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An Awakening Giant in the World's Fastest Growing Region

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Résumé de l'article

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China's Insurance Market:

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by

Brent Sutton*

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1. Introduction

For several years now, the fastest growing insurance markets have been those located in the Asia-Pacific region. Driven by strong economic growth, an emerging middle-class, and financial sector de-regulation and liberalization, these markets now account for a significant portion of the new insurance policies being written world-wide each year. Many countries in the region have seen insurance premiums written increase by 10 percent per annum over the past five years, and growth rates in excess of 15 percent have not been uncommon. Not surprisingly, these markets have become a magnet for insurance companies from North America and Europe who, faced with mature insurance markets at home and encroachment by other domestic financial institutions into their traditional

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business, are looking to Asian consumers for new business growth.

As late as 1990, China was considered a "non-starter" by all but a very few international insurance companies, and not without good reason. Political uncertainty in the wake of Tiananmen Square, an outdated and inefficient financial system and government policies directed at keeping insurance the exclusive domain of domestic companies kept foreign interest in China at bay. Since then, China has committed to modernizing its financial system and to allowing foreign financial institutions limited access to its markets. With more than 30 foreign insurance companies having established representative offices so far, China has quickly emerged as one of the most sought-after markets in the region. This interest extends to Canadian insurers; to date, one Canadian firm has established representative offices in China and has applied for an operating license, another is in the process of setting up a representative office, and several others are exploring the feasibility of establishing representative offices in the near future.

The purpose of this article is to: (1) examine China's insurance markets and institutions; (2) review the financial sector reforms currently underway in China; and (3) outline the conditions under which foreign insurance companies will be permitted to operate in China. The article concludes by commenting on the key principles that will shape the rules governing the admission of foreign insurance companies into China over the next few years.

2. China's Insurance Market

Market Size and Growth

Insurance premiums written in China totalled 52.7 billion renminbi (RMB) (about $US 6.2 billion) in 1993, or about 1.7 percent of gross domestic product (GDP).[1] As expressed in local

[1] Industry figures on insurance premiums written in China are not publicly available, and those figures that are reported tend to be subject to frequent revision.

currency, this represents a nominal increase of 53 percent over 1992[2] and an average annual nominal increase of 42 percent over the past five years (see Chart 1). Property and casualty insurance makes up the largest portion of the market, accounting for about 65 percent in 1993, down significantly from the more than 90 percent share it accounted for five years earlier. Life insurance, first re-introduced into China in 1982, has seen premium volume nearly double in each of the past two years. Motor vehicle, fire and marine make up the largest lines of property and casualty insurance.

China's distinct culture and social traditions and institutions has resulted in the popularity of a number of insurance products that may seem unusual to North Americans. Such products include insurance for farm animals (which often constitute a large percentage of a farmer's total wealth), bicycle insurance, marriage and education insurance to cover the cost of weddings and tuition in the event of a parent's premature death, and family planning insurance to cover retirement costs should a couple's only child be a girl (and thus be unable to provide parental support).

Despite rapid growth in the volume of insurance written over the past few years, China's insurance market, by almost any measure, remains vastly underdeveloped. Premiums per capita and as a percentage of gross domestic product (GDP) are well below those in other countries [3]. Moreover, the share of China's total financial assets held by insurance companies is very low by

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Moreover, conversion into U.S. dollar equivalents are highly sensitive to the particular exchange rate used as China operated under a dual exchange rate regime until January 1, 1994. The figures used in this analysis were derived by aggregating premiums written by the People's Insurance Company of China (PICC), the China Pacific Insurance Company and the Ping An Insurance Company. These figures are generally smaller than those quoted elsewhere because the premiums earned from the foreign branches of PICC and China Pacific were subtracted from the totals. Conversion into U.S. dollars was done using a trade-weighted swap market rate as provided by Hoe Ee Khor, "China's Foreign Currency Swap Market," IMF Paper on Policy Analysis and Assessment, December 1993.

[2]Insurance premiums grew more modestly when expressed in U.S. dollars because of the sharp depreciation of the renminbi in 1993.

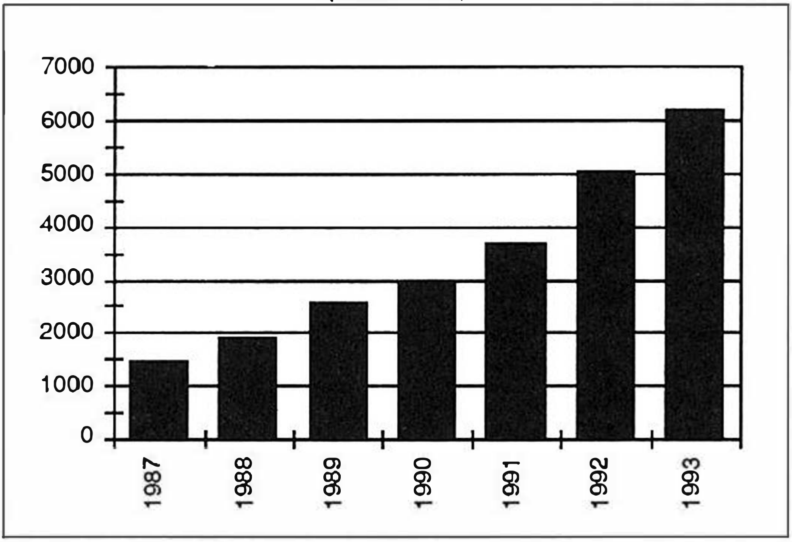
[3]See Canadian Re, "World Insurance in 1992," *Sigma*. Economic Studies No. 3/94 (1994).

international standards. Finally, an inadequate distribution system means that insurance is not readily available in many parts of the country, especially in those regions outside the major cities and coastal regions.[4]

Chart 1

Insurance Premiums in China

($U.S. millions)



Source: The People's Bank of China.

The demand for insurance depends on many factors.[5] Rising national income, an emerging middle class and uncertainty surrounding changes to the social safety net are all expected to increase the demand for life insurance products in China over the next decade. The desire of the Chinese government to encourage competitors to the four state-owned

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[4]Interviews with industry and government officials, May 1994.

[5]See, for instance, Swiss Re, "Economic Determinants in the Development of the Insurance Business," *Sigma. Economic Studies No. 7/89* (1989) and Mark J. Browne and Kihong Kim, "An International Analysis of Life Insurance Demand," *The Journal of Risk and Insurance* 60(IV) (December 1993), pp.616-634.

national banks[6] will also be a positive factor in the development of the life insurance sector.

Property and casualty insurance should experience considerable growth as well. Economic expansion has been fuelled by large investments in real estate, plants and equipment, all of which need to be insured against loss. Rising national income has led to a rapid increase in the number of automobiles, boosting the demand for motor vehicle insurance. Reforms to state-owned enterprises are making managers more risk adverse as they are now responsible for the profitability of their enterprises, thereby making adequate insurance coverage a business necessity. Lastly, the dramatic increase in the volume of China's exports and imports will spur demand for trade-related insurance products.

There is little doubt that China's insurance market is poised for substantial growth. If economists are correct in their predictions regarding the growth prospects for China over the remainder of the decade, then insurance demand is sure to follow. Chart 2 provides three estimates of how quickly insurance premiums may grow in China between 1994 and the year 2000. These figures are direct premiums written expressed in real U.S. dollars. The estimates are based on assumptions of economic growth in China and increases to "insurance penetration" (i.e., direct premiums expressed as a percentage of gross domestic product). The *low* growth estimate assumes annual real GDP growth of 5 percent and insurance penetration of 2.5 percent by the year 2000. The corresponding figures for the *medium* and *high* growth estimates are 8 percent and 10 percent for GDP growth and 3.0 percent and 3.5 percent for insurance penetration.

[6]China's financial system is dominated by the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC), the Bank of China (BOC), and the People's Construction Bank of China (PCBC). See Chen Yuan, editor, *Almanac of China's Finance and Banking* (English Edition). Beijing: People's China Publishing House, 1993.

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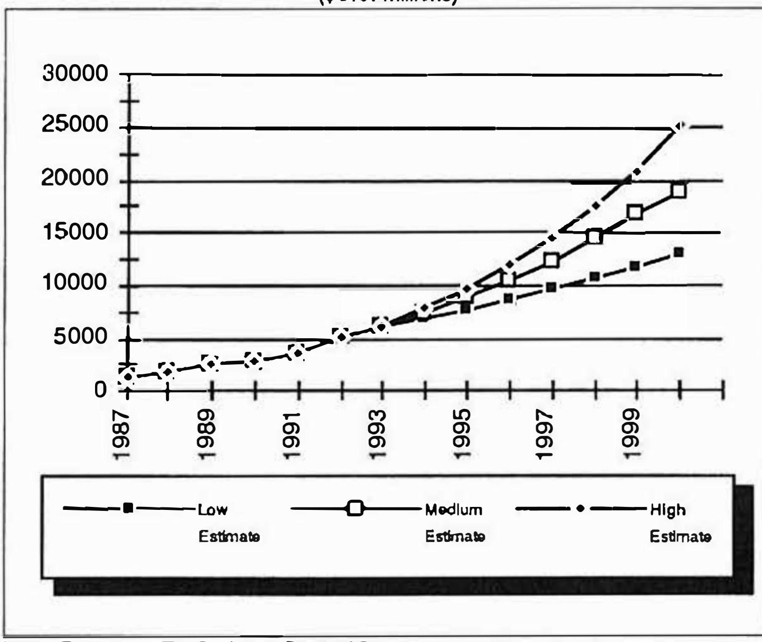
Chart 2

Forecast of Premium Growth in China

($U.S. millions)



Source: Estimates by The Conference Board of Canada.

Under the medium term growth estimate, insurance premiums (as expressed in *real* U.S. dollars) are expected to grow by just under 20 percent per year, reaching $US 19 billion by the end of the decade (and more optimistic scenarios show that this figure could reach as high as $US 25 billion). This level of growth is considerably higher than that in Canada, although the much larger size of the Canadian insurance market at present means that by the year 2000, Canada's insurance markets will still probably be about twice the size of China's (as opposed to the almost six times difference today).[7] Of course, many

[7] In 1992, direct premiums written in Canada totalled $CDN 47.8 billion (or $US 36.6 billion at current exchange rates). Assuming premium growth in real terms of 2 percent per year, the Canadian insurance market will reach $US 42.9 billion by the year 2000.

additional factors will affect actual growth rates, such as the receptivity of the Chinese population to insurance products and the extent to which non-insurance financial institutions are able to satisfy financial needs with competing products. Assumptions regarding these developments are not captured by the forecast.[8]

Regulation

Insurance companies are licensed and supervised by the People's Bank of China (PBC) under the Provisional Regulations Governing the Management of Insurance Enterprises, issued by the State Council in 1985.[9] Key provisions include:

- insurance companies must have minimum paid-up capital of 20 million RMB (about $US 2.3 million) for life business and 30 million RMB (about $US 3.4 million) for property and casualty business.
- 20 per cent of the capital must be kept on deposit in a bank approved by the PBC as a guarantee fund.
- policy terms and rates for all classes of insurance must be approved by the PBC.
- quarterly financial statements by each *branch* must be filed with the PBC.
- commissions paid to agents and brokers are regulated by the Ministry of Finance, and the rates for agents are set well below international norms.
- insurance companies must receive approval from the PBC and appropriate local government departments before branches can be established in that jurisdiction.

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[8]In addition, there has been considerable debate about the actual size of China's economy. Based on alternative measures of national living standards, several observers believe that official statistics on China's GDP *under* report the true size of the economy. If this is true, then the potential growth of China's insurance market could be much larger than forecasted here. See William H. Overholt, *The Rise of China*. New York: Norton, 1993, pp.51-54.

[9]The State Council is China's highest executive body and is composed of China's most senior leaders. The PBC, as well as other government departments and agencies, are responsible to the State Council. The National People's Congress, China's top legislative body, must approve all laws issued by the State Council before they can come into force.

- insurance companies must cede 30 per cent of their insurance business to the People's Insurance Company of China (PICC).

PBC supervision of domestic insurance companies is not as clearly defined nor as well developed as that in other countries. This is largely because, until recently, the PICC was the only insurance company permitted to operate in China and it operated as an agency of the PBC. At present, the PBC does not have the legal authority to regulate and supervise insurance companies

(although in practice this authority has not been challenged and will be rectified with the new insurance law) and few PBC officials have the necessary operational knowledge and experience to carry out effective supervision. Considerable training is currently underway (much of it supported by foreign insurance companies) to develop this expertise.[10]

Competition[11]

China's insurance market is dominated by one company, the People's Insurance Company of China. Established in 1949 by the new communist government as the sole provider of insurance in China, PICC today accounts for more than 95 per cent of the premium volume in the country. PICC operates 4,200 branches and sub-branches throughout China, employing 200,000 people on a full and part-time basis, including 110,000 agents. Agents are paid by salary rather than commission. Premium income for life and non-life business reached 49.8 billion RMB (about $US 5.7 billion) in 1993, with property and casualty insurance accounting for 65 per cent of the total. Between 10 and 15 per cent of PICC's total premium income comes from its more than 70 subsidiaries, branches and agencies operating outside of China. At the end of 1993, PICC reported that approximately 350 million people had life insurance policies with the company, while about 145 million families had

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[10] Interviews with industry and government officials, May 1994.

[11] See generally, Sean Armstrong, "Insurers Prepare to Tap China's Massive Market," *Best's Review* (Life and Health Edition), May 1994, pp.72-74.

domestic property coverage and 700,000 enterprises had commercial property insurance.[12]

PICC faces little competition at present. Two national insurance companies have recently been established, the Ping An Insurance Company in 1988 (a joint stock company) and the China Pacific Insurance Company in 1990 (a subsidiary of the Bank of Communications).[13] Ping An is generally viewed as the more aggressive of the two,[14] but for reasons elaborated on below, both operate in the shadow of their much larger competitor. The formation of another 15 domestic insurance companies has been approved recently, most of them as joint ventures between the central government and local provincial authorities.[15] In addition, a number of government ministries offer limited lines of insurance to specific groups of people.[16] The People's Bank of China is also considering applications to establish insurance companies from a number of non-bank financial institutions, such as the powerful China International Trade Investment and Trust Corporation (CITIC).[17] So far, only one foreign insurance company has been permitted to operate in China and its activities are restricted to Shanghai, although a license for a second company has recently been approved.

Competition is further constrained by the regulatory system. Because domestic insurance companies must reinsure 30

[12] *World Insurance Report*, January 18, 1994, p.6.

[13] Philip Halliard, "China's Calm Before the Storm," *The Review (Worldwide Reinsurance)*, November 1993, p.18.

[14] Robert K. Meyers, "China's Untapped Potential," *Business Underwriter*, April 5, 1993, p.19.

[15] These companies include: Insurance Co. of Xinjiang Production and Construction Company, Dalian Life Insurance Co., Changsha Life Insurance Co., Benxi Life Insurance Co., Zhuhai Life Insurance Co., Xiamen Life Insurance Co., Xiangtan Life Insurance Co., Dandong Life Insurance Co., Guangzhou Life Insurance Co., Taiyuan Life Insurance Co., Harbin Life Insurance Co., Anshan Life Insurance Co., Nanjing Life Insurance Co., and the Fuzhou Life Insurance Co.

[16] Craig Allen and Allen Wang, "The Insurance Market in China," mimeo, American Embassy in Beijing, October 1993.

[17] The United Insurance Company was formed by CITIC, in cooperation with two state trading companies and one of China's largest shipping companies. See Sandy Hendry, "Chinese Giant May Compete with State Insurer," *The Journal of Commerce*, August 4, 1993.

per cent of their business with PICC, the insurer has an opportunity to examine the wording of every policy written by its domestic competitors. In addition, by refusing to reinsure a risk, PICC has an effective veto over any new business generated by other domestic insurance companies. The power of PICC also extends to the setting of premium rates. Rates are approved by the PBC through consultation with domestic insurers. Its size and underwriting experience gives PICC a decided advantage over the national other companies in influencing the outcome of this process.

3. Reforming China's Financial System

Reforms to China's financial system began in earnest in 1992 following Deng Xiaoping's pronouncements about the successful financial initiatives taking place in south-east China. [18] There was increasing recognition that China's move to a "socialist market economy" required an effective and efficient financial system, and that many of the pre-conditions needed to support such a system were absent. Problems included: inadequate or non-existent financial laws and regulations; reliance on fixed interest rates and credit ceilings for the conduct of monetary policy; the mixing commercial loans and policy loans (i.e., loans mandated by government regardless of credit worthiness) in the four specialized state-owned banks; imprudent inter-bank lending practices; price instability; and too little competition.[19] Over the past three years, senior officials have been drafting appropriate laws that would transform China's financial system to one that more closely resembles those found in advanced industrialized economies. The establishment of a new insurance law and associated regulations has been central to this process.

[18] Several other reforms took place throughout the 1980s, the most important of which occurred in 1984. Prior to 1984, China had a mono-banking system, with the People's Bank of China operating both as a central and commercial bank. In 1984, China moved to a two-tier banking system when four state-owned specialized banks were established or re-activated, and the PBC focused on central banking functions. See Paul Bowles and Gordon White, *The Political Economy of China's Financial Reforms*. Boulder Co.: Westview Press, 1993 (especially Chapter 4).

Financial Sector Reforms[20]

In November 1993, the State Council approved a plan that would bring about significant changes to the operation of the central bank and the structure of the banking system. Foremost among the changes included in the new Central Bank Act are that the key objective of the PBC is to be price stability, rather than economic growth, and that over time monetary policy is to rely to a greater extent on indirect controls, such as open market operations and changes to discount rate and bank reserve requirements. Other important changes include prohibiting the central bank from financing government deficits, bolstering the supervisory capabilities of the PBC over banks and non-bank financial institutions in China, and putting in place prudential regulations and monitoring systems targeted more closely at maintaining the solvency of financial institutions.

Under the new Commercial Bank Act, the four specialized state-owned banks are to operate strictly as commercial banks and three new policy banks[21] have been established to provide loans in priority areas of the government. The four specialized banks will remain state owned and will be restricted from non-commercial banking activities, such as trust, insurance, securities and investment banking. The intent of these changes are to have the banks operate in a profit-oriented manner and to promote competition with China's financial system. The new Bills of Exchange Act and the Company Act (both expected to come into force in 1994) will also affecting banking activity in China by providing greater legal certainty regarding the rights and responsibilities of borrowers and lenders.

A third sets of reforms is aimed at increasing the efficiency of financial markets. Measures include deepening and extending the maturity of securities in the government bond market,

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[19] Interviews with industry and government officials, May 1994.

[20] See generally, Chen Yuan, editor, *China Financial Outlook '94*. Beijing: China Financial Publishing House, 1994.

[21] They are the National Development Bank, the Agricultural Development Bank of China and the Export-Import Bank of China. Policy loans on the books of the four specialized commercial banks are to be transferred to the policy banks.

improvements to the clearing, payment and settlement system, and strict limits on the maturity of loans made through the inter-bank market. In addition, the government is committed to establishing a National Securities Law, although the drafting process is taking longer than expected due to reported policy differences between members of the drafting committee.

A final set of reforms is addressing the exchange rate system. The most significant change so far has been the elimination of the dual exchange rate regime on January 1, 1994.

However, the foreign exchange earnings of all state-owned companies must be sold to Chinese financial institutions designated by the PBC. Foreign companies and joint ventures will continue to be able to buy or sell foreign exchange in swap centres. A foreign exchange market was established in Shanghai in April 1994 in which foreign financial institutions are permitted to participate, but they are restricted to selling foreign exchange. China has stated its intention to make the renminbi convertible at some time in the future, but has not yet committed to a firm timetable as to when this is to be achieved.

Insurance Sector Reforms

China's insurance laws are being reviewed as part of the financial sector reform process. As in other sectors, the current laws and regulations governing the insurance industry were crafted at a time when the financial system was largely isolated from foreign influences, and was clearly structured to perpetuate the dominant position of the PICC within China. While existing regulations are lacking or deficient in a number of areas, the key objectives of the reforms are to establish a comprehensive legal framework for the industry, to put in place sound prudential regulations relating to solvency and policyholder protection, and to promote competition through the establishment of additional domestic insurance companies. The terms and conditions under which foreign insurance companies should be granted access to China is also to be addressed.

To deal with these issues, the Insurance Law Drafting Committee was established by the PBC in October 1991, headed by a former president of the PICC. Other members of the committee include officials from the PBC, the Research Institute of Insurance (a department of the PICC), and executives from the three national insurance companies. As part of its work, the committee undertook extensive examination of insurance laws in Japan, North America and Europe. The goal of the committee is to produce a draft insurance law that is consistent with international standards and practices, while at the same time accommodating China's current level of development and economic structure.

The Insurance Law of the PRC was expected to come into force in early 1994, following submission of the fifth version of the Act to the State Council on December 31, 1993, but has been delayed because of differences among interested parties over specific parts of the text. The draft law is now not expected to be ready for consideration by the National People's Congress before 1995 and some officials have commented privately that this might not even occur until 1996.

While the draft insurance law has not yet been released, some key policy directions relating to how the industry is to be structured have been discussed. First, firms will be licensed to underwrite life insurance or property and casualty insurance, but not both. This could affect the activities of the three national insurance companies, although most observers expect that their ability to continue to be write both lines of insurance will be grandfathered under the legislation. Second, government departments will be prohibited from writing insurance products, except for those products related to social security programs (e.g., pensions and unemployment schemes).[22] Third, banks are most likely to be prohibited from owning insurance companies. Again, this could affect China Pacific, which is owned by the Bank of Communications, unless grandfathered under the law. It is not clear whether non-bank financial institutions, such as the numerous investment trust companies, will be permitted to own

[22] P.T. Bangsberg, "China to Bar Banks, Government Units From Insurance Trade," *The Journal of Commerce*, January 6, 1994.

insurance companies. Fourth, property and casualty insurers will likely continue to be required to reinsurance at least 20 per cent of their premium volume with the PICC. It is less certain if this requirement will be maintained with respect to life insurance business.[23] Fifth, insurance agents and brokers are likely to be subject to regulations on minimum qualifications. Responsibility for licensing, and the specific standards to be adopted, has not been determined. Finally, insurance companies will belong to the tax base of the central government, thus avoiding the many local taxes that complicate the pricing of policies and that place insurance products at a competitive disadvantage relative to other financial products.

4. Foreign Insurers In China

Since 1949, China's insurance market has been closed to foreigners when insurance companies that had operated in China for years prior to the communist revolution found themselves excluded from the market. Shortly after China embraced the "Open-Door Policy" in 1978, a few international insurance companies, largely from Japan and the United States, moved to establish representative offices in Beijing. However, it was only after 1992, when China indicated that it would be liberalizing its financial sector, that a large number of international insurers moved to establish a presence in China. As of early 1994, approximately 30 foreign insurance companies had established about 50 representative offices in China.[24]

As shown in Table 1, Japan has the largest number of representative offices located in China, followed by the United States and Hong Kong. At present, only one company from Canada has representative offices in China (Manulife), although London Life has received permission to establish a

[23] Beverly Chau, "Insurers Face China Pitfalls," *South China Sunday Morning Post*, May 22, 1994.

[24] While the specific activities of each representative office vary by company, their principal functions are to liaise with officials from the PBC and PICC, monitor China's economic and regulatory environment, and contact market research on the insurance sector. Other activities include raising the profile of the company within the financial services community and coordinating training programs for Chinese nationals.

representative office in Beijing and has an application pending to establish a second office in Shanghai. Both Mutual Life and Sun Life have indicated an interest in China, but neither has moved to apply for a representative office thus far. No Canadian-owned property and casualty insurance companies have shown an interest in China.

Only one foreign insurance company is currently operating in China, although a second foreign company has recently been given permission to establish a branch. After considerable lobbying and pressure from the U.S. government, American International Group (AIG), through its Hong Kong subsidiary, American International Assurance Company (AIA), received permission to establish a branch in Shanghai in October 1992. AIA's activities are restricted to Shanghai and the Pudong Special Economic Zone and the firm offers property, casualty and liability insurance to foreign-owned subsidiaries and joint ventures, as well as life, medical and personal accident insurance to foreign tourists and residents. AIA is permitted to write policies in local or foreign currencies. AIG has indicated that it has been pleased with its first year of operation in China and, as of the beginning of 1994, AIA had a sales force of over 1,000 agents and is widely-believed to be writing in excess of 10,000 new policies per month (up from an average of 2,500 policies per month in 1993).[25] In August 1994, Tokio Marine and Fire Insurance Company received permission to establish a branch in Shanghai on terms similar to those of AIA.

[25] P.T. Bangsberg, "AIG Unit Plans Chinese Expansion," *The Journal of Commerce*, September 29, 1993; and Allen and Wang, "The Insurance Market in China."

Table 1
Foreign Representative Offices in China

Company	Country	Location of Office
Colonial Mutual	Australia	Beijing
National Mutual	Australia	Beijing
Manulife	Canada	Beijing, Shenzen, Shanghai, Cheng Du
London Life	Canada	Beijing, Shanghai*
Allianz	Germany	Beijing
Top Glory Insurance	Hong Kong	Beijing
Gui Jiang Insurance	Hong Kong	Beijing
Asia Insurance	Hong Kong	Shenzen
Minan Insurance	Hong Kong	Shenzen, Haikou
Nippon Fire & Marine	Japan	Beijing
Taisho Marine & Fire	Japan	Beijing, Dalian, Shenzen, Guangzhou, Shanghai,
Tokio Marine & Fire	Japan	Beijing, Shanghai (Branch), Shenzen, Dalian, Guangzhou,
Sumitomo Marine & Fire	Japan	Beijing, Dalian, Shenzen, Guangzhou, Shanghai
Chiyada Fire & Marine	Japan	Beijing, Shanghai
Nichido Fire & Marine	Japan	Beijing, Shangai, Dalian, Shenzen, Guangzhou
Nippon Life	Japan	Beijing
Toho Mutual Life	Japan	Beijing
Dai-Ichi Mutual Life	Japan	Beijing
Yasuda Fire & Marine	Japan	Beijing
ING Insurance	Nether.	Beijing, Shanghai, Guangzhou*
Winterthur Swiss	Switz.	Beijing
Zurich Insurance	Switz.	Beijing
Worldwide Insurance	Taiwan	Beijing
Commercial Union	U.K.	Beijing
General Accident	U.K.	Beijing
Eagle Star Insurance	U.K.	Beijing, Shanghai
Sun Alliance	U.K.	Beijing, Dalian
Prudential	U.K.	Beijing, Shanghai,* Guangzhou*

Company	Country	Location of Office
American International Group	U.S.	Beijing, Shanghai, Guangzhou
China America Insurance	U.S./China	Beijing
Continental Insurance	U.S.	Beijing
American International Assurance	U.S.	Shanghai (Branch)
Cigna	U.S.	Beijing
Aetna International	U.S.	Beijing, Shanghai
Lincoln National	U.S.	Beijing
Chubb	U.S.	Beijing
American Reinsurance	U.S.	Beijing
TransAmerican Life	U.S.	Beijing

* Application pending with PBC.
Source: The People' Bank of China; The Conference Board of Canada based on media reports.

In 1993, the PBC issued Provisional Measures on the Administration of Foreign-Funded Insurance Institutions in Shanghai Municipality, which set out some of the terms and conditions under which foreign insurance companies will be granted licenses to operate in China. The three most basic conditions for licensing are that the applicant must have: (1) a business history of at least 30 years; (2) total corporate assets in excess of $US 5 billion; and (3) established a representative office in China for at least three years. These represent *minimum* conditions and their satisfaction in no way guarantees that an application will be accepted by the PBC or the local government in Shanghai. If approved, foreign insurers will be able to establish a wholly-owned subsidiary or a joint venture with a local financial institution. Foreign-funded companies will be permitted to engage in the same business activities that are currently enjoyed by AIA.

The application process remains highly discretionary, as in the banking sector, and maintaining a positive corporate image with Chinese officials is considered to be a crucial part of a successful entry strategy. An unwritten factor that is given considerable weight in the application process is the degree of "involvement" an applicant has with China and, in particular, the contribution that company has made to China's development. This has led most foreign insurance companies with representative offices in China to fund and/or offer training programs for PICC and PBC officials, particularly in the field of actuarial sciences. For instance, Manulife has trained a number of PICC actuaries in Hong Kong and is currently training two PBC officials in Toronto. Direct investment in China is also viewed favourably and many observers credit the large investments made by AIG in Shanghai over the past decade as an important factor in its successful application for a branch license.

Access to China's insurance market will be influenced by the outcome of the current negotiations for China to rejoin the General Agreement on Tariffs and Trade (GATT) and to become a founding member of the World Trade Organization (WTO). As part of the process, China is currently preparing a list of market access schedules, including one for financial services, for member countries outlining the terms and conditions under which foreign companies will be permitted to operate. These schedules are the product of bilateral discussions that have been taking place since December 1993 and are expected to be presented for further negotiation in Fall 1994. Conditions of entry for insurance services are likely to reflect the Provisional Measures outlined above, although current GATT members, and especially the United States and the European Union, are demanding much greater concessions. China has resisted these demands arguing that its insurance institutions and governing structures are still in their infancy and need time to develop further before being exposed to foreign competition. China had hoped to become a founding member of the WTO, scheduled to come into force at the beginning of 1995, but continuing disagreements over the extent and timing of market access commitments in financial services and other areas places this outcome in considerable doubt.

5. Outlook for Foreign Insurers in China

China is widely viewed as the next big insurance market to emerge in the Asia-Pacific region. This potential has generated interest from a variety of foreign insurance companies, including a number from Canada, in entering the market. China's insurance market is still effectively closed to foreigners, although it has given every indication that this policy will change in due course; a commitment that is backed by China's desire to rejoin the GATT, which carries with it the obligation of increased market access. Strong pressure by the United States, who sees trade in insurance services as one means to correct its growing trade imbalance with China, provides further impetus for China to allow foreign insurance companies into the country. The specific terms and conditions of access to China's insurance market are still unfolding, but it is possible to offer some observations on how it is likely to develop.

First, China is likely to extend its de facto policy of *market gradualism* to insurance services. This means that applications for business licenses by foreign insurers are likely to be approved in stages (or rounds), where a small number of foreign insurers from a range of countries are granted licenses at the same time, with a delay before the next round of licenses are approved. In addition, the business powers of those approved to operate in China will be limited to specific market segments, initially focusing on the needs of other foreign enterprises operating in the country. This cautious approach to market liberalization has been followed in other countries (including those in developed countries) and has been applied by China in other sectors, including banking.

Second, *regional experimentation* will shape the geographic areas in which foreign insurance companies are permitted to operate. Since 1978, when it first began to open to the world economy, China has sought to limit foreign participation to particular regions of its economy, most notably through the establishment of special economic zones and open cities. This allowed China to experiment with different economic policies while sheltering the rest of the country from their effect. This policy has been extended to financial services where Shanghai (and to a lesser extent Shenzen and Guangzhou) has been designated the financial capital of China. The largest number of foreign bank branches approved in China has been in Shanghai, the activities of AIA and Tokio Marine and Fire are also restricted to the region. Foreign insurance companies receiving approval to operate in China over the next few years will undoubtedly see their activities limited to a single city or region.

Third, market access will be granted at the *discretion* of the PBC and local government officials. It is highly doubtful that China will fully embrace or even approximate a licensing system where the satisfaction of certain minimum conditions will extend to foreign insurers the right of establishment. This means that it will be imperative for companies seeking to establish operations in China to maintain a positive and visible profile with the PBC and other regulatory officials, either by offering training programs or through direct foreign investment. Companies from countries where Chinese financial institutions are interested in establishing operations will naturally have an advantage in securing license approval.

In terms of market size, regulatory structure and consumer awareness and acceptance, China's insurance industry is very much in its infancy. While China is committed to allowing foreign insurance companies to participate in its market, access will be granted slowly so as to permit new domestic companies to form, to allow existing companies to adjust to a more competitive environment, and to enable a comprehensive regulatory structure and supervisory system to develop. For foreign insurance companies, this means that China must be viewed as a long-term opportunity that is unlikely to yield sizeable returns before the end of the century and, even then, only for those companies that are truly committed to the market.