A STRATEGY FOR OPENING UP THE CHINESE INSURANCE INDUSTRY

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Abstract

This project analyzes China's current insurance policy, focusing on its "gradual, paced" policies for allowing foreign competition into the market. The goal of the project is threefold: to analyze the potential effects of allowing increased foreign competition in China's insurance market; to generate recommendations for Chinese policymakers; and to set out a detailed plan of action for liberalizing the industry.

China's insurance industry has developed very quickly. Insurance premiums increased by nearly 40 percent annually from 1980 to 1998—a rate that far outpaced the country's 9.7 percent GDP growth rate. Such growth shows that the insurance sector is increasingly important to the country's economy. The growth is also attracting the attention of foreign insurance investors, even though China's insurance sector is relatively closed.

China will need to liberalize its insurance market in the near future in order to meet the commitments it made in its WTO accession agreements. Yet even if China had not made WTO commitments on insurance, current economic and social welfare reforms in China are increasing the country's need for a strong commercial insurance industry. Although policymakers remain concerned about how the domestic industry will fare in the face of foreign competition, past experience indicates that foreign pariticipation in the insurance market can help it grow and diversify.

With the goal of developing a coherent strategy for regulating the insurance sector in the years to come, this project analyzes commercial, legal, policy and political issues that will need to be accounted for in any liberalization effort. These analyses highlight the real impacts of foreign participation on the domestic insurance industry, and conclude that 1) the overall impact of foreign entry will be positive, and 2) the market should be opened in the near future.

The project also outlines steps Chinese policymakers will need to take in order to liberalize the country's insurance sector. In considering the adoption of a new policy, domestic political and public relations issues will need to be considered, as will implementation and enforcement issues.

Finally, the project offers a comprehensive strategy for reforming the current insurance policy and legal framework. The strategy suggests Western style legislative and public relations building activities that can help the Chinese government and business community develop more fruitful relations.

A Strategy for Opening the Chinese Insurance Industry

Introduction

A. Scenario

For the purpose of this project, I assume the fictitious role of a staff analyst in the China Insurance Regulatory Commission's (CIRC's) Department of Policies and Regulations, Division of Policy Study. I have been tasked with developing a strategy for opening up the Chinese insurance market.

B. Overview

From 1949 to 1988, the People's Insurance Company of China was the sole provider of insurance in China. Since 1988, however, China's insurance industry has developed very quickly. Insurance premiums increased by 39.6 percent each year from 1980 to 1998, an impressive figure compared to China's 9.7 percent annual GDP growth rate for the same period. Thirteen domestic companies are now established.

The potential market for insurance in China is huge. In 1998, 120 billion yuan in insurance premiums were collected. According to the World Bank, premiums in China will reach at least 200 billion yuan (US$ 24.44 billion) by the year 2000.

The Chinese insurance market was partially opened to foreign companies in 1992. About 202 representatives of foreign insurers now represent 11 different foreign insurance companies in China. However China's massive market potential has led to demands from foreign insurance investors that China do more to increase access to its insurance market. Moreover, while the Chinese government has favored a "gradual, paced" policy for liberalizing the domestic insurance industry, the rapid development of China's insurance sector is straining the government's regulatory policies.

With the structural transformation of China's economy, the Chinese government has adopted a series of social welfare reforms, particularly pension and health-care system reforms that will increase opportunities for insurance companies and also create pressure for ensuring that the private sector insurance system is capable of covering growing portions of the Chinese population. With this concern in mind, the China Insurance Regulatory Commission (CIRC), a new insurance regulatory body, is considering how best to support the development of China's domestic insurance industry, including how or if it should open this industry to increased foreign competition.

CIRC's concerns are compounded by the fact that China will likely join the WTO this year. China needs a strategy for living up to commitments it made during the accession process.

C. Issues

The main obstacle to developing a policy framework for opening up the Chinese insurance industry is the concern that such opening will hurt the Chinese domestic industry, which is still in its infancy. The healthy development of the domestic insurance industry must be considered before any steps toward market liberalization are taken.

Nonetheless, China's experience to date suggests that increased foreign participation in its insurance market will benefit the industry' overall development, and China will be obligated to liberalize its insurance market if it is to join the WTO. China has already finished its bilateral accession negotiations with the United States, Canada and other countries, and it is likely to become a full WTO member within the year.

It is clearly time for CIRC to develop an overall strategy for allowing increased foreign participation in China's insurance market. Specific issues that need to be addressed include:

- Licensing: To obtain a license, foreign insurers must meet national requirements that include several formal criteria. This process lacks transparency and companies report that the rules are applied unevenly. Does the CIRC need to reform the licensing criteria and improve the transparency of its process for granting licenses?
- Geographic Restrictions: Currently, foreign insurers are only allowed to operate in Shanghai and Guangzhou. Should these areas be gradually expanded to include other coastal cities or to all of China's large and medium-sized cities?
- Ownership: Life insurance companies are the only insurers that are allowed to enter the market via 50-50 joint ventures with Chinese firms. Other insurance companies are only allowed to enter as branches. CIRC must determine whether or not non-life insurers should be allowed to participate in joint ventures and, if so, what percent ownership they should be permitted.
- Scope Restrictions: Currently, China limits the products and services a foreign insurance firm may sell. For example, foreign companies may not engage in group insurance sales to Chinese citizens. Does this policy need to be reformed in order to open up the Chinese insurance market?
- Insurance Brokers: China's insurance law includes provisions for brokers but does not lay out whether these provisions apply equally to foreign brokers. In fact, the law is silent on foreign brokers, and as of April 1999, just one foreign insurance broker had been licensed in China. Does China need to reinterpret or change its existing rules?
- Investment Opportunities: Both foreign and Chinese insurers are limited to investing in bank deposits and Chinese government bonds. As insurance premiums in China increase, the issue of expanding the investment opportunities available to insurers is becoming increasingly important.

D. Organization of the Project

Section I provides background on the development and current economic situation of China's insurance industry. It also provides general information about the market for insurance in China, the international context in which China is attempting to reform its insurance policies, and the legal and policy framework that regulates the industry.

Section II provides in depth anaylses of commercial, legal, policy, and political and public relations issues that affect China's ability to liberalize its insurance industry. This section also provides an analysis of policy implementation issues that will need to be addressed.

Finally, Section III offers a comprehensive strategy for liberalizing China's insurance market.

A Strategy for Opening the Chinese Insurance Industry
Section I: Background paper

Background Paper

A. History of China's Insurance Industry

Insurance was first sold in China when two British insurance companies entered the Shanghai market in 1846. In 1875, the Merchants Shipping Bureau of the Qing Government established China's first insurance institution, the Merchants Insurance Bureau, and for the following 150 years, foreign companies monopolized the market. Then, with the founding of the People's Republic of China in 1949, China established its own government-controlled insurance company, the People's Insurance Company of China (PICC), and all foreign companies withdrew.

The PICC's own monopoly came to an end in April 1988 with the establishment of Pingan Insurance Co. Ltd. in the Shenzhen special economic zone. When the China Pacific Insurance Co. Ltd. was established in Shanghai in 1991, a true insurance market began to take shape. Today, there are 13 domestic insurance companies operating in the country (see Exhibit 1).

In September 1992, the American International Group's American Assurance Company (AIA) became the first foreign insurance company since 1952 to receive approval to establish a branch office in China. Other foreign companies quickly followed suit:

- In 1994, Tokyo Marine Insurance Co. of Japan also received approval to establish a branch in the city.
- Winterthur Swiss Insurance Co. opened an office in Shanghai in 1996 and became the first foreign company in China to offer property insurance.
- In November 1996, Manulife Insurance Co. of Canada and China Chemical Industry Import and Export Corp. joined hands to establish the Zhonghong Insurance Co., the first life insurance joint venture project in China.

Eleven foreign insurance companies with about 202 representatives are now operating in China. The most recent arrivals include John Hancock Mutual Life Insurance Co., Boston; Sun Life Assurance Co., Toronto; Prudential Assurance Co.; and Chubb Corp. (see Exhibit 2 and 3).1[1] Another 113 companies from 17 countries have applied for licenses without success.

B. Market Review

1. Market Competition

The development of the insurance industry in the People's Republic of China can be divided into three stages. From 1949 to March 1988, the People's Insurance Company of China (PICC) monopolized the market. Then, with the establishment of Pingan in 1988 and China Pacific in 1991, PICC's monopoly was broken and the market was characterized as a "tripartite confrontation." Since September 1992, more domestic companies, as well as foreign ones, have entered the market, and true competition has begun to take shape (see Exhibit 4). As recently as 1997, however, the premium income of the PICC, Pingan and China Pacific still accounted for 96.56 percent of total Chinese insurance premiums.2[2]

2. Market Size and Potential

Although China's' insurance industry grew at a rapid 40 percent per year between 1980 and 1998,3[3] insurance premiums in 1991 were still just 23.4 billion yuan (US$282 million). By 1997, however, this figure had leapt to 108 billion yuan (US$ 13 billion), and the total assets of insurance companies reached

164.6 billion yuan (US$ 19.81 billion).4[4] During the first five months of 1999, total premiums were already 52.895 billion yuan, representing a 7.29 percent increase over the same period during the previous year. According to World Bank estimates, premiums in China will reach at least 200 billion yuan (US$ 24.44 billion) by the year 2000 (see Exhibit 5).

The Chinese insurance industry is changing as it grows. In 1997, life insurance premiums surpassed property insurance premiums for the first time, accounting for 60 million yuan (US$7.2 billion) or 56 percent of total premiums .5[5] In major Chinese cities, the life insurance share of the total market was even higher: in Beijing, it was 70.7 percent, in Shanghai, 64.8 percent, and in Guangzhou, 60.5 percent. In the first five months of 1999, of the total 52.895 billion yuan in premiums, 31.276 billion yuan came from life insurance (up 11.07 percent from the previous year), and 21.629 billion yuan came from property insurance (up 3.06 percent).6[6]

There is no question that the Chinese insurance market holds great potential. To date, however, it remains almost completely untapped, even compared to insurance markets in developing countries.

<u>Insurance Density</u>. In 1995, worldwide per capita premium income was US$357, while China's per capita premium income was just US$6.10. In 1996, Chinese per capita spending rose to $7.64, which is higher than India's $1.70 per capita, but far below Thailand's $30. If China were to reach the worldwide US$357 per capita level, premium income in China would be US$400 billion. However this level still does not approach the levels of developed countries. In 1996, Great Britain spent $1,775 per capita, and the United States spent $2,191.

- Insurance Penetration. Premium income in developing countries generally accounts for three to four percent of GNP. In 1997, China's premium income was 108 billion yuan or just 1.4 percent of GNP. If China were to realize the 3.5 percent average insurance penetration of developing countries, its premium income would be 261.7 billion yuan.

- Life insurance. Although China's life insurance premiums now represent nearly 40 percent of total premiums, life insurance represents 56.1 percent of total premiums on a worldwide basis, and 76.8 percent of premiums within Asian countries.

- Non-life insurance. China's market for insurance other than life insuarnce is estimated to be worth $6.5 billion.[7]

3. Foreign Companies in China

Although AIA snatched up 45 percent the Shanghai life insurance market within in three years of entering the city,7[8] the market share of foreign companies has dropped significantly in recent years. From 1995 to 1997 the Shanghai market grew about 50 percent, but foreign companies' share of the market dropped from 20 percent in 1995 to seven percent in 1997. AIA's share of the Shanghai life insurance market concomitantly fell to an estimated 14 percent or only 1.5 percent of the national market.8[9]

According to the China Insurance Institute, the 1997 Shanghai property insurance shares for Tokyo Marine and Winterthur Schweizerische Versicherungs Gesellschaft were only 0.46 percent and 0.16 percent respectively. Foreign companies currently hold a mere one percent of the nationwide insurance market.

C. The Chinese Market for Insurance

1. Consumer Awareness and Domestic Attitudes Towards Openness

The vast majority of Chinese people still enjoy free medical care, low-rent housing and retirement pensions. It is not surprising then that the majority also still consider insurance to be unnecessary. Even when citizens (usually in big cities) recognize insurance as a necessity, they lack basic insurance knowledge. In a survey conducted by the Beijing Road to the Future R&D Company found that only 18.6 percent of respondents said that they know insurance well.9[10]

According to a case study conducted in Shanghai, the majority of Chinese feel that the introduction of foreign insurers has advantages. They believed that the benefits of foreign participation in the market overwhelm any perceived disadvantages. A majority felt that more foreign insurers should be introduced to the market.

2. The Product Scope of China's Insurance Industry

Like insurance industries in other developing countries, China's insurance sector once emphasized business insurance such as marine, fire, commodity, transportation, and casualty insurance. Now, however, China permits insurance companies to offer either of two broad categories of insurance: property insurance and life (group and individual) insurance. Property insurance includes business property, family property, cargo transportation, motor vehicle, ship, and agricultural insurance. Life insurance instruments include "simple" life insurance (similar to term life); life insurance with saving features; group life insurance; "simple" and group disability insurance; group accident insurance; highway accident insurance; collective-enterprise employee retirement insurance; individual pension insurance; children's education and marriage insurance; major medical insurance; and other combination products.

3. Key Players

Opening up China's insurance market is a complex undertaking that involves not only the CIRC but also many other government agencies. Major government agencies that will be involved in the decision-making process include:

The Ministry of Foreign Trade & Economic Cooperation (MOFTEC), which is responsible for foreign trade policy and represents China in WTO negotiations;

- The National People's Congress, which has the legislative power of the State;
- The State Council, which is the executive body of the highest organ of state power and administration;
- The Ministry of Labor and Social Security, which administers the unemployment welfare framework; and
- The Ministry of Health, which carries out the health-care framework.

In addition to the above government agencies, the other two players are:

- The domestic insurance companies, which claim that China's insurance industry is still an infant industry that needs to be protected; and
- The state owned enterprises (SOEs), which can no longer afford to be the sole providers of health and pension insurance and therefore have a large stake in seeing that effective reforms are carried out.

D. The International Market for Insurance

Insurance has been on the international trade agenda since the Uruguay Round began negotiating the General Agreement on Trade in Services (GATS), the first set of rules covering international trade in services (see Exhibit 4 for information on Asian countries' GATS commitments).

The WTO financial services agreement, which includes insurance, was signed in December 1997 and covers 102 countries representing 95 percent of the global financial services market. Under the agreement, which went into effect at the beginning of March 1999, 60 countries pledged to open their insurance sectors to foreign competition. Fifty-five nations now allow 100 percent foreign-owned subsidiaries and branches. Ten additional countries allow majority control. Only four countries—the Dominican Republic, Honduras, Sri Lanka and Tunisia—do not permit majority ownership. Malaysia allows 51 percent for existing investments but only 30 percent for new ventures.

The developed countries, especially the United States, treated the 1997 agreement as an historic accomplishment. In a letter to the President Bill Clinton, the Washington-based International Insurance Council claimed victory stating that the agreement "captures more than 98 percent of the world's insurance business in over 60 countries within a system of binding foreign trade principles. The USTR takes great satisfaction in the success."10[11] There is no doubt that developed countries are in a much better position to benefit from the WTO agreements on insurance than are developing countries.

While China is not a WTO member yet, it is expected to gain membership within the year 2000. Liberalization of China's insurance industry has been a major issue for both the United States and the EU during accession negotiations.

E. Legal and Policy Background

1. China's Social Welfare Reforms

As part of its overall program for resutructuring the country's economy, the Chinese government has launched a series of social welfare reforms. In turn, these reforms are generating a growing need for private, commercial insurance. Commercial insurance will play an import role in maintaining social stability in the country.

- Pension Reform. This was one of the first components of the social security system in China to be selected for reform. China's social security system was designed to deliver most social services and benefits through SOEs. Now, however, with the SOEs increasingly unable to meet their social service obligations, the government has proposed the so-called New Unified Pension System Reform, which shifts publicly funded pensions from the SOEs to a mix of private and public providers. The shift will offer good opportunities for insurers.

- Health Care Reform: In China's urban areas, where approximately 30 percent of China's 1.2 billion people live, there are two formal health insurance systems: the government system and the state enterprise system. Roughly only 140 million workers and 60 million family members were covered under these two systems at the end of 1997.[12] In rural areas, only 120 million farm and village enterprise employees are covered by the government system, the so-called Cooperative Medical System (CMS). Around 64 percent of the rural population still has no health insurance at all. In 1994, China's State Council began studying how to improve China's overall standard of health care and how to reform the current urban health care system.

2. China's Insurance Laws and Regulations

The rapid expansion of China's insurance industry in the 1980s pushed the Chinese government to begin establishing laws and regulations to manage the insurance market and make it more competitive. In 1992, to regulate the experimental opening of the Shanghai insurance market, the government issued the Shanghai Administrative Measures for Foreign-Invested Insurance Companies, the so-called Shanghai Measures. Some of these measures also applied to Guangzhou.

Then, on June 30, 1995, a national insurance law was promulgated at the fourteenth session of the Standing Committee of the Eighth National People's Congress of China; it became effective on October 1, 1995. The insurance law mainly focuses on regulating the domestic insurance industry. It also includes some provisions on foreign insurers. In 1996, the Provisional Regulations for Administration of Insurance were established to supplement the insurance supervision section in the 1995 law.

In 1997 and 1998, partly in response to the growing number of door-to-door sales agents in a number of industries, new regulations were enacted to control the activities of insurance agents and brokers. The government issued the Provisional Regulation for Administration of Insurance Agents in November 1997, and the Provisional Regulation for Administration of Insurance Brokers in February 1998.

Self-regulation by the insurance industry is developing rapidly as well. In 1994, the Shanghai branches of PICC, Pingan, China Pacific, and AIA formed China's first insurance industry association to coordinate and self-regulate the insurance market in Shanghai. By the end of 1997, insurance companies had established industry associations in 19 cities.

Chinese law and regulations stipulate that insurance companies and agencies must regard property and life insurance business as separate entities. Additionally, the 1995 insurance law stipulates that premiums can only be deposited in banks or used to purchase government and financial bonds or various other funds approved by the State Council. According to the law, "the use of premiums to establish securities institutions or invest in enterprises is strictly prohibited."

As for foreign participation in the Chinese insurance market, the insurance law lays out the following rules:

1. To obtain a license, foreign companies must: (a) have been established for more than 30 years; (b) have maintained a representative office in China for over two years—an office that is not allowed to sell insurance; (c) have total assets of more than $5 billion at the end of the year prior to their license application.

2. Licensed foreign insurance companies must gain government approval before they begin selling any new insurance products. (Approval generally takes 3-6 months.)

3. Foreign insurers are limited to operations in Shanghai and Guangzhou.

4. Life insurance companies can be licensed to form 50-50 joint ventures with Chinese firms. Non-life companies can be licensed only as branches. Foreign insurance companies are licensed as either life or non-life companies, but may not write both types of insurance.

5. Premiums can only be invested in bank deposits, government or financial bonds, or other fund allocation methods approved by the State Council. The use of premiums to establish securities institutions or invest in enterprises is strictly forbidden.

6. Foreign property/casualty insurers may only do business with foreign companies operating in China. They may not underwrite Chinese businesses or individuals.

7. Foreign life insurers may not sell pension products or make group insurance sales to Chinese citizens (which account for over 60 percent of the market).

8. Foreign investment in Chinese insurance companies is limited to a maximum of five percent for each foreign company. Total foreign investment in any one Chinese company is limited to 25 percent.

Despite the clarity of these provisions, the process that foreign companies must go through to obtain a license lacks transparency and each company seems to be evaluated based on different criteria. Personal contacts, support from a company's home country government, and a company's "demonstrated commitment to the Chinese market" in the form of contributions to the Chinese economy are reportedly deciding factors in obtaining a license.

Footnotes

11[1] China's insurance market, available from http://ww.latelinenews.com, accessed 12 Dec. 1998.
i[2] Ibid 1.
12[3] JingXiao Xue, *The Progress in Multilateral Negotiations on Financial Services and the Opening-up of Chinese Financial Industry*, 1998.
13[4] New star publishers, *Insurance Reform and Development*, 1997.

A Strategy for Opening the Chinese Insurance Industry
Section II: Analytical Papers

Analytical Papers

The following analytical papers examine the challenge of liberalizing China's insurance market from five perspectives: commercial, legal, policy, political and public relations, and enforcement/implementation. The analyses reach a common conclusion: China needs to open its insurance market and should actively prepare for the challenges of accomplishing this opening.

<u>Commercial Analysis</u>

The commercial analysis highlights the real impacts of the foreign participation on the domestic insurance industry. The analysis finds that:

- The Chinese insurance industry is an infant industry.
- The market still lacks market competition.
- The market is growing very quickly.
- Insurance market demand is bigger than market supply.
- Foreign companies hold only one percent of the national insurance market.
- The market has enormous potential. The number of insurance companies is expected to double in the next three to five years; insurance sector income is expected to continue to grow at an average annual rate of about 30 percent; and premiums are expected to at least double.

The commercial analysis also demonstrates that the overall impact of foreign company participation in the domestic insurance industry is positive:

- The entry of foreign companies has not influenced domestic companies' market share.
- The entry of foreign companies has improved the competitive level of the Chinese insurance market.
- Domestic companies have learned new sales and management techniques from the foreign companies.
- Consumers have benefited from foreign competition because domestic companies have had to improve the quality products and services in order to compete with the foreign companies.

Legal Analysis

The legal analysis offers a framework for understanding China's current insurance law and regulations. Specifically, the legal analysis focuses on the following issues:

- Licensing
- Ownership
- Insurance brokers
- Geographic restriction
- Products and service scopes
- Investment opportunities

Policy Analysis

The policy analysis finds that China's decision-making process lacks transparency, especially in terms of licensing and helping foreign insurance companies find joint ventures partners. Improving the transparency level of the insurance industry's regulatory oversight will be critical to the liberalization process. Policy making and licensing decisions should be based on the market rather than on non-market factors, such as political concerns and relationships.

China's central government is engaged in a vigorous bureaucratic effort to accelerate the reform of the social security system and create a system of health care and pensions appropriate for a market economy. However, current reforms are incomplete because they still do not acknowledge the large contribution commercial insurance can make. If China wants its economy to become a market-based economy, it should encourage the development of a commercial insurance industry.

The analysis also finds that market restrictions on foreign companies should be loosened immediately. Rules confining insurers to invest premiums in government bonds and bank deposits should be lifted, and foreign insurance brokers should be allowed to obtain licenses. At the same time, however, the domestic industry should continue to receive some protection in order to give it room to develop in the face of new foreign competitors. Restrictions on the scope of products that foreign insurers may sell should be loosened only gradually. Geographical restrictions, city-by-city controls, and ownership restrictions should also be loosened slowly.

Political and Public Relations Analysis

Opening up the Chinese insurance industry is a complex challenge that involves many interest groups including government agencies, the domestic insurance industry, state-owned enterprises, and domestic consumer groups. At the same time, insurance reform will be key to China's overall economic development since state-owned enterprises are no longer able to supply health and retirement insurance.

Implementation Analysis

Once China decides to open its insurance industry and adopts new policies, CIRC will need to develop a comprehensive enforcement scheme. To be successful, this will need to be a cooperative effort that involves a number of government agencies, as well as industry associations. Without cooperation, illegal and corrupt activities are likely to plague the liberalization effort.

Commercial Analysis

Although Chinese insurance companies fear that their development will be stunted by increased foreign competition, China has agreed to open the industry to greater competition as part of its WTO accession agreements. Even if these agreements had not been made, however, China would benefit from increased foreign participation in the sector. In fact, China's experience to date supports the view that competition, both domestic and foreign, will strengthen the industry during this phase of rapid development.

A. Reasons for Current Market Growth

China's insurance industry is developing very quickly. It is estimated that, from 1980 to 1998, China's insurance market grew 39.6 percent annually. There are several reasons for this growth:

- For more than 40 years, commercial insurance was virtually unavailable in China. The country represents the world's largest untapped insurance market.

- In recent years, overall economic growth in China has been strong. China's economy was growing at more than 10 percent per year before the Asian financial crisis. The growth rate in 1998 was eight percent, and this year it will be more than seven percent.

- Competition between domestic insurers has accelerated growth. Since 1996, several domestic insurance companies, such as Tian An and Tai Kang, have been established. The three major insurance companies in Beijing are now facing a big challenge from Tai Kang Life Insurance Co.

- Competition between domestic companies has increased marketing efforts which, in turn, has increased consumer awareness of and demand for insurance products.

- The entry of foreign insurers into the market has pushed domestic companies to improve their services. Insurance buyers are receiving better service, which encourages consumers to buy insurance.

- Social welfare reforms have also spurred insurance sales. As reform of the social security system has deepened, life insurance as a portion of total insurance in China increased from 0.2 percent in 1982 to 41.75 percent in 1996; by the end of 1997, it had leapt to 55.5 percent. Recently, China's government decided to implement further social services reforms that cover pensions, health insurance, unemployment insurance and birth insurance. All of these reforms will accelerate the demand for commercial insurance and spur the industry's development.

Case 1: Shanghai Study13[13]

Shanghai is the birthplace of the Chinese domestic insurance industry. During the 30s and 40s, some 232 insurance companies had offices in the city; it was the insurance capital not only of China, but also of the Far East. Shanghai was also the first city in China to open its insurance sector to foreign investors since China began re-opening the industry in the 1990s. The People's Bank of China granted a license to AIA in 1992, and this was followed by licenses to Japan's Tokyo Marine and Fire Insurance and to Winterthur. Total premium income of the Shanghai market has increased dramatically. Life insurance premiums grew from RMB 560 million in 1992 to RMB 5.7 billion in 1997. Property and casualty insurance was RMB 3.1 billion in 1997. PICC grew in Shanghai over the 1992-1995 period at an average annual rate of 27.3 percent, CPIC at 119.8 percent, and Pingan at 101.7 percent. Foreign investors have been keen to enter the Shanghai market where the economic growth rate has been above 13 percent per year for five years and per capita income has on average grown over 23 percent per year. Now Shanghai hopes to speed the development of a multi-level insurance company system to make the city the reinsurance center of China.

B. Market Participants

During the 1990s, the Chinese insurance market was characterized as a "tripartite confrontation" between three big state owned insurance companies—the People's Insurance Company of China, the China Pacific Insurance Company Ltd., and the Pingan Insurance Company of China. In 1997, the premium income of these three companies accounted for 96.56 percent of total premiums. PICC's premiums alone accounted for roughly 70 percent of the market. China Pacific accounted for 11.9 percent (11.6 percent of the property insurance market and 12 percent of the life insurance market), and Pingan accounted for 15.8 percent (eight percent of the property insurance market and 22 percent of the life insurance market).

The rapid growth of these three companies is not expected to change any time soon:

- People's Insurance (Life) Co. Ltd. posted a premium income of 30.33 billion yuan in the first half of 1999, and China Life seized 77 percent of China's life insurance market in 1998.
- China Pacific Insurance Co. increased its premium income 13.07 percent in the first half of 1999 to reach 7.018 billion yuan.
- Pingan Insurance Co. maintained growth momentum in the first half this year, with its insurance premiums rising 48 percent to 10.95 billion yuan.

Despite these phenomenal growth rates, the three insurance companies fell far short of meeting the needs of China's vast insurance market, and this has opened the door for other domestic insurance companies to develop. Indeed, small domestic companies are growing very quickly and are expected to create competition for the three large carriers in the years to come.

Any major changes in market share in the coming years are expected to be driven by competition among domestic companies. While AIA captured about 45 percent of the Shanghai life insurance market when it first entered the Chinese market in the early 1990s, a recent study shows that domestic companies have successfully improved their competitive abilities. Domestic companies have forced AIA back to a modest level of market share (see Case 2 below).

Case 2. Foreign company market share remains small in Shanghai13[14]

One of the great misconceptions concerning the impact of foreign entry into the Shanghai insurance market is that foreign companies have taken over a big part of the market. The reality is that, while the Shanghai market grew about 50 percent during 1996-97, foreign companies' market share dropped from 20 percent to about seven percent (see Exhibit 6). AIA grew rapidly when it first established itself in Shanghai, but domestic competitors responded aggressively and have forced AIA back to a modest estimated 14 percent share of the Shanghai life insurance market (only 1.5 percent of the national market). Of the 20,000 life agents active in Shanghai, only about 10 percent are AIA agents. Some 4,000 former AIA agents have joined domestic companies.

Chinese insurance companies have further strengthened their financial position by aggressively investing in other markets. Currently, PICC has more than 80 overseas branches in Hong Kong, Britain, the United States, Macao, and other countries and regions, and this overseas growth has paralleled the growth of competition within the PRC. In Hong Kong, for example, the market share of mainland Chinese companies rose from five percent in 1991 to more than 25 percent in 1997. The fact that mainland companies are succeeding in Hong Kong, one of the world's most competitive markets, is a testament to these companies ability to thrive in highly competitive environments.

If China opens up its insurance market, the real impacts of foreign participation, such as how many Chinese insurance companies will be hurt and to what extent, are unclear now. However, one result is clear: The entry of foreign insurance companies into China will bring heavy pressure on Chinese companies and force them to improve their management and operational efficiency.

C. The Benefits of Foreign Competition for Domestic Companies

China's insurance industry is still in its developmental, infant stages. Only 13 domestic companies and 11 foreign insurance companies currently operate in China (well over

5,000 companies sell insurance in the United States). Foreign competition can help ensure that China's industry develops in the most efficient way possible.

Indeed, foreign insurance companies bring efficient management systems and advanced sales techniques to China's insurance industry, and domestic insurers and industry regulators have in many cases learned and copied these techniques in order to increase their own companies' efficiency and profitability. For example:

- Following the lead of foreign companies, Shanghai regulators now require insurance agents to pass an exam.13[15] Among the first batch of test-takers, 43 percent were employees of domestic insurance companies, compared with 90.4 percent of the third batch. A better trained and more professional sales force will better service Shanghai insurance buyers.13[16]
- It was AIA that introduced China to the door-to-door sales method, a practice commonly used in international insurance sales for well over 100 years. In Shanghai, AIA was the first to use door-to-door canvassing.13[17]

D. The Benefits of Foreign Competition for Chinese Consumers

Because China 's economy has been almost entirely a peasant farming economy for thousands of years, the concept of long-term investment is unknown to the vast majority of Chinese. Insurance doesn't readily make sense to most Chinese who believe that the young generation should support their aging parents. To the extent that the Chinese consider outside assistance at all, this assistance has been provided for more than 30 years as part of China's planned economy. People are still accustomed to enjoying free medical and retirement pensions under the old social welfare system.

Thus, most Chinese consider insurance to be unnecessary if they've even considered it at all. But the entry of foreign insurance companies into the Chinese market has begun to change this perception. Indeed, many people in Shanghai recognized the need for insurance only when AIA began door-to-door canvassing. Increased competition in China's insurance sector will help further the Chinese people's knowledge of insurance as more and more companies compete for consumers' attention. Foreign firms have also benefited consumers by introducing new products, more coverage, and more information about their insurance policies—all at increasingly competitive rates.

E. Both Domestic Insurers and Consumers Benefit from "Goodwill" Programs

China also benefits from the "goodwill" programs that foreign insurance companies provide. Because foreign companies must have an established office in China for two years prior to being eligible to apply for a license and begin selling insurance, these companies have plenty of time to establish such programs.

The programs cost millions of dollars each year and would not be possible without foreign assistance. They include professional training, educational support, seminar organization, and financial sponsorship of research, and they will help improve both domestic and foreign companies' services and ultimately benefit consumers. Some programs offer direct training to consumers.

A few examples of goodwill programs are:

- The Chubb School of Insurance. This school was established by the Chubb Group of Insurance Companies in cooperation with the Shanghai University of Finance and Economics in 1995. Located at the university, the school offers specialized training and courses of one- or two-week duration to Chinese insurance industry regulators and officials, insurance agents and brokers, and the local staffs of Chubb, as well as domestic insurance companies. Subjects include risk management, marketing, management of specialized areas of underwriting, claims, catastrophe management, and solvency. Chubb provided the insurance industry experts who conducted the initial courses for the Shanghai University staff that now teach the courses. 13[18]

- Young Leaders Development Program. The American International Assurance Company Limited Foundation launched this program in 1996. Each year, 24 first-year students are selected from the six universities in Hong Kong and a series of systematic leadership skills training workshops are organized for them.13[19]

- MetLife Scholarship Fund. Metropolitan Life Insurance Co. started a $100,000 scholarship fund at China's Central Finance and Economic University in October 1999. The goal of the fund is to encourage outstanding teachers and top-performing students at the university. MetLife and the university also intend to explore further opportunities for training insurance teachers and professionals.13[20]

F. Market Potential

As discussed in the background section, the Chinese insurance market has great potential. Per capita premium spending is far below the worldwide average, and premiums as a percent of GNP are still less than the average for developing countries.

According to Professor Wei Runquan, an executive member of the China Insurance Society, China's GDP reached 5,770 billion yuan in 1995, with total saving deposits approaching 3,000 billion yuan. If calculated in terms of internationally accepted norms for the contribution the insurance makes to the national economy, the potential scale for China's 1995 insurance market would have hovered between 320-360 billion yuan, or eight times higher than actual premiums that year. Wei also notes that the average per-capita outlays for life insurance coverage in Japan and the United States stand at US$3,800 and US$1,000 respectively. China's per capita outlays are just US$1.3. Professor Wei contends that national economic growth, maturation of the market economic system, the enhanced awareness of 1.2 billion people of the need for insurance, and government policies that encourage development of the insurance sector provide powerful guarantees for the continued expansion of the insurance sector.13[21]

As previously noted, total Chinese premiums from 1981 to 1994 (13 years) grew at a compound rate of 39 percent from $200 million to $6 billion. CIRC experts predict that, if premiums continue to grow at a relatively high compound rate of 30 percent a year, life and property casualty insurance premiums could total $63.6 billion by 2003.13[22] If growth is a more conservative 10 percent annually, the total by 2003 would still be $14.1 billion. If growth were to take off at 50 percent, the projection becomes $230.6 billion.

Examination of specific rural areas' market potential provides further evidence of China's overall insurance market potential. Zhangzhou and the Yellow River Delta are representative of current economic development levels in China since both have largely rural, agrarian economies. The forecasts in both areas show that insurance premiums will at least double within the next three to five years.

- Zhangzhou is located in Jiangxi Province and has a total population of 7.55 million. Its rural population is 6.37 million, accounting for 84.4 per cent of the total population. Zhangzhou, like most of China, relies on agriculture as its primary industry. Accordingly, the insurance market forecast in this area gives a reasonable picture of China's market potential, and Zhangzhou's insurance density has grown over 100 percent in just the last three years. It is expected to grow almost fivefold over the next 10 years 13[23] (see Exhibit 7).

- The Yellow River Delta is located in Shandong Province and is one of the three biggest delta areas in China. Although economic development in this area has been slow to date, it is expected to develop very quickly in the next century because of its rich natural resources. The insurance industry in this region has developed very rapidly since 1992. Its insurance density has doubled in the last five years. (Exhibit 8 shows the insurance premiums in this area, and exhibit 9 shows the market potential.)13[24]

G. Conclusion

Although China's insurance industry is still in its infancy, the overall impact of foreign company participation in the industry has been positive. Although foreign companies' market share remains small, they have improved the competitiveness of the Chinese insurance market. Domestic companies have learned from the foreign companies' management and sales techniques, and they have benefited from the "goodwill" programs offered by foreign firms. Chinese insurance consumers have also benefited. They now have better opportunities to learn about and purchase insurance policies.

But because demand still far outstrips supply, China would benefit still more if it were to further open its markets to foreign competition. Since domestic companies currently control the market, they are well positioned to improve in the face of foreign competition even if China were to open its insurance market now. Chinese policy-makers should re-think the current policy of “gradual, paced” liberalization of the domestic insurance industry.

Footnotes

[13] "China in our hands," available from http://web.lexis-nexis.com, Internet, accessed June 1999.

[14] "Impact of foreign insurance company entry into the Chinese market," Amcham Insurance Industry Forum, May 1998.

[15] *"Why countries are hesitant to open markets,"* Huang zhen, Economic Review, China, May 1998.

[16] "*Impact of foreign insurance company entry into the Chinese market,*" AmCham Insurance Industry Forum, May 1998.

[17] Ibid 5.

[18] News available from http://www.chubb.com/china, Internet, accessed 20 Dec. 1998.

[19] News available from http://www.aia.com.cn, Internet, accessed May 1999.

[20] News available from http://www.lexis-nexis.com/universe/docu, Internet, accessed November 1999.

[21] *" Insurance reform and development in China,"* PICC, 1997.

[22] Forecast by CIRC’s Policy Study Division.

[23] "*China's insurance market: current situation and its trend,*" Qiu sanfa, Yan xudong and Zhou erchang, Insurance Research, 1999.

[24] "*China's insurance market: current situation and its trend,*" Qiu sanfa, Yan xudong and Zhou erchang, Insurance Research, 1999.

Legal Analysis

A. Domestic Law Analysis

On June 30, 1995, the insurance law was promulgated at the Fourteenth Session of the Standing Committee of the Eighth National People's Congress of China. It became effective on October 1, 1995. The law represents a major step forward in transforming insurance regulation in China. It sets forth rules for:

1. Insurance contracts,
2. Insurance companies,
3. Insurance operation rules,
4. Insurance supervision and regulation,

5. Insurance agents and brokers, and
6. Legal liability.

The law applies to all insurers, including those with foreign ownership and foreign branches. However, Article 148 includes a giant loophole stating that foreign joint ventures and branches will be governed by the law “or other laws and administrative regulations if they provide otherwise.”13[1]

Indeed, the basic principle of current policies is still that the domestic insurance industry should be opened to increased competition in a “gradual, paced” manner. As outlined below, the government still controls the industry very tightly.

1. Licensing

According to the insurance law and Shanghai rules, foreign companies are only allowed to obtain licenses and conduct business in China if they meet the following formal criteria. A company must:

- Have operated a Chinese representative office for a minimum of two years (although this office cannot engage in insurance sales until a license is obtained).
- Have total parent company assets exceeding $5 billion in the year prior to the application for a license.
- Have 30 years of continuous underwriting experience.
- Have a qualified senior management team that controls the company’s insurance operations.

According to foreign companies, a number of other informal, non-transparent criteria have impeded their success in obtaining licenses. (For futher discussion of this problem, see the policy analysis section below). 113 companies from 11 countires have applied for insurance licenses in China and, while most meet the above criteria, very few have actually received licenses.

2. Ownership

Under the insurance law, foreign non-life insurance companies are licensed as branches, and foreign life insurance companies are allowed to set up 50-50 joint ventures with Chinese firms. In practice, however, foreign companies have little choice in joint venture partners. As highlighted by a 1998 China Insurance Institute study of 20 foreign insurance companies, China only has three big insurance companies, and each company can participate in only one joint venture. Although choosing a joint venture partner company outside of the Chinese insurance industry can help a foreign company obtain a license from CIRC, especially if the Chinese company is recommended by the Chinese government, the foreign insurance investor is likely to have difficulties cooperating with a Chinese company that has no insurance experience.

In short, the insurance law's provisions on ownership have effectively limited the entry of foreign companies and hampered the development of the insurance market. CIRC needs to re-think its ownership policies in order to reduce their negative effects.

3. Insurance Brokers

The insurance law includes two sections concerning the regulation and licensing of insurance brokers and agents. These sections are:

- Measures for the administration of brokers, and
- Provisional regulations on the management of insurance agents.

In theory, the insurance law was designed to protect consumers in their transactions within the insurance industry. However, the law is silent on whether foreigners may obtain broker licenses, and in the absence of a clear law, Chinese officials have only allowed one foreign company to obtain such a license. To make matters worse, a number of foreign companies have gone ahead and engaged in broker activities calling themselves "risk management consultants," which fall wholly outside of China's regulatory structure.

Accordingly, CIRC needs to re-think how to regulate these "risk management consultants." Just giving them broker licenses and letting them operate businesses according to the rules may be the best option. Insuarnce brokers play a very important role in the insurance markets of many developed countries. Brokers' business accounts for more than 50 percent of insurance business in the United States and 90 percent in the United Kingdom.

4. Geographic Restrictions

Foreign insurers are only permitted to operate in Shanghai and Guangzhong, and this requirement limits the development of China's insurance market. China's economic development and reforms will continue to stimulate demand for various kinds of insurance services all over the country. Indeed, the case studies of Zhangzhou and the Yellow River Delta show that the Chinese market for insurance holds great potential, even in undeveloped areas. Because domestic insurers cannot meet market demand, China should begin to allow more foreign pariticpation in the market. The geographical restriction should be removed within a couple of years, and city-by-city approvals should be replace with provincial-wide licensing administrations.

In the past, China's economic reforms have begun in Shanghai, Guangzhou and other coastal cities and then spread out to cover all of China. Since the Shanghai insurance market has already been open for more than seven years, it is now time to allow more foreign participation in other parts of the country. Indeed, the impact of foreign insurance companies in Shanghai has been largely positive.

5. Products and Services

China's insurance sector once emphasized business insurance such as marine, fire, and casualty. Currently, China permits insurance companies to offer either of two broad categories of insurance: property insurance or life (group and individual) insurance. Foreign property and casualty insurers may only do business with foreign companies operating in China, not Chinese businesses or individuals. Foreign life insurance companies may not engage in group insurance sales to Chinese citizens.

Recently, the growth of the middle class, particularly in Shanghai and other booming coastal cities, has raised demands for various kinds of insurance, such as personal property insurance. China's social reforms have also raised the demand for new types of insurance. However, compared to other developed countries, China lacks a variety of categories of insurance.

If China were to loosen its limitations on the scope of services foreigners are permitted to offer, foreign companies would quickly expand the overall business scope of the Chinese insurance market. However, if CIRC were to permit foreign insurers to engage in group insurance sales, domestic companies might suffer large, immediate losses. Therefore, the CIRC should consider allowing foreign life and property insurance companies to create new types of insurance in order to meet market demand. It should also loosen the foreign limitation on group insurance—but it needs to do this gradually in order to give domestic companies room to develop.

6. Investment Opportunities

Article 104 of the Insurance Law limits both foreign and Chinese insurers to investments in bank deposits and Chinese government bonds.

> *The application of funds at insurance company(sic) is limited to bank deposits, trading of government and financial bonds and other forms of fund application stipulated by the State Council.*

Currently, most Chinese insurance companies invest more than 40 percent of their funds in bank deposits and 30 percent in government bonds. Insurance companies in other countries have many more investment opportunities. In the United Kingdom, for example, insurers invest more than 28.7 percent of their capital in the stock market, 21.9 percent in government bonds, 19.7 percent in real estate and 9.1 percent in company bonds.

Clearly, if an insurance company is limited to investment in bank deposits, it will be unduly affected by the bank interest rate, and this is precisely what has happened in China since 1996—interest rates have been cut seven times and now stand at just 2.25 percent. On the other hand, if an insurance company has more investment options, it can diversify its risks. Domestic Chinese companies have long complained that investment restrictions have threatened their businesses.

In 1995, the American International Group (AIG) received the Chinese government's approval to invest in Renminbi-denominated A-share markets in China. However, because the market was still unstable, immature, and somewhat speculative, AIG decided not to make such investments. Five years later, the Chinese stock market is more mature, and both domestic and foreign insurance companies are interested in making stock investments. In November 1999, CIRC began allowing Chinese insurance companies to invest in mutual funds and to buy into such funds on the secondary market. The next step is to consider how to widen the investment channels for foreign companies.

B. China's International Obligations

After 13 years of effort, Chinese accession to the WTO finally seems imminent. Accordingly, China's insurance sector needs to be opened to foreign competition based on WTO rules and the bilateral agreements reached with individual countries.

1. China-U.S. Agreement on WTO Accession

China formally requested accession to the General Agreement on Tariffs and Trade (GATT) on July 11, 1986. On November 15, 1999, Washington and Beijing finally reached bilateral agreement on the conditions for China's entry into the WTO.13[2] The agreement includes:

- Prudential Criteria: China agreed to award licenses solely on the basis of prudential criteria, with no economic needs tests or quantitative limits on the number of licenses issued.
- Geographic Limitations: China agreed to permit foreign property and casualty firms to insure large-scale risks on a nationwide basis immediately upon accession. The country also agreed to eliminate all geographic limitations for future licenses over five years and to allow access to the key cities of priority U.S. interest in two or three years.
- Scope: China agreed to expand the scope of allowable activities for foreign insurers to include group, health and pension lines of insurance, which represent about 85 percent of total premiums, phased in over five years.
- Investment: China agreed to allow majority foreign ownership of insurance companies remove onerous joint venture requirements on foreign life insurers, and phase out internal branching restrictions. Life insurers will be allowed to own 50 percent of a company and, on accession, 51 percent ownership rights will be phased in within one year. For non-life and reinsurance, China will allow 51 percent ownership on accession and allow wholly owned subsidiaries in two years.

2. Understanding the GATS

The General Agreement on Trade in Services (GATS) is the first ever set of multilateral, legally-enforceable rules covering international trade in services. It was negotiated in the Uruguay Round and signed in 1995. The agreement covers all internationally traded services, including insurance. China participated in all the negotiations on GATS and made specific commitments to provide access to its insurance market. The extended service negotiations were reopened in April 1997, and an improved set of commitments was agreed to in December 1997, however China did not participate in this negotiation.

The key principles of the GATS are the provision of market access, national treatment, and most-favored-nation (MFN) status. The MFN clause requires that the members of the WTO accord to “services and service suppliers of any other member treatment no less favorable than that it accords to like services and service suppliers of any other country.”13[3] Because not all of the WTO members were willing to apply the MFN principle to all service sectors, Article II of the GATS permits members to annex to the Agreement MFN exceptions in relation to specified measures. MFN exceptions reflect that there is flexibility in the GATS rules.

Under the GATS, each member country negotiated its own specific sectoral commitments, and these were listed in country schedules appended to the Agreement. Article XVI of the GATS also leaves room for flexibility. It states that limitations on market access restrictions must be eliminated but allows for countries to make reservations in their individual schedules.

Article XVII contains the national treatment provision of the Agreement. The approach here is very similar to the market access approach, with national treatment applicable only to scheduled sectors, and only then if reservations are not made to the contrary. Another significant difference between national treatment in GATT and GATS is that in the former, national treatment is established as a principle to be applied across the board, whereas in the later, national treatment is subject to negotiation—it is to be granted, denied or qualified, depending on the sector and member concerned.

The GATS also provides flexibility in that, on many issues, it only sets forth principles, which are subject to further in-depth negotiation.

In GATS 1995, China made commitments concerning its insurance sector, and China has agreed to further insurance sector liberalizations in its bilateral WTO agreement with the United States. China will need to live up to these commitments, but it does not need to make any new commitments in the near future. Indeed, as seen in the case studies below, other countries such as Malaysia and Singapore that are already in the WTO and are more developed than China have given weaker insurance commitments than China. Malaysia has even backtracked on liberalization policies, lowering rather than raising allowable foreign ownership of joint venture projects.

Case 3. Malaysia's insurance policy13[4]

Basic information on Malaysia:

Population: 21.7 million

GNP/Capita (US $): 4,466

GDP Growth: 8.4% in 1997

Currently, 65 licensed insurance companies operate in Malaysia, and 60 of these have at least some foreign equity. Twenty-one have foreign equity of between 50 and 100 percent, and foreign ownership accounts for 38 percent of total premiums. Because Malaysia's health care services are being privatized, its insurance market has great investment potential. Demand for life insurance products is also expected to grow significantly since only about 12 to 15 percent of the population is currently covered.

Since Malaysia adopted a more open policy, the number of foreign insurance companies has increased sharply. However Malaysian regulators and lawmakers argued in the mid-1990s that their country needed restrictions on foreign ownership of local insurers to keep from becoming an economic colony of more developed countries. Accordingly, Malaysia stipulated in its GATS commitments that foreign branches must incorporate locally. The country further stipulated that foreign shareholding by a parent company shall not exceed 30 percent—although the limit was increased to 49 percent after intense lobbying by the United States. In 1997, as the American International Groups took the issue before the WTO, the limit was increased to 51 percent.

Now, Malaysia is requiring foreign insurers to turn branch offices into locally incorporated subsidiaries and divest 100 percent equity stakes down to 51 percent. Some firms are given five years to do so. New entrants are restricted to 30 percent ownership of joint ventures.

Case 4 : Singapore’s insurance policy

Background information on Singapore:

Population: 3.1 million

GNP/ Capita (US$): 30500

GDP Growth: 7.8 in 1997

The life insurance industry in Singapore is also growing at a healthy pace. In 1996, new premium business grew 12.4 percent, and single premium business grew 26.8 percent. Total annual premiums in force expanded by 17.3 percent.

Singapore long maintained a closed-door policy to foreign insurance companies. But in its 1995 GATS commitments, it offered a relatively open policy (see Exhibit 4), and now Singapore is one of the most open of the Asian insurance markets. While Singapore still limits foreign ownership of domestic insurers to 49 percent, it now allows foreign branches and subsidiaries in all sectors of the market.

As mentioned above, the GATS offers flexibility in making commitments. Indeed, Malaysia is a member of the WTO and its economy is more developed than China’s. Nonetheless, Malaysia’s insurance industry is becoming more rather than less closed.

Policy Analysis

To date, the Chinese government has opened the country’s insurance sector only on a "gradual, paced" basis. It has been reluctant to allow foreign investors into the market except on a tightly controlled basis. The government will need to change its policies if the demand for insurance is to be met in the coming years.

Indeed, as the government deepens its social welfare reforms, demand for insurance in China is expected to grow faster than supply—this despite the fact that the number of Chinese insurance companies is expected to double over the next three to five years. The entry of foreign companies can help meet market demand. Foreign companies will also keep pressure on domestic companies to offer a diverse set of quality insurance products. Moreover, China will have to open its insurance sector as part of its entry into the WTO.

China's policies for regulating the insurance sector need to be revised so that they are based on market rather than political factors.

A. China's Non-Transparent System for Foreign Licensing

Foreign insurance companies have complained that China's licensing process is not transparent and that it is based on informal factors rather than on transparent laws and regulations. Under the current system, these companies believe that if they don't demonstrate a long-term commitment to China by offering seminars, setting up research institutes or contributing to Chinese educational institutions, they will not obtain a license.

The statistics seem to bear out their suspicions. To date, 113 foreign companies from 17 countries have applied, but although most of them met the criteria mentioned above, they have not been granted licenses. A 1998 China Insurance Institute study offers furthe evidence of the problem. Of the 20 foreign companies surveyed, most believed that the relations between their home country and China is the most important factor in determining whether or not licenses are granted (see Exhibit 10). Foreign companies also believe that a company's status in its home country is an important factor, as well as a company's contribution to the Chinese education system. The companies saw networking and making connections or "gaunxi" as key to foreign investors in all business sectors; they believe that non-market factors are more important than economic ones. In fact, the central government, specifically, the State Council, does wield a great deal of influence in licensing decisions, meaning that licensing often has to do with political or other issues rather than legal or market factors.

As noted above, the China Insurance Institute has also studied and noted the problem of ownership for foreign firms. Foreigners simply have very few options in choosing joint venture partners (see Exhibit 11).

B. Policy Reform: Bringing Commercial Insurance into China's Social Welfare Framework

Until recently, China's health-care and pension insurance systems were based on central planning. Now China is reforming these systems, and the reforms will undoubtedly generate more business for insurers. If the CIRC can convince the central government to incorporate commercial insurance carriers into its reforms, the potential for Chinese insurance companies operating in China will skyrocket.

1. The Health-Care System

In rural areas, around 64 percent of the Chinese population has no health insurance. Only 120 million farm and village enterprise employees are covered by Cooperative Medical System (CMS) plans, and CMS is not an effective or efficient system even though it has been in operation for several decades. CMS lacks qualified personnel, stable financial resources, an effective fund collecting mechanism, and essential health facilities and equipment.

In China's urban areas, most workers are covered by the government or SOE health care systems. There are many problems associated with these systems. While GDP was growing at 9.8 percent (1978-1993), the combined spending for these programs grew at an annual rate of 11 percent between 1978 and 1992, and jumped to 13 percent between 1986-1993. The government's health care budget increased from 14 percent in 1978 to 30 percent in 1993. In recent years, the 11 percent enterprise set-aside for medical expenses has simply been insufficient, and enterprises profits have had to be used to supplement the shortfall. In some cases, the shortfalls have imposed large financial burdens on enterprises by limiting their resources for reinvestment in capital equipment and for other welfare services, such as pensions.

In 1994, the State Council launched a pilot program in Jiujiang, Jiangxi Province, and Zhenjiang, Jiangsu Province with the goal of reducing health care subsidies in SOEs.[5] Three tiers of financing were introduced: Medical savings accounts (MSAs), out-of-pocket spending in the form of deductibles, and social risk pooling. MSAs provide incentives for consumers to be more cost-sensitive in their demand for health services; deductibles act to further increase cost sharing by patients; and social risk pooling aims to protect persons against catastrophic expenses. Employees and employers contribute one percent and 10 percent, respectively, of their total wage bill each year, and these contributions are divided between two accounts. Five percent goes to the social risk pool, and six percent goes to the individuals' MSAs.

The program was expanded in 1997 to over 60 other cities, and it is likely to become national policy, applicable to domestic and foreign-invested firms. However, primary data collected from these two mid-sized cities indicates that the program has some undesirable side effects. People are not allowed to choose which hospital they go to, not everyone has the same right to health care, and fraud is rampant because so many people are uninsured. The study also shows that, in 1994 in Zhenjiang and Jiujiang respectively, 13.7 and 15.9 percent of workers were not able to get their health expenditures reimbursed on time. Thus, although MSAs have become a widely proposed model for health care reform, they are not problem free. Moreover, relying on MSAs ignores the contribution that commercial providers can make. Instead of, or at least in addition to, further expanding MSA programs, the State Council should give the private sector greater lattitude to provide coverage.

Indeed, the government's economic reforms are stimulating consumer demand for better quality and an expanded range of health services, and provisions need to be made for the rapidly growing segment of the population that works for private companies. In 1978, 72 percent of new urban job entrants were assigned to the state sector, but by 1985, the proportion had fallen to 61 percent.[6] While foreign-invested private enterprises are required to provide health insurance benefits via the Foreign Enterprises Service Corp. (FESCO), other private enterprises most often offer no medical coverage at all. The following two examples illustrate the problem:

- Zhang Jing has worked with a foreign-funded enterprise since graduating from college. Zhang earns a fairly high income when compared to her classmates assigned to SEOs. However, said Zhang, "I am constantly obsessed by a feeling of instability. For example, I could be fired for failing to do a good job, and my income may be lower than that paid by a state-owned business." The feeling of instability spurred Zhang to obtain medical and retirement insurance.[7]

- Ma Jianghua has operated a private business for 10 years. In 1988, a friend convinced Ma to buy medical and retirement insurance from Pingan's Shenzhen Branch. "I pay a fixed annual premium to the insurance company. The insurance in turn provides coverage if I am ill. The policy basically provides the same coverage as the free medical care system. In addition, at age 65, the insurance company will provide me with a monthly retirement pension. My retirement pension will compare favorably with pensions paid to employees of state-owned enterprises and institutions."

Premier Zhu Rongji announced in June 1999 that China was to set up a nationwide, integrated medical care program in three to five years. The time is ripe for CIRC to advocate liberalization of the domestic and foreign commercial medical insurance setors.

2. Pension Reform

The pension system for state employees was first established in the 1950s. It provided lifetime pensions upon retirement to women (age 50) and men (age 60) who had a record of at least 20 years employment. The weakness and limitations of this system are becoming apparent as China shifts towards a market-oriented economy.

First, the enterprise-based system is already losing its ability to meet its present obligations. It will be no better able to meet its obligations in the coming years as declining mortality rates and the one-child family policy accelerate the aging of the population. The urban population aged 60 and above will account for over 10 percent of the urban total in 2000 and nearly 13 per cent in 2010.

Second, the financial burden on enterprises with more retirees is growing disproportionately to those with relatively young workforces. Enterprises with older workforces are finding it increasingly difficult to compete with younger enterprises, and some have already been forced to reduce, delay, or completely cancel pension benefits to retirees. In Hainan province, for example, nearly 30 percent of SOEs were unable to fully meet pension obligations.[8]

Third, employment in non-state sectors, where pension benefits are smaller or nonexistent, have been growing since the 1980s. The shares of urban employment in foreign-funded, private, and individual enterprises will only increase in the next century.

There is no question that pension reform is needed and that the key objective of the reform should be to move away from a pay-as-you-go system toward a system with diversified financing. In the short run, the government will need to continue to make significant contributions in its role as pension guarantor. Indeed, the old economic system is failing and today's elderly population has no ability to buy commercial insurance. In a long run, however, employees should pay for their pensions using commercial insurance; employers should no longer be the sole contributors to the pension fund.

Footnotes

[1] It is worth noting that the Chinese approach to law is quite different than that of the West. Whereas in the West laws are made to rule man, the Chinese see man ruling the law.

[2] "Market access and protocol commitments," http// www.insidetrade.com/1999. "April 8, 1999 U.S. List of Chinese Commitments," http//www.insidetrade.com/, 1999. "Administration Fact Sheet on China Agreement," http//www.insidetrade.com/1999.

[3] Article II:1, GATS Agreement, 1995.

[4]*" Discussing Malaysia's insurance future,"* East Asian Executive Report; Washington, Jun 15, 1997; *"WTO agreement: not perfect but good enough,"* National Underwriter; Chicago; Dec 22-Dec. 29, 1997.

[5] *"The health market,"* The China business review; Washington, November, 1998.

[6] China State Statistical Bureau, 1996.

[7] " *Insurance Boom*," a report form the Painan Insurance Co. 1998.

[8] "*Pension reform in China: preparing for the future*" http://www.census.gov/ipc/www/ebsum, Feb.1999.

Political and Public Relations Analysis

A. Political Importance

1. International Level

As the world's largest developing and socialist country, China is the most likely challenger to western countries, especially the United States. By opening its markets and joining the WTO, China can send a strong political message that it is willing to play the trade game by international rules. Moreover, China's entry into the WTO will help persuade the world that China's rise is an opportunity rather than a danger and will help strengthen foreign businesses' confidence in making investments in China. WTO membership will also promote China's link to the world economy, which in turn will help create a more stable environment for China's economic development, thereby helping China realize the strategic goal of sustained, rapid and healthy development of its national economy.

Opening the insurance sector, one of, if not the most, sensitive sector of the Chinese economy, will help China build international political credibility.

2. Domestic Level

Because the insurance industry is linked to overall welfare reforms, opening this sector to foreign participation is extremely sensitive domestically. Any discussion of insurance liberalization quickly leads to issues of political and social stability, as well as the question of the communist party's leadership. If the government fails to offer well-functioning insurance programs that cover the majority of the population, its political authority will be questioned, if not challenged. Only a well-functioning insurance system will ensure the success of China's market reforms; the provision of pensions and health insurance outside of the SOEs will be key to encouraging people to be willing change jobs and find jobs in the private sectors.

B. Political and Public Relations

Other than domestic and foreign insurance companies, the groups that have the largest stake in the liberalization of China's insurance industry are government agencies, domestic industries, and consumer groups.

1. Government Agency Interests

Several government agencies are concerned with the issue of liberalizing the Chinese insurance industry. They are: the National People's Congress, the State Council, the

Ministry of Foreign Trade & Economic Cooperation (MOFTEC), the Ministry of Health, the Ministry of Labor and Social Security, and local governments.

a) *The National People's Congress and the State Council*

The National People's Congress and the State Council have decision-making authorities. Their concerns focus on whether commercial insurance will ensure a stable Chinese society, which is crucial to the political stability of the country.

Historically, China's central government has been divided into two groups. One group represents Northern China, especially Beijing, and cares about political power. The other group represents Southern China, especially Shanghai, and cares about commercial interests. It is not surprising then that Shanghai's foreign insurance business is more advanced than Beijing's. Moreover, it is clear that the CIRC will confront these differences as it tries to raise insurance liberalization issues with the National People's Congress and the State Council. The central government is likely to continue to prefer opening only the southern part of China to foreign competition, not the North. CIRC will need to prepare media and legislative strategies if it is to advance recommendations for the liberalization of geographical restrictions.

b) The Ministry of Foreign Trade & Economic Cooperation (MOFTEC)

- MOFTEC's interests include:
  - China's WTO accession,
  - Economic and trade relations with foreign countries,
  - China's role in the world trading system,
  - China's economic interests, and
  - China's role in APEC countries.

MOFTEC is CIRC's most important ally for a number of reasons:

- MOFTEC represents CIRC in international negotiations both at the bilateral and multilateral levels, and MOFTEC has already tried to put insurance sector liberalizations on a number of negotiating agendas. Strong relations with MOFTEC will be particularly important since China is expected to join the WTO prior to the conclusion of the next round of service negotiations (which include insurance).

- After China joins the WTO, CIRC will face implementation issues and will likely have to defend against disputes with foreign insurers. MOFTEC will still be China's chief international negotiator.

- MOFTEC can help CIRC monitor relations with other Chinese government agencies. It also has power to address issues directly with the State Council.

c) Ministry of Health, Ministry of Labor and Social Security

Good relations between these two agencies and CIRC will be crucial in any attempt to bring commercial insurance into China's overall social welfare reforms. These two agencies will lose some of their power as part of the reforms and, accordingly, may act as an impediment to change.

d) Local governments

As early as 1979, China started to devolve government authority from central to local levels. Now, local governments have more power to determine the structure of the local economy. They issue licenses, coordinate local business development, resolve business disputes and even participate in the national policymaking process. Moreover, local governments have more power now to resist central government policy changes they don't agree with. While pressure from the central government can force them to accept policy changes, local governments will still control the rate at which changes, such as insurance policy changes, are made. Accordingly, CIRC will need to build and monitor its relationships with local governments. It will also need good relations with the State Council in order to ensure that the central government will step in when local governments act to impede insurance industry reforms.

2. Domestic Industry Interests

Nearly all Chinese industries are involved in the issue of liberalizing the insurance industry.

a) State owned enterprises

Virtually all of the Chinese SOEs care about insurance issues. They employ a large proportion of the urban work force, and they play a large role in providing social security and health services. They are all eager to decrease the burden of supplying pension, health care, and unemployment benefits. SOEs can help CIRC in making the case to the central government that China's insurance industry needs to be liberalized. Cooperation with SOEs will also be crucial in implementing any new insurance policies.

b) Banking groups

The issue of how to increase insurance companies' investment opportunities is directly related to China's banking problem; banking problems will hamper any effort to allow insurance companies greater investment options. If Chinese banks remain weak, they will not be able to provide the basic infrastructure needed to support an insurance industry. Accordingly, CIRC should mobilize political support to push through a set of reforms in the banking sector. The CIRC should also work together with banking groups to develop possible solutions, specifically options that will help the insurance industry.

c) Securities industry

On October 26, 1999, China's financial authorities announced a long-awaited measure that gave domestic insurance companies more options for investing their premium income. Because CIRC plans to call for similar measures for foreign companies in the near future, it will need to establish stable relations with the securities industry.

d) Domestic insurance industry

The domestic industry's major interests include:

- Maintaining their market share,
- Avoiding competition with foreign firms, and
- Increasing their growth opportunities.

The domestic insurance industry will oppose any attempt to open the Chinese insurance sector to foreign competition. CIRC will need to find a way to maintain good relations with the domestic industry while at the same time advocating for more foreign participation in the market.

3. Consumer Group Interests

Before developing a strategy for opening up the insurance market, the CIRC should clearly understand the positions of domestic insurance consumer groups. First, the CIRC should acknowledge that most Chinese still lack insurance awareness, and it should develop basic education materials concerning how insurance works. Because consumers from different social classes, age groups and work situations have different needs, the CIRC will need to develop multiple education approaches in order to build a broad base of consumer support.

a) Consumers from different social classes

Consumers from urban areas will have more knowledge of insurance than their rural counterparts.

b) Consumers from different age groups

It has been nearly twenty years since China began its rapid economic development, and the young generation is now accustomed to making decisions based on economic factors. The older generation, however, is having a harder time adapting to this new way of life.

c) Consumers from different work situations

Employees at private or foreign companies have more motivation to buy insurance than employees who have what they perceive to be stable, long-term employment at an SOE.

Analysis of Implementation Issues

Implementing and enforcing its international obligations on insurance (as well as other sectoral liberalization policies) will be a serious challenge for China in the coming years. In order to ensure success, CIRC will need to develop a comprehensive enforcement scheme that draws on the coordinated efforts of administrative, legislative, and private enforcement bodies. Currently, however, such cooperation is lacking in China.

A. Institutional Barriers

1. Administrative Enforcement Mechanism

When CIRC was established in 1998, it became China's first insurance regulatory body, and supervision and regulation of the industry were transferred from the People's Bank of China to CIRC. The establishment of CIRC indicates that China recognizes the special challenges involved in regulating the insurance industry. However, effective enforcement of central government policies will still be difficult because local insurance regulatory agencies have not yet been established. Additionally, there is a serious shortage of insurance regulators.

2. Private Enforcement

By the end of 1997, 19 provincial insurance associations had been set up in China. As self-regulating organizations, these associations can play an important role in normalizing business activities in the insurance market. However, a national insurance organization has not yet been established. Such a national organization could help provincial associations develop their professional knowledge and help CIRC build links with industry leaders.

3. Policy and Law Measures

The promulgation of laws and regulations relating to the liberalization of China's insurance sector will face opposition from both the domestic industry and factions within the central government. In order to head off these opposition forces, CIRC will have to take the offensive within political circles. A white paper on insurance liberalization should be circulated as a first step.

B. Market Disorder

Corruption and illegal activities are common in China's insurance market. Underwriters have offered inordinately high commissions to agents and excessively high returns to policy buyers in order to gain a larger market share. The CIRC closed down the offices of HongKong-based Jardine Insurance Brokers Ltd,, which was operating in the Chinese market without a license in 1999. After China joins the WTO, one of CIRC's crucial tasks will be to seriously investigate and deal appropriately with all kinds of illegal and anti-competitive practices.

STRATEGY PAPERS

Key Recommendations

A. Policy Changes

China's current "gradual, paced" liberalization policy needs to be revised. CIRC should submit a proposal for a new policy to the State Council and push the central government to issue a new policy for liberalizing the insurance sector as soon as possible. The new policy should be based on market rather than political factors.

Additionally, CIRC should 1) continue to expand its reform of the health insurance system by speeding up China's transition to a commercially provided health insurance system and encouraging individuals to buy life insurance, and 2) develop a nationwide campaign to convince individuals to purchase commercial pension insurance.

Chinese regulators should promote the use of market and financial methods rather than administrative orders to regulate the insurance industry.

B. Legal Changes

In order to prepare China for its imminent entry into the WTO, CIRC should draft regulations for foreign insurance firms operating in China and submit these to the State Council for approval in 2000. The key recommendations may include:

Recommendations for changes to the Insurance Law

	Content	**Speed**
Licensing	-Reform licensing criteria -Improve transparency -Speed licensing-approval procedures	Immediate action
Ownership	-Give foreigners more latitude in choosing venture partners -Allow 50% foreign ownership of life insurance companies and make plans to phase in 51% foreign ownership rights within one year after WTO accession -Allow 51% foreign ownership of non-life insurance	Gradual loosening
Insurance broker	Encourage the entry of foreign insurance brokers	Immediate action
Product and service scope	Expand the scope of products that foreign insurers can sell to include group and pension lines of insurance	Gradual loosening
Geographical restrictions	-Eliminate all geographic limitations for future licenses -Replace city-by-city approvals with provincial-wide licensing	The limitation can be phased out over five years
Investment	Permit foreign insurance companies to invest in stocks and mutual funds	Immediate action

C. Implementation

In order to ensure that any new regulatory policies and laws are fully implemented, a comprehensive enforcement scheme will need to be established.

- CIRC should establish administrative enforcement mechanisms as soon as possible at both national and local levels, with local regulatory agencies reporting directly to CIRC. The enforcement mechanisms should protect fair competition, reduce monopolies, and promote the competitiveness of the domestic insurance industry. To be successful, there will need to be cooperation between administrative, legislative and private sector officials.

- CIRC should increase the transparency of its regulatory functions in order to encourage new entrants into the insurance market. Policy statements should be readily available to all interested parties.

- CIRC should encourage the development of private sector enforcement mechanisms by calling for the establishment of a national insurance association.

- CIRC should take action to improve the quality of insurance professionals. CIRC should issue qualification requirements for insurance professionals and use foreign insurers' good-will programs to promote the development of insurance education.

D. International level

At the international level, CIRC should focus on the following:

- CIRC should encourage cooperation between foreign and domestic companies. Foreign insurance companies have a long history of growth and advanced management ideologies. CIRC should encourage domestic firms to strengthen their cooperative ties to these companies.

- When engaging in bilateral or multilateral negotiations, CIRC should encourage MOFTEC to use the flexibility built into the GATS principles in developing its negotiating position. China has already made adequate insurance concessions in the context of its bilateral negotiation with the United States; it should consider further liberalization very carefully.

- CIRC should prepare itself for the new round of WTO negotiations on services. If China joins the WTO this year, it will need to be prepared for this round.

E. Public Relations

CIRC will need good relations with all relevant interest groups if it is to succeed in persuading the central government to adopt new liberalizing policies, let alone effectively enforce them. These interest groups include government agencies, domestic consumers and the domestic insurance industry.

A Strategy for Opening China's Insurance Industry
Section III: Strategy Papers

Domestic Public Relations Strategy

Objective:

The objective of the public relations strategy is to build support for liberalization of the Chinese insurance market. To obtain this objective, a coalition should be established that includes as many interest groups as possible—the more people or interest groups involved in the coalition, the more powerful it will be. Additionally, a coordinated government system should be established in order to enforce the policy.

A. Coalition Building Strategy

The following interest groups should be targeted for the coalition:

Industries:

Nearly all Chinese industries have a stake in the issue of opening up the insurance industry. However CIRC should focus its efforts on banking, securities, and other financial services companies. It will also want to give special attention to industries that are likely to adopt pension and/or health insurance reforms in the near future.

Domestic consumers:

Domestic consumers will benefit from insurance market liberalizations and should be targeted for the coalition. Specific groups include:

- Individual life and non-life insurance buyers (people who work at private or foreign companies)
- Employees of state-owned enterprises
- Rural populations

Obviously, consumers from different social classes, age levels, and work environments will have different attitudes towards the issue of insurance reforms. The CIRC will need to adjust its approach for each of these different interest groups.

Media outlets:

Media resources will provide the most effective means for educating the public on insurance sector reforms and insurance purchasing options more generally. It will be crucial for CIRC to cultivate good relationships will all major media groups, including:

- CCTV (the national TV station)
- Local TV stations
- People's Daily[34]
- China Daily[35]
- Local newspapers

- "Insurance Journal"
- Internet

Academics:

Academic groups are just beginning to get involved in research on the insurance industry, and this research will be important to CIRC as it reforms China's insurance sector. Accordinlgy, CIRC should consider these groups' interests and design a proposal to achieve general support for reforms from them. The main academic target groups are:

  - Insurance research centers
  - Universities

B. Coordination Between Government Agencies

Since opening up the insurance sector is part of China's overall economic reform, it is absolutely critical to gain as much support as possible in government agencies, including MOFTEC, the NPC, the State Council, the Ministry of Labor, and the Ministry of Health. CIRC should call for the establishment of a coordinated program among agencies that will enable it to work efficiently with these agencies.

In the short run, CIRC should propose that the State Council call for strengthening cooperation among government agencies to implement the new insurance policy; only the State Council has the power to bring all agencies together and insist upon their support for CIRC.

In the long run, CIRC should pursue stable relations with other government agencies by establishing working groups that will study the effects of liberalization policies and make recommendations to the State Council. Members of the groups should come from CIRC, MOFTEC, the Ministry of Labor and the Ministry of Health.

- The working groups' activities might include:
  - Holding news conferences.
  - Conducting market research and investigations.
  - Settling disputes among different government agencies.
  - Submitting annual reports to the State Council.

C. Building Support from Domestic Insurance Groups

New insurance sector policies will not succeed without support from the domestic industry. Domestic insurance companies claim that they are still young and need some protection. Accordingly, they are likely to oppose liberalization policies. To help gain their support for reforms, CIRC should:

- Emphasize that allowing more foreign participation will benefit the domestic industry.
- Develop policy and legal frameworks to assist the development of domestic companies.
- Encourage the establishment of linkages between domestic and foreign companies.

Summary of key recommendations:

- Build a coalition in order to get more support for opening up the Chinese insurance market.
- Establish a working party in order to strengthen cooperation among government agencies.
- Build support from the domestic insurance industry.

Legislative Strategy

The legislative strategy will focus on targeting local and national government agencies to form greater support for reforms.

Objectives:

Convince the State Council and National People's Congress (NPC) that opening the Chinese insurance industry is necessary.

- Convince the central government that liberalization should be based on CIRC's recommendations.
    - Convince the central government to issue policy statements nationally.
    - Convince the NPC to pass new insurance regulations and laws.
    - Establish a long-term enforcement mechanism.

The legislative strategy includes both short-term and long-term strategies:

A. Short-Term Strategy

The short-term strategy will be focused on achieving changes in the insurance law. CIRC can take following actions:

Consensus building

The 16th meeting of 9th NPC Standing Committee will be held later this year. CIRC's primary goal for this meeting should be to convince the NPC and State Council to put the issue of insurance industry liberalization on the agenda. The coalition, especially domestic consumers, interested industries and academics, should do the following:

- Press the State Council to engage in a dialogue with the coalition.
- Support the current social welfare reforms.
- Press the NPC Standing Committee and Law Committee to seriously consider the insurance liberalization issue, including implementation issues (see exhibit 12, sample letter to NPC Law Committee member).
- Introduce CIRC's policy recommendations to the NPC and State Council.
- Offer testimony before the NPC.
- Provide a set of informational documents.

The documents can include:

- A white paper (see exhibit 13 for sample white paper)
- Case studies done by CIRC and other insurance research centers (including this project)
- Documents that include all data and policy recommendations
- Sample newsletters (see exhibit 14)

High-level meetings

CIRC should organize high-level government meetings to gain support from other government agencies and urge them to cooperate in CIRC's efforts to liberalize the insurance industry. The target government agencies include:

- MOFTEC
- Ministry of Labor
- Ministry of Health
- Central Bank
- State Council

Local NPC representatives

Local NPC representatives will need to be convinced to vote for insurance liberalizations. Because representatives from southern China will be more receptive, CIRC should target them first.

B. Long-Term Strategy

The long-term strategy focuses on establishing a stable legal enforcement mechanism. CIRC should submit draft regulations for foreign insurance firms and submit them to the State Council for approval this year. Additional steps that should be taken include:

- Establishing a working group (see public relations strategy).
- Persuading the State Council to pass regulations to enforce new policies.
- Convincing government agencies to cooperate with the State Council and CIRC.

Summary of key recommendations:

- The short-term strategy focuses on changing the Insurance Law.
- The long-term strategy focuses on pursuing a stable legal enforcement mechanism.

Media Strategy

Using the media will be extremely important for CIRC and its coalition. Media sources offer a powerful means of addressing the public and disseminating information on policy issues. In the past, Chinese government agencies have seldom used this tool. CIRC should use all available media tools in order to create greater visibility of the insurance issue.

Objective:

The primary goal in using the media is to generate greater public support for reforms and the goals of the legislative strategy. The secondary objective in using the media is to educate Chinese insurance consumers about insurance.

Target audiences:

- Government agencies and the central government. Media publicity will help gain the attention of decision-makers in these agencies. CIRC will only achieve its legislative goals if such decision-makers focus adequate attention on the insurance issue.

- Domestic consumers. Chinese consumers do not have enough knowledge about insurance. The media will play an important role in educating consumers and gaining public support for legislative changes.

Main Focus:

The media strategy will focus on:

- The positive changes that will come with insurance market liberalizations.

- The strategic importance of opening up China's insurance market.

- The positive impact on domestic insurance buyers of opening the insurance market.

Actions:

The media strategy will involve the following:

<u>1st Level: Introduce the issue and get more public attention</u>

- A press conference should be held to address current policy concerns and possible future changes. (The conference can be held in August 2000.)

- A press release should be issued after the conference.

- Case studies and academic papers should be published and their results should be sent to the media.

- CIRC officials should make television announcements.

<u>2nd Level: Initiate a public debate</u>

- Initiate TV debates with interest groups, such as domestic insurance companies and consumers.

- Initiate TV programs and interviews with experts on insurance.

- Initiate a debate between influential experts who are for and against liberalizations.

- Publish a CIRC/coalition newsletter to inform interest groups and industry associations on reform progress.

- Issue internal policy reports and submit them to the State Council in order to keep the Council informed of CIRC's activities.

3rd Level: Public education

Due to the fact that a majority of Chinese citizens still lack insurance awareness and knowledge, CIRC should develop a long-term media strategy that focuses on educating the public and preparing for policy implementation. CIRC should:

- Initiate TV education programs featuring insurance experts.
- Invite foreign insurers to participate in the TV education programs.
- Strengthen current education programs currently offered in cooperation with foreign companies.
- Expand insurance research programs.
- Help local insurance associations establish insurance education programs.
- Work with foreign insurance companies to publish articles on insurance policies and business.

Special recommendation:

A statistical report made public by the China Internet Information Center on January 8th this year shows that, by the end of 1999, the number of Chinese subscribers to the Internet had reached 8.9 million and the number of computers in China linked with the Internet had reached 3.5 million. The numbers show that the Internet will be an effective media tool in China, and CIRC should take advantage of it.

CIRC should also consider launching its own web site. The site should have both English and Chinese versions. It should explain insurance policies and regulations to the public and allow a direct line of feedback from the public. The site also can answer frequently asked questions about insurance and insurance policy.

The main contents of this web site can include:

- A description of CIRC
- News from CIRC
- News from the world insurance industry
- Laws and regulations
- Information on foreign insurance companies
- Information on China's insurance market
- Statistical reports
- Questions and answers concerning the liberalization of the Chinese insurance market.

Currently, there are several Chinese insurance web sites that CIRC should provide links to. These are

http://www.china-insurance.com/
http://gulili.163.net/
http://www.zg169.net/~fengzh/
http://serve.cei.gov.cn/sd/index.htm

Summary of key recommendations:

- 1st level: Introduce the issue and get more public attention
- 2nd level: Begin a public debate
- 3rd level: Educate the public and prepare to enforce new policies
- Special point: Begin building a web site

Footnotes:
[34] The People's Daily is China's official newspaper. There are both English and Chinese version of the paper.
[35] China Daily targets overseas readers. There is an English language version of it.

A strategy for opening up the Chinese insurance industry
Section III: Strategy papers

Research and Education Strategy

Objective:

The goals of this strategy are: 1) to promote the establishment of a national research center and strength academic research on insurance; and 2) to strengthen the nationwide education program.

A. Identification of Problems

A few Chinese universities have recently established insurance departments. For example, the Chubb Group of Insurance Companies and Shanghai University of Finance and Economics established the Chubb School of Insurance in 1995. Beijing University established its insurance department in late 1990s. In general, however, China still lacks academic research and education on insurance. China does not have a national insurance research center that can offer long-run technical assistance to both policy makers and the insurance industry. Additionally, China still lacks public education programs that are needed to educate the Chinese public about insurance.

1. Strengthen Academic Rresearch

(1) Establish a national insurance research center

CIRC should promote the establishment of a national research center as one of its key strategies for developing and opening up the Chinese insurance industry.

The insurance industry and CIRC would benefit from the establishment of a research center in several ways. Such a center would encourage collaboration on research projects, as well as:

- Provide an umbrella organization to attract research funding (including international funding);
- Assist universities in establishing research priorities;
- Enhance the visibility of research efforts in particular areas;
- Facilitate interaction between researchers and insurance industry officials;
- Provide a means for researchers to offer policy suggestions to policy makers; and
- Provide a focal point for cooperation between Chinese researchers and international institutions.

The research center could be supported in part by CIRC and other government agencies. It should also seek funding from domestic and foreign insurance companies and other interested parties.

Possible domestic funding sources:

- Domestic insurance companies
- Local governments
- CIRC
- Other government agencies such as the Ministry of Health and the Ministry of Labor
- SOEs

Possible international funding sources:

- Foreign insurance companies
- International insurance associations
- International organizations
- International insurance institutions

Possible projects for the research center in the short-run:

- Study of foreign countries' regulatory models
- International trade policy (specifically insurance policy)
- China's insurance market

- Web site development
- Joint research with international insurance institutions

(2) Support university research programs

Some universities have already established joint research programs with foreign insurance companies. CIRC should encourage this cooperation and offer more support.

In northern China, CIRC can give more support to Beijing University and Renmin University. In southern China, CIRC should make Fudan and Shanghai Universities priorities since the insurance industry is centralized in Shanghai.

- CIRC can support the university programs by:
    - Helping them develop visiting scholar programs
    - Making institutional visits
    - Encouraging local & overseas industry visits
    - Facilitating teaching materials exchanges
    - Providing technical support
    - Facilitating technical exchange
    - Developing a publication exchange
- Establishing a student exchange program through which students would have the opportunity to work in foreign insurance institutions

Other possible support for university insurance programs might come from:

- Domestic and foreign insurance companies
- International insurance associations
- International organizations

(3) Immediate programs

If China joins the WTO this year as expected, it will have to make substantial changes to its insurance regulations, particularly those regulations governing access to the market by foreign insurers. Accordingly, CIRC should hold at least one seminar in the near future to begin preparing for these changes. The seminar might be titled: *"Experts Meeting on Insurance Regulation and Supervision in China."* It should focus on:

- International regulatory trends
- International laws and WTO agreements

- China’s insurance policy reform model

2. Strengthen Education Programs

CIRC should be concerned with both public education and industry training.

(1) Public education

As previously noted, the media should be used to educate the public about insurance. CIRC should use TV, the Internet and newspapers in its education campaign, and it should tailor its education messages to different consumer groups based on their social class, age and work situations.

(2) Industry training

China still does not have enough trained insurance professionals. CIRC should issue a provisional regulation on insurance agent qualifications in the near future. However, if such a regulation is issued, CIRC will need to help the domestic industry strengthen its training programs.

The training programs can be co-organized by CIRC, industry associations, and individual companies. The programs might include presentations by university experts, international insurance associations, and CIRC officials.

The training programs should cover:

- Insurance theory (property, life and marine)
- Insurance finance
- Insurance accounting
- Risk management
- Reinsurance
- Actuarial
- Law
- International insurance case studies

Summary of key recommendations:

- Establish a national insurance research center
- Support university research programs.
- Hold a Seminar: "Experts Meeting on Insurance Regulation and Supervision in China."
- Strengthen public education programs.

- Strengthen industry training programs.

Implementation Strategy

Objective:

If China joins the WTO this year, the central government will have to change its current insurance policy. From this standpoint, the implementation of new liberalization policies is a major near-term mission for CIRC that will require a well coordinated plan.

Key Players:

- The key players include:
  - The central government, including the State Council and the NPC Standing Committee.
  - CIRC
  - Local governments
  - The Ministry of Health and the Ministry of Labor
  - The domestic insurance industry
  - Domestic interest groups

Actions

1. CIRC should adopt regulatory reforms.

CIRC's main actions should include:

a) Improving its transparency level.

CIRC can establish and use its web site and newsletter to publish its policies and relevant regulatory documents. In terms of licensing, CIRC should clarify its regulations that apply to foreign insurers.

b) Accelerating internal reforms

CIRC should improve its efficiency and reduce illegal insurance operations.

c) Establishing an administrative enforcement mechanism.

CIRC should also take action to establish an administrative enforcement mechanism. CIRC should cooperate with local governments to establish local insurance regulatory bodies. (CIRC already has administrative power to govern local insurance regulatory agencies.)

2. The central government should coordinate the implementation process.

CIRC should push the central government agencies, specifically the NPC Standing Committee and State Council, to coordinate the whole implementation process.

a) *Establish a working group to carry out policy implementation.*

In the long run, a working group that involves officials from all relevant agencies will be needed if reforms are to be successfully implemented

b) *Implement policy enforcement measures.*

CIRC should push the central government to use its powers to ensure that policy enforcement measures are properly implemented. For example, insurance policy can be addressed in NPC's documents, and central government agencies can issue various policy statements.

3. The private sector should establish enforcement mechanisms.

CIRC should encourage the domestic industry and other interest groups to police themselves.

a) *Establish a national association.*

A national association can help CIRC explain the liberalization policies to individual companies and strengthen insurance companies' abilities to regulate themselves. In addition, insurance associations can establish strong relations with foreign insurance companies. (See international strategy paper.)

b) *Improve public education level.*

The insurance industry (both domestic and foreign insurers) should contribute to education programs. First, the industry should educate its employees in order to improve the quality of insurance professionals. Second, it is critical to educate insurance consumers.

Summary of key recommendations

For CIRC: 1) accelerate reforms; 2) improve transparency; 3) establish administrative enforcement mechanisms.

For the State Council and the NPC Standing Committee: 1) establish a working group; 2) use policy enforcement measures.

For industry: 1) establish a national association; 2) improve public education level.

International Strategy

Objectives:

This strategy is designed to: 1) increase foreign governments' and business groups' understanding of China's insurance sector reforms; 2) build good relations between CIRC and foreign governments and industry associations; 3) provide recommendations for future international negotiations.

A. International Media Campaign

Once China decides to open its insurance market, it should generate an international media campaign to announce its policies and let the world know that foreigners are welcome in its insurance market. It should:

- Hold a press conference to announce its policy reforms.
- Publish articles and op-ed pieces in the China Daily and other major international newspapers. Since most foreign insurers who want to enter the Chinese market are either American or European, CIRC should also try to place op-eds in U.S. and European papers (see exhibit 22 for sample op-ed pieces).
- Hold seminars for potential foreign investors.
- Use the Internet. As mentioned above in the domestic media strategy section of this paper, CIRC can establish its own web site and use this web site to provide information to the international community.

B. Building International Relations

Opening up the Chinese insurance industry does not simply mean just letting foreign insurers into the market. Opening up means that China would like to cooperate with foreign countries and insurance industries to develop the Chinese insurance market. Therefore, it is critical for CIRC to build good relations with foreign insurers and governments so that exploration of common interests will be possible.

1. Building Good Relations with Foreign Governments

Governments usually play a role in assisting business. They negotiate trade issues and present business interests in the international arena. Accordingly, CIRC will need to maintain good relations with foreign governments.

First, CIRC should cooperate with other Chinese government agencies, such as the Ministry of Foreign Affairs (MOFA) and MOFTEC in order to build good relations with foreign nations. It is especially important to gain support from the United States and European countries, since they can bring years of valuable industry experience to China.

Second, CIRC should establish stable long-term relations with foreign government agencies that regulate the insurance sector. CIRC is a new regulatory body. It can learn from its foreign counterparts if it establishes good relations with them.

2. Building Good Relations with the International Insurance Community

In most Western countries, there is a special business to government relationship that does not exist in China. In these countries, particularly in the U.S., business has more power and often influences the policy decision making process. Accordingly, industry associations play an important role in the West. They keep in close contact with government offices, special interest groups, professional organizations, the news media and other opinion leaders. CIRC can learn from these associations and should strive to establish good relations with them.

First, CIRC should encourage the Chinese insurance associations to establish ties with international insurance associations, including:

The United States:

- National Association of Insurance Commissioners (NAIC)[36]
- National Association of Mutual Insurance Companies (NAMIC) [37]
- Health Insurance Association of American [38]
- American Insurance Association[39]

Canada:

- Canadian Life and Health Insurance Association Inc.[40]

Malaysia:

- Life Insurance Association of Malaysia[41]

Korea

- Korea Non-Life Insurance Association[42]

Second, CIRC should encourage Chinese insurers to establish a long-term joint program with foreign insurance companies and associations. These programs might include:

- International seminars
- International insurance fairs
- Information exchange programs
- Informal dispute settlement meetings

C. International Negotiation Strategy

In negotiating its bilateral agreements for WTO accession, China has already agreed to allow more foreign participation in its insurance sector. However, China has not yet concluded its bilateral negotiations, and if China joins the WTO, it will participate in the next round of trade negotiations. China will need to be prepared to hold the line and not offer any new concessions in the near future.

1. Guidelines for future negotiations

China has already agreed to significant insurance industry liberalizations and will need time to fully implement these commitments (as well as allow the domestic industry to adjust) before it makes new concessions. Chinese negotiators should study other developing countries' GATS commitments on insurance before entering into negotiations. Principles or guidelines for the liberalization of China's insurance sector should include:

- GATS rules: The GATS offers flexibility for individual countries to negotiate special commitments, limited national treatment etc. It also offers special treatment for developing countries. At present, China is pursuing its WTO membership, but this does not mean that China should accept everything its counterparts want.

- National treatment: Currently, China's insurance law is somewhat contradictory. On the one hand, it places a number of limitations on the allowable business scope and geographic locations for foreign insurers. On the other hand, foreign insurance companies in China are enjoying super-national treatment, such as preferential taxation. China should abolish super-national treatment and also eliminate many of the limitations on foreign insurers.

- China's economic development. China has already made significant concessions in its bilateral agreement with the United States. Given that the Chinese insurance industry is still in its early development stages, new commitments should be made very carefully.

2. Bilateral negotiation strategy

In future bilateral negotiations, CIRC can take following actions:

- Study other countries' insurance policies and international agreements in order to prepare for future negotiations.
- Show economic and industry data to support CIRC's arguments.
- Approach negotiations on a case-by-case basis, using different strategies for different negotiations as appropriate. Such an approach will help CIRC control the speed of required liberalizations.
- Cooperate with MOFTEC. MOFTEC is China's lead negotiator on all trade issues, including insurance issues. CIRC can offer evidence, industry data, research, and studies to assist MOFTEC. Moreover, CIRC can make its opinions clear to MOFTEC in order to promote its interests.
- Use the power of the media to support China's negotiating interests.

3. Prepare for WTO Negotiations on Services

Last December, WTO member countries failed to launch a new round of trade negotiations. However, services (including insurance) will still be on the next round agenda as part of the built-in agenda. If China joins the WTO this year, it will need to participate in these negotiations.

In order to prepare for WTO negotiations, CIRC should first develop a long-term action plan, which includes study of international trade agreements and insurance policies. In fact, CIRC should direct its Department of Policies and Regulations, Division of Policy Study, to immediately establish a working group that includes participation of universities and foreign insurance companies.

The overall strategy for future WTO negotiations should include:

- Forming alliances with other developing countries. Most developing countries, such as India and Malaysia, confront challenges similar to China's. Alliances can help ensure that these challenges are adequately addressed within the context of WTO negotiations.
- Using WTO principles to pursue special treatment for the developing countries. Special treatment might include 1) extending transition periods for developing countries to implement WTO agreements; 2) expanding technical cooperation.

Summary of key recommendations

- ➢ CIRC should generate an international media campaign to announce its policies and to change its image.
- ➢ CIRC should build good relations with foreign countries and government agencies.

14[5] China's reinsurance sector premiums were Yuan 9.6 bil in 1997, available from http://www3.xls.com. Internet, accessed Dec. 1998.
15[6] Nationwide Financial News, available from http://www.web.lexis-nexis.com Internet, accessed July 1,1999.
16[7] *China—opportunities and obstacles for the insurance industry in an emerging country*, CPCU Journal, Spring 1998.
17[8] Ibid 4.
18[9] *Impact of Foreign Insurance Company Entry into the Chinese market*, AmCham Insurance Industry Forum, May 1998.
19[10] Qixiang Sun, *China's Insurance Industry: Contradiction, Challenges and Countermeasures*, 1998.
20[10] Qixiang Sun, *China's Insurance Industry: Contradiction, Challenges and Countermeasures*, 1998.
21[11] John Jennings, *U.S. insurers hail WTO deal to life world trade barriers*, National Underwriter; Chicago, Dec. 1997.
22[12] Xuesheng Li, *The Health Market*, The China Business Review; Washington ; Nov/Dec 1998.
23[4] New star publishers, *Insurance Reform and Development*, 1997.

- CIRC should encourage the Chinese insurance associations to build long-term relations with foreign insurance associations.
- CIRC should develop an immediate strategy for future bilateral negotiations.
- CIRC should prepare for the next round of WTO negotiations on services.

Footnotes:
36 NAIC is the U.S. association for insurance regulators. Its web site address is http://www.naic.org.
37 NAMIC is a U.S. insurance association. Its web site address is: http://www.namic.org
38 The Health Insurance Association of America is the most prominent U.S. trade association representing the private health care system. Its 290 members provide health, long-term care, dental, disability, and supplemental coverage to more than 123 million Americans. The web site address is http://www.hiaa.org.
39 American Insurance Association's web site address is :http://www.aiadc.org.
40 Canadian Life and Health Insurance Association Inc. is a national association in Canada. Its web site address is www.CLHIA.ca.
41 http://www.liam.org.my/
42 http://www.knia.or.kr/

A Strategy for Opening the Chinese Insurance Industry
Section II: Analytical Papers

Analytical Papers

The following analytical papers examine the challenge of liberalizing China's insurance market from five perspectives: commercial, legal, policy, political and public relations, and enforcement/implementation. The analyses reach a common conclusion: China needs to open its insurance market and should actively prepare for the challenges of accomplishing this opening.

Commercial Analysis

The commercial analysis highlights the real impacts of the foreign participation on the domestic insurance industry. The analysis finds that:

- The Chinese insurance industry is an infant industry.
- The market still lacks market competition.
- The market is growing very quickly.
- Insurance market demand is bigger than market supply.
- Foreign companies hold only one percent of the national insurance market.
- The market has enormous potential. The number of insurance companies is expected to double in the next three to five years; insurance sector income is expected to continue to grow at an average annual rate of about 30 percent; and premiums are expected to at least double.

The commercial analysis also demonstrates that the overall impact of foreign company participation in the domestic insurance industry is positive:

- The entry of foreign companies has not influenced domestic companies' market share.
- The entry of foreign companies has improved the competitive level of the Chinese insurance market.
- Domestic companies have learned new sales and management techniques from the foreign companies.
- Consumers have benefited from foreign competition because domestic companies have had to improve the quality products and services in order to compete with the foreign companies.

Legal Analysis

The legal analysis offers a framework for understanding China's current insurance law and regulations. Specifically, the legal analysis focuses on the following issues:

- Licensing
- Ownership
- Insurance brokers
- Geographic restriction
- Products and service scopes
- Investment opportunities

Policy Analysis

The policy analysis finds that China's decision-making process lacks transparency, especially in terms of licensing and helping foreign insurance companies find joint ventures partners. Improving the transparency level of the insurance industry's regulatory oversight will be critical to the liberalization process. Policy making and licensing decisions should be based on the market rather than on non-market factors, such as political concerns and relationships.

China's central government is engaged in a vigorous bureaucratic effort to accelerate the reform of the social security system and create a system of health care and pensions appropriate for a market economy. However, current reforms are incomplete because they still do not acknowledge the large contribution commercial insurance can make. If China wants its economy to become a market-based economy, it should encourage the development of a commercial insurance industry.

The analysis also finds that market restrictions on foreign companies should be loosened immediately. Rules confining insurers to invest premiums in government bonds and bank deposits should be lifted, and foreign insurance brokers should be allowed to obtain licenses. At the same time, however, the domestic industry should continue to receive some protection in order to give it room to develop in the face of new foreign competitors. Restrictions on the scope of products that foreign insurers may sell should be loosened only gradually. Geographical restrictions, city-by-city controls, and ownership restrictions should also be loosened slowly.

Political and Public Relations Analysis

Opening up the Chinese insurance industry is a complex challenge that involves many interest groups including government agencies, the domestic insurance industry, state-owned enterprises, and domestic consumer groups. At the same time, insurance reform will be key to China's overall economic development since state-owned enterprises are no longer able to supply health and retirement insurance.

Implementation Analysis

Once China decides to open its insurance industry and adopts new policies, CIRC will need to develop a comprehensive enforcement scheme. To be successful, this will need to be a cooperative effort that involves a number of government agencies, as well as industry associations. Without cooperation, illegal and corrupt activities are likely to plague the liberalization effort.

Commercial Analysis

Although Chinese insurance companies fear that their development will be stunted by increased foreign competition, China has agreed to open the industry to greater competition as part of its WTO accession agreements. Even if these agreements had not been made, however, China would benefit from increased foreign participation in the sector. In fact, China's experience to date supports the view that competition, both domestic and foreign, will strengthen the industry during this phase of rapid development.

A. Reasons for Current Market Growth

China's insurance industry is developing very quickly. It is estimated that, from 1980 to 1998, China's insurance market grew 39.6 percent annually. There are several reasons for this growth:

- For more than 40 years, commercial insurance was virtually unavailable in China. The country represents the world's largest untapped insurance market.

- In recent years, overall economic growth in China has been strong. China's economy was growing at more than 10 percent per year before the Asian financial crisis. The growth rate in 1998 was eight percent, and this year it will be more than seven percent.

- Competition between domestic insurers has accelerated growth. Since 1996, several domestic insurance companies, such as Tian An and Tai Kang, have been established. The three major insurance companies in Beijing are now facing a big challenge from Tai Kang Life Insurance Co.

- Competition between domestic companies has increased marketing efforts which, in turn, has increased consumer awareness of and demand for insurance products.

- The entry of foreign insurers into the market has pushed domestic companies to improve their services. Insurance buyers are receiving better service, which encourages consumers to buy insurance.

- Social welfare reforms have also spurred insurance sales. As reform of the social security system has deepened, life insurance as a portion of total insurance in China increased from 0.2 percent in 1982 to 41.75 percent in 1996; by the end of 1997, it had leapt to 55.5 percent. Recently, China's government decided to implement further social services reforms that cover pensions, health insurance, unemployment insurance and birth insurance. All of these reforms will accelerate the demand for commercial insurance and spur the industry's development.

Case 1: Shanghai Study23[13]

Shanghai is the birthplace of the Chinese domestic insurance industry. During the 30s and 40s, some 232 insurance companies had offices in the city; it was the insurance capital not only of China, but also of the Far East. Shanghai was also the first city in China to open its insurance sector to foreign investors since China began re-opening the industry in the 1990s. The People's Bank of China granted a license to AIA in 1992, and this was followed by licenses to Japan's Tokyo Marine and Fire Insurance and to Winterthur. Total premium income of the Shanghai market has increased dramatically. Life insurance premiums grew from RMB 560 million in 1992 to RMB 5.7 billion in 1997. Property and casualty insurance was RMB 3.1 billion in 1997. PICC grew in Shanghai over the 1992-1995 period at an average annual rate of 27.3 percent, CPIC at 119.8 percent, and Pingan at 101.7 percent. Foreign investors have been keen to enter the Shanghai market where the economic growth rate has been above 13 percent per year for five years and per capita income has on average grown over 23 percent per year. Now Shanghai hopes to speed the development of a multi-level insurance company system to make the city the reinsurance center of China.

B. Market Participants

During the 1990s, the Chinese insurance market was characterized as a "tripartite confrontation" between three big state owned insurance companies—the People's Insurance Company of China, the China Pacific Insurance Company Ltd., and the Pingan Insurance Company of China. In 1997, the premium income of these three companies accounted for 96.56 percent of total premiums. PICC's premiums alone accounted for roughly 70 percent of the market. China Pacific accounted for 11.9 percent (11.6 percent of the property insurance market and 12 percent of the life insurance market), and Pingan accounted for 15.8 percent (eight percent of the property insurance market and 22 percent of the life insurance market).

The rapid growth of these three companies is not expected to change any time soon:

- People's Insurance (Life) Co. Ltd. posted a premium income of 30.33 billion yuan in the first half of 1999, and China Life seized 77 percent of China's life insurance market in 1998.

- China Pacific Insurance Co. increased its premium income 13.07 percent in the first half of 1999 to reach 7.018 billion yuan.

- Pingan Insurance Co. maintained growth momentum in the first half this year, with its insurance premiums rising 48 percent to 10.95 billion yuan.

Despite these phenomenal growth rates, the three insurance companies fell far short of meeting the needs of China's vast insurance market, and this has opened the door for other domestic insurance companies to develop. Indeed, small domestic companies are growing very quickly and are expected to create competition for the three large carriers in the years to come.

Any major changes in market share in the coming years are expected to be driven by competition among domestic companies. While AIA captured about 45 percent of the Shanghai life insurance market when it first entered the Chinese market in the early 1990s, a recent study shows that domestic companies have successfully improved their competitive abilities. Domestic companies have forced AIA back to a modest level of market share (see Case 2 below).

Case 2. Foreign company market share remains small in Shanghai23[14]
One of the great misconceptions concerning the impact of foreign entry into the Shanghai insurance market is that foreign companies have taken over a big part of the market. The reality is that, while the Shanghai market grew about 50 percent during 1996-97, foreign companies' market share dropped from 20 percent to about seven percent (see Exhibit 6). AIA grew rapidly when it first established itself in Shanghai, but domestic competitors responded aggressively and have forced AIA back to a modest estimated 14 percent share of the Shanghai life insurance market (only 1.5 percent of the national market). Of the 20,000 life agents active in Shanghai, only about 10 percent are AIA agents. Some 4,000 former AIA agents have joined domestic companies.

Chinese insurance companies have further strengthened their financial position by aggressively investing in other markets. Currently, PICC has more than 80 overseas branches in Hong Kong, Britain, the United States, Macao, and other countries and regions, and this overseas growth has paralleled the growth of competition within the PRC. In Hong Kong, for example, the market share of mainland Chinese companies rose from five percent in 1991 to more than 25 percent in 1997. The fact that mainland companies are succeeding in Hong Kong, one of the world's most competitive markets, is a testament to these companies ability to thrive in highly competitive environments.

If China opens up its insurance market, the real impacts of foreign participation, such as how many Chinese insurance companies will be hurt and to what extent, are unclear now. However, one result is clear: The entry of foreign insurance companies into China will bring heavy pressure on Chinese companies and force them to improve their management and operational efficiency.

C. The Benefits of Foreign Competition for Domestic Companies

China's insurance industry is still in its developmental, infant stages. Only 13 domestic companies and 11 foreign insurance companies currently operate in China (well over

5,000 companies sell insurance in the United States). Foreign competition can help ensure that China's industry develops in the most efficient way possible.

Indeed, foreign insurance companies bring efficient management systems and advanced sales techniques to China's insurance industry, and domestic insurers and industry regulators have in many cases learned and copied these techniques in order to increase their own companies' efficiency and profitability. For example:

- Following the lead of foreign companies, Shanghai regulators now require insurance agents to pass an exam.23[15] Among the first batch of test-takers, 43 percent were employees of domestic insurance companies, compared with 90.4 percent of the third batch. A better trained and more professional sales force will better service Shanghai insurance buyers.23[16]
- It was AIA that introduced China to the door-to-door sales method, a practice commonly used in international insurance sales for well over 100 years. In Shanghai, AIA was the first to use door-to-door canvassing.23[17]

D. The Benefits of Foreign Competition for Chinese Consumers

Because China 's economy has been almost entirely a peasant farming economy for thousands of years, the concept of long-term investment is unknown to the vast majority of Chinese. Insurance doesn't readily make sense to most Chinese who believe that the young generation should support their aging parents. To the extent that the Chinese consider outside assistance at all, this assistance has been provided for more than 30 years as part of China's planned economy. People are still accustomed to enjoying free medical and retirement pensions under the old social welfare system.

Thus, most Chinese consider insurance to be unnecessary if they've even considered it at all. But the entry of foreign insurance companies into the Chinese market has begun to change this perception. Indeed, many people in Shanghai recognized the need for insurance only when AIA began door-to-door canvassing. Increased competition in China's insurance sector will help further the Chinese people's knowledge of insurance as more and more companies compete for consumers' attention. Foreign firms have also benefited consumers by introducing new products, more coverage, and more information about their insurance policies—all at increasingly competitive rates.

E. Both Domestic Insurers and Consumers Benefit from "Goodwill" Programs

China also benefits from the "goodwill" programs that foreign insurance companies provide. Because foreign companies must have an established office in China for two years prior to being eligible to apply for a license and begin selling insurance, these companies have plenty of time to establish such programs.

The programs cost millions of dollars each year and would not be possible without foreign assistance. They include professional training, educational support, seminar organization, and financial sponsorship of research, and they will help improve both domestic and foreign companies' services and ultimately benefit consumers. Some programs offer direct training to consumers.

A few examples of goodwill programs are:

- The Chubb School of Insurance. This school was established by the Chubb Group of Insurance Companies in cooperation with the Shanghai University of Finance and Economics in 1995. Located at the university, the school offers specialized training and courses of one- or two-week duration to Chinese insurance industry regulators and officials, insurance agents and brokers, and the local staffs of Chubb, as well as domestic insurance companies. Subjects include risk management, marketing, management of specialized areas of underwriting, claims, catastrophe management, and solvency. Chubb provided the insurance industry experts who conducted the initial courses for the Shanghai University staff that now teach the courses. [23][18]

- Young Leaders Development Program. The American International Assurance Company Limited Foundation launched this program in 1996. Each year, 24 first-year students are selected from the six universities in Hong Kong and a series of systematic leadership skills training workshops are organized for them.23[19]

- MetLife Scholarship Fund. Metropolitan Life Insurance Co. started a $100,000 scholarship fund at China's Central Finance and Economic University in October 1999. The goal of the fund is to encourage outstanding teachers and top-performing students at the university. MetLife and the university also intend to explore further opportunities for training insurance teachers and professionals.23[20]

F. Market Potential

As discussed in the background section, the Chinese insurance market has great potential. Per capita premium spending is far below the worldwide average, and premiums as a percent of GNP are still less than the average for developing countries.

According to Professor Wei Runquan, an executive member of the China Insurance Society, China's GDP reached 5,770 billion yuan in 1995, with total saving deposits approaching 3,000 billion yuan. If calculated in terms of internationally accepted norms for the contribution the insurance makes to the national economy, the potential scale for China's 1995 insurance market would have hovered between 320-360 billion yuan, or eight times higher than actual premiums that year. Wei also notes that the average per-capita outlays for life insurance coverage in Japan and the United States stand at US$3,800 and US$1,000 respectively. China's per capita outlays are just US$1.3. Professor Wei contends that national economic growth, maturation of the market economic system, the enhanced awareness of 1.2 billion people of the need for insurance, and government policies that encourage development of the insurance sector provide powerful guarantees for the continued expansion of the insurance sector.23[21]

As previously noted, total Chinese premiums from 1981 to 1994 (13 years) grew at a compound rate of 39 percent from $200 million to $6 billion. CIRC experts predict that, if premiums continue to grow at a relatively high compound rate of 30 percent a year, life and property casualty insurance premiums could total $63.6 billion by 2003.23[22] If growth is a more conservative 10 percent annually, the total by 2003 would still be $14.1 billion. If growth were to take off at 50 percent, the projection becomes $230.6 billion.

Examination of specific rural areas' market potential provides further evidence of China's overall insurance market potential. Zhangzhou and the Yellow River Delta are representative of current economic development levels in China since both have largely rural, agrarian economies. The forecasts in both areas show that insurance premiums will at least double within the next three to five years.

- Zhangzhou is located in Jiangxi Province and has a total population of 7.55 million. Its rural population is 6.37 million, accounting for 84.4 per cent of the total population. Zhangzhou, like most of China, relies on agriculture as its primary industry. Accordingly, the insurance market forecast in this area gives a reasonable picture of China's market potential, and Zhangzhou's insurance density has grown over 100 percent in just the last three years. It is expected to grow almost fivefold over the next 10 years 23[23] (see Exhibit 7).

- The Yellow River Delta is located in Shandong Province and is one of the three biggest delta areas in China. Although economic development in this area has been slow to date, it is expected to develop very quickly in the next century because of its rich natural resources. The insurance industry in this region has developed very rapidly since 1992. Its insurance density has doubled in the last five years. (Exhibit 8 shows the insurance premiums in this area, and exhibit 9 shows the market potential.)23[24]

G. Conclusion

Although China's insurance industry is still in its infancy, the overall impact of foreign company participation in the industry has been positive. Although foreign companies' market share remains small, they have improved the competitiveness of the Chinese insurance market. Domestic companies have learned from the foreign companies' management and sales techniques, and they have benefited from the "goodwill" programs offered by foreign firms. Chinese insurance consumers have also benefited. They now have better opportunities to learn about and purchase insurance policies.

But because demand still far outstrips supply, China would benefit still more if it were to further open its markets to foreign competition. Since domestic companies currently control the market, they are well positioned to improve in the face of foreign competition even if China were to open its insurance market now. Chinese policy-makers should re-think the current policy of “gradual, paced” liberalization of the domestic insurance industry.

Footnotes

[13] "China in our hands," available from http://web.lexis-nexis.com, Internet, accessed June 1999.

[14] "Impact of foreign insurance company entry into the Chinese market," Amcham Insurance Industry Forum, May 1998.

[15] *"Why countries are hesitant to open markets,"* Huang zhen, Economic Review, China, May 1998.

[16] "*Impact of foreign insurance company entry into the Chinese market,*" AmCham Insurance Industry Forum, May 1998.

[17] Ibid 5.

[18] News available from http://www.chubb.com/china, Internet, accessed 20 Dec. 1998.

[19] News available from http://www.aia.com.cn, Internet, accessed May 1999.

[20] News available from http://www.lexis-nexis.com/universe/docu, Internet, accessed November 1999.

[21] *" Insurance reform and development in China,"* PICC, 1997.

[22] Forecast by CIRC’s Policy Study Division.

[23] "*China's insurance market: current situation and its trend,*" Qiu sanfa, Yan xudong and Zhou erchang, Insurance Research, 1999.

[24] "*China's insurance market: current situation and its trend,*" Qiu sanfa, Yan xudong and Zhou erchang, Insurance Research, 1999.

Legal Analysis

A. Domestic Law Analysis

On June 30, 1995, the insurance law was promulgated at the Fourteenth Session of the Standing Committee of the Eighth National People's Congress of China. It became effective on October 1, 1995. The law represents a major step forward in transforming insurance regulation in China. It sets forth rules for:

1. Insurance contracts,
2. Insurance companies,
3. Insurance operation rules,
4. Insurance supervision and regulation,

5. Insurance agents and brokers, and
6. Legal liability.

The law applies to all insurers, including those with foreign ownership and foreign branches. However, Article 148 includes a giant loophole stating that foreign joint ventures and branches will be governed by the law "or other laws and administrative regulations if they provide otherwise."23[1]

Indeed, the basic principle of current policies is still that the domestic insurance industry should be opened to increased competition in a "gradual, paced" manner. As outlined below, the government still controls the industry very tightly.

1. Licensing

According to the insurance law and Shanghai rules, foreign companies are only allowed to obtain licenses and conduct business in China if they meet the following formal criteria. A company must:

- Have operated a Chinese representative office for a minimum of two years (although this office cannot engage in insurance sales until a license is obtained).
- Have total parent company assets exceeding $5 billion in the year prior to the application for a license.
- Have 30 years of continuous underwriting experience.
- Have a qualified senior management team that controls the company's insurance operations.

According to foreign companies, a number of other informal, non-transparent criteria have impeded their success in obtaining licenses. (For futher discussion of this problem, see the policy analysis section below). 113 companies from 11 countires have applied for insurance licenses in China and, while most meet the above criteria, very few have actually received licenses.

2. Ownership

Under the insurance law, foreign non-life insurance companies are licensed as branches, and foreign life insurance companies are allowed to set up 50-50 joint ventures with Chinese firms. In practice, however, foreign companies have little choice in joint venture partners. As highlighted by a 1998 China Insurance Institute study of 20 foreign insurance companies, China only has three big insurance companies, and each company can participate in only one joint venture. Although choosing a joint venture partner company outside of the Chinese insurance industry can help a foreign company obtain a license from CIRC, especially if the Chinese company is recommended by the Chinese government, the foreign insurance investor is likely to have difficulties cooperating with a Chinese company that has no insurance experience.

In short, the insurance law's provisions on ownership have effectively limited the entry of foreign companies and hampered the development of the insurance market. CIRC needs to re-think its ownership policies in order to reduce their negative effects.

3. Insurance Brokers

The insurance law includes two sections concerning the regulation and licensing of insurance brokers and agents. These sections are:

- Measures for the administration of brokers, and
- Provisional regulations on the management of insurance agents.

In theory, the insurance law was designed to protect consumers in their transactions within the insurance industry. However, the law is silent on whether foreigners may obtain broker licenses, and in the absence of a clear law, Chinese officials have only allowed one foreign company to obtain such a license. To make matters worse, a number of foreign companies have gone ahead and engaged in broker activities calling themselves "risk management consultants," which fall wholly outside of China's regulatory structure.

Accordingly, CIRC needs to re-think how to regulate these "risk management consultants." Just giving them broker licenses and letting them operate businesses according to the rules may be the best option. Insuarnce brokers play a very important role in the insurance markets of many developed countries. Brokers' business accounts for more than 50 percent of insurance business in the United States and 90 percent in the United Kingdom.

4. Geographic Restrictions

Foreign insurers are only permitted to operate in Shanghai and Guangzhong, and this requirement limits the development of China's insurance market. China's economic development and reforms will continue to stimulate demand for various kinds of insurance services all over the country. Indeed, the case studies of Zhangzhou and the Yellow River Delta show that the Chinese market for insurance holds great potential, even in undeveloped areas. Because domestic insurers cannot meet market demand, China should begin to allow more foreign pariticpation in the market. The geographical restriction should be removed within a couple of years, and city-by-city approvals should be replace with provincial-wide licensing administrations.

In the past, China's economic reforms have begun in Shanghai, Guangzhou and other coastal cities and then spread out to cover all of China. Since the Shanghai insurance market has already been open for more than seven years, it is now time to allow more foreign participation in other parts of the country. Indeed, the impact of foreign insurance companies in Shanghai has been largely positive.

5. Products and Services

China's insurance sector once emphasized business insurance such as marine, fire, and casualty. Currently, China permits insurance companies to offer either of two broad categories of insurance: property insurance or life (group and individual) insurance. Foreign property and casualty insurers may only do business with foreign companies operating in China, not Chinese businesses or individuals. Foreign life insurance companies may not engage in group insurance sales to Chinese citizens.

Recently, the growth of the middle class, particularly in Shanghai and other booming coastal cities, has raised demands for various kinds of insurance, such as personal property insurance. China's social reforms have also raised the demand for new types of insurance. However, compared to other developed countries, China lacks a variety of categories of insurance.

If China were to loosen its limitations on the scope of services foreigners are permitted to offer, foreign companies would quickly expand the overall business scope of the Chinese insurance market. However, if CIRC were to permit foreign insurers to engage in group insurance sales, domestic companies might suffer large, immediate losses. Therefore, the CIRC should consider allowing foreign life and property insurance companies to create new types of insurance in order to meet market demand. It should also loosen the foreign limitation on group insurance—but it needs to do this gradually in order to give domestic companies room to develop.

6. Investment Opportunities

Article 104 of the Insurance Law limits both foreign and Chinese insurers to investments in bank deposits and Chinese government bonds.

> *The application of funds at insurance company(sic) is limited to bank deposits, trading of government and financial bonds and other forms of fund application stipulated by the State Council.*

Currently, most Chinese insurance companies invest more than 40 percent of their funds in bank deposits and 30 percent in government bonds. Insurance companies in other countries have many more investment opportunities. In the United Kingdom, for example, insurers invest more than 28.7 percent of their capital in the stock market, 21.9 percent in government bonds, 19.7 percent in real estate and 9.1 percent in company bonds.

Clearly, if an insurance company is limited to investment in bank deposits, it will be unduly affected by the bank interest rate, and this is precisely what has happened in China since 1996—interest rates have been cut seven times and now stand at just 2.25 percent. On the other hand, if an insurance company has more investment options, it can diversify its risks. Domestic Chinese companies have long complained that investment restrictions have threatened their businesses.

In 1995, the American International Group (AIG) received the Chinese government's approval to invest in Renminbi-denominated A-share markets in China. However, because the market was still unstable, immature, and somewhat speculative, AIG decided not to make such investments. Five years later, the Chinese stock market is more mature, and both domestic and foreign insurance companies are interested in making stock investments. In November 1999, CIRC began allowing Chinese insurance companies to invest in mutual funds and to buy into such funds on the secondary market. The next step is to consider how to widen the investment channels for foreign companies.

B. China's International Obligations

After 13 years of effort, Chinese accession to the WTO finally seems imminent. Accordingly, China's insurance sector needs to be opened to foreign competition based on WTO rules and the bilateral agreements reached with individual countries.

1. China-U.S. Agreement on WTO Accession

China formally requested accession to the General Agreement on Tariffs and Trade (GATT) on July 11, 1986. On November 15, 1999, Washington and Beijing finally reached bilateral agreement on the conditions for China's entry into the WTO.23[2] The agreement includes:

- Prudential Criteria: China agreed to award licenses solely on the basis of prudential criteria, with no economic needs tests or quantitative limits on the number of licenses issued.
- Geographic Limitations: China agreed to permit foreign property and casualty firms to insure large-scale risks on a nationwide basis immediately upon accession. The country also agreed to eliminate all geographic limitations for future licenses over five years and to allow access to the key cities of priority U.S. interest in two or three years.
- Scope: China agreed to expand the scope of allowable activities for foreign insurers to include group, health and pension lines of insurance, which represent about 85 percent of total premiums, phased in over five years.
- Investment: China agreed to allow majority foreign ownership of insurance companies remove onerous joint venture requirements on foreign life insurers, and phase out internal branching restrictions. Life insurers will be allowed to own 50 percent of a company and, on accession, 51 percent ownership rights will be phased in within one year. For non-life and reinsurance, China will allow 51 percent ownership on accession and allow wholly owned subsidiaries in two years.

2. Understanding the GATS

The General Agreement on Trade in Services (GATS) is the first ever set of multilateral, legally-enforceable rules covering international trade in services. It was negotiated in the Uruguay Round and signed in 1995. The agreement covers all internationally traded services, including insurance. China participated in all the negotiations on GATS and made specific commitments to provide access to its insurance market. The extended service negotiations were reopened in April 1997, and an improved set of commitments was agreed to in December 1997, however China did not participate in this negotiation.

The key principles of the GATS are the provision of market access, national treatment, and most-favored-nation (MFN) status. The MFN clause requires that the members of the WTO accord to "services and service suppliers of any other member treatment no less favorable than that it accords to like services and service suppliers of any other country."23[3] Because not all of the WTO members were willing to apply the MFN principle to all service sectors, Article II of the GATS permits members to annex to the Agreement MFN exceptions in relation to specified measures. MFN exceptions reflect that there is flexibility in the GATS rules.

Under the GATS, each member country negotiated its own specific sectoral commitments, and these were listed in country schedules appended to the Agreement. Article XVI of the GATS also leaves room for flexibility. It states that limitations on market access restrictions must be eliminated but allows for countries to make reservations in their individual schedules.

Article XVII contains the national treatment provision of the Agreement. The approach here is very similar to the market access approach, with national treatment applicable only to scheduled sectors, and only then if reservations are not made to the contrary. Another significant difference between national treatment in GATT and GATS is that in the former, national treatment is established as a principle to be applied across the board, whereas in the later, national treatment is subject to negotiation—it is to be granted, denied or qualified, depending on the sector and member concerned.

The GATS also provides flexibility in that, on many issues, it only sets forth principles, which are subject to further in-depth negotiation.

In GATS 1995, China made commitments concerning its insurance sector, and China has agreed to further insurance sector liberalizations in its bilateral WTO agreement with the United States. China will need to live up to these commitments, but it does not need to make any new commitments in the near future. Indeed, as seen in the case studies below, other countries such as Malaysia and Singapore that are already in the WTO and are more developed than China have given weaker insurance commitments than China. Malaysia has even backtracked on liberalization policies, lowering rather than raising allowable foreign ownership of joint venture projects.

Case 3. Malaysia's insurance policy23[4]

Basic information on Malaysia:

Population: 21.7 million

GNP/Capita (US $): 4,466

GDP Growth: 8.4% in 1997

Currently, 65 licensed insurance companies operate in Malaysia, and 60 of these have at least some foreign equity. Twenty-one have foreign equity of between 50 and 100 percent, and foreign ownership accounts for 38 percent of total premiums. Because Malaysia's health care services are being privatized, its insurance market has great investment potential. Demand for life insurance products is also expected to grow significantly since only about 12 to 15 percent of the population is currently covered.

Since Malaysia adopted a more open policy, the number of foreign insurance companies has increased sharply. However Malaysian regulators and lawmakers argued in the mid-1990s that their country needed restrictions on foreign ownership of local insurers to keep from becoming an economic colony of more developed countries. Accordingly, Malaysia stipulated in its GATS commitments that foreign branches must incorporate locally. The country further stipulated that foreign shareholding by a parent company shall not exceed 30 percent—although the limit was increased to 49 percent after intense lobbying by the United States. In 1997, as the American International Groups took the issue before the WTO, the limit was increased to 51 percent.

Now, Malaysia is requiring foreign insurers to turn branch offices into locally incorporated subsidiaries and divest 100 percent equity stakes down to 51 percent. Some firms are given five years to do so. New entrants are restricted to 30 percent ownership of joint ventures.

Case 4 : Singapore's insurance policy

Background information on Singapore:

Population: 3.1 million

GNP/ Capita (US$): 30500

GDP Growth: 7.8 in 1997

The life insurance industry in Singapore is also growing at a healthy pace. In 1996, new premium business grew 12.4 percent, and single premium business grew 26.8 percent. Total annual premiums in force expanded by 17.3 percent.

Singapore long maintained a closed-door policy to foreign insurance companies. But in its 1995 GATS commitments, it offered a relatively open policy (see Exhibit 4), and now Singapore is one of the most open of the Asian insurance markets. While Singapore still limits foreign ownership of domestic insurers to 49 percent, it now allows foreign branches and subsidiaries in all sectors of the market.

As mentioned above, the GATS offers flexibility in making commitments. Indeed, Malaysia is a member of the WTO and its economy is more developed than China's. Nonetheless, Malaysia's insurance industry is becoming more rather than less closed.

Policy Analysis

To date, the Chinese government has opened the country's insurance sector only on a "gradual, paced" basis. It has been reluctant to allow foreign investors into the market except on a tightly controlled basis. The government will need to change its policies if the demand for insurance is to be met in the coming years.

Indeed, as the government deepens its social welfare reforms, demand for insurance in China is expected to grow faster than supply—this despite the fact that the number of Chinese insurance companies is expected to double over the next three to five years. The entry of foreign companies can help meet market demand. Foreign companies will also keep pressure on domestic companies to offer a diverse set of quality insurance products. Moreover, China will have to open its insurance sector as part of its entry into the WTO.

China's policies for regulating the insurance sector need to be revised so that they are based on market rather than political factors.

C. China's Non-Transparent System for Foreign Licensing

Foreign insurance companies have complained that China's licensing process is not transparent and that it is based on informal factors rather than on transparent laws and regulations. Under the current system, these companies believe that if they don't demonstrate a long-term commitment to China by offering seminars, setting up research institutes or contributing to Chinese educational institutions, they will not obtain a license.

The statistics seem to bear out their suspicions. To date, 113 foreign companies from 17 countries have applied, but although most of them met the criteria mentioned above, they have not been granted licenses. A 1998 China Insurance Institute study offers furthe evidence of the problem. Of the 20 foreign companies surveyed, most believed that the relations between their home country and China is the most important factor in determining whether or not licenses are granted (see Exhibit 10). Foreign companies also believe that a company's status in its home country is an important factor, as well as a company's contribution to the Chinese education system. The companies saw networking and making connections or "gaunxi" as key to foreign investors in all business sectors; they believe that non-market factors are more important than economic ones. In fact, the central government, specifically, the State Council, does wield a great deal of influence in licensing decisions, meaning that licensing often has to do with political or other issues rather than legal or market factors.

As noted above, the China Insurance Institute has also studied and noted the problem of ownership for foreign firms. Foreigners simply have very few options in choosing joint venture partners (see Exhibit 11).

D. Policy Reform: Bringing Commercial Insurance into China's Social Welfare Framework

Until recently, China's health-care and pension insurance systems were based on central planning. Now China is reforming these systems, and the reforms will undoubtedly generate more business for insurers. If the CIRC can convince the central government to incorporate commercial insurance carriers into its reforms, the potential for Chinese insurance companies operating in China will skyrocket.

1. The Health-Care System

In rural areas, around 64 percent of the Chinese population has no health insurance. Only 120 million farm and village enterprise employees are covered by Cooperative Medical System (CMS) plans, and CMS is not an effective or efficient system even though it has been in operation for several decades. CMS lacks qualified personnel, stable financial resources, an effective fund collecting mechanism, and essential health facilities and equipment.

In China's urban areas, most workers are covered by the government or SOE health care systems. There are many problems associated with these systems. While GDP was growing at 9.8 percent (1978-1993), the combined spending for these programs grew at an annual rate of 11 percent between 1978 and 1992, and jumped to 13 percent between 1986-1993. The government's health care budget increased from 14 percent in 1978 to 30 percent in 1993. In recent years, the 11 percent enterprise set-aside for medical expenses has simply been insufficient, and enterprises profits have had to be used to supplement the shortfall. In some cases, the shortfalls have imposed large financial burdens on enterprises by limiting their resources for reinvestment in capital equipment and for other welfare services, such as pensions.

In 1994, the State Council launched a pilot program in Jiujiang, Jiangxi Province, and Zhenjiang, Jiangsu Province with the goal of reducing health care subsidies in SOEs.[5] Three tiers of financing were introduced: Medical savings accounts (MSAs), out-of-pocket spending in the form of deductibles, and social risk pooling. MSAs provide incentives for consumers to be more cost-sensitive in their demand for health services; deductibles act to further increase cost sharing by patients; and social risk pooling aims to protect persons against catastrophic expenses. Employees and employers contribute one percent and 10 percent, respectively, of their total wage bill each year, and these contributions are divided between two accounts. Five percent goes to the social risk pool, and six percent goes to the individuals' MSAs.

The program was expanded in 1997 to over 60 other cities, and it is likely to become national policy, applicable to domestic and foreign-invested firms. However, primary data collected from these two mid-sized cities indicates that the program has some undesirable side effects. People are not allowed to choose which hospital they go to, not everyone has the same right to health care, and fraud is rampant because so many people are uninsured. The study also shows that, in 1994 in Zhenjiang and Jiujiang respectively, 13.7 and 15.9 percent of workers were not able to get their health expenditures reimbursed on time. Thus, although MSAs have become a widely proposed model for health care reform, they are not problem free. Moreover, relying on MSAs ignores the contribution that commercial providers can make. Instead of, or at least in addition to, further expanding MSA programs, the State Council should give the private sector greater lattitude to provide coverage.

Indeed, the government's economic reforms are stimulating consumer demand for better quality and an expanded range of health services, and provisions need to be made for the rapidly growing segment of the population that works for private companies. In 1978, 72 percent of new urban job entrants were assigned to the state sector, but by 1985, the proportion had fallen to 61 percent.[6] While foreign-invested private enterprises are required to provide health insurance benefits via the Foreign Enterprises Service Corp. (FESCO), other private enterprises most often offer no medical coverage at all. The following two examples illustrate the problem:

- Zhang Jing has worked with a foreign-funded enterprise since graduating from college. Zhang earns a fairly high income when compared to her classmates assigned to SEOs. However, said Zhang, "I am constantly obsessed by a feeling of instability. For example, I could be fired for failing to do a good job, and my income may be lower than that paid by a state-owned business." The feeling of instability spurred Zhang to obtain medical and retirement insurance.[7]

- Ma Jianghua has operated a private business for 10 years. In 1988, a friend convinced Ma to buy medical and retirement insurance from Pingan's Shenzhen Branch. "I pay a fixed annual premium to the insurance company. The insurance in turn provides coverage if I am ill. The policy basically provides the same coverage as the free medical care system. In addition, at age 65, the insurance company will provide me with a monthly retirement pension. My retirement pension will compare favorably with pensions paid to employees of state-owned enterprises and institutions."

Premier Zhu Rongji announced in June 1999 that China was to set up a nationwide, integrated medical care program in three to five years. The time is ripe for CIRC to advocate liberalization of the domestic and foreign commercial medical insurance setors.

2. Pension Reform

The pension system for state employees was first established in the 1950s. It provided lifetime pensions upon retirement to women (age 50) and men (age 60) who had a record of at least 20 years employment. The weakness and limitations of this system are becoming apparent as China shifts towards a market-oriented economy.

First, the enterprise-based system is already losing its ability to meet its present obligations. It will be no better able to meet its obligations in the coming years as declining mortality rates and the one-child family policy accelerate the aging of the population. The urban population aged 60 and above will account for over 10 percent of the urban total in 2000 and nearly 13 per cent in 2010.

Second, the financial burden on enterprises with more retirees is growing disproportionately to those with relatively young workforces. Enterprises with older workforces are finding it increasingly difficult to compete with younger enterprises, and some have already been forced to reduce, delay, or completely cancel pension benefits to retirees. In Hainan province, for example, nearly 30 percent of SOEs were unable to fully meet pension obligations.[8]

Third, employment in non-state sectors, where pension benefits are smaller or nonexistent, have been growing since the 1980s. The shares of urban employment in foreign-funded, private, and individual enterprises will only increase in the next century.

There is no question that pension reform is needed and that the key objective of the reform should be to move away from a pay-as-you-go system toward a system with diversified financing. In the short run, the government will need to continue to make significant contributions in its role as pension guarantor. Indeed, the old economic system is failing and today's elderly population has no ability to buy commercial insurance. In a long run, however, employees should pay for their pensions using commercial insurance; employers should no longer be the sole contributors to the pension fund.

Footnotes

[1] It is worth noting that the Chinese approach to law is quite different than that of the West. Whereas in the West laws are made to rule man, the Chinese see man ruling the law.

[2] "Market access and protocol commitments," http// www.insidetrade.com/1999. "April 8, 1999 U.S. List of Chinese Commitments," http//www.insidetrade.com/, 1999. "Administration Fact Sheet on China Agreement," http//www.insidetrade.com/1999.

[3] Article II:1, GATS Agreement, 1995.

[4]*" Discussing Malaysia's insurance future,*" East Asian Executive Report; Washington, Jun 15, 1997; *"WTO agreement: not perfect but good enough,*" National Underwriter; Chicago; Dec 22-Dec. 29, 1997.

[5] *"The health market,"* The China business review; Washington, November, 1998.

[6] China State Statistical Bureau, 1996.

[7] " *Insurance Boom*," a report form the Painan Insurance Co. 1998.

[8] "*Pension reform in China: preparing for the future*" http://www.census.gov/ipc/www/ebsum, Feb.1999.

Political and Public Relations Analysis

A. Political Importance

1. International Level

As the world's largest developing and socialist country, China is the most likely challenger to western countries, especially the United States. By opening its markets and joining the WTO, China can send a strong political message that it is willing to play the trade game by international rules. Moreover, China's entry into the WTO will help persuade the world that China's rise is an opportunity rather than a danger and will help strengthen foreign businesses' confidence in making investments in China. WTO membership will also promote China's link to the world economy, which in turn will help create a more stable environment for China's economic development, thereby helping China realize the strategic goal of sustained, rapid and healthy development of its national economy.

Opening the insurance sector, one of, if not the most, sensitive sector of the Chinese economy, will help China build international political credibility.

2. Domestic Level

Because the insurance industry is linked to overall welfare reforms, opening this sector to foreign participation is extremely sensitive domestically. Any discussion of insurance liberalization quickly leads to issues of political and social stability, as well as the question of the communist party's leadership. If the government fails to offer well-functioning insurance programs that cover the majority of the population, its political authority will be questioned, if not challenged. Only a well-functioning insurance system will ensure the success of China's market reforms; the provision of pensions and health insurance outside of the SOEs will be key to encouraging people to be willing change jobs and find jobs in the private sectors.

B. Political and Public Relations

Other than domestic and foreign insurance companies, the groups that have the largest stake in the liberalization of China's insurance industry are government agencies, domestic industries, and consumer groups.

1. Government Agency Interests

Several government agencies are concerned with the issue of liberalizing the Chinese insurance industry. They are: the National People's Congress, the State Council, the

Ministry of Foreign Trade & Economic Cooperation (MOFTEC), the Ministry of Health, the Ministry of Labor and Social Security, and local governments.

a) *The National People's Congress and the State Council*

The National People's Congress and the State Council have decision-making authorities. Their concerns focus on whether commercial insurance will ensure a stable Chinese society, which is crucial to the political stability of the country.

Historically, China's central government has been divided into two groups. One group represents Northern China, especially Beijing, and cares about political power. The other group represents Southern China, especially Shanghai, and cares about commercial interests. It is not surprising then that Shanghai's foreign insurance business is more advanced than Beijing's. Moreover, it is clear that the CIRC will confront these differences as it tries to raise insurance liberalization issues with the National People's Congress and the State Council. The central government is likely to continue to prefer opening only the southern part of China to foreign competition, not the North. CIRC will need to prepare media and legislative strategies if it is to advance recommendations for the liberalization of geographical restrictions.

b) The Ministry of Foreign Trade & Economic Cooperation (MOFTEC)

- MOFTEC's interests include:
  - China's WTO accession,
  - Economic and trade relations with foreign countries,
  - China's role in the world trading system,
  - China's economic interests, and
  - China's role in APEC countries.

MOFTEC is CIRC's most important ally for a number of reasons:

- MOFTEC represents CIRC in international negotiations both at the bilateral and multilateral levels, and MOFTEC has already tried to put insurance sector liberalizations on a number of negotiating agendas. Strong relations with MOFTEC will be particularly important since China is expected to join the WTO prior to the conclusion of the next round of service negotiations (which include insurance).

- After China joins the WTO, CIRC will face implementation issues and will likely have to defend against disputes with foreign insurers. MOFTEC will still be China's chief international negotiator.
- MOFTEC can help CIRC monitor relations with other Chinese government agencies. It also has power to address issues directly with the State Council.

c) Ministry of Health, Ministry of Labor and Social Security

Good relations between these two agencies and CIRC will be crucial in any attempt to bring commercial insurance into China's overall social welfare reforms. These two agencies will lose some of their power as part of the reforms and, accordingly, may act as an impediment to change.

d) Local governments

As early as 1979, China started to devolve government authority from central to local levels. Now, local governments have more power to determine the structure of the local economy. They issue licenses, coordinate local business development, resolve business disputes and even participate in the national policymaking process. Moreover, local governments have more power now to resist central government policy changes they don't agree with. While pressure from the central government can force them to accept policy changes, local governments will still control the rate at which changes, such as insurance policy changes, are made. Accordingly, CIRC will need to build and monitor its relationships with local governments. It will also need good relations with the State Council in order to ensure that the central government will step in when local governments act to impede insurance industry reforms.

2. Domestic Industry Interests

Nearly all Chinese industries are involved in the issue of liberalizing the insurance industry.

a) State owned enterprises

Virtually all of the Chinese SOEs care about insurance issues. They employ a large proportion of the urban work force, and they play a large role in providing social security and health services. They are all eager to decrease the burden of supplying pension, health care, and unemployment benefits. SOEs can help CIRC in making the case to the central government that China's insurance industry needs to be liberalized. Cooperation with SOEs will also be crucial in implementing any new insurance policies.

b) Banking groups

The issue of how to increase insurance companies' investment opportunities is directly related to China's banking problem; banking problems will hamper any effort to allow insurance companies greater investment options. If Chinese banks remain weak, they will not be able to provide the basic infrastructure needed to support an insurance industry. Accordingly, CIRC should mobilize political support to push through a set of reforms in the banking sector. The CIRC should also work together with banking groups to develop possible solutions, specifically options that will help the insurance industry.

c) Securities industry

On October 26, 1999, China's financial authorities announced a long-awaited measure that gave domestic insurance companies more options for investing their premium income. Because CIRC plans to call for similar measures for foreign companies in the near future, it will need to establish stable relations with the securities industry.

d) Domestic insurance industry

The domestic industry’s major interests include:

- Maintaining their market share,
- Avoiding competition with foreign firms, and
- Increasing their growth opportunities.

The domestic insurance industry will oppose any attempt to open the Chinese insurance sector to foreign competition. CIRC will need to find a way to maintain good relations with the domestic industry while at the same time advocating for more foreign participation in the market.

3. Consumer Group Interests

Before developing a strategy for opening up the insurance market, the CIRC should clearly understand the positions of domestic insurance consumer groups. First, the CIRC should acknowledge that most Chinese still lack insurance awareness, and it should develop basic education materials concerning how insurance works. Because consumers from different social classes, age groups and work situations have different needs, the CIRC will need to develop multiple education approaches in order to build a broad base of consumer support.

a) Consumers from different social classes

Consumers from urban areas will have more knowledge of insurance than their rural counterparts.

b) Consumers from different age groups

It has been nearly twenty years since China began its rapid economic development, and the young generation is now accustomed to making decisions based on economic factors. The older generation, however, is having a harder time adapting to this new way of life.

c) Consumers from different work situations

Employees at private or foreign companies have more motivation to buy insurance than employees who have what they perceive to be stable, long-term employment at an SOE.

Analysis of Implementation Issues

Implementing and enforcing its international obligations on insurance (as well as other sectoral liberalization policies) will be a serious challenge for China in the coming years. In order to ensure success, CIRC will need to develop a comprehensive enforcement scheme that draws on the coordinated efforts of administrative, legislative, and private enforcement bodies. Currently, however, such cooperation is lacking in China.

A. Institutional Barriers

1. Administrative Enforcement Mechanism

When CIRC was established in 1998, it became China's first insurance regulatory body, and supervision and regulation of the industry were transferred from the People's Bank of China to CIRC. The establishment of CIRC indicates that China recognizes the special challenges involved in regulating the insurance industry. However, effective enforcement of central government policies will still be difficult because local insurance regulatory agencies have not yet been established. Additionally, there is a serious shortage of insurance regulators.

2. Private Enforcement

By the end of 1997, 19 provincial insurance associations had been set up in China. As self-regulating organizations, these associations can play an important role in normalizing business activities in the insurance market. However, a national insurance organization has not yet been established. Such a national organization could help provincial associations develop their professional knowledge and help CIRC build links with industry leaders.

3. Policy and Law Measures

The promulgation of laws and regulations relating to the liberalization of China's insurance sector will face opposition from both the domestic industry and factions within the central government. In order to head off these opposition forces, CIRC will have to take the offensive within political circles. A white paper on insurance liberalization should be circulated as a first step.

B. Market Disorder

Corruption and illegal activities are common in China's insurance market. Underwriters have offered inordinately high commissions to agents and excessively high returns to policy buyers in order to gain a larger market share. The CIRC closed down the offices of HongKong-based Jardine Insurance Brokers Ltd,, which was operating in the Chinese market without a license in 1999. After China joins the WTO, one of CIRC's crucial tasks will be to seriously investigate and deal appropriately with all kinds of illegal and anti-competitive practices.

STRATEGY PAPERS

Key Recommendations

A. Policy Changes

China's current "gradual, paced" liberalization policy needs to be revised. CIRC should submit a proposal for a new policy to the State Council and push the central government to issue a new policy for liberalizing the insurance sector as soon as possible. The new policy should be based on market rather than political factors.

Additionally, CIRC should 1) continue to expand its reform of the health insurance system by speeding up China's transition to a commercially provided health insurance system and encouraging individuals to buy life insurance, and 2) develop a nationwide campaign to convince individuals to purchase commercial pension insurance.

Chinese regulators should promote the use of market and financial methods rather than administrative orders to regulate the insurance industry.

B. Legal Changes

In order to prepare China for its imminent entry into the WTO, CIRC should draft regulations for foreign insurance firms operating in China and submit these to the State Council for approval in 2000. The key recommendations may include:

Recommendations for changes to the Insurance Law

	Content	Speed
Licensing	-Reform licensing criteria -Improve transparency -Speed licensing-approval procedures	Immediate action
Ownership	-Give foreigners more latitude in choosing venture partners -Allow 50% foreign ownership of life insurance companies and make plans to phase in 51% foreign ownership rights within one year after WTO accession -Allow 51% foreign ownership of non-life insurance	Gradual loosening
Insurance broker	Encourage the entry of foreign insurance brokers	Immediate action
Product and service scope	Expand the scope of products that foreign insurers can sell to include group and pension lines of insurance	Gradual loosening
Geographical restrictions	-Eliminate all geographic limitations for future licenses -Replace city-by-city approvals with provincial-wide licensing	The limitation can be phased out over five years
Investment	Permit foreign insurance companies to invest in stocks and mutual funds	Immediate action

C. Implementation

In order to ensure that any new regulatory policies and laws are fully implemented, a comprehensive enforcement scheme will need to be established.

- CIRC should establish administrative enforcement mechanisms as soon as possible at both national and local levels, with local regulatory agencies reporting directly to CIRC. The enforcement mechanisms should protect fair competition, reduce monopolies, and promote the competitiveness of the domestic insurance industry. To be successful, there will need to be cooperation between administrative, legislative and private sector officials.

- CIRC should increase the transparency of its regulatory functions in order to encourage new entrants into the insurance market. Policy statements should be readily available to all interested parties.

- CIRC should encourage the development of private sector enforcement mechanisms by calling for the establishment of a national insurance association.

- CIRC should take action to improve the quality of insurance professionals. CIRC should issue qualification requirements for insurance professionals and use foreign insurers' good-will programs to promote the development of insurance education.

D. International level

At the international level, CIRC should focus on the following:

- CIRC should encourage cooperation between foreign and domestic companies. Foreign insurance companies have a long history of growth and advanced management ideologies. CIRC should encourage domestic firms to strengthen their cooperative ties to these companies.

- When engaging in bilateral or multilateral negotiations, CIRC should encourage MOFTEC to use the flexibility built into the GATS principles in developing its negotiating position. China has already made adequate insurance concessions in the context of its bilateral negotiation with the United States; it should consider further liberalization very carefully.

- CIRC should prepare itself for the new round of WTO negotiations on services. If China joins the WTO this year, it will need to be prepared for this round.

E. Public Relations

CIRC will need good relations with all relevant interest groups if it is to succeed in persuading the central government to adopt new liberalizing policies, let alone effectively enforce them. These interest groups include government agencies, domestic consumers and the domestic insurance industry.

A Strategy for Opening China's Insurance Industry
Section III: Strategy Papers

Domestic Public Relations Strategy

Objective:

The objective of the public relations strategy is to build support for liberalization of the Chinese insurance market. To obtain this objective, a coalition should be established that includes as many interest groups as possible—the more people or interest groups involved in the coalition, the more powerful it will be. Additionally, a coordinated government system should be established in order to enforce the policy.

A. Coalition Building Strategy

The following interest groups should be targeted for the coalition:

Industries:

Nearly all Chinese industries have a stake in the issue of opening up the insurance industry. However CIRC should focus its efforts on banking, securities, and other financial services companies. It will also want to give special attention to industries that are likely to adopt pension and/or health insurance reforms in the near future.

Domestic consumers:

Domestic consumers will benefit from insurance market liberalizations and should be targeted for the coalition. Specific groups include:

- Individual life and non-life insurance buyers (people who work at private or foreign companies)
- Employees of state-owned enterprises
- Rural populations

Obviously, consumers from different social classes, age levels, and work environments will have different attitudes towards the issue of insurance reforms. The CIRC will need to adjust its approach for each of these different interest groups.

Media outlets:

Media resources will provide the most effective means for educating the public on insurance sector reforms and insurance purchasing options more generally. It will be crucial for CIRC to cultivate good relationships will all major media groups, including:

- CCTV (the national TV station)
- Local TV stations
- People's Daily[34]
- China Daily[35]
- Local newspapers

- "Insurance Journal"
- Internet

Academics:

Academic groups are just beginning to get involved in research on the insurance industry, and this research will be important to CIRC as it reforms China's insurance sector. Accordinlgy, CIRC should consider these groups' interests and design a proposal to achieve general support for reforms from them. The main academic target groups are:

  - Insurance research centers
  - Universities

B. Coordination Between Government Agencies

Since opening up the insurance sector is part of China's overall economic reform, it is absolutely critical to gain as much support as possible in government agencies, including MOFTEC, the NPC, the State Council, the Ministry of Labor, and the Ministry of Health. CIRC should call for the establishment of a coordinated program among agencies that will enable it to work efficiently with these agencies.

In the short run, CIRC should propose that the State Council call for strengthening cooperation among government agencies to implement the new insurance policy; only the State Council has the power to bring all agencies together and insist upon their support for CIRC.

In the long run, CIRC should pursue stable relations with other government agencies by establishing working groups that will study the effects of liberalization policies and make recommendations to the State Council. Members of the groups should come from CIRC, MOFTEC, the Ministry of Labor and the Ministry of Health.

- The working groups' activities might include:
  - Holding news conferences.
  - Conducting market research and investigations.
  - Settling disputes among different government agencies.
  - Submitting annual reports to the State Council.

C. Building Support from Domestic Insurance Groups

New insurance sector policies will not succeed without support from the domestic industry. Domestic insurance companies claim that they are still young and need some protection. Accordingly, they are likely to oppose liberalization policies. To help gain their support for reforms, CIRC should:

- Emphasize that allowing more foreign participation will benefit the domestic industry.
- Develop policy and legal frameworks to assist the development of domestic companies.
- Encourage the establishment of linkages between domestic and foreign companies.

Summary of key recommendations:

- Build a coalition in order to get more support for opening up the Chinese insurance market.
- Establish a working party in order to strengthen cooperation among government agencies.
- Build support from the domestic insurance industry.

Legislative Strategy

The legislative strategy will focus on targeting local and national government agencies to form greater support for reforms.

Objectives:

Convince the State Council and National People's Congress (NPC) that opening the Chinese insurance industry is necessary.

- Convince the central government that liberalization should be based on CIRC's recommendations.
  - Convince the central government to issue policy statements nationally.
  - Convince the NPC to pass new insurance regulations and laws.
  - Establish a long-term enforcement mechanism.

The legislative strategy includes both short-term and long-term strategies:

A. Short-Term Strategy

The short-term strategy will be focused on achieving changes in the insurance law. CIRC can take following actions:

<u>Consensus building</u>

The 16th meeting of 9th NPC Standing Committee will be held later this year. CIRC's primary goal for this meeting should be to convince the NPC and State Council to put the issue of insurance industry liberalization on the agenda. The coalition, especially domestic consumers, interested industries and academics, should do the following:

- Press the State Council to engage in a dialogue with the coalition.
- Support the current social welfare reforms.
- Press the NPC Standing Committee and Law Committee to seriously consider the insurance liberalization issue, including implementation issues (see exhibit 12, sample letter to NPC Law Committee member).
- Introduce CIRC's policy recommendations to the NPC and State Council.
- Offer testimony before the NPC.
- Provide a set of informational documents.

The documents can include:

- A white paper (see exhibit 13 for sample white paper)
- Case studies done by CIRC and other insurance research centers (including this project)
- Documents that include all data and policy recommendations
- Sample newsletters (see exhibit 14)

High-level meetings

CIRC should organize high-level government meetings to gain support from other government agencies and urge them to cooperate in CIRC's efforts to liberalize the insurance industry. The target government agencies include:

- MOFTEC
- Ministry of Labor
- Ministry of Health
- Central Bank
- State Council

Local NPC representatives

Local NPC representatives will need to be convinced to vote for insurance liberalizations. Because representatives from southern China will be more receptive, CIRC should target them first.

B. Long-Term Strategy

The long-term strategy focuses on establishing a stable legal enforcement mechanism. CIRC should submit draft regulations for foreign insurance firms and submit them to the State Council for approval this year. Additional steps that should be taken include:

- Establishing a working group (see public relations strategy).
- Persuading the State Council to pass regulations to enforce new policies.
- Convincing government agencies to cooperate with the State Council and CIRC.

Summary of key recommendations:

- The short-term strategy focuses on changing the Insurance Law.
- The long-term strategy focuses on pursuing a stable legal enforcement mechanism.

Media Strategy

Using the media will be extremely important for CIRC and its coalition. Media sources offer a powerful means of addressing the public and disseminating information on policy issues. In the past, Chinese government agencies have seldom used this tool. CIRC should use all available media tools in order to create greater visibility of the insurance issue.

Objective:

The primary goal in using the media is to generate greater public support for reforms and the goals of the legislative strategy. The secondary objective in using the media is to educate Chinese insurance consumers about insurance.

Target audiences:

- Government agencies and the central government. Media publicity will help gain the attention of decision-makers in these agencies. CIRC will only achieve its legislative goals if such decision-makers focus adequate attention on the insurance issue.

- Domestic consumers. Chinese consumers do not have enough knowledge about insurance. The media will play an important role in educating consumers and gaining public support for legislative changes.

Main Focus:

The media strategy will focus on:

- The positive changes that will come with insurance market liberalizations.

- The strategic importance of opening up China's insurance market.

- The positive impact on domestic insurance buyers of opening the insurance market.

Actions:

The media strategy will involve the following:

1st Level: Introduce the issue and get more public attention

- A press conference should be held to address current policy concerns and possible future changes. (The conference can be held in August 2000.)

- A press release should be issued after the conference.

- Case studies and academic papers should be published and their results should be sent to the media.

- CIRC officials should make television announcements.

2nd Level: Initiate a public debate

- Initiate TV debates with interest groups, such as domestic insurance companies and consumers.

- Initiate TV programs and interviews with experts on insurance.

- Initiate a debate between influential experts who are for and against liberalizations.

- Publish a CIRC/coalition newsletter to inform interest groups and industry associations on reform progress.

- Issue internal policy reports and submit them to the State Council in order to keep the Council informed of CIRC's activities.

3rd Level: Public education

Due to the fact that a majority of Chinese citizens still lack insurance awareness and knowledge, CIRC should develop a long-term media strategy that focuses on educating the public and preparing for policy implementation. CIRC should:

- Initiate TV education programs featuring insurance experts.
- Invite foreign insurers to participate in the TV education programs.
- Strengthen current education programs currently offered in cooperation with foreign companies.
- Expand insurance research programs.
- Help local insurance associations establish insurance education programs.
- Work with foreign insurance companies to publish articles on insurance policies and business.

Special recommendation:

A statistical report made public by the China Internet Information Center on January 8th this year shows that, by the end of 1999, the number of Chinese subscribers to the Internet had reached 8.9 million and the number of computers in China linked with the Internet had reached 3.5 million. The numbers show that the Internet will be an effective media tool in China, and CIRC should take advantage of it.

CIRC should also consider launching its own web site. The site should have both English and Chinese versions. It should explain insurance policies and regulations to the public and allow a direct line of feedback from the public. The site also can answer frequently asked questions about insurance and insurance policy.

The main contents of this web site can include:

- A description of CIRC
- News from CIRC
- News from the world insurance industry
- Laws and regulations
- Information on foreign insurance companies
- Information on China's insurance market
- Statistical reports
- Questions and answers concerning the liberalization of the Chinese insurance market.

Currently, there are several Chinese insurance web sites that CIRC should provide links to. These are

http://www.china-insurance.com/
http://gulili.163.net/
http://www.zg169.net/~fengzh/
http://serve.cei.gov.cn/sd/index.htm

Summary of key recommendations:

➢ 1st level: Introduce the issue and get more public attention
➢ 2nd level: Begin a public debate
➢ 3rd level: Educate the public and prepare to enforce new policies
➢ Special point: Begin building a web site

Footnotes:
[34] The People's Daily is China's official newspaper. There are both English and Chinese version of the paper.
[35] China Daily targets overseas readers. There is an English language version of it.

A strategy for opening up the Chinese insurance industry
Section III: Strategy papers

Research and Education Strategy

Objective:

The goals of this strategy are: 1) to promote the establishment of a national research center and strength academic research on insurance; and 2) to strengthen the nationwide education program.

A. Identification of Problems

A few Chinese universities have recently established insurance departments. For example, the Chubb Group of Insurance Companies and Shanghai University of Finance and Economics established the Chubb School of Insurance in 1995. Beijing University established its insurance department in late 1990s. In general, however, China still lacks academic research and education on insurance. China does not have a national insurance research center that can offer long-run technical assistance to both policy makers and the insurance industry. Additionally, China still lacks public education programs that are needed to educate the Chinese public about insurance.

1. Strengthen Academic Rresearch

(1) Establish a national insurance research center

CIRC should promote the establishment of a national research center as one of its key strategies for developing and opening up the Chinese insurance industry.

The insurance industry and CIRC would benefit from the establishment of a research center in several ways. Such a center would encourage collaboration on research projects, as well as:

- Provide an umbrella organization to attract research funding (including international funding);
- Assist universities in establishing research priorities;
- Enhance the visibility of research efforts in particular areas;
- Facilitate interaction between researchers and insurance industry officials;
- Provide a means for researchers to offer policy suggestions to policy makers; and
- Provide a focal point for cooperation between Chinese researchers and international institutions.

The research center could be supported in part by CIRC and other government agencies. It should also seek funding from domestic and foreign insurance companies and other interested parties.

Possible domestic funding sources:

- Domestic insurance companies
- Local governments
- CIRC
- Other government agencies such as the Ministry of Health and the Ministry of Labor
- SOEs

Possible international funding sources:

- Foreign insurance companies
- International insurance associations
- International organizations
- International insurance institutions

Possible projects for the research center in the short-run:

- Study of foreign countries' regulatory models
- International trade policy (specifically insurance policy)
- China's insurance market

- Web site development
- Joint research with international insurance institutions

(2) Support university research programs

Some universities have already established joint research programs with foreign insurance companies. CIRC should encourage this cooperation and offer more support.

In northern China, CIRC can give more support to Beijing University and Renmin University. In southern China, CIRC should make Fudan and Shanghai Universities priorities since the insurance industry is centralized in Shanghai.

- CIRC can support the university programs by:
  - Helping them develop visiting scholar programs
  - Making institutional visits
  - Encouraging local & overseas industry visits
  - Facilitating teaching materials exchanges
  - Providing technical support
  - Facilitating technical exchange
  - Developing a publication exchange
- Establishing a student exchange program through which students would have the opportunity to work in foreign insurance institutions

Other possible support for university insurance programs might come from:

- Domestic and foreign insurance companies
- International insurance associations
- International organizations

(3) Immediate programs

If China joins the WTO this year as expected, it will have to make substantial changes to its insurance regulations, particularly those regulations governing access to the market by foreign insurers. Accordingly, CIRC should hold at least one seminar in the near future to begin preparing for these changes. The seminar might be titled: *"Experts Meeting on Insurance Regulation and Supervision in China."* It should focus on:

- International regulatory trends
- International laws and WTO agreements

- China's insurance policy reform model

2. Strengthen Education Programs

CIRC should be concerned with both public education and industry training.

(1) Public education

As previously noted, the media should be used to educate the public about insurance. CIRC should use TV, the Internet and newspapers in its education campaign, and it should tailor its education messages to different consumer groups based on their social class, age and work situations.

(2) Industry training

China still does not have enough trained insurance professionals. CIRC should issue a provisional regulation on insurance agent qualifications in the near future. However, if such a regulation is issued, CIRC will need to help the domestic industry strengthen its training programs.

The training programs can be co-organized by CIRC, industry associations, and individual companies. The programs might include presentations by university experts, international insurance associations, and CIRC officials.

The training programs should cover:

- Insurance theory (property, life and marine)
- Insurance finance
- Insurance accounting
- Risk management
- Reinsurance
- Actuarial
- Law
- International insurance case studies

Summary of key recommendations:

- Establish a national insurance research center
- Support university research programs.
- Hold a Seminar: "Experts Meeting on Insurance Regulation and Supervision in China."
- Strengthen public education programs.

- Strengthen industry training programs.

Implementation Strategy

Objective:

If China joins the WTO this year, the central government will have to change its current insurance policy. From this standpoint, the implementation of new liberalization policies is a major near-term mission for CIRC that will require a well coordinated plan.

Key Players:

- The key players include:
    - The central government, including the State Council and the NPC Standing Committee.
    - CIRC
    - Local governments
    - The Ministry of Health and the Ministry of Labor
    - The domestic insurance industry
    - Domestic interest groups

Actions

1. CIRC should adopt regulatory reforms.

CIRC's main actions should include:

a) Improving its transparency level.

CIRC can establish and use its web site and newsletter to publish its policies and relevant regulatory documents. In terms of licensing, CIRC should clarify its regulations that apply to foreign insurers.

b) Accelerating internal reforms

CIRC should improve its efficiency and reduce illegal insurance operations.

c) Establishing an administrative enforcement mechanism.

CIRC should also take action to establish an administrative enforcement mechanism. CIRC should cooperate with local governments to establish local insurance regulatory bodies. (CIRC already has administrative power to govern local insurance regulatory agencies.)

2. The central government should coordinate the implementation process.

CIRC should push the central government agencies, specifically the NPC Standing Committee and State Council, to coordinate the whole implementation process.

a) Establish a working group to carry out policy implementation.

In the long run, a working group that involves officials from all relevant agencies will be needed if reforms are to be successfully implemented

b) Implement policy enforcement measures.

CIRC should push the central government to use its powers to ensure that policy enforcement measures are properly implemented. For example, insurance policy can be addressed in NPC's documents, and central government agencies can issue various policy statements.

3. The private sector should establish enforcement mechanisms.

CIRC should encourage the domestic industry and other interest groups to police themselves.

a) Establish a national association.

A national association can help CIRC explain the liberalization policies to individual companies and strengthen insurance companies' abilities to regulate themselves. In addition, insurance associations can establish strong relations with foreign insurance companies. (See international strategy paper.)

b) Improve public education level.

The insurance industry (both domestic and foreign insurers) should contribute to education programs. First, the industry should educate its employees in order to improve the quality of insurance professionals. Second, it is critical to educate insurance consumers.

Summary of key recommendations

For CIRC: 1) accelerate reforms; 2) improve transparency; 3) establish administrative enforcement mechanisms.

For the State Council and the NPC Standing Committee: 1) establish a working group; 2) use policy enforcement measures.

For industry: 1) establish a national association; 2) improve public education level.

International Strategy

Objectives:

This strategy is designed to: 1) increase foreign governments' and business groups' understanding of China's insurance sector reforms; 2) build good relations between CIRC and foreign governments and industry associations; 3) provide recommendations for future international negotiations.

A. International Media Campaign

Once China decides to open its insurance market, it should generate an international media campaign to announce its policies and let the world know that foreigners are welcome in its insurance market. It should:

- Hold a press conference to announce its policy reforms.
- Publish articles and op-ed pieces in the China Daily and other major international newspapers. Since most foreign insurers who want to enter the Chinese market are either American or European, CIRC should also try to place op-eds in U.S. and European papers (see exhibit 22 for sample op-ed pieces).
- Hold seminars for potential foreign investors.
- Use the Internet. As mentioned above in the domestic media strategy section of this paper, CIRC can establish its own web site and use this web site to provide information to the international community.

B. Building International Relations

Opening up the Chinese insurance industry does not simply mean just letting foreign insurers into the market. Opening up means that China would like to cooperate with foreign countries and insurance industries to develop the Chinese insurance market. Therefore, it is critical for CIRC to build good relations with foreign insurers and governments so that exploration of common interests will be possible.

1. Building Good Relations with Foreign Governments

Governments usually play a role in assisting business. They negotiate trade issues and present business interests in the international arena. Accordingly, CIRC will need to maintain good relations with foreign governments.

First, CIRC should cooperate with other Chinese government agencies, such as the Ministry of Foreign Affairs (MOFA) and MOFTEC in order to build good relations with foreign nations. It is especially important to gain support from the United States and European countries, since they can bring years of valuable industry experience to China.

Second, CIRC should establish stable long-term relations with foreign government agencies that regulate the insurance sector. CIRC is a new regulatory body. It can learn from its foreign counterparts if it establishes good relations with them.

2. Building Good Relations with the International Insurance Community

In most Western countries, there is a special business to government relationship that does not exist in China. In these countries, particularly in the U.S., business has more power and often influences the policy decision making process. Accordingly, industry associations play an important role in the West. They keep in close contact with government offices, special interest groups, professional organizations, the news media and other opinion leaders. CIRC can learn from these associations and should strive to establish good relations with them.

First, CIRC should encourage the Chinese insurance associations to establish ties with international insurance associations, including:

The United States:

- National Association of Insurance Commissioners (NAIC)[36]
- National Association of Mutual Insurance Companies (NAMIC) [37]
- Health Insurance Association of American [38]
- American Insurance Association[39]

Canada:

- Canadian Life and Health Insurance Association Inc.[40]

Malaysia:

- Life Insurance Association of Malaysia[41]

Korea

- Korea Non-Life Insurance Association[42]

Second, CIRC should encourage Chinese insurers to establish a long-term joint program with foreign insurance companies and associations. These programs might include:

- International seminars
- International insurance fairs
- Information exchange programs
- Informal dispute settlement meetings

C. International Negotiation Strategy

In negotiating its bilateral agreements for WTO accession, China has already agreed to allow more foreign participation in its insurance sector. However, China has not yet concluded its bilateral negotiations, and if China joins the WTO, it will participate in the next round of trade negotiations. China will need to be prepared to hold the line and not offer any new concessions in the near future.

1. Guidelines for future negotiations

China has already agreed to significant insurance industry liberalizations and will need time to fully implement these commitments (as well as allow the domestic industry to adjust) before it makes new concessions. Chinese negotiators should study other developing countries' GATS commitments on insurance before entering into negotiations. Principles or guidelines for the liberalization of China's insurance sector should include:

- GATS rules: The GATS offers flexibility for individual countries to negotiate special commitments, limited national treatment etc. It also offers special treatment for developing countries. At present, China is pursuing its WTO membership, but this does not mean that China should accept everything its counterparts want.

- National treatment: Currently, China's insurance law is somewhat contradictory. On the one hand, it places a number of limitations on the allowable business scope and geographic locations for foreign insurers. On the other hand, foreign insurance companies in China are enjoying super-national treatment, such as preferential taxation. China should abolish super-national treatment and also eliminate many of the limitations on foreign insurers.

- China's economic development. China has already made significant concessions in its bilateral agreement with the United States. Given that the Chinese insurance industry is still in its early development stages, new commitments should be made very carefully.

2. Bilateral negotiation strategy

In future bilateral negotiations, CIRC can take following actions:

- Study other countries' insurance policies and international agreements in order to prepare for future negotiations.
- Show economic and industry data to support CIRC's arguments.
- Approach negotiations on a case-by-case basis, using different strategies for different negotiations as appropriate. Such an approach will help CIRC control the speed of required liberalizations.
- Cooperate with MOFTEC. MOFTEC is China's lead negotiator on all trade issues, including insurance issues. CIRC can offer evidence, industry data, research, and studies to assist MOFTEC. Moreover, CIRC can make its opinions clear to MOFTEC in order to promote its interests.
- Use the power of the media to support China's negotiating interests.

3. Prepare for WTO Negotiations on Services

Last December, WTO member countries failed to launch a new round of trade negotiations. However, services (including insurance) will still be on the next round agenda as part of the built-in agenda. If China joins the WTO this year, it will need to participate in these negotiations.

In order to prepare for WTO negotiations, CIRC should first develop a long-term action plan, which includes study of international trade agreements and insurance policies. In fact, CIRC should direct its Department of Policies and Regulations, Division of Policy Study, to immediately establish a working group that includes participation of universities and foreign insurance companies.

The overall strategy for future WTO negotiations should include:

- Forming alliances with other developing countries. Most developing countries, such as India and Malaysia, confront challenges similar to China's. Alliances can help ensure that these challenges are adequately addressed within the context of WTO negotiations.
- Using WTO principles to pursue special treatment for the developing countries. Special treatment might include 1) extending transition periods for developing countries to implement WTO agreements; 2) expanding technical cooperation.

Summary of key recommendations

- ➢ CIRC should generate an international media campaign to announce its policies and to change its image.
- ➢ CIRC should build good relations with foreign countries and government agencies.

- CIRC should encourage the Chinese insurance associations to build long-term relations with foreign insurance associations.
- CIRC should develop an immediate strategy for future bilateral negotiations.
- CIRC should prepare for the next round of WTO negotiations on services.

Footnotes:

[36] NAIC is the U.S. association for insurance regulators. Its web site address is http://www.naic.org.

37 NAMIC is a U.S. insurance association. Its web site address is: http://www.namic.org

[38] The Health Insurance Association of America is the most prominent U.S. trade association representing the private health care system. Its 290 members provide health, long-term care, dental, disability, and supplemental coverage to more than 123 million Americans. The web site address is http://www.hiaa.org.

[39] American Insurance Association's web site address is :http://www.aiadc.org.

[40] Canadian Life and Health Insurance Association Inc. is a national association in Canada. Its web site address is www.CLHIA.ca.

[41] http://www.liam.org.my/

42 http://www.knia.or.kr/