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The China Report

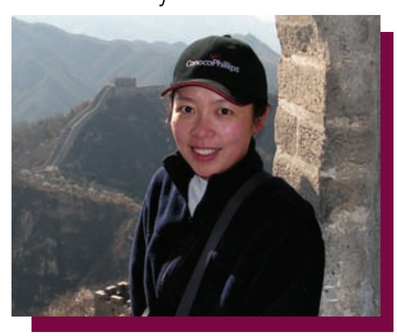
How a nation of 1.3 billion is coping with the accelerated new concept of insurance

Jessica Xie

Jessica Xie of Hylant Group's Large Account Practice traveled back to her native China this spring to provide a state-of-the-industry report in the fastest growing segment in the world. What she learned was encouraging, but to the uninitiated, securing favorable coverage often requires patience and a firm grasp of some widely unknown local customs.

Arriving early in my client's Shanghai office, its local directors and I caught up on personal news and proceeded to review the facility's new property insurance I had recently secured.

The client – a large U.S. manufacturer – had an interest in a joint venture with a local firm. By all reasonable measures, the partnership was stable and had routinely followed Western protocols.



But it wasn't long into my visit before we stumbled upon a disturbing fact: another policy somehow had already been secured. Unbeknownst to their American owners and to me, a local minority partner had purchased local coverage without notifying the U.S. managing partner.

The local insurance transaction was the result of a long-earned personal relationship, one of millions that drive the bulk of Chinese commerce nationwide. Blindsided, their American partners today are still working on the issues of the duplicate insurance coverage.

It was a valuable glimpse into a culture I've known all my life that has increasingly hidden behind a façade of Western business ideals. While China has miraculously transformed its economy, below the surface remains vestiges of old habits.

Only within the decade have most Chinese businesses seen the need for any insurance at all. The concept exploded a few years ago, when motorists were first required to carry liability insurance. Today, businesses and individuals are shopping for everything from whole life and health insurance to directors' and officers' liability coverage.

Brokers worldwide have rushed in, but have been limited by a joint venture as required by Chinese law. That restriction lifts next year, leaving the market to likely widen even farther.

Newly formed domestic carriers are dramatically undercutting their Western competitors with steep discounts. They have been quick to adopt Western cues, but I've discovered that low prices too often accompany poorly designed policies, badly worded contracts and seemingly absent claims services.

Nonetheless, foreign carriers continue to struggle for a competitive edge as the Chinese start to understand the value of a good policy. Agents of domestic carriers are everywhere, hocking coverage solely on the merits of price – on street corners and shopping plazas, hospitals and hotels. The offers are tempting and the promises convincing, but the services routinely deceive.

China, in fact, has no insurance professionals who were raised in the industry. It is simply too new. In fact, many state-owned carriers are run by former government bureaucrats, who jumped onboard overnight once the state saw the need. The same occurred within China's banking and brokerage industry, and the results were near disastrous.

As China's insurance industry consistently grows near 25 percent, government regulations and supervision have lagged behind. The industry still lacks financial rating systems, and while there have been no reported insolvencies, no funds are available should the need arise. The sense among consumers, true or false, is that the government would step in if needed.

Competition among domestic carriers is so fierce that low prices have rendered them powerless to provide reasonable terms. And while a few state-owned companies still dominate the market, it's getting harder to tell them apart.

For Western-based businesses, finding a well-known global carrier with a local presence is best advised. Many carriers often establish local sales agents without the support of claims and service representatives. While those companies should be avoided, they remain favorable over domestic carriers that offer little support at all.

Chinese customs continue to reemerge, even under the guise of large global carriers, which staff their offices with locally raised account executives. Training is often first on their agenda to offset this effect, but as I have seen, the industry is saddled with the habits of its environment.

The culture has long maintained a disdain for brokers in any industry. They are seen as worthless middlemen who drive up the price. Vendors often are chosen on existing relationships and referrals, rather than America's tendency toward empirical pursuit.

As the complexity of insurance continues to play a larger role in a company's bottom line, the need for American businesses to secure knowledgeable brokers is perhaps no more important than in an environment such as China.

This is especially true with larger, complex transactions, where brokers act more as consultants and less as sales agents. Sophisticated businesses are beginning to acknowledge this as they realize their existing policies don't fit their long-term needs for financial security.

Some American brokers bring to the table partnerships with knowledgeable representatives stationed in the area. The Worldwide Broker Network (WBN), for instance, provides instant access to local markets, armed with the street sense of Chinese customs and the intellectual cache of Fortune 500 firms.

China is an economic frontier that will continue to transform and affect a more substantial role in the world's economy. But as the rules change, basic assumptions should not be taken for granted. As for my manufacturing client in Shanghai, they are pursuing a way to cancel their backroom policy, which they now realize should never have been written in the first place. Ironically, during my trip, I uncovered 12 storage facilities leased by that same client with inventory not covered. They were seemingly minor exposures that simply slipped through the cracks of asset accounting.

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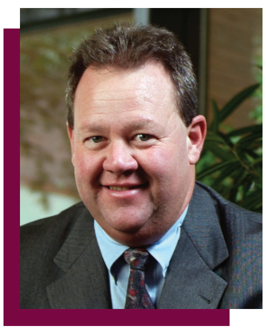
Personal Relationships Foster Consumer Savings

Forgotten Chinese business custom can elude Western investors at substantial cost



Rich Yarborough

While Western sales professionals widely acknowledge that personal relationships foster big deals, the practice is considered more a rite of passage in China, where relationships dominate a culture driven by whom you know and can dictate failure and success.

Conversely, astute consumers are equally keen to the notion that cultivating vendor relationships attract exclusive discounts and enhanced service. These ancient customs remain as pervasive today as ever in a country where capitalism was put on hold for half a century. Favorable premiums still are frequently sealed over the chill of cocktails and a firm handshake.

Even global carriers, as they descend upon the world's fastest developing market, employ local representatives engrained with these same ideals. It is not uncommon for similar businesses to pay entirely different premiums through well-known Western underwriters based on the broker-client relationships.

"Anyone shopping for business insurance in China would be remiss to discount the effects of personal relationships and what they mean to a company's bottom line," said Rich Yarborough, a vice president with the Hylant Group's Large Account Practice, who specializes in world markets. "It's an issue that Western businesses too often ignore when entering this market."

Yarborough recommends that Western businesses align themselves with large global underwriters that have an active presence in their area. They should seek professionals whom they trust and feel confident can cultivate an effective relationship before deciding on a final program.

"Relationships in the U.S. are important," he said. "But in China you can't just put out three bids and hope to get the best price. It just doesn't work that way."

China's Insurance Blitz

The nation's accelerated history of asset protection

Just a dozen years ago the very concept of insurance was nonexistent in the Chinese vernacular. State-owned assets negated the need, and few citizens held property worthy of protecting. Today, however, hedging financial risk rests firmly on the forefront of an explosive business culture, as the world market watches the smoke clear from a firestorm of new products, pricing and pitfalls.

It started just a decade ago, when motorists were mandated to carry liability coverage. Quickly, everyone with a driver's license was introduced to the value of insurance. Businesses and property owners saw a new need, as families secured life policies to protect their children.

Demand from a market of 1.3 billion piqued the interest of underwriters worldwide as well as enterprising domestic investors. In just a few years, the Tory notion of financial indemnity had infiltrated a socialist state larger the whole Western world combined.

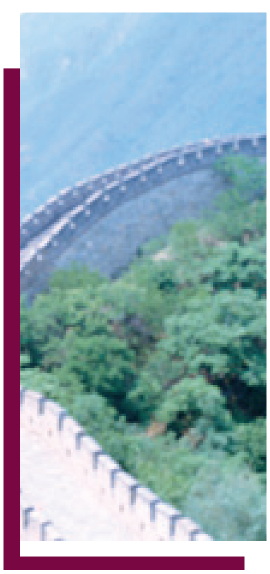
Local customs and cultural mores soon found their place, but foreign investors with Chinese holdings have been left to interpret how best to navigate the uncharted risks of a nation still struggling with its own identity.

In a wash of cultures, Western businesses today are lured by deep discounts offered by newly formed Chinese carriers. Though, the services and claims frequently fail to impress Western expectations.

Global carriers have established a presence throughout China, and with them come much of the same pricing, services and adjustments that the United States and Europe have come to expect.

But global carriers have been restricted by state policy forbidding foreign companies from offering insurance in China. Joint ventures with domestic companies have been required for foreign entrée and often limit an outsider's ability to complete.

That all changes in 2007, when the restrictions lift and the market opens.



China's Insurance Timeline

While insurance in the United States and Europe has evolved slowly throughout the past two centuries, its history has accelerated dramatically in China, where in just eight years it has swept the nation and drawn attention from investors around the world.

Mid 1980s - Deng Xiaoping opens market to private insurers

1992 - The first foreign insurance company, AIG, was licensed to write life and non-life policies in Shanghai based on a joint venture it established with a Chinese partner

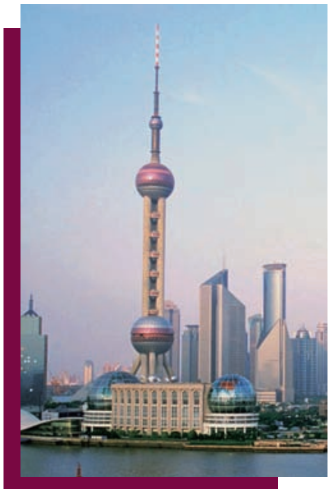
Circa 1997- Several more foreign companies establish joint ventures and receive licenses to sell insurance in China

1998 - Government establishes the Chinese Insurance Regulatory Commission

2002 - China joins the World Trade Organization and agrees to open the insurance market completely in 2007

2006 - Drivers' insurance is mandated for drivers nationwide

2007 - Foreign brokers will be allowed to establish wholly owned operations in China subject to certain requirements



Chinese Insurance Facts At a Glance:

- China's Insurance industry has grown an average of 26 percent for the past 10 years.
- Total premiums in China were $60 billion in 2005, and expected to reach $100 billion by 2009
- About 40 foreign insurers are established in Beijing, Shanghai, Guangzhou and Tianjin, including AIG, Liberty Mutual and MetLife. About that many private domestic carriers are also established in developed cities.
- Foreign insurers will be allowed to sell policies in 2007 without the need for a Chinese joint venture. It was a condition of China joining the WTO in 2002.
- Know the Rules of the Game
- The China Insurance Regulatory Commission (CIRC) recently issued its guide of all current and past insurance laws and regulations. For a copy, visit www.circ.gov.cn. When there, choose the English option at the top right corner, and click on laws and rules.

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