WORLD INSURANCE REPORT 2008

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Spotlight on Developing Markets: India and China

INTRODUCTION

We receive many requests for perspective on the insurance sector in developing markets, so we decided to include China and India in the *2008 World Insurance Report*. However, these markets are fundamentally different in many respects from mature markets, so we have addressed them separately.

In this section, we summarize some of our key findings on each market. In analyzing customer behavior, we found certain similarities between the two markets: Both are very under-penetrated compared to mature markets, both are growing fast, and will continue to do so, and each country has a huge insurable base.

Beyond these general conditions, however, the markets are completely different—from their legal frameworks and market structures to the needs of their customers. The competitive landscapes are also dissimilar, presenting insurance companies with different issues as they look to establish or grow a presence in either market. Finally, the customers in each market display quite different perceptions of insurance, and behave quite differently when buying it—a reality that is critical for insurers to understand.

INDIA HIGHLIGHTS

- **Insurance reforms earlier this decade paved the way for private participation, fostering strong growth. However, the insurance sector still remains mostly under-penetrated.**
- **Life insurance is largely used as a means to improve finances, while non-life coverage is not considered a necessity.**
- **Since the ranks of the middle class are growing, and per capita income is rising, the insurance market could double in size in the next 5-to-6 years.**
- **Insurance companies are increasingly adopting a strategy of deploying multiple distribution networks to increase market penetration, and reach the masses not currently served.**
- **Customers fit into distinct segments: Up-market or modern, traditional, and rural and un-/semi-educated. These segments present an opportunity for insurers that can tailor their approach.**

REFORMS FUEL RAPID GROWTH IN THE INSURANCE SECTOR

India's Insurance Regulatory and Development Authority (IRDA) Act of 1999 ended the monopoly power previously held by the state-owned insurers—Life Insurance Corporation and General Insurance Corporation—and opened the life and non-life sectors to private competition. Since then, the industry has seen an increase in the number of new entrants, both domestic and foreign. Life insurance products are the most ubiquitous, with customers keen to tap the tax and income benefits they provide.

By any measure, India's insurance sector has been growing fast. For example:

- IRDA has so far issued 29 licenses (both life and non-life) to new private Indian insurance companies, most of which have global insurance companies as partners[12]. Foreign direct investment (FDI) in domestic insurers is currently capped at 26%, but the sector has still attracted more than $540 million of FDI in the last six years[13].
- Insurance penetration, measured as a ratio of gross premiums to the country's gross domestic product (GDP), rose from 2.3% in 2000 to 4.8% in 2006[14].
- Insurance density, which measures gross premiums per capita, shot up from $9.90, in 2000 to $38.40 in 2006[15].
- Gross written premiums (GWPs) reached $38.3 billion in 2006, after growing at a compound annual growth rate (CAGR) of 25.1% for 2002-06[16].
- GWPs in life insurance were $32.5 billion, equivalent to 84.9% of the market's overall value in 2006, while non-life GWPs totaled $5.8 billion. (P&C accounted for 91.9% of GWPs in 2006, while the accident and health segment generated the remainder[17]).

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[12] Insurance Regulatory and Development Authority, India

[13] 'Insurance sector attracted USD 543 mn FDI: Bansal', PTI, Sept. 21, 2007

[14 - 15] 'Insurance penetration has doubled in 6 yrs', The Hindu Business Line, Nov. 2, 2007

[16 - 17] 'India - Insurance - Market Overview', Datamonitor, Oct. 2007

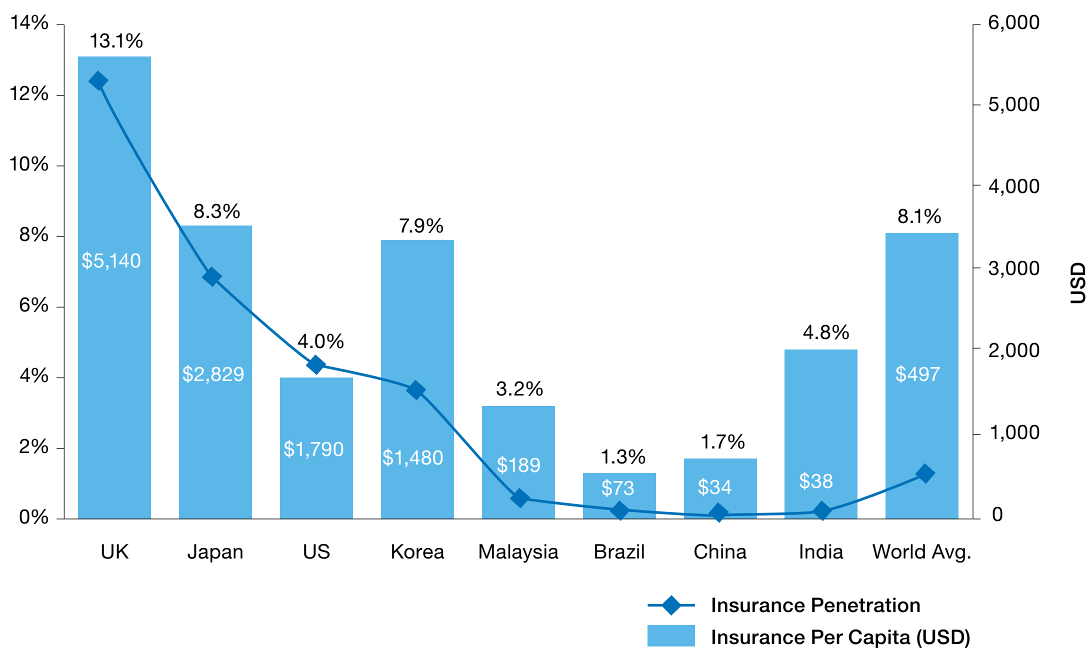
PENETRATION IS STILL WOEFULLY LOW

Despite recent growth, there is still tremendous untapped potential in the Indian insurance sector. India accounts for 16% of the world population, but accounted for only 1.68% of the world life insurance market in 2006[18]. India is also far behind world averages in terms of insurance penetration, and insurance density (see Figure S.1). A mere 20% of the insurable population aged 20 to 60 years is currently covered by life insurance[19].

Likewise, India's non-life GWPs account for just 3% of the Asia-Pacific market's total. By contrast, Japan generates as much as 50% of the region's non-life gross premiums written, while South Korea and China account for 14.5% and 13.1%, respectively[20].

Our survey also demonstrated India's low penetration levels: The average number of policies (life and non-life) held by an Indian consumer is just 1.33, compared with the average of 5.2 polices per client for mature markets.

Figure S.1 Life Insurance Penetration & Density in 2006 (by country)



Source: Life Insurance Council, India, 2006

[18 - 19] 'Life Insurance Industry – Present & Future', Life Insurance Council, Sep. 18, 2007

[20] 'India - Non-Life Insurance - Market Segmentation', Datamonitor, Sept. 2007

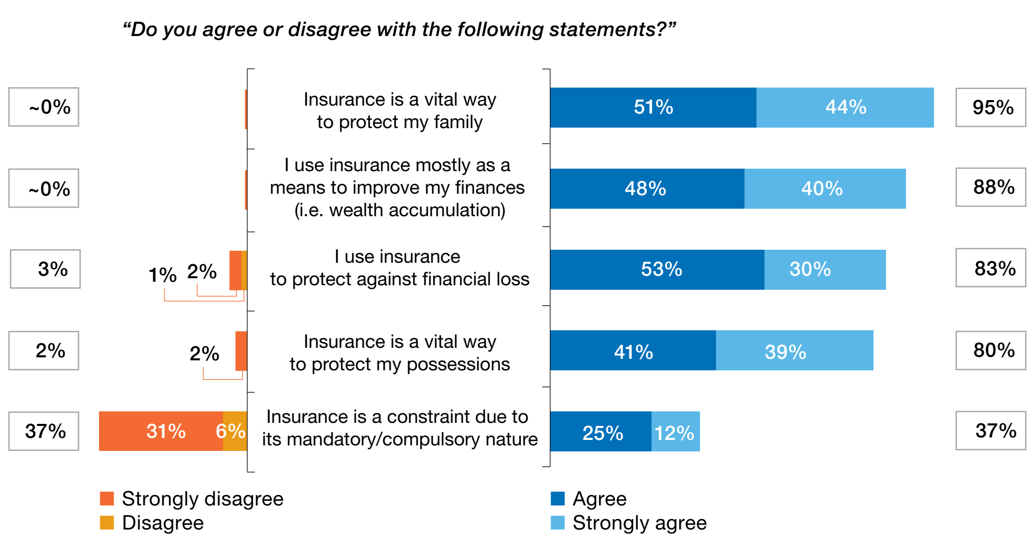
LIFE INSURANCE IS SEEN AS A WAY TO IMPROVE FINANCES; NON-LIFE COVERAGE IS NOT DEEMED NECESSARY

Life products are seen in India primarily as a means of improving financial health. India lacks any system of social security, and life insurance products offer tax benefits, and income protection. Endowment or whole-life policies provide good saving options, and are more popular in India than simple term-life plans that offer pure risk protection. More recently, soaring Indian equity markets have also fueled interest in unit-linked insurance plans (ULIPS), which combine insurance coverage and equity investments in a single policy. These hot products have even eclipsed interest in more traditional endowment, term and whole-life policies, and accounted for more than 80% of the premiums collected by the insurance industry in fiscal 2007[21]—further demonstrating the attitude among customers that life products are a means of accumulating wealth.

Our survey confirms customer perceptions about life products. Among respondents to our customer survey in India, 88% said they use insurance primarily as a means to improve personal finances, compared with 11% of respondents from mature markets, where insurance is seen first and foremost as a way to protect possessions and family.

Our survey also demonstrated the relative indifference that customers in India have toward non-life coverage. Notably, there are no real substitutes for non-life insurance products, but many consumers choose not to get coverage, anyway, doubting it is necessary. (The exception is motor insurance, which is required by law.) Customers, in describing their perceptions about insurance, focused first on its value in protecting family and finances, and accumulating wealth, and only then on the role of insurance in protecting possessions (see Figure S.2).

Figure S.2 Customer Perception of Insurance in India (%)



Source: Capgemini analysis, 2007.

[21] Business Standard, Oct. 22, 2007

GROWING INCOMES AND AFFLUENCE WILL FUEL THE DEMAND FOR INSURANCE

The insurance industry is likely to continue its growth streak, thanks to rising per capita incomes among the strong middle class, and spreading affluence. The burgeoning middle class currently forms 22% of the total population, and is estimated to reach 32% by 2010[22]. With the country's GDP growing at an average rate of 9-10% per annum, the disposable income of the booming middle class is expected to grow by 8.5% annually until 2015[23]. As a result, the appetite for insurance products is expected to increase, boosting overall penetration levels to around 6% of GDP by 2012 from the current 4.8%. This could drive GWPs in the Indian insurance industry up by a CAGR of around 13% to more than $80 billion in the next 5 years[24].

STRATEGY OF MULTIPLE DISTRIBUTION NETWORKS HELPS TO TARGET THE MASSES

Currently, the top priority for insurance companies is to acquire as many customers as possible in order to gain a leadership position as the market becomes even more competitive. Consequently, the issues that insurers in India face are very different from those in mature markets, where insurers are juggling multiple types of distribution networks to retain access to key customers, and to increase wallet share. More than integrating existing distribution networks, insurers in India are investing heavily in additional networks—from banking to telemarketing, the Internet, and direct sales—in order to reach underserved markets, and potentially reduce costs.

Tied agents will remain the dominant channel for most insurance companies in the next few years, largely because customers often need face-to-face interaction to help them buy complex insurance products. However, the banking channel is likely to grow in the future, at the cost of tied agents and independent financial advisors (IFAs), since—unlike mature markets—consumers in India want to purchase more of their insurance products through banks.

With the rise of convenience banking in India, most insurance companies have successfully tapped both commercial and cooperative banks to reach greater customer bases, and capitalize on higher cross-sell opportunities. Convenience banking bundles mundane retail financial products, such as credit cards, with convenience services that range from bill-paying to concierge services (e.g., arranging theater reservations). Convenience banking has, therefore, created high service levels and one-stop shopping options that customers have come to expect. To deliver on the convenience-banking proposition, and to exploit the opportunity, banks have for some time offered a wide range of financial products, including insurance.

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[22] 'Retail in India: Getting Organized to Drive Growth', CII, November 2006

[23] 'The Great Indian Retail Story', Ernst & Young, 2006

[24] As per Capgemini Analysis based on estimated GDP growth and penetration levels over the next five years

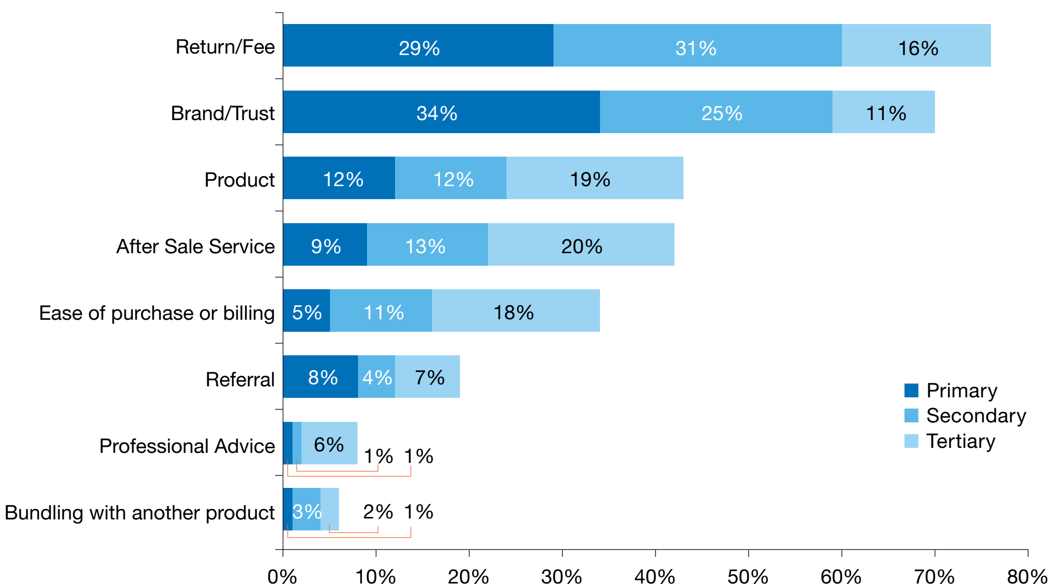
CUSTOMER SEGMENTATION IS KEY IN THE ACQUISITION RACE

Insurers can implement a successful distribution strategy by understanding the preferences and needs of existing target customer segments, and catering to the new segments that will emerge from the growing base of affluence and shifting demographics. In short, insurance companies will need to understand how to respond effectively to each segment's needs, and deliver more than price and products.

In general, customers in India value the brand name and trustworthiness of the service provider more than any other factor when purchasing an insurance product (see Figure S.3). This attitude has helped incumbent life insurer LIC protect much of its market share (it still accounts for 80% of premiums written[25]) even after 6 years of liberalization.

After brand, the most influential factor for customers in India is returns/fees—consistent with the perceptions of life insurance as a means of wealth accumulation, and non-life as an unnecessary expense. This peculiar way in which customers perceive insurance in India has led many private insurers to penetrate the market by offering innovative life products with higher returns (or lower prices in the case of non-life) along with protection cover.

Figure S.3 Factors Influencing Customers Purchasing Decisions in India (%)



Source: Capgemini analysis, 2007.

[25] 'Under-capitalisation ails insurance: S & P', Daily News & Analysis, Oct. 5, 2007

Notably, our survey shows there are some preferences and behavior that vary significantly by customer segment. We identified three broad customer types, roughly demarcated on the basis of economic and socio-cultural differences, which display distinct purchase behavior and distribution-network usage. Insurers can most effectively cater to these segments by tailoring their approach, and adopting distinct distribution strategies for each segment (see Figure S.4).

Figure S.4 Strategic Imperatives for Insurers in India (per customer segment)

Customer segment	Customer Profile	What Do Customers Value?	Customer Needs and Goals	Potential Value for Insurers	Preferred Distribution Networks	Strategic Imperative for Insurers
Up-market or "Modern"	▪ Affluent ▪ Knowledgeable ▪ Progressive ▪ High awareness levels	▪ Choice ▪ Convenience	▪ Wealth management and accumulation	▪ High – given the rising number of high-net-worth individuals (HNWIs) in the country, and their diverse financial needs	▪ Face-to-face (complex products) ▪ Internet, telemarketing, direct mail (simple products)	▪ Develop a separate distribution network for high-net-worth individuals and mass affluent ▪ Maybe partner with wealth managers/ financial planners (One of the major private life insurance companies is reportedly contemplating this approach, and may set up a separate network to serve this segment with a tailored product offering) ▪ Make sure to provide self-service options
Traditional	▪ Long-time customers ▪ Middle class ▪ May be retired/ retiring	▪ Brand ▪ Value	▪ Tax benefits ▪ Income protection ▪ Retirement planning	▪ High – given the growing affluence of the burgeoning middle class in India	▪ Tied sales agents ▪ Direct sales	▪ Employ integrated multi-distribution model with distinct brand value propositions, e.g., retirement planning specialist network ▪ Use other networks for simple products ▪ Provide training on advisory capabilities to direct sales force, and tied agents ▪ Consolidate customer information for holistic view across networks
Rural and Un-/ Semi-educated Customers	▪ Low income ▪ Little exposure to insurance	▪ Indifferent to insurance	▪ Long-term savings (but income too low to require tax benefits or income protection)	▪ Low – segment is huge, and under-served, but incomes low, so costly to serve small-ticket coverage	▪ Regional Rural Banks (RRBs) ▪ Rural branches of commercial and co-operative banks ▪ Village panchayats (administrative bodies) ▪ Rural non-governmental organizations (NGOs)	▪ Partnerships with RRBs, commercial and cooperative banks with rural branches, Micro-Finance Institutions (MFIs), rural NGOs ▪ Develop separate product offerings, such as micro-insurance, and bundle those products with other similar savings products

Source: Capgemini analysis, 2007.

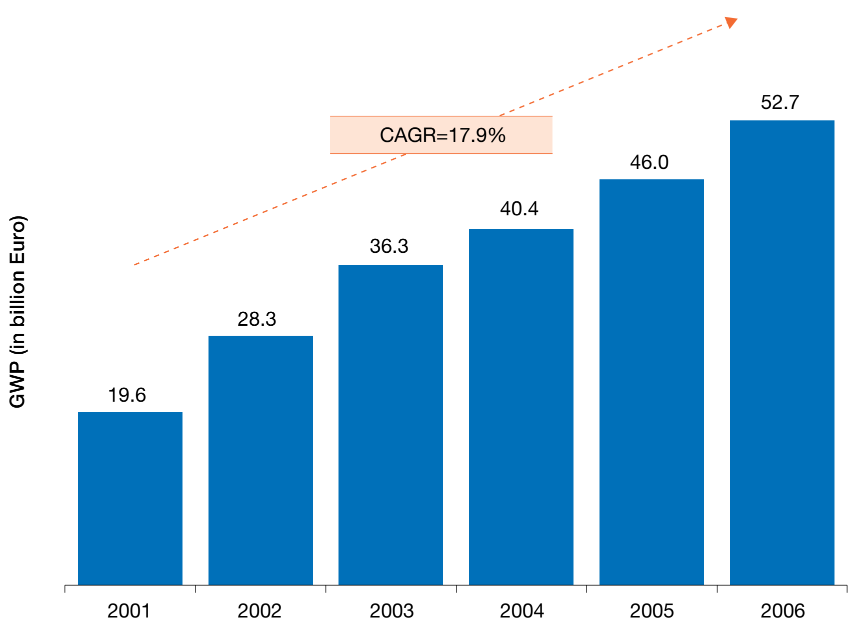
CHINA HIGHLIGHTS

- **China's insurance sector is restructuring, and growing fast, but the market is still consolidated in the hands of a few large players.**
- **Insurers still have much to do to gain customer awareness and trust; spending on insurance is minute, and few customers are aware of, or see merit in, insurance products.**
- **Physical distribution networks still dominate, and it may be efficient for foreign insurers to opt for a bancassurance model to leverage local bank branches, sales people, and call centers.**
- **Large insurers are likely to pursue an integrated financial services strategy to leverage scale and capabilities. Size will also be critical to improving brand recognition, expanding the breadth of service, and enhancing networking strategy.**

CHINA'S INSURANCE SECTOR IS RESTRUCTURING, AND GROWING FAST

China's insurance market enjoyed compound annual growth of 17.9% in 2001-06. In 2006, gross written premiums totaled €52.7 billion—€38.6 billion for life and €14.1 billion for non-life (see Figure S.5). However, the overall penetration rate is still far below the average of mature markets. Our survey shows that customer own an average of 1.4 policies—both life and non-life.

Figure S.5 Gross Written Premiums in China, 2001 to 2006



Source: CIRC statistics

China's insurance market was reopened in 1980 as part of financial reform efforts, and the People's Insurance Company of China (PICC) resumed its role as the state-owned insurance company after a break of nearly 50 years. Since then, the insurance sector has undergone a drastic transformation.

The 1995 Insurance Law split PICC into three business lines (life, property, and reinsurance)—a restructuring that was formalized in 1998, when the three lines became independent business entities. The Law, and the end of the PICC's monopoly, paved the way for greater market competition.

MARKET IS STILL CONSOLIDATED IN A FEW HANDS

Nevertheless, the top three players still hold more than 70% of the total market in both life and non-life insurance today. In life insurance, the top three are China Life Insurance (created from PICC), Ping An Insurance, and China Pacific Insurance Company (CPIC). Non-life features the same names, led by PICC, and followed by CPIC and Ping An[26]. The rest of the market is highly fragmented, shared among myriad smaller players, and the ranks are growing all the time.

In 1999, the China Insurance Regulatory Commission (CIRC) was established as the supervisory successor to the central People's Bank of China. According to the CIRC, which now issues insurance licenses, there were 98 insurance companies, and 2,110 licensed agencies, operating in China in 2006.

The CIRC has introduced numerous regulations aimed at opening up investment channels for insurers, and encouraging innovation in insurance sales and service. CIRC is also responsible for introducing regulations, such as compulsory third-party liability coverage for drivers, which have helped to stimulate non-life insurance sales. The regulatory body is also working on new legislation, but the new Insurance Law is not likely to pass before the end of 2007.

CIRC now grants insurance licenses to applicants that meet its capitalization and personnel requirements, and large Chinese enterprises are keen to set up their own insurance subsidiaries. For example, China Post and some of the major commercial banks have said they intend to set up insurance businesses, largely to pursue cross-selling opportunities. CIRC issued 50 new licenses from September to November 2007[27] to new players that are targeting less developed cities in mid- and western China, where there is less competition—and possibly greater market potential.

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[26] CIRC statistics, Capgemini analysis

[27] 'Small and medium insurers speed up expansion and CIRC issued 12 licenses in 2 days': Guangzhou Daily, Nov. 21, 2007

CIRC is also responsible for licensing and supervising foreign insurers. As of the end of September 2007, 42 foreign companies[28] were participating in insurance joint ventures (JVs), including many large international insurers, such as Allianz, AXA and Generali.

These leading global players found the JV opportunity attractive, even though their share was capped at 50% by Chinese regulators. In many cases, foreign partners bring capabilities to these ventures, while the Chinese partners—which need not be from the financial services sector—bring the required assets and liquidity.

There is one only wholly foreign owned insurance operation in China: AIG's life business (American International Assurance), which was granted a full license in the 1990s. Thereafter, China capped foreign participation, but has pledged as part of its World Trade Organization commitments to open the sector further to direct foreign investment.

For now though, other foreign insurance companies are keeping a watchful eye on China, lured by the tremendous potential, but mindful that early entry could be extremely costly.

INSURERS HAVE MUCH TO DO TO GAIN CUSTOMER AWARENESS AND TRUST

Overall, spending on insurance is paltry in China, because of low incomes, and limited ownership of underlying assets (e.g., motor vehicles), or limited coverage of owned assets (e.g., property). In general, customers in China hold insurance because regulation requires it (including the social security and health insurance required for all employees), and customers are more likely to have life insurance than non-life coverage.

Notably, there is a huge gap between the number of policies sold in booming regions and in under-developed areas. Awareness of the need for risk protection and investment management is also far stronger in richer, well-developed urban centers, such as Beijing in the north, Shanghai in the east, and Guangzhou in the south.

Our survey also shows that few customers have much awareness of insurance in general, or the benefits it can bring. Some firms are using considerable resources to promote certain products, and this provider "push" approach is helping to drive the market. Customer awareness about individual insurance companies is also generally low, although the major insurers are obviously better-known. Among the insurers, the top 4 insurers enjoy the best customer awareness, but our survey shows the vast majority of customers recognize only one insurer—typically their own insurer, or the most active player in the region.

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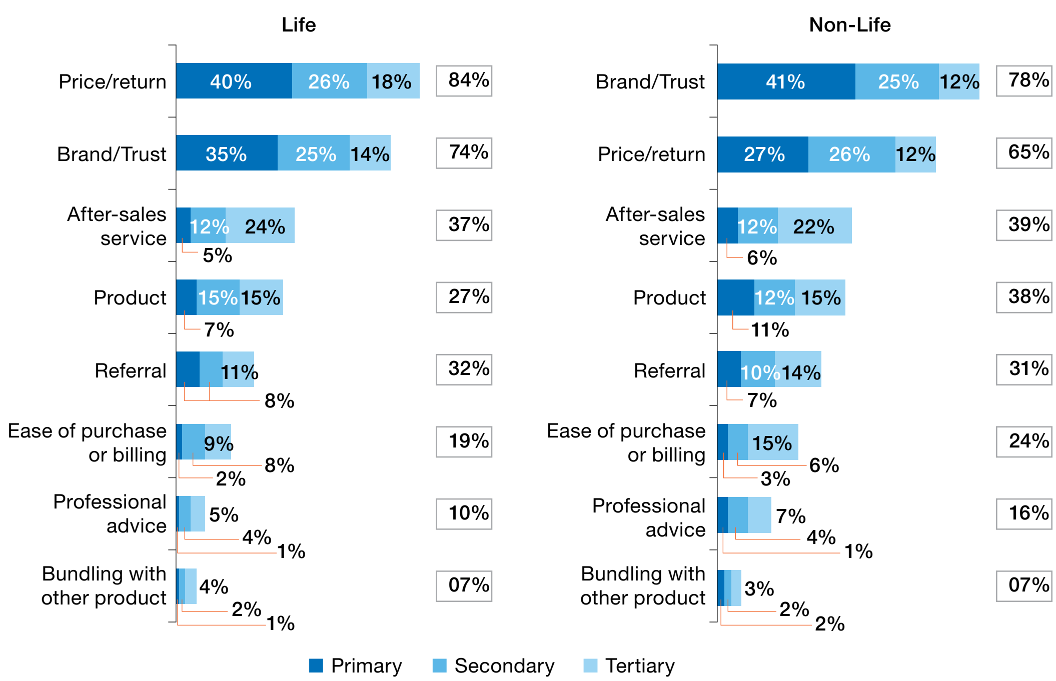
[28] CIRC Media release, Nov. 8, 2007

Nevertheless, brand and trust is the top purchase influence for non-life insurance, and the second most important influence for life insurance (See Figure S.6).

Figure S.6 Purchase Influencers for Life and Non-Life Customers in China (%)



Source: Capgemini analysis, 2007.

To service customers effectively, and win new customers, insurers can seek to establish trust with customers, make the benefits of insurance clear to them, and work to retain customer relationships.

Establishing trust is particularly important, because the most attractive customer segments are increasingly solicited by insurance providers, but as yet remain dubious of the value that these providers can deliver. Making the benefits of products clear will require insurers to educate customers, since few have yet had much exposure to products. Retaining and deepening customer relationships will be a long-term effort.

PHYSICAL DISTRIBUTION NETWORKS STILL DOMINATE

Our survey shows physical distribution networks are, by far, the most commonly used vehicle for insurance information-gathering. The vast majority of insurance customers use face-to-face communication to collect information before buying insurance. Few use the telephone or Internet.

According to our survey, physical networks (agents, brokers, direct insurers) also account for the lion's share of policy sales—and will continue to in the future, though the rankings will change slightly. Customers expect to acquire most of their life and non-life policies via tied agents in 3 years' time, but sales through multi-tied agents, direct writing companies and bancassurance are expected to increase. There is also likely to be a sharp drop in sales through the mobile salaried sales force.

Clearly, then, insurers need to continue promoting physical distribution networks. Late entrants, such as foreign insurers, may find it most efficient to enter bancassaurance ventures to leverage local bank branches, sales people, and call centers. Banks can also help to legitimize insurance as a wealth management product. (CIRC is actively promoting bancassurance, and has issued several regulations aimed at promoting bancassurance as a distribution network.)

LARGE PLAYERS ARE LIKELY TO PLY INTEGRATED FINANCIAL SERVICES

Large insurers are likely to pursue an integrated financial services strategy, aiming to provide a comprehensive service to customers, and leverage scale and capabilities in customer relationship management, IT, and other key areas of operation. Size will also be critical to improving brand recognition, expanding the breadth of service, and enhancing networking strategy. A good example of that strategy is the case of Ping An, which has established a strong presence as an integrated financial services provider after the successful acquisition and integration of Shenzhen Commercial Bank.

Small insurers, meanwhile, can be most effective by pursuing niche business, and being innovative in products, pricing and customer experience. Small players can also gain an edge by investing wisely in alternative infrastructure (e.g., client contact centers), which can utilize new modes of interaction (e.g., telephone) to offset their lack of branch and sales-force scale, and to help differentiate their customer experience.

Not surprisingly, foreign insurers—which can leverage capabilities built in sophisticated mature markets—are already proving they can be first to market with innovative products and product-mixes, built on their analyses of market trends and customer preferences. However, they still account for less than 5% of actual premiums, so foreign insurers will have to focus on building stronger brand awareness, and convincing customers to become buyers.

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