

China: Exposure draft on new regulations for insurance portfolio transfers

On 22 March 2011, the China Insurance Regulatory Commission (“CIRC”) released an exposure draft entitled “Tentative Administrative Measures on Insurance Portfolio Transfers by Insurance Companies” (referred to in this e-alert as “Draft Measures”). The Draft Measures apply to transfers of insurance portfolios by insurance companies which are not dissolved, bankrupt or insolvent. The exposure draft has been released for public comment until 11 April 2011.

This e-alert describes the key aspects of the Draft Measures and provides some observations and commentary on possible business implications.

Key Aspects of the Draft Measures

- Any insurance portfolio transfer requires the approval of the CIRC.
- The transferee should take up all responsibilities with respect to policyholders, the insured parties and the beneficiaries of the original insurance contracts.
- Qualifications of the transferee:
 - The business being transferred should be within the existing licensed business scope of the transferee.
 - It must possess good corporate governance and sound internal controls.
 - It must have an adequate solvency ratio after the transfer.
 - It must have no records of material regulatory non-compliance in the past two years.
 - It should have branch offices in the locations where the transferred insurance policies were originally issued.
 - It must have carried out a feasibility study on managing the transferred business going forward.
 - It must comply with any other conditions that CIRC may prescribe.
- Documents to be submitted for CIRC approval:
 - Basic corporate information of both parties involved in the transfer.
 - Insurance business transfer agreement.
 - Transfer schedules.
 - Feasibility study on the management of the business to be transferred.
 - Assessment reports issued by professional consulting firms.

- Reserve valuation report on the insurance business to be transferred.
 - Solvency report of the transferee in the preceding year and analysis of the impact of the transfer on the transferee's solvency ratio.
 - Documentation from the Board of Directors or shareholders of both parties approving the transfer agreement.
 - Any other documents that may be required by the CIRC.
- Both the transferor and the transferee should carry out a reserve valuation on the transferred business to ensure reserves are appropriate and adequate according to CIRC rules.
- Both parties should engage legal firms, accounting firms and other relevant consulting firms to assess the value of the transferred business and the legality of the transaction.
- After the CIRC has approved an insurance business transfer agreement in principle, the Draft Measures require that the transferor shall promptly notify the policyholders and the insured parties in writing of basic information about the transferee, provide an outline of the transfer programme, give details of the responsibilities undertaken and other related matters. Consent of the policyholders and the insured parties is required.
- The transferee should account for the transferred business separately from its other business.

Observations

- The Draft Measures require that the transferee has branch offices in locations where the transferred policies were first issued. It is not clear how this requirement should be interpreted, for example, whether the issuing location is at the city or at the province level.
- It is not clear how the transfer will impact the existing reinsurance arrangements on the transferred business. This may trigger re-negotiations of those reinsurance treaties.
- The Draft Measures do not provide specifics of the nature of the feasibility study required to be carried out by the transferee. As in other insurance markets, we would expect this to include aspects such as the effect on the financial security and benefit expectations of policyholders and the potential impact on policyholder service standards.
- The requirement to provide notice to policyholders about a portfolio transfer arrangement is a common requirement internationally. However, the Draft Measures do not specify what level of policyholder notification is considered adequate or how to resolve situations where some policyholders cannot be reached.
- According to the Draft Measures, policyholder consent is required after the CIRC has approved the portfolio transfer agreement. However, the Draft Measures do not specify what minimum level of consent is required or what happens if adequate policyholder consent is not obtained. In practice, it is likely to be difficult to obtain consent of all policyholders. In many

other insurance markets, policyholders have the right to object before an insurance portfolio transfer can be approved but are not required to actively give consent.

- The requirement to engage specialist advisors is similar to the situation in many other insurance markets. However, there is no specific mention of “actuaries” in the Draft Measures. It is common in other markets for an independent expert opinion from an actuary to be required before an insurance portfolio can be transferred.

Impact on business

The Draft Measures may assist in making the process of transferring blocks of business less problematic, which may help both the transferor and the transferee to achieve various objectives:

For the transferor, it can potentially help to:

- Re-organise its corporate structure by transferring the business of one or more of its subsidiaries into a single subsidiary.
- Sell part of the company’s business by transferring a particular book of business in order to release capital and sharpen strategic focus.
- Adjust the risk profile of its business to reduce exposure to certain risks.
- Unlock the value of a run-off portfolio.

For the transferee, it can potentially help to:

- Gain accelerated access to a market.
- Enlarge its policyholder base.
- Gain access to new lines of business or different distribution channels.
- Utilise its excess administrative capacity and increase economies of scale.

However, some aspects of the Draft Measures present significant practical challenges. In particular, the requirement for the transferee to have branches in the location of original policy issuance will make qualification as a transferee difficult for both foreign joint venture insurance companies that do not have extensive nationwide branch office coverage and new entrants that have no existing branches. Moreover, the need for separate accounting of the transferred business is likely to create additional administration complexity and increase costs for the transferee.

Conclusions

The introduction of a set of clear regulatory requirements covering insurance portfolio transfers will be beneficial to the industry. This brings China more in line with other international insurance markets where similar regulations have existed for several years. With increasing competition and growing scrutiny on profitability and risk and capital management, more insurance companies are re-considering their business strategy in China. Companies that lack sufficient scale and capital resources may consider specialising on certain market niches. The transfer of “non-core” insurance portfolios could provide an efficient way for some companies to achieve that goal.

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