

Is China Playing By the Rules? Free Trade, Fair Trade, and WTO Compliance
Wednesday, September 24, 2003
10:30 AM - 12:30 PM

Statement of
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Overview

Thank you, Mr. Chairman and Commission Members, for the opportunity to testify. If it is acceptable, I would like to have my written testimony, which expands on my oral comments, added to the record.

The U.S. insurance industry strongly supported PNTR for China because the Chinese accession package was extremely broad and deep, and when fully implemented holds the promise of opening the vast Chinese insurance market to U.S. insurance and retirement security providers. We were aware from the outset that no agreement is self-implementing, and that the key to realizing successful profit from Chinese accession to the WTO is an efficient and transparent implementation process.

With the ongoing leadership and support of the U.S. Government trade negotiators and facilitators, ACLI and our property casualty counterparts at the American Insurance Association have established what we consider to be a positive implementation dialogue with the Chinese Insurance Regulatory Commission (CIRC), which has already led to a much improved communications and transparency process for U.S. insurers in China.

Based on draft regulations just released by CIRC, we are cautiously optimistic that our primary concern to date (unjustifiably high capitalization requirements) has largely been addressed. As the next step, we have submitted a detailed list of additional questions to which we are seeking clarification from CIRC. We are optimistic that the United States Trade Representative ("USTR") will be able to schedule a meeting to review this agenda by the end of the year.

Background

China's formal membership in the World Trade Organization offers great promise and opportunity for life insurers. The ACLI and the broader U.S. Insurance industry, especially our property casualty counterpart -- the American Insurance Association, were strong supporters of Permanent Normal Trade Relations (PNTR) for China because the insurance liberalization commitments contained in China's schedule of specific commitments and "Working Party Report" were broad and deep, holding the promise of opening the Chinese market to U.S. insurance companies and pension providers. Through experience with bilateral insurance agreements in Japan and South Korea, we knew at the time of China's accession that no agreement is self-implementing, and that the most important part of the opening of the Chinese insurance market would be in the implementation phase.

With China now in the WTO, through the good offices of the U.S. Trade Representative, the U.S. Commerce, State and Treasury Departments, and through the communications of many interested members of Congress, we (ACLI and AIA) have begun the process of establishing a dialogue with the Chinese Insurance Regulatory Commission (CIRC) about the implementation of their liberalization

commitments. Establishment of regular, straightforward two-way communication is, in our opinion, the best way to avoid possible misunderstandings, frustrations or disappointment about China's liberalization process.

The task before CIRC is substantial, as it is in everyone's interest that the Chinese insurance market not only be open but well run and prudentially sound. Our intent is therefore to make a positive contribution to this process, by providing CIRC and other Chinese decision makers our comments on their implementing regulations, and where appropriate, include technical research to help them in setting standards that meet the test of prudential justification.

Individual company experience with CIRC varies greatly. Some describe relations as perfect and others describe them as frustrating, but our member companies support this constructive engagement approach for the same reasons many companies have funded representative offices all over China, some going back for more than ten years. The Chinese market is seen to have tremendous potential, and many U.S. companies, like our international competition, see entry into China as key to a global strategy. Recent industry press headlines such as "Chinese Insurance Premium Grew 33% For First Seven Months" and "China Will Be Second Largest Insurance Market by 2032, Says IBM", typify stories of the growth of the market since first being liberalized in 1992 – we intend to be part of that.

With regard to China's implementation of their WTO insurance commitments, while the process is moving forward, the lack of clarity in the regulatory process has slowed and confused the fulfillment of China's insurance liberalization obligations.

Since joining the WTO in December of 2001, Chinese insurance regulators have promulgated five sets of regulations with the stated intention of implementing China's WTO insurance commitments. The first set went into effect in early February of 2002 and provided a general framework for the regulatory structure but offered little specificity regarding the implementation of their liberalization commitments. Procedures for branching, capitalization and solvency regulation and other fundamental processes by which U.S. Insurers could procure a license and begin operations were not included. US insurers provided an analysis of these regulations for USTR, pointing out the vagaries of the regulation as well as several specific regulatory articles that could be inconsistent with China's WTO obligations. USTR then met with Chinese regulators to communicate these questions and concerns and were told additional regulations would be forthcoming.

Chinese regulators subsequently released a second set of regulations in late February 2002 to further clarify the licensing procedures. USTR again communicated directly with CIRC regarding questions and concerns, which still had not been clarified. CIRC informed USTR of further forthcoming regulations and stated that China would fully implement their WTO liberalization commitments.

Concurrent with this informal bilateral dialogue, USTR had requested answers to a detailed set of the same questions at the Transitional Review Mechanism discussion in the WTO Committee of Trade in Financial Services. This engagement has been continued at each subsequent CTFS meeting, with the same questions being echoed by the Governments of Canada, the European Union, Australia, South Korea and Switzerland.

Based on both the formal requests in the CTFS and the informal bilateral dialogue, in October of 2002, Ambassador John Huntsman requested a meeting with CIRC that would be open to a small number of U.S. and Chinese insurance industry representatives as well as USTR representatives. At the suggestion of USTR, it was decided to focus exclusively on the highest priority issue -- capitalization levels required

of an initial establishment of a foreign insurer, and subsequent capitalization required when additional branches would be opened.

Our concerns were that the regulations were unclear because of conflicting overlap from multiple regulations, and because the amounts called for were well outside of prudentially justifiable international norms, thus creating a barrier to entry for many U.S. insurers. Our objective for the meeting was to seek clarification of the specific requirements, and to provide information on international benchmarks for prudentially justifiable capitalization levels. Thanks again to USTR, the U.S. Embassy in Beijing and the U.S. Commerce Department, on December 13, 2002 we participated in a meeting in Beijing with CIRC, Chinese industry representatives and a U.S. Government and industry delegation headed by Deputy Assistant USTR, Charles Freeman.

Our presentation, attached for entry into the record, was entitled "A Recommendation for Revisions to the Capitalization Requirement Rules for Life Insurance Companies Operating in China", highlighted just how far outside international norms China's capitalization levels were, and presented a model that our consultant, Watson Wyatt Insurance Consulting Limited, felt might be more appropriate for the Chinese life insurance market. CIRC listened, agreed that our worst-case projection of the capitalization requirements was currently correct, stated that there were plans to revise the relevant regulations, and agreed to consider our views.

Meanwhile, we discussed our capitalization concerns with other service industry groups in the U.S., Canada, Europe and Japan, fellow members of the "Financial Leaders Group" and found that our capitalization concerns were not unique. Service sectors such as banking, securities, auto finance and express delivery are facing similar problems. Thus, in February of 2003, the Financial Leaders Group delivered a letter to Chinese officials commenting on the prudentially unjustifiably high capitalization levels in many services sectors, including insurance, and the issue was again highlighted at the CTFS meetings in Geneva by the Quad Governments. CIRC subsequently stated that additional regulations to fulfill China's WTO liberalization commitments would be forthcoming.

It should be noted that neither of the first two insurance regulations were publicly released in draft for public comment. The U.S. industry provided comments anyway: No formal response was received.

On July 31, 2003 a third set of regulations ("The Draft Trial Implementing Rules on the Regulations of the PRC on the Administration of Foreign-Invested Insurance Companies") were placed on the CIRC website with a request for public comment by August 15. To our surprise, on August 18, 2003, another set of regulations ("Draft Administrative Regulations on Insurance Companies of the People's Republic of China") was also posted to the CIRC website requesting public comment by September 16. In both instances, we translated the draft regulations and circulated them widely within the U.S. insurance industry.

In both instances we submitted formal written responses to CIRC within the requested time frame. We commended them for their public outreach, and stated that their openness supports our firm belief that the most important factor contributing towards the successful development of the Chinese insurance sector will be the institutionalization of a regular and robust public dialogue. We expressed our hope that this initiative can be expanded through increased communication and cooperation with interested international companies and industry associations, and committed ourselves to provide professional and timely responses to CIRC on an ongoing basis. We also stated that a dialogue on these drafts and/or any revised drafts that CIRC circulates for additional comment would be an excellent basis for continuing the dialogue we began last December in Beijing.

The major notable development in these recent drafts is a significant lowering of the required capital for initial establishment and full national operations, which, if implemented, bring the capitalization requirements closer to the acceptable range of international comparables for some lines of business and business models. This is a major step forward for CIRC, which we feel supports the benefits of continued dialogue. We plan to extend this dialogue to now include our other priority areas of concern.

Continuation of this dialogue must be two-way. Many of our concerns involve confirmation of our understanding of the meaning of vague or conflicting regulations. So that this dialogue is as clear as possible, we hope to receive written responses to our inquiries from CIRC. This has also been requested by USTR. We look forward to a meeting in Beijing to focus on this agenda by the end of the year, and greatly appreciate USTR's efforts to schedule it.

Top priorities we would like to have included in the dialogue agenda are (by category of type of issue):

Fundamental Assumptions

We seek confirmation of the following fundamental assumptions, which are key to our understanding of the prudential intentions of the Chinese Insurance Regulatory System.

Fundamental Assumption - 1

That CIRC is undertaking, through measures to date and in the future, an approach consistent with the PRC's WTO obligations regarding market access, national treatment and transparency, and that the only discrimination (differences) between provisions for domestic and foreign insurance companies is where there is a clear and necessary prudential justification. Furthermore, that it is the goal of CIRC is to have one set of regulations and procedures for domestic and foreign companies, so that the regulations are consistent with China's WTO commitments.

Fundamental Assumption - 2

That there are three (3) documents/rules/regulations relevant to this exercise. They are (working back from the present): (A) the Draft Insurance Company Administrative Regulations (hereinafter the "Measures."); (B) the Draft Trial Implementing Rules on the Regulations of the PRC on the Administration of Foreign-Invested Insurance Companies, July 31, 2003 (hereinafter "Implementing Rules"); and (C) The Administrative Regulations on Foreign-Invested Insurance Companies of the PRC, Feb. 2002 (hereinafter the "Administrative Regulations").

Fundamental Assumption - 3

That the three documents are each intended to accomplish a specific regulatory function and that there is no intentional overlap or conflict between the provisions of the three documents, especially with regard to the application of measures as between domestic and foreign companies.

Fundamental Assumption - 4

That only the "Implementing Rules"; and the "Administrative Regulations" are applicable specifically to foreign companies.

Fundamental Assumption - 5

That the "Measures." are relevant to all companies both domestic and foreign equally without discriminatory interpretation.

Implementation Gaps

We would like written responses to three questions regarding gaps in the regulations where they should reference major elements of the implementation of China's WTO liberalization commitments:

Implementation Gap - 1

It should be noted in the "Implementing Rules" that several existing joint venture companies have foreign registered capital interests that are above 50%. It should be confirmed that these companies, and any subsequent foreign companies approved by CIRC to own more than 50%, are grandfathered in accordance with China's WTO commitments, and that such companies will be allowed to expand geographically (through branches and sub-branches) in their current ownership structure.

Implementation Gap – 2

Prior to China's WTO accession, a number of foreign insurance companies were allowed to establish operations in the PRC. All of these companies were requested by the Chinese Government to incorporate as operational branches, not as subsidiaries.

However, in both of the two new sets of draft regulations (the "Administrative Regulations," and the "Implementing Rules"), there does not appear to be any article that addresses the maintenance and development of these branch operations. We believe a section should be added explaining the administrative procedures under which a "guaranteed branch/sub-branch structure" should be allowed to operate. (By "guaranteed branch/sub-branch structure" we mean branches and sub-branches whose solvency is guaranteed and supported by the total assets of the parent company.) The branch/sub-branch structure is a well-established international norm appropriate for application in China. Accordingly, regulations should be developed to govern those branches already established in China and such future branches that may be established in China. We recommend that these regulations conform to the internationally accepted branch/sub-branch operating structure.

Indeed, in most countries and in accordance with international norms, when insurance companies enter foreign markets, they are allowed to establish an initial branch or home office and then expand to new locations throughout the country through a network of sub-branches. These sub-branches report to the original branch or home office.

This branch/sub-branch structure is supported by, and legally tied back to, its corporate parent. Thus, branch operations should not be treated as if they were separate, stand-alone entities. Likewise, because a branch/sub-branch structure is supported by its parent corporation's assets, the company should not have to re-capitalize when expanding to a new location. This branch/sub-branch operating structure is an established international norm and a widely accepted principle of operation.

For property casualty insurance companies the ability to expand by sub-branch is particularly important. Foreign insurance companies should be allowed to expand geographically in the Chinese insurance market in accordance with established international norms and operating practices (i.e., through the use of the internationally accepted branch/sub-branch structure). Specifically, foreign insurance companies should be able to establish a branch (with a reasonable initial capitalization) backed up by the strength of the parent organization, and be allowed to expand throughout the country - in accordance with China's timetable for the phase-out of geographical restrictions - through the establishment of sub-branches. The establishment of sub-branches should not be limited to the immediate, licensed region or territory. Also, the company should not have to separately capitalize each new location.

We also request clarification with respect to branch boundaries. We believe that it is more efficient to establish provincial-level branches rather than only municipal-level branches. Domestic companies are able to operate at the provincial level with access to all cities and localities in the province. To date

foreign companies have received approval to operate at only in one specific city. Foreign companies like their domestic counterparts should have provincial level licenses.

The proposed rules are also silent as to their impact on existing insurance company operations, including existing branches. It is, therefore, assumed that branches and other insurance company operations that exist today may, but are not required to, continue to operate under the conditions and approvals that existed prior to this rule, including but not limited to operations, financial structure, capital and mode of establishment. This understanding should be confirmed.

Implementation Gap – 3

In addition to its insurance and reinsurance liberalization commitments, China committed to liberalize its pension market within five years of joining the WTO. To date, no regulations or laws have been released in anticipation of the opening of this important market sector. CIRC or other relevant authorities, should begin a public comment process well in advance of the approaching phase in deadline to gain the broadest level of comment and support for this fundamental undertaking.

National Treatment Questions

In addition to the questions on fundamental assumptions and the further information needed to fill the implementation gaps, we would also like to receive confirmations from CIRC on the following specific questions regarding national treatment.

National Treatment Question - 1

RE: Article 3 on the August 18th Draft of Administrative Regulations on Insurance Companies of the People's Republic of China. If we understand this correctly we interpret it to say that with respect to branch boundaries for foreign invested insurance companies, that they are treated the same as domestic companies which we understand are defined at the provincial-level (On May 21, CIRC approved Min Sheng Life to prepare 4 branches in Beijing, Nanjing, Hangzhou, and Shijiazhuang. (Source: China Insurance News, June 2003) If this is a correct understanding we believe that it is more efficient, and is a major step forward for CIRC in fulfilling their mission to implement China's WTO national treatment obligations. Domestic companies are able to operate at the provincial level with access to all cities and localities in the province. To date foreign companies have received approval to operate at only in one specific city. Foreign companies like their domestic counterparts should have provincial level licenses.

National Treatment Question – 2

RE: Article 11 on the August 18th Draft of Administrative Regulations on Insurance Companies of the People's Republic of China. If we understand this correctly, we interpret it to say that with respect to branch applications for foreign invested insurance companies, that they are treated the same as domestic companies which we understand can apply for any number of branch approvals simultaneously with no limit to the number of branches a company may be granted at any given time.

National Treatment Question - 3

RE: Article 13 of the August 18th Draft of Administrative Regulations on Insurance Companies of the People's Republic of China. As there is no reference to any waiting period, we request confirmation in this article that no waiting period exists before licensed insurance companies, domestic or foreign, can apply for branch or sub-branch licenses.

National Treatment Question – 4

RE: Article 99 of the August 18th Draft of Administrative Regulations on Insurance Companies of the People's Republic of China. As it is so vague, we are concerned that Article 99 could be used to justify

discrimination against foreign insurers, contrary to China's WTO commitments on national treatment. Accordingly, we would urge confirmation that the scope of Article 99 is limited solely to matters where the prudential justification will be clearly explained and limited to as least discriminatory as possible.

Prudential Justifications

In addition to the questions on fundamental assumptions, the further information needed to fill the implementation gaps, and questions of national treatment we would also like to receive responses from CIRC on the following questions of prudential justification.

Prudential Justification - 1

RE: Article 6 (b) of the August 18th Draft of Administrative Regulations on Insurance Companies of the People's Republic of China. We would like to understand the prudential reasoning behind the capitalization requirements. We believe that RMB200 million is too prescriptive in nature and may be much higher than international norms with respect to specific business models and risks being assumed. We feel that CIRC should be granted the discretion to lower this amount where it feels appropriate. Also, we request clarification of the scope of the initial establishment of RMB 200 million. Please confirm that this includes the right to establish sub-branches without limitation as to numbers.

Prudential Justification – 2

RE: Article 12 of the August 18th Draft of Administrative Regulations on Insurance Companies of the People's Republic of China. We would like to understand the prudential reasoning behind the branching capitalization requirements of RMB20 million for each additional branch. We feel this is duplicative, contrary to China's WTO commitments, and has no prudential justification. Additionally we feel it is an inefficient use of capital, which will raise the cost of products to Chinese consumers.

In summary, it is vitally important that all parties work together in a clear and open manner to ensure understanding of CIRC's implementation process. Any measures China implements that give the impression of falling short of its WTO commitments and denying U.S. insurance companies meaningful market access in China could create hostility. Thus, it is in the interests of CIRC to continue a meaningful two-way dialogue to make the implementation of China's WTO insurance commitments as smooth and positive as possible.

ACLI and our industry colleagues appreciate the hard work and high-level leadership of USTR and the other relevant U.S. Government agencies that have helped establish and grow this dialogue with China. Likewise, the industry greatly appreciates the ongoing support of Members of Congress. We consider ourselves still at the beginning of a complex process, and will look forward to an ongoing relationship with your Commission as we proceed through the years to come. While we do not know when China's draft regulations will enter into force, it is our hope that our dialogue, with your and the government's assistance, will produce a transparent and effective body of regulations comporting with China's strong and admirable WTO commitments. We will report to you as circumstances develop.

Thank you for your interest and consideration in this matter. I would be pleased to answer any questions that you may have.