the influence of motor insurance in the chinese insurance market

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China is in fashion. The extraordinary development of the Asian giant attracts admiring glances from the whole world and few dispute the positive development of its economy, especially with regard to its macroeconomic figures. The said consensus is nothing of the sort when figures are interpreted and trends examined.

How and to what extent China will change the global status quo, and how the world will affect China, is a debate that generates different opinions among experts and affects -and interests- the man in the street.

Over the last 20 years China has increased the size of its economy tenfold, measured in terms of GDP. This growth achieves its true dimension if we compare it with the average GDP growth of the ten principal economies, which for that period was 290%. (Source: IMF, 1987 data; Sigma Magazine, 2007 data, Swiss Re, No.3/2008). (Table 1).

Furthermore, its development has the virtue of being planned. The relative weight of the primary sector in the total economy has been falling until it reached 11.3% in 2007. Its contribution is being replaced by the secondary (48.6%) and tertiary (40.1%) sectors. (Source: National Bureau of Statistics of China), and although there is a substantial difference between rural and urban per capita income, the government is making efforts to reduce it.

Against this background, the Chinese insurance sector has taken on a major dimension in absolute terms. During the period 1997 to 2007, the Chinese insurance market rose from 17th to 10th position in the world rankings.(Table 2).

Its relative weight in the world market

Table 1. List of the 10 largest global economies. GDP in USD. Comparison between 1987 and 2007.

Country	1987	2007	% Growth
United States	4,739.5	13,844.0	292.1%
Japan	2,961.8	4,408.0	148.1%
Germany	1,136.9	3,326.0	292.5%
China	321.4	3,214.0	1,000.0%
United Kingdom	690.9	2,773.0	401.4%
France	923.3	2,558.0	277.0%
Italy	777.0	2,111.0	271.7%
Spain	309.7	1,438.0	464.3%
Canada	421.6	1,426.0	338.2%
Brazil	319.5	1,314.0	411.3%
Total	**12,601.6**	**36,412.0**	**228.9%**

Source: FMI; SIGMA, SWISS RE, No. 3/2008 increased from 0.65% to 2.28% (Sigma No. 3/1999; Sigma No. 3/2008. Swiss Re). Nevertheless, penetration (% of GDP) and density (per capita premiums in USD) figures continue at a low level, the said factors holding more modest positions in their respective world rankings (Table 3).

Its dimension and potential can be explained through its own paradoxes. Its development marks the difficulties it is experiencing, as well as the challenges and opportunities it represents. A large market, but too young and immature which changed course in 1949, following the creation of the People's Republic of China, when all insurance transactions were nationalised and grouped under the State People's Insurance Company of China (PICC), and when during the Wuhan National Financial Conference of 1958, its progress came to a full stop with domestic insurance business being suspended, on the basis that under a State monopoly covering all economic activities, and thanks to the prevailing principle of universal social welfare, insurance was unnecessary. For more than 20 years, the PICC was restricted to international business, primarily aviation and maritime.

It was not until 1980 that the People's Republic of China (PICC) returned to domestic insurance business, and in 1984 it became independent from the People's Bank of China (PBOC), via a decree that opened up opportunities to create other companies, the precursor of a process of opening up that basically comprised three phases.

The first, from 1988 to 1991, saw the creation of the companies Ping An and China Pacific. During the second stage, as a result of the new insurance law of 1995, the number of operators began to grow. In 1996, the new regulations produced a restructuring of the PICC, which became an insurance holding company comprising three State companies, splitting off loss, life and reinsurance business. The said companies are the precursors of the current PICC, China Life and China Re. Towards the end of the second stage, the insurance regulatory body, the China Insurance Regulatory Commission (CIRC), was formed, taking over the functions of the PBOC. The last stage began in 2001 when China joined the World Trade Organisation, setting out the bases for the creation of more insurance companies. Three years later, in 2004, there were 54 insurance companies operating in the market: 26 in Non-Life (14 domestic and 12 foreign) and 28 in Life (9 domestic and 19 foreign). By 2008 there were 97 insurance companies in total, of which 43 in Non-Life branches (28 domestic and 15 foreign) and 54 in Life (30 domestic and 24 foreign).

By 2007, the total size of the Chinese insurance market had reached USD 96,315 million in premiums. Its USD percentage growth in comparison with 2006 was 33%, well above GDP growth. This growth was no novelty and was to extend into 2008, when, during the first half of the year, it produced USD 81,902 millions worth of business, which represented 85% of that generated throughout the whole of 2007 (Table 4). Most of the business was in life

Table 2. Changes in the chinese insurance market's position in the world rankings

	1997	2000	2005	2007
Non-life	16	15	12	11
Life	15	18	8	8
Total	**17**	**16**	**10**	**10**

Source: SIGMA, SWISS RE

Table 3. Changes in the insurance penetration and density indices in China

		1997	2000	2005	2007
Penetration	% of GDP	1.46	1.79	2.70	2.90
	World ranking	62	61	49	48
Density	Per capita premiums (USD)	10.90	15.20	45.70	68.60
	World ranking	77	73	71	69

Source: SIGMA, SWISS RE

Table 4. Comparison of insurance penetration and density indices in China for 2007

		North America	Latin America	Europe	Asia	Africa	Oceania	World	China
Penetration	% of GDP	8.70	2.50	8.00	6.20	4.30	6.60	7.50	2.90
Density	Per capita premiums (USD)	3,984.80	154.10	1,962.40	210.70	55.30	2,059.50	607.70	68.60

Source: SIGMA, SWISS RE

insurance, the proportion of which in comparison with total premiums was 70.3% in 2007, rising to almost 76% in the first half of 2008. The share achieved by foreign companies was almost 6% in 2007 (8.0% in Life and 1.2% in Non-Life), although this fell significantly during the first half of 2008, to 3.9% (4.8% in Life and 1.1% in Non-Life).

Against this background motor insurance takes on special relevance. Despite the relatively lower weighting of Non-Life insurance, motor insurance accounted for more than 21% of total premiums in the market in 2007 (71.1% of the total of Non-Life). Its importance is more than numeric, as it acts as a point of contact between people and insurance and plays a decisive role in the diversification of sales in markets where, as in China, insurance is not a familiar concept for the population.

As such, it is a point of discussion for carrying out a process of opening up which has been consolidating since China's entry into the Word Trade Organisation (WTO), the corollary of which is freedom of access to markets. There is currently a restriction on underwriting compulsory insurance cover by foreign Non-Life companies, which means that they cannot take on compulsory motor public liability cover.

In practice, this restriction denies the foreign insurance sector access to motor insurance in China, also making it unviable to develop sales networks designed to reach individual customers, which significantly restricts their development opportunities in other personal loss branches.

This is one of the main reasons for the smaller market share of foreign companies in Non-Life branches.

This has encouraged major competition between local insurance companies who in 2007 produced a total of USD 20,310 million in motor premiums. The fight to increase market share is channelled through a rapid expansion of sales networks which are not adequately structured, with non-technical prices and too high intermediation commissions, frequently circumventing the established regulations. This situation led the regulatory body, the CIRC, to issue a Moratorium on the Approval of Insurance Company Sales Offices in September 2008, announcing that measures were being looked at to correct the situation.

With its eyes fixed on growth, the players concentrated their efforts on new business, competing among themselves to attract car dealerships and repair shops. Between them, it is calculated that they

control 70% of new sales in both commercial and private vehicles. It is estimated that the cost of acquisition via these channels is more than four times higher than the average obtained via proprietary networks. On the other hand, it is obvious that the interests of those channels do not coincide with those of the insurance companies, especially in the case of repair shops. And not only with regard to claims, but also with regard to customers. Details of the insured are not fully shared with the insurance companies, because they are reluctant to give them the information so as to prevent them approaching the customer directly on the first policy renewal.

While distribution control is not at its best, there is still much work to be done in terms of claims handling. With information systems which were not designed to exercise adequate management control, the insurance companies cannot analyse claims properly and so cannot take the appropriate measures. Companies do not have information output broken down by claims, nor there are objective adjustment systems to help the repair shops and insurance companies reach agreement, and so the process of claims adjustment could be greatly improved in the search for technical balance.

There is much information available in terms of financial indicators and statistics, but it is not particularly useful. The information is sketchy and poorly organised, if what you want from it is to understand the real status of the various business lines. This lack of information is more marked in the Non-Life branches. In order to draw conclusions you need to carry out an arduous search in a sea of data, separate it, sort it out and make adjustments in order to get any conclusions. According to the Yearbook of China's Insurance, published by the CIRC in 2007, during 2006 Non-Life insurance companies as a whole made a loss of 4.05% with regard to total premiums. The good earnings made by a few companies which obtained permission from the regulator to invest in the equity markets (not all of them were allowed to because China operates a regulatory mechanism governed by selective authorisation), helped to partially offset those losses. All in all, the pre-tax result published by the CIRC in the said yearbook, showed a loss of 0.14% of total premiums for the whole of the Non-Life sector.

As it did not publish full data for 2007, the CIRC expects the Annual Report of China Insurance Market 2007, of June

2008, to show a worsening of the technical indicators. According to the said report, the 2007 Non-Life market grew 32% in premiums, 66.6% in total assets, 26.1% in claims and 78.1% in volume of technical reserves, in local currency. The report placed the total costs (internal and external) of the industry at almost 40% of premiums. A general calculation indicates what can be expected in the year: Total premiums of USD 30.48 thousand million, claims paid of USD 15.59 thousand million, a change in premium reserves of USD 2.70 thousand million and a change in claims reserves and adjustment costs of USD 3.90 thousand million puts the total loss ratio at 72.8% of total premiums. If we add costs of 39.93% as indicated in the report, we get a combined ratio of 112.7%.

2008 will not be a better year. The cost of the snow storms in the South at the beginning of the year and the tragic Sichuan earthquake, is estimated at around USD 1,460.64 million for the whole of the insurance industry (Life and Non-Life), according to calculations published on the CIRC's Website. The year is set to see a worsening of non-catastrophe business, which caused the Moratorium mentioned earlier in this article. Clearly, the current global financial crisis will not help the sector offset the predicted technical losses.

Under these circumstances, the CIRC is working on a new insurance law to help control the situation and has quickly intervened to avoid the financial crisis having an impact on insurance companies. In China, the crisis coincides with a growth cycle, just at the time when it was feeling inclined to dip its toes into international markets, and it is likely to put a halt to this venture. However, China will come out of the crisis relatively unscathed. The relative isolation from and sparse "contamination" with international markets, its excessive liquidity, the traditional nature of its financial products and restrictions on capital accounts, will help the impact on economic development and economic agents to be much gentler than in other countries.

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With its own problems of lack of maturity, the Chinese insurance market will continue to develop and attract attention on all sides. Its development depends on whether the necessary adjustments are made to resolve problems, which entails an expansion not free from danger or attraction.