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vol.117 (12.September.2011)

Recent developments in China's bancassurance market

Nomura Research Institute, Ltd.

In China, insurance sales by banks have been plagued by problems such as unethical sales tactics and bribery to gain access to sales channels. Recently, regulators have issued new regulations to protect consumers' interests while insurers have pursued further sales channel diversification.

Latent risk in banks' insurance agency operations

With bank capital requirements becoming stricter even in China, insurance agency (bancassurance) operations are becoming increasingly important as a stable source of fee income for Chinese banks. Since 2008, Chinese banks and insurers have been permitted to own equity interests in each other pursuant to a memorandum of understanding[1] between the China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC). The past two years have seen a series of insurance company acquisitions by banks (Exhibit 1). For insurers, capital tie-ups with banks promise increased access to bank customers through the bancassurance channel.

Exhibit 1. Capital tie-ups between banks and insurers

(1) Acquisitions of insurers by banks

Date of acquisition	Bank	Insurer	Equity interest	Notes
September 2009	Bank of Communications	China Life-CMG Life Insurance	62.5%	Name changed to BoCom CMG Life Insurance. First acquisition of an insurer by a bank.
May 2010	Bank of Beijing	ING Capital Life Insurance	50.0%	
June 2011	China Construction Bank	Pacific-Antai Life Insurance	51.0%	Name changed to CCB Life Insurance.
Still pending	China Merchants Bank	CIGNA & CMC Life Insurance	50.0%	The parties entered into a purchase agreement in May 2008 but placed the deal on hold for three years before reviving it in June 2011. Currently awaiting regulatory approval.
Still pending	Agricultural Bank of China	Jiahe Life Insurance	51.0%	Awaiting regulatory approval.
Still pending	Industrial and Commercial Bank of China	AXA-Minmetals Assurance	60.0%	Awaiting regulatory approval.

(2) Acquisition of bank by insurer

Date of acquisition	Insurer	Bank	Equity interest	Notes
June 2011	Ping An Insurance	Shenzhen Development Bank	52.38%	Shenzhen Development Bank owns a controlling (90.75%) interest in Ping An Bank.

Source: NRI, based on media reports

The bancassurance business thus benefits both banks and insurers. From a consumer protection standpoint, however, bancassurance has long been criticized in China. Specific complaints include inadequate disclosure of risks and marketing of insurance products misleadingly presented as banking (e.g., savings deposit) products. Also problematic is that until recently insurers have typically paid sales commissions directly to banks' sales personnel. This arrangement is conducive to bribery in the form of an insurer offering high commission rates[2] to induce a bank to act as its sales agent while the bank's personnel conceal commission income received from the insurer.

As the consumer insurance market grows, such problems pose an increasingly urgent imperative for China's regulatory authorities. In response, the CRBC and CIRC have issued a series of directives (Exhibit 2). In January 2010, they jointly issued the Notice on Promoting Sound Development of Banks' Life Insurance Agency Operations through Structural Adjustments Thereto, which was followed in November 2010 by the CBRC's Notice on Further Promotion of Legally Compliant Sales and Risk Management in Commercial Banks' Insurance Agency Operations.

The latter notice requires individuals who sell insurance products directly to customers at commercial bank branches to be bank sales personnel licensed as insurance agents. It also prohibits commercial banks from allowing insurance company personnel to operate as sales agents in their branches and prohibits their branches from partnering with more than three insurers as a general rule.

These notices were partially superseded by the CIRC's March 2011 Guidance on Regulatory Supervision of

Exhibit 2. Recent regulatory developments

Date	New regulations
January 16, 2008	Memorandum of Understanding Concerning Enhancement of Cooperation Between Banks and Insurers and Cross-Sector Regulatory Cooperation (CBRC/CIRC) • Allows banks and insurers to invest in each other (on a pilot basis) if they meet a certain requirements and have effective risk buffers in place.
November 5, 2009	Administrative Measures Concerning Commercial Banks' Equity Investments (Pilot Program) in Insurers (CBRC) • Limits the number of insurers in which commercial banks may invest to one per bank.
January 13, 2010	Notice on Promoting Sound Development of Banks' Life Insurance Agency Operations Through Structural Adjustments Thereto (CBRC)
November 9, 2010	Notice on Further Promotion of Legally Compliant Sales and Risk Management and Commercial Banks' Insurance Agency Operations • Limits the number of insurers with which bank branches may form cooperative relationships to a maximum of three. • Requires individuals that sell insurance to customers at bank branches to be licensed insurance agents and prohibits insurance company personnel from selling insurance at bank branches.
March 7, 2011	Guidance on Regulatory Supervision of Commercial Banks' Insurance Agency Operations (CIRC) • Prescribes detailed, comprehensive regulations regarding banks' insurance agency operations (e.g., agency licensure, operational regulations)
April 7, 2011	Supervisory Regulations Concerning Insurers' Utilization of Financial Institutions as Insurance Agencies (Draft) (CIRC)

Source: NRI, based on CBRC and CIRC documents

Commercial Banks' Insurance Agency Operations. Drafted from a consumer protection standpoint, this guidance most notably includes the following provisions.

First, to ensure continuity of customer service, cooperative sales arrangements between banks (or individual bank branches) and insurers must have a minimum duration of one year.

Second, bank branches that offer bancassurance services must be licensed as an insurance agency by the CIRC. Additionally, their sales personnel must meet the requirements stipulated in the aforementioned November 2010 CRBC notice and, if they sell investment-linked insurance products (variable annuities), have at least one year of insurance sales experience and a minimum of 40 hours of specialized training.

Third, insurance agency agreements between insurers and banks must be executed by their respective head offices as a general rule.

Fourth, commission payments from insurers to banks must be remitted in bulk from a first-tier branch of the insurer to a first-tier (or at least second-tier) branch[3] of the bank. Additionally, insurers are prohibited from paying commissions to banks on an off-the-books basis and their personnel are prohibited from providing economic benefits to banks or bank personnel except pursuant to the alliance agreement between the bank and insurer[4]. Banks and bank personnel are likewise prohibited from seeking noncontractual economic benefits. These prohibitions are obviously intended to prevent bribery.

Fifth, when a bank sells insurance products that differ from each other in terms of complexity, it must physically separate the sales stations at which the different products are sold within its branches. In particular, variable annuities may not be sold at the same station where savings deposit products are sold. Additionally, banks may not use promotional language or concepts such as deposits or interest in selling insurance products. These provisions are intended to prevent sales tactics that may cause customers to confuse insurance products with banking products such as deposit instruments.

Sixth, insurers must set their sales commission rates at reasonable levels. This requirement is intended to prevent a vicious cycle of price competition as a result of insurers over-aggressively pursuing scale alone.

Seventh, insurers and banks must clearly delineate their respective responsibilities and avoid shifting responsibilities to the other party.

Eighth, in terms of regulatory supervision, the CBRC and CIRC are to cooperate more closely with respect to bancassurance operations, presumably in the aim of avoiding the perils of silo-based regulation.

Future outlook

While the regulatory authorities have been implementing such remedial measures targeted at bancassurance services, insurance sales channels have continued to broaden.

In April 2011, the CIRC released a draft[5] of supervisory regulations with respect to insurers selling insurance through financial institutions acting as insurance agencies (the regulations' final version had yet to be released as of late July). These regulations pertain to the insurance agency operations of non-insurer financial institutions such as banks and securities brokerages. The entry of financial institutions other than banks into the insurance agency market should reduce the risk of bribery and lead to competition that exerts downward pressure on commission rates. Meanwhile, for securities firms seeking to reduce their dependence on the brokerage business, insurance sales are an additional source of fee income.

Note

1) Memorandum of Understanding Concerning Enhancement of Cooperation between Banks and Insurers and Cross-Sector Regulatory Cooperation.

2) Insurers typically pay commissions to agents for five years. Standard commission rates are 3% of premiums for policies with lump-sum premium payments and 2.5% for policies with installment payments. (Chinese Insurance Dictionary, *Hoken Mainichi Shimbun*, 2008).

3) First-tier branches are province-level branches; second-tier branches are city-level branches subordinate to first-tier branches.

4) Specific examples of such economic benefits include payments of cash or marketable securities, reimbursement of expenses, and payment of travel expenses.

5) The CIRC released the draft to solicit comments from the public.

Author's Profile

Takeshi Jingu

Chief Researcher
Nomura Research Institute (Beijing), Ltd.

E-mail : kyara@nri.co.jp

Inquiries to : Financial Technology and Market Research Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

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