China's Agricultural Insurance is Catching Up

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By Liang Tao

China is one of the largest agricultural economies globally. According to the Statistics Report for 2013 published by the National Bureau of Statistics of China in February 2014 and data from the Food and Agriculture Organization of the United Nations, by the end of 2013, China’s cereal, cotton, meat and aquatic production reached 601.9 million tons, 6.3 million tons, 85.4 million tons and 61.7 million tons, representing 23%, 25%, 28% and 37% of the world’s annual production respectively. As of the end of 2013, the number of people employed by the agricultural sector was approximately 241.7 million, or 31.4% of China’s total work force. China is among the few countries most affected by natural disasters to which agricultural sector is particularly venerable.

However, China’s agricultural sector is relatively under-insured compared to their counterparts in developed countries. In fact, according to data from China Insurance Regulatory Commission (“CIRC”), China’s agricultural insurance premium, which experienced a sharp annual increase of 27.4% to RMB 30.7 billion, only represented about 0.5% of Chinese agricultural GDP in 2013.

Meanwhile, the agricultural insurance market in China is quite small compared to other lines of insurance, with China’s agricultural insurance premium accounting for 1.8% of total Chinese insurance premium in 2013.

Chinese central government increasingly recognizes the importance of utilizing risk management tools associated with agricultural insurance, with a view to ensuring growth of the
agricultural economy and the stability of rural society. In November 2012, the State Council of China promulgated the Regulation of Agricultural Insurance (the “2013 Regulations”) which took effect on March 1, 2013. The 2013 Regulations combined with China’s Insurance Law and Agriculture Law serve as the overarching rules regulating agricultural insurance sector in China, which also marked China’s latest efforts in reviving its agricultural insurance industry.

**History of agricultural insurance in China**

Since the Communist Party of China came to power in 1949, China’s agricultural insurance sector witnessed rise and fall in different phases. People’s Insurance Company of China (PICC) was founded in 1949 as the sole insurer in China at that time, and provided agricultural insurance coverage in a few specific regions on a pilot basis. Such initial pilot phase was terminated in 1958 when China started to establish collective people’s commune and launched a series of mass campaigns, during which agricultural insurance business together with most of other insurance lines were abandoned and prohibited in China.

In 1978, agriculture policy reform was initiated by Deng Xiaoping in China, with agricultural and rural economy growing rapidly since then; and PICC revived its pilot program of agricultural insurance with its agricultural insurance premium increasing steadily. In 1993, China’s agricultural insurance premium peaked around RMB 820 million with extensive products available in most regions of China. However, it was a turning point for China’s agricultural insurance sector. Since 1993, the agricultural insurance premium shrank dramatically, because China started to deepen its market-oriented reform. For example, PICC started in 1994 to transform from a quasi-governmental insurance agency mainly performing policy function to a commercial company competing under market environment; as a result, agricultural insurance business became less attractive for insurers due to its high loss-ratio and high underwriting cost.

In 2004, Chinese central government abolished taxes on special agricultural products, and implemented an annual reduction in agricultural tax by 1% or more starting from 2004 and finally eliminated this tax nationwide by January 1, 2006. Also, Chinese government sponsored various programs to commercialize and support China’s agricultural sector. Against such a background, the decreasing trend of China’s agricultural insurance premium reversed in 2004, upon which China launched several pilot programs of agricultural insurance, issued laws and incentive policies at the state level, provided financial subsidies with respect to agricultural insurance premiums. Today, these pilot programs, laws, incentive policies, and financial subsidies constitute the current regulatory regime of China’s agricultural insurance sector.

**Licensed agricultural insurers**

According to the 2013 Regulations, Chinese agricultural insurance business is carried out “on a market basis with governmental guidance”; only the China-incorporated insurance companies and agricultural mutual insurance entities (the “Mutual Insurers”), which have obtained special approval from CIRC, can engage in the agricultural insurance business in China. At present, among 165 existing insurance companies, there are around fifteen insurance companies are approved by CIRC to provide agricultural insurance coverage, including PICC, China Pacific Insurance, Xinjiang-focused China United Property Insurance, Heilongjiang-focused Sunlight, Jilin-focused An Hua, and Shanghai-focused An Xin, etc.

In May 2014, CIRC issued a draft rule on the Mutual Insurers for public comments, under which an agriculture-related Mutual Insurer operating nationwide shall have 1,000 or more policyholders and paid-in operating fund of RMB 50 million or more when it’s set up. Notably, though...
such draft rule has not been enacted, the agriculture-related Mutual Insurers have already actually operated in China for several years. China Fishery Mutual Insurance (“CFMI”) is one of the largest agriculture-related Mutual Insurers in China, which is eager to be explicitly recognized by central government through being specified and regulated by laws and regulations. Since its inception in 1994, CFMI has provided insurance coverage of RMB 739.4 billion, with an annual insurance premium of approximate RMB 1 billion.

**Insurance products, subsidies and reinsurance**

Though CIRC encourages insurers to develop innovative agricultural insurance products, the multi-peril crop insurance (“MPCI”), which provides comprehensive protection against weather-related causes of loss and certain other perils, has dominated China's market. MPCI is designed to deal with complex damage to crops, such as loss caused by both strong wind and rainfall, while its administration cost, loss adjustment cost, and skill requirements for underwriters are quite high. In the event that insurers provide MPCI to large farms, the cost associated with the loss adjustment and administration could be significantly reduced by relying on its developed infrastructure with economy of scale arising. However, most of China's farmland is decentralized to individual and small farmers, apart from certain state-owned large military farms in Xinjiang and Heilongjiang. That's why MPCI is widely accepted in Xinjiang and Heilongjiang, while insurers are not very successful to sell MPCI to individual farmers outside the state-owned farms.

Since 2007, the Ministry of Finance of China has issued a set of pilot policies of subsidies in order to finance agricultural insurance premiums in selected provinces such as Xinjiang, Inner Mongolia, Henan, Fujian, Gansu and Jilin. For different agricultural insurance products, the percentage of subsidies varies; subsidies provided by both local and central governments in 2013 for insurance products covering crop, livestock and forest represented at least 60%, 70% and 55% of the total premiums respectively.

Before 2002, China Reinsurance Corporation (“ChinaRe”) monopolized the domestic reinsurance market, as direct insurers were mandatorily required to cede their 20% premiums to ChinaRe. Such compulsory cession was gradually reduced upon 2002, completed removed by December 2005, and replaced by a new arrangement, under which domestic direct insurers were required to first offer 50% of their reinsurance business to at least two China-registered reinsurers prior to soliciting offshore reinsurers. In 2010, Chinese reinsurers “right to be first offered” was eliminated as well. As such, China's agricultural insurers now enjoy more flexibility when selecting the reinsurers. At present, key domestically-licensed reinsurers include ChinaRe and PICC Reinsurance, while SwissRe, MunichRe and Lloyd's also set up their branches in China with reinsurance licenses issued by CIRC.

**International experience and recommendations**

Given MPCI is very expensive for China's individual farmers, an innovative agricultural product, which is low-cost for both insurers and farmers, is needed. The agricultural index insurance has been adopted in several countries which would be a possible choice. Compared with MPCI, cost of index insurance is less, as its loss assessment objectively depends on area yield index or weather index, which would result in less on-site visits performed by loss adjustors. Therefore, premium of agricultural index insurance would be lower and more acceptable for farmers.

International experience shows that no smart or efficient public program could be designed and carried out if the government cannot appropriately understand its roles from regulatory, social, and market perspectives. In most successful cases, agricultural insurance regulators have much work to do apart from directly offering premiums subsidies. As such, Chinese government may consider making more efforts to further enact detailed implementing rules, enhance data management of the whole industry, and reduce the transaction costs.

In certain developed economies such as the U.S., Germany and Japan, agricultural insurance market as well as alternative risk transfer deal could play an important role to deal with extreme weather or catastrophic event. For example, through issuing catastrophe bonds, catastrophic risks in agricultural sector could be absorbed by the capital market players which have deep pockets and the demand to diversify their investments. In the event of disasters, China may try to resort to the insurance market instead of tending to provide government aids.

In a word, China needs to ensure the safety and stability of its agricultural sector which provides 1.3 billion people with food every day. China's agricultural insurance regulatory regime is evolving rapidly to address key challenges such as under-insured sector, potential catastrophic event, and outdated products. But, no one can fit all. International experience cannot be directly transplanted in China; meanwhile, when overlooking China's provincial diversity and difference, high price could be paid.

(Author: from an international law firm)