

**Insurance and China's Entry into the WTO**

**by**

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## **Abstract**

Insurance emerged as one of the most hotly debated issues regarding China's entry into the World Trade Organization as a result of both historical precedents and the potential for significant market growth. The new rules for insurance operations in China under the WTO will allow insurers more freedom to enter and operate in this market. This article provides an explanation of the history of insurance operations in China, the role of insurance in the WTO negotiation process and the effect that membership in the WTO will have on insurance operations in China.

## **Introduction**

After 15 years of arduous negotiations between China and the members of the World Trade Organization (WTO), on November 12, 2001, at the Trade Ministerial<sup>1</sup> meeting in Doha, Qatar, trade ministers from 142 member countries at the WTO summit unanimously approved membership for China. China's entry into the WTO occurred after lengthy negotiations in which China had to satisfy its trading partners, most notably the United States and the European Union, that it is doing enough to open its economy to international competition. Triumph at Doha--China's formal membership of the WTO -- is not simply a victory for China but a significant achievement for the entire system of world trade (Economist, 2001c).

## **History of WTO**

International trade has increased rapidly since World War II. Merchandise exports grew on average by 6% annually; total trade in 2000 was 14-times the level of 1950.<sup>2</sup> The substantial growth in commercial services and merchandise trade over the last 20 years is illustrated in Figures 1 and 2. As a means of facilitating international trade, the World Trade Organization was founded in 1995. One of the youngest of the international organizations, the WTO is the

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<sup>1</sup> The Trade Ministerial Meeting is the highest level regular meeting of the WTO, attended by the ministers responsible for trade and commerce of member countries. Generally many important proposals are discussed and agreements are achieved in these meetings.

<sup>2</sup> <http://www.WTO.org>

successor to the General Agreement on Tariffs and Trade (GATT) established in 1947. This Agreement was originally part of a draft charter for an International Trade Organization, the third leg of the Bretton-Woods<sup>3</sup> post-war order, along with the International Monetary Fund<sup>4</sup> and the World Bank<sup>5</sup> (Pillars of Peace (1946)). GATT, which consisted of a large number of negotiated trade concessions and rules of conduct governing world trade, first became effective in January, 1948. The agreement was designed to provide an international forum that encouraged free trade between member states by regulating and reducing tariffs on traded goods and by providing a common mechanism for resolving trade disputes. Most of the rounds of negotiations dealt with reducing tariffs and struggled to produce acceptable rules to govern international trade. Three especially significant rounds were the Kennedy Round (1964-1967), the Tokyo Round (1973-1979) and the Uruguay Round (1986-1994). The Kennedy Round developed agreement on anti-dumping provisions. The Tokyo Round went further, dealing with subsidies and countervailing measures, technical barriers to trade, import licensing procedures, government procurement and other non-tariff areas of concern. The Uruguay Round, the last of held under GATT, led to the creation of the WTO.

The negotiations continued after the end of the Uruguay Round. In February, 1997, agreement was reached regarding telecommunications services, with 69 governments agreeing to wide-ranging liberalization measures that went beyond those agreed in the Uruguay Round. In

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<sup>3</sup> The conference was held at Bretton Woods, New Hampshire, in July 1944, to establish a formal mechanism to foster international trade.

<sup>4</sup> The IMF was founded in 1946 to promote cooperation among countries on issues of monetary policy and to provide a resource to assist countries in need of temporary financial assistance.

<sup>5</sup> The World Bank was initially established to help rebuild Europe after World War II. Current resources are used to provide assistance after natural disasters, wars and developing economies.

the same year 70 members successfully concluded a financial services deal covering more than 95% of trade in banking, insurance, securities and financial information.

With a recent GDP growth rate of 8% per year, China is becoming more competitive in world trade due to its plentiful, inexpensive and skilled labor forces, abundant natural resources, and more open policies toward trade. Past disputes over such issues as the unauthorized use of intellectual property in China and dumping (selling products below the cost of production) have impaired international trade relations. China's entry into the WTO, with rules for fair international trade and formal processes for solving disruptions, should be a source of mutual benefit for both China and its trading partners. However, the structural shifts required by WTO rules are likely to initially cause significant problems for many industries in China before the benefits of increased trade outweigh the costs (American Chamber of Commerce of China, 2001, Economist, 2001b, Chinabiz.org, 2002). Agriculture and state-owned industries, especially, are expected to incur losses as markets in China open up to world trade. However, opening financial markets, including insurance and other risk management services, is likely to provide a benefit to offset the losses in other areas. The mastery of risk was noted by Peter Bernstein as the one factor that separates developed societies from those rooted in the past, those that have not achieved significant economic development (Bernstein, 1996). Developing a modern system of risk sharing by expanding and updating the insurance industry will facilitate China's economic expansion. Modernization of insurance markets can provide an impetus to the country's growth in economic markets that can eventually offset the losses from other areas. The requirements of meeting its commitments to WTO will encourage China's government to expedite political and economic reforms, revise the related legal framework, and develop an open market system where all participants have equal access to the market. With effective and efficient insurance markets available to encourage financial development in all other areas of the

economy, the changes wrought by WTO membership can, eventually, lead to very positive results for the country.

China first applied to join GATT 15 years ago. The application process has been lengthy and difficult, with both sides having serious concerns about the impact of increased trade (Economist, 2001a). China's government expressed concern about the political and economic effects of opening domestic markets to international trade too soon and the international community expressed anxiety over the potential for China to flood markets with low cost goods. Such a long negotiation was described by China's Premier Zhu Rongji as "a negotiation that lasted for a black hair to change into a white one". The key turning point came in November 1999, when the United States and China signed a trade deal that was endorsed, albeit narrowly, by the US Congress.

One sticking point during the whole negotiation process of China's entry into the WTO, and even the final hurdle for reaching an agreement, was related to the insurance industry. The international community placed a high value on expediting the opening of insurance markets in China, including facilitating the license issuing process, eliminating rules on product limitation, and lessening geographical restrictions on operations. Another key issue was the need to provide a balance between the numbers of licenses offered to insurers from the United States and from the European Union, and even among countries within the European Union. These issues turned into the primary stumbling blocks several times during the negotiations, a development which brought the insurance industry to the forefront politically in China. As the Chief Negotiator Representative of China, Long Yongtu, told public media upon the final accession of China's membership, "The insurance industry was always the most difficult

negotiation field in the whole negotiation process. Also, many people, including myself, began to realize the importance of insurance.”<sup>6</sup> In order to understand why insurance played such a key role in the process of China’s entry into the WTO, knowledge of the historical development of the insurance industry in this country is essential.

## **Insurance in China**

The insurance industry emerged as a business in China in the early 1800s. The first insurance institution, *Canton Insurance Society*, was established in 1805 by British and Indian businessmen in south China. Foreign insurers were the only participants in this market until 1865, when the first Chinese insurance company, *Yi He Insurance Company*, was established in Shanghai. Under competitive pressure, *Yi He* did not survive for long. The first Chinese insurance business with a far-reaching influence on the whole industry appeared with the foundation of the *Commercial Bureau of Insurance (Bao Xian Zhao Shan Ju)* in 1875 in Shanghai, a company whose business focused on marine insurance. From 1865 to 1912, 35 Chinese insurance companies were established, which included 27 property and casualty insurance companies and 8 life insurance companies, but by 1914, 26 of these 35 companies had become bankrupt. By then there were 148 foreign insurance companies writing policies in China’s insurance market, either through their own branches or through Chinese agencies (China Insurance Academy, 1998). According to *Chinese Insurance Annual Statistics 1999*, foreign insurers controlled almost 80% of the market at that point. World War I limited the business expansion of foreign insurers, giving Chinese insurers an opportunity to develop. From 1912 to 1925, 39 new Chinese insurance companies were established, mainly in Shanghai. During World War II, insurance companies were used as a speculative financing tool to consolidate capital from many small investors, given the lack of alternative investment options

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<sup>6</sup> <http://www.china-insurance.com/>, WTO-China insurance industry International Conference, November 12, 2001

for small businesses. This led to a period of extended prosperity for the insurance industry. From 1940 to 1943, 97 new Chinese insurance companies were founded in Shanghai. By 1948 the total number of insurance companies rose to 241, which included 178 Chinese insurers and 63 foreign insurers. As the most highly populated and most developed city, Shanghai was the birthplace for China's insurance industry and has always been the main arena for insurance competition. Interestingly, in 1992 Shanghai became the first city in China after the foundation of People's Republic of China in 1949 to open its insurance market to the world.

China's insurance industry then entered a very remarkable period of history, rebounding between the various campaigns to create a new socialist system. In 1949, the People's Insurance Company of China was established by combining some domestic insurance companies and given the monopoly over the whole domestic insurance industry. All foreign insurers were expelled from the country over the next seven years. However, since the "new socialist system" had the goal of providing "cradle-to-grave" social security to all people, insurance was regarded as an unnecessary business. As a result, all insurance operations except international cargo and aviation insurance were abolished at the WuHan national financial meeting of 1958. China's government just kept "PICC" as the company title to all foreign customers, but actually PICC was reorganized and became a small department in the People's Bank of China (PBOC), the central bank of China. The remaining international insurance business was operated by a governmental department, not an independent enterprise. The situation without domestic insurance operations lasted for almost 21 years until Deng Xiaoping<sup>7</sup> initiated the "Reform and Open" policy in 1979 and launched a series of reforms aimed at stimulating economic growth. Restructuring business networks, recruiting new employees, and developing the market occurred over the next three years, until PICC was

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<sup>7</sup> (1904~1997), the most powerful government leader in China in the 1980s.

separated from the PBOC in 1982 as an independent insurance company supervised by the PBOC. The first national insurance meeting, hosted by the PBOC and attended by government officials related to the insurance industry, was also held in 1979. Those two steps symbolized the development of China's "modern" insurance industry. Similar to many other financial institutions in China, PICC was set up as with an administrative organization that corresponded with governmental agencies. It had the corresponding levels of branches to any administrative units, from national level to province level, to city level, even to county level, similar to a government department. This model was built not based on market demand, but on a government administrative model. This structure generated many cost inefficiencies and internal control problems, but it does have the advantage of broad distribution channels which helped it compete with other insurers, especially as foreign insurers enter the market in the post-WTO era.

The monopoly situation of a single market with only one state-owned player was finally broken in 1988 with the establishment of a shareholder owned company, PingAn Insurance Company in Shenzhen, the first special economic district selected by Deng Xiaoping. American International Group (AIG) was the first foreign insurance company to establish operations in China under this new environment. From 1988 to 1996, 18 new shareholder owned insurance companies joined the fast-growing market, including 9 domestic companies and 9 foreign insurance companies, with 4 AIG full ownership branches. The entry of AIG meant that the market that had been closed for 43 years, since 1949, was opened to foreign insurers for the first time, bringing new approaches to providing insurance services. By granting operation permission for AIG, China's government began the opening of its insurance market.



In 1996, PICC was reorganized into a holding company (PICC GROUP) with three completely independent subsidiaries (Property, Life and Reinsurance). The official explanation for such a reorganization was to carry out the requirement of separating life and property business according to the *China Insurance Law*, which had just been promulgated and was effective October 1, 1995. Rigid central control of operations contributed to the failure of this organization through the loss of effective internal control in corporate finance, business operations, and human resource management. Financial connections between the different branches of PICC were hard to disentangle when the companies were separated. Some of the financial relationships among the companies were not settled until the disbandment of the entire PICC GROUP two years later. At the same time, some domestic stock insurers gained the opportunity to develop quickly and gain market share. The establishment of the China Insurance Regulatory Commission (CIRC) in November, 1998, combined with the requirements of WTO negotiations and pressure from the international insurance community, led China's government to expedite the pace of issuing new licenses to foreign insurers. As of early 2002, there are in all 22 licenses for companies in 11 different countries plus 5 branch licenses for AIG and 2 branch licenses for Royal & Sun (UK) and AXA (France). Of these 22 licenses, 7 are for property and casualty insurers and 15 for life insurers. Eight insurers have already started to do business in China, primarily in Shanghai. Of the five American insurers with licenses (Chubb Insurance, John Hancock Mutual Life, Trans america (ARGEON), New York Life, and MetLife), Chubb and John Hancock have already started operating in Shanghai (American Chamber of Commerce of China, 2001). When China was accepted into the WTO in November, 2001, there were a total of 31 insurance companies issuing policies in China's insurance market, including 14 domestic insurers and 17 foreign insurers. The 31 companies consist of 15 property and casualty insurers, 13 life insurers, 1 state-owned re-insurer and 2

comprehensive insurers. The 16 foreign insurers include six branches of AIG and two branches of MingAn (based in Hong Kong). The remaining 13 foreign insurers are preparing to begin operations. (See Table-1)

Since the restructuring of PICC in 1982 and the breakthrough of the monopoly with stock companies (in 1988) and entry of foreign insurers in 1992, China's insurance market has been growing at a phenomenal rate of 10 to 15 percent per year. The combined insurance industry premiums were \$19.27 billion in 2000, an increase of 14.5 percent over 1999, according to CIRC official statistics. The total assets of China's insurance companies reached \$40.75 billion in 2000, an increase of 19.3 percent over 1999. Of this total, \$7.23 billion, or 37.5 percent, were property-liability insurance, a 14.8 percent increase over 1999. Life insurance income increased 14.4 percent to \$12.05 billion, accounting for the remaining 62.5 percent of the total premium income. The trend of premiums from 1990 to 2000 is shown in Figure 3. Total income from premiums is expected to exceed US\$20 billion in 2001 and US\$33.82 billion by 2005. This level, if achieved, would constitute 2.3 percent of the total gross domestic product (GDP) value with an average premium per person of \$27.78. (China Insurance Almanac (1999), [www.circ.gov.cn](http://www.circ.gov.cn), Jebson(2000))

While both property-liability insurance and life insurance have grown significantly, life insurance premiums have grown more rapidly, and have exceeded property-liability premiums since 1997. China's life insurance market is becoming more attractive because of China's huge population, the reforms to state-owned enterprises, and the growth of joint-ventures. Since China's government does not provide life insurance, health insurance or other employee benefits to employees of joint-ventures, these employees provide a ready market for these coverages. Also the life insurance business has transformed itself from a business aimed solely

at corporate sales to the simultaneous development of both group and personal business, an approach facilitated by the introduction of the personal sales agent system of AIG. One of the notable benefits of allowing foreign insurers into the market is that they bring new approaches with them, as exemplified by AIG's market distribution system. The market for property-liability insurance has also remained strong, which can be attributed to greater corporate accountability, higher insurance awareness of managers of state-owned enterprises, more foreign investment in the east coast area, and increasing automobile and housing consumption. (Insert Figure 3 here.)

Despite the impressive recent growth rates for insurance premiums, the whole insurance market in China is still in its infancy because of the limited number of products available, inexperienced management of insurance companies and low insurance awareness by the public. Two key measures of insurance markets that are commonly used to evaluate the development level of the insurance industry, **insurance density** and **insurance penetration**, are still very low in China compared with developed markets. **Insurance density** is the average insurance premium per capita. **Insurance penetration** is the ratio of insurance premiums to Gross Disposable Product. In developed countries, approximately 3-5 percent of the GDP is generally spent for property-liability insurance and 4-8 percent of GDP is spent for life insurance (Sigma (1999) page 18). As shown in Figure 4, growth of insurance density (1994-1999), and Figure 5, growth of insurance penetration (1994-1999), the insurance industry is still only a small part of China's economy, comprising in total less than 2 percent of GDP (China Insurance Almanac (1999), [www.circ.gov.cn](http://www.circ.gov.cn), Jebson(2000)).

(Insert Figures 4 and 5 here)

China is expected to become an even more attractive market for insurers for both social and legal reasons. The market demand for insurance is tied to economic development. A

growing economy such as China leads to a growth in capital resources and assets, which brings a corresponding requirement of protection those assets. Also the improvement of the standard of living and reforms of the medical system and welfare system increase the demand for life insurance. China's government is seeking to reshape its old national social security system in light of its huge population base and deteriorating state-owned enterprises. The government is shifting part of its heavy burden of "from cradle to grave" social security to society. The cost of providing such security to an aging population, combined with the effects of a one-child policy, is overwhelming. Reforms of state-owned enterprises provide more opportunities and incentives to purchase commercial insurance.

One important step in China's efforts to expand its undeveloped insurance market is to construct an appropriate regulatory frame work for the insurance industry by establishing the regulatory body and constructing the legal basis. Before 1998, the Department of Insurance under the PBOC took the position of market watchdog. However, during this period it was actually the central bank's responsibility to regulate the insurance market. As a result, the potential importance of the insurance industry in the national economy was always overshadowed by the role of the banking industry. In 1998, facing market problems and intending to expand the function of financial industry, China's government decided to separate financial regulation into three main branches, banking, stock market, and insurance. CIRC became the new market supervisor for the insurance industry.

The *1983 Regulations on Contracts for Property Insurance* and the *1985 Provisional Regulations on the Administration of Insurance Enterprises* were the earliest regulatory legislation related to insurance. The *1992 Provisional Measures on the Administration of*

*Insurance Institutions with Foreign Investment in Shanghai (Shanghai Measure)* was the first legislation addressing foreign insurers. The 1992 measures were developed to deal with the entry of AIG into the insurance market in China. The long-awaited *China Insurance Law* was effective on October 1, 1995. Interestingly, *China Insurance Law* provided a legal basis for insurance operation, which initially expedited the development of insurance markets, but some of the provisions later proved to be impediments.

Doing business in China presents a number of challenges, as well as opportunities. Similar to other industries in China, the insurance industry also faces many problems as the economy shifts from a centrally-planned economy to a market-oriented one. The main challenges involve:

- A limited supply of employees with expertise in insurance, notably in finance, actuarial science and marketing.
- A legal environment without a long history of consistent rulings.
- Severe imbalances in geographical supply and demand based on the geographical distribution of competition.
- Investment restrictions and the immature capital markets that limit the potential for investment returns and can expose insurers to substantial investment risk
- Low consumer awareness of the benefits of insurance<sup>8</sup>

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<sup>8</sup> In Chinese the term for insurance is the same word as is used for a safe with a combination lock. There have been instances when people have come to insurance companies to buy a safe.

Facing such a rapidly growing market with these problems, China's insurance regulatory system finds itself in a very delicate position. Generally the main responsibilities for insurance regulators are the regulation of market conduct and solvency surveillance, in contrast with the deregulation trend in developed markets. However, the main reason to establish the CIRC is to strengthen insurance regulation. The dilemma is to balance the interests of the state-owned insurers that wrote over 70 percent of the market, with that of customers that could be either owned by the state or independent. With almost half of employees of CIRC coming from the disbanded PICC GROUP, conflicts of interest could easily develop. Despite these problems, the establishment of the CIRC improved the position of insurance industry in the national economy, and an independent regulatory body strengthened the supervision and brought many new opportunities to the market. All new products must be approved by the CIRC before they can be issued, all shares transfer need to be authorized by the CIRC before being implemented, and any change of investment allocations have to be approved by the CIRC. Developing new products, distributing policies in different geographic areas and appointing senior managers are generally considered to be internal affairs for insurance enterprises; however, in China all these functions need the involvement of the CIRC.

CIRC has branches in all provinces except Tibet. These branches are extensions of the head office in Beijing and are responsible for local regulatory affairs. In the early development of the market, such a heavily regulated network may be necessary; however, this structure will come under pressure in a post-WTO era. Under such circumstance, the capability of regulators becomes as vital in the industry development as management performance, human resource

development, and market strategy of insurers. One significant case is that CIRC led a product revolution aimed at pressuring life insurers to transfer traditional saving-type products into investment-linked products since 1999. By being able to see the financial effect of lower interest rates on all the insurers operating in the market, the regulators were able to require domestic insurers to stop writing policies that exposed them to significant risk and shift over to investment linked products. The result is that all life insurers in China's market have their own different investment-linked products. China's market became the only market in Asia to have such products before 2000. This is an example of a case in which the regulator seemed to go beyond the general responsibility of insurance regulators in other countries.

During the negotiations of China's WTO membership, governments and the insurance industry in both the United States and the European Union showed concern about the structure of the insurance market that would develop in China. When China's insurance markets first opened up in the 1980s, much of the structure of the market, from policy forms to marketing systems, was based on the structure in Japan. In contrast, now China's insurance regulators send representatives to Europe and the United States to learn about approaches to insurance regulation. They also encourage domestic companies to adopt product designs from American and European companies. For example, CIRC encouraged the John Hancock Insurance Company to establish the North America Actuarial Science Center in China's universities. They also sent employees to Standard Life (UK) to learn actuarial science while they were constructing China's own actuarial exams. Another indication of the globalization of China's insurance markets is based on the experience of all foreign entrants. China's government appears to first decide which countries will be awarded licenses and then to choose one or two companies from each of those countries. As well as encouraging diversification in the market,

this strategy allows the emerging insurance industry to benefit from a wide variety of different technologies and experience, as well as maximizing political benefits.

### **What the WTO Means for China's Insurance Industry**

With an expected annual growth rate in insurance premiums of 12% through 2005, a population of more than 1.3 billion, and a GDP growth rate of 8%, China's insurance industry represents a huge market.<sup>9</sup> American insurance companies have spent millions of dollars over several decades lobbying the U. S. government for licenses in China. As one part of China's economic reforms, China's government started permitting limited foreign access to the emerging insurance market in 1992 with AIG's entry into Shanghai. However, various criteria required by the PBOC for approval to operate within China, special requirements for a business license from local governments, the slow pace of comprehensive insurance legislation, and incidences of protectionism, all hampered the pace of entry of foreign insurance companies. Even for those fortunate entrants, strict restrictions on the geographic scope of operations, the insurance products that could be issued, and the selection of partners all slowed their further development. The combination of three factors, the vast market potential, the strict limitations on entry, and slow approval of permission to operate, led to insurance becoming one of the most heated points of contention during China's WTO entrance negotiations.

In the negotiations leading to the U.S.- China Bilateral WTO Agreement of November, 1999, insurance played an important role. The specific agreements regarding insurance were as follows:<sup>10</sup>

"For insurance, China now restricts foreign companies to operating in Shanghai and Guangzhou. Under the agreement:

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<sup>9</sup> Report of National Insurance Meeting in XinJiang 2000

<sup>10</sup> Briefing on the Clinton Administration Agenda for the WTO



- Geographic Limitations: China will permit foreign property and casualty firms to insure large-scale risks nationwide immediately upon accession, and will eliminate all geographic limitations in three years.
- Scope: China will expand the scope of activities for foreign insurers to include group, health and pension lines of insurance, which represent about 85% of total premiums, phased in over 5 years.
- Prudential Criteria: China agrees to award licenses solely on the basis of prudential criteria, with no economic needs test or quantitative limits on the number of licenses issued.
- Investment: China agreed to allow 50 percent ownership for life insurance. Life insurers may now choose their own joint venture partners. For non-life, China will allow branching or 51% ownership on accession and form wholly owned subsidiaries in 2 years. Reinsurance is completely open upon accession (100 percent, no restrictions). While the United States agreed to China's request to limit foreign equity participation in life insurance to 50%, China agreed to significantly accelerate the elimination of geographic restrictions the percentage of equity participation in the first few years."

China's WTO commitments relating to insurance industry focus on four points: clarifying principles of issuing licenses, eliminating the geographic limitations, expanding products scope, and determining the ownership of equity for foreign investment. Each of these points is explained in detail below.

China's obligation to meet issue licenses solely on the basis of "prudential criteria", without discretionary economic needs test or quantitative limits on the number of licenses issued, is the foremost concern of all foreign insurers. Prudential criteria means a transparent process and objective criteria for all applicants, rather than based on nationality. The basic requirements for a qualified applicant include 30 years of experience, total assets of US\$5 billion, and a history of having a representative office in China for at least two years. "Without discretionary economic needs test" means a member country is prohibited from disallowing licensure or other activities of a foreign-invested company even if the company might influence the country's domestic companies negatively. "Without quantitative limits" means there will be no limitation on the number of licenses granted. "Without discretionary economic needs test" is a very technical expression of the negotiation agreement, which is likely to lead to problems in later implementation. Such a commitment increases foreign investors' confidence, compared

with past decisions to grant licenses described by foreign insurance practitioners as “arbitrary and politicized”.<sup>11</sup>

The agreement also provided for an elimination of geographical restrictions. Although there are 18 foreign insurance companies operating in China’s market now, less than a 5% market share has been achieved by these insurers in aggregate. This low market share is primarily the result of the strict restrictions in business geographic area and products scope. Before China became a member of WTO, only Shanghai, Guangzhou, Shenzhen, Foshan and Dalian, were open for foreign insurers. Almost all domestic companies have branches in Shanghai; Shenzhen is a newly-developed special economic district with limited population; Foshan is a very small city in south Guangzhou; Dalian is an extra city included in the negotiation agreement between China and Japan. According to China’s WTO commitments, upon accession, foreign insurers and insurance brokers will be permitted to provide services in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan. Within two years after China's accession, foreign insurers and insurance brokers will be permitted to provide services in the following additional cities: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. Within three years after China's accession, there will be no geographic restrictions. Although the new areas open for operations may appear very attractive, the efficiency of the approval process could become a bottleneck and an effective control tool for China’s insurance regulators to restrict the pace of liberalization. An instructive example of this process was when Sun Life Canada met resistance when it applied to build a joint venture of life insurance in Tianjin after receiving its operation permission in 1999.

A third point addressed in the agreement related to expanding product scope. Currently, the products issued by foreign insurers are tightly restricted. Foreign property-liability insurers

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<sup>11</sup> Lincoln Reinsurance Reporter 2000.1

can only underwrite the risks of foreign invested enterprises and foreign life insurers can only sell individual life policies and are prohibited from selling group life products or any types of health, pension, and annuities products. According to the final agreement, upon China's accession, foreign property-liability insurers will be permitted to provide insurance under "master policies" and insure large scale commercial risks. Foreign property-liability insurers will be permitted to insure Chinese enterprises abroad and write property insurance, related liability insurance and credit insurance of foreign-invested enterprises in China. Within two years after China's accession, foreign property-liability insurers will be permitted to provide the full range of services to both foreign and domestic clients. Foreign insurers are permitted to provide individual (not group) insurance to foreigners and Chinese citizens; within three years after accession, foreign insurers will be permitted to provide health insurance, group insurance and pension/annuities insurance to foreigners and to Chinese citizens. China's government is also trying to develop its reinsurance market, which currently has only one state-owned reinsurance company. Upon accession, foreign insurers will be permitted to provide reinsurance services for life and property-liability insurance as a branch, joint venture, or wholly foreign-owned subsidiary, without geographic or quantitative restrictions on the number of licenses issued. Current insurance regulations require all property-liability insurers to reinsure 20 percent of their business with China Re. The requirement will be phased out within four years after accession. Although this agreement conflicts with the *Articles 101, 102 and 103 of China Insurance Law*, the law is expected to be revised immediately.

The final and most significant part in China's WTO commitments is to determine the form of relationship for foreign invested companies. According to the agreement, foreign property-liability insurers will be permitted to establish as a branch or as a joint venture with 51

per cent foreign ownership. Within two years after China's accession, foreign property-liability insurers will be permitted to establish as a wholly-owned subsidiary; i.e., with no form of establishment restrictions. Upon accession, foreign life insurers will be permitted 50 per cent foreign ownership in a joint venture with the partner of their choice. The joint venture partners can freely agree to the terms of their relationship within the limits contained in the schedule. For insurance brokerage of large scale commercial risks, international marine, aviation, and transport insurance and reinsurance, upon accession, a joint venture with foreign equity of no more than 50 per cent will be permitted; within three years after China's accession, the foreign equity share may be increased to 51 per cent; within five years after China's accession, wholly foreign owned subsidiaries will be permitted. There are no limitations on foreign ownership for other brokerage services. One important liberalization is that foreign life insurance companies can now select their own joint ownership partners (previously they were assigned partners), and property-liability insurance companies do not have to deal with the partnering issue.

One significant factor affecting the entire negotiation process among the United States, the European Union, and China, involved the role of American International Group (AIG), a major U.S. insurer. China is actually the birthplace of AIG, as a young American businessman, Cornelius Vander Starr, opened an insurance agency named American Asiatic Underwriters (AAU) in Shanghai in 1919, selling fire and marine policies for some American insurance companies (Allen et al, (1999)). Later Starr began AAU's counterpart, Asia Life Insurance Company (ALI), to issue life policies to Chinese citizens, and then expanded business throughout Asia. All foreign insurance companies, including AAU and ALI, were expelled by China's government after 1949. AIG began the process of gaining reentry to China's insurance markets in the 1970s. Chairman Maurice Greenberg worked to improve relations

between the United States and China. In addition, AIG agreed not to repatriate any profits for at least ten years. AIG became by far the most successful of all foreign companies in China. AIG gained its first license in 1992, and now operates wholly-owned life and property-liability insurance businesses in Shanghai, Guangzhou, Shengzhen, and Foshan, the only foreign insurance company allowed to do this. The United States and the European Union disagreed over whether China's terms of accession to the WTO should allow AIG to continue to be the only foreign company that can open new wholly-owned life insurance branches in China. Currently two European companies and one Canadian company own 50% equity of their current life insurance operations. China's services schedule stipulates a 50% equity cap for all foreign life insurance companies, but the United States has been trying to press China to allow companies already in China to establish branches based on their original equity structures. However, the European Union has resisted that effort and insisted that any new insurance branches be subject to the equity limits in China's service schedule. Also the different understandings about the "Grandfather clause" have hampered the negotiations. The grandfather clause, in modern law, refers to any legal provision that excuses an individual or corporation from a requirement or prohibition because the person or corporation has enjoyed a certain privilege or right at some time in the past. For example, a law that requires teachers to be certified may include a grandfather clause that allows teachers working when the law was passed to continue teaching without certification.<sup>12</sup> The treatment of AIG became the last hurdle to China's WTO accession negotiation. This was solved by adding a footnote to the agreement

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<sup>12</sup> *The term "grandfather clause" emanated from a legal provision used by some Southern states after the Civil War to restrict voting rights of African Americans. These states adopted literacy tests for voters. Although many African Americans failed these tests, many whites did also. The states then adopted grandfather clauses that allowed anyone who previously had the right to vote to continue to be eligible. These were termed "grandfather clauses" because, in some cases, these clauses extended to descendents, as well, so if your grandfather had the right to vote, you would also, even if you could not pass the literacy tests. The U.S. Supreme Court declared such provisions to be unconstitutional in 1915. (Sefton, (2001))*

stating that all companies would receive equal treatment under the most-favored-nation provisions at the core of the WTO. The formal footnote is, “Any further authorization provided to foreign insurers after accession under more favorable conditions than those contained in this schedule (including the extension of grandfathered investments through branching, sub-branching or any other legal form), will be made available to other foreign service suppliers which so request.” This wording satisfied all participants in the negotiation as well, and led to final approval of China’s admission into the WTO.

### **Future Developments**

China’s entry into WTO will bring far-reaching influence to its developing insurance industry. Moreover, the influence will be diversified based on different ownership structure of insurance companies. Among domestic insurance companies, state-owned companies will experience stronger competition with the elimination of the government’s informal support (Economist, 2001b). The state-owned insurance companies will accelerate their shareholding reforms, transferring from state-owned companies into stock companies. PICC, a property-liability insurer with a strong financial position, is moving to be listed in the stock market. The deteriorating financial situation resulting from asset and liability management issues may lead China’s government to reorganize and reform China Life. China’s WTO commitment to open its reinsurance market will place China Re into a new competitive market, with the loss of the fixed reinsurance business required by the China Insurance Law. For domestic stock companies, China’s entry into the WTO will give well-prepared companies, especially those that took steps to incorporate international operation rules, a more fair, transparent, and market-oriented developing opportunity. At the same time, some others will struggle under intensified competition. Because the CIRC gradually loosened the limitation of

trans-provinces operation and granted more freedom to domestic stock companies to open more branch companies, it is now possible for some small-scaled domestic insurance companies to organize into commercial unions through which they can share the resources of locating in different geographic areas, expand distribution channels, and lower operating costs. These types of commercial unions may become a new operation model in the insurance market.

Based on China's present insurance market situation, its insurance related legal environment, and its WTO commitments, foreign investors in insurance will face the following conditions after they get operation permission in China. Foreign life insurance companies have to obey the agreement of establishing joint-ventures with an upper limit of 50% ownership. Although companies may now chose their own partners, it is still a challenge to find a well qualified business partner, one with nearly equivalent financial strength, matching management techniques, and a close relation with the local government. Current regulatory rules require that each branch must be separately capitalized. If an established joint-venture plans to expand its operations into other geographic areas with new sub-branches, the two partners each need to contribute capital equally. However, given the typical financial strength of China's enterprises, most companies will face financial pressure limiting further investment. The result will be foreign investors that want to expand business by establishing new branches, but their Chinese partners' limited financial strength will hamper further development. As there is no requirement that the partner be an insurance company, some foreign insurers may attempt to form partnerships with non insurance companies, such as chemical, petroleum, electric, or other industrial firms that have a strong financial position. However, these types of partnerships will generate special challenges, since the Chinese partner would lack professional experience in insurance.

One alternative way for foreign investors to invest in China's insurance industry is to own stakes in domestic companies. Currently, no domestic insurance companies are listed yet, but such companies as PingAn, TaiKang, and XinHua have foreign investors as shareholders. Morgan Stanley and Goldman Sachs have held stakes in PingAn Insurance Company for several years. The limitation is that each foreign investor is only allowed a maximum 5% stake in a single company and all combined stakes held by foreign investors are capped at 25%.

This approach to invest in China's insurance market is subject to limitations under current regulations. Article 104 of China Insurance Law states, "The application of funds of a insurance company is limited to bank deposits, trading of government and financial bonds and other forms of fund application stipulated by the State Council." This restriction became the main legal obstacle for investment of insurance funds, but China Insurance Law may be revised soon. Under the current regulations, it is possible for insurance companies to set up a special insurance investment company or several mutual funds, providing a potential investment option in the future for foreign investors.

Domestic insurance companies, especially the state-owned insurance companies, have a broad distribution network within China. Foreign companies tend to have more advanced insurance products and professional management skills. A practical alternative to investing in a domestic insurers would be to develop a strategic commercial union to exploit these complementary advantages.

The party facing the greatest challenge under the post-WTO environment is likely to be the insurance regulators. Regulators will have to adjust their operating style in light of the new market environment. The principle of fair trade makes it much more difficult for regulators



to protect domestic enterprises, even the state-owned companies. Some old regulatory tools will have to be discarded as regulatory control is shifted to focus on different elements of insurance operations.

## **Conclusion**

China's accession into the WTO will bring about profound changes in a market poised for rapid growth. The loosening of restrictions in the insurance market should provide an expanded array of products for China's citizens and corporations, fostering growth and development. New opportunities for foreign insurers to participate in this growing market are available, but successful entrants must pay close attention to the details of regulatory policy and the unique elements of the market structure in this country. The stakes in this market, as well as the risks, are recognized to be significant, so much so that issues related to insurance markets were the last items to be finalized before WTO membership for China was attained. Insurance is understandably a key element of the future for both China and its trading partners.

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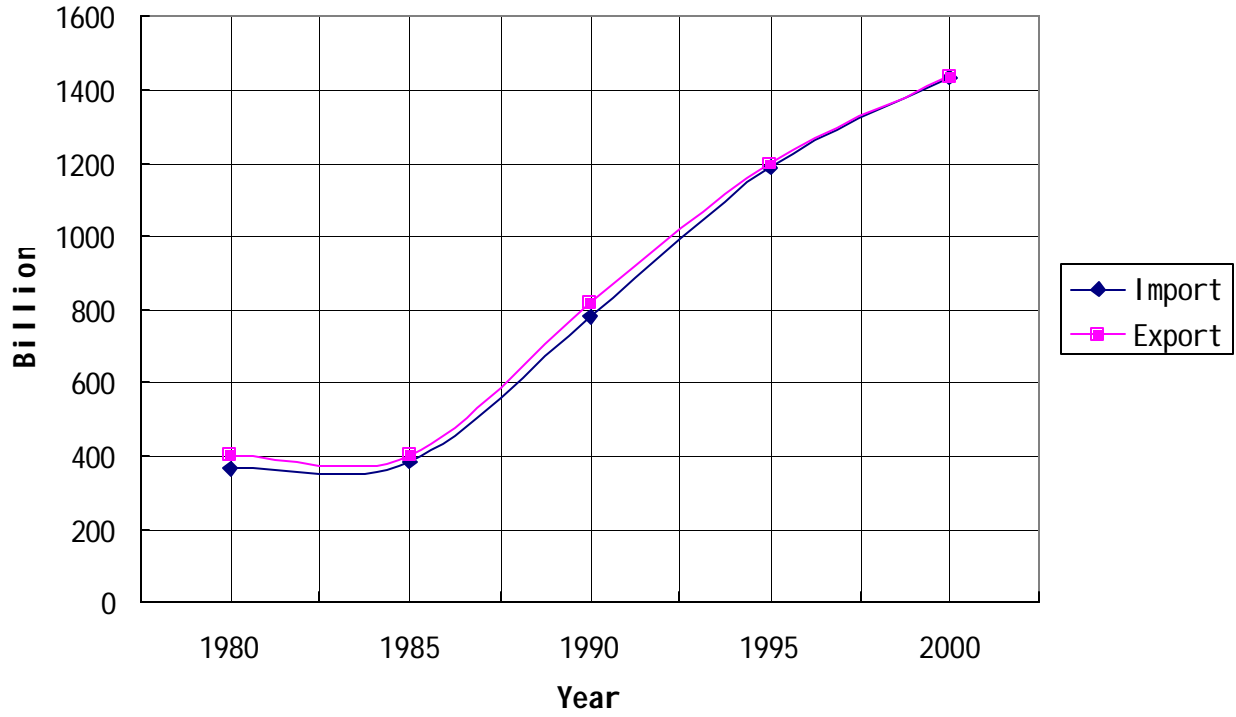
<http://www.csrc.gov.cn>

[http://www.moftec.gov.cn/moftec\\_cn/wto/](http://www.moftec.gov.cn/moftec_cn/wto/)

<http://english.peopledaily.com.cn/home.shtml>

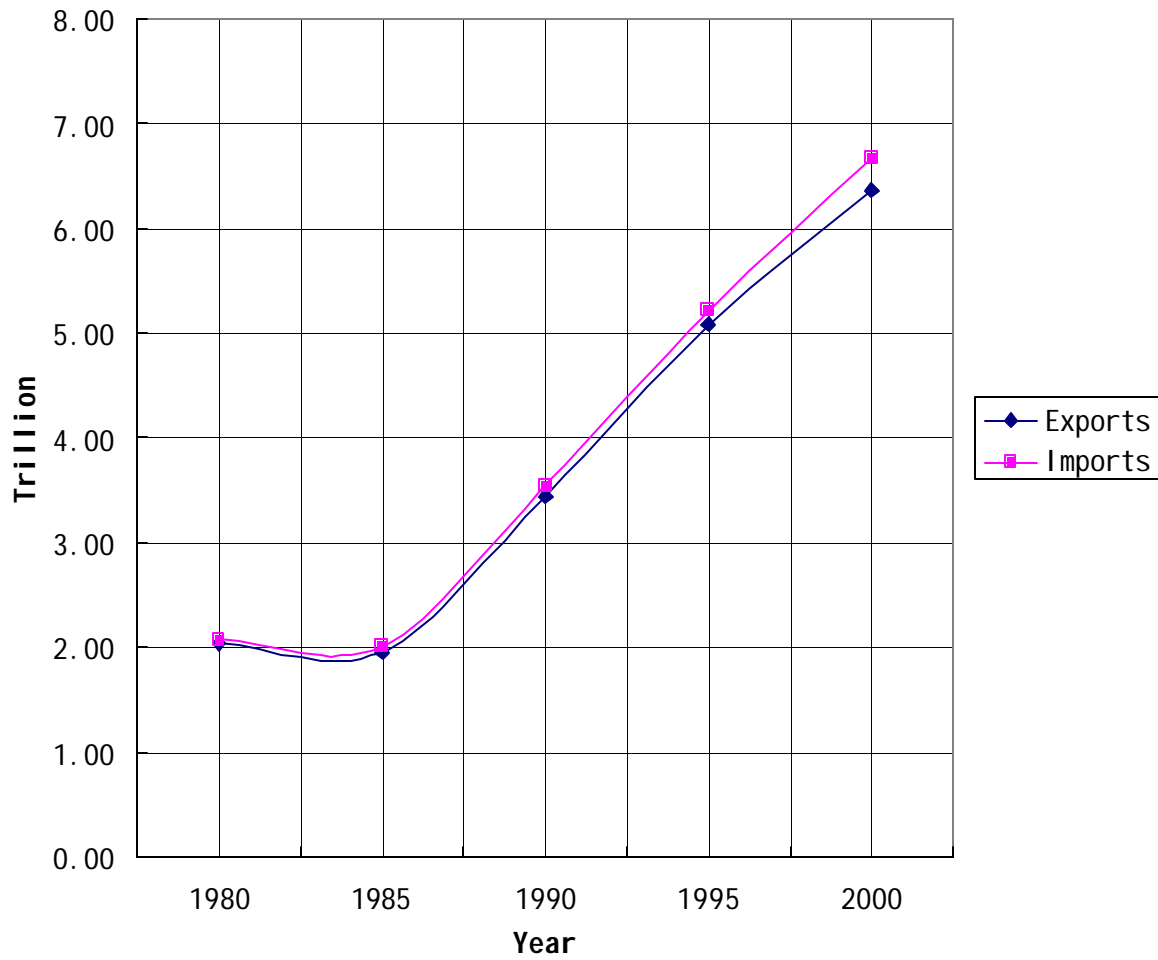
<http://www.WTO.org>

**Figure 1**  
**World Trade-Commercial Service**  
**(1980-2000)**



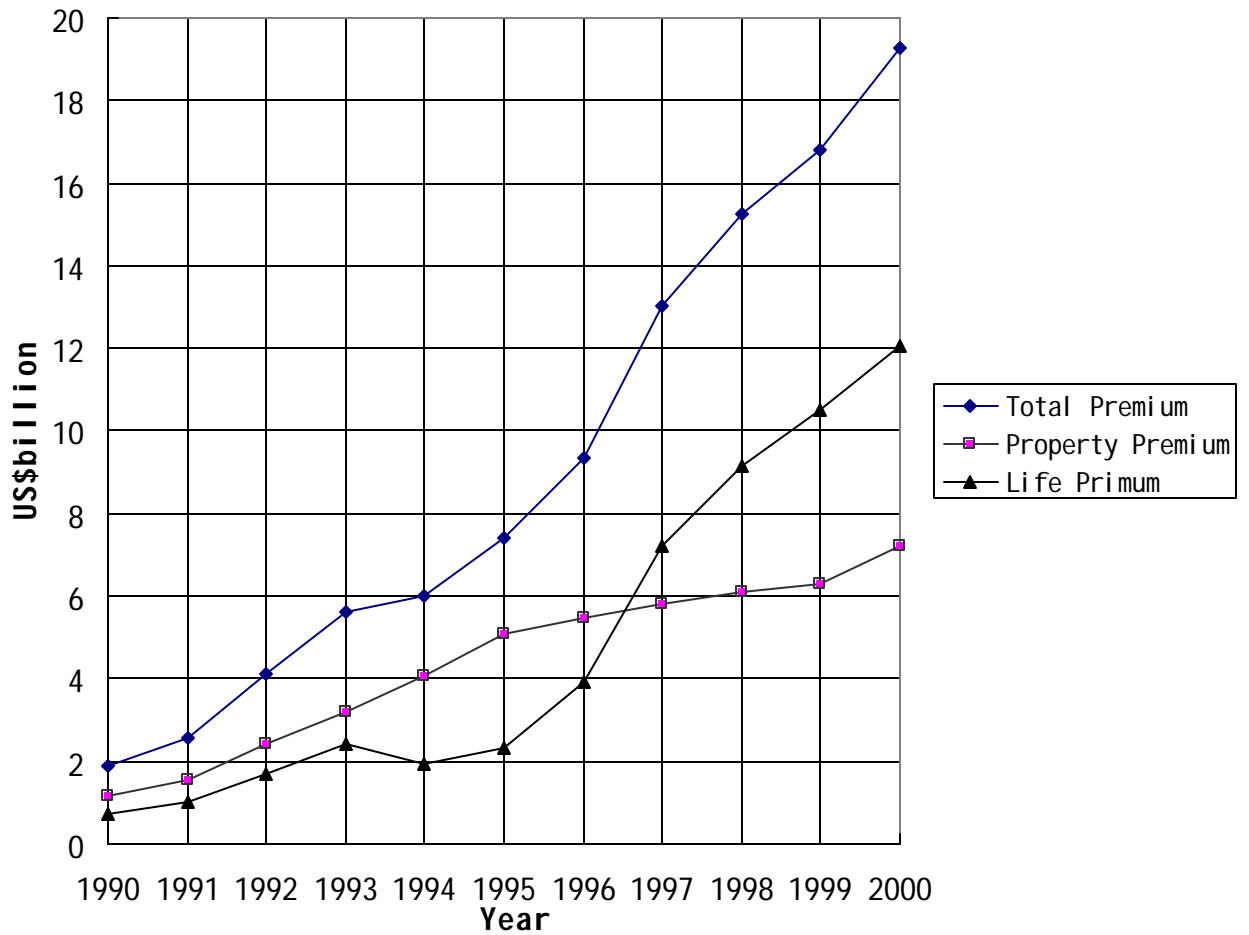
Data Source: [www.WTO.org](http://www.WTO.org)

**Figure 2**  
**World Trade-Merchandise**  
**(1980-2000)**



Data Source: [www.WTO.org](http://www.WTO.org)

**Figure 3**  
**Growth in Premium Income in China**  
**(1990-2000)**



Data Source:

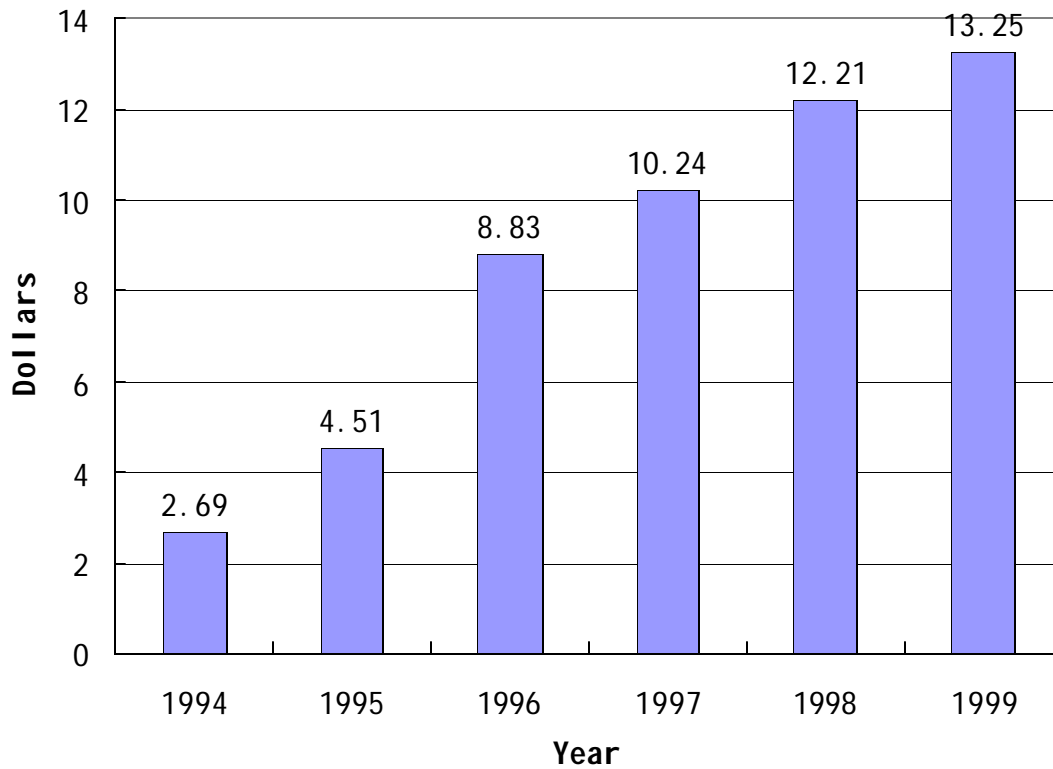
China Insurance Almanac (1999),

China Insurance Almanac (2000),

Jebson(2000),

[www.circ.gov.cn](http://www.circ.gov.cn)

**Figure 4  
Growth of Insurance Density  
(1994-1999)**



**Insurance Density= Written Premium/Population**

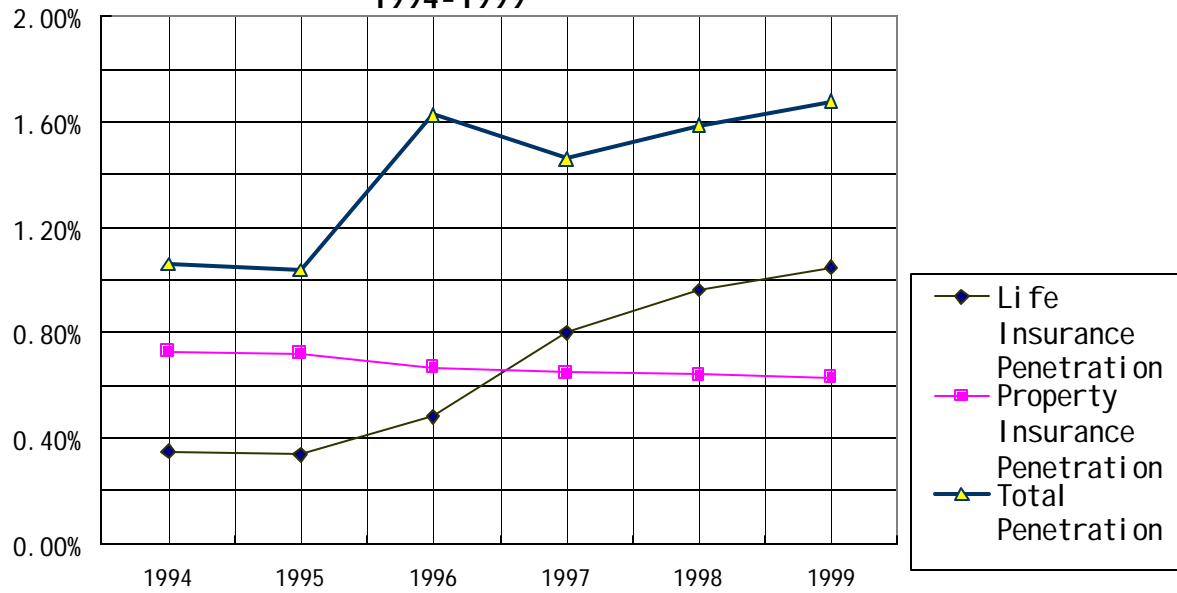
Data Source:

China Insurance Almanac (1999),

Jebson(2000),

[www.circ.gov.cn](http://www.circ.gov.cn)

**Figure 5**  
**Growth of Insurance Penetration**  
**1994-1999**



**Insurance Penetration = Written Premium/Gross Disposable Product**

Data Source:

China Insurance Almanac (1999),

Jebson(2000),

[www.circ.gov.cn](http://www.circ.gov.cn)



**Table-1 Companies Approved to Write Insurance in China**

<b>Property-Liability</b>	<b>Life</b>	<b>Comprehensive/Reinsurance</b>
PICC	China Life	Pacific
Xinjiang Jianshe Bintuan	Xin Hua (New China)	Ping An
HuaTai	TaiKang	
Sinosafe	Zhonghong	China Reinsurance
DaZhong	Pacific-Aetna	
YongAn	Allianz DaZhong	
TianAn	AXA-China Minmetals	
Tokio Marine-Shanghai	John Hancock- TianAn	
AIU-Shanghai	AIA-Shanghai	
AIU-Guangzhou	AIA-Guangzhou	
AIU-Shenzhen	AIA-Foshan	
AIU-Foshan	Prudential (UK)	
Royal and Sun –Shanghai	Colonial-China Life	
Winthur (Switzerland) –Shanghai	<i>Sun Life (Canada)</i>	
MinAn-Shanghai	<i>New York Life (US)</i>	
MinAn-Haikou	<i>MetLife (US)</i>	
Chubb-Shanghai	<i>TransAmerica(AGEON) (US)</i>	
<i>Allianz (Germany)</i>	<i>Generali (Italy)</i>	
<i>Gerling(Germany)</i>	<i>ING (Netherland)</i>	
<i>Japan (I)</i>	<i>CNP (France)</i>	
<i>Korean (I)</i>	<i>CGNU (UK)</i>	
	<i>AIG Branches</i>	

\* Companies in italics are preparing to start business now.