

The Role and Powers of the Chinese Insurance Regulatory Commission in the Administration of Insurance Law in China

by Jeffrey E. Thomas*

1. Introduction

The Chinese insurance market has generated intense international interest. It has grown from a single company with about U.S.\$200 million in revenue in 1978,¹ to a competitive market including foreign-invested enterprises² generating U.S.\$19.27 billion in premium revenue in 2000.³ The market grew at the astonishing pace of about 37 per cent a year from 1980 to 1997.⁴ Although the pace of growth has slowed, premiums grew by 14.5 per cent in 2000,⁵ and are projected to grow by about 12 per cent per year for the next five years.⁶

Market circumstances are favorable for continued growth. China's economy is the sixth largest in the world,⁷ and is growing rapidly,⁸ yet only about 1.79 per cent of its GDP is spent on insurance.⁹ This compares to an average of penetration rate of 9.1 per cent for developed countries,¹⁰ and an average of 3.2 per cent penetration in other emerging markets.¹¹ Insurance density in China is also relatively low compared to other countries. Per capita spending on insurance in China was only U.S.\$15.2 in 2000, compared to an average of U.S.\$2,384 for developed countries¹² and an average of U.S.\$42 for emerging markets.¹³ To put it slightly

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¹ Lancaster (1995).

² As of 2000, there were 31 insurance companies operating in China, including four state-owned companies, nine share-holding companies, five joint ventures, four foreign insurers, and nine branch companies of overseas insurers. "Profile: China's Insurance Sector", *Asia Pulse*, 11 August 2000.

³ Swiss Re, p. 30.

⁴ Ji and Thomas (2001).

⁵ Swiss Re, p. 30.

⁶ Ji and Thomas (2001).

⁷ Swiss Re, p. 37.

⁸ Chinese Gross Domestic Product grew at the rate of 8.1 per cent in 2000: Swiss Re, p. 37.

⁹ Swiss Re, p. 36. With this penetration rate, China ranked 61st overall.

¹⁰ *Ibid.*, p. 20.

¹¹ *Ibid.*, p. 24.

¹² *Ibid.*, p. 20.

¹³ *Ibid.*, p. 24. This figure would be much higher without the inclusion of China and India. About half of the emerging markets have insurance density of between U.S.\$100 and \$400. South Korea, Hong Kong and Taiwan, which share some cultural values with China, but are further developed, have insurance density in excess of U.S.\$1,000.

differently, Chinese insurance premiums only account for 1 per cent of the world's insurance premiums even though it accounts for 25 per cent of the world's population.¹⁴ China predicts that total premiums will reach more than U.S.\$33 billion by 2005.¹⁵

To manage and control this rapid growth, a national Insurance Law was adopted in 1995, followed by the creation of the Chinese Insurance Regulatory Commission (CIRC) in 1998 to administer the law. This article analyses the role and powers of CIRC in the administration of the national Insurance Law of China. It describes the law and the CIRC's administrative powers, and puts them into the appropriate legal and cultural context. It then considers the impact of the China's accession to the World Trade Organization (WTO) on CIRC's exercise of its administrative powers.

This article will show that while the Insurance Law appears to provide a static and predictable set of ground rules for the insurance market, CIRC's broad statutory discretion, combined with the absence of meaningful review and a cultural tolerance for highly concentrated administrative power, substantially undermines the predictability of the law. Although China's accession to the WTO provides a theoretical legal framework with limits on CIRC's discretion, this framework is unlikely to have much practical effect on CIRC's exercise of its discretion in the short run. Consequently, insurers doing business in China must develop a good working relationship with CIRC, and should be careful not to rely too heavily on apparent legal rights or legal remedies.

This article begins by sketching a historical overview of developments in the insurance industry, and then puts that history into the context of developments in the legal system. A general description of the Insurance Law and its enforcement mechanisms follows. The article then analyses the extent of CIRC's administrative discretion under the statute, the effectiveness of limitations on that discretion provided by the legal system, and the effect of such discretion on enforcement in the case of Sedgwick Insurance Risk Management Consultants (China) Ltd. The article next considers the effect of China's accession to the WTO on CIRC's ability to exercise administrative discretion, and then draws some general conclusions.

2. Historical overview and context

An understanding of the administration of Chinese insurance law requires some consideration of its historical context. This will provide a baseline for considering the progress that has been made, and will help identify cultural forces that continue to have an effect on administration and operation of law.

A brief history of Chinese insurance

The beginnings of the Chinese insurance industry go back to ancient traders on the Yangtze river. In the early 20th century, the expansion of trade and the initiation of industrialization led to the establishment of a more formalized insurance market. After the Communist revolution in 1949, however, the insurance industry was nationalized and the People's Insurance Company of China was established. The People's Insurance Company

¹⁴ Ruquet.

¹⁵ Ji.

maintained a monopoly on all insurance business in China until the 1980s. As a monopoly, it was both the sole supplier of insurance and the “regulator” of all insurance activity.

Communist ideology and programs eroded the demand for insurance during the first 30 years of Communist rule. The restrictions on private ownership of property and comprehensive social entitlement programs reduced the perceived need for insurance, ultimately leading to the suspension of underwriting by the People Insurance Company. In 1978, as part of efforts to modernize the economy, the People’s Insurance Company resumed operations. It initially had premium revenue of only U.S.\$200 million and a mere 3,000 employees, remarkably small numbers for a country of over 1 billion people.¹⁶

The reforms initiated in 1978, with accompanying political and economic changes, reversed the decline in the insurance industry. As foreign investment flowed into China, the demand for insurance protection grew. The Chinese Government used this demand to build its domestic insurance market. It required joint ventures to buy insurance from domestic insurers. The economic growth spurred by foreign investment generated additional demand for insurance in the domestic economy.

As the demand for insurance increased, the Chinese Government found it necessary to adopt regulatory measures. Provisional regulations ended the monopoly of the People’s Insurance Company in the mid-1980s, and competing domestic insurers were created. In 1992, foreign insurers were allowed a very limited participation in the Chinese market through joint ventures by the Shanghai Interim Management Regulation for Foreign Insurance Institutions. These various piecemeal regulations culminated in the adoption of the comprehensive Insurance Law in 1995, which was followed by the establishment of CIRC in 1998.

The context of legal reform

Regulatory reforms for the insurance market took place in the context of sweeping reform and reconstruction of the legal system. Although preliminary efforts to modernize the legal system were begun in the late 19th century, they were swept away by the Communist revolution in 1949. Initially, legal development was based on the Soviet model, but the anti-rightist movement initiated a period of decline for the Chinese legal system. The legal system was labeled as bourgeois and its role in Communist China gradually diminished until it was virtually abandoned during the Cultural Revolution.

At the conclusion of the Cultural Revolution, the country began an ambitious and unprecedented reconstruction of the legal system in part to build an infrastructure for economic modernization. Although this process has been far from perfect, leaving plenty of room for further improvement, one legal scholar noted, “The new legal system which has emerged from the ravages of the Cultural Revolution is nothing less than amazing and it should be recognized as such.”¹⁷

Reconstruction of the legal system has generated a remarkable volume of legislative and rule-making activity, and has initiated the rebuilding of legal institutions. Law schools, which were closed during the Cultural Revolution, have gone from two in 1977, to more than 80.¹⁸ The professional bar, which was abolished in 1958, now has about 120,000 practicing

¹⁶ Lancaster.

¹⁷ Brown, p. 28.

¹⁸ Chenguang, p. 13.

lawyers.¹⁹ The courts have been rebuilt and expanded. Court personnel grew from 58,000 in 1979 to more than 292,000 in 1995.²⁰ About 158,000 judges work in the courts.²¹

Remarkable as this reconstruction has been, it is easier to adopt new laws and expand institutions than it is to make those laws and institutions work effectively. "Implementation of law remains a major challenge to the nascent legal system."²² Although there are a variety of reasons for the difficulty in implementation, for purposes of this article, I want to focus on two barriers to effective legal implementation: traditional Chinese legal culture, and weaknesses in Chinese courts.

Traditional Chinese legal culture: the secondary nature of law

Traditional Chinese legal culture goes back for more than 4,000 years. During nearly all of that time, the legal system was supporting authoritarian rule. It was primarily concerned with imposing the government's will on the people, rather than on regulating relationships between individuals. The government utilized a hierarchical administrative structure as part of the legal system, and recognized different rights and responsibilities of individuals depending on their status. Government officials had broad inherent authority, and their conduct often could be characterized as "rule of man" rather than "rule of law".²³

Chinese legal culture was substantially influenced by Confucian philosophy. Government officials qualified for their positions by passing an examination in Confucian classics, which made law secondary to Confucian rules of conduct. In addition, Confucian rules made a person's rights and duties contextual and dependent upon one's status and the relationships of those involved. Under Confucian principles, co-operation and harmony were valued, and the virtue of yielding and the superiority of non-contentiousness were stressed. "Chinese society has in many respects held to this contextualist approach to law", with law still subjected to "extra-legal considerations, such as the relationship and circumstances of the parties and the demands of commonly held standards of justice".²⁴

Chinese courts are subject to extra-legal influences

The courts, of course, operate within this legal culture and also reflect it. Courts are considered to be at the same level as the agencies, and therefore give broad latitude to administrative agencies.²⁵ Consistent with Confucian values, courts continue to apply a contextualist approach to cases, recognizing the importance of relationships and individual circumstances. As one scholar of Chinese law has put it: "A striking characteristic of Chinese legal culture is primacy of interpersonal relationships [often referred to as 'guanxi'] over legal relationships."²⁶

The influence of extra-legal considerations is fostered by structural weaknesses in the

¹⁹ Lubman (2000). Although this is a remarkable turn-around in a relatively short time, the number of lawyers is still quite low relative to the population and the number of cases. In 1996 there were nearly 5.26 million cases in the Chinese legal system (Brown, p. 3). In the U.S., there are approximately 800,000 lawyers (*ibid.*, p. 3, n.10).

²⁰ Lubman (1999), p. 253.

²¹ Brown, p. 3.

²² Chenguang, p. 15.

²³ *Ibid.*, pp. 5, 14; Lubman (1999), p. 11.

²⁴ Chenguang, p. 9.

²⁵ Lubman (1999), pp. 3, 8.

²⁶ *Ibid.*, p. 303.

judicial system. Chinese courts are not independent. Decisions are subject to approval by judicial officers, who are subject to the People's Congresses. This creates a strong incentive for local protectionism and makes law secondary to politics in judicial decision-making. Moreover, courts continue to emphasize the virtue of compromise. Mediation is formally recognized as part of the civil procedure, and more than half the cases brought to court are resolved through mediation.

Another weakness is the poor quality of judicial personnel. Courts have difficulty finding sufficient numbers of qualified personnel. The need to fill some 158,000 judicial positions in a society with only some 120,000 lawyers has made it impossible to appoint judges from the ranks of professional lawyers. Initially, most judges came from the Party, the military or public security bureaus, and many of these judges did not have a university-level education.²⁷ As a result of these challenges, "judicial ignorance of the law is a real danger".²⁸

The implications for Chinese insurance law

The weaknesses in the judicial system and the influence of traditional Chinese legal culture have a significant bearing on CIRC's administration of Chinese insurance law. Because of weaknesses in the judicial system, the courts cannot exercise meaningful review of administrative decisions. Moreover, both judicial review and administrative action operate within Chinese legal culture, which puts much greater emphasis on relationships and context, and much less emphasis on substantive and procedural rules, than do Western legal cultures. As a result, administrative actions that might be viewed as arbitrary or unreasonable in a Western culture are tolerated and accepted as part of the legal system. Before turning to a specific example to illustrate these conclusions, we begin with a general description of Chinese insurance law and its enforcement.

3. A description of Chinese insurance law

The stated purpose of the Chinese Insurance Law is to "protect the legitimate rights and interest of the parties involved, strengthening supervision and regulation of the insurance industry and promoting its healthy development".²⁹ On the whole, the law advances these objectives. It protects rights by codifying them in the Insurance Law and creating related legal duties. It strengthens supervision and regulation by articulating regulatory standards and empowering an oversight agency. The law promotes healthy development of the industry by imposing requirements to protect against insurer insolvency. Observers have generally responded favorably to the new law.³⁰

The following subsections outline substantive requirements of the law and CIRC's enforcement options. They do not provide an exhaustive description of Chinese insurance law, but instead illustrate the nature of the requirements. Although the statute includes a number of specific requirements, CIRC retains broad discretion to interpret or expand those requirements. CIRC also has broad enforcement authority.

²⁷ *Ibid.*, p. 253; Cohen (1997), pp. 796–797.

²⁸ Lubman (1999), p. 254.

²⁹ Insurance Law of the People's Republic of China Article 1 (hereinafter "Insurance Law of the PRC").

³⁰ For example, see Tong, reporting that "The birth of the Insurance Law also received a warm reception from overseas insurance companies . . . 'The law will lay a firm foundation for a healthy insurance environment in China', said Joerg-Michael Luther, chief representative of German-based Allianz's Beijing office."

Substantive provisions

The Insurance Law has the kind of substantive provisions one would expect in a comprehensive insurance law. Industry observers noted that the law is “a very good start in the implementing of an internationally acceptable standard of insurance regulation”,³¹ and that it will “lay a firm foundation for a healthy insurance environment”.³² The law includes basic definitions and duties, as well as specific detailed requirements, on nearly all aspects of the insurance business. For example, the law defines “insurance”,³³ an “insurance contract”,³⁴ “agents”,³⁵ and “brokers”.³⁶ It requires that all insurance activities comply with the Insurance Law,³⁷ and imposes the obligations of “utmost good faith”³⁸ and fair competition.³⁹ Although these terms are defined, their definitions are sufficiently vague that CIRC maintains side latitude in deciding what activities are subject to the law,⁴⁰ and what activities might be considered bad faith.⁴¹

The Insurance Law includes specific requirements for establishment of an insurance company. An insurer must be a stock company or a state-owned enterprise,⁴² must have a minimum of 200 million Renminbi in registered capital⁴³ (of which 20 per cent must be deposited with an approved bank as a guarantee fund),⁴⁴ and must have qualified management, a sound organizational structure, and sufficient facilities.⁴⁵ A prospective insurer must submit an application, a feasibility study and other requested documents to CIRC,⁴⁶ and once

³¹ Lancaster.

³² Tong, quoting Joerg-Michael Luther, chief representative of Allianz's Beijing office.

³³ “Insurance is the term used in this Law to refer to a commercial insurance transaction whereby an insurance applicant, as contracted, pays insurance premiums to the insurer, and the insurer bears an obligation to indemnify for property loss of damage caused by an occurrence of a possible event that is agreed upon in the contract, or to pay the insurance benefits when the insured person dies, is injured or disabled, suffers diseases or reaches the age or term agreed upon in the contract.” Insurance Law of the PRC, Article 2.

³⁴ An “insurance contract” is defined as “an agreement whereby the insurance rights and obligations are specified and agreed by the applicant and the insurer”. Insurance Law of the PRC, Article 9.

³⁵ An “agent” is defined as “an entity or individual, that has been delegated by an insurer and collects handling fees therefrom, to transact insurance business on behalf of the insurance company within the scope of the delegated authority”. Insurance Law of the PRC, Article 122.

³⁶ A “broker” is defined as “an entity which, based on the interests of the applicant, provides intermediary services between the applicant and the insurer so that they enter into an insurance contract and receives a commission in accordance with laws.” Insurance Law of the PRC, Article 123.

³⁷ Insurance Law of the PRC, Article 3.

³⁸ *Ibid.*, Article 4.

³⁹ *Ibid.*, Article 7.

⁴⁰ All those who are engaged in “insurance activities” are subject to the Insurance Law. See Insurance Law of the PRC, Article 3. “Insurance” is defined as the payment of “insurance premiums, as agreed in the contract” in exchange for a promise to indemnify or “to pay insurance money upon death, injury, deformity or illness”. Insurance Law of the PRC, Article 2. Depending on what is meant by “insurance premiums” and “insurance money”, neither of which is defined, this definition could be construed to include contracts with indemnity provisions that would normally not be considered insurance.

⁴¹ The phrases “utmost good faith” and “fair competition” are not defined in the statute, and are sufficiently vague that they could be applied to any behavior that CIRC finds inappropriate. Scholars in the U.S. have had difficulty defining bad faith in the insurance context. See Jerry, pp. 151–162.

⁴² Insurance Law of the PRC, Article 69.

⁴³ *Ibid.*, Article 72.

⁴⁴ *Ibid.*, Article 78.

⁴⁵ *Ibid.*, Article 71.

⁴⁶ *Ibid.*, Article 73.

the application is approved, must submit articles of association, a list of shareholders, a certificate verifying paid-up capital, a business plan, and various other documents.⁴⁷

Once an insurer is approved by CIRC to do business, CIRC continues to have substantial review authority over the insurer's operations. CIRC must approve any branch office,⁴⁸ and any changes to the name of the company, the amount of registered capital, the business premises, the scope of business, and or any change to the investors who hold more than 10 per cent of company shares.⁴⁹ Similarly, CIRC must approve any division or merger of the company, any amendment to the articles of association, or any changes of the company's Chairman or General Manager.⁵⁰ The statute does not include any standards governing approval of such changes. Consequently, CIRC has broad discretion.

The Insurance Law also gives CIRC authority over an insurer's use of premiums. As one would expect, the law includes a statutory reserve requirement⁵¹ and a required solvency margin.⁵² Insurers are also required to place at least 20 per cent of non-life business with reinsurers.⁵³ Investments must be "conservative, sound and safe", and are limited by statute to bank deposits, government and financial bonds, and other investments approved by the State Council.⁵⁴ These regulations may be supplemented in CIRC's discretion. For example, CIRC can adopt additional reserve requirements⁵⁵ and can require additional reinsurance.⁵⁶ CIRC can also modify approved investments. It recently expanded the list of approved investments to include a limited amount of securities.⁵⁷

CIRC also has significant discretion in the regulation of insurance products. Basic insurance clauses and premium rates are to be set by CIRC for major types of commercial insurance.⁵⁸ As with other provisions, the statute does not include any standards against which these decisions can be evaluated, leaving it to CIRC's discretion. In addition, the statute does not specify any procedures to allow insurers or consumers to comment on CIRC's exercise of its discretion in such matters.

Although sales and claims practices are not explicitly subject to CIRC's discretion, the statutory requirements are sufficiently vague to give CIRC a significant amount of room to interpret them. For example, the statute requires insurance contracts to be entered on a "fair, voluntary and mutually beneficial basis", and that insurance contracts cannot "infringe upon the public interest".⁵⁹ CIRC has the right to interpret what is "fair" or in the "public interest". Examples of more explicit statutory guidelines are those which require insurers to "explain

⁴⁷ *Ibid.*, Article 74.

⁴⁸ *Ibid.*, Article 79.

⁴⁹ *Ibid.*, Article 81(1)–(4), (7).

⁵⁰ *Ibid.*, Article 81.

⁵¹ *Ibid.*, Articles 93–95.

⁵² *Ibid.*, Articles 97–98.

⁵³ *Ibid.*, Article 101.

⁵⁴ *Ibid.*, Article 104.

⁵⁵ *Ibid.*, Article 95.

⁵⁶ The additional reinsurance may be required if a single insured event would result in liability of more than 10 per cent of the insurers paid-up capital and accumulated reserve. Insurance Law of the PRC, Article 99. This risk is termed a "risk unit" (*ibid.*), which is to be calculated in accordance with a formula approved by CIRC. Insurance Law of the PRC, Article 100.

⁵⁷ "China allows insurance firms to enlarge funds", *China Online*, 14 March 2000, noting that CIRC had announced that the amount Chinese insurers could invest in the securities market was raised from 5 per cent of total capital assets to 10 per cent.

⁵⁸ Insurance Law of the PRC, Article 106.

⁵⁹ *Ibid.*, Article 10.

the contract terms and conditions of an insurance contract”,⁶⁰ and give “specific and clear explanations” of exclusions.⁶¹ Similarly, insurers must process insurance claims in a “timely manner”.⁶² Although these terms are more concrete than “fairness” or the “public interest”, they still allow a certain amount of regulatory discretion. CIRC still has the right to interpret what constitutes a sufficient explanation and “timely” processing.

The regulation of intermediaries is explicitly subject to CIRC’s discretion. The law provides that agents and brokers must meet the qualifications to be outlined in regulations, must be licensed, registered, and pay a guarantee deposit or be insured for professional indemnity,⁶³ and are subject to general supervision by CIRC.⁶⁴ Thus, the statute conveys even greater discretion concerning intermediaries than insurers. Although the insurers are subject to a number of specific and concrete requirements, intermediaries are almost entirely subject to regulations to be adopted by CIRC without procedures for input or review. Similar discretion is common in the U.S. regulation of intermediaries,⁶⁵ but, as will be seen below, the discretion afforded CIRC has less meaningful limits than is customary in the U.S.

Enforcement provisions

The enforcement provisions give CIRC broad authority to enforce the Insurance Law. Although the statute identifies some specific conduct that will be penalized, the provisions rely to a substantial extent on CIRC’s discretionary application of penalties. In addition, CIRC is given broad investigatory and adjudicatory authority, and, consistent with Chinese administrative law, may add additional enforcement mechanisms to those specified in the statute.

A number of the enforcement provisions identify offending conduct and specify the possible sanctions. For example, an insurer that conducts business beyond the scope of its license is subject to administrative orders, forfeiture of illegally obtained premiums, a fine of 100,000 to 500,000 Renminbi, and, if the violation is not properly corrected, revocation of the insurer’s license.⁶⁶ Prohibited conduct mostly relates to the administrative requirements of the Insurance Law, though some also concern fraud and consumer protection.

Some provisions, however, allow CIRC to impose a sanction for any conduct found to be improper. For example, managers and other insurance personnel are subject to a warning, to being replaced, or to a fine of 5,000 to 50,000 Renminbi if they are directly involved in a violation of the Insurance Law.⁶⁷

⁶⁰ *Ibid.*, Article 16.

⁶¹ *Ibid.*, Article 17. Failure to provide a “specific and clear” explanation results in the exclusion being unenforceable (*ibid.*).

⁶² Insurance Law of the PRC, Article 23. Once an agreement is reached with the insured, the insurer must pay the policy benefits “within ten (10) days” (*ibid.*). If the insurer fails to timely process the claims or make payments, the insurer must “compensate the insured or the beneficiary for any damage incurred thereby” (*ibid.*). In addition, if the amount due under the policy cannot be determined within 60 days, the insurer is to pay “the minimum amount which can be determined by the evidence and information obtained” (*ibid.*), Article 25.

⁶³ Insurance Law of the PRC, Article 127. In addition, insurers are to maintain a registration book of their agents. *Ibid.*, Article 129.

⁶⁴ *Ibid.*, Article 128.

⁶⁵ Intermediaries are subject to general licensing and supervision by regulatory authorities in the U.S. For example, see New York Consolidated Law Service, Insurance § 2101, *et seq.*

⁶⁶ Insurance Law of the PRC, Article 136.

⁶⁷ Insurance Law of the PRC, Article 143.

When CIRC determines that the law has been violated, the enforcement provisions provide a broad array of sanctions. CIRC can issue official warnings,⁶⁸ order replacement of offending personnel,⁶⁹ order the insurer to correct the violations,⁷⁰ take over the insurer's operations,⁷¹ impose fines,⁷² and, ultimately, revoke an insurer's or intermediary's license.⁷³ Fines range from 5,000⁷⁴ to 500,000⁷⁵ Renminbi, or can be a multiple of up to ten times the illegally obtained profits.⁷⁶ In addition, the Insurance Law also appears to give CIRC the right to create additional administrative sanctions. Several provisions refer to "administrative sanctions" without specifying what those sanctions may be.⁷⁷ In light of the inherent regulatory discretion under Chinese administrative law, this reference supports CIRC's adoption of additional remedies.

CIRC has broad powers to investigate for possible violations of the Insurance Law. Insurers are required to submit various monthly statistical reports⁷⁸ and annual reports to CIRC.⁷⁹ In addition, CIRC has the right to inspect the business, financial and capital circumstances of insurers and to require additional written reports or information.⁸⁰ Agents and brokers are also subject to these inspection and reporting requirements.⁸¹

Two enforcement provisions are designed to limit improper use of CIRC's discretionary power. One provides that a regulator who approves the application of a prospective insurer, agent or broker that does not comply with the requirements of the law is subject to administrative sanctions and, if the conduct is serious enough to constitute a crime, to criminal proceedings.⁸² A second provision provides that a regulator is subject to administrative sanctions and, if serious enough, to criminal proceedings, for abuse of power, economic corruption, dereliction of duty, favoritism, or neglect of duty.⁸³ These provisions, however, do not specify the punishment for regulators beyond "administrative sanctions", thus apparently leaving the punishment to CIRC's discretion.

⁶⁸ Insurance Law of the PRC, Article 143.

⁶⁹ Insurance Law of the PRC, Articles 108, 143.

⁷⁰ For example, see Insurance Law of the PRC, Article 132, correcting conduct that induced applicants to make incomplete disclosures, and Article 137, correcting changes in information and details of business without approval.

⁷¹ This remedy is available for violations regarding reserve funds, reinsurance and use of capital funds. Insurance Law of the PRC, Articles 109–111. CIRC can also implement a "take over" of the insurer for serious violations that hinder the public interest and which seriously threaten insurer solvency (*ibid.*, Article 113). For more details about the take-over powers, see *ibid.*, Articles 114–116.

⁷² For example, see Insurance Law of the PRC, Articles 132, 133, 136–140.

⁷³ For example, see Insurance Law of the PRC, Article 136, for failure to obey orders regarding scope of approved business.

⁷⁴ Insurance Law of the PRC, Article 143.

⁷⁵ *Ibid.*, Articles 136, 140.

⁷⁶ *Ibid.*, Article 142, for agents or brokers acting without a license. Another provision authorizes fines of one to five times the illegally obtained gains for transacting business beyond the scope of approval (*ibid.*, Article 136).

⁷⁷ For example, see Insurance Law of the PRC, Articles 135, 145, 146.

⁷⁸ Insurance Law of the PRC, Article 118.

⁷⁹ *Ibid.*, Article 117.

⁸⁰ *Ibid.*, Article 107.

⁸¹ *Ibid.*, Article 130, applying Articles 107 and 117 to agents and brokers.

⁸² *Ibid.*, Article 145.

⁸³ *Ibid.*, Article 146.

4. The scope of CIRC's powers in administering the Chinese Insurance Law

As the previous section notes, although the Insurance Law establishes a comprehensive regulatory framework for the insurance market, it retains substantial regulatory discretion for CIRC. This section will review the statutory basis for that discretion, and will then put that discretion into the context of the administrative review statutes and Chinese legal institutions and culture. Finally, this section will examine a specific case of enforcement to provide an empirical assessment. While the adoption of the Chinese Insurance Law and the establishment of CIRC represent important progress towards meaningful regulation of the insurance market, the breadth of CIRC's discretion combined with the absence of meaningful accountability substantially limits the role of law and its predictability. At the same time, broad discretion combined with an absence of review heightens the importance of a good relationship with CIRC, which is consistent with Chinese history and practice as related to administrative agencies.

The statutory basis for CIRC's discretion

Although on its face the Insurance Law appears to be a major step in establishing a comprehensive regulatory framework generally consistent with international standards,⁸⁴ observers should be careful not to overstate the practical significance of these reforms. Closer analysis shows that the law, though modern and even innovative in some respects, is still a product of China's legal culture and history. Most significantly, the law continues to put heavy emphasis on centralized regulatory power exercised with substantial discretion and little accountability. Under the Insurance Law, CIRC has substantial discretion to interpret and apply vague requirements, to impose new or supplemental requirements, and to determine the existence of a violation and the appropriate sanction for that violation. This explicit authority is augmented by CIRC's inherent power under Chinese administrative law to issue supplemental regulations as deemed necessary to carry out its perceived mandate.⁸⁵ This authority is not subject to any meaningful statutory limitations.

For example, although the Insurance Law outlines the requirements for a company to be recognized and licensed as an insurer, the licensing decision is ultimately left to CIRC's discretion in light of its perceived needs of the industry. If CIRC refuses a license, the prospective insurer has no recourse under the statute. With respect to intermediaries, CIRC's discretion is even greater. It has the right to set the initial requirements as well as to decide which intermediaries should be licensed. A supplemental provision even goes so far as to provide that regulations adopted by CIRC governing foreign insurers would pre-empt the statutory provisions of the Insurance Law.⁸⁶

Similarly, regulatory discretion has been preserved regarding insurer operations. CIRC has authority to supplement specific statutory requirements for statutory reserves or reinsurance, and can modify investment practices. Moreover, the statute does not provide any limits on two important aspects of insurer operations, policy terms and premiums. CIRC

⁸⁴ See Lancaster, who concluded: "Overall, most people who have studied the final result, give [the Insurance Law] high marks as a major step forward in transforming insurance regulation in China towards: international standards of accountability of management, balance in protecting insured and insurer rights, defining the role of the regulator."

⁸⁵ Lubman (1999), p. 143.

⁸⁶ See Simms.

has virtually unfettered authority to formulate insurance clauses and set premium rates for major types of commercial insurance. Not only does an insurer have no recourse if they disagree with CIRC's decision, but there are no provisions requiring hearings or any other means for formal input from insurers on these issues. While CIRC receives such information informally, it is not required to do so.

Additional discretionary authority is maintained by the use of vague and undefined terms. For instance, the requirement that all insurers and policyholders act in "good faith", is not defined by the statute and may be interpreted in many different ways. This requirement can be used by CIRC to condemn conduct that does not violate any of the more specific provisions of the statute. While this makes it easier for CIRC to regulate the industry by giving it greater flexibility, it undermines the predictability of the statute. In addition, although limited judicial review is technically available regarding the application of this term, its vague nature makes it easy for CIRC to justify its interpretation.

This interpretive discretion extends throughout the regulatory process. At the beginning of the process, CIRC has discretion to decide whether an insurer has sufficiently qualified management and sound business practices, which can be interpreted in many different ways. After an insurer is licensed, CIRC has interpretive discretion to approve changes in the insurers operations. If an insurer wants to make certain changes, including things as minor as its business location, it must obtain CIRC approval. The statute contains no guidelines for granting or withholding of such approval.

The enforcement provisions further enhance CIRC's discretionary powers. CIRC is entitled to decide whether an insurer has violated the statute, and if it finds a violation, it can choose from a range of administrative sanctions, including administrative orders, confiscation of ill-gotten gains, various fines and revocation of a license. In addition, senior management and other personnel involved in the offense could be fined individually or replaced by administrative order. Finally, if these sanctions do not seem suitable, CIRC might exercise its general administrative power to impose a different administrative sanction.

Although the Insurance Law includes two enforcement provisions to limit improper use of regulatory discretion, these provisions are not a meaningful limitation. Those provisions forbid the abuse of discretion by individual regulators, as in the case of corruption,⁸⁷ but do not prevent the agency using its discretion in whatever manner it sees fit. Moreover, it is unclear whether these provisions will be meaningful as to individual regulators because they do not identify any specific sanction. Thus, even a regulator's abuse of discretion is to be dealt with by CIRC in its discretion. Serious abuses by an individual regulator, of course, may constitute a crime, and these provisions recognize the possibility of criminal sanctions. But whether to prosecute a violation as a crime would be a decision for the criminal authorities applying criminal law.

CIRC's discretion in the context of the Chinese legal system

Broad statutory discretion in itself is not necessarily bad. It gives CIRC substantial authority to act quickly and to effectively modify and enforce the law. However, if CIRC's discretion is to operate within a system of a rule of law as understood in many westernized countries, it must be subject to meaningful review by the courts or some other governmental body. Unfortunately, although China's legal system has made remarkable progress in a

⁸⁷ Insurance Law of the PRC, Articles 145, 146.

relatively short time, statutory limits, traditions and institutional weaknesses prevent meaningful oversight of CIRC's discretion. Broad administrative discretion without meaningful accountability has been a part of Chinese legal culture for thousands of years, and has traditionally been exercised in light of relationships and other extra-legal considerations. Reformed legal institutions have been given some responsibility for administrative oversight, but they operate within the context of these traditions and are still weak. As a result, those subject to regulations have little expectation of administrative accountability, at least compared to the expectations of those who are subject to regulation in Western countries like the United States.

This tolerance of discretion without accountability is reflected by the fact that courts are considered to be equal or even subordinate to agencies in the legal hierarchy, rather than above them. Courts' lack of status is evident in the rules for interpretation. As a general matter, courts are not given the power to interpret administrative rules. Such power is reserved for the agencies, the State Council or the National People's Congress.⁸⁸ Although efforts to improve agency oversight are underway, agencies persist in their independence.⁸⁹ The courts therefore are hesitant to challenge CIRC's administrative prerogatives, especially when they can be justified by reference to statutory language.

One important effort to improve administrative oversight was the adoption of the Administrative Procedure Law (APL) in 1989. This authorizes citizens to bring lawsuits against administrative agencies. Although the APL was significant because agency decisions previously were not subject to any judicial review, the law is very limited in scope. It explicitly excludes review of administrative rules and regulations with general binding effect.⁹⁰ Rules or regulations adopted by CIRC are therefore outside the scope of judicial review. The APL also excludes punishment of administrative personnel,⁹¹ so CIRC's exercise of discretion in punishing administrative misconduct cannot be reviewed in court.

The most promising provision of the APL authorizes review of administrative "concrete administrative actions",⁹² but even that provision is relatively narrow in its scope. It authorizes judicial review for actions such as administrative sanctions, infringement on managerial decisions, and refusal to permit a license.⁹³ This would seem to apply to many actions of CIRC. To be reviewed, however, the action must be "concrete" not "discretionary". Judicial review does not extend to matters of discretion.⁹⁴ Therefore, if CIRC acts within its discretion, for instance denying a license in the interest of the insurance industry rather than because the applicant did not meet the statutory qualifications, that decision is not subject to judicial review.

Even when judicial review is technically available, plaintiffs face formidable obstacles, including the agency's influence on the court and the risk of retaliation.⁹⁵ As a consequence, although there have been some successful cases brought against agencies, the number of cases

⁸⁸ Lubman (1999), p. 205.

⁸⁹ Dicks, p. 82.

⁹⁰ Administrative Procedure Law of the People's Republic of China, Article 12 (hereinafter "Administrative Procedure Law of the PRC").

⁹¹ Administrative Procedure Law of the PRC, Article 12.

⁹² Song.

⁹³ Administrative Procedure Law of the PRC, Article 11.

⁹⁴ Lubman (2000).

⁹⁵ Lubman (1999), p. 210.

has been fewer than expected⁹⁶ and continues to be relatively small.⁹⁷ Most of those cases, nearly 60 per cent, are resolved by withdrawal by the plaintiffs.⁹⁸ Moreover, the kinds of cases being brought against agencies are those where there is no ongoing relationship between the plaintiff and the agency. The most common cases are those against the security organs for improper detention. Although a litigant must still weigh the risk of possible retaliation for bringing such a suit, the absence of a continuing relationship with the agency makes it easier to file suit. In contrast, those subject to CIRC regulations, if they intend to participate in the insurance industry, have an ongoing need for CIRC's approval and co-operation.

Another significant obstacle to meaningful judicial review is the institutional weaknesses of the courts. Judges with limited education and training may be hesitant to contradict CIRC, or may incorrectly interpret the Insurance Law. In addition, judges view rights contextually and recognize a legitimate role for relationships. A party's "legal" rights therefore can be mitigated by other non-legal factors, including the existence of a relationship between the judge and someone having an interest in the case.⁹⁹ CIRC, as a powerful organ of the central government, is well positioned to use these tendencies to protect itself and its decisions. Moreover, judges are subject to political influence, which further protects CIRC from meaningful judicial review of its actions.

One possible alternative to judicial oversight is review of CIRC's discretion by the State Council. CIRC reports directly to the State Council, and is subject to its orders, policies and directions. State Council oversight, however, is unlikely to be very specific. The State Council is the governmental agency responsible for oversight of all national rules and regulations. Oversight by the State Council is therefore akin to oversight of a governmental agency in the United States by the Cabinet. While the State Council has the power to prevent or remedy the most serious mistakes or abuses, it is unlikely to have the time or the inclination to review many specific grievances concerning CIRC's exercise of administrative discretion. Moreover, the State Council works in the same context that tolerates administrative discretion with limited accountability. Therefore, although a party could theoretically petition the State Council for relief from CIRC's conduct, it is quite unlikely that such a petition would be effective in anything but the most extreme cases.

The application of CIRC's power: the case of Sedgwick

The effect of CIRC's broad statutory discretion within the context of the Chinese legal system is illustrated by the case of Sedgwick Insurance Risk Management Consultants (China) Ltd (Sedgwick). Although Sedgwick had been licensed in 1993, CIRC suspended its operations for three months in 1999. This case was the first, and is perhaps still the most prominent, exercise of CIRC's enforcement authority. It was widely followed and analysed in the international press, both for the insurance trade and more generally, and sets a precedent for CIRC's future enforcement actions. This section will provide some additional background

⁹⁶ Song, p. 1.

⁹⁷ Lubman (2000). As of 1998, there were approximately 98,000 administrative cases brought, bringing the ten-year total to about 460,000 (Songnian). Although this is a substantial number, it is quite small compared to 3.2 million civil cases brought in 1997, or a total of more than 19 million civil cases from 1990 to 1997 (and civil cases do not include economic dispute cases) (Lubman (1999), pp. 254–255, tables).

⁹⁸ Lubman (1999), p. 209.

⁹⁹ *Ibid.*, p. 278. "A striking characteristic of Chinese legal culture has been the primacy of interpersonal relations over legal relationships" (*ibid.*, p. 303).

details of the case, and then will show the scope of CIRC's discretionary enforcement power, the influence of relationships and extra-legal considerations, and the lack of meaningful accountability for CIRC's actions.

Details of the Sedgwick case

Sedgwick established a presence in China in 1981, and was granted the first intermediary license in 1993. This license was to "place coverages and offer risk management services".¹⁰⁰ Shortly after CIRC was established in November 1998, it began a rectification initiative aimed at shutting down illegal brokering operations. Some insurance representatives who were petitioning for licenses were covertly engaged in brokering activities, and the law restricting such activities had not been rigorously enforced.¹⁰¹ CIRC issued a warning followed by a series of inspections to eliminate this illegal brokering.

Because Sedgwick was licensed, foreign insurers were "shocked" when CIRC found Sedgwick in violation and suspended its operation for three months.¹⁰² The official report said Sedgwick was suspended for exceeding its license by directly brokering a large number of insurance contracts. In addition, Sedgwick was cited for accounting practices done without permission of the tax authorities and for "lack of operating capital, delaying the transfer of premiums to insurance companies, changing the locations of operation two times without permission, and appointing three senior managers without their qualifications being approved by CIRC".¹⁰³

Sedgwick had been targeted by CIRC to be an "example",¹⁰⁴ and to serve as a "warning" to others.¹⁰⁵ One of the primary reasons CIRC focused on brokering activity was because of its competitive impact on domestic insurers, who complained to the newly appointed regulatory authorities.¹⁰⁶ The enforcement effort successfully shifted power in the insurance market back to local companies and away from international insurers.¹⁰⁷ This was confirmed in a statement by CIRC Chairman, Ma Yongwei, that his agency's "efforts to clean up the nation's insurance sector, including the three-month suspension of the British

¹⁰⁰ Shapiro. Although Sedgwick understood that its license included brokerage services, the license in fact specified only risk management and reinsurance work, though the understanding between Sedgwick and the regulators was that Sedgwick had the right to do brokerage work. Sedgwick was to be a pilot case for brokers in China, and the regulators were hesitant to give Sedgwick's status as a broker too much formal recognition. (Personal interview with former Sedgwick employee, 7 August 2000.)

¹⁰¹ Souter.

¹⁰² See Chan.

¹⁰³ "British Insurance Firm Punished", *China Daily*, 13 May 1999. The improper accounting practices were transferring 10 per cent of its annual revenues to its parent group as operating costs and writing off some bad accounts receivable without approval of the tax authorities.

¹⁰⁴ As one news source put it: "China Daily, which enthusiastically reports official thinking and actions, went on to say that this made Sedgwick 'the first example of insurance authorities' attempts to rectify the insurance business this year.'" "Sedgwick Suspended for Three Months in China", *BestWire*, 17 May 1999.

¹⁰⁵ Bangsberg (1999).

¹⁰⁶ Harding. This interpretation is confirmed by a careful reading of official CIRC statements. In the official *China Daily* story about the suspension, Ma Yongmei, the Chairman of CIRC, was quoted as saying, "The intermediary market has been flooded with underground brokerages and agents, which have seriously disturbed the markets." "British Insurance Firm Punished", *China Daily*, 13 May 1999.

¹⁰⁷ See Souter.

Sedgwick Insurance and Risk Management Consultants (China), [had] resulted in increased revenues to the domestic insurance sector”.¹⁰⁸

The breadth of CIRC's discretion

This case illustrates the breadth of CIRC's regulatory discretion. Even though Sedgwick had been licensed as an intermediary in 1993, no one questioned CIRC's right to interpret that license as precluding brokerage activities in 1999.¹⁰⁹ In addition, Sedgwick was cited for “delaying transfer of premium to insurance companies” even though the Insurance Law contains no requirements for the transfer of premiums. The remaining offenses (insufficient capital, changing location and hiring three managers without approval) also demonstrate how easily CIRC can find violations because so much is subject to their discretionary review.

The three-month suspension shows the breadth of CIRC's discretion for enforcement sanctions. Although CIRC has many explicit sanctions at its disposal, suspension of operations is not among them. The Insurance Law provides that offending brokers “shall be subject to action by the [regulators], and forfeiture of illegal gains, and a fine of not less than five, nor more than ten times as much as the illegal gains”.¹¹⁰ Granted, “action by the regulators” might be interpreted as including a suspension (though one would more often think of warning and cease and desist orders). But that interpretation still proves the point: the statute gives CIRC broad discretion to select and impose administrative sanctions.¹¹¹

Cultural tolerance for broad discretion and the importance of relationships

The reaction to Sedgwick's suspension reflects the cultural tolerance for administrative discretion in China. Although the story was widely covered in the trade publications and international media, there was virtually no criticism of CIRC's conduct in the case, and there was no discussion of CIRC's choice of sanction. Sedgwick consistently made “no comment” other than to say it was “working co-operatively with the commission to resolve any concerns it may have”.¹¹² This shows that CIRC's conduct was within the scope of industry expectations. While the industry was surprised and shocked by the suspension, given CIRC's broad statutory discretion, its inherent discretion to carry out its mandate, and the long history of powerful agencies in China, no one complained that CIRC acted beyond its authority.

The suspension also illustrates the importance of relationships and the influence of local protectionism. One of the primary reasons for the action against Sedgwick was to benefit

¹⁰⁸ “CIRC Chairman Says Suspension of Sedgwick Has Profited China's Insurance Sector”, *ChinaOnline*, 21 June 1999.

¹⁰⁹ As noted in Note 100 above, Sedgwick's license did not specifically identify brokerage activities, though it was quite clear that such activities were within the scope of what Sedgwick was authorized to do in 1993. Although this ambiguity was identified by some observers as the source of the dispute with CIRC (see Harding), it was never directly addressed by CIRC or Sedgwick. This shows the apparent unquestioned authority of CIRC to make its interpretation, notwithstanding prior understandings and years of activity undertaken pursuant to that understanding.

¹¹⁰ Insurance Law of the PRC, Article 142.

¹¹¹ Although probably not applicable to brokers, sanctions for an insurer exceeding the scope of its business license include an administrative order to cease and desist, the confiscation of ill-gotten gains, a fine of one to five times those gains, a fine of between 100,000 and 500,000 Renminbi, and in “serious” cases, the revocation of an insurer's license. Insurance Law of the PRC Article 136. Again, suspension is not among them, though perhaps it could be implied from the right to revoke a license.

¹¹² Goddard.

domestic insurers. At a minimum, this shows a tendency by CIRC to protect the local enterprises. In addition, it seems likely that domestic insurers used their relationships with CIRC to encourage the enforcement efforts. At the same time, however, CIRC had to consider its ongoing relationship with Sedgwick, which had been operating in China since 1993. CIRC's choice of sanction balanced these conflicting concerns. The suspension was better for domestic insurers than a fine because a fine, though cutting into profits, would still allow Sedgwick to maintain its market share. On the other hand, suspension was better for Sedgwick than license revocation because it would still allow Sedgwick to participate in the market once the suspension was lifted.¹¹³

The importance of relationships was most evident in Sedgwick's response to the suspension. Instead of arguing that its conduct was within the scope of its license or that CIRC had exceeded its legal authority, Sedgwick chose to accept the suspension and to co-operate fully with CIRC. This acquiescence sought to preserve the relationship with CIRC as much as possible. Had Sedgwick resisted, CIRC's authority would have been questioned, and the relationship would have been put under greater strain. The importance of fostering a good relationship with CIRC is well known within the Chinese insurance industry. Foreign insurers provide seminars, training, technical expertise and make educational donations to foster their relationship with the regulators.¹¹⁴

The importance of preserving the relationship is further illustrated by Sedgwick's response to rumors that the European Commission might look into the suspension. Instead of trying to use the possibility of an investigation as leverage to seek concessions from CIRC, Sedgwick issued an immediate "rebuttal" that unequivocally declared that it would "accept any punishment handed out . . . by China Insurance Regulatory Commission".¹¹⁵ This showed CIRC that Sedgwick had fully submitted itself to CIRC's authority, and that it would not question that authority through outside interference.

This acquiescence was necessary to avoid the risk of further sanctions. The contrasting case of Jardine Insurance Brokers shows the kind of risk Sedgwick wanted to avoid. When CIRC found that Jardine was engaged in unauthorized brokering, CIRC *permanently* closed Jardine's representative office in Beijing and *banned* its representative from the Chinese insurance industry rather than suspending its operations.¹¹⁶ Although there are important differences between the circumstances of these two cases,¹¹⁷ the Jardine case shows the possible consequences of resisting CIRC's authority. One of the reasons for the harsh sanction against Jardine was its failure to be as submissive as Sedgwick. CIRC's public pronouncements emphasized that Jardine "attempted to hide its unlicensed business", and "refused to admit that it had violated the Chinese insurance laws and regulations".¹¹⁸ Sedgwick did not

¹¹³ Suspension also had the benefit of maintaining Sedgwick's presence in the market so that domestic insurers and brokers could learn from Sedgwick's practices.

¹¹⁴ See Bangsberg (1998); Macleod and Macleod.

¹¹⁵ "Sedgwick Accepts Punishment", *China Daily*, 25 May 1999.

¹¹⁶ "China to Close Jardine Office", *Business Insurance*, 13 September 1999, p. 1.

¹¹⁷ Most notably, Jardine was still in the representative office stage, while Sedgwick had been licensed for a number of years. As a result, Jardine's violation was more serious. Nevertheless, the Jardine sanction shows the extent of CIRC's power, and demonstrates the risk Sedgwick had to face in its decision of how to respond to the suspension. Even though CIRC had better reasons for permanently closing the Jardine office, Sedgwick knew that CIRC had the power and discretion to do the same in its case, and therefore that the safest course was to accept the punishment and fully co-operate with CIRC.

¹¹⁸ "British Insurance Brokers Penalized for Illegal Business", *China Business Information Network (CBNET)*, 10 September 1999.

want CIRC to have a similar perception about it, and submitted to CIRC's authority to avoid possible retaliation.

The absence of meaningful judicial review

The Sedgwick case also reflects the lack of meaningful judicial review of CIRC's decisions. Although the decision to suspend Sedgwick's license was probably subject to review under the APL as a "concrete administrative action", Sedgwick did not seek judicial review. The poor quality of judicial decision-making and the lack of judicial autonomy made the outcome highly uncertain, even if Sedgwick had a strong legal position. Moreover, even if Sedgwick could have succeeded in reversing the suspension through judicial review, the damage to the relationship with CIRC might have been irreversible, and, in the long run, much more harmful to Sedgwick than the three-month suspension.

Conclusions from the Sedgwick case

The scope of CIRC's power and authority in the Sedgwick case has both positive and negative dimensions. On the positive side, it shows that CIRC has meaningful regulatory authority that can be imposed with swiftness and certainty. If an insurer fails to abide by CIRC's warnings or regulations, it will face serious consequences. On the other hand, this case also shows the lack of meaningful limitations on CIRC's discretion. Even though Sedgwick could have argued that its conduct was within the scope of its license, no one questioned CIRC's authority to find Sedgwick in violation of the law, or to impose a sanction not specifically authorized by the law. In light of the breadth of CIRC's regulatory discretion, the cultural tolerance for such discretion, the importance of relationships and the absence of independent judicial review, Sedgwick's best alternative was to quickly and completely submit itself to CIRC's authority and hope for the best.

The Sedgwick case also shows the scope of unpredictability in the administration of Chinese insurance law. Even though it had an intermediary license, CIRC had the power to interpret that license to exclude brokerage activities. In addition, CIRC had little trouble finding a variety of violations to justify imposing the suspension. An insurer operating in this regulatory environment therefore must recognize that notwithstanding the detailed statutory provisions, CIRC has virtually unlimited authority to modify, interpret and enforce the law.

5. The impact of Chinese accession to the World Trade Organization

The breadth of CIRC's discretion, and the resulting unpredictability, will be limited to some extent as a consequence of China's accession to the World Trade Organization (WTO). Although the WTO does not have the power to directly review and reverse CIRC decisions, China, as a member of the WTO, has agreed to abide by certain international standards which, if violated, are subject to international sanctions. This section will briefly outline China's commitments as a WTO member as they apply to insurance, and will then analyse the consequences of those commitments for CIRC's oversight of the insurance market.

China's WTO commitments

In order to become a member of the WTO, China made numerous specific commitments regarding access to its insurance market. China agreed to use prudential criteria for licensing, which means that new licenses are to be granted without regard to an economic needs test and

without quantitative limits. This should substantially open the market to foreign insurers. In addition, China agreed to liberalize and phase out geographic restrictions on foreign insurers over a five-year period, and to more liberally allow for the establishment of branch offices. It also agreed to allow substantially greater foreign direct investment – up to 50 per cent of life insurers, 51 per cent of non-life insurers and up to 100 per cent of reinsurers. In making such investments, foreign companies will be authorized to pick their own joint venture partners. Finally, China agreed to liberalize the product lines available to foreign insurers. It will phase in the right to sell group insurance, health and pension products, which are some of the most lucrative product lines developing in the Chinese market.¹¹⁹

In addition to these specific commitments for insurance, China agreed to abide by the general administration, transparency and judicial review requirements of the WTO. In the Protocol Agreement, China promised to administer its law, regulations and other measures “in a uniform, impartial and reasonable manner”,¹²⁰ to only enforce those laws, regulations and other measures “that are published and readily available to other WTO Members, individuals and enterprises”,¹²¹ and to provide “tribunals, contact points and procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application”.¹²² These commitments are consistent with the requirements under the General Agreement on Trade in Services (GATS), which provide that regulations should be “administered in a reasonable, objective and impartial manner”¹²³ and subject to “objective and impartial” review¹²⁴ based on objective, transparent and not unduly burdensome or protectionist criteria.¹²⁵

The consequences of China's WTO commitments

These commitments, especially those that are specific to insurance, provide some limitation on CIRC's discretion. They make it more difficult for CIRC to arbitrarily deny a license, refuse to allow the establishment of a branch in a new city, or to forbid foreign investment in a particular company. They also require China to provide more meaningful review of administrative actions. In accord with these commitments, CIRC adopted new regulations for foreign-funded insurers effective 1 February 2002,¹²⁶ and granted new licenses to several foreign insurers immediately after formal accession to the WTO.¹²⁷

While China's WTO commitments provide some limitation on CIRC's discretion, the extent to which China can or will live up to all of its commitments remains to be seen.¹²⁸ China

¹¹⁹ See, e.g., Bhala, pp. 1517–1518. For a good summary of China's WTO commitments relating to insurance, see “Insurance Sector's WTO Promises Revealed”, *China Online*, 29 November 2001. For the complete outline of the specific commitments, see WTO, “Report of the Working Party on the Accession of China”, Addendum, Schedule LCII, Part II – Schedule of Specific Commitments on Services.

¹²⁰ WTO, Protocol on Accession of the PRC § 2(A)2.

¹²¹ *Ibid.*, § 2(C)1.

¹²² *Ibid.*, § 2(D)1.

¹²³ WTO, General Agreement on Trade in Services, Article IV, Domestic Regulation § 1.

¹²⁴ *Ibid.*, § 2.

¹²⁵ *Ibid.*, §§ 3–4.

¹²⁶ See CIRC, Regulations on Administration of Foreign-Invested Insurance Firms. The full text of these regulations is available on *China Online*.

¹²⁷ See “Insurance Sector Opens Further Following Official WTO Entry”, *China Online*, 21 December 2001.

¹²⁸ See, e.g., Cohen (2001).

has been slow to abide by other international trade commitments in the past.¹²⁹ Local interests are likely to continue to encourage CIRC to interpret regulations to protect the domestic market. Consistent with this tendency for local protectionism, when CIRC granted new licenses to foreign insurers, it also granted additional licenses to domestic insurers to open up dozens of new branches and more than 100 sub-branches.¹³⁰ The long-standing and systemic weaknesses in China's legal system, combined with the difficulty of changing China's legal culture, will continue to make it unlikely that such decisions will be subject to meaningful domestic review, at least in the short term.

International review of CIRC decisions under WTO dispute settlement procedures provides an important alternative to domestic review, but some of the same concerns about retaliation apply. An insurer will likely hesitate to initiate international review because of the risk of CIRC retaliation.¹³¹ Similarly, an insurer's home country, which has to formally make the complaint with the WTO, may be unwilling to risk possible Chinese diplomatic retaliation. China has demonstrated a willingness to respond diplomatically, and with growing efforts against "globalism", China may be able to exploit the increasingly deep divisions within WTO.¹³²

Moreover, the WTO dispute resolution process may be unable or unwilling to find China in violation. China may be able to negotiate avoiding an adverse report during the conciliatory stage of the process. If compromise fails, the dispute resolution mechanism may have difficulty finding that a CIRC decision is an act of protectionism instead of an act to address a legitimate domestic concern. The dispute resolution process has never been used for services, which tend to be more comprehensively regulated than goods. These comprehensive regulations reflect a wide variety of significant domestic concerns that could be used to mask protectionist activity. For example, CIRC has a right to be concerned about the stability of the insurance market to protect policyholders. Yet decisions that are couched in terms of market stability could actually be used to protect domestic insurers from international competition.¹³³

Nevertheless, although the WTO process may not do very much to specifically limit CIRC discretion, China's accession to the WTO is a significant commitment. It shows a desire to be more engaged in international trade and its accompanying legal framework. As China participates in that framework, it will become more familiar with international norms. At the same time, it will become more integrated into the global community, which should create additional incentives and expectations for greater transparency and legal accountability.

¹²⁹ See, e.g., Mastel, pp. 988–990, recounting the history of China's non-compliance with international commitments regarding protection of intellectual property.

¹³⁰ "Local Insurers Stunned by 'Sudden' Approvals to Expand Across China", *China Online*, 14 December 2001.

¹³¹ For example, when Sedgwick learned of a rumor that the European Union may investigate the reasonableness of its suspension, see Sheel Kohli, "EC Called Into Mainland Insurer Suspension Row", *S. China Morning Post, Business Post*, 21 May 1999, at 1, it immediately denied the rumor and offered to "accept any punishment" CIRC would choose to impose so as to not jeopardized its ongoing relationship with CIRC. "Sedgwick Accepts Punishment", *China Daily*, 25 May 1999.

¹³² See Mastel, pp. 991–994.

¹³³ This difficulty is illustrated by the Japanese film case, in which the dispute panel refused to accept the argument of the United States that Japanese regulations created preferential film distribution for domestic producers. The panel was reluctant "to draw conclusions about the real purpose and effect of many of the measures in question", and, in challenging a facially-neutral domestic regulation, the complainant faced a "high burden of proof". Yerxa and Marantis, p. 802.

6. Conclusions

Although the Chinese Insurance Law has established some basic parameters for the regulation of insurance, CIRC's broad discretionary authority minimizes the importance of those parameters. CIRC has statutory and cultural authority to interpret, modify, supplement and enforce the law. That authority is not subject to meaningful judicial review because of judicial ignorance, deference, and dependence on political bodies. Insurers are unlikely to seek judicial review even when it is available because of the risk of possible retaliation.

The reliance on broad and independent discretion makes the administration of the Chinese insurance law unpredictable. The regulators are free to interpret, reinterpret, modify or supplement the law whenever they choose. They can easily find violations of the law and impose punishments as harsh or as personal as suits their purposes. Chinese insurance law therefore is only as static and predictable as the regulators make it.

China's membership of the WTO provides some limitations on CIRC's discretion. As a condition to accession China agreed to provide greater access to its insurance market and to use prudential criteria in the granting of new licenses. China also agreed to greater transparency and to meaningful administrative review. Nevertheless, because of weaknesses in the legal system and because of Chinese legal culture, CIRC will continue to have broad regulatory discretion that, at a domestic level, is not subject to meaningful review. While international commitments theoretically limit CIRC's discretion in some respects, the risks of retaliation and the difficulty of proving protectionist motivations minimize the practical effect of these commitments. In the long run, however, China's commitment to engagement with the international trading community may provide incentives and opportunities that, along with its domestic commitment to rule of law and legal reforms, will help develop more meaningful administrative review in the future.

In light of CIRC's broad discretion and the absence of meaningful review or limitations at present, an insurer's positive relationship with CIRC is of the utmost importance. A good relationship is necessary to obtain administrative approvals for initial and continued participation in the market, and may help insurers avoid getting into trouble with the regulators. It may also influence CIRC to adopt interpretations, regulations or enforcement actions beneficial to the insurer. Should an insurer become the subject of CIRC enforcement, the insurer should humbly submit to CIRC's authority to preserve its relationship. For now, resisting is pointless. Although seeds of change have been planted and are beginning to bear fruit, it will take time to substantially change legal institutions and traditional values.

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