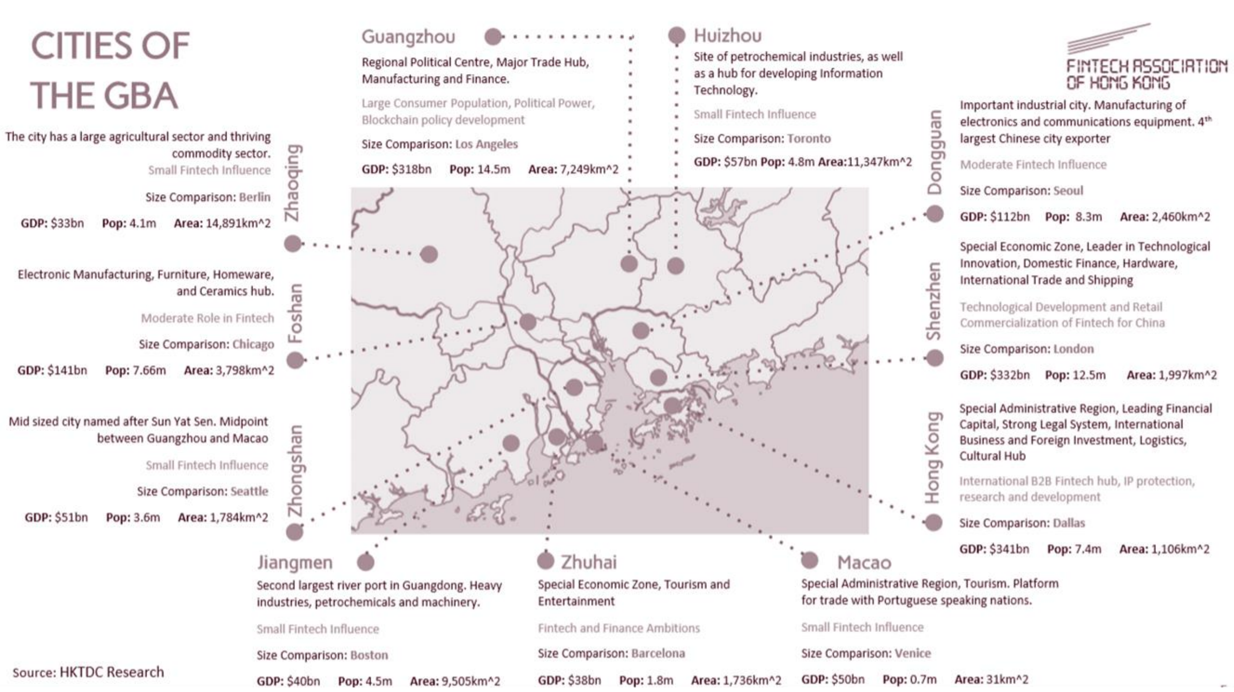
INSIGHT
JUNE
2019

WHAT DOES THE NEW GREATER BAY AREA PLAN MEAN FOR HONG KONG INSURERS?

In recent years, China's central government authorities have worked to encourage the financial cooperation between HK and Mainland China with trade facilities between countries. The GBA Plan marks a turning point in business opportunity for HK insurers to increase their mainland footprint as it should bolster Hong Kong's competitiveness in the region.

What is the GBA?

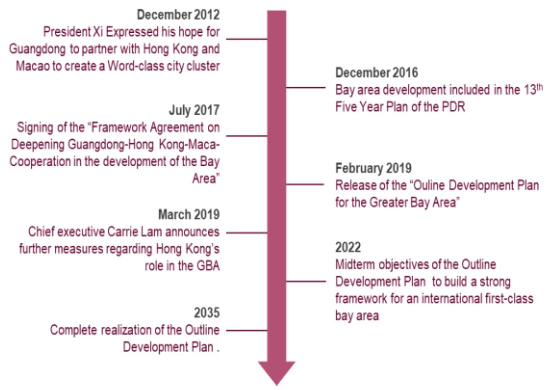
The ambition is to coordinate the economic development of the two Special Administrative Regions of Hong Kong and Macao, and the nine cities in Guangdong Province. With the ambition to use the Pearl Delta River region's assets to define a growth framework of high potential in this area, the development of the GBA arrives during an eventful period for Hong Kong amid China's Belt and Road Initiative (BRI) and Closer Economic Partnership Arrangement (CEPA). The GBA is also seen as a strategic asset for China's blueprint development with the declared ambition to compete with and even exceed the San Francisco Bay Area ("Silicon Valley"), or Tokyo Bay Area.



What is the Outline Development Plan?

The GBA Outline Development Plan was released on Monday 18th February by China's central government authorities to enhance regional economic collaboration, on top of the geographic connection initiated through the high-speed rail link and the Hong Kong-Zhuhai-Macau Bridge. This Outline Development Plan pushes forward the transformation of the bay area. The GBA was initiated on the 1st July 2017, when the National Development and Reform Commission and the governments of Guangdong, Hong Kong and Macao signed a framework agreement, witnessed by President Xi Jinping.

The GBA Main Milestone



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The Belt and Road Initiative (BRI) is a global development strategy, first adopted by the Chinese government in 2013. The main objective is to address an "infrastructure gap" and to accelerate economic growth across APAC, Africa and Europe. The Chinese government calls the initiative "a bid to enhance regional connectivity and embrace a brighter future" and should enable China to increase its global business dominance. This gigantic project should facilitate Chinese industrial exports.

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The CEPA provides the following main provisions for insurers:

- Hong Kong insurance companies can access Mainland China's market via a strategic merger with a local player, as long as they meet the conditions set out in China's WTO accession agreement
- The limit to capital contributions that insurance companies from Hong Kong can provide to the Chinese mainland Chinese insurers is increased from 10% to 15%

What is the impact for insurers

This dynamic plan should offer new opportunities for Hong Kong insurers. Indeed, taking advantage of and having access to the GBA's economic growth is a strong growth driver for Hong Kong insurers. Hong Kong's insurance market is saturated compared to China. One of the main growth factors of Hong Kong insurance market remains the increasing number of insurance purchases by mainland Chinese consumers. The percentage of insurance policies purchased by Chinese mainlanders in the Hong Kong market increased from 5% in 2005 to 37% in 2017.

This new initiative could also make certain markets more accessible to foreign competition. Two types of actors could challenge the market shares of Hong Kong insurers:

- Singapore and Shanghai will not wait for Hong Kong to leverage innovation to tap into the Mainland market;

- Chinese insurers will not wait on the banks of the Sham Chun river.

This article begins by exploring the new opportunities presented by the GBA plan, discussing steps that may allow Hong Kong insurers to seize them, followed by an analysis of potential pitfalls they should be wary of in attempting to do so.

A. The door to an under-insured gigantic market is opening

According to the Swiss Re Institute, China's insurance market will quadruple in 14 years to reach US$2.36 trillion in insurance premiums by 2032. Hong Kong insurers should consider strengthening their presence in this market to benefit from the growth of this sector. This will have a ripple effect for Mainland China's reinsurance market which could reach up to US$197bn by 2020 according to specialists.

The GBA Outline Development Plan should accelerate these growth figures, and provide greater synergies between areas. Hong Kong insurers will have to define a smart conquest strategy in order to benefit from this growth. However, Hong Kong insurers will also look to evolution of the regulatory framework to optimize their footprint and accelerate their access to the mainland Chinese market with the following drivers:

1. "Mutual Market Access" - Reduced barriers to access Mainland customers through the FSDC's proposition of "Insurance Connect";

2. “Cross-border products” - New range of products made available (insurance and reinsurance product development);

3. “City specialization” - Opportunities to leverage strengths of other GBA cities, especially Shenzhen as a FinTech hub.

1. Seize an unprecedented opportunity to better serve Mainland customers

The text as published, refers to a closer proximity between Hong Kong, Macao and Guangdong Province enhancing Hong Kong's competitiveness as an insurance hub. Although the text provides very little precision for the plan at the moment, this novelty could have major impacts on the distribution of insurance products from Hong Kong insurers.

Although mechanisms to reduce barriers to entry into the Chinese market are not yet clearly defined, some scenarios could be considered like an “Insurance Connect” scheme which would enable GBA residents to buy insurance freely throughout the region. This model has already been deployed with the innovative trading platform “Stock Connect”. This cross-boundary investment channel connects both the Shanghai and Hong Kong Stock Exchanges, where investors in each market are able to trade shares on the other.

If the GBA plan promotes direct distribution to the mainland market, Hong Kong insurers could also benefit from global GBA growth and the evolution of the insurance market in China. The distribution of insurance products would be revolutionized as Hong Kong insurers would no longer have to utilize a Chinese joint venture to reach the mainland market.

Another scenario to strengthen links within the GBA could be relaxed limits on the foreign ownership of joint ventures in Mainland China’s financial services. Insurers in Hong Kong should be allowed to set up facilities on the Mainland through sole proprietorship, joint ventures and cooperation.

2. Pave the way to product innovation

Hong Kong’s role as a financial center is also highlighted by the GBA plan which aims to develop several parts of the insurance sector.

Marine insurance is likely to be a key sector during the coming years for Hong Kong Insurers. As a natural marine insurance hub, Hong Kong should consolidate its leadership position by relying on the increase in world maritime trade, particularly trade induced by the BRI. In this sector, innovation could come from a trading platform for international marine insurance.

A strong growth driver should be the development of cross-boundary health and motor insurance products, including underwriting, investigation and claims tailored processes. In 2018, 63% of Hong Kong insurers’ critical-illness policies underwrote mainland customers. The GBA should promote the movement of people between all 11 area-members. Connections between Hong Kong, the Mainland, and Macao, which have three distinct regulations, offer to insurers the opportunity to provide specific products. Considering the expected economic growth in the region and the increased market access provided by the GBA plan for people, services, and goods, Hong Kong insurers should very seriously consider the new consumption habits of all GBA citizens and adapt their strategies to provide products accordingly.

Cross-boundary RMB re-insurance. The Hong Kong reinsurance market is currently experiencing an upward trend that could be further reinforced by easier access to the GBA market. Two reasons are behind this current favorable wind.

The China Banking and Insurance Regulatory Commission (CBIRC) introduced preferential incentives for mainland cedants reinsuring. Implemented in July 2018, this notice lowered the capital requirement for a mainland insurer who cedes risk to a Hong Kong reinsurer. This incentive has had a significant and direct impact on Hong Kong reinsurance market growth. Moreover, the HKSAR Government is facilitating the growth of the Hong Kong reinsurance market by offering both a 50 per cent profits tax concession for professional reinsurance and captive insurance businesses, and adapting the regulations on financial products. Indeed, insurance-linked securities (ILS) products have been identified as a key driver of future growth for the Hong Kong reinsurance industry. These special purpose vehicles represent a promising way for insurers to offload non-financial risks such as natural disasters, longevity risk, or life insurance mortality.

With the new Outline Development Plan for the Greater Bay Area, and the potential growth of the mainland reinsurance market, Hong Kong seems to have all the elements to assume a central role in its development.

3. Specialize to get stronger together

A key element of the Outline Development Plan is to define a specialization for each of the regions that make up the GBA. This specialization must be defined in-line with the comparative advantage of each city to increase interactions between regions in-line with David Ricardo's theory of international trade. Based on comparative advantage, country specialization and free trade should increase total production, and hence accelerate the region's economic growth. Regarding the insurance industry in particular, key players in the near future will likely be:

Hong Kong, the risk management center of the GBA, the city must endeavor to build insurance industry frameworks to retain and increase its dominance in this sector. Beyond the GBA, in which the operational implementation and specific rules remain opaque, local regulation should complete the Outline Development Plan to support Hong Kong's status as a leader by encouraging companies in the region to utilize Hong Kong as the main risk platform. Regulatory developments to increase Hong Kong's attractiveness have already occurred since the CBIRC defined the solvency regimes between China and Hong Kong as equivalent on 16th May 2018. This adaptation made it possible to facilitate exchanges between the two countries.

Qianhai, Nansha and Hengqin, area of Operations. Support Hong Kong insurers establishment of operations in Qianhai, Nansha, and Hengqin. According to China's government, the first steps of the plan's execution should be in the three special economic zones: Qianhai of Shenzhen, Nansha of Guangzhou and Hengqin of Zhuhai. These emerging cities have high potential for economic growth. A possible strategic move for Hong Kong insurance companies would thus be to expand their footprint in those high potential areas, specifically health insurance.

Shenzhen, area of Innovation. The Outline Development Plan is forecasting the promotion of a pilot InsurTech zone in Shenzhen. With already existing ties to the Hong Kong players and a convenient geographical location, the development of Shenzhen should bring benefits to the Hong Kong insurance industry. At this stage, only limited information has been published in the plan. Nevertheless, the government has stressed its willingness to leverage Hong Kong's higher education institutions by allowing increased access to central government funding. The idea being to create synergies between Hong Kong universities and startups incubated in Shenzhen. For insurers, Shenzhen appears to provide great opportunities to resolve their main KYC issues using technology, tailored products, IOT systems and bots by leveraging the InsurTech innovation zone in Shenzhen. This initiative should very quickly increase Shenzhen's notoriety as a hub for InsurTechs, providing a credible alternative for insurance companies that had opened a hub in Singapore. Some of the advantages Shenzhen can offer are infrastructure, access to the Chinese market and data privacy limitation.

B. Hong Kong insurers must be prepared before crossing the threshold

Traditional Hong Kong distribution networks are not applicable to the GBA and Hong Kong insurers will face various obstacles.

First, barriers to entry make it difficult for Hong Kong insurers to open branches directly in Mainland China, and lead to two main problems. The first is restricted access to the distribution of insurance products for mainland customers. The second is the lack of physical touch points to allow insurers to manage their customer relations (investigation, claims and complaint management) for all cross-boundary products sold directly in Hong Kong. Hong Kong insurers can already build a partnership with a local actor, but two options can be envisaged in order to increase the collaboration between the two countries. The first is a relaxation of the partnership rules between Hong Kong and mainland third parties. The second is an "Insurance Connect" scheme which enables GBA residents to buy insurance freely throughout the region.

The second issue concerns capital flows from the mainland. Indeed, money transfers outside of China are cautiously controlled by the Chinese government. However, the "Stock Connect" scheme provides a starting point for the centralization of all capital flows. This kind of scheme should be designed with life insurance features but appears as a serious way to control capital flows. The scheme could incorporate blockchain technology to provide transaction tracking. Another solution would be to create a single point of contact directly in Hong Kong for Mainland Chinese customers wishing to open a life insurance policy in Hong Kong. This would increase control over capital and allow transactions to be referenced.

The final question concerns the regulatory framework for reinsurance vehicles. Bermuda, which sees 75% of worldwide ILS transactions, has established itself as a leader in the global ILS market by imposing a very flexible legal framework. In comparison, Hong Kong's ILS regulation is more complex than in other countries. Some regulations have started to evolve surrounding this subject. For instance, the UK government has recently updated the ILS tax framework in order to directly attract Chinese reinsurance, raising demand. The Legislative Council Panel on Financial Affairs started to undertake changes on this subject with the publication on the 3rd June 2019 of measures which should facilitate the issuance of ILS in Hong Kong. One of the key regulatory requirements is to “enable a special purpose vehicle (‘SPV’) set up by (re)insurance companies to be authorized as a ‘special purpose reinsurer’ for issuing ILS”.

Conclusion

The Outline Development Plan offers great opportunities to big businesses with the resources to meet the associated challenges, however small companies could be left out to an extent. Early movers have already started to react; NWS Holding is taking over FTLife Insurance to strengthen its regional footprint in both Life and Health insurance, and if other Hong Kong insurers are up to the challenge, it could be to the detriment of Singapore where insurers will be unable to leverage the GBA plan to the same extent.

The GBA plan could be one of the last chances for Hong Kong insurers to achieve meaningful growth by leveraging mainland opportunities.

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