

# FOCUS

## CHINA – INSURANCE



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## PRC INSURANCE LAW LIBERALISATION

As China's burgeoning insurance sector looks set to expand further, a raft of new regulations aim to open investment channels for insurance companies that should increase their competitiveness, as well as introduce new measures to enhance risk management. Partner Niranjan Arasaratnam and Senior Associates Troy Zhang and Julian Donnan look at the recent developments.

New regulations aim to make Chinese insurance firms more competitive at a time when trade barriers are being lowered to international players

### DRAFT RULES ON OFFSHORE INVESTMENTS OF INSURANCE FUNDS

On 21 December 2006, the draft *Rules on Offshore Investments of Insurance Funds* (the **Offshore Investment Rules**) were released by the industry regulator, the China Insurance Regulatory Commission (**CIRC**). Chinese insurance companies have long been subject to stringent controls on their offshore investment activities. The Offshore Investment Rules, however, alter this position by permitting offshore investment by PRC insurance companies in the following types of financial products:

- Money market products, including commercial bills, certificates of deposit and money market funds.
- Fixed return products, including bank deposits, structured deposits, bonds, convertible bonds, securitisation products and trust products.
- Equities, including shares and equity products.
- Other products approved by CIRC.

Fixed return products and equities should have a rating of no less than A or A+, as assessed by an internationally recognised rating agency.

The Offshore Investment Rules limit offshore investment to 15 per cent of the total assets of the insurance company (the previous limit being 80 per cent of the insurer's previous year's foreign exchange reserves) and also opens the possibility for a financial manager appointed by the insurance company to enter into offshore derivative transactions to hedge risk.



The Offshore Investment Rules further propose the appointment of a qualified foreign investment management company to manage the offshore investment and the appointment of an offshore custodian to hold the offshore assets.

This is an extension of the 'Qualified Domestic Institutional Investor Scheme', commonly referred to as QDII (see AAR *Focus: Funds Management* – August 2006), which was designed to free the domestic monetary reserves of China's largest financial institutions for international investment. With estimates valuing the total assets in China's insurance sector at more than A\$300 billion at the end of 2006, the Offshore Investment Rules mark a further step towards liberalising large capital flows out of China.

Finally, the Offshore Investment Rules formalises the principle that the insurer's investment assets are separate from assets of the manager or custodian that manages/holds the insurer's investment assets. This is a welcome reform as the PRC's rudimentary trust law has not provided certainty regarding legal ownership of an insurer's assets.

The precise date for promulgation of the Offshore Investment Rules has not yet been clarified by CIRC.

## CIRC RULES PERMIT INSURERS TO INVEST IN DOMESTIC BANKS

On 26 October 2006, CIRC issued the *Circular on the Investment in Equity Interests of Commercial Banks by Insurance Institutions* (the **Circular**), which permits PRC insurance companies to make equity investments in unlisted PRC domestic commercial banks.

The Circular sets out the parameters for investing in commercial banks by insurance companies, including an in-principle restriction on material investment in more than two banks (a 'material' investment, for these purposes, is a reference to five per cent or more of the equity in the relevant bank).

Insurers have been permitted to own shares of listed PRC banks since 2004 (as evidenced, for example, by China Life Insurance Company's investments in the Bank of China and China Construction Bank).

## AUDIT OF DIRECTORS AND SENIOR MANAGEMENT PERSONNEL

The draft *Administrative Rules on Economic Liability Audit of Directors and Senior Management Personnel of Insurance Companies* (the **Draft Audit Rules**), issued by CIRC for consultation in December 2006, aim to reduce corporate governance risks among PRC insurers through audits of directors and senior management.

The Draft Audit Rules outline an audit-based evaluation of directors and senior management personnel of insurance companies by reference to the insurer's:

- financial liabilities and performance;
- operational results; and
- record of compliance with laws and regulations.

The Draft Audit Rules contemplate that an audit will be conducted on directors and senior management at no less than three year intervals, although CIRC may demand a specific audit if it has reason to consider there has been a serious breach of the law, inadequate solvency ratios or unusual financial results.

The Draft Audit Rules focus on the audit process itself and not the consequences of the process. If the audit discloses serious neglect of duty by the directors and senior management, other laws within the insurance sector open the possibility for CIRC to impose administrative sanctions on the relevant individuals or they may be exposed to civil or criminal liability.

CIRC proposes that the Draft Audit Rules, once implemented, will enhance its ability to exercise an oversight function in respect of corporate governance of insurance companies.



# PROGRESS ON THE PRC'S NEW INSURANCE LAW

Recent reports indicate that the amendments to the PRC's Insurance Law are in the process of being reviewed by the State Council and may be submitted to the Standing Committee of the National People's Congress in the first half of 2007. It is expected that the proposed amendments may be passed by the PRC's legislature towards the end of 2007.

Major amendments reportedly incorporated in the latest draft include:

- permitting PRC insurers to expand the use of their assets particularly to include general investment in securities and real estate projects in China; and
- enlarging the business scope of insurance companies to include management of annuity funds on trust and other businesses associated with insurance.

These amendments will mark the first major revisions to the PRC's Insurance Law since 2002.

These measures represent the PRC Government's trend towards removing barriers to the diversification of investment channels and business activity for its major financial institutions. This step might be regarded as a competitive necessity since China insurers will be operating in a sector likely to be shared with international players entering the domestic market as China fulfils its commitments to the World Trade Organisation to remove trade barriers.

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