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How Chinese Used Insurance to Dodge Currency Controls

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Before the Chinese regulator stepped in this week with measures against the insurance industry aimed at curbing the country's $1 trillion worth of capital outflows in 2015, hundreds of thousands of mainland Chinese had been flocking to Hong Kong to buy policies using their China-issued UnionPay credit or debit cards.

Using the cards enabled them to get around China's controls that officially limit citizens from converting no more than $50,000 per year and sending it abroad. By swiping the cards at insurers such as AIA Group Ltd., Prudential Plc, and Manulife Financial Corp. in Hong Kong, mainland residents bought policies denominated in Hong Kong dollars and U.S. dollars -- averaging $50,000 but reaching as much as $1 million or more -- with the equivalent amount of yuan deducted from their bank accounts back home.

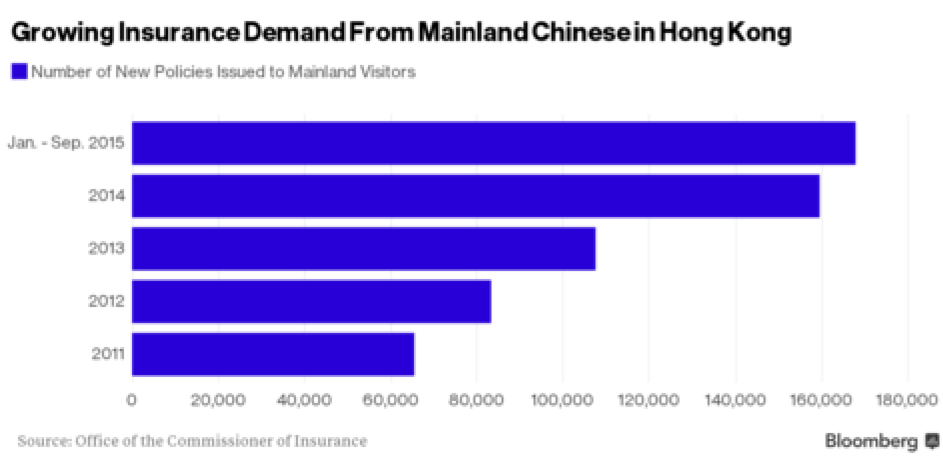
The money could then be cashed out and sent anywhere in the world as a clean source of funds from an insurance policy. Such policies, in addition to providing better health care, beneficiary payments and returns than those on the mainland, are also popular because they're shielded from seizure in the event of bankruptcy in China or criminal proceedings, which have been intensifying under President Xi Jinping's anti-corruption campaign. Thus, Hong Kong's insurance policies have been turned into actual insurance for billions in Chinese cash.

"More mainland Chinese are buying insurance products in Hong Kong to prepare themselves for further yuan depreciation," said Zheng Chunming, a Shanghai-based analyst at Capital Securities Corp. "The Chinese authorities are indeed concerned about cash outflows as the economy itself is not performing well."

Surging Demand

To cater for surging demand, Hong Kong insurers added 23,000 agents and brokers over the past five years, bringing the total to more than 93,000, with many of them Chinese mainland students freshly graduated from Hong Kong's universities, according to Hong Kong's Office of the Commissioner of Insurance.

Policies sold to mainlanders surged to a record HK$24.4 billion ($3.1 billion) in 2014, a 64 percent increase from the year before and a 146 percent jump since 2012. In the first nine months of last year, 22 percent of Hong Kong's new premiums were collected from mainland Chinese, an almost six-fold increase from a decade ago, according to the Commissioner of Insurance's office.



Effective Thursday, China’s State Administration of Foreign Exchange is making sure purchases of insurance products overseas using China UnionPay Co. cards are cappedat $5,000 per transaction, people familiar with the matter said.
Insurance belongs to a category of so-called restricted merchants subject to a $5,000 payment cap per transaction, UnionPay International said in an e-mailed reply to questions. An investigation by the payments provider found that some overseas merchants hadn’t applied the restricted classification to insurance, and UnionPay is asking them to comply with the regulations, it said.

Starting Jan. 1, China also limited cash withdrawals using UnionPay cards overseas at no more than the equivalent of 100,000 yuan, while previously there was no restriction.

Money-laundering Risks
Last year, Insurance Commissioner Annie Choi, who was later replaced, warned of growing money-laundering risks through the use of insurance policies and changes made to inflate their value after purchase.

"These changes, including advance premium payment, policy loan, lump sum top up, policy assignment, changes in the beneficiary or early surrender, may make it possible for a life insurance policy to become an unnoticed tool for money laundering,” she said in a speech at a financial crimes conference in April.

“Any insurance product that allows the policyholder to cash out after a short period of time bears the risk of money laundering,” said Simon Lee, a senior lecturer at Chinese University of Hong Kong’s business school. “They may put in a large amount of money into a policy all at once and redeem pretty early. They don’t mind losing part of it as long as they can get most of their money back.”

Prosecution Fears
Increasingly, mainland Chinese have become concerned about prosecution for "economic crimes," Lee said, so they prefer insurance policies in Hong Kong which can’t be seized by mainland authorities in the event of bankruptcy or a corruption conviction. Even if the policyholder dies, the beneficiary can still get the death benefit from his or her life insurance policy.

Chris Chen, a 38-year-old teacher in eastern China’s Zhejiang province, was among those who traveled to Hong Kong late last year and again in January to buy insurance policies so that he could get around the capital controls and accumulate enough U.S. dollars to send his son to study abroad.
“I spent three months studying Hong Kong’s insurance products and realized they are indeed better and more reliable,” said Chen. “There’s so much trouble when it comes to foreign currencies in China. I can’t move much of my money out to the U.S. from China, but I can move as much as I want from Hong Kong.”

Payment Method
UnionPay is the main payment method for mainland visitors buying insurance in Hong Kong, according to Linda Sun-Mattison and fellow analysts at Sanford C. Bernstein & Co. in Hong Kong. While UnionPay cards are mainly used for paying initial premiums, bank transfers are commonly used for recurring payments, the analysts said.

The typical size of single-premium sales at AIA is about $50,000 per policy, with ticket sizes ranging from $3,000 up to $1 million "or even higher,” the Bernstein analysts wrote in a report Tuesday.

Prudential and AIA kept their sales centers in the Tsim Sha Tsui district of Hong Kong open late on Wednesday night to accommodate Chinese customers who wanted to buy policies before the UnionPay restrictions came into effect. Prudential’s office stayed open until 10 pm, and AIA until 9 pm, several hours beyond the normal 6 pm closing time, according to the firms’ customer-service staff at the sales centers.

The curb could be a blow to insurance agents such as Raymond Ng. Spending up to a third of his time in China looking for clients, Ng once sold a policy of HK$2 million to a mainlander. About half of his Chinese clients have bought so-called saving insurance products, which can allow policyholders to get back more than 80 percent of their money in the first year when they cancel the policy, provided they paid their premiums in full at the beginning.

Even if the buyer holds on to it, the insurance policy can provide about 4 percent annual return each year, which compares a fixed deposit rate of about 1 percent, Ng said.
The curb could also hurt the business of insurers such as Prudential which reported an 84 percent increase in its "annual premiums equivalent" sales from Hong Kong in the first half of 2015, compared with a year earlier. AIA’s value of new business in Hong Kong rose 29 percent in the same period, according to its interim report.

Shares Fall
Shares of major Hong Kong-listed insurers closed about 5 percent lower Wednesday following news of the China regulator’s move. AIA slumped as much as 9.4 percent, Prudential dropped 7.5 percent, after being halted in London trading the day before, and Manulife fell 6.2 percent.

Because the regulator stopped short of a complete ban, evading capital controls through UnionPay cards could still work -- for example a $100,000 policy can be purchased with 20 transactions, according to Hong Kong-based Credit Suisse Group AG analyst Charles Zhou.

"Shopping overseas is indeed difficult to control, while the authorities may check on their credit card transactions," said Capital Securities’ Zheng. "People may get questioned if they use their credit cards for too many times a day.”