

# SCOR Papers

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## Non-Life Insurance Market Growth in China: Can we predict it?

### *Abstract*

*Insurance consumption patterns in China have been gaining interest because the country is expected to be a major driving force of global insurance market growth in the decades to come. With the huge market potential, it is a challenge to follow the trajectory of non-life insurance consumption in China, particularly across different lines of business. Dr Shinichi Kamiya from the Insurance Risk and Finance Research Centre (IRFRC) at Nanyang Business School discusses the underlying issues in this article.*

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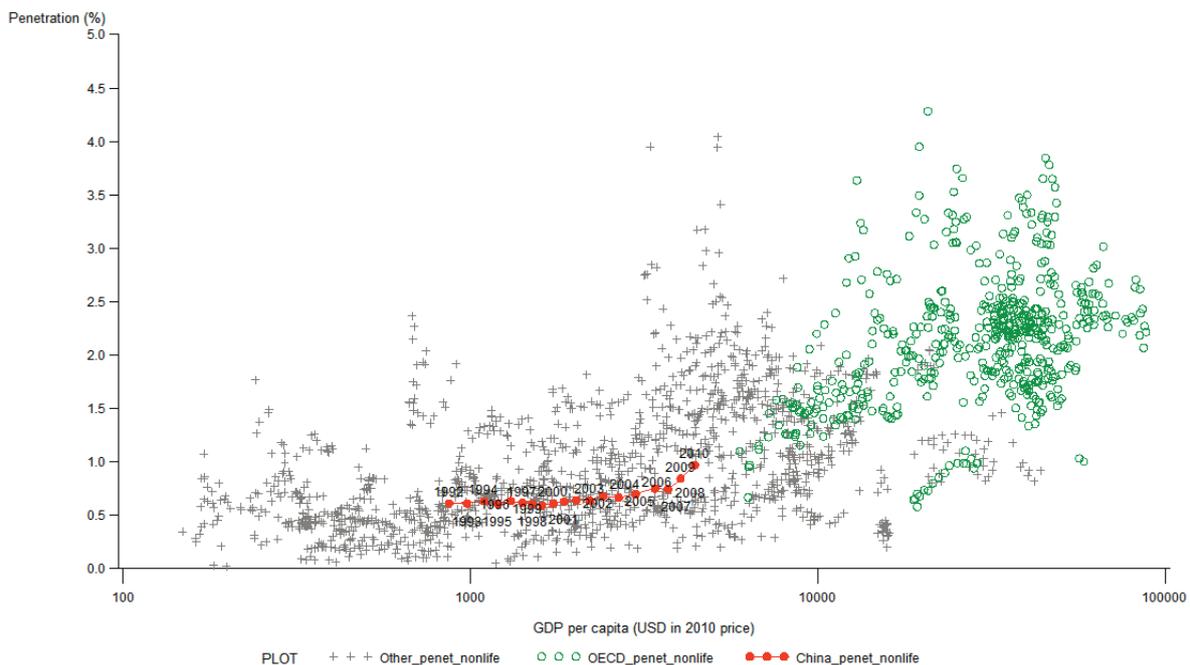
## Growth of the Chinese Economy and Uncertainty

Over the next few decades, the growth of insurance in China will have an enormous impact on the size of the global insurance market. The outlook for the country's insurance markets appears rosy, if predictions for its economic growth are anything to go by. The Economist Intelligence Unit forecasts China's GDP to grow at an average of 7.3% each year between 2011 and 2020, and then 4.1% annually in the next decade, bringing its GDP in 2030 to US\$18 trillion in terms of 2010 prices. Assuming a penetration rate of 2% of GDP, non-life premiums in China would total US\$360 billion, second only to the US. It remains to be seen if this scenario of China's economic growth will come to pass, but it is consistent with other forecasts. The 2% non-life penetration rate is a reasonable estimate, in line with the world average. But does this simple prediction work?

The chart confirms that insurance market growth is tightly associated with a country's economic growth. But recent history of other high-growth emerging economies raises questions about current expectations for China's GDP trajectory. Will China, for instance, fall into the "middle income trap", which caused economic growth in Brazil, Russia and South Africa to taper off after an initial period of rapid expansion? The productivity

of China's middle class, robust domestic consumption and competitive production technology are expected to insulate China from the middle income trap. And hopefully, the Chinese government has an eye on this risk and is ready to take steps to help the country avoid the predicament. Financial crises are another potential spanner in the works. A banking crisis reduces GDP by 20% on average. And historically, while a country's economy regains lost ground relatively quickly after a crisis, recovery by the non-life market lags significantly. Even after 15 years, the industry may still be behind its pre-crisis standing in the economy. These characteristics were observed in a number of countries after the 1997 Asian financial crisis and the Scandinavian banking crisis in the early 1990s.

As China further liberalises its capital controls and banking system, it will become more vulnerable to financial crises. Moreover, if critics are right that China's economy is a bubble, then when the bubble pops, even if it were just a temporary blip, it is possible that non-life premiums would suffer considerably in the intermediate term. In these scenarios, the assumptions of stable economic growth and rising insurance penetration would prove too optimistic.



## Risk Averse and Insurance Awareness

Although economic output holds the strongest explanatory power for aggregate consumption of non-life insurance, the relationship is not consistent across the different lines of business within non-life industry.

To better understand insurance consumption, other factors need to be carefully considered. The degree of risk aversion is an important determinant because highly risk-averse individuals are willing to pay more to protect their wealth against loss. Studies have found that Chinese tend to be relatively less risk averse than other nationalities because risk-taking is often rewarded with higher returns during the country's transition from a planned to market economy. This attitude toward risk would have a negative impact on insurance demand.

More fundamentally, awareness of insurance may be relatively low in China compared with developed countries. Chinese culture is socially collectivist, so that catastrophic losses are usually covered by family financial aid, donation from the community and charities, and government assistance. This implicit form of mutual insurance serves as an alternative to private insurance products. The government is addressing this issue, with the Ministry of Education and the China Insurance Regulatory Commission (CIRC) jointly announcing in December 2006, a campaign to raise insurance awareness. Such promotions are expected to alert consumers of their risk exposure, and the available products to manage risk, thus increasing demand for insurance.

## Other Factors That Affect Non-life Insurance Demand

Urbanisation is potentially another key factor in the demand for non-life insurance. A more urbanised population often leads to higher motor vehicle ownership with a corresponding impact on Motor insurance. However, if China were to implement a similar system such as that in Singapore where the government implements stringent policies to restrict the number of motor vehicles on the road to manage traffic flow, increased urbanization may have a negative impact on motor insurance.

Financial system efficiency is another key factor affecting insurers' operations. The regulatory environment for the financial sector is a large determinant of access to capital market financing, diversity of investment opportunities, and rules pertaining directly to the insurance sector. Government policy on financial markets thus has a great effect on the supply of insurance (as well as demand).

China's non-life insurance market is dominated by three largest domestic players: People's Insurance Company of China, China Pacific Insurance and Ping An Insurance. They together control more than 60% of the non-life market in China. The foreign players from overseas developed insurance markets are yet to establish their presence in

China, through new product development, new distribution channels, new technology, modern management, etc. These can facilitate a further development of the insurance market in China.

In the 2010 China Insurance Yearbook, the CIRC pointed out four problems with the country's insurance companies: (1) high operational costs, (2) insufficient product development, (3) unhealthy competition leading to excessive agent and broker commissions, and (4) bad faith on sales practices and claim management. As the CIRC starts to address these problems and the market becomes more competitive, it is possible that the situation will improve in the near future.

Forecasting the development of any market is not an exact science, yet history does provide a useful guide. While any country may have idiosyncrasies that cause its own market to develop differently from the patterns seen in other countries, it turns out that much of the cross-country variation in insurance consumption can be explained by the observable factors that have been discussed in this article. Still, the rising importance of emerging markets to the global insurance industry makes it important that further research continues to refine existing models and identify new factors, even if they are as yet unquantifiable.

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