New Trends in China's Life Insurance Market Following WTO Accession

by Ginka Sa
Insurance Research Group
saginka@nli-research.co.jp

Following its accession to the World Trade Organization, China has complied with commitments to open up the insurance market in successive steps, and has rapidly created an environment that facilitates entry by foreign insurance companies. Meanwhile, Chinese insurance companies have also been expanding their business operations and centers. However, the insurance industry has not been able to escape the effects of the ailing domestic economy, falling stock prices, mounting bad loans of financial institutions, and rising unemployment.

Under these conditions, consumer demand is plunging while competition is intensifying in the insurance market. New developments such as the introduction of new products and construction of new sales channels warrant close attention.

1. Present Condition of China's Life Insurance Market

The life insurance market has experienced strong growth recently. Premium income for life insurance grew 42.8% to 142.4 billion yuan RMB in 2001, and 59.7% to 227.5 billion yuan RMB (approximately ¥3.4 trillion) in 2002.

Figure 1 Growth of Premium Income

(Unit: billion yuan)

	2000	Annual change	2001	Annual change	2002	Annual change
Premium income	159.60	14.6%	210.90	32.1%	305.30	44.8%
Property insurance	59.80	14.8%	68.50	14.6%	77.80	13.6%
Life insurance	99.70	14.3%	142.40	42.8%	227.50	59.8%

Sources: *Yearbook of China's Insurance 2002*; and web site of the China Insurance Regulatory Commission.

2. Development Phases of the Life Insurance Market

Before embarking on full-fledged market reforms, China had practically no modern insurance business. In particular, life insurance products for individuals were almost nonexistent except for postal life insurance. Thus the modern life insurance industry actually began in earnest in the 1980s following the market reforms.

The transformation of products in the life insurance market has been dramatic. The market's development thus far can be divided into four phases, as described below.

(1) Phase 1: Traditional Insurance

From the late 1980s to early 1990s, mainstream life insurance products consisted of traditional non-participating protection policies such as term, whole life, and old-age insurance.

At the time, the nation was in the midst of severe inflation, and the interest rate on ordinary bank deposits was around 10% (in July 1995, interest on ordinary term deposits was 10.98%). Since banks offered interest rates adjusted for inflation, the scheduled yield on traditional life insurance policies was also quite high, reaching approximately 8% in many cases.

Products aimed at children (educational insurance and casualty insurance) also sold well. This is attributed in no small part to the nation's one-child birth control policy.

(2) Phase 2: Variable Insurance

As inflation was reined in, the interest rate on ordinary term deposits was cut eight times, and the interest rate on one-year instruments fell 1.98% in December 2002. This created a reverse spread that was unbearable for insurance companies.

To solve the reverse spread problem, Ping An Insurance Co. studied the experiences of England, Singapore, and the U.S., and introduced variable life insurance products, which shift asset management risks to the insured. After being endorsed by the China Insurance Regulatory Commission (CIRC) as an effective solution of the reverse spread problem, variable life products quickly spread nationwide. For the next two to three years, variable life grew rapidly, at one point becoming the bestselling product on the market.

However, this situation did not last for long. From mid 2001, as the investment environment deteriorated and the stock market slumped, the poor investment performance of variable life products created many problems. In particular, Ping An Insurance Co. became entangled in numerous problems throughout the country.

(3) Phase 3: Participating Life Insurance

As the popularity of variable life insurance plunged, hopes of overcoming the reverse spread problem grew dim. Meanwhile, participating life insurance products surged in popularity and became a mainstream product. With participating insurance, whole life, old-age, or pension insurance is packaged together with dividends paid out of the company's profits and investment returns. While life insurance protection is still emphasized, the modest investment return helps satisfy the investment psychology of consumers.

(4) Phase 4: Postal Life Insurance Sales by Banks

In 2002, life insurers collaborated with banks to develop postal life insurance products with a savings component. The products are sold through bank branch offices, providing substantial savings in sales cost. The products have enjoyed a boom, with premium income reaching approximately 5 billion yuan in November 2002, or 77% of the 6.5 billion yuan in new life insurance premiums for the same period.

Figure 2 Growth Rate of Major Life Insurance Products

(Unit: billion yuan)

	Premium income 2000	Premium income 2001	Change	Growth rate
Participating	0.86	27.16	26.30	3,046.9%
Universal	0.53	4.03	3.50	655.9%
Variable	1.66	10.66	9.00	542.3%
Traditional non-participating	95.08	100.56	5.48	5.5%

Source: *Yearbook of China's Insurance 2002*.

3. Deregulation of Foreign Currency-Denominated Insurance

Chinese and foreign insurance companies are now allowed to conduct business in foreign currencies. Regulations on foreign currency-denominated insurance business were eased in November 2002, when the CIRC and State Administration of Foreign Exchange (SAFE) jointly promulgated and implemented the Interim Measures on the Administration of Foreign Exchange in Insurance Business.

Foreign-currency-denominated insurance business refers to for-profit insurance transactions underwritten in China for property insurance, life insurance, and reinsurance in which premiums and benefits are paid in foreign currency in accordance with the provisions of the insurance policy.

4. Future Issues

Following WTO accession, China's life insurance market is unmistakably a very promising market with strong potential for continued growth in the future. However, the market is still not as mature as in industrialized countries. Numerous problems remain unsolved, including conflict between insurance executives and consumers, lack of products designed to meet consumer needs, delayed development of the legal framework for insurance, and inadequate supervisory responsibility of the CIRC. These are critical issues that must be addressed in the future.