Chapter IV

Insurance Sector

In 2006, the insurance sector implemented the *Opinions of the State Council of China on the Reform and Development of the Insurance Industry*, pressed ahead with the insurance system reform, expanded the coverage, improved the capital utilization, strengthened the supervision, and enhanced the risk prevention capability. As a result, the insurance sector was evidently stronger and maintained its favorable growth momentum.

Recent Developments

More insurance institutions emerged. In 2006, 14 insurance companies were established. As of the end of 2006, there were 107 insurance institutions, including 7 insurance groups and holding companies, 38 property insurance companies, 48 life insurance companies, 5 reinsurance companies and 9 insurance asset management companies.

Total assets increased. As of the end of 2006, the total assets of insurance companies reached RMB 1.97 trillion yuan, up by 29% over the previous year, with the total assets for property insurance companies of RMB 236.6 billion yuan, assets for life insurance companies of RMB 1.74 trillion yuan, and assets for reinsurance companies of RMB 31.609 billion yuan.[1]

Premium income grew steadily. In 2006, the premium income amounted to RMB 564.14 billion yuan, a y-o-y growth of 14.4%, including RMB 150.94 billion yuan property insurance premium income, up by 22.6% over the previous year, RMB 359.26 billion yuan life insurance premium income, up by 10.65% and RMB 53.94 billion yuan health and accident insurance premium income, up by 19 %.

Claims and benefit payments increased. In 2006, various claims and benefit payments totaled RMB 143.85 billion yuan, up by 26.6% over the previous year, including RMB 79.629 billion yuan for property insurance claims, RMB 46.541 billion yuan for life insurance benefit payments, and RMB 17.677 billion yuan for health and accident insurance claims payments.

The return on capital utilization improved. As of the end of 2006, the balance of insurance fund reached RMB 1.78 trillion yuan, a growth of 26.2% y-o-y. The investment yield ratio in 2006 was 5.8%, up by 2.2 percentage points over the previous year.

Insurance intermediaries further developed. As of the end of 2006, there were 2 110 professional insurance intermediaries, up by 17.22% over the previous year, including 1 563 insurance agencies, 303 insurance brokers and 244 surveyors and loss adjusters. There were 141 278 cross-sector insurance intermediaries, up by 17.10% y-o-y. The sector employed 1 558 million insurance salespersons. In 2006, insurance earned premium income via intermediaries reached RMB 447.751 billion

1 Because the premium income from property insurance and life insurance and that from reinsurance may overlap and due to the consolidation of balance sheet during financial calculation, the sum of assets in property insurance companies, life insurance companies and reinsurance companies is larger than the total assets for insurance companies.

yuan, increasing by 24.48% over the previous year, accounting for 79.37% of the total premium income of the industry.

The sector was further opened up. As of 11 December 2006, the sector was fully opened up except for certain restrictions, for example, foreign-funded property insurance companies cannot conduct compulsory insurance businesses, and foreign-funded life insurance companies should be joint ventures with foreign ownership being equal or below 50%. As of the end of 2006, there were 41 foreign-funded insurance companies, including 24 sino-foreign joint venture insurance companies and 17 solely foreign-funded ones. 133 foreign insurance companies from 20 countries and regions established 195 representative offices in China. In 2006, foreign-funded insurance companies earned premium income worth RMB 25.921 billion yuan (excluding foreign reinsurance companies), accounting for 4.59% of the total premium income of the industry.

The regulation system continued to improve. In 2006, CIRC further improved the legal framework of insurance supervision, conducted on-the-spot inspection, cracked down on underground insurance, steadily strengthened the disclosure of administrative punishment information, implemented the solvency reporting system, included structure of corporate governance and internal control system in the regulatory system, strengthened the supervision over capital utilization, and practically safeguarded the rights and interest of the insured, hence having improved ability to fend off risks in insurance sector.

Box 8 Perils of Underground Insurance

Underground insurance or illegal overseas insurance is sold by overseas insurance companies without the approval of the regulatory authority to residents in the Mainland China. Most underground insurance is life insurance with long term, deposit nature and high insurance amount. In recent years, underground insurance is spreading from coastal areas to inland areas.

Selling underground insurance violates the *Criminal Law*, *Insurance Law*, *Administrative Regulations on Foreign-Funded Insurance Companies* and *Administrative Provisions on Insurance Companies.* Without regulation on the domestic insurance market, they are extremely dangerous and pose a serious threat to the healthy development of the domestic insurance market. First, outflow of insurance resources seriously wreaked havoc on domestic insurers and disturbed the insurance market order in China; second, there is possibility that purchase of overseas insurance is a disguise of money-laundering to legalize illegal income; third, underground insurance is likely to destabilize the protection of the legitimate rights and interests of domestic policyholders and the insured.

Due to the serious perils caused by underground insurance, concerning authorities have launched a more forcefully war against them. The State Council of China printed and issued on March 27, 2007 the *Key Points of the Work for Rectifying and Regulating Market Economy Order Nationwide in 2006*, which emphasized the "crack-down on underground insurance". Consumers should enhance awareness of self-protection, and purchase insurance via formal channels.

Reform and Achievement

In 2006, the insurance sector carried out *Opinions of the State Council of China on the Reform and Development of the Insurance Industry*, *Guidelines of the Eleventh Five-Year Plan for the Development of the Insurance Industry in China* and other documents, and made noticeable progress in insurance services innovation, utilization of insurance capital, integrated businesses and institutional reform.

Insurance services were deepened and service scope widened

Agricultural insurance pilot programs yielded periodic results. In 2006, the agricultural insurance premium income nationwide reached RMB 846 million yuan, up by 16.2% over the previous year, and the insurance amount was RMB 73.321 billion yuan, covering 73 million mu (1 mu = 0.067 hectare) grain and 110 million live stock (poultry), reversing the trend of the gradual shrinkage in agricultural insurance in recent 10 years initially.

Health insurance developed rapidly. In 2006, *Measures for the Administration of Health Insurance* and *Notice on Promoting the Healthy and Regulated Development of Rural Life Insurance Business* were issued. The annual health insurance premium income stood at RMB 37.690 billion yuan, a y-o-y growth of 20.86%. The pilot programs of insurance companies participating in the new farmer's cooperative medical care schemes enlarged to 66 counties (county-level cities and districts) in Jiangsu, Henan and Guangdong provinces (autonomous regions), etc.

Liability insurance businesses continued to grow. In 2006, the liability insurance premium income stood at RMB 5.63 billion yuan, up by 24.3% over the previous year. Relevant authorities made more efforts to develop the liability insurance in certain fields, which further enhanced social administrative function. On 1 July 2006, *Regulation on Compulsory Traffic Accident Liability Insurance for Motor Vehicles* came into effect.

Box 9 Compulsory Traffic Accident Liability Insurance for Motor Vehicles

Regulation on Compulsory Traffic Accident Liability Insurance for Motor Vehicles came into effect as of 1 July 2006. The compulsory traffic accident liability insurance for motor vehicles is the first compulsory insurance stipulated by laws. The compulsory motor accident liability insurance is defined as a liability insurance where the insurance company insures against the injury or death of people in the vehicle and other victims apart from the insured, and the property loss thereof caused by road accident to the insured motor vehicle to the extent of the liability limit.

The establishment of the compulsory traffic accident liability insurance for motor vehicles benefits to road accidents victims in getting effective economic compensation and medical treatment, facilitates to reduce the economic burden of the faulty party in road accidents, and is good to maintain roadway traffic safety and raise the safety awareness through the differential premium rates that "award the well-behaved and punish the poorly-behaved", fully display the social guarantee function of insurance and maintain social stability.

Insurance companies actively participated in the administration of pension. In 2006, premium income of traditional pension insurance stood at RMB 62.6 billion yuan, while pension insurance companies managed annuity plans of 295 companies, with the assets under management worth RMB 1.63 billion yuan, accounting for 65% of the fiduciary business of legal persons. In addition, insurance companies actively conducted pension insurance business for farmers who've lost their land. The premium income of this business reached RMB 3 billion yuan, covering nearly 200 000 people.

Expanded channels available for the utilization of insurance funds

In 2006, *Pilot Administrative Measures on Indirect Investments in Infrastructure Projects With Insurance Funds* and other documents were issued, which gradually removed the restrictions on insurance funds investing in infrastructure and banks' equity.

The amount of insurance funds accumulated continued to increase and insurance companies further optimized the investment portfolio. First, China Life Insurance Company Limited (China Life), Taikang Life Insurance Company Limited, Ping An Insurance Group (Ping An Group) and China Pacific Insurance (Group) Company Limited were approved to be pilot companies to make investment in infrastructure projects, and they invested RMB 10 billion yuan in Beijing-Shanghai high-speed railway project. Second, insurance companies conducted pilot programs of equity investment. China Life purchased 30% shares of China Southern Power Grid and invested in Bohai Industry Fund Management Company. Third, insurance companies were actively involved in the IPO of big-cap blue-chip shares, by investing in BOC, ICBC, Daqin Railway A-shares. Fourth, insurance companies steadily expanded bond investment. As of the end of 2006, insurance institutions invested in bonds worth RMB 945.1 billion yuan, a y-o-y growth of 27.30%, and kept the status of the second largest institutional investor in the bond market. The proportion of bond investment in the total insurance asset investment was 53. 14% , exceeding that of banks' deposits by 19 percentage points (Table 4. 1). Fifth, insurance companies purchased foreign exchange to invest in overseas market. In 2006, the total overseas investment stood at USD 2. 46 billion. Insurance companies optimized their asset portfolios, made a better asset-liability match and diffused market risks, by taking advantage of the expansion of capital utilization channels and the diversification of insurance assets management approaches.

Table 4. 1 Investment Portfolio of Insurance Funds in 2006

	Balance at the end of the period (*100 million of RMB yuan*)	**Increase y-o-y** (*percent*)	**In the balance of funds** (*percent*)
Bank deposits	5 989. 10	15. 94	33. 67
Bonds	9 451. 44	27. 30	53. 15
T-bonds	3 647. 01	1. 57	20. 51
Financial bonds	2 754. 25	52. 61	15. 49
Corporate bonds	2 121. 56	16. 13	11. 93
Subordinated bonds	928. 62	13. 15	5. 22
Securities investment funds	912. 08	−17. 62	5. 13
Securities purchased under agreements to resell	179. 73	546. 51	1. 01
Stocks (equity)	929. 24	484. 87	5. 22
Others	323. 80	52. 13	1. 82
Total	**17 785. 39**	**26. 14**	**100**

Source: CIRC.

Pilot programs for integrated financial services made steady progress

Opinions of the State Council of China on the Reform and Development of the Insurance Industry stipulated that we'll steadily push forward the pilot programmes of integrated operation for insurance firms, exploring possibilities of closer co-operation among insurers, banks and securities firms at broader and deeper levels, and support the efforts of insurance firms to transform into insurance holding companies enhancing international competitiveness through restructuring and acquisition, provided that they are in a position to do so. Meanwhile, opinions showed that insurers are encouraged to expand investments in asset securitization instruments, invest in real estate and venture capital on a trial basis, purchase shares in commercial banks. *Notice on Equity Investment in Commercial Banks by Insurance Institutions* was issued according to the *Opinions*, which explored new channels for insurance companies to expand the insurance services and improve competitiveness through utilizing the banking resources. At the end of June 2006, China Life and its parent company China Life Insurance Group bought shares of CITIC Securities with RMB 4.64 billion yuan. In November, China Life purchased 20% shares of Guangdong Development Bank. By then, its equity investment in listed banks and securities companies totaled RMB 28 billion yuan. On 28 July 2006, Ping An Group and Shenzhen Commercial Bank entered an agreement of investing RMB 4.9 billion yuan for 89.24% shares of the latter.

Started the shareholding reform of China Reinsurance Group

The development of reinsurance lagged behind, constraining the rapid and sound development of the entire insurance sector. China Re-insurance (Group) Company (China Re) is the only solely state-owned reinsurance company in China, which took a large portion of the reinsurance market. In recent years, due to external and internal reasons, China Re had difficulties in operations and was not able to meet the requirements for the development of the insurance sector. Therefore, the government decided to build China Re into a solvent, modern insurance company with strict internal control system, safe operation, good service and efficiency, and high international competitiveness. At the end of 2006, China Re started the shareholding reform.

Made new progress in insurance consumers' education

In 2006, relevant authorities actively launched consumers' education campaigns to safeguard the rights and interests of insurance consumers. Because insurance terms are hard to understand, definitions of major illness insurance were given; standard *Insurance Terms* were issued and implemented; simplified life insurance demonstration clauses were promoted nationwide. It is an initial progress in simplification of clauses and service standardization in insurance sector. *Guidelines on Strengthening Insurance Education in Schools* was issued, which clearly put forward to incorporate the ABC of insurance into the national education system to strengthen insurance education in primary, secondary schools and colleges.

Soundness Assessment

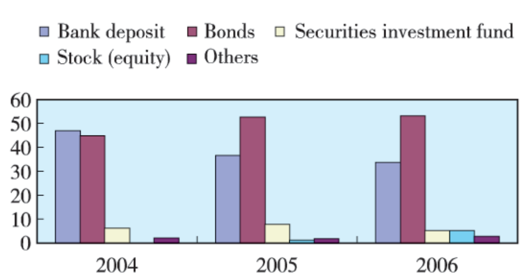
The soundness assessment for the insurance sector is mainly conducted through analysis and evaluation of a series of indicators to measure the healthiness and vulnerability of the sector and reflect the general development and the risk-prevention capability. *The Financial Sector Assessment: A Handbook* issued by the World Bank and IMF put forward a framework of financial soundness indicators for the insurance sector, including capital adequacy, asset quality, reinsurance, adequacy of claims and actuarial, management soundness, earnings and profitability, liquidity, and sensitivity to market risks. At present, China's insurance sector is at the initial development stage. On the basis of international experiences, we made soundness assessment for the insurance sector in China by selecting capital adequacy, profit structure, market competition, product portfolio and other quantitative indicators.

The financial conditions of insurance institutions are generally sound, but the capital adequacy of a few institutions should be improved. As of the end of 2006, the total assets of insurance companies reached RMB 1.97 trillion yuan, up by 29% over the previous year; the premium income in 2006 stood at RMB 564.14 billion yuan, increasing by 14.4% over the previous year; return on insurance fund investment was 5.8%, a y-o-y growth of 2.2 percentage points. Such indicators show that the insurance sector was by and large healthy, and the long existent risks, especially the historical problem of interest spread loss, were gradually solved. But at the same time, a few insurance companies' underwriting capability was constrained by insufficient capital fund. China Re took the biggest share of the reinsurance market but its capital fund was only RMB 3.9 billion yuan, which limited its underwriting capacity and business development. It is an urgent issue to raise the capital fund of China Re.

The return of insurance funds is closely linked to the financial market, and we should pay close attention to the influence of financial market fluctuations on the financial soundness of insurance companies. In 2006, because of changes of policies on insurance fund investment, the improvement in investment skill of insurance institutions and breakthroughs in the capital market reform, the investment yield rate reached a record high. At the same time, the investment portfolio changed noticeably, with continuous drop of bank deposits and increase of bond investment (Figure 4.1). In 2005, the ratio of bond investment to insurance fund investment for the first time exceeded that of bank deposit; as of the end of 2006, bond investment grew to 53.14% of the total. Equity investment's share in the total insurance funds grew from 1.12% in 2005 to 5.22% in 2006. The development and changes in the financial market increasingly have more influence on the investment return and profitability of insurance companies; therefore, close attention should be paid to the influence of fluctuations in the financial market on the financial soundness of insurance companies.

Figure 4.1 Changes of Insurance Fund Investment Portfolio

(*percent*)



Source: CIRC.

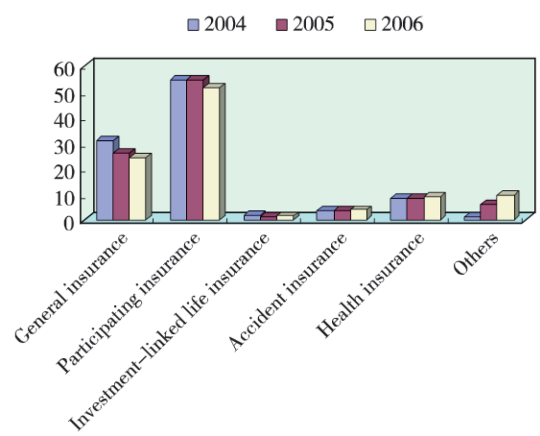
The insurance market became more competitive and better disciplined. Competitiveness is the basis for healthy development of the insurance sector. In recent three years, the number of property insurance companies increased from 34 in 2004 to 38 in 2006, and that of life insurance companies increased from 35 in 2004 to 48 in 2006. With more market participants, the market competition was gradually enhanced, which was beneficial to the management and competitiveness of insurance companies.

Business structure of insurance companies was unsound and flawed with high concentration in certain insurance lines. Life insurance businesses focused on participating insurance, whose share was over 50% of life insurance in recent three years, while the share of general insurance diminished year by year. The market segmentation in life insurance was inadequate. Premium income of accident insurance and health insurance in 2006 increased moderately (Figure 4.2). Premium income of property insurance was excessively concentrated on vehicle insurance. In 2006, vehicle insurance, enterprise property insurance, cargo insurance, accident insurance and liability insurance accounted for over 90% of the total premium income of property insurance (Figure 4.3), with the share of vehicle insurance up to 70%.

The insurance sector continued to grow rapidly, and there was plenty of room to solve existing problems during the process of development. In recent three years, the average annual growth of premium

Figure 4.2 Structure of Life Insurance Premium Income

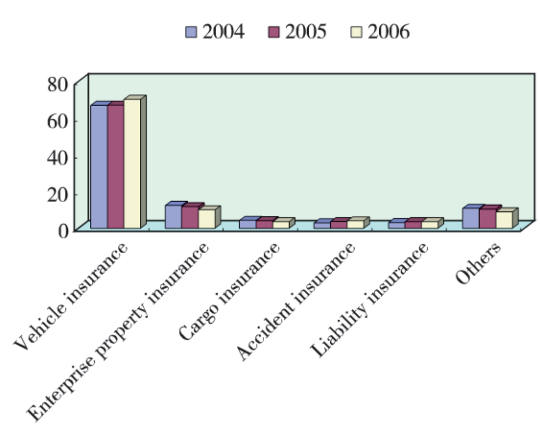
(*percent*)



Source: CIRC.

Figure 4.3 Structure of Property Insurance Premium Income

(*percent*)

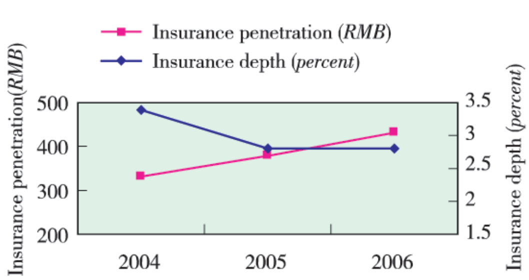


Source: CIRC.

income was 13.3%, and the annual growth rate of total assets averaged at 29.9%. The sector maintained a rapid development momentum. The insurance penetration in 2006 stood at RMB 431.3 yuan, but still lower than the world's average of USD 518.5 in 2005. The insurance depth in 2005 and 2006 was around 2.8% (Figure 4.4), far below the world's average of 7.52% in 2005. The insurance business in certain regions was not developed adequately (Figure 4.5). There is huge development potential in the sector. It is necessary to take advantage of the development opportunity to solve existing problems.

The crisis response capability was enhanced. While the insurance companies become stronger, the policyholder protection fund system made progress in 2006. A Board of Directors of the Fund was established, the decision - making mechanism improved, and

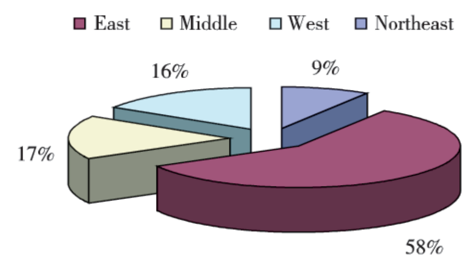
Figure 4.4 Insurance Depth and Penetration in China



Source: CIRC.

the accumulated policyholder protection fund amounted to RMB 8 billion yuan at the end of 2006 to strengthen the crisis response capability of the sector.

Figure 4.5 Breakdown of Premium Income by Regions in 2006



Source: CIRC.

Aspects Worth Attention and Reform Measures

Currently, the insurance sector is still in the initial development phase. While the sector developed rapidly, there were still some problems to be solved. The *Opinions of the State Council of China on the Reform and Development of the Insurance Industry* needed to be implemented in order to prevent risks and promote the healthy development of the sector.

Exert the function of commercial insurance to perfect the multi-tiered pension insurance system

So far, China has put in place a "three-tiered"[1] pension insurance system, but its de-

1 The World Bank put forward the concept of multi-layer pension system. The first layer is compulsory, state-run non-provident layer; the second layer is compulsory, privately run provident layer; the third layer is complementary, voluntary and provident pension plan.

velopment lag behind, and the three tiers are imbalanced. There is a large gap in the first tier pension insurance fund and the fund management system should be optimized. The second tier led by enterprise annuity develops slowly. Because of obscurity in related policies, heavy social burden on enterprises, lack of professional knowledge in the design of annuity plans, and incomplete concerning supervision and risk control mechanism, enterprise annuity hasn't been in good shape. The third tier—private saving pension insurance—develops very fast, but the base is small. Because of lack of insurance awareness of the public and few commercial pension insurance products available, the coverage of private saving pension insurance is quite limited. As such, insurance institutions should utilize their actuarial expertise and expertise in investment, account management and pension payment to participate more actively in enterprise annuity programmes. Concerning parties need to cooperate and actively promote the well-balanced development of a multi-tiered pension system, including the basic pension insurance, enterprise annuity and private saving insurance, so as to build up the pension insurance system in China.

Speed up the development of agricultural insurance, and establish a reinsurance system and catastrophe reserve system for agricultural insurance

Developing agricultural insurance is an effective means to ease catastrophe losses and promote agriculture development as well as to support to build the new socialist countryside. At the same time, China suffers from frequent occurrences of natural disasters, and economic losses account for 3-4% of GDP per year. Therefore, reinsurance system and catastrophe reserve system for agricultural insurance is important. In recent years, the agricultural insurance has made great progress but cannot meet the demands of the agricultural development. To speed up the development of agricultural insurance, we need to make corresponding policies and regulations based on agricultural catastrophes to promote the development of agricultural insurance.

Box 10 Catastrophe Insurance

Catastrophe risk refers to risk that is likely to cause huge losses in terms of properties and lives, including not only risks associated with earthquakes, floods, hurricanes and other natural catastrophes, but also risks caused by explosions, environmental pollution and other man-made disasters. Catastrophes inflict upon lives and properties. Insufficient remedies may result in social instability. Therefore, governments attach great importance to the development of catastrophe insurance, which has been an important approach to reduce catastrophe losses and conduct catastrophe rescue.

According to statistics from Swiss Re, since 1970, the trend towards higher catastrophe claims has been in evidence in the global insurance market. While in the 1970s the claim burden was still around USD 5 billion per year, in the period 1987-2003 it rose to USD 22 billion. In 2004, property insurers worldwide claimed catastrophe losses worth USD 46 billion, and the loss coverage ratio reached 40%. Natural disasters caused losses estimated at USD 220 billion in 2005, of this figure, property insurers worldwide registered catastrophe-related claims of USD 83 billion, which is a new record.

Due to the features of catastrophes such as infrequency, great destructibility and dangerousness, more and more countries have developed innovative approaches to cope with catastrophe risks. At present, there are generally three approaches in the international insurance market: first, special catastrophe projects and plans launched by governments and international organizations, and jointed managed by governments, insurance companies and industrial associations; second, catastrophe reinsurance; third, new financing methods for catastrophe risks, such as catastrophe options, disaster bonds, insurance risks securitization, insurance-linked securities, or insurance derivatives.

Promote the development of liability insurance and safeguard the interests of the public

Liability insurance features economic indemnity, social administration and far-reaching social commonwealth. Liability insurance developed very fast in recent years, but compared to liability in insurance developed countries, it's still on a small scale and low in coverage, influenced by the national economic development, legal environment and risk awareness of the public. Liability insurance shall be promoted more forcefully, and pilot programs need to be undertaken in high-risk sectors, so as to display the role of liability insurance in easing social conflicts and maintaining social stability.

Prevent risks associated with insurance fund utilization and improve the fund management

In 2006, the return on insurance fund reached the highest level in recent years, but still low compared to that of other countries. At present, there are many bottlenecks constraining the efficiency of fund utilization. For example, the capital market is not mature enough; the financial instruments available for medium-and-long term investment are limited; the management mode of insurance fund is crude; risk management is at a low level. We should further explore more channels for insurance fund utilization, and encourage insurance companies to make equity investment in banks. Meanwhile, it's essential to put in place the insurance fund management system that insurance fund can be invested in a more market-oriented fashion with stronger professional standards and better compliance, improve the capital utilization methods and risk management techniques, optimize risk identification, analysis and quantification, so as to achieve the risk quota management. In addition, the sector should explore custodian system for insurance fund utilization, regulate investment behaviors, establish a regulatory information system, improve the regulatory system so that the risks associated with insurance funds can be prevented, and strengthen the external discipline of fund utilization.

Strengthen products innovation and raise the core competitiveness of insurance companies

At present, products innovation is increasingly becoming the key to improve competitiveness of insurance companies. Even though insurance companies have developed some new insurance products, the ever-increasing social demand isn't met yet. Insurance companies should endeavor to strengthen their independent innovation capability, and develop market-driven beneficial products whose risks are controllable, on the basis of absorbing advanced products and technologies from overseas markets. Insurance companies should also improve their actuarial techniques to reasonably design and price their products.

(By Xu Zhong, Wang Shaoqun and Chen Min)