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China Close to Opening Its Auto Insurance Market

A.M. Best Analyst: Foreign Players May Ease Loss Pressure in Motor Market

Car buyers shop for vehicles in China. Car sales in China are driving insurance growth in the sector. Sales in China climbed 6.7% in July.

Imaginechina via AP Images

By Rebecca Ng

China is close to opening its highly regulated compulsory third-party motor liability insurance market to foreign insurers, a move A.M. Best Co. believes "will alleviate solvency pressure for domestic nonlife companies and premium pressure for motor products" in a market hobbled by deteriorating underwriting conditions.

The motor market constitutes more than 70% of China's nonlife industry. "With a strong growth of above 30% in the compulsory motor insurance market in recent years, the domestic nonlife companies are having some solvency pressure," said Hong Kong-based MM Lee, general manager of analytics with A.M. Best Asia-Pacific Ltd. Lee indicated the problem is caused by the imbalance of demand and supply forces.

China first introduced compulsory liability insurance in 2006. Currently, there are 33 Chinese property/casualty insurers operating in the market. In 2010, the market reported an operating loss of 7.2 billion yuan (US$1.1 billion). Of that, underwriting losses accounted for 9.7 billion yuan, offset by 2.5 billion yuan in investment income, according to the China Insurance Regulatory Commission (*Best's News Service, Aug. 5, 2011*).

The three big nonlife insurers, including PICC Property and Casualty, China Pacific Property Insurance and Ping An Property and Casualty, all recorded combined ratios above 100 in 2010, while all three were below 100 in 2008 and below 90 in 2007, noted A.M. Best.

The high claims ratio, particularly for non-passenger vehicles, has been a drag on the domestic motor insurance sector, as insurers are "still trying to find the right operating model," said Sharon Khor, head of insurance in greater China at consultancy Accenture.

Rising claims costs and falling premium rates are producing negative underwriting results in China, according to consultancy Celent. "The increase of compensation levels, medical costs, price of motor parts and labor costs resulted in an increase of the average cost of claims. The regulator decreased the premium rate for third-party liability insurance and raised the liability amount since 2008, which has worsened the situation," said Wenli Yuan, a senior analyst at Celent.

When the CIRC first introduced compulsory liability insurance, a universal premium rate was set with a fixed loss limit of 60,000 yuan. Since July 2007, the floating premium rate came into effect. "Renewal policies which have favorable claim records can enjoy a premium discount, so the average premium per policy is decreased," said Yuan.

The average premium rate for automobile insurance is likely to fall by low single digits based on the floating rate scheme in China, said equity analyst Olive Xia at Core Pacific-Yamaichi in a research report. Flexible pricing for automobile insurance is expected to "intensify price competition going forward," she said.

Although most insurance companies had underwriting losses for compulsory third-party liability insurance for motor vehicles, they are seeing underwriting profits for

■ Continued: **MOTOR,** page 2

■ MOTOR

From page 1

commercial motor vehicle insurance, which also allows overall motor vehicle insurance to be profitable, said Yuan.

"Currently, there is already high competition in the motor vehicle insurance market. The Chinese regulator might have concerns about increased competition," she said.

Strong compulsory motor insurance market growth also means that demand has been increasing much faster than the supply, driving up prices, according to A.M. Best.

"From a regulatory perspective, the authority would like people to be able to afford insurance, or buy at an adequate rate," said Lee, adding the opening up of the market "will ease forces like domestic nonlife insurers' solvency pressure and motor premium rising pressure."

In China, many foreign insurers who have been in the market some time are failing to generate satisfactory profits. Many are taking a long, hard look at the feasibility of their relationships with the local partners. However, they are not about to quit, as they see China as an underinsured market with huge upside potential, said international law firm Clyde & Co in a report.

One area of optimism for insurers is the CIRC's considering whether to open the market for compulsory motor insurance to foreign firms, "allowing overseas insurers to boost their business in the world's largest car market," noted the law firm.

Top 10 Motor Insurers in China in 2010**

(Yuan Billion)

	Names	2010 Premium Income	2009 Premium Income
1	PICC Property and Casualty Insurance Co., Ltd.	**30.58**	25.02
2	Ping An Property & Casualty Insurance Company of China Ltd.	**12.05**	7.99
3	China Pacific Property Insurance Co., Ltd.	**9.25**	6.77
4	China United Insurance Holding Co. Ltd.	**4.64**	4.69
5	China Continent Property & Casualty Insurance Co. Ltd.	**3.36**	2.87
6	Sunshine Property and Casualty Insurance Co., Ltd.	**3.29**	2.26
7	China Life Property & Casualty Insurance Co. Ltd.	**3.03**	2.29
8	Anbang Insurance Co. Ltd.	**2.65**	2.04
9	Tianan Insurance Co. Ltd.	**2.31**	1.93
10	Yong An Insurance Co. Ltd.	**1.67**	1.79

**In terms of premium income in 2010.
Source: Insurance Association of China.

Audio:

Listen to the entire interview with MM Lee at *www.ambest.com/audio.*

Yuan said foreign players can help China to form a "healthier" growing motor vehicle insurance market with their "advanced technology and risk management experience."

She said because foreign property and casualty insurers have not gotten approval from the regulator to sell compulsory third-party liability insurance for motor vehicle, they are at a disadvantage in selling commercial motor vehicle insurance as "customers usually want to buy this business line from the same insurer."

Yet even as the CIRC reviews deregulation, continuous business growth with a scalable market size are key concerns among domestic players as they contemplate potential industry integration, said Khor.

Global Writers Weigh China Auto Insurance Options

By Rebecca Ng

Foreign insurers are eager to see whether China's insurance regulator will further open the country's vast automobile insurance market to competition, but capital concerns, service differentiation by region and questionable profitability will still make entry decisions complex for many.

"Service is our winning formula worldwide and China is no exception. The challenge is to differentiate our services among local companies in various provincial markets," said Jackson Tang, China managing director of Liberty Insurance Co. Ltd., a subsidiary of U.S.-based Liberty Mutual Group.

Liberty has had an auto insurance business in Chongqing, its China headquarters, since 2005. It is now the leading foreign auto insurer in the country, serving 73,000 drivers in Chongqing, Beijing and Zhejiang, and will open another branch in Guangdong, according to Tang.

As an active player in auto market, Tang said Liberty "welcomes" the China Insurance Regulatory Commission's move toward opening mandatory third-party liability insurance to foreign insurers and "will be interested in developing this new business."

With more than 18 million new vehicles, including passenger cars and commercial vehicles, registered in China in 2010, "the market and its potential is big" when compared with the 15.6 million new vehicles in Western Europe, according to Germany-based insurer Allianz SE.

"This offers a huge opportunity, but with a high

■ Continued: **AUTO,** page 3

■ AUTO

From page 2

claims ratio in the Chinese market this also bears challenges for profitability of third-party motor business, which an insurer has to assess with care," said Kamesh Goyal, regional chief executive of Allianz Insurance Management in Asia Pacific, based in India.

He said in China, the insurer is offering noncompulsory motor business with a local partner in Guangdong province. "An opening up of the third-party market would enable us to do motor business more efficiently," said Goyal.

Since it inception in 2006, Liberty noted mandatory third-party liability insurance has operated well, serving millions of Chinese drivers. But some problems have harmed the industry efforts, Tang said. For example, "some provinces run a loss in MTPL, and rejections to accept MTPL applications are not uncommon though legally not correct."

The CIRC has taken measures to address these issues, such as introducing differential tariffs in certain provinces and enforcing acceptance of MTPL applications. At the same time, the Beijing-based insurance regulator is considering opening MTPL to foreign-invested companies.

If implemented, Tang said, this opening would help improve the performance of MTPL and the overall auto insurance market, with consumers benefiting from the introduction of best practices from foreign markets and competition.

Tang believes there are "practices, systems and techniques" in mature country markets, such as the United States, where auto carriers have decades of experience in underwriting and pricing auto insurance, that can be used in China, where the "relatively young industry still has tremendous room for improvement."

Opening MTPL to foreign-invested companies will provide consumers with more choices and project a "progressive" image for the industry, said Tang.

"Indeed, experiences in the U.S. and the other well-developed insurance markets have shown that a reduction in market entry barriers for auto insurance results in healthy competition, lower premiums and expanded coverage, which are for the benefits of both consumers and insurers," he explained.

Global reinsurers have raised concerns about the funding capability of Chinese direct insurers for business developments, particularly motor insurers who are facing problems with claims management with rising loss ratios.

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China managing director of Liberty Insurance Co. Ltd

"The motor insurance market in many established markets has been unprofitable following strong price wars. However, we don't see that profitability in China will be a concern in the short-term."

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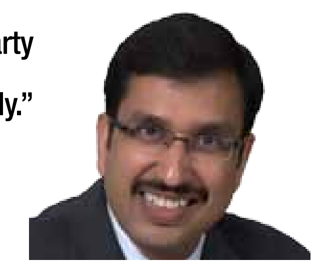

Munich Re expects premium income in China will rise to about 1.1 billion euros (US$1.6 billion) in 2011, driven by the demand for motor insurance. "The motor insurance market in many established markets has been unprofitable following strong price wars. However, we don't see that profitability in China will be a concern in the short-term," said John Wilkinson, Munich Re's CEO for Greater China.

"What makes the Chinese motor insurance market different to markets in Europe is the regulation of insurance rates and its short-tail character, making the business profitable for primary insurers and reinsurers," he said.

Munich Re noted the large primary insurers in China need to "find the capital to support their immense growth." The use of reinsurance, compared to subordinated loans, provides flexibility, and a reinsurer's consulting services and risk partnership can help reduce the capital amount insurers need to support the increasing demand for motor cover in China, where car sales jumped 32% last year.

"The demand from these large transactions has risen sharply in the last few years," said Wilkinson.

In the first half of 2011, China saw a 14% growth in motor insurance premium income compared

■ Continued: **AUTO,** page 4

■ AUTO

From page 3

with the first half of 2010. Considering the 39% growth observed for all of 2010, growth of Chinese motor insurance market "has obviously slowed down from its peak speed," with challenges arising from "underwriting selection, sales channel control and claim management" of insurers, said Yinyin Huang, vice president and senior casualty treaty underwriter with Swiss Re. The industry believes this slowdown is due to a broad motor market slowdown, with factors including "higher oil prices, restrictions on car purchases in cities such as Beijing to alleviate traffic conditions and the expiration of tax incentives for the purchases of small cars," said Beijing-based Huang.

Ping An Confident as Motor Market Prepares for Reform

By Rebecca Ng

Ping An Insurance (Group) said it sees "continuous motorization in China" along with tighter insurance regulation as creating new business opportunities that will offset any threat from the opening of the compulsory third-party liability motor insurance market to foreign players.

The China Insurance Regulatory Commission proposed in August to deregulate the compulsory third-party liability insurance market for motor vehicles in China and open the market to foreign insurers, following a rise in loss ratios among domestic nonlife players.

The CIRC said the move will serve its goal of "protecting the best interests of the insured and to promote healthy market development for motor insurance," said Yinyin Huang, vice president and senior casualty treaty underwriter at Swiss Re.

"Overall, we believe opportunities are more than challenges," said Yongfeng Ma, deputy general manager of motor insurance at Ping An Property and Casualty Insurance Company of China Ltd., the second-largest nonlife insurer in the country.

In view of the regulatory environment, "stricter regulations and healthier market environments will continue," said Ma, adding that as the industry benefited from market improvements, "the growth trend of the profitability of the industry will continue."

In addition, the promotion of online sales of motor insurance and the enhancement of market discipline in the nonmotor insurance sector have improved the domestic motor market operating environment, he said.

PICC Property and Casualty, the largest nonlife and motor insurer in China, earlier said it will face a number of challenges in the second half of 2011, including the end of government policies to encourage the purchase of vehicles and the introduction of vehicle purchase restrictions in some cities, along with the slowing growth of vehicle sales.

Top Three Insurers China Motor

The Chinese motor insurance market is dominated by the following three companies, listed with 2010 premium income from motor business.

1	PICC Property and Casualty	30.58 billion yuan
2	Ping An Property and Casualty	12.05 billion yuan
3	China Pacific Property Insurance	9.25 billion yuan

Source: China Insurance Regulatory Commission.

"It is impossible for motor insurance to always remain in rapid growth," said Ma. He explained that during the regulatory improvement process, intermediary fees such as commissions and handling fees, which were "running off from [the incomes of] insurers have returned to the premium," leading to premium growth.

"Following the expansion of the premium base, the premium proportion contributed by new motor sales may decline, but China's motorization in the mid to long term has not yet finished, and China will continue to be the largest motor sales country in the world," Ma said.

Amidst economic recovery, China has surpassed the United States to become the world's largest new vehicle sales market since 2009. As a result, the auto insurance market is "growing rapidly," said Jackson Tang, managing director of Liberty Insurance Co. Ltd., a subsidiary of U.S.-based Liberty Mutual Group in China.

"Driven by regulation of pricing competition, the auto insurance line began to report underwriting profit in 2009," said Tang. "As auto insurance accounts for 70% of the property and casualty insurance sector in China, its profits have turned the P&C sector around, after years of underwriting losses."

Ma added that "no matter if the market is open or not, Ping An P&C has already developed domestic competitive advantages in sales channels, risk management, technology and services."

The insurer said new channels like telesales and cross-selling have reported "substantial" effectiveness, with telesales motor insurance already contributing profit. For customer service, the company provides roadside assistance free of charge, noted Ma.

For risk management, he said Ping An established a "secure" customer database, and conducts "risk identifications and detections" through the combination of adopting

■ Continued: **PING AN,** page 5

■ PING AN

From page 4

international actuarial methods with its underwriting system to enhance underwriting quality.

Lead Players

The Chinese motor insurance market is dominated by three companies: PICC Property and Casualty, Ping An Property and Casualty and China Pacific Property Insurance. Premium income generated from motor business in 2010 was 30.58 billion yuan (US$4.78 billion), 12.05 billion yuan and 9.25 billion yuan, respectively, according to the CIRC.

Beijing-based PICC P&C's 2011 first-half net profit rose 96.7% to 5.29 billion yuan, driven by an improving underwriting environment in China. Its motor business turnover rose 9.3% to 64.33 billion yuan (*Best's News Service, Aug. 15, 2011*).

As at June 30, PICC P&C's motor combined ratio was 93, compared with 97.7 a year earlier.

"The motor loss ratio stayed the same but the total expense ratio declined [in 2011 first half]. That is enough to budge the combined ratio down. Because the profit margin is so small, even a small shift in combined ratio will change profit a lot," said Edward Jen, a Hong Kong-based equity analyst with the insurance sector research department at Samsung Securities Asia Ltd.

Although motor insurance accounted for 70% to 80% of PICC P&C's total business, its underwriting profit growth was not driven by government policies encouraging auto purchases, noted Jen, who added cost control in terms of cost efficiency and natural economies of scale have helped the insurer improve its combined ratio and underwriting profit.

Since compulsive motor insurance was first introduced in China in 2006, the CIRC said the system has operated effectively. Following economic changes, the regulator noted this mechanism has encountered new problems and requires more supervision of insurers. The CIRC said it will study the opening of this market to foreign insurers to introduce new technologies and management from overseas.

"There still [is] sufficient market competition in China, [with] around 50 property and casualty insurers at present," said Ping An's Ma. The overall profitability of the domestic nonlife sector is "positive," mainly due to rapid macroeconomic development of the country and continuous improvement of the market environment.

"If the [compulsory third-party liability insurance] market opens to foreign insurers in the future, we will learn the advanced technology from them, in order to provide better customer service," he noted.

In the first six months of this year, Ping An P&C premium income from motor business rose 35% to 30.79 billion yuan. Ma said the company will look to maintain a "better than the market" motor insurance growth.

In 2010, China's compulsive motor insurance sector reported an operating loss of 7.2 billion yuan. Of that, underwriting losses accounted for 9.7 billion yuan, offset by 2.5 billion yuan in investment income. In addition, insurers paid 12.34 trillion yuan for 12.28 million claims, up 19% from 2009. They also made advance payments for salvage amounting to 95.97 million yuan, up 18% from the previous year, according to the CIRC.

"As auto insurance accounts for 70% of the property and casualty insurance sector in China, its profits have turned the P&C sector around, after years of underwriting losses."

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China managing director of Liberty Insurance Co. Ltd

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Audio:

Listen to the entire interview with Yinyin Huang at *www.ambest.com/audio.*