



The rise of private health insurance in China

Consumer demand presents huge opportunities and risks

EY

Building a better working world

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Data source for all insurance companies and health insurance companies referenced in this report: FT Confidential Research

Foreword



Jonathan Zhao
EY Asia-Pacific
Insurance Leader



Andy Ng
EY Greater China
Insurance Leader

The Chinese mainland is a market that has fueled growth throughout the Asia-Pacific region. After decades of rapid expansion, the economy in China is transitioning to meet the domestically driven needs of an aging, urbanized population. Nowhere is that transition more apparent than in health care and the health insurance industry.

Health care in China has been an issue of national importance and government focus since the early reforms of the 1980s. As health care expenditures increase, current public health care systems are becoming inadequate to cover the costs incurred. As a result, the private health care system is thriving, as more Chinese and foreign health insurance companies enter a market, which is expected to exceed RMB5 trillion by 2020. The government is encouraging private health care providers by relaxing regulatory restrictions and offering incentives to Chinese consumers.

To better understand market trends, demographics and the wide array of health care options, EY global insurance sector conducted a survey of 2,000 middle-to-upper middle class consumers living and working in mainland China. Our objective was to identify risks and opportunities for private health insurance providers, relying on income and age as primary drivers.

Key findings that emerged from our survey respondents:

- ▶ 93% rate their coverage as “not satisfactory” or only “somewhat satisfactory”
- ▶ 33% report no savings to deal with serious health emergencies
- ▶ 80% believe that pollution in China will lead to long-term health care complications

As we explored this market, we tested our hypotheses that there is significant demand for private health insurance in China. The landscape continues to move toward mobile health technology, and consumers still value the role of traditional Chinese medicine (TCM).

We hope this report will offer insights into this diverse private health insurance market and the opportunities and risks for Chinese and foreign players to participate.

Executive summary

The overarching demand for private health care in mainland China presents huge opportunities for insurance companies with the right strategies. The market for private health insurance continues to grow: from RMB1.5 trillion in 2014 to RMB2.4 trillion in 2015.¹ Even the most conservative estimates project revenues of more than RMB5 trillion by 2020.²

The rapidly expanding middle class demands high-quality medical services at a time when the public health care system is strained and the population is aging. There is growing government support for private sector involvement in the full spectrum of the health and medical system from cradle to grave, and from private hospital to insurance. The Chinese Government is promoting private health insurance by relaxing regulatory restrictions and providing tax incentives to Chinese consumers.

At the same time, new technologies are disrupting health insurance. Established players are enhancing their offerings by launching mobile apps and internet-based services to help customers select from a wider array of health care options, while internet companies are investing in technologies that will fundamentally change the health care industry.

To identify risks and opportunities for private health insurance providers in China, EY surveyed 2,000 targeted consumers in major cities across the country. Extensive interviews were conducted along with surveys, policy reviews and research. The objective was to understand what consumers want, relying on demographics such as income and age as the primary drivers.

More than one-third of respondents said that public health insurance was unsatisfactory, and 89% thought they were likely to suffer long-term health consequences due to environmental pollution. Only 14% felt they had enough savings to cover unexpected health emergencies, while 61% said they recently purchased private health insurance for

the first time. These figures highlight an increasing consumer demand for private health coverage and show the willingness of Chinese consumers to use new technologies to select and access health care. The information presents a compelling reason for insurance companies to take risks and offer new products.

What will consumers buy? And how can insurance companies tap this expanding Chinese market? This report examines consumer demand against a backdrop of regulation, evolving demographics and digital innovation.

¹ The China Insurance Regulatory Commission (CIRC)

² Chinese language report from China Investment Research.



Survey



Interviews



Research

Methodology review

In the last quarter of 2015, EY's Global Insurance Sector conducted a first-of-its-kind survey of 2,000 consumers who are employed and living in first-, second- and third-tier cities across China. Extensive interviews were held with industry consultants and executives in private health insurance and related industries, including professionals and executives at insurance companies, private and public hospitals, and pharmaceutical companies.

FT Confidential Research provided a detailed review of regulations, tax structure and laws, government policy papers, and existing literature and media reports on China's health insurance industry.

This approach enabled us to explore the consumer market for private health insurance in China from three different perspectives: survey, interviews and research. Our objective was to better understand risks and opportunities at the consumer level and test our hypotheses that there is significant demand for private health insurance.



01

**Health care and health
insurance landscape in China**

Several significant factors are influencing consumer purchasing behavior and the shift from public to private health plans. Five drivers resonate throughout our survey and are reflected in the findings: technology, aging and urbanizing population, rising health costs, the need for private hospitals and China's regulatory and tax systems.

1. Technology in health care

Consumer demand for better, direct care and internet connectivity on mobile devices has unlocked a wealth of new opportunities. Integrating wearable devices and smartphones will help health insurers improve the customer experience and provide an incentive for healthy behavior.

New technologies are the most disruptive force in health care and health insurance today. At the heart of China's health care technology revolution are mobile phone apps that are changing consumer behavior. Many Chinese skipped desktop computers entirely and moved to smartphones or tablets. Of approximately 700 million people with internet access in China, 86% connect through their phones.³

Mobile platforms now streamline payments of medical expenses at hospitals and enable users to circumvent hospital waiting rooms and connect with medical

practitioners online. Ping An Good Doctor, a digital subsidiary of Ping An Insurance, provides 24-hour one-on-one consultation with specialists and doctors through a convenient app. The service enrolled 25 million users within six months, with a target of 300–500 million users by 2019.⁴

Ping An Good Doctor competes with other medical service platforms like Tencent's Guahao.com, which allows users to schedule hospital appointments and seek medical advice online. It covers nearly 1,000 hospitals across the country, allowing a seamless experience for nearly 700 million users. Chunyu Doctor is a telemedicine app that allows patients to consult with doctors via mobile phone, for free, with more advanced consultations available to fee-paying customers. These examples highlight the many opportunities for private insurers to innovate.

2. Aging, urbanizing population

Health care expenditure as a percentage of China's total gross domestic product has increased from a low of 3.7% in 1994 to 5.6% in 2013, when the country spent an estimated RMB3.2 trillion.⁵ This is one of the most dramatic increases in health care spending in modern history. Since 2001, public spending has surpassed private spending as a proportion of total health care expenditure. And, health care expenditures are expected to increase between 9.5%–11.8% through 2018, reaching an estimated RMB5.7 trillion.⁶

Despite providing universal coverage to China's population, current public health insurance systems are insufficient to cover the costs incurred, particularly for extended inpatient care. The issue becomes more severe as China's population ages. Less active lifestyles and environmental pollution are increasing the incidence of diseases like chronic obstructive pulmonary disease (COPD), cancer and obesity.

Currently, 15.5% of China's population is above 60 years old. By 2050, one-quarter of the population is expected to be 65 and over; half will be 45 and older. Due to the One-Child Policy and rising cost of living, the fertility rate dropped from 29.2 per 1,000 in 2002 to 12.2 per 1,000 in 2011.⁷ For most families, a single child is the sole source of support for their elderly parents, and China's younger generation can expect to face a heavy tax burden. Although the One-Child Policy was changed in 2015 to allow families to have two children, many have been reluctant to have a second child due to high costs. Even if having two children becomes the norm in China, it will be more than two decades before a benefit is realized.

China's population is also increasingly urban. In 2014, 54.7% of the population lived in an urban area. By 2050, that will increase to 73%⁸ – meaning that cities will struggle to provide low-cost, quality health care.

³ Geoffery A. Fowler and Joanna Stern, "Why we're jealous of Chinese Smartphones," *The Wall Street Journal*, 18 August 2015.

⁴ Danielle Li, "Online medical service platform launched by PingAn Group may have raised USD 500 million," *AllChinaTech.com*, 21 January 2016.

⁵ "Health Expenditure, total % (% of GDP)," *The World Bank website*, <http://data.worldbank.org/indicator/SH.XPD.TOTL.ZS/countries/1W-CN?display=graph>, accessed 14 November 2015.

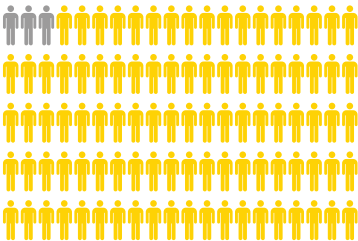
⁶ FT Confidential Custom Research Report, Jeremy Goldkorn, May 2016.

⁷ Kaihong Hu, Nianxiu Lin, and Peian Wang, "State Council Policy Briefing on November 13, 2015," Policy Briefing, State Council, Beijing, China, 13 November 2015. Adele Hayutin, "China's Demographic Shifts: The Shape of Things to Come," Stanford Center on Longevity, 24 October 2008.

⁸ "An Urban World," *UNICEF website*, <http://www.unicef.org/sowc2012/urbanmap/#>, accessed February 2016.

97%

of the population
uses three public
health insurance
systems



3. Looming crunch for public health insurance

Three public health insurance plans are collectively called Basic Medical Insurance (BMI): the Urban Employee Basic Medical Insurance plan (UEBMI); the Urban Resident Basic Medical Insurance plan (URBMI); and the New Cooperative Medical Service (NCMS). However, plans were announced in January 2016 to merge the URBMI and NCMS plans to universalize coverage and reimbursement rates.

UEBMI	UEBMI is the most generous public health insurance plan, as it is funded by employees, their employers and provincial or municipal governments. Employers contribute 6%-12% of the employee's salary to the fund depending on the province, while the employee contributes 2%. UEBMI takes total insurance premiums and divides it into two separate accounts, the Social Pool Fund (SPF) and Personal Savings Accounts (PSAs). The UEBMI has the highest average premiums and the highest reimbursement rate.
URBMI	URBMI is provided to unemployed adults, children, students and seniors. The program has less funding because local and provincial governments are solely responsible for paying into the funding pool. Also, individuals in the insurance pool have less purchasing power.
NCMS	NCMS is administered by the National Health and Family Planning Commission to expand health insurance coverage to rural residents. As of 2011, the enrollment rate was 97.5%.

These systems cover 97% of the population. Actual coverage is minimal, with large disparity between plans and high out-of-pocket spending. There is a looming funding crunch as health care expenditures outgrow public funding. If no action is taken, the BMI fund will operate at a deficit by 2017, and the general fund will accrue an outstanding debt of RMB735 billion by 2024.⁹ The government will need to either subsidize this funding deficit or reduce coverage.

4. Rising health care costs create a funding gap

For 30 years after the People's Republic of China was established, the government subsidized more than half of the costs of hospitals and clinics.¹⁰ Hospitals were losing money on every new patient.

To make up for the shortfall and enable hospitals to remain solvent, the government allowed a 15% profit margin on drugs and set prices for new and high-tech diagnostic services at above cost. This created the incentive for doctors and hospitals to pass on costs to patients, a trend that may continue as long as public hospitals are underfunded.

⁹ "China: Study Warns of Looming Deficit in Basic Medical Insurance Fund," *Asian Insurance Review*, 13 February 2015.

¹⁰ Winnie Yip and William C. Hsiao, "The Chinese Health System At A Crossroads," *Health Affairs*, March 2008.

Tax subsidies and health insurance

To help make up for shortfalls in the public health insurance system, the Chinese Government has begun to explore tax subsidies for individuals who purchase private health insurance. The pilot program began in May 2015 and has been rolled out to a major city in each province, as well as the four municipalities that report directly to the central government – Beijing, Shanghai, Chongqing and Tianjin.

Eligible private health insurance plans, which include comprehensive private health insurance plans, allow individuals to deduct up to RMB2,400 per year from taxes paid for wages and salary, remuneration for services, business operations by self-employed industrial or commercial households and/or contracted operations of enterprises partially or wholly funded by state assets.

One issue with China's tax structure is that private health insurance has been traditionally taxed as income. If the pilot program is applied nationally, it will incentivize a wider adoption of private health insurance and make it more accessible for individuals and their families. However, for individuals with high-end health insurance plans, the tax deduction is not significant. This may change as official statements have suggested further tax incentives may be offered directly to employers to encourage the provision of private health insurance to their employees.

Our survey suggests that the policy will be effective: 40% of respondents said tax credits offered by the government would be a significant factor when considering the purchase of private health insurance.



Doctors typically have low salaries but receive bonuses tied to hospital revenues, which can lead to overprescribing drugs to increase hospital income. In addition, sales associates from pharmaceutical companies sometimes bribe doctors to ensure their products are prescribed over less expensive or more effective drugs.

As a result, hospitals have relied on drug sales to provide 40% or more of their budgets.¹¹ While the Chinese Government has sought to expand the “essential drug list” of subsidized medicines and focus on unethical prescription practices, reliance on drug sale profits remains widespread. With local governments unable to provide adequate funding, hospitals may mark up other health services to address budget shortfalls.

The funding gap also leads to hospitals competing for patients – even when patient needs may be better served at different institutions. Under current conditions, the cost of health care can only increase.

5. VIP wards and private hospitals

Seeing a doctor at a public Chinese hospital is not easy. Patients usually wait in line to take a number just to be allowed to make an appointment. Scalpers can run a thriving practice trading numbers outside hospitals. The more affluent are increasingly avoiding this treatment by paying for “VIP wards” at public hospitals. These offer patients more personal treatment and higher standard rooms than the regular wards. The hospital gets a new revenue stream while satisfying patients’ demands.

The government, however, caps the space allowed for such facilities at 10% of total hospital capacity. So despite a traditional preference among the Chinese for public hospitals – which have in the past attracted more notable doctors and are reputed to exist for the public good rather than profit – private health care is growing rapidly. The umbrella of private facilities include general hospitals, trauma centers and specialized practices ranging from TCM to OB/GYN services. From 2008-2012 the number of private hospitals in China nearly doubled from 5,400 to 9,800.¹²

¹¹Patti Waldmeir, “China Drug Reforms Risk Placing Hospitals on Life Support,” *Financial Times*, 26 May 2015.

¹²Eric Yan and Helen Chen, “Op-ed: A prescription for Sustaining Growth at China’s Specialty Hospitals,” *China Economic Review*, 20 November 2014.



02

**Booming private health
insurance market**

The private health insurance sector is thriving. From 2013 to 2014, total medical insurance premiums increased 41%, from RMB112.3 billion to RMB158.7 billion, rising another 52.5% to RMB241.1 billion in 2015.¹³ According to China Insurance Regulatory Commission (CIRC), five insurance companies specialize in health insurance and another 100 offer health insurance products, including 28 foreign life insurance companies. CIRC reported more than 2,300 health insurance products in the market in 2015.

The dramatic increase in the past two years exceeds the high growth rate typical of the previous decade, when total medical insurance premiums averaged a 27% annual growth from 2007 to 2013.¹⁴ This exceptional growth may continue for years to come as more middle-class households purchase private health insurance.

Chinese private insurers

The number of foreign companies in the Chinese market is increasing, but the dominant players in China's private health insurance market are large domestic insurers. The three largest health insurers are Ping An Health Insurance Company (中国平安健康保险) and PICC Health Insurance Company (中国人保控股公司) and China Life Insurance (中国人寿保险). China Life is the largest domestic life insurance company (and the world's largest life insurer), with 10% of its total premium income derived from health insurance. Other large Chinese health insurance companies include Hexie Health Insurance Company (和谐健康保险), which is part of the Anbang Insurance Group (安邦保险集团) and Kunlun Health Insurance Company (昆仑健康保险).

Currently, most private health insurance plans provide supplementary insurance products to complement public health insurance plans. Supplementary insurance and critical illness products are the most developed in the market, primarily because the public insurance systems cannot fully cover the costs of catastrophic illnesses.

Most Chinese insurers rely on large in-house sales staff, as well as private insurance brokers to facilitate their distribution and sales channels. Private insurance brokers can help private health insurance companies find customers that they would otherwise not locate through other sales paths, and Chinese consumers are accustomed to paying companies or individuals to help them navigate complicated bureaucracies and decisions. However, brokers diminish health insurers' profits with significant commissions.

The market is highly competitive. Chinese insurers are responding by offering deep discounts that squeeze profitability. However, companies are beginning to differentiate their products with a range of innovations and partnerships. These include technology-driven products and sales solutions, including the use of mobile street-side stalls to perform basic diagnostic tests and market and sell insurance products, direct sales over the internet, and internet-based brokerages.

Other initiatives include partnering with private hospital operators. In 2013, New China Life Insurance invested RMB500 million to set up NCI Health Investment Management Company, which operates medical centers, clinics and other health care services. In March 2016, the Hong Kong private clinic chain Human Health

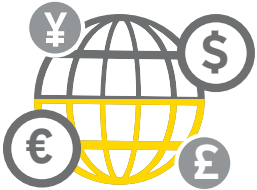
Holdings announced a plan to establish three health care centers in Shanghai and to further expand into China's biggest cities in a joint venture with Ping An Insurance. China's first hospital founded as a joint venture between a local government and an insurance company opened in May 2016: Sunshine Insurance Group invested RMB3 billion to set up Sunshine Union Hospital in Weifang, Shandong province, in partnership with that city's government. The hospital has a capacity of 2,000 beds.

Another project that involves insurers working with local government is the Ningbo Cloud Hospital, located in Ningbo, Zhejiang province. The Ningbo Health and Family Planning Commission announced plans to develop a joint venture with a private company, Neusoft Xikang Healthcare Technology Co., for a service delivery and data system that will use a cloud network to "integrate community health centers, hospitals, pharmacies, insurance companies and third-party diagnostic labs." The hospital plans to eventually provide patients with telemedicine consultations to refill prescriptions and improve health education and awareness, and to use the data it generates to enable insurers to better manage risk.

Such schemes should allow for efficient management of health care costs and sharing of patient data, the lack of which is currently one of the biggest obstacles for insurance companies to manage risk. If these projects succeed, they are likely to be replicated nationwide, with enthusiastic government support.

¹³ "China: Medical insurance accounts for up to 56% of life insurers' total premiums," *Asia Insurance Review*, 15 May 2015.

¹⁴ Helen Chen and Justin Wang, "Insider Analysis from L.E.K. Consulting on the Private Health Insurance Market in China: Business as Usual or Breakthrough Imminent?" *Elsevier Business Intelligence*, 26 March 2012.



Foreign life insurance companies (private health insurers) are limited by Chinese law to a maximum ownership of 50%

Foreign health insurers in China

Many international groups have acquired stakes in existing Chinese insurance companies to gain a foothold in the market. Most of the 20 largest multinational insurance companies have operations in China, including Discovery Holdings, a South African company that acquired a 24.99% stake in Ping An Health Insurance in 2009.

Foreign life insurance companies (private health insurers) are limited by Chinese law to a maximum ownership of 50%; splitting the rest with domestic Chinese investors. Foreign insurance companies have strict regulations. The CIRC defines an insurance company as foreign owned if it holds a stake of 25% or more in the venture. Some foreign insurers have acquired less than 25% to avoid more stringent rules. One is a de facto limit by CIRC on foreign life insurers' ability to establish branch offices, thus limiting expansion.

Without sales volume from Chinese companies' branch networks, foreign health insurers are less able to dilute their risk. It takes a significant investment to identify consumer health care costs because of the dramatic differences in cost and care between cities and provinces. It may take years to realize returns as the market matures and expands.

Some foreign companies are finding innovative ways to overcome regulatory obstacles and make profitable inroads into the market. Cigna took an unconventional route, skirting the traditional market for group insurance plans to reach high-income individual customers. Unlike other insurance companies that rely on branches and a large sales force, Cigna operates a network of call centers that use big data to target potential customers.

Even its Chinese partner is unconventional: rather than identifying a domestic health insurance counterpart, the company created a joint-venture with China Merchants Bank, which is known for its customer-centric approach and clientele of upper-middle class professionals. The company has also successfully leveraged its credentials as a US health insurance company, providing packages that will fly customers to the US for treatment in cases of serious medical emergencies.



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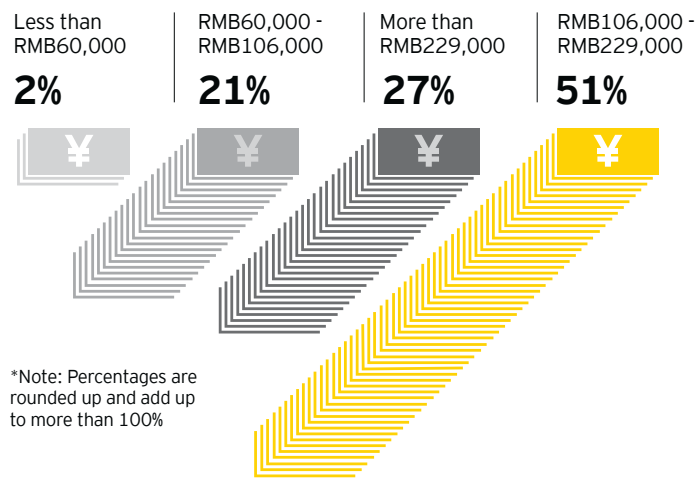


03

Survey results – what matters to consumers

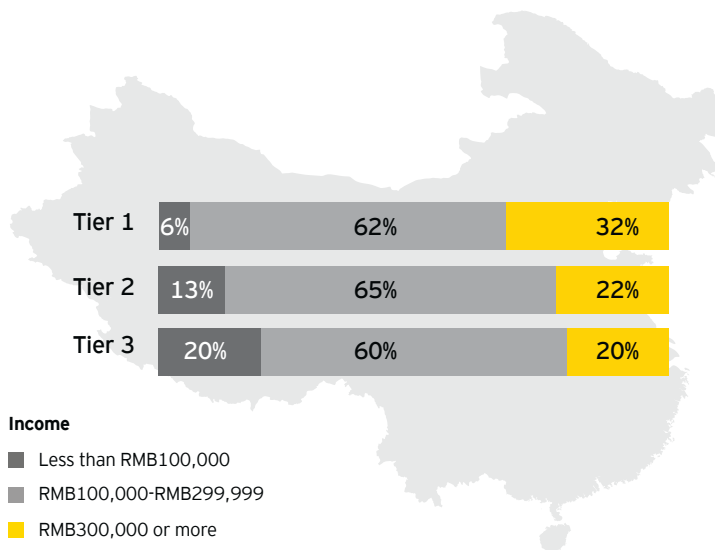
EY surveyed consumers who are employed and whose incomes fall solidly into China's mid-to-upper-middle class: annual incomes of RMB60,000 to RMB229,000, as shown in Figure 1.

Figure 1: Annual income of survey respondents



The findings conclusively support the views of medical professionals, health care executives and government employees that we spoke to in our research: consumer demand for commercial alternatives to public health care plans continues to grow.

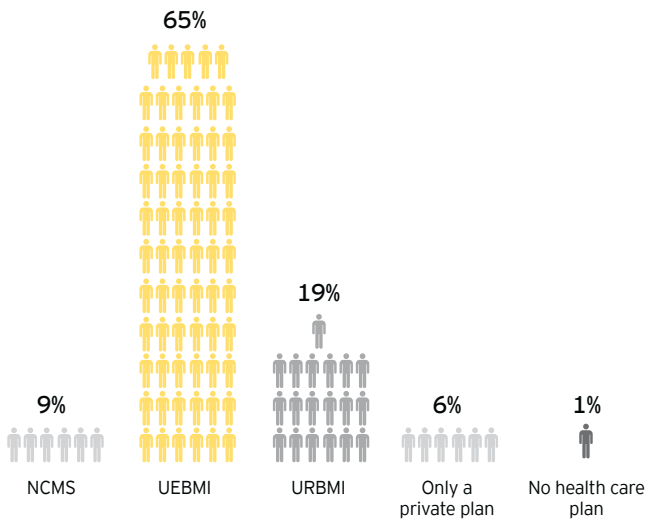
Figure 2: Economic background of EY survey respondents in mainland China





Respondents favor UEBMI plan

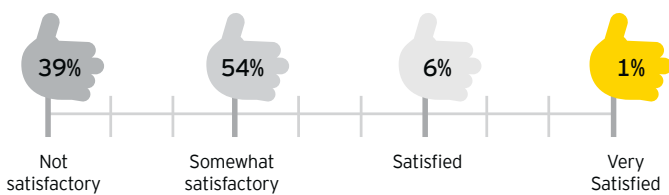
Figure 3: Survey response to public insurance plans



As this survey targeted employed urbanites who may be considered middle class, 65% of respondents said they were covered under the UEBMI, the most generous public health insurance plan funded by employees, their employers, and provincial or municipal governments.

Low satisfaction with public health care

Figure 4: Survey respondents' satisfaction with public health insurance plans



Showing the startling inadequacies of public health insurance, the vast majority of the survey respondents (54%) rated their coverage as only "somewhat satisfactory." Only 6% reported being "satisfied" with their coverage, while 39% were "not satisfied."

Lack of confidence to cover major health problems

Due to deficits in public health insurance coverage, out-of-pocket health spending is a major concern for Chinese consumers. Survey respondents have generally tried to save money for unexpected health problems. Nonetheless, 33% reported no savings, and 40% saved RMB99,999 or less, an inadequate amount to deal with serious health emergencies (see Figure 5). Unsurprisingly, only 22% were comfortable that they had saved enough money to cover unexpected future health problems (see Figure 6).

Figure 5: Survey respondents' opinions on how much they have saved for health issues

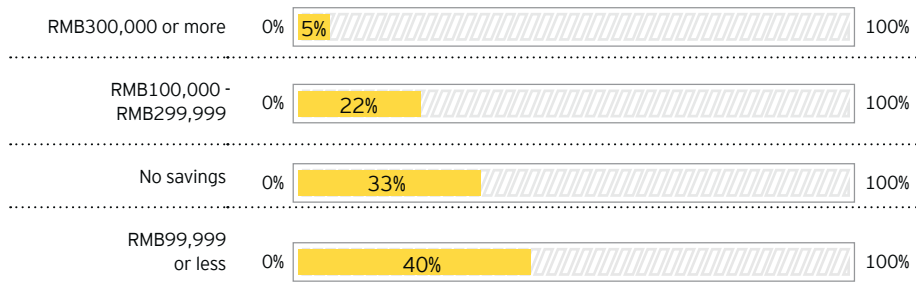
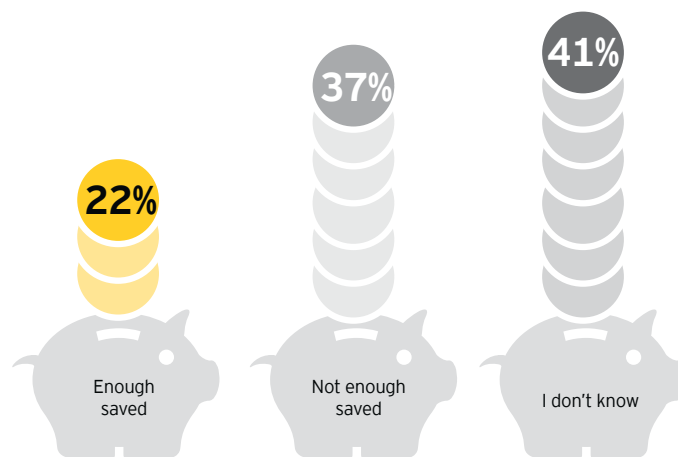
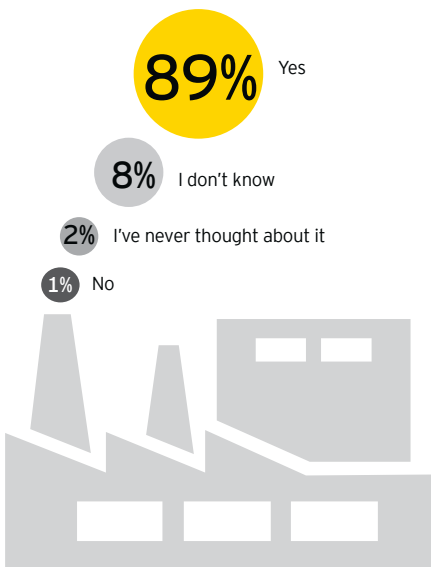


Figure 6: Survey respondents' opinion of whether they have saved enough money in case of a medical emergency



Pollution may lead to new health concerns

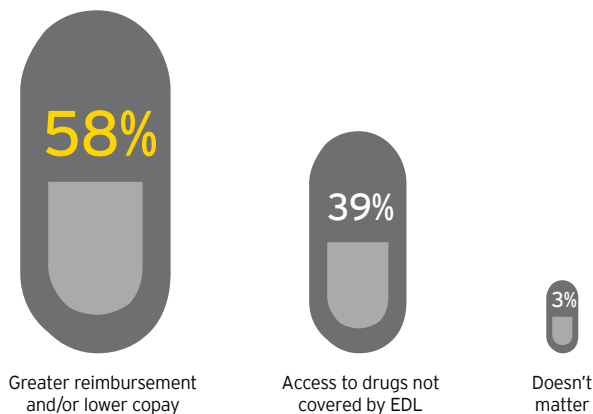
Figure 7: Is pollution contributing to long-term health issues?



While air pollution has been a long-standing phenomenon, heightened awareness about its adverse health effects is relatively new and growing. A decade ago, many government officials and citizens would argue that pollution was a necessary side effect of economic development. The last few years have seen a sea-change in attitudes toward environmental issues. This concern is reflected clearly in our survey, with an overwhelming 89% of respondents believing that pollution in China is leading to long-term health complications for them and their families.

Skyrocketing drug costs

Figure 8: What is most important in your private health insurance plan prescription drug coverage?

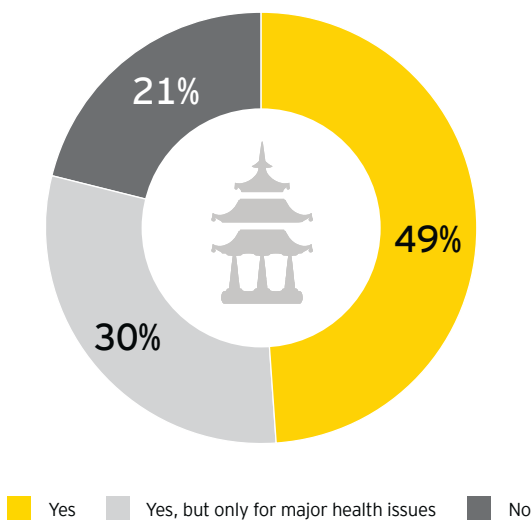


Drug costs are a major concern, and despite the Chinese Government's best attempts to bring costs under control through its Essential Drug List (EDL), prices continue to rise. Among the survey respondents, 77% reported that they had been prescribed drugs not covered by the EDL. When asked about the most important services in their private health insurance plan, 65% cited extended prescription drug coverage.

When asked more specifically about the types of prescription drug coverage they expected, survey respondents preferred a greater reimbursement and lower co-pay for prescription drugs. The second largest group preferred coverage of prescription drugs not covered by the EDL.

Going home for treatment: the challenge with residence permits

Figure 9: Survey respondents on whether they return to their hometowns for health care



While China's urban middle class is mobile (moving to cities where opportunities lie), public health care has not caught up. This is a result of the residence permit or *hukou* (户口) system, under which Chinese people receive reimbursement for health care only in the city of their hukou registration. A majority of urban professionals are immigrants and are at odds with the *hukou* system.

In fact, 79% of survey respondents indicated that they have to return to the place of their household registration to get health care. Of this group, 49% would return home for any health problem, and 30% would return for only serious medical issues. Since traveling for health care can be inconvenient, costly and even dangerous, there is a huge opportunity for private health insurance providers.

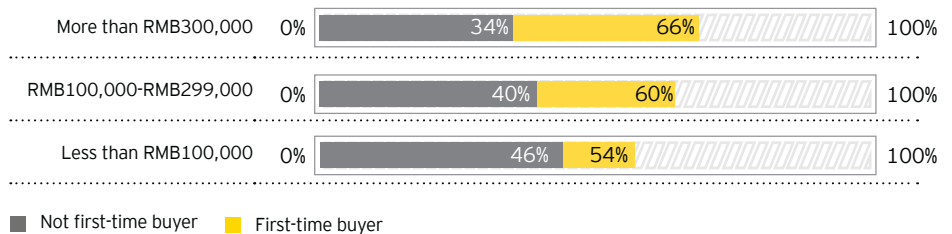




Private health insurance buyers: new to the market

According to our survey, 61% of respondents are first-time purchasers of private health insurance. Notably, the percentage of first-time buyers increases as income levels rise, suggesting that wealthier Chinese consumers are more aware of private health insurance products.

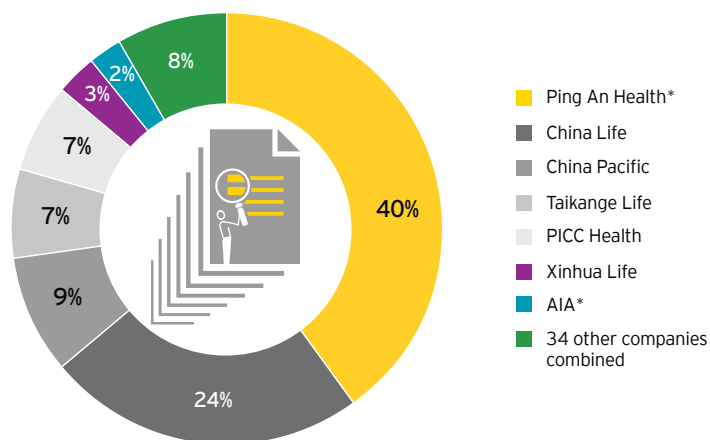
Figure 10: First-time private health insurance purchasers among survey respondents



Choice of insurance providers

Of respondents that have health care, 64% purchased private health insurance from Ping An Health or China Life. Another 28% cited five health insurance companies and 8% reported 34 different companies.

Figure 11: Survey respondents identified these health insurance companies

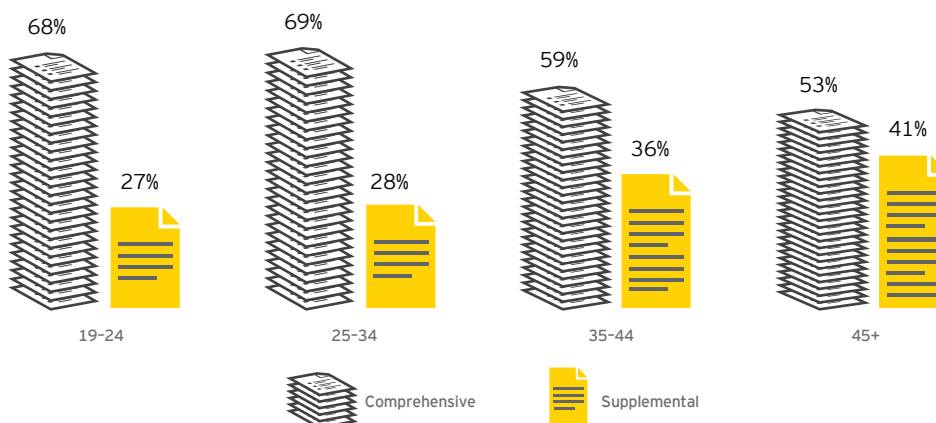


*Foreign invested insurance companies

While the market may seem to have consolidated among a few insurance providers, most plans comprise supplementary insurance products designed to complement public health insurance plans. Other plans are designed specifically for critical illnesses.

Although the government provides new critical illness coverage, out-of-pocket spending remains high. There is a move toward comprehensive coverage, especially among young people. According to our survey, 60% of respondents who had purchased a private health insurance product in the past year described their private health insurance plans as comprehensive coverage.

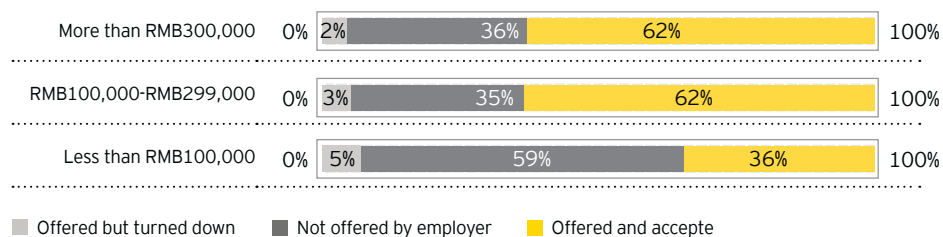
Figure 12: Comprehensive vs. supplemental private health insurance by age group



Employer-provided health insurance

Our survey found that 65% of respondents were offered private health insurance through their employers. The vast majority accepted the coverage, suggesting that Chinese companies are interested in utilizing group health insurance plans as a benefit to attract and retain top talent.

Figure 13: Employer-provided health insurance by income level

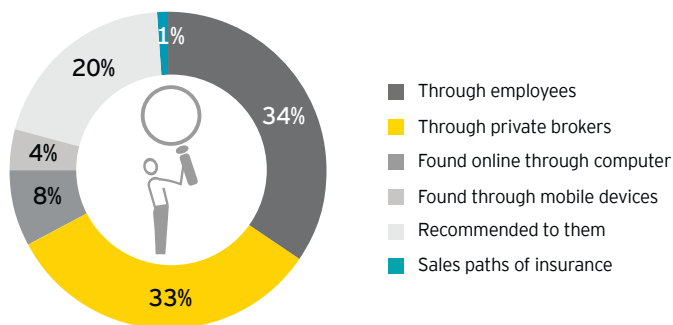




Selecting private health insurance plans

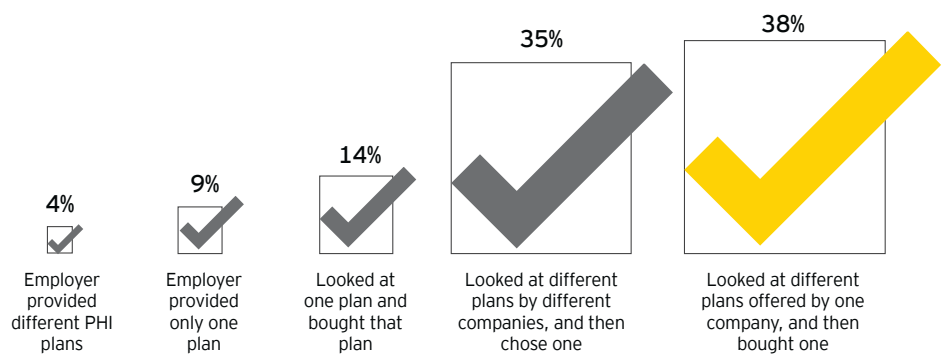
Excluding those respondents with employer-provided health insurance, we found that private health insurance sales vary and rely heavily on interpersonal relationships. One-third of consumers purchased their plans through private health insurance brokers. Another 20% made their selection based on family recommendations. A minority found their plans online through their computer (8%) or mobile device (4%).

Figure 14: How respondents discovered their private health insurance plans



While respondents considered broker or family recommendations, most were savvy and cautious consumers, weighing multiple options before making a decision. In fact, 38% explored multiple plans offered by a single company, and 35% reviewed plans from different private health insurance companies before selecting one.

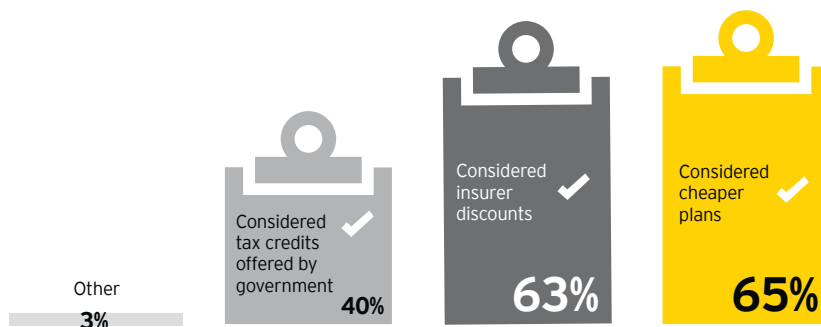
Figure 15: Survey respondents' private health insurance selection process



Consumers are price-sensitive, looking for discounts and tax credits

Chinese consumers consider multiple cost factors when choosing their private health insurance plans. Cost factors such as purchasing less expensive plans and factoring in insurer discounts attracted consumers to their current private health insurance plans. Insurance companies may need to offer initial lower premiums to attract new customers.

Figure 16: Cost factors considered by respondents

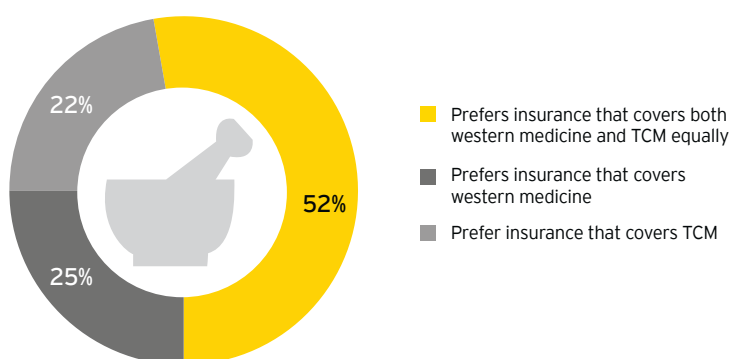


The role of traditional Chinese medicine

Traditional Chinese medicine (TCM), a large school of medicinal practices developed in China over millennia, is considered an invaluable part of the Chinese health care system. The industry, including treatment and drug sales, was valued at RMB7 trillion in 2015.

Despite TCM prominence in Chinese health care, our survey showed no clear preference for TCM over Western medicine. Survey respondents valued both equally, and most asked that their private health insurance plans cover both Western medicine and TCM.

Figure 17: Preference for TCM vs. Western medicine

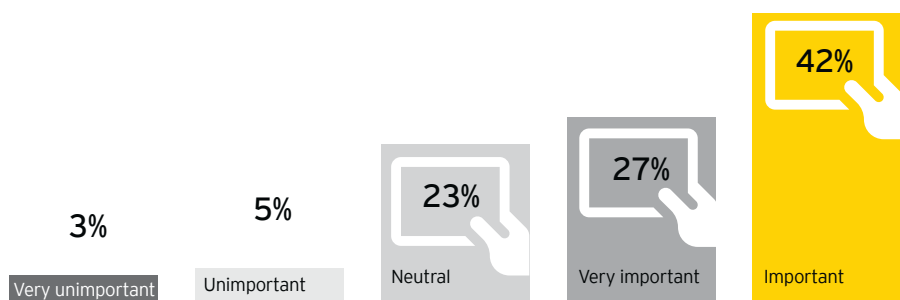




Electronic health records

Nearly three-quarters of respondents rated access to their own electronic medical records as either important or very important, indicating the significant role of electronic medical records in attracting and retaining customers.

Figure 18: How important is access to electronic medical records as a feature of your private health insurance plan?



Mobile health innovation and wearable technology

Mobile health technology (mHealth) is a rapidly growing industry that can further connect customers with their health information through smartphone integration. With a simple smartphone attachment, basic medical tests like ECGs or glucose monitors can be conducted by patients themselves. In 2014, the market for mHealth in China was RMB2.84 billion. This market is expected to increase dramatically to a projected RMB7.18 billion in 2016, an increase of 153%.¹⁵

When asked what online services their private insurance company offered, 51% of respondents used no services. However, a majority indicated that services such as wearable health technology, access to electronic health records and remote doctor's consultations were important when purchasing health insurance.

According to the survey, 54% of the respondents viewed the opportunities for obtaining health data from wearables as "important" or "very important" vs. 16% that did not.

Figure 19: How important is health data from wearable technology?

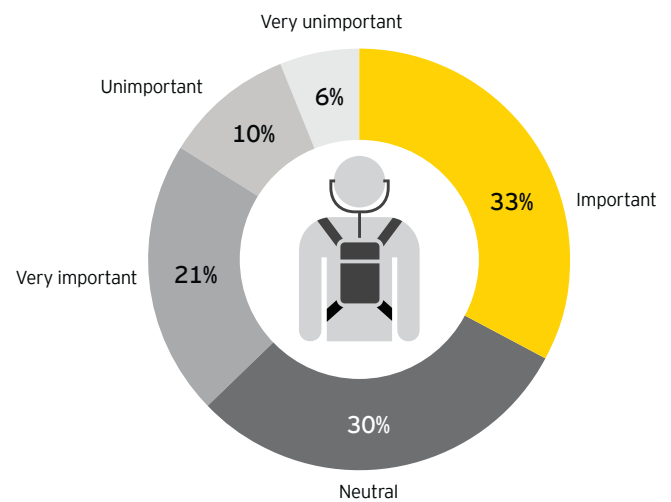
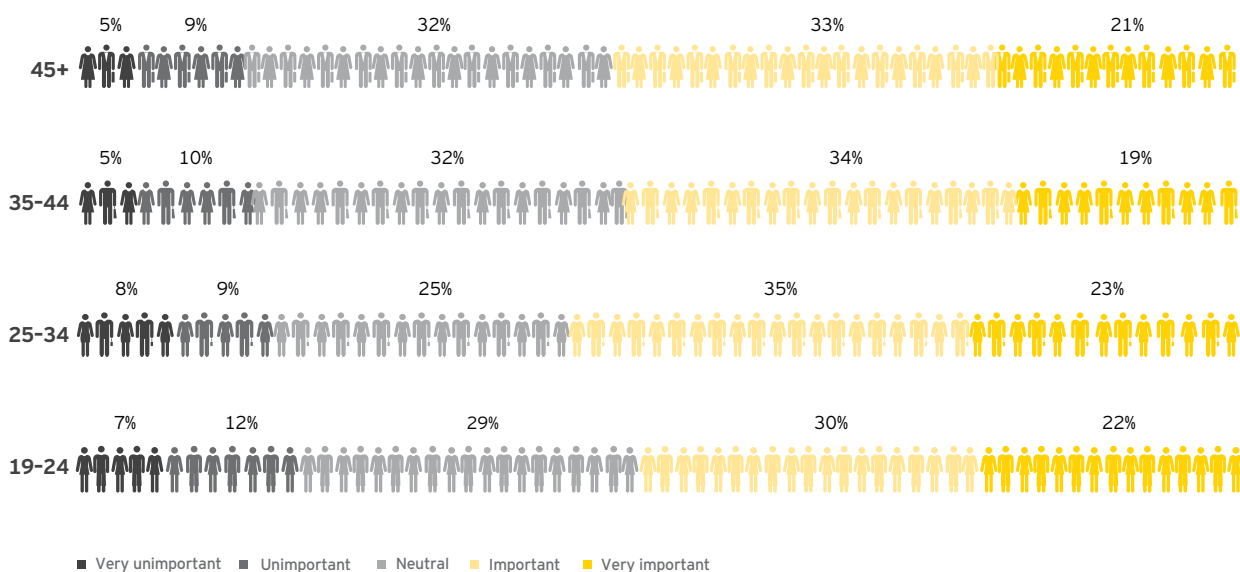


Figure 20: How important is health data from wearable technology by age group?



¹⁵"China's mHealth Market Value from 2011-2017 (in 100 million RMB)," Statista, March 2014.



04

**Regulatory issues change
the stakes for insurers**

A new regulation in 2014 enabled insurers, domestic and foreign, to invest and own more than one company in the same segment of the industry. Foreign companies (as well as domestic investors) may now own a stake in more than one insurance company that sells similar types of products. Previously, insurers were allowed to own only one subsidiary that competed in either life or non-life insurance. In addition, investors are now allowed to use loans to finance up to 50% of their stake, alleviating foreign enterprises of the burden to rely on hard cash to finance acquisitions.

Some analysts believe these new regulations will afford new opportunities for foreign insurance companies and other well-capitalized foreign firms to use loans to fund their expansion within China. Because of this, the market may consolidate as less well-capitalized ventures fail to keep pace with larger competitors. This may allow foreign insurance companies to avoid restrictions on physical expansion within China by acquiring stakes in existing health insurance companies that have a geographical presence in underutilized areas.

In July 2015, the CIRC announced it would approve online insurance companies that could offer insurance services through self-operated or third-party-operated insurance sales platforms. German insurer Allianz recently joined with Baidu and Hillhouse Capital to create an online insurance company to take advantage of the new regulations. The online market is still largely geared to property and automobile insurance, but life and health insurance are likely to follow.

One new closely watched regulatory movement is the opening of the Shanghai Free Trade Zone (SFTZ). The development of professional health insurance is highlighted in the regulations as one of 18 key service sectors to be promoted. The government is encouraging the expansion of health insurance companies in the SFTZ by allowing foreign investors to invest up to 100% in these companies, as well as making it easier to establish local branches. If foreign health insurers would prefer a joint venture with a Chinese company, the SFTZ regulations require that the Chinese company hold at least 30%, which still allows the foreign company majority control.

The SFTZ also removes the requirement for foreign insurers to operate a nonrevenue-earning representative office for two years before being approved to do business. Regulators have not clarified the scope for insurance companies operating in the SFTZ to expand their services beyond the zone. However, if this works, similar nationwide policies may follow, as happened with the opening of China to a market economy after trial periods with Special Economic Zones in the 1980s.

Foreign companies (as well as domestic investors) may now own a stake in more than one insurance company that sells similar types of products.



05

The way forward

There is a high level of consumer demand and interest in private health insurance products to supplement or replace public health insurance. With public insurance plans facing funding shortfalls, the government is promoting private health insurance by relaxing some regulatory barriers and providing tax incentives to Chinese individuals. Employer offered health insurance is increasingly popular for Chinese companies as a means to attract and retain talent. And, group insurance offers the most cost-effective way for insurers and companies to provide health insurance.

The insurance industry is in the early stages of technology-driven disruption and has an opportunity to roll out digital innovations that will position insurers to succeed in the changing market. Health care costs and reimbursement rates for public health insurance plans vary significantly between different cities and provinces. Drugs account for a significant amount of patients' out-of-pocket expenses, for both inpatient and outpatient treatments. This is an opportunity to offer insurance products, but risk still exists as the cost of care remains unpredictable.

China's urban population is growing rapidly, with more than half now living in cities. Middle- and upper-middle-class incomes are increasing, opening private health insurance to wider segments of the population. The Chinese population is aging, and the labor pool is shrinking, leading to a heavy funding burden for public insurance plans. The long-term health effects of pollution are an added concern for China's urban middle classes.

In spite of the opportunities, the risks can be challenging. There is no standardized system of patient data collection or method of assessing health care costs. China's health care providers have historically not collaborated with private insurance providers, and they have no incentive to do so. The regulatory environment for insurance is liberalizing; however, strict regulations for foreign insurers remain. The market is huge and growing rapidly, but regulatory challenges will prevent all but the biggest foreign players from succeeding.

Reforms aimed at relaxing regulations restricting mergers and acquisitions, promoting new online insurance platforms, developing free-trade zones and a new risk and solvency regulatory system bode well for new opportunities. Yet, it is highly unlikely that there will be a level playing field for foreign insurers.



Notes:



Contacts

Shaun Crawford

EY Global Insurance Leader
+44 207 951 2172
scrawford2@uk.ey.com

Warrick Gard

EY Global Insurance Health Leader
+61 2 9248 4484
warrick.gard@au.ey.com

Rohan Sachdev

EY Emerging Markets Leader
+91 226 192 0470
rohan.sachdev@in.ey.com

Jonathan Zhao

EY Asia-Pacific Insurance Leader
+852 2846 9023
jonathan.zhao@hk.ey.com

Andy Ng

EY Greater China Insurance Leader
+86 10 5815 2870
andy.ng@cn.ey.com

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