China Issues New Measures to Regulate Equity Holdings in Insurance Companies

March 2018

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Introduction

After two rounds of consultation, the China Insurance Regulatory Commission ("**CIRC**") released the final version of the *Administrative Measures for Equity Interests in Insurance Companies* (the "**New Measures**") on March 7, 2018, which will take effect on April 10, 2018. (See our previous alert on the first draft: [China's draft regulations to affect investment in Chinese insurance companies](#)) The New Measures are issued following the failure of Anbang Insurance Group, with its chairman under criminal investigation. The CIRC intends to clean up the market through an overhaul of regulations.

In this article we summarize the main features of the New Measures.

Regulatory Framework for Supervision of Equity Interests

The CIRC aims to exercise comprehensive supervision over investments in insurance companies through eligibility requirements in relation to shareholders and rules in relation to funds used for the acquisition, conduct of shareholders and reporting.

The CIRC intends to adopt strict supervision in relation to shareholder structures and funding sources, including:

a) looking through to the ultimate source of funding;

b) identifying investors, affiliates and persons acting in concert with regard to shareholding and funding;

c) having insurance companies report their actual controllers, controlling shareholders, affiliates and/or persons acting in concert as well as relevant changes; and

d) looking through any concealed ownership, nominal shareholder or other structures.

Shareholding Cap of One Third for a Single Shareholder

To ensure insurance companies focus on providing insurance services and are not being used as financing platforms, the CIRC is limiting the maximum shareholding percentage in relation to Chinese insurers to one third, i.e. approximately 33.3%[1], for a single shareholder.

An exception from the equity cap may apply to insurance companies establishing or investing in other insurance companies for the purposes of innovation and specialization of their business, or consolidating their operations under a single group management. However, in such a case the relevant insurance company acting as an investor would not be allowed to transfer its controlling shareholder rights.

Impact on Existing Shareholdings

CIRC indicated during a press conference on March 7, 2018 in relation to the New Measures that the cap of 33.3% will not, in principle, be applied retrospectively to adjust the shareholding structure of existing insurers. As a possible exception, the CIRC may provide guidance to certain insurers that have hidden risks in their shareholding structure, and will take specific regulatory measures in response to such risks. For new investments in Chinese insurance companies, the 33.3% equity cap will be rigorously enforced.

In addition, Mr. He Xiao-feng, director of the Development and Reform Department of CIRC, commented during the press conference that there could be two effects on existing insurers which have a single shareholder owning more than 51% of its equity. First, such shareholder may not be permitted to further increase its equity stake in connection with future financings or capital increases. Second, in the case of an insurer that does not have a good governance structure (e.g., shareholder disputes or a weak board) and where one shareholder owns more than one third of the equity, the CIRC may request it to increase the percentage of independent directors on the board to half of the total number of directors. We note such a requirement has been reflected in the *Draft*

[1] Article 29 of the Administrative Measures for Equity Interests in Insurance Companies

Interim Measures for the Administration of Insurance Companies' Independent Directors[2].

New Categorizations and Restrictions for Shareholders

Largely in line with the second draft of the measures, the New Measures adopt four categories of shareholders as follows:

1. "Financial Shareholders I" refers to shareholders holding less than 5% of the equity of insurance companies.

2. "Financial Shareholders II" refers to shareholders holding not less than 5% but less than 15% of the equity of insurance companies.

3. "Strategic Shareholders" refers to shareholders holding not less than 15% but less than one third of the equity of insurance companies, or shareholders who may exert substantial influence on shareholder's (general) meetings of insurance companies through their voting power.

4. "Controlling Shareholders" refers to shareholders holding not less than one third of the equity of insurance companies, or shareholders who may exert controlling influence on shareholder's (general) meetings of insurance companies through their voting power.

The New Measures set forth various requirements to regulate each of the above types of shareholders as well as special types of investors such as partnerships, financial institutions and public institutions. For instance, there are minimum net asset requirements for Financial Shareholders II, Strategic Shareholders and Controlling Shareholders.

Investors and their affiliates and/or persons acting in concert are only able to be the controlling shareholders of one insurance company engaging in similar business activities, and the Controlling Shareholders or Strategic Shareholders of no more than two insurance companies in aggregate across all business lines, unless otherwise approved by the CIRC. An insurance company is not allowed to set up or invest in another insurance company engaging in similar business activities. The exception would be insurance companies establishing or investing in other insurance companies for the purposes of innovation and specialization of their business. However, an insurance company is not allowed to be a Strategic Shareholder in an insurance company where it is the Controlling Shareholder of two or more insurance companies.

Moreover, the New Measures provide for a lock-up period for each type of shareholder. A Financial Shareholder I cannot transfer its equity for one year from the day of becoming Financial Shareholder I, except where it has bought shares of a listed insurance company.

[2] Issued on December 26, 2017 and open for public comment until January 3, 2018. Under the Draft, for an insurance company which has a controlling shareholder, more than half of the total number of directors should be independent directors. For the purposes of the Draft, "controlling shareholder" refers to a shareholder who owns more than 50% of the equity in the company, which is slightly inconsistent with the New Measures. We await further updates on this point.

The lock-up period is 2 years for Financial Shareholders II, 3 years for Strategic Shareholders and 5 years for Controlling Shareholders.

Negative lists

The New Measures confirm a "negative list" of persons who are prohibited from becoming shareholders in insurance companies (such as those with an unclear shareholder structure) or Controlling Shareholders (such as those in a poor financial position). In particular, the New Measures strictly prohibit investors from entrusting others or accept an entrustment to invest in insurance companies.

The New Measures also introduce a “negative list” of funds which cannot be used directly or indirectly to acquire equity interests in insurance companies, such as loans related to insurance companies and funds acquired through charges over deposits or other assets of insurance companies, or funds acquired by the investor inappropriately using the financial influence of the insurance company. Additionally, the New Measures restate that investors must only use their own funds to acquire equity interests in insurance companies and cannot use measures to evade this self-funding requirement. In particular, no investor may establish a shareholding agency, assign the rights to its expected returns or employ similar means to evade regulations requiring the use of its own funds.

Limited Impact on Foreign Insurers Operating in China

The New Measures primarily target Chinese invested insurance companies that are registered in the PRC. They also apply, by reference, to insurers with more than 25% foreign ownership. According to statements at the press conference held by the CIRC, the CIRC will consider the shareholder qualifications set out in the New Measures when examining and reviewing foreign-invested insurance companies. The CIRC is likely to issue specific rules to implement the requirements of the New Measures with regard to foreign-invested insurance companies. It is possible that the CIRC may request foreign invested insurance companies to increase the number of independent directors on the board. [3]

It is worth noting that the dominant legislation for foreign invested insurers, *the Regulation on the Administration of Foreign-invested Insurance Companies*[4], provides that a wholly foreign-owned property & casualty insurance company is allowed, which is still valid since that regulation has a higher status than the New Measures. Additionally, at the press briefing held by the State Council Information Office on 10 November 2017, the deputy minister of the Ministry of Finance, Mr. Zhu Guang-yao, announced that it was planned that in 3 years' time, single or multiple foreign investors who establish life insurance businesses in the PRC would be allowed to hold up to 51% of the shares. The restriction on the shareholding percentage would then be completely removed in 5 years' time.

In light of the above, we expect to see further relaxation of the rules relating to the percentage of foreign investments together with enhanced supervision of Chinese investors of insurance companies in the near future.

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3 The Draft Interim Measures for the Administration of Insurance Companies' Independent Directors provide that they will apply, by reference, to insurers with more than 25% foreign ownership.

4 Issued by the State Council on December 12, 2001 and most recently revised on February 6, 2016.

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