Markets and Countries: China

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Introduction and general information

The stunning rise of China as a major economic power during the last 30 years is surely one of the greatest transformations of our era. Today, China is the largest manufacturer, exporter, and holder of foreign exchange reserves in the world. In the late Seventies, however, it was still a very marginal player in the global economy, representing just 2% of world GDP (PPP), compared with 15% in 2012. In fact, China is currently the **world's second-largest country** after the USA in terms of GDP, having overtaken Japan in 2010.

The roots of China's economic rise lie in the reforms implemented by Deng Xiaoping in the late Seventies. Between then and 2012, real gross domestic product (GDP) grew at a compound annual rate of 10% (source: IMF), generating an enormous increase in Chinese household income and standard of living.

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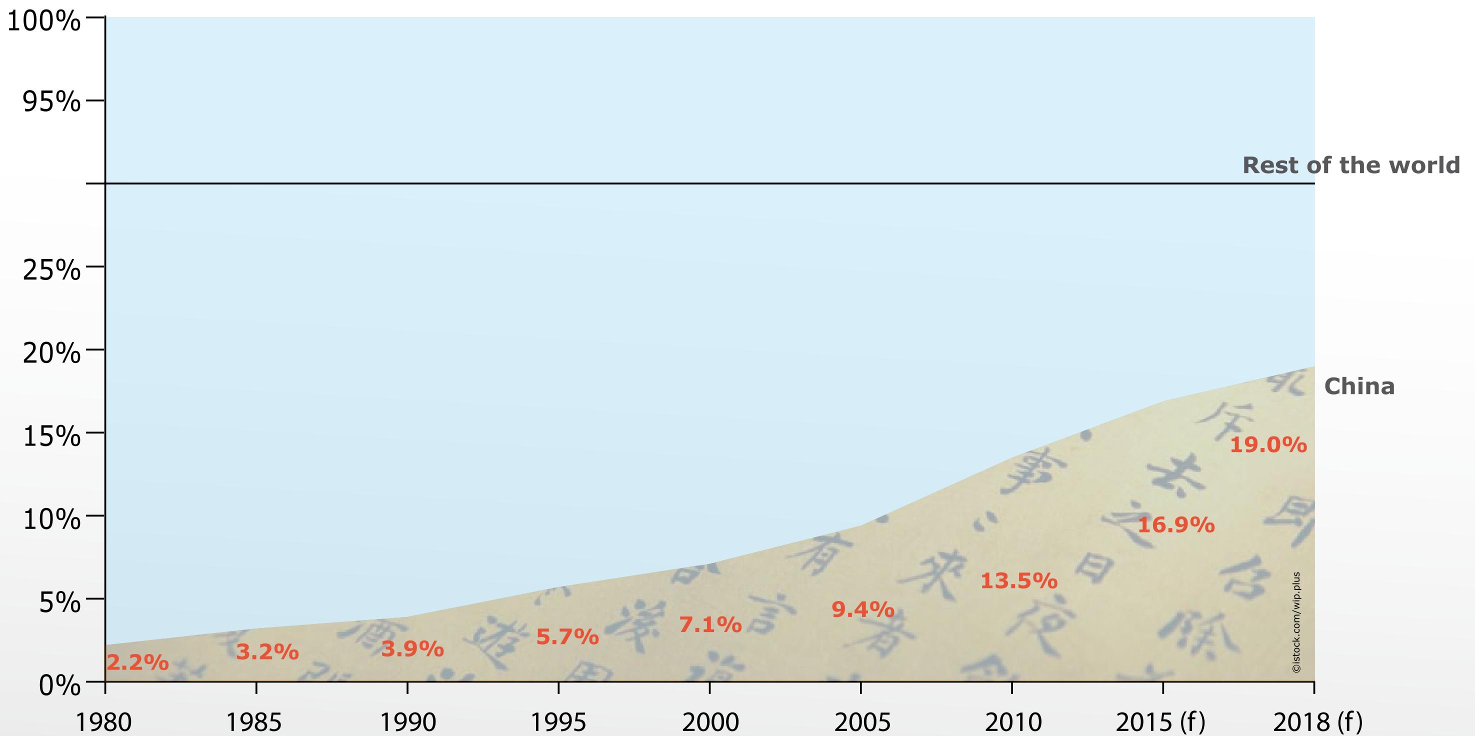


Fig 1. Chinese GDP based on purchasing power parity (PPP), share of world total – Source: IMF

The **urban/rural** divide is still significant, however: incomes vary greatly from region to region, with most of China's wealthier residents living in the prosperous Eastern urban areas. In rural areas, average disposable income is as low as $1.000, while in the large highly developed East Coast cities such as Shanghai, Shenzhen and Beijing, average household incomes reach levels comparable to those of the developed economies.

The **boom of the middle class** is one of the most evident signs of this success story: estimates indicate that whereas in 2000, only 4% of Chinese urban households were classified as middle class, over the last decade the proportion has soared to roughly 65%. In other words, approximately 450 million Chinese households earn at least 9,000 USD per year[1].
According to Helen Wang - an expert on China's middle class and author of "The Chinese Dream: The Rise of the World's Largest Middle Class and What It Means": "A rule of thumb to define a middle-class household is to have at least one third of the disposable income for discretionary spending".

(1) McKinsey & Company

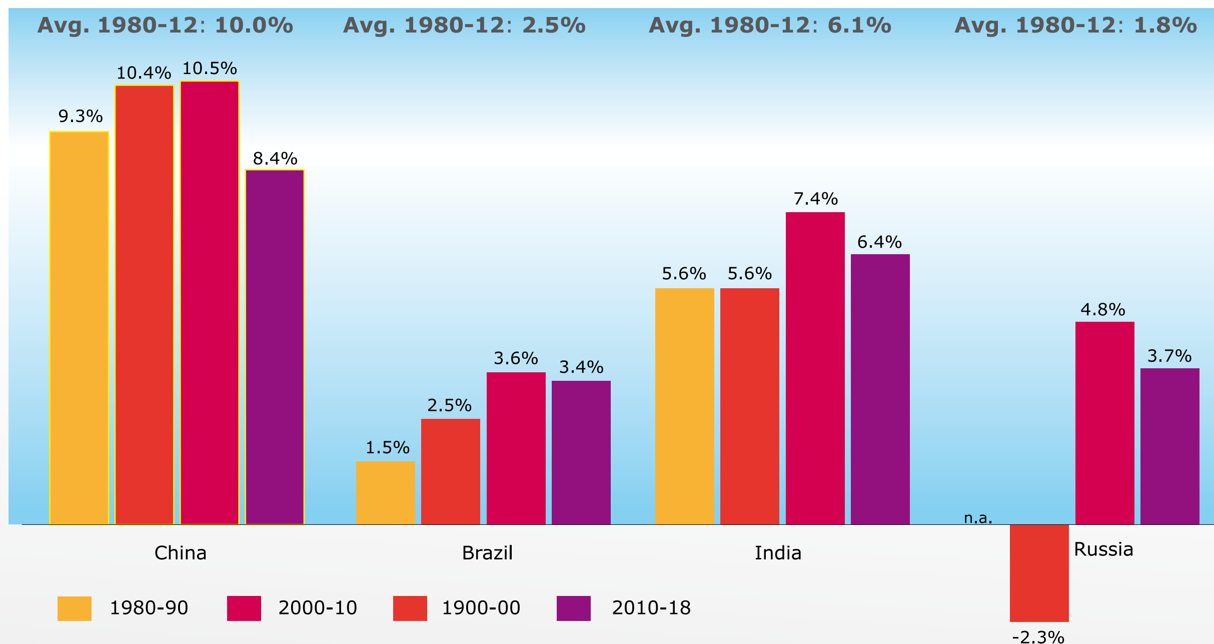


Fig 2. China's real GDP growth rate (1980-2018) vs the other BRIC economies– Source: IMF

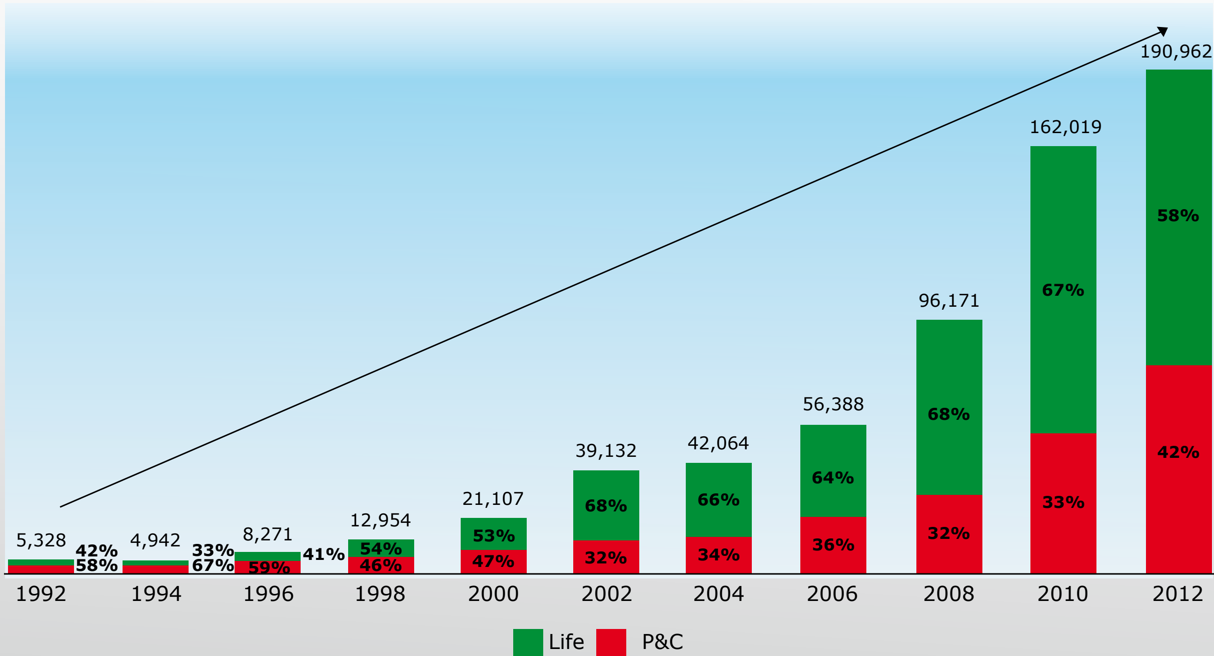
Nowadays, after 30 years of economic growth, the large majority of Chinese urban residents are middle-class families that can afford to rent a 65 square meter apartment in a tier 1 city (Shanghai, Beijing, Shenzhen), spend 35% of their income on food, own a car (and therefore purchase a motor insurance policy). Above all, middle-class households on average still have 20% of their income to put aside in savings[2], a situation that is driving the enormous growth of the Chinese life insurance market.

Insurance in China, the story so far….

Since the end of the state monopoly in 1986, the growth of the Chinese insurance market has been stunning. According to the Sigma Study issued by Swiss Re in 2012, Chinese total premiums amounted to roughly € 190 billion, compared to just € 1 billion in 1986. During the same period, average per capita insurance consumption increased 70-fold, from roughly 2 € to almost 140 € per person. Today, in terms of total premiums, the **Chinese market is ranked 5th in the world** (2nd in Asia after Japan), up from the 29th position in 1986.

(2) Estimate by James Roy, senior analyst at China Market Research

Despite the very recent boom, the origins of the insurance industry in China can be traced back to the early 1920s; at that time, the domestic market was dominated by foreign-owned insurers, who used Shanghai as a hub for their insurance operations in the Far East. AIG (American Insurance Group), a global player today, was established in Shanghai in this period with American capital.
Eventually, with the Communist Revolution and Mao Zedong's rise to power in 1949, the insurance industry was nationalized through the creation of the



People's Insurance Company of China (PICC). The monopoly lasted until 1986 when a second insurer, Xinjiang Corps Insurance Company, was established, to operate in the Xinjiang province only.
Two years later, in 1988, Ping An was founded. It was the first private company to obtain a license to operate in the Shenzhen SEZ[3]. In 1992, the government granted AIG a license to underwrite policies in Shanghai, a clear indication that the Chinese market was opening up to foreign players.

([3]) Special Economic Zone. SEZs are areas with free-market economic policies and special government systems intended to attract foreign capital.

Since then, the insurance industry has grown very fast, with premiums showing a dramatic CAGR[4] of 20% in the twenty years between 1992 and 2012. The rapid increase in premium volumes created the need for a regulatory framework. In 1995, the Insurance Law of the People's Republic of China was promulgated, and in 1998 the China Insurance Regulatory Commission (CIRC) was established, to monitor activities in the insurance sector.

Finally, since 2001, the year China **joined the WTO**, foreign insurance companies have been officially allowed to operate on the Chinese market. Nevertheless, non-domestic investors are subject to important ownership limitations whereby they may not own more than 50% of

Time Line	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	00	09	10	11	12
Regulation	End of PICC State monopoly									Issue of the insurance law of China			Establishment of CIRC (insurance regulatory body)			China joins the WTO										Implementation of Social Insurance	
Life			Ping An is the first private insurers to obtain the license				AIG is the first foreign player to re-enter in the Chinese market										Generali enter the market										
P&C																	Generali enter the market				Introduction of compulsory MTPL						Compulsory MTPL opened to foreign players

any local company. The choice of a valid Chinese partner is therefore a critical factor for a successful player on the Chinese insurance market.

The Main Rules:

When China joined the WTO, **foreign insurance companies** were officially allowed to operate on the Chinese market. They must follow a number of rules:

- All qualified foreign companies can obtain a license without numerical limits, based on China's perceived economic needs.

([4]) Compound Annual Growth Rate

The cradle of Insurance

Insurance in some form is as old as society and was regularly transacted in ancient times. So-called bottomry contracts, for example, were known to traders in Babylon between 4000-3000 BC, as testified in the Code of Hammurabi. Bottomry was also practised by the Hindus in 600 BC and is described by Demosthenes in ancient Greece. Under a bottomry contract – aptly called by the French "*prêtre à la grosse aventure*" – loans were granted to merchants with the provision that if the shipment was lost at sea the loan did not have to be repaid. The very high interest on the loan – as much as 12% – covered the insurance risk. Ancient Roman law also contemplated bottomry contracts, in which an agreement was signed and funds deposited with a money changer: it was a practice sharply criticised by Plutarch, who called it "the most disreputable form of money-lending."

However the age-old and instinctive idea of not putting all your eggs in one basket was, most likely, first put to good practical and commercial use by the Chinese.

While the ancient Egyptians left irrefutable evidence of basic forms of insurance, notably burial societies, economic historians believe that it was the Chinese who first developed, as early as 5000 B.C., a practice that can be described as the most rudimentary forerunner of insurance.

At that time, boat owners found it advantageous to redistribute their cargoes into several boats when they approached treacherous river rapids or embarked on long sea voyages. If one boat was lost, all the boat owners shared the loss and no-one faced financial ruin. Risk diversification is what we call it these days!

- Upon entry on to the Chinese market, foreign life insurers are required to set up 50:50 joint ventures with a domestic partner of their choice.
- Licenses are issued on a "province by province" basis, with the result that, on average, foreign players are able to obtain a new provincial license every two/three years.
- Alternatively, foreign investors may buy equity shares in domestic insurance companies, provided that foreign investments do not exceed 25% of Chinese life insurers' equity. No limits are imposed on these companies' geographical expansion.

Given the limited number of available licenses, foreign players are normally restricted to larger cities and more developed provinces where competition is very intense. Deciding where and when to open a new provincial branch is a crucial strategic issue for foreign investors on the Chinese market.

The Chinese life and P&C markets: current situation, future potential and growth drivers

The Chinese life segment has experienced robust growth in recent years. Since 2002, when the market opened up to foreign capital, the life segment has reported 19% CAGR. Despite this very positive trend, in 2010/11 the market recorded a slowdown mainly because of restrictions on the bank distribution channel prohibiting insurance company representatives from selling insurance products in bank branches. Currently, the blockbuster products on the Chinese life market are **participating[5] whole life and endowment policies**. Unit-linked products were very popular until the end of the last decade, but with the stock market crash and the global financial crisis of 2008/09 demand has declined dramatically, and today many insurers no longer supply this kind of policy.
The Chinese **P&C market** is currently in a period of transition as the regulator implements guidelines to enhance risk management practices and improve the customer experience (in claims settlement for example). At the moment, the P&C segment consists largely of motor covers (accounting for 70% of total premiums), although commercial property lines have been

([5]) With PAR (participating) products, the policyholder receives dividends based on the growth of the company.

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developing at a very fast pace in the last few years. Until now, the P&C market has been driven mainly by the very rapid increase in the number of private vehicles, which automatically translates into motor premiums.

In 2012 the insurance regulator (CIRC) and the State Council (one of China's leading government bodies) promulgated several new regulations opening up the **MTPL** (compulsory motor insurance market) to foreign-owned players. Currently, the motor segment is highly concentrated, with the market share of the top 3 players rising from roughly 60% in the mid-2000s to almost 70% since 2010. On the other hand, with the introduction of the new liberalization policies, the market share of the top players is likely to decrease in the coming years, enabling newcomers to take advantage of the situation.

From an international perspective, China, with €191.5 bn of total premiums, is by far the **largest life insurance market** among the **emerging economies** (fig 4) and the fifth biggest in the world after USA, Japan, United Kingdom and France.

China is the largest country in the world in terms of population, with more than 1.3 billion people. So an analysis of the dimension and potential of the Chinese insurance market is a useful exercise, taking into consideration not only total premiums but also a series of ratios such as life insurance penetration (premiums as a percentage of GDP) and premium density (premiums per capita).

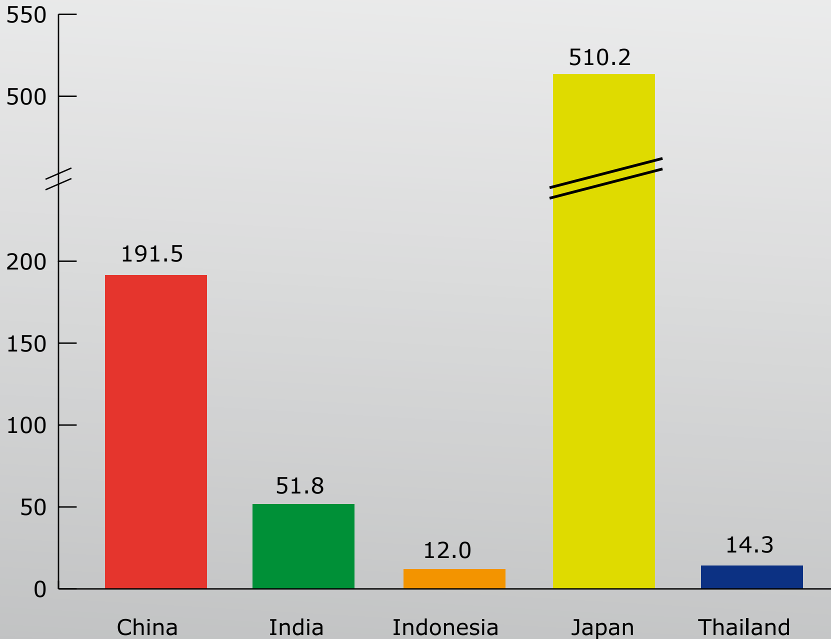

Fig 4. Emerging Asian insurance markets - Source: Swiss Re

The analysis compares China with four other emerging Asian markets: India, similar in size with a population of more than 1 billion people, Taiwan, which

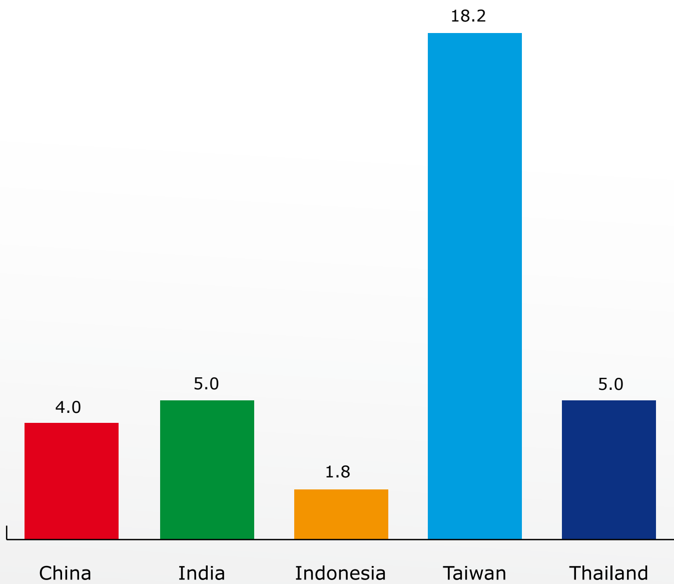

Fig 5. Insurance penetration (GWP as a % of GDP) - Source: Swiss Re

shares the same culture and traditions as Mainland China, Thailand, which displays a very similar level of income per capita (at constant Purchasing Power Prices)[6], and Indonesia, which, like China, has reported very fast GDP growth[7] in the last few years.

As shown in Fig 5 and 6, in 2012 Chinese life insurance penetration was significantly lower than in India and Thailand and significantly behind Taiwan. This means that the market has not yet expressed its real potential and that there is still room for further market growth in the medium/long term.

We believe that, apart from the exceptional economic transformation currently taking place, a number of other important economic, social and cultural factors are driving the Chinese insurance market.

Emerging affluent urban middle class:

In emerging countries like China, the spread of wealth originates largely in urban areas. As people continue to move from the countryside to the cities, raising their socio-economic status, the potential market for insurance companies will continue to expand. Moreover, from the insurers point of view, the concentration of consumers in cities facilitates business growth, since distribution of policies, premium collection,

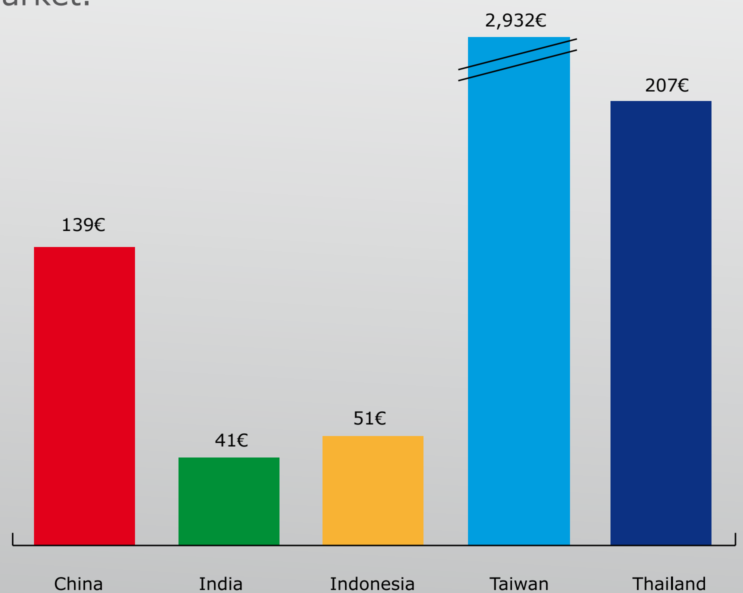

Fig 6. Insurance Density (GWP per capita) Source: Swiss Re

([6]) In 2012, PRC had 9,162 USD per capita (PPP) while Thailand had 10,126 USD per capita (PPP), source: IMF.
([7]) According to the IMF, the average real GDP growth rate in 2008-12 was China +9.2%, Indonesia +5.9%

claim settlements, marketing costs and underwriting procedures are easier to manage.

Expanding automobile market:
The Chinese private car market grew at a CAGR of 24% from 2005 to 2011, overtaking the USA as the world's largest new automobile market. According to McKinsey, the car market will continue to grow in the next 10 years (8% CAGR until 2022), with positive spillover effects for the motor insurance market.

High household savings rate:
There are several reasons why Chinese are stubborn savers: one could be the strong emphasis that Confucian philosophy puts on saving rather than on spending[8]. Another driver is that the many economic reforms introduced in the 1980s/90s may have pushed people with surplus income to increase their savings as provision for old age, unemployment and medical expenses. Whatever the main reason, the result is that the Chinese average household savings rate is one of the highest in the world (≈27% in 2010[9]), with a positive effect on the total amount of household financial investments and the purchase of life policies.

The result of the *One Child policy*: a rising dependency ratio in the coming years:
Another important growth driver is the rise of the dependency ratio, which compares the number of people who are not in the workforce (under 15 and over 65 years old) with the number of people in the workforce (15-64 years old). During the last thirty years, the dependency ratio has steadily declined as the <15 years old population has decreased due to the *One Child Policy*. Over the coming years, however, the dependency ratio is expected to start rising as average life expectancy increases and the "*One Child Policy*" generation enters the workforce. Additionally, in the past the typical Chinese family tended to have a large number of children to satisfy the workforce demand of an agricultural society and to support parents in their old age. Today, the *One Child Policy* combined with the progressive urbanization of the population may have led parents to realize that adequate financial provision needs to be made for their old age (through the purchase of a life policy), as a substitute for the support of a large family.

(8) In the "Book of Rites" (礼记), Confucius strongly encourages people to "Size your spending based on your income (量入而出)."
(9) Estimate based on data from the National Bureau of Statistics of China.

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Generali in China

As of today, Generali operates on the Chinese market through two companies, **Generali China Life** and **Generali China Insurance**, and is one of the very few foreign players with both life and P&C licenses. Generali China Life is one of the largest joint venture companies with foreign ownership in China, in terms

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Generali in China time line

1910 – Offices open in Shanghai, Guangzhou (Canton), Tientsin ⟶ marine risks.

1924 – Offices open in Beijing (Peking) ⟶ fire and transportation risks.

1949 – Nationalization of foreign businesses ⟶ Generali leaves China. An agency continues to operate in the British colony of Hong Kong, and later becomes a branch office.

1996-97 – Representative offices are set up in Beijing (1996) and Shanghai (1997) ⟶ preparatory steps for operation on the local market.

2000 – The China Insurance Regulatory Commission (CIRC) authorizes Generali to form a life insurance company as a joint venture with a Chinese partner.

2002 – The CIRC grants Generali a permanent license to operate in life insurance on the Chinese market through a joint venture. (This was the first operating license granted by the government after China's entry into the WTO). The new company, Generali China Life Insurance Company, is equally owned by Generali and the China National Petroleum Corporation (CNPC).

2004 – The CIRC grants Generali China Life a permanent license to begin life insurance operations in the Chinese capital. The new branch in Beijing addresses a market of 12 million inhabitants, which today accounts for 8% of the national life assurance market.

2005 – Generali China Life launches a pension program for 390,000 people with a single non-recurring premium of approximately US$ 2.4 billion, the world's largest life contract ever.

2006 – The CIRC authorizes Generali and CNCP to form a property & casualty joint venture. After fulfilling all legal requirements, Generali becomes the only foreign group licensed to operate in both the life and the P&C sectors in China, through two local companies.

2007 – The CIRC grants Assicurazioni Generali a license to establish a new branch, Generali China Insurance Company. The new branch is the only company with joint Chinese-foreign ownership to operate in the P&C sector in China. It is located in Daqing, in Heilongjiang province, an area with a particularly fast-growing P&C market: growth in 2006 was 33%, compared with 23.4% for the Chinese market as a whole.

of both premium income and total assets. Today, Generali has about 1,700 employees in China, and life and/or P&C operations in more than 10 provinces. Its main goal is to become a top-ranking insurance company in China.

To close with the words of **Sergio Di Caro**, the Head of the ASIA region: *"The Chinese insurance market is one of the most interesting worldwide. We are currently in a normalization phase following the tremendous growth of recent years. Despite some short-term volatility, I remain very optimistic and positive about the future prospects of the market. In terms of insurance potential, we believe that a number of segments will open further, along the lines of the pension segment. This, combined with a less restrictive regulatory environment, will generate great opportunities. Our experience in China so far has been extremely rewarding. We are committed to continue investing in talents and allocating resources. This will enable our local operation to continue to prosper together with our local partner."*

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