Internet Transforms Finance - Understanding Regulation of Online Insurance Business in China

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By Liang Tao

China's internet population grew to 591 million by this June, with an internet penetration rate increasing from 20% in 2008 to 44% in June 2013. The last five years has also witnessed an explosion in the growth of electronic commerce transactions in China whose trading volume increases from 3.1 trillion RMB in 2008 to 7.9 trillion RMB in 2012. More specifically, the internet and related technology developments are significantly changing the characteristics and landscapes of the financial service industries of China.

In banking industry, almost all of the banks have launched their online banking systems to provide online banking service to customers, while emerging internet companies showed great interests in providing banking-related online service through leveraging their capacities and experience in the internet industry. Similarly, securities industry is being affected by the internet products such as mobile stock trading software and online platform for securities investment fund. In insurance industry, insurers, insurance agents, insurance brokers (“Insurance Institutions”) and certain internet service providers (“ISPs”) have started to provide a wide range of online insurance service, including online sale of insurance policies, online comparisons among insurers, and online intermediary service.

To better understand how the internet has transformed the online insurance business in China, it's of great importance to have a full picture of the impact of the internet on China’s insurance market and business models, China’s regulatory regime governing the emerging online insurance business, and the major obligations of the Insurance Institutions conducting the online insurance business.

Online Insurance Business Models

The internet creates online channels that challenge the traditional insurance distribution networks aggressively. Through internet, China’s consumers can now easily run online comparisons, with low costs, among hundreds of insurers or thousands of insurance products. The internet helps consumers avoid the information asymmetry, spurs the insurers to reduce the insurance premium rates, and therefore can reduce the costs of customers’ insurance coverage and enhance insurance affordability and availability. As the internet reduces transaction costs, it creates new opportunities for the Insurance Institutions.

To take advantage of the internet, more and more Insurance Institutions in China have engaged in the online insurance business. In general, the online insurance business is structured in two models: (i) self-controlled model, under which the Insurance Institutions directly operate the websites, and therefore can control their online images, but they would bear more expenses arising from establishing, maintaining and promoting the websites; and the S Model: (ii) outsourcing model, under which the Insurance Institutions adopt the O Model. The websites under the O Model are open online platforms set up by the ISPs which do not have any insurance business license, and serve as the business-to-consumer marketplaces in which the Insurance Institutions are invited to open their online retail stores.

Regulation of Online Insurance

China has not formulated an overarching rule governing the online insurance business, while the China Insurance Regulatory Commission (“CIRC”), China’s insurance regulator, previously issued a draft rule regulating the online insurance business in 2011 (“2011 Draft Rule”), under which online insurance business are defined as “business activities engaged by the Insurance Institutions through self-controlled or non-self-controlled websites, including online sale of insurance products and online provision of insurance intermediary service.” However, the 2011 Draft Rule has not been officially adopted by the CIRC till now.

At present, China’s law only permits the Insurance Institutions to engage in the online insurance business. Any other entity or individual rather than an Insurance Institution is strictly prohibited from engaging in the online insurance business such as comparing insurance products online, recommending insurance products online, or providing intermediary service online. As such, any employee or sale agent of an Insurance Institution, as an individual, is not allowed to engage in the online insurance business in his/her own name, for example, setting up a personal blog to promote insurance products. Also, any entity rather than an Insurance Institution is prohibited from carrying
out the online insurance business, which means the ISPs under the O Model or other internet companies without insurance business license can only provide internet-related technical service to the Insurance Institutions and cannot engage in the online insurance business directly or independently.

All insurance agents and brokers are required to file reports with the CIRC within 10 working days after they launch their online insurance business. Furthermore, on May 16, 2013, the CIRC promulgated a circular clarifying the market entry thresholds for insurance intermediaries (“Circular 40”), under which the CIRC requires that any insurance agent or broker proposing to engage in the online insurance business should have a registered capital not less than 50 million RMB. Notably, such registered capital requirement under the Circular 40 does not apply retroactively to the insurance agent or broker which had duly engaged in the online insurance business on or before April 27, 2013.

According to the current rules, the insurers are not subject to any explicit restriction of registered capital for the purpose of engaging in the online insurance business, provided that the online insurers are required to meet a series of special conditions. Pursuant to a circular promulgated by the CIRC on August 13, 2013, an online insurer proposing to launch its business shall meet the conditions including, but not limited to (i) setting up independent information security department; (ii) putting in place the electronic commerce system which can support the online insurance business; (iii) retaining transaction records properly; (iv) forming the disaster recovery system; and (v) putting in place the outsourcing management system to control the risks associated with the outsourcing arrangements.

Obligations of Insurance Institutions

The absence of the overarching rule and the piecemeal legislative landscape do not mean that the Insurance Institutions doing the online insurance business are immune to stringent obligations. On the contrary, as the online insurance business grows rapidly with profound social impacts, the CIRC takes a very careful approach to the emerging online Insurance Institutions by frequently fine-tuning its regulatory regime to adapt to the quickly evolving online insurance business, instead of taking a great leap forward. That’s why the 2011 Draft Rule has not been finalized by the CIRC after over-two-year internal discussion. In addition to the typical obligations associated with traditional insurance business, the Insurance Institutions are also required by the CIRC to perform the following three types of obligations in connection with the online insurance business.

First of all, the Insurance Institutions are obligated to ensure that the websites under both the S Model and the O Model are established on a legitimate and safe basis. Regardless of whether the websites are set up by the Insurance Institutions or the ISPs, servers of such websites must be physically located in mainland China, and such websites shall be duly filed with the Ministry of Industry and Information Technology (“MIIT”), China’s internet regulator, and obtain the value-added service permit or website registration certificate from the MIIT. In addition, the Insurance Institutions are required to maintain sound internet security systems with sufficient cyber-attack protection functions and technologies, including firewall, encryption, third-party electronically authentication, data recovery, etc.

Secondly, the Insurance Institutions carrying out the online insurance business shall perform their obligations relating to the protection of digital personal information. On December 28, 2012, China’s Standing Committee of the National People’s Congress promulgated the “Decision on Strengthening Internet Information Protection” (“Decision”) which is the first law enacted specifically addressing the issue of internet information protection in China. In accordance with the Decision, both the Insurance Institutions hosting websites and the ISPs are required to duly protect internet users’ personal information. To implement the Decision, on July 16, 2013, the MIIT issued the “Provisions on the Protection of Personal Information of Telecommunication and Internet Users”, pursuant to which both the Insurance Institutions hosting websites and the ISPs are required to adhere an array of information collection and utilization rules, such as (i) disclosing their internal rules for collecting and using the personal information; (ii) disclosing the purposes, methods, and scope for collecting and using the personal information; (iii) obtaining the consent of the data subject prior to collecting and using the personal information; (iv) keeping the personal information strictly confidential; and (v) taking necessary measures to ensure the safety of the personal information.

Lastly, the Insurance Institutions carrying out the online insurance business are required to fully disclose information relating to themselves as well as the insurance products they offer. To fill the information gap left by the absence of face-to-face communication, the CIRC requests the Insurance Institutions doing the online insurance business to disclose relevant information and documents on their self-controlled and/or non-self-controlled websites, such as: (i) insurance business licenses issued by the CIRC; (ii) business licenses issued by the enterprise registration authority; (iii) contact information; (iv) underwriters and sellers of insurance products; (v) all terms and conditions of insurance contacts; and (vi) complaint channels for policyholders.

Outlook

Overall, the growing importance of internet dramatically affects China’s insurance market and the Insurance Institutions, as it does for other financial service industries. As the internet adds more fuel to the fire of insurance pricing transparency, the insurance market will become more competitive in China.

China’s online insurance business moves ahead faster than rules of the CIRC. Internet benefits consumers through reducing information cost and insurance price, while it presents challenges for the CIRC which has to regularly revise its regulatory rules to keep pace with the fast-changing insurance market. Hence, it is advisable for the Insurance Institutions to closely monitor the market and legislative development with a view to carry out the online insurance business in compliance with relevant rules.

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