

China Tightens Regulations on Investing Insurance Funds in Shares of Listed Companies

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Introduction The entire Chinese economy, including its insurance industry, has experienced rapid growth in recent years. Speculative investments have become an inevitable byproduct of this growth. One of the most well-known examples of a risky insurance company investment was the bitter takeover battle by Evergrande and Baoneng for control of China Vanke Co. Ltd. (Vanke), China's biggest real property company (by sales). Since 2015, Baoneng has used its majority-owned insurance arm Foresea Life, and other of its units, to amass a 25 percent stake in Vanke. Baoneng is now the company's largest shareholder. Evergrande units have accumulated 14 percent in Vanke according to its November 2016 regulatory disclosure. Vanke's shares dropped 16 percent in 2016. Given these activities, many industry experts believe the China Insurance Regulatory Commission's (CIRC) recent imposition of restrictions on stock investments by insurance institutions is an attempt to curtail speculative and risky investments. It is interesting to note that the circular "Further Strengthening the Regulation of Investment in Stocks in Insurance Funds" (the 2017 Circular) not only regulates future stock investment, but also does not seem to give any grandfather rights to insurance companies' existing investments. Instead, it requires them to adjust their investment proportions within two years or the time limit prescribed by the relevant regulatory body until the regulatory requirements are met. **The 2017 Circular** On January 24, the CIRC issued the 2017 Circular. One of its effects was to nullify the section of a 2014 circular titled "Strengthening and Improving the Supervision and Administration of the Use of Insurance Funds" (the 2014 Circular). The 2014 Circular discussed insurance company investments in listed company shares. This included the right to participate in the listed company's financial and operating policy decisions, or the ability to control the listed company. The 2014 Circular stated that this is subject to equity investment management and must comply with relevant regulations on equity investment with insurance funds. In replacing those 2014 provisions, the 2017 Circular specifies additional requirements and restrictions on investing insurance funds in the stock of a listed company. The 2017 Circular puts the investment in the shares of a listed company into three categories: (i) general

stock investment; (ii) major stock investment; and (iii) listed company acquisition. It also establishes a comprehensive solvency adequacy ratio before an insurance company can invest in a listed company's stock. The categories are differentiated based on: (1) whether the stock investment in a listed company meets or exceeds 20 percent of the listed company's overall stock capital; and (2) whether such stock investment results in control or actual control over the listed company. The term "ordinary stock investment" refers to a stock investment in a listed company by an insurance institution or by an insurance institution and a non-insurance person acting in concert, in which the stock investment is: (i) less than 20 percent of the total stock capital of the listed company; and (ii) the investment does not result in control of the listed company. The term "significant stock investment" refers to a stock investment in a listed company by an insurance institution or by an insurance institution and a non-insurance person acting in concert in which the stock investment is: (i) equal to or more than 20 percent of the total stock capital of the listed company; and (ii) the investment does not result in control of the listed company. The "acquisition of a listed company" includes becoming the controlling shareholder. The insurance institution's solvency ratio at the end of the previous quarter shall not be less than 100 percent when the insurance institution undertakes a general stock investment. When carrying out a major stock investment and acquisition of a listed company, the insurance institution's solvency ratio at the end of the previous quarter shall not be lower than 150 percent, and the insurance institution must have completed filing of its stock investment management capability and must be in line with the internal control regulatory requirements for insurance fund use. The 2017 Circular also provides that the insurance institution must use its own funds to acquire listed companies and that an insurance institution may not pledge the listed company's stock that it is purchasing to finance such purchase. Other restrictions include that an insurance institution shall apply to the CIRC for prior approval when it intends to purchase shares in a listed company. It also limits the industries in which an insurance institution may purchase shares in a listed company, insurance companies, non-insurance financial enterprises and industries related to insurance business. The key to any of these types of investments is that the company in which the insurance entity chooses to invest has stable cash flow return expectations. As a general capital rule, the book balance of all equity investments of an insurance company shall not exceed 30 percent of the total assets of such company at the end of the immediately prior quarter. The book value of a single stock investment by an insurance institution shall not exceed 5 percent of the total assets of the insurance institution at the end of the immediately prior quarter, except as otherwise provided for in the acquisition of listed companies or investment in stocks of commercial banks listed on the Stock Exchange. For insurance institutions that have already increased their blue-chip stock holdings pursuant to relevant policies, the proportion of investment should be adjusted within two years or within the time limit prescribed by the relevant regulatory body until the regulatory requirements are met.

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