

# CLIENT UPDATE

## CHINA INSURANCE REGULATOR ISSUES NEW M&A REGULATION

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### OVERVIEW

The China Insurance Regulatory Commission (“CIRC”) has unveiled the new Insurance Company Mergers and Acquisitions Regulations (the “New Regulations”), which will allow insurers with competing businesses in China to acquire and merge with each other, effective June 1, 2014. Under current regulations, M&A in the insurance industry has been restricted, as insurance firms controlled by the same controlling shareholder are banned from selling products which compete with each other. Subject to various restrictions, the New Regulations will allow an acquirer to control two insurers which operate in the same field of business. The New Regulations represent a significant opportunity for both domestic and foreign insurers who wish to build and expand their business in China.

### BACKGROUND

The insurance industry in China is widely known to be heavily regulated. Originally established in 1998, the CIRC is the regulatory body authorized by the PRC State Council to regulate and supervise the insurance industry through its broad powers, ranging from promulgating regulations for the industry as a whole to the oversight of individual companies such as approving policy terms and premium rates.

The insurance industry has long been categorized as an area of restricted foreign investment and has therefore been subject to strict regulatory scrutiny, which has made it difficult for foreign investors to gain entry to and maintain a substantial presence in the Chinese market. In a statement published on its website, the CIRC states that the purpose of the New Regulations is to promote the “marketization” of the Chinese insurance industry, noting that the industry is ready to be opened to these types of M&A now that relevant unfair competition laws are in place, and acknowledging that M&A will be more effective if the target and acquirer (or merger parties) operate in the same business. This statement and these New Regulations are consistent with the trend in recent years to open up the insurance industry in China to market forces.

## **REGULATION DETAILS**

### *Definition of M&A*

Acquisition is defined in the New Regulations as a transaction where either (1) the acquirer acquires more than 1/3 of the equity of the target and also becomes the largest shareholder or (2) the acquirer becomes the largest shareholder of the target by acquiring 1/3 or less of the equity of the target, but gains control of the target. Acquirer includes any affiliates and other persons acting in concert. The acquirer will be required to undertake in writing not to transfer any equity or shares in the target for a period of three years after closing, with exceptions for transfers to affiliates and other special circumstances.

Merger is defined as the combination of two or more insurance companies into one, either by absorption or consolidation. As part of the approval process, CIRC will determine the revised business scope of the new insurance company post-merger. If the revised business scope of the new insurance company is narrower than the original business scope of the merger parties, then the merger parties will be required to transfer any businesses beyond the new scope to certain authorized third parties within 6 months after obtaining CIRC’s approval of the merger.

## **REMOVAL OF RESTRICTIONS ON CONTROL OF TWO COMPANIES ENGAGING IN THE SAME BUSINESS**

The New Regulations remove the current prohibition that bans insurers from owning stakes in more than one insurance company that competes in the same products and will therefore likely lead to consolidation in the domestic market. The New Regulations should also create an effective means for foreign insurers to gain greater market share by using their interests in existing Chinese insurers to establish and expand their presence in China.

## **USE OF ACQUISITION FINANCING**

The New Regulations will assist insurers by allowing acquisition loans to fund potential transactions, provided that the acquisition loan cannot exceed 50% of the acquisition price paid in cash.

## **RELAXING SHAREHOLDER QUALIFICATION REQUIREMENTS**

Acquirers who are covered under the New Regulations will not need to comply with the current rule requiring that any shareholder of an insurance company who proposes to hold or acquire more than 20% of the shares of an insurance company must have been an existing shareholder for at least 3 years.

## **APPROVAL PROCEDURES**

CIRC will be responsible for the approval of proposed M&A transactions based on its review of various documentation required to be submitted to it. In deciding whether or not to grant approval, CIRC states that it will mainly focus on the effect of the proposed transaction on (1) the continuing operation of the target or merged insurance company following the transaction and (2) the insurance market and industry as a whole in China. The New Regulations emphasize the roles of accounting firms, legal counsel, and qualified asset appraisers who are required to be independent and diligent in issuing professional opinions in relation to proposed M&A transactions. CIRC also states that the New Regulations aim to protect consumers of insurance products by requiring comprehensive disclosure of significant matters relating to the merger or acquisition every quarter for the 12 months following its Closing.

Depending on the nature of the transaction, other governmental agencies such as the Ministry of Commerce and the State-owned Assets Supervision and Administration Commission may be involved in M&A transactions as well. All M&A transactions will need to be registered with the State Administration for Industry and Commerce following receipt of approval by CIRC.

## **FOREIGN-INVESTED INSURANCE COMPANIES**

Whilst the New Regulations present opportunities for foreign investors, foreign investors who will hold more than 25% of the equity or shares in a target insurance company following an acquisition or merger will still need to comply with the existing qualification requirements under the Administrative Regulations of Foreign-Invested Insurance Companies, which requires that (1) the foreign investor has been operating in the

insurance business for at least 30 years, (2) the foreign investor has established a representative office within China for at least 2 years, (3) the total assets of the foreign investor as at the end of the previous year are not less than USD 5 billion, (4) the country or region from which the foreign investor originates has a sound insurance regulatory system and the investor is subject to effective regulation under relevant competent authorities, (5) the foreign investor meets the solvency standards of its country or region of origin, (6) the competent authorities of the country or region from where the foreign investor originates has consented to the filing of the M&A transaction in China and (7) the foreign investor satisfies any other prudent conditions prescribed by CIRC. In addition, foreign investors will need to comply with all relevant foreign investment rules, including the current limitation against owning more than 50% of a domestic life insurer.

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Please do not hesitate to contact us with any questions.

April 16, 2014