JT&N's December, 2017 PRC Insurance News Alert

Welcome to the latest edition of the JT&N PRC Insurance News Alert, reporting recent regulatory developments affecting the PRC insurance sector. We welcome your comments, questions and feedback. The preceding JT&N PRC insurance News Alert was published in October 2017. To receive a back issue or to contact us, please visit our website (http://www.jtnfa.com/CN/index.aspx). Please note: Recipients who no longer wish to receive this News Alert may reply to jtninsurance@jtnfa.com and request to be deleted from our distribution list.

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1. Further "Opening-Up" of the Life Insurance Industry Announced

On November 10, 2017, Vice Finance Minister Zhu Guangyao announced that foreign ownership limits in life insurance companies would increase from 50% to 51% in three years' time, and 100% foreign ownership will be permitted in five years' time.

2.

Currently, foreign investment in life insurance companies is capped at 50%, a limit potentially deemed constraining to foreign investors from the perspective of corporate governance and/or profitability. Raising the permitted equity ownership percentage is expected to increase the attractiveness of China's life insurance market to foreign investment.

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Questions?

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2. Draft Revised Insurance Company Solvency Rules Released for Public Comment

On October 20, 2017, CIRC released the "Draft Administrative Rules for the Solvency of Insurance Companies" (the "Draft Solvency Rules") for public review, with a comment period that closed on October 27. If promulgated, the Draft Solvency Rules would supersede the "Administrative Rules for the Solvency of Insurance Companies," promulgated by CIRC on July 10, 2008, prior to the 2016 official implementation of the China Risk Oriented Solvency System ("C-ROSS").

In order to establish a more accurate understanding of the specific solvency conditions of insurance companies, the Draft Solvency Rules propose to replace the existing "solvency ratio" index with a basket of three new criteria: (i) "core solvency ratio;" (ii) "comprehensive solvency ratio;" and (iii) CIRC-assigned "comprehensive risk rating." Pursuant to the Draft Solvency Rules, an insurance company must have a core solvency ratio not less than 50%, a comprehensive solvency ratio not less than 100% and a comprehensive risk rating not lower than "B." Core solvency ratio is intended to measure the adequacy of an insurance company's high-quality capital, while the comprehensive solvency ratio is intended to measure the overall adequacy of an insurance company's capital. Core solvency and comprehensive solvency ratios are calculated pursuant to standards prescribed under C-ROSS, while comprehensive risk rating is determined by CIRC by weighing the above two solvency ratios and other risk factors in accordance with standards prescribed under C-ROSS. Pursuant to the Draft Solvency Rules, CIRC may impose a graduated scale regulatory measures on any insurance company whose solvency level or other regulatory compliance standard fails to meet requisite benchmarks, increasing in severity depending on the seriousness and basis for such failure.

3. Draft Insurance Funds Internal Control Guidelines for Public Comment

On October 10, 2017, CIRC released the "Draft Practical Guidelines for the Internal Control of Insurance Funds (No. 4 to No. 6)" (each respectively "No. 4," "No. 5" and "No. 6" and, collectively, the "Draft Practical Guidelines") for public review, with a comment period that closed on October 23. If promulgated, the Draft Practical Guidelines will supplement the "Practical Guidelines for the Internal Control of Insurance Funds (No.1 to No. 3)" promulgated by CIRC on December 15, 2015 (together with the Draft Practical Guidelines, the "Practical Guidelines"). The Practical Guidelines are intended to comprise implementing rules for the higher-level "Guidance for the Internal Control of Insurance Funds" (the "Internal Control Guidance"), promulgated by CIRC on December 15, 2015. Specifically, No.1 addresses insurance company control regarding insurance fund usage in bank deposit, No. 2. addresses fixed-return investment, No. 3 addresses stocks and stock fund, No. 4 addresses equity investment, No. 5 addresses real-estate investment, and No.6 addresses financial products.

With respect to the relationship between the Internal Control Guidance and the Practical Guidelines, the Internal Control Guidance prescribes overarching guidance, including objectives, principles, key measures and other similar general matters in connection with internal control of insurance fund usage. The Practical Guidelines are based on the Internal Control Guidance, and prescribe implementing measures, e.g., with respect to specific types of investment. Key topics included in the new Draft Practical Guidelines include risk factors with respect to the specific investment type, necessary internal control procedures with respect to the specific investment type, qualification requirements for an insurance institution to conduct the specific type of investment and other similar matters.

About JT&N:

JT&N is a leading full-service PRC law firm, top-ranked by Chambers & Partners, Legal 500, and IFLR1000, among others.

4. Draft Revised Health Insurance Measures Released for Public Comment

On November 15, 2017, CIRC released the "Draft Administrative Measures of Health Insurance" (the “Draft Measures”) for public review, with a comment period that closed on December 20. If promulgated, the Draft Measures will supersede the “Administrative Measures of Health Insurance,” promulgated by CIRC on August 14, 2006. Among the most significant changes, the Draft Measures include a new chapter governing (i) the provision of health management services by health insurance companies and (ii) the cooperation between health insurance companies and qualifying medical institutions. Other major amendments proposed by the Draft Measures relate to the definition of health insurance, corporate governance, health insurance product design, and medical innovation.

With respect to provision of health management services by health insurance companies, the Draft Measures provide that, in order to reduce the health risk of insureds and also reduce losses incurred from disease, insurance companies may combine health insurance products with health management services, such as health risk evaluation and intervention, disease prevention, health consultation, health maintenance, health care and other similar services. Matters relating to health management services may be prescribed in relevant health insurance policies or in separate health management service agreements. With respect to health insurance products covering health management services, if such costs exceed 20% of the net premium of such insurance products, then the prices for such services must be separately listed in the insurance policies. With respect to cooperation with medical institutions, the chapter encourages insurance companies to actively cooperate with hospitals, rehabilitation centers, public medical insurance agencies and other similar medical institutions.

In addition, the Draft Measures propose the following major amendments.

- With respect to the definition of health insurance, the Draft Measures emphasize the protective function of health insurance and specify that medical casualty insurance is a type of health insurance.
- With respect to corporate governance, insurance companies which are not specialized health insurance companies would be required to establish a health insurance department to conduct health insurance business.
- With respect to product design, pursuant to the Draft Measures, (i) long-term health products may contain a fee adjustment clause with clear conditions for triggering such adjustment; (ii) if the premium rate of a short-term health product is a floating rate, it may not exceed 30% of the standard rate; (iii) cooling-off period for long-term health products may not be less than fifteen days; and (iv) insurance periods of long-term care products (a type of long-term health insurance) will be no less than five years.
- With respect to innovations in medicines, instruments, and diagnosis and treatment methods, pursuant to the Draft Measures, insurance companies are encouraged to extend their product coverage to encompass these innovations. However, insurance companies are expressly forbidden from requiring genetic profiles, other than family medical history, from clients and/or using genetic profiles for purpose of underwriting or fee adjustments.

5. China Financial Stability and Development Committee (FSDC) Launched

On November 8, 2017, the Financial Stability and Development Committee (the "FSDC") under the State Council and chaired by Vice Premier Ma Kai held its first meeting in Beijing, four months after Chinese President Xi Jinping announced its establishment plan on the National Financial Work Conference on July 5, 2017. The FSDC is intended to act as a "deliberation and coordination organ" under the State Council, responsible for balancing and coordinating significant matters in connection with financial stability, reform and development.

According to an article released by the State Council on its official website (http://www.gov.cn/guowuyuan/2017-11/08/content_5238161.htm), following the first FSDC meeting, the FSDC's responsibilities include those listed below.

- Implementation of finance-related decisions and arrangements decided by the Central Committee of the Communist Party of China and the State Council.
- Deliberation of major reform and development plans for China's finance sector.
- (i) Planning the development and reform of the finance sector and financial regulation; (ii) coordinating monetary policies and matters in connection with financial regulation; (iii) planning and coordinating major matters in connection with financial regulation; and (iv) coordinating financial policies and relevant fiscal or industrial policies and other similar policies.
- Analysis of domestic and international financial circumstances, coping with international financial risks, researching policy requirements with respect to the prevention, and handling of systemic financial risk and financial stability.
- Direction of local-level financial reform and regulation, supervising the performance of financial regulators and local governmental bureaus.

The establishment of the FSDC is expected to strengthen linkages among the banking, securities and insurance subsectors. In the near term, the FSDC is expected to address regulatory issues in connection with shadow banking, the asset management business, internet finance and financial holding companies, as described by Zhou Xiaochuan, Chairman of the People's Bank of China, during remarks at a Group of 30 (G30) International Banking Seminar on October 15, 2017.

Our Offices

JTN has offices in Beijing, Shanghai, Shenzhen, Chengdu, Hefei, Jinan, Shenyang and Xi'an

6. Onsite Inspection Program Results in Increased Number of Regulatory Letters Issued by CIRC

In 2017, CIRC conducted extensive onsite inspections of insurance companies that focused particularly on corporate governance, and furnished the basis for the significantly increased number of regulatory letters. As of December 31, CIRC has published eighteen regulatory letters in 2017 addressing insurance company deficiencies relating to corporate governance on the official CIRC website (http://www.circ.gov.cn/web/site0/tab5168/). This reflects a significant increase as compared with 2016, when only one such regulatory letter was published for the entire year, reflecting a trend of increased regulatory scrutiny exercised by CIRC over the China insurance market. By way of background, publicly disseminated regulatory letters are an example of a tool used by CIRC to encourage market discipline among licensed insurance institutions. If CIRC identifies an incidence of noncompliant activity, CIRC may elect to publish a letter that identifies the particular shortcoming and demand rectification, e.g., submission of a rectifying report or formation of a rectifying working group.

Corporate governance deficiencies frequently cited by CIRC in its recent regulatory letters relate to the topics listed below.

- Shareholder and shareholding, e.g., restrictions on shareholding percentage of a single shareholder, duty of timely reporting change of shareholder to CIRC and other similar requirements.
- Operations and performance of shareholder meetings, the board of directors, the board of supervisors and the senior management personnel, e.g., mandatory establishment of working rules for the board of directors, duty to timely submit a board of supervisor working report to CIRC, and other similar requirements.
- Internal controls, e.g., maintenance of sufficient number of internal auditors, establishment of appropriate incentive rules, and other similar requirements.
- Management of affiliate transactions, e.g., establishment of an affiliate transactions archive, mandatory audit of affiliate transactions, and other similar requirements.

Among the identified deficiencies, CIRC expressed particular concern regarding management of affiliate transactions, going so far as to require four insurance companies to suspend certain affiliate transactions with specified affiliated parties. This year, CIRC also published other nineteen regulatory letters in connection with various problems of insurance companies including telemarketing operations, life insurance products, solvency and insurance fund investments. The regulatory letter published by CIRC on November 28, 2017, for the first time, announced that it would mandate an insurance company (Kunlun Health Insurance Co.) to "clear out" some of its shareholders who violated CIRC regulatory requirements.

7.Retrospective Administration of Insurance Sales Practices Circular Promulgated by CIRC

On October 31, 2017, CIRC promulgated the "Circular on Matters Related to Implementation of Temporary Measures for Retrospective Insurance Sales Practices" (the "Circular"). By way of background, CIRC had promulgated the related "Temporary Measures for Retrospective Insurance Sales Practices" (the "Temporary Measures") on June 28, 2017. Pursuant to the Temporary Measures, insurance companies and insurance intermediaries must record and preserve the key points of each insurance sales process by video/audio recording and other technical means when the policyholder is an individual, with the purpose of recapturing sales practices, enquiring about important information, and better identifying problems and liability. The Circular supplements the Temporary Measures, providing detailed guidance pertaining to video and audio recording, including: commencement time; client notification; sales personnel identification; video/audio electronic preservation and other similar matters. In addition, the Circular provides the model languages for sales personnel's reference during an insurance sale process.

8. Non-Life Chief Actuary Circular Promulgated by CIRC

On November 29, 2017, CIRC promulgated the "Circular on Matters Regarding Implementation of Chief Actuary Rules in P&C and Reinsurance Companies" (the "Circular"), superseding the "Circular on Actuarial Work in Non-life Insurance Business" promulgated by CIRC on July 8, 2010. Pursuant to the Circular, every P&C and reinsurance company licensed to conduct business in China must establish and fill the senior management position of "Chief Actuary," replacing previously established "Actuary Responsible Person" position, not later than January 1, 2020, or whenever an Actuary Responsible Person position falls vacant, whichever is earlier.

Each Chief Actuary must be qualified for actuarial work in the insurance company's area of business (e.g., P&C related actuarial work for a P&C company), possess at least eight years of relevant experience, including five years of insurance actuary, insurance finance or insurance investment work experience, and must be approved by CIRC. In contrast, the previously mandated Actuary Responsible Person position was a non-senior management position (pursuant to relevant CIRC rules) carrying lesser qualification requirements and a narrower scope of responsibility. For example, in order to be selected, an Actuary Responsible Person candidate only required three to five years of non-life actuary-related prior experience. However, assignment of Actuary Responsible Person also was subject to CIRC approval. Consistent with the overall aim of enhancing internal control procedures involving actuarial work and reinforcing actuarial-related capability of non-life insurers, a Chief Actuary is expected to engage in an expanded scope of responsibilities, including involvement in corporate governance, solvency management, products design and other similar matters.

9. Draft Revised Rules for Insurance Company Directors, Supervisors and Senior Management Released for Public Comment

On December 14, 2017, CIRC released the "Draft Administrative Rules for Qualification Approval of Insurance Company Directors, Supervisor and Senior Management Personnel" (the "Draft Rules") for public review, with a comment period that will close on January 16, 2018. If promulgated, the Draft Rules would supersede the "Administrative Rules for Qualification Approval of Insurance Company Directors, Supervisor and Senior Management Personnel," promulgated by CIRC on January 8, 2010 and revised on January 23, 2014.

Pursuant to the Draft Rules, among other changes, headquarters-level senior management personnel would be subject to heightened qualification requirements, as further detailed below.

- The secretary of the board of directors must have no less than five years prior finance-related work experience, or no less than eight years of economics-related work experience, as compared with the existing requirement of no less than five-years prior work experience "in relevant areas which make the candidate competent for performing his/her duties."
- Any candidate must possess a bachelor's degree, as compared with the existing standard where a lesser degree, e.g., a two-year degree received from a junior college, may suffice, so long as a candidate can satisfy certain alternative conditions (e.g., prior relevant work experience, an intention to work in underdeveloped and remote regions, or other qualifying circumstances).
- If a general manager's prior working experience was at an insurance company, it must be an experience no less than five-years at a position no lower than the general manager of a provincial-level branch, as compared with the existing requirement of no lower than the general manager of a branch.

Additionally, pursuant to the Draft Rules, any insurance company senior management personnel serving at any branch lower than the provincial level must have no less than three years prior finance-related work experience, or no less than five years of economics-related work experience, as compared with the current arrangement where work experience requirements for senior management personnel serving at branches below the provincial level vary depending on the level of the branch.

Other noteworthy changes in the Draft Rules are summarized below.

- Expanded scope of applicability – the Draft Rules are applicable to insurance companies and mutual insurance companies, and apply by reference to reinsurance companies and insurance asset management companies.
- Longer "clean record" period -- any candidate must have a record free of administrative penalties for the prior two years prior to application, as compared with the existing one year requirement.
- Candidate application packages – in addition to existing requirements, any candidate application package must also include a due-diligence investigation report regarding the candidate, reflecting the investigation process and results, which has been completed prior to the date of the application to CIRC.
- Newly-added proscriptions against concurrent assignments -- Pursuant to the Draft Rules, CIRC would prohibit any of the following concurrent assignments:
    - no chairman of the board of an insurance company may concurrently serve as the chairman of the board for another insurance company, subject to certain exceptions (e.g. the chairman of the board of an insurance group (holding) company concurrently serve as the chairman of the board for its subsidiary);

  - no chairman of the board of an insurance company may concurrently serve as the general manager of the same insurance company; and
  - no senior management personnel of an insurance company or a branch may concurrently hold three or more senior management positions at the same company or at the same branch, subject to certain exceptions (e.g. a senior management personnel concurrently serve as secretary of the board, chief compliance officer, chief actuary and other similar senior management personnel as prescribed by CIRC).
- Revised re-approval exemptions – the Draft Rules specifies the circumstances where a re-approval could be exempted for a candidate who has been approved by CIRC before (e.g. transfer to a position lower or at the same level with the prior position in the same institution, an insurance company director or supervisor to serve as a director or supervisor in another insurance company in the same area, i.e. P&C to P&C, a senior management personnel (other than the general manager) of an insurance company to serve at a position lower or at the same level in another insurance company). However, re-approval is still required if a director of an insurance company is transferred to or concurrently assigned to a senior management position. In addition, CIRC further provides in the Draft Rules that even if a re-approval is exempted, an insurance company must timely file relevant documents in accordance with CIRC rules.
- Expanded regulatory enforcement mechanisms
  - CIRC would have the discretion to identify an existing director, supervisor or senior management personnel as an "inappropriate candidate," and prohibit such individual from serving as director, supervisor or senior management personnel for a period of two years.
  - As noted above, publicly disseminated regulatory letters are an example of a tool used by CIRC to encourage market discipline among licensed insurance institutions. Pursuant to the Draft Rules, CIRC would also have the option of issuing regulatory letters to individual directors, supervisors and senior management personnel.

10. Draft Insurance Asset Liability Management Regulatory Measures Released for Public Comment

On December 15, 2017, CIRC released the "Draft Regulatory Measures for Insurance Asset Liability Management" (the "Draft Measures") for public review, with a comment period that will close on December 31, 2017. The Draft Measures, when promulgated, are to serve as the "general provisions" governing the CIRC asset liability management regulatory regime, which is to be comprised of (i) the finally promulgated "Regulatory Measures for Insurance Asset Liability Management" and (ii) the "Regulatory Rules for Insurance Asset Liability Management (No.1 to No. 5)" (each respectively Implementing Rule "No. 1," "No. 2," "No. 3," "No. 4", and "No. 5" and, together, the “Implementing Rules”), which were released by CIRC for public comment on July 28, 2017. As reported in an article published by CIRC on its official website (http://www.circ.gov.cn/web/site0/tab7924/info4076887.htm), CIRC expects to officially launch the regulatory regime in the near future. The Draft Measures and the Implementing Rules apply to life insurance companies and P&C insurance companies licensed by CIRC.

The Draft Measures provide general guidelines as well as describing related assessments and a rating system applicable to insurance company asset liability management, which is defined to mean “a process by which an insurance company, subject to its risk preference and other conditions, is continuously formulating, implementing, supervising, and improving its strategies in connection with asset and liability.” In addition, the Draft Guidance also specifies relevant duties of the board of directors, senior management personnel and other related departments with respect to asset liability management.

CIRC will periodically rate insurance company asset liability management based on a score that will be assigned to an insurance company (the “Comprehensive Test”), calculated on the basis of a “Quantification Test” and a “Capability Test,” as outlined below.

- CIRC will test insurance company asset liability management capability pursuant to criteria described in Implementing Rules No. 1 and No. 3 (the “Capability Test”). Specifically, No. 3 applies to life insurance companies and No. 1 applies to P&C insurance companies.
- CIRC will assess the relationship between insurance company assets and liabilities pursuant to criteria described in Implementing Rules No. 2 and No. 4, (the “Quantification Test”). Specifically, No. 2 applies to P&C insurance companies and No. 4 applies to life insurance companies.

Based on Comprehensive Test results, CIRC will assign insurance companies with letter grades of “A,” “B,” “C” or “D,” where “A” is the highest grade and “D” is the lowest. An “A-rated” insurance company may benefit from preferential policies. “C-rated” companies may be subjected to the imposition of regulatory measures intended to rectify assessed deficiencies and mitigate risk. “D-rated” companies may be subjected to further penalties and sanction, including forced adjustment of business structure, suspension new insurance product approval, restrictions on compensations of directors and senior management personnel, and other similar penalties and sanctions.

In addition, if CIRC deems the asset liability management capability of an insurance company is lower than a certain standard set forth by CIRC, CIRC will impose restrictions on the company’s insurance fund investments (e.g. refusal of registering equity-investment qualifications, real-estate investment qualifications and other similar restrictions). CIRC will renew the relevant standards periodically by considering the average level of capability with respect to the industry concerned and other relevant factors.

11. Draft Anti-Insurance Fraud Guidance Released for Public Comment

On December 14, 2017, CIRC released the “Draft Guidance on Anti-Insurance Fraud" (the “Draft Anti-Insurance Fraud Guidance”) and the “Draft Practical Guidelines on Anti-Insurance Fraud (No. 1) – Guidelines on Anti-Auto Insurance Fraud” (the “Draft Anti-Auto Insurance Fraud Guidelines”) for public review, with a comment period that closed on December 24. These draft measures are applicable to insurance group (holding) companies, insurance companies and their branches, and apply by reference to insurance professional intermediaries, reinsurance companies, and other relevant institutions.

The Draft Anti-Insurance Fraud Guidance provides overarching guidance with respect to insurance company anti-insurance fraud internal management, as well as the correlating responsibilities of CIRC, the Insurance Association of China (the “IAC”) and the China Insurance Information Technology Co., Ltd. (the “CIITC”). The Draft Anti-Insurance Fraud Guidance proposes a set of work arrangement that CIRC will take the leading role and the IAC and the CIITC will respectively exercise their supporting duties as directed by CIRC.

The Draft Anti-Auto Insurance Fraud Guidelines support the Draft Anti-Insurance Fraud Guidance by prescribing specific implementing measures relevant to the sub-sector of auto insurance-related fraud. Pursuant to the Draft Anti-Insurance Fraud Guidance, an insurance company must establish an insurance fraud risk management system with the key functions, features, and components including: (i) effective supervision and regulation by the board of directors, the board of supervisors, and senior management personnel; (ii) organizational structure and internal control processes for insurance fraud risk management; (iii) clear division of responsibilities and authority; (iv) identification, calculation, assessment, supervision, and disposal of fraud risks, and other similar features. Ultimate responsibility for fraud risk management is entrusted to the insurance company’s board of directors, while the senior management personnel are to exercise responsibility for fraud risk management implementation.

The Draft Anti-Insurance Fraud Guidance includes a noteworthy emphasis on technology providing, for example, that an insurance company must establish information systems for identifying, calculating, assessing, monitoring, controlling and reporting fraud risk, or enable its existing information systems to perform such tasks. In addition, the IAC must establish an anti-insurance fraud information-sharing platform, an anti-insurance fraud database and other similar information systems, and the CIITC must focus on developing an “intelligent anti-insurance fraud information management platform” based on big data technology.

With respect to the Draft Anti-Auto Insurance Fraud Guidelines, implementing details related to anti-auto insurance fraud are organized under topics such as risk prevention, data and information system, identification, assessment and investigation of risk and other similar topics. The Draft Anti-Auto Insurance Fraud Guidelines also reflect a comparable emphasis on technology requiring, for example, that an insurance company must apply big data analysis, cloud platform and other technology to establish an intelligent system in order to detect fraud conducted by an individual or by a group.