TESTIMONY OF THE

AMERICAN INSURANCE ASSOCIATION

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Hearing on

Corporate Accountability, Access to Credit, and Access to Markets in China's Financial System – the Rules and their Ramifications for U.S. Investors

Panel on

Market Conditions and Access Issues for Banking, Investment, Insurance and other Services Firms

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On behalf of the American Insurance Association (AIA), I am pleased to offer this testimony to the U.S.-China Economic and Security Review Commission.

AIA is the leading property-casualty insurance trade organization in the U.S., representing approximately 300 major U.S. insurance companies that provide all lines of property-casualty insurance to consumers and businesses in the United States and around the world. AIA members write more than $117 billion annually in U.S. property-casualty premiums and approximately $225 billion annually in worldwide property-casualty premiums. AIA members make up some of the most globally active property-casualty insurers.

AIA works closely with the Office of the U.S. Trade Representative (USTR), the Treasury Department, the State Department, the Department of Commerce, and other government agencies on issues confronting U.S. property-casualty insurers in China. We particularly appreciate the work of USTR and the Department of Commerce on the U.S.-China Insurance Dialogue, part of the U.S.-China Joint Commission on Commerce and Trade (JCCT). Our trade negotiators are among the most dedicated in the world. We maintain a very strong relationship with the National Association of Insurance Commissioners (NAIC). NAIC has been very helpful in supporting U.S. property-casualty insurers that have operations in China.

China remains a very important market for U.S. property and casualty insurers. Though China's economy is not growing at the breakneck pace that it was in recent years, it continues to present enormous potential for insurers because 1) it is experiencing faster overall economic growth than developed economies, 2) its insurance sector continues to grow faster than those of developed economies, and 3) insurance penetration remains quite low relative to other economies.

U.S. insurers offer the experience and know-how to develop a first-rate insurance system in China that can meet the demands of China's population. They offer specialized, innovative products and global networks, in contrast to local insurance companies that offer scaled-down, standard products not suited for the dynamic environment of the 21st century economy.

China's Potential for Insurers and the Benefits of Insurance

Economic growth and demand for insurance go hand in hand. As Chinese corporations grow in size and number, they need to insure their property and products, and protect themselves from liability. Furthermore, China's urbanized middle class growth is increasing demand for insurance. The China Institute for Reform and Development, a government think tank, predicts that the middle class will encompass 600 million people by 2020. Members of China's middle class are buying cars, homes and other insurable assets. They need a way to safeguard and protect those assets that they've worked hard to earn. By pooling risk in an efficient insurance system, companies and individual consumers are able to grow and invest with confidence.

Facing a largely mature market and stagnant growth at home, U.S. insurers see a potential growth story in China and other Asian markets. In fact, a recent study from PricewaterhouseCoopers (PwC) found that non-Chinese property-casualty insurers expect that there will be a 20% growth in total premiums in China by 2015. It has been predicted that China alone will account for 21% of global gross premiums by 2020. At the same time, China remains an underinsured market compared to the rest of Asia. Property-casualty insurance penetration in China remains extremely low, at around 2%.

China's insurance sector is not as developed and efficient as it could be, to the detriment of insurers and consumers alike. The insurance markets around the world that most-successfully serve their domestic constituencies and support national economic development are typically composed of diverse players: domestic and international, large and small companies. Dynamic, diverse insurance markets feature strong competition in products, services, pricing, specialization, innovation, technology, and variety of business models. Higher economic growth is driven by competition and consumer choice. This is true of every country that has done well economically in the long term. Many of these key elements are either missing or are poorly developed in China, however. It remains dominated by state-owned insurers such as the PICC Property and Casualty Company. As a result, Chinese companies and the public are underserved at a time when insurance should be playing a major role both as a catalyst and safety-net for growth and prosperity.

A developed insurance sector would help encourage those sectors that China has identified as "strategic emerging industries" (SEIs). These industries, which include energy conservation and environmental protection, next generation information technology, bio-technology, advanced equipment manufacturing, new energy, new materials and new-energy vehicles, are all technology heavy. Their development will require sophisticated specialty insurance products that we take from granted in the U.S., but which largely are not available in China.

A developed insurance sector would also have a stabilizing impact in China. Insurance generates an income smoothing effect, providing for greater financial and societal stability. Insurance enables businesses and individuals to embark on higher risk, higher return activities that they would otherwise not be able to undertake, supporting productivity and growth. This is especially relevant for those most susceptible to economic downturn and social upheaval, as increasing access to insurance helps people to manage risk and obtain security, which is a key goal of financial inclusion. A developed insurance sector would also lead to long-term investment in China's infrastructure, from roads and bridges to schools and hospitals.

Foreign Participation and Underdevelopment of the Insurance Sector

One reason for the underdevelopment of China's insurance sector is limited participation of foreign insurers in the market. For instance, there are only twenty-one foreign property-casualty insurers in China, and those twenty-one foreign insurers held only a 1.2% share of the Chinese insurance market in 2012.

That is not to say that the ability of foreign insurers to participate in China has not improved dramatically. There have been remarkable improvements in China's insurance legal and regulatory regime since it acceded to the World Trade Organization (WTO) in 2001, and on the whole China's commitments in the property-casualty insurance sector are strong. For example, foreign property-casualty insurers are permitted to own 100% of their operations in China, which is not the case in many other countries, including major emerging economies. One notable recent development is the opening of China's compulsory motor vehicle third party liability (MTPL) insurance sector to foreign insurers. Being able to offer MTPL insurance is important to offering the full suite of auto insurance. Auto insurance is one of the most crucial emerging sectors in China and accounts for roughly 70% of China's property-casualty market.

We have also been encouraged by China's willingness to open the lines of communication between the two governments and also between the Chinese government and foreign business. For instance, the China Insurance Regulatory Commission (CIRC) has agreed to notice-and-comment periods for proposed regulations, though sometimes we wish those periods were longer.[1] CIRC officials meet regularly with insurance leaders in China and in the U.S., which has gone a long way to dispel much of the misunderstanding between the regulator and those foreign companies it regulates.

However, there is clearly room for improvement in China's insurance sector that will benefit both foreign insurers and the Chinese economy and consumers. The State Council has already overseen fundamental reform of other financial services sectors, but insurance reform has lagged.

All too often, foreign insurers are discouraged from operating fully in China. They face numerous licensing and other hurdles that stifle their ability to participate fully in China's insurance sector. These barriers explain the contradiction between the tiny 1.2% share of the Chinese property-casualty insurance market held by foreign insurers and the expectations of massive growth opportunities. Despite the projections of rapid growth in China's insurance sector, pessimism that foreign insurers will be able to be part of it abounds. Foreign property-casualty insurers surveyed by PwC believe their share of the Chinese insurance sector will remain the same for the next three years. In 2007, those foreign insurers believed that their market share would increase to 10-20%.

Furthermore, once in the Chinese market, the cost of doing business associated with regulatory hurdles and other factors limit the ability of foreign insurers to make a profit, which calls into question the long-term sustainability of foreign operations in China. Though there are twenty-one foreign property-casualty insurers in China, only three have been able to turn a significant profit in China.

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[1] Most recently, CIRC released draft affiliate reinsurance regulations on December 24, 2012 with a comment deadline of December 31st. We believe this to be an unreasonably short time frame for comment coinciding with internationally recognized holidays.

To that end, I offer the following specific recommendations which I believe would greatly increase foreign participation in China's insurance sector to the benefit of US insurers and Chinese consumers alike:

Specific Recommendations

- **CIRC should focus on regulating and not be responsible for developing domestic insurance companies.** CIRC is charged with a dual mission: to both regulate the industry and develop China's domestic industry. A central tenet of good regulatory practice is that regulators must be independent and impartial. The social objectives and regulatory objectives of CIRC create an enormous potential for conflicts of interest. As the International Monetary Fund (IMF) and World Bank's 2012 Financial Sector Assessment Program (FSAP) report for China pointed out, "the range of commercial and social objectives almost inevitably will lead to conflicts with the supervisory objectives."

- **CIRC should harmonize treatment of domestic and foreign insurers.** Central to CIRC's emphasis on regulation should be harmonization of treatment for domestic and foreign insurers. Separate regulatory structures – one for domestic and one for foreign companies through the International Affairs department – are no longer justified and not in keeping with either international best practices or the International Association of Insurance Supervisors' (IAIS) core principles.

- **Foreign insurers should receive national treatment and be allowed to apply for and be awarded multiple new internal branch licenses at the same time, if the company chooses to apply for multiple licenses simultaneously.** The abilities to expand geographically and diversify risk portfolios are basic, fundamentally important insurance principles. Insurance companies need to be able to develop geographic reach and risk diversification in order to avoid concentration of risk and unbalanced, over-exposed books of business. CIRC should make it clear that foreign-invested insurers are able to submit multiple applications for branch approval, and if qualified, CIRC should approve them concurrently.

- **The burdensome costs for foreign insurers to operate in China should be reduced**. The cost of operating in China is very high compared to most other markets. Administrative burdens and compliance are particularly onerous, including CIRC's I/T requirements and rules regarding claims, finance and compliance personnel for new internal branches. CIRC should adopt global best practices in terms of regulatory maintenance and compliance costs.

- **In line with the State Council's explicit goal to build a liability culture and improve food and product safety, CIRC should help advance an understanding of the new Tort Liability Law and its relevance to the insurance sector**. To shift financial burdens away from the state, it is essential that Chinese companies purchase liability insurance to protect their balance sheets. In particular, product liability insurance should be required for companies bidding on government contracts.

- **International brokers should be given national treatment and allowed to service Chinese small and medium enterprises (SMEs).** If approved, this development would lead to a better understanding of loss control and risk-management techniques among companies currently not being served by foreign brokers. Currently, foreign brokers are very limited in the types of policies they are permitted to service.

Conclusion

The best path forward to bring about positive change in international insurance trade between the U.S. and China is continued engagement between CIRC, the Chinese Ministry of Finance, the NAIC, USTR, and other relevant U.S. Government agencies.

USTR has launched an ambitious round of negotiations for a US-China Bilateral Investment Treaty (BIT) that we hope will bring greater access and protection for U.S. insurers. The BIT should also address growing issues such as competition with state-owned commercial operations.

The Strategic and Economic Dialogue and the JCCT, mentioned earlier, also offer opportunities for the U.S. Government to continue to address specific issues in China. We will continue to work with USTR and other US Government agencies on identifying and advocating for the U.S. property-casualty sector’s priorities in those dialogues.

We also look forward to continuing our direct engagement with CIRC, as well those ministries and government agencies that are involved in the development of strategic emerging industries (SEIs) in China, including the Ministry of Commerce, the National Development and Reform Commission, the Ministry of Science and Technology and the Ministry of Industry and Information Technology.

Though progress never moves as fast as one would hope, we have seen remarkable improvements in the last decade that we will build upon. Like any dutiful regulator, CIRC wants to protect Chinese consumers and grow the Chinese economy. What we have to continue to do is demonstrate why long-term foreign involvement in China’s insurance sector will do just that.

Thank you for the opportunity to testify today.