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# China Update: The Life Insurance Industry—Not Many Get Invited

***by Yuan Chang***

To foreign insurers, the attraction of operating in a country with more than 1.2 billion people, and counting, is irresistible. For them the China market has become the prime target for expansion. Amid the explosion of activities in a multifaceted economic reform, growth of insurance in China in the past few years has been nothing but extraordinary. For life insurance alone, premium income more than doubled just in the last two years. Nearly 100 insurers from all over the world are seeking ways to get in the crowded door of the China insurance industry, but only a handful of the "fortunate" have been granted a license to operate primarily in one city—Shanghai.

If there is one thing common among these foreign companies, it is that they all have endured and maneuvered through a long and drawn-out process. In such a process, they needed to observe and study, to establish strong and close relationships with all levels of government officials at essential departments, to demonstrate long-term commitment to China, and finally to enjoy the good fortune of being the beneficiary of a favorable climate of nation-specific foreign relationships. For those waiting, there is no known pattern to follow and there is no formula that remotely approaches certainty of success.

Why the need for such a long, drawn-out process? Why can't China accelerate the process of opening up the insurance market? In approximately the past five years, there have been 10 single-city licenses issued to seven foreign companies. It is not, however, a thoughtless expression of antiforeigner sentiment. Foreign capital and foreign technology, along with foreign persons, are very much welcome in China. Contrary to how it may appear, it is not the result of a grand design to extract as many contributions of value as possible from those waiting outside the gate. It is not even a focus on the understandable political need to protect the fledgling domestic life insurance industry.

It is, in my opinion, the manifestation of a dilemma.

Chinese leaders know that they have to open the insurance sector to foreign competition in order to develop a healthy insurance industry. They realize that the development of a healthy insurance industry, especially life insurance, is essential to the building of a strong and healthy financial industry. They understand the need for foreign management, technology, and capital from foreign insurers, which can be made effectively available only if the foreign insurers are allowed to operate inside the boundaries of China and enjoy the same operating environment as the domestic insurers.

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The leaders may need to have a clearer appreciation of the role of the life insurance industry in the economy, what it can contribute, and what risk it presents. But they do have a perspective of what foreign competition can do to the domestic industry. No doubt they are worried that domestic insurers are not ready for foreign competition. Individual life insurance and distribution of these products by career agency forces are new and virtually unheard of before the first foreign company began operation in Shanghai in 1992.

Compared to foreign insurers, domestic insurers are deficient in most categories of management activities, such as actuarial techniques, asset management techniques, operating know-how, and risk control. After all, China's largest insurer has a short history, less than 20 years, since it was reinstated in 1979; whereas most foreign insurers waiting to enter the China market each have more than 100 years of operating experience.

But they also must know that the domestic industry may never be ready for modern competition without adequate stimulation from the foreign sector. Without the management techniques and technological framework the foreign companies can provide, the domestic process of reaching maturity in all likelihood will take much longer than desired. To provide a level playing field, certain protective measures might be provided to domestic companies and mandated cooperative effort may also be appropriate. But sooner or later, the proverbial ugly bride must meet her in-laws, as the Chinese would say.

It is not only desirable, but necessary, that the contributing force of life insurance be effectively unleashed into a developing economy. When an insurance company sells an insurance policy or annuity to a buyer, it undertakes a long-term liability in exchange for an asset in the form of cash premium. To support the long-term liability, these assets must be invested in similarly long-term instruments. It is simply long-term capital by another name. In effect, at each institution a large volume of small savings is converted to a single stream of long-term capital.

Insurers, private or state-owned, are the only institutions that gather long-term assets, which they do very effectively. If the gathered funds can be used in the construction of the developing economy, then the life insurance industry will have fulfilled one-half of its role, the other half being that of a provider of individual and family financial security. The earlier the life insurance industry can be of use in this arena, the better it is for the economy.

But there is more to worry about!

Chinese leaders also must be concerned about the risk of financial failure and its impact on an unevenly growing economy, now further accentuated by the still-brewing Asian financial crisis. There is the feeling at the top that China is lucky to have been insulated against the spread of the crisis into

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China, albeit not immune. But that feeling is not a very satisfying one because such insulation will not always be available if financial reform is to proceed on schedule. So it is with the life insurance industry. While the impact of foreign insurance companies is minute at this time, the risk that comes inevitably with a fast-growing industry will be considerable.

Because of China's short insurance history, no one in China has a comprehensive understanding of the risks that an insurance company faces or the risks to the economy and the society if one fails. This is an uncomfortable feeling. Without the comfort of knowing the nature and possible sources of future problems, one could hardly be sure that these problems can be brought under control when they are known. In general, well-managed institutions in a healthy external environment present very little concern. The fear, however, is that neither is assured. Indeed indications are to the contrary.

In a developing economy where well-balanced regulations are wanting, the situation is difficult for even domestic companies. China's current insurance law is at best formative. Its existing framework is fragmentary and prohibition-oriented rather than integrative and promotive to a healthy industry. Problem prevention can never be too extensive. What if some major problems are not preventable in the current laws? What if some problems are simply left out? What about the problems we cannot foresee? What if … Should one be worried? Decidedly so. Obviously much needs to be done and much can be done.

In such an environment, why are such worries directed at foreign institutions only? Wouldn't domestic companies, possibly even less well-managed, be as much a menace to financial tranquility as the foreign companies? To foreigners, the answer is probably yes but among Chinese officials, the answer is *no*!

Right or wrong, there is still a strong feeling among Chinese officials that if a problem is anticipated, the government can always mandate cooperation from even privately owned Chinese enterprises to prevent the problem. Right or wrong, there is also the belief that such mandated cooperation will be hard to come by from foreign enterprises without pre-existing laws that support such mandate. Right or wrong, until the leadership believes that the regulatory facilities are fully equipped, it is best to "probe the next rock to cross the river." Probing the next rock does not translate to a full run.

Lest I am taken to exaggeration, visualize an American insurance company being told to sell the high-end apartments in their approved portfolio because the government thinks that the real estate bubble is about to burst. Its first reaction, if not its first response, would probably be, "You have no basis to do that. Where is the law?" Right or wrong, right now there is no law. Right or wrong, the Chinese leadership does not want to deal with it.

Right or wrong?

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# Highlights of the 1997 International Underwriting Congress

***by Chris Cook and Vera Dolan***

The first International Underwriting Congress (IUC) took place February 23–26, 1997 in Mexico City. More than 670 registrants representing 237 companies from 40 countries attended. The conference organizer, the Vermont Insurance Institute, was encouraged by the IUC's success to begin planning for the next IUC to be held in June 1999 near London. The following are summaries of presentations made at the first IUC.

## Critical Illness Products

A summary of critical illness/dread disease products sold in the U.K. was presented by Jerry Brown, chief life and disability underwriter at Mercantile & General Re in London. A review of the experience with these products in Australia, New Zealand, and Asia was presented by Michael Molesworth, assistant general manager at Cologne Life Re, Australia.

"Critical illness insurance in its modern form was developed in South Africa in the early 1980s. It is a health insurance that seeks to protect consumers against the financial consequences of potentially catastrophic illness and injury by paying a lump sum on the occurrence of specified events such as the diagnosis of invasive cancers or myocardial infarction. The product has been successfully transported to many other developed insurance markets," Mr. Brown said.

"The payment of a critical-illness claim is a survival, living benefit. It is payable to the insured, not the insured's dependents. It is based on the diagnosis of specified diseases, not necessarily on their severity. Payment is made even if there has been a full recovery, and it is not based on the inability to work. The typical U.K. critical-illness product consists of six "core" diseases and 10 to 12 "additional" events. The six core diseases include: myocardial infarction, coronary artery bypass surgery, stroke, cancer, major organ transplantation, and kidney failure," Mr. Brown explained.

Mr. Brown described that as the number of critical illness sales have greatly increased in the U.K. over the past five years, the number of new endowment sales has decreased to a