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THE ROAD TO CHINA-- AN ANALYSIS OF INSURANCE ENVIRONMENT OF CHINA FOR FOREIGN INSURERS

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ABSTRACT

Insurance markets are becoming increasingly international as insurers expand their client base by branching out and offering products in new foreign markets. As these insurers enter foreign markets, it becomes extremely important for them to understand the local nuances of the markets in which they will be doing business. The aim of this paper is to examine the insurance environment of China in order to provide an analysis for foreign insurers entering this market. The paper explores essential considerations that insurers must bear in mind. These issues include the Chinese economy at large, an overview of China's insurance industry competitive landscape, a history of China's insurance industry, and an overview of the regulatory environment.

Keywords: Insurance
China

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Chapter 1

Introduction

More than any other time in history, people today around the globe are increasingly connected to one another. The flow of information, goods, services, and financial resources to and from different parts of the world is even more rapid. This phenomenon is known as globalization. Globalization impacts almost all industries, and the insurance industry has also flown with the general trend towards globalized markets. This general trend has been evident in the fact that, in recent years, there has clearly been more rapid growth in global trade, direct investments and portfolio investments than in the production of goods and services. In recent years there has also been a strong increase in the demand for insurance in the emerging markets. Removal of regulatory barriers to market entry, consolidation in the insurance markets on account of increased capital, and general economic growth will provide insurers with new business opportunities. Clearly insurance markets are no longer confined to the borders of the country where they are domiciled; in fact quite the opposite, insurance markets are becoming increasingly international. Insurers are branching out and offering products in new foreign markets, especially the emerging markets to expand their client base and grow their market share.

As the insurers enter foreign markets, it becomes extremely important for them to understand the specifics of the new markets in which they will be doing business. The aim of this paper is to examine the insurance environment of a country outside of the United States, namely China. With huge economies and population size, coupled with fast industrialization and globalization, China is arguably the most challenging and promising emerging insurance market, will be among the world's economic locomotives in the coming decade and should spell ample opportunities for the development of insurance. The paper should be able to provide a clear analysis for foreign insurers interested in this market to spot future trends, development opportunities, risks and alternatives.

Chapter 2

Hypotheses

In order to spot future trends, development opportunities, risks and alternatives for foreign insurers interested in China's insurance industry, the paper looks at the industry's history, growth potential of the overall market, importance of the insurance industry in economic growth, competitive landscape, and most importantly, fairness of the regulations.

Hypothesis

I examine three hypotheses in this thesis.

1. The first hypothesis states that a healthy insurance industry is a necessary component supporting the economic growth of an emerging economy.
2. The second hypothesis states that the Chinese insurance market is growing in

terms of premium volume.

3. The third hypothesis states the market is moving toward a freer one and more government supporting policies are consistent with the fair trade percepts, which includes market access, non-discrimination, and transparency.

Related Concepts

Market access means the right of a foreign firm to enter a country's market. Access can be via establishment or cross-border, with the mode of access giving rise to different public policy considerations. (Skipper & Kwon, 2007)

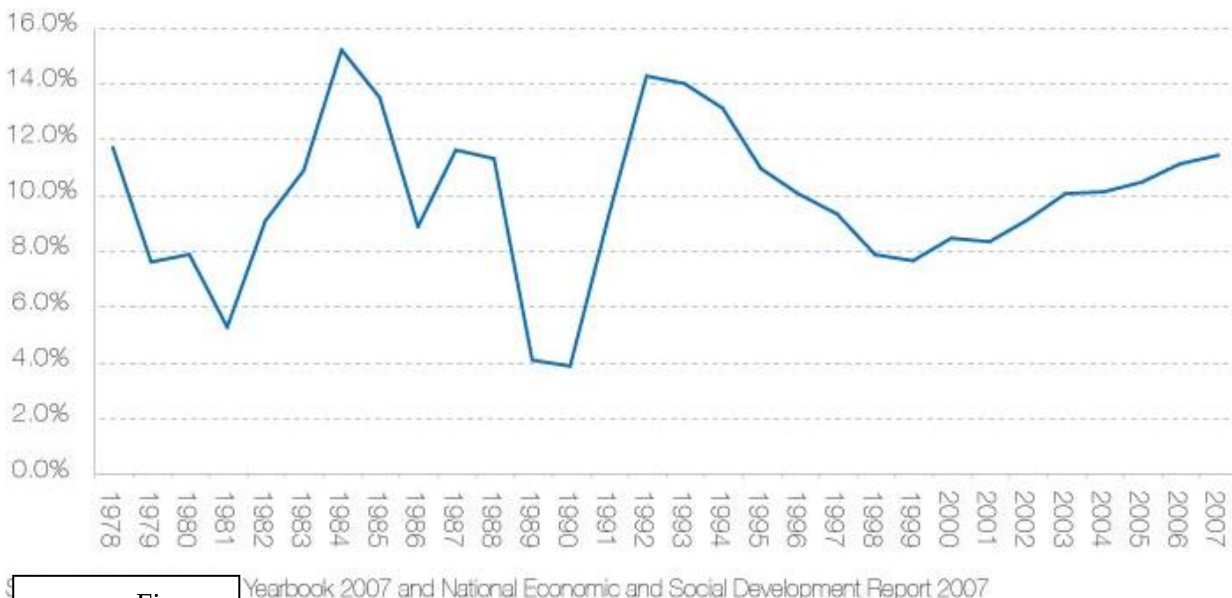
Non-discrimination means that no country's firms obtain better market access than any other country's firms do. Thus, a most-favored-nation trading partner's businesses enjoy the best possible—that is, the most favorable—market access. (Skipper & Kwon, 2007)

Transparency requires that regulatory and other legal requirements regarding market access and domestic operation should be clearly set out and easily available. (Skipper & Kwon, 2007)

Chapter 3

The Chinese Economy

As the largest country in Asia, with respect to area, gross domestic product (GDP) and populations, China stands as a crucial market in this part of the world. In addition, China is one of the ten biggest economies in the world, based on GDP. The Chinese Economic Reform that started in late 1978 even turned China into the fastest growing major economy in the world. In 2007, China's GDP registered an 11.4% growth, a 13-year high, to reach RMB 24.66 trillion (US$3.24 trillion) as seen in Figure 1. (National Bureau of Statistics of China, 2007)



Figure

In 2006, China also ranked as the fourth largest economy in the world, with figures amounting to only approximately 2% less than Germany as seen in Table 1. (The World Bank Group, 2006)

World's Top 10 Biggest Economies

Ranking	Country	GDP (US$ trillion)	World share
1	US	13.2	27.4%
2	Japan	4.34	9.0%
3	Grmany	2.91	6.0%
4	China	2.67	5.5%
5	UK	2.35	4.9%
6	France	2.23	4.7%
7	Italy	1.84	3.8%
8	Canada	1.25	2.6%
9	Spain	1.22	2.5%
10	Brazil	1.09	2.3%

Source: World Bank

Table 1

Two years later, China replaced Germany as the world's third largest economy. In terms of GDP per capita, China exceeded US$1,000 for the first time in 2003. After a mere four-year period, China more than doubled its GDP per capita to US$2,455 in 2007. Although this figure is still far behind the world's developed countries, it is a respectable achievement for a nation with such a huge population of 1,338,612,968. Such a population not only makes China the most populous country in the world but also presents one overall measure of the potential impact of the country within its region and on the world – especially as a country where the majority of its people lived below the poverty line only three decades ago.

Chapter 4

Overview of China's Insurance Industry

Historical Timeline of the Industry

When People's Republic of China was founded in **1949**, the People's Insurance Company of China was formed by the newly organized government and authorized to handle all forms of insurance, including all insurance relating to foreign trade and foreign insurance operations. Although private Chinese and foreign players continued to hold pieces of the market, PICC controlled 70% of premiums by 1950 and continued to dominate the market until the late 1960s. Starting in **1966**, the Cultural Revolution put a stop to most domestic insurance activities for approximately a decade.

When the market resumed in **1978,** as Deng Xiaoping initiated economic reforms and open door policies, PICC re-established itself and assumed sole leadership of the industry.

From the **mid 80s to early 90s**, PICC's monopoly was challenged as three new Chinese companies entered the domestic market. And in **1992**, the American Insurance Assurance Co., an AIG subsidiary, won the right to open a branch in Shanghai to sell individual life and property insurance, making it the first ever foreign player to enter the Chinese insurance market since the formation of the PRC. AIG later reoccupied its original building on the Shanghai Bund and expanded its business to include Guangzhou and then Shenzhen. Only three years later, in **1995**, the insurance market in China had grown to 100 times its 1980 size, measured by premium volume. In 1995 alone, more than 100 million people bought property coverage.

In **1998**, the China Insurance Regulatory Commission (CIRC) was established to regulate the industry and ensure that it met China's obligations as a new member of the World Trade Organization (WTO). And since then, CIRC has grown to a nation-wide network of 33 branches overseeing China's rapidly modernizing insurance industry.

It was notable that from 1992 to 2000, China gradually approved the entry of 16 additional leading foreign insurers.

In **2003**, innovation was made when a market-oriented premium rate reform system was launched based on several months of trial operations, and the Chinese insurance market began to expand even more rapidly. Development of the system provoked the needs of actuarial tools, therefore, developed foreign actuarial models and talents are in need.

In **2007**, A truly market-based system was taking its first steps, with eight insurance groups, 62 Chinese and 43 foreign companies doing business in the PRC.

For the majority of the period since the communists took power, the Chinese people have been looked after by the state. The “work-unit” provided for all individuals’ requirements and looked after them into their old age. Free healthcare meant that health insurance was unheard of. Even though the “work-unit” culture has now largely disappeared, the market in insurance has been limited by the Chinese saving culture (reducing need for insurance because of large savings stockpiles) and the high cost of education and housing. However, a turning point occurred in 2006 when the Eleventh Five-Year plan stipulated a need to directly promote the establishment of a stronger insurance industry. China has called on the insurance industry to plan a critical role in the nation’s social and economic development during the plan and beyond by enabling people to insure their lives, health and property and by investing insurance funds in infrastructure and other projects. Furthermore, problems of speed, efficiency, transparency and regulation have been generally addressed in the interest of protecting consumers in China and sustaining a healthy and rapid development of the insurance industry.

Importance of the Insurance Industry

Here, the first hypothesis, which states that the insurance industry supports the economic growth is discussed.

The insurance industry plays a number of important roles in China's modern economy. Enterprises need insurance to protect themselves against risks such as business failure, and fire and natural disasters. Individuals also require insurance services in areas such as health care, life, property and pension. The insurance industry also provides crucial financial intermediary services, transferring funds from the insured to capital investment, a critical need for China's on-going economic expansion.

As we can see, as China has transformed its economy from a centrally planned to a market-oriented one, initiation and development of insurance service industries have been necessary to support continued economic transformation. Foreign insurance companies have been invited by the Chinese government to play an increasingly important, though carefully restricted, role in China's economic modernization. At the same time, many reforms require a sound and efficient insurance service industry, and success of these reforms is a prerequisite for China's social stability, which is a necessary political condition for sustaining China's economic growth.

Because insurance is such a strategic industry, the Chinese government on the one hand has opened the insurance industry to foreign investment and assistance. On the other hand, it has carefully regulated the speed and scope of foreign involvement in order to protect China's still nascent domestic insurance industry and to match insurance industry growth with society's demand for insurance services.

As we can see, insurance supports China's economic growth by helping to stabilize the financial situation of individuals, families and organizations.

Growth Potential

The second hypothesis, which states that the Chinese insurance market is growing in terms of premium volume is discussed here.

Foreigners have been motivated to enter China's insurance industry by their desire to participate in the largest potential insurance market in the world.

In 1980, when the insurance market was first reopened as part of the post-1979 financial reforms, insurance premiums totaled only RMB 640 million (US$ 77.4 million). Beginning in 1980, China's insurance market grew at an average rate of 26%, reaching RMB159 billion (US$19.2 billion) by the year 2000, a 249 fold increase. The growth rate of insurance premiums slowed to about 12% per year for the next 5 years, but still reaching RMB 280 billion (US$33.7 billion) by the year 2005.

Even with the impressive current growth rate, China's insurance market is still small compared with other foreign insurance markets. For example, the Chinese insurance density (premiums per capita) was RMB127 (US$15.30) in 2000 while the world average was US$ 360. The market penetration (percentage of premiums in GDP) was about 1% of China's GDP, compared with world levels of 6-7%. Another measure of the current small size of China's insurance market is that its total assets are RMB337.4 billion (US$ 40.7 billion), while an international medium-sized insurance company has assets of over US$ 100 billion.

China's market was also small compared with other developing countries. For example, in 1996, Chinese per capita spending on insurance was US$ 7.64 compared with Thailand, US$30.

Given that China's economy has grown at about 8% per year since 1979, even surviving the Asian financial crisis, most foreign investors, including those in the insurance sector, do not want to be left out of the most rapidly expanding and largest potential insurance market in the world.

In the paper "The Chinese Insurance Market Estimating its Long-Term Growth and Size," Zheng, Liu and Dickinson used ''world insurance growth curve'' in conjunction with estimates of China's future GDP growth to estimate the growth and size of China's insurance industry for the period 2006– 2020. There are clearly other factors – social, political, cultural, demographic, and market structure – that also have an impact, but other empirical studies have shown that the key factor in the long term is growth and development of the overall economy.

A large amount of historical data is used to estimate the ''world insurance growth curve''. Following that, the authors outline the assumptions made about China's GDP, BRIP, price index and exchange rate. Eventually, based on the world insurance growth curve, and data on China's national economy and China's insurance industry, the authors calculated the mid- and long-term (2006–2020) growth potential for China's insurance industry under the approach of ''Market Exchange Rate''. Combining the ''Market

Exchange Rate'' method as well as the ''Purchasing Power Parity (PPP)'' method, the authors made a modification to the previous calculation. Finally, the size of China's insurance industry by 2020 was estimated. (Zheng, Liu, & Dickinson, 2008)

The authors showed that if China's GDP grows over that period at a rate of 6–9 percent per year, the possible range of China's insurance industry growth rate would be 7.7–17.9 percent, with a more likely range of 9.8–14.8 percent. In the median scenario, the average annual real growth rate for China's insurance industry during the period 2006–2020 would be 12.3 percent. Thus, by the year 2020, the size of China's insurance market would be 5.7 times of that of 2005, and the overall insurance penetration would be 5.6 percent, with 4 percent for life insurance and 1.6 percent for non-life insurance. The growth rate of China's insurance industry during the period 2006–2020 would be almost double the world average and by 2020, China's share of the world insurance market would be about 4.0 percent. All of these statistics will support my writing. (Zheng, Liu, & Dickinson, 2008)

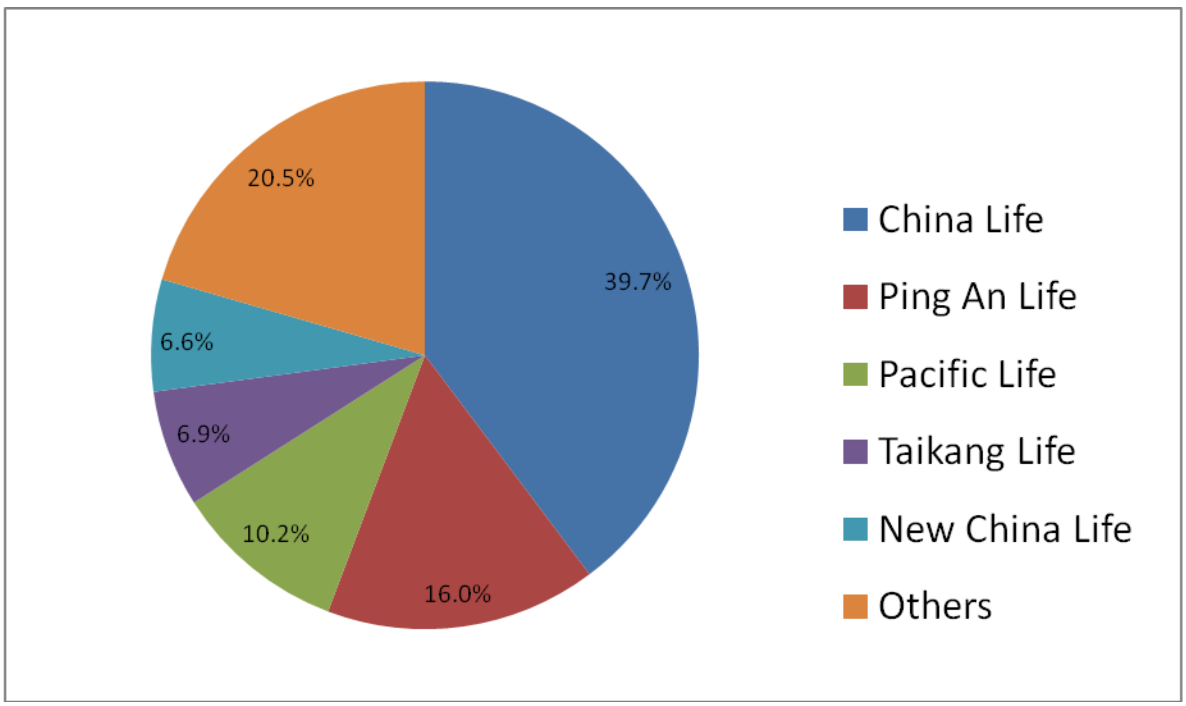
The authors also mentioned the difference of opinion among economists regarding the medium- and long-term growth potential of China's insurance industry. According to many, China's insurance industry has tremendous growth potential and as a result has witnessed an influx of international insurances companies. On the other hand, growth data mentioned above have suggested a decline in the growth rate of China's insurance industry, accompanied by a sharp increase in market competition.

In general, we can conclude that Chinese insurance market is growing in the long term as the overall economy grows.

Major Domestic Players

At a company level, China Life Insurance Co., Ltd. is the biggest life insurer. In 2007, it accounted for 39.7% of the life insurance market. Together with life insurance retained by China Life Insurance Group, China Life Insurance accounted for a 43.9% market share in China's life insurance businesses. Ping An Life Insurance is the second largest life insurer in China. In 2007, it accounted for 16.0% of total gross premiums written, while China Pacific Life Insurance ranked third with a market share of 10.2%. See Figure 2.

Market Shares of Life Insurers in



Source: China Insurance Regulatory Commission

Figure 2

Foreign Insurers in China

As one of the most liberated industries in the service sector, foreign insurers have been playing an increasingly important role in China's insurance market but there is still a long way to go for them. Foreign insurers discussed in this section include foreign-owned enterprises, foreign-invested enterprises, and joint ventures. Currently, foreign life insurers score better than their non-life counterparts. In March 2005, Generali China Life, the first Sino-foreign joint venture insurance company established after China's entry to WTO, caught the world's attention by securing a RMB 20 billion deal with China National Petroleum Corporation (CNPC) to provide group life insurance to CNPC's 390,000 retirees. This single deal increased the market share of foreign life insurers from 2.7% at the end of February 2005 to 20% by the end of March 2005.

However, the RMB 20 billion deal was just a one-off event and CNPC, being its Chinese partner in a joint venture life insurance company, could be a possible reason why Generali China Life Insurance was able to secure the deal.

In contrast, AIA, the life insurance arm of AIG in China, is a better benchmark of foreign life insurers' influence in the industry. In 2007, it raked in RMB 8.9 billion worth of premiums, ranking eighth among all life insurers and first among foreign life insurers. AIA was the only foreign life insurer among the top 10 life insurers. See Table 2.

Top Five Foreign Life Insurers in

Ranking	Company	Premiums (RMB billion)	Market Share
1	AIA	8.9	1.8%
2	Aviva-COFCO Life	3.54	0.7%
3	Generali China Life	3.3	0.7%
4	CITIC-Prudential Life	3.01	0.6%
5	Allianz China Life	3	0.6%

Table 2

Source: China Insurance Regulatory Commission

Note: AIA's relative success in China is due to its long presence in the country. It started life insurance operations in Shanghai in 1992 and had entered other cities prior to that. As such, the pace of AIA's expansion in China is a much more valid benchmark to gauge the growth of foreign insurers.

Foreign life insurers accounted for 8.0% of China's life insurance market in 2007 as compared to only 2.6% in 2004, while foreign non-life insurers only accounted for 1.2% of China's non-life market share in 2007 - a figure that remains unchanged when compared to 2004.

With a lower possibility of competing with Chinese companies in terms of networks, many foreign life insurance companies are adopting a geography-focused strategy.

Currently, Shanghai, Guangdong and Beijing, as the regions open earliest to foreign insurers, are the three most important markets for foreign insurance companies. In 2007, the three markets accounted for 78.7% of total foreign life insurance premiums written and 93.4% of total foreign non-life insurance businesses. Their strategy has provided them with a much stronger presence in these key markets. For example, in 2007, the market shares of foreign life insurers and foreign non-life insurers were 29.8% and 12.0% respectively in Shanghai - 3.7 times and 10 times that of the national average respectively.

As the three regional markets are seen to be saturated, some newcomers have begun to venture into China's vast hinterland. Groupama, the second largest insurance company in France, has chosen Chengdu, the capital city of Sichuan, as its headquarters in China. Chengdu is the largest insurance market in Central and Western China as measured by its 2006 gross premiums.

Chengdu has also been chosen as the first expansion site of Haier New York Life, a joint venture between New York Life Insurance Company, the largest mutual life insurance company in the United States, and China's Haier Group. It launched operations in Shanghai in late 2002.

In June 2006, Great Eastern, a Singaporean life insurance company, set up a joint venture life insurance company in China with its headquarters in Chongqing, the second largest insurance market in Central and Western China.

China's insurance sector is still in its development stage. In 2006, while China accounted for 20% of the world's population and 5.4% of the world's economy, it only accounted for 1.9% of the world's insurance market. The future is certainly promising and the low market share of foreign players indicates room for late–comers to the industry. Of course, their success is very much dependent on whether they have done their homework.

Structures of Chinese Insurance Companies

An old Chinese saying says that if you know both yourself and your enemy, you can win numerous battles without jeopardy, so let's now take a look at the domestic competitors.

Despite the booming market, most Chinese insurance managers agree that there is still a lot of work ahead in building the domestic players into strong and solid insurance companies. The biggest problem is that the domestic insurance companies, as with China's state banks and state-owned companies in general, have yet to become truly independent business organizations.

In a scenario that is familiar to observers of the Chinese economy, almost all the Chinese insurance companies are tied to an assortment of government units. For example, according to China and the New World Order by George Gu and William Ratliff, the biggest Chinese insurance company, China Life, which is already a top 500 global company and listed on the New York Stock Exchange, is in fact run by the central government. (Gu & Ratliff, 2006)

Meanwhile, Ping An (Safe Life) Insurance is run by the Shenzhen city government, and Dazhong (Everyone) Insurance is owned by 23 state companies that belong to Shanghai, Zhejiang, and Jiangsu provincial and municipal governments. Another insurer, Yong An(Everlasting Peace) of Xian, has shareholders from numerous large companies in the oil, telecommunications, rail, postal, and other sectors, all of which are under control by the central government. (Gu & Ratliff, 2006)

This type of organizational structure is common for the entire state sector. The biggest state companies are run by the central government, while small and midsize state companies are run by provincial and local governments.

This type of structure means that there are enormous frictions among the various state companies. The companies belonging to the central government certainly get more privileges. For example, in the past, they were allowed to play in national markets, while companies belonging to various provincial and local government units were allowed to operate only in their own areas.

However, Gu and Ratliff's book also pointed out that the insurance sector has some noteworthy exceptions to the general rule. Some insurance companies run by city and province level government units have outperformed. In particular, within the last two decades of its existence, Ping An Insurance has taken the second spot in China's insurance sector. This is mainly due to Ping An Insurance's strong leadership. The company has appointed more than a dozen senior executives who have previously worked for global financial and consulting firms. Under their strong management, the company has been able to attain a dominant position among domestic insurers. (Gu & Ratliff, 2006)

In fact, one regional executive working for a big four global accounting firm has been very impressed by the Ping An management. He said that they are very pro-international and eager to follow global professional standards. This has become a top strength for the company. (Gu & Ratliff, 2006)

Many international investors agree with him. Looking across Ping An's share allocation, some foreign giants like Morgan Stanley, Goldman Sachs, and HSBC has become significant shareholders in the company, which is now listed on the Hong Kong stock exchange. In particular, HSBC has continued to increase its stake in Ping An and now holds 19.9% of the Chinese insurer, a limit set by Beijing for a single foreign shareholder.

Behind this increased foreign interest is a satisfying performance sheet from the Ping An management. In 2005, its sales reached over $8 billion and profits were $530 million, which makes the insurer a top performer in China. (Ping An Insurance Company of China, 2009)

But many other Chinese insurance companies have had lackluster performances so far. In the first half of 2010, premium income of New China Life was RMB 54625 million, PICC Life RMB 45790 million, while the premium income of Ping An reaches RMB 90496 million.

The basic problem is that governmental bureaucracy is heavily integrated in the insurance industry. That is, these companies are organized in parallel to government structures, and their top managers are government officials, not insurance professionals. This bureaucratic establishment has already created disasters for China's banking and brokerage sectors. It is casting a shadow over the insurance industry as well.

Under this bureaucratic environment, numerous Chinese insurers have already suffered tremendous losses despite the rapid growth. Some highly inexperienced and substandard decision makers have involved their firms in high-risk deals such as highly illiquid real estate projects, which predictably resulted in financial distress.

But the chronic problem of separating business and government will not be resolved soon for the insurance sector any more than for China as a whole. The bottom line is again the weakness of the society and the unlimited number of ways in which bureaucratic power can continue to expand.

Foreign insurers can look to bring more efficiency to the current business operation mode.

Industry Survey

During my research, I conducted phone interviews with senior executives with actuarial background of 6 foreign insurance companies that have operations in China, focusing on the strategic and emerging issues surrounding how their companies have expanded activities in China. All of these executives were originally from China, had over 5 years of actuarial experience oversea, and returned to China after year 2000.

A standard questionnaire was used during interviews with these senior executives. Questions include, but not limited to:

1. What’s the biggest disadvantage that China’s insurance industry is facing?
2. What’s most unique about conducting insurance business in China?

3. Where are foreign insurance companies usually located and why?
4. What's the key growth phenomenon of China's insurance industry?

At times, individuals declined to answer particular questions or were unable to provide sufficiently accurate response.

The interviews uncovered that one of the biggest disadvantages the insurance industry facing in China is a short supply of skilled and experienced workforce. Even in major cities, it is difficult to find qualified people to carry out the job for which they are hired. Even though the insurance market comprises 1.815 million staff, accounting for 40% of the total number of employees working in financial enterprises, most insurance companies rely on foreign talents and oversea returnees when it comes to actuarial recruiting.

I found the executives' responses to the question of "what's the most unique about conducting insurance business in China" interesting. All of them mentioned that in China, not just insurance, but any kind of business is done mostly through 'Guan Xi', which means relationships and networking. One of them even said that "Never underestimate 'Guan Xi.'" Foreign insurers do need to be dealing with a person of influence; therefore it might be a good idea to hire local representatives/consultants to monitor deals and relationships. Also, through many years of business experience in China, four of the executives interviewed brought up the point that people do frequently make business deals at the dinner table; for example, in northern China, a common business custom is to conduct business over an evening of dinner and drinking.

All of the senior executives I interviewed work in offices located in the major cities such as Beijing and Shanghai. In fact, foreign insurance companies have mainly focused on the larger coastal cities due to the demand in these areas. Since many people are still living in poverty, insurance is a relatively new concept for Chinese and only around 6% of the population has a clear idea of its benefits. When it comes to the key growth phenomenon in the recent years, the senior executives pointed to the middle-class society, which did not exist before. One of the interviewees also pointed out that, through his observation, China's growth model, due to both size and unequal distribution of wealth, is likely to be sustained for a long time to come. At the same time, as this middle class grows in both the coastal cities and in the second-tier cities further inland, the market for all types of insurance is expected to keep growing.

All senior executives interviewed agreed that China's insurance industry is one such area offering strong growth prospects for western companies willing to get involved in China.

Other Industry Opinions

A PWC report shows that foreign insurers have not yet been able to make inroads into the domestic market, based on interviews with senior executives of 29 foreign life, property, and casualty insurance providers in China. (Liu & Walley, 2009)

Foreign insurers account for a total market share of less than 5 percent of life insurance. The survey estimated that foreign companies' share of the market will increase to 8 percent by 2012, down from the prediction in last year's report that they expected a 10 percent market share to be reached in 2011. (Liu & Walley, 2009)

Chapter 5
Insurance Regulation in China

Now we will move on to an overview of China's insurance regulations, as well as testing the third hypothesis, which states that the Chinese insurance market is moving toward a freer one and more government supporting policies are consistent with the fair trade percepts, which includes market access, non-discrimination, and transparency.

Regulatory Authorities

From 1949 to 1998 the People's Bank of China was the regulatory authority for the insurance industry in China, except between 1952 and 1959, when the Ministry of Finance assumed the role. (Hao, 2009)

In November 1998, the State Council established the China Insurance Regulatory Commission ("CIRC") as the industry's regulator. The rationale was to achieve separate operation and regulation of the banking, securities and insurance industries. CIRC, a ministerial institution directly under the State Council, supervises and manages the insurance market and maintains the legal and stable operation of insurance operations in the country, in accordance with the functions of administrative management authorized by the State Council and relevant laws, rules and regulations. Given the importance of CIRC, we shall discuss different area of regulation by this authority below.

A number of other regulatory authorities are involved in insurance regulation in China. Nearly all government departments and institutions (and their local offices) are in some way linked to the regulation of the industry. The main institutions with a partial involvement in insurance regulation are: the State Administration of Industry and Commerce, which plays a role the registration of companies; the China Banking Regulatory Commission and China Securities Regulatory Commission, particularly in respect of the use of insurance funds; the State Administration of Taxation; the Ministry of Finance and its local offices, particularly in respect of accounting systems and standards; the State Administration of Foreign Exchange; and the Ministry of Labor and Social Security.

Goals of CIRC Regulation

CIRC was initially regarded as a semi-ministerial institution and was upgraded to a ministerial institution in 2003. It has 15 internal departments and a nationwide network of local offices.

According to relevant laws and administrative regulations, the commission's main responsibilities are summarized as follows:

It formulates policies, strategies and plans regarding the development of the insurance industry, drafting provisions and rules on insurance supervision and regulation and establishing guidelines for the management of insurance companies. It examines and approves the establishment of insurance companies and their branches, insurance groups, insurance holding companies and insurance asset management companies in conjunction with other relevant authorities. This task includes: assessing and approving the establishment of representative offices by overseas insurance organizations, including intermediaries such as insurance agencies, brokers, loss adjusters and their branches; examining and approving overseas products in which Chinese insurance and non-insurance organizations invest, and the merger, division, reorganization and dissolution of insurance organizations; and participating in the bankruptcy and liquidation of insurance companies. It examines and certifies the qualifications of senior managers in all insurance-related organizations and establishes the basic qualifications for insurance practitioners. It assesses and approves the clauses and premium rates of statutory insurance products, newly developed life insurance products and insurance products that are relevant to the public interest. This involves accepting for filing the insurance clauses and premium rates of other insurance products. It carries out a market supervision role by: supervising the solvency and market conduct of insurance companies; managing the insurance protection fund; monitoring the insurance guarantee deposits; formulating rules and regulations on insurance fund management on the basis of the Insurance Law and relevant state polices; and supervising insurance fund management. It supervises the business operations of companies involved in statutory insurance or insurance with an impact on public policy, and certain forms of organization and operation, including captive insurance and mutual insurance. It is responsible for the administration of institutions such as the China Insurance Association. It investigates and penalizes irregularities, including unfair competition by insurance organizations and practitioners and direct or disguised engagement in insurance business by unauthorized organizations. It examines information management and internal monitoring by laying down standards for insurance industry information systems; establishing risk assessment, early warning and risk-monitoring systems; and compiling statistics and report forms and disclosing them in accordance with state regulations.

CIRC Subsidiary Departments

CIRC's Subsidiary departments include General Affairs Office, which handles general administrative matters; Development and Reform Department, or Policy Research Office, which formulates development strategies, industrial rules and policies of the insurance industry; Finance and Accounting Department, which formulates implementation rules and procedures of finance and accounting of insurance enterprises and for the supervision in the insurance industry; Life Insurance Supervision Department, which carries out supervision over life insurance companies, formulate rules and regulations of supervision and actuarial systems of life insurance and supervises the asset quality of insurance enterprises and their payment ability; Reinsurance Supervision Department, which functions similarly to those of the Life Insurance Supervision Department, but over reinsurance companies and property and casualty insurance companies; Insurance Intermediaries Supervision Department, which carries out supervision over insurance intermediary institutions; Department of Supervision of Insurance Fund Operations which carries out supervision over insurance fund operations, builds up systems for risk appraisal, pre-warning and supervision of the operation of insurance funds; International Affairs Department, which is in charge of contacts and co-operation between China Insurance Regulatory Commission and relevant international organizations, regulatory institutions and insurance institutions in foreign countries and regions; Laws and Regulations Department, which formulates rules and regulations over insurance supervision; Statistical Information Department, which formulates the statistical system for the insurance industry, sets up and maintains data base for the industry; Agencies Management Department, which formulates rules and regulations for the management and co-ordination of agencies dispatched out by the headquarters of the Commission; Personnel and Education Department, which carries out human resources management functions; Supervision Bureau, which supervises and examines the implementation of governmental laws, rules, regulations and policies in the insurance industry, metes out punishment of any conduct in violation of governmental laws, rules, regulations and disciplines, responds to reports, charges and appeals against targets of supervision and guides disciplinary work in the insurance industry; and Publicity Department, which is in charge of publicity, and the building up of socialist culture and ethics in the insurance industry.

Other Matters of CIRC

CIRC, People's Bank of China, banking and securities regulatory institutions exercise a working system of division of labor based on co-operation, exchange of information and co-ordination of relevant policies.

CIRC sets up regulatory bureaus in the provinces, autonomous regions, municipalities and cities whose economic plans are listed directly under the Central Government and separately from the provinces where they are located. CIRC exercises vertically management of all the agent offices stationed in various localities. (China Insurance Regulatory Commission, 2005)

Significant Regulatory Developments

China's insurance industry has experienced significant changes in the past 20 years. It has gone from being a predominantly closed market in the early 1990s, to one in which foreign insurers now account for more than half of all insurance companies. During this time, market access and regulatory transparency have improved. Other improvements favorable to the industry will also be discussed below.

Market Access

In the recent years, there have been several positive developments in the insurance regulatory environment, especially after China's entry to World Trade

Organization ("WTO"). Relevant agencies have adopted new rules and advanced draft legislation. We shall discuss some of these favorable changes to foreign insurance companies here.

First of all, life insurer entry was allowed. China committed to allow foreign life insurance companies to enter the market through joint ventures subject to a 50% ownership cap as part of its WTO accession agreement in 2001.

Secondly, we saw the removal of the requirements that reinsurance cessions be offered first to domestic reinsurance companies and that CIRC approve overseas reinsurance cessions from the 2009 Newly Amended Insurance Law("The amended Insurance Law"). These two requirements limited reinsurance capital by excluding foreign reinsurers from China's market.

Rise in Regulatory Transparency

Also, there has been rise in regulatory transparency on the part of CIRC and other government departments. Regulations are generally now posted on the website of CIRC or other relevant departments, and often with an invitation for public comments.

Other Improvements

Other improvements include a broadened investment channels for insurance funds and introduction of risk-based supervisory approach**.**

The amended Insurance Law significantly expands the types of investment vehicles in which insurance companies will be allowed to invest their funds. This change will be favorable to both domestic and foreign insurance companies.

Until recently, insurance companies were only allowed to channel their funds into severely restricted investment options, choking off sustainable growth. These restrictions have resulted in a significant proportion of insurance premiums being invested in either Chinese treasury bonds or bank savings. In comparison, in the West, funds are commonly invested in stocks, which generate the returns necessary to cover pay-outs on premiums, as well as costs and profits.

The amended Insurance Law, for the first time, allows insurance companies to use their funds to invest in 'immovable assets' (which is not defined but presumably includes real estate). Investments by insurance companies in bonds, shares and units in securities investment funds are also now permitted. (Dang, 2009)

Besides the amended Insurance Law, the CIRC introduced a risk-based supervisory approach starting in January 2009, which classifies insurers into four groups based on performance indicators in solvency, corporate governance, fund utilization and operations, each resulting in different supervisory actions. Compared to the then existing principle-based supervisory approach, the risk-based approach will more efficiently use regulatory resources and impose less onerous regulatory burden on firms.

The Problem of Inequitable Regulation

Although foreign insurance companies are allowed market entry, their ability to compete fully is hampered by discrimination problems. Evidence has shown that foreigners may not have been treated equally as their domestic competitors.

Insurance competition restrictions, both explicit and implicit, are present in the areas below.

Geographical Barrier

First of all, even though there is no formal regulatory distinction between Chinese-invested and foreign invested insurance companies when it comes to branching in the country, there is evidence of different, sometimes unequal treatment.

A barrier to geographic expansion in the Administrative Measures on Insurance Company Management is the requirement that an insurance company have no record of penalties imposed during the previous two years. According to American Chamber of Commerce in China White Paper, some AmCham-China companies have been penalized for minor infractions and therefore, are prohibited from establishing branches and sub-branches for two years at a time.

In addition, even though the amended Insurance Law provides that the insurance regulatory authority shall examine application to establish a branch and render a decision whether or not to approve within 60 days of the receipt of application material. Qualified foreign insurers experience much longer waits before receiving approval to establish branches. Moreover, while Chinese-invested insurance companies have obtained multiple concurrent branch approvals, many of which were granted in batches within a short period of time, enabling them to rapidly build their networks, foreign insurance companies continue to report that they are told by local and national CIRC officials that multiple branch applications cannot be submitted simultaneously or, if submitted, the applications will not be concurrently reviewed and approved.

Foreign-invested insurance companies also appear to have to go through separate procedures, while Chinese-invested insurance companies are entitled to simpler and faster procedures for the registration of branches and sub-branches.

For example, all their applications must be submitted by their head office and are subject to CIRC approval. By contrast, Chinese-invested insurance company applications can be submitted by branches, and applications only need to be reviewed by local CIRC bureaus instead of CIRC headquarters.

Product Barrier

In addition to geographical barrier, there also exists a product barrier for foreign insurers on the Property and Casualty side.

Currently, foreign insurers are not allowed to write Mandatory Third Party Liability Insurance for Auto ("MTPLIA") coverage. This restriction has blocked foreign firms from China's auto insurance market, which accounts for 70% of the property and casualty market.

MTPLIA actually has received much public attention, many times controversial since its inception in 2006. As MTPLIA moves forward, underwriting losses have arisen in many provincial markets. And the underwriting losses in the auto insurance segment have impacted the overall property and casualty sector.

It might be of the industry and public's best interest to lift the restriction, because by comparison, the US private passenger auto segment has been profitable over the past decade. The profitability is attributable to quality risk control, pricing and data management skills, which are standard practices in mature markets, but have yet to be utilized in China. Therefore, opening MTPLIA will attract foreign companies and encourage them to bring best practices to China to improve the performance of MTPLIA and the auto insurance market as a whole. Such improvements will benefit industry and consumers in the long sun.

Summary

Even though there is still unfairness in China's insurance regulations, we can conclude that China's market is moving toward a freer one, and more government supporting policies are consistent with the fair trade percepts.

Chapter 6

Conclusion

Entering the Market

An advantage that western insurance companies may be able to take advantage of is that the majority of the insurance firms are very large, state owned behemoths which react slowly to market trends.

Finding a correct strategy for entry into the Chinese market is also the key, including decisions such as which city or province, which partners, what type of business presence etc. Foreign insurers do need to know that, instead of "grabbing a piece of the market," they will be more welcomed if they are willing to be "part of the market" and build long-term sustainable business in the country. Once the relative business decisions have been made, introductions can be sought with suitable partners. Again, detail is required. Chinese websites are generally not bilingual, and sometimes do not open in the US. Telephoning potential partners is also haphazard, even in Chinese, with the phrase "I'll just transfer you" commonly being followed by the phone going dead. When selecting partners be sure that they provide a close match, or that there are suitable areas for collaboration.

Also as mentioned earlier, there is a certain etiquette framework to keep in mind when doing business with Chinese. It is very important to acknowledge and understand and respect the key differences between Chinese and Westerners to ensure success. Formality is generally retained longer than in the West – meetings will start with a set introduction to everyone present, exchange of name cards and then a set spiel about the company. Following the meeting, a banquet may well be suggested which will generally involve copious amounts of alcohol, numerous specialty dishes, but will retain an atmosphere of formality and mutual respect – diners are expected to make a quick toast to other diners each time they sip an alcoholic drink. With such differences in business culture, it is essential to have some cultural tuition before departure. If the foreign insurance company does not have Chinese staff, then hiring a Western intermediary to deal with Chinese interactions is often a good solution.

Forward Looking

China's insurance market has maintained steady growth and become the world's sixth largest market. This is partly attributable to positive structural changes, improved market order, better risk control and a progressive legal framework under the direction of the CIRC. Foreign insurers have continued confidence in the commitment to the China market and have increased investment, continued best practices transfers to their China operations and made other developmental contributions to the insurance industry.

However, market access issues continue to limit the scope of foreign insurers' geographical expansion, investment options and product offerings. These barriers continue to deny Chinese consumers and society the full benefits of a robust and competitive insurance industry, preventing individuals from effectively insuring their health and property and companies from more efficiently managing their risk. Although the insurance industry grew 30% from 2007 to 2008, foreign insurers' market share actually shrank from 6% to 4% over the same period.

As insurance plays an increasingly important role in China, all insurance companies, including those with foreign investment, actively contribute. A level playing field is critical, as a fair and open business environment benefits consumers and the long-term interests of the industry.

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- Key projects focused on AG38 statutory reserve requirements for SGUL products
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2009 **China Merchants Futures –** Shenzhen, China
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- Conducted daily fundamental and technical research overview on broad market and individual sectors to support trade idea generation
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