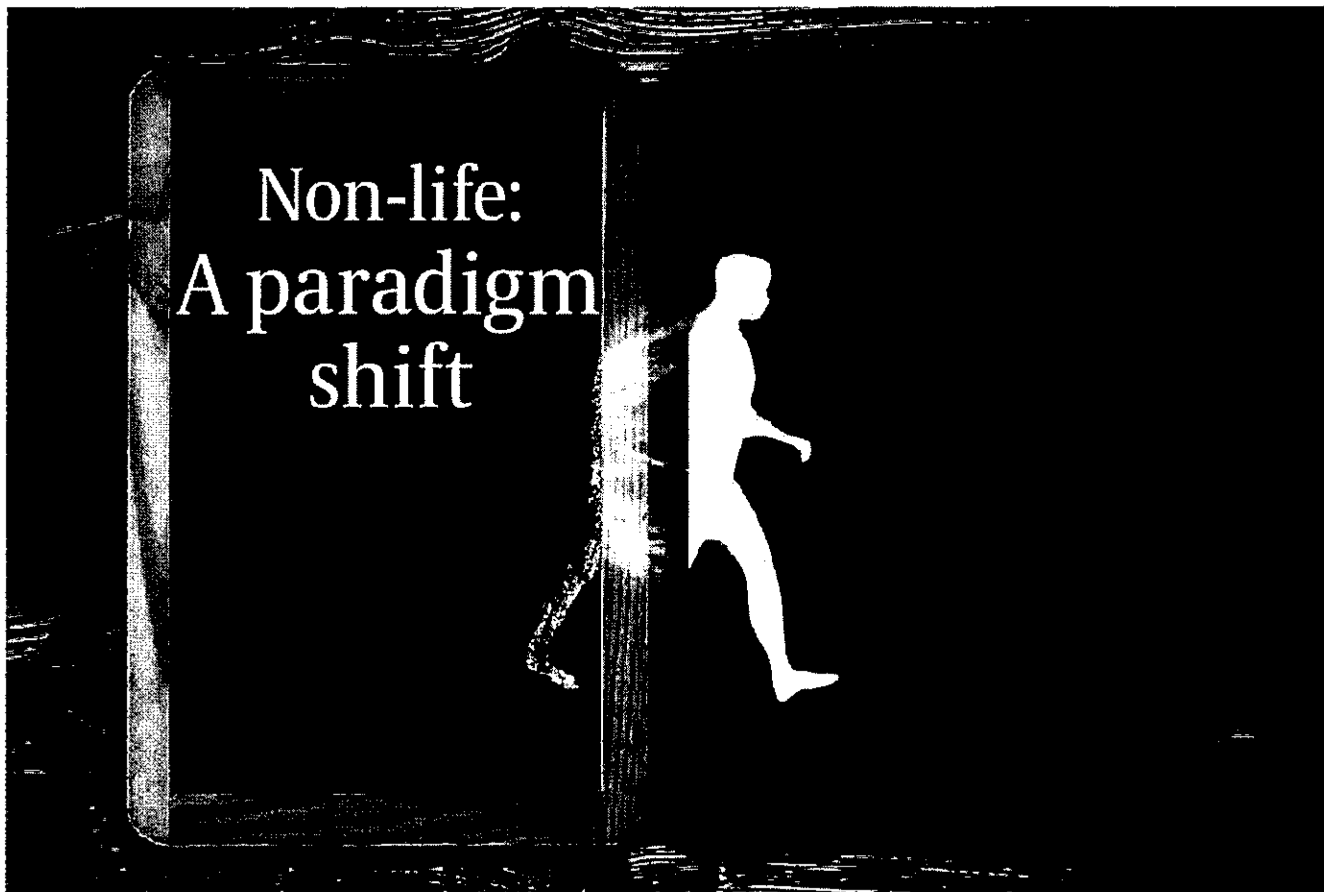

Non-life: A paradigm shift

Thailand's non-life sector has been liberalising gradually. **Mr Marc Breuil of Berkshire Hathaway Specialty Insurance** recommends that further opening up segments of the sector would help as domestic insurers need to develop robust risk-bearing capabilities in order to be sustainable. One way to do this is by offering new licences to foreign companies and requiring these companies to play their role in the training and development of local talent.

With its 66 million population and 5.5% insurance penetration, Thailand's insurance market is the eight largest in Asia. It relies on a strong and open economy which thrives on exports, tourism, public investment and foreign direct investment.

Yet the insurance sector in Thailand has always been considered a domestic sector with a strategic importance, hence to be liberalised very gradually. Thailand has historically tightly managed foreign companies' access to its financial services sector – and in particular to its non-life insurance sector.

To put this in a regional context, while ASEAN has been focusing on promoting the free circulation of goods and services among its 10 members since 2007, many member states have been equally reluctant to liberalise the most important sector of their respective economies – the financial services sector (hence the replacement of the AEC 2015 blueprint by a more reasoned AEC 2025 blueprint).

In the wake of the 2017 announcement by the Thai Ministry of Finance to allow non-Thai shareholders to now hold up to 100% of the voting shares of domestic companies, some observers have predicted a renewed interest for cross-border deals involving Thai non-life carriers.

Heavy public investment in the economy

With a GDP growth at 2.9% in 2016 and 2017's forecast around 3%, the Thai economy has not gone back into the double-digit growth that buoyed its non-life insurance sector until 2013. Whilst showing signs of recovery, Thailand still faces challenges.

With the important export sector only growing marginally, a key driver of growth has been the heavy public investment – the administration has unveiled 56 major infrastructure projects worth about THB2.3 trillion (US$67.4 billion) for 2016 and 2017. (Source: Bank of Ayudhya)

P&C sector – Foreign entities have significant contribution

The Thai P&C sector includes a significant contribution from foreign entities now representing about 30% of the premiums written.

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Global P&C companies are less willing today to further expand their geographical footprints in Asia. It appears clear that the "white knight strategy" favoured by the Thai non-life sector will not suffice to drive consolidation into the sector.

In reality, the dependency on international markets is much greater. Within the industry, the motor insurance portfolio has been a source of profit and growth and contributed to attracting both local and foreign investment – namely Japanese and Australian.

Given Japanese investment in the automotive sector in Thailand (among other industry sectors), it was only logical that the big three Japanese P&C companies took seventh, 12th and 15th positions by market share following a well-established business model. (Source: OIC statistics 2015)

Thriving motor till 2013

Until 2011, the motor insurance account was profitable. Its growth contributed to the Kingdom's double-digit non-life sector growth until 2005 and then again from 2010 to 2013 under the influence of the first-time buyer government schemes.

The business model was simple and attractive enough: organic growth driven by a booming automobile market and its corollary: upfront cash invested in meaningful-yielding asset classes. Motor insurance written premium still represents around 57% of the entire P&C premiums and together with the Miscellaneous account, they represented 92.4% of the $6 billion premium written in 2015.

Since 2013, the model is being challenged: direct premium growth is stuck between 1% and 2% p.a. and profitability has dwindled.

Despite the 2012 & 2013 rebounds driven by auto sales and increased property (flood) premiums, the non-life combined ratio went back up to 93.5% in 2015 – excluding future loss development. Combined ratios in the motor account have been over 100% since 2015 according to the Thai General Insurance Association.

The prolonged period of low interest rates and the aftermath of the 2011 floods have left the non-life sector in a more precarious situation that most observers would have predicted.

Structural weaknesses

The 2011 $15 billion floods exposed specific weaknesses in the sector, namely a shortage in capital and a dependency on international reinsurance capacity.

On the capital front, efforts made to bring consolidation in the non-life sector have not been as successful as in other ASEAN countries.

Whilst the Kingdom is drafting the second phase of its RBC framework (RBC2), the sector remains much too fragmented with 36 companies having less than 1% market shares and little hope of ever reaching critical mass.

Despite a stated objective towards consolidation, little progress has been made since 2011. Thailand is reluctant to implement capital requirements for fear of forcing multiple companies below solvency level. But insufficiently capitalised companies present a prudential risk to their policyholders, which prompted OIC to halt the activities of Kamol Insurance in 2015.

Nevertheless, authorities have delayed RBC implementation and continue to favour a "white knight" strategy – which includes encouraging foreign entrants to purchase weaker local carriers. In a sense, the new legislation enacted in early 2017 reinforces that strategy.

Premium outflows

The 2011 events also highlighted the interaction between the Thai non-life sector and the international reinsurance markets. When international capacity withdrew following the floods, the sector realised their dependency on international treaty capacity.

With Thailand having all but one reinsurance company, the Thai P&C sector had to accept paying dearly for flood cover, cut down their writings or face higher levels of risks. In 2012 alone, the inward treaty and facultative business originating from Thailand and placed in Singapore increased by 67% to S$315 million (US$227.5 million) (source MAS, SOF, table AG 17).

There were even larger premium outflows in 2015 with over S$450 million of Thai treaty and facultative inward business placed in the Singapore offshore market (SOF) – an amount even larger that the SOF premium originating from Japan or Korea.

While such premium flows produce commission income to local cedants, it feeds the Singapore insurance hub but does little towards building a strong and sustainable local P&C sector with adequate risk-bearing capabilities and a pool of professional resources.

Will rising yields help restore profitability?

With local carriers' risk retentions low in most classes other than motor, the ability for domestic non-life companies to generate both commission income and investment income is essential to generate profit while maintaining acceptable levels of risk.

The Kingdom's benchmark interest rates are hovering at their lowest level ever at 1.5% as re-affirmed by Bank of Thailand in July 2017 and remain many notches below their all-time high of 5% in 2003.

Yet, the P&C sector has taken good note of the rebound of fixed yields in the beginning of 2017 with the 10-year government yield stabilising around 2.5% after bottoming out at 1.7% in early 2016. It will also have welcomed the rebound of Thai equities during the same period – almost climbing back to their 2013 high.

Despite newfound optimism, the prolonged period of low interest rates and the lacklustre economic growth have brought in excess capacity and increased competition in motor and other lines. With online sales looming on the horizon, it seems the sector may not return to yesteryears' profitability.

Rather, certain players are questioning a traditional business model that carries large overheads and focuses on distributing motor insurance and fronting for industrial risks. The last cross-border transaction of size in-

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volved German insurer Ergo taking a 40.26% share into Thaisri Insurance in May 2016, leaving founding families Panichewa and Srifuengfung with about 60% shares. Two months later, the 450 staff, 70 branches & THB2.5 billion insurance company announced a sweeping restructuring plan, including moving away from motor insurance.

Paradigm shift

Unlike Singapore, Labuan or the UAE, which have built insurance hubs by offering unencumbered access to international insurance or reinsurance carriers, Thailand has not offered any new insurance and/or reinsurance licence to foreign companies for over 20 years preferring instead to direct potential entrants towards purchasing or investing into local assets.

Until recently, the Thai non-life sector was attractive enough for foreign entrants to ignore legacy issues and invest into and partner up with local players. Losing this attractiveness would bear negative consequences for the sector's needed rationalisation and internationalisation.

Global P&C companies are less willing today to further expand their geographical footprints in Asia. Plus, the combination of legacy, cultural and language issues in an environment where English proficiency is generally low, makes further cross-border transactions in the Thai non-life sector less likely.

It appears clear that the "white knight" strategy will not suffice to drive consolidation into the sector. Instead, it may have the inverse effect whereby the barriers to entry are inducing local owners to hold on to assets in which they see residual value rather than push for consolidation. Given the high degree of outward cession in the large and complex risk segments, new foreign entrants may elect to pursue Thai business from other hubs instead of setting up in Thailand.

Unique vantage point

With its strategic geographic location and multiple economic strengths, Thailand offers a unique vantage point into the regional market. Its geographic proximity to the Greater Mekong Subregion (GMS) and the CLMV countries represents an opportunity for Thai insurance companies to expand regionally.

But the non-life sector in Thailand will not benefit from CLMV integration if it only remains purely internally focused. To tap into those business opportunities, the Thailand P&C sector needs to be more outward-looking.

Over time, the stronger local carriers will diversify their business models and decrease dependency to reinsurance in selected areas. Whether through disruption or competitive pressures, motor insurance no longer offers the same long-term opportunities as it once did.

To be sustainable, domestic insurers need to develop robust risk-bearing capabilities from actuarial to underwriting, from engineering and cat modelling to claims handling. One way to achieve that would be to further open up segments of the Thai non-life sector by offering new licences to foreign companies and requiring them to play their role in the training and development of local talent. In time, the Thai non-life sector can then aim to build up its own regional P&C hub to emulate the successes of some of its ASEAN counterparts.

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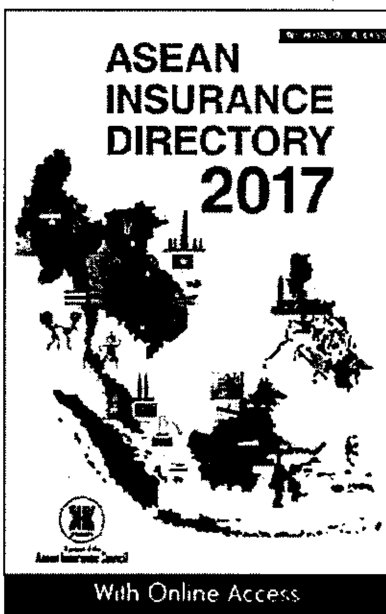

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