CONTRADICTIONS IN CHINA'S INSURANCE INDUSTRY: LOW-GROWTH AND LOW-INTEREST

Dr. Wang Xujin, Guo Xia, Yi Shanmei*
Insurance Department, Beijing Technology and Business University, China

Abstract

Since China's insurance industry was restored in 1980, insurance premium income increased from 460 million Yuan in 1980 to 1.433925 trillion Yuan in 2011, and the annual growth rate was more than 20%. However, in 2012, although the premium income reached 1.55 trillion Yuan, the growth rate was only 8% and the rate of return on investment (ROI) was only 3.38%. Thus, with the pressure caused by the contradictions between sustainable income growth and low ROI, it is very important to solve these so as to maintain sustainable and steady insurance growth; and at the same time, it is also favorable for insurance to play its role as a social stabilizer as well as an economic booster for the insurance industry. This paper is divided into four parts: the first part analyzes the five basic characteristics of China's low-growth and low-interest insurance industry; the second part elaborates the principal contradictions; the third part analyzes the development environment of China's insurance industry; and the final part proposes recommendations to resolve the contradictions.

Keywords: low-growth, low-interest, insurance industry

บทคัดย่อ

ตลาดการประกันภัยในประเทศจีนได้รับการฟื้นฟูในปี พ.ศ.2523 ทำให้รายได้ของเบี้ยประกันภัยเพิ่มขึ้นจาก 460 ล้านหยวน ในปี พ.ศ. 2523 เป็น 1.433925 ล้านล้านหยวน ในปี พ.ศ. 2554 และมีอัตราการเจริญเติบโตมากกว่า 20% อย่างไรก็ตาม ทั้งที่รายได้ของเบี้ยประกันภัยมีถึง 1.55 ล้านล้านหยวน ในปี พ.ศ. 2555 แต่อัตราการเจริญเติบโตมีเพียง 8% และอัตราผลตอบแทนจากการลงทุน (ROI) มีเพียง 3.38% ดังนั้น จากแรงกดดันนี้ จึงจำเป็นต้องมีการแก้ปัญหาความขัดแย้งระหว่างการเติบโตของรายได้อย่างยั่งยืนและอัตราผลตอบแทนจากการลงทุนต่ำ เพื่อที่จะรักษาการเจริญเติบโตของการประกันภัยอย่างคงที่และยั่งยืน และในขณะเดียวกัน การประกันภัยก็แสดงบทบาทเสมือนสิ่งที่สร้างความมั่นคงและการส่งเสริมทางเศรษฐกิจสำหรับอุตสาหกรรมการประกันภัย งานวิจัยนี้แบ่งออกเป็น 4 ส่วน ได้แก่ (1) วิเคราะห์ลักษณะของการเจริญเติบโตต่ำของประเทศจีนและผลประโยชน์ต่ำทางด้านการประกันภัย (2) อธิบายเพิ่มเติมเกี่ยวกับการขัดแย้งหลัก (3) วิเคราะห์การพัฒนาสภาพแวดล้อมของอุตสาหกรรมการประกันภัยในประเทศจีน และ (4) เสนอคำแนะนำในการแก้ความขัดแย้ง

*Professor Dr. Wang is Director of the Insurance Dept. and Director of the Insurance Research Centre at the university, and Executive Director of the Insurance Institute of China. Email: wangxujin @foxmail.com Guo Xia and Yi Shanmei are graduate students majoring in Risk Management and Insurance

THE CHARACTERISTICS OF CHINA'S INSURANCE INDUSTRY WITH LOW GROWTH RATE AND LOW RATE OF RETURN

Firstly, the growth rate has fallen back to single digits, while property insurance achieved a higher growth rate than personal insurance. From 460 million Yuan in 1980 to 1.55 trillion Yuan in 2012, China has become one of the leaders in premium income, with its international ranking rising from 13th[1] when joining the World Trade Organization in 2001 to 6th[2] in 2010. While its scale keeps expanding, the growth rate dropped from an average of more than 20% to only 8% in 2012. In comparison with the relatively fast-growing property insurance, the growth rate of personal insurance decreased to single digits of 7.1% and 4.6% for the latest two years as shown in Table 1.

Table 1: Growth of Premium Income in China, 1980-2012

Year	GDP (million Yuan)	Growth Rate (%)	Premium Income (million Income	Growth Rate (%)	Property Insurance Premium Insurance Income (million Yuan)	Growth Rate (%)	Life Insurance Premium Income (million Yuan)	Growth Rate (%)
1980	451780	7.8	460	-	460	-	-	-
1981	486240	5.2	780	69.5	780	69.5	-	-
1982	529470	9.1	1030	32.1	1028.4	31.8	1.6	-
1991	2161780	9.2	17824	31.9	13683	28.17	4141	45.76
1996	6788460	9.6	78539	32	45249	15.82	33290	63.02
1997	7446220	8.8	108097	37.6	48073	6.24	60024	80.31
2000	8944220	8	159590	14.5	59840	14.8	99750	14.4
2001	9731480	7.5	210940	32.2	68540	14.6	142400	42.8
2002	10239790	8	305415	44.6	77981	13.3	227464	59.7
2003	11652850	9	388040	27.1	86940	11.7	301100	32.4
2004	13651500	9.5	431810	11.3	108990	25.1	322820	7.2
2005	18232100	9.9	492730	14	122990	12.9	369740	14.5
2006	20940700	10.7	564140	14.4	150940	22.6	413200	11.8
2007	24661900	11.4	703576	25	199770	32.4	503806	21.9
2008	30067000	9	978410	39.6	233671	16.97	744739	47.82
2009	33535300	9.1	1113730	13.8	287580	23.1	826150	10.93
2010	40120200	10.4	1452797	30.4	389564	35.46	1063233	28.69
2011	47156400	9.2	1433925	10.5	461782	18.5	972143	7.1
2012	51932200	7.8	1550000	8	533100	15.4	1016900	4.6

Source: The Yearbook of China's Insurance for 2012

Secondly, personal insurance is still the leading portion, yet has kept decreasing in recent years. China restored property insurance in 1980 and personal insurance in 1982, and the proportion of the latter has risen from a lowly 0.16% to the dominating 55.53% in 1997, and all the way to 77.6% in 2003. But since the global economic crisis, this number has gradually shrunk to 65.61% in 2012, leaving 34.39% to property insurance. The internal structure of the two has also shifted considerably. In property insurance, vehicle insurance occupies more than 75%. In personal insurance, about 90% belongs to life insurance (more than 90% of which is taken up by unconventional insurance), whose major part is the participating insurance. The detailed information is included in Tables 2, 3, 4, 5 and Figure 1.

Table 2: Structure of Premium Income in China, 1980-2012

Year	Property Insurance Premium Income (million Yuan)	Proportion (%)	Life Insurance Premium Income (million Yuan)	Proportion (%)
1982	1028.4	99.84	1.59	0.16
1985	2869	86.68	441	13.32
1990	10676	68.51	4908	31.49
1995	39070	65.67	20420	34.33
1996	45249	57.61	33290	42.39
1997	48073	44.47	60024	55.53
2000	59840	37.5	99750	62.5
2001	68540	32.49	142400	67.51
2002	77981	25.53	227480	74.47
2003	86940	22.4	301100	77.6
2004	108990	25.24	322870	74.76
2005	122990	24.96	369750	75.04
2006	150940	26.76	413200	73.24
2007	199770	28.39	503802	71.61
2008	233670	23.88	744739	76.12
2009	287580	25.82	826150	74.18
2010	389400	26.50	1080000	73.50
2011	461782	32.20	972143	67.80
2012	533100	34.39	1016900	65.61

Table 3: Insurance Business Structure in China, 2001-2012 (percentages)

Business	2001	2002	2003	2006	2007	2008	2009	2010	2011	2012
1. Business Property Insurance	17.69	15.74	14.37	11.01	9.35	8.97	7.7	6.74	7.15	6.76
2. Family Property Insurance	2.74	3.04	2.23	0.71	0.85	0.54	0.5	0.48	0.51	0.53
3. Vehicle and Third-party Liability Insurance	61.33	60.6	62.13	73.4	74.3	72.86	74.96	74.6	75.95	75.16
4. Project Insurance	0.91	0.98	1.42	1.56	1.58	1.68	1.72	1.76	1.6	1.17
5. Agriculture Insurance	0.48	0.61	0.53	0.54	2.67	4.74	4.66	3.37	3.77	4.51
6. Cargo Insurance	5.9	5.36	4.7	3.52	3.16	3.04	2.13	1.96	2.12	1.91
7. Liability Insurance	4.02	4.73	4.01	3.56	3.33	3.5	3.21	2.88	3.21	3.45
8. Credit Insurance	0.43	0.95	0.96	1.81	1.74	1.57	2.44	2.38	2.5	3.01
9. Bond Insurance	0.61	1.18	0.23	0.53	0.21	0.27	0.27	0.57	1.22	1.75
10. Others	5.89	6.79	9.42	1.9	2.79	2.83	2.41	5.26	1.98	1.73

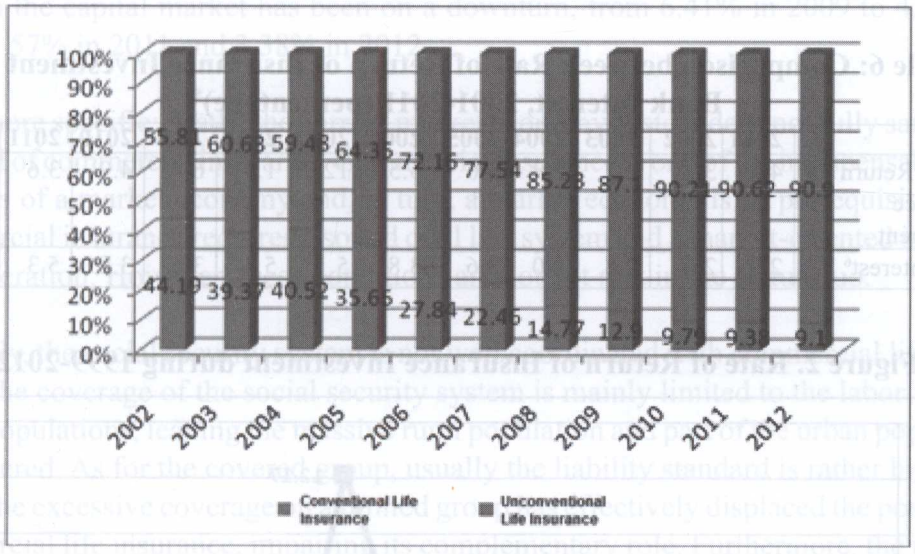
Table 4: Structure of Personal Insurance in China, 2000-2012

Year	Life Insurance (million Yuan)	Proportion (%)	Health Insurance (million Yuan)	Proportion (%)	Accident Insurance (million Yuan)	Proportion (%)
2000	85100	85.36	6534	6.52	8114	8.12
2001	128800	90.39	6225	4.35	7546	5.26
2002	207400	91.16	12201	5.36	7901	3.47
2003	266950	88.66	24192	8.03	9958	3.31
2004	284600	87.98	27131	8.38	11800	3.65
2005	324700	87.75	31184	8.43	14142	3.82
2006	359264	86.95	37690	9.12	16247	3.93
2007	446375	88.6	38417	7.63	19010	3.77
2008	665837	89.41	58546	7.86	20356	2.73
2009	745744	90.27	57398	6.95	23005	2.78
2010	967951	91.04	67747	6.37	27535	2.59
2011	869559	89.45	69172	7.12	33412	3.43
2012	890800	87.7	86280	8.5	38620	3.8

Table 5: Development of Participating Insurance, Universal Insurance and Investment-linked Insurance, 2002-2012 (percentages)

Year	Participating Insurance	Universal Insurance	Investment-linked Insurance
2002	51.1	1.55	3.16
2003	57.84	0.59	2.2
2004	56.54	1.24	1.7
2005	56.89	6.17	1.29
2006	59.37	11.07	1.72
2007	49.76	18.94	8.84
2008	57.06	21.79	6.38
2009	70.97	14.15	1.98
2010	77.02	11.61	1.58
2011	77.99	11.45	1.18
2012	75.57	14.65	0.68

Figure 1: Structure of Life Insurance Products, 2002-2012.



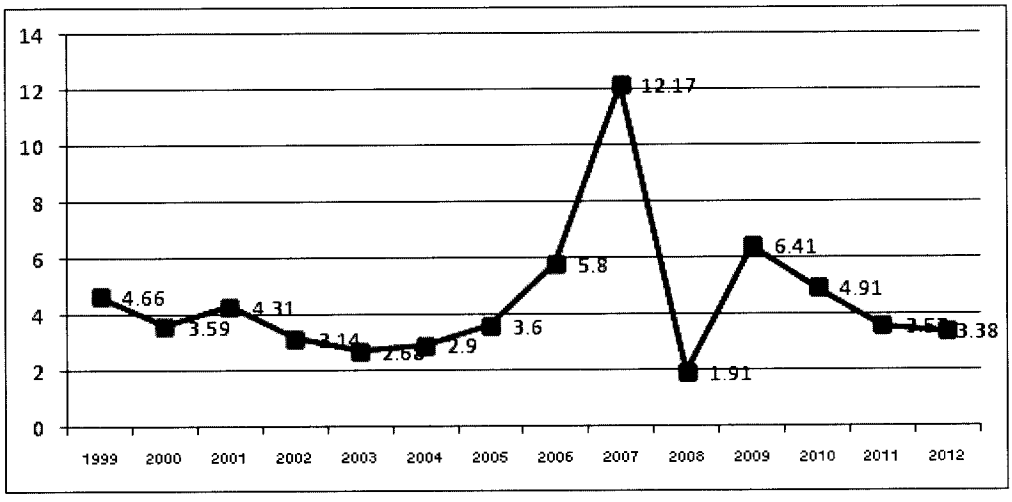
Thirdly, as the number of insurance company increases, the market is less concentrated, gradually forming a monopolistic competition. The total number of insurance companies in China started from 1 in 1980 to 52 in 2001, 130[3] in 2011 and 137 in 2012, among which 75 are life insurance companies and 62[4] are property insurance companies. Regarding market share, the proportion of the top three companies in life insurance dropped from 95.41% in 2001 to 66.6% in 2011 and 65.34% in 2012, while its counterpart in property insurance decreased from 95.25% in 2001 to 55.48% in 2011 and 55.15% in 2012. If we expand our scope to the top five companies, in life insurance their share shrank from 78.5% in 2008 to 71% in 2012 and, in property insurance from 75.5% in 2008 to 74% in 2012. This trend indicates a less concentrated market and a gradually formed monopolistic competition.

Fourthly, the investment channel of insurance is being perfected, and investment plays a more significant role in promoting the development of the industry, although with a relatively low rate of return. Since the Insurance Law was issued in 1995, the channel is constantly being improved. The range was at first limited to bank deposit, financial bond, government bond and other forms approved by the State Council in 1995, which was then revised in 2009 into a broader range as bank deposit, security, real estate and other forms approved by the State Council. In 2012, the China Insurance Regulatory Commission (CIRC) adopted a series of new policies that allow investing in financial derivatives, which is favorable for managing investment risk, raising the rate of gain and promoting product innovation. But due to the global economic crisis since 2008, the rate of return of insurance in China has remained at a comparatively low level, bringing pressure on the profitability and underwriting capacity of insurance companies. Even though the rate of return reached as high as 12.2% in 2007, the annual average over the 11 years from 2001 to 2011 was merely 4.7%, barely higher than the interest rate of a 5-year bank deposit. In 2012, this rate fell to 3.38%. The depression in the capital market is the main cause of such low rates of return, the detailed information of which is the provided in Table 6 and Figure 2.

Table 6: Comparison between Rate of Return of Insurance Investment and Bank Interest, 2001-2011 (percentage)[5]

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average
Rate of Return of Insurance Investment	4.3	3.1	2.7	2.9	3.6	5.5	12.2	1.9	6.4	4.9	3.6	4.7
Bank Interest[6]	2.9	2.8	2.8	3.0	3.6	3.8	5.1	5.4	3.6	3.8	5.3	3.8

Figure 2. Rate of Return of Insurance Investment during 1999-2012



Fifthly, supervision of the insurance industry has improved, as well as its public image. China has established a system of laws and regulations, centered on the Insurance Law, to provide legal support for an ordered development. As for the supervision philosophy, it has been focused on protecting consumer's interest in recent years, and achievements have been made in eliminating misleading statements in sales and in facilitating claim settlement. Also, improvements have been made in the information disclosure mechanism in the industry. The supervision system, which is concentrated on solvency, contributes to the future development of the industry.

EXISTING CONTRADICTIONS IN THE INSURANCE INDUSTRY

China's insurance industry is currently faced with several contradictions that are mostly reflected in the pressure of both slowed growth of premium income and decreased investment return. On the one hand, the annual growth rates in premium income from 2009 to 2011 are respectively 13.8%, 30.4%, 10.5%, although 2012 witnessed the first single-digit growth rate in 20 years, a mere 8%. On the other hand, the rate of return on investment in the capital market has been on a downturn, from 6.41% in 2009 to 4.94% in 2010, 3.57% in 2011 and 3.38% in 2012.

To be more specific: firstly, the current market economy system does not fully satisfy the demand of commercial insurance. Commercial insurance is one of the indispensable constituents of a market economy and, in turn, a market economy is its prerequisite. Also, commercial insurance requires a sound civil law system and a market-oriented independent operation. However, these conditions are not yet met in the status quo.

Secondly, the social security system is not well coordinated with commercial life insurance. The coverage of the social security system is mainly limited to the labor force in urban populations, leaving the massive rural population and part of the urban population not covered. As for the covered group, usually the liability standard is rather high. In a sense, the excessive coverage on a limited group has effectively displaced the position of commercial life insurance, impairing its complementary role. Furthermore, the un-covered have a basic need for social security but are often unable to afford extra coverage, while the covered enjoy so much more than basic coverage from social security that they lack the need for commercial insurance as a complement but rather as an investment. This results in the unreasonably high proportion of investment type products in the life insurance market, which also has to bear with insufficient investment channels for the public.

Thirdly, the instability in the capital market is disadvantageous to the development of the insurance market. These two markets are tightly related. For instance, the insurance market is a major factor of a sound capital market. According to foreign experience, insurance investment is a principal capital source, an institutional, long-term and value investor, contributing to the stability of the capital market. In turn, the capital market is

a major source of profit for insurance investment. Therefore, product innovation has a crucial role in the development of the insurance industry. As competition in the market intensifies, it is common for the modern insurance industry to operate with an underwriting deficit, relying on profit from investment and achieving overall gain eventually. However, the profitability of insurance investment suffers from the instability of the capital market in China, which erects barricades to product innovation and the further development of the insurance industry. The annual average rate of return on investment of China's insurance industry over the 11 years spanning from 2001 to 2011 is only 4.7%, and even worse for 2012 and 2013. The depression of the capital market has severely degraded the rate of return on investment of the insurance industry, as illustrated in Tables 7 and 8. This has affected the competitiveness of not only life insurance products which feature the function of saving or investment, but also non-life insurance products, which, in developed countries, usually achieve an overall gain by using profit from investment to make up for the deficit in underwriting (Table 9). However, due to the extremely low rate of return on investment, China's insurance industry has to seek profit through underwriting rates, which impairs consumer willingness to purchase and thus potential business expansion of property insurance.

Table 7: Investment Allocation of Insurance Companies in 2011

	Investment Amount (million Yuan)	**Proportion (%)**	**Return (million Yuan)**	**Rate of Return (%)**
1. Bank Deposits	1773717	31.97	66128	4.14
2. Bonds	2612469	47.09	105696	4.38
(1) Treasury Bonds	474240	8.55	20530	4.24
(2) Financial Bonds	1248520	22.51	48224	4.42
(3) Corporate Bonds	882503	15.91	36617	4.4
3. Securities Investment Funds	291585	5.26	-4420	-1.49
4. Buy-backs of Assets	25146	0.45	1573	4.31
5. Stocks	380187	6.85	-10331	-2.61
6. Long-term Stock Investments	195323	3.52	9151	5.09
7. Real Estates	31012	0.56	4231	18.2
8. Insurance Asset Management Products	7229	0.13	150	1.95
9. Financial Derivative Instruments	290	0.01	9	10.51
10. Loans	200311	3.61	7199	5.28
11. Borrowing	84	0	0	0
12. Others	30031	0.54	3214	14.35
Total	**5547385**	**100**	**182600**	**3.57**

Table 8: Investment Allocation of Insurance Companies in 2012

	Investment Amount (million Yuan)	Proportion (%)	Return (million Yuan)	Rate of Return (%)
1. Bank Deposits	2034309	33.59	94311	4.64
2. Bonds	2748125	45.37	128815	4.69
(1). Treasury Bonds	473121	7.81	20184	4.27
(2). Financial Bonds	1306735	21.58	61428	4.70
(3). Corporate Bonds	959810	15.85	47031	4.90
3. Securities Investment Funds	294209	4.86	-25428	-8.64
4. Buy-backs of Assets	47356	0.78	1462	3.09
5. Stocks	388796	6.42	-30639	-7.88
6. Long-term Stock Investments	190532	3.15	14243	7.48
7. Real Estates	34277	0.57	2916	8.51
8. Insurance Asset Management Products	23600	0.39	775	3.28
9. Financial Derivative Instruments	222	0.00	-26	-11.90
10. Loans	256986	4.24	14064	5.47
11. Borrowing	84	0.00	-1	-0.97
12. Others	38140	0.63	3919	10.28
Total	**6056639**	**100.00**	**204412**	**3.38**

Table 9: Rate of Return for Non-Life-Insurance Companies in Different Countries (%)

	United States 94-04	Canada 94-04	United Kingdom 94-04	Germany 94-04	France 95-04	Japan 96-04
Claim Ratio	78.7	73.3	73	71.3	80.8	61.2
Expense Ratio	26.4	29.8	31.2	27.5	23.3	38.1
Dividend Ratio	1.1	n.m	n.m	1	1.1	0.1
Combined Ratio	106.2	103.1	104.2	99.9	105.2	99.4
Standardized Underwriting Performance	-6.9	-3.7	-4.7	-2.4	-6.1	0.4
Net Investment Performance	16.2	13.8	16.8	15.4	13.4	4.7
Other Expenses/ Revenues	0	0.4	-0.5	-0.3	-0.3	-0.8
Rate of Return (pretax)	9.2	10.4	12.8	12.7	7	4.4

Fourthly, the underdeveloped company management is inconsistent with the fast growing business. Since 1980, China's insurance industry has been developing rapidly, with an annual premium growth rate close to 30% and a constantly increasing investment profit. But company management failed to keep up the same pace, and especially the problem of ownership. It leads to difficulty in the establishment of a board of directors or a board of supervisors that answer to the shareholders. As a result, a proper incentive mechanism is yet to be put in place.

Fifthly, self-discipline of the industry needs to be strengthened. Self-discipline has fallen behind the fast development of the insurance industry. Corresponding organizations need to play a more significant role in defending the interest of the entire industry. The key is to set up the appropriate organizational structure and regulatory framework around the interest of the industry, letting various self-discipline organizations speak for themselves.

Sixthly, the internationalization of the insurance market is restricted by the administrative system. It has been 12 years since China joined the World Trade Organization and the insurance market is fairly open to the world. Product and price are important marketing strategies, however, in China, approval from the authority on both premium rate and specific clauses in the policy are needed for those life insurance products that are newly developed or that concern the public interest. Particularly, the interest rate of life insurance is required to be no more than 2.5%, and discount on vehicle insurance cannot be more than 30%, which, to some extent, restrain public demand and future development.

Seventhly, expansion of business is in conflict with enhancement of efficiency. Insurance companies are actually raising commission to compete for a larger market share. On the other hand, they have to emphasize efficiency, especially some property insurance companies which managed to lower their total cost ratio to less than 100%. In such cases, the claim ratio reduced, but the expense ratio, in fact, increased in 2009 and 2010. Assuming the compensation standards remain the same, this increase in efficiency is actually achieved at the price of a poorer management and lower coverage standard for the insured. Of course, according to Table 10, a decreased cost ratio and an increased claim ratio in 2011 and 2012 indicates improvement in management and consumer benefit.

Table 10: Total Cost Ratio and Claim Ratio, 2006-2012 (%)

	2006	2007	2008	2009	2010	2011	2012
Total Cost Rate	102.7	114.2	106.7	104.5	97.3	95.26	97.23
Claim Ratio	52.75	51.81	60.7	54.79	45.08	61.22	61.25
Total Expense Ratio	49.95	62.39	46.0	49.71	52.22	34.54	35.98

Eighthly, the market potential is not fully exploited, but unbalanced structure hinders its release. The insurance rate in China is relatively low. In 2012, for example, 87.7% of the personal insurance business is life insurance, the rest is health insurance at 8.5% and accident insurance at merely 3.8%. Within life insurance, conventional business takes up only 9.8%, a relatively low proportion of risk management product. In property insur-

ance, vehicle insurance accounts for 75.16%. Other types of insurance need to be further exploited.

Ninthly, the public welfare nature of compulsory traffic accident liability insurance for motor vehicles contradicts its marketization. The corresponding regulation puts emphasis on the non-profit principle while, at the same time, demands a direct operation, which is a serious mismatch. Only under the agent mode can non-profit non-deficit operation be achieved, for under the direct mode, non-profit-non-deficit operation cannot be achieved on a company scale or industry scale because of the law of large numbers. But it is the nature of an insurance company to maximize its profit. Binding public welfare with marketization will lead to an ambiguous boundary between market and government, diminishing the enthusiasm of insurance companies.

Tenthly, the development of China's insurance industry has clear regional differences. The unbalanced development in the economy results in that in the insurance industry too. Developed regions, as represented by Guangdong, Jiangsu, Beijing, Shanghai, Zhejiang, and Shandong, have sufficient insurance suppliers and massive demands, bringing high premium income. The central and western regions, however, are not only less developed but also have a poor awareness of insurance, contributing less to the total premium income. Details are provided in Table 11.[7]

Table 11: Premium Income in Different Regions of China in 2012[8]

Region	Premium Income (million Yuan)	Proportion (%)	Region	Premium Income (million Yuan)	Proportion (%)
Eastern China	895506.3217	57.82	Heilongjiang	34414.9837	2.22
Beijing	92308.7131	5.96	Anhui	45361.2517	2.93
Tianjin	23815.715	1.54	Jiangxi	27171.8884	1.75
Hebei	76615.8299	4.95	Henan	84113.1801	5.43
Liaoning	40241.5779	2.60	Hubei	53331.0559	3.44
Dalian	16061.9948	1.04	Hunan	46511.4274	3.00
Shanghai	82063.6807	5.30	Western China	292235.29	18.87
Jiangsu	130128.048	8.40	Chongqing	3310267.03	2.14
Zhejiang	81987.6977	5.29	Sichuan	8195283.43	5.29
Ningbo	16470.5624	1.06	Guizhou	1502155.49	0.97
Fujian	38477.8842	2.48	Yunnan	2712984.03	1.75
Xiamen	9291.7667	0.60	Tibet	95372.34	0.06
Shandong	96774.7993	6.25	Shaanxi	3653273.14	2.36
Qingdao	16028.8055	1.03	Gansu	15876.7491	1.03
Guangdong	129085.6191	8.33	Qinghai	3240.0753	0.21
Shenzhen	40126.5705	2.59	Ningxia	6268.8277	0.40
Hainan	6027.0569	0.39	Xinjiang	23556.0368	1.52
Central China	352622.77	22.77	Inner Mongolia	24774.372	1.60
Shanxi	38464.9109	2.48	Guangxi	23825.8713	1.54
Jilin	23254.0721	1.50	**Total**	**1548792.98**	**100**

It can be seen from Table 11 that the premium incomes of the 16 provinces and cities in the eastern region add up to 895.506 billion Yuan, equivalent to 57.82% of the total in the country, compared to that of 352.623 billion Yuan and 22.77% of the total for the 8 provinces and cities in the central region. The western region accounts for 292.235 billion Yuan, 18.87% of the total premium income. The top five premium incomes come from Guangdong province, Jiangsu province, Shandong province, Beijing and Shanghai, all belonging to the eastern region and amounting to a number much larger than the central or western region of 503.686 billion Yuan. In areas where the insurance industry is less developed, the total share of the five provinces, Guizhou, Hainan, Qinghai, Ningxia and Tibet, is only 2.03%, less than that of a middle-level province. Imbalance is a grave problem in the development of insurance industry.

ANALYSIS OF THE ENVIRONMENT OF THE INSURANCE INDUSTRY

The environment can be divided into two parts: domestic and international. Globalization, financial liberalization and global economy fluctuation remain as themes of the international environment. Globalization of an economy includes the penetration and expansion of foreign capital, accelerating acquisition and reorganization within the industry, and also directly bringing in new competition. Financial liberalization is favorable to economies of scale and product innovation, but, at the same time, is accompanied with enormous potential risk and the possibility of the absence of supervision. Fluctuations in the global economy bring about instability, such as the western debt crisis and decrease in demand.

The domestic environment can be further divided into economic and social environments. The former includes fluctuation and restructuring in the growing national economy, strategic adjustment in the regional economy structure, the trend of financial integration, improvements in the investment environment, imbalance of development between regions and between urban and rural areas, and the relatively large regional difference in risks. The latter mainly consists of the population aging, the development of the social security system, the enhancement of the legal system, and people's rising awareness of insurance and the rule of law.

These domestic influences are collectively embodied in a series of policies: the ones on economic development – that aim at maintaining growth and adjusting the structure, including a moderately loose monetary policy and a proactive fiscal policy; the ones on urbanization; the ones on allocation led by doubling the income and creating income with a purchasing power of 64 trillion Yuan; the ones on the liberalization of interest rate; and the ones on fully implementing the social security system. These policies will motivate the recovery of the capital market, bringing increase in demand and structural change in the insurance industry.

SUGGESTIONS FOR RESOLVING THESE CONTRADICTIONS

Based on the current macroeconomic trend and development in capital market, the following possible solutions are proposed.

Firstly, continue to push the marketization of the economy. Fundamental features of a market economy are private property, freedom of contract, and self-responsibility. These are the basis of a market economy and also the premise for strengthening company management. Only when ownership is clarified can the investors have enough incentive and companies respond to market demands and make a profit. Also, since commercial insurance is an indispensable element of the market economy and, in turn, the market economy its premise, insurance companies should invite more from the private sector to buy their shares. This will vitalize the market and lead to better company performance.

Secondly, raise the general awareness of insurance. This includes consumer awareness, government awareness and insurer awareness. As for the government, it has to understand the function of insurance as a social stabilizer and economic propeller. Measures such as tax exemption, tax extension, pretax deductible and financial subsidies, can be introduced by the government to encourage purchase of insurance and further resolve social risks. Meanwhile, the development of the insurance industry will contribute to the stability of the capital market and economic growth. Insurers also need to fully understand the function of insurance, especially those of hazard and loss prevention, and disbursement of compensation and payment. Insurance companies should explore and enhance these risk managing functions and, by reasonable and effective underwriting and timely and equitable claim settlement, produce benefits for people, and thus the desire for insurance.

Thirdly, promote market-oriented policy premiums. In a market economy, product strategy and price strategy are crucial to marketing. After 33 years since China restored its insurance industry, insurance companies are now equipped with the ability to draft clauses and decide policy premium rates. Besides, it has been 12 years since China joined the WTO. It is practical and necessary to push forward marketization reform on policy clauses and premiums in order to motivate development of the industry.

Fourthly, appreciate the importance of statistics in insurance. On premium rate, China has compiled a Mortality Table several times as a numerical basis to help scientifically determine appropriate premiums. But beyond life insurance, similar research has to be strengthened, especially for motor vehicle insurance. A motor vehicle collision research center should be established under the lead of the Insurance Association of China, with insurance companies as members. The research results can serve as a basis for premium rates, and the social influence of the insurance industry will also be enhanced.

Fifthly, diversify sales channels. At the moment, the sales channels in insurance industry are direct selling, agency, and broker modes. As the marketization of bank interest pro-

ceeds, the importance of bancassurance will increase. Also, the proportion of sales using the internet and telephone will take on an upward trend with the increase in urbanization. In a word, new vitality will be brought to the industry.

Sixthly, optimize the industrial structure. It includes the structure of products and services, and also the balance of regional distribution. The structure optimization of products and services should include improvement in risk management services, exploration into investment type products, and development of derivative products. For the traditional risk transfer product, such as motor vehicle insurance, business property insurance, family property insurance, cargo insurance, and project insurance, the improvement should be innovative products that horizontally satisfy the crossfield demands and vertically inspire potential markets. As for unconventional products, the main task is to design appropriate strategy to expand the business. For example, insurance companies should focus on policy-favored products for agricultural business, seek government support in laws and policies for liability insurance products, and coordinate the business mode and operation principle in compulsory motor vehicle insurance. For investment type products, it is important to maintain their correspondence to risk in the capital market. As regards derivative products, insurance companies need to be continually aware of the latest developments in the world and put emphasis on thorough research to effectively offset grave disasters and losses.

Balancing regional distribution lies in differentiation of operation modes to serve local economies, and organizational structure should meet the needs in different districts on various levels. Service and products should be tailored to the diverse demands over a broad demographical range of consumers, and sales channels should accommodate local conditions, especially to open up the agency mode and cross-selling[9], to reduce cost. Differentiation will not only reduce costs, but also manage risks. In achieving reasonable regional distribution, certain favorable policies contribute to the process, such as tax benefit, market access, and investment preference.

Seventhly, foster specialized personnel. Talent is the first productive force, in which lies the future of the industry. In order to promote sustainable development and competitiveness of the industry, what is urgent now is to set assessment standards and establish training systems.

Eighthly, routinize self-discipline measures. Since the Insurance Association of China represents the interest of the industry, its organizational structure and regulatory regime have an essential role in coordinating the development of the industry, maintaining fair competition in the market and promoting the social influence of the insurance industry.

Ninthly, improve flexibility in investment. Insurance investment is the foundation of future development and innovation of the industry. Based on the enhancement of the domestic capital market and insurance company's investing capacity, further improvement could be made in two aspects: supervision and operation. In the former, restrictions on

investing methods should be further relaxed while making adjustments on the investment structure. As for operation, insurance companies need to refine their decision-making process and their investment expertise. When selecting an investment project, an insurance company should favor those with high and fast return to avoid credit risk, and stick to the procedure to maintain security, flexibility and profitability in investment. As a result of enhanced profitability, an insurance company will acquire higher solvency and competitiveness.

Tenthly, systematically integrate the social security system and commercial insurance. The goal is to realize a united social security system across urban and rural areas and to fully exploit the complementary function of commercial life insurance. The social security system and commercial insurance have their competing aspect as well as mutual engagement. A well-coordinated integration of the two would constitute the protection system of the national economy. It would contain a thorough social security system that promotes equal public service in both urban and rural districts, and a commercial insurance industry that utilizes its commerciality and expertise to satisfy the further demands in the market.

In conclusion, an economically strong nation must have a developed insurance industry as its backup. Insurance acts as a stabilizer for social development and a booster for economic growth. A developed insurance industry is a key factor of a stable capital market, and a vigorous capital market is advantageous for further advance of the insurance industry. A systematic resolution of the low-growth and low-return issue in the insurance market is favorable to both long-term social and economic development.

Endnotes

[1]Swiss Re, Singma, 2002. 6, P29.

[2]Swiss Re, Singma, 2011. 2, P33.

[3]Data from *A summary of China's Personal Insurance Market in 2011* in the Year Book of China's Insurance 2012.

[4]The same standard is used as 2001 to calculate the numbers in 2011 and 2012, excluding insurance groups, insurance asset management company and other companies.

[5]Data source: CIRC, Wind, sorted by Guosen Securities.

[6]Interest rate of 5-year deposit, averaged by 12 months.

[7]Business from groups and headquarters, amounting to 8428.6023 million Yuan, is not attributed to any region, however, the majority belongs to Eastern China.

[8]Data source: the China Insurance Regulatory Committee, http://www.circ.gov.cn/web/site0/tab61/i121281.htm.

[9]It should be pointed out that currently there are companies that have adopted cross-selling or have expanded business beyond assigned territory, which is a worthy attempt of system innovation.

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