International Section News

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Life in China: Part Two

by Cao Qing Yang

Editor's Note: Executives who attended our 1998 Strategic Issues Conference were given up-to-the-minute briefings on a number of emerging insurance markets in the Asia-Pacific region. Here's what one expert had to say about the People's Republic of China.

Taxation & Investment

In 1997, mainland China made a big adjustment in its tax policy toward the insurance industry. Before that, an insurance company paid a 5% business tax and a 33% income tax, with two caveats: PICC paid a 55% income tax and whole life, health and annuity operations were exempt from the business tax.

The 1997 adjustment raised the business tax to 8%, except for foreign insurance companies established before 1997 and insurance companies with foreign investments, whose business tax rate remained unchanged until this year, when it was raised to the 8% rate. At the present time, there is no inheritance tax in mainland China or specific tax regulations pertaining to a policyholder's premium payments, maturity benefits, surrender values, and so on.

According to mainland China's Insurance Law, the capital of life insurance companies can only be used in the form of bank deposits, state and financial bond transactions, and other ways stipulated by the state council. A local-national insurance company is not allowed to be involved in other securities or corporate investments. In comparison, foreign life insurance companies operating in Shanghai have access to more investment channels, including corporation security, investment by share, and entrusted foreign exchange loans.

At present, bank deposits are the primary investment channel for insurers. These investments can only generate a small return. Since 1996, the government has made four downward adjustments in the bank interest rate, which has decreased from 10.98% to 5.22%. The interest rate of state bonds has been reduced from 9.6% to 6.5%. At present, local-national life insurance companies achieve an average investment return of around 6.5%.

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Council of Section Chairpersons Meeting

Angelica Michail will attend the meetings in November 1999 and May 2000. The Council approved her request for the Section to provide funds to cover her expenses to attend the meetings.

Next Meeting

The Council agreed to attempt four meetings a year — three by phone and one face-to-face at the Annual Meeting. Suggested months for conference calls were December 1999/January 2000, March 2000, and June 2000. Since the calls will involve members in Europe, Australia, etc., the Council determined the best time to schedule meetings to get the most participation would be 6:00 p.m. E.S.T. The Council tentatively decided the next call would take place the week of January 3rd. Lois Chinnock will survey the members as to the preferred date.

IAA 2002 Cancun Meeting

The Council decided that the International Section should support the meeting. Jim Toole agreed to speak to Luis Huerta at CONAC to determine how the International Section Council could support the meeting (perhaps include a Section member on the planning committee).

Miscellaneous

- Jeanette Selin provided a review of the publications survey results and will send hard copies of the results to the Council. Interest was expressed in reinvestigating reciprocal arrangements.
- Jay Han inquired about setting up an actuarial club in Seoul, Korea.
- Angelica asked for ideas for research projects in the coming year.
- The Council presented the past chair Bruce Moore and member Ric Geisler (who are rotating off the Council) with thank you gifts for their contributions to the International Section.

Supervision & Self Discipline

In 1995, the Insurance Law mentioned earlier took effect in mainland China. Since then, the People's Bank of China (PBOC) has promulgated three sets of regulations: "Provisional Regulations on the Administration of Insurance Industry" (1996), "Regulations of Insurance Agent (trial)" (1997), and "Regulations of Insurance Brokers (trial)" (1998).

As the supervisory organization of the insurance industry, the PBOC oversees the establishment, modification and termination of insurance companies. The bank also supervises the scope of insurance company business operations, solvency and investment, the terms and conditions of major products and their premium rates, and the activities and qualifications of insurance agents and brokers. The PBOC has the power to penalize companies or individuals that violate industry laws and regulations.

An insurance company that operates nationally must have registered capital of RMB¥ 500 million or more, while one operating regionally must have no less than RMB¥ 200 million. All companies must reserve 20% of their registered capital.

An insurance company may take one of two forms in mainland China: a limited-liability shareholding company or a state-owned company. Senior-level personnel must be qualified for their positions, and companies must have at least one actuary recognized by the PBOC. Insurers whose premium income reaches a designated level may apply to set up a new branch.

Solvency and investment supervision occurs through regular checks and an annual report system.

The lowest solvency margin acceptable to the PBOC is actual assets less actual liabilities. If an insurer's solvency level falls below this, the PBOC will ask the company to improve its financial status through reinsurance, business transfer, or simply suspending underwriting. The PBOC has the right to declare steeply insolvent companies bankrupt after certain court proceedings.

Before they can be sold, the head office of the PBOC must examine and approve the provisions and premium rates of long-term life products. For all other products, the PBOC requires only the submission of provisions and premium rates, which it then keeps on file. Another PBOC requirement is the insurers must cede 20% of their accident business to PICC (Reinsurance).

"Because of the country's existing healthcare system, few individuals have complete medical records."

The 1997 "Regulations of Insurance Agent (trial)" establishes a supervisory body that keeps watch over agents' activities and ensures they have acquired their certificates through examination. Records of these agents also must be filed with the PBOC. Violators are fined or disqualified as agents or brokers forever.

In late 1997, some irregular practices emerged in the life insurance market, which forced the PBOC to tighten its regulation and supervision.

To date, 19 provinces and cities in mainland China have set up insurance associations, which supervise and coordinate with each other. In 1997, all companies signed the "Guild convention," guaranteeing a well-ordered, fair and competitive market. So far, however, there is no life insurance guild organization at the national level and those at the local level play a minor role.

Restrictive Factors

As you can see, life insurance has become one of the fastest-growing industries in mainland China. But there are several problems that — if left unsolved — will hinder further development.

One of these is investment restrictions. You will recall that local-national life companies can only make bank deposits, buy and sell state and financial bonds, or make a few other minor investments. What's more, the terms of permitted investments are greatly restricted. While life insurers are averaging a 6.5% return on investment, the interest rate they promise in life insurance products is around 6.5%. Obviously, their after-tax profit is very low — in some cases, nonexistent. Nevertheless, Chinese companies continue to guarantee relatively high interest rates on their products for fear of losing their market share.

A second challenge is product design. At present, most products are traditional and those with a savings component comprise more than 60% of total premium income. To offset the disadvantages of limited investment, life insurers must either redesign existing products or launch new products. At present, however, participating, universal, and variable insurance products can not be sold in mainland China. Product design also is hampered by the lack of experience data, such as morbidity tables. Finally, what we need most here is an array of health plans. Unfortunately, rising medical expenses, a lack of cooperation between medical providers and insurance companies, and high claims rates make many companies reluctant to step into this market.

Another challenge is agent administration. Fewer than 5% of the 350,000 agents in mainland China have a university education, a rate that's relatively higher in Beijing (9%) and Shanghai (8%). Forty percent of agents leave their companies within one year and less than 10% stay in the same place for three years. The public image of agents needs improvement. Eager to broaden market share, life insurance companies are neglecting the vocational and moral education of agents, as the rising number of lawsuits filed against agents attests.

Professional training is a fourth challenge. Mainland China has not established its own actuarial examination or reporting system and there are fewer than 30 ASAs in the country. We lack

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experienced underwriters and senior managers knowledgeable about new developments in the international insurance arena. We also face a shortage of accounting, computer and investment personnel. Although more than 10 universities now offer insurance courses and several well-known associations (among them, SOA, LOMA, and CII) have established examination centers here, the shortage of qualified and experienced staff will not be alleviated in the near future.

A final challenge is supervision and regulation. Life insurance companies use the same accounting standards as non-life insurance companies, which needs to change. And because there is no complete standard of classification for life insurance business, the data we get is far from accurate.

Market Analysis

Despite these challenges, mainland China's economy and insurance markets continue to grow, as a closer look at some recent statistics shows.

In 1997, the country's GDP reached RMB¥ 7.47 trillion, insurance density was 1.4%, and insurance penetration was RMB¥ 90. Seventy percent of life insurance premium income came from the more developed areas of the country, with 40% coming from Beijing, Shanghai, Guangdong, Jiangsu and Zhejiang province, even though they represent only 17% of the total population. Insurance penetration was highest in Beijing at RMB¥ 550 (US$ 66), followed by Shanghai at RMB¥ 440 (US$ 53). According to "The Survey of China Resident Expenditure in 1998," 19% of families in 12 large cities purchased a life insurance policy in 1997. Public awareness of life insurance continued to grow; in fact, a year-end consumer survey ranked it among the top ten issues in 1997.

As mentioned earlier, life premium

Market Milestones

To date, mainland China's evolving insurance market has passed through three distinct phases:

Monopolized Market (1982 to 1992)

- China's market is overwhelmingly dominated by state-owned People's Insurance Company of China (PICC), whose market share exceeds 90%.
- The range of available life products — among them, industrial, endowment, annuity and accident policies — is quite limited and the emphasis is on group business.
- Public awareness about insurance is weak.

Monopoly with Competition (1992 to 1994)

- Ping An Insurance Company of China, Ltd. and the Pacific Insurance Company of China, Ltd. are established in close succession.
- Foreign insurance companies begin to enter China with AIA and Tokio Marine & Fire opening subsidiaries in Shanghai and broker Sedgwick attaining to an operating license.
- Premium income increases steadily; as a result, competition among companies grows more and more intense.
- AIA's introduction of the life agent system causes China's individual life insurance market to immediately take shape.
- Life insurance begins to attract more attention from the public.
- PICC still has 80% of market share.
- At the end of 1994, total life premium income hits RMB¥ 15 billion, but future development is seriously undermined by a shortage of insurance professionals.

Market Competition (1995 to present)

- In 1995, China issues the Insurance Law, which establishes a regulatory framework for life insurance and mandates that companies can not combine property and life insurance operations; as a result, PICC reorganizes, becoming PICC (Group), which has three wholly-owned subsidiaries known as PICC (Life), PICC (Property), and PICC (Reinsurance).
- Several new life insurance companies emerge, including two local-national companies (New China and Tai Kang) and one joint-venture company (Zhong Hong Life).
- Individual business develops rapidly, with some 350,000 agents selling hundreds of products.
- Market competition intensifies. As a result, some companies resort to irregular practices, such as setting improperly low premium rates and improperly high agent commissions.
- The government responds by strengthening regulatory supervision.
- New companies — both foreign and local-national — make every effort to gain a foothold in the Chinese market.
- Life premium income continues to climb, reaching RMB¥ 21 billion in 1995 and RMB¥ 33 billion in 1996. In 1997, life premium income reaches RMB¥ 60 billion (56% of total premium income), surpassing property premium income for the first time.

income grew 82% in 1997, reaching RMB¥ 60 billion by year-end. One factor behind this amazing growth was the guaranteed interest rate of life insurance products, which was higher than that of bank deposits. This attracted people to buy life insurance. In October 1997, the one-year deposit interest rate decreased 1.8%, dropping from 7.4% to 5.67%. In November, consumers engaged in the panic buying of life insurance; premium income that month reached RMB¥ 20 billion (one-third of life premium income for all 1997).

Another factor was the life agent distribution channel. In 1997, life agents had spread from a handful of large cities to most areas of mainland China except Tibet. As we saw earlier, their number grew to 350,000 in 1997. In 1998, they generated RMB¥ 22 billion of individual life insurance premium income, a 290% increase over 1997.

The country's social security system is a third factor driving the growth of the life insurance sector. Because the system provides insufficient protection, more and more people who work in non-state-owned enterprises have been purchasing life insurance policies for themselves.

“At present, participating, universal and variable insurance products cannot be sold in in mainland China.”

What does the future hold for mainland China's life insurance industry? In a word, lots.

The country started to improve its social security system in 1998. The establishment of a retirement pension and social health insurance system will result in new opportunities for life insurance companies. It also will influence the business structure of life insurance. Business analysts predict the proportion of individual life business to grow from the present 35% to more than 50%.

The diversification of individual investment also will influence the life insurance industry. Bank deposits now account for 80% of individual investments in mainland China; by the end of 1997, these deposits exceeded RMB¥ 4.6 trillion. The residential housing reforms currently underway may divert a large part of this capital to the real estate market, as may an impending investment fund.

Investment diversification will have an unfavorable effect on the popularity of savings-feature life insurance products. At present, 70% of mainland China's premium income comes from these products. If life insurance companies do not offer investment-related and participating products over the next several years, we'll have difficulty growing our business.

Insurance brokers will become an important distribution channel for life products. Direct marketing channels such as on-line and mail-order sales will emerge.

With the adjustment of national economic policy, the differences between coastal and inland areas will be reduced gradually. As a result, the life insurance market will be broadened. In the next five years, the wealthy rural area in the southern part of mainland China will become an attractive market.

We also will see further opening up of the life insurance market. In 1998, three foreign companies —AXA/ National Mutual, Aetna, and Allianz — gained access to this market via joint ventures with local-national companies. Such alliances will improve the managerial capabilities of local-national companies and, consequently, their competitive edge in the marketplace.

Finally, life insurance companies will continue work on their technology infrastructure with the goal of delivering more convenient and value-added customer service.

As you can see, mainland China's life insurance industry has made considerable progress during the past several years. Compared with the international life insurance industry, however, we still are at the preliminary stage and expect to face many challenges along the way. In fact, Southeast Asia's financial crisis has given us both lessons and valuable experience. I believe the future of mainland China's life insurance industry lies in a steady and sustained development strategy — and I'm confident of our prospects.

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