

“The Development and Regulation of China’s Insurance Market: History and Perspectives”

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Synopsis by Mattie Merriman

Chen, Tennyson, Wang and Zhou outline the history of the insurance market in China, giving vital insight into the laws and regulations that control the insurance market and the impact these have had on opening up the private insurance market to foreign insurers and investors. The authors discuss market size and development, insurance market structure, the insurance regulatory system and supervision, including of foreign insurers, and their overall perspectives on insurance regulation in China. This synopsis, using Chen at al article and other outside sources, outlines the short history of the Chinese insurance market, discussing both the market structure and regulatory environment, and gives insight into what the future holds for the evolving Chinese insurance market.

The Market

Since 1980, China’s insurance market has become the 6th largest in the world and the nominal premium income has increased at an average rate of 30% annually.¹ In 1995, the Insurance Law of the People’s Republic of China was implemented to supervise the domestic insurance companies in China, and in 1998 the China Insurance Regulatory Commission (CIRC) was established to separate insurance regulation from other areas of regulation. In 2000, China entered the World Trade Organization (WTO), opening up the market to foreign capital. China’s joining of WTO resulted in a focus on solvency regulation. Insurance regulation in China has switched from mainly promoting and improving the domestic insurance industry to focusing more on keeping market order. Table 1 contrasts the Chinese insurance market in 1980 to 2010, demonstrating the tremendous growth that has occurred in the insurance market size, development and structure.

Table 1
China’s Insurance Market: Size, Development and Structure

1980	<ul style="list-style-type: none"> • Private insurance dominated by property casualty • Limited life insurance • Nominal insurance premiums, all lines of business, at 460M yuan • Insurance premium per capita is 1 yuan <ul style="list-style-type: none"> ○ Premiums relative to GDP are 0.1%
2010	<ul style="list-style-type: none"> • Life insurance three times the size of property casualty <ul style="list-style-type: none"> ○ 88% of life insurance is participating life insurance ○ 5% is private health insurance • Property-liability market is 77% auto insurance • Social insurance and private insurance about the same size • Nominal insurance premiums, all lines of business, grew to 1.45T yuan (a 30% growth per a year, which is double the GDP growth) • Insurance premium per capita is 1,000 yuan (equivalent to \$158.50 U.S. dollars in 2010) <ul style="list-style-type: none"> ○ Premiums relative to GDP are 3.65%²

¹ See CIRC, 1981–1997, 1998–2011, *Yearbook of China’s Insurance* (China’s Insurance Yearbook Editorial Press).

² See Chen, Tennyson, Wang and Zhou, 243-244

Yet even with all this recent growth and maturity, the Chinese insurance market is still not on par with other countries and has below worldwide averages in insurance penetration, which is the ratio of the percentage of total insurance premiums to GDP, and density, which is the ratio of total insurance premiums to total population. Compared to other countries, in 2010, China ranked 61st in insurance density and 39th in penetration.

Both the size of the private insurance market and the number of insurance companies has increased. Beginning in 1980, the government controlled People's Insurance Company of China was the lone option for insurance in China. By 2010 there were 126 insurers in the market.³ One explanation for the increase in the total number of insurers offered by Chen et al is China's joining of WTO. This action opened the Chinese insurance industry to foreign competitors. And this growth in foreign firms is more apparent in the life insurance market than in the nonlife insurance market. However, China has more restrictive regulations for both foreign insurers and foreign investors.

China's Insurance Regulatory System

In China, insurance regulation is governed by laws passed by the National People's Congress (NPC), administrative regulations developed by the State Council, and rules issued by the CIRC.⁴ The CIRC has independent rule-making authority and has regulatory responsibilities which Chen et al described as comparable to insurance regulators in other countries. The first law, the Insurance Law, came into effect in 1995 and established a basic social insurance framework for all employees in China, including foreign employees.⁵

Legal supervision of the insurance industry falls to the Supreme People's Court. But these courts are not independent of the state and are managed and funded by the local governments. As noted by Chen et al, China is relatively unfamiliar with being governed by contract and liability norms, making it difficult to make rulings with an underdeveloped case law system.⁶ There are more obstacles to the judicial supervision of the insurance markets including a limited number of well-trained judges in insurance law and an inconsistency in judgments on similar cases. There is also an informal social supervision of the insurance industry via statements from consumers, media and public opinion. The CIRC recently started emphasizing that consumers need to become more informed so that their feedback can further aid in the supervision of insurers. But social supervision is difficult when behavioral norms for customers in the insurance market are not clearly laid out, as demonstrated by the high number of fraud cases.⁷

Evolution of Insurance Regulation and Supervision

There have been three major forces that have shaped the development of China's insurance regulation: the progress of domestic insurance markets, the growing ties between international

³ According to the Herfindahl-Hirschman Index (HHI) the private insurance markets in China are relatively concentrated. As of 2010, the HHI for life insurance was 1800 and for nonlife insurance it was 1850; and according to the U.S. Department of Justice, any HHI value over 1800 is considered concentrated (Chen, Tennyson, Wang and Zhou, 245-246)

⁴ See Zheng, W., 2011, China's Insurance Regulation: Framework, Issues and Prospects, in: P. M. Liedtke and J. Monkiewicz, eds., *The Future of Insurance Regulation and Supervision: A Global Perspective* Basingstoke: Palgrave Macmillan), pp. 337-353.

⁵ See <http://www.chinabusinessreview.com/the-new-prc-social-insurance-law-and-expatriate-employees/>

⁶ See Chen, Tennyson, Wang and Zhou, 252

⁷ See Huang, D., and J. T. Query, 2007, Designing a New Automobile Insurance Pricing System in China: Actuarial and Social Considerations, *Casualty Actuarial Forum*, Winter: 67-102. World Wide Web: <http://www.casact.org/pubs/forum/07wforum/07wforum.pdf>.

markets, and international improvements in insurance supervision. For foreign insurers looking to enter the China insurance market, it is important to consider and look at these three forces as it helps explain the current laws and regulations in China and gives hints into what the future insurance market might look like. In 2006, China adopted the “three pillars” of insurance supervision, which were articulated by the International Association of Insurance Supervisors. These three pillars consist of “regulation of corporate governance structure, regulation of market behavior, and regulation of solvency.”⁸ Furthermore, as they continue to develop their insurance regulation, China is watching the progress in the European implementation of Solvency II, as well as researching the management of systemic risk. Solvency II aims to improve consumer protection, modernize supervision, deepen the EU market integration and increase international competitiveness of EU insurers.⁹

There are six main areas of Chinese insurance regulation that China has modernized in both regulatory process and content. The major developments in regulation have been made in the areas of asset management, solvency, insurance protection fund, insurance rate regulation, disclosure and consumer protection, and regulation of foreign insurers.

Asset Management Regulation

Asset management in China is restrictive. Restrictions include a max limit of 20% of assets that can be invested in stocks or corporate bonds, with no more than 10% in real estate and mortgages, and almost half of a firm’s assets must be invested in government bonds and bank deposits for both life and nonlife insurers. These are much lower than the maximum limits in other IAIS reporting jurisdictions which average a maximum limit of 37% for corporate bonds, 27% for stock shares and 31% for mortgages.¹⁰

Solvency Regulation and Supervision

Following China’s joining of WTO, the first set of requirements for solvency supervision were put into effect using a ratio-based solvency monitoring system. In 2002 solvency regulation required insurers to submit periodic reports on their solvency. And in 2003, CIRC began to create a solvency regulatory system which culminated with the establishment of The China Insurance Solvency Standards Committee in 2007. By 2008 CIRC had created a dynamic risk-based solvency regulatory structure that compared to international standards and resulted in the “first-generation insurance solvency regulation system in China.”¹¹ However, following the financial crisis, CIRC announced the drafting of a “second-generation system” to be released in 2014 to better fit the new market environment and global situation. Because of CIRC’s increasing concern with solvency regulation, there has been a growing requirement of capital injections from insurance shareholders. Starting in 2006, CIRC performed spot-inspections. These inspections act as an additional method for supervising the insurers by looking into a firm’s operations, activities and financial situation. The use of these on-site examinations has continued to be used as a supervisory tool.

The Insurance Protection Fund

In 2005, CIRC created the Insurance Protection Fund (IPF) in China, similar to Insurance Guaranty Funds in the U.S., and in 2007 its supervision was transferred to the China Insurance Protection Fund Ltd. Co. For insolvent nonlife insurers, the IPF will provide compensation for losses up to 50,000 yuan to policyholders. For insolvent life insurers, the IPF will compensate the new life

⁸ See Chen, Tennyson, Wang and Zhou, 253

⁹ See <http://www.lloyds.com/the-market/operating-at-lloyds/solvency-ii/about/what-is-solvency-ii>

¹⁰ See Chen, Tennyson, Wang and Zhou, 254

¹¹ See Chen, Tennyson, Wang and Zhou, 254

insurer who takes on the insolvent insurers' policies for any losses associated with the transfer. Although there have been no cases of insurance company bankruptcies in China, IPF has given capital to two companies in financial distress.

Insurance Rate Regulation

When China had only the single government-owned insurance firm, it was normal to have government-set rates, but as more firms entered the marketplace and competition increased, the government experimented with rate regulation relaxation. Today, however, the majority of insurance product lines remain under rate regulation. Rate regulation is born out of concerns that firms in the Chinese market will solely focus on attaining market share by selling homogeneous products at too low a price. Therefore, the rate regulation objective is to set minimums on premium rates in order to prevent insolvencies due to vicious price competition. An illustration of China's experience with rate regulation can be seen in the regulation of private passenger automobile insurance, which remains the most stringently rate-regulated line. The first wave of market-oriented rate regulation reforms of automobile insurance was from 1988 to 1993. During this time rate regulation was relaxed from government set rates to prior approval of rates. The second wave of regulation was from 2001 to 2006, during this period CIRC allowed firms to set their own rates but this failed due to problems with under pricing. The third and final wave of regulation changes started in 2011. During this wave, CIRC placed solvency and filing requirements on firms that wished to set their own rates.

Disclosure and Consumer Protection

A persistent problem that has stunted the growth of the insurance market has been irregularities in claim handling. According to a 2010 survey, "difficulty in claim filing was thought to be the most important concern for the consumers when considering purchasing insurance (49.3%)."¹² Regulators are dedicated to improving the contracting environment. A 2009 modification of the Insurance Law, which increased consumer protections, puts short run pressures on insurers to disclose information.¹³ The law set a format for insurance contracts so that consumers will be less likely to overlook vital terms and conditions. The modification also put time limits and procedure requirements for claim payments. Furthermore, to terminate contracts an insurer must prove that the insured acted in an improper or fraudulent behavior.¹⁴

Regulation of Foreign Insurers

China's insurance regulation discriminates against foreign insurers and investors. Since China's entrance into WTO, facets of insurance companies operations have slowly been freed from restrictions, yet there still are some very critical restrictions on foreign insurers. Some of these restrictions include: foreign nonlife insurers are not permitted to underwrite third-party liability insurance for motor vehicles, and foreign investor are restricted to holding a maximum of 50% of a life insurer's shares. Because of these restrictions, foreign insurers are "struggling" in the China market, as seen in the low market share that foreign insurers have: 1% market share in nonlife sector and 5% market share in life sector.¹⁵ Because these market share values are much lower compared to in other countries, there is no doubt that is in part due to the discriminatory regulation in China.

¹² See <http://www.cqn.com.cn/news/wqpd/gmwq/366934.html>.

¹³ See Jin, T., 2009, The Impact of Implementation of New Insurance Law on Insurance Industry Economic *Research Guide*, 33: 88-89.

¹⁴ See Li, L., and X. Chongmiao, 2009, Consumer Protection in China's New Insurance Law, *China Insurance Study*, 5: 3-7.

¹⁵ See Chen, Tennyson, Wang and Zhou, 259

Perspectives on Insurance Regulation in China

Even though China's insurance regulatory system evolved rapidly, it also did so unevenly, with some areas being overregulated while other areas having little regulation. The fast pace growth and focus of recent reforms have aimed to balance these differences in regulations. The rapid expansion of the insurance market, the international changes in insurance markets and the financial crisis all contributed to regulatory changes in China. The most recent focus has been on consumer protection. China has a unique approach to transitions and this approach can be seen in both the evolution in the insurance industry as well as the overall economy. According to Pollitt and Bouckaert, "the political system shapes the perceptions of what evolution is desirable and the administration system determines what is feasible; together, these determine the speed and direction of reforms" and in the case of China's insurance regulatory system, "evolution" can be seen in the dynamic changes in the regulations.¹⁶ The status and development of insurance regulation is also influenced by the stage of economic development in China. Although developing countries face unique difficulties when regulating private industries, China is unique in that it was not fully a developing country, but a country shifting from a centrally planned economy.¹⁷ Furthermore, because of China's history of state administration, its regulatory capacity and fiscal efficiency are stronger.¹⁸ China's history left it with a strong "top down" bureaucratic system. This system created an initial focus on expanding the market rapidly and led to the neglect of consumer protection, which was later focused on and improved. A remaining issue in China's insurance industry is due to the limited constraints on government actions. As conveyed in this synopsis, the development of China's insurance regulation has undergone terrific progress in a very short time period.

Foreign insurers currently hold an insignificant portion of the market share in China, yet the large and growing economy and current regulatory environment, similar to western standards, suggests the prospects for a market opportunity if the regulatory environment becomes less discriminatory to foreign insurers. As an example of the potential of the insurance market, MetLife recently launched a digital platform in China to make it easier for middle class citizens to purchase life insurance.¹⁹ And according to a PricewaterhouseCoopers's survey, its participants, consisting of 31 companies in China, view China's insurance market with "great optimism" and see many new opportunities through the evolution of consumers needs in the fastest growing insurance market in Asia.²⁰

¹⁶ See Pollitt, C., and G. Bouckaert, 2000, *Public Management Reform: A Comparative Analysis* (Oxford, UK: Oxford University Press).

¹⁷ See Qian, Y., 1999, *The Institutional Foundations of China's Market Transition* (Washington, DC: World Bank's Annual Conference on Development Economics).

¹⁸ See van Rooij, B., 2011, *The People's Regulation: Citizens and Implementation of Law in China*, Amsterdam Law School Legal Studies Research Paper.

¹⁹ See <http://www.businesswire.com/news/home/20141126005099/en/MetLife-Announces-China%E2%80%99s-Digital-Platform-Opens-Frontier#.VPYjR7DF9sM>

²⁰ See http://www.pwccn.com/webmedia/doc/634908438005007110_foreign_insurance_cn_dec2012.pdf

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