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## C-ROSS: A Major Reform of China's Insurance Regulatory System

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The China Risk Oriented Solvency System, or C-ROSS, entered the transitional stage of implementation as its 17 solvency regulatory rules were released in Beijing on 13 February 2015. This means a risk-oriented, internationally comparable solvency system reflecting Chinese insurance market realities is now in place.

### **A revolutionary reform**

C-ROSS is a milestone in the reform and development of China's insurance regulation. In the words of Xiang Junbo, Chairman of the China Insurance Regulatory Commission, it will have a revolutionary impact on China's insurance market.

*A project to facilitate the transformation and upgrading of China's insurance industry*

China's insurance market has undergone three consecutive years of rapid growth since 2012. The year 2014 saw the fastest growth since the international financial crisis, with national premium income hitting RMB 2 trillion for the first time, 17.5 per cent higher than the previous year. The industry's profit also hit a record high, registering RMB 200 billion, achieving 106 per cent growth year on year. China's insurance industry moved up in the global ranking in terms of market size from No. 6 in 2012 to No. 3 in 2014. As one of the most important insurance markets in the world and with the "new normal", China's insurance industry has to adapt to the new situation. C-ROSS is expected to enable insurers to expand and grow in a more rational way as insurers bear in mind both risks and capital in their pursuit of such development goals as size, speed and returns. With the advent of the new system, insurers will transform and upgrade their development pattern by reshaping their strategy planning, operation mode and risk management. They are expected to develop in a more balanced and sustainable way under more refined management.

*A major step in the all-round, deeper reform and regulation modernisation*

The principle guiding the Chinese government's governance reform in recent years has been "Giving the market a decisive role in resource allocation". It is on this principle that the CIRC has based C-ROSS. The CIRC is trying to streamline the relationship between market and regulation, trimming the list of items requiring administrative approval, and giving the market greater freedom and incentives to develop and innovate, while effectively identifying, preventing and mitigating risks. Solvency regulation sets the bottom line for risks and is the key to risk control of the industry.

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<sup>+</sup> Chairman, China Insurance Regulatory Commission.

### *A contribution to the international insurance regulatory reform*

The international standards for insurance supervision are being upgraded. C-ROSS, a system that reflects China's market characteristics and international reform trends, can contribute to more representative, fairer and sounder standards for sustainable and inclusive growth of the global insurance industry.

### **The framework and characteristics of C-ROSS**

C-ROSS is a complete, logical and substantial system, which can be summarised as "one framework", "three features" and a series of regulatory and supervisory tools.

#### *Framework*

On the basis of thorough research of international insurance regulatory reform and feasibility studies, C-ROSS adopts a regulatory framework of "three pillars" and reshapes it according to the characteristics of China's insurance market to ensure that it is viable and reflects the realities of the emerging market.

The quantitative regulatory requirements of Pillar 1 address three quantifiable risks, namely, insurance risk, market risk and credit risk. Through scientific measurement, Pillar 1 requires insurers to hold adequate capital for the risks. The tools of Pillar 1 include (1) available capital evaluation criteria, (2) minimum capital requirements, (3) capital classification, (4) stress testing, and (5) supervisory measures.

The qualitative regulatory requirements of Pillar 2 address risks that are difficult to quantify and require more qualitative regulatory tools, especially for emerging markets with imperfect and immature financial systems, and incomplete basic sector data. These include operational risk, strategic risk, reputational risk and liquidity risk. For example, operational risk in some countries is classified as a quantitative risk but, due to the lack of historical data, C-ROSS uses qualitative regulatory tools to assess it. The regulatory tools of Pillar 2 include (1) integrated risk rating, (2) solvency risk management requirements and assessment, (3) liquidity risk supervision, (4) supervisory inspection and analysis, and (5) supervisory measures. The above-mentioned "solvency risk management requirements and assessment" means the regulator evaluates insurers' solvency risk management capabilities. The evaluation results are linked directly with the insurers' capital requirements.

The market discipline mechanism of Pillar 3, through public information disclosure and transparency enhancement, leverages market disciplinary power to address risks which are difficult to deal with by the conventional regulatory tools of Pillars 1 and 2. The tools of Pillar 3 include (1) requirements governing insurers' public information disclosure on solvency, (2) a sustainable two-way communication mechanism established between the regulator and market stakeholders, and (3) ratings on insurers issued by credit rating agencies.

Based on international financial regulatory practices and the reality of the development of domestic insurance groups, C-ROSS also has a regulatory framework for the regulation of insurance groups' solvency, which extends the definition of "insurance group" by taking not only normal insurance groups, but also various kinds of invisible or conglomerate insurance groups into the scope of regulation so as to reinforce the regulation of a series of sophisticated group risks.<sup>1</sup>

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<sup>1</sup> Three kinds of groups will be under supervision in C-ROSS:

- a) insurance holding groups, including the parent insurance group (holding) company or insurance company and the insurance or non-insurance company (ies) under its direct/indirect control or co-control;
- b) non-insurance holding companies, including the parent non-insurance institution and the insurance company (ies) and/or non-insurance company (ies) under its direct/indirect or co-control;
- c) conglomerate groups, meaning groups of multiple insurance companies (jointly) controlled by a single, de facto controller or people acting in concert with no explicit controller.

### Features

Every technical standard of C-ROSS embodies the three distinctive features of the system, namely, risk-orientedness, reflection of Chinese market characteristics and international comparability.

**C-ROSS is a risk-oriented solvency regime.** The risks of insurers are classified into seven major categories, which are further subdivided into more specific risks. Regulatory standards are formulated based on the risk classification and subdivision. Quantitative regulatory indicators (solvency adequacy indicators) and qualitative, integrated risk-rating methods are used to accurately identify, fully cover and comprehensively analyse all kinds of risks, and to measure the risk profile of the underwriting, investment, corporate governance and liquidity of insurers accurately and promptly.

**C-ROSS reflects the characteristics of China's insurance market and features the development of emerging markets.** As the most important emerging market, China differs from Western mature markets in market structure, growth speed, risk features, data accumulation and insurance expertise. With full consideration of the reality of the Chinese market and the principle of risk prevention, C-ROSS measures risks scientifically and changes the over-conservative reserving requirements of the current solvency system to raise the efficiency of capital. In order to improve the viability of the system and reduce the cost of implementation, risk modelling and measuring are performed during the construction of the system, and a composite factor-based method is adopted with regard to quantitative capital standards, making it easier for insurers to implement C-ROSS at a lower cost. C-ROSS is designed to be flexible and dynamic to adapt better to the rapid changes of the emerging market. Therefore, it can be updated and fine-tuned to adjust to market conditions and regulatory needs without changing the framework. The models and factors of C-ROSS are based on the data collected in the last two decades from China's insurance market and calibrated through several rounds of quantitative tests. The test result shows that C-ROSS, with a sound risk classification system, is responsive to risks and can identify and measure insurance industry risks scientifically, accurately and comprehensively.

**C-ROSS is internationally comparable.** Against the backdrop of economic globalisation, China's insurance industry is actively implementing the strategy of "attracting foreign investment and going global", and becoming more and more closely connected with the international insurance market. C-ROSS is comparable with other representative solvency regimes in the world in terms of its "three-pillar" structure and specific regulatory standards and requirements. An internationally comparable solvency regime can both encourage global capital to enter China's insurance market and facilitate the presence of Chinese insurers in the global market.

### Transition period of C-ROSS

C-ROSS has been in the transitional implementation stage since the beginning of 2015, which is a milestone for China's insurance industry. During the transition period, the current solvency system will remain in force. The CIRC will decide when to fully implement C-ROSS based on an assessment of the situation and the preparedness of the industry.

CIRC welcomes the presence of foreign insurers from more jurisdictions, is willing to communicate and share solvency regulatory experience with other regulators in the world, and is devoted to contributing to the reform of global insurance solvency system for sustainable and sound development of the global insurance market.