

# AN INTRODUCTION TO INSURANCE IN CHINA: FORTUNE FAVOURS THE BRAVE

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It is no secret that economic growth has exploded in China in recent years. China makes many of the world's industrial and consumer products or their component parts. China's exports also include pharmaceutical, agricultural and consumer food products. Its insurance market is catching up with its booming economy.

Insurance premiums in China are rising 25% per year. Some predict sustained double-digit premium growth in premiums for at least the next five years. Foreign insurers and reinsurers, along with brokers, adjusters and third-party administrators, are eager to participate in this burgeoning market. As the Chinese insurance market matures, claims and coverage issues will increase.

## Trends

The growth of insurance in China reflects increasing personal prosperity. The biggest demand continues to be life and motor insurance. The provision of personal lines is dominated by domestic Chinese insurers which are sometimes reinsured with foreign reinsurers.

The demand for commercial policies in China lags behind personal lines but is gaining. The leading commercial policy demand by market share is commercial property insurance. Appetite for commercial property insurance reflects the increase of private, rather than government run, business concerns. This demand is linked to foreign investment in manufacturing Chinese exports.

At present foreign insurers write only a small portion of the business in China. There is capacity for significant growth in this area.

## Regulation

It has been widely reported that the Chinese insurance market has opened up to foreign insurance companies. In April 2007, Lloyd's officially opened its China office in Shanghai, the most important city for commercial business and insurance in China. Lloyd's joined a number of other foreign insurers operating in China.

The active involvement and inclusion of foreign insurers in China has been permitted by the China Insurance Regulatory Commission. This step must be seen as a method of inviting foreign capacity and expertise into a developing industry and economic infrastructure. The involvement of foreign insurers in China permits access to

Chinese markets. Chinese insurers are also able to take advantage of foreign reinsurance and investment opportunities.

## Foreign Risks

Few Chinese insurers offer, and few Chinese manufacturers want to buy, Chinese product liability coverage for the large number of products manufactured in China for export to North America and Europe. Further, there is an absence of Chinese insurers writing D&O cover where foreign claims issues may arise. Chinese insurers are wary of claims exposure and coverage disputes in North America and Europe. The US, Canada and England are often specifically excluded in coverage offered by domestic Chinese insurers. Further, many Chinese insurers do not have domestic claims networks in place which are able to effectively cope with large or complicated issues arising in foreign jurisdictions. For many domestic claims, Chinese insurers appoint third party adjusters.

With the scale of manufacturing, foreign investment and corporate growth there is a gap in the market. Currently, foreign insurers are meeting this need. The People's Insurance Company of China ("PICC"), the largest non-life Chinese insurer, is a notable exception. With assistance from foreign advisers, PICC is actively building a claims network and seeking to write new lines of business and compete with large foreign insurers. Another local insurer has sought to solve the problem by incorporating a claims control clause which identified a suitable foreign claims network.

There are clear opportunities for foreign insurers to participate in the Chinese insurance market. However, these opportunities may be time limited. The global heavyweights will face competition for these business lines as Chinese insurers become more sophisticated and better equipped to accept risks generated by China's economic expansion.

## Legal Issues

The demand for insurance in China and for Chinese related lines of business will continue to grow as the Chinese economy expands. The unique legal landscape of China impacts how on how claims and coverage disputes are resolved. In China, as in all developing jurisdictions, effective dispute resolution will be a central element of success. Appropriate policy wording can anticipate the issues and provide insurers certainty in conducting business.

The resolution of insurance claims issues through China's court system presents unique problems. A lack of legal precedents is one. A lack of an experienced court system with a well-settled rule of law is another. Fortunately, China has a relatively lengthy history of arbitration to provide alternate forums to resolve international disputes.

## The People's Court

China's court system, otherwise known as the People's Court, has undergone considerable change over the past ten years. Reforms have followed foreign legal and commercial influence. Judicial appointments were previously filled by former army officers and local party members, which opened the system to charges of corruption. More

recently, the People's Court has retired most non-lawyer judges, replacing them with appointed judges who have legal training. Yet, problems persist within the court system, as the new judges are inexperienced in adjudicating cases. Likewise, the People's Court still receives reports of corruption from litigants. China has attempted to modify its courts, based upon its history of deficiencies, by making an effort to modernise the entire system.

Matching its accompanying economic expansion, China is continuing to overhaul its legal system with support from overseas. It has developed almost 400 law schools over the past two decades. Hundreds of thousands of judges and lawyers have been quickly trained. However, despite these numbers, the People's Court is still, at best, a nascent system for resolving disputes. ADR and arbitration are the preferred methods to resolve disputes involving foreigners.

### Arbitration in China

China has developed an arbitration system to support the People's Court. This assists parties to resolve commercial disputes in a more efficient and cost-effective fashion. Consequently, China has become one of the fastest growing and, due to the scale of economic growth, most popular forums for international arbitration.

Arbitrations are currently quicker and offer more certainty than the People's Court by relying on trained and experienced arbitrators to handle complex commercial claims. As in other jurisdictions, arbitration renders final and binding decisions, which, if stipulated, can remain confidential. Chinese arbitration decisions are internationally recognised and enforceable.

Moreover, Chinese arbitration awards are enforceable in China provided that proper agreement, notice, and arbitration rules are utilised. The arbitration rules will be familiar. An examination of the procedures and process for conducting arbitration in China reveals influence by the American Arbitration Association ("AAA"). China has followed numerous polices and procedures set forth in the AAA rules.

Insurers should determine upon arbitration at the contract stage. Chinese courts will honor agreements to arbitrate and will provide assistance and supervision for arbitral processes. The Chinese courts cannot accept a dispute arising out of a transaction if there is a valid agreement to arbitrate. However, it's worth noting that ad hoc arbitrations might not be enforceable in the People's Court.

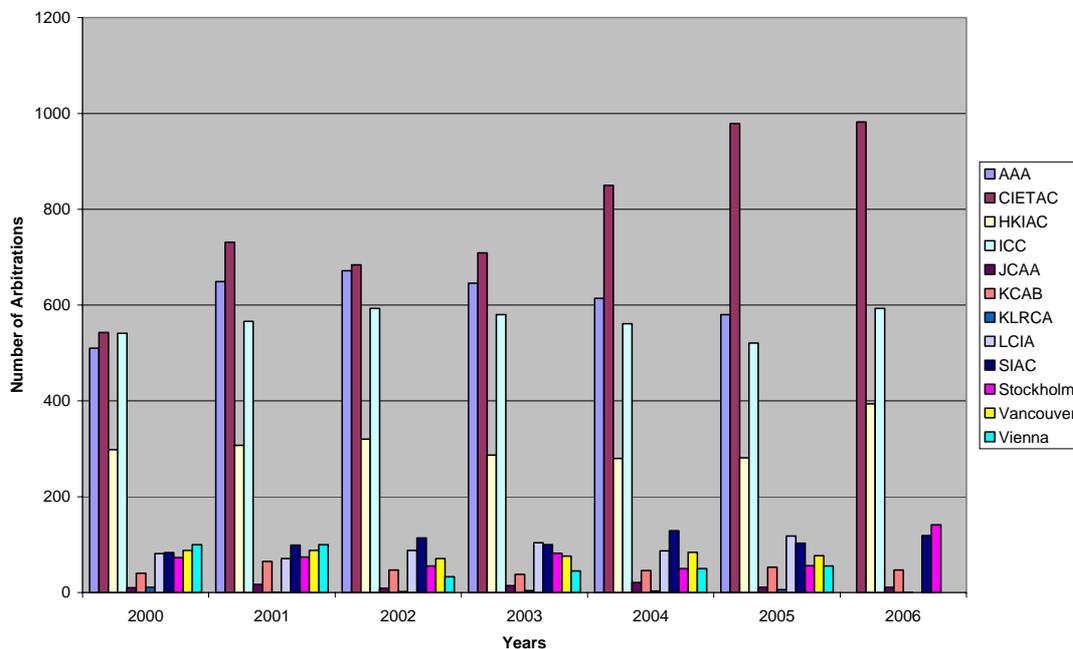
### CIETAC

China ranks first in the world in terms of the number of cases handled by commercial arbitration bodies. There are 185 arbitration commissions in China and care should be taken in selecting the appropriate commission. One of the most commonly used arbitration forums for international disputes in China is the China International Economic and Trade Arbitration Commission ("CIETAC"). From 1995 to 2000, CIETAC received 4,200 new international commercial arbitrations – more than any other commercial arbitration body in the world.

CIETAC began in 1956 as a forum to settle disputes arising from contracts and transactions in foreign trade. However, once the development of international commercial arbitration began to grow, the scope of cases given to CIETAC included other economic activities, such as investment, financing and agency.

CIETAC is flexible and allows parties to agree on the applicable rules, proper law, language to be used, the place of arbitration, and the nationality of the arbitrator. It provides the parties with a secretariat to handle administrative issues for the tribunals. With the consent of the parties CIETAC encourages a combination of conciliation with arbitration similar to US med-arb agreements. CIETAC is an expedient option; awards can sometimes be rendered in three months. Under the ordinary procedure a resolution can be reached in an average of eight months. Finally, the fees associated with arbitrating through CIETAC are relatively low compared to other arbitration institutions.

**International Arbitration Cases Received**



- AAA - American Arbitration Association
- CIETAC - China International Economic and Trade Arbitration Commission
- HKIAC - Hong Kong International Arbitration Centre
- ICC - International Chamber of Commerce
- JCAA - Japan Commercial Arbitration Association
- KCAB - The Korean Commercial Arbitration Board
- KLRCA - Kuala Lumpur Regional Centre for Arbitration
- LCIA\* - London Court of International Arbitration
- SIAC - Singapore International Arbitration centre
- STOCKHOLM - Arbitration Institute of the Stockholm Chamber of Commerce
- VANCOUVER\* - British Columbia International Commercial Arbitration Centre
- VIENNA - International Arbitral Centre of the Austrian Federal Economic Chamber

- Data prepared by HKIAC with the assistance of the named institutions above

## Chinese Conciliation/Mediation

As in more familiar jurisdictions, there are alternatives to litigation and arbitration in China. ADR is not a foreign concept in China and is used regularly to settle disputes. Conciliation and mediation have the same meaning in China. Chinese courts and Procedural Law have placed a great emphasis on encouraging parties to settle disputes by mediation. Further, Arbitration Law, Article 51 confirms that a written conciliation statement and a written arbitration award has the same legal validity and effect. Accordingly, both judges and arbitrators can be expected to urge conciliation.

China has conciliation service providers, ad hoc mediations, conciliation-arbitration and conciliation-litigation. Conciliation service providers offer conciliations in China and in partnership with international conciliation centres. Like American med-arb, Chinese conciliation-arbitration and conciliation-litigation offers conciliation by the arbitrator or judge prior to commencing the binding process.

## Conclusion

China growth presents opportunities for insurers. Commercial property, product liability, D&O and reinsurance are the leading commercial Chinese insurance issues for foreign insurers. Local capacity for writing these commercial lines is limited by a fledgling claims network. This situation is likely to change with increased investment by Chinese insurance companies.

With all developing jurisdictions understanding the local legal landscape is a vital component to effective underwriting. The legal backdrop for conducting commercial business in China is changing and large scale investments are being made. While commercial activities continue insurers should question whether they wish disputes to be resolved in the People's Court or by arbitration. Conciliation and arbitration clauses may offer more certainty for insurers. Clauses should be carefully considered and probably incorporated into policies concerning commercial risks in China.

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