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Penetrating the Great Wall of China

Track: International

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Recorder: CRAIG W. REYNOLDS

Summary: For several years only a few foreign insurers were permitted to provide life and health insurance in China. In recent years, regulators have been more receptive to the new entry of foreign insurers to service a population of over one billion.

The panel discusses:
- *Brief history of the development of the market*
- *Market demographics, including regionalization*
- *Types of products*
- *Distribution systems*
- *Regulatory requirements for entry and continued operation*

Mr. Craig W. Reynolds: I am with Milliman & Robertson (M&R) in Seattle. I have worked on and off in the Asian market over the 11 years that I have been with M&R, particularly in Japan and Korea, and to a lesser extent in China.

On our panel is Tom Laine from MetLife. Tom is an assistant vice president of marketing and sales with international operations in MetLife. He has worked there since 1979 and currently is a member of MetLife's China Steering Committee. He will be talking about the process of market entry into China and what it takes for an American company to enter the Chinese market. It is a somewhat complicated process, and I am sure he will have some good insights.

Speaking next will be August Chow of William Mercer. August is a principal with the Mercer Enterprise Risk Practice in Canada. He works about half the time on projects in Canada and the other half on projects in the Greater China area. He has also lived and worked in Hong Kong for several years.

My portion of the talk will be largely to give an introduction and an overview of the Chinese market. I hope to set the stage for some of the details the other speakers will be giving. It is based on my experience in China, which has involved both software marketing and some limited amount of consulting and promotional work in China. I believe that M&R was the first American firm to lease pricing and projection software to domestic Chinese companies. Also, we recently opened our first office in Hong Kong. We view China as a very great opportunity for insurers, and I hope we will be working a fair amount in that area in the next few years.

I would like to talk a little bit about why we might care about China. Obviously, China has the largest population of any country in the world by quite a large measure. If you look at the statistics on insurance spending as a percentage of gross domestic product (GDP), China is one of the lowest among the Asian countries, but it is growing fast. And we believe that this is a growth market. The Chinese insurance spending as a percentage of GDP is increasing dramatically, and the GDP itself is also increasing. China has a very rapidly growing middle class and there are limited investment options available to it. China's stock market and mutual funds are not as well developed as the U.S. and other western countries. Generally, insurance is viewed primarily as a savings option.

Currently, the insurance market there is largely dominated by three large domestic companies: China Pacific, the People's Insurance Company of China (PICC), and Ping An Insurance. One of those companies is a state-owned enterprise that has dominated the market, but the others are growing fast. AIG has been the longest-term foreign player in China, but there are a number of other companies operating there, and there are over 100 western companies that have opened representative offices in China, which is essentially the first stage toward opening up an office there. According to some of the statistics I have seen, there has been an annual 34% growth rate each year in insurance premium spending in China since 1980, which is quite a phenomenal growth rate.

Along with that growth, China really qualifies as an emerging market in every sense of the word and has many of the problems that an emerging or a developing market economy might have. First, there are relatively few companies. Some of the products that are there are interesting by U.S. standards. Most of the products we have seen are loosely speaking what we call traditional-type products, much like what we might see in the U.S.—either term insurance products or savings- or endowment-style products. As is common in many of the Asian countries, they are largely bundled products. It is very common to see health products or endowment benefits or health riders, cancer incidence, or other similar benefits bundled in with these products. The way the pricing is done is very similar to the way it is in other Asian countries where it is essentially a commutation function-driven process. A company will develop assumptions about mortality and so forth and simply develop a premium, as in effect, an Mx divided by Nx, generalized as appropriate for the various ancillary benefits that are provided on the products.

One of the big problems that has arisen in the Chinese market is the limited investment options that are available for Chinese companies. I talked earlier about the fact that they were very limited for Chinese insureds, but they are also very limited for the Chinese companies as well. Generally speaking, until fairly recently companies could only invest in government bonds and bank deposits. Bank deposits are currently yielding an interest rate of around 2.5%. Only a limited supply of government bonds is available. So it has not had many available options.

Some of the companies have been investigating things such as offshore reinsurance as a way to boost some of their returns, but issues related to currency exchange risk and other issues make that a somewhat problematic approach.

Another problem some of the companies are dealing with is a lack of experienced actuarial staff. Although it is certainly true that the Society program through Nanjing and other places is starting to generate a number of trained actuaries, it is still very much evolving in that end.

Regulation is still evolving. I believe August will be talking about that a little bit as well. With companies growing at a rate of 34% a year, some of them are experiencing systems issues. There are problems with data quality, data management, and very decentralized structures. Many of these companies have a very decentralized management structure. If they have operations in four or five or ten different cities, a lot of the administration will be done in each of these locations using different systems. We found great difficulty in getting good data out of the companies when helping them with some of the projects we are working on. And, as I indicated before, the product pricing issues are somewhat problematic. Western-style pricing, including things such as an Anderson-style profit study taking into account lapses and expenses, is rare. Risk management and asset/liability management (ALM) are also rare.

Some of the interest rates that were available to insurance companies in 1997 were around 11%. Today they are around 2.5%. They were generally selling products that in some cases had long-term interest guarantees of 8% or more and were backing it with bank deposits with short-term interest rates or government bonds of about ten years in length. It does not take rocket science to see that there are some ALM risks involved. Some of the companies are experiencing quite a bit of pain related to that right now.

One other issue facing the Chinese companies is that there is relatively limited underwriting going on. The pricing tables that are being used for mortality are generally attained age tables. There is a 1990-93 mortality study that most of the companies have been working with. Select and ultimate data are not available. Companies have generally done limited or no mortality studies of their own, and certainly limited or no expense or lapse study analysis. Because they are not generally doing pricing or projection work, even if they had that data, it generally has not been reflected. I am referring to the domestic Chinese companies when I talk about this. I presume that the foreign companies are doing a little bit more work in that area.

That is my broad overview background on the market. What I would like to do now is yield to Tom. He is going to give us some information about the market entry process in China that MetLife went through.

Mr. Thomas P. Laine: As Craig indicated, I'd like to just talk briefly about what the process is, if can you call it that. Getting an insurance license in China is not a very well laid-out process.

I'd like to talk first about both the formal and informal requirements for getting a license, which also could be called the written and unwritten rules for obtaining a license. Then I will discuss what the companies have been doing in general to meet these informal requirements. Afterwards I'll talk more specifically about what MetLife has been doing. Finally, I'll talk a little bit about what the impact of the World Trade Organization (WTO) will be on getting a license in China.

Getting a license in China, as Craig indicated, is not a straightforward process at all. It's not very transparent. You have some guidance from the Chinese government, but basically, most of what you need to do is not written anywhere and you just have to feel out on your own what makes sense. Also, as Craig indicated, there are more than 100 companies with rep offices in China. Having a rep office is one of the requirements for getting a license, so we can assume that all these 100 companies are waiting in a long line to get a license and yet only a few licenses are issued each year. It's clear that China is significantly restricting the number of licenses.

The formal or written requirements are fairly minimal. A company has to have been in the insurance business for at least 30 years, have total assets of at least $5 billion, and have had at least 1 rep office in China for at least 2 years. I think that virtually all of the 100 companies waiting in line satisfy these minimal requirements. So, as I said, it's clear that other requirements are also necessary.

The informal or unwritten requirements include: first, doing what is usually called goodwill projects. Goodwill projects are basically projects designed to help develop the insurance profession or the insurance industry in China. The Chinese government has been quite open about saying that if you'd like to get an insurance license in China, then it would be helpful if you would do things along these lines. You could certainly have mixed feelings about a requirement of this kind. But it's at least true that China is genuinely trying very hard to bring their insurance industry to Western standards and all of these goodwill projects contribute toward that end. Goodwill projects include such things as establishing scholarships and endowments, particularly in insurance-related fields at Chinese universities; sponsoring conferences in China; setting up training programs in the U.S. or China or whatever country your company is from to help train industry professionals or insurance regulators; making charitable contributions; and making investments in China. These investments might be made on their own merit so they're not really goodwill projects, but in other cases the investment might be geared more toward just establishing your company's interest and desire to contribute to China, so these could be considered goodwill projects. Goodwill projects could also include publishing insurance columns in Chinese newspapers to help educate the Chinese population on insurance.

Another informal requirement is to make as many contacts with high-level Chinese insurance officials as you can. Most people feel that the decision about which companies should get a license is made at the highest levels, probably including being made by President Jiang Zemin or Premier Rongji Zhu. So, of course, it is important to have your CEO meet with President Jiang or Premier Zhu. The State

Council, which is China's administrative body charged with the day-to-day running of China, is also very important. Premier Zhu is the head of the State Council and ministries report to the State Council.

Another important organization is CIRC, the Chinese Insurance Regulatory Commission, which, as its name suggests, is the body charged with regulating insurance in China. CIRC itself, although on the ministry-level, is probably not powerful enough to say that company X should get a license. It's probably at least true that if the CIRC says that a certain company has not been a good contributor to China, or is not, for whatever reason, a good candidate to get a license, it would carry significant weight. It's also helpful to make contact with Chinese ministries, particularly those like the Ministry of Labor and Social Security, which have some connection to the insurance industry.

Finally, China currently doesn't grant national licenses to foreign insurance companies, so companies have to start up initially in one of the open cities and then eventually branch into other cities. Thus, it's important in seeking a license to make contacts with officials in the city that you're planning on getting a license in.

Another important and formal requirement is support for China's entry into the WTO. As you may know, China is very close to achieving this. It's expected that early next year China will accede to the WTO, but it was a long and difficult process for China and it's very important for the Chinese that they get into the WTO. They feel this is crucial to helping to further reform their economy, so it's very helpful if your company is known to the Chinese as being one of the companies that supported WTO in the governments of whatever country you're from.

Of course, it helps if you're a large and reputable company. All other things being equal, given a choice between two companies, one of which is large and the other smaller, China will generally pick the larger of the two companies.

That's an overview of what companies generally have been doing to meet these informal requirements. It's really remarkable that when you look through searches of news articles that various companies all seem to have been doing the same sort of thing.

What has my company MetLife been doing? Well, with some variations, basically similar things. We've been doing a lot of goodwill projects. One which we did just recently in July that is different from what some other companies have been doing was to conduct a three-day training program in Beijing at CIRC's headquarters. Terry Lennon, executive vice president of MetLife and a former chief life insurance regulator at New York State, participated in the program. The idea of the training program was basically to give an overview of US insurance regulatory principles so that the Chinese might take whatever they wish from that to help them decide how their insurance regulation can be improved further.

We've also established scholarships at a number of Chinese universities, including a $100,000 scholarship at the Central University of Finance and Economics in Beijing.

We've conducted a couple of major conferences in China, including a Social Security conference in Beijing in 1999, which was co-sponsored with the Ministry of Labor and Social Security. A number of people from MetLife spoke at the conference about the U.S. private pensions and Social Security systems and the Chinese speakers spoke about their systems. The idea was to foster an exchange of ideas between the two sides, particularly to help China get some ideas for how to further reform the Social Security system, which is badly in need of reform.

In May 2000, we had a housing finance conference, which MetLife sponsored, in which the Secretary of Housing and Urban Development, Andrew Cuomo, spoke. China is very interested in developing a private housing market, and housing finance, of course, is an important issue in doing so. Since private housing is relatively a new development in China, housing finance is very underdeveloped. We had speakers from MetLife talking about insurance-related housing finance issues such as mortgage insurance and we had speakers from other areas of the housing finance industry and the U.S., as well as Chinese speakers.

We've hosted innumerable delegations of visitors from China to the New York home office from either industry or from government. For example, we've had a number of groups come to MetLife to learn about variable insurance products, which are just being introduced in China and are becoming popular partly in response to the low interest rates, which Craig mentioned. Some of these meetings have been helpful to MetLife as well. Of course, you can always learn things from meeting with people from China. And we've established good relationships with a number of insurance companies that have been helpful to us in understanding the Chinese market better.

And we've established an extensive training program for officials of China's Ministry of Labor and Social Security, which again is geared toward helping to introduce them to the U.S. Social Security and private pension systems to help them get ideas for what they might do in China.

MetLife has also been a very strong supporter of China's entry into the WTO. In fact, we've been one of the most active companies in any industry, insurance or otherwise, in supporting WTO and the passage of Permanent Normal Trade Relations (PNTR) in Congress. As you may know, PNTR is the last major step which needs to be taken for China and the U.S. to fully benefit from the WTO. We've contacted hundreds of U.S. house members and senators in support of PNTR. We also hosted two meetings in New York between the Chinese ambassador and Republican and Democratic delegations, so there could be an exchange of ideas between the two groups, particularly in regard to PNTR. A number of issues on the U.S. side came up as to why PNTR might not be a good idea, and the Chinese ambassador had an opportunity to address those and generally to make the case that China should enter into the WTO and PNTR.

And just last July, our CEO Bob Benmosche had a meeting with President Jiang, which everybody seemed to think went fairly well.

Finally, let me just mention a little bit about the impact of WTO on licensing because at first glance it may seem that WTO can make a significant difference. And, in fact, there are significant concessions which China made as part of the WTO agreement, which the U.S. and China signed in November 1999. In particular, there are only three or four cities that are open currently. As part of the agreement, more cities will open up and eventually the entire country will open up to foreign insurance companies.

Also, the range of products that a life insurance company can sell is being expanded. Currently life insurers are restricted to selling just individual life insurance, but in the future they'll be allowed to sell group life insurance and pension products. But specifically in regard to licensing, there is a clause in the agreement that says that licenses are to be awarded solely on the basis of prudential criteria with no quantitative limits on a number of licenses issued. This seems to be saying that subject to some reasonable criteria such as the formal requirements that I mentioned earlier, insurance companies can get a license in China, but almost no one expects this to be the case. In fact, Ma Yongwei, the chairman of CIRC, stated publicly that this is not going to be the case; China has to take into account the stable development of the insurance industry in China and will continue to restrict the issuance of licenses to foreign companies. Again, you can have mixed feelings about that kind of policy, but it probably is true that if China were suddenly to grant 100 licenses to these companies waiting to get in, it would lead to a fairly chaotic market and fierce competition that might be destabilizing, which might not be a good thing.

In any case, the upshot of the WTO agreement most likely means that more licenses will be issued in the future than in the past, but China will continue to limit the number of licenses considerably. This means that for the companies that are seriously interested in getting a license in China, it will probably be helpful for them to continue to do the sorts of things, goodwill-type projects and so on, that companies have been doing in the past.

So there is, in fact, a Great Wall when it comes to getting an insurance license in China. If your company is on that long list of companies waiting to get in, I wish you the best of luck. It can be done, but it is not easy. And now I'll turn it over to August.

Mr. August C. Chow: Thank you very much, Craig and Tom for your presentation. I think it makes my presentation a lot easier because you have said most of it already. I'll just try to fill in some of the holes. As mentioned by Craig, I worked in Hong Kong for four years from 1995 to 1998 and moved back to Toronto, but I still spend considerable amount of time traveling overseas. This year, I have already made four overseas trips to the Greater China region, which includes Hong Kong, Taiwan, and China. Some of you might have heard that Norm Crowder, SOA President, recently was in Tianjin, China, attending the opening of the Nankai University's Risk Management and Actuarial Research Center—a research center supported by the SOA. I was there attending the conference as well, so it's very exciting in China. Craig had mentioned some of the problems facing the insurance companies in China, but I think there are also a lot of opportunities. I'm glad to see some familiar faces in the audience from overseas, including Tom Jaros from Hong Kong and Richard Wang from Taipei. I'm sure that they're also qualified to talk about the subject as well.

First, I would like to give you a brief overview of the insurance market in China covering the major players in China, both domestic and international companies. Tom talked about how to get approval from the Chinese government to apply for an insurance license in China. Once you get the official letter of invitation from the CIRC or the State Council to apply for a license, there's a host of procedures that you have to work on. This will be my second topic covering some of the key steps that you need to take for the establishment of an insurance license in China. I will review some of the procedures and items that you have to be aware of. Finally, I will talk about some of the regulatory and actuarial considerations in China.

Firstly, an overview of the major players in China. China Life is the state-owned enterprise (SOE). It's the only SOE insurance company in China and is also the biggest insurer and has the longest history in China, as mentioned by Craig. The company used to be known as the People's Insurance Company of China (PICC). About two years ago, the Chinese regulators required all the insurance companies in China to separate the operation between life, nonlife (property & casualty [P&C]), and reinsurance. So at that time, PICC changed its name to China Life, China Insurance, and China Re. In 1949 when the Communists took over the country, all commercial insurance activities were stopped. In 1982, PICC reactivated their life operations.

Xin Jiang Life Insurance Company is a very small insurance company located in the northern part of China. Most of the business is for agricultural insurance.

Ping An's company headquarters are located in Shenzhen, which is in the southern part of China, just north of Hong Kong. The company was established in 1988, but is one of the fastest growing and most aggressive companies in China. Ping An was the first insurance company writing variable life (VL) business in China last year. There is a rumor that Ping An will be seeking to list its stock on the exchanges next year through an initial public offering. The company has developed a more Western style management as compared to other domestic companies in China.

China Pacific is headquartered in Shanghai. While the company also writes both life and nonlife business, most of the business written is P&C. The company's life business is not as big as that of China Life and Ping An. If one tries to rank these companies in terms of life operations, China Life is the largest, followed by Ping An, then China Pacific.

Now let me discuss some of the recent domestic insurance companies established in China. In 1994, there were two nonlife licenses issued, Tian An and Dazhong. Both companies are licensed in Shanghai. Both of these companies have recently entered into joint venture (JV) life operations with foreign companies.

In 1996, there were five domestic licenses issued, two life (New China, Tai Kang) and three nonlife (Hua Tai, Yong An, Huan An). If we have some extra time at the end, I can go into some more detail about these five companies.

There have been rumors earlier this year that there will be up to five new licenses given to domestic companies, but no announcement has been made by the CIRC. One of the concerns expressed by the Chinese officials is the lack of management in China. If you look at the recent domestic insurance companies established in China in 1994 and 1996, most of the company's senior management came from Ping An, China Life, and China Pacific, so there is a serious shortage of Chinese executives who know how to manage insurance companies. As the transcript of this session is being typed, the Chinese authorities have just announced that four new domestic insurance company licenses will be granted. The names of the four new companies are Min Sheng, Heng Sheng, Oriental Life, and Sheng Ming.

Domestic insurance companies in China are given either a national license or a regional license. A national license means you are allowed to write business throughout China, but if you have a regional license, you can only write business in certain parts of China. For foreign insurers, there's a different set of licensing rules that I will talk about shortly.

Turning to the international insurance companies, AIG was the company that had the longest history in China, established back in 1992. AIG is also the only international insurance company currently with three licenses in China. It was licensed in Shanghai in 1992, Guangzhou in 1995, and Shenzhen in 1999. AIG is also unique in that they have both life and nonlife branch licenses in China. It's the only foreign company in China with a life branch operation. All the other foreign life companies operating in China must have a JV operation. We understand that AIG has very strong and deep roots in China. Some foreign companies tried to follow AIG in setting up a life branch operation in China, but all have failed.

The second foreign insurance company licensed in China was Tokyo Fire & Marine, a Japanese company. It has had a nonlife branch in Shanghai since 1994. Next was Manulife in 1996, which was the first foreign insurance company with a JV operation in China. Their Chinese partner, SinoChem, is a state-owned enterprise in China. This was followed by Winterthur, a Swiss company, with a nonlife branch operation in 1996.

I'd like to mention some of the licensing rules in China. First of all, foreign insurance companies can only be licensed in China on a city-by-city basis. AIG is licensed in Shanghai, Guangzhou, and Shenzhen. Therefore, when you receive a license, say in Shanghai, you need to work on your next city license. The granting of a second city license is not automatic, but, as mentioned by Tom earlier, this may be changed in the next few years as China becomes a WTO member. At the present time, the rule for foreign insurers is city-by-city licensing.

In addition, if you have a nonlife branch operation, you can only issue nonlife business to foreign companies. In China, foreign insurers cannot offer nonlife business to Chinese companies. Another rule is that foreign life companies can only issue individual business and not group business in China.

And finally, if you establish a JV operation in China, it will take quite some time before you can start writing business. Based on experience, some companies took more than two years to start operation. Later, I will outline some of the reasons why it takes so long to establish operations.

Aetna was the next foreign insurance company to get a license in China. The situation with Aetna was interesting as it chose to have a JV operation with China Pacific, which already has a life and a nonlife insurance operation in Shanghai and throughout China. The negotiation between Aetna and China Pacific was based on China Pacific having a Chinese wall between their existing business and the new business to be written jointly with Aetna.

Allianz, a German company, received the approval to apply for a life license in 1997 and started operation in 1999. Allianz's Chinese JV partner is Dazhong, a domestic nonlife insurer.

AXA/UAP, a French company, was the next foreign company licensed in China. The JV partner is MinMetals, an SOE company. As you can see, Aetna, Allianz, and AXA all had different types of JV partners: a domestic life company, a domestic nonlife company, and a state-owned enterprise.

Next was Royal Sun Alliance, an U.K. Company, who received a nonlife license in Shanghai in 1998. This was followed by CMG, Colonial Mutual Group, an Australian company. The company started operation about two months ago. CMG decided to partner with the Shanghai branch of China Life, the largest insurance company in China. Again, it took a very long time to close the deal.

In April 1999, four more licenses were given to foreign insurers, namely Chubb and John Hancock in the U.S., Prudential Assurance in the U.K., and Sun Life in Canada. I believe that Chubb with a nonlife branch operation in Shanghai had already commenced business about two months ago. In China, it's fairly easy to start a nonlife operation, as you don't have to find a JV partner and the rules are a lot simpler. John Hancock, Prudential, and Sun Life, they have not started operation yet. John Hancock's Chinese partner is Tian An, which has a nonlife license in Shanghai. Rumor has it that Tian An may have some problems raising capital for their JV operation.

Prudential Assurance decided to start the operation in Guangzhau. As you can see, most foreign companies chose Shanghai, which is the financial center of China. However,-Sun Life's plan is to have their license in Tianjin.
About five months ago, there was an announcement by a Chinese official that seven new licenses would be given to European insurers. It's interesting that ING will be one of the seven European insurers. Because ING has recently bought Aetna's international operation (including Aetna's operation in Shanghai), it remains

to be seen whether the Chinese government will grant a second license to the ING Group in China.

Are there going to be more licenses granted to U.S. insurers? I'm sure the answer is yes, but the questions are: How many and when? I understand that there are at least six to seven U.S. insurers actively lobbying the U.S. and Chinese governments for a license. Something that Tom has not mentioned in his presentation is that in addition to all the activities conducted by companies in China, lobbying is also very important and sometimes can be very costly as well.

I would like to make further comments on the city license granted to foreign insurers. As mentioned earlier, foreign insurers are granted licenses in China on a city-by-city basis. Shanghai, Guangzhau, and Shenzhen are the only cities that are open to foreign insurers. It is expected that more cities will become open to foreign insurers, including Tianjin, Dalian, and Chongqing. Dalian and Tianjin are coastal cities. Chongqing is one of the very large inner cities in China. Development of inner cities in China has been a top priority for the Chinese government. Most of the development in China in the last ten years has been concentrated along the coastal cities. The Chinese government currently encourages the banks and insurers to open operations in the inner cities.

Another observation that you have probably already noticed is that the Chinese government issued licenses to foreign insurers on a country-by-country basis. The U.S. was the first country, followed by Japan, Canada and Switzerland, a European country. The second round started with the U.S., then Canada, Europe, and Australia. To be granted a license, companies have lobbied extensively. The lobbying is not only to your own government, but it's also to the Chinese government at all different levels. In China, there is the ministry level, the State Council, the CIRC, as well as the local provincial and municipal governments. Companies need to have a strategic lobbying plan, from the top down to the bottom.

Let's look at some insurance statistics in China. Table 1 shows the amount of new life insurance premiums written in China from 1995 to 1998. If one looks at the ratio of premium to GDP, it is still a very small percentage. However, when one looks at the growth pattern, it's very impressive that the annual growth rate has been more than 30% over the last 5 years. In 1999, the total life premium was 87.9 billion renminbi (RMB). This is the local currency in China. One U.S. dollar is about 9 RMB. So you can do your arithmetic.

TABLE 1
LIFE INSURANCE PREMIUM IN CHINA (1995-1999)

	(1)	(2)	(3)
Year	GDP (Billions)	Life Prem (Billions)	(2)/(1)
1999	8,300	87.9	1.06%
1998	8,000	68.3	0.86%
1997	7,500	60.2	0.81%
1996	6,800	32.5	0.48%
1995	5,800	20.4	0.35%

Table 2 shows the new premium income in 1999 by domestic and foreign international companies. As you can see, the business was dominated by China Life, followed by Ping An and China Pacific. However, I'd like to point out a couple of points when you look at the statistics. First, foreign companies are licensed in one or two cities only, while domestic companies are licensed either nationally or regionally. Secondly, domestic companies issue both individual and group life business, while foreign companies are allowed to write only individual life business. Therefore, when you compare the numbers, you have to take these into consideration. If you look at the Shanghai market only, AIG was actually a top leader in the sale of individual life business.

TABLE 2
1999 LIFE INSURANCE PREMIUM IN CHINA, BY COMPANIES

		RMB (Billions)	
Domestic:	China Life	60.3	
	Ping An	17.9	
	China Pacific	6.6	
	New China Life	1.1	
	Tai Kang Life	0.5	86.4
International:	AIA (SH&GZ)	1.350	
	Manulife	0.084	
	Aetna	0.028	
	AXA	0.006	
	Allianz	0.005	1.5
			87.9

My next topics will be some of the key issues in establishing insurance operations in China. As mentioned by Tom earlier, your company tries to get its foot into the door and to receive a green light to apply for a license in China. On paper, the requirements for a foreign insurer to establish an insurance operation in China are fairly straightforward: setting up a representative office in China for a minimum of two years and having worldwide assets of at least US $5 billion and an operating history of more than 30 years. Many international insurers can easily meet these requirements. However, it is equally important to demonstrate to the Chinese officials the amount and type of contributions that your company has made in China each year, the goodwill projects in China that were mentioned earlier by Tom, as well as the amount of lobbying effort your company made to the Chinese and your own government.

Next, I will concentrate on the four topics in terms of how to prepare yourself to start up an operation in China. The first one is the city selection, followed by JV partner selection, the products, and finally distributions.

In terms of city selection, there are only a few cities that are open in China right now. One of the earlier decisions you need to make is to decide where you would like to start your business. Would you like to follow the trend starting an operation in Shanghai or would you like to go against the flow by picking an inner city, such as Chongqing? Before you make the decision, you probably need to do market studies to answer a host of questions: Who are your customers? What are the people's disposable income and spending habits? How many televisions or refrigerators do they own, etc.? You also want to look at the competition: How many competitors are already operating in that city? What products are offered? What distribution systems are used?

Tom mentioned partnership in his presentation. I would think this is probably the most important decision. You will find that foreign insurers spend a lot of time to look for the right partner. As mentioned, if you operate a life license in China, the current rule requires you to find a JV partner. Currently, there are three types of partners you can choose from. The first category is the domestic life insurers; the second category is the domestic non life insurers; and the third category is the domestic non-banking, non-securities financial institutions. The Chinese officials prefer these companies because it would be easier for these companies to learn about foreign technology. However, as we have seen, many domestic insurers have already entered into JV agreements. There are discussions that the Chinese officials may expand the type of Chinese companies that foreign companies can enter into a JV with.

What are the criteria for selecting your JV partner? You need to find out what your company's strategy is in China and what your company's culture is. Is there a good fit between your company and the Chinese partner? You will sometimes be surprised to find out that many companies in China think that insurance is a quick way to make profits because they only think about receiving premiums and not about paying claims.

You may want to find out some of the JV experiences of those foreign companies who have gone through the process in China. You would want to learn from their mistakes and avoid making similar mistakes.

Once you find a suitable list of partners, you need to negotiate with them. What are the critical issues facing the Chinese partners? What do they want? How do you negotiate with them? In this process, you will also have to negotiate with the Chinese regulators. The CIRC could at times act like a gatekeeper that if a Chinese partner could not successfully negotiate with you, it might go to the regulators and ask the regulators to help. Once you finish the negotiation, you need to sign a Memorandum of Understanding with your partner. You should be aware that your Chinese partner also has to be accepted by the regulator as well. This would make the negotiation more complicated.

After negotiation, you need to prepare a number of JV documents. You need to prepare a feasibility study, a business plan, a technology transfer agreement, and a JV agreement. It's an agreement between your company and the Chinese partner.

One of the interesting issues that you may face when negotiating with your Chinese partner is the pre-incorporation expenses. Are the pre-incorporation expenses to be shared by the partners? How many expatriates are allowed to work in the JV company? What are their titles? Who will appoint the general manager? Who will join the company's board of directors? For expatriates, how much of the foreign salary is to be shared by the JV company? As we know, there's a significant gap between the local salary in China and the salary in the U.S.

Another example is the value of goodwill. Your company has a brand name in the U.S and internationally. Is the JV company going to pay for this brand name in China?

The CIRC has set a minimum amount of required capital for a JV operation, which is RMB 200 million. How much capital would be contributed between the foreign company and the Chinese partner? As mentioned, the Chinese partner doesn't necessarily have spare capital. Getting RMB $100 million from a Chinese firm may require the company to raise capital from their shareholders, which can be a very time-consuming exercise.

Management control can also be an important negotiation item.

Moving on to insurance products in China, I will try to cover some of the current products and future products likely to be sold in China, and the product features and pricing assumptions that are currently used in China.

Historically, insurance products sold in China are mostly personal accident and saving products, e.g., anticipated endowment. There's a very heavy savings component. In terms of anticipating endowment, it's really like a whole life product with a periodic payment to policyholders every five or ten years. This product is very common in Asia and in China.

As some of you may know, interest rates in China have declined over the last three years. I think the interest rate back in 1996–97 was close to 10%. Today, the interest rate is about 2.5%. The People's Bank of China (PBOC), lowered the interest rates seven times during the last three years. This lowering of interest rates posed a big problem to the domestic insurance companies because there is a very significant interest-rate gap between the pricing interest rate of the saving products issued two or three years ago versus the new money rate that can be earned by insurers today. Insurers in China can invest only in bank deposits, government Treasury bills, and a limited number of close-end mutual funds.

As a result of the low interest-rate environment, insurers in China began to issue new products during the last 12 months: the participating whole life and the universal life (UL) and VL products. As I mentioned earlier, Ping An was the first life insurer launching VL in China. I understand that CMG has also been pushing very hard to sell VL in China since they received the license to sell products in Shanghai.

In China, product filing to the CIRC is mandatory before you can sell the product. Early this year, the CIRC issued a circular that for the simple products, a company is required only to file the product without the need of approval by the CIRC, but for the participating whole life and UL/VL plans, approval by the CIRC is still required.

In 1999, the CIRC issued a product regulation stipulating the clauses that have to be included in the policy contract. If you look at the policy provisions a of contract issued by domestic insurers, you will find that the policy contract may only be two or three pages without many details.

Over the last few years, the CIRC had issued a number of insurance and actuarial regulations. There are pricing regulations, reserve regulations, solvency margin regulations, reinsurance regulations, and the first ever China-insured life mortality table.

I just want to spend a few minutes on the China insured life mortality table—the China Life 1993 table that was published by the PICC in 1995. The experience was based on the PICC so this was not an industry table, but, of course, PICC was the biggest insurance company with more than 80% market share. So you can say it's almost an industry table. The table was done on an aggregate basis. It didn't have select and ultimate rates. It didn't have smoker/nonsmoker rates either and was done on a national basis, i.e., the rates were not separated by regions or between coastal and inner cities. We suspect that there is probably some mortality differentiation between people living in a big city or in a rural city. Ten years ago, there was little underwriting done in China. Most of the insurance issued at that time was group insurance. As insurers are currently required to use the China Life table for product pricing and setting up reserves, there should be implicit mortality gains embedded in this table. However, this mortality gain may not be enough to offset the negative spread of the interest rates. I understand that the CIRC is considering commissioning the study and the publication of a new mortality table in 2001.

Turning to the distribution system, career agents are the main distribution system used in China, which was introduced by AIG when it entered into the China market in 1992. Nowadays, all the life insurers in China, domestic and foreign, use the agency system. In fact, Ping An is the most aggressive company with more than 10,000 agents in Shanghai, compared to AIG with 6,000 agents.

In China, the insurance broker system is also allowed, but it is not as well-established as the agency system. There are currently only three domestic brokerage firms in China: one is in Beijing, one in Shanghai, and one in Guangzhou. About two years ago, the CIRC issued regulations on insurance agents and brokers. All insurance agents in China are required to write an examination before they can be hired by life companies and sell insurance business. The examination used to be offered twice a year only, but it recently has been changed to once every quarter. The life companies are lobbying the CIRC to have more frequent examinations given to the agents.

Finally, I'd like to cover some of the other regulatory considerations in China. In 1992, the regulators issued a Shanghai Memo as AIG entered into the Shanghai market. The Shanghai Memo stipulated the rules for foreign insurers operating in the Shanghai market.

In 1995, there was the China Insurance Law with more than 150 articles. The law was very comprehensive, covering aspects of insurance companies, policyholders, and insurance agents. Article 93 referred to reserve valuation, Article 106 referred to product pricing, and Article 119 required all life companies to have an actuary.

Under the reinsurance regulations issued in 1996, insurers are required to reinsure 20% of health business and personal accident business to the state-owned reinsurance company. Life insurance, however, is exempt from the mandatory reinsurance. There were also regulations on insurance agents and insurance brokers issued in 1997 and 1998 respectively.

In 1999, there were regulations on product pricing, reserving as well as solvency margin requirements. Insurance companies now can invest in equities and close-end mutual funds, but the choice is still very limited. It is hoped that the CIRC or the State Council could broaden the allowable investment in China in the near future. A few months ago, the CIRC issued new regulations on the pricing of investment-linked product and the participating life product. There were also new regulations on the administration of domestic insurance companies.

Turning to the pricing regulations, the law currently prescribes an interest rate not to exceed 2.5%. For mortality, the law prescribed the CL 1993 Table.

The law also prescribed the maximum amount of commissions and management expenses to be used in the pricing. The prescribed amount varies by product type, policy duration, and the policy premium paying period.

For reserving, the law prescribed a net premium methodology. The net premium is defined as gross premiums minus commissions and management expenses, which to some extent is quite similar to the Canadian Policy Premium Method. The valuation interest rate cannot be more than your pricing interest-rate assumption or what's been prescribed by CIRC. The reserve also cannot be less than the policy cash value.

As mentioned earlier, the Chinese regulators have also issued a new set of solvency margin rules. It basically follows that of the European and the European Economic Community/Common Market margin, which is defined as 4% of reserve, plus 0.3% per million of the net amount at risk. If the policy's duration is shorter, the factor used in the net amount at risk could be reduced to either 0.15% or 0.1%.

In summary, there are real opportunities in the China insurance market, but at the same time there are areas that you need to watch out for. Choosing the right JV partner is likely a very key area. Things in China are not as transparent as in other international countries; therefore, getting reliable data to do your research is also very important. Sometimes you may want to get data from two or more sources so that you can verify the accuracy of data. Companies will be facing more competition as the CIRC issues more licenses to domestic and foreign insurers. Currently there are about ten foreign insurers operating in China, but there are many more waiting in line. So, be prepared.

Mr. Gary Corbett: I have a simple question. On the JV, is there a percentage that you can only own, say 49%, as in Indonesia or something like that?

Mr. Chow: The rule right now is that foreign insurers cannot own more than 50%. If you look at the experience in the past, Manulife was the only one with a 51% ownership, but that was before the current rule came out. If you look at the recent transactions, some have 49% and some have 50%.

Mr. Corbett: Second question. Going back into the late 1980s when I remembered talking to PICC, there was some thought then that a lot of life insurance might be sold through banks; that the banks would set up their own insurance companies. I see some suggestions here that you can't even ally with banks in the JV. I understand, too, in China the banks are almost industry banks, i.e., there would be an agricultural bank, there will be this and that. Have they made no move into the insurance business?

Mr. Chow: I understand that the PBOC a few years ago made a statement that banks and insurance operations had to be separated, which is different from what we are seeing in North America. The four pillars are collapsing in North America, but the Chinese government is making a clear distinction to separate the banks and the insurance industry.

Mr. Corbett: I think insurance companies are selling and distributing products through banks in China.

Mr. Chow: Yes, but what I just talked about is the ownership of insurance companies. In terms of product distribution, you are correct that some insurance companies in China are lining up with the banks, such as the Bank of China and the Bank of Construction, to sell insurance products to the bank customers. It's too early to tell how successful they are at this moment. I know other insurance companies are using the post office to sell insurance. So there are alternative distributions in China. E-commerce should also have potential, but it may be a bit premature right now because a lot of e-commerce regulations have not been set up in China yet.

Mr. Joshua David Bank: I have one question for each of you. August, in your opinion, are industrial life and credit life viable products for the Chinese marketplace? And Tom, was there a conscious idea of how long it would take for MetLife to recover their goodwill investments in China?

Mr. Chow: Let me answer your question on credit life. In China five years ago credit cards were not very common, but now in big cities such as Shanghai, Beijing, or Guangzhou, you see more and more people carrying credit cards. So I think that credit life can be a viable product in China.

Mr. Bank: How about mortgage insurance?

Mr. Chow: Under the old communist market, the Chinese government provided housing to citizens. So there was no need for people to own houses in the past. However, things have changed. The Chinese government now encourages people to own houses; therefore, there should be a natural expansion of mortgage insurance in China.

Mr. Laine: That's an interesting question. I think that first of all even though I made a point of all the things that we've been doing in terms of goodwill projects, most of these really haven't been that expensive. Other companies have spent a lot more money on goodwill projects and doing such things as retaining President George Herbert Bush, for example, to make trips to China with them and help get meetings and so on. MetLife has deliberately taken the approach that we're not going to try to spend a lot of money and get a license in China that way, even though there's nothing wrong with that. And we probably haven't invested all that much, so we expect the market to be reasonably profitable and we're comfortable that in some reasonable period of time we'll be making the rate of return we expect to make.

Mr. Chow: Based on some of the business plans I have seen for the China insurance market, companies are hoping for a breakeven between eight and ten years. You mentioned Bush, and I heard about Henry Kissinger, too.

Mr. Reynolds: One of the issues we struggled with as a consulting firm doing business in China is the non-convertibility of Chinese currency and the ability to get paid and take money out of the country and get it back into dollars. How do you expect that the Western companies are going to deal with that when it does come time to take profits out of China? Is the expectation that the currency markets will be more liquid by then?

Mr. Laine: I mean China has stated that they plan to make their currency convertible. In fact, it was advancing toward that goal up until the Asian crisis, and when the Asian crisis occurred, it observed the fact that its currency wasn't convertible. This helped it to withstand it a little bit better than it otherwise might have, so that slowed down the progress toward conversion. But it has gradually been doing it; nonetheless, it has taken various technical steps in that direction and so, almost certainly, by the time anybody has some significant amount of profits to repatriate from China, the currency will be convertible.

Mr. Chow: Without giving out the name of a company, I understand that one company has an agreement with the government that the company will not be taking any profits out for the first ten years.