

## NECESSARY REFORM OF INSURANCE LAW IN CHINA AFTER ITS WTO ACCESSION

Kuan-Chun Chang\*

### I. INTRODUCTION

On November 11, 2001, the World Trade Organization (WTO) Ministerial approved China's WTO accession package, officially allowing China to become the 143rd full member of the WTO. As a result, experts predicted approximately \$56 billion per year would be pumped into the economies of China and its major trading partners.<sup>1</sup> However, as of 1999, China's insurance services market plainly needed such a financial infusion since only 20% of people in China had joined an insurance scheme.<sup>2</sup> Despite a population of 1.3 billion, China's insurance premium income was only 1.67% of its GNP in 1999 as compared to the world's average of 7.3%.<sup>3</sup> Additionally, the per capita expenditure on insurance premiums was only Renminbi (RMB) 110.58 (approximately equivalent to USD \$13.32) as compared with USD \$430 in the United States.<sup>4</sup> Thus, China's WTO accession created significant opportunity to boost and expand the insurance industry once the market opened up and certain restrictions were lifted.

Prior to its WTO accession, China's insurance market had grown steadily at an average rate of 37.6% per annum after resuming insurance business in 1980.<sup>5</sup> China's Insurance Law of 1995 was the first sophisticated legislation designed to address the significant obstacles associated with expanding the insurance market. The Insurance Law of 1995 encouraged more investors to invest in the Chinese market. However, while domestic insurance companies multiplied, the operation of foreign insurance companies in China was still severely restricted by Chinese domestic regulations and restrictions. For example, geographic

---

\* S.J.D. candidate, Georgetown University Law Center; LL.B., National Chengchi University, Taiwan (1997); M.B.A., National Chengchi University, Taiwan (2000); LL.M., University of Pennsylvania (2001); LL.M. in Banking and Financial Law, Boston University (2002).

1. Tatiana Boncompagni, *Eastward Ho! Entry into WTO was Just the Beginning. Get a New \$56 Billion Trade Marketplace*, LEGAL TIMES, Jan. 7, 2002, at 12.

2. *Review of Reform of Chinese Insurance Industry*, CHINESE SECURITIES NEWS (Beijing), Apr. 3, 1999.

3. *Foreign Investors Set Foot in China's Insurance Market*, 21 CHINA ECON. NEWS 6 (2000).

4. *Id.*

5. The domestic insurance business in China was suspended in 1958. See *infra* Part III of this paper for details.

restrictions were imposed on most foreign insurance underwritings.<sup>6</sup> Also, China required foreign investors to have license permits for either wholly foreign-owned branches or up to 51% ownership in a Sino-foreign joint venture company. This licensing system enabled the Chinese government to control the number of branches and joint ventures owned by foreign investors. China's restricting group insurance policies to domestic companies evinces such an exercise of control.<sup>7</sup>

The General Agreement on Trade in Service (GATS) covers financial service, which is defined to include insurance and insurance-related services.<sup>8</sup> As a full member of the WTO, measures adopted by the Chinese government to regulate foreign insurance and related services must be consistent with obligations outlined in GATS.<sup>9</sup> Moreover, as indicated in the Protocol of the Accession of the People's Republic of China, the concessions and commitments listed in the Schedules annexed to the Protocol must be implemented as stated.<sup>10</sup>

Accession to the WTO has created the toughest challenge ever confronted by China's weak legal system. China's ability to implement these obligations and commitments is crucial in determining the success of its accession.<sup>11</sup> In the field of insurance and related services, China

---

6. Official Website of the Chinese Insurance Regulatory Commission (establishing twenty-eight domestic insurance companies including property, casualty and life insurance companies by August 2000), at [http://www.circ.gov.cn/circ\\_zj.htm](http://www.circ.gov.cn/circ_zj.htm) (last visited Jan. 10, 2004) [hereinafter Chinese Insurance Regulatory Commission]; see also YADONG LUO, CHINA'S SERVICE SECTOR 155 (2001) (limiting foreign insurers in their underwriting business to Shanghai and Guanzhou while permitting AIG to operate in Shenzhen and Foshan.).

7. LUO, *supra* note 6; see Chinese Insurance Regulatory Commission, *supra* note 6.

8. See General Agreement on Trade in Service, Apr. 15, 1994, WTO Agreement, Annex 1B, art. 5(a) [hereinafter GATS] at [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm#finalact](http://www.wto.org/english/docs_e/legal_e/legal_e.htm#finalact) (last visited Jan. 10, 2004) (defining the "insurance and insurance related service" as:

"(i) Direct insurance (including co-insurance): (A) life, (B) non-life; (ii) Reinsurance and retrocession; (iii) Insurance intermediation, such as brokerage and agency; (iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.").

9. Marrakesh Agreement Establishing the World Trade Organization provides, Apr. 15, 1994, RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS: THE LEGAL TEXTS, 33 I.L.M. 1144 (1994), art. 16(4); available at [http://www.wto.org/english/docs\\_e/docs\\_e.htm](http://www.wto.org/english/docs_e/docs_e.htm) (last visited Jan. 10, 2004) [hereinafter WTO Agreement]. "Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements." *Id.*

10. Protocol of the Accession of the People's Republic of China WT/L/432, at Pt. II (1) (Nov. 23, 2001) [hereinafter Protocol].

11. SUPACHAI PANITCHPAKDI & MARK L. CLIFFORD, CHINA AND WTO CHANGING CHINA, CHANGING WORLD TRADE 147 (2002).

agreed to relax its restrictions on the form of establishment, geographic coverage, business scope, and licensing within five years from the date of accession.<sup>12</sup> Therefore, the most important issue to address is China's commencement of legal reforms, including those related to insurance law in accordance with its obligations and commitments. The Insurance Law of the People's Republic of China (Insurance Law) was amended at the end of 2002 and the Administration of Foreign-funded Insurance Companies Regulation (AFICR) was promulgated at the end of 2001. However, further review is needed as to whether these two main pieces of legislation and other relevant regulations are consistent with China's obligations under GATS and its accession agreement.

The primary goal of the WTO is to ensure through its agreements that members operate a non-discriminatory trading system with well-defined rights and obligations. Each member country receives guarantees that its exports will be treated fairly and consistently in other countries' markets; and each member promises to do the same for imports into its own market.<sup>13</sup> The WTO also affords developing countries some flexibility in implementing their commitments and ensures that service sectors of member countries are open to foreign competition.<sup>14</sup> As a result, all WTO agreements are designed to establish a multilateral world trading regime, which aids the liberalization of international trade and breaks down tariff and non-tariff barriers to ensure a non-discriminatory trade environment.<sup>15</sup>

However, the contribution of this design to the overall modernization of China's domestic legal system is limited. In fact, only sweeping changes in the legal and administrative system can pave the way for sustained economic growth.<sup>16</sup> China lacks a sound legal system to regulate the order of domestic business activities and to protect consumers, who are in turn less willing to initiate transactions with enterprises.

The insurance business will be adversely affected if a system with either no regulation or incomplete regulation and supervision is implemented for rates, consumer protection, capital adequacy, and licensing. For example, a failed insurance pricing system can cause the

12. See Report of the Working Party on the Accession of China WT/ACC/CHN/49/Add.2 (Oct. 1, 2001) [hereinafter Report].

13. The WTO Agreements, available at [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm](http://www.wto.org/english/docs_e/legal_e/legal_e.htm) (last visited Jan. 10, 2004).

14. *Id.*

15. See MICHAEL J. TREBILCOCK & ROBERT HOWSE, THE REGULATION OF INTERNATIONAL TRADE 21–22, 26, 38 (2002).

16. PANITCHPAKDI & CLIFFORD, *supra* note 11, at 144.

problems of adverse selection and feelings of unfairness for policyholders, thus downsizing the insurance market.<sup>17</sup> Additionally, an insufficient consumer protection system may not tackle asymmetric information and bargaining power resulting in lost consumer confidence in the insurance market. For this reason, reformation of insurance law and related regulations to establish a proper insurance supervisory system is another material factor in boosting the Chinese insurance market and attracting foreign insurance businesses. Otherwise, the benefit to the insurance market brought by WTO accession may be mitigated by the negative effects of an immature legal system.

Based on the ideas presented above, this paper will include five parts: Part I will clearly examine China's obligations under the General Agreement on Trade in Service and its WTO commitments through official WTO documents. Part II will briefly introduce the history of China's insurance business and relevant legislation, discuss the recent rapid growth in the Chinese insurance market, and reveal that, although the legal reform in insurance law and related regulations has been initiated, other reforms are still necessary to back the continuing growth of the insurance market. Part III will examine whether the Insurance Law of 2002 and related regulations have conformed with all obligations and commitments that China owes the WTO and determine whether further amendments are needed. Part IV will compare China's Insurance Law and other regulations with international standards to see if any disparity exists. This analysis will utilize guidelines, standards, and principles released by the International Association of Insurance Supervisors (IAIS).<sup>18</sup> To cure any defect based on the IAIS standard, relevant legislation from two major insurance markets, the United States and the European Union, will be presented as guidance for the recommendation of further amendments to China's Insurance Law. Finally, Part V will describe an optimal legal system of insurance laws and regulations in the post-WTO era.

---

17. See SCOTT E. HARRINGTON & GREGORY R. NIEHAUS, RISK MANAGEMENT AND INSURANCE 117 (1999) (defining "adverse selection" as the tendency of buyers with high expected losses to buy more coverage than buyers with low expected losses when charged the same premium).

18. *International Association of Insurance Supervisors, By-Laws* [hereinafter IAIS] at <http://www.iaisweb.org/bylaws.pdf> (last visited Jan. 10, 2004). In 1994, the International Association of Insurance Supervisors was established to represent insurance supervisory authorities of some 100 jurisdictions. *Id.* It was formed to promote cooperation among insurance regulators, to set international standards for insurance supervision, to provide training to members, and to coordinate work with regulators in the financial sectors and international financial institutions. *Id.*

## II. CHINA'S OBLIGATIONS AND COMMITMENTS IN FINANCIAL SERVICE AFTER ITS WTO ENTRY

While the WTO Charter is confined to institutional measures, the Charter explicitly outlines four important annexes. Annex 1 contains the "Multilateral Agreement," which comprises the bulk of the Uruguay Round results. These provisions are all mandatory because these texts impose binding obligations on all members of the WTO. Annex 1B to the Multilateral Agreement incorporates GATS, which consists of general obligations and schedules of concessions. As insurance and related services fall within the GATS definition of "financial service," the following paragraphs will cover China's obligations under both the Multilateral Agreement and GATS. This part will also examine China's commitment regarding insurance and related services according to the Schedule of Specific Commitments on Services attached to the Decision of the Accession of the People's Republic of China.<sup>19</sup>

### *In General*

The Multilateral Agreement (i.e. Agreements Establishing the World Trade Organization) outlines primarily the operational and structural affairs of the WTO. Nevertheless, it specifies that each member state has an obligation to ensure conformity to its laws, regulations, and administrative procedures in accordance with the obligations provided in the annexed agreements.<sup>20</sup> Studies indicate that China's WTO obligations will not be integrated into its domestic law until appropriate domestic legislation and regulations incorporating those obligations are either promulgated or amended.<sup>21</sup> Therefore, unless exceptions are otherwise granted by other agreements of the WTO, the Insurance Law and related regulations must be amended in accordance with GATS. The amendments will ensure the obligations are rooted in domestic legislation so that courts and insurance regulators act consistently with the law rather than their own unrestricted discretion.

### *Obligation under GATS*

GATS focuses on four types of services: (1) services from the territory of one member country into the territory of any other member;

---

19. Report, *supra* note 12; Protocol, *supra* note 10.

20. WTO Agreements, *supra* note 13.

21. Donald D. Clarke, *China's Legal System and the WTO: Prospects for Compliance*, 2 WASH. U. GLOBAL STUD. L. REV. 97 (2003).

(2) services in the territory of one member country to the service consumer of any other member; (3) services provided by a service supplier of one member country through a commercial presence in the territory of any other member; and (4) services provided by a service supplier of one member country through the presence of natural persons of a member in the territory of any other member.<sup>22</sup> The agreement imposes four major obligations: most-favored-nation (MFN) treatment, transparency, obligations concerning domestic regulation, national treatment, and obligations prescribed in two annexes regarding financial services to member countries.

As for MFN status, each Member commencing covered measures for the services and service suppliers of another member country (unless an exemption listed in the Annex to the article II exemptions exists) shall immediately and unconditionally afford treatment no less favorable than that it affords to like services and service suppliers of any other country.<sup>23</sup> Given that only three types of service—maritime transport, international transport, and freight and passenger transport—have been listed in China's Article II Annex, measures applied to insurance and related services of any other member country should be consistent with Article II of GATS.<sup>24</sup>

With respect to transparency, each member state is required to publish promptly (or, in emergency situations, by the time of entry into the force) all relevant measures of general application which pertain to or affect the operation of GATS. International agreements signed by member states that are relevant measures of general application which pertain to or affect the operation of this agreement or affect trade in services shall also be published.<sup>25</sup> Furthermore, GATS requires each member state to inform the Council for Trade in Services promptly (or at least annually) of the introduction of newly-passed laws, changes to existing laws, or administrative guidelines that may significantly affect trade covered by specific commitments under GATS.<sup>26</sup> Each member state also owes a duty to respond promptly to all requests by any other member state for specific information on any of its measures of general application or international agreements within the meaning of GATS Article III:1. GATS mandates that member states establish one or more inquiry points to provide specific information to other members upon

---

22. GATS, *supra* note 8, art. I, § 2.

23. *Id.* art. II, §§ 1, 2.

24. See Report, *supra* note 12; see also Protocol, *supra* note 10, pt. I, para. 4.

25. GATS, *supra* note 8, art. III, § 1.

26. *Id.* § 3.

request for all relevant matters and those subject to the notification requirement in Article III:3. Such inquiry points shall be established within two years of the effective date of the Agreement Establishing the WTO.<sup>27</sup> Appropriate flexibility regarding the time limit for establishing such inquiry points may be granted for individual member countries.<sup>28</sup>

Based on Article III, China further agreed in its Protocol of the Accession (the Protocol) that, “[It] undertakes that only those laws, regulations and other measures pertaining to or affecting trade in services that are published and readily available to other WTO Members, individuals and enterprises, shall be enforced.”<sup>29</sup> In addition, “China shall make available to WTO Members, upon request, all laws, regulations and other measures pertaining to or affecting trade in services, before such measures are implemented or enforced. In emergency situations, laws, regulations and other measures shall be made available at the latest when they are implemented or enforced.”<sup>30</sup> Also, the Protocol obligates China to publish or designate an official journal specifically for the publication of all laws, regulations and other measures pertaining to or affecting trade in services and to publish its laws, regulations or other measures therein.<sup>31</sup> A reasonable period must also be given for comment by the appropriate authorities before such measures are implemented, except for those laws, regulations and other measures involving national security, specific measures setting foreign exchange rates or monetary policy, or other measures whose publication would impede law enforcement.<sup>32</sup> This journal shall be published on a regular basis and copies of all issues shall be made readily available to individuals and enterprises.<sup>33</sup> Additionally, upon request of any individual, enterprise or WTO member country, China has the duty to establish or designate an inquiry point from which all information relating to the measures required to be published under paragraph 2(C)(1) of the Protocol may be obtained.<sup>34</sup> China must reply to requests for information completely, accurately, and reliably while representing the authoritative view of the Chinese government and doing so within a reasonable time period.<sup>35</sup>

---

27. GATS, *supra* note 8, art. III, § 4.

28. *Id.*

29. Protocol, *supra* note 10, pt. I, para. 2(C)(1).

30. *Id.*

31. Protocol, *supra* note 10, pt. I, para. 2(C)(2).

32. *Id.*

33. *Id.*

34. Protocol, *supra* note 10, pt. I, para. 2(C)(3).

35. *Id.*

With regard to national treatment, the treatment awarded by each member state to service and service suppliers of any other member state, regarding all measures affecting the supply of services, should be no less favorable than those granted to each Member State's domestic service and service suppliers.<sup>36</sup> Additionally, the Protocol imposes a duty of non-discrimination. China promised that foreign individuals and enterprises as well as foreign-funded enterprises will be afforded treatment no less favorable than that afforded to other individuals and enterprises with respect to: "(a) the procurement of inputs services necessary for production and the conditions under which their goods are produced, marketed, or sold in the domestic market and for export; and (b) the prices and availability of services supplied by national and sub-national authorities and public or state enterprises in areas including transportation, energy, basic telecommunications, other utilities and factors of production."<sup>37</sup>

Article VI of GATS pertains to "domestic regulation" and obligates each member country to ensure the reasonableness, objectivity, and impartiality of the administration regarding all measures of general application affecting trade in service.<sup>38</sup> GATS also mandates that member countries maintain a justified judicial review system (whether judicial, arbitral, or administrative) of appropriate remedies for administrative decisions affecting trade in service.<sup>39</sup> If the review procedure is not separated from the agency entrusted with making the administration decision, the impartiality and objectivity of the procedure itself need to be ensured by the Members.<sup>40</sup> Pursuant to the Protocol:

Review procedures shall include the opportunity for appeal, without penalty, by individuals or enterprises affected by any administrative action subject to review. If the initial right of appeal is to an administrative body, there shall in all cases be the opportunity to choose to appeal the decision to a judicial body. Notice of the decision on appeal shall be given to the appellant and the reasons for such decision shall be provided in writing. The appellant shall also be informed of any right to further appeal.<sup>41</sup>

---

36. GATS, *supra* note 8, art. XVII, § 1

37. Protocol, *supra* note 10, pt. I, para. 3.

38. GATS, *supra* note 8, art. VI, § 1.

39. *Id.* § 2(a).

40. *Id.*

41. Protocol, *supra* note 10, pt. I, para. 2(D)(2).



### III. CHINA'S COMMITMENT REGARDING ALL INSURANCE AND INSURANCE RELATED SERVICE

Pursuant to the Final Schedule of Services Commitments, China agreed to a wide range of procedures intended to open the market, which is effective from the date of accession to a maximum of five years.<sup>42</sup> This Schedule pertains primarily to GATS supply mode 3 ("commercial presence" in China) but also includes important undertakings with respect to GATS supply mode 1 ("cross-border supply" of insurance services).<sup>43</sup> Major aspects of the obligations imposed by the Final Schedule regarding insurance and related services are discussed below.

#### *Form of Establishment*

Foreign non-life insurers will be permitted to establish branches or joint ventures with 51% foreign ownership.<sup>44</sup> Within two years after China's accession, they will also be permitted to establish wholly-owned subsidiaries without establishment restrictions.<sup>45</sup> Foreign life insurers may enjoy 50% foreign ownership in a joint venture with a partner of their choice.<sup>46</sup> The joint venture partners are allowed to freely agree to the terms of their engagement provided they remain within the limits of the commitments contained in this schedule.<sup>47</sup>

As for the brokerage for insurance of large scale commercial risks, brokerage for reinsurance, and brokerage for international marine, aviation, and transport insurance and reinsurance, joint ventures with foreign equity of no more than 50% will be permitted at the time of accession.<sup>48</sup> The foreign equity share shall be increased to 51% within three years after China's accession; and, wholly foreign-owned subsidiaries will be permissible within five years after China's accession. Joint venturers remain unbound as to other brokerage

---

42. Report, *supra* note 12, pt. II, § 7.

43. Donald J. Lewis & Peter Rhodes, *Foreign Insurers "in Good Hands:" China Offers New Opportunities in the Insurance Service Sector*, 10 CHINA L. & PRAC. 26, 28 (Jan. 2003).

44. Report, *supra* note 12, pt. II, § 7A(3)(A).

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

services.<sup>49</sup>

### *Geographic Coverage*

Foreign life and non-life insurers as well as insurance brokers have been permitted to provide services in Shanghai, Guangzhou, Dalian, Shenzhen, and Foshan since the date of accession.<sup>50</sup> Now, these entities are permitted also to provide services in Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan, and Tianjin.<sup>51</sup> Within three years of China's accession, geographic restrictions will be completely removed.<sup>52</sup>

### *Business Scope*

As of the date of accession, foreign non-life insurers are permitted to provide "master policy" insurance/insurance of large-scale commercial risks without geographic restrictions.<sup>53</sup> Also, pursuant to the principle of national treatment, foreign insurance brokers are permitted to provide "master policy" insurance no later than Chinese brokers under conditions no less favorable.<sup>54</sup> In addition, foreign non-life insurers are allowed to provide insurance of enterprises abroad as well as property, related liability, and credit insurance of foreign-invested enterprises in China.<sup>55</sup> Finally, foreign non-life insurers have been permitted to provide a full range of non-life insurance services to both foreign and domestic clients from two years after China's accession.<sup>56</sup>

Foreign insurers are permitted to provide individual (but not group) insurance to foreigners and Chinese citizens, as well as to offer health insurance, group insurance and pension annuity insurance to both groups within three years after accession. As of the date of accession, foreign insurers have been permitted to provide reinsurance services for life and non-life insurance as a branch, joint venture, or wholly foreign-

---

49. Report, *supra* note 12, pt. II, § 7A(3)(A).

50. *Id.* § 7A(3)(B).

51. *Id.*

52. *Id.*

53. *Id.*

54. See Report, *supra* note 12, Annex III ("[M]aster policy is the policy that provides blanket coverage for the same legal person's property and liabilities located in different places. Master policy may only be issued by the business department of an insurer's head office or that of its authorized province-level branch offices. Other branches are not allowed to issue master policy."); see *id.* pt. II § 7A(3)(C).

55. Report, *supra* note 12, pt. II § 7A(3)(C).

56. *Id.*

owned subsidiary without geographic or quantitative restrictions on the number of licenses issued.<sup>57</sup>

### *Licenses*

Upon accession, licenses are issued without requiring a showing of economic need or quantitative limits. For the establishment of a foreign insurance institution, the following qualifications must be met: (a) the investor shall be a foreign insurance company with more than 30 years of establishment experience within a WTO member country; (b) the insurance company shall have a representative office for two consecutive years in China; and (c) the total assets the insurance company owns shall exceed US \$5 billion at the end of the year prior to application, except for insurance brokers.<sup>58</sup> The current total asset threshold for insurance brokers is US \$500 million. However, this threshold will be lessened each year following accession. Brokers were required to have total assets of more than US \$400 million within one year after accession, more than US \$300 million within two years after accession, and are required to have more than US \$200 million within four years of accession.<sup>59</sup>

Considering the above-mentioned commitments, experts foresaw that an incomparable opening of the market would occur and restrictions, including geographical limitations, would be lifted so that the market shares of foreign insurers would sharply increase. This deliberate opening of the insurance sector by the PRC government seems to be a purposeful policy decision associated with other domestic economic reforms, such as the privatization of state-owned enterprises and construction of a partly private-funded social security system in the future. Thereby, China has historically committed to granting foreign insurers business opportunities.<sup>60</sup> However, making commitments is one thing, but implementing those commitments is another. Part VI of this article will examine the extent of implementation and, therefore, compliance with these commitments.

---

57. Report, *supra* note 12, pt. II § 7A(3)(C).

58. *Id.* § 7A(3)(D).

59. *Id.*

60. Lewis & Rhodes, *supra* note 43, at 30.

#### IV. BRIEF HISTORY OF THE INSURANCE INDUSTRY AND REGULATIONS REGARDING SERVICE IN CHINA

##### *Brief History of the Chinese Insurance Industry*

##### *Period Before the Foundation of the People's Republic of China*

Insurance in China has a long history. Thousands of years ago, businessmen traded food and goods between inland China and its coastal cities on the Yangtze River. This thousand-kilometer trek exposed small boats to a variety of risks such as bandits, rapids, and pilferage. To prevent the total loss of any one shipment, the businessmen established collective agreements to share the occurrence of the loss of any vessel.<sup>61</sup> For instance, a businessman who shipped five percent of the total amount of cargo on a vessel would absorb five percent of any loss or damage to that shipment.<sup>62</sup>

Despite this early form of insurance, the modern insurance industry did not appear until the early 19th century. In 1805, the first Guangzhou Insurance Firm was established by a British businessman in Guangzhou City.<sup>63</sup> The first Chinese businessman's insurance company was set up in 1876, which is considered the beginning of the Chinese insurance industry.<sup>64</sup> However, from the end of the Opium War in 1842 until the beginning of the 20th century, foreign companies dominated the Chinese insurance market.<sup>65</sup> Even after the collapse of the Qing dynasty in 1911, the Chinese conducted their insurance business primarily to support foreign trade.<sup>66</sup> The industry remained structured in this way throughout World War II and the Civil War until the victory of the Communist Party and the foundation of the People's Republic of China (hereafter the PRC).

##### *Period After the Foundation of the People's Republic of China*

The development of the insurance industry can be divided into four

---

61. Jennifer A. Meyer, Note, *Let the Buyer Beware: Economic Modernization, Insurance Reform, and Consumer Protection in China*, 62 FORDHAM L. REV. 2125, 2136 (1994).

62. *Id.*

63. LINBO FAN, *The Insurance Market System in FINANCIAL REGULATION IN THE GREAT CHINA AREA MAINLAND CHINA, TAIWAN AND HONG KONG SAR* 158 (Joseph J. Norton et al. eds., 2000).

64. *Id.*

65. John J. Hampton, *Insurance in China*, 42 CHARTERED PROP. CASUALTY UNDERWRITERS 106 (1989).

66. *Id.*

periods: (1) the "period of adjustment" from 1949 to 1952; (2) the "period of suspension" from 1953 to 1978; (3) the "period of resumption" from 1979 to 1994; and (4) the "period of the development of modern regulation" from 1995 until the present.<sup>67</sup>

#### *Period of Adjustment (1949~1952)*

In October 1949, the Chinese government formed a state-owned enterprise, the People's Insurance Company of China (hereinafter the PICC) in Beijing.<sup>68</sup> During the first decade of its operation, the PICC made rapid and steady progress by setting up regional branches and offices in all the provinces, autonomous regions, and municipalities.<sup>69</sup> During that time, the Communist government interfered with the operation of private insurance companies. The Communist government incorporated the insurance companies one by one into the PICC causing private insurance companies to gradually disappear from the market.<sup>70</sup> Pursuant to the decision of the State Council, the PICC was designated in 1951 as the only institution to engage in mandatory insurance (i.e. mandatory insurance of state-owned enterprises).<sup>71</sup> Also during this period, the PRC government started imposing restrictions on foreign insurance institutions. These Restrictions included prohibitions on remitting foreign currency from and provided harsh punishment for companies that violated the laws and regulations, forcing foreign insurance companies to completely withdraw from the Chinese insurance market in early 1952.<sup>72</sup>

#### *Period of Suspension (1953~1978)*

In 1959, the philosophy of the "Great Leap Forward" inspired the government to change its attitude toward insurance.<sup>73</sup> Communist doctrine mandates that the government protect its organizations and individuals so that other means of security such as insurance becomes meaningless.<sup>74</sup> Although the PICC maintained operations in the cities

67. HAO-MIN ZHU, DA LU JIN RONG ZHI DU YU SHI CHANG [The Financial Regulation and Market in the Mainland China] 124 (2002).

68. ZHU, *supra* note 67, at 124.

69. Alberto Monti, *The Insurance Contracts in the People's Republic of China - A Comparative Analysis of Policyholders' Rights*, 3 GLOBAL JURISTS TOPICS 1, 4 (2001).

70. ZHU, *supra* note 67, at 124.

71. *Id.*

72. *Id.*

73. Liu Hongru, *Developments in the Reform of China's Banking and Financial System*, 2 J. CHINESE L. 323, 356 (1988).

74. *Id.*

of Shanghai and Hangzhou, its businesses were limited to foreign trade activities, primarily insuring cargo and hull risks.<sup>75</sup> The State subsequently assumed all damage claims and the domestic market nearly evaporated.

Suspension of insurance continued during the next two decades. From 1959 to 1976, China endured a series of domestic political upheavals which further slashed the already limited market.<sup>76</sup> For example, the Cultural Revolution exacerbated existing disturbances and created "hazards and perils that were not insurable even if the PICC had not been eliminated from the market."<sup>77</sup> Insurance activities in Shanghai and Hangzhou, which had continued operating during previous political policy changes, were also suspended by the government.<sup>78</sup>

#### *Period of Resumption (1979~1994)*

The Communist government could not uphold its responsibility to assume insurance-type claims and re-authorized the industry in 1979.<sup>79</sup> In conjunction with the Four Modernizations and the Open Door Policy, China resumed trade and investment activities with foreigners.<sup>80</sup> To promote these policies and facilitate foreign investment, the National People's Congress passed "The Law of the People's Republic of China on Chinese Foreign Joint Ventures."<sup>81</sup> Article 8 of the Joint Venture Law mandates that Chinese insurance companies serve all joint venture insurance needs.<sup>82</sup> Since the PICC was the only authorized insurer at the time this law passed, this provision effectively granted a domestic monopoly.<sup>83</sup>

This monopoly ended in 1985 with the passage of the Provisional Regulations Regarding the Administration of Insurance Enterprises (Regulations.) The Regulations opened the domestic market to other Chinese insurers but still reserved certain lines of insurance for the PICC such as foreign business projects.<sup>84</sup> In 1988, China Merchant

---

75. ZHU, *supra* note 67, at 125.

76. Hampton, *supra* note 65, at 106.

77. *Id.*

78. *Id.*

79. Meyer, *supra* note 61, at 2138.

80. Hampton, *supra* note 65, at 106.

81. *Id.*

82. See The Law of the People's Republic of China on Chinese Foreign Joint Ventures, art. 8 (1979).

83. Hampton, *supra* note 65, at 106.

84. FAN, *supra* note 63, at 158.

Steam Navigation formed the Ping An Insurance Company, which were followed in 1990 by the China Pacific Insurance Company and the Xinjiang Agricultural Insurance Company.<sup>85</sup> Then in 1991, the China-Pacific Insurance Company was formed.<sup>86</sup> Domestic competitors subsequently entered the marketplace, resulting in the erosion of the PICC monopoly.<sup>87</sup>

Rapid growth in foreign-related insurance business and foreign-owned insurance companies can also be observed during this period. Until 1995, the PICC owned nine foreign-related and overseas insurance institutions, some of which were holding companies or group companies.<sup>88</sup> In October 1992, the American International Group (AIG) became the first foreign-owned insurance company permitted to initiate both life and property insurance business in China's largest city, Shanghai.<sup>89</sup> In 1995, AIG was allowed to extend its business to Guangzhou.<sup>90</sup> In 1994, the Tokyo Marine & Fire Insurance Company, the biggest property and casualty insurance company in Japan, also initiated business in Shanghai.<sup>91</sup> Thereafter, foreign insurance business started returning to the Chinese market in the form of foreign-owned companies, representative offices or joint ventures with local companies.<sup>92</sup> This progress brought the Chinese insurance market into a new era.<sup>93</sup> By the end of 1996, five foreign-owned insurance companies and some 126 representative and liaison offices from 77 foreign insurance companies were operating in the insurance market in China.<sup>94</sup>

#### *Period of the Development of Modern Regulation (1995~present)*

With continuing economic reform and removal of market restrictions, the climate of development accelerated the maturing of China's market. For example, the PICC obtained status completely independent from the People's Bank of China (PBC), the central and former supervisory organ, while vastly expanding and developing its

---

85. WEN-HUA LIU, *WTO YU ZHONG GUO JIN RONG FA LU ZHI DU DE CHONG TU YU GUI BI* [WTO and its Conflicts with the Legal System of China's Financial Law and the Avoidance] 373 (Beijing 2001).

86. ZHU, *supra* note 67, at 125.

87. LIU, *supra* note 85, at 373.

88. FAN, *supra* note 63, at 159.

89. ZHU, *supra* note 67, at 125.

90. LUO, *supra* note 6, at 159.

91. *Id.*

92. ZHU, *supra* note 67, at 125.

93. *Id.*

94. FAN, *supra* note 63, at 159.

business to control almost 80% of the domestic insurance market.<sup>95</sup> In October 1998, the State Council decided to restructure the former PICC Group, which had three subsidiaries and set up four independent, state-owned insurance companies: (i) the China Reinsurance Company (CRC); (ii) the China Life Insurance Company; (iii) the new People's Insurance Company of China (PICC); and (iv) the China Insurance Company Limited, which oversees the China Insurance Company Limited of Hong Kong.<sup>96</sup> At the same time, the total number of foreign insurance companies and Sino-foreign joint ventures grew. Insurance firms from Canada, Switzerland, Germany, Australia, and France entered the Chinese insurance market.<sup>97</sup> However, geographic restrictions limited their business to Shanghai and Guangzhou, which thereby limited their market share to as low as one percent.<sup>98</sup>

Another important feature of this period is the creation of the modern insurance regulation and supervision system. In October 1995, the Insurance Law of PRC (Insurance Law) was promulgated which combined insurance contract law with laws regarding insurance supervision and administration.<sup>99</sup> It is the first national legislation to deal comprehensively with insurance matters.<sup>100</sup> For the purpose of strengthening insurance supervision and facilitating the development of the Chinese insurance market, the amendment of the Insurance Law as a part of the post-WTO accession legislative renovation was completed in October 2002.<sup>101</sup> In addition, the structure and authority of financial supervisors were also adjusted. In 1998, the authority over insurance supervision and regulation was transferred from the People's Bank of China to the newly established regulatory institution, the China Insurance Regulatory Commission (CIRC), which was formed because of the rapid growth in the Chinese insurance sector and the lack of

---

95. Before November 1998, China's insurance industry was regulated by the PBC. Now, the China Insurance Regulatory Commission (CIRC), a newly-established government agency, is charged with the supervision and administration of the insurance industry in China. FAN, *supra* note 63, at 159.

96. See *China's Insurance Sector: Overview of Recent Changes*, 21 E. ASIAN EXECUTIVE REP. 2, 8 (Feb. 15 1999), available at WESTLAW 21 No. 2 EAEXREP 8.

97. LUO, *supra* note 6, at 159.

98. *Id.*

99. See Insurance Law of the People Republic of China 1995, available at <http://www.qis.net/chinalaw/lawtran1.htm> (last visited Feb. 6, 2004).

100. GUANGHUA YU & MINKANG GU, LAW AFFECTING BUSINESS TRANSACTIONS IN THE PRC 132 (2001).

101. Xu Guojian & Richard L. Merti, *Amending the Insurance Law: Long-Term Policy or Expedient Measures*, 10 CHINA L. & PRAC. 21 (2003).



sufficient industry oversight.<sup>102</sup> As for the administration of foreign-funded insurance companies, the Administration of Foreign-funded Insurance Companies Regulation (AFICR) was promulgated on December 12, 2001. The AFICR responsibilities include licensing, minimum capital requirements, and other qualification requirements for instituting a foreign-funded insurance operation in China.<sup>103</sup>

### *Brief History of Chinese Insurance Legislation*

China's insurance law legislation can be traced back to the end of the Qing Dynasty. The Qing government drafted the Qing Commercial Law, which provided two chapters concerning loss and life insurance.<sup>104</sup> However, the Qing Dynasty collapsed before this law was implemented.<sup>105</sup> In 1929, the Guomindang (KMT) government drafted the Insurance Law, revised it in 1937, and promulgated the Maritime Law, which is relevant to marine insurance in 1931.<sup>106</sup> After the foundation of the PRC in 1949, a series of insurance acts and regulations, consisting of rules, administrative decisions, ordinances, methods and notices, were promulgated by the State Council.<sup>107</sup> Most of these acts and regulations focused only on compulsory insurance, including compulsory insurance for the property of state institutions and for the property of ship, train, and airplane passengers.<sup>108</sup>

The Insurance Law of 1995 was the first national legislation that provided an overall framework for understanding insurance regulation in China.<sup>109</sup> This legislation consisted of eight chapters with a total 152 articles.<sup>110</sup> The first chapter covered general principles including the purpose of the law, the definition of insurance, the scope of the law, and principles of the insurance industry.<sup>111</sup> Chapter Two, pertaining to insurance contracts, consisted of three sections: (1) the general rules of the formation, amendment, and performance of the insurance contract; (2) property insurance; and (3) life insurance contract.<sup>112</sup> Chapters Three through Five provided the rules and requirements of insurance

102. China's Insurance Sector, *supra* note 96, at 8.

103. ZHU, *supra* note 67, at 127.

104. YU & GU, *supra* note 100, at 126.

105. *Id.*

106. FAN, *supra* note 63, at 158.

107. *Id.*

108. YU & GU, *supra* note 100, at 126-7.

109. *Id.* at 132.

110. Insurance Law, *supra* note 99.

111. *Id.*

112. *Id.*

company administration and supervision, including licensing, scope of business management of premiums, liquidation, and continuous supervision.<sup>113</sup> Chapter Six offered rules for supervision of insurance and related industries such as insurance agents and brokers.<sup>114</sup> Finally, Chapters Seven and Eight included provisions regarding legal liabilities and sanctions.<sup>115</sup>

Articles pertaining to the supervision and administration of insurance companies were still in the early stages of development. Therefore, the CIRC promulgated the Regulation Regarding the Administration of Insurance Companies in 2000.<sup>116</sup> The Regulation has ten chapters with 119 articles, which provide more detailed rules for supervising and administering insurance companies.<sup>117</sup>

The insurance industry in China changed drastically between 1995 and 2002. Compared to merely one insurance company in the market, the total number of companies had reached 53 by the end of 2002 and total annual premium income had risen from RMB 460 million in 1995 to RMB 226.3 billion through the first three quarters of 2002.<sup>118</sup> This growth resulted in an increasing number of insurance consumers and products, also generating need for higher quality service and upgraded regulatory systems.

With these changed objectives, several parts of the Insurance Law of 1995 were no longer suitable for application in the current market. Some original provisions even became obstacles to reasonable operation in the altered environment.<sup>119</sup> Soon after its establishment, the CIRC placed amendment of the Insurance Law of 1995 atop its list of priorities. Eventually, the People's National Congress granted legislative approval to this amendment on October 28, 2002. Four ultimate goals are expected to be achieved through this amendment: (i) sustaining reform and development of China's insurance industry; (ii) strengthening supervision and regulation of the industry; (iii) standardizing regulation of insurance enterprises and business operations; and (iv) fulfilling pledges to adopt international practices made during the WTO accession negotiations.<sup>120</sup>

---

113. Insurance Law, *supra* note 99.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. China Insurance Regulatory Commission, *available at* <http://www.circ.gov.cn/assay/index.htm> (last visited Jan. 10, 2004).

119. Guojin & Merl, *supra* note 101, at 21.

120. *Id.*

The creation of the CIRC on November 19, 1998 as the sole regulator of China's insurance industry reallocated the authority for supervision of financial institutions and restructured the supervisory and regulatory body.<sup>121</sup> Although insurance business is considered financial business, the Chinese government insisted that different financial businesses should be operated and managed separately while being subject to supervision by different authorities.<sup>122</sup> As the work of the CIRC is directed toward fostering and developing the insurance market and prudent risk management, the CIRC is charged with four major duties: (i) to study and formulate polices concerning the development of the insurance industry; (ii) to make new laws and regulations regarding the business of insurance to improve the insurance legal system; (iii) to supervise the business practices of insurance companies and the operation of new insurance laws and regulations; and (iv) to establish a risk assessment system to investigate the solvency of insurance companies.<sup>123</sup>

With respect to the administration of foreign-funded insurance institutions or foreign investment in the insurance sector, China lacked a single overall legislation until the promulgation of the Administration of Foreign-Funded Insurance Companies Regulations (AFICR) on December 12, 2001. Nevertheless, China has promulgated several specific laws and regulations since 1992: (i) Administration of Foreign-Funded Insurance Institutions in Shanghai Tentative Procedures in 1992; (ii) the Administration of Representative Offices in China of Foreign Financial Institutions Procedures in 1996; (iii) Letter of the People's Bank of China Regarding Equity Ratios of the Chinese Party and the Foreign Party in a Chinese-Foreign Joint Equity Life Insurance Company; (iv) Interim Rules on Qualifications of Senior Management Personnel in Insurance Institution in 1999; (v) Contract Law in 1999; and (vi) Regulation Regarding the Administration of Insurance Companies in 2000.<sup>124</sup>

In summary, the legislative history of modern Chinese insurance laws and regulations is relatively short. Admittedly, building a legal regulatory system for insurance and achieving the current scale in approximately eight years (beginning with the promulgation of Insurance Law in 1995) is an accomplishment. In spite of this

121. YU & GU, *supra* note 100, at 128.

122. *Id.*

123. China Insurance Regulatory Commission, *available at* [http://www.circ.gov.cn/circ\\_je.htm](http://www.circ.gov.cn/circ_je.htm) (last visited Jan. 10, 2004).

124. YU & GU, *supra* note 100, at 128-129.

accomplishment, some parts of current laws and regulations are still immature and in need of amendment and supplement. The following parts of this article will review the compliance of current laws and regulations with WTO obligations and commitments as well as the extent of their harmonization with other international standards.

#### V. CURRENT LAWS AND REGULATIONS REGARDING THE SERVICE OF INSURANCE, AND THE REVIEW OF THEIR COMPLIANCE TO CHINA'S OBLIGATIONS UNDER WTO

The newly amended Insurance Law of 2002, the Administration of Foreign-Funded Insurance Companies Regulations, and the Regulation Regarding the Administration of Insurance Companies are three cornerstones of the modern Chinese insurance legal system. The first two are significant because they were either revised or formulated for the purpose of fulfilling the obligations of the post-WTO era. The following discussion will first present delineations and material elements of these three pieces of legislation. Then the following parts will review the extent of China's compliance with the WTO agreement and relevant commitments concerning China's accession to determine whether a situation of non-compliance still exists.

##### *Current Laws and Regulations*

##### *Insurance Law of 2002*<sup>125</sup>

The Insurance Law of 2002 generally retains the structure and organization of the Insurance Law of 1995. It contains eight chapters with 158 articles.<sup>126</sup> Chapter One covers general principles including the purpose of the law, definitions, and the scope of the law and principles of the insurance industry.<sup>127</sup> Chapter Two provides the general rules of insurance contracts and specific rules for property insurance and life insurance contracts.<sup>128</sup> Chapters Three through Five provide the rules and requirements of insurance company administration and supervision, including licensing, the scope of premium business management, liquidation, and continuous supervision.<sup>129</sup> Chapter Six gives rules for

---

125. The following discussion is based on Insurance Law, art. 16 (2002) (P.R.C); *PRC Insurance Law (Revised)*, 10 CHINA L. & PRAC. 39, Dec. 2002–Jan. 2003, at 61, 63.

126. *PRC Insurance Law (Revised)*, 10 CHINA L. & PRAC. 39, Dec. 2002–Jan. 2003, at 61, 63.

127. *Id.*

128. *Id.*

129. *Id.*

the supervision of insurance agents and brokers, while Chapter Seven includes provisions regarding legal liabilities and sanctions.<sup>130</sup> Finally, Chapter Eight is comprised of miscellaneous provisions.<sup>131</sup>

### *Insurance Contract*

#### *Formation of an Insurance Contract*

To avoid moral hazard, Article 12 of the Insurance Law requires an applicant to have an insurable interest in the insured subject matter as the prerequisite for an effective insurance contract.<sup>132</sup> Therefore, if the applicant holds no insurable interest in the subject matter, the corresponding insurance contract shall be deemed invalid.<sup>133</sup> An insurance contract is concluded "when an applicant makes a request for insurance, the insurer agrees to underwrite the insurance and the terms and conditions of the contract are agreed upon."<sup>134</sup> Although the Insurance Law does not explicitly require that the insurance contract should take written form, it is required that the insurer issue the insurance policy or other insurance certificate to the applicant; however, other forms of a written agreement may also be adopted subject to the consensus of both parties.<sup>135</sup>

#### *Rights and Duties of Parties under the Insurance Contract*

Because the insurance contract is formed on the basis of the principle of "utmost good faith," both insurer and insured bear duties to disclose relevant information.<sup>136</sup> Insurance Law mandates that the

130. *PRC Insurance Law*, *supra* note 126.

131. *Id.*

132. "To determine the existence of an insurable interest in the subject-matter of the insurance contract, the subject-matter must be precisely defined. It has been suggested that, although insurance contracts are referred to as though they insure something, no contract of insurance insures anything; that what is insured is the person owing or responsible for such thing against the loss which may be occasioned to him from the damage to or destruction of the thing, or from the damage resulting from the use or abuse of the thing." If the insured has an insurable interest, it is said, he will be less tempted to destroy insured property. See MALCOLM A. CLARKE, *THE LAW OF INSURANCE CONTRACT* 98-100 (1994); Moral hazard refers to "the effect on the insured's incentives to reduce expected losses". For example, once the insured purchase theft insurance, his incentive to take precautions to reduce the likelihood of theft is reduced. See HARRINGTON & NIEHAUS, *supra* note 17, at 167.

133. Shonghua Renmin Gongheguo Fagui Huidian [Collection of Laws and Regulations of the People's Republic of China] (1995) (P.R.C.) [hereinafter *Insurance Law of P.R.C.*], art. 12(2) (2002).

134. *Id.* art. 13(1).

135. See *id.* art. 13(2)(3).

136. See MALCOLM A. CLARK, *THE LAW OF INSURANCE CONTRACT* 708 (1994).

insurer explain the full contents of the contract to the applicant, specifically mentioning all insurer's liability exemptions to the applicant.<sup>137</sup> If the insurer fails to specifically explain the item of exemption, then "the clause of the contract stipulating the said exemption shall not carry validity."<sup>138</sup> Conversely, the insurer has the right to make relevant inquiries to the applicant regarding the insured subject or the circumstances of the insured, about which the applicant is required to provide truthful disclosure.<sup>139</sup>

Where the applicant deliberately conceals facts, fails to respect the duty of truthful disclosure, or negligently fails to execute the duty of truthful disclosure so as to materially affect the insurer's decision regarding provision of insurance coverage or increase of premiums, the insurer has the right to rescind the insurance contract.<sup>140</sup> In the case of deliberate failure, the insurer is not liable for indemnifying the insured or paying the insurance benefits for the insured event occurring before the rescission of the contract, and owes no duty to refund the insurance premium collected.<sup>141</sup> If the applicant negligently fails to fulfill his duty of truthful disclosure and the negligence has significant linkage with the occurrence of the insured event, the insurer is not liable for indemnifying the insured or paying the insurance benefits for the event occurring prior to the rescission of the insurance contract, but the premium must be refunded.<sup>142</sup> Furthermore, the applicant also bears the obligation of informing the insurer and all related insurers if they have obtained double or multiple insurance coverage.<sup>143</sup> However, normally after the insurance contract is concluded, the applicant is obligated to pay the insurance premium as agreed and the insurer is obligated to indemnify the insured or to pay insurance benefits when the insured event occurs.<sup>144</sup>

### *Performance of the Insurance Contract, Liabilities from Breach and Interpretation of the Insurance Contract*

Generally, both parties to the insurance contract shall perform the insurance contract in accordance with the principles of honesty and

137. See PETER M. EGGERS & PATRICK FOSS, GOOD FAITH AND INSURANCE CONTRACTS 5-6 (1998); Insurance Law of PRC, *supra* note 133, art. 17(1), 18.

138. Insurance Law of PRC, *supra* note 133, art. 18.

139. *Id.* art. 17(1).

140. *Id.* art. 17(2).

141. *Id.* art. 17(3).

142. *Id.* art. 17(4).

143. Insurance Law of PRC, *supra* note 133, art. 41.

144. *Id.* art. 10(2)(3).

good faith.<sup>145</sup> To the applicant and/or the insured, this means assuming the obligation to promptly notify the insurer of the occurrence of the insurance event.<sup>146</sup> In addition, contractual law obligates the applicant to take every measure necessary to prevent or mitigate damages once the insurance event occurs.<sup>147</sup> Furthermore, while the insurance contract is valid, the insured is required to notify promptly the insurer when the degree of risk to the insured subject increases and the insurer is entitled to increase the premium or to rescind the insurance contract.<sup>148</sup>

In return, the insurer is obligated not only to indemnify the insured and pay the insurance benefits but also to bear necessary and reasonable expenses incurred by the insured to prevent or mitigate damages after the occurrence of an insurance event.<sup>149</sup> If an insurance event occurs due to a third party causing damage to the insured subject, then from the date of indemnifying the insured, the insurer shall be subrogated to the right of the insured to claim compensation from the third party up to the amount of the indemnity paid.<sup>150</sup> Finally, the insurer or the reinsurer must preserve the confidentiality of any information concerning the business, property or personal matters of applicants, insured, and beneficiaries.<sup>151</sup>

Where arguments arise between the insurer and the insured or the insurer and the applicant regarding the meaning of terms and clauses of the insurance contract, the People's Court or arbitration institution shall construe the term or clause in question against the insurer.<sup>152</sup> Because an insurance contract is considered a contract of adhesion, almost all clauses in the contract are prepared by the insurer in advance. The imbalance of bargaining power between the individual applicant and insurer limits the applicant merely to accept or decline the already-set clauses.<sup>153</sup> For these reasons, insurance laws of developed countries such as the United States provide that "an insurance policy is construed 'most favorably to the insured and most strictly against the insurer.'"<sup>154</sup>

145. Insurance Law of PRC, *supra* note 133, art. 5.

146. *Id.* art. 22.

147. *Id.* art. 42(1).

148. *Id.* art. 37.

149. *Id.* art. 42(2).

150. Insurance Law of PRC, *supra* note 133, art. 45.

151. *Id.* art. 32.

152. *Id.* art. 31.

153. ZONG-RONG LIU, BAO XIAN FA [Insurance Law] 36 (1995).

154. *Vargas v. Ins. Co. of N. Am.*, 651 F.2d. 838, 839-40 (2d Cir. 1981) (*quoting* *Index Fund, Inc. v. Ins. Co. of N. Am.*, 580 F.2d. 1158, 1162 (2d Cir. 1978), *cert. denied*,

China's legislation regarding interpreting insurance contracts appears to be consistent with modern insurance law principles. However, problems remain which will be discussed in the remaining parts of this article.

### *Insurance Companies*

In the People's Republic of China, insurance companies are limited to two organizational forms: "[a] stock company with limited liability; or [a] solely State-owned company."<sup>155</sup> Unlike the practice in the U.K. and the U.S, mutual insurance companies are prohibited in China.<sup>156</sup> The establishment of an insurance company must be pre-approved by the Insurance Regulatory Authority.<sup>157</sup> Five conditions must be satisfied for an insurance company to be established: (i) qualified articles of association; (ii) minimum amount of registered capital; (iii) qualified senior management personnel with professional knowledge and experience; (iv) sound organizational structure; and (v) required business premises and business-related facilities.<sup>158</sup> However, mere satisfaction of these five conditions does not guarantee approval. When examining an application for approval, the CIRC will consider the needs of development and fair competition within the insurance industry.<sup>159</sup>

### *Rules for Insurance Business Operation*

Once established, the insurance company shall commence its business in accordance with the business scope approved by the CIRC. For the purpose of protecting policyholders, unless otherwise approved by CIRC, an insurance company is not allowed to simultaneously engage in both the property and life insurance business.<sup>160</sup> Insurance companies are also prohibited from engaging in any business not stipulated by the Insurance Law.<sup>161</sup> If the maximum amount of the loss caused by a single insured event exceed 10% of the sum of the paid-in capital and common reserve of such insurance company, the portion exceeding the threshold must be insured.<sup>162</sup> Reinsurance coverage

---

440 U.S. 912 (1979)).

155. Insurance Law of PRC, *supra* note 133, art. 70.

156. Yu & Gu, *supra* note 100, at 141.

157. Insurance Law of PRC, *supra* note 133, art. 71.

158. *Id.* art. 71. The minimum registered capital required for establishing an insurance company is RMB 200 million. *See id.* art. 73.

159. *Id.* art. 72(2).

160. *Id.* art. 92(2).

161. *Id.* art. 92(3).

162. Insurance Law of PRC, *supra* note 133, art. 100.



which an insurance company should take out must respect the relevant regulations of CIRC.<sup>163</sup> Utilization of insurance funds by insurance companies must be safe and sound in nature while abiding by the principles of security and guarantee of preservation and appreciation of asset value.<sup>164</sup> To ensure safety and soundness, the utilization of funds by insurance companies is limited to bank deposits, government bonds, financial bonds, and other types of utilization specially provided by the State Council.<sup>165</sup>

### *Supervision and Administration of the Insurance Industry*

Additionally, the Insurance Law mandates that clauses and premium rates of insurance policies which bear on the public interest, insurance products for compulsory insurance as prescribed by law, and new types of life insurance must be submitted to the Insurance Regulatory Authority for review and approval.<sup>166</sup> When exercising these powers of review and approval, the Authority must protect the public interest and prevent unfair competition.<sup>167</sup> Clauses and premium rates for all other types of insurance products shall be placed on record with the Insurance Regulatory Authority.<sup>168</sup> The Insurance Law requires that the Authority formulate a complete system of benchmark indices for monitoring the solvency of insurance companies, and exercising monitoring and control over the minimum solvency of insurance companies.<sup>169</sup> The Insurance Regulatory Authority is granted the power to inspect an insurance company's business, including its financial affairs and funds utilization, and to request the disclosure of relevant written reports and information within specific time periods.<sup>170</sup> If the insurance company fails to allocate funds to various reserve portfolios, make reinsurance arrangements pursuant to the relevant articles, or materially violate articles relating to the utilization of insurance funds, then the regulator will issue an order to rectify the deficiency within a specific period of time.<sup>171</sup>

---

163. Insurance Law of PRC, *supra* note 133, art. 101.

164. *Id.* art. 105(1).

165. *Id.* art. 105(2).

166. *Id.* art. 107(1).

167. *Id.*

168. Insurance Law of PRC, *supra* note 133, art. 107(2).

169. *Id.* art. 108.

170. *Id.* art. 109.

171. *Id.* art. 111.

*Insurance Brokers and Agents*

Insurance brokers and agents are prohibited from engaging in the following conduct while carrying out insurance business activities: (i) defrauding the insurer, the applicant, the insured, or the beneficiary; (ii) concealing important circumstances related to the insurance contract; (iii) impeding the applicant from performing obligations stipulated in the Insurance Law to make truthful disclosure, or inducing such applicant not to make truthful disclosure; (iv) promising to provide other interests to the applicant, the insured or the beneficiary not provided in the insurance contract; or (v) resorting to administrative power, occupational or professional convenience, or any other improper mean, to impel, induce, or restrict an applicant from entering into any insurance contract.<sup>172</sup>

*Regulation Regarding the Administration of Insurance Companies*<sup>173</sup>

The Regulation Regarding the Administration of Insurance Companies was promulgated by the CIRC in January 2000.<sup>174</sup> This regulation contains nine chapters with a total of 119 articles and provides more detailed provisions regarding the procedure and relevant affairs of licensing, operation of insurance businesses, insurance premiums and contract clauses, management and utilization of insurance funds, solvency of insurance companies, reinsurance, monitoring and inspection, and liabilities.<sup>175</sup> To fulfill China's commitments of accession, the CIRC further amended two articles of this regulation.<sup>176</sup> First, applicants are entitled to a written notice if their application for establishment of insurance company or representative office is disapproved.<sup>177</sup> Prior to these amendments, the regulator was not obligated to notify applicants if the application was declined with "non-notification" deemed to be rejection.<sup>178</sup> Second, regulators reviewed and approved the application based on the needs of insurance market development prior to amendment, but now the Authority does so

---

172. Insurance Law of PRC, *supra* note 133, art. 130.

173. Regulation Regarding the Administration of Insurance Companies (2000) (P.R.C.), available at <http://www.circ.gov.cn> (last visited Mar. 27, 2004) [hereinafter RRAIC].

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. RRAIC, *supra* note 173, arts. 9, 18.

in accordance with the needs of prudential regulation.<sup>179</sup> As a result, less protectionism will be introduced during the application review process because the decision is focused on whether the foreign insurance operation has a safe and sound operation but disregard for assisting the growth of domestic companies. Third, to eliminate local protectionism, the amendments abolished the condition that establishing an insurance branch should be beneficial to the development of the local insurance market.<sup>180</sup>

Thus, the Regulation Regarding the Administration of Insurance Companies created a truly unique solvency supervision system. Now, the considerations for deciding solvency are the total premium collected, the type of business, and the valid period of the insurance policy.<sup>181</sup> However, the risks that an insurance company assumes are far greater than a normal business because the risks pertaining to the operation of an insurance business vary significantly. To base the determination of whether an insurance company is solvent or not solely on its fixed percentage of reserves neglects the dynamic nature of different types of risks. Therefore, such a basis for this determination oversimplifies the situation.

*Administration of Foreign-Funded Insurance Companies Regulations (the AFICR)*

As defined in the AFICR, foreign-funded insurance companies structure themselves in three forms within China, which are approved for establishment and operation within China pursuant to the relevant laws and administrative regulations of the PRC: (i) equity joint insurance companies between foreign insurance companies and Chinese insurance companies and enterprises; (ii) foreign capital insurance companies with investments and operations by foreign insurance companies; and (iii) branches of foreign insurance companies.<sup>182</sup> The minimum registered capital of the equity joint insurance companies and wholly foreign-owned insurance companies shall be RMB 200 million or the equivalent in freely convertible currency.<sup>183</sup>

To be a qualified applicant for setting up a foreign-funded

179. RRAIC, *supra* note 173, art. 17.

180. Decision of Abolishment, *available at* <http://www.circ.gov.cn> (last visited Jan. 10, 2004).

181. *See* RRAIC, *supra* note 173, arts. 81–83.

182. Administration of Foreign-Funded Insurance Companies Regulations, art. 2 (2002) [hereinafter AFICR].

183. *Id.*

insurance company in China, applicants must satisfy the following criteria: (i) they shall have been in the insurance business for at least 30 years; (ii) they shall have had a representative office within China for at least two years; (iii) they shall have total year-end assets of no less than USD \$5 billion in the year before the application; (iv) their country or region of origin shall have a good system of insurance regulation and the foreign insurance company shall have been subject to effective regulation by the relevant authorities in its country or region of origin; (v) it shall have compensation capacity in accordance with standards of its country or region of origin; (vi) the relevant authorities in its country or region of origin shall agree to the application; and (vii) any other prudential criteria established by the CIRC.<sup>184</sup> In other words, CIRC investment approval involves a two-step process: (1) an examination of the foreign insurer's qualification; and (2) an approval of the documentation for the establishment of a foreign-funded insurance company.<sup>185</sup>

The standard timeframe for the completion of these approval procedures is long. First, the CIRC has six months to approve or deny the original application.<sup>186</sup> Then, successful applicants have a year to submit all establishment documentation.<sup>187</sup> After the formal submission by the applicant, the CIRC has 60 days to provide the second and final approval.<sup>188</sup> After formation, foreign-funded insurance companies are permitted to engage in all or some of property insurance (indemnity insurance, liability insurance and credit insurance) and personal insurance (life, health and accidental insurance) business. However, company business operation, financial condition and utilization of funds are subject to the inspection of the CIRC, which retains the power to require the submission of relevant documents, data and written reports from foreign-funded insurance companies.<sup>189</sup>

## VI. REVIEW OF COMPLIANCE TO THE WTO OBLIGATION AND COMMITMENT

With respect to complying with the Domestic Regulation Clause in Article VI of GATS, China adopted some praiseworthy amendments, of

---

184. AFICR, *supra* note 182, art. 8.

185. Donald J. Lewis, *China in Action: WTO Implementation in the Insurance Sector Off to a First Start*, 16 CHINA L. & PRAC. 27, 28 (2002).

186. AFICR, *supra* note 182, art. 10.

187. *See id.* arts. 10, 11.

188. *Id.* art. 12(1).

189. *Id.* art. 19.

which one requires the regulator to inform applicants by written notification in the case of declined application. This requirement fulfills the obligation to “ensure that the general application is administered in a reasonable manner.”<sup>190</sup> In addition, according to paragraph 308(g) of Report of the Working Party on the Accession of China, China is required to ensure that the applicant for a license is informed in writing and without delay regarding the reasons for the termination or denial of an application.<sup>191</sup> The applicant is then given the opportunity to submit a new application addressing the reasons for termination or denial.<sup>192</sup> By promulgating Article 10 and 12 of AFICR, China fulfilled this obligation.

However, some articles of the AFICR still do not comply with obligations under Article VI. According to paragraph 308 of the Report of the Working Party on the Accession of China, the situation that “China’s licensing procedures and conditions would not act as barriers to market access and would not be more trade restrictive than necessary” is of special concern.<sup>193</sup> Whether the nearly two-year licensing procedure mentioned above meets the requirement of “within a reasonable period of time after submission of an application” under Article VI of GATS remains questionable. Moreover, the seventh criteria for foreign-funded insurance companies, “other prudential criteria formulated by the CIRC,” seems to grant too much discretion to the regulator.<sup>194</sup> The uncertainty produces the likelihood of arbitrary decisions by the CIRC, which may violate the obligation to “administer all measures of general application in a reasonable, objective, and impartial manner.”<sup>195</sup>

Although the Administrative Litigation Law (ALL) was promulgated in 1989, it is questionable whether the requirement under Article VI: 2(a) of GATS and Part I: 2(D) of the Protocol on the Accession of People’s Republic of China is satisfied with respect to establishing or maintaining a tribunal and procedural requirements regarding the review of administrative actions.<sup>196</sup> The People’s Court has subject matter jurisdiction over the administrative actions concerning rejection or non-response to legitimate license applications;

---

190. GATS, *supra* note 8, art. VI, § 1.

191. Report, *supra* note 12.

192. *Id.*

193. *Id.*

194. Lewis, *supra* note 185.

195. Report, *supra* note 12.

196. *Id.*

however, only the citizens of the PRC are allowed to access this judicial review mechanism.<sup>197</sup> Even though foreign natural persons or legal persons are permitted to use this review procedure, plaintiffs still face significant obstacles such as huge costs, great chance of losing, difficulty in enforcing the verdict, and implied damage to relationships.<sup>198</sup> On its face, ALL allows China to meet requirements related to judicial review but inconsistency still exists in reality.

In fact, qualifications (4) to (7) of Article 8 of AFICR go further than that required by WTO commitments. As no similar criteria exist for establishing domestic insurance companies, a potential violation of national treatment is foreseeable. Criterion seven creates an opportunity for the CIRC to formulate criteria other than those provided in the AFICR. Extension of less favorable treatment to applicants of foreign-funded insurance companies violates Article XVII of GATS.<sup>199</sup> Further, permitting forms of insurance establishment under the AFICR to exclude "companies limited by shares" also violates Article XVII of GATS.<sup>200</sup> However, under the Insurance Law, "companies limited by shares" are permitted under the Insurance Law, which appears to treat foreign applicants less favorably than domestic insurance services.<sup>201</sup>

Furthermore, whether qualifications (4) to (7) of Articles 8 of AFICR is inconsistent with MFN treatment is also problematic. Each member country maintains its own standard regarding solvency and other prudential matters. An insurance company that is consistent with all prudential standards in one country may be inconsistent in another. Therefore, diversified standards of applicants' home countries may lead to different treatment among applicants. These criteria are not particularly onerous and appear justified under the "prudential carve-out" exemption of Article 2 of the Annex on Financial Services of GATS.<sup>202</sup>

---

197. Administrative Litigation Law of P.R.C., art. 11(4) (1989) [hereinafter ALL]. The People's Court has jurisdiction where "citizens, legal persons or other organizations" are not satisfied with certain administrative actions. *Id.* The word "citizen" here seems to indicate that foreigners' rights to access this review mechanism are precluded. *Id.*

198. STANLEY B. LUBMAN, *BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO* 210 (1999).

199. GATS, *supra* note 8, art. XVII.

200. *Id.*

201. See Insurance Law of P.R.C., *supra* note 133, art. 70.

202. GATS, *supra* note 8, art. 2. "Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the

Many developed countries have legislation similar to the provisions discussed above. For example, when considering licensing of foreign banking organizations, the Federal Reserve Board ("Board") of the United States seeks assurance of the foreign bank's financial and managerial strength as well as its support to the U.S. subsidiary bank.<sup>203</sup> Nevertheless, due to its jurisdictional limitations, the Board usually requests the opinions of bank regulatory authorities in the home country.<sup>204</sup> Criteria in Article 8 of AFTCR, especially (4) through (6), are formulated for the purpose of ensuring the managerial and financial stability of the foreign insurance company, which can be recognized as "measures for prudential reasons and for the protection of investors."<sup>205</sup> The exemption, provided by Article 2 of Annex on Financial Services, would be applicable because it is not utilized as a tool for avoiding China's commitments or obligations.

As for the obligation of transparency, relevant information regarding the latest legislation of insurance supervision and administration is available on the website of CIRC.<sup>206</sup> However, the only available version is in Chinese. Therefore, although the information can be deemed publicly available, it is unclear whether the CIRC has the capability to "respond promptly to all requests by other member countries for specific information."<sup>207</sup>

## VII. NECESSITY OF FURTHER REFORM

Some parts of current Chinese insurance-related legislation are inconsistent with requirements under GATS and require further amendment. Although current legislation satisfies obligations and commitments of WTO membership, the insurance market in China provision of a healthy, safe, and sound environment for both domestic and foreign insurance companies is not guaranteed. GATS is simply a framework agreement and its detailed commitments focus primarily on eliminating market restrictions, creating a non-discriminatory

---

Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement." Lewis, *supra* note 185, at 28.

203. FEDERAL RESERVE BOARD, BANK HOLDING COMPANY SUPERVISION MANUAL § 2100.1 at 409 (Dec. 1992), available at <http://www.federalreserve.gov/boarddocs/supmanual/bhc/bhc0603.pdf> (last visited Jan. 10, 2004).

204. *Id.*

205. Lewis, *supra* note 185, at 28.

206. Legislation of Insurance Supervision and Administration, available at <http://www.circ.gov.cn/policy/index.asp> (last visited Mar. 27, 2004).

207. GATS, *supra* note 8, art. III, § 4.

environment. Meanwhile, other objectives such as approaching a healthy, safe, and sound insurance market by mitigating market imperfections, ensuring the financial stability of insurers, and establishing generally acceptable insurance practice have never been considered.<sup>208</sup> Certainly, "a free market competitive system. . . [brings] efficiency, flexibility and. . . [economy, but it] also provides instability and uncertainty for participants, whether they are producers, employees, or consumers."<sup>209</sup> Unpredictability in estimating the probability of claims and other uncertainties tends to discourage risk-averse foreign insurers from offering insurance products.<sup>210</sup> As a result of this market imperfection, consumers may choose to seek protection from other products if the insurance market provides them insufficient protection.

Therefore, a concrete and thorough regulatory system is the most powerful instrument for bolstering the continued growth of China's insurance market and reducing the adverse effects caused by uncertainty and unpredictability. Only the establishment of a governmental regulatory system through legislation can attain the goals of consumer protection, quality maintenance, and non-discrimination. Although the rule of law challenges the Communist tradition in China, only recognition of the rule of law as valid can transform it into a distinct form of power. Furthermore, only attainment of this power can lay the foundation for an effective and efficient insurance supervisory system.<sup>211</sup> The following paragraphs explore the shortages in the current Insurance Law and provide suggestions on amendments to facilitate the market order through "the law."

### *Insurance Contract*

#### *The Structure of Insurance Law*

The Insurance Law of 2002 combines two different types of law: insurance contract law, which is categorized as civil legislation, and the laws regarding insurance supervision and administration, which are categorized as administrative law.<sup>212</sup> "In the societies that obey the notion of the rule of law, it is theoretically and conceptually necessary

---

208. See BANKS McDOWELL, *THE CRISES IN INSURANCE REGULATION* 27, 31-6 (1994); see HARRINGTON & NIEHAUS, *supra* note 17, at 645.

209. McDowell, *supra* note 208, at 18.

210. HOWARD KUNREUTHER & MARK V. PAULY, *INTERNATIONAL TRADE IN INSURANCE* 34, 35 (1991).

211. Lubman, *supra* note 198, at 307-8

212. Insurance Law, *supra* note 126, at 61.



to maintain a distinct separation between civil and administrative legislation.<sup>213</sup> In fact, many of the world's leading insurance markets such as Germany and Japan utilize dual statutes: one regulates contractual transactions and the other regulates government administration in the marketplace.<sup>214</sup> Under insurance law, "the issue is to clearly and carefully separate matters better dealt with through contractual agreements of mutual consensus from matters appropriately governed by administrative mediation."<sup>215</sup> Separate "legislation will [serve to] protect insurance participants' rights from being arbitrarily subjected to inappropriate administrative power."<sup>216</sup> Furthermore, the use of separate statutes to address contractual and administrative aspects respectively functions such that an amendment made to one part may not disturb the other. "This practice maintains the continuity and stability of the law as a whole, and minimizes disruption to the balance between flexibility and consistency built into the overall regulatory system."<sup>217</sup>

#### *Formation of the Insurance Contract*

Although Article 13 of Insurance Law requires the insurer to issue an insurance policy or insurance certificate and allow other forms of written agreements, a writing is not a condition to the conclusion of an insurance contract.<sup>218</sup> Majority groups in civil law countries advocate that the conclusion of insurance contracts takes place immediately after the insurer's acceptance of the offer even though the acceptance takes oral form.<sup>219</sup> In fact, this assertion better serves the needs of consumer protection. If an insurance contract must be in written form, then the insured may be left with no insurance protection during the period between the acceptance of the offer and the issuance of the insurance policy. This lapse in protection occurs because the insurance contract is not yet concluded until the insurance policy or certificate is issued.

Nevertheless, the majority theory closes this loophole. The Enforcement Rules of Taiwanese Insurance Law provides a worthy reference for future amendment: "With regard to property insurance, if

213. Guojin & Mertl, *supra* note 101, at 23.

214. For details, see <http://www.fsa.go.jp/refer.html> (last visited Feb. 6, 2004).

215. Guojin & Mertl, *supra* note 101, at 23.

216. *Id.*

217. *Id.*

218. HSIN-FA LIN, BAO XIAN CHI YUE XIAO LI LUN [A Study on the Validity and Invalidity of the Insurance Contract] 74 (1996); LIU, *supra* note 153, at 38.

219. *Id.*

the insured event occurred before the insurance policy is issued by the insurer, but the insurance premiums have been paid by the applicants, the insurer shall bear the risk."<sup>220</sup>

#### VIII. CONSUMER PROTECTION

In interpreting insurance contracts, Article 31 of the Insurance Law provides that disputes as to the meaning of terms or clauses should be construed in favor of the insured and beneficiary.<sup>221</sup> Although Article 31 appears to conform to the principles of the ambiguity doctrine in spirit, the legislation proves problematic.<sup>222</sup> Article 31, sweeping in scope, grants uniformly favorable interpretation to insured or beneficiaries without recognizing that ambiguity exist. As a result, a clause or term is automatically construed against the insurer in situations where no ambiguity exists.<sup>223</sup> Certainly, Article 31 advantages the insured or the beneficiary. However, where the insured or beneficiary is obviously incorrect, this law is applied, appearing to be unfair to the insurer while granting a windfall to the insured. Article 31 needs further amendment in accordance with the ambiguity rule. Otherwise, insurers may withdraw from the market as a result of the great legal risk.

Moreover, the Insurance Law lacks two other principles of insurance law—one from Common Law, reasonable expectation, and the other from Civil Law, control of the content of the insurance contract. The reasonable expectation doctrine applies when an ambiguity exists. Insurance contracts should provide the coverage that either the insured reasonably believed was being purchased or a reasonable person in the place of the insured would expect after reading the policy.<sup>224</sup> Once the doctrine is applied, (1) an insurer will be denied any unconscionable advantage in an insurance transaction; and (2) the objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.<sup>225</sup> A contract of adhesion is an example of

---

220. Enforcement Rules of the Insurance Law, art. 25 (1995) (Taiwan), available at <http://www.insurance.gov.tw/English/in1.asp#b> (last visited Jan. 10, 2004).

221. Insurance Law of P.R.C., *supra* note 133, art. 31.

222. *Id.*

223. *Id.*

224. ROBERT H. JERRY, UNDERSTANDING INSURANCE LAW 141–42 (2d ed. 1996).

225. Robert E. Keeton, *Insurance Law Rights At Variance With Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970).

unequal bargaining power between the insurer and the individual insured. Civil Law Countries correct this imperfection by adopting the principle of "control of the content of the insurance contract."<sup>226</sup> Taiwanese Insurance Law provides that:

"In case any of the following is included in an insurance contract, and the including of which was obviously unfair when the contract was signed, that portion of the agreement is void: (1) The liabilities of the insure required by this Law are exempted or reduced; (2) the applicant, beneficiary or insured is made to waive or restricted from asserting its rights under this Law; (3) The applicant or insured's liabilities are increased; or (4) Other material disadvantages imposed upon the applicant, beneficiary or insured."<sup>227</sup>

Both principles are deemed important in consumer protection and should be addressed in future amendments.

Additional deficiencies in the current legal regime exist. For example, an insurer will not sacrifice its own interests if a conflict arises between itself and an insured. Yet the Insurance Law does not require the insurer to avoid conflicts of interests. According to the principles provided by the International Association of Insurance Supervisors (IAIS),

"where the conflicts [of interest] arise, the service provider should ensure fair treatment to all its customers by disclosure, internal rules of confidentiality, declining to act, or otherwise. A service provider should not unfairly place its interests above those of its customers and where a properly informed customer would reasonably expect that the service provider would place the customer's interest above its own; the service provider should live up the expectation."<sup>228</sup>

This principle should be implemented in the form of legislation.

### *Supervision and Administration of Insurance Companies*

#### *Capital Adequacy*

The current solvency supervision system, set forth in the

226. CHAO-GUO JIANG, BAO XIAN FA GI CHU LI LUN [The Fundamental Theories of Insurance Law] 39 (1996).

227. Insurance Laws & Regulations of the Republic of China, art. 54-1(2002) (Taiwan), available at [http://www.insurance.gov.tw/English/in\\_lasp#2](http://www.insurance.gov.tw/English/in_lasp#2) (last visited Jan. 10, 2004) [hereinafter IAIS, Insurance Core Principles].

228. INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS, PRINCIPLES FOR THE CONDUCT OF INSURANCE BUSINESS 5 (1999), available at [http://iaisweb.org/133\\_ENU\\_HTMP.asp](http://iaisweb.org/133_ENU_HTMP.asp) (last visited Jan. 10, 2004).

Regulation Regarding the Administration of Insurance Companies, is oversimplified and disregards the variety of risks within insurance operations by focusing solely on the underwriting risk.<sup>229</sup> In fact, "capital adequacy requirements should reflect the size, complexity, and business risks of the company in jurisdiction."<sup>230</sup> The United States and the European Union address effectively the solvency risk born by global insurance companies. The U.S. model utilizes a risk-based model, "Risk-Based Capital" (RBC), which evaluates insurer capitalization by examining risk characteristics inherent to the insurer's unique operations.<sup>231</sup> Further, The RBC addresses four major categories of risk for property/casualty insurers: (i) off-balance sheet risk; (ii) asset risk; (iii) credit risk; and (iv) underwriting risk.<sup>232</sup> On the other hand, risks addressed in the life/health RBC model are similar to the property/casualty model except for the inclusion of asset risk, insurance-pricing risk, interest -rate risk and business risk.<sup>233</sup> The adjusted RBC amount is compared to an insurers actual "total adjusted capital" (TAC) to determine its RBC position.<sup>234</sup> Specific duties are provided for both the insurers and the regulators based on the figures generated by the RBC formulas. Certain company regulatory actions are required if an insurer's TAC falls below specified levels, namely: company action level, regulatory action level, authorized control level, and, mandatory control level.<sup>235</sup>

The European Union's Solvency Margin Model refers to "the financial resources of an insurance undertaking," in essence the difference between the assets and the liabilities of the insurer.<sup>236</sup> This kind of safety capital is necessary to absorb discrepancies between the anticipated and actual expenses and profits.<sup>237</sup> Throughout the EU, the level of solvency margin generally is linked to the overall business volume, either premium income or claim payments, of an insurance

---

229. See *infra* pp. 119-22.

230. IAIS, *Insurance Core Principles*, *supra* note 228, at 9.

231. Jan-Juy Lin, *The Capital Adequacy of Insurance: Reviewing the Current Global Standards in INTERNATIONAL FINANCIAL SECTOR REFORM: STANDARD SETTING AND INFRASTRUCTURE DEVELOPMENT* 78 (Say Goo & Zongfei Zhou eds. 2002).

232. See NAIC Risk-Based Capital for Insurers Model Act § 2(c) (Nat'l Ass'n of Ins. Comm'rs 1995) [hereinafter RBC Model Act].

233. *Id.* § 2(B).

234. *Id.* § 2(E).

235. See *id.* §§ 3-6.

236. Lin, *supra* note 231, at 73.

237. See *Solvency of Insurance Undertakings*, in Conference of Insurance Supervisory Authorities of Member State of European Union, COM(97)398 final, at 1.

undertaking conducted in the previous year.<sup>238</sup> For a non-life insurer, the minimum solvency margin is determined by either the annual amount of premiums or contributions, or the average burden of claims for the past three financial years.<sup>239</sup> The amount of the solvency margin is equal to the higher of the premium basis result and the claim basis result.<sup>240</sup> For a life insurer, solvency margin is determined according to the classes of insurance underwritten, with reference to capital at risk and mathematical provisions and taking into account reinsurance cessions to a certain extent.<sup>241</sup> China currently uses a less developed version of the solvency margin mode. Both models are operating well in the U.S. and EU respectively, either may be the reference for further reform.

### *Supervision of Insurance Holding Companies*

As mentioned above, the PICC was restructured in 1999 as part of the restructuring of the industry. The PICC is still an insurance holding company, which controls three subsidiaries while four other state-owned insurance companies were established.<sup>242</sup> Because the insurance holding company system does exist in China but no specific laws or regulations have been provided addressing issues of its supervision, the need is imminent for formulating a supervisory system to regulate and administer these companies. In addition, considering the trend towards integration among different financial sectors makes the establishment of a supervisory system reacting to this trend inevitable.<sup>243</sup>

The US and the EU provide models for solvency supervision of insurance holding companies and groups. The U.S. model provides rules related to: (i) authorization of establishment of subsidiaries; (ii) acquisition of control or merger with domestic insurers; (iii) standards and management of the insurance holding company systems; (iv) examination of insurance holding company systems; and (v) receivership.<sup>244</sup> Meanwhile, the EU model principally focuses on problems arising from financial conglomerates, such as double or

238. Lin, *supra* note 231, at 73.

239. Council Directive, 73/239/EEC, art. 16, 1973 O.J. (L228).

240. *See id.*

241. *See* Council Directive 79/267/EEC, art.19 1979 O.J. (L63), at 10.

242. *See infra* pp. 112–19.

243. *See generally Report on Consolidation in the Financial Sector*, Group of Ten, at 1–9 (Jan. 2001) (discussing introduction and summary of findings as well as policy implications).

244. *See generally Insurance Holding Companies System Regulatory Act* (Nat'l Ass'n of Ins. Comm'rs 2001).

multiple leverage, intra-group transactions, cooperation and information sharing among different regulators, and consolidated supervision.<sup>245</sup> Both models emphasize different aspects of solvency supervision and should be considered valuable material for formulating Chinese insurance holding company law.

### *Asset Management*

Currently the Regulation Regarding the Administration of Insurance Companies basically permits only four types of assets in which insurance companies can invest: government bonds, financial bonds, bonds issued by state-owned enterprises, and bank deposits.<sup>246</sup> Established with prudential management in mind, the scope of permissible investments in China is narrower than the scope of admitted assets and permissible investments in the U.S.<sup>247</sup> However, the too-narrow scope of allowable investments may hamper the companies' profits-generating ability because investments by insurance companies are intended to maximize profit and meet the need for capital and reserves.<sup>248</sup> An optimal supervision system for asset management must balance higher expected returns from holding riskier investments against solvency prevention. The model introduced by the IAIS emphasized controlling and monitoring investment plans and procedures without limiting the subject of investment.<sup>249</sup> The Report on Supervision Standard on Asset Management by Insurance Companies, permits four main types of financial assets: (i) bonds and other fixed income instruments; (ii) equities and equity type investments; (iii) debts, deposits, and other rights; and (iv) property.<sup>250</sup> The Report and the NAIC reserves creation of the investment plan, and duty to monitor, measure, report, and control investments to the insurer.<sup>251</sup>

The Report permits jurisdictions to "adopt the approach of imposing legislative restraints on the investment policies and

---

245. See generally European Parliament and Council Directive 98/78/EC of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group, 1998 O.J. (L330).

246. Regulation Regarding the Administration of Insurance Companies, art. 80 (2000) (P.R.C.), available at [http://www.circ.gov.cn/list\\_detail.asp?auto\\_id=140](http://www.circ.gov.cn/list_detail.asp?auto_id=140) (last visited Jan. 10, 2004).

247. See generally Investments of Insurers Model § 2AA-JJJ (Nat'l Ass'n of Ins. Comm'rs. 1996).

248. HARRINGTON & NIEHAUS, *supra* note 17, at 89.

249. IALA, *supra* note 18.

250. *Id.* at 4.

251. *Id.* at 5; see also RBC MODEL ACT, § 4.

procedures of insurers.”<sup>252</sup> Such legislation should be capable of ensuring the existence of: “(i) ongoing [board] of directors and senior management oversight; (ii) comprehensive, accurate, and flexible systems [allowing] the identification, measurement, and assessment of investment risks, and the aggregation of those risks at various levels; (iii) adequate procedures for the measurement and assessment of investment performance; (iv) adequate and timely communication of information on investment activities [among] all levels [of the] insurance company; and (v) rigorous and effective audit procedures and monitoring activities to identify and report weaknesses in investment controls and compliance.”<sup>253</sup> If the plan, procedure, and risk of investment is measured, managed and monitored with care and sophistication, then limiting the scope of permissible investments to bank deposits and a few low risk bonds is unnecessarily conservative. More practically, China should amend regulations relevant to asset management of insurance companies to comply with international standards.

#### IX. CONCLUSION

The newly amended Insurance Law of 2002 and newly promulgated Administration of Foreign-Funded Insurance Companies Regulations (AFICR) address some issues concerning China’s WTO accession and satisfy most obligations and commitments. However, some articles in the AFICR, particularly qualification of applicants of foreign-funded insurance companies and establishment forms) still do not comply with the National Treatment Clause and the Domestic Regulation Clause of GATS. The excessive discretion granted to CIRC is the most problematic of these inconsistencies. However, this broad grant of statutory authority can be beneficial as well by allowing the CIRC to act quickly and effectively to enforce and modify the law. Since the CIRC’s discretion operates within a system governed by rule of law as understood in many westernized countries, the exercise of such discretion must be subject to meaningful review by courts or relevant governmental authorities. Although the Chinese legal system made significant progress recently, statutory limits, traditions, and institutional weakness frustrates such meaningful review.<sup>254</sup> Therefore,

252. IAIA, *supra* note 18, at 5; see also RBC MODEL ACT, § 4.

253. RBC Model Act, §§5, 6.

254. Jeffery E. Thomas, *The Role and Powers of the Chinese Insurance Regulatory Commission in the Administration of Insurance Law in China*, 27 THE GENEVA PAPERS ON RISK AND INS. 413, 424 (2002).

narrowing the scope of the CIRC's discretion is the best way to fulfill commitments and obligations under GATS and avoid governmental arbitrariness.

While newly promulgated or amended laws and regulations meet the minimum standards imposed by China's accession to WTO and provide adequate consideration to foreign insurance companies, further legislative action is required to sufficiently prepare for the challenges presented by the full opening of China's insurance market.<sup>255</sup> For example, the Insurance Law must undergo additional revision and new laws and regulations must be promulgated imminently. Further reform of relevant insurance laws and regulations should address: (i) separation of insurance contract law and law regarding insurance supervision; (ii) consumer protection; (iii) clarification of the conclusion of insurance contract; (iv) capital adequacy and solvency regulations; (v) the insurance holding company; and (vi) establishment of a risk-management-oriented supervisions system of asset management. The Chinese government cannot avoid one certainty: the time for reform is now.

---

255. Guojian & Mertl, *supra* note 101, at 25.