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Hong Kong/China Insurance

# Welfare Expansion and Insurers Aligned for an Optimistic Future

Insurers are likely to supplement public funding. Government expenditure on welfare has expanded 10-fold in China in the past 15 years and we expect it to double in the next 10 years. We think the sector can continue to thrive and expect Life GWP to reach >US$1trn by 2030. This report offers new insights into how welfare policy expansion will drive the next stage of insurance market development.

# Welfare Expansion and Insurers Aligned for an Optimistic Future

**Expanding welfare policies will help to drive private insurance growth:** Much research has been written on China's economic growth, but far less about its growing welfare policies. Government spending on welfare has increased almost 10x in the past two decades to Rmb6.2trn in 2021, accounting for 25% of fiscal spending. We think it could double again in the next decade. Commercial insurers play a crucial role in welfare policy, often working alongside or supplementing government support. They are a necessary part of the system that aims to raise social equality and achieve "common prosperity". As the government increases spending towards levels comparable with OECD economies, we expect commercial insurers to benefit through increasing penetration and product diversification.

INDUSTRY VIEW

**Hong Kong/China Insurance | Asia Pacific**

In-Line

**A sustainable, multi-pillared welfare system needs SOE and commercial insurers:** Life insurance should benefit from China's common prosperity policy in a number of ways: 1) a bigger middle class will mean a bigger addressable market (targeted to reach ~600mn by 2025); 2) expanded government insurance plans, mostly operated by insurers, will grow awareness and create cross-selling opportunities; and 3) slowing GDP growth and an aging population could see the government look to insurers to free up its limited resources. We are already seeing greater tax support and subsidies in health and pensions to increase demand directly. Our new industry model projects a penetration rate of 4.0% by 2030 (from 2.9% in 2021) with gross written premiums (GWP) of US$1.1trn from US$0.5trn at end 2021.

**Investors are undervaluing the sector's long-term prospects:** Investors are concerned that the impact of sweeping policy adjustments across a range of industries – such as education, property and the internet – to achieve "common prosperity" will cause a potential spillover into insurance, leaving private insurers with a small total addressable market (TAM) and a thin margin business. However, over the next decade, we expect policy tailwinds from a move to a more consumption-driven economy and a reduction in savings rates, along with the provision of tax exemptions, to drive significant product and coverage expansion in the sector, particularly for pension, medical and life insurance. We expect the poor stock performance of the past three years to reverse.

**Expected winners by segment; more divergent strategies will help private insurers:** Of the state-owned enterprises (SOE), we prefer China Life (EW). We expect SOEs to focus on the mass-market, and sacrifice margin for a larger TAM. China Life should benefit from greater customer access and steady earnings growth. For commercial insurers, we prefer AIA (OW), Ping An (OW) and CPIC (OW). We think these companies will be most able to differentiate themselves in the mass-affluent to high-end segments, sticking to a high-margin approach with a smaller TAM. They have the balance sheets to handle the investment required to enhance networks, products and services.

# Contents

# Executive Summary - Why the Insurance Sector Could Be an Unexpected Beneficiary of China's "Common Prosperity"

**Deep dive into China's welfare system and the implications for insurance:** In 2019, the 19th National Congress put forward a new goal of building a universal social welfare system, emphasizing improving “access” to childcare, education, employment, housing, medical services, elderly care, and social assistance. In 2021, the authorities proposed a further goal of pursuing "common prosperity" for China's next stage of development. Since then, we have seen a period of intense regulatory change that reset the trajectory of many sectors. In this report, we look in detail at China’s recent welfare reforms, how public benefits are delivered by private-sector players like insurers, and the implications for the insurance industry generally as the sector evolves. There has been much research done on China’s economic development, but little on China’s welfare policies, we believe.

**Long-term growth prospects becoming a new source of debate for Chinese life insurers.** China's Insurance industry has performed poorly over the past three years - down ~45% for A shares and ~35% for H shares (vs a 20% decline for MSCI China). While the sector was affected by Covid lockdowns, which dampened consumer demand across a range of industries, it underperformed other financial and consumer stocks (by ~20ppts for A shares and ~10ppts for H shares), despite showing more resilient dividend growth and a higher ROE profile than those industries. A new concern has emerged for investors that the impact of sweeping policy adjustments across a broad range of industries –from education and property to health care and the internet – to achieve a "common prosperity" could cause a potential spillover to insurance, leaving private insurers with a small TAM market and a thin margin business.

**China stepped up its welfare spending significantly from 2000.** China's economy has grown exponentially since the country opened up in 1978, but the primary focus on growth in the early years resulted in relatively poor levels of welfare support and social protection. This started to change on a broad basis from 2000, with nationwide health insurance and pension programs being established and extreme poverty eliminated. Government spending on welfare has grown at a CAGR of 17% in the past 15 years, rising from Rmb0.57trn to Rmb6.2trn, which has strengthened the social safety net substantially for the entire population of 1.4bn.

**Promote a fair and sustainable welfare system to avoid the "middle-income" trap.** With per capita GDP at US$12.6K as of 2021, according to the National Bureau of Statistics of China, China almost reached high-income country status (as defined by the World Bank) in 2021. By 2035, China aims to become “a moderately developed country”, with GDP per capita doubling to ~US$20K, as outlined in China's 2035 long-term development target. To continue its growth journey, China has been trying to shift away from export-focused growth towards a consumption-led economy. The experience of other developed countries suggests this period in history is often accompanied by accelerated levels of welfare spending to help redistribute income and free up savings to ensure strong domestic consumption demand. As of 2021, China's total welfare spending (from both government and social insurance funds) was 10.5% of GDP, according to the The Ministry of Human Resources and Social Security (MOHRSS). We estimate it will increase to 12.3% by 2025 and 15.3% by 2030.

**Insurers do not compete against but rather complement the government's welfare system.** Despite investor concerns that private insurers could get crowded out by the expansion of social insurance programs, our analysis of China's welfare policies and the government's fiscal budget suggests otherwise, as outlined below:

1) Life GWP enjoyed substantial growth (18% CAGR) during 2000-2021, a period of significant expansion in government spending on social insurance programs (rising from virtually zero to Rmb2.9trn in 2021). The establishment of social insurance schemes may have improved affordability and awareness and seems to have helped stimulate commercial demand at the same time. No crowding out effect was evident during that period.

2) Social insurance is there for everyone but can not cover everything. In our previous reports on the health insurance market (China Health Insurance: Crossing the Innovation Chasm) and the pension market (Prepare for an "Aged" China), we detailed coverage limitations of social insurance programs. In China, the reimbursement ratio of social health insurance is about ~60% for inpatient costs (vs ~90% in Europe) and the replacement ratio of public pension is about 42% (vs >60% for mandatory schemes in Europe). With an aging popula-

tion and a moderation of GDP growth, it could be difficult for government alone to lift these protection ratios substantially, potentially leaving space and opportunity for commercial insurers.

3) Commercial insurance products not only supplement social programs but can free up limited government resources. Families with additional commercial coverage are better protected against a possible return to poverty as a result of sudden illness or loss of primary earnings, saving government funding for other family assistance. Affluent families with private insurance can also seek care from private hospitals and senior care centers for better services, alleviating pressure on public resources. With commercial insurers a pivotal part of China's multi-pillar welfare system, it is likely they will continue to expand with government programs to help balance welfare policies and improve system efficiency.

**More policy tailwinds ahead.** Broadly speaking, welfare policy and tax rules are the two factors that direct how an insurance market evolves. In China, we believe these two factors will work in favor of insurers in the next few years. We note that China's life insurance industry has managed to grow into the second-largest life market globally, despite virtually no tax support. Over the next decade, we expect policy tailwinds (particularly tax exemptions) to drive most of the product and coverage expansion in the sector, in particular in the areas of pensions (tax exemptions have just been announced), medical (the government is expanding products and services that are eligible for tax exemptions), and Long Term Care products (which is being piloted in the social insurance scheme with direct government subsidies).

**Expansion in the life insurance sector is on track; we still expect >US$1trn GWP by 2030.** We expect a continued expansion of the life insurance industry in the next decade, with GWP to reach over US$1trn by 2030 (penetration of 4% and 10-year CAGR of 9%), still on track to become the largest life industry globally. Life insurance products have been spreading out from high tier cities to low tier cities in recent years as household wealth grows in China, creating an even bigger middle class. In our view, this is the group that most needs commercial coverage because they are still financially vulnerable, they are not the super rich (self-insured) or the poor (use social plans).

**More divergent strategies ahead**. Private insurers, in our view, should try to differentiate themselves from government programs to emphasize the quality of their products and services and focus on more lucrative markets - AIA, Ping An and CPIC have been showing signs of moving their strategies in this direction. SOE players could continue to stay large and comprehensive, trying to supplement government programs with more competitive pricing and inclusive offerings – a bigger market share but likely lower margin.

**Key risks to our forecasts:** 1) Significant slowdown in GDP growth and wealth creation; 2) delayed policy announcements on tax support due to tighter government budgets; and 3) a change in welfare strategy from multi-pillar to some other format.

# Why Is the Market So Bearish on Life Insurers?

**Fundamentally, Chinese life insurers delivered a resilient performance despite Covid disruptions.**

**GWP:** Despite sharp declines in new sales, gross written premium has been relatively flat since 2019 for the industry, suggesting solid and consistent management on existing in-force business. This also provides a strong support to earnings.

**Assets:** Life insurers did not stop expanding their balance sheets during Covid – total assets grew by 17.6% in 2020 and 6.9% in 2021.

**Earnings & Dividend**: While insurers' earnings suffered some declines, mainly due to capital market volatility, managements have said they view these declines as short term, and have maintained their progressive dividend policies; across the sector, dividends were up by 1.4% p.a. during 2019-2021.

**ROE:** The sector's ROE remained at >10%, higher than other financial or consumer sectors as shown in Exhibit 1 and Exhibit 2 .

**Exhibit 1:** Sector performance - A share market

| Sector | Revenue growth % | Earnings growth % | ROE % | PE multiple |
|---|---|---|---|---|
| Insurance* | 4.0 | -10.8 | 12.7 | 11.2 |
| Banking | 7.2 | 7.1 | 10.1 | 4.5 |
| Broker & Others | 27.9 | 36.9 | 8.2 | 15.2 |
| Healthcare | 12.7 | 47.2 | 9.7 | 31.0 |
| Discretionary Consumption | 4.1 | 6.2 | 5.5 | 41.0 |
| Auto & parts | 6.8 | 28.4 | 5.4 | 48.4 |
| **Total** | **13.6** | **14.2** | **8.8** | **16.2** |

* Insurance segment of A share listed insurance companies; 2-year average for revenue growth, earnings growth and ROE

Source: Wind, Morgan Stanley Research

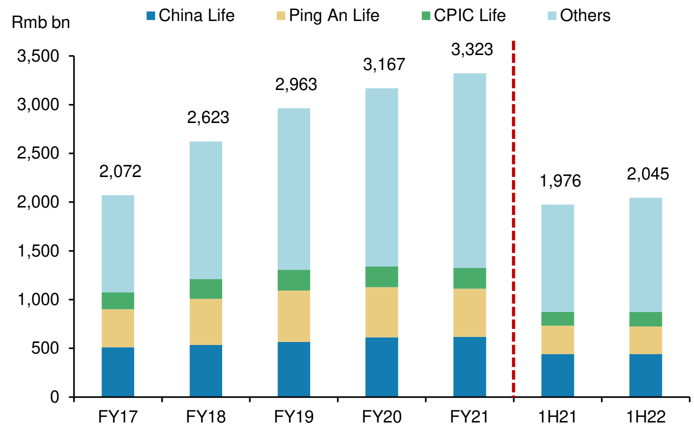
**Exhibit 2:** Sector's performance - H share market

| Sector | Revenue growth % | Earnings growth % | ROE % | PE multiple (negative excl) |
|---|---|---|---|---|
| Insurance* | 1.8 | -5.3 | 10.2 | 7.7 |
| Banking | 9.9 | 10.0 | 8.8 | 4.0 |
| Broker & Others | 24.7 | 34.6 | 4.9 | 7.0 |
| Healthcare | 17.5 | -16.4 | 0.0 | 13.6 |
| Discretionary Consumption | 5.3 | -39.7 | -0.3 | 18.0 |
| Auto & parts | 11.2 | 7.8 | 6.3 | 19.4 |
| **Total** | **12.4** | **6.6** | **7.1** | **6.5** |

* Insurance segment of A share listed insurance companies; 2-y average for revenue growth, earnings growth and ROE

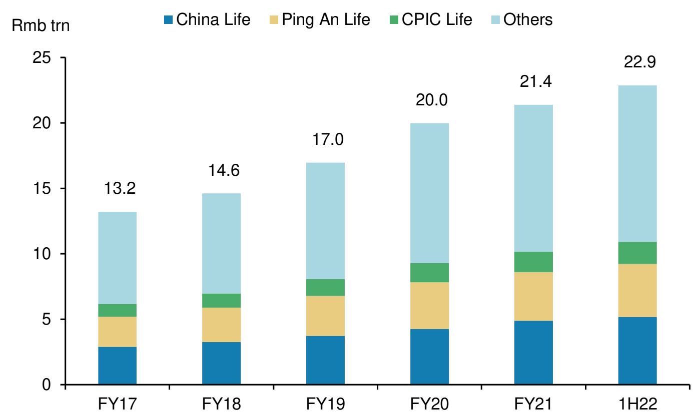
Source: Wind, Morgan Stanley Research

**Exhibit 3:** Even with Covid disruption, Life GWP was largely flat ...



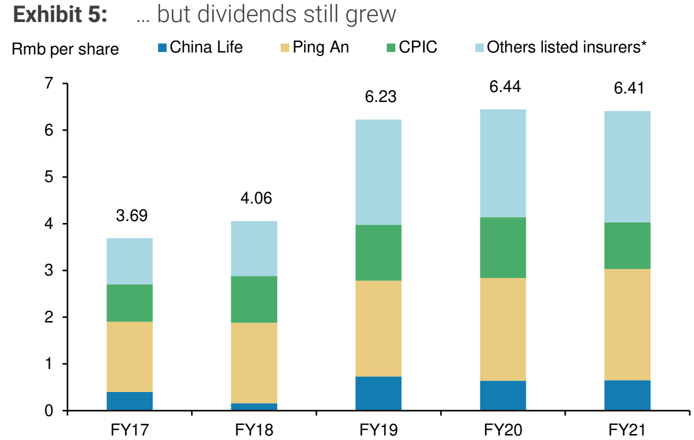

Source: Company data, China Insurance Year Book, Morgan Stanley Research

**Exhibit 4:** ... total assets still expanded




Source: Company data, China Insurance Year Book, Morgan Stanley Research

**Exhibit 5:** ... but dividends still grew



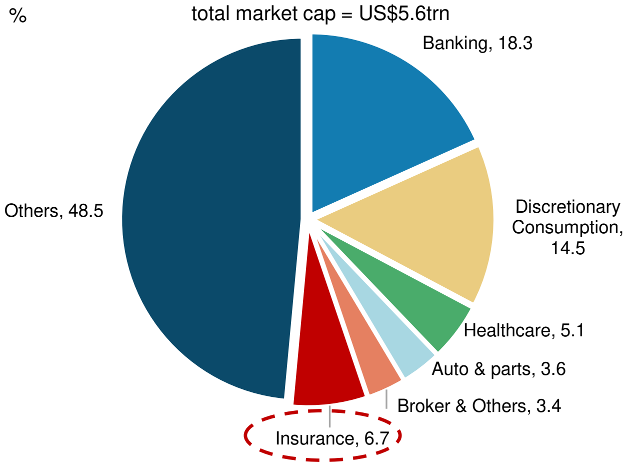

*Including NCI, CTIH, PICC P&C and PICC Group; Assuming RMB/HKD = 1.1

Source: Company data, China Insurance Year Book, Morgan Stanley Research

**However, share prices did not react to these positive fundamentals.** Chinese insurers accounted for 4.5% of the total profit reported by A-share listed companies, but only 2.3% of total market capitalization, due to their low valuation. They have slightly better representation in the H-share market, with 7.7% contribution to total earnings but 6.7% of market cap. Despite a relatively resilient balance sheet and dividend trends, insurers still rank as one of the worst performing segments since 2020, declining ~35% for H shares and ~45% for A shares, (vs. a 20% decline for MSCI China) as of end-September 2022, underperforming other financial and consumer stocks (see Exhibit 8 and Exhibit 10 ).

**While Covid was a disruption, investors have expressed deeper concerns about the sector's long-term growth and return profile.** While Covid has disrupted the insurance sector's face-to-face sales models and it is still difficult for businesses to grow in the near term, we also hear concerns from investors about the sector's long-term outlook, particularly after seeing substantial adjustments experienced by other sectors during the recent regulatory reset. A new debate for the sector is around its future TAM and its long term ROE against a backdrop of an increasing focus on common prosperity, which has seen P/E fall to historical lows of only 3-6x for most listed insurers, including high-quality companies like Ping An and CPIC.

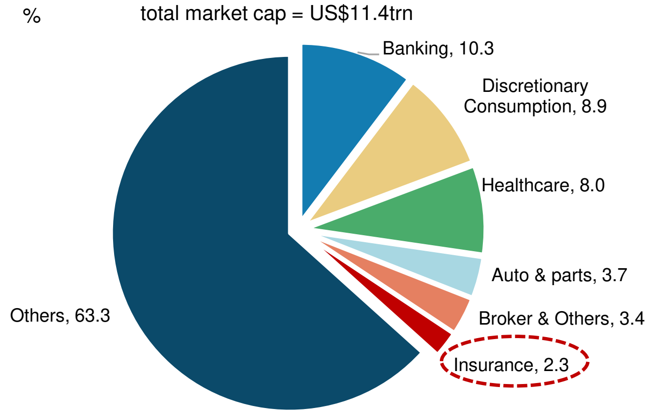
**Exhibit 6:** Market cap by sector - H share




Note: as of 30 September 2022

Source: Wind, Morgan Stanley Research

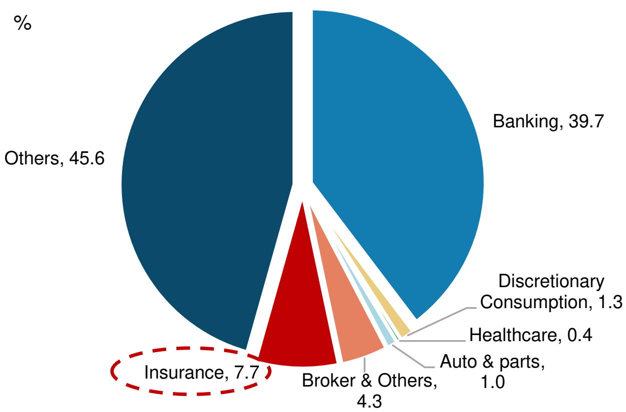
**Exhibit 9:** Market cap by sector - A share




Note: as of 30 September 2022

Source: Wind, Morgan Stanley Research

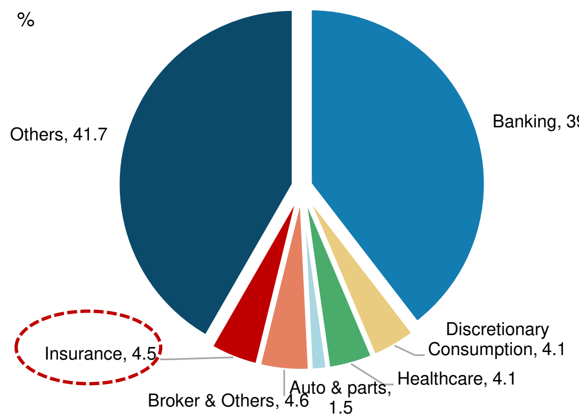
**Exhibit 7:** Earnings composition by sector – H share




Note: FY21 statistics

Source: Wind, Morgan Stanley Research

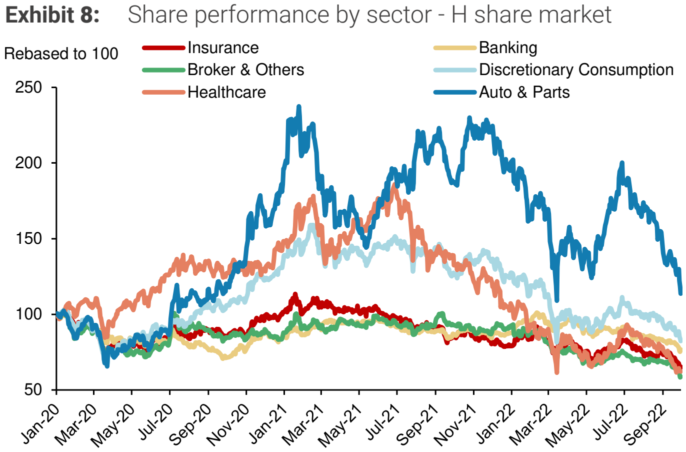
**Exhibit 10:** Earnings composition by sector – A share




Note: FY21 statistics

Source: Wind, Morgan Stanley Research

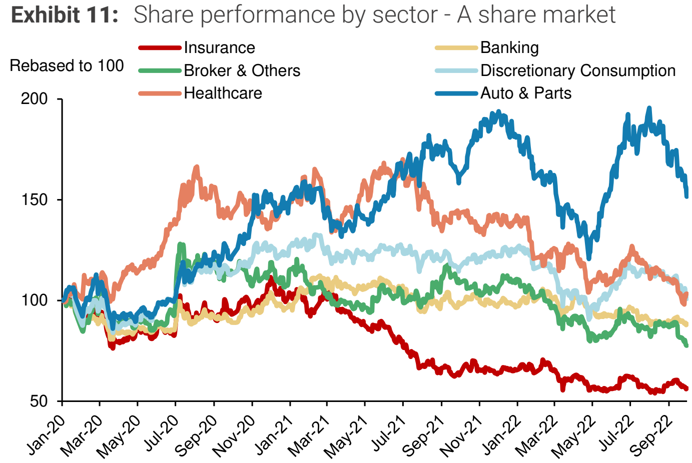
**Exhibit 8:** Share performance by sector - H share market




Note: Assuming 2 January 2020 as 100%

Source: Wind, Morgan Stanley Research

**Exhibit 11:** Share performance by sector - A share market




Note: Assuming 2 January 2020 as 100%

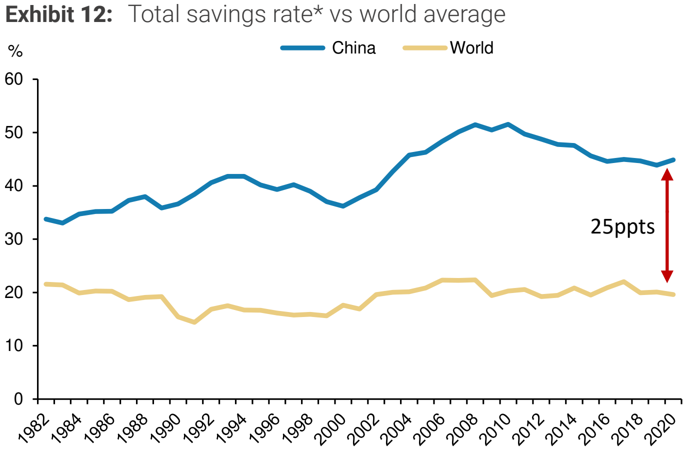
Source: Wind, Morgan Stanley Research

# Welfare Expansion Is a Core Element of China's Consumption-Led Growth Transition

**Savings rate still much higher than the global average...** China's national savings rate peaked in 2008 at 51.5% and declined gradually to reach 45% in 2020. However, it is still one of the highest rates globally. As of 2020, it was 25ppts higher than the global average and 5ppts higher than other east Asia countries (which typically enjoy higher savings rates than the rest of the world).

**... but could see a structural decline.** China's household savings have been hovering at ~25% of GDP (half of total national savings). In terms of disposable income, Chinese households save about 35% vs 10% in major EU countries in 2021, according to OECD data and we believe this could be contributing to the imbalances observed in China's economy. Slower wage growth and a change in China's demographic trend (increasing dependency ratio) could put downward pressure on China's household savings rate. Government savings (only 3% of China's national savings on average in the past 10 years) could also be in decline in order to support better social welfare, while we expect China's enterprise savings to remain stable or see a slight increase due to rising external uncertainties.

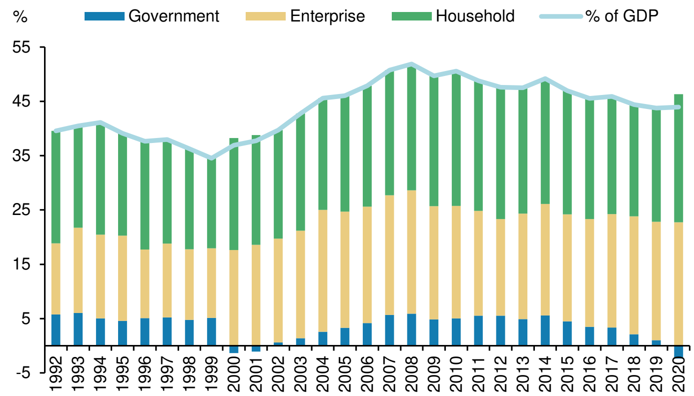
**Exhibit 12:** Total savings rate* vs world average




* % of GNP; Gross savings are the difference between gross national income and public and private consumption, plus net current transfers.

Source: World Bank, Morgan Stanley Research

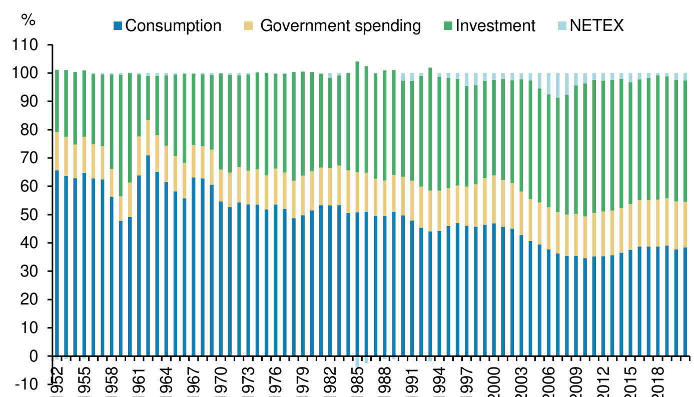
**Exhibit 13:** China's savings mix* as % of GDP




* excluding savings from foreign department

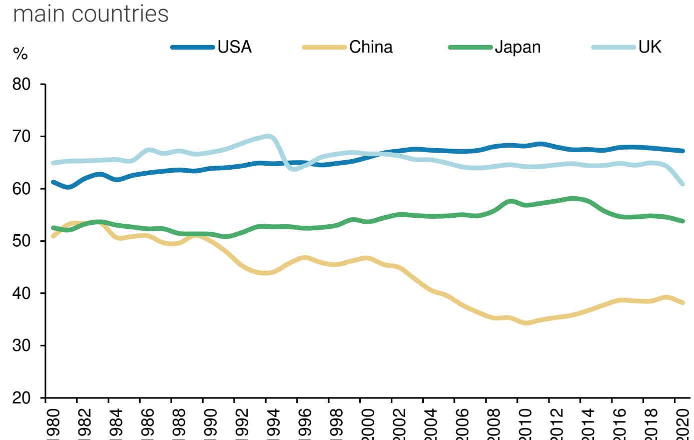
Source: NBS, CEIC, Morgan Stanley Research

**Exhibit 14:** GDP composition - Consumption contribution has been around 38%




Source: CEIC, Morgan Stanley Research

**Exhibit 15:** Consumption contribution to GDP is higher in other main countries

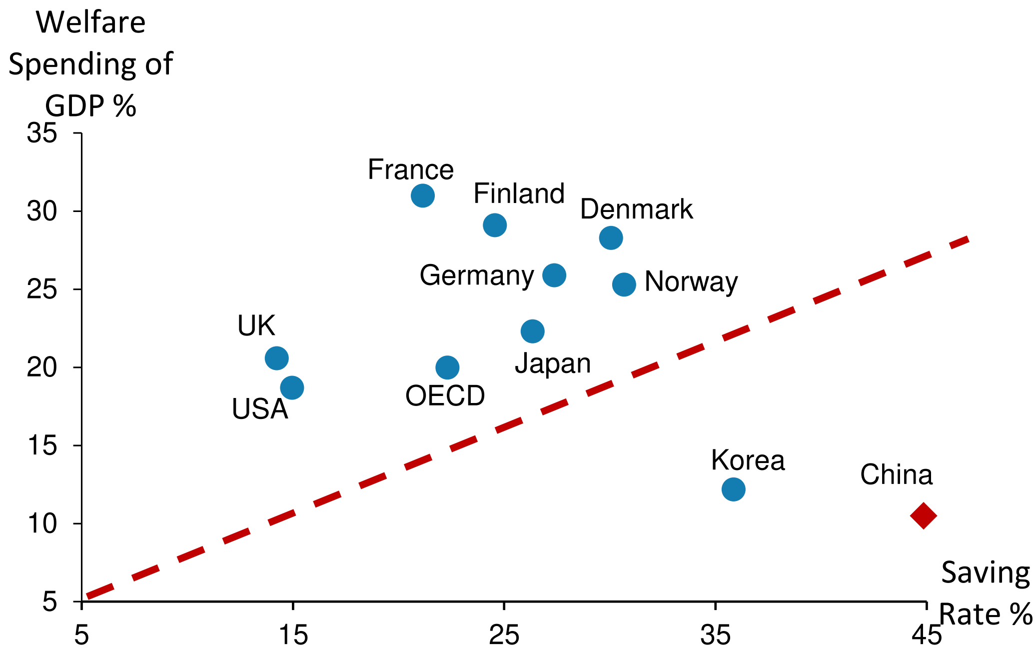



Source: World Bank, Morgan Stanley Research

**High savings rate could be constraining consumption growth.** While China's GDP per capita rose to US$12.6K in 2021, exceeding the world average of US$12.3K, its consumption per capita was only US$4K in 2020, comparable only to Jamaica and Peru. Private consumption was ~1/3 of GDP (~60% of the global average) as of 2020. Its high savings rate played a pivotal role in China's investment-led growth phase in 2000-20. However, in recent years, it has caused distortions in China's economic structure, such as over-investment and over-capacity, credit-based bubbles, and diminishing returns.

**The high savings rate could be a result of insufficient social welfare.** While China has built a relatively extensive social security system, covering most of its population, the protection levels are still relatively low – social health insurance still has limited coverage scope (co-pay, annual cap), leaving still large out-of pocket expenses to be covered by individuals (28% of total health care spending in 2021). Pensioners receive a monthly income of ~Rmb4,000 on average in urban areas but only Rmb200 in rural areas. China's total welfare spending is still only 10.5% of GDP vs the OECD average of 20%.

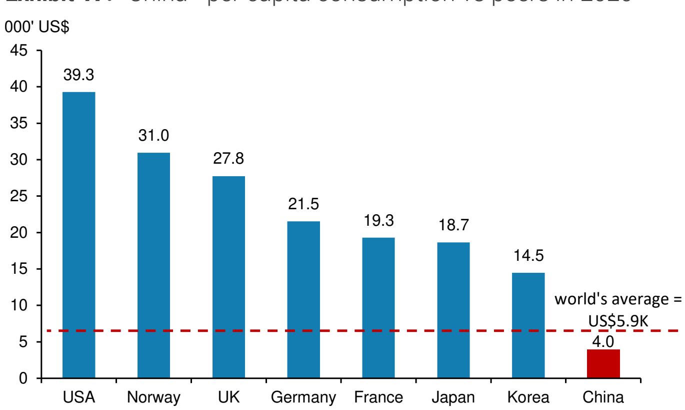
**Exhibit 16:** Welfare spending (as a % of GDP) vs. saving rate for key countries




Note: Saving rate is in FY20; Welfare of GDP is in FY21 for China and FY19 for others

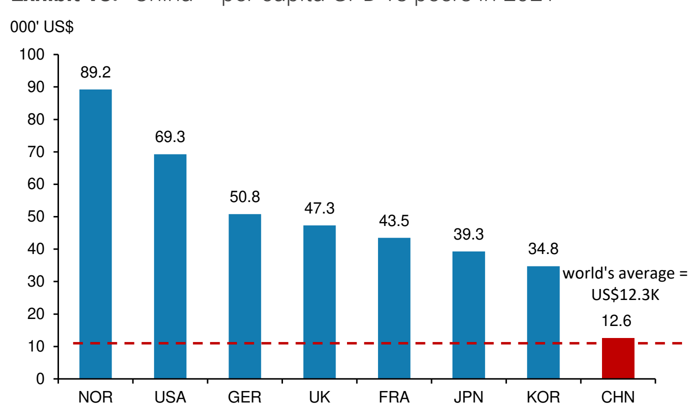
Source: World Bank, OECD Stat, Morgan Stanley Research

**Exhibit 17:** China - per capita consumption vs peers in 2020




Source: CEIC, Morgan Stanley Research

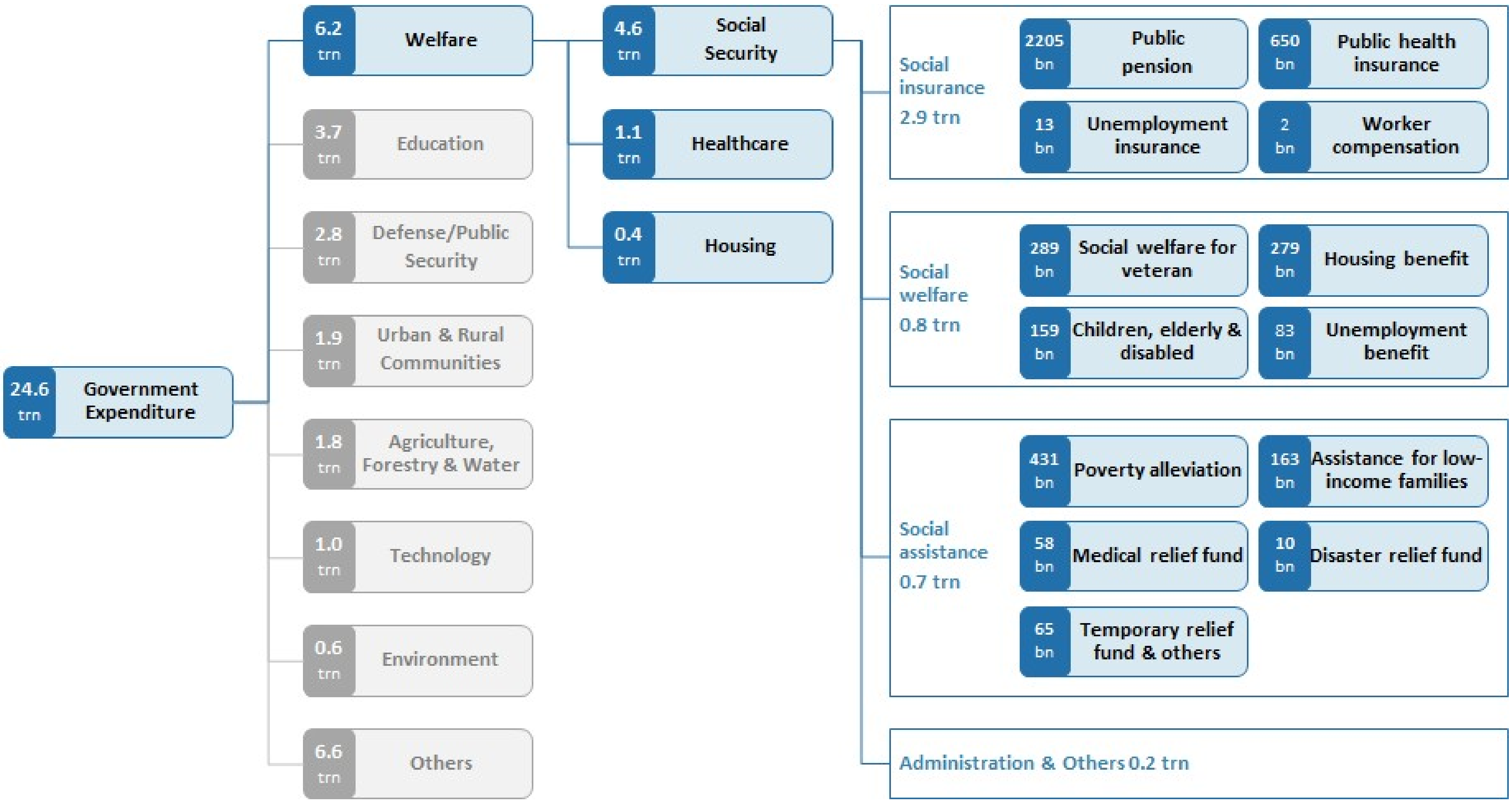
**Exhibit 18:** China – per capita GPD vs peers in 2021




Source: CEIC, Morgan Stanley Research

# Government Spending on China's Welfare System

**Exhibit 19:** China's government expenditure in 2021




Note: Some items were reclassified into Welfare from Others

Source: MOHRSS, MOF, Morgan Stanley Research

# Changes in China's Social Welfare System

Globally, challenges are mounting for the continued development of social security programs. Common issues facing governments include shifting government priorities (growth vs distribution), de-globalization (rising inequality and uncertainty), as well as aging populations (financial sustainability of welfare programs). In this section, we review how China has rebuilt its welfare system, which has helped it facilitate reform and regain economic growth in the past four decades. Social security reform has been at the top of the Chinese government's agenda since early 2000, and it maintains the view that there is a positive relationship between welfare and economic progress.

China's social security system has undergone comprehensive and profound change since the mid-1980s to adapt to the country's new economic model and to minimize the potential for social change. In 2021, China spent Rmb4.7trn on various social security programs (accounting for 19% of government expenditure). Of that amount, more than half went on social insurance at Rmb2.9trn. If we include other welfare spending on housing and health care, total spending was around Rmb6.2trn.

## 2.1 Overview of China's Welfare System.

### Social Assistance

**Social assistance** mainly provides support for low income families, but also includes various funds for disaster relief and medical relief to help families facing hardship. This is a small category in China's welfare system, with spending of only Rmb727bn in 2021 (see Exhibit 20 ).

**Poverty alleviation.** Spending in this category was Rmb431bn in 2021. While China's poverty line has been raised, the poverty ratio has been declining steadily. The government declared that extreme poverty ended in China in 2021 after many years of targeted effort.

### Social Insurance

Government spending on social insurance is the largest item in China's social security system, at Rmb2.9trn in 2021 (Rmb2.2trn on pensions, Rmb650bn on medical insurance, Rmb2bn on worker compensation and Rmb13bn on unemployment insurance). Different from countries whose social security programs are fully funded through taxation, China requires joint contribution from corporates and individuals in addition to various government subsidies. Total spending from the four social insurance programs was Rmb8.7trn in 2021 (as shown in Exhibit 21 ).

**Exhibit 20:** Social assistance programs - 2021

| Social Assistance Programmes | Expenditure (Rmb bn) |
|---|---|
| Poverty alleviation | 431.0 |
| Assistance for low income families | 162.7 |
| Medical relief fund | 58.2 |
| Disaster relief fund | 9.7 |
| Temporary relief fund & others | 65.2 |
| **Total** | **726.8** |

Source: MOF, Morgan Stanley Research

**Exhibit 21:** Social insurance programs - 2021

| Public Insurance Project (Rmb bn) | Government Spending | % of gov | Social* Spending | % of social | Total Expenditure** |
|---|---|---|---|---|---|
| Public pension | 2,205 | *36.7* | 3,798 | *63.3* | 6,003 |
| Public medical insurance | 650 | *26.9* | 1,769 | *73.1* | 2,419 |
| Worker compensation | 2 | *2.4* | 95 | *97.6* | 98 |
| Unemployment insurance | 13 | *8.5* | 137 | *91.5* | 150 |
| **Total** | **2,870** | ***33.1*** | **5,799** | ***66.9*** | **8,669** |

* Including corporates and individual contribution;

**Total expenditure aligns with 2021 National Social Insurance Funds Expenditure;

Source: MOF, Morgan Stanley Research

## Social Welfare

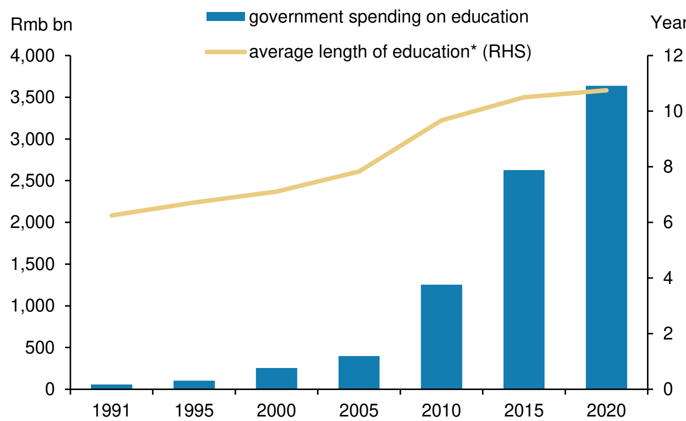
In addition to social assistance and security programs, government spending on welfare encompasses more than simply food and shelter. In China, housing, health care and education are three key areas where the government provides strong support.

**Housing benefits** include two schemes: *First,* government housing in urban / rural areas to help low income families. Government spending on affordable housing (Rmb279bn in 2021) has not been large in China given it previously operated on an allocation system before the 1980s. Together with financing from financial institutions, total government housing investment was ~Rmb700bn in 2021 (~1% of total FAI of the property sector). During the 14th five-year plan, the government plans to build a total of 10mn new rental apartments.

*Second,* housing provident funds to help urban employees with housing-related expenditure. This fund requires an equal contribution from employees and employers of 5%-12% of salary. As of the end of 2021, the fund had a balance of Rmb8trn, with Rmb22trn in contributions made (as of 2021) since the establishment of the fund, covering 4.1mn employers and 164mn employees.

**Education benefits.** Similar to housing benefit, education was free for all before the 1980s. The system was reformed over time and now only compulsory education is still free of charge and moderate fees are charged for higher level education (secondary school and above). In recent years, the support system for disadvantaged groups has increased. Government spending increased from Rmb58bn in 1991 to Rmb3.7trn in 2021, a 50-fold increase in the last thirty years.

**Exhibit 22:** Government spending on education has increased, as has the average length of education




*average length for age >6 before 2006 and for labor age between 16-59 after 2006

Source: MOE, MOF, Morgan Stanley Research

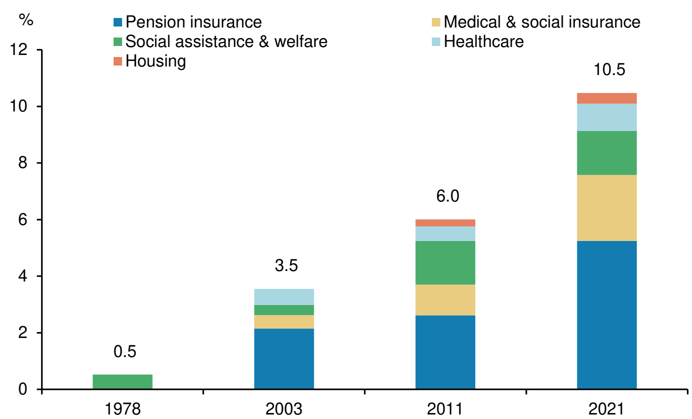
## 2.2 A Glance at History

China's economy has undergone a series of transformations since 1949. The development of social security programs has been intertwined with changes in ownership and controls of the economy.

**Pre 1978 – the planned economy era and the "iron rice bowl" approach.** During this period, China's social security functions were carried out by work units in urban areas and production teams in rural areas. Government, public institutions and state-owned SOEs were responsible for the welfare of employees and their family members and fulfilled the needs of society from cradle to grave (e.g., childcare, education, job placement, housing, subsistence, health care and elderly care). Rural residents were attached to different local production teams where welfare benefits were delivered collectively, including social aid, education, and health care services. During this period, all rural households were guaranteed access to land and all urban households were guaranteed jobs. This provided the Chinese population with a degree of economic security and limited the numbers in need of assistance. The government took on a relatively small social role during this period, being in charge of disaster relief and related poverty alleviation only. However, this began to change when China started its economic reforms. The welfare system was also highly fragmented given it was organized at the local level, a challenge that China continues to face today.

**1978-2000 – piloting new welfare systems to support economic reform.** This was quite a progressive period for welfare development in China. To support the economic reform process, China's social security system underwent fundamental changes to help cushion potential social risks during a period of immense change. Many local trials started of new schemes such as "paid health care" or "vocational pension plans" in order to move from a work-unit-based system of free benefits to a social-insurance-based system of welfare. However, during this period, GDP was the government's top priority, which meant that resource allocation tilted further towards urban areas and away from rural areas, making the benefit gap between the urban and rural populations wider still. Rural residents had to spend large amounts of their savings to pay for what should have been provided for by social welfare programs, including amounts for education and health care. China also had increasing numbers of migrant workers from rural areas who were exposed to greater risk of unemployment but not covered by urban social security programs. Data suggests that in 1996, rural residents accounted for 75% of China's population, but received only 6% of total national welfare expenditure.

**Exhibit 23:** Social welfare spending as a % of GDP



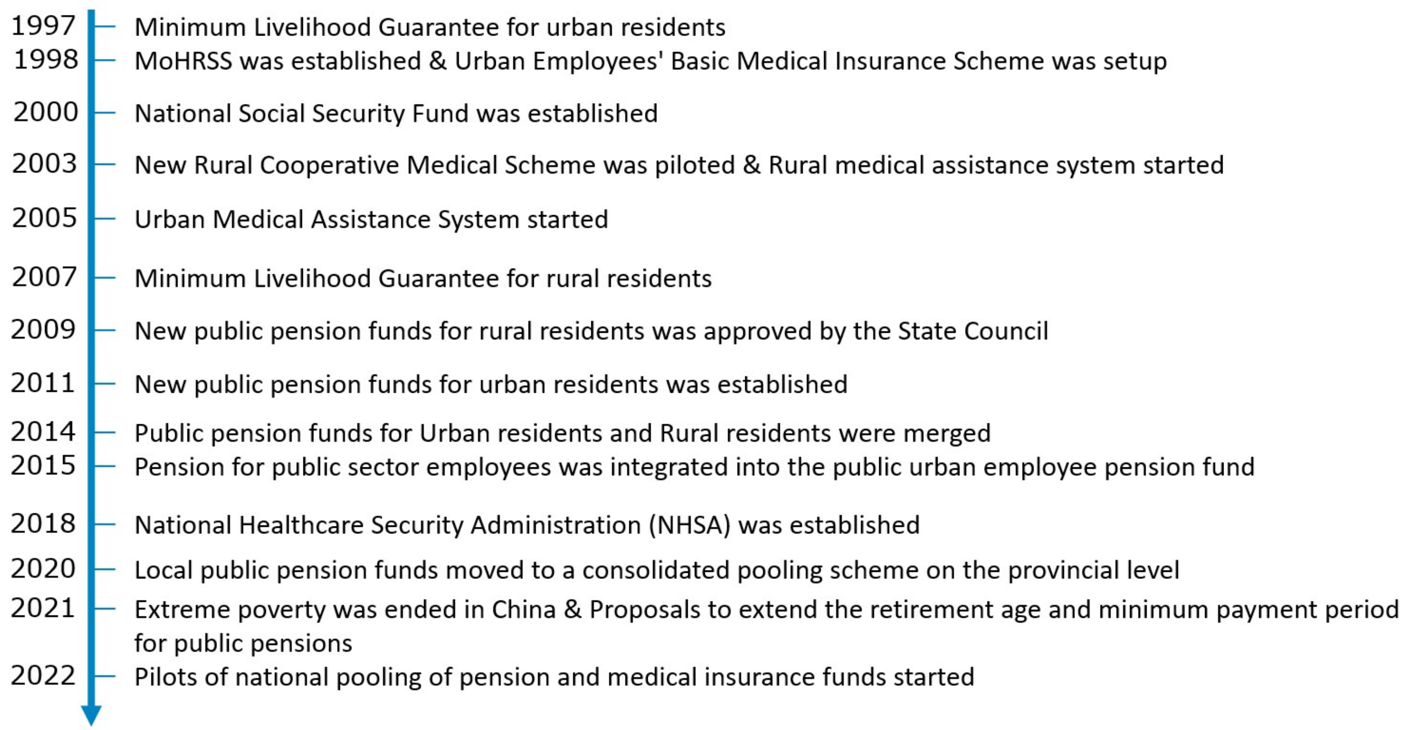

*including social assistance, social welfare and others

Source: MOF, MCA, Morgan Stanley Research

**2000-2020 – Rebuilding the social security system:** In 1998, the Chinese Government set up a new division called The Ministry of Human Resources and Social Security (MOHRSS), to oversee the further development of China's welfare programs.

The new division introduced key changes to social security programs, removing the link between individuals and their work unit (for welfare purposes), and forming a new system with greater flexibility (benefits portable when changing employers), sustainability (contributions from employee & employers required with government subsidies when needed) and improved equality (more integrated plans with reduced rural and urban gaps). Detailed achievements are included in Exhibit 24 .

**Exhibit 24:** Key changes in China's social security system:1997-2022




Source: Ministry of Human Resources and Social Security, Morgan Stanley Research

## 2.3 Substantial Fiscal Support

**Strong economic development a pre-condition for welfare expansion.** Government expenditure on welfare has been growing at over 10x in the past 15 years, rising from Rmb0.57trn in 2006 to Rmb6.2trn in 2021, implying an CAGR of 17%. This could not have been achieved without China's rapid economic growth but we notice the investment in welfare has been outgrowing GDP by 6ppts on average since 2006, suggesting increasing government focus on people's livelihoods.

**Already a significant part of government spending...** Government expenditure on welfare accounted for 14% of total government spending in 2006 vs. a 25% in 2021 (19% for social security, 4.5% for healthcare and 1.8% for housing, see Exhibit 25 ). Social security is becoming the largest area of national general public expenditure by the Chinese government across all areas, taking share from general public services, national defense and education. Within the welfare program, we note that subsidies to the pension and insurance funds have been growing faster than to other areas ( Exhibit 26 ) with the highest level of government support received in recent years.

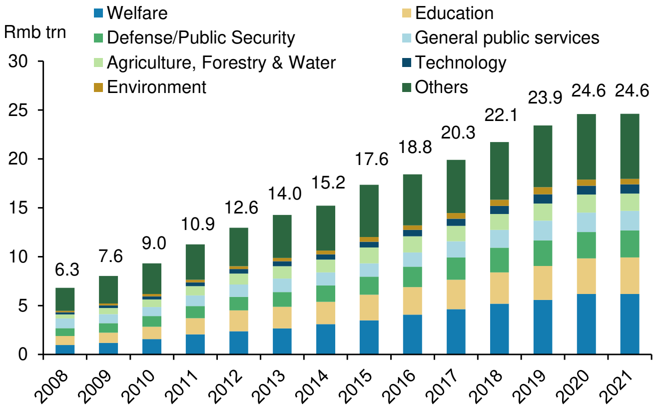
**... but still lags developed countries.** Total welfare expenditure (including total social insurance expenditure, social assistance, social welfare, healthcare expenditure and affordable housing, which is more comparable globally) as a % of GDP has seen consistent increases for China over the past 15 years, rising from 5.4% in 2008 to 10.5% in 2021. However, we note this is still behind developed countries such as the Nordic states, other main EU members, and even the US (see Exhibit 31 ).

**Exhibit 25:** Details of Government Welfare Spending 2011-2021

| Rmb trn | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Social Security** | **1.69** | **1.95** | **2.20** | **2.47** | **2.84** | **3.31** | **3.55** | **4.01** | **4.30** | **4.65** | **4.65** |
| **Social insurance** | **0.94** | **1.06** | **1.22** | **1.37** | **1.67** | **1.94** | **2.04** | **2.24** | **2.43** | **2.69** | **2.87** |
| - Public pension | 0.60 | 0.69 | 0.78 | 0.87 | 1.10 | 1.31 | 1.52 | 1.68 | 1.83 | 2.08 | 2.20 |
| - Public medical insurance | 0.33 | 0.37 | 0.43 | 0.48 | 0.57 | 0.62 | 0.50 | 0.55 | 0.59 | 0.61 | 0.65 |
| - Other social insurance | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.02 |
| **Social assistance** | **0.18** | **0.20** | **0.23** | **0.25** | **0.37** | **0.50** | **0.58** | **0.75** | **0.83** | **0.88** | **0.73** |
| - Poverty alleviation | 0.05 | 0.07 | 0.08 | 0.09 | 0.12 | 0.23 | 0.32 | 0.49 | 0.56 | 0.56 | 0.43 |
| - Assistance for low income families | 0.07 | 0.07 | 0.08 | 0.07 | 0.17 | 0.17 | 0.15 | 0.15 | 0.15 | 0.17 | 0.16 |
| - Medical relief fund | 0.01 | 0.01 | 0.01 | 0.02 | 0.02 | 0.03 | 0.03 | 0.05 | 0.05 | 0.06 | 0.06 |
| - Disaster relief fund | 0.02 | 0.03 | 0.02 | 0.02 | 0.02 | 0.03 | 0.02 | 0.01 | 0.01 | 0.02 | 0.01 |
| - Temporary relief fund & others | 0.02 | 0.03 | 0.03 | 0.03 | 0.04 | 0.05 | 0.05 | 0.06 | 0.06 | 0.07 | 0.07 |
| **Social welfare** | **0.42** | **0.51** | **0.53** | **0.59** | **0.70** | **0.76** | **0.74** | **0.75** | **0.77** | **0.86** | **0.81** |
| - Social welfare for children, elderly & disabled | 0.03 | 0.04 | 0.05 | 0.06 | 0.10 | 0.11 | 0.12 | 0.13 | 0.15 | 0.15 | 0.16 |
| - Social welfare for veteran | 0.07 | 0.09 | 0.11 | 0.12 | 0.14 | 0.14 | 0.17 | 0.18 | 0.24 | 0.31 | 0.29 |
| - Housing benefit | 0.26 | 0.31 | 0.30 | 0.34 | 0.39 | 0.44 | 0.38 | 0.37 | 0.29 | 0.31 | 0.28 |
| - Unemployment beneift | 0.06 | 0.06 | 0.07 | 0.08 | 0.08 | 0.07 | 0.07 | 0.07 | 0.08 | 0.08 | 0.08 |
| **Administration & Others** | **0.15** | **0.18** | **0.22** | **0.26** | **0.09** | **0.12** | **0.20** | **0.27** | **0.27** | **0.21** | **0.24** |
| **Healthcare** | **0.25** | **0.29** | **0.32** | **0.46** | **0.46** | **0.53** | **0.80** | **0.87** | **0.93** | **1.15** | **1.10** |
| **Housing** | **0.12** | **0.13** | **0.15** | **0.16** | **0.19** | **0.24** | **0.28** | **0.31** | **0.35** | **0.40** | **0.43** |
| **Government Welfare Spending** | **2.07** | **2.38** | **2.67** | **3.09** | **3.49** | **4.08** | **4.62** | **5.19** | **5.58** | **6.19** | **6.18** |
| **Government Expenditure** | **10.92** | **12.60** | **14.02** | **15.18** | **17.59** | **18.78** | **20.31** | **22.09** | **23.89** | **24.57** | **24.57** |

Source: MOF, Morgan Stanley Research

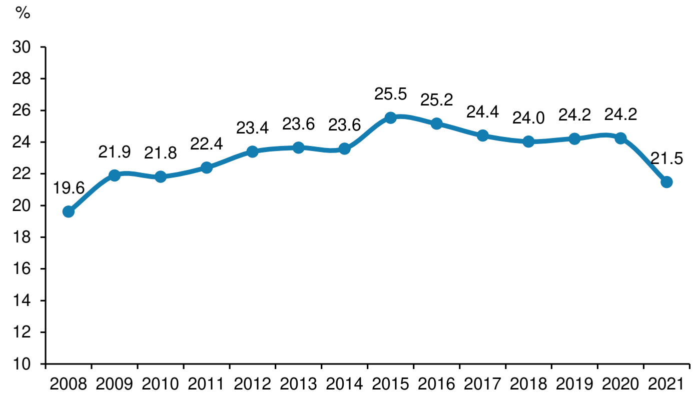
**Exhibit 26:** China's government spending




Note: Some items were reclassified

Source: MOF, Morgan Stanley Research

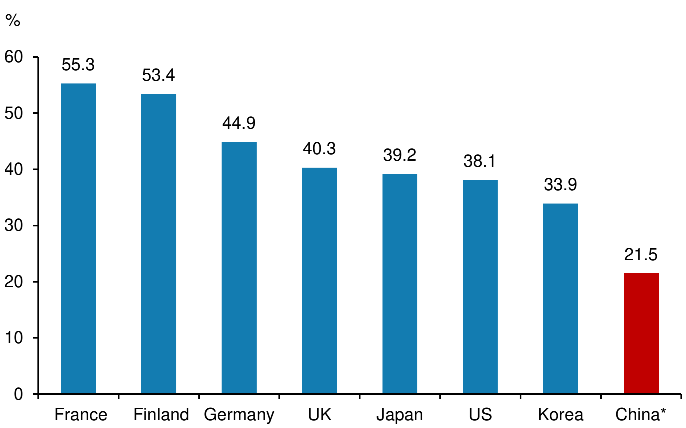
**Exhibit 29:** China's government spending as a % of GDP




Note: Only including national general public budget expenditure

Source: MOF, Morgan Stanley Research

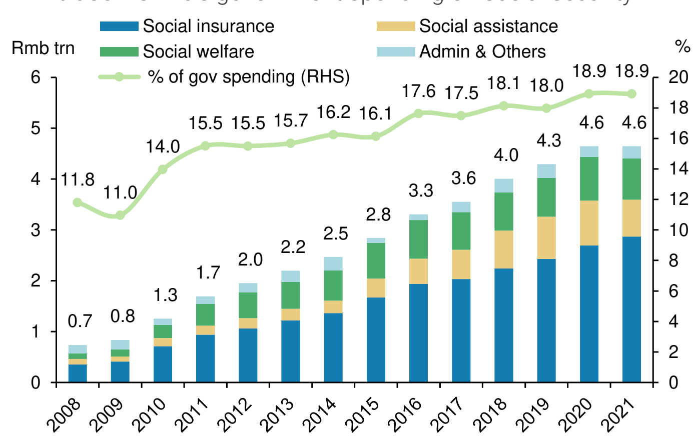
**Exhibit 27:** Government spending as a % of GDP, China vs developed countries




* Only including national general public budget expenditure; FY21 for China and FY19 for others

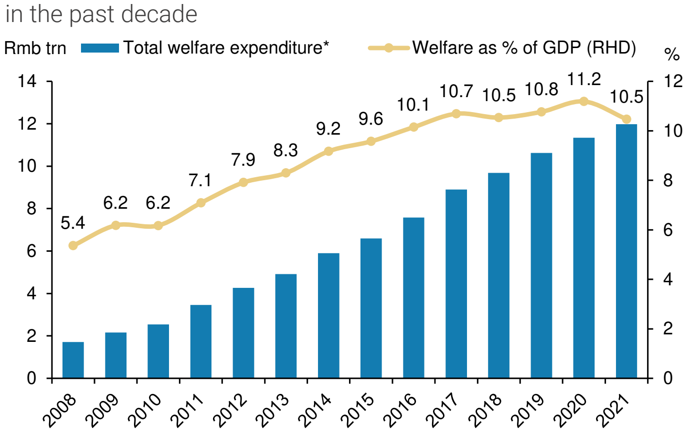
Source: MOF, OECD Data, Morgan Stanley Research

**Exhibit 30:** China's government spending on social security




Source: MOF, MOHRSS, Morgan Stanley Research

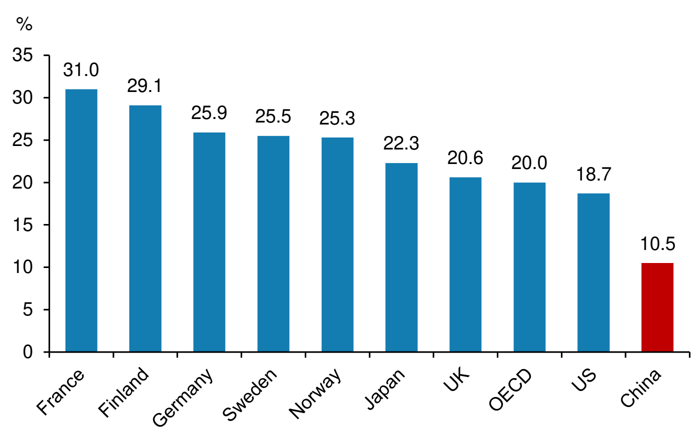
**Exhibit 28:** China's welfare spending as a % of GDP has increased in the past decade




* including total expenditure on social insurance fund

Source: MOF, MOHRSS, Morgan Stanley Research

**Exhibit 31:** China's welfare spending as a % of GDP vs developed countries




Note: FY21 for China and FY19 for others

Source: OECD Stat, MOF, MOHRSS, Morgan Stanley Research

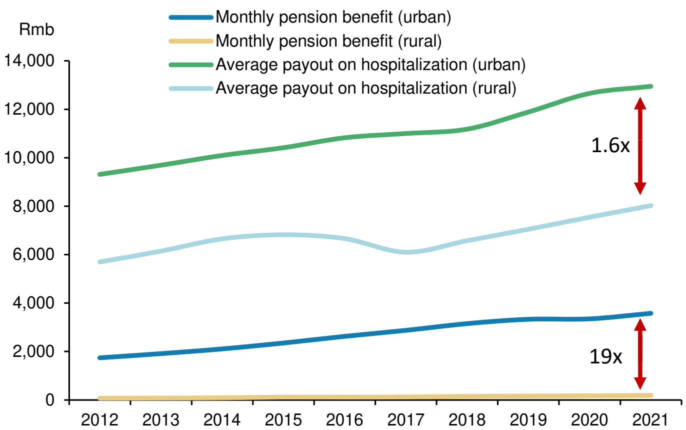
## Section 2.4 Future policy direction

**Building a sustainable social security system, with extensive coverage.** This will mean that benefit levels cannot be too high and social security will serve its purpose of guaranteeing and improving people's basic livelihoods. China is unlikely to pursue a welfare model that over-stretches its fiscal capacity. China's economy faces structural adjustments and future GDP growth and our China Economics team expects China's economy to slow to <5% during 2020-30. Welfare spending typically accounts for around 25% of GDP in developed markets (see Exhibit 31), with one-third funded directly by government spending and the rest coming from employers and employees. We expect China to continue to increase its welfare spending, but at a more moderate pace in the next decade, at 8% CAGR. While this is slower than before (17% between 2006-2021), we estimate it will still outstrip GDP with total spend doubling in the next decade, on our estimates (see Exhibit 36 for details). These expansions will help meet growing payouts from public health and pension plans as China ages further, but they are unlikely to alter or improve the current benefit schemes materially, in our view.

**Focusing more on equality and redistribution.** China's current welfare system still has a long way to go and with a limited budget. Two areas in particular that require attention include: 1) Inclusivity – currently, there are significant numbers of employees (such as flexible workers / migrant workers) that do not have access to proper social welfare in the cities that they work in. 2) Imbalances – there continues to be significant differences in the benefits paid to rural and urban recipients in terms of social health and pension insurance. The social insurance system is likely to be integrated / consolidated at a larger scale over time, with more roles and responsibilities assumed by central government rather than local government, based on recent reforms.

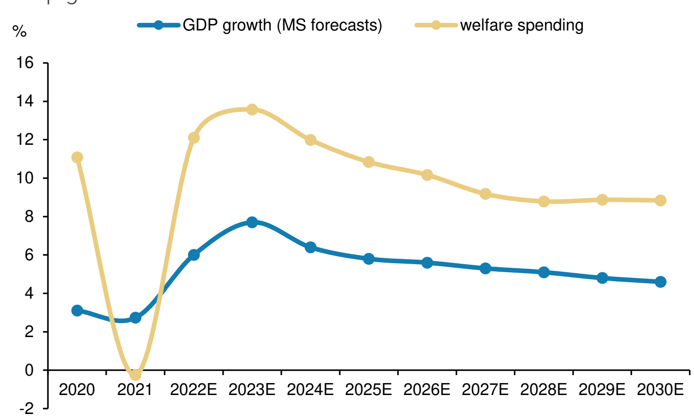
**Multi-layered system is needed / private capital is welcomed.** In China's 14th Five-year plan, commercial pension / annuities / medical insurance are clearly encouraged to complement the social security system. Private capital is also welcome to participate in welfare services (such as for senior care and health care) to meet the growing need for nursing care. With a low fertility rate and aging population, China's traditional family care model is undergoing rapid change, with more one-child families or more recently one-person families (empty-nest families), that require a substantial increase in social services.

**Exhibit 32:** Welfare spending in China's rural vs urban settings



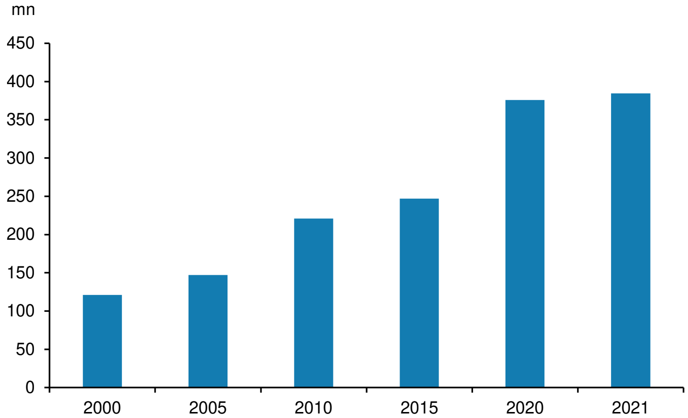

Source: NHSA, MOHRSS, Morgan Stanley Research

**Exhibit 33:** We expect the growth rate of welfare spending to outstrip growth in GDP in future



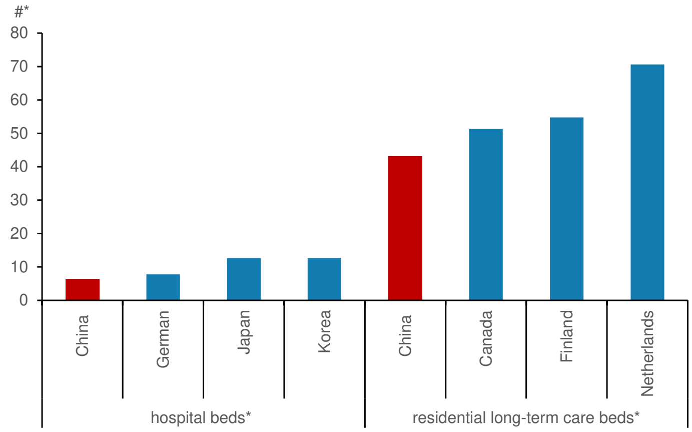

Source: Morgan Stanley Research (E) Estimate

**Exhibit 34:** # of migrant workers is growing in China




Source: NBS, Morgan Stanley Research

**Exhibit 35:** China's hospital beds and residential long-term care beds were still below developed markets as of end-2020




* hospital beds per 1K inhabitants and residential long-term care beds per 1K population over 65; as of end-2020

Source: OECD data, MOHRSS, NHSA, Morgan Stanley Research

**Exhibit 36:** Government expenditure on welfare, 2020-30E

| Rmb bn | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E | 2028E | 2029E | 2030E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Nominal GDP | 101,357 | 114,367 | 121,229 | 130,564 | 138,920 | 146,977 | 155,208 | 163,434 | 171,769 | 180,014 | 188,294 |
| *Nominal GDP Growth %* | *2.7* | *12.8* | *6.0* | *7.7* | *6.4* | *5.8* | *5.6* | *5.3* | *5.1* | *4.8* | *4.6* |
| National General Public Expenditure as % of GDP | *24.2* | *21.5* | *22.5* | *24.0* | *24.0* | *24.0* | *24.0* | *24.0* | *24.0* | *24.0* | *24.0* |
| National General Public Expenditure | 24,568 | 24,567 | 27,277 | 31,335 | 33,341 | 35,274 | 37,250 | 39,224 | 41,225 | 43,203 | 45,191 |
| **Social insurance** | 2,695 | 2,870 | 3,214 | 3,617 | 4,036 | 4,436 | 4,854 | 5,240 | 5,665 | 6,156 | 6,686 |
| *as % of total exp* | *11.0* | *11.7* | *11.8* | *11.5* | *12.1* | *12.6* | *13.0* | *13.4* | *13.7* | *14.2* | *14.8* |
| **Social assistance** | 880 | 727 | 831 | 960 | 1,091 | 1,228 | 1,374 | 1,529 | 1,693 | 1,864 | 2,044 |
| *as % of total exp* | *3.6* | *3.0* | *3.0* | *3.1* | *3.3* | *3.5* | *3.7* | *3.9* | *4.1* | *4.3* | *4.5* |
| **Social welfare** | 861 | 810 | 919 | 1,055 | 1,192 | 1,335 | 1,487 | 1,648 | 1,818 | 1,995 | 2,181 |
| *as % of total exp* | *3.5* | *3.3* | *3.4* | *3.4* | *3.6* | *3.8* | *4.0* | *4.2* | *4.4* | *4.6* | *4.8* |
| **Administration & Others** | 214 | 240 | 315 | 405 | 430 | 455 | 481 | 506 | 532 | 558 | 583 |
| *as % of total exp* | *0.9* | *1.0* | *1.2* | *1.3* | *1.3* | *1.3* | *1.3* | *1.3* | *1.3* | *1.3* | *1.3* |
| **Healthcare** | 1,147 | 1,101 | 1,167 | 1,286 | 1,454 | 1,641 | 1,823 | 2,011 | 2,184 | 2,374 | 2,601 |
| *as % of total exp* | *4.7* | *4.5* | *4.3* | *4.1* | *4.4* | *4.7* | *4.9* | *5.1* | *5.3* | *5.5* | *5.8* |
| **Housing** | 398 | 430 | 480 | 543 | 606 | 671 | 739 | 811 | 887 | 965 | 1,047 |
| *as % of total exp* | *1.6* | *1.8* | *1.8* | *1.7* | *1.8* | *1.9* | *2.0* | *2.1* | *2.2* | *2.2* | *2.3* |
| Total government expenditure on welfare | 6,194 | 6,179 | 6,927 | 7,867 | 8,810 | 9,765 | 10,759 | 11,746 | 12,778 | 13,912 | 15,142 |
| National Social Insurance Funds Expenditure | 7,837 | 8,669 | 9,536 | 10,490 | 11,539 | 12,693 | 13,962 | 15,358 | 16,894 | 18,584 | 20,442 |
| *YoY %* | *4.9* | *10.6* | *10.0* | *10.0* | *10.0* | *10.0* | *10.0* | *10.0* | *10.0* | *10.0* | *10.0* |
| **Government exp on welfare as % of total exp** | **25.2** | **25.1** | **25.4** | **25.1** | **26.4** | **27.7** | **28.9** | **29.9** | **31.0** | **32.2** | **33.5** |
| **Total Welfare* as % of GDP** | **11.2** | **10.5** | **10.9** | **11.3** | **11.7** | **12.3** | **12.8** | **13.4** | **14.0** | **14.6** | **15.3** |

* Welfare spending = Government expenditure on welfare + National Social Insurance Funds expenditure - Government expenditure on social insurance

Source: MoF, Morgan Stanley Research (E) Estimates

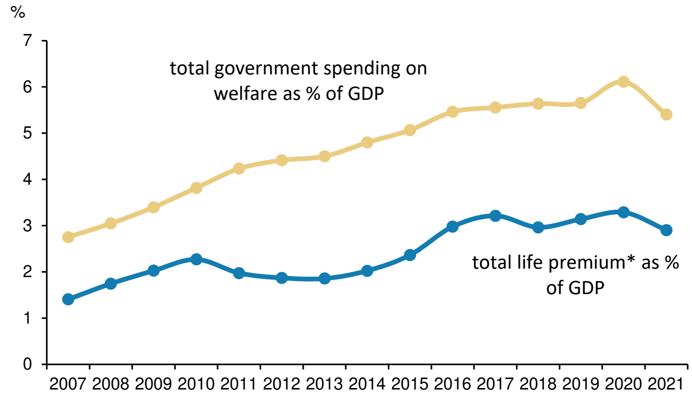
# Welfare Reform - A Tailwind or Headwind for Insurance?

## Commercial insurance has thrived alongside China's welfare expansion in the past two decades

**Life insurance penetration has more than doubled to 2.9% in the past 20 years.** While government was busy building its social insurance program, commercial insurance was developing in parallel, GWP increased from Rmb142bn in 2001 to Rmb3.3trn in 2021. Penetration (Life GWP as a % of GDP) also doubled from 1.3% to 2.9% during the period. At the same time, household spending on commercial insurance grew at 1.5x the rate of GDP growth. Excluding savings policies, and just looking at health insurance development in China, we do not see much of a crowding-out effect – the health insurance premium is now ~25% of the total life & health sector with a growth CAGR of 28% in the past decade (the business only started about 10 years ago). Premium density is still small at Rmb598 per capita, with significant room to grow.

**Private insurance is spreading quickly in China from high-tier to low-tier cities, consumers are showing broader awareness and acceptance of the sector.** Taking health insurance as an example, initially, products were taken up by residents in tier 1 cities such as Beijing, Shanghai, and Shenzhen, contributing 31% to total health premiums in 2015. However, coverage has spread rapidly to other places, with 20% of health premiums in 2020 coming from tier 2 cities and 36% from even lower tier cities (up by 15ppts in total compared with 2015). This is over the same period that the government rolled out multiple new social health insurance plans, including new rural/urban residents coverage, enhanced coverage on critical conditions, and city supplementary health plans. We believe strong promotion / education by the government of these programs has increased overall awareness of insurance and thus stimulated commercial demand.

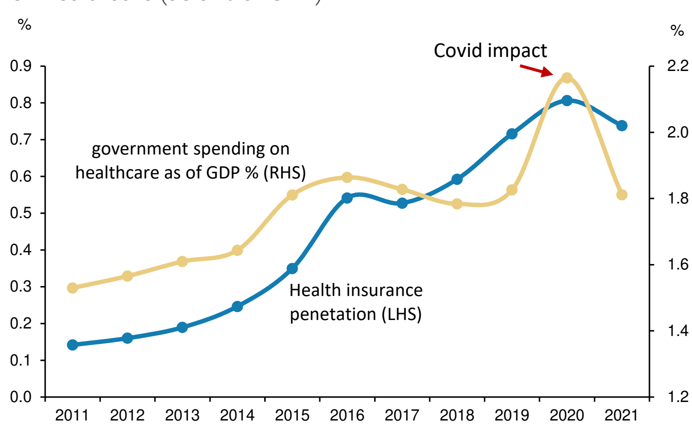
**Exhibit 37:** Life insurance penetration vs welfare spending as a % of GDP




* Unit-linked accounts and universal life premium were included

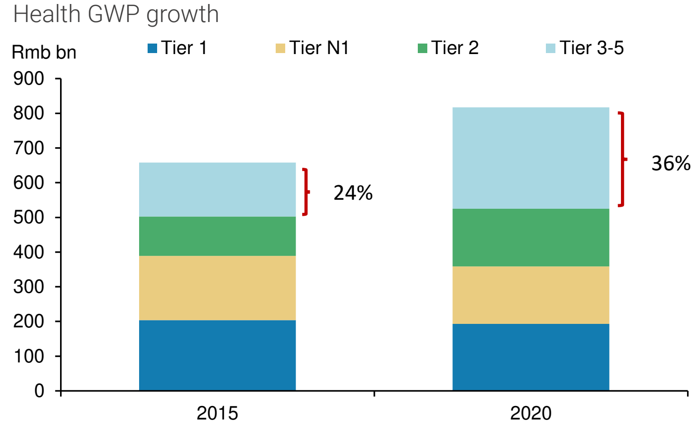
Source: CBIRC, MOF, Morgan Stanley Research

**Exhibit 38:** Health insurance penetration vs government spending on healthcare (as a % of GDP)




Source: NHC, CBIRC, CEIC, Morgan Stanley Research

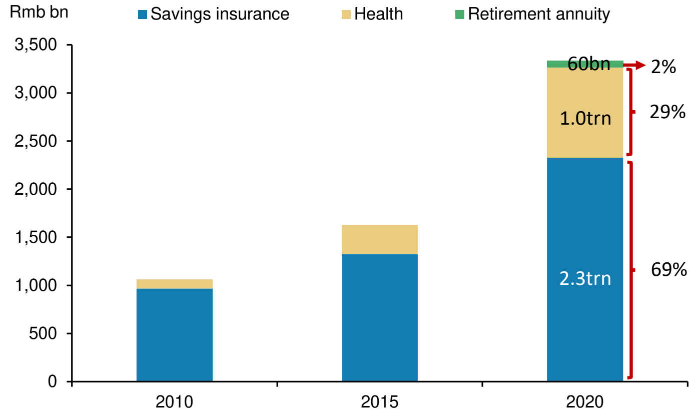
**Exhibit 39:** Tier 3-5 cities are becoming the main contributor to Health GWP growth




Source: CBIRC, Morgan Stanley Research

**Supportive tax policies will be key drivers of further product diversification.** China's life insurance market has grown into the second largest life insurance market globally (in terms of GWP), second only to the US life market, despite no meaningful support from the tax system and with a product category that was quite limited. With the government rolling out a system of tax support for commercial insurance products (pension in April 2022; health currently in pilot), we expect to see greater product innovation and diversification in this space, particularly in the areas of health care, long term care and pension insurance.

**Exhibit 40:** Life insurance products are still concentrated in savings, with limited product options



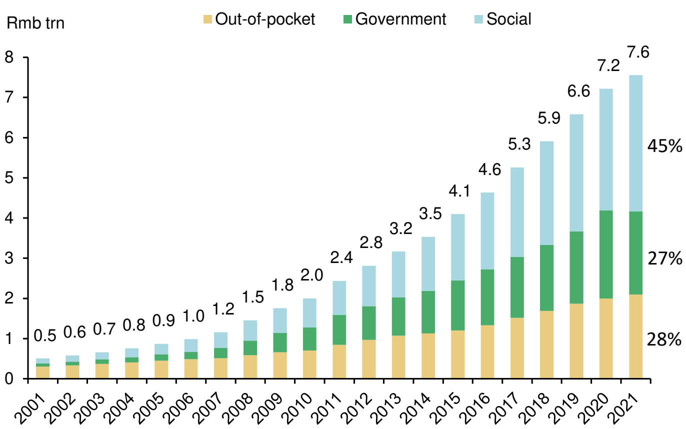

Source: CBIRC, Morgan Stanley Research

## Still Significant Protection Gaps Even with Growing Social Insurance Schemes

**Health Insurance – out of pocket expenses still high.** Despite improved social health insurance coverage (almost all Chinese residents are now covered), there are still significant out-of-pocket expenses for Chinese households for health care, at ~30% (vs. 20% for OECD countries). This out of pocket spending (Rmb2.1trn in 2021) has been a result of coverage restrictions in China's social insurance plans, such as deductibles, caps, limitation of networks, services and drug plans. These gaps are addressable business opportunities for private insurance, in our view.

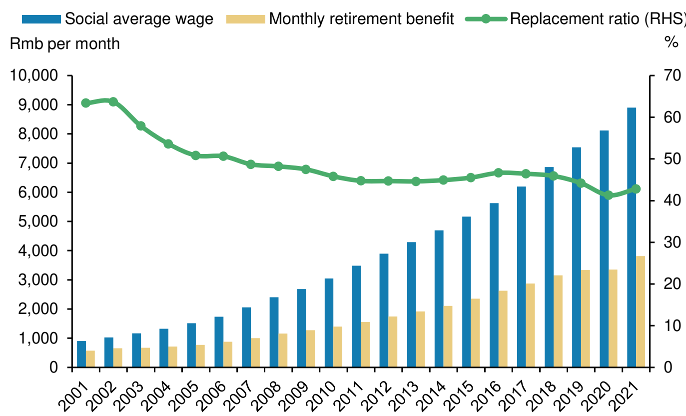
**Pension insurance – low replacement ratio.** China's pension system is another area receiving increased attention and government support. While basic pension plans cover over 1bn members of the population, according to the Ministry of Human Resources and Social Security, the fund is still small with an insufficient replacement ratio – in rural areas, it is only 10-15% of pre-retirement income, and for urban employees it has come down to ~40% of pre-retirement income. Even though many employees enrolled in enterprise annuity plans, the scale is also small and can only raise the replacement ratio by a moderate 5ppts per annum. To maintain a family's pre-retirement life style, commercial annuities / pensions are also needed to supplement government and corporate plans.

**Exhibit 41:** China's health expenditure - out of pocket expenses are still high




Source: NHC, Morgan Stanley Research

**Exhibit 42:** Urban employee pension plans - payout from public plans can equate to 40% of pre-retirement incomes




Note: replacement ratio for urban employee plans =Urban Employees Funds received per capita/ Average income for employees in urban units

Source: NBS, MOHRSS, Morgan Stanley Research

**Exhibit 43:** An illustration of deductibles, co-payments, and caps for China's social health insurance (Beijing)

| Items | Schemes | Deductibles (Rmb) | Max limit (Rmb) | Co-pay % | | |
|---|---|---|---|---|---|---|
| | | | | Primary care | Secondary | Tertiary |
| Outpatient | UEBMI | 1,800 | Up to 20,000 | 90% | 70% | 70% |
| | BMURR | 100-550 | Up to 4,000 | 55% | 50% | 50% |
| Inpatient | UEBMI | 1,300 | Up to 300,000 | 90-99% | 87-99% | 85-99% |
| | BMURR | 150-1,300 | Up to 250,000 | 80% | 78% | 75% |

Source: Beijing government data, Morgan Stanley Research.

**Exhibit 44:** Three reimbursement catalogues of China's social health insurance

| Reimbursement list | Categories | # of items | Reimbursement rules |
|---|---|---|---|
| Drugs | Class I drugs | 640 | 100% included, subject to UEBMI/BMURR caps |
| | Class II drugs | 2003 | Require 10-30% co-pay |
| | Class III drugs | >190k | Not covered under social insurance |
| Medical services | Covered services | Essential and reasonable diagnosis services | 100% included, subject to UEBMI/BMURR caps |
| | Partially covered | Certain mature medical services, e.g. CT screening | Require ~20% co-pay |
| | Non-covered | Preventive/rehabilitation/mental services, innovative treatments | Not covered under social insurance |
| Medical facilities | Covered services | Essential and reasonable facilities, e.g. standard wards | 100% included, subject to UEBMI/BMURR caps |
| | Non-covered | High-end medical devices/screenings | Not covered under social insurance |

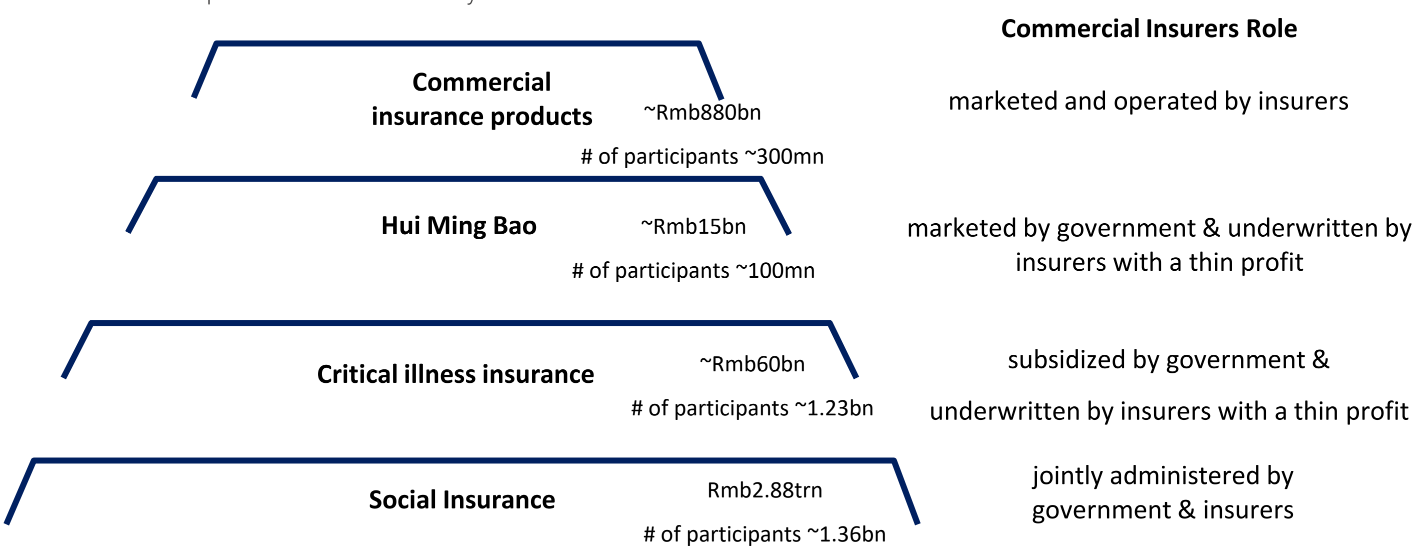
Source: Nation Healthcare Security Administration (NHSA), Morgan Stanley Research.

## Commercial insurance is an integral part of the welfare system

**Role of private insurers in the public health insurance system:** While probably less well known, Chinese insurers (especially SOEs) have been quite active in helping the government deliver public services, such as administering public health insurance plans for local government and settling claims for individuals. This service could become more necessary once China moves to a national pooling scheme for health insurance given commercial insurers' extensive networks and a national service capability. Government can often leverage insurers' superior underwriting systems and entrust business to insurers, such as medical insurance for critical illness (nationwide plan) and various additional municipal medical insurance plans. There are also tax exempted commercial health plans in pilot (spending of Rmb2,400 per year on health insurance and services are income tax deductible).

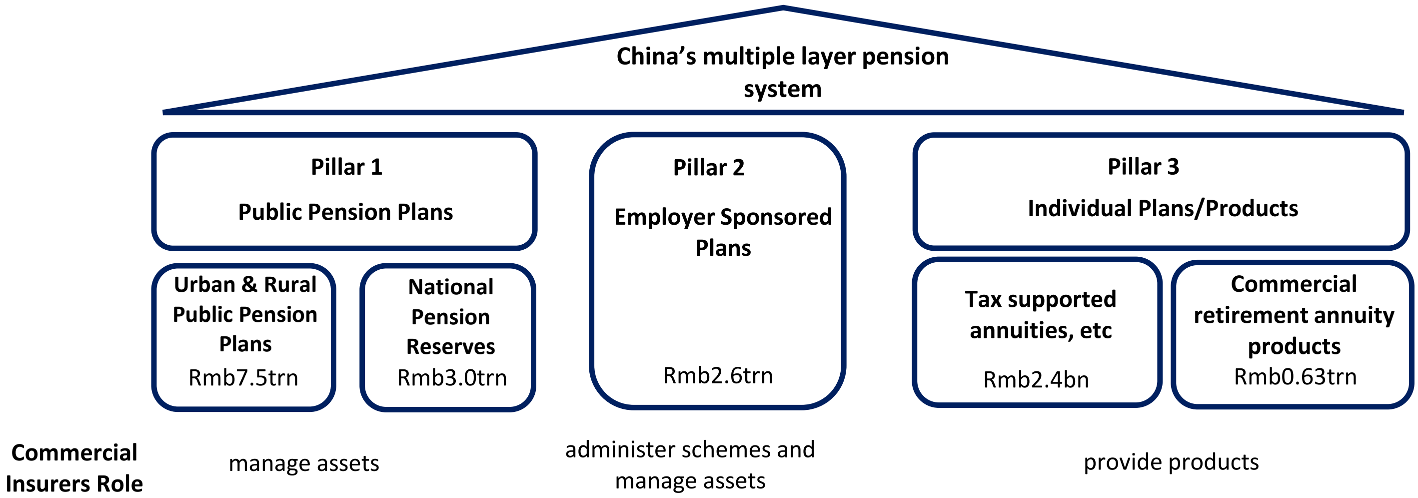
**Role of private insurers in the public pension insurance system**: Private insurers are helping China's pension system in multiple ways, ranging from managing public / private pension assets, to administering government or corporate pension plans, to offering to be a full-service commercial retirement annuity product provider.

**Exhibit 45:** China's public health insurance system and role of commercial insurers




Note: Revenue or premium in 2021; Source: Morgan Stanley Research. Hui Ming Bao equates to city-customized commercial medical insurance plans

**Exhibit 46:** China's pension system and role of commercial insurers




Source: SSF, MOHRSS, CBIRC, Morgan Stanley Research

**Exhibit 47:** Insurers' participation in China's public health insurance system

| | PICC | China Life | CPIC |
|---|---|---|---|
| **Critical illness insurance** | covers 550 million people | over 200 programs covering >350 million people | 61 programs covering 100 million people with premium income at Rmb6.1bn |
| **Long-term care insurance** | >100 projects with Rmb1.3bn premium income, covering 48mn people | 61 programs in 17 provinces and cities, covering 23 million people | serves over 40 cities and covers 48 million people |
| **City-customized commercial medical insurance plans (Hui Ming Bao)** | >140 large and medium cities, covering more than 55 million people | 54 projects in 15 provinces and cities, covering >10 million people | 35 projects covering >21 million people |

Source: Company Data, Morgan Stanley Research

# We Expect Life Premiums to Exceed US$1trn by 2030

**Opportunities exist for quality names who can consolidate share:** In this section, we update our industry projections and look at the future market opportunity from a top-down perspective. We look at the development of life insurance globally at different income levels and try to estimate China's development path by city tier. Our conservative forecasts point to a penetration rate of 4% by 2030, which implies a GWP of >US$1trn by 2030 and a CAGR of 9% in the next decade. While this may be lower than our previous industry projections due to GDP growth slowing down amid the recent Covid disruptions, this growth is still attractive vs many other sectors and would support - we estimate - low double-digit growth for high-quality names who could consolidate their market share.

According to Morgan Stanley's China Economics team, China's GDP, while adjusting to a more sustainable rate of growth, should still average ~4% through the end of this decade, getting close to Rmb190trn by 2030. China is well on track to attaining per-capita GDP of US$20,000 by 2030, according to MS forecasts (~US$12.6k in 2021).

**Tier 1 cities - solid growth should continue.** Tier 1 cities in China include Beijing, Shanghai, Guangzhou and Shenzhen and represent the most developed economies in China. Tier 1 cities reached per capita GDP of US$27K in 2021, already 2x China's overall average levels. These four cities accounted for 6% of China's population, 13% of its GDP and 17% of its life insurance GWP as of 2021, based on data from the National Bureau of Statistics. According to Morgan Stanley's China Economics team, per capita GDP in tier 1 cities could reach close to US$40K by 2030, double again from its current level. This is similar to neighboring regions, Japan and Hong Kong today. If we assume life penetration could increase to levels seen in these advanced economies over time from the current 3.9% to 5.5% by 2030, this could mean a continued 7% CAGR in these markets in the next decade. While this is slower than the CAGR of 11% in the past decade, it is still solid and stronger than growth from most other comparable countries. Tier 1 cities will remain important markets for China going forward.

**Tier 2 cities - could see the greatest uplift in the next decade.** Tier 2 cities (and new tier 1 cities) include over 45 cities in China, and are mostly capital cities or based in coastal areas. Tier 2 cities have shown the most rapid economic development in past decades, with rising GDP contribution (~40% of China's total in 2021) and per capita GDP (US$17k in 2021). Penetration also improved substantially from 1.9% in 2011 to 3.2% in 2021. In the next decade, if these cities continue to experience strong development, they could see conspicuous income improvement, with GDP per capita reaching new highs of US$29K (CAGR of 6.3% between 2021-30e), exceeding the current levels in Beijing and Shanghai. If we assume life penetration follows suit (reaching ~4.4% in 10 years), GWP could reach ~Rmb3.5trn and represent ~50% of the total market in 2030.

**Low-tier cities - becoming addressable for commercial insurance.** Tier 3 and tier 4 cities (160 cities in total) house China's largest population (653mn residents, 46% of the national total) and its GDP per capita is already close to US$10K as of 2021 getting close to the inflection point for insurance demand. We believe these cities are receiving increased attention by commercial insurers and will see accelerated development in the next decade. We note that tier 5

**Exhibit 48:** Insurance market - key metrics

| Rmb bn | T1 | NT1 | T2 | T3 | T4 | T5 | Total |
|---|---|---|---|---|---|---|---|
| Total population (in millions) | 83 | 200 | 219 | 367 | 286 | 258 | 1,413 |
| Number of cities | 4 | 15 | 30 | 70 | 90 | 131 | 340 |
| Average population (in millions) | 20.8 | 13.3 | 7.3 | 5.2 | 3.2 | 2.0 | 4.2 |
| GDP per capita (US$) | 26,731 | 18,022 | 15,448 | 10,522 | 9,585 | 7,958 | 12,647 |
| Insurance penetration (%) | 3.9 | 3.4 | 2.9 | 2.5 | 2.6 | 2.1 | 2.9 |
| GDP per capita CAGR (21-30) % | 4.4 | 6.2 | 6.4 | 5.2 | 4.6 | 3.0 | 5.6 |
| 2030E GDP per capita (US$) | 39,400 | 30,844 | 26,988 | 16,580 | 14,311 | 10,423 | 20,656 |

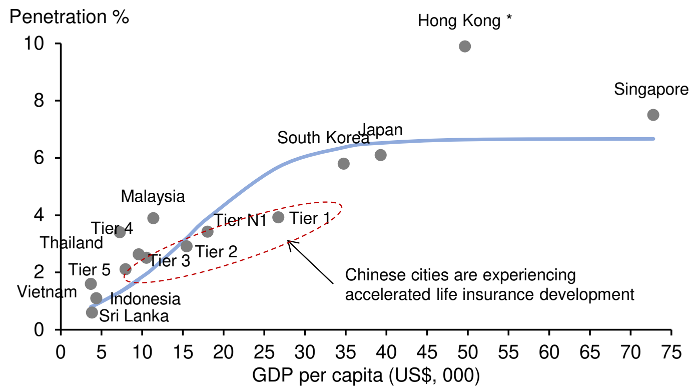
*2021 GWP data includes Health and A&H insurance sold by P&C

Source: Historical data is as of 2021. **Projected urban household per capita income growth, 2020-30 CAGR. Source: China Insurance Yearbook, CEIC, Morgan Stanley Research estimates cities (~11% of GDP and 18% of the population) will likely need time to develop (GDP per capita reaching US$10K in 10 years) and may need to continue relying on government and inclusive products for its residents.

Overall, we expect over Rmb7trn in GWP (over US$1trn) by 2030 for China's life insurance market, with an overall CAGR of 9%, mostly driven by growth from tier 2 cities (contributing ~50% of the incremental market).

**Bear/Bull case range** US$0.9trn-1.6trn: We assume no penetration increase in our bear case with a flattish 3% into the future despite China's income growth. We estimate life insurance will grow in-line with nominal GDP in China at a 6% CAGR in the next 10 years, with GWP reaching US$0.9trn in 2030. In our bull case, we assume a higher penetration of 5.5%, to reflect a more evident household wealth shift from property / savings to long-term insurance assets due to China's rapidly aging population and increasing government support in the sector; our bull case is US$1.6trn GWP.

**Exhibit 49:** S-curve for penetration in selected insurance markets in 2021




* Hong Kong's penetration is based on local business only

Source: Swiss Re, Morgan Stanley Research

**Exhibit 50:** Premium projection by tier cities

| Rmb bn | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E | 2028E | 2029E | 2030E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **# of population (mn)** | 1,412 | 1,413 | 1,413 | 1,412 | 1,412 | 1,411 | 1,410 | 1,409 | 1,407 | 1,405 | 1,402 |
| **GDP** | 101,969 | 114,367 | 121,229 | 130,564 | 138,920 | 146,977 | 155,208 | 163,434 | 171,769 | 180,014 | 188,294 |
| **Real growth y-y %** | 2.3 | 8.1 | 2.8 | 5.2 | 4.3 | 4.0 | 3.8 | 3.6 | 3.4 | 3.2 | 3.1 |
| **Deflator %** | 0.7 | 4.4 | 3.1 | 2.4 | 2.0 | 1.8 | 1.7 | 1.7 | 1.6 | 1.6 | 1.5 |
| | | | | | | | | | | | |
| **GDP mix %** | | | | | | | | | | | |
| Tier 1 | 13 | 13 | 13 | 12 | 12 | 12 | 12 | 11 | 11 | 11 | 10 |
| Tier 2 | 40 | 39 | 39 | 40 | 40 | 40 | 41 | 41 | 41 | 41 | 42 |
| Tier 3 and below | 47 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 |
| **Total** | **100** | **100** | **100** | **100** | **100** | **100** | **100** | **100** | **100** | **100** | **100** |
| | | | | | | | | | | | |
| **GDP per capita (US$)** | | | | | | | | | | | |
| Tier 1 | 22,247 | 26,731 | 26,297 | 29,804 | 31,017 | 32,278 | 33,591 | 34,958 | 36,380 | 37,860 | 39,400 |
| Tier 2 | 13,871 | 16,676 | 16,560 | 18,946 | 20,105 | 21,335 | 22,641 | 24,026 | 25,496 | 27,056 | 28,712 |
| Tier 3 and below | 7,720 | 9,503 | 9,304 | 10,495 | 11,081 | 11,699 | 12,352 | 13,041 | 13,769 | 14,537 | 15,348 |
| **Overall China** | **10,465** | **12,650** | **12,348** | **14,222** | **15,137** | **16,024** | **16,935** | **17,851** | **18,784** | **19,715** | **20,656** |
| | | | | | | | | | | | |
| **Penetration %** | | | | | | | | | | | |
| Tier 1 | 4.1 | 3.9 | 4.0 | 4.2 | 4.4 | 4.6 | 4.8 | 5.0 | 5.1 | 5.3 | 5.5 |
| Tier 2 * | 3.3 | 3.2 | 3.3 | 3.4 | 3.6 | 3.7 | 3.8 | 4.0 | 4.1 | 4.3 | 4.4 |
| Tier 3 and below | 2.6 | 2.5 | 2.5 | 2.6 | 2.7 | 2.8 | 2.9 | 3.0 | 3.1 | 3.2 | 3.3 |
| **Overall China** | **3.1** | **2.9** | **3.0** | **3.1** | **3.3** | **3.4** | **3.5** | **3.6** | **3.7** | **3.9** | **4.0** |
| | | | | | | | | | | | |
| Tier 1 | 539 | 573 | 621 | 683 | 740 | 795 | 851 | 906 | 961 | 1,015 | 1,067 |
| Tier 2 | 1,359 | 1,405 | 1,567 | 1,772 | 1,977 | 2,189 | 2,417 | 2,656 | 2,910 | 3,176 | 3,455 |
| Tier 3 and below | 1,268 | 1,345 | 1,481 | 1,654 | 1,823 | 1,995 | 2,177 | 2,367 | 2,565 | 2,770 | 2,983 |
| **Total life premium** | **3,167** | **3,323** | **3,669** | **4,109** | **4,540** | **4,980** | **5,445** | **5,929** | **6,437** | **6,960** | **7,504** |
| **Premium @ 6.5 (US$bn)** | **459** | **519** | **564** | **632** | **698** | **766** | **838** | **912** | **990** | **1,071** | **1,154** |

*2021 GWP data includes Health and A&H insurance sold by P&C

Source: China Insurance Year Book, Morgan Stanley Research, E= Morgan Stanley Research estimates

**Exhibit 51:** Projections for bull and bear cases

| US$ bn | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E | 2028E | 2029E | 2030E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Base case** | | | | | | | | | | | |
| **Penetration** | 3.1 | 2.9 | 3.0 | 3.1 | 3.3 | 3.4 | 3.5 | 3.6 | 3.7 | 3.9 | 4.0 |
| **Premium @ 6.5** | **459** | **519** | **564** | **632** | **698** | **766** | **838** | **912** | **990** | **1,071** | **1,154** |
| | | | | | | | | | | | |
| **Bull case** | | | | | | | | | | | |
| **Penetration** | 3.1 | 2.9 | 3.2 | 3.5 | 3.8 | 4.0 | 4.3 | 4.6 | 4.9 | 5.2 | 5.5 |
| **Premium @ 6.5** | **459** | **519** | **596** | **699** | **804** | **915** | **1,033** | **1,158** | **1,290** | **1,428** | **1,593** |
| | | | | | | | | | | | |
| **Bear case** | | | | | | | | | | | |
| **Penetration** | 3.1 | 2.9 | 2.9 | 2.9 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.1 |
| **Premium @ 6.5** | **459** | **519** | **546** | **592** | **633** | **674** | **714** | **755** | **797** | **838** | **898** |

Source: Morgan Stanley Research, E= Morgan Stanley Research estimates

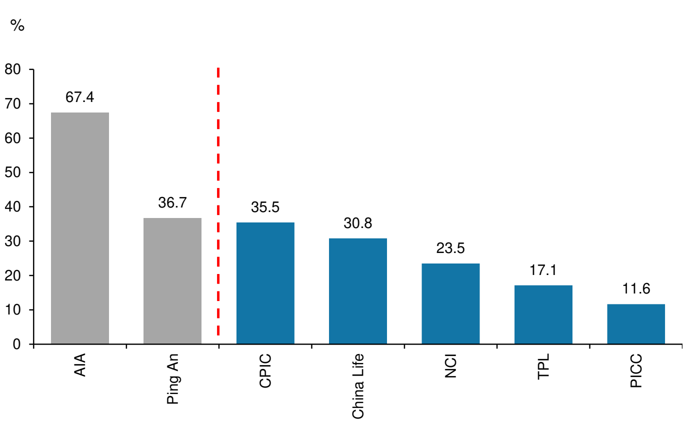
# Companies Adopt Different Strategies as the Welfare Industry Expands

**Private insurers will likely continue to focus on high end business with better margin.** Exhibit 53 shows that private insurers manage more assets than SOE insurers on a per-policy basis (Rmb20k for AIA, Rmb21k for Ping An, Rmb6k for CPIC and Rmb8k for China Life), indicating a higher-end customer profile. This could be due to differences in geographical presence, where private insurers invest more in high-tier cities. This customer segment tends to be more lucrative, but also demands better quality and a more comprehensive service. As private insurers continue to upgrade their distribution, expand their own care networks and invest more in technology to enhance customer experiences, their business models could become increasingly tailored to high-end customers.

**SOEs may change gear and engage in more inclusive business practices going forward.** SOEs currently engage in a product strategy similar to what private insurers are using - China Life's agency margin was similar to Ping An's at ~30-40% in 1H21. However, we see a possibility that SOEs will increase product and service supply for mass / low income segments in the future to support the government's initiative to reduce inequality. While this could mean a potential reduction in product margin, it may not necessarily imply pressure on earnings growth given SOEs can access a larger market with this strategy. Sometimes SOEs can even obtain more government resources / subsidies to cushion the margin downside. The segment also represents the largest client base in China and could have long-term cross-selling potential if managed well.

**Volume or margin - which one is better?** As private and SOE insurers gradually grow apart, we see pros and cons for both business models - SOE insurers could have access to a large number of customers via growing government programs; they will likely continue to have conservative balance sheets and dominant market shares. Capital returns could be low but earnings growth could be easier and more visible - we think China Life could still be a good low risk compounder in the next decade. By contrast, private insurers will still need to make large investments and deep reforms to meet rising expectations from more affluent Chinese families. These high margin segments are attractive businesses but they remain competitive. The ecosystem model with comprehensive in-house, health and wealth services also need large balance sheets to support investments with long pay-back periods - we see AIA, Ping An and CPIC have a better chance to excel in this new operating environment.

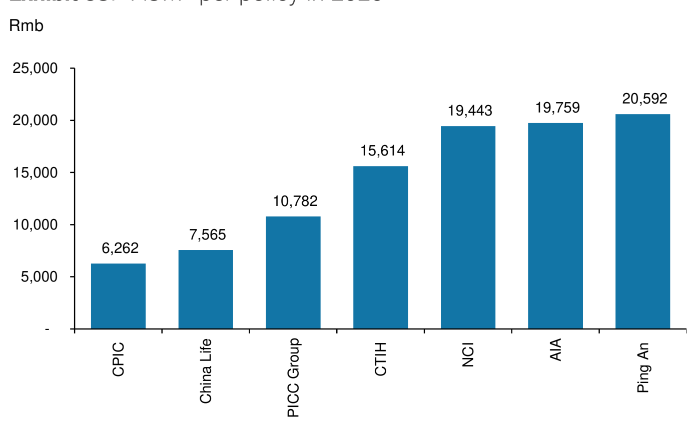
**Exhibit 52:** New business margin in agency channel by company in 1H22




AIA is based on overall VNB/APE margin in 1H22

Source: Company data, Morgan Stanley Research

**Exhibit 53:** AUM* per policy in 2020




*AUM per policy is approximated by Reserves/In force policy numbers

Source: Company data, China Insurance Yearbook, Morgan Stanley Research

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|---|---|---|---|---|---|---|---|
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| Overweight/Buy | 1342 | 38% | 295 | 41% | 22% | 590 | 39% |
| Equal-weight/Hold | 1582 | 45% | 335 | 47% | 21% | 702 | 46% |
| Not-Rated/Hold | 0 | 0% | 0 | 0% | 0% | 0 | 0% |
| Underweight/Sell | 610 | 17% | 84 | 12% | 14% | 219 | 14% |
| Total | 3,534 | | 714 | | | 1511 | |

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## INDUSTRY COVERAGE: Hong Kong/China Insurance

| COMPANY (TICKER) | RATING (AS OF) | PRICE* (10/13/2022) |
|---|---|---|
| **Jenny Jiang, CFA** | | |
| China Life Insurance (601628.SS) | U (05/27/2015) | Rmb32.43 |
| China Life Insurance (2628.HK) | E (02/25/2019) | HK$9.68 |
| China Pacific Insurance (Group) Co., Ltd (601601.SS) | E (07/25/2018) | Rmb20.69 |
| China Pacific Insurance (Group) Co., Ltd (2601.HK) | O (05/27/2015) | HK$14.00 |
| China Reinsurance Group (1508.HK) | U (09/13/2018) | HK$0.45 |
| China Taiping Insurance (0966.HK) | O (07/27/2022) | HK$6.01 |
| Fosun International Ltd (0656.HK) | O (09/28/2020) | HK$4.78 |
| New China Life Insurance Company Ltd (601336.SS) | U (12/13/2014) | Rmb27.43 |
| New China Life Insurance Company Ltd (1336.HK) | U (04/08/2020) | HK$14.22 |
| PICC Group (1339.HK) | O (04/08/2020) | HK$2.26 |
| PICC Group (601319.SS) | U (04/03/2019) | Rmb5.15 |
| PICC P&C Company Ltd (2328.HK) | O (05/19/2016) | HK$8.21 |
| Ping An Insurance Company (2318.HK) | O (05/27/2015) | HK$38.00 |
| Ping An Insurance Company (601318.SS) | O (05/27/2015) | Rmb41.36 |
| Waterdrop Inc. (WDH.N) | O (09/16/2022) | US$1.07 |
| ZhongAn Online P & C Insurance Co Ltd (6060.HK) | O (07/27/2022) | HK$16.60 |

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* Historical prices are not split adjusted.

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