



The Developments and Future Prospects of Insurance Industry in China

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Abstract

During the past three decades, the insurance industry has developed from a virtually nonexistent industry to a large, open industry. This fast growing economy coupled with the largest population in the world, rising personal income, and economic system reform could not only explain the rapid growth of China's insurance industry, but also foretell the increasing importance of China's insurance market in the future. This paper provides an analysis of the generic development of China's insurance industry from 1980 under the context of China's economic reform and opening up and its future prospects. First we simply cover the development of insurance industry in china during the period of 1980-2003 and we divide it into three stages: (1) resumption and restoration, (2) market-oriented reform, and (3) opening up and rapid growth. Then we forecast its future trends. Finally, presents the conclusion.

Keywords: Insurance industry, Developments and prospects, China

1. Introduction

As a country with a history of more than five thousand years, ancient people of China developed various measures with similar conditions could share risks and help each other. These measures can be considered the most primitive forms of insurance. But the real modern insurance was introduced to China by the West during the final of Qing Dynasty, which controlled China's insurance market profitably for a long period of time. And this may have contributed to the concern that China's insurance industry might again be controlled by foreign capital and the prudence in granting foreign insurers licenses to operate in China.

Since the Founding of New China, the insurance industry was revived from 1980 when economic system reform and opening up began. During the past three decades, the insurance industry has developed from a virtually nonexistent, minimal, and closed industry to a large, open industry with potential promise. The volume of insurance premiums grew rapidly from RMB 0.46 billion in 1980 to RMB 388 billion in 2003, 230 ranking China eleventh in the world with 1.6 percent of the global market share (China Insurance Regulatory Commission (CIRC); Swiss Re 2004, p.35). This fast growing economy coupled with the largest population in the world, rising personal income, and economic system reform could not only explain the rapid growth of China's insurance industry, but also foretell the increasing importance of China's insurance market in the future.

China's insurance industry was deeply affected by the reform and opening up of China. On one hand, the economic system reforms recreated China's insurance market and thus determined the direction of the industry. China's market-oriented economic system reform was a gradual process of institutional change dominated by the government. As a result, only state capital could be found in China's insurance industry and the market was exceedingly concentrated at the beginning of the industry's restoration. On the other hand, opening up to the outside exposed the infant industry to fierce international competition, bringing great opportunities along with grave challenges to domestic insurers.

2. The development of insurance industry in china since 1980

From the 3rd Plenary Session of the 11th Chinese Communist Party (CPC) Central Committee led by Deng Xiaoping at the end of 1978, the economic system reform and economic construction became the main theme of China's development. Then, nation's financial system, governed by the People's Bank of China (PBOC), came into being. Concurrently, the insurance industry was restored and developed rapidly in the ensuing years. To explore the development of the insurance industry in China, we divided into three stages consistent with the gradual development of China's economic system reform: (1) resumption and restoration, (2) market-oriented reform, and (3) opening up and rapid growth.

2.1 the Resumption and Restoration period (1980-1985)

At the initial stage of economic system reform, the government aimed at developing the commercial insurance system and encouraging the domestic insurance business. These reforms came twenty-one years after the closure of the insurance industry. At this stage, all insurance business was monopolized by PICC, which was directly controlled by the central government. Insurance regulation was carried out by the PBOC, People's Bank of China. The terms and rates of policies were set and/or approved by the "regulator." As a result, the insurance product portfolio lacked variety, there was narrow use of complex actuarial science in pricing, and the price structure was simplistic. Additionally, the distribution channels were limited. Also, insurance assets were simply deposited in banks without consideration to an investment policy of diversification between bonds, equities, or real estate.

In 1982, the total gross life insurance premiums totaled only RMB 1.6 million (CIRC). From this very small base, both the non-life and life insurance businesses grew significantly with annual growth rates exceeding GDP growth rates. As Table 2.1 indicates, during this period, the life insurance business was insignificant relative to non-life insurance market. At this stage, enterprise property insurance and transportation equipment insurance (insurance coverage on motor vehicles, keel boats, and fishing boats) dominated the market.

Insert Table 2.1 here

2.2 the Beginning of Market-Oriented Reform period (1986-1991)

In March 1985, the State Council of China enacted Interim Regulations on the Administration of Insurance Enterprises, setting out the requirements for the establishment of insurance companies. At this stage, The PBOC's direct administration of the insurance industry began to give way to supervision as the market-oriented reforms progressed. In 1995, PBOC established the Division of Insurance Supervision under its Department of Non-Banking Financial Institutions Supervision, which took over the responsibility of insurance supervision.

During this period, the limit on insurance investment channels and risk control mechanisms were relaxed. This resulted in extensive investment in real estate, securities, and trusts, which led to substantial investment in non-performing assets. However, there were no visible changes in the distribution system and insurance product portfolio. As Table 2.2 shows, while the volume of life insurance premiums was lower than that of non-life insurance, the fast growth of insurance premiums remained higher than GDP growth

Insert Table 2.2 here

2.3 the Opening Up and Rapid Growth period (1992-2003)

The 14th National Congress of CPC in 1992 and the 3rd Plenary Session of the 14th CPC Central Committee in 1993 confirmed China's irreversible commitment to market-oriented reforms. Individuals and enterprises lost their traditional economic safeguard and were responsible for assuming financial risks. As a result, many factors contributed to the rapid growth of the insurance industry, including the fast growing economy, rising personal income, accelerating industrialization and urbanization, and social security system reform. In the remainder of this section, the current state of various aspects of China's insurance market is examined. From 1992 to 2003, the average annual growth rate of gross premiums remained at over 30 percent. Table 2.3 shows the volume of insurance, both life and non-life and GDP. It can be seen that the volume of life insurance premiums surpassed that of non-life insurance for the first time in 1997 and remained higher in the subsequent years. The rapid growth of premium income and an expanded capital base explain the substantive increase in the total assets of the industry.

Generally speaking, the competitiveness of the market has been on the rise as the number of insurers has increased over time, but China's insurance market is still characterized as a typical oligopoly market. The government remains heavily involved in the industry, though not as much as before.

Insert Table 2.3 here

3. The future Trends in China's Insurance Industry

We forecast that China's insurance industry will maintain a two-digit growth rate in the coming eight to ten years and the growth rate will be descending over time. As to the development of the industry itself, the market system will keep up with international standards gradually and the following trends will be the most prominent features in an environment characterized by globalization, financial integration, aging population, and dynamic information technologies.

3.1 Growing Competition in the Insurance Market

China's insurance market will be more competitive as more foreign capital flows in and the number of insurers increases. The competitiveness of the insurance industry is growing at an accelerating pace. We anticipate that in next 3 year both of the respective market shares of the top 5 insurers in the life and non-life insurance sectors will fall to about 65 percent and 70 percent respectively and that the largest life insurer will hold about 40 percent of the market while the largest non-life insurer will hold about 45 percent. At the same time, the fierce competition will drive the insurers to pay

a great deal of attention to the quality of service and the functions of insurance products. However, on the whole, China's insurance market will still be characterized as a concentrated oligopoly in the medium-term.

3.2 Deepening Cooperation with Other Financial Institutions, Especially Banks

The cooperation between insurers and banks will be strengthened greatly. Bancassurance has been a success in China, because banks have advantages over insurers in customer resources and marketing. People in China are acquainted with and have steadfast trust in banks and therefore, bank services can be easily accepted. Bancassurance can be expected to continue to be one of the major distribution channels for life insurance. Besides strengthening strategic cooperation between the two industries, there will be more and more holding companies controlling both banks and insurance companies.

Finally, with a view to the coming financial integration, various innovative measures for the controlling of systematic financial risks, such as insurance securitization, will become popular, but not in the near term. The development of insurance securitization is a complex project and is demanding for both the insurance market and the securities market. Presently, the preconditions for insurance securitization do not exist in China, including theoretical research, the training of professional personnel, and the establishment of required infrastructure (e.g., legislation system). However, alternative risk transfer mechanisms will surely be important means for risk management by China's insurance industry.

3.3 Optimization of the Product Portfolio

With respect to China's life insurance sector, the demand for health and pension insurance will increase rapidly and steadily along with the aging population and the deepening of social security reform. On the health insurance side, while currently the government provides a large portion of health care in urban areas, this portion is declining. Consequently, the role of private health insurance is rising. Note, however, that there is hardly any private health insurance in rural areas of China. However, it is worth indicating that severe adverse selection and moral hazard exist, and domestic insurers lack experience in risk control. Therefore, China's insurers need to improve their health plans and intensify their cooperation with hospitals in order to control the medical costs and reduce adverse selection and moral hazard. Managed care plans will be introduced in China and will likely become the major operation pattern of health insurance in the next five to eight years. As for pension insurance, the insurance industry is faced with great opportunities and foreign insurance companies specializing in pension will play an important role in the market.

4. Conclusions

China's insurance industry developed rapidly from a virtually nonexistent, minimal, and closed industry into a large, open industry with great potential. This is supported by the growing insurance demand resulting from the government's efforts to create market-oriented reforms in the 1980s. As to the supply side, China's insurance market is characterized by an increase in the number of insurers and organizational restructuring of the state-owned insurers, which gradually lost their former monopoly of insurance market. While the market has become more competitive, it is still characterized as a typical oligopoly and the government remains heavily involved in the industry, though not as much as before. Furthermore, the geographic distribution of China's insurance industry is highly imbalanced. As a developing industry in a developing economy, China's insurance industry undoubtedly has tremendous potential. Some factors, including excellent economic prospects, accelerated economic system reform, and the large and aging population will drive China's insurance industry to grow continuously and rapidly. However, the development of the industry might be bottlenecked by the immature domestic capital market, shortage of professional personnel, unfavorable image of the industry, and lack of public good faith. Despite these challenges, we forecast that

China's insurance industry will maintain a two-digit growth rate in the forthcoming eight to ten years and the growth rate will be decreasing over time. As to the development of the industry itself, the market will catch up with international standards gradually and become more and more competitive. There will be deepening cooperation between insurers and other financial institutions, especially banks. Optimization of product portfolios and diversification of distribution channels are also expected, though agents and brokers will continue to play a crucial role.

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Table 2.1 Economic Growth and Insurance Premiums in China, 1980-1985(RMB 100M)

items	value in year					
	1980	1981	1982	1983	1984	1985
GDP	4517.8	4860.3	5301.8	5957.4	7206.7	89889.1
Total Premiums	4.6	7.8	10.3	13.2	20	33.1
Non-Life Insurance premiums	4.6	7.8	10.3	13.1	19.3	28.7
life insurance Premiums	N/A	N/A	N/A	0.1	0.7	4.4

Source: National Bureau of Statistics of China (2004), §3.1, §3.3, China Insurance Regulatory Commission (CIRC).

Table 2.2 Economic Growth and Insurance Premiums in China, 1986-1991(RMB 100M)

items	value in year					
	1986	1987	1988	1989	1990	1991
GDP	10201.4	11954.5	14922.3	16917.8	18598.4	21662.5
Total Premiums	45.8	71	110.4	97.6	135.2	178.2
Non-Life Insurance premiums	34.5	46.1	72.9	78.1	106.8	136.8
life insurance Premiums	11.3	25	37.5	19.6	28.4	41.4

Source: National Bureau of Statistics of China (2004), §3.1, §3.3; China Insurance Regulatory Commission (CIRC).

Table 2.3 Economic Growth and Insurance Premiums in China, 1992-2003(RMB 100M)

year	GDP	Total Premiums	Non-Life Insurance premiums	life insurance Premiums
1992	26651.9	211.7	147.4	64.3
1993	34560.5	395.5	251.4	144.1
1994	46670	500.4	336.9	163.5
1995	57494.9	594.9	390.7	204.2
1996	66850.5	777.1	452.5	324.6
1997	73142.7	1087.9	480.7	607.2
1998	76967.2	1247.6	499.6	748
1999	80579.4	1393.2	521.1	872.1
2000	88254	1595.9	598.4	997.5
2001	95727.9	2109.2	685.4	1424
2002	103935.3	3053.2	778.6	2274.9
2003	116603.2	3880.4	869.4	3011

Source: National Bureau of Statistics of China (2004), §3.1, §3.3, China Insurance Regulatory Commission (CIRC).