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The Chinese non-life insurance market – Are you ready to face the challenge?

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In this White Paper

Executive summary

The Chinese non-life insurance market is one of the most important growth markets globally. It offers unprecedented opportunities and growth potential to domestic and foreign insurance companies. However, the opportunity coming from this business sector needs to be weighed against fierce local competition, strong regulatory requirements and significant differences in market dynamics between the provinces and cities in a fast changing economic environment.

Given this, global insurers are questioning how to best enter the market, with some raising concern that the opportunities for profitable growth are limited in the short-term. However over the long-term continued macroeconomics progress such as GDP and industry growth and changes in social factors, such as the continued rise of the Chinese middle class and their need to secure their growing wealth, will drive new developments and opportunities in the market.

In addition to cultural and language barriers, one of the key reasons for the currently limited footprint of foreign insurers in China is the need to manage the stringent local regulatory requirements. The China Insurance Regulatory Committee (CIRC) dominates with their central office in Beijing and the local bureaus in the provinces who dictate specific local reporting requirements.

A consequence of the strictly enforced regulations is the need for a special localized approach for IT, both for applications and the infrastructure that have to be handled by an experienced local team with careful planning and a thorough evaluation of the local alternatives.

The Chinese insurance market is “too big to miss”. Although it is not easy to enter or to compete in it, it is really important for foreign insurers to realize that the current, transitional period offers significant opportunities to gather experience and seize market share. Starting immediately is key as it will take three to five years to complete the licensing process, which includes as a first phase opening a Representative Office for a minimum of two years.

BearingPoint and its local partners offer advice and support to help you enter this important market and master the challenges.

The Chinese non-life insurance market

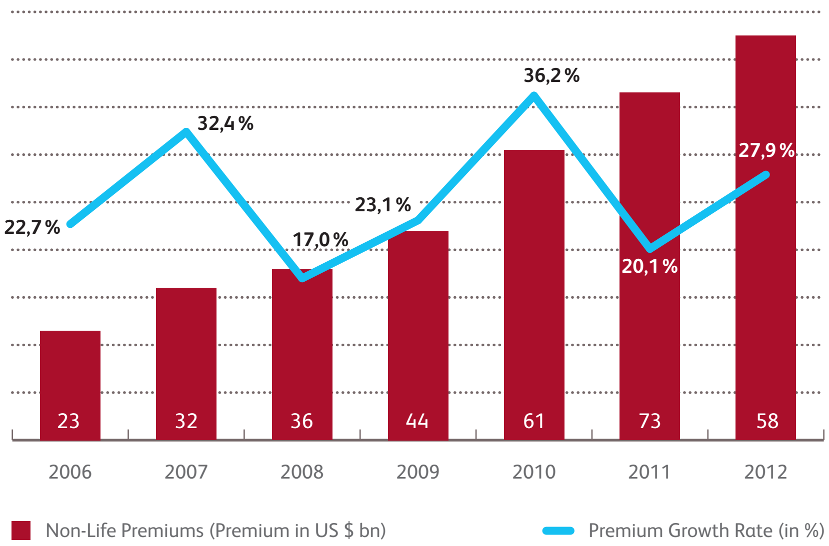
With a nominal gross domestic product (GDP) in 2012 of US$ 13.581 bn, China's economy is the second largest in the world.[1] The new Chinese government expects a further rapid growth of the GDP of 8 % per year with an increase of the GDP per capita to US$ 10,936 by 2014.[1] The expanding GDP, the growing income, the aging population, the increasing investments in fixed assets, the exploding numbers of motor vehicles and privately owned houses and apartments have led to an increase of demand for insurance products.

Opportunities

Growing non-life market over the last years – with upward tendency

China is expected to become one of the four largest non-life insurance markets in the next five to ten years. During the last six years the Chinese non-life insurance markets expanded at an average Premium Growth Rate of 27.9 % while the global insurance market grew only by 2.7 % during the same time period. In 2012, total non-life premium volume for China amounted to approx. US$ 85 billion.

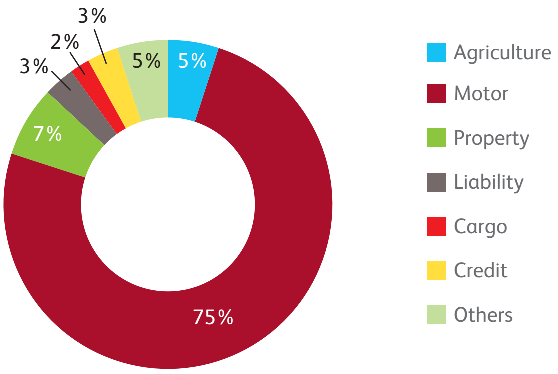
FIGURE 1: NON-LIFE PREMIUMS AND PREMIUM GROWTH RATE IN CHINA[2]



[1] Lloyd's, Market Presentation China, Lloyd's China CEO, Eric Gao (January 2013)

The motor vehicle insurance, agriculture and health insurance have been the highest growth segments of the Chinese non-life market. As figure 2 shows, Motor still dominates the non-life Insurance market with a market share of 75 % in 2012. [2]

FIGURE 2: NON-LIFE MARKET SHARE IN CHINA 2012[2]



Increasing deregulation improves market access

Previously the Chinese market had regulations in place that created high entry barriers for foreign insurance carriers by limiting their share of ownership of a Chinese insurance carrier. Furthermore, certain lines of businesses were exclusively reserved for domestic insurers and regulation required that a share of reinsurance must be bought locally from the monopolist China Re. As an example, excluding foreign insurers from participating in the motor business barred them from nearly 80 % of the Chinese non-life insurance premium. Much of this has been deregulated. Now non-life insurers may be 100 % owned by foreign investors, there is no (official) need to buy re-insurance from China Re and since mid 2012 the motor business is also open to foreign insurers. This last deregulation alone has more than quadrupled the accessible premium volume for foreign insurers.

Globalization is an opportunity

The increasing interlacing of the Chinese and global market leads to growing numbers of non-Chinese companies investing in China consequently requiring insurance coverage for their investments. Foreign companies are significantly more inclined to do business with insurance companies they also do business with in other parts of the world.

In addition, as the majority of local Chinese insurers do not yet act as global insurers managing risks outside of their geographical boundaries, the growing investments by Chinese companies into foreign markets also presents business opportunities for international carriers.

[2] Credit Suisse, China non-life Insurance, (2012)

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Challenges

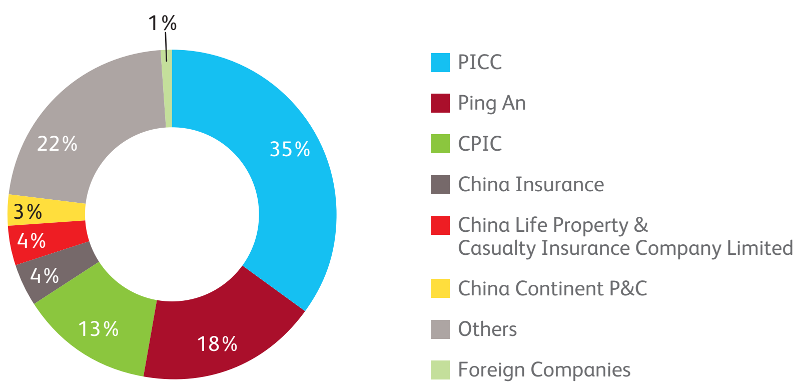
High competitiveness of Chinese market

As of December 2012, there were 62 market players sharing the Chinese insurance market, with 41 Chinese and 21 foreign insurance companies. The market is thus dominated by state-owned local players. The three biggest local domestic insurers – PICC, PingAn and CPIC – dominate the vast majority of the market with a 66 % market share as of the end of December 2012. There is intense competition amongst domestic rivals for the pre-existing lines of business, whereas foreign companies have, so far, succeeded in specific areas where there is less local expertise like specialty, large commercial risks and reinsurance.

According to CIRC, the total market share of the foreign insurers on the non-life market was as little as 1 % in 2012. The largest foreign players as of September 2012 are:

1. **Chartis Insurance Company China Limited** is the top foreign non-life insurer, with premium income of RMB 0.9 billion in 9/2012.
2. **Liberty Mutual had total** premium of RMB 0.5 billion in 09/2012.
3. **Allianz** with a premium income of RMB 0.5 billion in 09/2012, which is an increase of 58 % compared to the same period the year before.[3]

FIGURE 3: CHINA MARKET SHARE 2012[1]



Cultural hurdles

The Chinese way of doing business is, when compared to other countries, primarily based on personal relationships. Some important points to always keep in mind are:

- face first (mian zi)
- invite and involve experts in the discussions
- act with caution

Prominent among these cultural hurdles are the language capabilities, English is not widely spoken in the country, especially by senior Chinese business people. This will

[3] Towers Watson, The Chinese Insurance Market, Issue 22 (September 2012)

change in the future as the younger generation increasingly learns English. Chinese families are very ambitious and striving for their children's success and professional life, so they often invest privately in their children's English language capabilities.

Government support is the key

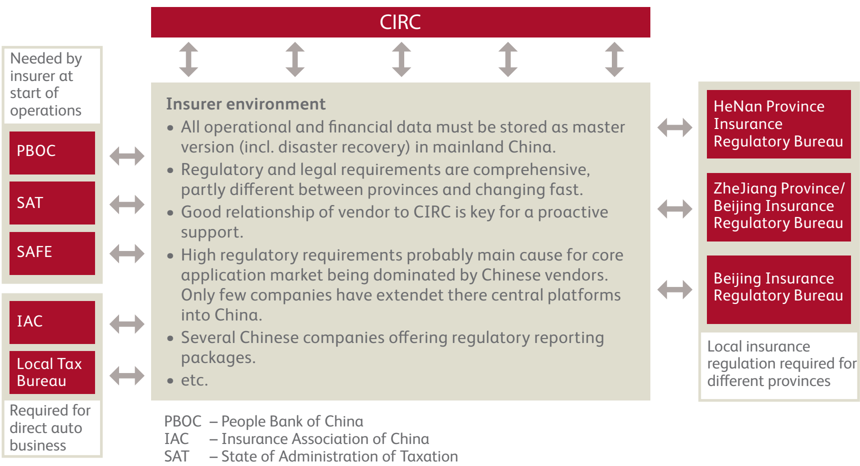
The regulatory environment in China will always be the key driving force for the growing insurance industry. Protecting China's nascent insurance market and following a gradual "open-door" strategy, the Chinese government has placed a number of requirements on foreign-based insurers looking to operate in the country.

A prospective foreign insurer starts by setting up a representative office and only after a minimum required presence of two years, is allowed to apply for a business license. The license will be awarded by the local CIRC office of the province where the insurance company wants to establish their business. To get the license approval, the insurer must fulfill broad official and unofficial criteria that includes nationwide and regional specific CIRC requirements. This process can take three to five years and requires intensive relationship building with the authorities as a critical success factor. This application process only allows the insurer to do business in the province where it took place and has to be reiterated for each region where the insurer wants to set up business. Only some well-defined business (essentially large commercial) are allowed to be written nationwide from one province although this excludes sales and operational staff outside the admitted province.

Next to the licensing process the reporting landscape in China is very comprehensive with different governmental institutions in China requiring different types of reports with dozens of tables on a regular or ad hoc basis. Part of the reporting varies by province as CIRC operates local bureaus in each province with their own specifications.

Establishing good relationships with official institutions, esp. CIRC is key to support the licence process.

FIGURE 4: CHINESE REGULATORY ENVIRONMENT



PBOC – People Bank of China
IAC – Insurance Association of China
SAT – State of Administration of Taxation
SAFE – State Administration of Foreign Exchange
CIRC – Chinese Insurance Regulatory Commission

IT environment

The availability of a local IT infrastructure is a key requirement to receive the business license from CIRC. After applying for a license the insurer will receive a pre-license after an average of 6 to 12 months, although this process may take longer. From the time the pre-license is granted there is approximately 10 months to implement the applications and set-up the datacenter. At the end of this period, the CIRC will visit the insurer's office to execute an onsite inspection verifying the business processes as well as operability and conformity of the IT environment.

Because of the special and fast changing requirements of the Chinese market and the time pressure given when the pre-license is awarded, only a few foreign insurance companies decided to adapt their global or regional solutions for the Chinese market. The same is true for global software vendors where most are still struggling to get a larger footprint in mainland China.

This results in a similar scenario to the insurance market with local software vendors dominating the insurance IT software market. Traditionally local Chinese insurers buy Chinese and go for custom developments. Because of this, many Chinese software companies are working this way and only a few offer packaged solutions. Understanding of the project delivery approach, methodology and quality are also factors to consider as they vary from the Western approach.

Important considerations have to be made in the areas of IT security, documentation, integration capabilities and usability as well as ongoing support and different work and communication cultures. These need to be addressed through strong local on-the-ground project management and business & IT resources as well as other mitigation efforts.

For a successful market entry it is important that foreign insurers select a solution which is adapted to the Chinese market:

- Proven "End to End" solution in China
- Strong local market know-how that includes regulatory reporting capabilities
- A flexible and comprehensive support package which allows for fast reactions to the changing market and regulatory environment

IT infrastructure requirements

Local regulation requires all operationally relevant data to be stored in mainland China (i.e. excluding Hong Kong, Taiwan, Macao). Also the disaster recovery site needs to be locally placed in China. Consequently, core insurance, party, non-life ledger and document management applications and their data must be hosted in China. Without restrictions the insurer may have copies of this data outside of China, as long as the master resides in China. The insurer though is allowed to outsource the hosting of applications within mainland China making use of a local available offering of datacenter services; these services are dominated by local service providers. The fulfillment of these requirements will be verified by the local regulator (CIRC) as part of the onsite inspection exercise.

BearingPoint's approach

Key success factors

To enter the Chinese insurance market, foreign insurance companies face a number of challenges. To successfully overcome them BearingPoint has identified the following key success factors:

- Local project team – ideally Chinese speakers with experience in Chinese and international market and companies – are critical to a successful IT project implementation
- A thorough understanding of Chinese business culture and needs
- Development of good relationships with governmental offices, especially CIRC
- Deep understanding of local market and regulatory requirements
- Close relationships with local providers and tight management of vendors of IT solutions

BearingPoint can help you enter the Chinese market

- Provide you with local and global insurance business and IT expertise
- Help you understand the local market and regulatory requirements
- Evaluate the market for IT offerings (applications and infrastructure) to find the right solution for your needs
- Advise on the best negotiation of contracts taking into account the Chinese environment
- Provide project management, quality assurance, architecture and business requirements advice and support for a smooth and speedy implementation

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BearingPoint consultants understand that the world of business changes constantly and that the resulting complexities demand intelligent and adaptive solutions. Our clients, whether in commercial or financial industries or in government, experience real results when they work with us. We combine industry, operational and technology skills with relevant proprietary and other assets in order to tailor solutions for each client's individual challenges. This adaptive approach is at the heart of our culture and has led to long-standing relationships with many of the world's leading companies and organizations. Our 3500 people, together with our global consulting network serve clients in more than 70 countries and engage with them for measurable results and long-lasting success.

For more information, please visit: www.bearingpoint.com

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