SOCIETY OF ACTUARIES

Article from:

Reinsurance News

February 2010 – Issue 67

China Reinsurance Market Overview

By Xueyun Huang & Meipan Tian

Xueyun Huang, ASA, is deputy director with the China Life Reinsurance Company in Beijing, China. Xueyun can be reached at huangxueyun@chinalifere.cn.

Meipan Tian, FSA, is chief actuary with the China Life Reinsurance Company in Beijing, China. Meipan can be reached at tianmeipan@chinalifere.cn.

China's life insurance industry has been expanding rapidly over the past few years. However, the life reinsurance sector, starting from a weak base, has lagged behind the development of the life insurance sector. It wasn't until 1996 that the first professional and specialized reinsurance company in China, China Reinsurance Company (ChRC), was established. From 1996 to 2002, ChRC was the only specialized reinsurance company in China's insurance market while the number of direct insurers increased from 11 to 46 during the same period. ChRC plays the role of the national reinsurance company and also has the exclusive right to operate the compulsory reinsurance business, which was stipulated by regulations that direct insurers must cede 20 percent of the gross written premium of the personal accident (PA) and health insurance business.

Things began to change after China entered into the World Trade Organization (WTO) in 2001. According to China's commitment upon entry to the WTO, foreign companies are allowed to provide life and non-life reinsurance services in the form of joint ventures, branches and subsidiaries. In addition, there should be no limitations on the number or districts they operate in. Compulsory reinsurance cession by domestic insurers was prescribed to be reduced by 5 percent annually, within four years after entry in the WTO, with the 20 percent compulsory reinsurance share to be canceled.

Starting in 2003, Munich Re, Swiss Re, Gen Re, Lloyd's, Scor Re and Hannover Re set up their local branch offices respectively in Beijing or Shanghai. At the same time, top global reinsurance brokers such as Aon Re, Guy Carpenter, Benfield and Willis Re have opened offices in China and play a very active role in the market. In order to promote the reform of the state-owned insurance companies, ChRC was restructured into China Reinsurance (Group) Company in 2003 which received a further capital injection of $4 billion by Central Huijin Investment Ltd. in 2007 to become the largest reinsurer in Asia by registered capital. At present, China Reinsurance (Group) Company still has the largest market share, and China Life Reinsurance Company, one of the key subsidiaries of China Reinsurance (Group) Company, accounts for about 80 percent of the life reinsurance premiums written in China.

The removal of compulsory cession and the arrival of new entrants brought many changes. The reinsurance market has now become much more competitive and more fragmented. The demand for reinsurance from direct insurers has been more diversified. The quality of services, financial stability, product development capability and training resources have become more important criteria when choosing reinsurers.

Even so, the reinsurance market is still in its initial stages. For the life reinsurance sector, proportional reinsurance dominates the market. Non-proportional reinsurance has increased a little in recent years and makes up less than 1 percent of the market. With proportional reinsurance, traditional coinsurance and yearly renewable term plans are most commonly used, with modified coinsurance plans emerging to satisfy special requirements from some direct insurers. For life and PA business, direct insurers' retentions are high and they prefer to use surplus reinsurance since the average sum assured is low. However, for critical illness and medical insurance plans, direct insurers keep their retentions low and use quota share to transfer risk to reinsurers since the health insurance business can be volatile. As for non-proportional reinsurance, catastrophe plans are the most popular.

In 2006, China's reinsurance premiums came to 21.7 billion yuan ($2.87 billion), of which life reinsurance premiums only accounted for 20 percent. From 2004 to 2006, the ratio of reinsurance premiums to direct insurance premiums was as low as 4 percent. Reinsurance premiums grew by an average of 9.2 percent a year from 1996 to 2006, contrasting with growth of direct insurance premiums of 21.9 percent and China's GDP growth of 11.4 percent.[1] By the end of 2006, the total assets of China's reinsurers had reached 31.2 billion yuan, less than two percent of the total for the insurance industry.

---

[1] China Insurance Regulatory Commission: "Guidelines for the Development of China's Reinsurance Market" June 2007.

The underdevelopment of the reinsurance industry drew the attention of China's State Council and China Insurance Regulatory Commission (CIRC). In 2006, the State Council released Some Opinions of the State Council on the Reform and Development of the Insurance Industry, in which the need to speed up the development of the reinsurance industry was stressed. In the next year, the CIRC issued Guidelines for the Development of China's Reinsurance Market. In this report, the CIRC summarized the status quo of the reinsurance industry, analyzed the contributing factors to the development of the reinsurance market and established the following objectives for the future development of the sector.

The contributing factors which would help boost the reinsurance sector and promote its development in a healthy way include:

1. STRONGER REINSURANCE REGULATIONS.

In October 2005, the CIRC issued regulations on reinsurance business for the first time. The regulations established the general framework for reinsurers conducting business in China. It set forth new requirements for staff and products of reinsurance companies and set up a reporting system on reinsurance reserves, solvency and reinsurance business. Without the prior approval of CIRC, foreign insurance companies could not conduct reinsurance transactions with their affiliated companies overseas. The solvency of branches of foreign reinsurance companies should be judged on the basis of their parent companies and concerned reports should be delivered to the CIRC to prove the parent companies' solvency and state of performance. In June 2009, the amendment to the regulation was circulated to insurance companies seeking opinions.

In November 2007, the CIRC issued notification which required direct insurers to review their reinsurance plans annually and select reinsurers according to specific criteria including credit ratings, solvency levels, registered capital, etc. For example, the reinsurance treaty leaders should either be state-owned enterprises or have credit ratings not lower than A- by S&P or A.M. Best or Fitch or A3 by Moody's.

CONTINUED ON **PAGE 10**

2. REGULATORS HAVE PUT MORE EMPHASIS ON SOLVENCY THAN MARKET CONDUCT.

In 2008, the CIRC introduced a new regulatory regime aimed at enhancing its supervision over the solvency of Chinese insurers. The Administrative Provisions on the Solvency of Insurance Companies (New Provisions) came into force on Sept. 1, 2008, replacing the Administrative Provisions on Solvency Levels and Regulatory Indices of Insurance Companies introduced by the CIRC in 2003. Unlike the 2003 rules, which stipulate solvency levels and 11 regulatory indices for P&C insurers and 12 regulatory indices for life insurers, the New Provisions focus on Solvency Adequacy Ratio calculated as the ratio of Actual Capital to Minimum Capital and require insurance companies to undergo dynamic solvency testing and assess Minimum Capital on the basis of risks to which the insurer is exposed. Until now, the calculation of Minimum Capital was similar to the EU Solvency I approach.

At present, the solvency requirements for reinsurance companies are similar to direct insurers.

The new regime also applies to Chinese incorporated insurance companies as well as Chinese branches of foreign insurance companies. Compliance with the New Provisions is critical for all insurers doing business in China. Insurers with insufficient solvency levels will be prevented from expanding their new business or from declaring dividends to shareholders or be restricted in asset investment, etc. Through the new provisions, insurers are urged to shift their focus from expanding business scale to improving business quality. For those insurers with problems with solvency, reinsurance arrangements are one of the most popular solutions they would consider.

3. DIRECT INSURERS HAVE PUT MORE EMPHASIS ON PROTECTION PRODUCTS.

In recent years, the booming stock market helped boost sales of savings and investment products. According to McKinsey, from 2004 to 2008, the market share of protection products dropped from 42 to 23 percent. However, the situation has changed since 2008. One reason is that the huge volatility in China's stock market since 2008 has caused the demand for investment products to decrease. Another major reason is the great effort that the CIRC has taken to urge insurance companies to shift their business focus to protection products. The increase in sales of protection products leaves more room for the development of the reinsurance market.

According to the CIRC, China aims to increase its insurance premiums by 2010 to one trillion yuan, and it aims to expand its reinsurance premiums to 66 billion yuan by the same year. ■