

CHINA'S INSURANCE MARKETS: MORE THAN JUST GROWTH

Asia Capital Re issues a new report on the state of the Chinese insurance market and finds the market returning to profit

A seven-fold increase in premiums in just 10 years

In 2010, China displaced Japan as the world's second largest economy, thus firmly establishing itself as a key player in the global financial system. China's GDP quadrupled from 2000 to 2010, reaching almost CNY 40 trillion, or US\$6 trillion, at average 2010 exchange rates (see Table 1).

Within this same decade, China's property & casualty (P&C) insurance markets expanded at an average annual growth rate of 21%, which is significantly faster than the country's vibrant economy. Total P&C premium volume for China in 2010 amounted to approximately CNY 403 billion (US\$60 billion) [see Table 1].

Motor remains the dominant line of business

Motor insurance accounted for 74.6% of China's P&C sector in 2010 (see Chart 1). This dominant position reflects the introduction of mandatory third-party liability insurance in 2006 and a dramatic increase in car ownership, which has catapulted China to the global number one position as far as vehicle sales are concerned (18.5 million in 2011). Agricultural and credit & surety insurance have been growing fastest recently (see Chart 2), as the government is keen to harness insurance solutions to enhance the stability of agricultural output and as a consequence of China's accelerating integration into the global economy, respectively.

Turnaround in underwriting results According to the Yearbook of China's Insurance, the industry suffered underwriting losses from 2006 to



TABLE 1: CHINA KEY FIGURES 2010 VERSUS 2000

Year	P&C Premium Written (in CNY million)	P&C Premium Written (in US\$ million)	GDP (in CNY million)	GDP (in US\$ million)	P&C insurance penetration (premiums as a share of GDP)
2000	59,839	8,988	9,921,500	1,490,229	0.6%
2010	402,689	60,485	39,798,300	5,977,785	1.0%

Sources: Yearbook of China's Insurance 2011, National Bureau of Statistics of China, own calculations (all US\$ figures reflect the average 2010 US\$/CNY exchange rate of 6.66)

2009. The worst underwriting year was 2008, which recorded a combined ratio of 106.7% when the Sichuan earthquake, snowstorms and investment losses in the wake of the global financial crisis took their toll on China's insurers. In 2009, the combined ratio improved to 104.5%. This positive trend accelerated in 2010 and in the first half of 2011 when the market combined ratio fell to 97.3% and below 93% for the market's Top 3 insurers, respectively. The main drivers behind this market turnaround can be summarised as follows:

 The massive losses of 2008 brought a number of insurers close to a "near-death" experience, raising awareness of the benefits of market discipline and responsible competition.

- The China Insurance Regulatory Commission (CIRC)
 has tightened solvency capital and corporate executive
 'fitness' requirements, slowed the pace of expansion
 pursued by a number of companies, enforced the 'cash
 before cover' principle in motor business to reduce
 risks in relation to premium receivables and capped
 commission levels, among other initiatives.
- Investment returns recovered as from mid-2009. Despite these improvements, the compulsory motor insurance sector remains in the red, with underwriting losses in 2010 amounting to approximately US\$1.5 billion, according to the CIRC. Against this backdrop, the Chinese government has recently announced that it will open up the compulsory motor third-party liability (MTPL) insurance market to foreign insurers in order to inject new technologies and underwriting skills into the segment.

Although most P&C players experienced underwriting losses for MTPL insurance, underwriting profits for

CHART 1: PROPERTY & CASUALTY BUSINESS MIX 2010

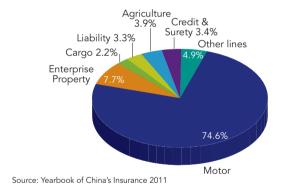
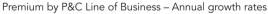
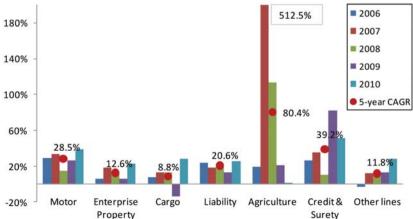


CHART 2: COMPOUND ANNUAL GROWTH RATE (CAGR) BY LINE OF BUSINESS 2006-2010





Source: Authors' own calculations based on figures from Yearbook of China's Insurance 2006-2011

commercial motor vehicle insurance are contributing to the overall profitability of motor insurance. According to the Yearbook of China's Insurance 2011, motor insurance reported in 2010 a loss ratio of 46%, and an underwriting profit (US\$ 931 million) for the first time since 2005.

In order to further stabilise the market, the CIRC is considering a wide-ranging commercial motor insurance pricing reform. According to the document released after gathering feedback in October 2011, insurers must meet the following requirements in order to enjoy full pricing flexibility in commercial motor insurance:

- Two consecutive years of underwriting profit/combined ratio below 100%
- Two consecutive years of solvency margin above 150%
- Previous year's underwriting capacity of over 300,000 cars
- Three years of experience in operating commercial motor insurance with good corporate governance and internal controls
- Cancellation of pricing flexibility if an eligible insurer sees a decrease in solvency to less than 150% for a year and an increase of the combined ratio to more than 100% over two consecutive years.

All other insurers would need to adhere to the risk loadings suggested by the Insurance Association of China (IAC), whilst they could retain some flexibility over expense loadings.

High market concentration

As of year-end 2011, 59 P&C insurers were active in China. Of those, 38 were domestic and 21 were foreign companies. The Top 5 insurers account for 74% of the total market. This very high concentration, among other factors, reflects the fact that domestic players still dominate the local scene, with state's insurer PICC successfully holding its own and, Ping An, the second largest player and China's first joint-stock company founded in 1988, gaining market share (see Table 2).

China started issuing licenses to foreign insurers in 1992. However, their collective share of the P&C market was as little as 1.1% in 2010, according to the CIRC. The largest foreign players are Chartis, Tokio Marine and Mitsui Sumitomo Insurance. The limited footprint of foreign insurers in China is attributable to cultural, language and regulatory obstacles, geographical restrictions as well as their exclusion from compulsory motor insurance. This segment, however, is expected to be opened up to foreign insurers soon – offering access to a premium volume of about US\$15 billion.

Distribution: Direct sales dominate

According to the CIRC 73% of China's P&C business is sold directly (primarily through corporate branch





TABLE 2: TOP 5 P&C INSURERS BY MARKET SHARE								
	2007	2008	2009	2010				
PICC P&C	42.5%	41.6%	39.9%	38.2%				
Ping An P&C	10.3%	10.9%	12.9%	15.4%				
CPIC P&C	11.2%	11.4%	11.4%	12.8%				
China United	8.8%	7.8%	6.5%	4.8%				
China Continent	4.8%	3.9%	3.4%	3.4%				
Source: CIRC								

networks and call centres) and via the agency channel. Cross-sector intermediaries, including banks, post offices, car dealers, travel agents etc., handle 19% of the market and account for a major part of personal lines business. As in other countries, bancassurance is far less important for the P&C sector as compared with the life segment of the market.

Recent CIRC regulations limiting commissions for all lines to a maximum of 15% are expected to further boost the share of direct sales at the expense of agency distribution. While the role of brokers in China is still marginal, it is the fastest growing distribution channel.

Regulation: Medium-term trend towards Risk-Based Capital

Regulatory reform is a major driving force behind the dynamic development of China's insurance markets. These efforts started in the 1980s and experienced a significant acceleration following China's accession to the World Trade Organization (WTO) in 2001. Over the past two decades, foreign insurers were admitted to the market, foreign equity participations in major domestic insurers were allowed, compulsory cessions to China Re were dismantled, compulsory lines of business were introduced, and accounting and investment rules were modernised – to name a few regulatory milestones.

In terms of solvency regulation, the CIRC still applies a framework comparable to Solvency I, with capital requirements determined as a function of premium and reserve levels. Medium-term, the CIRC is expected to move towards a risk-based capital approach, in line with a trend observable throughout Asia.

Outlook: Rapid expansion entails new opportunities and challenges

Over the next ten years, we expect the Chinese P&C insurance market to expand at an average annual rate of at least 15%. The pace of expansion is likely to slow down from the more than 20% CAGR recorded in the first decade of the 21st century, as a result of a natural base effect as well as in light of less vibrant car sales due

to rising petrol prices and road traffic control schemes introduced in major cities.

On the back of these dynamics, the country's P&C sector could well be the world's second largest by 2020, coming close to a premium volume of US\$250 billion, twice the current market volume of Germany.

Despite this bright outlook, the rapidly expanding Chinese insurance market faces a number of challenges. For example, the country's insurers will need more capital to support future growth and cushion against potentially unfavourable movements in capital markets

According to A.M. Best, the NPW/capital ratio for the Top 3 P&C insurers has increased from 3.1 in 2006 to 4.2 in 2010. Capital injections appear to be inevitable as retained profits alone are not expected to suffice in sustaining strong capital bases. A move towards Risk-Based Capital may add further urgency to this challenge. China's insurers start responding: In 2011, additional capital of CNY 65 billion (US\$10.2 billion) was raised from their shareholders and another CNY 56 billion through subordinated debt in a bid to beef up their capital position.

Separately, the overarching trend towards rate deregulation may impact the industry's growth and profitability outlook, especially for commercial motor insurance business.

Finally, the insurance industry will need to prepare for accelerating asset value concentration in areas of China that are prone to natural disasters such as earthquakes, floods and typhoons. Addressing this challenge will require a concerted approach by the public sector (e.g. through tightened loss prevention regulations), in collaboration with the domestic insurance and global reinsurance industry. \square

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CHART 3: PROPERTY & CASUALTY INSURANCE DISTRIBUTION MIX

