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Draft Regulations Set to Change Landscape of Investments in Chinese Insurance Companies

The China Insurance Regulatory Commission ("CIRC") recently released draft Measures for the Administration of Equity Interests in Insurance Companies (the "Draft Measures"). CIRC has indicated that it wishes to finalize and implement these regulations quickly.

If adopted, the Draft Measures will affect future M&A transactions in the Chinese insurance industry by broadening the types of permitted investors while also increasing the restrictions and conditions applicable to various categories of investors.

Highlights

Most importantly, the Draft Measures:

- expand the categories of investors that may become shareholders of insurance companies, but set maximum shareholding percentages for some of them;
- create new conditions and restrictions for PRC insurance companies investing in other domestic insurance companies;
- set financial qualification requirements for holders of 10% or more of the share capital of an insurance company, lower than the 15% threshold under existing regulations;
- increase the maximum permitted ownership of a single investor from 20% to 33.3% while significantly narrowing the exceptions to this rule;
- impose a 3-year or 2-year lock-up on promoters of insurance companies who hold a 20% or 10% equity interest, respectively;
- remove the requirement that investors must use their own funds to acquire an interest in an insurance company, thereby enabling debt financing and possibly other structured transactions;
- do not substantially change the regime for foreign investors in PRC insurance companies, other than applying the enhanced qualification requirements to them.

Maximum Percentage Shareholding

Currently, a single shareholder (together with its affiliates) is limited to a 20% shareholding in a PRC insurance company (other than an insurance company with 25% or more foreign investment), but CIRC has granted an exemption for investors who have been shareholders of an insurance company for at least three years to increase their shareholding to up to 51%.

Under the Draft Measures, a single shareholder, together with its affiliates, will be able to hold up to one-third of the share capital of the subject insurance company.

New Shareholder Categorization and Qualification Requirements

The Draft Measures introduce and define the following three categories of shareholders:

Financial Shareholder	less than 10% equity interest and no major influence on the operation and management of the insurance company
Strategic Shareholder	(a) at least 10% but less than 20% equity interest; or (b) less than 10% equity interest and major influence on the operation and management of the insurance company
Controlling Shareholder	(a) at least 20% equity interest; or (b) less than 20% equity interest and controlling influence on the operation and management of the insurance company

The Draft Measures stipulate qualification requirements for each of the three shareholder categories. Generally, the new financial qualification requirements are similar to the existing ones, but apply from a lower shareholding threshold.

Insurance Companies as Shareholders of Other Insurance Companies

The Draft Measures create a special regime for insurance companies that invest in other PRC insurance companies: They will not be limited to holding only up to one third of the share capital. The Draft Measures also provide that insurance companies "can only invest in insurance subsidiaries that they have themselves established or acquired." This rule is not entirely clear. Hopefully, the final version of the Draft Measures will be more explicit.

The insurance company that is making the investment will also be subject to other qualification requirements that apply independently of the size of its shareholding.

Potential Impact

As a growing industry with substantial capital needs, China insurance has been an active M&A market in recent years. Based on the Draft Measures, CIRC seems determined on correcting some investment trends and attracting more diverse investors.

A number of large recent deals involved Chinese listed companies with core activities outside the financial services industry acquiring majority interests in insurance companies. Such deals would not be compatible with the Draft Measures. Instead, CIRC seems to encourage insurance companies to have several large shareholders (who each hold no more than one third of the share capital) and whose financial strength is more strictly tested than before.

At the same time the Draft Measures also make financing and other structured transactions easier by removing the requirement that an investor must use its own funds for investment in an insurance company, thus giving more investors access to this industry.

Finally, the Draft Measures recognize the special needs of distressed insurers and allow various exceptions in workout situations. Investors interested in distressed situations may also find increased opportunities under the Draft Measures.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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