Open Sesame - Anatomy of Regulatory Regime for Foreign Investment in China’s Private Health Insurance Market

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Open Sesame in China’s Private Health Insurance Market

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In April 2009, Central Committee of the Communist Party of China and the State Council of the PRC promulgated the Opinions on Deepening the Reform of the Medical and Health Care System ("Opinions"), which serves as the overarching guidelines governing China’s healthcare reform. The Opinions officially redefines the commercial or private health insurance as the supplement to the basic or public health insurance program, highlighting the position of the private health insurance. Compared with the public health insurance program run and subsidized by governmental authorities, private health insurance provides coverage by commercial insurers based on insurance agreements or policies.

Driven by strong economic growth, China’s total health expenditure has gained over 10% annually since the issuance of the Opinions in 2009. It is estimated that China will have 238 million senior citizens who are 65 years of age or older in 2030, accounting for 16.4% of the total population by then. The acceleration of China’s population aging will further push up the health expenditure. In consideration of the enormous growth potential, many foreign insurers have started to eye China’s private health insurance sector.

Main framework

The major laws and regulations which are applicable to foreign investments in China’s private health insurance market are Insurance Law revised in 2009, Regulations for the Administration of Foreign-invested Insurance Companies ("Foreign-invested Insurers Regulations") taking effect in 2002, and Measures for the Administration of Health Insurance ("Health Insurance Measures") which was issued in 2006 by the China Insurance Regulatory Commission ("CIRC"), China’s insurance sector watchdog. In accordance with the Health Insurance Measures, both life insurance companies and health insurance companies are entitled to write health insurance, while other kinds of insurance companies, e.g., property insurance companies, are only permitted to carry on short-term health insurance business.

Generally, in order to invest in China’s insurance market, foreign insurers have three viable investment vehicles, i.e., wholly foreign owned enterprise ("WFOE"), joint venture ("JV"), and domestic branches of foreign insurers ("Foreign Insurers Branch"). To apply with CIRC for a new WFOE, JV or Foreign Insurers Branch, a foreign insurer shall meet certain requirements. In addition to some qualitative requirements, such as satisfying the solvency standard of its mother country, the foreign insurer shall meet three quantitative requirements as below: (i) it shall have more than 30 years of establishment experience; (ii) it shall have a representative office for two consecutive years in China; and (iii) it shall have total assets of no less than US $5 billion at the end of the year prior to application.

Life insurance companies

Under commitments made by China when joining WTO in 2001, except for 50 percent foreign ownership cap on foreign-invested life insurance companies, foreign insurers enjoy the national treatment in the personal insurance sector. According to the Schedule of Specific Commitments on Services ("Schedule") resulting from the negotiations between the PRC and WTO members, within two years after China’s accession, foreign non-life insurers will be permitted to establish as a WFOE; i.e., with no form of establishment restrictions. Under the Schedule, upon accession, foreign life insurers will only be permitted 50 percent foreign ownership in a JV with the partner of their choice.

Therefore, in principle, foreign life insurers cannot form WFOEs or Foreign Insurers Branches in China. However, it is worth noting that American International Assurance Company Limited ("AIA") is the only exception for historical reasons. Prior to China’s WTO entry, AIA had established Foreign Insurers Branches in major cities of China, carrying on life insurance and health insurance business. To keep the WTO commitments, CIRC has never approved new Foreign Insurers Branch for AIA since the issuance of the implementing rules of the Foreign-invested Insurers Regulations in 2004. In 2007, CIRC also denied AIA’s application for a WFOE license, underscoring CIRC’s position with respect to the foreign equity cap on the life insurance companies.

Health insurance companies

In theory, as health insurance falls within the non-life insurance, foreign health insurers shall be permitted to carry on health insurance business in China through any form of investment vehicles, including WFOE, JV and Foreign Insurers Branch, according to the Schedule. Additionally, under the Catalogue for the Guidance of Foreign Investment Industries amended in 2011, only life insurance companies are subject to the foreign investment restrictions of 50 percent equity cap.

However, under the implementing rules of the Foreign-invested Insurers Regulations, foreign insurers’ shareholding in the personal insurance companies shall not exceed 50 percent. According to the Insurance Law, personal insurance includes, among others, both life
insurance and health insurance. Therefore, health insurance companies are also subject to the 50 percent foreign-owned equity cap. Theoretically, the Foreign-invested Insurers Regulations shall not conflict with China’s WTO commitments. However, in practice, none of the four existing health insurance companies in China is a WFOE or Foreign Insurers Branch. It remains unclear regarding whether a foreign health insurer can form a WFOE in China.

**Property insurance companies**

In contrast to the life insurance and health insurance, China totally opens up the property insurance market, allowing foreign property insurers to form WFOE, JV, or Foreign Insurers Branch freely. Notably, property insurance companies are only allowed to engage in short-term health insurance business, while life insurance companies and health insurance companies can write both long-term and short-term health insurance.

Based on the foregoing analysis, we can summarize the regulatory requirements on foreign investment in China’s private health insurance market as below:

**Equity restrictions on each single shareholder**

Under China’s regulatory regime over the common foreign-invested enterprises, 25 percent is an important equity holding threshold. In China’s insurance sector, if foreign ownership in an insurance company is below 25 percent, such insurance company is deemed as a “domestic insurance company”. The 25 percent rule expands the scope of “domestic insurance companies”, covering insurance companies without foreign investors and with foreign investors collectively holding less than 25 percent shares.

On June 10, 2010, Administrative Measures for Equities of Insurance Companies (“Equities Measures”) issued by CIRC became effective. The Equities Measures are only applicable to “domestic insurance companies” which are composed of “pure” domestic insurance companies without foreign investor and JVs in which foreign insurers’ collective holding percentage is below 25 percent. Under the Equities Measures, the capital contribution or shareholding ratio of a single shareholder and its affiliated parties in a “domestic insurance company” shall not exceed 20% of the registered capital of the insurance company, unless CIRC grants exemption specifically.

**De facto restrictions on foreign investments**

Although CIRC purports that foreign-invested insurance companies enjoy equal national treatment except for 50 percent ownership cap on foreign-invested life insurance companies, foreign-invested insurance companies still face certain de facto restrictions, compared with the “domestic insurance companies”. That’s why some foreign insurers decrease their holding percentage in JVs below 25%, transforming the foreign-invested insurance companies into “domestic insurance companies”. For example, Sun Life Financial cut its shares in Sun Life Everbright Life Insurance Co., Ltd. from 50% to 24.99%.

Foreign-invested insurance companies are subject to lengthy review when applying for new branches. Without explicit restrictions under relevant laws, foreign-invested insurance companies are only permitted to submit new branch application consecutively in practice. On the contrary, “domestic insurance companies” can apply for multiple new branches concurrently.

In addition, foreign-invested insurance companies are subject to strict foreign exchange control. Compared with the “domestic insurance companies” involving the foreign investment below the equity ceiling of 25%, foreign-invested insurance companies have to go through complex process and take a long time to convert foreign currency into RMB. Please note that foreign-invested companies in sectors other than insurance also face such problem.

Notwithstanding the foregoing, there are also a few examples, changing “domestic insurance companies” into foreign-invested insurance companies. For example, ACE increased its shares in Huatai Life Insurance Co., Ltd., exceeding the threshold of 25%. Basically, the selection between foreign-invested insurance companies and “domestic insurance companies” are subject to insurers’ business judgment, upon assessment of the pros and cons of the foregoing two vehicles.

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