Motor insurance

Asia's growth engine

Ernst & Young
Quality In Everything We Do

Index

Executive summary

Across Asia's emerging markets, motor insurance offers an exciting opportunity for growth. For several years, the sector has experienced strong and consistent revenue gains, which are forecast to continue. The combined markets of **China**, **India**, **South Korea (Korea)**, **Taiwan**, **Thailand**, **Vietnam**, **Malaysia** and **Indonesia** will generate in excess of US$75billion[1] in gross written motor insurance premiums in 2011.

However, many insurers are hesitant to tap into these high growth markets, put off by the apparent difficulties of achieving profitability in immature markets – and the risks of operating in unfamiliar and rapidly changing trading environments.

This paper is designed to help prospective entrants assess the best opportunities in this region and understand how to capitalise on them, looking at the dynamics within the above eight markets and their potential for growth. In addition, we observe that some established insurers may benefit from insights across these markets as they experience challenges either in regard to accessing premium growth or writing profitable books of business in these markets. This paper also examines the main challenges in each market and the strategies employed by the insurers that are achieving success in these markets.

Challenges of emerging motor insurance markets

While motor insurance in these emerging markets is relatively immature, its rate of change is rapid. Moreover, each market has unique characteristics, with regulatory forces, maturity of the market and the ability to innovate, price and develop products varying greatly between geographies. Challenges include:

- Regulatory forces:
  - Compulsory Third Party insurance (CTP) is not yet in place for Indonesia
  - China and India have restrictions on foreign investment
- Product Innovation:
  - Statutory tariffs are in place for six of the eight markets
- Market Maturity:
  - High accident rates
  - Evasion of CTP and prevalence of fraud
  - Traditional domination of market by local insurers

Strategies for success

Yet, some insurers are achieving profitable growth within these often heavily regulated and fragmented markets. And, within this group of successful companies, we are seeing consistent practices contribute to beating the average loss ratios for motor insurance in each market.

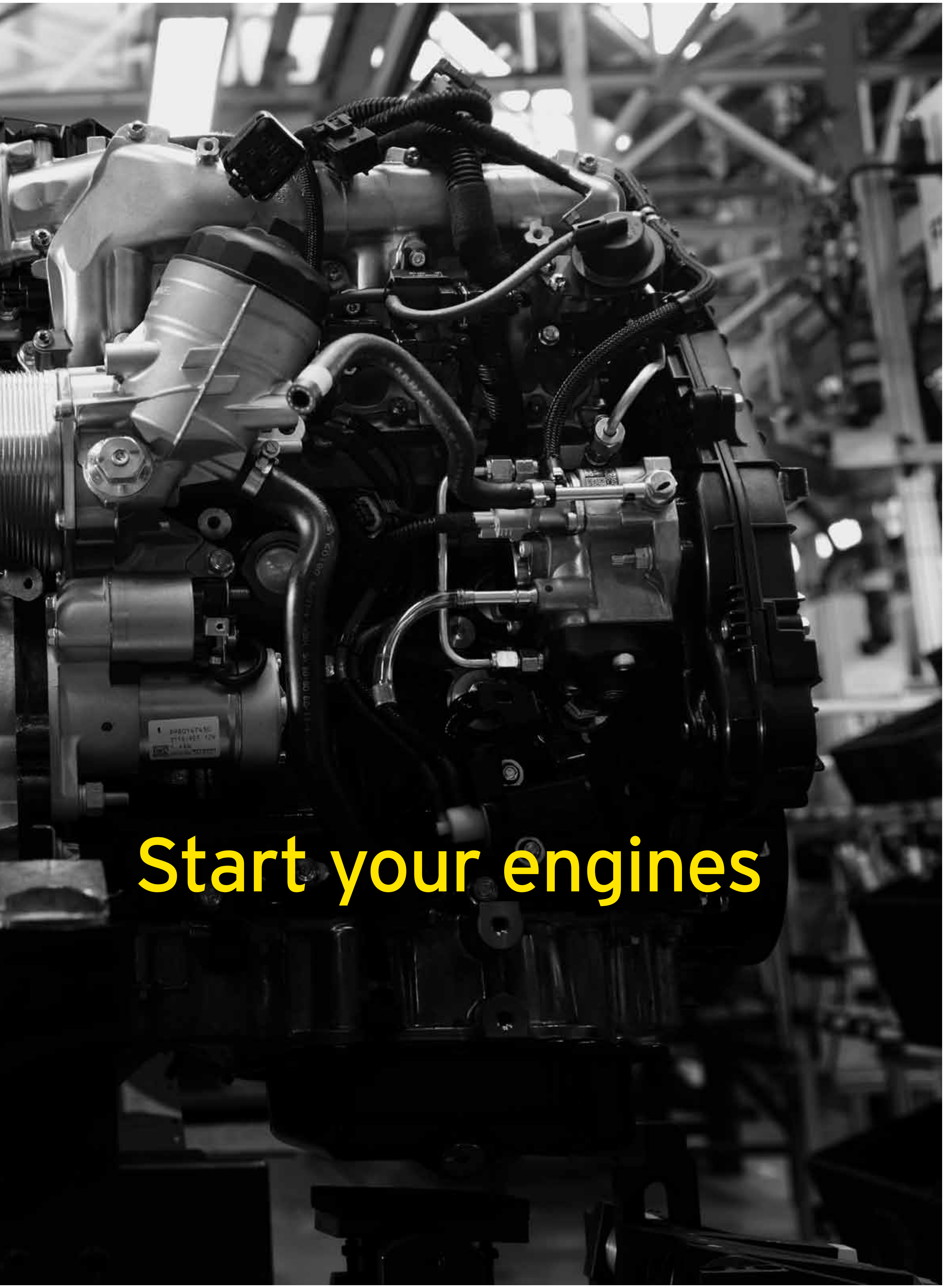
These profit-generating practices include:

1. Establishing alternative distribution platforms e.g. banks and car dealer groups
2. Competing on factors other than price e.g., service
3. Managing the claims process
4. Using IT systems to manage distribution and claims

Although none of these leading practices are particularly new or innovative, winning (i.e., those that have better than average loss experience and are achieving their fair share of growth) insurers are applying them strategically to produce profits in markets where other players are still struggling.

By employing similar tactics, insurers who understand these markets have a better chance of achieving profitable growth in the industry's new growth engine.

1 Ernst & Young estimate based on various market returns and growth forecasts



Start your engines

Introduction

Motor insurance in Asia offers both opportunity and risk on a grand scale. Its growth potential is vast, yet many insurers are failing to create profitable operating models. This growth opportunity is fuelled by a number of factors including growing economies, a rising 'car owning' middle class, rapid urbanisation and even regulatory and law changes. This paper examines both sides of the risk/opportunity coin, drawing on Ernst & Young's extensive experience of advising top insurers across the region.

In 2010, non-life gross written premiums (GWP) in our eight featured Asian markets exceeded US$150 billion[2], with expected annual growth rates forecast to reach 15% per annum for the next five years. While other non-life lines are expected to contribute to this growth, motor is the most prominent class of business, often representing more than half of non-life GWP.

We believe this large forecast increase in the motor insurance premium pool is realistic, given Asia's rapidly expanding economies, rising affluence and an increasing demand for insurance among a combined population of over three billion people. However, many insurers are discovering that, without action in product innovation, claims management processes and other key operational areas, this large and increasing GWP can quickly be swamped by operating losses.

There are many speed bumps along the road to profitable growth in motor insurance. Complacent entrants without sufficient understanding of the market quickly find themselves stagnating.

To help prospective new entrants avoid common mistakes, the **Markets** section of this paper sets the scene for motor insurance across Asia. Among other things, we explore how:

- Increasingly stringent regulation in **Indonesia** may force consolidation.
- With an internet penetration of over 80%, e-business in **Korea** is an important distribution method. However, it also provides some significant challenges that affect insurers' profitability
- While motor insurance in **India** is the most popular insurance product sold at banks, some other markets have experienced challenges in cross-selling insurance products in this way.
- **China** offers both the greatest challenge and the greatest opportunity in Asia. It has attractive economic indicators for potential growth, but significant foreign ownership restrictions.
- **Vietnam** is one of the biggest potential growth stories of all, with the government prioritising insurance industry development as part of its economic expansion plan.
- Takaful (insurance on Islamic principles) represents a growing opportunity. Other than in **Malaysia**, this market is largely undeveloped.

While average losses in these markets can be high, the top insurers consistently perform better than the market by implementing leading edge practices in key operational areas. We observe that there is no 'one-size-fits-all' to describe these successful insurers — for example the opportunities are not exclusively linked to dominant local players. Instead, it appears that insurers who have focussed on excelling in the basics in the local market are the ones achieving profitable growth.

2 Ernst & Young estimate

To succeed in Asia, motor insurance companies have to understand the individual market dynamics.

Motor insurance is a difficult class of business to manage but, with the appropriate strategies and operations in place, the rewards are there. We believe the opportunity for profit is significant for companies willing to adopt new strategies and tactics. But, with current business models and approaches, the opportunity is slipping away.

Despite using some leading practices from developed markets, many motor insurers in Asia continue to suffer losses. However, we have also seen a number of clear success stories, which combine to reveal a number of winning practices. While not disclosing any specific companies or work performed, our research and project experience has identified some recurring themes for what leading companies have in common.

In the **Leading practices** section, we explore these practices, as well as the 'no-through roads' that have blocked companies across the region and how to avoid them. This section reveals:

- How and why a local company dominates the **Indonesian** market
- How insurers in **India** have successfully reduced the claims processing time
- What companies in **Taiwan** have done to make inroads into a market that is widely regarded as over capitalised
- How a leading player in **Thailand** gets crucial help from its overseas joint venture partner
- How insurers in **Korea** are managing their poor loss experience
- Why domestic insurers in **China** have become more competitive

Finally, we summarize that with the right strategy and, crucially, the right resources committed to the right tasks, insurance companies can prosper in Asia's growth engine.


BLUE BIRD GROUP

The market

Size of the prize

The size of the prize for ‘getting it right’ in motor insurance in Asia is enormous and it is getting bigger. A successful top three player in each of our sample markets could achieve substantial profits regionally.

China

Population: 1.3 billion

Insurance penetration: 1.3%

Motor premium amount: USD$47b

Predicted growth: 12%

India

Population: 1.2 billion

Insurance penetration: 0.6%

Motor premium amount: USD$4b

Predicted growth: 19%

Scale

Motor dominates in **China** and **Thailand**, accounting for up to 70% of non-life premium. As expected, motor is less prominent in **Indonesia** (with just less than 30% of the non-life premium pool in 2010) due to the absence of Compulsory Third Party (CTP), but the situation would change quickly if CTP were introduced.

Thailand

Population: 64 million

Insurance penetration: 1.2%

Motor premium amount: USD$2.5b

Predicted growth: 9%

Growth

Positive growth is expected for all non-life markets in Asia over the next five years. Motor will be a big driver of this growth. **India**, **Indonesia** and **Vietnam** have particularly strong growth forecasts in excess of 15%. The main reasons being large and increasingly affluent populations combined with low insurance penetration and relatively immature economies.

Indonesia

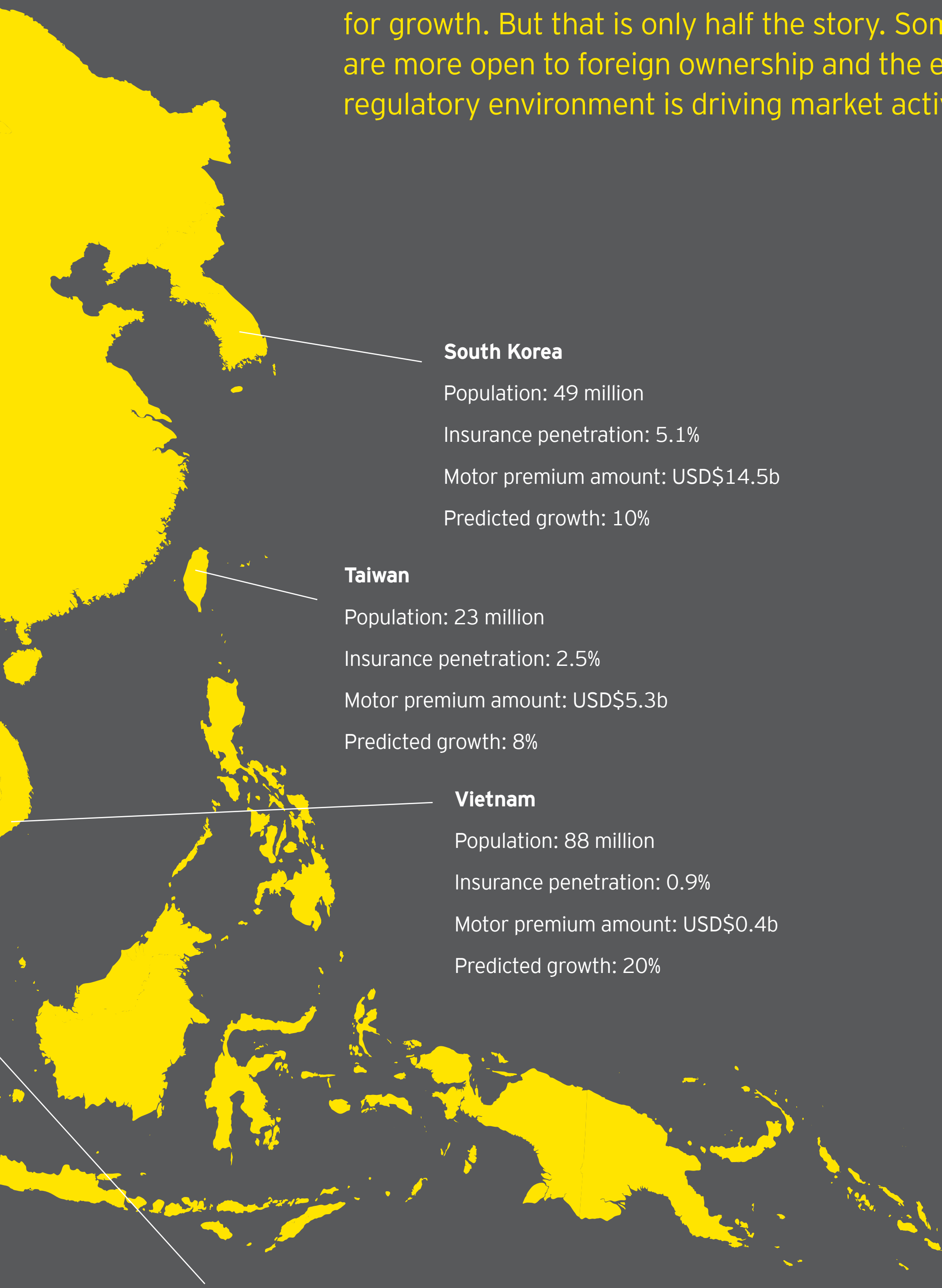
Population: 237 million

Insurance penetration: 0.5%

Motor premium amount: USD$1b

Predicted growth: 24%

Markets with rapidly growing economies and increasing insurance penetration are the most obvious candidates for growth. But that is only half the story. Some markets are more open to foreign ownership and the evolving regulatory environment is driving market activity.



Source: BMI via OneSource

Shifts: the insurance landscape is varied and evolving

Most markets have compulsory motor insurance in place, with varied restrictions on the way foreign insurers carry out their business.

Asia's motor insurance markets are relatively immature by Western standards, but they are developing quickly. Across the board, advanced solvency and reporting standards have been or are gradually being adopted. Diagram 1 indicates the current state of play across our eight featured markets. It's worth noting that, while Vietnam's non-life insurance market is still in its infancy, the government has prioritised its development as part of its plans for economic expansion. To this end, the insurance regulatory framework is being upgraded to bring it in line with international standards.

- **CTP** — All markets, except **Indonesia**, have introduced CTP. That said, **China** prohibits foreign insurers from writing CTP, although there have been increasing rumours of pending change.
- **Tariffs** — Statutory tariffs are commonly imposed on compulsory insurance due to its particularly sensitive nature. They prevent unsustainable price wars but often do not reflect claims costs and sometimes inhibit innovative pricing and product development. **Taiwan** and **Korea** are the only Asian markets to have 'de-tariffed' CTP, but political pressures often mean insurers still do not have complete pricing freedom.
- **Foreign ownership restrictions** — **China** remains the most challenging environment for foreign ownership, with overseas investors given geographically restricted licenses that have prohibited foreign insurers from moving into the motor market. In the past, markets such as **Vietnam**, **Thailand** and **Malaysia** also used to restrict foreign participation and ownership, but now entry barriers have been eased to some extent under World Trade Organization (WTO) entry rules. For example, foreign ownership in **Thailand** and **India** was previously restricted to 25% but this may increase to 49% subject to regulatory approval. Full liberalisation is expected by 2020 under WTO rules.
- **Risk-Based Capital (RBC) framework** — RBC requirements are gradually being introduced, shifting local market conditions. For example, introducing RBC requirements in **Malaysia** and **Indonesia** has resulted in market consolidation. The potential to unlocking market share in these markets will depend on how stringently these requirements are enforced against existing companies over entries by new companies.

Future market evolution

There are strong links between the regulatory developments shown in Diagram 1 and broader government policy issues. Looking beyond this snapshot, we can extrapolate from current trends to speculate about the next big market changes.

Certainly, the migration from tariffs to full risk based pricing typically correlates to market profitability and stability. Thus, as regulators look ahead to risk based capital and foreign entrants we often see a period of focus on these factors and a move towards partial de-tariffing of CTP.

We observe regulators balancing their desire to support local players by allowing domestic consolidation with the recognition that enhancing foreign investment can accelerate the market's development and capital base.

Diagram 1: Market snapshot

Markets	CTP	Tariffs	Foreign ownership restrictions	RBC
China	✓	✓	High	✗
India	✓	✓	Medium*	✗
Indonesia	✗	Not applicable	Low	✓
Korea	✓	✗	Low	✓
Malaysia	✓	✓	Medium	✓
Taiwan	✓	✗	Low	✓
Thailand	✓	✓	Medium	✓
Vietnam	✓	✓	Medium	✗

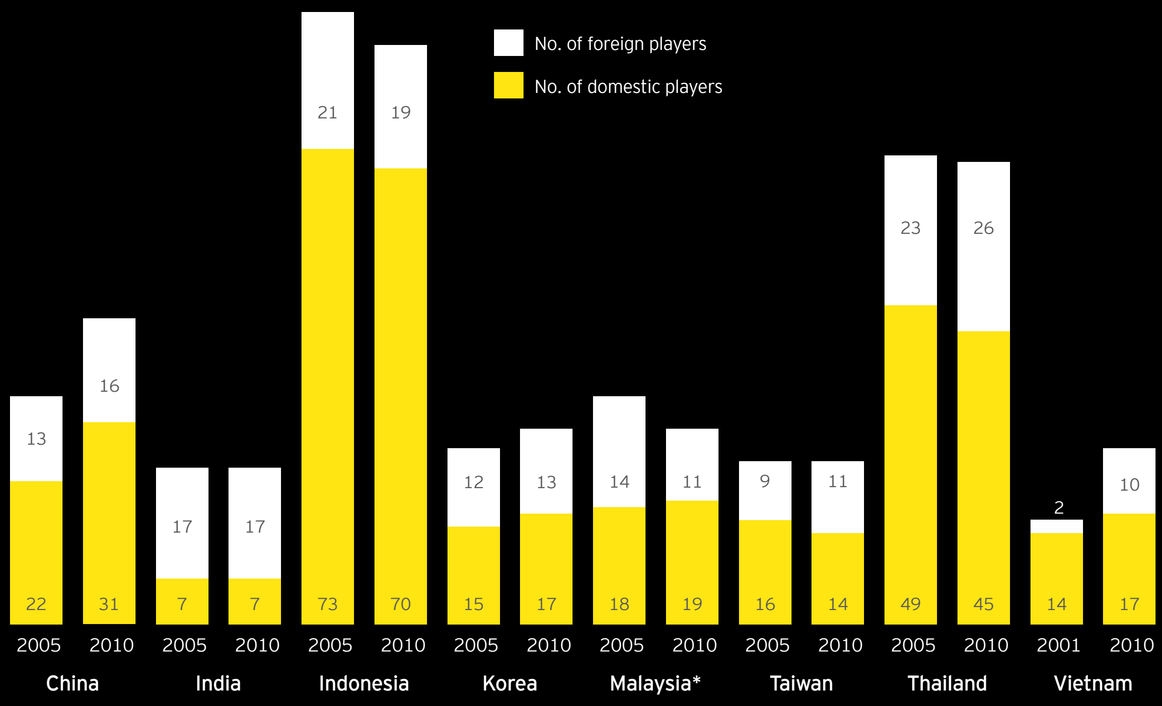
Foreign ownership restrictions key:

Low = Foreign ownership permitted since at least 2006
Medium = Foreign ownership recently permitted or restrictions eased
High = Foreign ownership restrictions currently in place severely impede ability of foreign multinationals to write motor business

* Foreign ownership is currently restricted to 26% but this may increase to 49% subject to the passing of the *Insurance Amendment Bill*.

Source: Ernst & Young

Diagram 2: Number of non-life insurers in 2005 and 2010



* Does not include Takaful insurers

Source: Ernst & Young

Table 1 displays the number of domestic and foreign[3] non-life insurers in 2005 (except **Vietnam**: 2001) and 2010 for markets in Asia, and the non-life market share of the top five. There are some interesting features to note:

- The number of foreign insurers has generally increased over the last five years, although some exits have been observed (for example, two large multinationals exited the **Malaysian** and **Vietnamese** markets)
- The **Indonesian** and **Thai** markets are particularly fragmented, but some consolidation has occurred over the past five years
- The number of players in **China** and **Vietnam** has increased dramatically. **Vietnam** now has 70% more non-life insurers than 10 years ago

3 A ‘foreign insurer’ is defined as a subsidiary or branch of a foreign incorporated insurer. In some markets, such as Thailand where majority foreign ownership is prohibited, a ‘foreign insurer’ constitutes significant involvement by a foreign company. However, definitions have been kept consistent over the years for each market (no data available for Vietnam in 2005).

Table 1: Market share of top 5 non-life insurers

Markets	Top 5 insurers Market share 2005	Top 5 insurers Market share 2010
China	86%	75%
India	86%	68%
Indonesia	48%	52%
Malaysia	51%	43%
Taiwan	56%	61%
Thailand	43%	48%

- For non-life insurance as a whole, the top 5 have lost market share in **China**, **India** and **Malaysia** but have strengthened in **Indonesia**, **Taiwan** and **Thailand**
- **China** and **India** are moving out of a period where the market was dominated by a handful of very large local insurers

Note: Information on top 5 insurers is not available for all markets. Statistics shown include all classes of non-life insurance.

Most insurance markets in Asia have been traditionally dominated by local players, often linked to important families or state owned entities. However, foreign and private insurers have rapidly penetrated the market with innovative product offerings, new business models, competitive prices, greater operational efficiency and stronger capital positions — as well as international experience.

Indeed, these attributes are often the catalyst for local owners to enter joint ventures (JVs) with foreign participants. For example, in **India**, where state insurers were previously the sole providers, JVs such as ICICI Lombard and Tata AIG have quickly gained ground. This has caused the non-life market share of state insurers to fall from 81% in 2005 to 59% in 2010.

China is intriguing. Despite an increase in competition, market share is still tightly controlled by the top five insurers. Foreign participation remains restricted, both in geographies and particularly in compulsory classes of business. At present, foreign insurers contribute less than 2% of total non-life GWP. In addition, the regulator grapples with the need to monitor distribution practices (including innovations such as outbound call centres, bancassurance and e-business) while maintaining market stability. However, we expect foreign insurers will be allowed to participate in motor CTP in the near term, which will act as a catalyst to further distribution changes and innovation.

Taiwan and **Korea** have mature economies, modest populations, and a sizeable non-life insurance industry. Thus, growth has been slower and sometimes stagnant compared to other markets in Asia, but the evolution and challenges of their markets hold valuable lessons. Indeed, both markets could easily be called 'Emerged Asia'. That said, while local players dominate market share, there may be further room for greater foreign presence through competition and M&A activity.

In **Taiwan**, where the market is widely believed to be over capitalised, GWP growth has been stagnant and the profit margins of many players are being squeezed by intense competition. As a result some past entrants have bought into the market, as evidenced by the purchase of Ming Tai and Central Insurance Company by MSIG and AIG respectively.

In **Korea**, some foreign insurers have gained significant market presence recently by acquiring smaller local players. They are also targeting non-traditional distribution channels, such as the internet, which has gained market presence.

Across the region, M&A activity is starting to intensify in many non-life insurance markets. Whether it will accelerate depends on regulators' appetite for applying the new RBC rules to existing insurers. If these rules are applied consistently, we expect M&A to speed up as small existing players may become technically insolvent. Yet the question remains whether regulators will favour consolidation over new entrants. In our opinion, the emergence of active M&A environment is likely to be slower than expected.

In China, we anticipate that foreign insurers will be allowed to participate in motor CTP in the near term, driving further distribution changes and innovation.

Considerations: regulation is increasing

Regulatory change in Asia is both a risk and an opportunity for insurers, who need to understand what regulators are trying to achieve and which regulations will receive most emphasis. Overall, there is still more room for deregulation in product innovation, pricing freedom and the use of distribution networks across the region. On the plus side, strengthening of regulation continues to occur in areas such as solvency, risk management, reporting and disclosure.

Capital

The European Solvency II system is often seen as the benchmark, and while it will not be adopted across Asia, it is already influencing improved Enterprise Risk Management (ERM) practices.

For example, in **Indonesia**, the most recent wave of enhanced capital requirements is already in place, with further developments expected in the next three years. This will be a challenge for a number of insurers who are facing under capitalisation issues. Market observers believe that up to up to a third of non-life insurers may struggle to meet the new requirements.

Vietnam has some way to go before catching its Asian peers in terms of its insurance regulatory framework. However, plans are now in place to meet international standards and WTO commitments. **Vietnam's** financial system is much stronger following its development under the Asian Development Bank's sponsorship, with the final phase of this program starting in 2008. The following year, following full market liberalisation, several foreign insurers entered **Vietnam**. In our view, these developments have set a strong foundation for future industry growth.

Distribution

In some markets, regulation directly affects the distribution of motor insurance. Agents and car dealerships, traditionally the main distribution channel for motor insurance in Asia, are being subjected to stricter governance and certification requirements in most markets. A similar situation also applies to brokers.

Some regulators in Asia have restricted commission levels to improve profitability in a highly competitive marketplace. For example, acquisition costs in **Indonesia** are limited to 25%. In **Thailand**, commission rates must not exceed 12% and 18% for CTP and voluntary (i.e. own damage) insurance respectively.

This has caused some insurers to attract intermediaries through informal incentives, while others are exploring alternative distribution channels, such as the internet. In **Korea**, bancassurance was proposed as a distribution channel for motor insurance, but implementation has been delayed due to strong opposition from insurers and intermediaries, who have argued that motor insurance products are complex and require more experienced sales personnel to distribute them properly.

In contrast, **Indonesia's** insurance regulator is encouraging insurers to take advantage of bank distribution networks. As a result, a few motor insurers have successfully gained market share through bancassurance arrangements.

Broadly, we see regulation in distribution as a positive, improving market discipline and profitability. However, the challenge is that often this can require insurers to change distribution channel emphasis or distribution practices.

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Compulsory Third Party Insurance (CTP)

Most markets have statutory tariffs for CTP. Coverage and benefit limits are also tightly controlled across the region and have a major impact on insurers. Tariffs often do not reflect actual claims costs and necessarily involve an element of cross subsidy.

Malaysia has particular problems, as tariffs have not been adjusted for decades and numerous insurers have been incurring substantial CTP losses. The situation is so serious that some people, such as those with older vehicles, have difficulty obtaining CTP coverage, requiring a pool to be set up as the 'insurer of last resort'. However, this situation is expected to improve with phased premium adjustments and the abolition of statutory tariffs by 2016.

Taiwan faces a different situation. Despite the absence of statutory tariffs, insurers need to 'file and use' policy wordings and premium rates. Many insurers find this to be extremely onerous, with some submitting daily regulatory returns as they continuously adjust their premiums in a highly competitive market.

CTP evasion is widespread across Asia despite various measures and penalties in place. For example, estimates indicate that less than 70% and 50% of cars have CTP insurance in **Vietnam** and **China** respectively. And the problem is worse for motorcycles. Consequently, most regulators have forced motor insurers to contribute to pools that fund claims arising from uninsured drivers, adding to the cost of operations and, to an extent, creating a disincentive to grow.

Indonesia is the only market in our group without CTP. Given the market has over 11 million registered passenger cars and many more times motorcycles, huge market opportunities are waiting. But lessons learnt from CTP in other markets mean that insurers need to be wary if and when CTP is implemented.

Importantly, we are seeing emerging regulatory interventions affecting profits in both CTP and voluntary motor business across the region. For example, following increases to compulsory coverage announced at the start of 2010, the 2011 loss ratio of voluntary motor insurance in **Thailand** is also expected to rise. The Office of Insurance Commission has announced the minimum death and disability coverage has been increased by 200% (from Baht 100,000 to Baht 300,000) starting from 1 July 2011.

Takaful

In **Malaysia** and Indonesia, the market composition differs due to the presence of takaful insurance.

In **Malaysia**, takaful policies made up around 10% of non-life GWP in 2009. Takaful insurance is still relatively uncommon in other markets due to the difficulties in achieving takaful principles in a regulatory environment geared to conventional insurance. However, we believe it will quickly gain prominence among the world's estimated 1.5 billion Muslims, 60% of whom are in Asia.

Evasion of CTP is widespread across Asia, despite various measures and penalties in place.

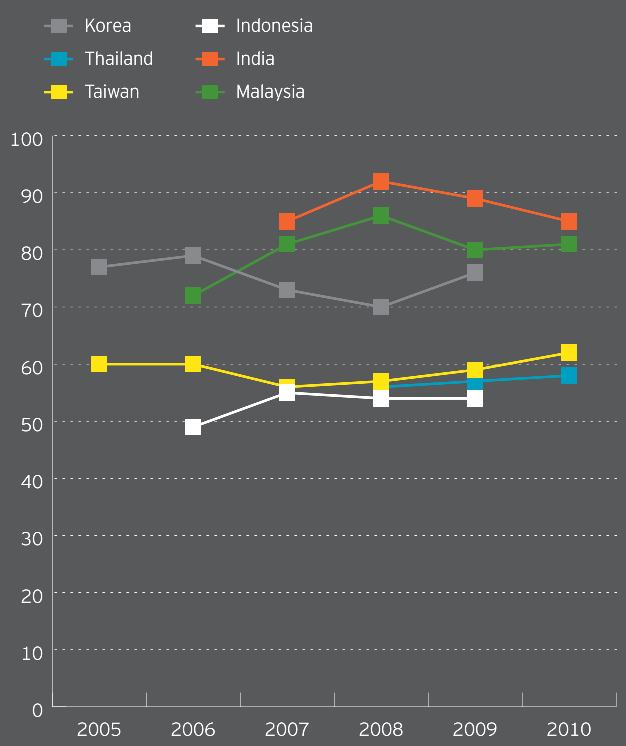
Profitability: a challenge for the average insurer

Average loss ratios tend to be high, but do not be misguided by the averages. Our project experience across the region has given us clear insights into some of the success stories. The leading insurers focus on the things that make a difference in their markets — and their results are better than average.

Diagram 3: Motor loss ratios in emerging Asia

Gross paid loss ratios

Net incurred loss ratios



Source: Ernst & Young analysis of various regulatory and market reports

Diagram 3 displays motor insurance loss ratios for each of our sample markets over the last four to six years, where data is available[4]. Despite the immense interest in motor insurance, not all insurers have managed to make satisfactory underwriting profits in Asia. As explained on page 19, a number of unfavourable factors have led to poor experiences particularly in **India**, **Malaysia** and **Korea**. However, some insurers have managed to exploit opportunities to their advantage.

Incurred loss ratio data is not available in **China** and **Vietnam**. Paid loss ratios appear to vary between 50%-60%, but it is difficult to draw any firm conclusions on profitability given the rapid growth rates and presentation of data in these markets. The loss ratios shown (for all except **China** and **Vietnam**) are on a net incurred basis. Overall profitability of these markets is also impacted by expense bases of the insurer. As we explore in the rest of this paper, these individual insurer's expense bases can vary significantly depending on, inter alia, availability of fit-for-purpose IT systems.

4 2010 data is not available for Indonesia, Vietnam and China. 2009 data is also not available for China. Loss ratios are available on a net incurred basis except for China and Vietnam (gross paid basis) and hence we show two separate graphs above.

Liability claims: local and global perspectives

Asian societies are typically not litigious, which yields fewer problems in CTP, such as rising court awards and long tail claims development, which are common in developed markets. The UK market, for example, has experienced significant increases in liability claims since 2007, plunging most insurers' motor portfolios into losses. However, as Asian societies become more affluent and knowledgeable of their rights, trends may imitate those of Western markets — notably of Commonwealth markets where the legal basis of many policies is similar to that in the UK. The general levels of awards in most Asian markets are low at present, but already show rising trends.

Table 2: Common challenges and impacts

Issue	Examples and challenges
Loss experience for private motor insurers by GWP	‣ There are examples of insurers who have leading edge practices or natural advantages in some or all of the areas explored in the rest of this paper. These insurers consistently 'beat the averages, for example, we would expect the better performing insurers in Indonesia to achieve loss ratios up to 10 percent lower than the average shown in Diagram 3.
Inflexible pricing	‣ CTP premium rates are regulated in most markets and do not always reflect underlying claims costs ‣ CTP loss ratios in **Malaysia** have exceeded 200% consecutively in recent years, while loss ratios for voluntary insurance averaged a much lower 60%
Fraud	‣ In **Taiwan**, repairers are known to offer customers 'free' repairs and services, such as re-painting. Costs are recouped from insurers with 'unknown causes' specified on claim forms ‣ Insurers in **Thailand** have attempted to improve anti-fraud systems and controls, but fraud is still extremely prevalent ‣ Even in technologically advanced **Korea**, losses from fraudulent motor claims amounted to approximately US$150 million in 2009, making up 70% of fraudulent claims in the insurance industry
Accident rates	‣ Accident rates in Asia are often high due to traffic congestion and a lack of traffic safety awareness ‣ The number of passenger cars in **China** has been increasing at 25% annually, causing roads to be overcrowded ‣ In some major cities accident frequency has approached 100% ‣ **Malaysia** has one of the highest vehicle theft rates globally ‣ It is fair to say that many markets in Asia are trying hard to improve frequency of claims through better roads, training and enforcements

Note: We have only shown markets where meaningful publically data is available.

Leading practices

The secrets of success

From our experience we observe that the insurers who excel in Asia do not have universally world class approaches in strategy, pricing, distribution, claims management and IT systems. However, none of them rate less than 'satisfactory' for any of these areas. To perform well, or even to be one of the 'best of the rest', many insurers will have to overhaul their operations.

Meaningful roadmaps for profitability and growth in Asian motor insurance look beyond the basics. They uncover local leading practices, review global leading practices and align the right resources to the right tasks. Most companies know they need to improve, but those performing well have already started and, by doing so, have gained a significant head start.

Distribution

The maturity of distribution models differs hugely across Asia. The best companies are embracing new distribution channels and building brand to reach out directly, or via banks, to consumers. In the future, we expect consumers will increasingly purchase insurance direct, rather than through dealers and agents. This evolution will happen more quickly than elsewhere in the world.

Today, motor insurance in Asia is predominantly distributed through brokers, agents and car dealerships. Yet, insurers rarely have sufficient detail on the relative profitability of the distribution platforms that they use. They fail to realise that a good distribution strategy is not just about getting the right volume of business, it is also about getting the right kind of business from the right places.

Indonesia is a case in point. Most Indonesians, do not see the need for insurance. Insurance is 'sold' rather than 'bought'; for example, when vehicles are purchased with finance and the lender imposes comprehensive motor insurance as a condition. This has caused motor insurers to focus their distribution efforts on building relationships with dealerships and lenders, such as banks and finance companies. It explains why a local insurer with conglomerate links to major dealerships, such as Toyota and Isuzu, holds a dominant place in **Indonesia's** motor insurance industry. Similarly, another prominent local insurer leverages its sister company, which is a major player in the vehicle finance market.

Yet dealerships, agents and brokers across Asia will need to work hard to stay relevant as direct distribution grows in prominence across the region. In our view, the growth of bancassurance is a precursor to this and a strong indicator of the likely shape of the evolving market. In future, a customer requiring motor insurance to take out a loan will have more options in the market, including banks and via the internet.

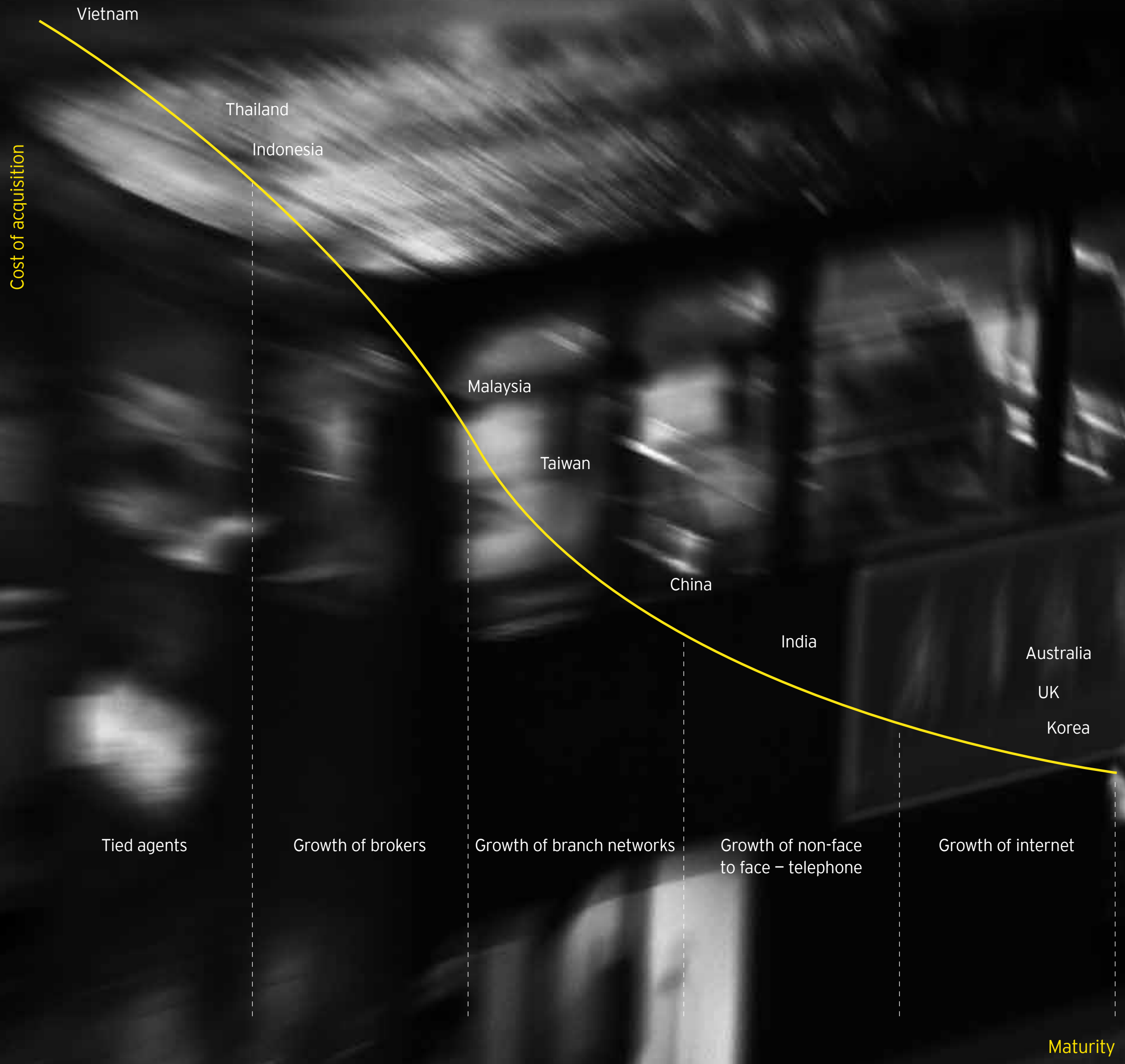
As direct distribution gains prominence, we expect the migration of distribution methods to happen more quickly in Asia than we saw in the rest of the world. Diagram 4 displays our subjective view of the maturity of the distribution of motor insurance in Asia compared to the **UK** and **Australia**. Mature markets tend to place emphasis on direct methods, such as the internet, while most Asian markets (with the notable exception of **Korea**) are currently heavily intermediary-based.

By way of contrast, Direct Line entered the **UK** motor insurance market in the early 1990s at a time of broker domination. It quickly achieved significant market share by selling direct to the consumer. More recently, price comparison websites have gained prominence, with approximately 42% of the **UK's** motor business placed through aggregators in 2009 — and approximately 25% of business placed direct with the insurer. The whole evolutionary process took more than 15 years.

Whereas, in **Korea**, a similar evolution took between 6-10 years and we expect other Asian markets to move even faster. Different markets will favour different distribution models, depending on a number of factors. However, Asia's early adopter status for internet and mobile technologies suggests most markets will move towards a direct model.

A sound understanding of 'how things work' in each market is a prerequisite for achieving a good distribution model.

Diagram 4: Distribution evolution in non-life insurance markets in emerging Asia and other sample markets



Commentary

- Predominantly tied agents and company employees selling direct to businesses and customers
- Development of MGA (Managing General Agent) style models for delegated underwriting in different geographic regions

- Development of brokers selling business from multiple underwriters
- Mostly commercial lines although personal lines growing driven by motor
- Relationship and advice remain key drivers of buying experience

- Tied agents move into branch locations and become more 'retail' focused
- Rapid increase in wealth and assets of individuals
- Brand building starts to replace relationship and advice
- Direct insurance sales through branches become predominant

- Brand, reputation, price and customer service become significant drivers for purchase decision
- Convenience becomes a major driver for customers
- Non-face to face direct sales start to grow

- Non-face to face sales dominate
- Internet channel emerges for international quotes and comparison
- Internet channels start to grow for new business and renewals

Source: Ernst & Young

Internet

Internet selling (e-business) is becoming an important distribution channel in motor insurance due to the rise of internet use across Asia. This channel has potential to reduce distribution costs, which can be passed on to customers as lower premiums. We therefore expect this distribution channel to grow significantly in the future. Already, a foreign insurer has just started to distribute motor insurance over the internet in **Thailand**.

Early lessons are available from **Korea**, which has one of the most IT savvy populations in the world, with an internet penetration of over 80%. This has turned e-business into an important distribution channel for **Korea's** insurers, accounting for over 20% of motor GWP in 2010. A few foreign players established a niche in this space in 2005 and a local top insurer belatedly entered the online market in 2009. However, not all insurers have benefited. Initially, profits slumped as consumers were able to easily compare premiums, resulting in much greater competition. Successful players have managed to find profitability by competing and differentiating on factors other than price, such as improving customer experience and strengthening brand.

However, **Korea** is unusual across the region, where e-business is in its infancy when it comes to distributing insurance.

In **China** where, despite the huge local internet population, many large insurers have found motor insurance e-business to be difficult due to technical problems linking to government databases, which hold accident history and insured values. Others have been unable to obtain regulatory permission for e-business. However, e-business is popular for other products, such as travel and personal accident, and there are signs that things are changing, with a local insurer recently starting to distribute online.

Similarly, in technologically advanced **Taiwan**, e-business for motor insurance particularly is still relatively unpopular, mainly due to widespread fear of lack of security and traditional reliance on agents. This is compounded by existing practices, which mean that, in many cases, insurance is bundled with a new car purchase and essentially considered 'free', resulting in limited customer interaction to sell alternative offers.

Again, despite the absence of regulatory constraints. However, a foreign multinational insurer has recently been the first to offer motor insurance online.

Call centres

Call centres are increasingly common sources of direct interaction with customers in markets that are heavily influenced by agents and dealerships. In **China**, one large insurer opened an outbound call centre in Pudong Shanghai with significant success, eliminating much of the 15% commission charged by agents.

Bancassurance

Bancassurance is also becoming an effective distribution channel for non-life insurance, despite contributing less than 5% of total GWP across Asia. With their wide branch networks and large customer databases, banks are able to reach out to more customers. They also typically have a better brand image than insurers.

For example, in **India** motor is the top non-life product sold through banks. Yet, this contrasts with **Thailand**, where bank staff often find it difficult to explain motor products to customers — compared to simpler products, such as personal accident. However, as banks capture and use more customer data, we expect this channel to become a more important distribution model across the region. Some of the insurers are already affiliated with banks. Those who aspire to be the 'best of the rest' will need to follow quickly.

Bancassurance is also becoming an effective distribution channel for non-life insurance despite contributing less than 5% of total GWP across Asia.

Despite innovative distribution methods seen elsewhere, in **Thailand** over 90% of motor insurance is still sold through agents. A top local insurer maintains a large force of agents who can reach out to rural and suburban areas inaccessible to newer technology-led methods, such as the internet. Another large local insurer imposes rigorous selection and certification criteria on its agents, thereby minimising credit control problems. Interestingly, some companies in **Thailand** have started to experiment with iPhone apps as a medium to distribute insurance products. In our view, this should be seen as a pilot with a 'metro' Bangkok segment focus.

In **Malaysia**, the government has been encouraging insurers to diversify distribution methods to include internet and telemarketing, but intermediaries have been opposing the change, with some success. In addition, some insurers are focusing on outbound call centres, aiming to eliminate the level of commission charged by agents, which averages 15%.

While e-business, bancassurance and telemarketing 'pros' and 'cons' can vary across the region, the writing is on the wall. Forward thinking companies have already developed plans for direct selling, which will be critical for success as markets mature. We expect this maturity to be fast tracked by the internet and insurers implementing the lessons learnt from developed markets over the last 20 years. To perform well or even the 'best of the rest', efficient and direct access to the markets will be crucial within the next five years.

As direct distribution gains prominence, we expect distribution methods to diversify more quickly in Asia than in the rest of the world.

Pricing and products

Insurers are in a race for good data from which to price risks appropriately, with the leading insurers moving away from simple rating factors related only to the sum insured. The ‘winners’ offer consumers clear coverage choices and have a good view of the ‘technical’ compared to the ‘commercial’ price.

Most regulators across Asia have placed various restrictions on policy coverage and premium rates, particularly for CTP. This makes appropriate product design and pricing crucial to both sales and profitability.

In markets that allow competitive pricing, such as **Indonesia**, many volume-focused insurers have been suffering losses after charging inadequate premiums. In this environment, one innovative top tier local insurer has prospered by offering customers the option of flexible risk sharing, thereby attracting price sensitive customers without having to bear too much risk.

Pricing innovations are also evident in Thailand, where rating factors and relativities are specified for both CTP and voluntary insurance. Here, some foreign multinational players have offered discounts for certain occupations in a bid to attract better quality risks. Others provide discounts for insuring multiple cars, in recognition of lower administration costs.

In addition to segmenting their prices, many insurers are revising their products to include a wide range of attractive benefits. A multinational operating in **Indonesia** has recently packaged extended warranty with motor insurance, while a large locally based insurer covers vehicle registration fees for customers. Many other insurers have offered benefits in terms of claims handling services — as further discussed in the following section.

We have observed some insurers gaining profitable growth in parts of Asia moving beyond rating business based solely on the car that is being driven and locality. Rating factors relating to driver characteristics (e.g. occupation, age, gender) and mileage are becoming increasingly common. We are even seeing some insurers investigate relatively new mature market technologies such as Pay-As-You-Go insurance.

Given the importance of customer choice, allowing consumers to vary deductibles and change price is surprisingly uncommon in Asia. Not surprisingly, those companies that offer these choices are often more profitable potentially because offering this level of sophistication often comes with a more granular rating structure or due to the reduction of small claims that comes with an increase in deductible.

The importance of data

In **Korea**, the market is highly advanced, with industry bodies playing a major role in aiding sound pricing. For example, the Korean Insurance Development Institute provides detailed statistical data, as well as recommended pure premium rates and relativities. A database of vehicle values and repair costs is also maintained, serving as a guide to sound pricing. In addition, most of the local insurers have their own detailed statistical data.

The significance of this information to the **Korean** insurance market demonstrates why it is so important to capture, verify and use both internal and external data. Companies that do not will be left behind. Currently, we regularly see insurers failing to leverage the external data available.

While there are practical ways to segment portfolios, only data can help to do this. For example, data will allow insurers to identify localities that attract poor risks or poor loss experiences, enabling them to make better decisions about where to open branches or position reps.

There are no new ideas, just a deeper understanding of how best to apply them.

Claims management

Companies that are performing well actively enhance their brand through the claims process. They usually have automated systems for spotting fraudulent claims and have strong relationships with repair shops and roadside assistance providers.

Yet, due to poor systems or inefficient processes, many insurers across Asia are simply not ready for the growth in claims that comes with premium growth. They need to understand the importance of the claims process, which is often the only opportunity for insurers to interact directly with consumers, offering an untapped opportunity to really differentiate on customer experience.

Diagram 5 evaluates our sample Asian markets based on their maturity in claims and IT processes, with **Korea** arguably the most advanced. In the face of high loss ratios in recent years, insurers are placing increasing importance on improving systems and optimising repairs to reduce inefficiencies in the claims process; although, this varies in sophistication across the region.

At one end of the spectrum, the Korean Automobile Insurance Repair Research and Training Centre, which focuses on improving repair procedures and claims estimation and computerising claims handling, shares its results with the rest of the industry. At the other, **Vietnamese** insurers show very little sophistication in claims management and IT; although, this situation may improve with the entry of foreign players and JVs, bringing insights and experience from mature markets.

In **Thailand**, many insurers have sought to form alliances with repair shops to control claims costs. One leading local player has provided certification to over 400 repair shops based on their cost and quality of repairs, at the same time using them as part of a marketing campaign. Meanwhile, a market leader in **Indonesia** has taken a different approach, leveraging its links with vehicle manufacturers to cost effectively provide high quality, guaranteed repairs.

Insurers are also increasingly taking advantage of systems to shorten the claims process. A local large **Indonesian** insurer has installed CCTVs in affiliated repair shops to allow faster damage surveys and hence faster repair approvals. In **India**, most insurers have tied up with automobile manufacturers, as well as repair shops, allowing them to bill the insurer directly so customers do not have to settle repair costs first.

Products that provide a wide range of claims related services, such as 24 hour roadside assistance and call centres, are becoming increasingly attractive. Even in **Indonesia**, where people are reluctant to take out motor insurance, customers who are forced to, tend to choose a more expensive, higher range product that provides comprehensive services. One large local insurer has enjoyed high volume and profitability as it is able to provide these services cost effectively through economies of scale. In **India**, a number of insurers are linking up with after sales service providers, creating a significant network across the country to provide roadside assistance at minimal cost.

An efficient claims process is vital to building brand image. A customer friendly claims process — ease of submission and progress tracking, minimal lead time, high quality repairs — is highly valued by customers as an accident or loss is usually associated with inconvenience and anxiety. Equally, a poor customer experience is brand destroying.

In **Malaysia**, there is currently no clear market leader in 'claims experience', with long claims settlement periods, usually between one to five years. However, now the regulator is looking at reducing this to between 6 to 18 months, insurers will have an incentive to create a better customer experience and build brand, drawing on insights and experience from mature markets.

The leading performing insurers have good relationships with repair shops, maximise use of IT systems, monitor customer feedback closely, set up challenging internal targets and KPIs and are developing claims leakage awareness to manage costs. But when customers experience poor claims handling, the brand is destroyed.

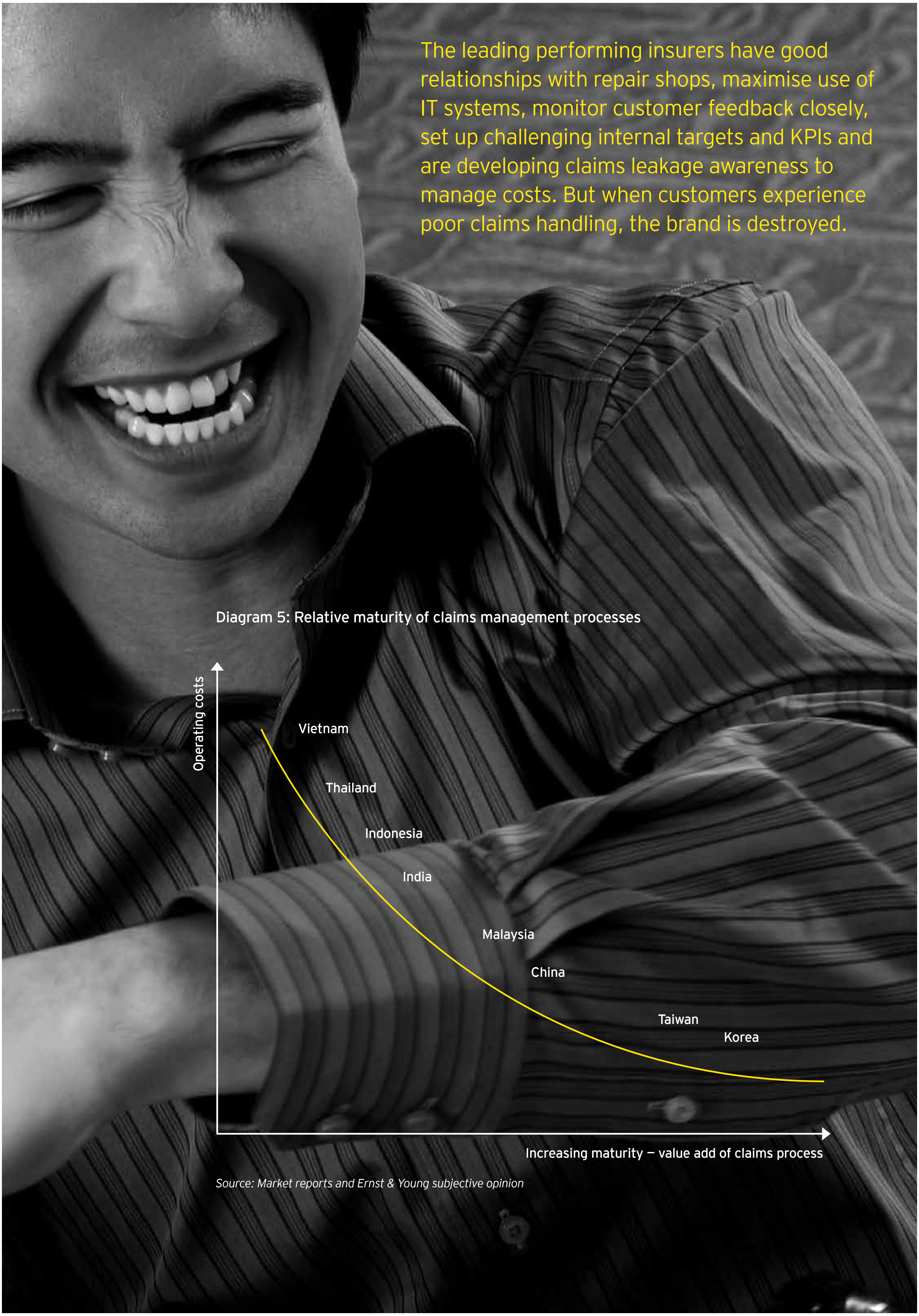


Diagram 5: Relative maturity of claims management processes

Source: Market reports and Ernst & Young subjective opinion

IT systems

IT inefficiencies often increase combined ratios to above acceptable levels. Regular manual interventions and an inability to embrace growing premium and claims volumes hold back all but the top tier motor insurers.

Motor insurance is a high volume, low unit risk business. Claims are fairly frequent compared to other lines of business, and customer interaction occurs regularly. Trends often emerge quickly and data is voluminous. All these factors combine to make an efficient IT system essential. This is why we have seen an increase in companies exploring hubs and centres of excellence to leverage IT platforms across a number of key market locations, particularly as many of their subsidiaries in each market lack the scale to justify such investment.

Centres of excellence offer cost and risk management benefits. Effective IT systems are crucial to building a customer base with reliable and useable data. For instance, insurers with good system capabilities are able to send out automated renewal notices at appropriate time intervals. Customers wishing to deal direct with insurers may do so through the internet. Relevant management divisions are able to view real time financial updates and take timely actions to capture market opportunities. The same applies to intermediaries and business partners, such as repair shops.

Those insurers who excel in distribution, pricing and claims management have integrated IT systems as the backbone of their operations. Leading companies use these systems to reduce manual interventions, driving down expenses and enhancing customer experience.

Similar to the speed of evolution in distribution, use of IT in claims management is also developing rapidly, with the use of SMS or texting updates already under active review.

A large **Indonesian** insurer, part of a diverse conglomerate group, has one of the lowest expense rates in the non-life insurance industry. Its systems integrate all operational aspects of its business and it is careful to recruit high quality, IT savvy staff. In **Thailand**, a local insurer has been able to implement efficient claims management systems with the help of a large foreign shareholder by leveraging lessons learnt from more developed markets.

While multinational insurers in Asia sometimes gain a comparative advantage over local insurers with regards to IT capabilities by applying systems proven elsewhere, not all have succeeded in seizing the advantage and managing their operations efficiently.

One key issue is that international systems are not necessarily suited to local operations. Careful systems implementation and training is needed to drive the advantage home.

This is also true of many second tier companies, which appear to have talented people and a great strategy, but are all too often hindered by systems issues. For example, actuarial and pricing outputs often need substantial manual manipulation before they can be used by finance departments. As well, there is often a poor understanding of systems that have been developed elsewhere.

In common with more developed markets, IT is often a challenge for management teams across Asia due to its complexity and cost, and the operational disruption associated with large scale change. However, we feel IT is becoming a 'must have' strategic enabler rather than merely a lever to drive cost efficiency.


Insurers with good systems are often related to a joint venture partner from a mature market, but we are also seeing increased investment by larger local players.

The finish line

Motor insurance in many markets in Asia can be profitable. The key is to get underneath market averages and excel in one or two of the differentiators. This will require investment, but the rewards are there.

Conclusion

At first glance, motor insurance across Asia does not always appear to be profitable, yet we are seeing some insurers consistently achieving both profitability and growth.

Their success depends on understanding the nuances of local market dynamics. Meaningful roadmaps for profitability and growth consider these nuances and look beyond the operational basics. They uncover local leading practices, review global leading practices and align the right resources to the right tasks at the right time.

Average losses in these markets can be high, but some insurers consistently perform better than the market — because they have leading edge practices in key operational areas, including:

- Accessing the markets — embracing new distribution trends
- Servicing the customer — creating a seamless claims experience for customers
- Managing costs — using IT and systems to manage costs
- Right product, right price — offering the right products at technically considered prices

We believe a well formulated strategy that balances all key operational areas explored in this paper underpins a 'winning' motor insurance operation. Companies need to make sure that key resources are working on the most important initiatives.

Most companies know that they 'need to improve', but leading insurers have already started, and by doing so, have gained a significant head start.

How Ernst & Young can help

With a global network of over 7,000 insurance professionals (1,200 across Asia), we provide our clients with a borderless approach, bringing global leading practice to our regional clients. Our people understand the insurance market dynamics, industry drivers and operational considerations, using our combined business advisory and technical knowledge to provide our clients with market leading insights and a global perspective.

Ernst & Young has advised a number of companies on strategies for their insurance and motor portfolio in Asia, with a focus on how they rate against local and international peers and the key tasks required to move their businesses forward. Our approach focuses on understanding the current state of the business in the context of competitors and market pressures.

You may be successful in these markets and wondering how to protect your investment. You may think you are performing below par, and want to validate that view with objective analysis that also suggests how to respond. You may need to weigh up your options for market entry — acquisition or greenfield?

We have deep knowledge of local markets, bolstered by experienced practices located across Asia-Pacific and complemented by data and insight from our other global insurance practices in Europe and the Americas. Our advice and analysis will support you to develop and execute a successful commercial strategy in the challenging, but high potential, motor insurance markets of Asia.

We believe a well formulated strategy that balances all key operational areas explored in this paper underpins a 'winning' motor insurance operation.

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Notes

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