A Pressing Need

China offers a huge opportunity for all insurance lines, but especially for property/casualty writers.

by Pang-Hsiang Chye and Joy Schwartzman

AP Photo/Andy Wong

Contributors: Pang-Hsiang Chye is a principal and consulting actuary with the Hong Kong office of Milliman. He may be reached at pang.chye@milliman.com. *Joy Schwartzman is a principal and consulting actuary with the New York office of Milliman. She may be reached at* joy.schwartzman@milliman.com.

"A unique opportunity exists in China today: to be the first country ever to develop a new earthquake insurance system without the undesired incentive of a major catastrophe," according to a 2005 Risk Management Solutions report.

Sadly, that opportunity is lost. The devastating earthquake that struck China's Sichuan Province on the afternoon of May 12, 2008, killed nearly 70,000 people and injured close to 375,000. Approximately 18,000 people are listed as missing.

The Sichuan (or Wenchuan quake, as it is known in China) was the country's deadliest temblor since 1976, and the first major seismic event to occur since China began its rapid economic growth. The Chinese building and investment boom of the past decade meant there was far more property at risk in 2008 than in 1976. In addition to killing or injuring hundreds of thousands of people, the earthquake left nearly 5 million people homeless.

▶ **The Background:** About 75% of P/C insurance sold in China is auto insurance.

▶ **What Happened:** Last year's Sichuan earthquake revealed the great need China has for P/C insurance coverage.

▶ **Watch For:** China's government to work with domestic and foreign insurers to help grow P/C business.

UTTER DESTRUCTION: A volunteer makes his way through the rubble caused by the May 12, 2008, earthquake that hit China's Sichuan Province. The temblor caused an estimated $20 billion in property damage. Only $1 billion of those losses was covered by insurance.

This tragedy has resulted in greater dialogue about the need for more property/casualty insurance coverage in the world's most populous country, which is home to the world's fastest growing economy. AIR Worldwide estimates property damage from the May 12 quake at $20 billion; only $1 billion of those losses—a scant 5%—was covered by insurance.

P/C insurance penetration rates vary widely by geography and line of business in China. They range from almost nothing for residential property, to about 50% for high-end commercial buildings in Chengdu, the capital of Sichuan, and full coverage for facilities owned by foreign multinationals. Demand for property insurance remains weak, especially among residential property owners.

Last summer's successful Beijing Olympics highlighted China as a major economic power on the world stage. However, it will take time for the nation as a whole to develop, particularly the non-coastal regions, and for insurance penetration rates to increase nationwide.

The two most significant factors impeding growth are likely to be:

• **A lack of awareness.** Home ownership in China is a relatively recent development. For years, the Chinese government supplied its citizens with everything they needed, and many who grew up under that system are not yet used to the idea of taking responsibility for their own property.

• **Attitudes toward insurance.** The penetration rate of cell phones was 41.6% at the end of 2007, according to statistics released by the China Ministry of Information—already higher than the world average and growing rapidly. The fact that it is more costly to own and maintain a cell phone in China than to pay most residential property insurance premiums suggests the low penetration rate for residential property insurance is a question of utility, not cost. Even in Taiwan and Singapore, where the vast majority of the population is ethnic Chinese, the general consensus toward insurance can be summed up as, "Insurance is of no value unless I make a claim." And many cannot imagine their homes catching fire. According to insurers in China, this attitude also seems to extend to commercial properties, with some owners preferring to self-insure.

Other contributing factors include reports that some policyholders have experienced difficulty receiving reimbursement, which has tarnished the domestic industry's credibility; a lack of seasoned insurance professionals to encourage greater participation; and that some leading insurers in earthquake-prone areas exclude earthquake cover from residential property insurance. Earthquake cover for commercial properties also can be limited in these areas.

Whatever the reasons, China obviously has a strong need for a concerted push—either by the government, private companies or both working together—to highlight the benefits of property insurance. China also needs to create a new national insurance infrastructure, one that will make all forms of property/casualty insurance easy and compelling for consumers to purchase; profitable for private insurance companies to provide; and practicable for the government to encourage and support.

International insurance firms, which already cover earthquake risks in China, could play a strong and positive role in this effort, providing both coverage and expertise. The opportunity to establish a Chinese earthquake insurance scheme prior to a major disaster may have been lost, but the opportunity to reach out to

History of Insurance in China

- **1949** The People's Insurance Company of China was formed by the newly organized People's Republic of China and authorized to handle all forms of insurance, including all insurance relating to foreign trade and foreign insurance operations. Although private Chinese and foreign players continued to hold pieces of the market, PICC controlled 70% of premiums by 1950 and continued to dominate the market until the late 1960s.
- **1966** The Cultural Revolution put a stop to most domestic insurance activities for approximately a decade.
- **1978** When the market resumed, PICC re-established itself and assumed sole leadership of the industry.
- **Mid-'80s to early '90s** Three new Chinese companies entered the domestic market and challenged PICC's monopoly. In 1992, the American Insurance Assurance Co., an AIG subsidiary, won the right to open a branch in Shanghai, making it the first foreign player to enter the Chinese insurance market since the formation of the PRC.
- **1995** A new national insurance law was adopted; the insurance market in China had grown to 100 times its 1980 size. In 1995 alone, more than 100 million people bought property coverage.
- **1998** The China Insurance Regulatory Commission was established to regulate the industry and ensure that it met China's obligations as a new member of the World Trade Organization.
- **2003** A market-oriented premium rate reform system was launched, based on several months of trial operations, and the Chinese insurance market began to expand rapidly.
- **2007** A truly market-based system was taking its first steps, with eight insurance groups, 62 Chinese and 43 foreign companies doing business in the PRC.

the underserved Chinese P/C insurance market is just beginning.

Government Promotion

Despite the traditionally low levels of P/C insurance policy purchases in China, all of the elements are currently in place for rapid growth of this sector. Perhaps most significantly, in the past few years China has been actively promoting and encouraging all kinds of insurance coverage, with an emphasis on P/C.

In 2003, government leaders asked the China Earthquake Association, the China Insurance Regulatory Commission and the Ministry of Finance to work together to provide a viable earthquake insurance scheme for the country. This led to a July 2004 International Conference on Continental Earthquakes held in Beijing. Among other sessions, 16 global experts in insurance and risk markets took part in a comprehensive workshop that examined lessons learned from earthquake insurance systems developed in New Zealand, Japan, California, Taiwan and Turkey.

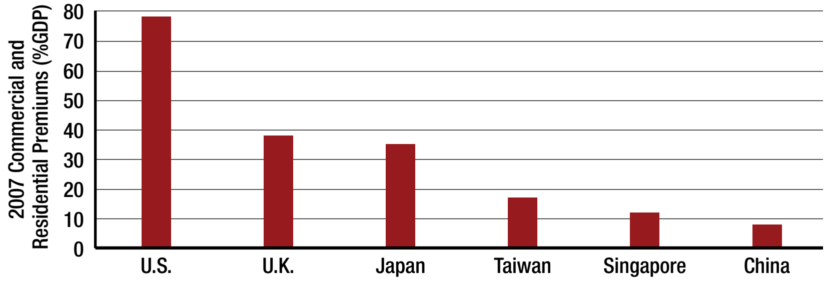
Since then, the government has sponsored or taken part in several studies and conferences, often meeting with hundreds of Western insurance companies and experts, to discuss ways of increasing China's nascent P/C insurance industry and spreading its benefits into rural areas. In January 2008, more than 100 insurance professionals from China and around the world met in Beijing to discuss the potential for micro-insurance in helping to protect the country's rural population.

Less than two weeks after the Sichuan quake, more than 100 representatives from the domestic Chinese insurance industry attended a seminar, co-produced by the CIRC and RMS, focusing on the data needed to develop a workable catastrophic insurance market in China. And in June, the country's top legislature reintroduced a draft amendment to China's Fire Control Law that would require public venues with potential fire risks to have fire insurance policies in place.

There is tremendous opportunity

Room to Grow

Around 75% of all P/C insurance premiums paid in China are for auto insurance. The prevalence of property coverage in China lags other countries when premiums are measured against GDP.



Source: Milliman

in China for insurance and reinsurance companies, particularly when it comes to earthquake insurance. International reinsurers likely will play a major role. Swiss Re and Munich Re have been in talks with the Chinese, with Wang Zhen, head of Munich Re's China division, expecting "fast progress."

Regardless of China's volatile seismic environment, recent studies affirm modern tools can enable insurers and reinsurers to price and manage risk effectively and profitably in the country. Chinese consumers and the country's insurance industry can benefit from the expertise and sharper competition that would come with greater participation by multinational companies. And multinationals will benefit from China's ongoing reform and economic growth.

The size of the country, the complexity of the Chinese insurance market and the unique characteristics of Chinese history and society, however, suggest that international insurers and reinsurers arm themselves with solid professional guidance before attempting to enter these waters.

Understanding the market, the people and the intricacies of federal, provincial and local Chinese governments is vital for foreign companies wishing to take full advantage of the opportunities presented by China's needs and growth. BR