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C H A N C E

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China Liberalises Insurance Capital Investment Regulation

Ever since the *PRC Insurance Law* was first promulgated in 1995, insurance capital has been stringently regulated in terms of the entities that are allowed to manage it and the eligible asset classes in which it could be invested. As a result, the business generation side of the insurance industry has far outgrown the asset management side of the industry, and insurance companies tend to rely on the capital markets to finance their capital needs. According to statistics published by the China Insurance Regulatory Commission (**CIRC**), insurance capital has reached RMB6,900 billion (USD1,105 billion)[1] as of September 2012, but only half of this amount has been put into investments.

Key issues

- Expanded universe of market participants
- Broadened capital base
- Increased asset classes
- Evolution of the Overseas Investment Regime
- Conclusion

For a long time, only insurance companies and their private equity arm, being insurance asset management companies (**IMACs**), have been allowed to manage insurance capital. Yet, they lack the level of expertise required to effectively manage a sizeable asset pool. CIRC has therefore, since mid-2010, issued a series of regulations to liberalise the regulatory regime governing insurance capital deployment. This article is intended to provide a high-level overview of these recent regulatory developments and assess their implications on relevant market participants. In particular, please see sections below which discuss the recent regulations that have (i) expanded the universe of market participants eligible for managing insurance capital, (ii) broadened the base of insurance company assets available for investment management and (iii) drastically increased the eligible asset classes for insurance capital allocation. While recent regulatory developments largely affect the domestic investment activities of insurance capital, they have also made ground-making changes in the overseas investment activities of insurance capital, as discussed below comparing the past with the existing overseas investment regime. A list of the major related regulations include:

(i) the *Circular on Several Issues Relating to the Adjustment of Insurance Capital Investment Policy*, issued by CIRC on 31 July 2010;

(ii) the *Interim Measures on the Deployment of Insurance Capital*, promulgated by CIRC and effective as from 31 August 2010 (**Insurance Capital Deployment Measures**);

(iii) the *Interim Measures on the Equity Investment of Insurance Capital* promulgated by CIRC on 5 September 2010 (**Private Equity Investment Measures**);

(iv) the *Interim Measures on Property Assets Investment of Insurance Capital*, promulgated by CIRC on 5 September 2010;

[1] USD-RMB rate is 1: 6.245.

(v) the *Circular on Relevant Issues Concerning the Regulation and Administration of the Deployment of Insurance Capital*, issued by CIRC on 7 May 2012;

(vi) the *Interim Measures on the Administration of Entrusted Investment of Insurance Capital*, promulgated by CIRC on 16 July 2012 (**Entrusted Investment Measures**);

(vii) the *Circular on Issues Relating to the Equity and Property Assets Investment of Insurance Capital*, issued by CIRC on 16 July 2012 (**Equity and Property Investment Circular**);

(viii) the *Interim Measures on Bond Investment of Insurance Capital*, promulgated by CIRC on 19 July 2012;

(ix) the *Notice on Investment in Relevant Financial Products with Insurance Capital*, promulgated by CIRC on 12 October 2012 (**Financial Products Notice**);

(x) the *Interim Measures on Financial Derivatives Transactions of Insurance Capital*, promulgated by CIRC on 12 October 2012 (**Interim Financial Derivatives Measures**);

(xi) the *Measures on Stock Index Futures Trading of Insurance Capital*, promulgated by CIRC on 12 October 2012 (**Stock Index Futures Trading Measures**);

(xii) the *Interim Administrative Provisions for Infrastructure Debt Investment Schemes*, promulgated by CIRC on 12 October 2012 (**Interim Infrastructure Bond Investment Provisions**);

(xiii) the *Notice on the Issues related to Insurance Asset Management Companies*, promulgated by CIRC on 12 October 2012 (**IAMC Notice**); and

(xiv) the *Implementing Rules of the Interim Administrative Measures on the Overseas Investment of Insurance Capital*, promulgated by CIRC on 12 October 2012 (**CIRC QDII Implementing Rules**).

Expanded universe of market participants

For a long time, the entities eligible to manage insurance capital have been limited to insurance group (holding) companies, insurance companies and IAMCs. The *Private Equity Investment Measures* first relaxed such restriction by allowing insurers to invest in private equity funds launched by qualified private equity managers. However, according to informal sources, only IMACs are currently deemed qualified private equity managers. Other private equity managers sponsored by securities companies, commercial banks and trust companies, etc. are excluded.

The recent *Entrusted Investment Measures* further increased the number of market participants by enabling qualified securities companies, securities asset management companies and fund management companies (**FMCs**) and their subsidiaries to conduct asset management businesses including separate account asset management and single client and collective client asset management. The introduction of more experienced and sophisticated fund managers such as securities companies and FMCs creates a more competitive environment for insurance asset management business. To date, 26 FMCs and securities companies have obtained approvals from CIRC to manage insurance capital under the *Entrusted Investment Measures*.

Broadened capital base

Previously, IAMCs were permitted to manage insurance capital only, which included the registered capital, common reserve funds, undistributed profits, various reserve funds and other funds of insurance companies. The *IMAC Notice* expands the capital available for investment management to include pensions, enterprise annuities, housing reserve funds and the funds of other qualified investors. The broadened capital base will help IAMCs expand their business lines and client base and better compete with other market participants.

Increased asset classes

Traditionally, government policy objectives determine how insurance capital may invest. These policy objectives aim to ensure the solvency of insurance companies and protect the rights and benefits of the policyholders. Over time, however, the eligible asset classes have gradually increased, though initially at a slow pace:

- In the 1995 and 2002 versions of the *PRC Insurance Law*, insurance capital were only permitted to be invested in bank deposits, treasury bonds and financial bonds.
- The current version of the *PRC Insurance Law*, last amended in 2009, expanded the eligible asset classes to include all types of bonds, stocks and shares of securities investment funds and real property.
- Under the *Insurance Capital Deployment Measures*, an insurer, subject to certain eligibility requirements, may invest up to 20%, 5%, 10% and 10% of its total assets as of the preceding quarter in stock and stock funds, unlisted equity and private equity funds, real property, and infrastructure bond investment plan respectively. On the other hand, the minimum investment ratio in bank deposit, treasury bond, central bank note, policy bank bond and monetary market fund is 5%.

Policymakers have gradually lifted the quantitative ceilings as they realise the importance of improving investment returns and asset-liability matching capability of insurers. Further details on various asset classes and relevant investment restrictions are set forth below.

Bonds

Under the *Bond Investment Measures*, bonds are re-classified into (i) government bonds, (ii) quasi-government bonds and (iii) enterprise (corporate) bonds comprising financial enterprise (corporate) bonds and non-financial enterprise (corporate) bonds. Hybrid and convertible bonds are newly-included as financial enterprise bonds, so insurance capital may now generally be invested in all the publicly-issued bond products available in the market.

Insurers are free to decide how to allocate investments in government bonds and quasi-government bonds. However, the balance of investments in unsecured financial enterprise (corporate) bonds should not exceed 50% of the insurers' total assets at the end of the preceding quarter.

Direct private equity investment

Under the *Equity Investment Measures*, insurance companies are permitted to make direct investments in the private equity of a handful of industries, namely, insurance companies, financial institutions and other insurance-related pension, medical and auto services companies. The *Equity and Property Investment Circular* further expands the eligible industrial sectors to include energy, resources, insurance-related modern agriculture and commercial circulation industries.

Private equity funds

The types of private equity funds in which a domestic insurer could invest include growth funds, buyout funds and emerging and strategic industry investment funds. In order to be eligible for insurance capital investment, a buyout fund could purchase publicly listed and tradable stocks, but only by means of non-transaction transfers such as strategic investments, private placement of additional shares and block trade. In addition, an insurer's exposure must not exceed 20% of the size of the buyout fund. An eligible emerging and strategic industry investment fund could look at equity investment in financial institutions, senior citizen nursing service institutions, medical care institutions, modern agriculture companies and companies that invest in, construct and manage public rental housing and low-rent housing projects. Insurers could also invest in fund of funds holding the portfolio of the above funds if the structure of a fund of funds is simple and clear.

An insurer's maximum exposure to unlisted shares and private equity funds has been raised from 5% to 10% of the insurers' total assets at the end of the preceding quarter.

Real estate

Insurers could now target real estate for self-use and non-self-use purposes as well as invest in real estate funds. Investment options include acquiring the shares of the special purpose vehicle of a real estate project, investing in an infrastructure bond investment plan and purchasing the real property directly.

An insurer's aggregate investments in non-self-use real estate, infrastructure bond investment plan and real estate-related financial products is now capped at 20% of the insurers' total assets at the end of the preceding quarter.

Financial products

The *Financial Products Notice* allows insurance capital to be invested in wealth management products of commercial banks, credit asset-backed securities of banking financial institutions, collective fund trust schemes of trust companies, special asset management schemes of securities companies, infrastructure investment schemes of insurance asset management companies, real property investment schemes and project asset-backed schemes.

The aggregate balance of investments in wealth management products, credit asset-backed securities, collective fund trust schemes, special asset management schemes and project-asset backed schemes must not exceed 30% of the total assets of insurance companies at the end of the preceding quarter. The balance of a single investment in each of such products must not exceed 20% of the issued scale of the relevant product.

The aggregate balance of investments in infrastructure investment schemes and real property investment schemes must not exceed 20% of the total assets of the insurance company at the end of the preceding quarter. The balance of a single investment in each of such products should not exceed 50% of the issued scale of the relevant product.

Financial derivatives

The *Interim Financial Derivatives Measures* makes it clear that insurance funds are allowed to participant in trading of financial derivatives, provided that their dealing activities are limited to the domestic derivatives market in China and for hedging purposes only. In other words, the insurance institutions shall neither enter into cross-border derivatives transactions nor trade for speculative purposes. The insurance institutions refer to any insurance group (holding) company, insurance company or IAMC.

The derivatives activities of insurance institutions (including forwards, futures, options and swaps) may be designated as hedging (i) for the risks of their current assets and liabilities and their corporate risks at an entity level; or (ii) for the price risks associated with any assets to be purchased in the next month provided that the hedging must be terminated or closed out within 5 business days if such assets are not purchased within such period.

Stock index futures trading

In addition, the investment options of insurance funds are broadened by the *Stock Index Futures Trading Measures* to the trading of stock index futures with the China Financial Futures Exchange for hedging purposes only.

All the purchase and/or sale of the stock index futures by an insurance company shall, as of the closing time of each trade date, be made in accordance with the position limit and/or investment limit (i.e. 20% of the total assets of the insurance company at the end of the preceding quarter).

Insurance companies are required to, as of the closing time of each trade date, maintain sufficient cash, central bank's notes, monetary funds or government or policy bank bonds due within one year in an amount no less than a double-margin in respect of each asset portfolio.

Evolution of the Overseas Investment Regime

The first set of rules governing the overseas investment of insurance capital includes the *Interim Measures for the Overseas Deployment of Insurance Foreign Exchange Funds* promulgated by CIRC and the People's Bank of China (PBoC) on 9 August 2004 (**2004 Interim Measures**) and its implementing rules issued by CIRC on 1 September 2005 (**2005 Implementing Rules**). In 2007, a separate qualified domestic institutional investor (QDII) regime was established under the *Interim Measures for Overseas Investment of Insurance Capital* promulgated by CIRC, PBoC and the State Administration of Foreign Exchange on 28 June 2007 (**2007 Interim QDII Measures**), which replaced the *2004 Interim Measures*.

The *2007 Interim QDII Measures* provided a general framework whereby insurance capital could be invested overseas. However, it did not contain any operational details. Since 2007, CIRC has drafted several versions of implementing rules and the latest draft was circulated for internal discussion early this year (**2012 Consultation Draft**). The final set of CIRC QDII Implementing Rules was eventually promulgated on 12 October 2012.

This section will briefly introduce the key changes of the CIRC QDII Implementing Rules, compared to the *2005 Implementing Rules* and the *2012 Consultation Draft*, in respect of eligibility requirements and permissible asset classes.

Eligibility requirements of different entities

Chinese insurance companies

	2005 Implementing Rules	*2012 Consultation Draft*	*CIRC QDII Implementing Rules*
Total assets	no less than RMB5 billion (USD800.6 million) at the end of the preceding year	not specified	not specified
Foreign exchange funds	no less than USD15 million or its equivalent in other foreign currencies at the end of the preceding year	not specified	not specified
Solvency ratio	not specified	no less than 150% at the end of the preceding quarter and at the end of the latest accounting year	no less than 120% at the end of the preceding quarter
Staff	not specified	• senior executive responsible for investments must have more than 10 years' work experience in the financial or economic industry; • no less than 3 professional personnel, at least 2 of whom must have more than 3 years' management	• senior executive responsible for investments must have more than 10 years' work experience in the financial or economic industry; • set up full-time job positions; • no less than 3 professional personnel,

		experience in overseas securities investment.	at least 2 of whom must have more than 3 years' management experience in overseas securities investment.
Track record	not specified	3 years	3 years

Domestic Investment Managers

	2005 Implementing Rules	*2012 Consultation Draft*	*QDII Implementing Rules*
Paid-in capital and total assets	not specified	no less than RMB100 million (USD16 million)	no less than RMB100 million (USD16 million)
AUM	not specified	no less than RMB50 billion (USD8 billion) in the last accounting year	no less than RMB10 billion (USD1.6 billion) in the last accounting year
Management experience and staff	not specified	• senior executive vestments must have more than 10 years' work experience in the financial or economic industry; • more than 3 years' experience in insurance asset management; and • more than 6 professional personnel, at least 1 of whom must have more than 5 years' experience in overseas securities investment management; and at least 3 of whom must have more than 3 years' experience in overseas securities investment management	• senior executive responsible for investments must have more than 10 years' work experience in the financial or economic industry; • more than 3 years' experience in insurance asset management; and • more than 5 professional personnel, at least 3 of whom must have more than 5 years' experience in overseas securities investment management; and at least 2 of whom must have more than 3 years' experience in overseas securities investment management
Management of affiliates' assets	not specified	Domestic investment managers can only manage their affiliates' assets and invest in the	Domestic investment managers can only invest insurance funds (not limited to affiliates' assets)

		Hong Kong market	under their management in the Hong Kong market

Overseas investment managers

	2005 Implementing Rules	***2012 Consultation Draft***	***CIRC QDII Implementing Rules***
Paid-in capital and net assets	no less than USD60 million	no less than USD30 million in the last accounting year	no less than USD30 million in the last accounting year
AUM[2]	no less than USD50 billion	• the average AUM is no less than USD100 billion in the latest 3 years; • non-affiliates' assets account is at least 50% of the total AUM or is no less than USD100 billion; and • institutional clients' assets account is at least 30% of the total AUM or is no less than USD100 billion.	• the average AUM is no less than USD30 billion in the preceding year; and • non-affiliates' assets account is at least 50% of the total AUM or is no less than USD30 billion
Management experience	more than 10 years' experience in international asset management and more than 5 years' experience in insurance asset management.	more than 5 years' experience in international asset management and more than 3 years' experience in pension or insurance capital management	more than 5 years' experience in international asset management and more than 3 years' experience in pension or insurance capital management
Staff	not specified	• the investment team has an average of	• the investment team has met eligibility

[2] The *2012 Consultation Draft* and the *CIRC QDII Implementing Rules* allow the AUM of the parent company or asset management institutions within the same group of an overseas investment manager to be calculated on a consolidated basis. However, assets managed by or related to investment advisors or investment banks are excluded from such calculation. An overseas investment manager participating in special asset management may be excused from the general AUM restrictions if (i) its AUM is not less than USD5 billion; (ii) the special assets under management account is no less than 70% of the total AUM; and (iii) it has good reputation and outstanding performance in special asset management.

		more than 5 years' work experience in the relevant industry; and • the key personnel has more than 8 years' work experience in the relevant industry	requirements of the local country/region; • the investment team has an average of more than 5 years' work experience in the relevant industry; and • the key personnel has more than 8 years' work experience in the relevant industry
Previous performance	not specified	not specified	good previous performance

Hong Kong subsidiaries of IAMCs that do not meet the eligibility requirements above will be allowed to invest insurance capital in the Hong Kong market only.

For Domestic custodians

	2005 Implementing Rules	***2012 Consultation Draft***	***CIRC QDII Implementing Rules***
Paid-in capital/net assets	paid-in capital is no less than RMB8 billion (USD1.28 billion) (PRC banks' foreign exchange capital being no less than RMB1 billion (USD160 million))	paid-in capital or net assets at the end of the last accounting year is no less than RMB30 billion (USD4.8 billion)	paid-in capital or net assets at the end of the last accounting year is no less than RMB30 billion (USD4.8 billion)
Asset under custody	not specified	no less than RMB200 billion (USD32 billion)	no less than RMB200 billion (USD32 billion)
Special requirements for WFOE banks or foreign bank branches	for foreign bank branches, the paid-in capital of their parent banks should be counted;	the parent banks' paid-in capital and asset under custody may be relied on where the parent banks of WFOE banks or foreign bank branches satisfy the paid-in capital and asset under custody requirements and assume joint and several liabilities.	the parent banks' paid-in capital and asset under custody may be relied on where the parent banks of WFOE banks or foreign bank branches satisfy the paid-in capital and asset under custody requirements and assume joint and several liabilities.

Capital adequacy ratio (CAR)	not specified	• the CAR should be 10% or above at the end of the preceding year; and • the core CAR should be 8% or above	• the CAR should be 10% or above at the end of the preceding year; and • the core CAR should be 8% or above
Long-term credit rating	not specified	A or above	A or above
Staff	not specified	at least 6 professional personnel	at least 6 professional personnel
Licensing requirements	domestic securities investment fund custody license	foreign exchange settlement and sale license	foreign exchange settlement and sale license

Overseas custodians

	2005 Implementing Rules	*2012 Consultation Draft*	*CIRC QDII Implementing Rules*
Paid-in capital/net assets	paid-in capital is no less than USD2.5 billion or its equivalent in other currencies	paid-in capital or net assets is no less than USD1 billion	not specified
Asset under custody	not specified	no less than USD100 billion	not specified
CAR	not specified	• CAR is 10% or above at the end of the preceding year; and • the core CAR is 8% or above.	not specified
Long-term credit rating	A or above	A or above	not specified

The CIRC QDII Implementing Rules have removed all capital, CAR and rating requirements that existed in the 2012 Consultation Draft. It now only requires insurance companies to have sufficient understanding of their custodian agents. Therefore, overseas custodian agents will only need to satisfy the general requirements under the *2007 Interim QDII Measures*.

Affiliation restriction

Any commercial bank that has one of the following relationships with an insurance company must not be its custodian or custodian agent:

(i) it directly or indirectly holds more than 10% of the shares of the insurer or more than 10% of its shares are directly or indirectly held by the insurer;

(ii) more than 10% of its shares and the insurer's shares are held by the same third party directly or indirectly; and

(iii) other affiliated relationships as indentified by CIRC.

Eligible asset classes

2005 Implementing Rules	*2012 Consultation Draft*	*CIRC QDII Implementing Rules*
• bank deposits; • foreign government bonds, international financial organization bonds and foreign corporate bonds; • bonds listed overseas by PRC governments or enterprises; and • monetary market products, such as bank notes and convertible deposits in large denominations	• money market products o commercial papers with a term not longer than 1 year o bank negotiable instruments o negotiable certificates of deposit in large denominations o reverse repurchase agreements o short term government bonds o overnight lending • fixed income products o bank deposits o government bonds o government-backed bonds o international financial organization bonds o corporate bonds o convertible bonds • equity products o common stocks o preferred stocks o global depositary receipts	• money market products o commercial papers with a term not longer than 1 year o bank negotiable instruments o negotiable certificates of deposit in large denominations o reverse repurchase agreements o short term government bonds o overnight lending • fixed income products o bank deposits o government bonds o government-backed bonds o international financial organization bonds o corporate bonds o convertible bonds • equity products o common stocks o preferred stocks o global depositary receipts

	o American depositary receipts o private equity (limited to insurance companies, non-insurance financial institutions, energy and mineral resource enterprises (for financial investment only)) • real properties (limited to acquiring overseas special vehicles and then investing in its onshore commercial and office properties)	o American depositary receipts o private equity (including financial institutions and senior citizen nursing, medical care, energy, resource, auto service and modern agriculture enterprises) • real properties (limited to the mature properties located in core districts in specified developed markets and with stable proceeds)
Stocks investment may only target the stock exchanges of New York, London, Frankfurt, Tokyo, Singapore and Hong Kong.	Insurance capital may be invested in 25 developed markets and 20 emerging markets.	

Compared to the QDII regimes administered by the China Banking Regulatory Commission and the China Securities Regulatory Commission, the QDII regime administered by CIRC allows insurance capital to be invested in a broader range of products (such as real estate) and asset classes. On the other hand, all QDII regimes share certain common characteristics, including prohibiting direct investment in precious metals, commodity derivatives and physical commodities.

In addition, the rule-making history of CIRC's new overseas investment regime has made market participants hopeful that hedge funds may also become an eligible asset class for insurance capital. However, the CIRC QDII Implementing Rules is silent on this point. It remains uncertain as to whether hedge funds would make the list of eligible asset classes in the near future. We will monitor and report any development on this front closely.

Conclusion

Chinese institutional investors have been playing an increasingly important role in the global investment management industry. However, to date, only a handful of Chinese institutions, namely, CDB Capital, China Investment Corporation, the State Administration of Foreign Exchange and the National Social Security Fund are able to make allocations to overseas investment funds. Given there is a sizeable amount of insurance funds in China, the recent CIRC enabling regulations present an exciting opportunity for overseas managers looking to raise funds in China. Better still, the *CIRC QDII Implementing Rules* have lowered the entry barriers for many of the participants and expanded the eligible asset classes that insurance capital may invest in. The pace and the breath of these ground-breaking changes is a testimony to the Chinese regulator's resolution to enhance the returns on insurance capital by bringing market competition into this important sector. We are hopeful that this embrace of market mechanism will represent the beginning of a win-win proposition for all parties involved.

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