

Focused on the real issues



As we begin the Chinese Year of the Dragon, Clyde & Co's Asia Pacific Corporate Insurance Group has made some predictions for the next 12 months for this dynamic and fast-moving region.

- **Wave of consolidation expected**

In markets across Asia-Pacific a number of factors are coming together to create the right conditions for a wave of rationalisation in the insurance industry; we expect a marked upturn in the number of corporate transactions in the coming year.

Although insurance companies in the region have been doing well – with a number of markets seeing solid growth in premiums last year, notably China with a 10.4% year-on-year increase to 1.43 trillion yuan (US\$226.4 billion) – times are getting tougher.

The recent spate of catastrophes in the region has put a considerable dent in the capital reserves of a number of companies, and investment returns have been falling – down 3.6% in China last year alone.

The region is by no means immune from the severe economic and financial conditions affecting other parts of the world, while rising inflation will impact the amount companies will need to set aside for long-tail claims. Fierce market competition will likely continue to drive down prices resulting in the smaller players in the market being further weakened.

Regulators across the region are pushing for fewer, stronger insurance companies in the market, with more robust balance sheets. The new chairman of the insurance regulator in China has publicly stated the need to reduce the number of under-performing entities as well as encouraging companies to find ways to boost their capital. This is a theme repeated elsewhere; for example Indonesia is expected to increase insurers' capital requirements by the end of the year.

- **Insurers look beyond borders for growth**

As competition for market share continues to increase in countries across the region, insurers will either roll up their sleeves and prepare for a dog fight or, more likely, turn their attention to opportunities elsewhere in Asia and beyond.

In a number of countries, such as Korea, the market is considered saturated and insurers there are starting to look further afield for growth.

There are a number of insurers in the region, especially in China, which have the scale and the intention – certainly in the long-term – to become truly global players. Historically, Chinese companies have not always met with success as they have pursued opportunities overseas – Ping An's acquisition of Fortis in 2006 being perhaps the most notable example, resulting as it did in write downs of around US\$5 billion.

However, the much publicised entrance of China Re into the Lloyd's market in London should be considered the start of a growing trend that sees greater interest in expanding overseas from insurers across the developing economies, especially in China. These companies will bring capital and Asian experience to the international insurance industry and in return will get access to the skills and talent available in more developed markets.

- **Creation of an Asian Insurance Exchange moves a step closer to reality**

The size of the market in Asia and the scale of the opportunity it represents, particularly in China, means that the creation of a regional insurance exchange is a logical development. It is no longer a question of 'if' this will happen, but 'when' – significant progress is likely this year.

The global banking crisis has highlighted the increasingly important role that the emerging markets will play in the development and integration of the world's financial system. As part of this process, new exchanges are being established in emerging financial centres.

The Chinese authorities have said that they want to create key exchanges across a range of asset classes. This ambition is one that should be taken seriously as China has a proven record in this area. Last year's launch of the Shanghai Shipping Exchange – the world's first electronic container derivatives platform – is a perfect example of this emerging market 'leapfrogging' mindset where aspiring economic powerhouses take hugely ambitious leaps in the hope of securing an early mover advantage.

The attraction of building an Asian Insurance Exchange, most likely based in China, is clear. As well as being the world's largest trading nation and second largest economy, China is already the sixth largest insurance market and is set to grow further. The China Insurance Regulatory Commission (CIRC) is looking to almost double annual premium income to CNY3 trillion (US\$436 billion) by 2015. Creating an insurance exchange in China would significantly assist in meeting this target. It would also benefit the region by keeping a significant amount of capital that currently goes overseas within the local economy – just looking at the Lloyd's market, in 2010, 10% of its premium income derived from Asia (US\$3.4 billion).

It is likely that the new exchange would trade in liability insurance, reinsurance, property and group life products and that foreign players would be allowed to participate. In future the exchange might expand to include risk securitisations, catastrophe bonds and other derivatives.

- **Seismic shift in the location of catastrophic losses**

With the combined catastrophe bill from Tohoku, Canterbury and Thailand now reaching around US\$60 billion – and with all three disasters now ranked among the 10 biggest insured losses of the last 30 years – the cost of future Asian cats is likely to make an even greater impact on the global insurance markets.

Historically, natural disasters in Asia have been devastating in their destruction of property and in terms of loss of life, but the insurance bills have been much less significant. However, rapid economic growth in the region, an increase in insurance penetration and a greater acceptance of the concept of liability insurance means that this is changing rapidly.

Flooding in Thailand, for example, affected around four million structures and losses so far are almost US\$11 billion. However, it is not merely the size of the losses from these catastrophes, but the spread, that indicates a seismic shift in the Asian market. Both the Japanese earthquake and tsunami – and the flooding

in Thailand – have caused major disruptions to businesses across the world because of their impact on supply chains. For Japan, the insured contingent business interruption loss is estimated to be US\$1 billion to US\$2 billion, while the overall cost of business interruption globally may be as high as US\$15 billion and is still rising.

The result is likely to be both a hardening of the market and structural changes in the way that reinsurers look at the region. Last year's large catastrophe bill in the Asia-Pacific region has blurred the lines between what constituted peak and non-peak risk zones in a global reinsurer's portfolio. For example, while some did not consider Thailand to be a 'cat-producing' country, recent events demonstrate that there may be no such thing as a 'cat-free' country. Global reinsurers will re-consider the diversification benefits of writing business in what were considered non-peak zones, and there will be an expected higher return on capital for those zones.

- **Foreign insurers to receive approval to sell compulsory motor insurance in China**

The China Insurance Regulatory Commission has submitted a proposal to the state council to allow foreign insurers to sell compulsory motor insurance. With China having overtaken the US in car ownership, this could be a significant engine for growth for international insurers.

This is the first time that Chinese regulators have seemed likely to open the motor third party liability (MTPL) insurance market to foreign players. However, it is likely that – even if the MTPL is opened to foreign investment – there will be a high entry threshold, including a minimum 30-year insurance business history, the requirement for a representative office that has been established for two years in mainland China and total assets of US\$5 billion (€3.6 billion).

Among the international players that have taken a lead in the Chinese motor market is IAG, which took a 20% stake in Bohai Property Insurance this year, and is using the relationship to sell top-up cover. However, the market is not without its challenges, not least the fact that it is loss making overall as a result of low premiums (in the region of US\$52 per vehicle), the number of accidents and fraud.

However, irrespective of any easing of the rules, issues around distribution still remain, with Chinese rivals having strong ties to local clients and nationwide networks – as well as the brand recognition – that will help them defend their dominance. For example, under local rules, groups with larger foreign interests could only open up two branches a year, whereas local insurers – and those with international investment of under 25% – could open as many as they please.



Andrew Holderness

Global Head of Corporate Insurance

E: andrew.holderness@clydeco.com

T: +852 2287 2808



Michael Cripps

Regional Head of Corporate Insurance

E: michael.cripps@clydeco.com.cn

T: +86 21 6035 6129



William Tsang

Partner

E: william.tsang@clydeco.com

T: +852 2287 2830



Carrie Yang

Partner

E: carrie.yang@clydeco.com.cn

T: +86 21 6035 6123