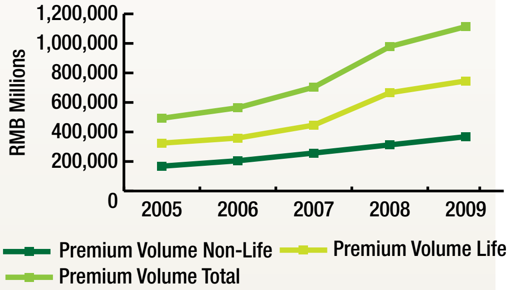
Market Review

September 20, 2010

Sector

Life & Non-Life

China Life & Non-Life – Premium Volume (2005-2009)



Source: Swiss Re: Sigma Insurance Reports 2005 to 2009

Related Reports

2009 Special Report:
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Market Analysis

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China: A Dangerous Wind or An Opportunity? A.M. Best's Perspective

The Chinese proverb "A crisis is an opportunity riding the dangerous wind" could be used to describe the insurance and reinsurance markets of China. As China's insurance market continues to develop and offer growth opportunities, participants simultaneously face a diverse range of challenges.

Socioeconomic developments have ensured that premium volume continues to rise. Virtually every aspect of China's insurance market is evolving with domestic and international insurers and reinsurers changing, not just in response to increased regulatory scrutiny, but as companies attempt to build a long-term future for themselves. A.M. Best notes:

- Intense competition remains a key characteristic of the Chinese non-life insurance market, although the desire to increase market share gradually is being balanced with the need to underwrite profitable business. Losses on the investment and underwriting side during the past two years and shareholder pressures are also contributing to a heightened focus on solvency.

- Some non-life insurers are employing a range of strategies to deliver improved underwriting results; for example, engaging in more realistic pricing and becoming more selective in their choice of risk. Insurers, particularly on the life side, are reassessing their product offering.

- The financial downturn has created a need for foreign companies to focus on their core business. However, the long-term importance of the Chinese insurance market forces international insurers and reinsurers to keep seeking opportunities in China despite considerable startup and investment costs in the country. The non-life, life and health care insurance sectors all are forecast to grow.

- Pricing and commission levels are beginning to improve, although competitive pressures remain as more companies recognise the opportunity China presents. Domestic and foreign (re)insurers face a wide range of challenges including addressing the shortage of expertise and talent in the country.

The Chinese (re)insurance market has expanded rapidly over the past decade and is well positioned to continue to grow from its current position as the world's seventh largest insurance market. However, in A.M. Best's opinion, it is just beginning to take on a new stage in its development and will continue to evolve.

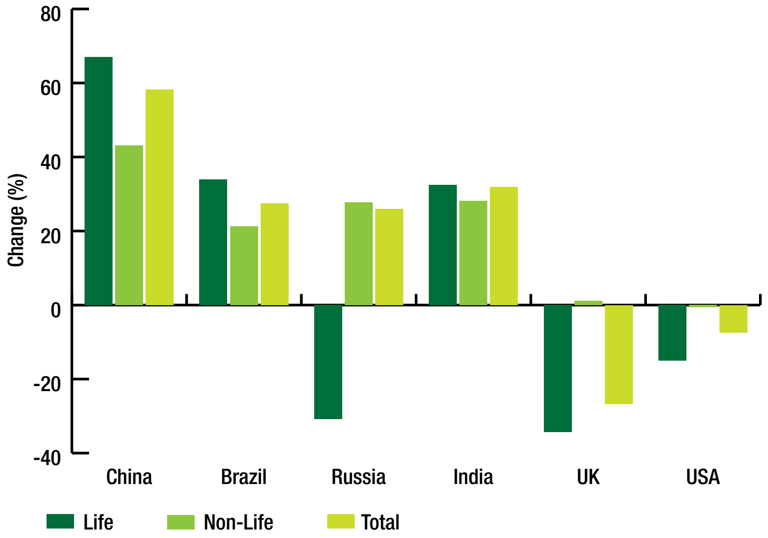
Impact of the Financial Downturn

As one of the world's fastest growing economies and largest exporters, China has been affected by the global events of the past two years but its economy has showed resilience. The pace of economic development eased in 2009 with gross domestic product (GDP) rising by 8.7%, down from growth of 9.6% in 2008.

The life and non-life insurance sectors have grown strongly, reflecting trends that include increased wealth and the awareness of the benefits of insurance. In 2008, total premiums underwritten climbed 39.1% year over year to RMB 978.4 billion (USD 144.12 billion, based on an exchange rate of RMB 1 = USD 0.147297), but growth decelerated in 2009 to a more modest 13.8% rise in total premiums to RMB 1,113.7 billion (USD 164.04 billion).

Exhibit 1

Change In Premium Volumes During the Financial Crisis* (2007-2009)



*Based on local currencies.
Source: Swiss Re: Sigma Insurance Reports 2007-2009

While insurance growth in China has moderated, it has outperformed other global insurance markets in terms of premium growth (see **Exhibit 1**). From 31 December 2007 until the end of 2009, total premiums rose by 58.3%. The four emerging markets of Brazil, Russia, India and China (BRIC) have achieved double-digit growth during the same period although total insurance premiums in Brazil, Russia and India rose at a lower range of 26.0% to 31.9%.

China's growth is even more remarkable when compared with the more mature insurance markets of the United Kingdom and the United States, each of which registered a contraction in total premium volume over the two-year period. However, it should be noted that UK life premium volume fell from an exceptionally high level after a significant increase in 2007 as a result of a change in the country's pension system in 2006.

There are clear signs that Chinese insurers are continuing to enjoy premium volume growth and improved profitability. Recent data released by the China Insurance Regulatory Commission (CIRC), the insurance regulator, showed the market is growing strongly still, with total insurance premiums for the first half of 2010 rising 33.6% from a year earlier to RMB 799.9 billion (USD 117.82 billion).

Actual growth rates could be higher than stated as companies' premium growth to varying degrees has been impacted by the introduction of new accountancy rules. Premium recognition and reserving methodologies have changed as financial reports under International Financial Reporting Standards (IFRS) and the PRC Generally Accepted Accounting Principles (GAAP) have converged. This can result in lower gross written premiums for some insurers, which must class part of their income as policyholders' deposits. Profits also may rise as realistic assumptions – for example, a company's own mortality estimates – are permitted for calculating policy reserves, as opposed to the previous compulsory use of CIRC-prescribed standards.

Insurers must use the new accounting rules for 2009 financial reports. A number of insurers already have been affected by the new accounting rules. For example, Ping An Insurance (Group) Company stated in its 2009 annual report that premium income for the year was RMB 112.2 billion (USD 16.53 billion), but would have been RMB 122.9 billion (USD 18.10 billion) under the old standard. Net profit for 2009 was RMB 14.5 billion (USD 2.14 billion) after the changes, compared with RMB 11.1 billion (USD 1.63 billion) under the previous system.

Companies' Performance – A Rating Agency's Take

Companies are in the process of compiling 2009 annual accounts and those that have to date reported results for 2009 have demonstrated signs of improved performance. Information collected by A.M. Best on the top five non-life companies, which control approximately 74% of the non-life market, based on total premiums underwritten, shows that business can be profitable despite intense competition (see **Exhibit 2**). The combined ratios for the top three insurers in 2007 and 2008 have tended to be below 100%.

Some companies' combined ratios improved year over year, including China Continent Property & Casualty, the fifth largest insurer. It increased its claims provisions in 2007, resulting in a combined ratio of 124.9%; however, it significantly improved its combined ratio in the past two years.

China United Property Insurance Company, the fourth largest domestic non-life insurer, suffered from a RMB 6.4 billion (USD 942.70 million) loss in 2007. It recorded a significant improvement in its combined ratio in 2008 but the CIRC took control of the company in May 2009 after it failed to find strategic investors.

Some of the CIRC's rules are likely to have helped improve profitability. For example, the regulator's introduction in August 2008 of a maximum agent's commission level of 15% for motor sales in Shanghai should result in improved profitability, considering that in some cases insurers were paying car dealerships and maintenance stores commissions in excess of 30%. The CIRC is now permitting agents and insurance companies to determine their own motor commission agreements. Some insurers have also signed "discipline" agreements in certain cities and provinces to ensure minimum pricing levels for motor risks.

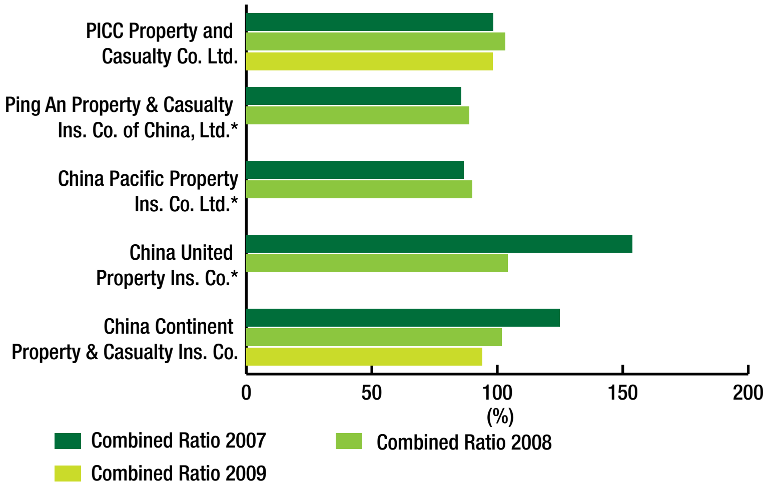
A.M. Best notes that insurers are also taking steps independently to improve profitability. For example, after large claims for collapsed power lines and electricity transmission towers from the January 2008 snowstorms, insurers began to exclude protection for transmission and distribution (T&D) lines as standard.

While some of the larger non-life insurers have posted combined ratios of less than 100%, competition can be intense among the smaller companies that lack scale. This has led to underwriting losses in the past. However, the CIRC's yearbook cataloguing 2009 company results – scheduled for publication later in 2010 – is expected to show reduced underwriting losses in 2009 for these smaller insurers.

There are other factors that are likely to have resulted in reduced underwriting losses, in addition to the CIRC's new rules (see **Regulatory Requirements Lead to Fundraisings**). In January 2008, snowstorms in central and southern China caused more than USD 1 billion of insured losses, while the Sichuan earthquake in May 2008, which claimed more than 80,000 lives, cost an estimated USD 1 billion in claims. In comparison, 2009 was a benign year for natural catastrophes.

Exhibit 2

China Non-Life – Combined Ratios of Five Largest Insurers (2007-2009)



* 2009 data not available.
Source: A.M. Best Co., BestLink

In addition to paying out claims for 2008's natural disasters, insurers were negatively affected on their balance sheets by the global financial downturn impacting investment portfolios. **Exhibit 3** shows that the five largest non-life insurers experienced a 24.5% fall in adjusted capital and surplus in 2008.

Stock market volatility and a tumble in the Shanghai Stock Exchange (SSE) Composite Index throughout 2008 impacted insurers as approximately 15% of their total assets have traditionally been held in equities. In 2009, Chinese bourses experienced strong gains but smaller insurers cannot rely on investment returns to support weak underwriting results in the future. Thus far in 2010, equity returns have not been sustainable.

Concerns regarding banks' ability to recover loans from local government financing vehicles and uncertainty about the stability of the real estate market have resulted in the SSE Composite Index losing about 10% of its value through late August.

While the five largest non-life insurance companies have been growing the amount of business they underwrite significantly over the past few years – by 14% alone during 2008 – their surplus levels have decreased over the past two years. Top line growth is resulting in these companies becoming increasing leveraged, with significantly higher ratios for net technical reserves to surplus and gross premiums written to surplus.

Exhibit 3

China Non-Life – Aggregated Data For Five Largest Insurers (2007-2008)

	2007	2008
Gross Premiums Written (USD Billions)	$23.9	$27.3
Capital & Surplus (USD Billions)	$4.4	$3.3
Change in Capital & Surplus	14.53%	-24.54%
Loss Ratio – Non-Life	73.73%	71.73%
Operating Expense Ratio – Non-Life	29.16%	27.59%
Combined Ratio – Non-Life	102.90%	99.32%
Return on Premiums	0.26%	-2.38%
Return on Assets	-1.46%	-1.28%
Return on Capital & Surplus	-9.99%	-11.84%
Net Premiums Written to Surplus	437.63%	639.30%
Net Technical Reserves to Surplus	407.89%	557.11%
Gross Premiums Written to Surplus	539.02%	816.45%

Source: A.M. Best Co., BestLink

Regulatory Requirements Lead to Fundraisings

As touched upon earlier in this report, the Chinese insurance market has been insulated

Rating China's Risks

A.M. Best's Country Risk analysis aims to identify aspects of a country that could create a difficult or unpredictable environment, impacting a (re)insurer's ability to meet policyholder obligations. This is based on an assessment of economic, political and financial system risks.

Under A.M. Best's Country Risk rating methodology, countries fall into one of five tiers, ranging from CRT-1 (Country Risk Tier 1), denoting a stable environment with the least amount of risk, to CRT-5 (Country Risk Tier 5) for countries that pose the most risk and, therefore, the greatest challenge to a (re)insurer's financial stability, strength and performance.

China has been classified as CRT-3 since May 2003. A country in this tier is defined as having a developing political environment, legal system and business infrastructure with developing capital markets and a developing insurance regulatory structure. CRT-3 countries tend to have characteristics consistent with those termed emerging markets. China's tier is at the high end compared to other BRIC countries, such as Russia and India, which are assessed as CRT-4.

In particular, China outperforms those countries in the category of economic risk. Understandably, China is in a lower tier than those countries that have more mature insurance markets including the United Kingdom and the United States (both CRT-1).

Although China is a desirable market with one of the world's largest economies and populations, there are significant risks for companies operating there. Opacity in the government and legal system, as well as burdensome regulation, increases the cost of doing business for any privately owned company.

Limitations to foreign participation in the local market, government controls on prices and involvement in economic activity – including banking – also pose challenges for investors. However, given the vast potential of China's domestic consumption in the coming decades, investors have accepted the shorter-term costs in exchange for the longer-term potential.

to a degree from external economic fluctuations, although it has not been completely immune. In 2009, the CIRC, addressing concerns surrounding nine aspects, including solvency, finance and corporate governance, ordered a number of companies to submit reports to the regulator.

The CIRC has increased its focus on solvency, operating a model that requires companies to maintain a solvency ratio of at least 100% of actual capital over the statutory minimum capital required (MCR), with 150% currently the recommended level.

In July 2008, the CIRC divided companies into categories. Grade I companies, or those with a solvency adequacy ratio of between 100% and 150%, must explain to the regulator how they plan to avoid insolvency. Grade II companies are those that have a solvency margin of more than 150%. At the time, the CIRC was granted a wide range of powers to intervene if an insurer's solvency adequacy ratio were to fall below 100%. These powers include requiring capital raisings, forcing the sale of assets and assuming control of the company.

Although the CIRC is focusing increasingly on solvency, data from PICC Property and Casualty, Ping An Property & Casualty and China Pacific Property Insurance, the three largest non-life insurers, show that solvency margins have deteriorated over the past three years (see **Exhibit 4**). The three companies, which collectively represent 64% of the non-life insurance market, have maintained solvency margins above regulatory requirements, although solvency ratios have fallen owing to a range of factors, including the rapid growth of premium income and a decline in capital and surplus.

One of the most significant results of the CIRC's scrutiny since July 2008 has been that additional capital is being sought by life and non-life companies as they look to support further growth and improve their solvency ratios. Capital has been raised primarily through private placements, although the initial public offering process is becoming an increasingly common route.

The debt markets have been utilised over the past two years, with market leaders among those raising subordinated debt to help improve solvency ratios. PICC Property and Casualty Company (China's largest non-life insurer by premiums with a solvency ratio of 111% at the end of 2009) raised RMB 6.0 billion (USD 883.78 million) in June 2010 by issuing 10-year subordinated debt.

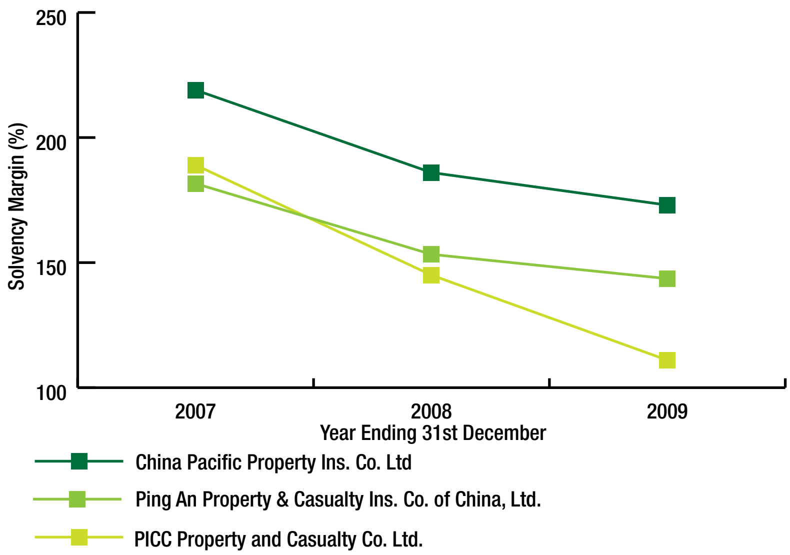
Ping An Property & Casualty Insurance Company, which had a solvency ratio of 143.6% as of year-end 2009, has twice increased its capital base in the past two years. In May 2010, partly to increase its capital strength, it raised RMB 2.5 billion (USD 368.24 million) in a 10-year subordinated debt issue. At the beginning of 2009, the company raised a similar amount, also through issuing debt.

Further fund raisings across life and non-life companies are anticipated to improve solvency positions and to fund growth. According to the CIRC, at the end of June 2010, nine insurers did not meet the regulator's solvency standard.

In addition to increasing its focus on solvency in recent years, the CIRC has taken a more discerning approach to other facets of the insurance market. Its new Insurance Law, which came into effect 1 October 2009, has not only consolidated previous regulation, but has also raised standards with wide-ranging rules aimed at increasing protection for policyholders and improving corporate governance.

Exhibit 4

China Non-Life – Solvency Margins Of the Top Three Insurers (2007-2009)



Source: Company annual reports

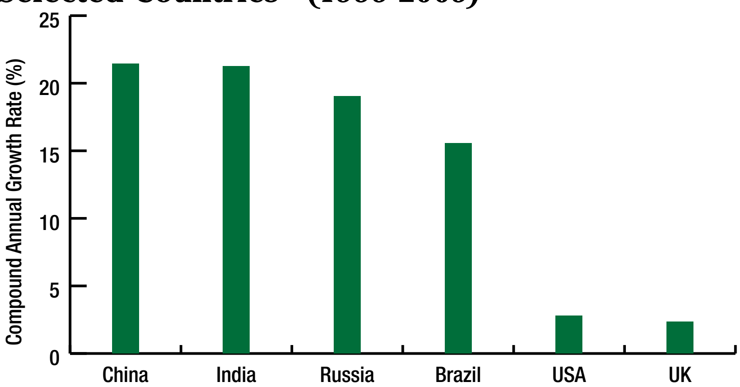
The regulator issued new restrictions for insurers on terminating policies. In addition, company management boards are required to submit internal control assessment, risk assessment and compliance reports on an annual basis. The new law stipulates that, among other things, an insurer must maintain a minimum registered capital of no less than RMB 200.0 million (USD 29.46 million) and must have a sound organisation structure and management system.

The CIRC also recently widened investment channels, permitting some insurers to invest in assets such as real estate projects and nonlisted companies. The broadening of asset diversification channels potentially could lead to better yields and improved profitability and aims to help improve insurers' asset-liability matching (ALM).

Insurance regulation has evolved since China gained entry to the World Trade Organization in 2001 and the CIRC has outlined a road map for market development, which involves moving toward a system that lies between Europe's Solvency I standards and a risk-based capital (RBC) approach in the medium term. The insurance regulator is observing closely the planned adoption of Solvency II in Europe, although it is unlikely to take any significant steps toward adopting this model in the short term.

Although increased insurance regulation is regarded by market participants as more onerous, there is recognition that change is needed as the market develops and there is also an expectation that more stringent rules will come into force.

Exhibit 5
Global Life & Non-Life – Market Growth in Selected Countries* (1999-2009)



*Based on local currencies
Source: Swiss Re: Sigma Insurance Reports 2001 to 2009

The past two years have been regarded as a turning point for life and non-life insurers as companies are being scrutinised by not just the regulator but other interested parties. Listed companies, including PICC and Ping An, are facing demands from shareholders to deliver improved underwriting profit.

Companies are using different methods to deliver a higher return on equity. There is an attempt to re-price some risks, or keep premiums stable where competition is severe. On the non-life side, some (re)insurers claim to be declining what they perceive to be unprofitable business or they are writing smaller lines to maintain existing relationships.

Pockets of insurers are concentrating on improving profitability and some say they are increasingly focusing on ALM, corporate governance and enterprise risk management (ERM). However, the regulator's attempts to focus on solvency and instil better pricing discipline could be undermined by high commission payments to agents and banks for life and personal lines products.

Insurance Market Drivers for the Non-Life Sector

As highlighted earlier in this report, the Chinese life and non-life insurance market has expanded sharply over the past decade and is expected to continue to exceed economic development. The International Monetary Fund is predicting that, given the strong rebound in exports and resilient domestic demand so far this year, China's economy should grow by 10.5% in 2010, and 9.6% in 2011.

Insurance penetration varies throughout the country but overall it is low at 3.4% of GDP, compared with India's 5.2%. Although China has the highest national population in the world with 1.3 billion inhabitants, the total size of its insurance market in terms of premium volume was slightly smaller than that of Italy's (USD 169 billion in 2009).

Exhibit 5 shows from 1999 to 2009, China's total insurance market posted a compound annual growth rate (CAGR) of 21.44%. Growth over this period was at a faster pace than other BRIC countries, although India's growth also was strong at 21.25% while Brazil's CAGR was much lower at 15.54%. Meanwhile, the considerably more developed insurance markets of the United Kingdom and the United States have seen CAGRs of less than 3% during the 1999-2009 period.

Growth is set to continue on the property/casualty (P/C) side, particularly for projects involving building and road construction, development of ports, terminals and the metro rail transit (MRT) and manufacturing projects including the supply of Airbus parts from Tianjin. Major "landmark" risks, including the Beijing Olympics and the Shanghai Expo, have required insurance cover, and the Beijing-to-Shanghai high-speed railway scheduled for opening in 2012 also is expected to provide (re)insurance opportunities.

Regulatory change should further encourage demand for insurance products. Certain lines of insurance are being made compulsory on a regional basis, including liability cover for mines and construction workers.

Beijing, Shanghai and some cities in Guangdong province, including Guangzhou and Shenzhen, are key insurance hubs in their own right, though insurers face intense competition there. Second- and third-tier towns in the north and west are experiencing an increase in demand for insurance as a consequence of industrialization in the region, as well as the government's advocacy for private sector participation in the provision of protection products for the rural population.

All major domestic players already have national footprints, although penetration and average premium size may be lower in the second- and third-tier cities. The intense competition in tier-one markets has also resulted in the emergence of smaller regional players in the second- and third-tier markets in recent years.

Motor is the largest class of business in China, representing 73% of non-life premiums, followed by commercial property (9% of non-life premiums) and agriculture (5%). Alternative and renewable energy and construction projects are seen as key opportunities for the (re)insurance market, given that China is expected to build 1,000 gigawatts of new power generation capacity over the next 15 years.

The growth of agricultural insurance (i.e., livestock cover) is forecast to continue. Natural catastrophes are a continuing concern for China. Recent severe weather has included flooding in South China, which the Civil Ministry and the Office of State Flood Control and Drought Relief Headquarters estimates caused economic losses of about RMB 83.8 billion (USD 12.34 billion) in May and June 2010.

The feasibility of creating a natural catastrophe pool is dependent upon cooperation among the CIRC and the government bodies responsible for subsidising the project, including the Ministry of Finance. A successful scheme needs to offer affordable cover for policyholders, but must also represent an attractive proposition for government stakeholders, as well as reinsurers and primary insurers, if an opportunity for carriers is provided.

Challenges to P/C Insurance Market Growth

Insurers' premium growth is rising strongly; however, as the insurance market is relatively young, there are a wide range of challenges facing insurers. These include the geographical landscape of China, with its numerous provinces, which creates efficiency difficulties and causes some companies to struggle to implement operating models.

In addition, insurers can also lack certain technical expertise as well as infrastructure; for example, data and IT platforms needed to run a profitable business. Brokers and insurers state that the Chinese insurance market can lack data and underwriting track records, with information varying by province. Some companies additionally are improving claims verification processes to reduce suspected fraud.

Multinational insurance companies complain that, as the market is growing so quickly, the shortage of talent is an issue. International qualifications are used as industry standards in China and a range of overseas bodies, including the Life Office Management Association in the United States, the Chartered Insurance Institute in the United Kingdom and the Australian and New Zealand Institute of Insurance and Finance, have affiliations and partnerships in China. However, international insurance companies state the skills, techniques and knowledge required for a successful industry are developing but not keeping pace with the rapid growth of the insurance market. There is, in particular, a shortage of qualified actuaries and risk management professionals in China.

The lack of market talent is partly connected with a sharp rise in the total number of companies operating in China over the past few years. This trend is expected to continue, although the pace of new start-ups could change as solvency standards increase. Generally, there has been limited merger and acquisition activity among insurers.

According to the CIRC, there were 139 insurance institutions in China at year-end 2008, including 31 domestic non-life companies and 16 foreign non-life companies and branches (see **Exhibit 6**). This number of

Exhibit 6

China Life & Non-Life – Breakdown of Insurance Companies (2007-2008)

Institution	2007	2008
Insurance holding companies	8	8
Domestic non-life companies	27	31
Foreign non-life companies and branches	15	16
Domestic life companies	30	30
Foreign life joint ventures and branches	24	26
Pension insurance companies	5	5
Health insurance companies	4	4
Insurance asset management companies	10	10
Reinsurance companies	6	9
Total	**129**	**139**

Source: The China Insurance Regulatory Commission (CIRC)

At a Glance: China's Life and Personal Lines Market

The Chinese life market has been impacted by the financial crisis, in part as a result of volatility in the global investment markets causing insurers, including market leader China Life, to make write-downs. China's second largest life company, Ping An, attracted significant attention when it recorded an impairment loss of RMB 22.8 billion (USD 3.36 billion) given a significant drop in the value of its investment in Belgium financial group Fortis.

Until recently, investment-linked products sold through bancassurance deals were common, but the global economic downturn has resulted in the CIRC encouraging the sale of traditional products. Consequently, there has been a switch from universal life or unit-linked products to mortality-type offerings and longer-term protection and savings products.

Product offerings are changing, but overall, the life market remains robust (see **Exhibit 7**). It has grown by 67% in the two years through December 2009 as China's economic expansion has acted as a catalyst to other drivers of insurance market growth.

Exhibit 7

China Life & Non-Life – Market Growth (2007-2009)

	Premium Volumes (RMB Millions)		
Sector	2007	2008	2009
Life	446,344	665,837	745,743
Non-Life	257,201	312,573	367,986
Total	**703,545**	**978,410**	**1,113,729**

Source: Swiss Re: Sigma Insurance Reports 2007-2009

There are numerous factors contributing to the strong growth of life products, including continued GDP growth resulting in a growing middle class and affluent individuals desiring more add-on products. Rapid urbanization is leading not just to wealth accumulation but also to a heightened demand for insurance from the rural population. Furthermore, a consequence of the "one child policy" is that elderly parents depending on the single child are in pursuit of support for their retirement from the private sector.

An ageing population is one of the many drivers anticipated to lead to heightened demand for life and health insurance products. Health insurance represented just 4.6% of premiums in the first six months of 2010, according to the CIRC. However, the health insurance market is expected to grow rapidly in the next few years, with a report by the Insurance Association of China and think tank The China Academy of Social Sciences forecasting it should grow by 5.4 times to 19 times by 2015. The report predicts that in five years, premiums could be between RMB 252.0 billion (USD 37.12 billion) and RMB 1.0 trillion (USD 147.30 billion).

The projected growth reflects significant health care reform in the country. The government has been encouraging the private sector to alleviate the burden on public funds and in April 2009 unveiled a road map to transform the current health care system over three years.

One of the most fundamental elements of the new reform will be the drive to ensure that 90% of China's population is covered by the country's basic medical insurance by 2011. This includes basic medical cover for college and university students, of which there are over 20 million in the country.

The government has committed RMB 850.0 billion (USD 125.20 billion) over the three-year period on its health care reform, and market participants estimate roughly half of the funding will be allocated toward medical insurance initiatives. The government already has pledged to increase its subsidies for policies; for example, it plans to contribute RMB 120.0 (USD 17.68) per annum per person to urban residents' basic medical insurance.

The four existing health market participants are anticipated to benefit from the health care reform, and new domestic and foreign entrants are hoping to capture the growth in this market.

Rural insurance is increasingly being offered and microinsurance is considered to be a means to access a new pool of rural policyholders as more than 700 million people are estimated to be living in the countryside. Since the first rural policy was sold in China in September 2008, microinsurance schemes have generated premiums of more than RMB 270.0 million (USD 39.77 million) through year-end 2009, according to the CIRC. Microinsurance can involve low premiums but is considered to be a long-term opportunity.

Distribution for life and personal lines risks is largely agency-driven, although the high costs associated with acquiring new business have caused insurers to examine different ways of attracting new customers. Many large domestic insurers are moving to a multichannel distribution model.

Bancassurance is becoming an increasingly popular channel, although commissions paid to banks can be high and offerings tend to be for specific products, such as life insurance or investment-type products.

Internet and telemarketing are also being gradually introduced, especially for travel and motor products, although online usage varies considerably throughout China. According to the CIRC, total premiums collected through the Internet reached RMB 7.8 billion (USD 1.14 billion) in 2009 and 32 insurers used the Internet as a distribution channel. Some insurers are selling policies through mobile phones and third-party portals.

participants rose by almost 8% from 2007, driven by new domestic non-life and reinsurance companies.

Foreigners Continue To Be Drawn to China

The vast majority of Chinese insurers remain focused on growing domestically. For example, local life insurers are particularly concentrated on organic growth given China's high population and low insurance penetration.

For many overseas life and non-life insurers operating in mature markets, relying on domestic growth is not an option and the Chinese insurance market's allure is set to continue. Data from the CIRC showed foreign insurers have underwritten more business in recent years, but they maintain a small presence – their market share has remained unchanged at around 1.2% of the non-life market (see **Exhibit 8**). In 2004, there was a sharp 52.8% rise in annual growth, although that was related to the removal of geographical underwriting restrictions that year.

Overseas life and non-life insurers are aware that it takes a considerable amount of time and capital to build a presence in China. They complain about the costs involved in attracting and retaining talent – particularly with agency forces for the life market – but see the Chinese insurance market as a long-term investment. They fear that remaining an outsider for too long could lead to greater entry hurdles at a later date as local insurers become more mature and sophisticated. Foreign companies can take a maximum 50% equity stake in a joint venture agreement.

Exhibit 8
China Non-Life – Foreign Insurers' Market Share (2004-2008)

	2004	2005	2006	2007	2008
Foreign Premiums (RMB Millions)	1,360	1,450	1,920	2,430	2,890
Annual Growth (%)	52.8	6.7	32.5	26.6	18.9
Foreign Insurers' Market Share (%)	1.21	1.13	1.21	1.16	1.18

Source: Axco Insurance Information Services

Brokers Need to Add Value

Distribution practices vary considerably across the Chinese insurance market with the life market heavily reliant on agents and representatives in institutions such as banks and postal offices.

Exhibit 9

China Non-Life – Top 10 Brokers by Market Share (2009)

Company Name	Market Share (%)
Chang'an Insurance Brokers Company Limited	12.3
Beijing Union Insurance Brokers Company Limited	7.6
Aon-COFCO Insurance Brokers Company Limited	5.5
Jiang Tai Insurance Brokers Limited	5.4
Willis Insurance Brokers Company Limited	4.8
Marsh Insurance Brokers Company	4.1
Jinsheng Insurance Brokers Company Limited	3.2
Huatai Insurance Brokers Company Limited	2.7
Air Union Insurance Brokers Company Limited	2.4
Changcheng Insurance Brokers Company Limited	2.4

Source: The China Insurance Regulatory Commission (CIRC)

In the P/C market, the broker market is developing, with the first regulations for the sector being introduced in 2000. There are now approximately 350 broking licences, with local and international brokers utilised for large commercial risks, particularly in the marine, cargo, aviation, infrastructure, engineering and property sectors.

The top 10 brokers controlled more than 50% of the non-life market in 2009 (see **Exhibit 9**) and both insurance and reinsurance brokers need to provide additional value, expertise and a network of contacts to benefit large customers with complex risks.

As Chinese companies – particularly in the industrial and manufacturing sectors – establish a greater global presence, international brokers could enjoy greater opportunities. These companies have a growing international presence and are

Reinsurance Characteristics

In line with the significant changes being made to the insurance market over the past few years, the reinsurance sector has also developed. The CIRC has gradually receded preferential treatment for domestic reinsurers over the past few years, although state-owned China Re, which with its subsidiaries received an A.M. Best Financial Strength Rating (FSR) of A (Excellent) and an Issuer Credit Rating (ICR) of "a" in July, remains the leading reinsurer. China Re has an operating history of 60 years and remains well positioned in the local market.

International reinsurers including Swiss Re, Munich Re, Scor and Hannover Re have opened offices in the country and are attempting to build up a significant presence in China. Lloyd's Reinsurance Company (China) Limited, which has an A.M. Best FSR of A (Excellent) and an ICR of "a+", is also classed as a local reinsurer and has recently been granted a licence to additionally write direct insurance.

Although the market has opened up, to an extent reinsurers without a local presence remain at a disadvantage to domestic reinsurers. Rules introduced in January 2010 have created new incentives for insurers to favour domestic reinsurers and those with a local presence: insurers placing business with a local reinsurer with a solvency adequacy ratio of at least 100% receive a 100% credit for reinsurance recoverables. Those ceding to a foreign reinsurer without a local presence receive a 90% credit for reinsurance recoverables.

The CIRC also has minimum financial strength requirements for foreign reinsurers. The regulator's rules include minimum paid-up capital levels and ratings. For example, lead reinsurers must be state-owned or have minimum ratings, including an A- (Excellent) rating on A.M. Best's FSR scale.

However, there is a recognition that foreign reinsurers can provide capacity as the direct market continues to grow strongly. The CIRC is in particular encouraging the development of an international shipping insurance and reinsurance market in Shanghai. Insurers are increasingly in pursuit of expertise and using not just domestic markets, but the London market, European carriers and Bermudan reinsurers. Reinsurance tends to be for natural catastrophes and large scale exposures such as marine and aviation risks.

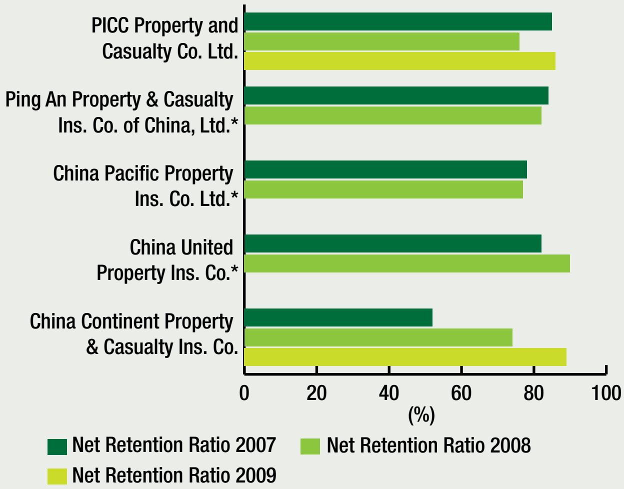
Stripping out motor risks, reinsurance levels for P/C risks are comparable to other Asian markets. Data collected by A.M. Best show over the past few years, net retention ratios have been 75.9% to 90% for the top four non-life insurers (see **Exhibit 10**). China Continent has steadily increased its net retention ratio over the last three years from 52% in 2007 to 89% in 2009.

Inwards reinsurance is written on a facultative basis by small local companies and foreign insurers seeking exposure to large risks. Over the past few years there has been a gradual move for overseas reinsurers with a local presence to accept business through treaties as opposed to on a facultative basis. However, given the series of severe natural disasters in the past few years, particularly for P/C reinsurers, this business has been loss-making and recently there has been a withdrawal of some quota share treaty capacity, especially for property, construction and engineering risks.

Overseas reinsurers attempting to increase premium volume at a viable pricing level must show they offer experience and knowledge on a global scale, and that they can improve ERM practices. Reinsurers are encouraging a change in mindset from insurance companies – that reinsurance is not just a charge to be recorded on profit and loss accounts, but rather a capital efficiency tool. Reinsurers are hoping to provide capacity through proportional and excess of loss policies to insurers building their top line against a backdrop of higher solvency demands.

Exhibit 10

China Non-Life – Top Five Insurers' Use of Reinsurance (2007-2009)



* 2009 data not available.
Source: A.M. Best Co, BestLink

increasingly in pursuit of global insurance cover. The London market and insurance centres in Southeast Asia, Korea and the Middle East are already being utilised to service such client requirements.

Chinese Market Well Positioned to Grow but Challenges Remain

In the immediate future, the Chinese life and non-life insurance markets are expected to continue to grow strongly and evolve.

Domestic insurers and reinsurers are striving to reach standards in other leading insurance markets and be recognised on a worldwide scale. This desire is reflected in part by Chinese (re)insurance companies pursuing ratings from international rating agencies.

Underwriting discipline is likely to become increasingly important. There are clear signs of an improvement in profitability, although it is premature to say there has been a complete turnaround.

In A.M. Best's opinion, financial results for 2010 will provide greater clarity as to whether 2009's improved combined ratios were a consequence of deep-rooted changes or a result of better underwriting conditions. To date there have been no catastrophes in 2010 on the scale of 2008, although this year's flooding in South China and the oil spill off the coast of Dalian in July – the largest in China's recent memory – will result in underwriting losses.

Companies can grow their top line business, although it is the evolution of operational and distribution capabilities together with discipline and professionalism that will differentiate them in the long term.

The CIRC is set to continue to strengthen regulatory systems but insurance market development is reliant on other changes including improving legal compliance and transparency.

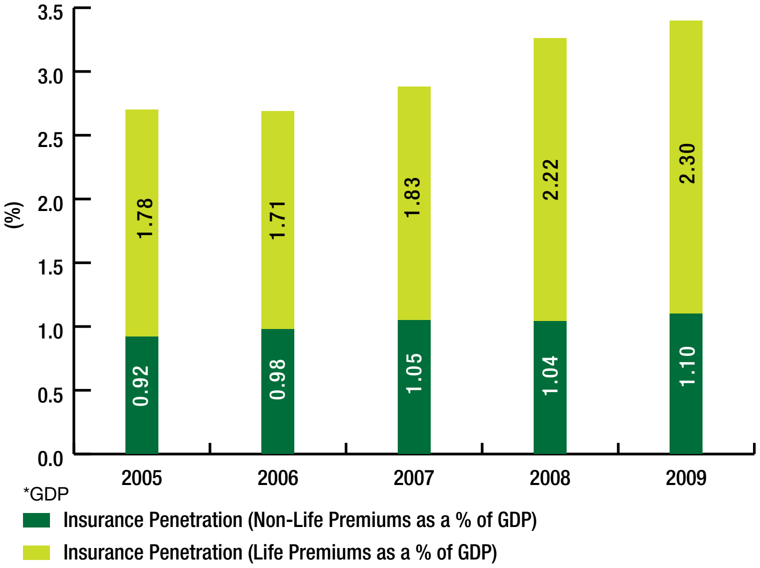
The challenges for the insurance market and its regulator are great, although the attraction of such a rapidly evolving market cannot be underestimated. For domestic and overseas insurers and reinsurers, China represents a great opportunity but continued evolution is key to its success.

Appendix

Exhibit 1A

China Life & Non-Life – Insurance Penetration as a Percentage of Gross Domestic Product* (2005-2009)

Insurance penetration in China has risen gradually over the past few years, driven by growth in the life market as wealth rises.

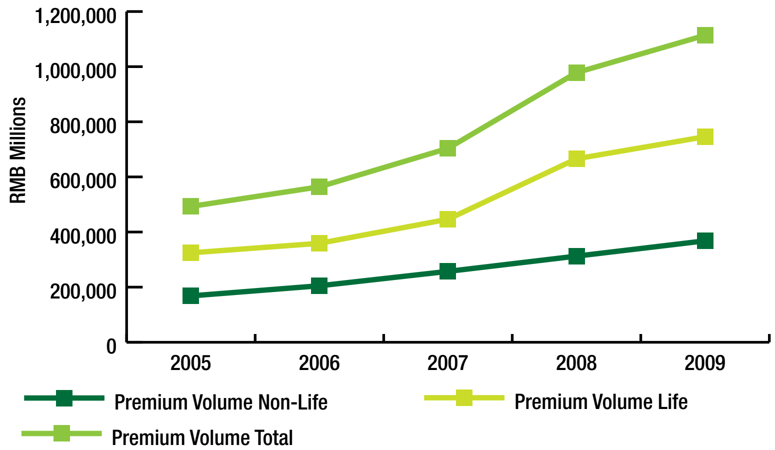


Source: Swiss Re: Sigma Insurance Reports 2005 to 2009

Exhibit 2A

China Life & Non-Life – Premium Volume (2005-2009)

Total premium volume has climbed significantly in the past five years, reaching RMB 1,113.7 billion (USD 163 billion) by the end of 2009.



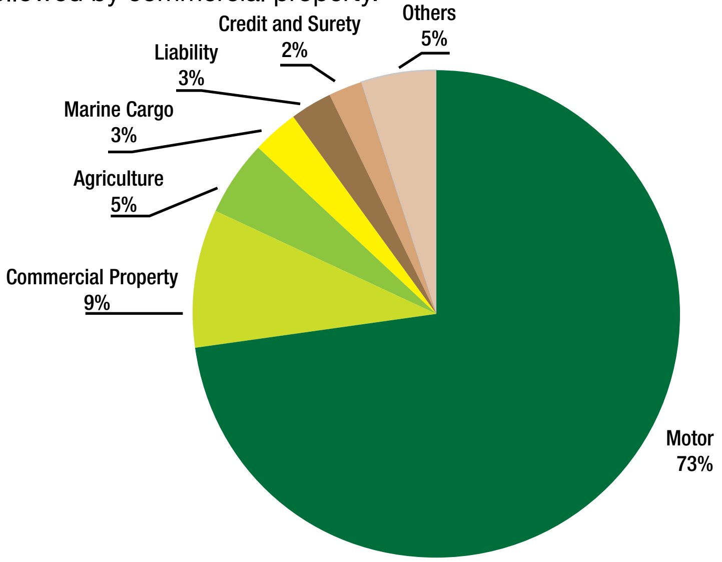
Source: Swiss Re: Sigma Insurance Reports 2005 to 2009

Appendix *(continued)*

Exhibit 3A

China Non-Life – Division of Premium Income (2008)

Motor continues to represent the main line of business for insurers, followed by commercial property.

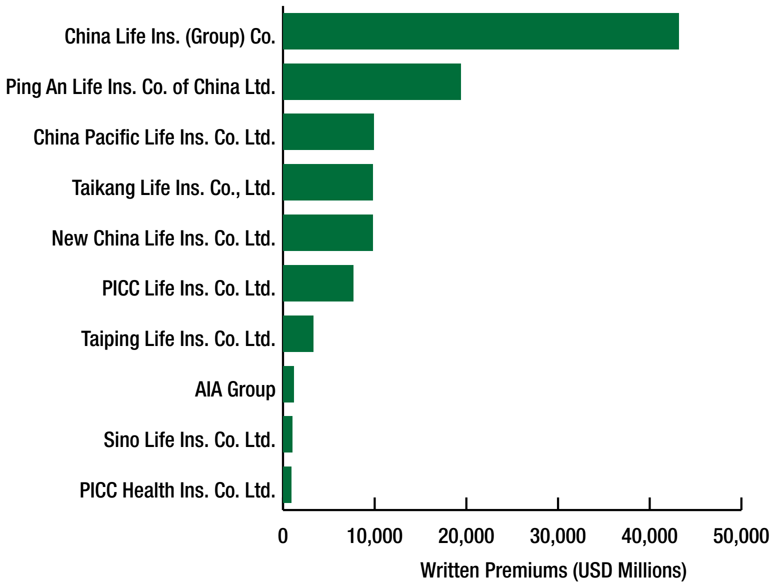


Source: The China Insurance Regulatory Commission

Exhibit 4A

China Life – Top 10 Companies (2009)

China Life Insurance (Group) Co., a state-owned financial and insurance company, is by far the dominant life assurer in Mainland China.



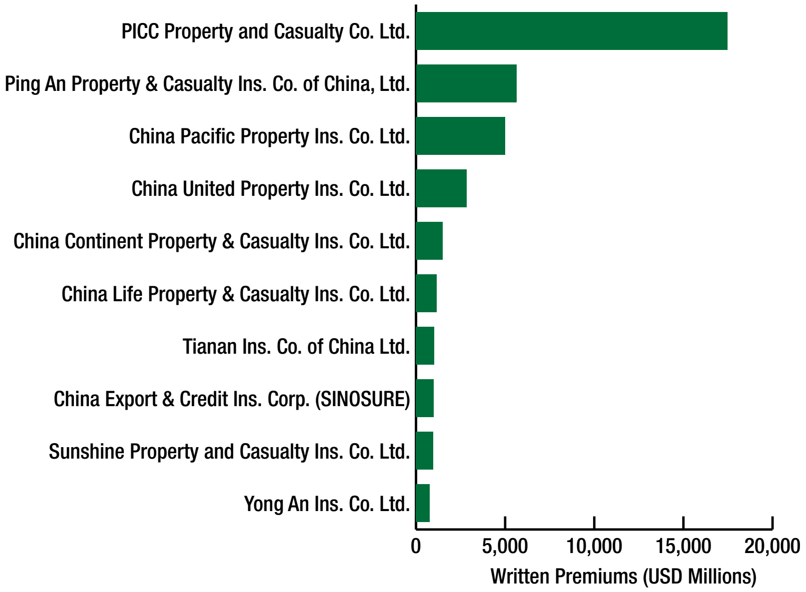
Sources: The China Insurance Regulatory Commission and The Yearbook of China's Insurance from Axco China Report 2010

Appendix *(continued)*

Exhibit 5A

China Non-Life – Top 10 Companies (2009)

PICC Property and Casualty, another state-backed enterprise, remains the clear market leader in the non-life insurance sector.

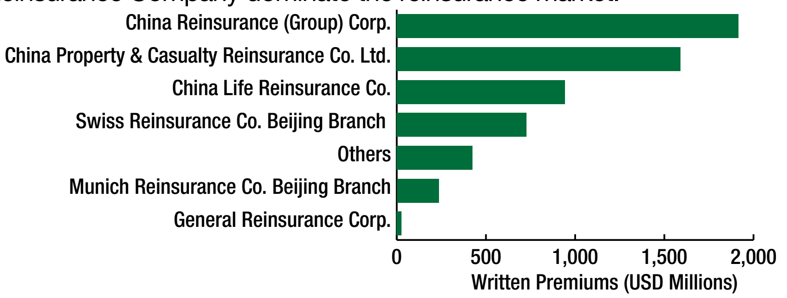


Sources: The China Insurance Regulatory Commission and The Yearbook of China's Insurance from Axco China Report 2010

Exhibit 6A

China Life & Non-Life – Top Reinsurers (2008)

China Reinsurance (Group) Corporation and its subsidiaries China Property & Casualty Reinsurance Company and China Life Reinsurance Company dominate the reinsurance market.



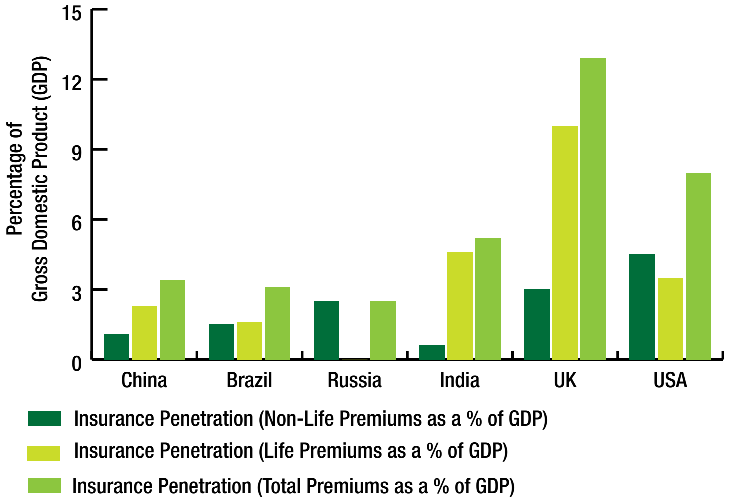
Sources: The China Insurance Regulatory Commission and The Yearbook of China's Insurance from Axco China Report 2010

Appendix *(continued)*

Exhibit 7A

Global Life & Non-Life – Insurance Penetration (2009)

Total insurance penetration in China is ahead of Brazil and Russia but significantly lower than in mature insurance markets.

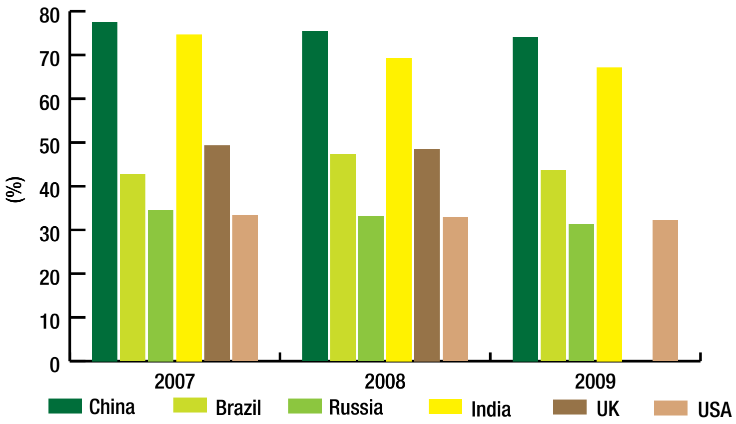


Source: Swiss Re: Sigma Insurance Report 2009

Exhibit 8A

Global Non-Life – Market Share Of Top Five Companies (2007-2009)

The total market share of the top five non-life companies is markedly higher in China than in Brazil and Russia and more developed countries.



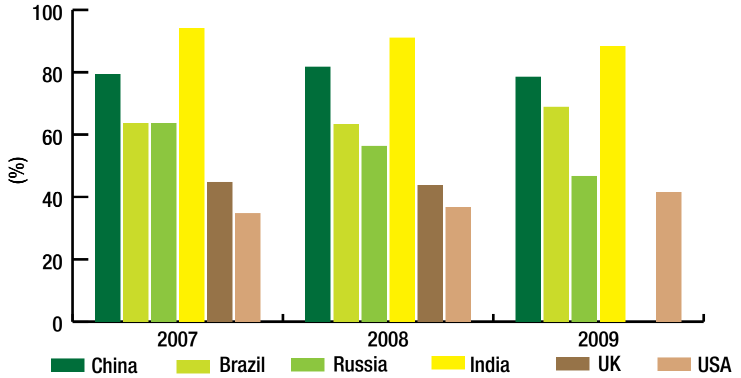
Note: 2009 UK data not available.
Source: Axco Insurance Information Services

Appendix *(continued)*

Exhibit 9A

Global Life – Market Share
Of Top Five Life Companies (2007-2009)

China's top five life companies have controlled more than 70% of the market in recent years, although their share is lower than the top five life companies in India.



Note: 2009 UK data not available.
Source: Axco Insurance Information Services

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