Challenges in Collections for Foreign Currency Insurance Policies

Mr Andre Johnson, Regional Product Manager of Asia Pacific Global Payments at Citi's Global Transaction Services, looks at the rising interest in foreign currency policies and how insurers can mimimise their exposures when underwriting these products.

As insurers look to expand their offerings across Asia, there has been a launch of a variety of foreign currency insurance policies. In many Asian countries, the uptake of these foreign currency policies has been strong. This trend has been supported by recent changes in regulations in several countries. Taiwan, for example, relaxed regulations in 2006, allowing insurers which have obtained regulator approval to offer foreign currency life insurance policies. Today, most countries in Asia allow insurers to issue some form of foreign currency policies, though regulator approval may be required.

Why the interest in foreign currency policies? The reason is that the issuance of foreign currency policies can benefit both the issuer and the policyholder. For both the issuer and the policyholder, the currency exposure of the foreign currency (typically US dollar, euro, Australian dollar) is generally considered more stable than local currencies. For the issuer, the funds can then be invested in markets that are generally more stable and with more developed capital markets without having an underlying currency exposure. For the policyholder, they may have plans to retire overseas or send their children to school overseas. So foreign currency policies can help match these long-term exposures.

The challenge with foreign currency policies, however, is having a streamlined process for collecting the policy premium and converting it to the foreign currency in an efficient and cost-effective manner.

Minimising Foreign Exchange Exposure

One of the primary challenges in the issuance of foreign currency policies is how to minimise foreign exchange exposure. Typically, an issuer will want to collect the premium in the foreign currency of the policy or convert the local currency to the foreign currency as quickly as possible and at guaranteed rates so that foreign exchange exposure can be minimised. By converting funds to the foreign currency as quickly as possible, the insurer can invest right away to get immediate return on the funds.

To make the policies attractive for the policy purchaser, generally the insurer will want to offer the flexibility to pay premiums in local or foreign currency. This leads to the question of what rate to apply to convert the local currency to the currency of the policy. Realistically for an insurer it is not efficient to book a live market rate each time a new policy is issued. Instead, an insurer may set a rate at the beginning of the day. However, a rate set at the beginning of the day can be subject to intra-day foreign exchange fluctuation. To minimise foreign exchange risk of setting a rate at the beginning of the day, outsourcing the foreign exchange management to a bank can frequently make sense.

At Citi, we work with insurance clients across Asia which have rolled out foreign currency policies. We currently support insurance clients with a variety of flexible foreign exchange and collection solutions. For example, in Japan we support insurance clients by giving them a fixed foreign exchange rate linked to the Bank of Tokyo-Mitsubishi rate published at 9am JPT. As the spread is pre-agreed, the rate to apply can be easily calculated by our insurance client's agents and no wide communication of the rate has to be made on a daily basis.

Flexible Solutions to Meet Local Market Requirements

Each market has different collection requirements driven by local market practices and regulations, requiring a customised approach to each market.

In Taiwan, for example, local regulations require premium payments be made in the same foreign currency as the policy, effectively making the payment cross-border, thereby increasing the cost of payment as fees and deductions can be incurred. Citi created a unique solution to address this challenge. Citi teamed up with partner banks to offer foreign currency drafts in up to 16 currencies drawn on Citi accounts, providing policy purchasers a wide range of locations to obtain foreign currency payments. Through a special lockbox setup, policy purchasers send the drafts to Citi and the drafts can be cleared much more quickly and less expensively than other methods of foreign currency collections. The result is a convenient and cost-effective solution for the policy purchaser to make the premium payment in the foreign currency.

In countries where cheques are the predominant payment method such as in Singapore, collections result in two challenges. First, at what rate to apply to calculate the amount of Singapore dollar owed and, second, how to handle the cheque collections and returns. Citi created a solution by providing a "sheet rate" at the beginning of the day. The insurance company's agents can easily calculate the amount of Singapore dollars required and the foreign exchange volatility risk is offloaded to Citi. The cheques are collected and converted right away to the foreign currency, usually US dollars, using the sheet rate. Returned cheques are processed when returned and funds are converted back to Singapore dollar.

As foreign currency insurance policies take different forms and become more popular around the region, the challenges in collecting premium payments can make it difficult but should not be a barrier to rolling out these new solutions.