China's Insurance Market
Navigating Challenges and Seeking Growth in a Time of Rebalancing

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Introduction

Access to the Chinese marketplace has been a strategic ambition for global companies and investors, to reap the benefits of a rapidly growing economy and modernizing society.

Global insurance companies have been no exception, and while many have already established a presence in the country, their market share remains limited and their growth potential constrained by numerous hurdles and obstacles.

This paper will provide an overview of the economic and social drivers of insurance, describe key features of the world’s third largest insurance market, and examine opportunities and challenges faced by foreign insurers operating in China. It will also attempt at giving indications about how well positioned players can build for their success in an environment of economic transition and rebalancing.

Through its joint venture partnership, Aon has built a significant presence in China, with Aon-COFCO establishing itself as the leading global broker and the preferred provider for multinationals operating in the country.

This paper has been prepared by Aon Inpoint Asia with the support of Aon Inpoint global colleagues, and with the invaluable insights provided by Aon’s Greater China team and leadership.

Sincerely,

James Platt
Chief Executive Officer
Aon Inpoint
Chinese insurance and the changing economy – Recent trends and developments

China’s insurance sector, and in fact the country itself, are going through a period of momentous changes, which will shape the future of the industry, creating new challenges or exacerbating existing ones, but also opening up spaces of opportunity and growth for global insurance companies well prepared for the journey.

China’s slowing economy\(^1\) is widely recognized as being the ‘new normal’ and expression of a longer term structural change from export- and manufacturing-led growth towards a stronger emphasis on domestic consumption and an increasingly prominent services sector. This shift will have profound effects on China over time, likely comparable to the transition, started in the 1980s, from a rural to an industrial and urbanized economy.

\(^1\) GDP growth rates have fallen from 11.2% in 2005 to projected 6.5% in 2016, still much higher than almost anywhere else in the world (National Bureau of Statistics of China; Asian Development Bank)

In this changed macroeconomic context, the extraordinary double-digit growth seen in China’s insurance market during the last decade will no longer be sustainable and in fact already shows clear signs of slowing down. Over the mid- to long-term however, rising consumption and the services sector will lead to the emergence of different risks and create increased demand for new products.
Recent regulatory developments

Of more immediate impact than shifts in the economic structure of the country are regulatory developments, which typically play a key role in China.

Progressive moves to a non-tariff system in motor insurance business, which contributes ca. 77% of property and casualty (P&C) premium, was started in 2013 and extended to an increasing number of cities in 2015 and 2016. This is transforming the motor insurance business, marked by oversupply and an already fierce competition which is now intensifying, causing further dropping of premium rates.

Another major development has been the roll-out of the China Risk Oriented Solvency System (C-ROSS) in 2016, which aims at strengthening the local regulatory framework and introducing a more sophisticated solvency regime. In the short term it is seen as not being especially favourable to foreign reinsurers in particular, who are faced with higher capital requirements for offshore business vs the high costs of starting and maintaining an onshore operation. In the longer term, C-ROSS is likely to prove beneficial to the whole industry by promoting a stronger focus on capital efficiency and risk management.

A similar positive effect is expected from the deployment of a new set of Directives on the Development of Insurance issued in 2014, which has led to a wider acknowledgment of insurance as an important economic sector, a key driver of social development and a risk management tool.

Market entry strategies

The joint venture market entry model is still the most commonly used by global insurers, with alternative approaches, such as full ownership or participating as financial investor in a domestic company, being adopted to gain market access and partake in the industry’s growth. In reality however, many joint ventures have not met their initially high expectations: integrating mature market practices and management with local practices and demand has proven to be very challenging. Consequently, several partnerships have not really succeeded, to the point that the foreign partner may decide to exit entirely. The question of the ideal market entry strategy remains thus unanswered, but it is clear that a ‘copy and paste’ approach aiming at transporting existing business practices and infrastructure to China doesn’t work.

Power shifts in distribution

Efficient, cost-effective distribution has always been a challenge in China: direct/agency and bancassurance are the incumbent channels and they are likely to continue playing an important role going forward. However, mobile technologies and e-commerce platforms have been adopted enthusiastically by the Chinese. This is leading to a notable power shift in favour of the channel, particularly in motor insurance business, as a consequence of the fast rise of internet (online) distribution, still small in size for now but growing at exceptionally fast rates.
Impressive growth (and future potential) sustained by powerful economic and social drivers

Drivers of insurance growth

The Chinese government aims at providing a regulatory framework to promote and guide the development of insurance. While this framework has supported the overall growth of the industry, it has not always been favourable to foreign insurers and has occasionally posed a major obstacle to their establishment in the country.

Global insurers, on the other hand, generally benefit from government policies favouring innovation, promoting increased risk awareness and improved risk management, as well as (cautiously) advancing market liberalization.

State governance and regulation may be important factors, but it is economic and social drivers which made China into the world’s third largest insurance market. Understanding what these dynamics have been in the past and how they may play out in the future is key to building a solid, long-term strategy to tap into current and emerging opportunities.

The extraordinary growth of life insurance in China has been primarily driven by demand for savings/investment instruments by an increasingly urbanized and well-educated population, with rising available household incomes and personal financial assets. In a more consumption-driven economy these drivers will remain powerful, stimulating further the expansion of personal lines.

Healthcare and retirement in particular are high agenda items for China. The public health and pensions sector is still developing, and needs to address middle class aspirations for better care and old-age protection. In coming years, health insurance is predicted to be an area of significant growth, as is retirement pensions. The rapid ‘greying’ of China’s population requires robust social security and pension systems, which are still in a state of work-in-progress.

The current predominance of motor insurance is quite characteristic of a P&C market in a relatively early phase of development and ready for product innovation. Indeed whilst the market has seen massive growth over the last two decades and is today the second largest in the world, China remains still relatively underinsured and penetration rates are below those found in more mature economies.

Domestic corporate insurance buyers tend to be price-sensitive, and added value services such as risk control struggle for attention and appreciation. Many businesses still self-insure rather than buy any commercial insurance, or perceive insurance as a form of cash flow management, entitling them to a return on premiums paid. Nevertheless, with time, the diffusion of stricter corporate governance and risk management best practices is likely to provide a stronger impetus for insurance and related added-value services.

Underlying drivers also remain important influencers: among them are large and increasing asset values, continued infrastructure development needs, evolving production value chains, urbanization and the shift towards a services economy.
The dominant position of domestic insurers

China’s insurance market is highly concentrated, and the dominance of large domestic players has been a defining characteristic for both life and non-life insurance sectors. The three major life insurance players control over 50% market share: only around 6% of premium is placed with foreign insurers. P&C insurance is perhaps even more concentrated, with the top three Chinese insurers covering 60% of the market and global insurers capturing barely above 1%.

An effective China strategy will therefore always need to be informed by a realistic assessment of the actual premium potential, as large sections of the market controlled by domestic players are de facto not accessible for international insurers.

At least in the medium term, this dominant position of domestic insurers will not be challenged, although future disruption may potentially come from internet-backed insurance companies.

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1 Aon Inpoint analysis, Annual Report of China Insurance Market 2015

### P&C insurance penetration: premium as % of GDP in 2014

<table>
<thead>
<tr>
<th>Country</th>
<th>P&amp;C Premium as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>4.3%</td>
</tr>
<tr>
<td>Japan</td>
<td>2.4%</td>
</tr>
<tr>
<td>UK</td>
<td>2.6%</td>
</tr>
<tr>
<td>China</td>
<td>1.5%</td>
</tr>
<tr>
<td>France</td>
<td>3.1%</td>
</tr>
<tr>
<td>Germany</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

Note: Excluding cross-border business
Source: Swiss Re Sigma

### P&C insurance density: premium per capita in USD in 2014

<table>
<thead>
<tr>
<th>Country</th>
<th>P&amp;C Premium per Capita USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>2360</td>
</tr>
<tr>
<td>Japan</td>
<td>852</td>
</tr>
<tr>
<td>UK</td>
<td>1185</td>
</tr>
<tr>
<td>China</td>
<td>109</td>
</tr>
<tr>
<td>France</td>
<td>1350</td>
</tr>
<tr>
<td>Germany</td>
<td>1617</td>
</tr>
</tbody>
</table>

Note: Excluding cross-border business
Source: Swiss Re Sigma

### P&C insurance premium by line of business in 2015*

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>Premium USD Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor</td>
<td>128b</td>
</tr>
<tr>
<td>Commercial property</td>
<td>5%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>5%</td>
</tr>
<tr>
<td>Liability</td>
<td>4%</td>
</tr>
<tr>
<td>Other</td>
<td>9%</td>
</tr>
<tr>
<td>Guarantee</td>
<td>28%</td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
</tr>
<tr>
<td>Household property</td>
<td>6%</td>
</tr>
<tr>
<td>Specialty</td>
<td>6%</td>
</tr>
<tr>
<td>Hull</td>
<td>8%</td>
</tr>
<tr>
<td>Engineering</td>
<td>11%</td>
</tr>
<tr>
<td>Cargo</td>
<td>12%</td>
</tr>
<tr>
<td>Credit</td>
<td>26%</td>
</tr>
<tr>
<td>USD 12b</td>
<td></td>
</tr>
</tbody>
</table>

Note: P&C insurance premium excludes Health and Accident
Source: CIRC, Aon Inpoint Analysis
Foreign insurers in China – an uphill road to success

High growth but still low penetration

In an uncertain global economic environment and with their traditional mature markets being increasingly saturated, it is not surprising that global and regional insurers look at China as a source of growth. There is a risk, however, to underestimate the strategic and operational challenges posed by the Chinese market: some of the more common obstacles originate from the strength of local players, the vast geography of the country, a difficult cooperation with domestic joint venture partners, acute talent shortages and an often partial understanding of market dynamics.

Key challenges faced by foreign insurers

Their highly competitive pricing, strong established relationships with clients, and underwriting flexibility give Chinese insurers a wide competitive edge, but distribution is a key factor. The ability to reach customers through a licensed national presence and a far-reaching network has been crucial for success: building a nationwide presence would have been complex and expensive in any case, but strict regulations around branch establishment have slowed foreign insurers’ efforts at upscaling their distribution capabilities.

Foreign insurers have been also faced with a continuous shortage of qualified and experienced staff: the talent pool remains shallow in an industry only a few decades old and competition for talent is fierce, driving up costs.

Less successful foreign insurers in China have often adopted a ‘copy and paste’ approach, importing their global practices and client propositions, in the belief that they could be effectively deployed within the country. This can be a costly mistake. A thorough understanding of, and thoughtful adaptation to, the specific nature of the Chinese market is a necessity: insurers entering China well prepared, with a solid strategy, objective view of market realities and strong execution capabilities are in a better shape to secure their position and achieve long-term success.

Indeed, several trends are encouraging and interesting opportunities for foreign insurers are surfacing in key product lines and areas of innovation.
Major emerging opportunities

- **Technology:** Both in life and non-life insurance, mobile technologies and e-commerce platforms are likely to increasingly act as alternative distribution channels and will help to bridge the gap with market leaders in terms of distribution reach and customer communication. Insurers able to effectively deploy technology in distribution and product innovation, especially in health insurance, will be in a better position to reap significant benefits in areas of unmet (and growing) demand, where they can leverage their global expertise and experience.

The impact of online technology goes beyond distribution, though, as the shared economy and social media are changing social dynamics and peoples’ lives. Uncovered risks are emerging and create a big opportunity for insurers, but to a large extent appropriate solutions simply do not yet exist: this is one area where the experience of global insurers in mature markets may be of limited use, as China is in fact ahead of the curve technologically, e.g. in the convergence of social media, online payments and personal finance.

- **Expertise:** Global insurers can compete effectively with domestic players mainly by identifying and breaking through into specialized segments of the business. So far, their success has been most remarkable in niche areas, where newer, emerging risks and more sophisticated buyers allow them to leverage international experience, advanced capabilities and the ability to innovate for competitive advantage.

So for example, while large state-owned enterprises enjoy strong business relationships with the domestic insurance industry, some of the more strategic privately owned companies may show stronger interest in implementing insurance and risk management best practices and may therefore present good prospects to foreign insurers owning exactly this type of expertise.

- **Agriculture:** Despite the industrialization rush of the reform period, China’s agricultural sector still plays a fundamental economic and political role. Rural development is thus a central concern of the government and agriculture insurance an area of great potential. Foreign insurers can bring in relevant expertise, but have been so far constrained by a general lack of adequate distribution capabilities.

- **Changing economy:** The biggest opportunities are likely to come from the structural changes in the economy mentioned earlier. A consumption-led economy will stimulate growth in demand for personal lines, and even more growth in demand for health, retirement and life insurance products, all areas where global companies can leverage their experience gained in mature markets in Europe and North America.

China’s move to higher-end manufacturing and an increasingly advanced finished industrial goods production system, as well as a booming services sector are also changing significantly the risk landscape. Specific lines of business relatively new to China are getting increasing attention from corporate insurance buyers, including property damage, business interruption, trade credit, cyber liability, product recall, and product liability. Surety, bonds and credit showed the highest CAGR (Compound Annual Growth Rate) of 41% over the 2009-13 period, followed by liability (27%)4.

Foreign multinational companies operating in China represent an important and growing client segment for international insurers, who may be running global programs for these clients. International brokers are also gaining in relevance, and already command a dominant share of the larger foreign corporations’ market, where international insurers are also strongly engaged.

- **China investment abroad:** Beyond China’s borders, the government’s call for the internationalisation of China’s insurance sector, including the overseas expansion of Chinese insurance companies and the provision of insurance services to Chinese overseas direct investment, allows foreign insurers to deploy competitive advantages both in terms of international network and service capabilities, as well as understanding of global markets. A very relevant example is the Belt and Road initiative, launched by the Chinese government to secure scarce natural resources, export overcapacity and demonstrate its geopolitical role.

4 Aon Inpoint analysis
China's globalization and the insurance opportunity

A driver and major beneficiary of globalization, China is today closely integrated with the world economy, both as a global manufacturing base and as an increasingly important global investor. This has important implications for insurance and allows competitive and innovative insurers to capture attractive growth opportunities, as described in the following two examples.

The Belt and Road initiative is expected to generate a new wave of overseas investments from China

Our research indicates that China has invested USD 471b in construction and engineering projects globally over the last ten years, 50% of which were directed to countries under the Belt and Road initiative. The top 20 contractors made 75% of these overseas investments. Centred around development of unblocked road, rail network between China and Europe, the initiative is generally regarded as top government priority. There is at least USD 140b of committed funding, and USD 110b worth of projects already signed off under the initiative.

Cumulative overseas investments including construction contracts and M&As from China are expected to reach USD 1.25 trillion by 2024. Aon Inpoint has analysed in depth the dynamics and key features of this overseas investment wave and estimated the associated insurance premium pools.

Foreign insurers are and will be playing a significant role in the provision of insurance protection for projects along this new Silk Road, by complementing the offering of Chinese insurers through the strength of their global networks, expertise in technical underwriting, and the ability to offer broad cover.

Export product liability is an important and growing insurance segment in China

Most Chinese export-oriented manufacturing companies are required by their foreign business partners to purchase product liability coverage. At the same time there is significant market growth in other casualty lines, such as financial lines.

These are arguably areas where international insurers can bring more experience into the market, be it in specialty lines, commercial liability or product recall liability, and contribute to the education of customers and the sophistication of the market.

China export value in USD 2010 to 2015

Source: International Trade Centre, Aon Inpoint analysis
Conclusions

Slower growth is the new normal, but while the dynamics of growth may be evolving, China will continue to follow the trajectory started over three decades ago towards an industrialized and services-driven economy. The low insurance penetration rates currently seen are an indication of the depth of the coverage gap: beyond periodical ups and downs, there is significant room for the insurance industry, which has been a key financial pillar in China’s extraordinary success story and will be as important in its future development.

Whilst insurance in China may enjoy a bullish long-term outlook, foreign providers wanting to capture a slice of its growing pie are faced with significant challenges. China is objectively a very complex marketplace, with a vast and varied geography, in many ways a whole continent with multiple regional dynamics. Foreign insurers have so far often appeared to struggle with upscaling and building brand awareness, their ambitions curtailed by the complexities of the market, but also by challenges such as local talent shortages and meeting local regulatory requirements.

A strong grasp of market realities and deep insights into underlying economic trends are therefore necessary for a long-term positioning and to identify areas where foreign insurers can potentially leverage their strengths. Any short-term focus is unlikely to yield the desired result, as is a market approach based on replicating uncritically products and propositions which may have been successful in other parts of the world.

Resilience, persistence, and a well-thought and fact-based strategy are necessary elements for success.
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Aon Inpoint’s focus is to always act in the best interests of Aon’s insured and cedent clients by enabling (re)insurers to compete more effectively so that Aon can provide valuable solutions and greater choice to our mutual clients.

Consistent with confidentiality and data compliance protocols, Aon Inpoint provides (re)insurers with access to Aon’s industry leading data analytics platforms, including Aon GRIP® and Re/View, combined with our consulting capabilities, enable (re)insurers to develop growth strategies, as well as to identify and execute business improvement and growth opportunities in new markets and product lines.
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