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INSURANCE AND CHINA’S ENTRY INTO THE WTO

Stephen P. D’Arcy
Hui Xia

ABSTRACT

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

INTRODUCTION

After 15 years of arduous negotiations between China and the members of the World Trade Organization (WTO), on November 12, 2001, at the Trade Ministerial Meeting1 in Doha, Qatar, trade ministers from 142 member countries at the WTO summit unanimously approved membership for China. China’s entry into the WTO occurred after lengthy negotiations in which China had to satisfy its trading partners, most notably the United States and the European Union, that it was doing enough to open its economy to international competition. Interestingly, issues relating to insurance markets were some of the final points on which agreement was reached. Triumph at Doha—China’s formal membership in the WTO—was not simply a victory for China but a significant achievement for the entire system of world trade (The Economist, 2001c), and it served to highlight just how important insurance markets are viewed in today’s world economy.

HISTORY OF WTO

International trade has increased rapidly since World War II. Merchandise exports have grown on average by 6 percent annually; total trade in 2000 was 14 times the level of

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1 The Trade Ministerial Meeting is the highest-level regular meeting of the WTO, attended by the ministers responsible for trade and commerce of member countries. In general, many important proposals are discussed and agreements achieved in these meetings.
1950. The substantial growth in commercial services and merchandise trade over the last 20 years is illustrated in Figures 1 and 2. The WTO was founded in 1995 as a means of facilitating international trade. One of the youngest of the international organizations, the WTO is the successor to the General Agreement on Tariffs and Trade (GATT) established in 1947. This agreement was originally part of a draft charter for an international trade organization, the third leg of the Bretton Woods\textsuperscript{2} postwar order, along with the International Monetary Fund\textsuperscript{3} and the World Bank\textsuperscript{4} (\textit{Pillars of Peace}, 1946). GATT, which consisted of a large number of negotiated trade concessions and rules of conduct governing world trade, first became effective in January 1948. The agreement was designed to provide an international forum that encouraged free trade between member states by regulating and reducing tariffs on traded goods and by providing a common mechanism for resolving trade disputes. Most of the rounds of negotiations dealt with reducing tariffs and struggled to produce acceptable rules to govern international trade. Three especially significant rounds were the Kennedy Round (1964–1967), the Tokyo Round (1973–1979), and the Uruguay Round (1986–1994). The Kennedy Round developed agreement on antidumping (selling products below the cost of production) provisions. The Tokyo Round went further, dealing with subsidies and countervailing measures, technical barriers to trade, import licensing procedures, government

\textsuperscript{2} The conference was held at Bretton Woods, New Hampshire, in July 1944, to establish a formal mechanism to foster international trade.

\textsuperscript{3} The IMF was founded in 1946 to promote cooperation among countries on issues of monetary policy and to provide a resource to assist countries in need of temporary financial assistance.

\textsuperscript{4} The World Bank was initially established to help rebuild Europe after World War II. Current resources are used to provide assistance after natural disasters and wars, as well as to aid developing economies.
The Uruguay Round, the last of those held under GATT, led to the creation of the WTO. The negotiations continued after the end of the Uruguay Round. In February 1997, agreement was reached regarding telecommunications services, with 69 governments agreeing to wide-ranging liberalization measures that went beyond those agreed to in the Uruguay Round. In the same year, 70 members successfully concluded a financial services deal covering more than 95 percent of trade in banking, insurance, securities, and financial information.

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

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

One sticking point during the whole negotiation process of China’s entry into the WTO, and even the final hurdle for reaching an agreement, was related to the insurance industry. The international community placed a high value on expediting the opening of insurance markets in China, including facilitating the license issuing process, eliminating rules on product limitation, and lessening geographical restrictions on operations. Another key issue was the need to provide a balance between the numbers of licenses offered to insurers from the United States and from the European Union and even among countries within the European Union. These issues turned into the primary stumbling blocks several times during the negotiations, a development that brought the insurance industry to the forefront politically in China. As the Chief Negotiator Representative of China, Long Yongtu, told public media upon the final accession of China’s membership, “The insurance industry was always the most difficult negotiation field in the whole negotiation process. Also, many people, including myself, began to realize the importance of insurance” (www.china-insurance.com, 2001). Knowledge of the historical development of the insurance industry in China is essential to understand why insurance played such a key role in the process of its entry into the WTO.

**Insurance in China**

The insurance industry emerged as a business in China in the early 1800s. The first insurance institution, the Canton Insurance Society, was established in 1805 by British
and Indian businessmen in south China. Foreign insurers were the only participants in this market until 1865, when the first Chinese insurance company, Yi He Insurance Company, was established in Shanghai. Under competitive pressure, Yi He did not survive long. The first Chinese insurance business with a far-reaching influence on the whole industry appeared with the foundation of the Commercial Bureau of Insurance (Bao Xian Zhao Shan Ju) in 1875 in Shanghai, a company whose business focused on marine insurance. From 1865 to 1912, 35 Chinese insurance companies were established, which included 27 property-liability insurance companies and 8 life insurance companies, but by 1914, 26 of these 35 companies had gone bankrupt. By then, 148 foreign insurance companies were writing policies in China’s insurance market, either through their own branches or through Chinese agencies. Foreign insurers controlled almost 80 percent of the market at that point (China Insurance Academy, 1998). World War I limited the business expansion of foreign insurers, giving Chinese insurers an opportunity to develop. From 1912 to 1925, 39 new Chinese insurance companies were established, mainly in Shanghai. During World War II, insurance companies were used as a speculative financing tool to consolidate capital from many small investors, given the lack of alternative investment options for small businesses. This led to a period of extended prosperity for the insurance industry. From 1940 to 1943, 97 new Chinese insurance companies were founded in Shanghai. By 1948, the total number of insurance companies rose to 241, which included 178 Chinese insurers and 63 foreign insurers. As the most highly populated and most developed city, Shanghai was the birthplace for China’s insurance industry and has always been the main arena for insurance competition. Interestingly, in 1992 Shanghai became the first city in China after the foundation of the People’s Republic of China in 1949 to open its insurance market to the world.

China’s insurance industry then entered a very remarkable period of history, rebounding between the various campaigns to create a new socialist system. In 1949, the People’s Insurance Company of China (PICC) was established by combining several domestic insurance companies, and was given a monopoly over the whole domestic insurance industry. All foreign insurers were expelled from the country over the next seven years. However, since the “new socialist system” had the goal of providing “cradle-to-grave” social security to all people, insurance was regarded as an unnecessary business. As a result, all insurance operations except international cargo and aviation insurance were abolished at the WuHan national financial meeting of 1958. China’s government just kept “PICC” as the company title to all foreign customers, but the PICC was actually reorganized and became a small department in the People’s Bank of China (PBOC), the central bank of China. The remaining international insurance business was operated by a governmental department, not an independent enterprise. The lack of domestic insurance operations lasted for almost 21 years until Deng Xiaoping initiated the “Reform and Open” policy in 1979 and launched a series of reforms aimed at stimulating economic growth. The government worked at restructuring business networks, recruiting new employees, and developing the market over the next three years, until the PICC was separated from the PBOC in 1982 as an independent insurance company supervised by the PBOC. The first national insurance meeting, hosted by the PBOC and attended by government officials related to the insurance industry, was also held in 1979. Those two steps symbolized the development of China’s “modern” insurance industry. Similar to many other financial institutions in China, the PICC was then set up with an administrative organization that resembled those of governmental agencies—i.e., with units at the national, provincial, municipal, and even the county levels. This model was not based
on market demand but on a government administrative model. The structure generated many cost inefficiencies and internal control problems, but it did have the advantage of broad distribution channels, which helped it compete with other insurers, especially as foreign insurers have entered the market in the post-WTO era.

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

In 1996, the PICC was reorganized into a holding company (PICC Group) with three completely independent subsidiaries (property, life, and reinsurance). The official explanation for such a reorganization was to carry out the requirement of separating life and property business according to the China Insurance Law, which had just been promulgated and became effective October 1, 1995. Rigid central control of its operations contributed to the failure of this organization through the loss of effective internal control in corporate finance, business operations, and human resource management. Financial connections between the different branches of the PICC were hard to disentangle when the companies were separated. Some of the financial relationships among the companies were not settled until the disbandment of the entire PICC Group several years later.

A second restructuring of the PICC Group began to unfold in May 1998 and was formally announced in 1999. In March 1999, China’s government announced the establishment of three independent state-owned insurance companies: the new PICC, the China Life Insurance Company (CLIC), and the China Reinsurance Company (CRC). In August 1999, the China Insurance Company Limited (CICL) was established in Hong Kong, consisting of all 83 official overseas representative offices and branches of the former PICC Group.5 At this point, the PICC Group was officially disbanded.

At the same time, some domestic stock insurers gained the opportunity to develop quickly and gain market share. The establishment of the China Insurance Regulatory Commission (CIRC) in November 1998, combined with WTO requirements and pressure from the international insurance community, led China’s government to expedite the pace of issuing new licenses to foreign insurers. As of early 2002, foreign companies from 11 different countries had 22 licenses, AIG had five branch licenses, and Royal & Sun (United Kingdom) and AXA (France) each had a branch license. Of these 22 licenses, seven are for property-liability insurers and 15 are for life insurers. Eight insurers have already started to do business in China, primarily in Shanghai. Of the five American insurers with licenses (Chubb Insurance, John Hancock Mutual Life, Transamerica

5 This number was included in an advertising pamphlet produced by the former PICC Group. This value represented all branches, local agencies, and brokers. The agencies and brokers are not in fact owned by the PICC Group. The actual number of overseas subsidiaries owned by the PICC Group is approximately 32.
AEGON], New York Life, and MetLife), Chubb and John Hancock have already started operating in Shanghai (American Chamber of Commerce of China, 2001). When China was accepted into the WTO in November 2001, a total of 31 insurance companies were active in China, including 14 domestic insurers and 17 foreign insurers. The 31 companies consist of 15 property-liability insurers, 13 life insurers, one state-owned reinsurer, and two comprehensive insurers. The 17 foreign insurers include six branches of AIG and two branches of MingAn (based in Hong Kong). The remaining 11 foreign insurers are preparing to begin operations (see Table 1).

Since the restructuring of the PICC in 1982, the breakup of the state monopoly in 1988, and the entry of foreign insurers in 1992, China’s insurance market has been growing at a phenomenal rate of 10 to 15 percent per year (Kundu, 2001). The combined insurance industry premiums were $19.28 billion in 2000, an increase of 14.5 percent over 1999, according to CIRC official statistics. The total assets of China’s insurance companies reached $40.75 billion in 2000, an increase of 19.3 percent over 1999. Of this

**Table 1**

Companies Approved to Write Insurance in China

<table>
<thead>
<tr>
<th>Property-Liability</th>
<th>Life</th>
<th>Comprehensive/Reinsurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>PICC</td>
<td>China Life</td>
<td>Pacific</td>
</tr>
<tr>
<td>Xinjiang Jianshe Bintuan</td>
<td>Xin Hua (New China)</td>
<td>Ping An</td>
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<tr>
<td>Hua Tai</td>
<td>Tai Kang</td>
<td>China Reinsurance</td>
</tr>
<tr>
<td>Sinosafe</td>
<td>Zhonghong</td>
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<tr>
<td>Da Zhong</td>
<td>Pacific-Aetna</td>
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</tr>
<tr>
<td>Yong An</td>
<td>Allianz Da Zhong</td>
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<tr>
<td>Tian An</td>
<td>AXA-China Minmetals</td>
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</tr>
<tr>
<td>Tokio Marine—Shanghai</td>
<td>John Hancock-Tian An</td>
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<tr>
<td>AIU—Shanghai</td>
<td>AIA—Shanghai</td>
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<tr>
<td>AIU—Guangzhou</td>
<td>AIA—Guangzhou</td>
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<tr>
<td>AIU—Shenzhen</td>
<td>AIA—Foshan</td>
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<tr>
<td>AIU—Foshan</td>
<td>Prudential (U.K.)</td>
<td></td>
</tr>
<tr>
<td>Royal &amp; Sun—Shanghai</td>
<td>Colonial-China Life</td>
<td></td>
</tr>
<tr>
<td>Winterthur (Switzerland)—Shanghai</td>
<td>Sun Life (Canada)</td>
<td></td>
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<tr>
<td>Min An—Shanghai</td>
<td>ING (Netherlands)</td>
<td></td>
</tr>
<tr>
<td>Min An—Haikou</td>
<td>AIA—Beijing</td>
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<tr>
<td>Chubb—Shanghai</td>
<td>TransAmerica (AEGON) (U.S.)</td>
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<tr>
<td>Allianz (Germany)</td>
<td>Generali (Italy)</td>
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<tr>
<td>Gerling (Germany)</td>
<td>New York Life (U.S.)</td>
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<tr>
<td>Japan (1)</td>
<td>CNP (France)</td>
<td></td>
</tr>
<tr>
<td>Korea (1)</td>
<td>CGNU (U.K.)</td>
<td>MetLife (U.S.)</td>
</tr>
<tr>
<td></td>
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<td>AIG (AIA) Branches</td>
</tr>
</tbody>
</table>

Companies in italics are preparing to start business now (as of March 2002).
Figu re 3


total, $7.23 billion in premiums, or 37.5 percent, were from property-liability insurance, a 14.8 percent increase over 1999. Life insurance income increased 14.4 percent to $12.05 billion, accounting for the remaining 62.5 percent of total premium income. The trend of premiums from 1990 to 2000 is shown in Figure 3. Total income from premiums is expected to exceed $20 billion in 2001 and $33.82 billion by 2005. This level, if achieved, would constitute 2.3 percent of the total gross domestic product (GDP), with an average premium per person of $27.78 (see CIRC, 1999; http://www.circ.gov.cn; Jebson, 2000).

While both property-liability insurance and life insurance premiums have grown significantly, life insurance premiums have grown more rapidly and have exceeded property-liability premiums since 1997. China’s life insurance market is becoming more attractive because of China’s huge population, the reforms to state-owned enterprises, and the growth of joint ventures. Since China’s government does not provide life insurance, health insurance, or other employee benefits to employees of joint ventures, these employees provide a ready market for this type of coverage. In addition, the life insurance business has transformed itself from a business aimed solely at corporate sales to one aimed at the simultaneous development of both group and personal business, an approach facilitated by the introduction of AIG’s personal sales agent system. One of the notable benefits of allowing foreign insurers into the market is that they bring new approaches with them, as exemplified by AIG’s market distribution system. The market for
property-liability insurance has also remained strong, which can be attributed to greater corporate accountability, higher insurance awareness of managers of state-owned enterprises, more foreign investment in the eastern coastal area, and increasing automobile and housing consumption.

Despite the impressive recent growth rates for insurance premiums, the entire insurance market in China is still in its infancy because of the limited number of products available, inexperienced management of insurance companies, and low insurance awareness by the public. Two key measures of insurance markets that are commonly used to evaluate the development level of the insurance industry, insurance density and insurance penetration, are still very low in China compared with those in developed markets. Insurance density is the average insurance premium per capita. Insurance penetration is the ratio of insurance premiums to GDP. In developed countries, the amounts spent on insurance in relation to the country’s GDP are in the range of 3 to 5 percent for property-liability insurance and 4 to 8 percent for life insurance (see Sigma, 1999, p. 18). Figure 4 shows the growth of insurance density in China over the period 1994–1999. As shown in Figure 5, which displays the growth of insurance penetration over the period 1994–1999, the insurance industry is still only a small part of China’s economy, comprising in total less than 2 percent of GDP (see CIRC, 1999; www.circ.gov.cn; Jebson, 2000).

China is expected to become an even more attractive market for insurers for both social and legal reasons. The market demand for insurance is tied to economic development. A growing economy such as China’s leads to growth in capital resources and assets,
which has a corresponding requirement to protect those assets. In addition, the improvement of the standard of living and reforms of the medical and welfare systems increase the demand for life insurance. China’s government is seeking to reshape its old national social security system in light of its huge population base and deteriorating state-owned enterprises. The government is shifting part of its heavy burden of “from cradle to grave” social security to society. The cost of providing such security to an aging population, combined with the effects of a one-child policy, is overwhelming. Reforms of state-owned enterprises provide more opportunities and incentives to purchase commercial insurance.

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

The 1983 Regulations on Contracts for Property Insurance and the 1985 Provisional Regulations on the Administration of Insurance Enterprises were the earliest regulatory legislation related to insurance. The 1992 Provisional Measures on the Administration of Insurance Institutions with Foreign Investment in Shanghai (Shanghai Measure) was the first legislation addressing foreign insurers (People’s Bank of China, 1998). The 1992
measures were developed to deal with the entry of AIG into the insurance market in China. The long-awaited China Insurance Law became effective on October 1, 1995. Interestingly, the China Insurance Law provided a legal basis for insurance operations, which initially expedited the development of insurance markets, but some of its provisions later proved to be impediments.

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

1. a limited supply of employees with expertise in insurance, notably in finance, actuarial science, and marketing.
2. a legal environment without a long history of consistent rulings.
3. severe imbalances in geographical supply and demand based on the geographical distribution of competition.
4. investment restrictions and immature capital markets that limit the potential for investment returns and can expose insurers to substantial investment risk.
5. low consumer awareness of the benefits of insurance.

Facing such a rapidly growing market with these problems, China’s insurance regulatory system finds itself in a very delicate position. In contrast with the deregulation trend in developed markets, the main reason to establish the CIRC was to strengthen insurance regulation. The dilemma is to balance the interests of the state-owned insurers that write more than 70 percent of the market with those of customers who could be either owned by the state or independent. With almost half of the employees of the CIRC coming from the disbanded PICC Group, conflicts of interest could easily develop.

Despite these problems, the establishment of the CIRC has improved the position of the insurance industry in the national economy, and an independent regulatory body has strengthened supervision and brought many new opportunities to the market. All new products must be approved by the CIRC before they can be issued, all changes in the ownership structure of a company need to be authorized by the CIRC before being implemented, and any change of investment allocations must be approved by the CIRC. Developing new products, distributing policies in different geographic areas, and appointing senior managers are generally considered to be internal affairs for insurance enterprises; however, in China all these functions need the involvement of the CIRC.

The CIRC has branches in all provinces except Tibet. These branches are extensions of the head office in Beijing and are responsible for local regulatory affairs. In the early development of the market, such a heavily regulated network may be necessary; however, this structure will come under pressure in a post-WTO era. Under such circumstances, the capability of regulators becomes as vital to industry development as do management performance, human resource development, and market strategy of insurers. For example, the CIRC has led a product revolution aimed at pressuring life insurers to transfer

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6 In Chinese, the term for insurance is the same word as is used for a safe with a combination lock. There have been instances in which people have come to insurance companies to buy a safe.
traditional saving-type products into investment-linked products since 1999. By being able to see the financial effect of lower interest rates on all the insurers operating in the market, regulators have been able to require domestic insurers to stop writing policies that expose them to investment risk and to shift over to investment-linked products in which the policyholders bear the investment risk. The result is that all life insurers in China’s market have their own different investment-linked products. China’s market became the only market in Asia to have such products before 2000. This is an example of a case in which the regulator has seemed to go beyond the general responsibility of insurance regulators in other countries.

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

**WHAT THE WTO MEANS FOR CHINA’S INSURANCE INDUSTRY**

With an expected annual growth rate in insurance premiums of 12 percent through 2005, a population of more than 1.3 billion, and a GDP growth rate of 8 percent, China’s insurance industry represents a huge market (*China Insurance News*, 2000). American insurance companies have spent millions of dollars over several decades lobbying the U.S. government for assistance in obtaining licenses to operate in China. As one part of China’s economic reforms, China’s government started permitting limited foreign access to the emerging insurance market in 1992 with AIG’s entry into Shanghai. However, various criteria required by the PBOC for approval to operate within China, special requirements for a business license from local governments, the slow pace of comprehensive insurance legislation, and incidences of protectionism have all hampered the pace of entry of foreign insurance companies. Even for those fortunate entrants, strict restrictions on the geographic scope of operations, the insurance products that can be issued, and the selection of partners have all slowed their further development. The combination of these three factors, along with the vast market potential, the strict limitations on entry, and slow approval of permission to operate, led to insurance becoming one of the most heated points of contention during China’s WTO membership negotiations.
In the negotiations leading to the U.S.-China Bilateral WTO Agreement of November 1999, insurance played an important role. The specific agreements regarding insurance were as follows:

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

- **Geographic Limitations:** China will permit foreign property and casualty firms to insure large-scale risks nationwide immediately upon accession, and will eliminate all geographic limitations in three years.

- **Scope:** China will expand the scope of activities for foreign insurers to include group, health and pension lines of insurance, which represent about 85 percent of total premiums, phased in over 5 years.

- **Prudential Criteria:** China agrees to award licenses solely on the basis of prudential criteria, with no economic needs test or quantitative limits on the number of licenses issued.

- **Investment:** China agreed to allow 50% ownership for life insurance. Life insurers may now choose their own joint venture partners. For non-life, China will allow branching or 51% ownership on accession and form wholly owned subsidiaries in 2 years. Reinsurance is completely open upon accession (100 percent, no restrictions). While the United States agreed to China’s request to limit foreign equity participation in life insurance to 50 percent, China agreed to significantly accelerate the elimination of geographic restrictions the percentage of equity participation in the first few years.7

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

China’s obligation to issue licenses solely on the basis of “prudential criteria,” without a discretionary economic needs test or quantitative limits on the number of licenses issued, is the foremost concern of all foreign insurers. “Prudential criteria” means a transparent process and objective criteria for all applicants, rather than criteria based on nationality. The basic requirements for a qualified applicant include 30 years of experience, total assets of $5 billion, and having a representative office in China for at least two years. “With no economic needs test” means that a member country is prohibited from disallowing licensure or other activities of a foreign-invested company, even if the company might influence the country’s domestic companies negatively. “With no economic needs test” is a very technical expression of the negotiation agreement that is likely to lead to problems in later implementation. Such a commitment increases foreign investors’ confidence, compared with past decisions to grant licenses described by foreign insurance practitioners as “arbitrary and politicized” (Lincoln Reinsurance Reporter, 2000). “With

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no quantitative limits” means that there will be no limitation on the number of licenses granted.

The trade agreement also provides for an elimination of geographical restrictions. Although 18 foreign insurance companies operate in China’s market now, they have achieved less than a 5 percent market share in aggregate. This low market share is primarily the result of the strict restrictions on business geographic area and product scope. Before China became a member of the WTO, only Shanghai, Guangzhou, Shenzhen, and Foshan were open to foreign insurers. Almost all domestic companies have branches in Shanghai; Shenzhen is a newly developed special economic district with limited population, and Foshan is a very small city in south Guangzhou. According to China’s WTO commitments, upon accession, foreign insurers and insurance brokers will be permitted to provide services in Shanghai, Guangzhou, Shenzhen, and Foshan, plus Dalian, an extra city included in the negotiation agreement between China and Japan. Within two years after China’s accession, foreign insurers and insurance brokers will be permitted to provide services in the following additional cities: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan, and Tianjin. Within three years after China’s accession, there will be no geographic restrictions.

Although the new areas open for operations may appear very attractive to foreign insurers, the efficiency of the approval process could become a bottleneck and an effective control tool for China’s insurance regulators to restrict the pace of liberalization. An instructive example of this process was when Sun Life Canada met resistance when it applied to build a joint venture of life insurance in Tianjin after receiving permission to operate in 1999. Sun Life was finally able to commence operations in Tianjin in early 2002.

A third point addressed in the agreement relates to expanding product scope. Currently, the products issued by foreign insurers are highly restricted. Foreign property-liability insurers can only underwrite the risks of foreign-invested enterprises, and foreign life insurers can only sell individual life policies and are prohibited from selling group life products or any types of health, pension, and annuities products. According to the final agreement, upon China’s accession, foreign property-liability insurers will be permitted to provide insurance under “master policies” and to insure large-scale commercial risks. They will also be permitted to insure Chinese enterprises abroad and write property insurance, related liability insurance, and credit insurance for foreign-invested enterprises in China. Within two years after China’s accession, they will be permitted to provide the full range of services to both foreign and domestic clients. Foreign life insurers are currently permitted to provide individual (not group) insurance to foreigners and Chinese citizens; within three years after accession, they will be permitted to provide health insurance, group insurance, and pension/annuities insurance to foreigners and to Chinese citizens.

China’s government is also trying to develop its reinsurance market, which currently has only one state-owned reinsurance company, China Re. Upon accession, foreign insurers will be permitted to provide reinsurance services for life and property-liability insurance as a branch, joint venture, or wholly foreign-owned subsidiary, without geographic or quantitative restrictions on the number of licenses issued. Current insurance regulations require all property-liability insurers to reinsure 20 percent of their business with China Re. The requirement will be phased out within four years after accession. Although this
agreement conflicts with Articles 101, 102, and 103 of China Insurance Law, the law is expected to be revised immediately.

The final and most significant part of China’s WTO commitments is to determine the form of relationship for foreign-invested companies. According to the agreement, foreign property-liability insurers will be permitted to be established as a branch or as a joint venture with 51 percent foreign ownership. Within two years after China’s accession, foreign property-liability insurers will be permitted to be established as wholly owned subsidiaries, i.e., with no form of establishment restrictions. Upon accession, foreign life insurers will be permitted 50 percent foreign ownership in a joint venture with the partner of their choice. The joint venture partners can freely agree to the terms of their relationship within the limits contained in the schedule. For insurance brokerage of large-scale commercial risks, international marine, aviation, and transport insurance and reinsurance, upon accession, a joint venture with foreign equity of no more than 50 percent will be permitted; within three years after China’s accession, the foreign equity share may be increased to 51 percent; within five years after China’s accession, wholly foreign-owned subsidiaries will be permitted. Foreign ownership for other brokerage services will have no limitations. One important result of liberalization is that foreign life insurance companies can now select their own Chinese joint ownership partners (previously they were assigned partners), and property-liability insurance companies do not have to deal with the partnering issue.

One significant factor affecting the entire negotiation process among the United States, the European Union, and China involves the role of AIG, a major U.S. insurer. China is actually the birthplace of AIG. As a young American businessman, Cornelius Vander Starr opened an insurance agency named American Asiatic Underwriters (AAU) in Shanghai in 1919, selling fire and marine policies for some American insurance companies (Allen, Leyssens, and Liu, 2000). Later Starr began AAU’s counterpart, Asia Life Insurance Company (ALI), to issue life policies to Chinese citizens, and then expanded the business throughout Asia. All foreign insurance companies, including AAU and ALI, were expelled by China’s government after 1949. In 1967, the structure of Starr’s companies was consolidated with American International Group (AIG), which became the primary entity. AIG began the process of gaining reentry to China’s insurance markets in the 1970s. Chairman Maurice Greenberg worked to improve relations between the United States and China. And AIG agreed not to repatriate any profits for at least ten years. AIG became by far the most successful of all foreign companies in China. AIG gained its first license in 1992 and now operates wholly-owned life and property-liability insurance businesses in Shanghai, Guangzhou, Shenzhen, and Foshan, the only foreign insurance company allowed to do this.

The United States and the European Union disagreed over whether China’s terms of accession to the WTO should allow AIG to continue to be the only foreign company that can open new wholly-owned life insurance branches in China. Currently, two European companies and one Canadian company own 50 percent equity of their current life insurance operations. China’s services schedule stipulates a 50 percent equity cap for all foreign life insurance companies, but the United States has been trying to press China to allow companies already in China to establish branches based on their original equity structures. However, the European Union has resisted that effort and insists that any new insurance branches be subject to the equity limits in China’s service schedule.
In addition, the different understandings about the grandfather clause have hampered the negotiations.

The grandfather clause, in modern law, refers to any legal provision that excuses an individual or corporation from a requirement or prohibition because the person or corporation has enjoyed a certain privilege or right at some time in the past. The treatment of AIG became the last hurdle to China’s WTO accession negotiation. This was solved by adding a footnote to the agreement stating that all companies would receive equal treatment under the most-favored-nation provisions at the core of the WTO. The formal footnote is as follows:

Any further authorization provided to foreign insurers after accession under more favorable conditions than those contained in this schedule (including the extension of grandfathered investments through branching, sub-branching or any other legal form), will be made available to other foreign service suppliers which so request. (http://www.moftec.gov.cn/moftec.cn/wto)

This wording satisfied all participants in the negotiation as well and led to final approval of China’s admission into the WTO.

**Future Developments**

China’s entry into the WTO will bring far-reaching influence to its developing insurance industry. Moreover, the influence will be diversified based on different ownership structures of insurance companies. Among domestic insurance companies, state-owned companies will experience stronger competition with the elimination of the government’s informal support (*The Economist*, 2001b). The state-owned insurance companies will accelerate their shareholding reforms, reorganizing from state-owned companies into stock companies. The PICC, a property-liability insurer with a strong financial position, is moving to be listed in the stock market. The deteriorating financial situation resulting from asset and liability management issues may lead China’s government to reorganize and reform the CLIC. China’s WTO commitment to open its reinsurance market will place China Re into a new competitive market, with the loss of the fixed reinsurance business required by the China Insurance Law. For domestic stock companies, China’s entry into the WTO will give well-prepared companies, especially those that have taken steps to incorporate international operation rules, a more fair, transparent, and market-oriented development opportunity. At the same time, others will struggle under intensified competition. Because the CIRC has gradually loosened the limitation of trans-provincial operation and granted more freedom to domestic stock companies to open more branch companies, it is now possible for some small-scale domestic insurance companies to organize into commercial unions through which they can share the resources of locating in different geographic areas, expanding distribution channels, and lowering operating costs. These types of commercial unions may become a new operations model in the Chinese insurance market.

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

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

Another limitation to investing in China’s insurance market is in Article 104 of the China Insurance Law, which states, “The application of funds of an insurance company is limited to bank deposits, trading of government and financial bonds and other forms of fund application stipulated by the State Council.” This restriction has become the main legal obstacle to investing insurance funds, but the China Insurance Law may be revised soon. Under current regulations, insurance companies can set up a special insurance investment company or several mutual funds, providing a potential investment option for foreign investors.

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

Revisions to China’s insurance laws are likely to occur in the near future. He Jingzhi, deputy to the Ninth National People’s Congress and president of the CLIC (Shanghai Branch), recently called for changes in China’s insurance laws to bring them in line with international practices (People’s Daily, 2002). This sentiment is echoed by many other insurance company representatives and insurance regulators.

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8 In May 2002, several ACE subsidiaries formed a partnership with HuaTai Insurance Company of China by purchasing in total a 22 percent interest in the firm.

9 On May 22, 2002, China’s cabinet passed the China Insurance Law (Revision). On June 24, 2002, this provision was submitted to China’s legislation, the National People’s Congress, for ratification.
The group facing the greatest challenge in the post-WTO environment is likely to be insurance regulators. Regulators will have to adjust their operating style in light of the new market environment. The principle of fair trade makes it much more difficult for regulators to protect domestic enterprises, even the state-owned companies. Some old regulatory tools will have to be discarded as regulatory control is shifted to focus on different elements of insurance operations.

**CONCLUSION**

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

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