Chapter IV

Insurance Sector

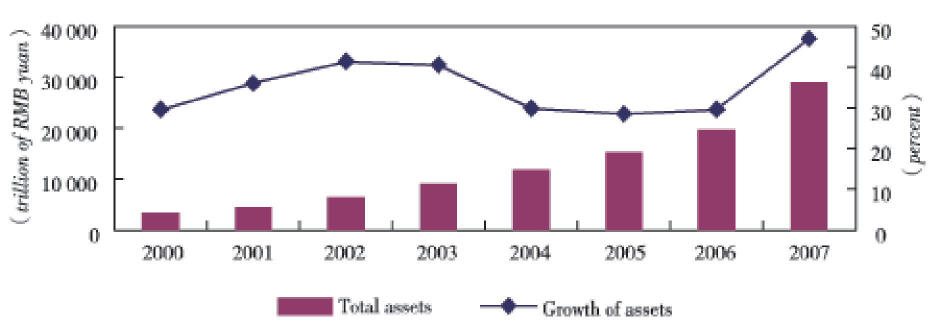
In 2007, China's insurance sector continued its sound development momentum. The overall strength of the insurance sector was further enhanced, the coverage continuously expanded, and the service capacity steadily improved. The reform of insurance companies was deepened, with their competitiveness further sharpening and returns on fund utilization increasing markedly. And insurance regulation was strengthened and risk prevention capability further improved.

Recent Developments

Entities engaged in the insurance business continued to increase. In 2007, more insurance institutions emerged together with a larger sales force. As of the end of the year, there were 119 insurance institutions and 2,331 professional insurance intermediaries, up 12 and 221 respectively over the previous year. There were 143,113 cross-sector insurance intermediaries and 2.01 million insurance sales representatives, up 1,835 and 456,000 respectively over the previous year.

Assets grew substantially. The asset of the insurance sector in 2007 recorded the fastest growth in the last eight years. As of the end of 2007 the total assets of the insurance industry reached RMB 2.9 trillion yuan, a y-o-y growth of 46.99%, or 36.93% excluding the growth due to statistical changes in the new *Accounting Standard for Business Enterprises* promulgated in 2006 (Figure 4.1). In particular, the total assets of property insurance companies, life insurance companies and reinsurance companies amounted to RMB 388.051 billion yuan, RMB 2.32 trillion yuan and RMB 87.726 trillion yuan respectively. [1]

Figure 4.1 Asset Changes in Insurance Sector



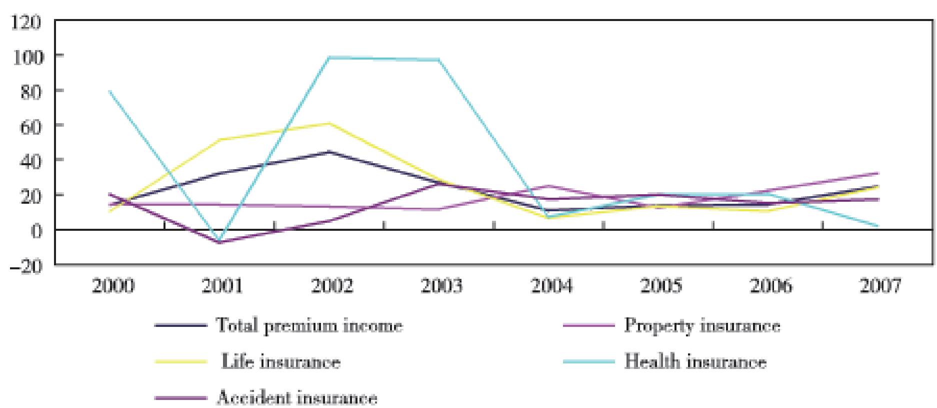
Source: CIRC.

1 The sum of assets of property insurance companies, life insurance companies and reinsurance companies is not equal to the total assets of the insurance sector due to the overlapping of property and life insurance premium with reinsurance premium and the consolidation of financial statements.

Premium income increased significantly. In 2007, the premium income reached RMB 703.58 billion yuan, a growth of 25% (Figure 4.2), including RMB 199.77 billion yuan property insurance premium income, up 32.6%, RMB 446.38 billion yuan of life insurance premium income, up 24.5%, RMB 19.01 billion yuan of accident insurance premium income, up 17.4% and RMB 38.42 billion yuan of health insurance premium income, up 2.4%. The growth of property insurance premium income outpaced that of life insurance premium income in 2007, while the growth of health insurance premium income was relatively slow affected by statistical changes in the new *Accounting Standards for Business Enterprises*. The total premium income of professional reinsurance companies reached RMB 31.632 billion yuan, representing a growth of 50.15%, and the ratio to premium income of direct insurance companies being around 8%.[1]

Figure 4.2 Premium Income Growth

(*percent*)



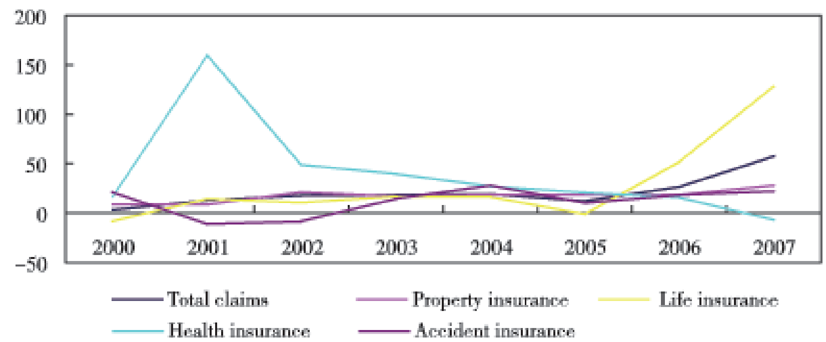
Source: CIRC.

Claim and benefit payments increased fast. In 2007, affected by concentrated expiration of some life insurance products, claim and benefit payments grew faster than the previous years. Various claim and benefit payments totaled RMB 226.521 billion yuan, a growth of 57.5% (Figure 4.3). In particular, property insurance claims paid were RMB 102.047 billion yuan, up 28.2%, life insurance claims and benefits paid RMB 106.445 billion yuan, up 128.7%, accident insurance claims RMB 6.343 billion yuan, up 22.8%, and health insurance claims RMB 11.686 billion yuan, down 6.6%.

1 The source of the data on professional reinsurance companies is CIRC's income statement of the insurance sector.

Figure 4. 3 Claim and Benefit Payment Growth

(*percent*)



Source: CIRC.

The rate of return on investment of insurance funds increased markedly. As of the end of 2007, the balance of invested insurance funds reached RMB 2.67 trillion yuan, a y-o-y growth of 37.2%, consisting of RMB 651.626 billion yuan bank deposits, RMB 396.112 billion yuan government bonds, RMB 471.563 billion yuan stocks, and RMB 253.046 billion yuan securities investment funds, with equity investment including stocks and securities investment funds increasing by 293.5% y-o-y. The investment income reached RMB 279.17 billion yuan, with the average rate of return on investment hitting 12.17%, a record high in history.

Reform and Achievements

In 2007, good progress was made in the areas of insurance service scope and depth, insurance fund utilization, reform of insurers and insurance regulation and supervision.

The Scope of Insurance Services Was Broadened and the Insurance Coverage Enlarged

Policy-oriented agricultural insurance and reinsurance business registered breakthrough. The fiscal authority for the first time provided subsidies to the agricultural insurance in a pilot program of five agricultural products in six provinces (autonomous regions, municipalities) including Jilin and Inner Mongolia, which covered 140 million mu (1 mu = 0.067 hectare), accounting for 70% of planting areas in pilot regions. Swine and sow insurance yielded good results. In 2007, 30.708 million sows, or more than 60% of national inventory were insured. Leading agricultural insurers including PICC, China United Property Insurance Company and Anhua Agricultural Insurance Co. Ltd signed agricultural reinsurance agreements with the China Reinsurance Group

(China Re), making arrangements for reinsurance of major grain products insurance in provinces (autonomous regions, municipalities) covered by central government insurance premium subsidies in 2007. The agricultural insurance premium income reached RMB 5.333 billion yuan in 2007, a y-o-y growth of 529.22%.

Box 5 Swine Insurance

In 2007, CPI hit record high, largely driven by pork price rise. In the first eleven months of 2007, pork price increase contributed 29.5% to CPI increase. Boosting live pig supply and stabilizing pork price became an important front for containing inflation. To this end, the State Council issued the *Opinions of the State Council on Facilitating Live Pig Production to Stabilize Market Supply*. Relevant government agencies actively carried out the spirit of the State Council and issued a string of documents including the *Urgent Notice on Setting Up a Swine Insurance System to Facilitate Live Pig Production*, and the *Provisional Rules on Managing Premium Subsidies for Sow Insurance* to gradually press ahead with swine insurance across the country. The sow insurance protects losses against various risks farms and farmers might incur in the process of raising pigs, including natural disasters such as flood, thunder storm, and lightning strike, serious diseases such as blue-ear and foot-and-mouth, and accidents such as fire and building collapse. The amount of the stock sow insurance is RMB 1000 yuan per pig, and the premium is RMB 60 yuan per pig, of which RMB 48 yuan will be borne by central and local governments and RMB 12 yuan by the policy-holder.

Thanks to joint efforts of relevant agencies, swine insurance grew rapidly. As of the end of 2007, a total of 55.9358 million live pigs were insured, with the premium and insured amount reaching RMB 1.826 billion and RMB 35.639 billion yuan respectively. In particular, 30.708 million sows were insured, with the premium and insured amount reaching RMB 1.597 billion and RMB 25.894 billion yuan respectively. The expansion of swine insurance has strengthened farmers' capability to withstand risks, boosted their enthusiasm in raising pigs, and contributed to sound interaction between the agricultural sector and insurance sector.

Liability insurance business was pushed ahead steadily. The first compulsory insurance scheme provided by laws, namely the compulsory liability insurance on motor vehicles continued to draw wide attention, especially from consumers. As local governments increased awareness and ministries strengthened collaboration, documents such as the *No-*

tice on Relevant Issues Regarding Advancing Medical Liability Insurance and the *Guidelines on the Work of Environmental Pollution Liability Insurance* were issued, and liability insurance business in the fields of tourism, safe production, fire fighting, construction projects, quality supervision, carriers and education were pushed ahead steadily. In 2007, the premium income of liability insurance reached RMB 6.66 billion yuan, growing by 18.92% y-o-y.

Insurance institutions' participation in corporate annuity business achieved positive results. The *Notice on Relevant Issues Regarding Pension Insurance Institutions Conducting Corporate Annuity Business* was issued in October 2007, allowing pension insurers to do corporate annuity businesses across the country, and thus broadening their scope of business. The *Administrative Rules on Pension Insurance Businesses of Insurance Companies* promulgated in November provided comprehensive and systematic rules for pension insurance business in the insurance sector. Among 24 licensed corporate annuity fund management institutions as the second batch of such institutions, 6 were insurance institutions, which obtained licenses for managing 10 corporate annuities. As of the end of 2007, corporate annuity custodian assets and invested assets of pension insurance companies stood at RMB 8.401 billion yuan and RMB 7.974 billion yuan respectively.

Box 6 Corporate Annuity

As a part of supplementary pension insurance, corporate annuity (also referred to as professional annuity or employer sponsored retirement plan), together with basic pension insurance, group pension annuity, and individual savings, forms a multi-tier pension insurance system. To promote the development of corporate annuity is the need of the pension insurance system reform as well as of the healthy development of financial markets.

There are two major types of corporate annuity: defined benefit plan (DB plan) and defined contribution plan (DC plan). The DC plan has grown rapidly abroad in recent years for its favorable tax treatment, flexibility, convenience and transparency. A successful DC plan case is the US 401 (k) plan, named after the section 401 (k) of *the US Internal Revenue Code*, which is also referred to as the tax deferred employee savings plan or deferred employee salary plan. A 401 (k) plan is a "portable" pension plan sponsored by an employer, and authorized by employees where employees contribute a certain percentage of pre-tax salary to the plan and can transfer the plan when changing jobs. To increase incentive of enterprises and their employees to save for retirement, *the US Internal Revenue Code* specifies any earnings on the individual account in the plan are tax deferred, and any withdrawal that is permitted before age 59.5 is subject to an excise tax, unless the purpose of the withdrawal is to pay expenses due to a hardship. Insurance companies, mutual funds, securities companies and banks are key players in the 401 (k) plan.

With the aging of population, China's pension insurance system is facing great challenges. In June 2006, the *Opinions of the State Council on the Reform and Development of the Insurance Sector* stated that "insurance institutions should bring their professional advantages in the areas of actuary, investment, account management and pension payment to full play, actively participate in corporate annuity business, and thus broaden the scope of supplementary pension insurance services". The National Financial Work Conference held in early 2007 clearly put forward advancing corporate annuity and financial market development. At present, we need to draw on successful international experience, encourage and guide employers to set up corporate annuity plans and promote insurance companies to actively participate in corporate annuity management so as to allow corporate annuity to fully play its role of supplementing basic pension insurance in China.

The Channels for Insurance Fund Utilization Were Further Expanded and Investment Yield Increased Significantly

The channels for insurance fund utilization continued to be expanded. In 2007, insurance institutions were permitted to conduct overseas investment with their own foreign exchange or by purchasing foreign exchange, marking that insurance asset management entered a new stage of global allocation. In addition, the percentage limit of equity investment of insurance funds was adjusted duly and properly in light of capital market developments, with the ceiling of direct investment in equity market raised to 10% from 5% of total assets at the end of last year.

Insurance companies kept adjusting investment portfolio (Table 4.1) in line with capital market developments, and thus gradually optimized their asset structure. First, the share of bank deposits in total investment of insurance funds declined to below 30% for the first time in 2007, down 9.28 percentage points. Second, bond investment fell somewhat, with the share of bonds in total investment dropping to 43.98% in 2007 from 53.15% in 2006. However, insurance companies were still the second largest institutional investor in the bond market, and played a dominant role in corporate bond and subordinated bond investment. Third, equity and stock investment grew rapidly, up by 293.5% over the previous year, and the share in total investment also rose significantly. Meanwhile, insurance companies actively participated in acquiring stakes in banks. China Life Insurance Company Limited (China Life) holds 893.6 million shares,

Table 4.1 Investment Portfolio of Insurance Funds in 2007

	Balance at the end of the period (*100 million of RMB yuan*)	Increase y-o-y (*percent*)	In the balance of funds (*percent*)
Bank deposits	6 516.26	5.38	24.39
Bonds	11 752.79	23.78	43.98
Government bonds	3 961.12	7.83	14.82
Financial bonds	4 937.73	33.76	18.48
Corporate bonds	2 801.65	34.75	10.48
Securities investment funds	2 530.46	85.35	9.47
Stocks (equity)	4 715.63	140.23	17.65
Others	1 206.8	154.55	4.52
Total	26 721.94	37.2	100

Source: CIRC.

or 6.17% of total shares of CMBC after involving in the bank's additional offerings, thus becoming the largest shareholder of the bank, and China Ping An Insurance Group (China Ping An) holds 4.93% of total shares of CMBC as its fourth largest shareholder. Fourth, overseas investment increased gradually. As of the end of 2007, the balance of overseas investment by insurance companies reached USD 9.852 billion.

The investment yield of insurance funds rose significantly. In 2007, investment income of the insurance sector reached RMB 279.17 billion yuan, more than the sum of investment income over the past five years, and the rate of return on investment hit 12.17%. In particular, investment income from funds, stocks and equity in unlisted companies took up more than 70% of total investment income.

The Competitiveness of Insurance Institutions Was Strengthened, Benefiting from the Shareholding Reform and Listings

The reform of insurance companies registered fresh progress. As significant progress was made in recapitalization and restructuring of China Re, the reform of state-owned insurance companies taking large market shares in the insurance sector was largely wrapped up. In 2007, China Life and China Ping An went listed back in the A-share market and CPIG successfully launched IPO in the A-share market. As of the end of 2007, a total of six domestic insurers were listed in domestic or overseas markets, which strengthened their capital strength and enhanced their influence in the insurance sector.

Corporate governance of insurance companies further improved and strength enhanced. Thanks to the shareholding reform and listings, operating concepts of insurance companies witnessed significant transformation, reflected by enhanced profitability awareness; their share structure improved considerably and market discipline strengthened increasingly; corporate governance further improved, with a mechanism of clearly defined responsibilities, effective check and balance and coordinated operation among the general shareholders' meeting, the board of directors, the board of supervisors and management being put in place, and thus the operation and management refined as well; in addition, capital adequacy ratio, underwriting capacity and overall profitability of insurers all saw a fresh increase, underpinning rising competitiveness.

Box 7 Progress Achieved in the Shareholding Reform of China Re

At the end of 2006, China Re vigorously started the shareholding reform in line with the requirements of "strengthening the leadership, making careful arrangements, and focusing on reforming the mechanism, improving corporate governance and internal management, and boosting employee qualities so as to achieve sustainable development". Drawing on successful experience of the reform of state-owned commercial banks and insurance companies, the China Re reform involved steps of financial restructuring, setting up a joint-stock company and going public.

In April 2007, Huijin Company injected USD 4 billion to China Re, and since then the shareholding reform of China Re encompassing improving corporate governance and intensifying internal control was carried out in full swing. In October, China Reinsurance (Group) Corporation (China Re Co.) was inaugurated. China Re Co. selected its CEO globally, and strengthened its control over subsidiaries in major lines of business through equity purchase or capital replenishment, thus achieving its goal of equity integration for the current stage.

The shareholding reform helped China Re optimize its capital structure, greatly increase its capital adequacy ratio and solvency ratio, enhance its capability to guard against risks and fully fulfill three mandates of reinsurance in "capital financing, risk management and technology transfer" so that China Re could play a leading role in the development of China's reinsurance market and promote sound and rapid development of the whole insurance sector.

The Insurance Regulation and Supervision Continued to be Strengthened, and the Insurance Guarantee Fund Management Further Improved

The regulation and supervision continued to be strengthened. China's Insurance Sector Solvency Regulatory Standards Committee was set up in August 2007 to improve the regulatory mechanism over solvency. As the core of insurance regulation, solvency regulation helps prevent and mitigate risks to the insurance sector, safeguard interest of policy holders, strengthen capital discipline, facilitate management improvement, and promote a shift from extensive operations to efficient operations as well as from disregard of cost to focus on profits. The regulator intensified supervision of market behaviors, conducted on-site examinations, and investigated and tackled violation of laws and regulations by Xinhua Life Insurance Company with embezzled money taken back and persons involved punished.

The insurance guarantee fund was further reformed. At present, China Insurance Guarantee Fund's operational pattern is characterized by "centralized management and coordinated utilization", with the council overseeing the management and use of the fund. The balance of the fund exceeded RMB 10 billion yuan at the end of 2007. To further improve management of the fund and enhance its capacity in preserving and increasing asset values and dealing with risks, relevant agencies have been planning to reform the operational pattern of the fund by drawing on international practice, adopting a market approach to manage the fund, separating the use and the management of the fund, and enhancing independency of the fund.

Soundness Assessment

In 2007, the insurance sector maintained healthy development in general. A balanced structure was gradually taking shape, market concentration continued to decline and capital strength was increased. Meanwhile, the sector was facing greater difficulties in asset-liability management. The product structure is yet to be optimized and solvency to be further improved.

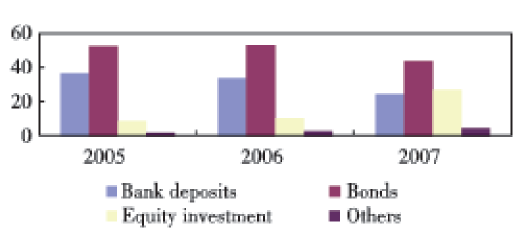
Affected by economic and financial environment, the sector was facing greater difficulties in asset-liability management. In 2007, as a result of interest rate hikes, attractiveness of traditional life insurance products diminished, and the surrender rate rose, posing higher requirement for life insurance product pricing and asset-liability management of insurers. In domestic financial markets there were few medium and long-term bonds, adding to difficulties of insurers in asset-liability management. The assets of the insurance sector denominated in US dollar and HK dollar totaled USD 21.51 billion, accounting for 85.9% of total assets denominated in foreign currencies. Therefore the continued RMB appreciation against the US dollar resulted in the shrink of insurers' foreign assets. Against this background overseas investment is a test to the sector's capabilities in undertaking investment and asset-liability management.

The sector was increasingly affected by capital market fluctuations as the proportion of equity investment was rising. Since insurance funds were allowed access to the stock market in 2005, insurers have been increasing equity investment year by year. Especially in 2007, the sector saw a substantial boost in investment in stocks and securities investment funds, with their proportion in investment portfolio rising to 27.1% (Figure 4.4). In the meanwhile, the rate of return on investment of insurers reached a record high at 12.17%, with the gains from funds, stocks and equity investments in non-listed companies taking up more than 70% of total investment income. Such a high investment yield of insurers was directly linked to the surge in capital market. As insurance funds are increasingly exposed to capital markets, large fluctuations of capital market will impact on profitability and solvency of insurers.

The sector saw increased competition and declined concentration. At the end of 2007, the Herfindahl Index (HI)[1] in the property insurance and life insurance markets stood at 0.221 and 0.222, down 0.022 and 0.032 respectively over the previous year. In the last four years, the decline of concentration in the property insurance market was larger than that in the life insurance market (Figure 4.5). The main reasons behind the decline of concentration in the insurance market were the substantial fall of market shares of the largest insurers with increasingly fierce competition. On the property insurance market, the market share of PICC dropped to 42.46%, down 2.66 percentage points over the previous year. And on the life insurance market, the market share of China Life fell to

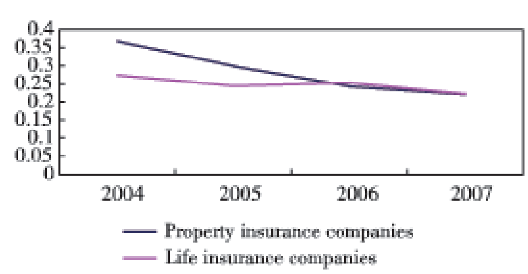
Figure 4.4 Changes of Insurance Fund Investment Portfolio

(*percent*)



Source: CIRC.

Figure 4.5 HI of the Insurance Sector



Source: CIRC.

1 HI is the sum of the squares of the market share of each institution in one sector. Higher HI means higher market concentration.

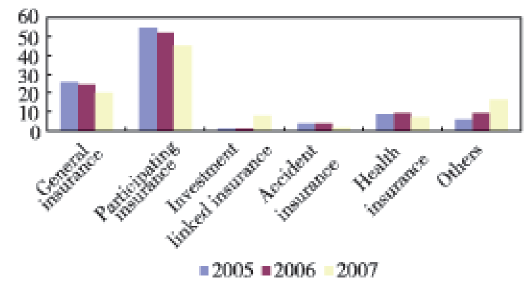
39.73%, down 5.54 percentage points over the previous year.

Business structure of insurance companies continued to improve, while concentration of product lines was relatively high. In 2007, the share of general insurance in life insurance businesses continued to decline, while the share of participating insurance remained at a high level of 44% despite some fall from the previous year. Meanwhile, affected by capital market developments, the share of investment linked insurance products rose by 6 percentage points (Figure 4.6). The premium income of property insurance was excessively concentrated on vehicle insurance. In 2007, vehicle insurance, commercial property insurance, cargo insurance, accident insurance and liability insurance together accounted for 89.86% of total property insurance premiums, with the proportion of vehicle insurance alone hitting 71.14% (Figure 4.7).

Progress was made in addressing imbalanced development, but there still room for development. Balanced growth of the insurance sector across regions has been taking shape. Growth accelerated in the western region (Table 4.2), with the premium income increasing by 29.84% over the previous year. Priority segments such as agricultural insurance and liability insurance were intensified, as in 2007 the premium income from agricultural insurance and liability insurance grew by 529.22% and 18.24% respectively over 2006. Investment channels of insurance funds were expanded to bank deposits, bonds,

Figure 4.6 Composition of Premium Income of Life Insurance

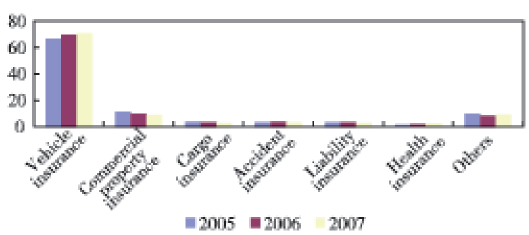
(*percent*)



Source: CIRC.

Figure 4.7 Composition of Premium Income of Property Insurance

(*percent*)



Source: CIRC.

funds and stocks etc., and the investment portfolio was improved. Gradual progress was made in addressing imbalanced development across regions, business lines and income sources. However, it should be noted that the regional gap in the development of the insurance sector remained large, and the shares of agricultural insurance and liability insurance in total property insurance premiums stood low at 2.56% and 3.19% respectively.

Table 4. 2 Premium Incomes by Regions

	2007 (100 million of RMB yuan)	2006 (100 million of RMB yuan)	Y-o-Y Growth (percent)
East	4 341. 52	3 493. 59	24. 27
Middle	1 487. 13	1 212. 54	22. 65
West	1 192. 98	918. 78	29. 84

Note: East covers 16 provinces (municipalities, cities specifically designated in the state plan) including Beijing, Tianjin, Hebei, Shanghai, Jiangsu, Zhejiang, Ningbo, Fujian, Xiamen, Shandong, Qingdao, Guangdong, Shenzhen, Hainan, Liaoning, and Dalian; Middle covers 8 provinces including Shanxi, Anhui, Henan, Hubei, Hunan, Jiangxi, Heilongjiang and Jilin; West covers 12 provinces (autonomous regions and municipality) including Guangxi, Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Ningxia, Inner Mongolia, Qinghai and Xinjiang.

Source: CIRC.

Capital strength increased, and solvency improved greatly, but still needs to be further enhanced. With successful listings of six insurers in domestic or overseas markets as well as capital replenishment and introduction of strategic investors of many insurers, capital strength of the insurance sector increased, underwriting capacity advanced considerably and solvency improved substantially. Meanwhile, a few insurance companies are still suffering inadequate solvency and limited underwriting capability, therefore need to further solidify their solvency.

Issues Worth Attention and Reform Measures

The insurance sector is an important component of a modern financial system. With gradual improvement of the market economic system and advancement of the drive in building a socialist harmonious society, the government has attached great importance to the insurance sector, and the demand of the society for insurance has increased rapidly. As of the end of 2007, household savings deposits reached RMB 17. 9526 trillion yuan, with a large proportion saved for the purpose of future pension and medical care needs. With a view to transforming tremendous potential insurance needs to materialized demand, the insurance sector needs to take advantage of the current strategic opportunity to gradually solve existing problems in the process of development.

Promote Sound and Rapid Growth of the Insurance Sector so as to Better Meet Needs of National Economic Development

In 2007, China's insurance sector grew fast, with the premium income increasing by 25%, exceeding the GDP growth and ranked No. 9 in the world. Total assets increased by a large margin over the previous year as well, reaching RMB 2. 9 trillion yuan. The overall strength of the sector has improved noticeably. However, compared with other financial sectors or the world average, China's insurance sector is still in its initial development stage. The insurance penetration (the ratio of premiums to GDP) was 2.93% and insurance density (premiums per capita) was RMB 532.42 yuan, while the average insurance penetration and density of the world in 2006 stood at 7.5% and USD 554.8. Total assets of the insurance sector accounted for merely around 4% of total financial assets in China, far below the average level of 20% in developed economies.

The aging of population, the greater role of market in economic activities, the upgrading consumption structure and increased insurance awareness create a good opportunity for development of the insurance sector in China, and also post higher requirements for the sector. In this respect, efforts need to be made to accelerate growth of the insurance sector and increase its penetration and contribution to economic and social development so as to better serve the drive of building a harmonious society. First, measures should be taken to continue to optimize regional structure, support leading growth of the insurance sector in the eastern region, accelerate growth in the middle, western, and northeastern regions, and actively promote reform and innovation of insurance experimental zones. Second, priorities should be given to agricultural insurance, liability insurance, commercial pension insurance and health insurance businesses. We need to steadily push ahead with insurance businesses related to the agriculture, rural area and farmers, actively expand the coverage of agricultural insurance, do a good job on pilot policy program in agricultural insurance, and explore developing agricultural reinsurance and catastrophe insurance. We need to explore developing small value insurance tailored to low income households, step up efforts in developing liability insurance, and actively extend and improve the compulsory liability insurance on motor vehicles. And we need to vigorously develop the market for corporate annuity, promote innovation of group pension annuity, undertake pilot programs of new individual pension products in qualified regions, and promote the insurance sector to participate in social insurance programs such as new rural cooperative medical insurance and basic medical care insurance of urban households. Third, efforts need to be made to strengthen legal and cultural construction in the insurance sector, continue to amend the *Insurance Law*, actively push forward legislation of agricultural insurance, forcefully undertake insurance publicity and risk education, and advance the building of integrity culture in the insurance sector.

Improve the Product Innovation Mechanism and Diversify Insurance Products

Currently insurance products are highly homogeneous in China, lacking tailored products, therefore it is hard to meet diversified demands of consumers of different classes and in different regions. Furthermore, insurance products are experiencing imbalanced development. The major reasons behind the above problems lie in the poor product innovation mechanism of insurance companies and lack of incentive in thoroughly analyzing needs of the public and meeting the demand of the market and consumers when developing products.

Therefore, measures need to be taken to advance the reform of insurance product management system and set up and improve a sound insurance product innovation mechanism so as to encourage and support insurers to prop up product innovation and diversify insurance products centering on significant changes in China's economic and social lives as well as consumption habits of urban and rural households.

Strengthen Corporate Governance and Deepen the Reform of Insurance Companies

Corporate governance of insurance companies is yet to be further improved. Now some insurance companies are experiencing problems of weak check and balance among the general shareholders' meeting, board and management, poor internal control, lack of effective discipline mechanism, which have led to untruthful financial figures, cooked accounting books and encroach of companies' interest through collusion of insiders and outsiders.

In this respect, insurance companies should focus on improving corporate governance and transforming operational mechanism to deepen the reform and try to establish themselves as modern financial enterprises featuring adequate capital, sound internal control, safe operation and good services and returns. Qualified insurance companies should be promoted to increase their capital by various means such as target placement and listing and develop themselves towards internationally competitive insurance holding (group) companies through restructuring as well as merger and acquisition. Insurance companies should step up efforts in advancing internal management and mechanism reform to standardize behavior of shareholders and management. They need to put in place and improve arrangements with respect to effective incentive and discipline, management of related party trading and information disclosure, strengthen accountability and enforcement of internal control. In addition, efforts should be made in pushing forward the shareholding reform of qualified group companies including continuing to advance the listing of China Re and the reform of China Export Credit Insurance Company.

Enhance Risk Management and Improve Management and Control Capabilities

In light of changing external environments and rapid development of the insurance sector, the sector is facing more complex risks including underwriting risk, market risk, credit risk, operational risk, liquidity risk, catastrophe risk as well as diversified operation risk and group risk, etc., which will all post challenges to risk management capability of insurance companies. Unable to adapt to fast changing environments, some insurance companies now pursue short-run interests, favor size and speed against efficiency and quality, and lack awareness of risk management.

To further enhance risk management and improve management and control capabilities, insurance companies should earnestly carry out the *Provisional Guideline on Risk Management of Insurance Companies* in line with requirements of the modern insurance regulatory system, to strengthen building the risk management system and put in place a comprehensive risk management system covering all business procedures and operational steps to conduct on-going monitoring as well as regular assessment and provide accurate early warning. Insurance companies should improve risk prevention in main business lines, set up a scientific risk prevention and control framework to identify and assess key risks to business operations and pay attention to adverse impact that strategic planning mistakes and weak corporate governance might have on the company. They should also adopt advanced risk management approaches and methods to improve capabilities in guarding against risks and maximize returns under reasonable risk levels.

Strengthen Insurance Regulation in a Comprehensive Manner with the Emphasis Placed on Solvency Regulation

Great changes have taken place in the development environment and size of the insurance sector by now, but the sector remains small and relatively underdeveloped. It is imperative to strengthen regulation and prevent risks when forcefully developing the insurance sector. To this end, vigorous measures should be taken to continuously improve the modern insurance regulatory system underpinned by regulation of solvency, corporate governance and market behavior. To strengthen solvency regulation, we need to promptly improve related standards and statistical systems, improve comprehensive analysis over solvency, and intensify regulation and supervision over companies whose solvency indicators are below the bar so as to truly prevent risks of insolvency. To advance regulation of corporate governance of insurance companies, we need to urge insurance companies to put in place and improve internal control and compliance management rules, improve decision making toward a more scientific manner and effectiveness of internal control, enhance information disclosure and increase transparency, undertake assessment of corporate governance and establish institutions for corporate governance. To strengthen regulation and supervision of market behavior, we need to improve follow-up supervision and assessment of on-site examination, investigate and punish behavior such as irrational price competition, embezzlement of premiums and cheating and misguiding consumers, address lack of integrity in a comprehensive manner and improve relevance and effectiveness of market behavior regulation.

(By Xu Zhong and Chen Min)