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Behind the Growth of the Chinese Life Insurance Industry

By Feng Sun

The world has been amazed by the rapid growth of the Chinese economy and its life insurance market during the last couple of decades. The annual premium compound growth rate has well exceeded 20 percent since 1996. Even with a sign of slowing down in recent years, the growth rates are still positive and people still are optimistic about the future of the Chinese life insurance industry.

Investors, researchers, and analysts strive to understand this phenomenon and forecast the future of the Chinese life insurance industry. Besides the economy, capital markets, regulatory and competitive landscapes, Chinese culture is something that we cannot afford to miss when it comes to gaining insight on the growth of the Chinese life insurance industry.

CHINESE CULTURE FACTORS

China has a long history, and the unique Chinese culture has a strong influence on people's life, their financial behavior, and further on the life insurance industry.

Addict To Savings

Economic theory suggests that countries experiencing strong GDP growth should see a drop in the savings rate as people are better able to predict their future incomes. China's savings rate, on the other hand, has continued to remain high regardless of its remarkable GDP growth. A popular explanation is that China's legendary savings habit is influenced by the Confucian values of thrift and frugality. Instead of consuming future personal earnings today like many other countries, Chinese people tend to spend less and save more for their future. This, for the most part, explains why the Chinese government is the largest debt holder of United States Treasuries.

When a certain income threshold is reached, Chinese people are as big spenders as they are savers. This habit of saving may change from generation to generation. However, surveys show that for the generations who are in their 20s to 50s today, this habit still dominates.

Respect and Taking Care of Elders

Old people are arguably among the happiest people in China. Respect and taking care of elders are often the basis for the way society is organized and has been at the foundation of Chinese culture and morality for thousands of years. The youngsters are expected to take care of their parents, emotionally and financially. This was, again advocated by Confucius and many Chinese families choose to follow this ancient principle.

With a low birth rate and one-child policy, China's elderly population is growing rapidly while the number of young adults is shrinking. This huge demographic shift starts to put financial pressure on the society. Even though the government steps in and the working population starts to save for their own retirement, there is no sign of changing of this tradition. This makes saving for retirement less of a concern in Chinese culture.

Gift/Present Giving

As in many other cultures, Chinese people have a tradition of gift giving for special events such as a birthday, wedding, promotion, or death. It is an essential part of life for Chinese to practice gift giving in social interaction in relation to their interpersonal relationship and cultural identity. However, unlike western cultures, the value of gifts has special meaning. More valuable gifts suggest more respect, higher social status and imply a better relationship. As a result, the value of a gift can be substantial. For instance, upon death of an elder, neighbors and relatives would collect significant amount of money or gifts for survivors. Interesting enough, it is, to some extent, an origin of life insurance among a small group of people without a formal insurance contact.

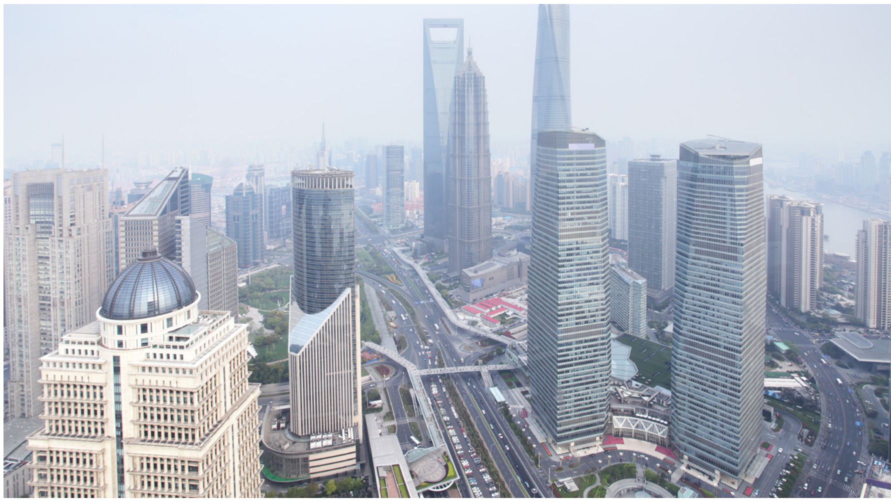
With the social and economic development in China, the patterns of gift giving have undergone some changes. However, the underlying cultural values seem intact, which makes people less worried about life events such as death.

Avoid Discussing Death
Chinese culture has a particular perspective on dying and death. Death is a taboo and Chinese families will not discuss issues of death and dying for fear of invoking bad luck. In order to postpone bad luck associated with death, Chinese people will try to prolong the patient's life as long as possible, while also acknowledging that death is part of the lifespan. This, combined with gift giving, could make life products with death benefits a hard sale.

RAPID GROWTH IN THE PAST

With hindsight, the rapid growth of the life insurance industry in China could mainly be attributed to the following factors:

- The rapid growth of the Chinese economy
- The habit of saving and avoiding talking about death in Chinese culture
- The credibility of banks and high compensation for both banks and agents.
- Demand for expansion of life insurance companies



As GDP grows in China, household income started to climb. Instead of increasing spending, people chose to save. Research shows that China's national savings rate is one of the highest in Asia and substantially higher than developed economies like those of the United States and the United Kingdom.

The savings habit has created a high demand for savings products. With a volatile Chinese stock market and lack of attraction of savings instruments in the capital market, savings-oriented insurance products became an alternative. This type of product usually has features like short-time, endowment-type, and minimal protection to satisfy the regulatory requirement. Protection is not the customers' main focus; it is simply a necessary ingredient to make it work as an insurance product.

In China, savings products have dominated the life insurance market. More than 70 percent of insurers' assets are tied to these products. These savings products are usually sold through banks for two reasons. One is that banks provide an easy access to wealthy customers. The other reason has to do with banks' brand name, or banks' credibility. In China, major banks are backed by the government, they are considered default-free, whereas insurance companies were undergoing the process of building up their reputations. People were more comfortable doing business with banks than with insurance companies directly. Essentially, insurance companies leverage banks' credibility to sell their products. Of course, they have paid the price as part of the commission.

The other driver of rapid growth is the hefty commission for captive agents, which is the case in most countries, but in a less-regulated emerging market like China, it had fostered sales, and some misleading sales as well, which caught regulators' attention later on.

Finally, as the capital market grew in China, investors saw the growth opportunity in the insurance industry. In particular, they believed as the business grew, fixed costs could be spread out and they would reap profit at a later date. The belief has led to huge premium increases.

SLOWING DOWN BUT STILL GROWING TODAY

By analyzing the history, we can easily understand the recent slowdowns.

GDP is expected to grow at a slightly lower pace —around 7 to 8 percent—which sets a tone for the growth rate of the life insurance industry. Households may spend less money on insurance.

Little by little, the culture is starting to change. Well-educated people are starting to realize that protection is more important than savings, and that they cannot depend on their offspring for retirement. We see protection products (such as critical illness) and retirement products (such as annuities) starting to grow in sales. However, switching from saving to protection (including basic life insurance) is a big step and it takes time.

From the insurers' perspective, savings products become less interesting because the products are homogeneous and easy to replicate. Vicious competition has led to price wars, which reduces the profits for insurers and increases their earnings volatility.

In addition, as insurers become financially strong, they have developed their reputation and credibility. As a result, they no longer need to pay banks hefty fees for support to sell their products. Therefore, insurers start to deemphasize bancassurance with the risk of losing their ability to access wealthy customers.

In the last few years, we have started to see some large insurers in China move away from the bank channel, instead switching their attention to protection products. To gain access to banks' customers, some insurers began to acquire banks and start joint-venture with banks.

Captive agents' compensation has not increased in more than five years. The agents are not as motivated as before, which leads to slow growth today.

WHAT TO EXPECT IN THE FUTURE

To form an opinion on the future of the life insurance industry in China, we need to take a look at every aspect that could potentially impact this industry.

- Regulators

  Chinese regulators are open to new ideas. They realized that insurance is a supplement to social security. As a result, they started to educate the public, promote protection-related products, and rethink reserve and capital requirements. They also raised the qualification standard for agents. These changes will lead the Chinese life insurance industry to the right track.

- Government and tax authorities

  The government also sees the benefits of private insurance, as it starts to bring in tax benefits for policyholders. The tests have started in certain areas and on a small scale, such as tax deferral for retirement savings. This would be a key driver of growth of the life insurance industry if there are tax advantages in place for insurance products.

- Customers

  As the number of policyholders is constantly increasing and with more interaction between agents and customers, the public will become well educated, and as the culture may change, we expect to balance the demands between savings and protection.

- Products

  If government, tax authorities and regulators move forward as expected, we would expect to see more products with a variety of insurance coverage, especially in life, medical/health, and pension areas. Savings products may still be in demand, but more retirement-oriented because of the fast aging population in China.

- Distribution Channels

  Bancassurance, as a main premium income source today, will continue to shrink unless there is some major development of cooperation between the business models of banks and insurers.

We would expect to see more agents, brokers and sales intermediaries in the future. As products become complex, interactions between agents and customers are expected to be more frequent and intensive. As the market becomes educated, the sales force should change accordingly. We should expect to see growth in the agency channel.

Telemarketing and Internet sales have gotten insurers' attention in the last few years due to lower costs. However, most products sold through these distribution channels were return-of-premium products with an A&H rider or low face amount, pure protection products. These channels work well for customers who bought insurance products previously or understood the products and know their needs. The telemarketing channel is still small, with a success rate of 0.5 percent for 2012 in China based on a survey conducted by Swiss Re. The key difference between internet sales and agency sales is that one is to attract motivated customers, and the other is to motivate or persuade potential customers. The latter is more important and fundamental, and it can be difficult to conduct over the internet. We would expect to see a somewhat rapid growth in this area as there are still a large number of motivated customers in China. However, unless an interaction mechanism can be developed over the internet to motivate potential customers, and underwriting can be simplified at the same time, we would not expect to see this distribution channel replace any other, but rather be a supplement.

Looking forward, we expect that the slower growth will continue for quite some time. As the influence of ancient culture becomes less of a concern, and the accelerated emergence of the middle class and urbanization, and as customers become more educated and have strong needs for protection, protection-related products will dominate the market.

As Chinese capital markets become mature, consistent and reasonable government taxation policies and regulatory requirements, as well as well-educated Chinese people and more experienced insurers, we can expect a bright future for the life insurance industry. Until then, there might be a number of painful steps the industry has to go through. □