentives for insurers to adopt highly speculative investment portfolios, and may lead an

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123. Law on Insurance Business, *supra* note 311, art. 98.2.

124. Decree 46, *supra* note 83, art. 13.

125. International Association of Insurance Supervisors, *supra* note 86, at 35.

126. Leflaive, *supra* note 88, at 26.

127. Joseph A. Fields, James B. Ross, Chinmoy Ghosh, and Keith B. Johnson, *Junk Bonds, Life Insurer Insolvency, and Stock Market Reactions: The Case of First Executive Corporation*, J. FIN. SERV. RES. 95, 108 (1994).



insurance company to a mismatched portfolio, whereby the technical provisions for fulfilling obligations against policyholders are not fully covered by those investment assets. This problem could be found especially in the case of an insurance company that is faced with financial difficulties.<sup>128</sup> This is worrisome because insurers in Vietnam are limited both in capacity and the professional skills needed to expand their investment activities to complicated sectors, such as corporate shares and bonds, and real estate.<sup>129</sup>

Concerns over diversification and concentration risks have been addressed intensively by other countries. In the EU, investment rules set limitations on a single investment and issuer by ten percent and five percent, respectively, of total gross technical provisions.<sup>130</sup> In the US, while providing a list of authorized classes of investment,<sup>131</sup> a maximum limitation is set for each class of assets.<sup>132</sup> Moreover, individual ceilings of three percent and five percent of permitted assets in life and non-life insurance, respectively, are established for securities of a single issuer and its affiliates.<sup>133</sup> A similar approach dealing with the concentration risk has also been found in Japan:

No insurance company may use for investment the kinds of assets specified by a Cabinet Office ordinance in excess of an amount calculated in accordance with such ordinance.<sup>134</sup>

A special account may be created in order to separate those assets corresponding to the underwriting reserve for insurance contracts.<sup>135</sup> In particular, the aggregate of the same asset categories shall not exceed ten percent of the total of the special account assets with respect to: (1) corporate bonds and stocks used by one and the same person/group; (2) loans and lending securities to one and the same person/group; (3)

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128. Kathy Ruby Petroni, *Optimistic Reporting within the Property-Casualty Insurance Industry*, 15 J. ACCT. AND ECON. 485, 504 (1992).

129. Lai, *supra* note 24, at 27-28.

130. Directive 2002/83/EC, *supra* note 99, at art. 24.1; *see also* Council Directive 92/49/EEC of Jun. 18, 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and amending Directive 73/239/EEC and 88/357/EEC (third non-life insurance Directive), art. 22.1.

131. NAIC, INVESTMENTS OF INSURERS MODEL ACT (2004), § 7.

132. *Id.* at § 8.A.

133. *Id.* at § 8.B.

134. Japan Insurance Business Law, *supra* note 104, at art. 97-2.1.

135. *Id.* art. 118.1.

deposits with one and the same person/group; (4) guarantee of obligation for one and the same person/group; and (5) assets related to trading in derivatives with one and the same person/group.<sup>136</sup>

*D. Supervision of Insurance Holding Companies*

In Vietnam, there is a tendency for banks to expand their activities into the insurance sector by establishing insurance subsidiaries.<sup>137</sup> On the other hand, insurance companies also seek involvement in banking and securities sectors. The first attempt was the establishment of BaoViet Financial-Insurance Conglomerate, which has a banking subsidiary and holds shares in three other commercial banks and two insurers.<sup>138</sup> Accordingly, this trend would raise a concern over prudential regulation and supervision of those financial conglomerates. Although Vietnam's current regulations have empowered the supervisory authority to enforce the compliance of insurers with solvency requirements, there is a lack of power in the supervision of financial conglomerates. As in China, these supervisory issues and problems may be overlooked due to the fact that financial conglomerates are only at an initial stage of development.<sup>139</sup>

According to Skipper, the rationale for financial services integration is cost advantage and revenue effects.<sup>140</sup> However, the challenge posed

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136. The General Insurance Association of Japan, *supra* note 119, at 81.

137. An expansion of banks to the insurance sector is evidenced by the establishment of BIDV-QBE Insurance Company Limited in 1999, a joint-venture between Bank for Investment and Development of Vietnam and Australian QBE Insurance Group, as well as the establishment of Incombank-Asia Insurance Company Limited in 2002, a joint-venture between Industrial and Commercial Bank of Vietnam and Asia Insurance Company to conduct non-life insurance.

138. Decision 310/2005/QD-TTg, *supra* note 72, at art. 1.2(g), 1.2(i).

139. Kuan-Chun Chang, *The Supervision of Financial Conglomerates in China in the Post WTO Era – The Challenges of Risk Concentration and Risk Contagion*, 11 U. MIAMI INT'L & COMP. L. REV. 1, 2 (2003).

140. Harold D. Skipper, Jr., *Liberalization of Insurance Markets: Issues and Concerns*, POLICY ISSUES IN INSURANCE: INSURANCE REGULATION AND SUPERVISION IN THE OECD COUNTRIES 99, 105-08 (OECD, 2001). Cost advantages of financial conglomerates could materialize through economies of scale (increase in production leading to decrease of average cost), economies of scope (multiple products produced at less cost than the sum of costs to produce each separately), and operational efficiencies. Revenue effect might materialize through economies of scope in consumption and market power.

by financial conglomerates is to understand their risk profile as a whole and to develop appropriate risk management systems for the entire group.<sup>141</sup> As noted by Leflaive, the fundamental concern is to formulate a solvency requirement applicable to the group because of an “increased contagion risk.”<sup>142</sup> Therefore, the scope of supervision on financial conglomerates must address, *inter alia*, their capital adequacy, reinsurance and risk concentration, intra-group transactions and exposure, and risk management.<sup>143</sup>

The experiences of other countries might be useful references for Vietnam in its revision of the insurance law in this area. In the case of the EU, additional supervision is introduced to insurance groups and conglomerates, whereby supplementary supervision is extended to an insurance company which is a parent company of or holds participation in at least one insurance company, or the parent company of which is an insurance holding company or non-insurance holding company.<sup>144</sup> Accordingly, the adjusted solvency margin of insurance conglomerates is calculated based on one of three methods: (i) deduction and aggregation method; (ii) requirement deduction method; or (iii) accounting consolidation-based method.<sup>145</sup> With regard to insurance holding companies in Japan, there is a distinction between company and supervisory levels. An insurance holding company is required by law to secure the sound and proper operation of the activities of insurance companies that are its subsidiaries.<sup>146</sup> Moreover, an insurance holding company must prepare and submit to the supervisory authority a business report, including activities and assets of the company and its subsidiaries.<sup>147</sup> At the supervisory level, additional oversight is focused on capital adequacy<sup>148</sup> and on risk management systems, including risk

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141. *Id.* at 115.

142. Leflaive, *supra* note 88, at 36.

143. International Association of Insurance Supervisors, *supra* note 86, at 31.

144. Council Directive 98/78/EC, art. 2 (European Cmty.) (mandating supplementary supervision of insurance undertakings in an insurance group).

145. *Id.* Annex I, § 3.

146. Japan Insurance Business Law, *supra* note 104, at art. 271-5.2.

147. *Id.* art. 271-8.1.

148. Capital adequacy of financial conglomerates may be calculated based on either combined equity capital or requisite equity capital, with adjustments for companies that are not subject to prudential regulations. *See* Japan Financial Services Agency, Guideline for Financial Conglomerate Supervision, § II-2.1 (May 2006), available at <http://www.fsa.go.jp/en/refer/legislation/index.html>.

contagion, credit risk, market risk and liquidity risk.<sup>149</sup> The supervisory authority is empowered to require insurance holding companies to submit or alter the reform plan in order to secure the sound and proper operation of insurance holding companies as well as to protect policyholders.<sup>150</sup>

In the US, rules provide for the solvency supervision of an insurance holding company relating to acquisition of control or merger, standards and management, examination, and receivership.<sup>151</sup> Specifically, under New York Insurance Law, insurance holding companies are required to disclose information which materially affects their financial conditions.<sup>152</sup> In addition, the supervisory authority has the power to examine holding insurance companies if supervisors believe that the operations materially affect the financial conditions of such companies.<sup>153</sup>

*E. A Need for the Establishment of Policyholder Protection Funds*

Effective regulation and supervision cannot ensure the prevention of financial difficulties. In Vietnam, an insurance company is required to apply remedial measures in cases where that insurance company's solvency margin is less than the minimum solvency margin.<sup>154</sup> In such a circumstance, an insurer must submit a solvency recovery plan to the supervisory authority, and if the insurer is unable to recover its solvency, a solvency control committee shall be established by the MOF.<sup>155</sup> However, as commented by Skipper and Klein, some insolvency is inevitable in a competitive insurance market.<sup>156</sup> Crisis in a key insurance company may affect the integrity and stability of the insurance market as well as the whole financial system; even the difficulty of a

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149. *Id.* § II-2.2.

150. Japan Insurance Business Law, *supra* note 104, at art. 271-13.1.

151. NAT'L ASS'N OF INS. COMM'RS, INSURANCE HOLDING COMPANY SYSTEM REGULATORY ACT 440-1 (2006).

152. N.Y. INS. LAW § 1504(a) (McKinney 2007).

153. *Id.* § 1504(b).

154. Law on Insurance Business, *supra* note 31, at art. 78.1.

155. *See id.* arts. 79, 80.

156. Harold D. Skipper, Jr. and Robert W. Klein, *Insurance Regulation in the Public Interest: The Path Towards Solvent, Competitive Markets*, 25(4) THE GENEVA PAPERS ON RISK AND INSURANCE 482, 496 (2002).

small insurer may also affect a wide range of policyholders.<sup>157</sup>

The main idea of policyholder protection funds is to protect policyholders in a situation where the insurer becomes insolvent, which may cause financial losses to those policyholders due to unpaid claims. As noted by Sekiguchi, policyholders' concerns are over the solvency of insurers, and thus the availability of such protection funds would protect them in case of an insurer's failure.<sup>158</sup> In theory, according to Yasui, there are four main arguments for the establishment of such a safety net in the insurance market, namely protection of non-professional policyholders, maintenance of public confidence, development of competitive markets, and a level playing field across the financial sector.<sup>159</sup> Moreover, from the perspective of consumers, the establishment of policyholder protection funds would ensure equal treatment among consumers.<sup>160</sup> This concern might be true in cases where foreign insurers who participate in safety net schemes in their home countries are permitted to supply insurance business in domestic markets. Accordingly, consumers of foreign insurers would be better protected than those of domestic insurers.

However, one of main drawbacks of policyholder protection funds is the moral hazard problem, which may provide consumers, insurers and supervisors with disincentives for appraising financial conditions of insurers.<sup>161</sup> It was believed that if a safety net existed, insurance supervisors would feel less pressure to ensure effective supervision.<sup>162</sup> Moreover, while insurers may develop a tendency to adopt risky business practices,<sup>163</sup> and consumers may become less careful in

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157. Vollbrecht, *supra* note 84, at 54.

158. Alan Sekiguchi, *Policyholders Protection Funds in OECD Countries*, INSURANCE REGULATION AND SUPERVISION IN ASIA 367 (OECD, 1999).

159. Takahiro Yasui, *Policyholder Protection Funds: Rationale and Structure*, POLICY ISSUES IN INSURANCE: INSURANCE REGULATION AND SUPERVISION IN THE OECD COUNTRIES 303, 305-309 (OECD, 2001).

160. See European Commission, *Insurance Guarantee Schemes: State of Play and Orientation of the Future Work*, Discussion Paper MARKT/2517/02-EN 4 (2002), available at [http://ec.europa.eu/internal\\_market/insurance/docs/markt-2517/markt-2517-02\\_en.pdf](http://ec.europa.eu/internal_market/insurance/docs/markt-2517/markt-2517-02_en.pdf).

161. Yasui, *supra* note 159, at 309.

162. Paul G. Roberts, *Insurance Company Insolvencies and Insurance Guaranty Funds: A Look at the Nonduplication of Recovery Clause*, 74 IOWA L. REV. 927, 932 (1989).

163. Jeff Hawkins, Comment, *Which Faultless Party Will Be Forced To Pay For Another's Failure? A Proposal For Legislatively Extending The Use of State Guaranty*

selecting insurers because they only consider the price rather than the quality and financial soundness.<sup>164</sup>

In response, the moral hazard problem might not be intensified due to the existence of a similar safety net in other financial services sectors, particularly deposit insurance in the banking sector.<sup>165</sup> In other words, although the problem of moral hazard exists when introducing a safety net scheme to the insurance sector, the experience of the banking sector would be persuasive for setting up a similar system in insurance sector. The practice of the US and Japan would demonstrate that this problem could be mitigated by the design, powers and duties of policyholder protection funds, whereby claims are partially compensated.<sup>166</sup> In the US, state guaranty associations are operated on a state-by-state basis, which were established in the late 1970's with a view toward protecting consumers from insurers' insolvency.<sup>167</sup> Policyholders are guaranteed to be paid up to a specified ceiling in case of failures of insurers.<sup>168</sup> For example, the purpose of the New York property/casualty insurance security fund is to pay allowed claims remaining unpaid due to the insolvency of an authorized insurer, and the payment of any one claim shall not exceed one million dollars.<sup>169</sup> The Policyholder Protection Corporation as a compulsory system was established in Japan in 1998 following the enforcement of the revised insurance law.<sup>170</sup> Membership

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*Funds to Absorb the Orphan Shares of Long-tail Claims*, 37 TEX. TECH L. REV. 215, 237 (2004).

164. European Commission, *supra* note 160, at 5.

165. *See id.*

166. There is no common approach to policyholder protection funds because the EU is in the process of harmonizing its insurance guarantee system. A draft Directive on policyholder protection funds addresses the problem of moral hazard by setting the coverage of compensation up to 90 percent of both life and non-life claims which are above 100 Euro. *See* European Commission, Working Paper on Insurance Guarantee Schemes: Meeting on Jun. 1, 2005, MARKET/25/2/05-EN 6, 8 (2005), available at [http://ec.europa.eu/internal\\_market/insurance/docs/2005-market-docs/markt-2512-05\\_en.pdf](http://ec.europa.eu/internal_market/insurance/docs/2005-market-docs/markt-2512-05_en.pdf)

167. William Goddard, *The Revolution of the Times: Recent Changes in U.K. Insurance Insolvency Laws and the Implications of Those Changes Viewed from a U.S. Perspective*, 10 CONN. INS. L. J. 139, 163 (2003).

168. *See* Nat'l Ass'n of Ins. Comm'rs, Post-assessment Property and Liability Insurance Guaranty Association Model Act § 8(A) (1996); *see also* Nat'l Ass'n of Ins. Comm'rs, Life and Health Insurance Guaranty Association Model Act § 3(C) (2001).

169. N.Y. INS. LAW § 7603 (McKinney 2007).

170. Nobuo Hara, *Policyholders' Protection Measures in Japan*, INSURANCE

in those funds is compulsory for insurers,<sup>171</sup> and the amount of levy shall be calculated based on both insurance premiums and underwriting reserves for the payment of insurance claims.<sup>172</sup> This requirement would ensure a fair contribution among insurers.<sup>173</sup> In order to mitigate the problems of moral hazard, the limitations on compensation are set at ninety percent for both life and non-life claims, and at one hundred percent for compulsory insurance.<sup>174</sup>

The second argument against this safety net scheme is that it may impose extra financial burdens on insurers who participate in this mechanism.<sup>175</sup> Such financial burdens may weaken the financial soundness of an insurer. Another aspect of this argument is that prudent insurers may object to paying for their competitors' mismanagement.<sup>176</sup> In other words, bad performance of insolvent insurers would be supported at the expense of other participating insurers, who conduct business operations in a prudent manner. Sekiguchi commented that, from the social point of view, because the funds provide a safety net for a broad coverage of people, those extra financial costs incurred by insurers could be justified, and thus the impact of failure of insurers on policyholders or beneficiaries is minimized.<sup>177</sup> In practice, concerns regarding financial burdens on the insurer may be addressed by assessment of contributions based on risk factors as well as the financial soundness of insurers.<sup>178</sup> Moreover, the experience of New York Insurance Law shows that when the fund is well capitalized, the members shall not be required to make further contributions.<sup>179</sup>

Another concern is that the existence of other available preventive and corrective measures, such as technical provisions and investment

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REGULATION AND SUPERVISION IN ASIA 396 (OECD, 1999).

171. Japan Insurance Business Law, *supra* note 104, at art. 265-3.1.

172. Japan Insurance Business Law, *supra* note 104, at art. 265-34.1.

173. *See* Hara, *supra* note 170, at 398.

174. Yasui, *supra* note 159, at 315.

175. *Id.* at 310.

176. Roberts, *supra* note 162.

177. Sekiguchi, *supra* note 158.

178. For example, it is reported that in the Korean system, insurers are classified under three groups corresponding to their respective financial soundness, whereby the least risky group shall enjoy the lowest contributions, and the most risky group shall be required to pay highest contributions. *See* Yasui, *supra* note 159, at 320-21.

179. No further contribution shall be made when the net value of the property/casualty insurance security fund is at least 150 million dollars. N.Y. INS. LAW § 7603(c)(1) (McKinney 2007).

rules, would make policyholder protection funds redundant.<sup>180</sup> While the main purpose of current existing solvency measures is to ensure the soundness of financial conditions of insurers, the objective of policyholder protection funds is, at least, to assure the minimum of payment of claims by policyholders in case of insolvency of an insurer. Accordingly, there may be a situation that even when all preventive and corrective measures are employed, an insurer still becomes insolvent, and then there might not be sufficient assets to cover its obligations to its insured. Moreover, as observed by Yasui, the recently introduced policyholder protection funds in several countries would suggest some limitations in the supervision of insurers' solvency through current preventive and corrective measures.<sup>181</sup>

Therefore, by setting up a policyholder protection fund in Vietnam, policyholders would be well protected against losses in the event that an insurer fails financially and is unable to pay claims and benefits. This system would strengthen public confidence in the domestic insurance market. Moreover, a similar system, the deposit insurance system, has been in place in Vietnam's banking sector since 1999.<sup>182</sup> Thus, establishment of this fund in the insurance sector could place insurers on the same level as banks. It might also increase competitiveness of domestic insurers compared to foreign insurers, who enjoy safety net schemes in their home countries.

## VI. CONCLUSION

Prudential regulations over insurance companies have been partly addressed by Vietnamese Insurance Law. However, compared to US, EU, and Japanese legislation, Vietnam's lack of detailed and proper regulations may cause problems with supervision of the financial health of insurers in Vietnam. Lessons from other jurisdictions are helpful for Vietnam in adopting regulations. Enhancements of prudential regulations to ensure the solvency of insurers and thus protect policyholders are desperately needed because Vietnam's insurance

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180. European Commission, Working Paper on Insurance Guarantee Schemes, MARKT/2525/03-EN 3 (2003), available at [http://ec.europa.eu/internal\\_market/insurance/docs/markt-2525-03/markt-2525-03\\_en.pdf](http://ec.europa.eu/internal_market/insurance/docs/markt-2525-03/markt-2525-03_en.pdf).

181. Yasui, *supra* note 159, at 312.

182. Decree No. 89/1999/ND-CP of the Government on Deposit Insurance (Vietnam) (Sept. 1, 1999).



sector is open to foreign participation and competition. The introduction and application of new prudential regulations, nevertheless, would be safe if Vietnam could satisfy the anti-avoidance provision under the prudential exception provided in the Annex on Financial Services. In other words, any measure found to be discriminatory against foreign insurance services and service suppliers, could not be justified by the prudential exception if it is used as a means of avoiding Vietnam's commitments and obligations under GATS.

Revision and introduction of new prudential regulations may be burdensome for law makers as well as the supervisory authority. Therefore, all prudential measures might not be implemented at once. Moreover, the enhancement of prudential regulations should proceed in accordance with the phased-in liberalization of the insurance service sector as well as the development of the market. At the present time, as weaknesses of Vietnam's insurance market include lack of management skills of insurance companies and inexperienced individual consumers,<sup>183</sup> supplementary measures for compliance with the current regulations seem to be a priority. Those measures provide for better information disclosure of the risk profile of an insurance company. The role of auditors and actuaries must be strengthened, including requirements of appointed actuaries for non-life insurers. Another provision necessary is that auditors and actuaries are required to report directly to the supervisory authority in cases where there is any issue which materially affects the solvency of an insurer. The reason is that those measures would ensure sufficient and qualified information to the public, enable prompt intervention by the supervisory authority in case of financially troubled insurers, and then improve public confidence in the insurance market. The success of implementation of those measures would facilitate conditions for introducing more complicated prudential regulations.

In a later period, with further expansion of the insurance market by diversifying market players, more stringent prudential measures are required. Accordingly, there would be, among other things, a fundamental improvement of solvency regime, including clearly identifying permissible assets for the purpose of determining the solvency margin, diversification of investment portfolios, and supervision of insurance holding companies. These measures would allow the supervisory authority to cope with an increasingly competitive

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183. Decision 175, *supra* note 72, at § A.II.3.

insurance market, including mergers and acquisitions as a result of competition. During this stage, establishment of a policyholder protection fund would provide an additional remedial mechanism to mitigate adverse impacts that might arise from liberalization.

All legal reforms could protect the interest of consumers, and improve public confidence. Consequently, it would ensure the stability of Vietnam's insurance services sector after its WTO accession.