

INTERNATIONAL MONETARY FUND



# **Staff Country Reports**

## **People's Republic of China: Detailed Assessment Report: Observance of IAIS Insurance Core Principles**

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FINANCIAL SECTOR ASSESSMENT PROGRAM

# PEOPLE'S REPUBLIC OF CHINA

IAIS INSURANCE CORE PRINCIPLES

# DETAILED ASSESSMENT OF OBSERVANCE

MARCH 2012

INTERNATIONAL MONETARY FUND  
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK  
FINANCIAL AND PRIVATE SECTOR  
DEVELOPMENT VICE-PRESIDENCY EAST ASIA  
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## GLOSSARY

AIA	American International Assurance Company
AIG	American International Group
AML/CFT	Anti-Money Laundering/ Combating the Financing of Terrorism
ASBE	Accounting Standards for Business Enterprises
CAA	Chinese Actuarial Association
CAMELMAC	Chinese Anti-Money Laundering and Analysis Center
CBRC	China Banking Regulatory Commission
CDS	Credit Default Swap
CIRC	China Insurance Regulatory Commission
CSRC	China Securities Regulatory Commission
EU	European Union
FIU	Financial Intelligence Unit
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
GAAP	Generally Accepted Accounting Principles
HQ	Headquarters
IAC	Insurance Association of China
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICP	Insurance Core Principles
IFRS	International Financial Reporting Standards
ISVAP	Istituto per la Vigilanza sulle Assicurazioni Private e di Interesse Collettivo
IT	Information Technology
JVs	Joint Ventures
MAT	Marine Aviation and Transit
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MTPL	Motor Third Party Liability
NAIC	National Association of Insurance Commissioners
P&C	Property and Casualty
PBC	People's Bank of China
PwC	PricewaterhouseCoopers
PICC	People's Insurance Company of China
RBC	Risk Based Capital
RMB	Chinese Domestic Currency
USD	United States Dollar

## I. EXECUTIVE SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

1. **Insurance companies in China are closely supervised and generally subjected to appropriate regulation.** The China Insurance Regulatory Commission (CIRC), employs a rules based framework and has achieved a high level of regulatory compliance from supervised companies. Generally, a high level of observance with the core principles can be seen on those core principles where a rules based approach and control can be exercised. In contrast insufficient regulation exists on market exit and portfolio transfers. Supervision should be strengthened on the adequacy of reserve levels, the insurer's observance of solvency requirements and the strictness with which CIRC ensures compliance with capital requirements. China's developing industry already represents the six-largest insurance market in the world and projections suggest ongoing annual growth rates of between 10 and 15 percent (PricewaterhouseCoopers (PwC)). The market demand for skilled resources continues to increase and must be satisfied if the projected rate of development is to be sustained and compromises on the suitability of personnel should be avoided at all costs. CIRC's internal organization could be improved to facilitate the ongoing addition of new recruits. A shift from rules based to principles based supervision is likely to become necessary if resources are to meet growing demands. However in the immediate future rules based approach seems most appropriate.

### A. Introduction

2. **This assessment of the People's Republic of China's compliance with International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) was carried out as part of the 2010 Financial Sector Assessment Program (FSAP).** The assessment was conducted by Henning Göbel, Insurance Expert and Chief Accountant, Federal Financial Supervisory Authority of Germany, BaFin.

3. **The CIRC has principal responsibility over insurance regulation in China and conducts its duties through its headquarters in Beijing and 35 regional branches, the insurance bureaus. Insurance supervision is not limited to the CIRC,** as it is affected by high level regulations issued by the State Council (including on compulsory motor insurance). In addition to formal regulations, CIRC has issued a range of directives, guidance notes etc under its mandate to develop the State Council's commercial and social policy objectives for the insurance market.

### B. Information and Methodology Used for Assessment

4. **This assessment is based upon information made available to the assessor in preparation for and during the June 2010 FSAP mission.** CIRC contributed a self-assessment and further information in response to requests before and during the mission. Requested documentation, including relevant laws and a number of key regulations were supplied in English. However many of the 42 key CIRC regulations and supporting directives and explanations were only available in Chinese. The assessment has been informed by

discussions with regulators and market participants. The assessors met with staff from the CIRC Headquarters (HQ), two large regional insurance bureaus and insurance companies and intermediaries and with industry and actuarial bodies. The assessors are grateful for the full cooperation extended by all.

5. **This assessment is based on the 2003 version of the IAIS Insurance Core Principles and Methodology.** It took into account relevant IAIS standards and guidance in addition to the ICPs.

### C. Institutional and Market Structure—Overview<sup>1</sup>

6. **The Chinese insurance market is the six largest in the world.** In 2008, 103 insurance companies were licensed, 56 of them life insurers and 47 non-life. For the period 2003–2008, growth rates were between 14.4 and 39.3 percent. Total gross insurance premium income of RMB 978.91 billion, equaling US\$143.4 billion, was recorded in 2008. The life insurance business currently accounts for approximately 75 percent of total premium income (Table 1).

**Table 1. China: Insurance Premiums (2002–2008)**

	2004	2005	2006	2007	2008
Number of non life insurers	32	35	38	42	47
Number of life insurers	32	42	48	54	56
Total	64	77	86	96	103
Non-life gross written premium income (Unit: RMB billion)	1,124.8	1,283.5	1,581.1	2,086.4	2,446.2
Growth		14.11 %	23.19%	31.96%	18.25%
Life gross written premium income (Unit: RMB 100 million)	2,933.67	3,647.03	4,059.1	4,944.11	7,342.6
Growth		24.32%	11.30%	21.80%	48.51%
Total gross premium income (Unit: RMB 100 million)	4,058.45	4,930.52	5,640.20	7,030.8	9,789.1
Growth		21.49%	14.39%	24.66%	39.23%

Source: CIRC, *China Financial Stability Report 2009*.

7. **China's life insurance market is highly concentrated (Table 2).** The top 10 insurance companies account for nearly 90 percent of gross premium. With the exception of American International Assurance Company (AIA), life insurance business is not open to foreign funded companies except through joint ventures where the foreign shareholder may have up to 50 percent of the equity.<sup>2</sup> The non-life business is also highly concentrated and continues to be dominated by the leading Property and Casualty (P&C) Insurance Group and People's Insurance Company of China (PICC).

<sup>1</sup> Greater detail of the institutional and market structure is provided in other parts of this assessment.

<sup>2</sup> Two foreign shareholders other than American International Group (AIG) have 51 percent shareholdings reflecting special circumstances.



**Table 2. China: Insurance Sector Concentration  
(In percent)**

	2005	2006	2007	2008	2009
Aggregate market share of the largest 5 life insurers	81.5	83.3	79.5	78.6	77.2
Aggregate market share of the largest 10 life insurers	91.4	90.3	87.4	89.1	89.0
Aggregate market share of the largest 5 property insurers	85.7	80.8	77.6	75.6	74.1
Aggregate market share of the largest 10 property insurers	95.7	93.1	90.1	86.9	85.4

Source: CIRC, *China Financial Stability Report 2009*.

8. **Life insurance accounted for 74 percent of gross premiums in 2009, a metric typical of an advanced economy.** However the P&C sector is dominated by motor insurance (which accounted for 70 percent of gross written premium) a metric more characteristic of an emerging market. This unusual pattern is likely to reflect both cultural and historical roots.

9. **The life insurance business mix has changed significantly in the last half of this decade with the traditional guaranteed return business dropping from 42 percent to 23 percent of life policies and being replaced by Universal Life and Investment linked business.** Participating business<sup>3</sup> throughout the decade has held approximately 55 percent of the market as it has provided a reasonably consistent and stable profit margin for the insurers and offers the possibility of an enhanced return to the policyholders.

10. **The non life business mix has remained largely static with motor and commercial property accounting for 80 percent and liability, Marine Aviation and Transit (MAT) and accident jointly accounting for another 11 percent.** The only clear upward trend in share of premium has been in the agricultural and medical insurance lines. Householder insurance accounts for only 1 percent of non-life premium and China, unlike other countries, is not seeing a boost in insurance sales from the development of the mortgage markets. It appears in part this may be due to banks not being prepared to monitor and enforce policy continuance.

#### **D. Main Findings**

11. **The preconditions for effective supervision are generally met.** Where principles are not full observed, generally one of two reasons applies (Table 3):

<sup>3</sup> Participating business has a low guaranteed return and offers the opportunity for additional participation in emerging profits.

- CIRC or other empowered official agencies have intentionally decided that the full implementation of the respective core principle would not fully take into account the current development phase of the Chinese insurance market or would be in conflict with constitutional arrangements. This observation may be applicable to principles on: supervisory authority, supervisory objectives, investments, derivatives and Anti-Money-Laundering (AML).
- CIRC has—in contrast to its overall comprehensive regulations—insufficient rules for some important areas of supervision. China takes a fairly pragmatic approach to regulation and will often wait for the actual emergence of business cases demanding new rules before acting. It is responsive rather than proactive and has thus missed important areas. This observation is applicable to principles on: change in control and portfolio transfer, exiting the market and insurance activity.

12. **There also areas, where CIRC has strong and explicit regulation in place but its application or implementation is assessed as being too loose and also bearing substantial reputational risks for CIRC.** This observation would be applicable to principles on: liabilities and solvency regime.

- CIRC has implemented a comprehensive supervisory framework and strong emphasis has been given to the implementation of suitable corporate governance rules and sufficient risk management systems for all insurance companies. The conditions for effective insurance supervision are largely met with some impediments stemming from the continuing battle of Chinese officials against corruption and bribery.
- The supervisory system is strong and well organized but CIRC has a compelling need for additional resources in its core supervisory departments. CIRC is responsible for a wide range of tasks in a very large and diversified market. It also has to be prepared for the continuing rapid growth of the scale and scope of China's many and diverse insurance markets. Today, its qualified staffing in some departments may not be adequate to permit it to carry out its responsibilities in a growing and changing market.
- The principles regarding the supervised entities are largely observed. Further regulation should be issued to facilitate portfolio transfers and to disconnect licensing arrangements from the registration of the legal entity.
- CIRC's ongoing supervision of insurance companies and the supervision of markets and consumers are tight and display a strong level of control. Most principles in these sections are fully observed. In fact, some of the supervisory reporting requirements seem almost too comprehensive and are reported too frequently. Disclosure and consumer protection are adequate and have recently been improved.

- The application of prudential requirements needs to be strengthened substantially, especially the liabilities and the solvency regimes. There are also some deficiencies in the regulation regarding quantitative investment requirements, but the authority has signaled that further regulation will be issued shortly. CIRC should also review its current arrangement with People's Bank of China (PBC) on fighting Money-Laundering. The shared responsibilities are not reflected in the activities carried out solely by PBC. The lack of adequate reporting back to CIRC is not acceptable and bears a reputational risk for CIRC. Processes and responsibilities should be reviewed and restructured to address this weakness.
- A summary of principle by principle assessments is exhibited in Table 3 which provides the grading and relevant comments applicable to each principle and rating:

**Table 3. China: Summary of Observance of the Insurance Core Principles—  
Detailed Assessments**

Insurance Core Principle	Grading	Comments
ICP 1 – Conditions for effective insurance supervision	LO	<p>The preconditions for effective supervision are largely met. Stronger enforcement is needed to eliminate a general perception of the acceptance of corruption and to minimize unethical behavior in the financial sector. CIRC bureaus have recently been engaged in an active campaign to reduce fraudulent behavior and to enforce ethical behavior of insurance company management and staff.</p> <p>The influence of the Chinese authorities over business development and companies' strategies is potentially hampering the desired growth of the market. China has to resolve the contradiction between a controlled market including tight control over the entry and expansion of foreign funded companies and the need to develop the life insurance market to provide sufficient coverage and innovations to facilitate the overall growth of the Chinese markets.</p>
ICP 2 – Supervisory objectives	PO	<p>CIRC's supervisory objectives are defined in broad terms.</p> <p>Financial stability, consumer protection and fair competition could be translated into operational goals and form the basis for a mission statement of CIRC. That statement could also help new staff to engage more quickly with the authority's tasks.</p> <p>The CIRC's second objective and related responsibilities for the development of the domestic market (as implemented) are rather unique for a supervisor. It was made clear to the assessor that both sets of objectives are essential to the controlled and sound growth of the sector and the need to supply insurance coverage to consumers and domestic industries. Generally supervisors support the development of the sector through ensuring a level playing field and adequate and prompt supervision. As such, the more hands on developmental objectives and responsibilities of CIRC are not in line with the ICP.</p> <p>Moreover, the range of commercial and social objectives almost inevitably will lead to conflicts with the supervisory objectives. Possible scenarios include decisions on adequacy of pricing, product design and consumer protection and licensing in the context of regional and social development. The</p>

		<p>regulatory and commercial objectives each require very distinct mindsets and skills. It is recommended the two mandates be separated and a suitable agency be identified to take ownership of the developmental, commercial and social objectives. This would help to ensure the supervisor has a clear objective and is able to undertake its role without conflict. This would help the government and the industry to understand better the risks to safety and soundness of actions taken.</p>
ICP 3 – Supervisory authority	PO	<p>CIRC is not independent and free from political interference. It became apparent, that the Chinese regulatory framework is based on strict control, cascading down from the state council to CIRC HQ to the insurance bureaus. In addition, the staffing levels of CIRC are not adequate. In particular, the areas of off-site monitoring, inspection, international cooperation, accounting and auditing and the staffing levels of key units in the insurance bureaus should be substantially strengthened through increased suitable staffing.</p> <p>As in ICP 2, it is recommended the commercial and social development objectives be disconnected from CIRC and consideration be given to establishing a development agency for the financial sector as a whole. As such, that agency could ensure a closer alignment of development in the banking, securities and insurance areas while also looking to the specific needs of each sector.</p>
ICP 4 – Supervisory process	LO	<p>At this time in the development of the sector the rules based approach for supervision undertaken by CIRC is appropriate and it is not recommended that CIRC should shift to a principle based system. In fact, interviews with staff and industry, including auditors and actuaries, have confirmed that the prescriptive system currently corresponds to the business culture in China. This should be reexamined going forward to determine the feasibility and appropriateness of the rules based approach as the industry continues to change. In addition, in the future it will be necessary to consider the potential impact on the CIRC which under the rules based system requires staff sufficient to undertake the labor intensive processes. Albeit that staff for CIRC will have to increase under both a rules and principles based system, staffing levels will need to be increased substantially under a rules based system in order to adequately manage the expected enormous size of the market and the</p>

		diversity of the provinces and market players.
ICP 5 – Supervisory cooperation and information sharing	O	The information sharing with authorities exists on an as-needs basis. It is recommended to establish information sharing in a pro-active manner and to provide those authorities supervising insurance groups with related business in China with information on the Chinese market on a regular basis. Reciprocally, CIRC should ask for respective information.
ICP 6 – Licensing	PO	The licensing process should not be restricted to control the market entry of insurers but must also facilitate changes of insurers’ strategy and ability to underwrite business. The separation of the formation of a company and insurance licensing should be made clearer. CIRC must be able to ensure that a company may be prohibited from writing new policies but still is liable and able to administer its current liabilities and contracts.
ICP 7 – Suitability of persons	O	<p>An insurance company has to apply for approval before changing its external auditor. In doing so, only the firm but not the responsible partners name will be submitted to CIRC. Without further inquiries, CIRC would not be aware of a potential mismatch between the complexity of the insurance company and the experience of the responsible auditor. It is recommended, that CIRC should request more detailed information on the background and function of the external auditor. Such approach would be more in line with the general attitude to control within the regulatory approach.</p> <p>CIRC maintains high requirements for the suitability of key personnel. The growth of the insurance market and the demand for highly qualified and experienced management skills should be monitored. Further development of the market should not be limited by the supply of suitable personnel or worse, lead to undesirable compromises. Hence, CIRC should ensure that a general awareness exists on the need of suitable output from universities and professional bodies and should encourage insurers to facilitate adequate training courses.</p>
ICP 8 – Changes in control and portfolio transfers	PO	CIRC must develop a suitable regulation to facilitate the transfer of portfolios. Specific attention must be given to the transfer of liabilities, the adequacy of reserves and technical provisions, the ability of the recipient of the portfolio to meet requirements on suitability, license and internal control. A transfer should not be dependent upon the acceptance of

		<p>policyholders or beneficiaries but timely notification of the intended transfer should be provided to them. A transfer of life insurance business should require the separation of the existing life policy business from the transferred business in the recipient's company.</p>
ICP 9 – Corporate governance	LO	<p>CIRC has issued sufficient regulation to ensure that corporate governance is recognized as one of the key fundamentals of the Chinese supervisory framework. Given the size of the country itself, the size of the market (already large at this early phase of its development) and the low quantity of insurance companies, regulating governance and enforcing its application is paramount to a sound and safe market environment.</p> <p>Preparatory research for this mission, interviews with insurance companies and further conversations have raised concerns on the robustness of the system against corruption, including bribery. It is believed that a stronger effort to reduce corruption is needed. This would especially address the distribution of insurance products, the handling of insurance claims, general trustworthiness of the legal system, accessibility of courts and protection of consumer rights.</p>
ICP 10 – Internal controls	LO	<p>The focus on internal control is rules based and sufficiently detailed. Reports to CIRC, both HQ and bureaus, are regularly and timely. Minutes of the various committees are submitted and analyzed.</p> <p>CIRC could consider asking external auditors to include in their regular audits an inspection of the risk managements systems and the internal control procedures at least for the large companies, where a full scope inspection cycle of five year might be too infrequent.</p>
ICP 11 – Market analysis	O	<p>The monthly submission required by CIRC is very substantive in size and level of detail. It is unclear to what extent the amount of data can actually be meaningfully analyzed in time: especially as data on technical performance usually does not vary significantly in that short a time period. CIRC should consider whether the monthly submission should be significantly reduced. Certain technical performance data could be required on a quarterly basis as is already the case for reinsurers.</p>
ICP 12 – Reporting to supervisors and off-site monitoring	O	<p>CIRC has established a comprehensive classification system and can now allocate supervisory resources efficiently according to the risk profile of each</p>

		supervised entity. The criteria within the classification system could be further enhanced to also reflect the technical performance of life business through the usage of embedded value accounting. Moreover, impact and probability of risks should be better reflected.
ICP 13 – On-site inspection	LO	On-site inspections should also be used to verify whether assumptions made off-site turned out to be accurate. There are merits in concentrating inspections in one department. However, the experience and understanding of how the insurance company operates and what its processes and business model are, is very important for all of CIRC’s staff involved in the operational supervisory process.
ICP 14 – Preventive and corrective measures	PO	The prevention process is thorough and comprehensive. It almost contains more rules than needed given the business culture explained above and has to be enforced in all areas, especially the prudential principles need to be enforced more rigorously. Corrective actions are solvency based and there is evidence of forbearance.
ICP 15 – Enforcement or sanctions	O	
ICP 16 – Winding-up or exit from the market	PO	Specific regulation under which a voluntary exit from the market via run off (for non life insurers) or portfolio transfer/ merger can be facilitated still needs to be produced. This is relatively urgent given current market conditions including the single insurer rule. Portfolio transfers should be subject to actuarial clearance and supervisory approval but not policyholder approval.
ICP 17 – Group-wide supervision	O	The Chinese market has been developed with a distinct aim to limit and restrict the quantity of companies in order to maintain manageable levels. China already ranks as the six largest insurance markets in the world. Most of the developed markets within the top 10 would have at least three times the quantity of companies. It is expected that the role of insurance groups will become more significant, requiring CIRC to further develop regulation to facilitate the supervision of insurance groups. This will certainly involve centralized risk management functions and group solvency requirements allowing for diversification.
ICP 18 – Risk assessment and management	O	The implementation of the risk management function requires substantial efforts from both companies and CIRC. Progress and adequacy of the systems are not easily measured through off-site



		<p>monitoring and supervisory reporting. The cycle for on-site inspections extends to five years. CIRC should agree to changes in regulation and require adequate audited reports for at least those companies with substantial market share or specific exposures.</p>
ICP 19 – Insurance activity	LO	<p>The insurance activity is sufficiently well defined. CIRC assumes a high level of control over the market. Limitations on the ability of the insurance companies to further develop products or business procedures in order to gain competitive advantage exist.</p> <p>CIRC should prevent insurers from taking loans and pledging assets covering capital requirements or technical provisions.</p> <p>Product approval and off-site monitoring must lead to early recognition of shortfalls and must lead to rectification plans with immediate effect and short response times.</p>
ICP 20 – Liabilities	PO	<p>CIRC should not allow insurers to maintain inadequate reserve levels. Policyholder and beneficiaries must expect CIRC to ensure minimum reserve levels at all times. Product approval and off-site monitoring must lead to early recognition of shortfalls and must lead to rectification plans with immediate effect and short response times. CIRC should also prevent insurers from writing new business for as long as reserve levels are inadequate. CIRC should prevent egregious cross-subsidizing of policies.</p> <p>The introduction of new accounting standards should have been applied with precautionary measures. Effects from re-measurement should have been deferred to other comprehensive income as part of equity and should have not been disbursed to shareholders for at least three years.</p>
ICP 21 – Investments	LO	<p>Chinese insurers face a very narrow range of investment categories and opportunities to invest their assets. Whilst quantitative and qualitative restrictions appear to ensure a safe and sound environment, it also overly exposes the insurers to domestic interest rate and credit risks. As described under ICP 22, CIRC should issue regulations to allow for macro and portfolio hedging CIRC has to assume that investment management must be capable of engaging in hedging activities. Analysis of the financial performance of Chinese insurers has shown a strong volatility of the investment income. The performance of traditional and with profit</p>

		<p>products in particular depend on reliable and stable investment returns. Insurers should have more flexibility to achieve those returns. Micro hedges are deemed to be insufficient and not flexible enough to provide suitable protection.</p> <p>CIRC should issue distinct regulations governing the quality of assets covering technical provisions and capital requirements. For those categories, related party transactions should not be permitted.</p>
ICP 22 – Derivatives and similar commitments	LO	<p>At the time of the assessment, insurers as a whole were not allowed to write or purchase derivatives. Thus there is limited scope to hedge investment risks. However selected exceptions were granted to six domestic insurers with adequate internal controls. Those insurers were allowed to purchase interest rate swaps on RMB as part of a pilot study. CIRC is has now issued a rule on stock index futures and is considering implementation procedures.</p>
ICP 23 – Capital adequacy and solvency	PO	<p>The solvency regime is rather static and insufficiently risk based. There are two main concepts of solvency frameworks at the centre of international regulatory debate: Solvency II, a European development, taking specifics of an insurer’s business model into account and also allows for a recalculation of assets and liabilities under a concept of full economic values. The second concept is the refinement of a risk-based-capital (RBC) approach, as applied in the U.S. markets. Conceptually, Solvency II might be more sophisticated but it is also far more complex in its application to insurer and supervisors. China is currently investigating what direction it should take between the two general approaches. Taking CIRC’s current rules and control based approach into consideration; a move towards Solvency II might not be recommendable. In line with its current development stage a refinement of its current solvency regime would build on the current principles of static analysis of claims and premium development, assessment of asset risk, recognition of growth developments and allowances for inflation and specifics of business lines. Furthermore, a re-measurement of liabilities for solvency purposes is strongly recommended.</p> <p>CIRC has currently eight companies, five non-life and three life, operating with solvency margins below 100 percent. Those companies are still allowed to write new business but might be limited in their geographical growth. Inadequate solvency</p>

		<p>levels have existed for some of these companies for more than two quarters.</p> <p>As a supervisory principle, no licensed entity should be allowed to write new business for as long as the solvency levels are not above 100 percent. If management of shareholders cannot within very limited timeframes provide capital injections, the company should be declared insolvent and be placed under the administration of the supervisor. The current situation with eight companies operating below 100 percent solvency ratios signals to the markets that breaches of capital requirement will not have serious consequences such as revocation of licenses or public warnings.</p> <p>The recognition of loadings for bank deposits with inadequately capitalized banks is paradoxical. The adequate measure would be to require companies to immediately withdraw the deposits, in order to secure policyholders and companies interests.</p> <p>CIRC should be aware of its potential reputational risks by failing to have an adequate solvency regulation. It also faces a reputational risk for failing to demonstrate adequate enforcement measures by permitting excessive forbearance. The forbearance is in contradiction with the overall hands-on approach and control over the supervised insurance companies.</p> <p>CIRC should prevent insurers from taking loans and pledging assets covering capital requirements or technical provisions.</p>
ICP 24 – Intermediaries	O	
ICP 25 – Consumer protection	O	<p>CIRC could introduce the disclosure of complaints per company to further enhance companies' discipline and to increase the awareness on customer satisfaction. The complaint function should be moved from the insurance association to a more independent source to enhance creditability of the process.</p>
ICP 26 – Information, disclosure and transparency towards markets	O	<p>Since the regulation on disclosure only recently has been introduced, a review process should be established to allow for modification and refinements within a timeframe of the next two years.</p>
ICP 27 – Fraud	O	<p>CIRC has increased substantially its efforts against fraud. Staffing levels should be increased to address fraud at a more appropriate level. Corruption and bribery are a concern. A stronger effort and adequate</p>

		staff will allow CIRC to contribute more effectively to an overall enhancement of market discipline in the financial sector.
ICP 28 –Anti-money-laundering, combating the financing of terrorism	PO	Currently the share of responsibility for AML between PBC and CIRC and the lack of active involvement and influence of the CIRC over the process results in a significant reputational risk to the CIRC, particularly as the current system as operated by PBC is not complete. A clear accountability is needed to respond in a timely manner to the specifics of AML. The rather opaque involvement of CIRC in conjunction with the lack of influence and involvement on inspections and sanctions is not satisfactory. A decision is needed as to where the AML function will be housed and then to ensure it is carried out effectively. If it is not with the CIRC, then it is essential that CIRC be adequately informed so as to properly supervise the sector. In addition the thresholds for the reporting of suspicious transactions should be more in line with those with income levels.
<i>Aggregate:</i> Observed (O) – #, largely observed (LO) – #, partly observed (PO) – #, not observed (No) – #, not applicable (N/A) – #.		

## E. Recommended Action Plan and Authorities' Response

### Recommended action plan

13. **Recommendations are listed below for those principles where the observance is either partly or not observed (Table 4).** It should be noted that in addition, to the extent there are recommendations for those principles found to be fully or largely observed they were provided in the summary table and are solely for consideration as a means to further enhance the supervisory system or to allow CIRC to benefit from other international experience.

**Table 4. China: Recommended Action Plan to Improve Observance of the Insurance Core Principles**

Principle	Recommended Action
ICP 2 – Supervisory objectives	<p>CIRC’s supervisory objectives are defined in broader terms.</p> <p>Financial stability, consumer protection and fair competition could be translated into operational goals and form the basis for a mission statement of CIRC. That statement could also help new staff to engage more quickly with the authority’s tasks.</p> <p>CIRC’s second objective and related responsibilities for the development of the domestic market (as implemented) are rather unique for a mainstream supervisor. The range of commercial and social objectives almost inevitably will lead to conflicts with the supervisory objectives. Possible scenarios include decisions on adequacy of pricing, product design and consumer protection and licensing in the context of regional and social development. The regulatory and commercial objectives each require very distinct mindsets and skills. It is recommended the two mandates be separated and a suitable agency be identified to take ownership of the developmental, commercial and social objectives. This would help to ensure the supervisor has a clear objective and is able to undertake its role without conflict.</p>
ICP 3 – Supervisory authority	<p>CIRC is not independent and free from political interference. It became apparent, that the Chinese regulatory framework is based on strict control, cascading down from the state council to CIRC HQ to the insurance bureaus.</p> <p>The staffing levels of CIRC are not adequate. In particular, the areas of off-site monitoring, inspection, international cooperation, accounting and auditing and the staffing levels of key units in the insurance bureaus should be substantially strengthened through increased suitable staffing</p>
ICP 6 – Licensing	<p>The licensing process should not be restricted to control the market entry of insurers but must also facilitate changes of insurers’ strategy and ability to underwrite business. CIRC must ensure that a company will be prohibited from writing new policies but still is liable and able to administer its current liabilities and contracts.</p>

Principle	Recommended Action
ICP 8 – Changes in control and portfolio transfers	<p>CIRC must develop a suitable regulation to facilitate the transfer of portfolios. Specific attention must be given to the transfer of liabilities, the adequacy of reserves and technical provisions, the ability of the recipient of the portfolio to meet requirements on suitability, license and internal control.</p> <p>A transfer should not be dependent upon the acceptance of policyholders or beneficiaries but timely notification of the intended transfer should be provided to them.</p> <p>A transfer of life insurance business should require the separation of the existing life policy business from the transferred business in the recipient’s company.</p>
ICP 14 – Preventative and corrective measures	<p>Corrective actions in line with Section 6 of the insurance law need to be applied more vigorously to insurers breaching solvency.</p>
ICP 16 – Winding-up or exit from the market	<p>CIRC should develop specific regulation under which an exit from the market can be facilitated via portfolio transfer or merger and which allows for run off of non life business.</p>
ICP 20 – Liabilities	<p>CIRC should not allow insurers to maintain inadequate reserve levels. Policyholder and beneficiaries must expect CIRC to ensure minimum reserve levels at all times. Product approval and off-site monitoring must lead to early recognition of shortfalls and must lead to rectification plans with immediate effect and short response times. CIRC should also prevent insurers from writing new business for as long as reserve levels are inadequate. CIRC has to prevent cross-subsidizing of policies.</p> <p>The introduction of new accounting standards should have been applied with precautionary measures. Impacts from re-measurement should have been deferred to other comprehensive income as part of equity and should not have been available to shareholders as dividends for at least three years.</p>

Principle	Recommended Action
ICP 23 – Capital adequacy and solvency	<p>CIRC has to facilitate the rectification of solvency margins for eight companies, five non-life and three life, operating with solvency margins below 100 percent.</p> <p>As a supervisory principle, no licensed entity should be allowed to write new business for as long as the solvency levels are not above 100 percent.</p> <p>If management or shareholders cannot within very limited timeframes arrange for capital injections, the company should be declared insolvent and be directed under the administration of the supervisor.</p> <p>The recognition of loadings for bank deposits with inadequately capitalized banks is paradoxical. The adequate measure would be to require companies to immediately withdraw the deposits, in order to secure policyholders and companies interests.</p> <p>CIRC should be aware of the reputational risks it is engaged in through insufficient solvency regulation but also through excessive forbearance and the contradiction with an overall hands-on approach on control over the supervised insurance companies.</p>
ICP 28 – Anti-money-laundering, combating the financing of terrorism	<p>A clear accountability is needed to respond in a timely manner to the specifics of AML. The rather opaque involvement of CIRC in conjunction with the lack of influence and involvement on inspections and sanctions is not satisfactory. A decision is needed as to where the AML function will be housed and then to ensure it is carried out effectively.</p> <p>If it is not with the CIRC, then it is essential that CIRC be adequately informed so as to properly supervise the sector.</p>

## F. Authorities' Response to the Assessment

We appreciate the FSAP assessors' recognition of what the CIRC has achieved in supervisory enforcement, categorized supervision, market analysis, regulatory cooperation, information sharing and consumer protection.

The assessors have also acknowledged the CIRC's efforts and progress made in corporate governance, internal control, group supervision, solvency regulation, risk management, and off-site supervision.

The assessors understand that, in the few fields not evaluated as "fully observed," the CIRC has taken appropriate regulatory measures and approaches based on China's own conditions including its unique market environment and development stage. The regulatory philosophy we follow is consistent with IAIS's core principles for insurance regulation. We focus on prudential supervision, emphasize risk prevention, make vigorous efforts to maintain the market order and to protect consumer interests, thus we have effectively maintained the stability of the market.

As a response to the assessor's comment on solvency supervision, the CIRC attaches great importance to this task. Drawing upon the solvency supervisory standards of the European Union (EU) and the U.S., we have established a solvency supervisory system tailored to China's realities. The current system reflects the status quo of China as an emerging market and facilitates the stability of our insurance market. The fact that China's insurance industry remained resilient to the global financial crisis proves the risk-control ability of our solvency supervisory system. Specifically, the current system takes into account the underwriting risk, investment risk, interest rate risk, credit risk and asset liability matching risk of insurance companies. The system has the basic features of a risk-based solvency supervisory system and provides a good foundation for the transition to a comprehensively risk-based system. Currently the CIRC is studying the solvency supervisory systems in the world and dedicated to further improve its own system.

With respect to AML, it should be seen that China has its unique mechanism for this function. As provided by China's Anti Money Laundering Law, the PBC leads the work of AML and other authorities should actively assist it in its work. The division of responsibilities among relevant authorities is clear. The CIRC bears its share of responsibility and carries it out in its daily supervision. In practice, insurance institutions observe the AML rules put in place by both the PBC and the CIRC. They have established complete internal controls and other relevant measures for this purpose, and are actively carrying out the AML obligations. In order to supervise the risks of insurance companies, the CIRC carries out inspections on their internal controls, which include AML controls, and exchanges information with the PBC (the AML Bureau) through adequate channels.

To address the emerging issues and changes as market develops, the CIRC has been improving its rules and regulations and striving to enhance effective supervision. Since the newly revised Insurance Law was promulgated on October 1, 2009, the CIRC has formulated and introduced new rules and revised old rules covering personnel qualification, information disclosure, asset management, equity management and other aspects. Efforts have been made to further enhance industry order, strengthen corporate governance and internal control, promote risk management capabilities of insurance companies, and fundamentally safeguard the legitimate interests of the stakeholders.

We also appreciate the recommendations of the assessors. We will carefully study these recommendations and take them into consideration in our regulatory practices and the formulation of rules and regulations.



## II. DETAILED ASSESSMENT

**Table 5. China: Detailed Assessment of Observance of the Insurance Core Principles**

<b>Conditions for Effective Insurance Supervision</b>	
<b>Principle 1.</b>	<p><b>Conditions for effective insurance supervision</b></p> <p><b>Insurance supervision relies upon:</b></p> <ul style="list-style-type: none"> <li>-a policy, institutional and legal framework for financial sector supervision.</li> <li>-a well developed and effective financial market infrastructure.</li> <li>-efficient financial markets.</li> </ul>
Description	<p>China's supervision policy framework for the insurance sector mainly consists of the insurance laws and regulations as well as various rules developed by CIRC. CIRC was established based on an administrative law issued by the State Council.</p> <p>The regulation and supervision of the Chinese Insurance market is carried out against a developed legal and institutional framework in which many market activities still are influenced or dominated by the Chinese government or its branches and agencies. Financial sector policies are strongly controlled by the government and a development role is given to the regulatory bodies.</p> <p>Policies on the financial sector and objectives on financial stability are defined centrally for all regions of China. The Chinese government defers the execution and specification of policy framework to the State Council.</p> <p>China's economy is fast growing and has already become the sixth largest insurance market in the world. The sheer size of the market and the variety in geographical structures including advanced markets in large cities, has allowed for various manifestations of corruption, unprofessional business conduct, and bribery and an unlevel playing field for foreign funded enterprises. Chinese agencies have significantly increased efforts to reduce these distortions but market participants still are reporting undesired behavior and breaches of business ethics.</p> <p>China has rapidly developed a framework for financial sector policy defining financial stability, the supply of financial services products and safeguarding measures such as regulation and supervision. Since 1998, the financial sector has developed in distinct ways for the securities markets, the banking and the insurance sector. Relevant laws and regulation have been issued and are further developed at a rapid pace.</p> <p>The policy framework allows for a controlled opening of the market in a limited capacity, with approval of insurers' new geographic license applications being subject to their meeting inspection requirements. Domestic insurers still dominate on a national basis although a small group of foreign insurers have attained reasonable market shares in some administrative areas where they have been established since the early 1990's "opening up."</p> <p>There is a developed framework for accounting, actuarial and auditing standards and respective professional bodies. The development of those standards has been conducted with the aim of international acceptance and convergence. Accounting standards are issued by the Ministry of Finance (MOF) of the PBC. In 2006, the MOF formally announced the issuance of Accounting Standards for Business Enterprises ("ASBEs") which consist of a new Basic Standard and 38 Specific ASBEs. The ASBEs cover nearly all of the topics under the current International Financial Reporting Standards ("IFRSs") literature and has become mandatory for listed Chinese enterprises from 1 January 2007. Other Chinese enterprises are also encouraged to</p>

	<p>apply the ASBEs. These standards are substantially in line with IFRSs, except for certain modifications which reflect China's unique circumstances and environment. In 2009, the MOF implemented sector specific accounting standards for insurance contracts, anticipating the adoption of IFRS 4 by the International Accounting Standards Board (IASB).</p> <p>The assessment of assets and liabilities for solvency purposes leans on EU based solvency I principles, guided by CIRC's regulation and also requires for asset risks to be recognized. Measurement of assets and liabilities for financial reporting purposes is based on Chinese General Accepted Accounting principles (GAAP) which was amended and became effective in 2009 and is rather IFRS compliant. Chinese companies are also reporting under Hong Kong rules and U.S.-GAAP, depending on the listing relevant requirements.</p> <p>In 1999, CIRC initiated the establishment of the Chinese Actuarial Association (CAA). Since 1999, CAA has conducted 15,000 examinations. CAA currently recognizes 200 fully licensed Chinese actuaries and 1,150 associates. There are 76 institutional members and 700 fellow members, of which 400 are fully licensed—including externally licensed. The first actuarial courses were conducted in 1987 at Chinese universities and currently, there are about 20 universities engaged in providing actuarial lectures. CIRC has adopted the concept of appointed actuary. Professional requirements are: actuarial degree for three years, eight years professional experience, and five years of senior management experience. Applicants have to meet CAA's requirements and have to pass exams. CAA then proposes candidates to CIRC and CIRC will then acknowledge the candidates and hand out the actuaries' certificate. This is a rather unique arrangement and grants CIRC oversight in an exceptional capacity.</p> <p>The State Council has responsibility over the compulsory Motor Third Party Liability (MTPL) insurance. State Council also specifies law and issues administrative law. This administrative law has to be converted into regulation through CIRC by the means of Chairman's ordinances or administrative measures and guidance or notes. There is sufficient availability from public sources of economic, social and statistical data relevant to insurance regulation.</p> <p>The PBC was responsible for supervision and regulation of China's insurance sector before 1998. Since its foundation in November 1998, CIRC has been performing its administrative management functions authorized by the State Council, supervising the national insurance market according to laws and regulations, and safeguarding the legitimate and steady development of the insurance sector. The functions of CIRC mainly include the following: supervising domestic life insurance, property insurance, reinsurance, and insurance intermediary markets and insurance assets management; formulating the development strategy, business planning and policies for the insurance sector; developing relevant insurance supervisory regulations; drafting relevant laws and administrative regulations, etc. In addition, as a nationwide self-regulatory organization the Insurance Association of China (IAC) also formulates sector standards and guidelines, under the guidance of CIRC, to regulate the operational practice of insurance entities and promote the openness, fairness and justice of the insurance market.</p>
Assessment	Largely Observed
Comments	<p>The preconditions for effective supervision are largely met. Stronger enforcement is needed to eliminate a general perception of the acceptance of corruption and to minimize unethical behavior in the financial sector. CIRC bureaus have recently been engaged in an active campaign to reduce fraudulent behavior and to enforce ethical behavior of insurance company management and staff.</p> <p>The influence of the Chinese authorities over business development and companies' strategies is potentially hampering the desired growth of the market. China has to resolve the contradiction</p>

	between a controlled market including tight control over the entry and expansion of foreign funded companies and the need to develop the life insurance market to provide sufficient coverage and innovations to facilitate the overall growth of the Chinese markets.
<b>The Supervisory System</b>	
<b>Principle 2.</b>	<b>Supervisory objectives</b> The principal objectives of insurance supervision are clearly defined.
Description	<p>The objectives for effective insurance supervision are consistently defined in a circular on the establishment of the CIRC and in the insurance law, both issued by State Council. The insurance law and the administrative note on the establishment of the CIRC state the main objectives as supervision and management of the insurance sector to maintain an orderly insurance market and to protect the legitimate rights and benefits of policy holders, the insured and the beneficiaries in order to facilitate the healthy development of the insurance sector. Regulations issued by CIRC confirm this set of objectives and contain rules which manifest the ability of CIRC to increase its control levels.</p> <p>CIRC's objective is to contribute to financial stability and to ensure an orderly and open insurance market with fair competition, protect the legitimate rights and benefits of policy holders and other beneficiaries and to facilitate the healthy development of the insurance sector.</p> <p>Where objectives may conflict, i.e., consumer protection and financial stability, priorities are established and sufficiently explained to CIRC's staff. The base insurance law does not contain an objectives clause however a range of objectives are listed on CIRC's web site. However, there is no evidence that CIRC's staff is insufficiently aware of or unclear about IRC's duties and expected contribution.</p> <p>CIRC has developed an Insurance Sector Emergency Response Plan in which deviations from standard procedures and measures are possible. Through that plan, a different prioritization of objectives can be obtained for a limited period. This plan serves also as contingency planning.</p> <p>In the past six years, and particularly since the multiple challenges experienced in 2008, CIRC has increased its efforts significantly to ensure a sound regulatory environment in China. The amount of regulation which has been issued on new aspects such as corporate governance, internal control or suitability of person, demonstrates that CIRC has increased its efforts to transfer broad objectives into operational achievements.</p> <p>In addition to supervision, CIRC also has a mandate to effectively develop the insurance market in an economic sense. Under CIRC's initiative, an insurance association has been established and insurers are addressed annually with recommendations as to how the market could be further developed and what strategy should be executed in the nearer future.</p> <p>The insurance bureaus are given eight main objectives of which the development of the provincial markets ranks highly. The key objectives include: 1) To develop the regional insurance market, 2) Implement regulation and enforce application, 3) Monitor and analyze the insurance market and prevent failures, and 4) conducts local supervision and impose sanctions where necessary.</p>
Assessment	Partly Observed
Comments	<p>CIRC's supervisory objectives are defined in broad terms.</p> <p>Financial stability, consumer protection and fair competition could be translated into operational goals and form the basis for a mission statement of CIRC. That statement could also help new staff to engage more quickly with the authority's tasks.</p>

	<p>CIRC's second objective and related responsibilities for the development of the domestic market (as implemented) are relatively unique for a mainstream insurance supervisor. It was made clear to the assessor that both sets of objectives are seen as being essential to the controlled and sound growth of the sector and the need to supply insurance coverage to consumers and domestic industries. However supervisors are normally expected to support the development of the sector through ensuring a level playing field and adequate and prompt supervision. As such, the more hands on developmental objectives and responsibilities of CIRC are not in line with the ICP.</p> <p>Moreover, the range of commercial and social objectives almost inevitably will lead to conflicts with the supervisory objectives. Possible scenarios include decisions on adequacy of pricing, product design and consumer protection and licensing in the context of regional and social development. The regulatory and commercial objectives each require very distinct mindsets and skills. It is recommended the two mandates be separated and a suitable agency such as a more independent industry association be identified to take ownership of the developmental, commercial and social objectives. This would help to ensure the supervisor has a clear objective and is able to undertake its role without conflict. This would help the government and the industry to understand better the risks to safety and soundness of actions taken.</p>
<p><b>Principle 3.</b></p>	<p><b>Supervisory authority</b></p> <p>The supervisory authority:</p> <ul style="list-style-type: none"> <li>- has adequate powers, legal protection and financial resources to exercise its functions and powers;</li> <li>- is operationally independent and accountable in the exercise of its functions and powers; and</li> <li>- hires, trains and maintains sufficient staff with high professional standards; and treats confidential information appropriately.</li> </ul>
<p>Description</p>	<p>Before 1998, PBC was responsible for supervision and regulation of China's insurance sector. Since its foundation in November 1998 as an Executive arm of the State Council, CIRC has been performing those functions authorized by the State Council. CIRC supervises the national insurance market according to laws and regulations, and safeguarding the legitimate and steady development of the insurance sector.</p> <p>CIRC performs the following tasks: supervising domestic life insurance, property insurance, reinsurance, and insurance intermediary markets and insurance assets management; formulating the development strategy, business planning and policies for the insurance sector; developing relevant insurance supervisory regulations; drafting relevant laws and administrative regulations.</p> <p>CIRC bases its regulatory framework on the base insurance law which serves as a framework law. Part 6 of the revised 2009 Insurance Law (as amended) deals with industry oversight and the powers of the supervisor. This law explicitly provides adequate powers for the CIRC to carry out its functions in the event that an insurer breaches prudential requirements. In addition a large volume of regulations have been issued (especially since 2007) relating to internal controls and governance and a risk rating system installed: this has effectively broadened powers of intervention. Much of this regulation is specified through guidance and its desired application is specified in regulatory notes. CIRC directly supervises non insurance group activities such as controlled asset management companies, although other interested supervisors such as the securities supervisor may also have oversight in their areas of specific responsibility. AML/CTF supervision relies on a joint oversight mechanisms to ensure adequate feedback.</p> <p>CIRC is governed by the chairman and four vice-chairmen. These executives form the board of CIRC. The members of the board are appointed by and can be removed by the State Council.</p>

	<p>The rationale for any replacement shall be published by the State Council. All staff of CIRC, including the board perform their duties as civil servants.</p> <p>CIRC receives its mandate from the State Council, within the scope of relevant governing high level law issued by the People’s Congress. In particular, in addition to its responsibility for financial stability and sound supervision, CIRC is also charged with commercial and social objectives alluding to the development of the insurance market. In addition there has been some movement of staff between the major state controlled insurers and CIRC which, if not subjected to appropriate transition rules, has the potential to compromise its independence.</p> <p>CIRC charges insurance companies 0.8 to 1.7 per mill of net accounted premium for regulatory and supervisory services depending on line of business. The regulatory fee is paid to the MOF. In return, CIRC receives a budget from MOF, based on organizational structure and future activities which are agreed with the State Council. CIRC is free to allocate its resources with the budget it receives, but must seek agreement to any changes in structure and strategy from the State Council.</p> <p>CIRC publishes an annual report in Chinese and English, although the English section is not available on the CIRC web site. However the annual report does not include details of CIRC’s own financials. A comprehensive annual statistical compendium based on Chinese GAAP data is published in Chinese.</p> <p>CIRC’s staff is adequately protected from any incrimination when discharging their duties. CIRC also believes it can attract sufficient talent to fill vacancies and to increase its capabilities. Working for CIRC is attractive due to job safety and general recognition. In 2010, vacancies of 190 staff were advertised and received 10,000 applications. At the end of 2010 CIRC employed 2,466 staff, of which 376 were located at CIRC HQ and 2,090 were located in the 36 insurance bureaus and 5 regional sub-branches.</p>
Assessment	Partly Observed
Comments	CIRC is not legally independent although there is a degree of operational autonomy. The regulatory framework is based on strict policy control, cascading down from the state council to CIRC HQ to the insurance bureaus. The areas of off-site monitoring, inspection, international cooperation, accounting and auditing and the staffing levels of related key units in the major insurance bureaus should be strengthened.
<p><b>Principle 4. Supervisory process</b></p> <p>The supervisory authority conducts its functions in a transparent and accountable manner.</p>	
Description	<p>All regulations are published through CIRC. A formal consultation process is established prior to changes in regulation and procedures and ensures the involvement of stakeholders. The supervisory authority follows statutory procedures as described in relevant laws (the <i>Insurance Law</i>, the <i>Administrative License Law</i> and the <i>Administrative Punishment Law</i>). CIRC has also issued guidelines and established internal processes to ensure a consistent application through its operations. CIRC has also implemented a disclosure practice to publish information on supervisory regulations, operational procedures and administrative sanctions</p> <p>CIRC’s administrative decisions are covered under the <i>Administrative Procedure Law</i>. As such CIRC has the right to act in a timely manner. Special process can be followed in emergency situations and a contingency plan exists. As such, administrative decisions can be challenged in court. However, if CIRC has applied formal processes in an orderly manner, appeals are likely to focus on the legitimacy of the act itself not on the content. There has been no experience of challenged decisions where undue delays were caused.</p>

	<p>Based on the Administrative Reconsideration Law of the People’s Public of China and the Regulations on Implementation of Administrative Reconsideration Law of the People’s Public of China, CIRC conducts administrative reconsideration according to law for specific administrative acts of the insurance supervisory authority. CIRC formulated Measures of CIRC on Administrative Reconsideration to clearly define the scope, application, acceptance and decision of administrative reconsideration and relevant legal liabilities to prevent and rectify illegal or inappropriate specific administrative acts, protect the legitimate rights and interests of citizens, legal persons and other organizations, safeguard and monitor the insurance supervisory authority to execute its duties according to law.</p> <p>A comprehensive annual report is published and freely available. Moreover, CIRC also regularly publicizes its achievements, plans and performance.</p> <p>The vast majority of regulations are rules based and accompanied by exact specifications on how CIRC expects the rules to be applied and how processes within the company should be established. This is consistent with the development approach China takes on its financial sector. This rules based approach aims to ensure a safe and sound path of development and reflects the desire of CIRC to control all relevant aspects of how insurance business is conducted in China. Interviews with insurance companies, domestic and Joint Ventures, confirmed that regulatory considerations are imposing considerable overhead expenses. CIRC’s regulatory processes are seen to be time consuming and are regarded as “cumbersome” by the industry. CIRC’s own resources are barely adequate to execute its own tasks and will be under constant stress to analyze the received information and to further develop important parts of the supervisory system such as the solvency regime and the risk based supervisory monitoring of companies.</p>
Assessment	Largely Observed
Comments	<p>At this time in the development of the sector the rules based approach for supervision undertaken by CIRC is appropriate and it is not recommended that CIRC should shift to a principle based system. In fact, interviews with staff and industry, including auditors and actuaries, have confirmed that the prescriptive system currently corresponds to the business culture in China. This should be reexamined going forward to determine the feasibility and appropriateness of the rules based approach as the industry continues to change. In addition, in the future it will be necessary to consider the potential impact on the CIRC which under the rules based system requires staff sufficient to undertake the labor intensive processes. Albeit that staff for CIRC will have to increase under both a rules and principles based system, staffing levels will need to be increased substantially under a rules based system in order to adequately manage the expected enormous size of the market and the diversity of the provinces and market players.</p>
<b>Principle 5.</b>	<p><b>Supervisory cooperation and information sharing</b></p> <p>The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.</p>
Description	<p>Within China, the Insurance Statistics Information System enables information sharing among CIRC headquarters and its 35 insurance regulatory bureaus. CIRC and the other financial sector regulators have established an information sharing mechanism. In June 2004, China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC) and CIRC signed a Memorandum of Understanding (MOU) under which duties were clarified and a periodical information and communication system established. A working party of the three heads of the regulatory body meets on a quarterly basis to discuss relevant issues and ensures appropriate level of information about the respective sector.</p>

	<p>CIRC has engaged in various agreements under which it can share information domestically with other regulatory bodies—in the HKSAR and Macao—and internationally with national supervisors such as National Association of Insurance Commissioners (NAIC) and the IAIS. Confidentiality aspects are considered within the signed agreements.</p> <p>China does not apply a home-host supervisory system yet. All licensed companies are subject to full and independent supervision through CIRC. Hence, criteria e., g., h., I, and j. are not applicable. However, CIRC has established contact with supervisors of those companies which have a branch or subsidiary established in China and do belong to an international insurance group, i.e., Istituto per la Vigilanza sulle Assicurazioni Private e di Interesse Collettivo (ISVAP), Italy for General China.</p>
Assessment	Observed
Comments	The information sharing with authorities exists on an as-needs basis. It is recommended to establish information sharing in a pro-active manner and to provide those authorities supervising insurance groups with related business in China with information on the Chinese market on a regular basis. Reciprocally, CIRC should ask for respective information.
<b>The Supervised Entity</b>	
<b>Principle 6.</b>	<b>Licensing</b> An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.
Description	<p>All insurance licenses are granted for a specific province and are granted by CIRC HQ with sufficient involvement of its respective insurance bureau. The thoroughness of the licensing process reflects its level of control over the development of the insurance market. Separate licenses are required to open new branches within China.</p> <p>The insurance companies are defined in Article 3 of the insurance law. Further regulation has been issued by CIRC to specify additional requirements. Those are the Regulations on the Administration of Insurance Companies and the Implementation Measures for Administrative Licensing of the CIRC.</p> <p>Unauthorized insurance activity is prohibited. The insurance law also states the permissible forms of an insurance company to be either a limited liability company or joint stock limited company. Foreign funded companies can only apply for a Personal Lines license through a Joint Ventures (JVs) with a registered Chinese company. Foreign funded companies can apply for a General Lines license but will not be allowed to write MTPL business.</p> <p>CIRC introduced the separation of Life and General Lines business in 2003 and requires separate licenses to conduct the respective lines of business.</p> <p>The stated licensing criteria are clear, objective and transparent. Article 68 of the Insurance Law requires shareholders to have a sustainable capability to make profits, have a sufficient credit standing, no records of material violation of law or regulation in the past three years and have a net assets value of no less than 200 million RMB.</p> <p>An applicant must forward bylaws (articles of association ) in compliance with the insurance law. Due to the strong emphasis on corporate governance, the requirements on those bylaws are very specific and detailed. The bylaw ensures that adequate committees on risk-management, compliance, internal control and compliance are set up.</p> <p>An applicant must also demonstrate sufficient funds and the necessary management structure, comprising the Board of Directors (executives and non-executives) and a Supervisory Board as well as skilled resources for the key functionaries. Existing businesses, when applying for a license, have also to provide audit reports for the last three years to confirm the applicant's</p>

	<p>general ability to generate profits, a confirmation that sufficient funds are reserved for the launch of the new operation.</p> <p>The application extends to a viable business plan including a forecast for the period of three years, a projection of respective solvency requirements and must also contain references to infrastructure, such as Information Technology (IT) and premises.</p> <p>Since the licensing process is very thorough and consumes considerable time, the application process foresees a license granted on probation. Within the probation period, the applicant can forward missing documents and evidences required by the CIRC.</p> <p>The separate formation of an insurance company and the granting of an insurance operating license is not made clear in the insurance law (Article 67 through 73), although it is clear from Section 6 of the law that separate licenses are involved and that an insurer may continue to operate even if defined lines of business may no longer be written.</p> <p>When international or foreign-funded insurance companies apply for a license, CIRC consults with the respective supervisory authority to investigate the appropriateness of the applicant.</p> <p>There is a perception that the application for a license to establish a branch as a foreign funded company is consuming considerably more time than the issuing of a license for a domestic applicant. Any difference in licensing processes would not be in accordance with the application of the principle.</p> <p>Since 2007, CIRC has issued 21 licenses for insurance companies and has approved 7,543 branches.</p>
Assessment	Partly Observed
Comments	<p>The licensing process should not be restricted only to controlling the market entry of insurers but must also facilitate changes of insurers' strategy and ability to underwrite business. The branch licensing process should also be applied on a more consistent basis with greater clarity as to how the rules are being applied.</p>
<b>Principle 7.</b>	<p><b>Suitability of persons</b></p> <p>The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.</p>
Description	<p>In 2009, CIRC redefined and strengthened its requirements on the suitability on executives and key personnel. The amended Insurance Law also alludes to the appropriateness of key functionaries and requires insurance companies to demonstrate suitability of shareholders.</p> <p>CIRC also drafted a regulation on <i>Administrative Measures on Equity Interest of Insurance Companies</i>, which is aimed at regulating shareholders acts and is publicized for social opinion. Relevant regulation such as the <i>Administrative Rules on Appointment Qualification of Directors, Supervisors and Senior Management of Insurance Companies</i>, the <i>Administrative Measures for Chief Actuary of Insurance Companies</i>, and the <i>Administrative Measures for Financial Head of Insurance Companies</i>, etc. addresses the suitability of person comprehensively.</p> <p>The appropriateness of personnel is ensured at three levels:</p> <p>On market entry. CIRC requires certain qualifications for key functionaries working on investment and capital markets, risk management and actuarial issues. As part of the licensing process a list of Directors, senior management has to be provided together with proof of acceptance.</p> <p>Ongoing supervision. Changes on shareholdings and on key functionaries have to be reported to</p>



	<p>CIRC. The <i>Insurance Law</i> grants authority to CIRC to monitor shareholders' activities of insurer owners and key functionaries and to object to changes if necessary.</p> <p>Enforce maintenance of ownership. CIRC maintains the right to force the removal of the responsible functionary from the position but also the right to insist that key functionaries are not replaced for as long as no adequate successor is been presented.</p> <p>The insurance law also states sanctions for key functionaries, including warning, fines, withdrawal of qualification, even disallowance of future acceptance for senior positions in the insurance sector.</p> <p>Since 2007, CIRC has approved approx 510 positions of board members and directors and approx. 26,100 for key functionaries.</p>
Assessment	Observed
Comments	<p>An insurance company has to apply for approval before changing its external auditor. In doing so, only the firm but not the responsible partners name will be submitted to CIRC. Without further inquiries, CIRC would not be aware of a potential mismatch between the complexity of the insurance company and the experience of the responsible auditor. It is recommended, that CIRC should request more detailed information on the background and function of the external auditor. Such approach would be more in line with the general attitude to control within the regulatory approach.</p> <p>CIRC maintains high requirements for the suitability of key personnel. The growth of the insurance market and the demand for highly qualified and experienced management skills should be monitored. Further development of the market should not be limited by the supply of suitable personnel or worse, lead to undesirable compromises. Hence, CIRC should ensure that a general awareness exists on the need of suitable output from universities and professional bodies and should encourage insurers to facilitate adequate training courses.</p>
<b>Principle 8.</b>	<p><b>Changes in control and portfolio transfers</b></p> <p>The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.</p> <p>The supervisory authority approves the portfolio transfer or merger of insurance business.</p>
Description	<p>The process under which a change in control is supervised is thorough and comprehensive. The insurance law and other regulations clearly define thresholds and also express CIRC's high standards on the issue.</p> <p>Control is defined in the Insurance Law: controlling shareholder refers to a shareholder whose capital contribution occupies 5 percent or more in the total capital of a limited liability company, a shareholder whose stocks occupies more than 50 percent of the total equity stocks of a joint stock limited company, or a shareholder whose capital contribution or proportion of stock is less than 50 percent but who enjoys a voting right which, according to its capital contribution or the stocks it holds, is large enough to impose a big impact upon the shareholders' meeting or its resolutions. As the "control over an insurer" complies with the aforesaid definition, the insurance regulations do not provide further definition.</p> <p>The CIRC examines and approves transactions involving change of over 5 percent equity interest of an insurer, and records change of less than 5 percent of equity interest. If a potential transferee with no more than 5 percent of equity interest (including associated parties) can possess over 5 percent of equity interest through purchase of additional share offering or share transfer, it should apply to the CIRC for approval. In order to invest in insurers, foreign financial equity is required to submit an opinion letter issued by the home supervisory authority to the</p>

	<p>CIRC.</p> <p>During the process of change in equity interest, the shareholder to hold control should meet the following requirements: having sustainable profit-making capability, good credit standing, no record of major violations of laws or regulations in the last three years, net assets value not less than 200 million Yuan, and should be approved by the CIRC. After the change in equity interest, the newly added board member and senior management of the controlling shareholder should meet qualification requirements and be submitted to the CIRC for approval.</p> <p>CIRC pays special attention to change in control where foreign funded insurance companies are affected. For General Lines business, foreign funded insurers must present a Chinese registered company as a partner. There have been numerous changes of Chinese partners in life insurer JVs, due to the unexpectedly long period it takes to reach breakeven and the opportunity cost of capital.</p> <p>China has not yet developed insurance specific regulation under which a portfolio transfer can be facilitated although division and merger are clearly contemplated by the <i>Insurance Law</i>. During the assessment, various interviews with CIRC, insurance companies and accounting firms revealed that a shortfall in this area had not previously been identified. It stands to reason, that in case a portfolio transfer becomes necessary, CIRC would quickly respond with adequate regulation to this problem. However, the orderly development of insurance supervision and the protection of policyholders and beneficiaries require a clear and enforceable framework under which a transfer of portfolio must be approved by CIRC.</p>
Assessment	Partly Observed
Comments	<p>CIRC must develop a suitable regulation to facilitate the transfer of portfolios. Specific attention must be given to the transfer of liabilities, the adequacy of reserves and technical provisions, the ability of the recipient of the portfolio to meet requirements on suitability, license and internal control. A transfer should not dependent upon the acceptance of policyholders or beneficiaries but timely notification of the intended transfer should be provided to them. A transfer of life insurance business should require the separation of the existing life policy business from the transferred business in the recipient's company.</p>
<p><b>Principle 9. Corporate governance</b></p> <p>The corporate governance framework recognizes and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.</p>	
Description	<p>CIRC has issued substantial regulations to support the overall importance of corporate governance for the supervisory process. Next to the solvency regime and market conduct, corporate governance is the main foundation of the supervisory framework in China.</p> <p>All insurers have to comply with well defined corporate governance principles, laid out in the <i>Company Law</i>, the <i>Insurance Law</i>, and the <i>Guiding Opinions on Regulations of Governance Structure of Insurers</i> and supportive regulatory documents. The compliance status is monitored through supervisory interviews and on-site and off-site inspections. Insurers have to provide progress reports in which compliance with recently issued requirements and guidelines are covered.</p> <p>Corporate governance regulation includes specifications in the <i>Company Law</i> and the <i>Insurance Law</i>. CIRC also issued a series of regulatory documents, such as the <i>Guiding Opinions on Governance Structure of Insurance Companies</i>, the <i>Operation Guidelines on Board of Insurance Companies</i>, and the <i>Opinions Concerning Regulation of Articles of Associations of Insurance Companies</i>. Regulation covers the rules of management, control structures and requires the establishment of specific committees to oversee compliance, risk management, investment, actuarial adequacy and remuneration. In accordance with the requirements, insurers</p>

	<p>establish rational structures of corporate governance according to their respective size. Joint stock companies are also subject to requirements set by the securities regulator and therefore have to establish a board of directors and a supervisory board.</p> <p>CIRC assesses compliance through interviews, approval of the articles of association (by-laws of the company), qualification reviews, on-site and off-site inspections and issues a risk warning letter or supervisory notice to urge insurers to improve compliance.</p> <p>CIRC requires insurers to clearly define responsibilities for the board of directors, formulate operational rules for senior management, identify the responsibilities of senior management, and clearly define the relations between the board of directors and the senior management whereby the general manager takes full responsibilities for daily operational management for the company and his or her responsibilities will not be reduced or exempted due to the duties of other senior management members.</p> <p>In 2008, CIRC issued guidelines on remuneration policies under which it is required to formulate a reasonable compensation policy. The <i>Notice on Issues Concerning Remuneration of Senior Management of Insurance Companies in the Year</i>, requires the remuneration of senior management of insurers should be linked to the developmental level of the industry, corporate operation status and personal performance to prevent unreasonable remuneration and excessively high remuneration.</p> <p>In 2009, CIRC implemented a risk-weighted classification of insurance companies. The rating is largely influenced by financial performance, solvency position and the compliance with corporate governance and internal control.</p> <p>Most of the recently issued regulations on corporate governance are issued as guidance and are not strictly legally binding. However, interviews with insurers and accounting firms have shown that the importance of governance and the emphasis of CIRC are clearly understood by all insurers. Moreover, the impact of governance on the classification system is another incentive to meet all regulatory expectations.</p>
Assessment	Largely Observed
Comments	<p>CIRC has issued sufficient regulation to ensure that corporate governance is recognized as one of the key fundamentals of the Chinese supervisory framework. Given the size of the country itself, the size of the market (already large at this early phase of its development) and the low quantity of insurance companies, regulating governance and enforcing its application is paramount to a sound and safe market environment.</p> <p>Preparatory research for this mission, interviews with insurance companies and further conversations have raised concerns on the robustness of the system against corruption, including bribery. It is believed that a stronger effort to reduce corruption is needed. This would especially address the distribution of insurance products, the handling of insurance claims, general trustworthiness of the legal system, accessibility of courts and protection of consumer rights.</p>
<b>Principle 10.</b>	<p><b>Internal control</b></p> <p>The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.</p>
Description	Regulations on internal control comprises the Insurance Law, Guiding Opinions on Corporate Governance of Insurance Companies, Internal Control Assessment Methods for Life Insurance Companies (For Trial Implementation), Notice on Matters Concerning Classified Supervisory Information Reporting, Notice on Related Issues Concerning Strengthening the Internal Control Construction and Increasing the Internal Control Enforcement of Property Insurance Companies

and others.

The regulations are very comprehensive and rules based. Where guidelines and notices are issued, CIRC clarifies in further correspondence how it expects the rules to be implemented and what control mechanisms are to be in place. CIRC also expects a progress report regularly. CIRC carries out inspections on internal control, driven by the risk weighted classification. CIRC responds through a risk indication letter or regulatory letter to insurers with insufficient controls demanding timely improvements.

In 2009, CIRC issued a Guidance Opinion on the Accountability Investigation of Insurance Institutions. These require insurers to establish and improve their systems for accountability in all relevant parts of the organization. Accountability needs to be defined, documented and needs to be reported back to CIRC. Insurers are also required to submit a self-assessment on their control mechanisms annually.

Chief Actuaries must participate in risk management, product development and asset and liability management. Where deemed necessary, CIRC can require the Chief Actuary to confirm the report on internal control.

The ultimate responsibility for internal control lies with the board of directors. The board is responsible for ensuring the prudent operations of the insurer within the framework of laws and policies. CIRC requires companies to ensure that written reports are submitted to the directors and managers when internal control deficiencies are discovered by continuous monitoring, independent assessment and inspections. Rectification should be carried out in time and the implementation is supervised in order to increase the effectiveness of the internal control system continuously.

The risk management department of an insurer should submit risk assessment report to senior management and the board of directors at least annually. The risk assessment report mainly contains

- risk management organizational system and basic process;
- overall risk management strategy and its implementation status;
- various risk assessment methods and results;
- forecast on major risk incidents and future risk status; and
- suggestions on risk management improvement.

CIRC requires insurers to establish systems, policies and procedures to ensure the integrity of the financial accounting and reporting systems and of all IT-supported system and also has requested insurers to produce contingency plans.

CIRC has not developed regulation to facilitate outsourcing activities of insurance companies. At licensing, CIRC investigates the operational capability very thoroughly and interviews with insurance companies have shown that changes to the operation would be discussed with CIRC's bureaus in advance. Moreover, there seems to be little infrastructure for outsourcing activities.

CIRC has also established clear regulation on the internal audit function. The audit committee has to

- examine the basic internal auditing system propose suggestions to the board of directors, and approve the annual corporate audit plan and audit budget;
- assess the performance of the chief auditor and propose suggestions to the board of directors;
- lead the internal auditing practice and supervise the quality of internal auditing;
- provide suggestions to the board of directors on the contracting of external auditors;

	<ul style="list-style-type: none"> <li>• coordinate internal auditing and external auditing functions;</li> <li>• regularly inspect the appropriateness and effectiveness of internal controls and resolve disputes concerning major internal control issues in a timely fashion;</li> <li>• oversee rectification and implementation of major problems discovered in internal and external auditing activities; and</li> <li>• perform other tasks designated by the board of directors.</li> </ul> <p>The internal auditing function should not be interfered with or influenced by other departments. The insurers are encouraged to conduct centralized or vertical management arrangements for internal auditing.</p> <p>While an excellent regulatory structure has been developed there has been a history of internal controls breaking down (e.g., various life insurance mis-selling issues) and it is too early to establish that the implementation stage has been a complete success.</p>
Assessment	Largely Observed
Comments	<p>The focus on internal control is rules based and sufficiently detailed. Reports to CIRC, both HQ and bureaus, are regularly and timely. Minutes of the various committees are submitted and analyzed.</p> <p>CIRC could consider asking external auditors to include in their regular audits an inspection of the risk managements systems and the internal control procedures at least for the large companies, where a full scope inspection cycle of 5 year might be too infrequent.</p>
<b>Ongoing Supervision</b>	
<b>Principle 11.</b>	<p><b>Market analysis</b></p> <p>Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws the conclusions and takes action as appropriate.</p>
Description	<p>Macro-economic data is submitted to CIRC from the MOF, the State Council and the Statistics Bureau of China. CIRC uses this data to produce forecasts and analyze trends relevant to the insurance market. This includes financial trends, demographics and socio-geographic trends.</p> <p>CIRC requires information from its insurers monthly, quarterly and annually. Monthly submission is unaudited and is comprised of, financials, technical performance and investment data. The account level information required is not far removed from original documents and leads to substantial data transmissions. The quarterly submission extends to unaudited information on solvency levels and operational information. The annual submission extends to the audited annual reports, the auditor’s management letter (which often includes a management report) and auditing reports. It is unclear to what extent the amount of monthly submitted data can actually be meaningfully analyzed in time. Especially since data on technical performance usually does not vary significantly in that short time.</p> <p>CIRC holds at least one insurance supervisory meeting each year to summarize and review its insurance supervisory work, both by quantitative analysis (market inspection, consumer complaint, and solvency, etc.) and qualitative analysis (soundness, effectiveness and efficiency of supervision, etc.), based on which CIRC proposes the supervisory thoughts and priorities for the following year.</p> <p>CIRC discloses the monthly and annual operational data (classified by operational body and administrative region) and quarterly development report of the insurance intermediary market on its official website in a timely order. CIRC compiles and publishes <i>China Insurance Almanac</i> and <i>Annual Report of the Chinese Insurance Market</i> etc. each year which provide detailed analysis and study of the business operations and development trends of the insurance industry</p>

	<p>in the previous year.</p> <p>CIRC pays close attention to and makes analysis of the macro data, especially for those macro trends likely to exert a major influence on the insurance market, e.g., the benchmark interest rate of the central bank, the interest rate of domestic bonds, and the trend of capital market, etc. In addition, CIRC is deeply concerned with the developments and trends of the international insurance market, the international financial market and other major insurance markets on a global basis.</p>
Assessment	Observed
Comments	The monthly submission required by CIRC is very substantive in size and level of detail. It is unclear to what extent the amount of data can actually be meaningfully analyzed in time: especially as data on technical performance usually does not vary significantly in that short a time period. CIRC should consider whether the monthly submission should be significantly reduced. Certain technical performance data could be required on a quarterly basis as is already the case for reinsurers.
<b>Principle 12.</b>	<b>Reporting to supervisors and off-site monitoring</b>
	The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.
Description	<p>CIRC regularly receives very comprehensive financial and technical data from the insurance companies. Insurers submit required data through a defined electronic interface and CIRC receives all data electronically. The ability to submit data electronically is a prerequisite to obtaining a license. Through this routine, substantial data consistency and plausibility checks are ready applied. As laid out under ICP 11, some of the standardized monthly reporting requests may be too detailed and could more appropriately become part of ad hoc additional requirements in the event an insurer adversely changes its risk status.</p> <p>Regulation on supervisory reporting include <i>Insurance Law, Regulations on the Administration of Insurance Companies, Notice on Printing and Issuing Insurance Statistical Indicators</i> (No. 85 [2004] of CIRC), <i>Notice on Starting to Use China Insurance Statistical Information System</i> (No. 123 [2004] of CIRC), <i>User's Guide to China Insurance Statistical Information System, Regulations on Off-site Supervision of Life Insurance Companies (For Trial Implementation)</i> (No. 5 [2005] of CIRC), <i>Guide to Off-site Supervision of Life Insurance Companies, Guidebook to Supervision of Non-life Insurance Companies, Administrative Provisions on the Solvency of Insurance Companies (Order No. 1 of 2008), Notice on Printing and Issuing Actuarial Reporting Standards</i> \ (No. 119 [2007] of CIRC), <i>Solvency Reporting Standards</i> (No. 1–16) and its Q&amp;A herein, <i>Notice on Related Matters Concerning Implementation of Classified Supervision of Insurance Companies</i> (No. 120 [2008] of CIRC), and <i>Notice on Analysis Reporting of Monthly Operations</i> (No. 47 [2009] of CIRC), etc.</p> <p>CIRC's uses supervisory reporting for off-site monitoring. A risk-weighted classification system was implemented in 2009. The classification systems ranks each insurer between A (good performance, no action required) to D (immediate action required). The classification is influenced by the following criteria:</p> <ol style="list-style-type: none"> <li>1. Solvency level.</li> <li>2. Corporate governance, internal control and general compliance.</li> <li>3. Asset management and Risk exposure to capital markets.</li> <li>4. Technical performance, including Growth, premium receivables, levels of IBNR, lapse ratio, and reserving level.</li> <li>5. Financial performance, including: Core operating ratio, cash-flow analysis, return on equity and overall profitability.</li> </ol>

	<p>The factors 1–5 are weighted according to importance and risks associated. Each company receives a grade between A and D.</p> <p>CIRC has established a solvency committee. It consists of the vice-chairmen and General Managers of CIRC. This committee receives the full report for all companies and decides on individual supervisory responses for each company in either band C or D. The solvency committee will subsequently order one or more of the property, life and inspection department to implement the action plan agreed upon by the solvency committee. CIRC’s department reports back to the solvency committee on the progress for each individual company. At the time of the assessment, 12 companies were in either category C or D.</p> <p>CIRC also uses other reported information to assess the insurance companies and to use this information to decide whether on-site inspections are needed. Off-site monitoring involves both CIRC HQ and the bureaus. This information extends to financial condition and performance, including financial information on any subsidiary of the insurance company. For that, CIRC has also set out the reporting format and definitions regarding accounting and consolidation techniques, the valuation method for assets and liabilities and the recognition of off-balance sheet exposures.</p>
Assessment	Observed
Comments	<p>CIRC has established a comprehensive classification system and can now allocate supervisory resources efficiently according to the risk profile of each supervised entity. The criteria within the classification system could be further enhanced to also reflect the technical performance of life business through the usage of embedded value accounting. Moreover, impact and probability of risks should be better reflected.</p>
<p><b>Principle 13. On-site inspection</b>  The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.</p>	
Description	<p>CIRC is empowered to conduct on-site inspections of insurance companies, insurance agents, insurance brokers, insurance asset management companies and representative offices of foreign insurance institutions. On-site inspections are carried out under the authority of CIRC and may use external resources, mainly technical specialists and accountants. CIRC also conducts on-site inspections to verify the accuracy of the information regularly received from the insurance companies and to verify whether regulatory procedures have been implemented. Normally, the inspection cycle comprises a period of five years. The full scope program is planned annually based on market conditions and the off-site solvency and statistical data.</p> <p>Outsourcing of operational functions is not a material feature of the market in China. A number of large domestic insurers have associated asset management companies and these are subject to full oversight by the supervisor.</p> <p>CIRC has laid out processes under which on-site inspections shall be conducted (<i>Working Procedures of CIRC on On-site Inspections</i>). The inspection team is required to list the conclusions of the inspection in a confirmation letter of on-site inspections. The letter is addressed to the senior management of the inspected company and should contain the discovered facts and problems and also give suggestions on rectification. The inspected company is required to comment on the confirmation letter within 10 days. Based on this response, CIRC decides on the final correction plan and informs the inspected company. Normally, a period of 12 months is given to implement the agreed rectification plan. A second report referring to sanctions and fines is reviewed by the Administrative Penalties Committee.</p> <p>In 2008, the inspection bureau was set up as a new department of CIRC HQ. The department now has 19 staff and oversees the inspection process. Its task is to manage and coordinate full</p>

	<p>scope on site inspections (limited scope on site inspections are handled by the Property and Life Departments) with support from the insurance bureaus in the provinces.</p> <p>On their return to CIRC the team writes 2 reports—one on administrative penalties and the other on problems identified for rectification of the findings. Under the separation of inspection and penalty doctrine the penalties report is reviewed by a Sanctions Committee.</p> <p>Between 2007–2009, CIRC conducted 22 on-site inspections; of which three were full scope. Inspections from insurance bureaus to regional offices of insurers were regularly conducted and comprised 1271 visits in 2007, 2214 in 2008 and 2371 in 2009.</p>
Assessment	Largely Observed
Comments	The number of full scope on-site inspections seems low given the size of the sector and the current challenges. However resources to achieve this seem to be inadequate. On-site inspections should also be used to verify whether assumptions made off-site turned out to be accurate and there are merits in concentrating inspections in one department. However, the experience and understanding of how the insurance company operates and what its processes and business model are, is very important for all of CIRC’s staff involved in the operational supervisory process.
<b>Principle 14.</b>	<b>Preventive and Corrective Measures</b>
	The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.
Description	<p>CIRC processes clearly indicate that it pays specific attention to prevention. The supervisory reporting is analyzed automatically and generates forecasts and trends which are deferred to supervisors for further action. This includes monitoring technical performance through reserving levels and performance ratios, solvency levels which are reported on a static level but are also subject to agreed and plausible growth scenarios.</p> <p>Preventive measures include regulatory interviews with the auditors, directors, supervisory board and senior managers of the insurer where insurers are required explain issues on its insurance business operation, risk control and internal management. CIRC can request programs for rectification to be submitted. Those programs normally involve.</p> <ul style="list-style-type: none"> <li>• Plans to increase capital before solvency margins are breached;</li> <li>• Restructuring the business;</li> <li>• Restricting the payment of dividends to shareholders;</li> <li>• Restricting the purchase of fixed assets or the scale of operation costs;</li> <li>• Restricting the establishment of new branches;</li> <li>• Restricting the level of salaries of directors, supervisors and senior managers; and</li> <li>• Ordering a stop of accepting new business.</li> </ul> <p>CIRC is also empowered to order an insurance company to make correction(s) within a prescribed time limit, and may order it to change key functionaries of senior management.</p> <p>The <i>Insurance Law</i> is the main foundation for CIRC to carry out administrative penalties. It stipulates the penalty measures for illegal practices concerning marketing, product, financial safety, asset management, and business expansion, etc. The types of penalties include warning, imposing a fine, restricting business scale, ordering a stop of accepting new business and revoking business permit, etc.</p> <p>The insurance law foresees an escalation process. Where an insurance company fails to make correction within a prescribed time limit after CIRC may decide to send in insurance professionals and appoint suitable persons of the insurer to form a rectification team. A</p>



	<p>rectification decision letter shall list the reasons for rectification, the members of the rectification group and the period of rectification. This letter will be made public. An insurance company will be governed by CIRC when either the company is seriously insolvent; or the company damages the public interests in violation of the insurance law.</p> <p>The business culture and the level of control exercised by CIRC clearly articulate that insurance companies should avoid breaches of regulation at all costs.</p> <p>As stated under ICP 23, the assessment revealed insufficient application of corrective measures based on the solvency levels of companies.</p>
Assessment	Partially Observed
Comments	The prevention process is thorough but corrective action is largely based on solvency measures and there is evidence of regulatory forbearance. It almost contains more rules than needed given the business culture explained above and has to be enforced in all areas, especially the prudential principles need to be enforced more rigorously.
<b>Principle 15.</b>	<b>Enforcement or sanctions</b>
	The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	<p>The insurance law enables CIRC to execute effective supervision. CIRC can enforce the regulation without undue delay and without authorization from other agencies. As described in ICP 14, the CIRC can apply a formal structure of prompt action to enforce its regulation.</p> <p>CIRC explicitly can enforce sanctions where the insurance company:</p> <ul style="list-style-type: none"> <li>• uses irregular policy wording or unapproved premium rates;</li> <li>• fails to draw or carry forward the technical reserve;</li> <li>• fails to conduct reinsurance as required or seriously violates the provisions on asset management;</li> <li>• breaches the solvency requirements, CIRC shall order transfer of insurance business, an increase of capital or restrict the forms and percentage ceiling in asset management; and</li> <li>• damages the public interests in violation of <i>Insurance Law</i>, which may seriously endanger or has seriously endangered the solvency of the company.</li> </ul> <p>The <i>Insurance Law</i> is the main foundation for CIRC to carry out administrative penalties. CIRC is entitled to sanction senior management and individual directors. The punishment measures include warning, imposing a fine, cancelling post-holding qualifications or work eligibility and prohibition from entering the insurance industry.</p> <p>The administrative penalties imposed by the insurance supervisory authority are regulated by <i>Administrative Punishment Law</i>. In addition, CIRC has issued <i>Procedures of CIRC for Administrative Punishment</i>, which regulates the procedures for investigation, defense, hearing the evidence and decision at length when the insurance supervisory authority implements administrative punishments and therefore, ensures the impartiality, transparency and justice of administrative sanctions.</p> <p>In the years 2007 to 2009 CIRC issued fines in the range between 830 to 976 and imposed fines between RMB 305 million and 484 million.</p>
Assessment	Observed
Comments	

<b>Principle 16. Winding-up and exit from the market</b>	
The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.	
Description	<p>The legal and regulatory framework clearly defines three conditions where an insurer is forbidden to continue operating insurance business.</p> <ul style="list-style-type: none"> <li>• the insurer is bankrupt, the insurer is seriously insolvent and seriously endangers the order of the insurance market and damages the public interests; and</li> <li>• the insurer seriously violates other provisions of other Chinese law and such violations have been stated in the corresponding clauses of the <i>Insurance Law</i>.</li> </ul> <p>Upon the application or approval of CIRC, the court may subject the insurer to bankruptcy liquidation if the insurer is under the circumstances as prescribed in <i>Enterprise Bankruptcy Law</i>. The bankruptcy procedures of the insurer must comply with relevant regulations of the <i>Enterprise Bankruptcy Law</i>. The procedures for the insurer to dissolve follow the relevant regulations of <i>Insurance Law</i> and <i>Regulations on the Administration of Insurance Companies</i>.</p> <p>A high legal priority is given to the protection of rights and entitlements of policyholders and other policy beneficiaries in the event an insurer becomes bankrupt or is insolvent. Those rights include , priority to compensation or insurance premium in bankruptcy liquidation procedure; for life business, policies, liabilities and technical reserves must be transferred to another life insurer; where an insurer is cancelled or announced bankrupt, the insurance guarantee funds shall be used to the benefit of the policyholder or beneficiaries.</p> <p>The law allows for voluntary exit from the market (Article 90) subject to CIRC approval. Life insurers must be voluntarily wound up either by merger or portfolio transfer. Portfolio transfers are permitted provided the transferee insurer’s solvency is not adversely affected, although there is no requirement that such action be in the interests of the policyholders of either company. However detailed regulations are still to be issued to deal with voluntary mergers, portfolio transfers or, for non life insurers, run off.</p>
Assessment	Partly Observed
Comments	<p>Regulation is required to facilitate voluntary exit from the market via portfolio transfer, merger or (in the case of non life insurance) run off. This is becoming more important as a number of foreign insurers need to rationalize holdings in PBC both for strategic reasons and following the introduction of the single insurer rule.</p> <p>Portfolio transfers should be subject to actuarial clearance and supervisory approval but not policyholder approval. A largely observed would have applied if voluntary exit were not an important current issue.</p>
<b>Principle 17. Group-wide supervision</b>	
The supervisory authority supervises its insurers on a solo and a group-wide basis.	
Description	CIRC carries out supervision and administration over insurance group companies. CIRC has also established sound regulation on the basis of <i>Administrative Measures on Insurance Group Companies (for Trial Implementation)</i> . This regulation was implemented in 2010 and its effectiveness will be reviewed in 2012. However, the regulation will not expire but remains in force until further notice.

*Administrative Measures on Insurance Group Companies (for Trial Implementation)* defines an insurance group and also a financial conglomerate: two or more of the subsidiaries are insurance companies and insurance is the main business of the conglomerate. Insurance group companies are approved by CIRC and registered as “insurance group” or “insurance holding” companies. They directly or indirectly control, jointly control or significantly influence its member companies. Member companies are group companies and the companies that are directly or indirectly controlled, jointly controlled or significantly influenced by the group company. The *Measures* specifies the outbound investment, corporate governance and capital requirements of insurance group members and therefore regulates insurance groups as a whole. The *Measures* cover all members in an insurance group. The capital requirements of an insurance group have to be met as well as all individual requirements of the single entities.

CBRC, CSRC carry out supervision and regulation on the banking and securities industries in China according to relevant laws, regulations and the authorization of the State Council. In June 2004, CIRC signed with CBRC and CSRC the Memorandum of Cooperation and Work Division Concerning Financial Supervision to clarify the supervisory work on financial groups. The parent companies of the financial groups, according to their business nature, are subject to the supervision of corresponding supervisory authorities. The relevant institutions and business of the financial groups, according to their business nature, are subject to the supervision of corresponding supervisory authorities.

The CBRC, CSRC, and CIRC, established a cooperation mechanism to prevent supervisory gaps. In 2003, CIRC set up a joint supervisory meeting system with CBRC and CSRC to coordinate supervisory policies, share supervisory information and enhance supervisory cooperation. CIRC signed with CBRC and CSRC *The Memorandum of Cooperation and Work Division Concerning Financial Supervision* to clarify the supervisory work on the existing financial groups. CIRC signed with CBRC *The MOU on Strengthening In-depth Cooperation between Banking and Insurance Sectors, and Trans-sector Supervisory Cooperation* to clarify supervisory cooperation between the two supervisory authorities.

*The Administrative Measures on Insurance Group Companies (for Trial Implementation)* specifies entry requirements, internal control system, capital management, risk management, and information disclosure of the insurance group company. Some other regulatory rules published by the CIRC also specify issues related to risk control of the insurance group.

In recent years, CIRC has been actively cooperating with foreign supervisory authorities to strengthen supervision on transnational insurance groups and prevent transnational transmission of insurance risks through signing different kinds of cooperation documents. CIRC has signed MOUs on cooperative supervision with the United States, Germany, Singapore, Korea, Hong Kong, Macao, and other countries and regions. CIRC has also signed Exchange of Letters on cooperative supervision with the Financial Services Authority (FSA) U.K.

*The Administrative Measures on Insurance Group Companies (For Trial Implementation)* regulates information disclosure including contents, methods and time limits on information disclosure of insurance groups. The *Administrative Provisions on the Solvency of Insurance Companies* and *No. 14 of Solvency Reporting Standards for Insurance Companies* prescribe the frequency, time and content of submitting the solvency report of the insurers including the insurance group companies.

At present, insurance group companies have to meet relevant requirements of the *Insurance Law, Regulations on the Administration of Insurance Companies* and *Administrative Measures for Insurance Permits*. CIRC does not allow the organizational framework of insurance groups to obstruct the regulatory effectiveness. CIRC does reject application for licenses

	<p>suspend the license if proposed or existing insurance companies fail to meet existing requirements for single entities.</p> <p>There is no significant insurance activity of Chinese insurance companies outside China. Some business is conducted in HK SAR and Macao.</p>
Assessment	Observed
Comments	<p>The Chinese market has been developed with a distinct aim to limit and restrict the quantity of companies in order to maintain manageable levels. China already ranks as the six largest insurance markets in the world. Most of the developed markets within the top 10 would have at least three times the quantity of companies. It is expected that the role of insurance groups will become more significant, requiring CIRC to further develop regulation to facilitate the supervision of insurance groups. This will certainly involve centralized risk management functions and group solvency requirements allowing for diversification.</p>
<b>Prudential Requirements</b>	
<b>Principle 18.</b>	<p><b>Risk assessment and management</b></p> <p>The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.</p>
Description	<p>CIRC has issued comprehensive regulations to introduce risk management as a fundamental part of its supervisory framework. The regulations are comprised of the <i>Guidelines on Risk Management of Insurers (Trial Edition)</i> and the <i>Administrative Provisions on the Solvency of Insurance Companies</i> promulgated in 2008. Insurance companies are required to establish an internal risk management system and mechanism. In fact, regulation on risk management is one of the few areas where CIRC has taken a principles based approach since it links application to size and complexity of the business. However, all insurers must maintain the ability to recognize, assess, report and control risk. The regulation requires insurers to establish a comprehensive risk management system that covers all business processes and operational areas. It also requires regular assessment and accurate alert procedures.</p> <p>Insurers should analyze and compare various risk factors according to the probability of risks and their influence on operation goals to identify the emphasis of risk management and tolerance level of risk limits. Determination of risk tolerance levels means insurers, through assessing financial status, operation needs and features of various business operations determine which kinds of risks they are willing to take and the maximum tolerable risk level and identify corresponding warning risk levels on the basis of risk versus benefit.</p> <p>CIRC regularly inspects insurers and their branch offices for their performance in risk management. The inspection covers the soundness and responsibility fulfillment of risk management functions; completeness, operability and actual operational status of risk management processes; timeliness and effectiveness of major risk treatments.</p> <p>The <i>Guidelines</i> and the <i>Administrative Provisions on the Solvency of Insurance Companies</i> require insurers to identify and assess various major risks, including insurance risk, market risk, credit risk and operation risk, etc., and specify the content, measures and procedures for risk assessment. Insurers are also required to assess market trends and risks on a regular basis and take appropriate measures to manage any adverse impacts of the market environment on its own business.</p> <p>Regulations specifying CIRC expectations on accountability also require insurers to establish adequate organizational structures for the risk management function. Risk management can be accommodated in a dedicated risk management committee under the Board or be a part of the audit committee.</p>

Assessment	Observed
Comments	The implementation of the risk management function requires substantial efforts from both companies and CIRC. Progress and adequacy of the systems are not easily measured through off-site monitoring and supervisory reporting. The cycle for on-site inspections extends to five years. CIRC should agree to changes in regulation and require adequate audited reports for at least those companies with substantial market share or specific exposures.
<b>Principle 19.</b>	<b>Insurance activity</b> Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.
Description	<p>The general direction for regulation in China stipulates a high level of control and almost directs the insurance companies on how they should conduct their business. Insurance activity is defined as covering risk through policies with approved wordings and—for compulsory insurance—with approved ratings. Insurance companies are not allowed to conduct non-insurance business within the licensed legal entity. Insurance companies have to submit a business plan and related strategies at licensing and must also submit subsequent changes to CIRC.</p> <p>Underwriting and pricing are included in risk management practice of the insurer. Hence, the insurer must be able to forward strategic underwriting and pricing policies approved by the board of directors. CIRC regularly reviews these plans and discusses related issues with the senior management and respective committees. These reviews are conducted at both CIRC HQ and in the regional bureaus.</p> <p>CIRC requires insurance companies to define clear strategies to mitigate and diversify risks. The use of reinsurance coverage is the most common form of risk transfer to mitigate and diversify risks. Risk mitigation through the purchase of balance sheet protection by means of financial instruments is prohibited.</p> <p>During on-site inspections, CIRC examines whether the insurer's insurance premium rates strictly conforms to the rates approved and recorded by the supervisory authority. CIRC also requires insurance companies to establish a complete system to strengthen control over expenses, including administration expenses, commissions and handling charges.</p> <p>CIRC regulations ensure that insurance activities are conducted in accordance the principles of protecting the public interests and preventing unfair competition. The regulation of tariffs and the approval of products and wordings support these principles. However, CIRC also assumes a responsibility for the commercial and social development of the insurance market. At the time of the assessment, an initiative from the Chinese government to facilitate the penetration of social health coverage relied on the usage of the insurance industry's infrastructure within the regions. The social health coverage intends to use insurance claim facilities to enable notification, handling and settlement of the non-insurance claims. This serves as an example, where CIRC's set of regulatory and commercial objectives involves the use of insurance companies to develop the markets and leads to rather blurry policy settings.</p>
Assessment	Largely Observed
Comments	<p>The insurance activity is sufficiently well defined. CIRC assumes a high level of control over the market. Limitations on the ability of the insurance companies to further develop products or business procedures in order to gain competitive advantage exist.</p> <p>Product approval and off-site monitoring must lead to early recognition of shortfalls and must lead to rectification plans with immediate effect and short response times.</p>

<b>Principle 20.</b>	<p><b>Liabilities</b></p> <p>The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.</p>
Description	<p>CIRC issued comprehensive regulations to ensure sufficient technical standards on both the adequacy of reserves and technical provisions and their overall levels. Insurance companies have to assess technical provisions and other liabilities according to specified criteria. CIRC regularly monitors the assessment results and can require insurers to increase technical provisions if deemed necessary. Information on reserve levels is submitted monthly, including run-off and chain ladder information.</p> <p>All General lines insurers must employ actuarial capacity. Personal lines insurer must apply the concept of the appointed actuary with a special reporting line to the risk committee and access to the supervisory board. CIRC has established the assessment criteria for technical provisions and other liabilities, including actuarial rules and solvency reporting standards. The assessment and evaluation of technical provisions and reserves is also specified through the “Enterprise Accounting Criteria.” The evaluation of liabilities for solvency purposes differs from the fair value based measurement for financial reporting and is assumed to be more conservative.</p> <p>Insurers submit actuarial reports to CIRC annually. These reports are reviewed through off-site monitoring. CIRC also conducts themed on-site inspections to assess the adequacy of technical provisions. Where insurers fail to provide technical provisions as required, CIRC can order the insurer to increase levels within prescribed time limits.</p> <p>Liabilities are reported on a gross basis with receivables against reinsurance. Positive credit ratings are required to offset liabilities. Since 2007, premiums have been increasingly ceded to foreign reinsurers and retention levels have decreased.</p> <p>Before 1998, Chinese life insurers underwrote business where guaranteed returns exceeded subsequent investment returns. Insurers are allowed to increase reserve levels gradually for those portfolios to allow for a negative reserve status until 2020. One company has transferred the “negative spread” business to a holding company to be administered more discretely. For this business, the reserves have been calculated using the guaranteed rate of return for discounting. In contrast to that, all recently written business is reserved using a discount rate of 2.5percent. Hence, there is a significant discrepancy between the current reserving status and the fulfillment value for business. Current regulation does not require the separation of various tariff generations within one product line. That creates the potential that undesirable cross-subsidies will be generated, especially where some of the earlier business remains under-reserved.</p> <p>CIRC has introduced new standards for financial reporting of insurance contracts. These standards are aimed at bringing harmonization between international standards under IFRS4 with Chinese GAAP. Since IFRS 4 Phase II has yet to be issued by the IASB, the Chinese MOF has issued local GAAP, anticipating the outcome of IFRS4.</p> <p>The recalculation of reserves for life business has been done using a higher discount rate of 4 percent as opposed to the previous 2.5 percent. The forbearance on reserve levels has been used to offset the demanded increase for the participation business written prior to 1998. Reserve levels overall appear to be accurate since a higher discount rate facilitated the increase in reserves for the “negative spread” business. Companies which did not have this legacy, have lowered overall reserve levels and accounted this effect through the income statement. Profits arising from this recalculation are disposable and can be paid out as dividends.</p>
Assessment	Partly Observed

Comments	<p>CIRC should not allow insurers to maintain inadequate reserve levels. Policyholder and beneficiaries must expect CIRC to ensure minimum reserve levels at all times. CIRC should also prevent insurers from writing new business for as long as reserve levels are inadequate. CIRC should prevent egregious cross-subsidizing of policies.</p> <p>The introduction of new accounting standards should have been applied with precautionary measures. Effects from re-measurement should have been deferred to other comprehensive income as part of equity and should have not been disbursed to shareholders for at least three years.</p>
<b>Principle 21.</b>	<p><b>Investments</b></p> <p>The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.</p>
Description	<p>CIRC has implemented regulations restricting insurers' ability to invest in both qualitative and quantitative ways. In general, insurance companies are required to invest their assets within the Chinese markets. Exposure to equities is now limited to 10 percent. CIRC does not provide distinct requirements for those assets covering technical liabilities. Exposures to related party transactions are not specified.</p> <p>Regulation requires insurers to define and document an investment strategy approved and reviewed annually by the board of directors, covering investment portfolio strategy and risk profile strategy.</p> <p>Investment is strictly regulated by the <i>Insurance Law</i>. Insurers must invest in a prudent manner and follow the principle of safety. Further regulation specifies the asset categories and the respective quantitative restrictions. This are:</p> <ul style="list-style-type: none"> <li>• Government bonds, no limits,</li> <li>• Bank deposits, no limits,</li> <li>• 10 percent max in equities,</li> <li>• 15 percent max in mutual funds,</li> <li>• 40 percent max in corporate bonds, all must have an investment grade rating, and</li> <li>• 6 percent max in domestic infrastructure products through the means of trust funds.</li> </ul> <p>Insurance companies can also invest directly or indirectly up to 15 percent in the equities of Chinese companies listed in Hong Kong. Further investments in non-domestic markets are not permitted. Restrictions on investment opportunities exist since insurers compete with banks on the domestic capital markets. This problem is recognized by CIRC.</p> <p>Insurer's report Asset Liability mismatches to CIRC. Monthly submission of the investment activity is very comprehensive and almost extends to the single transaction.</p> <p>Insurers have to align their investment policies with their risk management. Management has to define clear responsibilities and must implement suitable measures to ensure processes for internal control are in place. CIRC has also issued sufficient requirements to the suitability of key functionaries in the investment area.</p> <p>Insurers are not allowed to hedge their exposure to interest rate and credit risk in exceptional circumstances CIRC granted permission to five domestic insurers to purchase interest rate swaps on RMB.</p> <p>Since 2008, CIRC has required insurers to perform stress tests regularly and to report the results as part of the off-site monitoring.</p>

	Insurers are being encouraged to establish professionally managed asset management subsidiaries to centrally manage the assets of insurance group companies. These structures may offer the wider investment opportunities.
Assessment	Largely Observed
Comments	<p>Chinese insurers face a very narrow range of investment categories and opportunities to invest their assets. Whilst quantitative and qualitative restrictions appear to ensure a safe and sound environment, it also overly exposes the insurers to domestic interest rate and credit risks. As described under ICP 22, CIRC should issue regulations to allow for macro and portfolio hedging. CIRC has to assume that investment management must be capable of engaging in hedging activities. Analysis of the financial performance of Chinese insurers has shown a strong volatility of the investment income. The performance of traditional and with profit products in particular depend on reliable and stable investment returns. Insurers should have more flexibility to achieve those returns. Micro hedges are deemed to be insufficient and not flexible enough to provide suitable protection.</p> <p>CIRC should issue distinct regulations governing the quality of assets covering technical provisions and capital requirements. For those categories, related party transactions should not be permitted.</p>
<b>Principle 22.</b>	<p><b>Derivatives and similar commitments</b></p> <p>The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.</p>
Description	At the time of the assessment, insurers as a whole were not allowed to write or purchase derivatives. Thus there is limited scope to hedge investment risks. However selected exceptions were granted to six domestic insurers with adequate internal controls. Those insurers were allowed to purchase interest rate swaps on RMB as part of a pilot study. CIRC is has now issued a rule on stock index futures and is considering implementation procedures.
Assessment	Largely Observed
Comments	Macro and portfolio hedges are needed to effectively manage interest rate risk and also the use of Credit Default Swap (CDS) might be needed to manage the credit risk on corporate bonds. Individual and selective authorization to purchase derivatives and the absence of effective regulation endanger a level playing field. However this could be dealt with by requiring insurers below a certain size to employ licensed asset management companies if they wish to hedge risk in derivatives markets.
<b>Principle 23.</b>	<p><b>Capital adequacy and solvency</b></p> <p>The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.</p>
Description	<p>CIRC issued regulations to establish a solvency regime based on European Solvency I. Similar factors and components determine the capital requirements for technical provisions and reserves.</p> <p>In 2003, CIRC has developed a series of risk-based solvency rules, issued the <i>Administrative Rules on Solvency of Insurance Companies</i>, and established a risk-based, dynamic solvency supervisory system. These measures allow for a forecast of solvency margins in various growth scenarios. The dynamic tests have to be submitted annually. Regular assessment of solvency levels is submitted quarterly to CIRC.</p> <p>The Chinese solvency regime also addresses some of the risks stemming from assets risk</p>



	<p>exposure. The eligibility to cover solvency requirements is restricted for certain asset classes. This limitation has similar effects as a loading factor. Those factors are:</p> <ul style="list-style-type: none"> <li>• 5 percent on equity,</li> <li>• 10 percent on corporate bonds, with no recognition of investment grade,</li> <li>• 5 percent on mutual funds, and</li> <li>• 10 percent on bank deposits where the bank is inadequately capitalized.</li> </ul> <p>Solvency capital is defined in regulation and can be paid-in capital, retained comprehensive income as core capital and subordinated debt with characteristics of equity as subordinate capital.</p> <p>CIRC classifies insurers into three categories:</p> <ol style="list-style-type: none"> <li>1. <b>Inadequate company</b> refers to insurers with solvency ratio lower than 100 percent.</li> <li>2. <b>Class 1 adequate company</b> refers to insurers whose solvency ratio is from 100 percent to 150 percent.</li> <li>3. <b>Class 2 adequate company</b> refers to insurers whose solvency ratio is higher than 150 percent. CIRC takes different supervisory measures over these three kinds of companies.</li> </ol> <p>When companies are not at least in Class 2 and thus hold less than 150 percent of the required minimum solvency capital, the risk weighted classification system ranks those to category C or D. The company is asked to submit a plan how further deterioration of solvency levels can be achieved.</p> <p>Insurers are allowed to take loans and to pledge assets and the amount of liabilities and disposable assets could in some circumstances become imbalanced.</p> <p>For companies with inadequate solvency levels, CIRC currently prevents them from making distribution of shareholders' dividend, restricts certain business conduct and does not permit the opening of other / more branch offices. For Class 1 adequate companies, CIRC can require them to submit and implement a plan for preventing inadequate solvency. For Class 2 adequate companies, CIRC will not take supervisory measures.</p>
Assessment	Partly Observed
Comments	<p>The solvency regime is rather static and insufficiently risk based. There are two main concepts of solvency frameworks at the centre of international regulatory debate: Solvency II, a European development, taking specifics of an insurer's business model into account and also allows for a recalculation of assets and liabilities under a concept of full economic values. The second concept is the refinement of a RBC approach, as applied in the U.S. markets. Conceptually, Solvency II might be more sophisticated but it is also far more complex in its application to insurer and supervisors. China is currently investigating what direction it should take between the two general approaches. Taking CIRC's current rules and control based approach into consideration; a move towards Solvency II might not be recommendable. In line with its current development stage a refinement of its current solvency regime would build on the current principles of static analysis of claims and premium development, assessment of asset risk, recognition of growth developments and allowances for inflation and specifics of business lines. Furthermore, a re-measurement of liabilities for solvency purposes is strongly recommended.</p> <p>CIRC has currently eight companies, 5 non-life and 3 life, operating with solvency margins below 100 percent. Those companies are still allowed to write new business but might be limited in their geographical growth. Inadequate solvency levels have exists for some of these</p>

	<p>companies for more than two quarters.</p> <p>As a supervisory principle, no licensed entity should be allowed to write new business for as long as the solvency levels are not above 100 percent. If management of shareholders cannot within very limited timeframes provide capital injections, the company should be declared insolvent and be placed under the administration of the supervisor. The current situation with eight companies operating below 100 percent solvency ratios signals to the markets that breaches of capital requirement will not have serious consequences such as revocation of licenses or publicly warnings.</p> <p>The recognition of loadings for bank deposits with inadequately capitalized banks is paradoxical. The adequate measure would be to require companies to immediately withdraw the deposits, in order to secure policyholders and companies interests.</p> <p>CIRC should be aware of its potential reputational risks by failing to have an adequate solvency regulation. It also faces a reputational risk for failing to demonstrate adequate enforcement measures by permitting excessive forbearance. The forbearance is in contradiction with the overall hands-on approach and control over the supervised insurance companies.</p> <p>CIRC should prevent insurers from taking loans and pledging assets covering capital requirements or technical provisions.</p>
<b>Markets and Consumers</b>	
<b>Principle 24.</b>	<b>Intermediaries</b> The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.
Description	<p>Almost all insurance products are distributed through personalized intermediaries, tied agents (88 percent) and bank assurance (10 percent). Direct distribution through telemarketing and internet based sales is at its beginning (2 percent).</p> <p>CIRC has issued comprehensive regulation to ensure sufficient oversight of the distribution of insurance products. The main initiative is to ensure adequate qualification of tied agents and those involved in bank assurance. CIRC maintains an examination program since 1998, originally started by the PBC in 1996.</p> <p>CIRC does not register intermediaries but controls the examination process. A successful completion of the exams is a prerequisite to be engaged in the sales process. Insurers register the intermediary and submit totals to CIRC regularly. The pass rate for the exams is on average 65 percent.</p> <p>In 2010, there were 1,800 agency companies with average revenues of RMB 3million, 170,000 part time agencies, including bank assurance salespersons and 2,900,000 tied agents active in China.</p> <p>The ultimate responsibility for the quality of the sales process is with the insurance company. Any miss-selling or breach of regulation conducted by intermediaries is addressed against the insurer.</p> <p>In 2007–2009, filed complaints against intermediaries went down from 318 in 2007 to 147 in 2008 and to 90 in 2009. Prior to 2008, larger volumes of miss-selling did occur. This problem was addressed through joint efforts of the insurance industry and CIRC and has successfully been resolved.</p>
Assessment	Observed
Comments	

<b>Principle 25.</b>	<p><b>Consumer protection</b></p> <p>The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.</p>
Description	<p>CIRC has issued substantial regulations on consumer protection and is enforcing this mainly through its regional insurance bureaus.</p> <p>Specific regulations require insurers to train their personal in a number of areas, including on ethics. In particular, the insurance agent and brokerage staff shall receive pre-job training not shorter than 80 hours. The time for each person to receive training and education on the job shall not be shorter than 36 hours each year.</p> <p>Insurers and intermediaries have to provide relevant policy wording and sales information to customers in a way that is understandable and not misleading. Standard clauses are defined to be used by insurer for policy wording. There are also minimum requirements on the volume and contents of information each policyholder shall receive with the actual policy. All policies are subject to arbitration to allow an out-of court settlement between insurer and policyholder.</p> <p>CIRC has also issued regulation to facilitate the claims settlement process. The insurer shall lay out its claim settlement processes and services, define time limits for claim settlement, establish complaint and supervisory mechanism on claim settlement services and improve quality of claim settlement services effectively.</p> <p>A complaints function exists with the insurance association, equivalent to the ombudsman concept. Consumers can file complaints with CIRC. In the period of 2007–2009, those complaints were consistently in the range of 3,500 per annum.</p>
Assessment	Observed
Comments	CIRC could introduce the disclosure of complaints per company to further enhance companies' discipline and to increase the awareness on customer satisfaction. The complaint function should be moved from the insurance association to a more independent source to enhance creditability of the process.
<b>Principle 26.</b>	<p><b>Information, disclosure &amp; transparency towards the market</b></p> <p><b>The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.</b></p>
Description	<p>At the time of the assessment, CIRC issued a new regulation requiring comprehensive disclosure policies to be implemented. Prior to June 2010, disclosure and transparency rules have been at satisfactory levels. The new regulation also requires ad-hoc publication of substantial changes and on major developments.</p> <p>Disclosure requirements comprise:</p> <ol style="list-style-type: none"> <li>1. Basic information;</li> <li>2. Financial and accounting information;</li> <li>3. Information on risk management status;</li> <li>4. Information on insurance product operation;</li> <li>5. Information on solvency;</li> <li>6. Information on major associated transactions;</li> <li>7. Information on major issues; and</li> <li>8. Other information required by CIRC for disclosure.</li> </ol>

	Insurers must establish management systems on disclosure and submit information to CIRC for filing purposes. The management system should include content and criteria for disclosed information, the information review and distribution procedures. Insurers are required to regularly disclose information on risk management status. The information on risk management status should derive from the annual risk assessment report reviewed by the board of directors, including risk assessment and risk control. Risk assessment should include identification and evaluation of major risks, such as insurance risk, market risk, credit risk and operational risk.
Assessment	Observed
Comments	Since the regulation on disclosure only recently has been introduced, a review process should be established to allow for modification and refinements within a timeframe of the next two years.
<b>Principle 27.</b>	<b>Fraud</b> The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.
Description	<p>CIRC's regulations address fraud in a comprehensive manner. In 2009, CIRC issued <i>Notice on Strengthening Cooperation to Tackle Insurance Crimes</i>.</p> <p>The note has enhanced cooperation between regional insurance bureaus and other relevant agencies in the provinces geared to reduce opportunities for fraud and to improve preventive measures.</p> <p>CIRC distinct three dimensions of fraud:</p> <ul style="list-style-type: none"> <li>• <b>False insurance company</b> where insurance products are distributed by either non-licensed or insufficiently licensed companies. In 2009, there were 32 reported cases under this category.</li> <li>• <b>False policies</b> where either false stationary for policies or unapproved products have been sold. In 2009, there were 170,000 cases of false policies detected, some of them unsold but available in the market.</li> <li>• <b>False claims</b> where claims have been staged, fabricated or otherwise manipulated to the disadvantage of insurance companies. In 2009, there were false claims totaling to RMB 100 million.</li> </ul> <p>CIRC has dedicated resources in the inspection department and in the regional insurance bureau available to facilitate efforts against insurance fraud.</p>
Assessment	Observed
Comments	CIRC has increased substantially its efforts against fraud. Staffing levels should be increased to address fraud at a more appropriate level. Corruption and bribery are a concern. A stronger effort and adequate staff will allow CIRC to contribute more effectively to an overall enhancement of market discipline in the financial sector.
<b>Principle 28.</b>	<b>Anti-money laundering, combating the financing of terrorism (AML/CFT)</b> The supervisory authority requires insurers and intermediaries to take effective measures to deter, detect and report money laundering and the financing of terrorism.
Description	China has developed regulations on AML. However the AML/CTF MER and Technical Note carried out separately from this assessment point to 25 out of 40+9 FATF Recommendations being either non-compliant or partly compliant.

	<p>The main responsibility for AML lies within the PBC which also acts as the local Financial Intelligence Unit (FIU), (FIU functions within the PBC are split between the AML Bureau and CAMELMAC). Suspicious Transaction, STR, are reported based on several criteria: Cash transaction exceeding RMB 200,000 or US\$10,000. Any event listed in the description as “abnormal transaction” and any activity, where involved parties see potential for AML activities.</p> <p>Regulation on AML specifies that CIRC resumes responsibility on AML in conjunction with PBC. In 2009, PBC carried out approx. 1,600 onsite inspections in branches and headquarters of insurance companies: none of these inspections was conducted with participation of CIRC. A total of approx. 150 fines or other forms of sanctions have been issued by PBC against insurance companies. None of the outcomes of inspections have been reported to CIRC since replacement of senior management or withdrawal of was not deemed necessary.</p> <p>CIRC has nominally four staff in the inspection department dedicated to AML. However, during the assessment it became evident that CIRC is not materially involved in the prevention or investigation on money laundering.</p>
Assessment	Partly Observed
Comments	<p>This assessment allows for an interpretation of the Assessment Methodology that allows the PBC to effectively be the AML/CFT supervisor for the insurance sector. Currently the share of responsibility for AML between PBC and CIRC and the lack of active involvement and influence of the CIRC over the process results in a significant reputational risk to the CIRC. A clear accountability is needed to respond in a timely manner to the specifics of AML. The rather opaque involvement of CIRC in conjunction with the lack of influence and involvement on inspections and sanctions is not satisfactory. A decision is needed as to where the AML function will be housed and then to ensure it is carried out effectively. If it is not with the CIRC, then it is essential that CIRC be adequately informed so as to properly supervise the sector. In addition the thresholds for the reporting of suspicious transactions should be more in line with those with income levels.</p>