

Coalition of Service Industries’ Suggestions to U.S. – China Trade Forums

June 2009

The Coalition of Service Industries (CSI) appreciates the opportunity to present its top priorities for the 2009 U.S.-China Joint Commission on Commerce and Trade (JCCT). CSI is the leading business association dedicated to reducing barriers to U.S. services exports and mobilizing support for policies that enhance the global competitiveness of U.S. service providers. Our membership consists of U.S. corporations and associations engaged in many commercially important services sectors. Many of our member companies have significant presence in China and are deeply interested in China’s full implementation of its WTO commitments and the continuation of sectoral reforms.

The trade and investment issues that concern US fall under two primary categories: 1) Cross-Sectoral Issues; and 2) Sector-Specific Issues. Each of these is listed below in no specific order and explained on subsequent pages.

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Cross-Sectoral Priorities

Government Procurement of Software

Issue: CSI encourages China to revise its initial WTO offer on government procurement to include sub-national agencies and state-owned enterprises in its coverage and allow for procurement in important services sectors, such as infrastructure construction and utilities. The threshold value for qualifying projects should also be lowered.

Background: Although China has submitted its initial WTO offer on government procurement, the offer falls short of acceptable standards. It excludes sub-national agencies and many state-owned enterprises from its coverage, prohibits procurement in many important service sectors, such as infrastructure construction and utilities, sets a long transition period, and stipulates a high threshold value for qualifying projects. We hope that further discussions with Chinese authorities will result in a more ambitious government procurement offer to open China’s \$35 billion market and ensure a competitive supply of services to Chinese consumers.

We continue to urge China to withhold implementing new procurement regulations that do not conform to GPA principles, including the *Implementing Draft Measures on Government Procurement of Software* of March 2005. CSI members are concerned that these draft measures provide for strong preferential treatment for Chinese suppliers by restricting government procurement to domestic software products. To qualify as “domestic,” these products must be “manufactured” in China and the China-based development cost of the software must be at least 50%. The software copyright must also be owned by a Chinese entity or first registered in China.

China’s draft measures also contain a procurement preference for open source software that is inconsistent with international practice, the WTO Government Procurement Agreement, and sound, efficient, and merit-based procurement policy. We believe that any procurement regime should be based on performance, and not favor any technology or licensing model.

The draft measures propose the possible purchase of foreign software only on the basis of product-by-product waivers, and only if the software provider satisfies unspecified requirements with respect to the level of the company's investment, R&D expenditures, outsourcing work performed, or taxes paid in China. Thus, this exception will benefit a small group of providers, and will not promote the ultimate goal of developing a competitive, advanced software industry in China, based on international best practice.

China's domestic preference policy contradicts the general trend in international trade and procurement law toward open, transparent, technology-neutral, and non-discriminatory access to global markets. The measures will severely limit market access of our members, especially software companies, to China's government procurement, and will create a dangerous precedent for other sectors. The rules also run counter to the spirit of openness China committed to when it became a WTO member and assumed observer status with respect to the WTO Government Procurement Agreement.

Action Items:

- China should establish a firm and achievable timeline for China's completion of its GPA accession
- Clarify scope of goods, services and which government entities are covered in China's offer, making sure this is consistent with offers made by other large economies (are SOEs covered or not, definition of "domestic product")
- Eliminate discriminatory procurement rules that favor China-only products and services, including incentives for Chinese companies that buy domestically made goods and services
- Eliminate the Administrative Measures for Government Procurement on Initial Procurement and Ordering of Indigenous Innovation Products
- Eliminate Government Procurement Imported Products Measures

Intellectual Property Rights (IPR) Protection

Issue: Elimination of China's trade barriers in audiovisual, software, and IT goods and services is one of the factors that can help solve China's piracy problem and foster sound investment and economic growth, benefiting both U.S. and Chinese producers. However, current trade barriers and regulations make it difficult for U.S. companies to enter the Chinese market to supply legitimate IPR products, thereby ceding the market to counterfeit and pirate products.

Background: China's piracy and counterfeiting at the wholesale and retail levels, end-user piracy, Internet piracy, multi-channel signal piracy, and unauthorized access to 'overspill' satellite pay-TV programs remain rampant due to remaining inadequacies in China's laws, lenient penalties, uncoordinated enforcement among local and national authorities, and the lack of transparency in administrative and criminal enforcement. The piracy rate for optical media products and software is reported to be at least 80 percent. Internet piracy is growing rapidly. In fact, China is the hub of websites that stream pirated broadcast content and channels. China's law still stipulates inadequate criminal liability for copyright offenses, e.g., corporate end-user

and Internet piracy, unclear protection for temporary copies, and overly broad exceptions to protection of computer software. Criminal prosecution of piracy remains restricted by the Chinese criminal code, which requires a demonstration that piracy is occurring for the purpose of making a profit. The Administration should ensure that the upcoming JCCT meeting makes meaningful progress in holding China accountable to commitments made in earlier JCCT ministerial meetings to undertake efforts to ensure that software utilized by the Chinese government and enterprises is legitimate. So far, the progress has been disappointing in terms of Chinese government follow through on these commitments and the piracy rate remains far too high.

Action Items:

- CSI encourages China to resolve inadequacies in laws, penalties, enforcement, and transparency related to piracy and counterfeiting.
- The JCCT should, as a matter of priority, focus on steps to China's full implementation of its software legalization commitments announced in previous JCCT meetings.

Regulatory and Licensing Transparency

Issue: CSI encourages China to fully embrace and implement its WTO commitments to regulatory and licensing transparency, such as notice and comment requirements for new trade laws and regulations, improved licensing procedures, and judicial reviews.

Background: We commend China's efforts to strengthen regulatory transparency and adhere to public notice and comment requirement, which was promulgated under the State Council's directive of March 2006. At the 2007 and 2008 SED meetings, China confirmed its commitment to improve regulatory transparency and predictability, such as publishing all trade-related measures before they enter into force and providing an opportunity for public comment. However, we remain concerned that interested parties have often been unable to comment on important trade rules, and that transparency issues regarding licensing and implementation of measures persist.

It is in China's interest to fully embrace regulatory transparency. China made substantial WTO commitments to regulatory and licensing transparency, such as notice and comment requirements for new trade laws and regulations, improved licensing procedures, and judicial review. However, full implementation of these commitments simply has not taken hold in the Chinese bureaucracy. Chinese laws, regulations, and administrative practices frequently change without warning, and are frequently not applied uniformly. We are also concerned that China's rules often provide regulators with broad discretion, resulting in unpredictable rules and decisions.

A modern economy requires transparent government and regulation, including in the judicial process. Transparent rule-making and licensing are one of the best ways to fight corruption in China. Through consistent, adequate notice and comment periods and the involvement of key stakeholders in the regulatory development process, many specific trade and investment problems U.S. companies continue to confront might be eliminated.

We also encourage the Chinese Government to seek active participation by all stakeholders in regulatory reform. The review of the postal legislation, for example, would benefit from active consultation with the private express delivery industry. China should also consult with the private sector on its pending telecom bill, draft insurance law, and other important sectoral legislation. The opportunity for meaningful public comment on China's legislative measures is required by GATS rules on transparency and China's WTO accession commitments on notice and comment.

Chinese officials acknowledge that their regulatory agencies for securities, insurance, and other services are not sufficiently developed. China's trade negotiators have repeatedly used this argument as a reason to deny better offers on services. We suggest that USTR, Treasury, and other agencies offer technical assistance to help the Chinese strengthen their regulatory institutions. For instance, the Chinese telecom and postal regulators are not sufficiently independent in their functions and responsibilities from the state-owned monopolies. Enactment of sectoral laws that would establish independent regulators could serve as the basis for a significant expansion of China's telecom and express delivery sectors and those industries that depend on competitive telecom and express delivery services.

Action Items:

- China should seek active participation by all stakeholders in regulatory reform
- CSI suggests USTR, Treasury, and other agencies offer technical assistance to help the Chinese strengthen their regulatory institutions
- China should enact sectoral laws to establish independent regulators

Sector-Specific Priorities

Audiovisual, Publishing, and IT Products and Services

Issue: CSI fully supports the WTO case reviewing China's market access restrictions and applauds the outcome of the IP case. We encourage China to remove its limitations on foreign ownership in distribution and video replication, publishing, TV stations, and theater holding companies as one means to curb piracy. The elimination of market access barriers to distribute foreign pay TV programs and services, and an increase in the number of foreign revenue-sharing films allowed into the Chinese market are also important. We believe that some of the piracy issues can be alleviated by allowing foreign media companies to have a greater stake in their Chinese investments.

Background: China's WTO accession commitments in audiovisual services allow for foreign minority participation in cinema operations. However, China refuses to permit foreign majority enterprises, except in select cases that were grandfathered under a terminated experimental policy to allow up to 75% foreign investment in select cities. China also insists that the foreign partner cannot serve as Chairman of the cinema joint venture even if approved by its board.

China increased the number of foreign revenue-sharing films allowed into the market each year to 20, a minimal market opening measure. The terms of the revenue-sharing contract are dictated by the Chinese Government, and are not commercially reasonable by any standard. China continues to disrupt orderly marketing by instituting blackout periods when foreign films cannot be shown, and by imposing revenue targets. The orderly distribution of home entertainment products is also impaired by the imposition of rules restricting the choice of business partners, and by the terms of commercial agreements.

China also maintains primetime broadcasting and foreign content restrictions in pay and non-pay television. China does not permit the licensing of foreign pay television services, which stifles the growth of its cable and digital platforms. The recent SARFT regulations requiring that all internet content be licensed, and that a condition of license be that copyright be respected is, in theory, a step forward although the procedures for foreign content owners to obtain licenses for distribution of content online needs to be clarified. It is equally important that market access and a flexible regulatory environment be created to ensure digital investment in areas such as IPTV and online content services. All these restrictions, along with the lengthy approval process, only serve to expand the spread of illegal pirated content.

In the audiovisual distribution services sector, China is not abiding by its retail distribution services commitments, which are to allow foreign majority control with the ability to sell AV products. Contrary to this commitment, China has restricted foreign majority controlled retailers from securing AV retailing licenses.

In the publishing sector, control over content remains strict and China has stated that it will not approve any more foreign titles under Chinese publishing licenses, except technical and scientific publications. We find this decision troubling and urge China to reconsider it.

Action Items:

- China should permit licensing of foreign pay television services
- China should create a flexible regulatory environment to ensure digital investment in areas such as IPTV and online content services
- China should allow foreign majority controlled retailers to secure AV retailing licenses
- China should reconsider the decision not to approve any more foreign titles under Chinese publishing license outside of technical and scientific publications

Express Delivery

FedEx and UPS provide fast, reliable express delivery services (EDS), which are a key component of the vibrant, competitive logistics industry that is crucial to China's economic growth. EDS is one of the most sophisticated, capital-intensive logistics services available. The Chinese government has publicly recognized the importance of EDS to the Chinese economy by supporting modern supply chains through fast, highly reliable links between distant producers, suppliers and consumers – both internationally and domestically. Moreover, a robust domestic EDS industry will help China achieve its goals of enhancing domestic consumption.

The EDS industry faces numerous new impediments to its operations in China. The overall regulatory environment for foreign firms in China has become more challenging in recent years. A pattern has emerged – through legislative, regulatory, enforcement and standard-setting actions – whereby Chinese government policy and enforcement are deployed unfavorably to U.S. investors in China relative to their domestic competitors. The rapid liberalization and reform which followed China’s entry into the WTO seems to have abated, and we are seeing efforts to over-regulate markets. Should these trends continue, many of the important and mutually beneficial reforms of recent years are at risk.

Chinese government policy is splitting the EDS industry into its multiple parts – logistics, freight forwarding, trucking and aviation – which undermines the benefits realized by the sum of those integrated parts. EDS combines the best in information technology, multiple modes of transport, and service commitments to provide our customers with a complete package of premium, time-definite, money-back guaranteed transportation services. Actions taken or proposed by the Chinese government raise WTO concerns. More importantly, they will stunt the healthy growth of this important industry in China, raise costs to Chinese producers and consumers that rely on EDS, and constrain the overall competitiveness of China’s economy. These challenges are generally summarized below and then explored in further detail by specific issue:

Over-regulation: Perhaps the most pernicious barrier to a healthy EDS industry in China is over-regulation. The State Post Bureau (SPB) is considering unnecessary and burdensome standards, measures, inspections, reporting requirements, and licensing schemes. These actions undermine China’s own economic interest by negating the benefits that a thriving EDS business can offer to Chinese businesses and consumers.

Decentralized Regulation: EDS networks and other modern-day transportation and logistics networks cross physical, regulatory, and administrative boundaries on a daily, if not hourly, basis. Failure to develop a more seamless, hands-off transfer of goods and services between these boundaries will prevent EDS from thriving within China. EDS firms rely on national networks. We need to move in and out of cities and provinces every day. To enable efficient national networks, “one-stop shopping” for taxation, regulations, licenses and oversight in a single administrative headquarters location is required. These needs are not met by the current fragmented range of agencies and ministries that often present conflicting national, provincial, and local interlocutors and disparate guidance and enforcement. To the maximum extent possible, rules should be standardized, and industry should be subject to a single regulator in a single location.

Protectionism: Economies, companies, and consumers thrive when government policies stimulate competition between firms and locations. Many officials in China continue, however, to protect their regulatory prerogatives and support national champions by aiding local firms. The discrimination against foreign express companies included in the new Postal Law demonstrates China’s willingness to tilt the playing field in favor of its own companies, but it is but one example of a series of developments undermining express delivery operations in China.

The Postal Law and SPB

Issue 1: CSI is concerned about the recently passed Postal Law, its discrimination against U.S. businesses, and the potential for the SPB to implement the law disparately in favor of China Post and Chinese express delivery companies.

Background: China's new Postal Law, which the National People's Congress (NPC) passed on April 24, 2009, goes into effect on October 1, 2009. The law discriminates against U.S. and other foreign EDS companies and imposes a series of new requirements and restrictions that will harm both express delivery firms and the Chinese businesses and consumers they serve. The law also raises significant concerns about China's adherence to its WTO commitments.

The language in the law is often open-ended and ambiguous and thus subject to disparate application and enforcement. The full extent and impact of the law will not be known until the SPB promulgates implementing regulations and enforces the law. Based on prior practice, CSI is concerned that the SPB will target enforcement actions against foreign operators in favor of domestic firms.

The new postal law prohibits foreign businesses from investing in or operating a domestic "letter article" delivery business. "Letter articles" are broadly defined by the law to include all "information-carrying material," thus barring U.S. express delivery firms from carrying a wide range of items, including documents, within the domestic market. This broad definition of "letter articles" encompasses a private courier market that was active and thriving prior to China's WTO accession; a market in which U.S. companies expected to compete in reliance upon China's WTO commitments.

Other issues with the new Postal Law including the following:

- 1) New permitting requirements for express delivery companies' domestic and international services that have yet to be clearly defined.
- 2) 100% visual content inspection requirements for all domestic and international packages upon pick-up, which are unworkable in practice, inconsistent with international best practices and more onerous than necessary to ensure the quality of the service or to address security concerns.
- 3) Broad and ambiguous expanded powers for SPB to inspect domestic and international express delivery facilities, open packages, solicit reports, and levy stiff fines and penalties, including revocation of licenses and permits for three years, all of which threatens to stifle or interrupt normal business operations and erode the quality of service.
- 4) Establishment of a Universal Postal Services Fund, the details of which remain undefined, but which may require private express delivery firms to subsidize China Post's monopoly as well as competing services (*e.g.*, Express Mail Service or EMS).
- 5) Other potential subsidies for China Post, including preferential treatment for the establishment of facilities, access to various modes of transportation and use of China's transportation infrastructure, such as roadways, ports, etc.

Action Items:

- China should reconsider its decision to bar U.S. and other foreign businesses from a broadly and ambiguously defined domestic “letter articles” market and should instead ensure equal treatment for foreign companies relative to China Post and local Chinese delivery companies by barring special advantages or treatment for any one group.
- SPB should seek industry dialogue and input and incorporate that input into its final decisions as it develops implementing rules, regulations, measures and standards for the industry.
- The law and implementing regulations should establish a level playing field for all market participants to promote competition and the best service for China’s consumers.
- SPB’s implementation of the law’s permitting scheme, as well as other inspection and regulatory powers, should be even-handed and minimize interruptions to normal business operations so as not to degrade service quality.
- SPB should implement a simple registration system for express delivery firms to obtain permits for new operations, such as a domestic express service recordal, rather than through a permitting system dependent on government approval.
- Firms licensed to provide express delivery services should be authorized to perform all functions necessary to provide that service (*e.g.*, trucking, freight forwarding, etc.) without having to seek additional licenses and approvals.
- EDS firms should not subsidize China Post’s monopoly or competitive services through the Universal Postal Services Fund or any other new taxes, fees, or other charges levied specifically against the express delivery industry rather than users of China Post’s services or other businesses operating in China.
- Finally, when competing against private firms, China Post should not enjoy special advantages but instead should be required to compete on a level playing field under the same regulatory environment and other requirements and limitations.

Express Industry Associations and “Self Discipline”

Issue 2: CSI is concerned about the SPB’s establishment of EDS associations and their role in formulating “strict standards” and enforcing industry “self-discipline,” especially with regard to pricing and placing U.S. firms in jeopardy of violating U.S. and EU antitrust laws, as well as China’s own competition laws.

Background: SPB has established a national express association, the China Express Association (CEA) as well as express associations in every province in China, many of which are headed by former postal officials. The new postal law formalizes these “industrial associations” and, among other things, requires them to “formulate strict standards” and “enhance self-discipline.” This novel approach to standard-setting and market regulation will lead to legally binding requirements that create significant operational obstacles for U.S. EDS firms and place them in jeopardy of violating various antitrust and competition laws.

In January 2008, the SPB issued purportedly “advisory” standards for conducting express delivery operations and when industry objected to some of the standards, stressed that they were not mandatory. However, provincial and local SPB offices, as well as the new EDS associations, are implementing these standards as mandatory requirements. Moreover, a provision in SPB-

issued implementing measures makes these standards compulsory. The standards will regulate many aspects of day-to-day EDS business practices and operations despite the fact that U.S. express delivery firms have been operating their businesses and serving their customers successfully for decades.

Many of the EDS associations have presented express delivery firms with “self discipline” agreements and requirements, which, if signed or accepted, would put those firms at risk of violating not only their own country’s antitrust and competition laws, but also China’s new anti-monopoly law. If EDS companies refuse to sign these agreements or accept these requirements, they are threatened with exclusion from certain markets within China and with being posted on a website improperly and inaccurately identifying them as a “bad” company.

Industry associations in China are supposed to be voluntary, private commercial associations that serve members’ interests. A State Council “Opinion” from 2007 mandates that industry associations be clearly separated from the government. Several government statements and regulations prohibit associations from colluding to fix prices. Unfortunately, in practice, these industry associations are often quasi-official organizations closely tied to a specific ministry or agency, acting as regulators to promote government policies and enforce regulations. The 2007 State Council Opinion reflects some of the contradictions inherent in the Chinese approach. The Opinion calls for a separation between government and industry associations, but, like the Postal Law, it also calls for associations to assist in the management and supervision of their industry. The Opinion rejects price fixing, but calls for associations to practice “self discipline” and supervise “market order.”

SPB officials have repeatedly told industry that it must “manage” its alleged domestic express pricing problems. China’s pricing law is vague and could be deployed in a discriminatory manner. Especially in the context of the SPB’s industry association regime, CSI is concerned about how China will approach the appropriate role of competitive pricing in the China market.

Action Items:

- SPB’s advisory standards for the EDS industry should not be made mandatory through implementation by local SPB offices or EDS associations.
- EDS associations should not be empowered to issue binding standards, rules or requirements for conducting an EDS business in China at a national, provincial or local level.
- Standards, rules and requirements should not be more burdensome than necessary to ensure the quality of services and should not restrict the supply of services.
- EDS association practices and agreements should not violate China’s competition laws and should not put firms at risk of violating U.S. or EU antitrust or competition laws.
- EDS associations should not engage in discussions regarding pricing or other pricing activities. The price for services should be defined in a competitive marketplace.

Customs Reform, Modernization and Simplification

Issue 3: CSI encourages China to pursue customs reform, modernization and simplification to promote the fast, streamlined movement of goods across borders. Improved customs

facilitates the rapid movement of goods throughout the world.

Background: Customs reform, modernization and simplification are critical to a Chinese economy that relies heavily on the fast, efficient movement of goods across borders. Local Chinese customs, practices and procedures vary widely and are often inconsistent with the national General Administration of Customs (GAC) rules and regulations. Conversely, GAC retains final approval authority regarding customs agreements but often rejects practical recommendations by regional customs administrators. While GAC has met with industry in the past, those meetings usually consist of GAC explaining their policy rather than engaging in dialogue to seek practical solutions. Details are left to local customs offices that, again, often do not have authority to finalize an agreement.

Customs clearance is performed at origin or destination, not at port-of-entry or exit, promoting additional fragmentation of customs authority and supervision. While changing IT systems is admittedly time-consuming, difficult and expensive, China's IT systems for customs clearance do not meet modern standards or China's economic growth needs.

These deficiencies introduce uncertainty and inefficiencies for EDS providers and local customs authorities alike. Each local customs authority may adopt divergent practices. Deadlines may be ignored in practice; flights may be able to depart without all necessary approvals; data requirements may be simplified. Much of this "flexibility" is unofficial and not codified in any written agreements or published regulations and, therefore, leaves industry open to arbitrary and inconsistent treatment.

Turning to more specific customs policy concerns, the GAC is in the process of drafting new regulations to govern express clearance. The current express clearance regulations were promulgated in 2003 and provide simplified declaration for low-value, express shipments. They divide express shipments into three categories – documents, individual articles and goods – and provide expedited clearance procedures for each category. Rather than further liberalizing express clearance, GAC has said that the new regulations will be much stricter, increasing express delivery service providers' regulatory burdens and supervision.

GAC has been reluctant to share detailed information with industry regarding the new regulations they are developing. GAC is considering the following problematic provisions: 1) a rigid definition of "express parcels" as goods which are individually wrapped, destined for a specific person and address and for which the express firm has been responsible for the entire transport; 2) a visual inspection requirement upon pick-up to verify the name of the goods, serial number, amount and other information; and 3) a new ranking system for express companies that will allow customs authorities to revoke express clearance privileges for violations.

GAC is also purportedly implementing the World Customs Organization's SAFE Framework of Standards, which are intended to harmonize advance electronic cargo information (ACI) requirements for inbound, outbound and transit shipments. However, the GAC implementing order fails to provide separate, simplified procedures for transshipments. Submitting both inbound and outbound declarations for transshipments will gravely impair the efficiency of U.S. hub operations in China. Moreover, the implementing order's procedures are dauntingly

complex overall, and the industry has been given little time to make the IT and other changes necessary to comply. It also remains unclear how either the existing or new express clearance regulations discussed above will interface with China's new ACI requirements.

Another specific problem with the GAC's implementation of the SAFE Framework is its inclusion of a deadline for export ACI. The deadline for the submission of ACI for imports is four hours prior to the arrival of long-haul flights or "wheels up" for short-haul flights, and this is within the SAFE Framework recommendations. However, GAC proposes that export manifests must be provided four hours prior to aircraft loading, and this requirement is problematic for express delivery companies in practice and not recommended in the SAFE Framework.

Finally, one simple way China could streamline its customs clearance process is by raising its *de minimis* level to speed up the clearance of low-value goods.

Action Items:

- Customs processes should be uniform and promote the efficient movement of goods across borders and throughout China.
- Customs authority should be clearly defined and centralized to avoid varied procedures and divergent enforcement at differing locales.
- Customs IT systems should be modernized to efficiently handle the high flow of goods in and out of China, and GAC should seek and incorporate industry input into customs modernization.
- GAC should seek industry dialogue and input and incorporate that input into its final decisions as it develops new express clearance standards.
- New express clearance standards should further liberalize, not hinder, the movement of express delivery items through China customs.
- In its implementation of the SAFE Framework, GAC should include separate, simplified procedures for transshipments; remove the 4-hour ACI requirement for export goods; and ensure that its SAFE Framework implementation does not undermine the efficiency intended by its express clearance standards.
- GAC should improve the efficiency of customs clearance in China by raising the *de minimis* level to 1400 RMB (approximately US \$200).

Trucking Licenses and Inner-City Access

Issue 4: CSI encourages China to simplify its overly burdensome and cumbersome truck licensing regime and consolidate the regulatory and licensing process for trucking into one, centralized office with a streamlined process. Trucks and cargo delivery vehicles should also have access to major metropolitan areas during the business day.

Background: In its WTO accession protocol, China committed to open trucking to wholly foreign-owned enterprises; implementation was to have occurred in December 2004. However, the current complicated and prolonged application processes for trucking licenses effectively serve as a barrier to market access. Delay inhibits industry operations on the ground in China.

The permitting process first requires a firm to apply to the local transportation department at its headquarters location for approval to operate a trucking business. This application is then forwarded to the Ministry of Transportation in Beijing, which issues an approval letter. The approval letter allows the firm to obtain a trucking permit from the local transportation department and to expand the scope of its headquarters business license from the local agency of industry and commerce to include trucking.

Once the firm has obtained a trucking permit for its headquarters' operation and expanded the scope of its headquarters business license to include trucking, the firm is then eligible to repeat this process for each branch location. The firm submits branch applications to the transportation department in its headquarters location, which must seek the approval of the transportation department in the branch location. When the local transportation departments' (both headquarters and branch location) approvals have been obtained, the application moves back to the Ministry of Transportation, which issues an approval letter that allows the firm to obtain a trucking permit from the transportation department in the branch location and expand the scope of its branch business license from the local agency of industry and commerce to include trucking.

Trucks and other cargo vehicles are also largely denied city access during the business day in many key Chinese cities, creating unusual challenges to both Chinese and foreign service-providers and presenting yet another market access barrier. EDS companies are forced to use passenger vans for pick-up and delivery services, and, while this practice is generally accepted, fines and vehicle impoundment have occurred. Having access to the best, most efficient EDS services is especially critical in major metropolitan business centers during the business day.

Action Items:

- China should simplify and streamline the application process for trucking licenses, remove the requirement for separate central and provincial level approvals, and, to the degree possible, consolidate the regulatory and licensing process into one central office.
- China should also significantly improve its compliance with its existing commitments to grant licenses within 15 days (municipal and provincial) and 30 days (national).
- Express delivery trucks and other cargo vehicles should be allowed to access China's major cities during the business day.

Air Freight Sales Agency Licenses

Issue 5: CSI encourages China to modify existing regulations to allow wholly foreign-owned express delivery firms to obtain an Air Freight Sales Agency License.

Background: Express delivery firms provide freight forwarding to their customers as part of their broad portfolio of services. However, General Administration of Civil Aviation of China (CAAC) regulations restrict wholly foreign-owned enterprises (WFOEs) from obtaining Air Freight Sales Agency Licenses, which prevent wholly foreign-owned EDS firms from booking space directly with air carriers in China. Without the ability to book space on aircraft, WFOEs cannot perform an essential part of air freight forwarding services and cannot fully enter the air

freight forwarding market in China.

Action Items:

- The CAAC regulations that bar WFOEs from obtaining Air Freight Sales Agency Licenses should be modified to allow WFOEs to obtain such licenses.

Financial Services

Banking

Issue 1: Existing sectoral trade barriers hamper U.S. companies' market access and the development of a healthy Chinese banking sector

Background: Remove investment caps and allow establishment in the form of choice. Foreign investors in Chinese banks remain limited to 20 percent ownership by a single investor, with total foreign investment limited to 25 percent. Such caps are a significant obstacle to China's achievement of a more balanced, resilient, and stable economy and should be removed. Participation in Chinese markets by foreign banking institutions would bring world-class expertise and best practices with regard to products and services, technology, credit analysis, risk management, internal controls, and corporate governance. Countries which have followed this policy have seen a dramatic improvement in the efficiency and soundness of their financial sector, an increase in available credit, and the development of deep and liquid financial markets that spur economic growth.

China should also allow foreign banks to establish a presence in the corporate form of their choice. The efficient deployment of the capital and other resources of foreign financial institutions requires the flexibility to determine which particular corporate form – whether a wholly-owned subsidiary, branch, representative office, joint venture, or majority equity investment in an existing Chinese company – is most economical and appropriate within the broader strategic investment parameters. Restrictions on operational form can discourage foreign financial institutions from initiating business activities in China, despite finding the market attractive, which will not serve the interests of the consumer.

Ensure national treatment. While China imposes no explicit limits on the number of licenses provided to foreign banks and remaining geographic and customer restrictions were phased out as of December 2006, Chinese agencies and regulations continue to treat foreign banks more restrictively than domestic banks. For example, regulations require three years of operation and two continuous years of profitability before foreign bank branches are permitted to carry out local currency business.

Chinese authorities have also been slow to act on foreign banks' applications and continue to permit foreign banks to open only one branch every 12 months. In addition, a portion of foreign banks' branch capital must be deposited in Chinese banks, and foreign banks remain subject to minimum interest rate rules when borrowing from Chinese banks. Most problematic, the 75 percent loan-to-deposit cap is a single-obligor limit (10% of capital to a single borrower group)

and effectively discriminates against foreign banks because their small number of branches, exacerbated by a slow approval process, limits the deposit base of foreign banks.

Adopt a risk-based approach to capital. China imposes substantial asset and capital requirements on foreign banks that it does not apply to domestic banks. To establish a subsidiary in China, a foreign bank must have total assets of more than US\$10 billion and the subsidiary must maintain minimum capital of 1 billion renminbi (US\$129.2 million); to establish a branch, foreign banks must have total assets of more than US\$20 billion and each branch must maintain minimum operating capital of about \$12 million. These capitalization requirements also contribute to a bias in favor of subsidiaries over branches, though along with such other factors as the desire to engage in domestic retail business which requires a bank to incorporate locally and to participate in China's deposit insurance scheme.

China should change the way it assesses the capitalization of a bank to take into account a firm's overall risk and consolidated capital rather than using the current fixed minimum capital requirement. This change would bring China's capital requirements into alignment with global standards.

Action Items:

- China should eliminate or relax foreign ownership restrictions in Chinese banks
- China should reduce lengthy approval processes for opening new branches and offering new products and services
- China should harmonize capital requirements for foreign bank branches with those for domestic banks
- China should allow foreign banks greater access to China's debt and equity markets
- China should allow foreign banks to offer customers more products and services, such as credit and debit cards supported by payment brands of their choice and online banking
- China should allow foreign banks to use off-shore data storage and processing facilities for China-based transactions and clients, subject to appropriate privacy protections

Asset Management and Securities

Issue 2: We strongly urge China to go beyond its WTO commitments by allowing foreign firms to choose their form of establishment and equity participation levels, and permitting competition on the same basis as domestic firms.

Background: Foreign firms are currently permitted to own no more than 49% of joint-venture asset management firms in China, which is consistent with China's WTO accession commitments. The current restrictions make it difficult for U.S. asset managers to control and run their businesses as they would prefer. Increased participation of U.S. asset managers would help introduce world-class expertise and best practices with regard to products, services, risk management, internal controls, operations and governance. In addition, competition brought by U.S. asset managers would accelerate the adoption of such techniques and methodologies by domestic firms.

We are encouraged by changes to China's programs for qualified domestic institutional investors (QDIIs) that permit investments in overseas equities markets and should enable ordinary Chinese investors to benefit from asset diversification. We hope that the new rules will be implemented in a fair and transparent manner that allows all qualified asset managers—domestic and foreign—to participate on an equal basis. We encourage China to further liberalize restrictions on foreign investments held in the domestic portfolios of Chinese investors. Despite the recent liberalization, the restrictions are still quite stringent. If China further loosens the restrictions, domestic mutual funds, pension funds, and other institutions would be able to pursue portfolio diversification through international investment, creating advisory and management opportunities for U.S. asset managers.

We are encouraged that at the Third SED Meeting in December 2007 China reported that it had implemented its commitment to open further the A-share market to foreign investors by increasing the quota for qualified foreign institutional investors (QFIIs) from US\$10 billion to US\$30 billion and that certain entities have recently received QFII status. We are also encouraged that in April 2008 China announced that it intends to amend its rules on investments by QFIIs, including reducing time limits for QFIIs to remit funds out of China and permitting QFIIs to open foreign exchange accounts, and that at the Fourth SED in June 2008 China agreed to reduce the lockup period for certain QFIIs to 3 months. All these steps supplement the China Securities Regulatory Commission's revision of the QFII program in 2006. China also announced that it will resume joint venture licensing and expand the scope of security companies' operations, which we hope will be implemented in a non-discriminatory manner. Despite this progress, China continues to severely restrict outside investment in its securities markets, and foreign investors that do receive the limited licenses and investment quotas have to contend with complex requirements and bureaucratic hurdles that may disproportionately affect regulated entities.

Action Items:

- CSI continues to urge China's greater liberalization of the QFII regime to remove restrictions on investments by QFIIs, especially those restrictions on remittances that limit liquidity and raise the cost of investing in Chinese securities
- China should implement the changes in their programs for QDIIs in a fair and transparent manner that allows all qualified asset managers – domestic and foreign – to participate on an equal basis
- China should further liberalize restrictions on foreign investments held in the domestic portfolios of Chinese investors
- Expanding upon the scope of SED commitments on QFII, China has stated that foreign-invested insurance companies will be included in the financial institutions benefiting from these liberalizations. This commitment should be publically confirmed at JCCT, and as well as the results of preliminary application of the commitment

Electronic Payment Services

Issue 4: According to its WTO GATS Financial Services Schedule, China is required to grant full and unlimited market access and national treatment to foreign electronic payments providers. Despite its WTO commitments, China continues to restrict market access for U.S. and other foreign electronic payments providers by maintaining a government-protected, domestic monopoly, China UnionPay (“CUP”), in the domestic RMB bank cards market.

Background: CUP was established by the People’s Bank of China (PBOC) in March 2002. Owned by over eighty of China’s largest banks (and other state owned enterprises), its initial objective was to enable national cross-bank bank card transactions (for both point-of-sale and ATM) via one common inter-bank switch system and a unified logo (CUP mark on all RMB bank cards and at the point of sale/ATMs). Since December 2006, PBOC steadfastly refused other foreign and domestic electronic payments services providers to issue non CUP-branded RMB-denominated bank cards (e.g. credit, debit, pre-paid), build merchant acceptance networks to support such cards, and process inter-bank point-of-sale transactions involving such cards in China. The main reasons that were consistently cited were national security, non-convertibility of the RMB, and the need to build a strong CUP before allowing competition. As a result, foreign electronic payments companies’ businesses in China have been limited to the issuance of foreign currency-denominated bank cards and acceptance of foreign-issued bank cards. Due to demands from Chinese consumers and banks for greater convenience, such foreign currency bank cards are typically co-branded with CUP on one single card that features a foreign payment brand linked to a foreign currency account and the CUP logo linked to a RMB account. This is called a dual-currency, dual-branded (dcdb) card. DCDB cards are exclusively processed by CUP as CUP transactions when used in China and are processed over the foreign payment company’s network when used outside of China.

Operating from its protected home market, CUP has been rapidly expanding its card acceptance and issuance internationally since 2003. Unlike foreign electronic payments companies in China, CUP is able to have full and unencumbered access to the domestic bank card market in a growing number of foreign countries (more than 30) in which it has chosen to operate. Full access includes the issuance and merchant acceptance of CUP branded bank cards denominated in the local currency of the host country (e.g. Korea, Japan). No foreign governments are known to have refused CUP access to their domestic electronic payments markets on the grounds of national security, or protection of a domestic player, or on-shore processing requirements.

China’s failure to allow foreign electronic payments providers to independently operate RMB-denominated electronic payments businesses in the Chinese domestic market violates its WTO commitments and hinders progress toward achieving its stated economic goals. Independent evidence demonstrates that an open and competitive electronic payments system would benefit China and its economy. For instance, a recent study by the McKinsey Global Institute concluded: “Fixing the payments system problems and encouraging the use of electronic payment vehicles [in China] would result in savings for banks and corporations and would simplify the life of individuals. It would also improve the government’s control on the economy (as most black market activities are cash based), offer new business opportunities for the banks, and increase the stability of the financial system.”

In China's GATS schedule, it made open commitments in "banking services" to allow unrestricted market access and national treatment for "payments and money transmission services, including credit, charge, and debit cards" beginning in 2007. This means that China must allow financial institutions to issue (RMB) payment cards of their choice. Banks cannot be required to issue only CUP cards or co-branded CUP cards. In addition, China committed to allow unrestricted market access and national treatment for "advisory, intermediation, and other auxiliary financial services" for other financial services listed in its schedule, including payments. China also committed to open market access for the "provision and transfer of financial information, and financial data processing ...by supplier[s] of other financial services." Equally importantly, China took no exceptions that would allow CUP to operate as a monopoly.

The JCCT aims to promote China's ongoing economic reform program and further open the Chinese market to foreign competition. An open and competitive electronic payments system can play a key role in attaining these goals. A competitive payments system will best serve China's overall economic interest by enhancing consumer choice, spurring innovation, and stimulating consumer spending. Such a competitive system in China also will promote banking and retail industries, lower costs and improve services while protecting against risks to China's financial sector. Opening China's electronic payments sector to multiple players also will bring China into compliance with its WTO commitments and foster increased economic activity within China.

U.S. electronic payments providers have invested heavily in their clearance and settlement networks over the past fifty years. As a result, they have created the fastest, most secure, and most reliable worldwide networks for electronic payments, which allow for the processing of billions of electronic payments every year. U.S. providers should be able to operate through their own clearance and settlement networks in China. The U.S. electronic payments industry is committed to the Chinese market and expects full market access as guaranteed by China's WTO commitments. Despite numerous efforts by the U.S. Government to convince China to open its market to foreign electronic payments systems, China has not done so. The upcoming JCCT provides an opportunity for the U.S. Government to further address this issue.

Action Items:

- Issue final regulations (e.g. Payment Settlement Organizations Regulations) and pass final laws (e.g. Bank Card Law) to provide greater legal clarity for all participants in the electronic payment services industry, including foreign providers
- Permit financial institutions to issue RMB-denominated payment cards of their choice thereby adhering to China's WTO commitment to open the domestic market to foreign-owned electronic payment systems

Insurance

The U.S. Government should continue to engage the Government of China on a frequent basis through a multi-track approach leveraging the most appropriate formal dialogues, regulatory consultations and/or technical discussions. China made broad and deep commitments in the WTO to open the insurance and private pension markets to foreign participation, but there

remain many discriminatory differences in regulatory treatment for which there do not appear to be any prudential justifications. Indeed, we believe that such discrimination limits competition and impedes the delivery of services to Chinese consumers. The goal of Chinese regulators should be to implement regulations that are neutral as to ownership and blind as to national origin.

Especially important is the approval process for regional branching and sub-branching where CIRC maintains differentiated regulatory process which discriminate against foreign-invested insurers. China committed to remove all geographic restrictions for geographic expansion by 2005, but because of discriminatory limits on license approvals for foreign-invested insurers, China continues to impose *de facto* market access barriers to foreign entry and expansion. This along with the national treatment concerns, which prudentially unjustified discriminatory regulatory treatment create, form the basis for the issues which we would be asked included in the various U.S. – China bilateral dialogues.

Remove Equity Restrictions on Foreign Investment in Insurance Companies

Issue 1: In order to protect the safety and soundness of the market, CIRC should have the authority to allow foreign partners to increase their capital. To maximize the value of their investment in the sector, Chinese JV partners should be free to sell their stake to their foreign partners as part of an orderly continuation of the company if they choose to redeploy their capital.

Action Items:

- Remove the 50% cap on foreign ownership in life insurers in China
- Allow foreign insurers a choice of juridical form: branch, subsidiary or joint venture

Statutory Insurance

Issue 2: Foreign insurance companies are currently shut out of China’s “statutory insurance business.” Such business, according to China, includes “third party auto liability insurance.” To date, China has not provided a good rationale for allowing only local insurance companies access to this market.

Background: In its GATS schedule, China committed to allow foreign non-life insurers to provide the “full range of non-life insurance services” within China after December 11, 2003. China’s exclusion of foreign insurance companies from its third party auto liability insurance market thus raises concerns regarding China’s compliance with its WTO obligations. Furthermore, liberalizing the statutory insurance sector is in China’s own interest. Given the growing number of vehicles and the mandatory nature of this line of insurance, it is imperative that China opens its “third party auto liability insurance” market to allow foreign companies’ expertise, quality products and services, and healthy competition. Otherwise, China runs the risk of seeing a rise in claims and premium costs, resulting in domestic insurance companies becoming insolvent due to insufficient capital, and consumer outcry. Indeed, China is currently experiencing these very problems.

Action Items:

- China should open its “statutory insurance” market to allow foreign companies’ expertise, quality products and services, and healthy competition

Sub Branch Approvals – Market Access

Issue 3: When the moratorium was imposed in Oct. 2008, CIRC said it was temporary and would be addressed within months of release of the revised law which came out in Feb. 2009. CIRC also committed to an open and transparent comment process as the revised regulations were considered and to apply them equally to domestic and foreign companies. Because foreign companies have been required to apply through the International Department of central CIRC for any expansion since October 2008, there is currently a tremendous backlog of sub-branch applications from foreign-invested companies.

Action Items:

- In support of China’s commitment to address the moratorium on new licenses for regional sales offices, CIRC should amend the regulations for the three structures that perform functions comparable to regional sales offices, i.e., sub-branches, central sub-branches and departments, to allow foreign invested companies to apply directly to the local CIRC office under the same procedures as domestically-owned insurers and not through the International Department of central CIRC
- To clear this backlog CIRC should allow foreign-invested insurance companies to apply to local CIRC offices for all sub-branch categories, in exactly the same manner as domestically-owned companies

Concurrent Branch Approvals – Market Access

Issue 4: This issue has been raised in the SED, JCCT, JEC and the annual TRM since 2004, and foreign-invested companies confirm that a pattern of administrative practice which precludes multiple concurrent branch application approvals remains in place as of June 2009. U.S. industry has developed documentation as to the discriminatory regulations and the patterns of discrimination as demonstrated by publically announced branch license approvals. These documents have been shared with and verified with the industries from Canada, Europe and Japan. The Government of China is on record as agreeing with the US and other trade partners regarding concurrent branching and conversion, and stating that their laws and regulations provide for such treatment. In demonstration of this commitment, CIRC should make a public statement that foreign-invested and domestic insurers are welcome to submit

multiple applications for branch approval which, if qualified, will be approved concurrently.

Action Items:

- In demonstration of the repeated statements by CIRC that there is no discrimination between foreign and domestically owned companies as to the application approval process for geographic branch expansion, CIRC should issue a regulatory clarification that foreign-invested insurers are able to submit multiple applications for branch approval, and if qualified, CIRC will approve them concurrently

Enterprise Annuities

Issue 5: The establishment of a successful and efficient private pension system is critically important to China. The US government and industry organizations are prepared to cooperate with China on this important initiative to help bring world class best practices to the Chinese private pension market.

Background: During SED IV, the United States and China had substantive discussions on how best to work together to mitigate the economic risks associated with aging populations in both countries and to provide better social services such as health care and retirement. China in SED II committed to implement by SED III a streamlined licensing regime for financial services firms seeking to provide Enterprise Annuity services. The EA framework is already in place, and all relevant Chinese regulatory agencies (MHRSS, CBRC, CSRC and CIRC) are on record as supporting the increase in plan sponsors and participants. In June 2007, the Government of China announced the creation of an inter-agency committee to develop a set of unified national tax incentive policies for both employer and employee contributions to EA. Further, in the SED V jointly agreed outcomes, the US and China agreed to a technical dialogue on best practices tax incentives to promote EA products in China, and the US expressed a strong commitment to support the development of EA in China to build private savings in support of the social safety net.

Action Items:

- The Chinese government should encourage US financial services firms such as insurance companies to participate in the Enterprise Annuity market by supporting the establishment of the appropriate financial services entities in China by US financial services firms and awarding EA licenses to such entities
- The relevant Chinese government agencies should establish a transparent, clear and streamlined licensing process for financial services firms (including foreign-invested) seeking to provide EA services. Foreign firms with the requisite experience should be allowed to joint-venture with Chinese companies (insurance companies, banks, trust companies, etc.) to provide EA services in China
- In fulfillment of China's SED IV commitment on Transparency, China should end the informal moratorium on EA licensing (last batch of licenses were awarded in November

2007) and publish the procedure for companies to apply for EA authorization on an ongoing basis

- China should encourage a “one stop shop” for EA related products/services provision as this is in the best interest of plan participants
- China should permit the setting up of EA master trust plans for the interests of small and medium enterprises
- China tax authorities and pension-related agencies should work together for better and unified tax policies to encourage the development of the EA market
- Foreign ownership in EA related ventures should be allowed to rise to 100%
- Restrictions on investments (such as bans on foreign investments and equity caps) should be gradually relaxed for better long-term investment growth and risk diversification

Investments in Multiple Insurance Companies

Issue 6: China and the United States had positive high level and technical level discussions on the proposed “Measures on the Administration of Equity Interests in Insurance Companies” during the comment period, and in particular, on the issue of the U.S. concern that foreign financial institutions may continue to invest in a new or existing domestic insurance company without regard to whether that foreign financial institution has already invested in the same insurance sector in China. China will consider fully comments timely submitted from all parties, and continue to consult as appropriate. Based on a common understanding of China’s market access commitments, an unprecedented international outpouring of concern relative to these measures has been expressed to CIRC and to the Ministry of Commerce.

Action Items:

- China should not finalize the “Measures on the Administration of Equity Interests in Insurance Companies” until there is a full multilateral discussion of the market access and national treatment implications of these measures relative to China’s WTO commitments

Overseas Investment of Assets

Issue 7: In the Joint SED IV statement, China confirmed that it had recently issued regulations which specify relevant CIRC requirements to allow insurance companies in China (“Measures on Overseas Investments with Insurance Funds”), including foreign-invested companies, to invest a certain proportion of their assets overseas including creation of Qualified Domestic Institutional Investor funds. This commitment should be fulfilled by allowing foreign-invested insurers the same range of investment classes as Chinese domestic providers.

Background: Leveraging the global experience of foreign-invested companies will help develop products and domestic expertise if Chinese industry is to become competitive in global markets. It will:

- Allow insurance companies to outsource investments to qualified fund houses or security companies, including their overseas affiliated and parent companies.
- Allow foreign-invested insurers and their JV partners to create QDII funds to invest part of their assets or their customers' assets overseas through this asset class would enhance portfolio diversification.
- Allow Chinese consumers to invest a portion of their assets in international and domestic non-bank assets supports the risk management diversification goal as stated by the Government of China.

Action Items:

- China's commitment to allow investment should be fulfilled by allowing foreign-invested insurers the same range of investment classes as Chinese domestic providers
- The U.S. and China should report progress on this commitment in the JCCT by announcing the grant of Insurance Asset Management licenses to qualified foreign-invested insurers, and announcing that foreign-invested insurers will be approved by SAFE to use their parents as "Overseas Advisor" without being subject to any seasoning or asset thresholds that cannot be satisfied on the basis of international experience and global assets

Investment of Assets

Issue 8: In December 2005, CIRC issued the Regulations on the Administration of Insurance Funds which if implemented would mandate that insurers not qualifying for an Insurance Asset Management Company License (8 years operations in China and 10 billion RMB) must outsource their asset management (on-balance and off-balance sheet funds) to an Insurance Asset Management Company (IAMC). The Regulations stated that an insurance company that does not own an IAMC must outsource all its investments in equities, corporate bonds, derivative instruments and mutual funds to an IAMC or a professional investment institution (no specific definition was given). CIRC's official rationale is that an IAMC has better internal controls and investment capabilities for improving insurers' risk management and returns. ACLI and the U.S. government raised concerns with CIRC regarding potential disclosure of investment asset portfolio information to competitors and potential conflicts for the IAMC to allocate assets to its parent insurance company's portfolio or those of competing insurance companies. In early 2009 CIRC issued revised guidance on optional investment by insurers in new asset classes but with the requirement that companies have specifically set numbers of approved investment management staff physically in China and employed by the statutory entity wishing to access to additional investment options. Currently, insurance companies are required to outsource most new channel investment to IAMCs (asset management companies set up by insurance companies) if certain standards are not met, e.g., number of investment staff.

Action Items:

- CIRC should recognize the global experience, capital and organizational resources for all seasoning or staffing requirements for IMAC or other investment requirement. CIRC should focus on the desired risk management standards, rather than on the number of bodies necessary to guide each type of investment class
- Leveraging the global experience of foreign-invested companies will help Chinese industry to become competitive in global markets by developing products and domestic expertise
- Foreign-invested insurers should also have the option to work with mutual fund companies (several have foreign partners) to leverage their extensive experience and global best practice on fund management
 - Doing this would: 1) Avoid conflict of interest of solely outsourcing assets exclusively to domestic insurance asset management companies that are also competitors in the market; and 2) Promote competition, efficiency and improved service by allowing choice of qualified asset managers

Management Training Requirements

Issue 9: In 2008, CIRC released regulations which outline ongoing training requirements for senior executives of insurance companies to receive CIRC-approved training. The regulations are vague and do not provide clear definitions as to scope, compliance requirements or fulfillment options or equivalents.

Action Items:

- Clear definitions and scope should be provided, which clarify the scope, compliance requirements and fulfillment options
- Requirements should apply to a limited number of clearly defined and prudentially justified admitted management executives
- Fulfillment options should include U.S. or other comparable professional qualifications, designations or work experience

Innovative Products

Issue 10: The insurance industry is concerned that CIRC is considering a regulation that may limit sale of unit-link products. The regulators have conveyed that they viewed unit-link as investment products and that insurers should focus more on traditional protection products.

Background: Unit-link products are long-term contracts meant for customers to hold onto for the long-term. Merit for unit-link products as equity investments with insurance products provide higher returns to customers thereby meeting customer needs. Unit-link products are sold around the globe. By limiting the product, CIRC is sending a signal of limiting innovation in the market.

Action Items:

- There are effective distribution/good sales practices that foreign companies have deployed in China and worldwide to support unit-link products. These practices are compatible with CIRC's 2009 Notice Advancing Insurance Applications Precautions Work which is intended to educate and protect potential customers of life or health insurance products. By adopting good distribution practices in China, this will further strengthen compliance, disclosure and effective needs assessment of products

Portfolio Diversification – Corporate Bond Market Growth

Issue 11: Corporate bonds are one of the most important asset classes for insurers. In China, the corporate bond market is moving from a guaranteed (mostly by large state-owned banks) model to a market oriented (non-guaranteed) one. While the CBRC (banking regulator) has been discouraging banks from providing guarantees, CIRC has not allowed insurers (the largest purchasers of corporate bonds) to invest in non-guaranteed bonds due to credit risk concerns. The conflicting decisions by the banking and insurance regulators have created uncertainty in the market and hindered development of the corporate bond market. Although CIRC opened up investment in unguaranteed corporate bonds, the 30% ceiling for corporate bonds has not been lifted. Compared to government bonds, financial bonds and bank term deposits, corporate bonds match the liabilities of insurance companies better. While the industry takes into consideration CIRC's concerns, there is a strong need for insurers to do proper asset allocations with this asset class. The current limitation in the corporate bond market environment has further limited choices of investment vehicles for insurance companies. Fixed-income securities are the best match for insurance liabilities, especially for traditional products.

Action Items:

- We would propose that the 30% limit be revised
- We strongly encourage the regulators to provide effective guidance and regulations to promote the corporate bond market
- China should raise the upper limit of corporate bonds investment for insurance companies

Unfavorable Tax Rule

Issue 12: The new rules, as stated in the Ministry of Finance and SAT Notice Concerning the Policy for Before-Tax Deduction of Processing Fees and Commission Expenses by Enterprises, Caishui [2009] No. 29, allow property insurance companies to deduct processing fees and commission expenses equal to 15% of the difference between total premiums received in the current year and total policy surrenders in the current year. Personal insurance companies are subject to the same rule, but the cap on deductions is 10% rather than 15%.

The new rules thus simplify procedures by combining treatment of commissions, processing fees and surrenders in the same document. Although the new rules double the percentage cap for both property insurance companies and life insurance

companies, the difference between property insurance companies and personal insurance companies is widened from 3% (8%-5%) to 5% (15%-10%). Property insurance companies are also favored because they do not have surrenders which reduces the base amount to which the percentage is applied.

Another change that adversely impacts personal insurance companies relative to property insurance companies and personal insurance companies with long-term rather than short-term products is the removal under the new rules of the five-year carry-forward period. Under the former rules, life insurance companies could use total premiums receivable under long-term policies in calculating their deduction caps. This cap is now based only on current year income minus surrenders.

We believe that CIRC and the larger domestic companies are unlikely to be pleased by the new rules which discourage the long-term life policies which CIRC favors, and disadvantage personal insurers relative to property insurers.

Action Items:

- We believe that one objective should be to create parity between personal insurers and property insurers at the higher 15% cap
- We also believe that restoration of a multi-year (five-year?) carry-over period for premiums would restore an incentive for long-term life insurance policies. ACLI is currently developing materials on comparative data on tax treatment in the United States, Canada and other jurisdictions which may be helpful in beginning a discussion on this issue

Market Access for Non-Life Insurance

Issue 13: The most pressing concern for U.S. non-life insurance companies operating in China is market access. Other important issues for this sector include a lack of regulatory transparency and routine regulatory procedures that assure meaningful foreign insurer input and the inability to write political risk and mandatory third party auto liability insurance.

Despite the symbolic promise of China's accession to the World Trade Organization (WTO) in 2001 that raised expectations of market-opening in financial services, foreign insurers still hold only a 1.2% share of the non-life market. While the State Council has supported reforms in the banking and securities sectors, the China Insurance Regulatory Commission (CIRC), China's insurance regulator, continues to hinder foreign carriers' access. CIRC has severely limited the geographic expansion of foreign (including US) insurers.

Background: With U.S. \$34.4 billion of premiums written in 2008 and a 22% compound annual growth rate, the China non-life insurance market will surpass Korea's this year to become the world's 10th largest. Non-life insurance premium as a percentage of GDP is roughly 1%, about a fifth of the US level. Given this low level of overall insurance penetration, potential for growth

in China's addressable market is already strong and will expand further as the Chinese economy matures.

Although insurance premiums have expanded at an annual growth rate of 20% over the past two decades, non-life insurance's contribution to GDP in 2008 was 0.75%. The entire insurance sector makes up only 5.2% of China's total financial assets and is dwarfed by the banking and securities sectors. The State Council has already overseen fundamental reform of these sectors but insurance reform has lagged. Insurance liberalization would improve the efficiency of China's financial system, in turn aiding economic growth. Further, China's continued economic expansion hinges on specialization and productivity improvements that require specialized and innovative insurance products that its state-owned insurers cannot adequately provide.

In this regard, China requires, for example, participation of experienced foreign non-life insurers to mitigate domestic liability exposures (e.g., environmental liability, Directors & Officers liability), mitigate exposures in foreign markets (e.g., product liability, political risk liability), and enable growth in national priority areas such as life sciences and high technology.

CSI member companies have been active in China for more than a decade. We strongly supported China's accession to the WTO and are committed to playing an increasingly important role in development of China's insurance sector. An open Chinese insurance market benefits not only CSI companies but the people of China.

If non-life insurers are to play an optimal role in financial sector reform and continued Chinese economic growth, CIRC must remove restrictions hindering foreign insurers' access and accelerate its approval process for their geographic expansion.

Action Items:

- CSI encourages a State Council decision to reform and open up the insurance sector so it can contribute more effectively to China's economic development and job creation.

Political Insurance

Issue 14: Non-life insurance companies have been unable to gain CIRC approval to provide political risk insurance (PRI) coverage for Chinese companies. If companies gain approval to underwrite political risk in China, Chinese investors could access enhanced, highly sophisticated risk management practices. Numerous Chinese companies have expressed a deep interest in access to new risk transfer options. Achieving a commitment for resolution of this issue is necessary as a base element of any outcome acceptable to industry, but represents low hanging fruit.

Action Items:

- Allow foreign insurers to underwrite political risk insurance in China and approve all outstanding applications to do so

Retail Services

Issue: Measures issued by the Ministry of Commerce both discriminate against and encumber the ability of foreign retailers to fully invest and compete in China's retail services sector.

Background: Organized retailing services are a critical component to the development of a robust consumer society in China. Foreign retailers help enhance the level of service, contribute to improving critical infrastructure and supply chain management, and stimulate domestic consumption. They also help to maintain sustainable and healthy development of the national economy. Despite all these benefits, we would like to identify the following sectoral restrictions and practices that hamper the development of China's retail services.

- 1) *Restrictions on ownership.* Ownership limitations in NDRC's *Foreign Investment Industry Catalogue* and the *Measures for Commercial Sectors* are overly restrictive. A foreign retailer, that opens more than 30 stores in China selling certain commodities of different brands and from different suppliers, cannot be more than 49 percent foreign owned. By contrast, the limit for Hong Kong and Macao investors is 65 percent, but still too low. The restricted commodities include pharmaceuticals, pesticides, agricultural films, fertilizers, refined oils, food, vegetable oil, sugar and cotton, among others.
- 2) *Restrictions on tobacco.* On March 7, 2007, the NDRC issued new rules, which state that foreign commercial enterprises are not allowed to conduct wholesale or retail business related to tobacco. As current permits expired in late 2008, foreign invested retailers that once sold tobacco products are no longer authorized to sell these products. This restriction discriminates against foreign stores.
- 3) *Commercial Zoning.* According to the *Measures for Commercial Sectors*, when applying for a new site, foreign retailers must produce written confirmation from the local government stating that the proposed site complies with the city's commercial zoning plan. When commercial zoning plans exist, a public hearing process is also required, adding up to three months to the approval process. Furthermore, some locations have incomplete commercial zoning plans, making compliance confirmation impossible. Without this confirmation, MOFCOM will dismiss the foreign retailer's new site application as failing to comply with local commercial zoning plans. In some instances, the local government has arbitrarily used the commercial zoning plan to slow down or restrict foreign retail plans to open new stores, posing yet another level of risk on the foreign investor. In contrast, domestic retailers are not required to submit new site applications to MOFCOM for examination or approval. This requirement is in conflict with China's WTO commitment to lift all geographic limits on foreign retailers.
- 4) *Registered Capital.* According to Article 7 of the *Measures for the Administration on Foreign Investment in the Commercial Sector* ("Measures for Foreign Investment") issued by MOFCOM, the minimum registered capital for foreign retail investors must comply with the relevant provisions in the Company Law and other relevant regulations.

According to the Company Law, the minimal capital required for a company registration is fairly low- between RMB 30,000 (US \$4,400) and RMB 500,000 (US \$73,000). MOFCOM usually asks foreign retailers to increase their registered capital by approximately 10 times this amount for each new outlet application. In contrast, this provision does not exist for domestic retailers, regardless of the number of outlets.

- 5) *Concerns on the Big Box Law.* Related Chinese government agencies have worked together and completed a draft law for a zoning regulation on large scale commercial facilities (“Big Box Law”). In April 2008, the Legislative Office of the State Council solicited public comments on the draft and is preparing a revision. Foreign-invested retailers recommended removing language requiring supermarkets with construction areas above 10,000 square meters to be approved by MOFCOM and pushed for the approval process to take place at the local level for both foreign invested and local retailers. Most stores opened by local retailers are small and may never reach the scale that would trigger this approval process. Foreign retailers often open large-scale stores and as a result have to go through the lengthy approval process.

Action Items:

- Revise the Measures for Commercial and other related regulations in line with China’s WTO commitments and common international practices
- Treat domestic and foreign retailers equally for registered capital requirements assessed on additional outlets
- Lift the ownership restrictions on foreign retailers operating more than 30 stores in China and selling certain commodities provided in Article 18 of the Measures for Commercial Sectors
- Ensure that zoning review standards are the same for foreign and domestic retailers
- Lift restrictions on types of merchandise, such as pharmaceuticals and tobacco, or at a minimum ensure that regulations on the distribution restrictions are applied equally to Chinese and foreign retailers
- Formulate and promulgate the Big Box Law to ensure that foreign and domestic retailers are treated equally concerning compliance with urban development

Telecommunications

Issue: China’s narrow interpretation of market access opportunities for foreign participants and lack of an independent regulator remain key outstanding issues, which contradict its WTO accession commitments. Specifically, foreign market entry is being delayed by the Ministry of Industry and Information Technology’s definition of value-added services (VAS) for international value added network service licensing. The regulator has construed the meaning of VAS in China's WTO commitments so narrowly that any commercially important sectors, such as IP-virtual private networks (IP-VPN) services demanded by global enterprises, are excluded.

China's prohibition on resale absent a basic services license have also greatly limited market

access in both basic telecommunications and VAS. We believe that resale should be permitted, and subject to appropriately lower market entry requirements.

China's requirement to select a state-owned, licensed telecom company as a joint venture partner is also problematic. Incumbent licensees have limited incentive to partner with foreign competitors. Allowing foreign parties to partner with new entrant Chinese firms would create new opportunities for creative investment in telecom infrastructure and foster the type of competition that would benefit Chinese customers with better service and competitive pricing. It is not an ideal model for promoting competition to require foreign telecom service providers to partner with a company that may also be a horizontal competitor of their joint venture.

Contrary to its claims, China has not implemented its WTO Reference Paper commitment to establish an independent regulator. The Chinese Government still owns and controls all major telecom operators, and the Ministry of Industry and Information Technology serves in the chain of command as a leader rather than a regulator of the sector.

Despite the WTO commitment to discuss further sectoral liberalization, China has yet to submit an improved telecom offer with broader market access, including higher foreign equity participation. Ideally, China should commit to relax or eliminate foreign direct investment restrictions in all licenses, going beyond present WTO commitment by allowing 100 percent foreign direct investment. This would promote efficient, more profitable operations capable of providing the best quality services.

China's present capitalization requirements bear no reasonable relationship to the actual cost of market entry and serve as a market access barrier that should be removed. In 2008 China lowered the capitalization requirement to 1 billion RMB (\$146M), still significantly higher than any other country in the world. While the reduction in the capitalization requirement for a basic service license is a step in the right direction, China's capitalization requirement is still very high and continues to be a significant barrier to entry. The reduced capitalization requirement is 100 times the capital requirement for value added service licenses, which is itself many times the actual level of capital investment needed to build a national, non-facilities-based value added network. The reduced capitalization requirement in basic services continues to be an excessively burdensome and unjustified restriction that violates the GATS. A narrowly tailored performance bond would be sufficient to address any existing concerns. China should take additional steps to reduce the capitalization requirement to a reasonable level. Lowering the capitalization requirement for basic and value added service licenses, coupled with the elimination of FDI caps, would result in significant additional investment in the telecommunications sector which is a key driver in economic growth.

Nearly eight years after acceding to the WTO, China continues to maintain an array of market entry barriers in its telecom services sector that freeze out any meaningful foreign participation.

Action Items:

- China should allow foreign parties to partner with new entrant Chinese firms

- China should implement its WTO Reference Paper commitment to establish an independent regulator
- China should commit to relax or eliminate foreign direct investment restrictions in all licenses, going beyond present WTO commitment by allowing 100 percent of foreign direct investment