

MARSH

June 2007

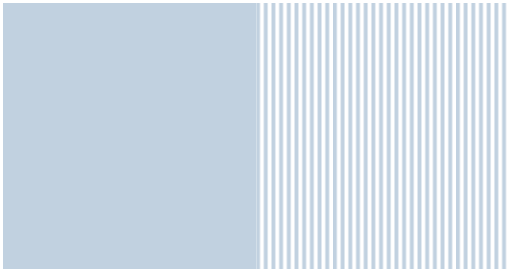
General Introduction to Risk and Insurance in China

Presented by Paul Wilkins
Marsh China

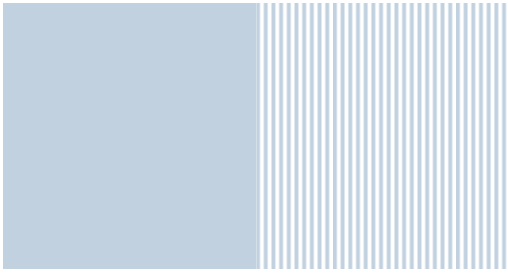


Agenda

- General Risk & Insurance Issues in China
- Overview of China Insurance Marketplace
- Some Discussion Items on Insurance Arrangements



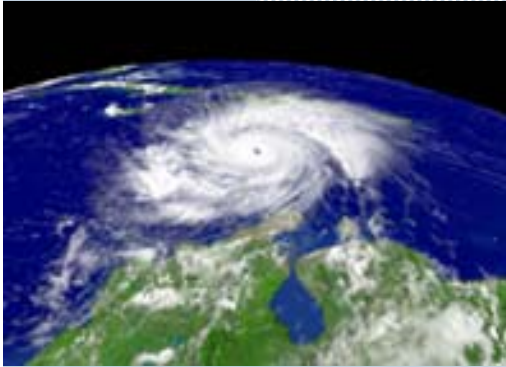
General Risk & Insurance Issues



Catastrophe Risk

Natural Disaster

Asia experiences the greatest regional number of natural catastrophes and fatalities globally

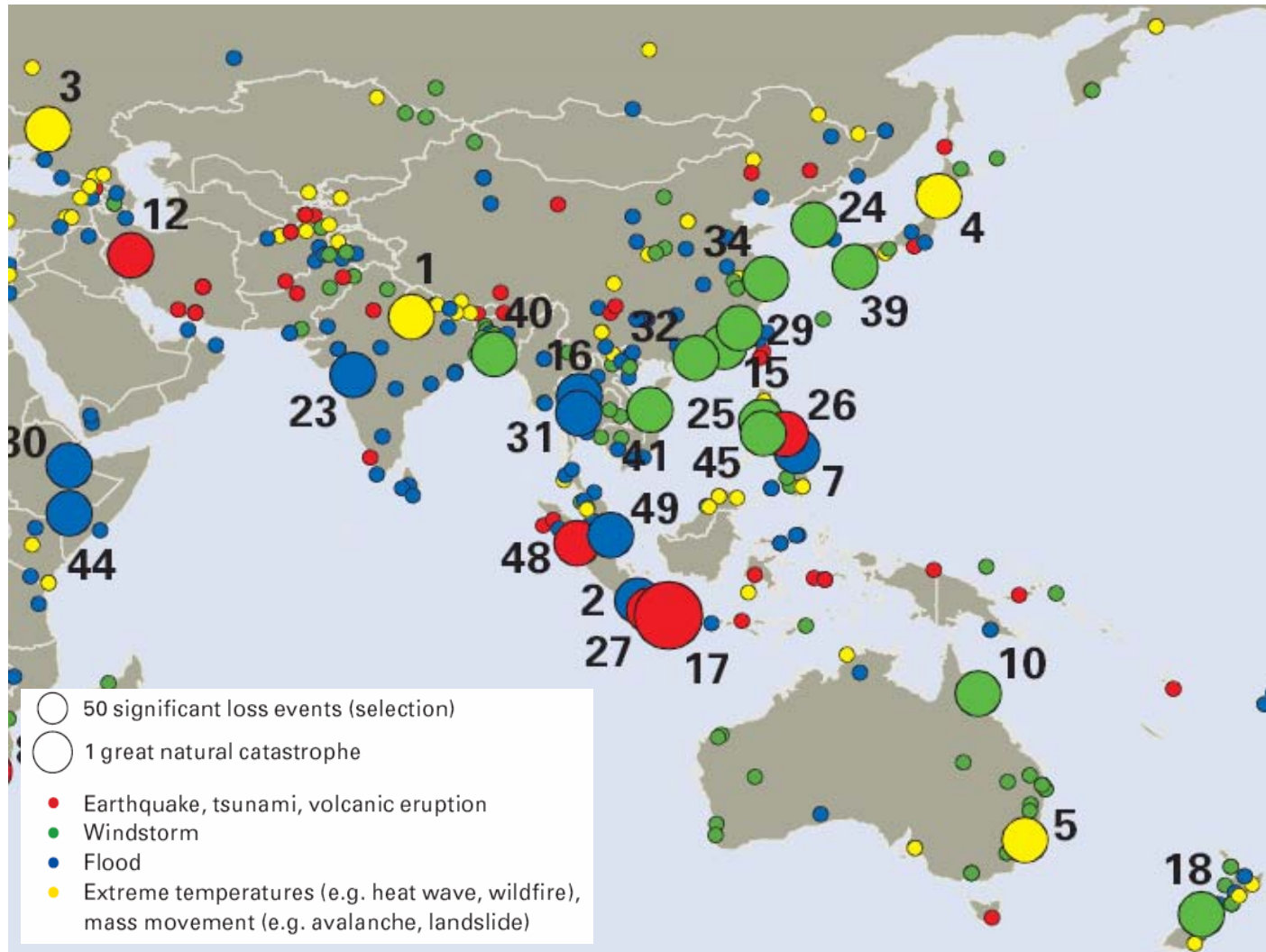


*Asia experienced 4,500 events ... experienced the **greatest number** of devastating and great natural catastrophes (225 events) ...*

*Asia was also **hardest hit** in terms of the **number of fatalities** (800,000). Almost 90% of these fatalities were caused by events in catastrophe categories 5 and 6 (devastating and great catastrophes).*

- Munich Re, Topics Geo 2005

Major natural disasters that may cause supply chain disruption include ...
Typhoon, Flood, Earthquake, Tsunami



Natural hazards in China

Estimated loss potentials vs. insured property loss

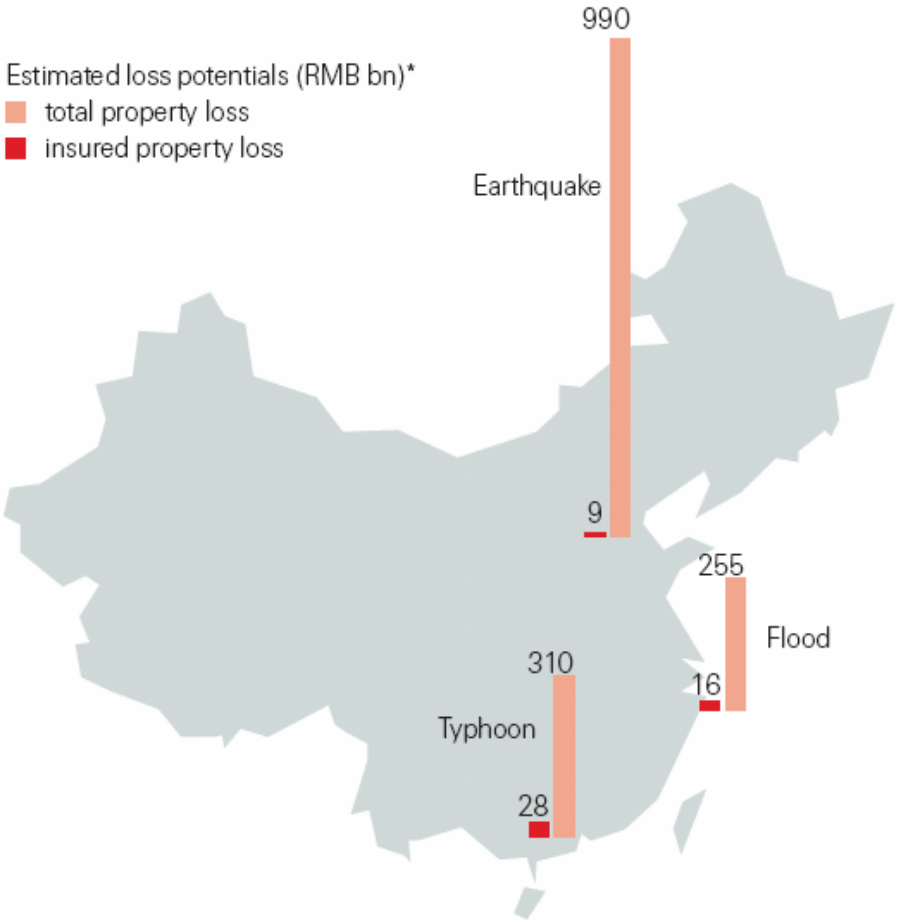


Figure 1: Estimated total property loss potentials and currently insured property loss potentials in China for the three main hazards of earthquake, typhoon and flood. Event loss figures represent a return period of roughly 200 years. *(Conversion: 1 USD = 8.28 RMB; 1 EUR = 9.20 RMB).

Natural hazards in China

Earthquake



Figure 2: Earthquake epicentre distribution in China. (© The Science Press and Beijing Normal University, 2004)

Natural hazards in China

Tropical cyclones

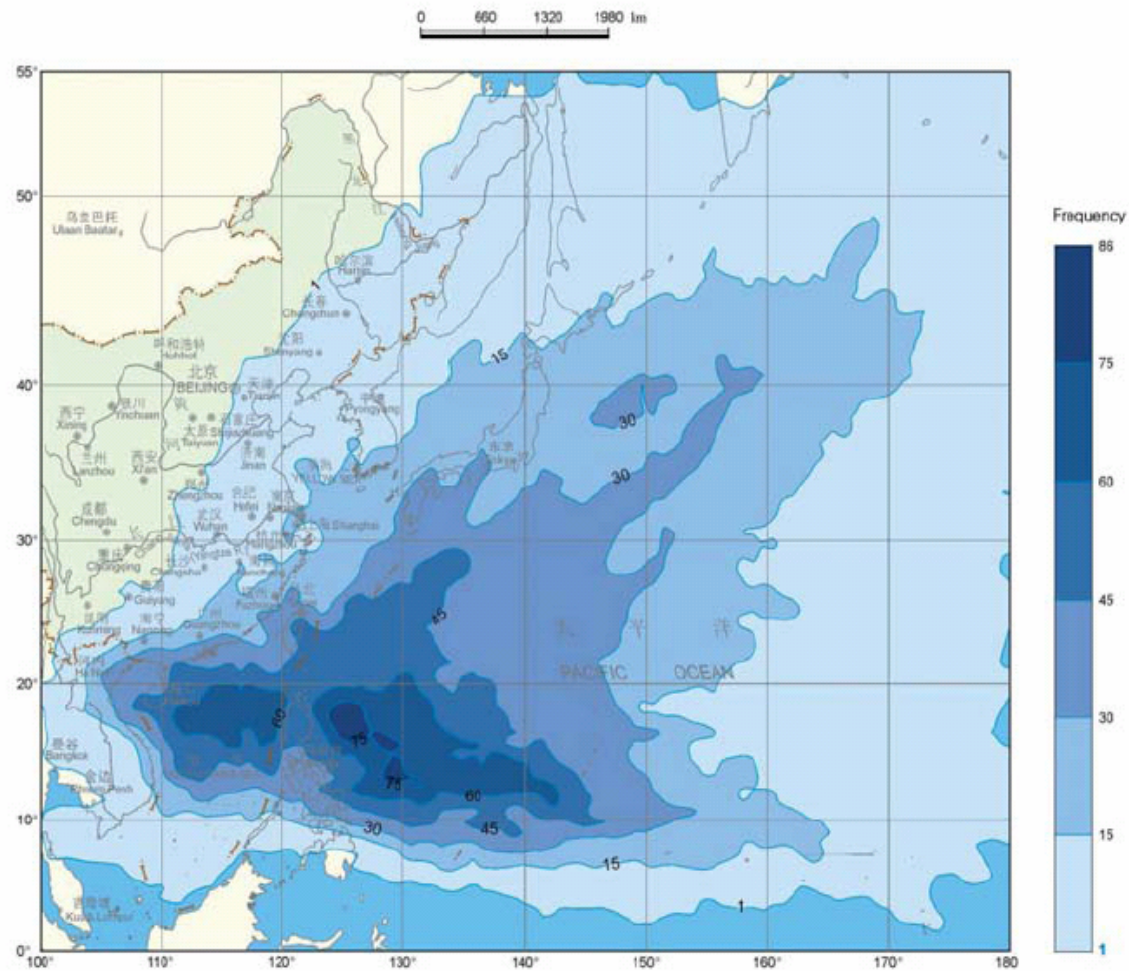


Figure 3: Track frequency of tropical cyclones in the northwest Pacific (1949–2000).

(© The Science Press and Beijing Normal University, 2004)

Natural hazards in China

Flood

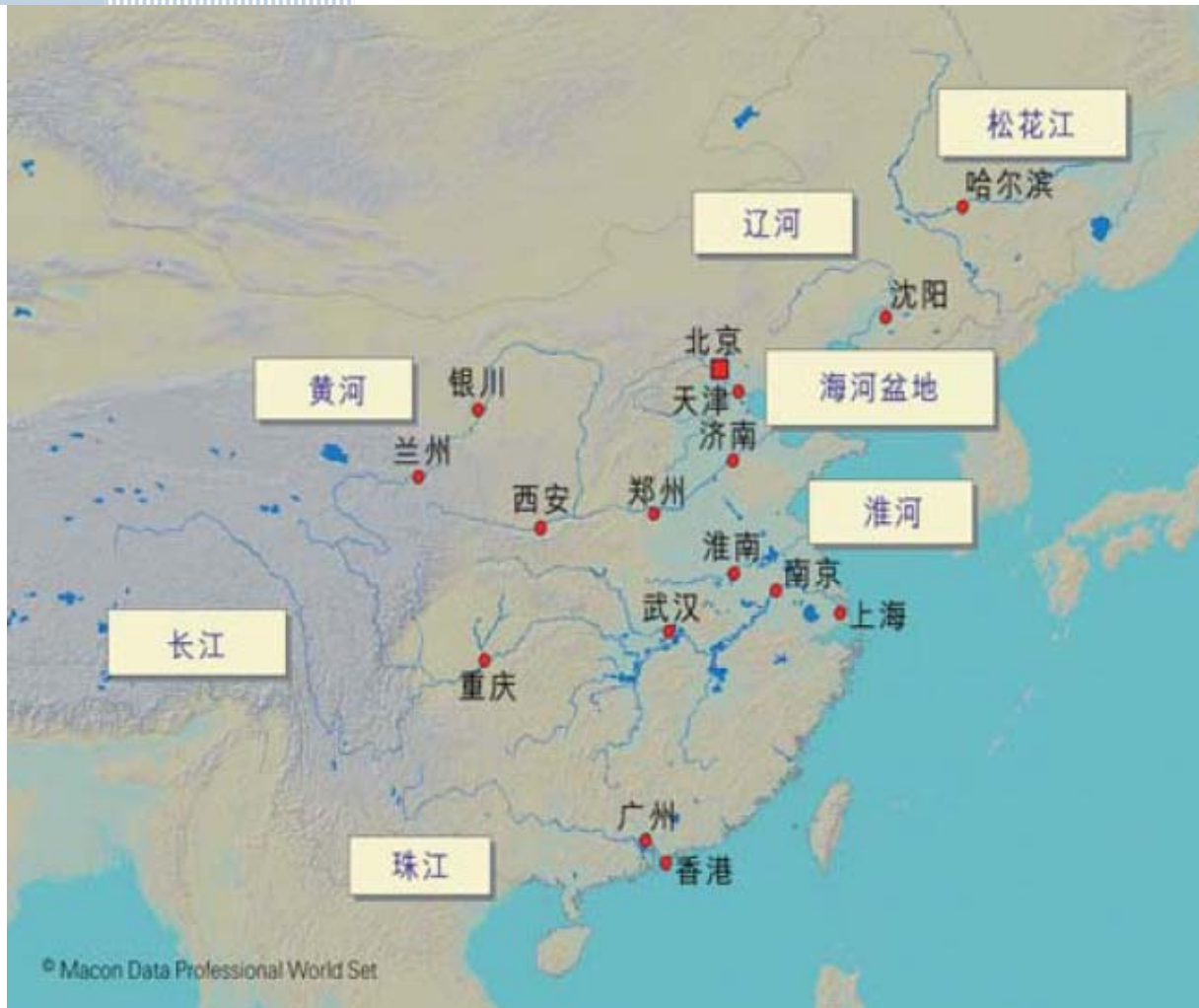


Figure 4: The seven major Chinese rivers/river basins exposed to severe flooding in the past. Among them the Yangtze, the world's third longest river.

(Source: Swiss Re, 2006)

Generic Risk Issues in China

- Low awareness of risk management across all quadrants
 - Strategic
 - Operational
 - Financial
 - Hazard
- Infrastructure risk is higher in emerging markets
 - higher still outside major cities
- Risk transfer market dominated by government-back insurers
- Risk transfer is traditionally purchased on a direct basis
- Few independent Loss Adjusters
- Broker – new concept with small market share

Risk Issues Facing Your Industry in China

- Operational Risk
 - Key Suppliers/Customers
 - Physical Protection
- Environmental Liability
 - Pollution under microscope
 - Employee Health
- Land Title Risk
 - 60% of all land sales in 2005 illegal according to the Ministry of Land & Resources
(Xinhua News Agency, 7 June 2006)

Risk Issues Facing Your Industry in China

- Fraud
 - Theft of monies (electronic & cash) by Employees is a high exposure both in terms of quantum and frequency in Asia and China specifically
- Political Risk
 - Foreign brands can be targeted
- Avian Flu
 - How does your company view this risk and has it taken any steps vis-à-vis BCP?
- Brand Protection
 - Even the most unlikely products are being copied and passed off as authentic

Risk Issues Facing Your Industry in China

Supply Chain

- Infrastructure Risk
 - Higher than average, especially away from the coastal cities
 - Logistics within China are inefficient and unreliable
- Legal Risk
 - Intellectual Property Rights are ineffectual and un-enforced
 - The “Rule of Law” is not independent and often political
 - Foreign interests are not treated fairly
- Recall Risk
 - Quality from suppliers is inconsistent
 - Counterfeiting of proprietary designs is rampant even by JV partners
 - China is the largest source of recall advisories & product failures

General Insurance Issues in China

Admitted Insurance

- Insurance must be placed with an insurance company licensed to conduct business in China for risks within the territorial limit of China, except:
 - International marine, aviation & transportation insurance
- 100% pure fronting is prohibited
 - some level of risk must be retained by the local insurance market

General Insurance Issues in China

Geographical Restrictions

- Insurance has to be purchased from an insurance company located in the same city where the risk is domiciled except for a “Large Commercial Risk”
- Definition of Large Commercial Risk
 - Total investment exceeds RMB150 million (Euro 15 million)
 - Total annual premium exceeds RMB400,000 (Euro 40,000)
- Large Commercial Risk can be placed
 - on a pan China basis (China Consolidated Insurance Program)
 - at insurer’s branch office with authorization from its head office.

General Insurance Issues in China

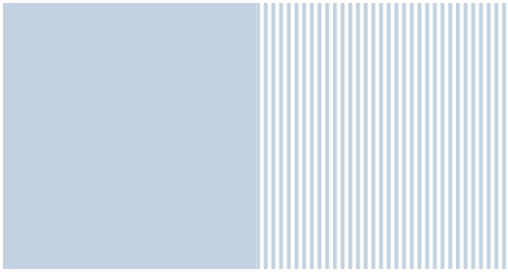
Compulsory Insurance

- Motor Third Party Liability
 - Liberalized the motor insurance market from tariff as from January 1, 2003
 - Compulsory Motor Third Party Liability Insurance under preparation to cater for the Road Traffic Administrative Regulations promulgated effective May 1, 2004
- Work Related Injury Insurance
 - Social scheme run by the state effective January 1, 2004, to be run by local governments (Social Insurance Bureau)
 - Dependent on various regions / provinces and at various stages of implementation
- Personal Accident for Construction Workers
 - Contractors are obligated to provide personal accident insurance for workers engaged in “dangerous” works on a construction site

General Insurance Issues in China

Reinsurance Regulation Change

- CIRC's new Reinsurance Business Administration Regulation which took effect on Dec 1, 2005 stipulates that:
 - All treaty and facultative reinsurance must be offered at least 50% of the amount to be reinsured to at least two reinsurance companies or four licensed reinsurance companies (Article 11)
 - The proportion of each risk ceded to the same one accepting companies shall not exceed 80% of the sum insured or liability of each risk (Article 12)
 - The proportion of each facultative reinsurance contract ceded to the enterprises which are affiliated to the insured (i.e. Captives) shall not exceed 20% of the sum insured or liability of the primary insurance business concerned (Article 12)
 - A foreign insurer must not engage in any reinsurance business with any of its affiliated enterprises without prior approval from CIRC (Article 22)



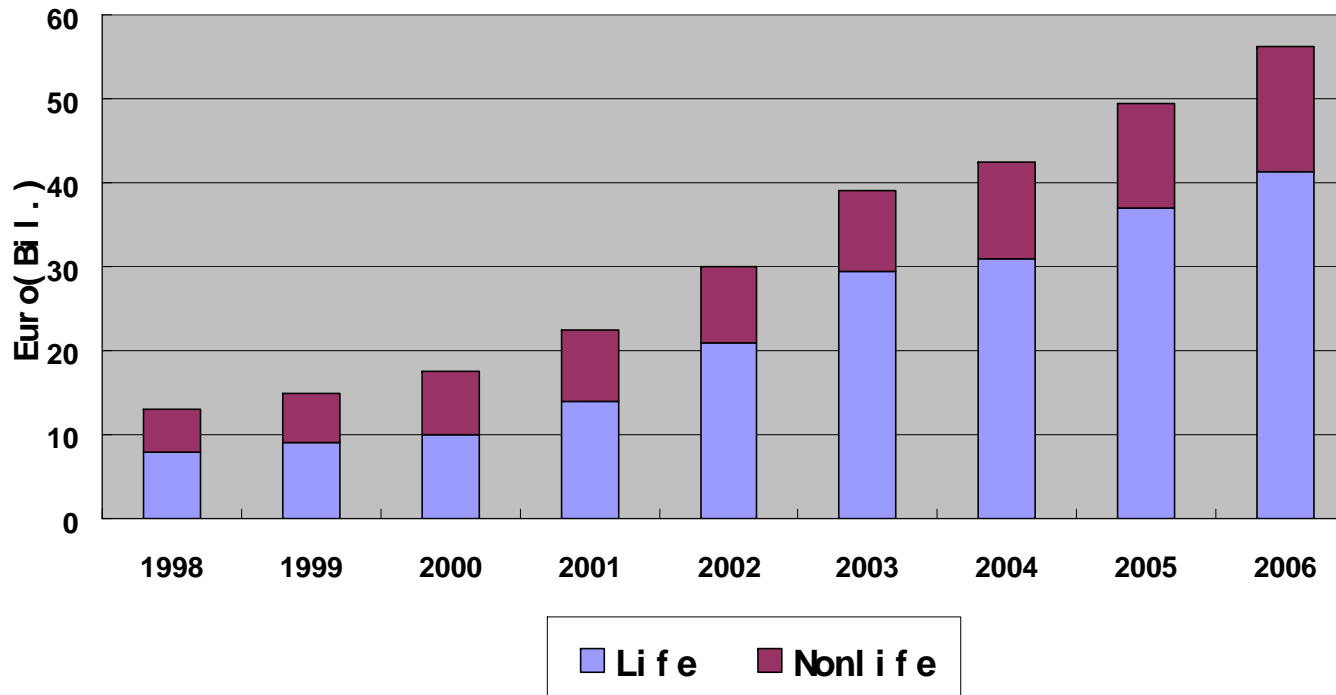
Overview of China Insurance Marketplace

Industry Overview

- In 2006 the country's insurance premium (Life +Nonlife) totaled RMB564 billion (Euro 56 billion)
- Growth rates of non-life insurance market have been between 20%-30% yearly, expected to continue for the next few years
- China is expected to be the 2nd largest insurance market in Asia by 2010 and 4th largest in the world by 2018
- Insurance penetration stands at a low 2.7% compare with other developed markets

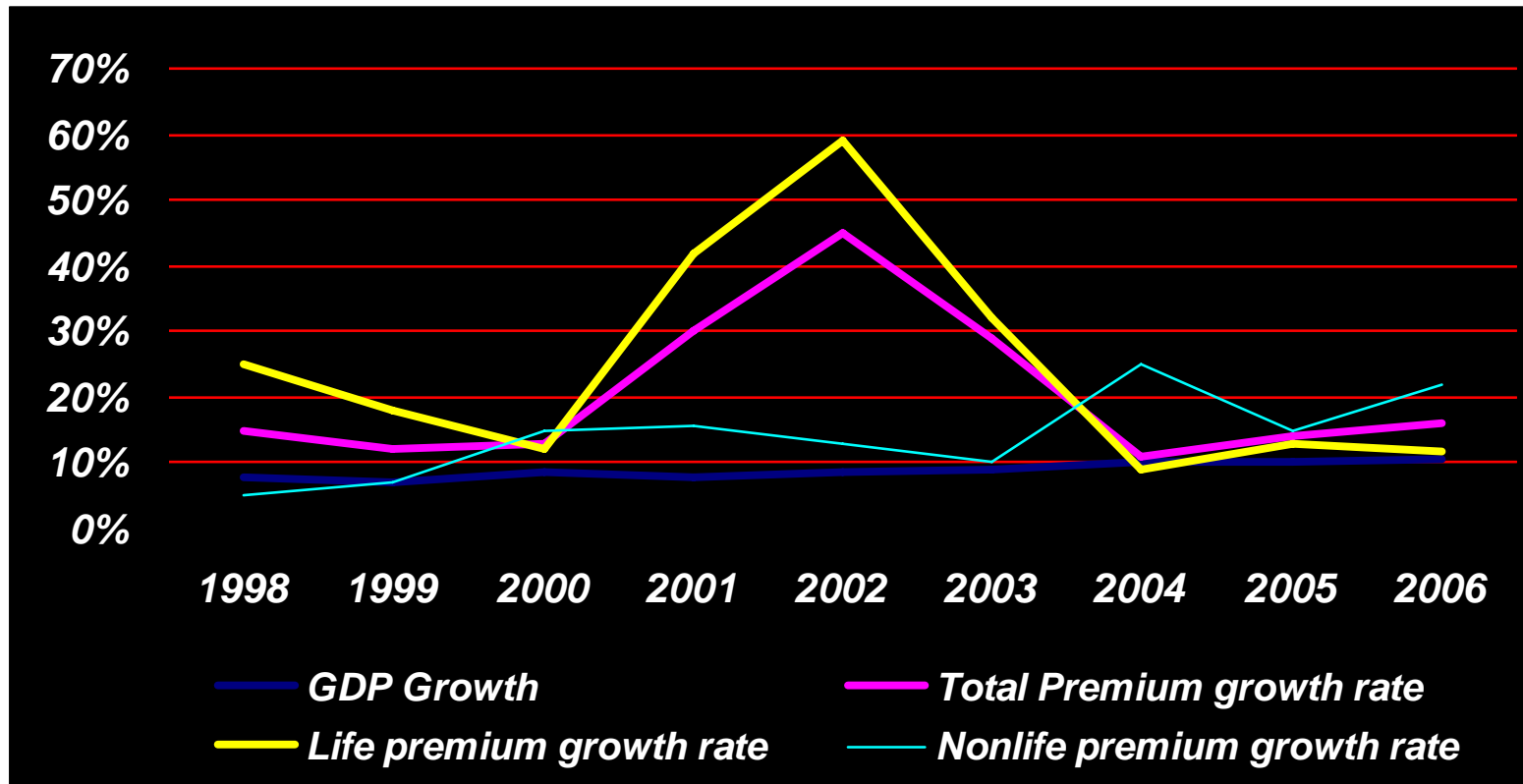
Insurance Premium Growth

Insurance Premium Growth



Source: S&P 2006 and CIRC Report

Premium Growth Against GDP



Source: S&P 2006 report

Industry Landscape

- Still dominated by Motor insurance (about 68% of total premium)
- The industry is expanding in terms of both number and type of company
- Top 3 Insurers currently have 70% combined market share, however, these shares have gradually decreased in recently years because of the higher growth rates of other companies
- PICC Property & Casualty Company Ltd. (“PICC P&C”)
 - 45% market share as of 2006
- Foreign insurers have very low market share

Non-Life Insurers operating in China

Local, existing

- **PICC** Beijing
- **CPIC** Shanghai
- **Ping An** Shenzhen
- **Huatai** Beijing
- **Tian An** Shanghai
- **DaZhong** Shanghai
- **Yong An** Xi'An
- **China United** Wulumuqi
- **Continent** Shanghai
- **Alltrust** Shanghai
- **Sinosafe** Shenzhen
- **Taiping** Shenzhen

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Local, startups

- **Bo Hai P&C** Tianjin
- **An Bang** Beijing
- **China Life P&C** Beijing
- **Sunshine** Beijing
- **Tian Ping** Shanghai
- **Du Bang** Beijing
- **Dong An P&C** Shenzhen
- **BOC** Beijing
- **Ming An** Shenzhen
- **Anxin** Shanghai
- **Huanong** shenyang

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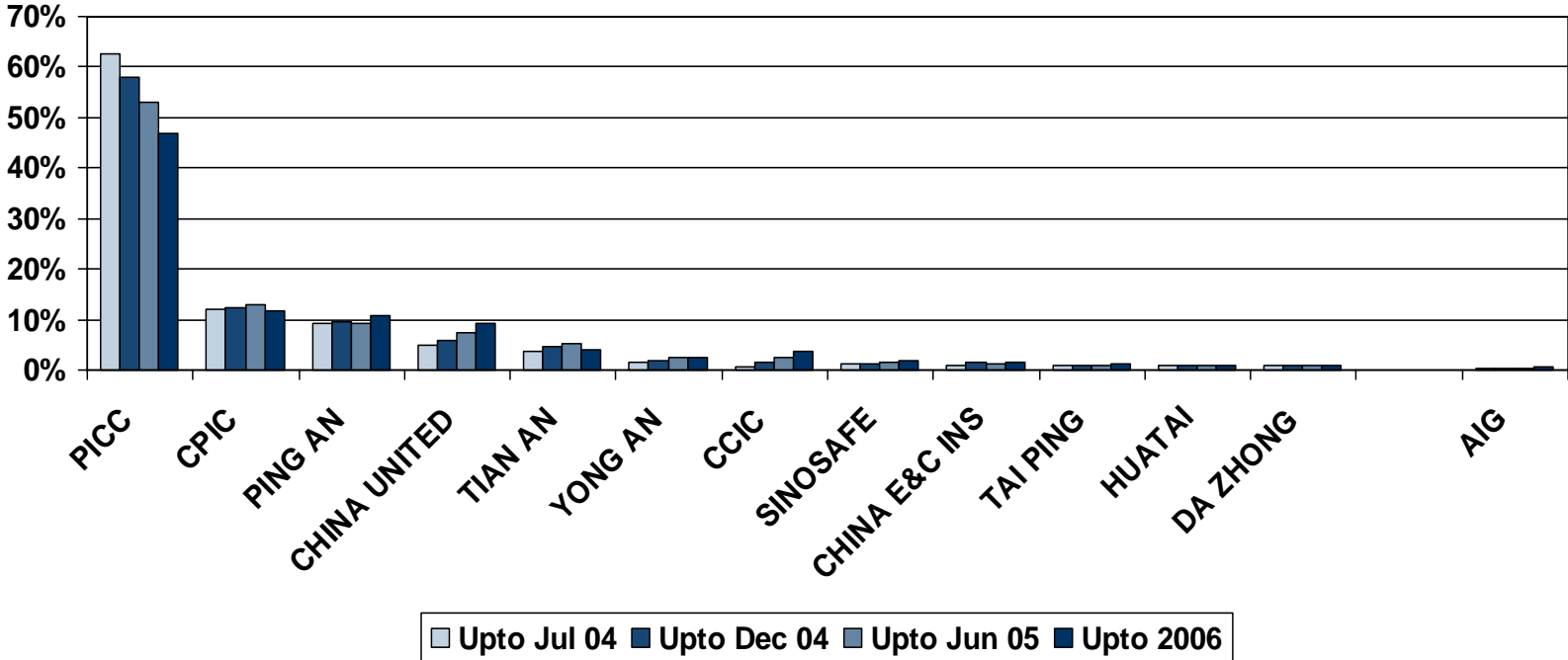
Foreign

- **AIG** Shanghai, Shenzhen
Guangzhou, Foshan
- **Winterthur** Shanghai
- **RSA** Shanghai
- **Chubb** Shanghai
- **Liberty** Chongqing
- **Tokio Marine** Shanghai
- **Mitsui** Shanghai
- **Samsung** Shanghai
- **Allianz** Guangzhou
Shanghai
- **Sompo** Dalian
- **Groupama** Chengdu
- **Zurich** Beijing

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China Non-life Market shares Movement

China Non-life Market Shares



Top 13 Domestic P&C Insurers in China (2006)

Unit Euro Million

Ranking	Company	Premium	Market Share	Security	Strategic Investors
1	PICC	712,993.67	45.12%	✓	AIG-18.9%
2	CPIC	181,226.87	11.47%	✓	IAG-24.9% ²
3	Ping An	168,624.71	10.67%	✓	HSBC-20.13%
4	China United	150,565.59	9.53%	✗	
5	Tian An	63,866.41	4.04%	✓	Millea ¹ -24.9%
6	China Continent	63,279.85	4.00%	✗	
7	Yong An	39,877.83	2.52%	✗	
8	An Bang	34,801.66	2.20%	✗	
9	SINOSAFE	28,313.16	1.79%	✗	
10	SINOSURE	28,020.18	1.77%	✗	
11	TAI PING	20,517.12	1.30%	✓	
12	SUN SHINE	17,509.68	1.11%	✗	
13	HUA TAI	14,777.69	0.94%	✓	ACE-22.1%

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¹- holding company of Tokio Marine; ²- regulatory approval pending

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Top 10 Foreign P&C Insurers in China (2006)

Unit Euro Million

Ranking	Company	Premium	Market Share	Operations	S&P
1	AIG	6,981.29	0.44%	Shanghai Guangzhou Shenzhen Foshan	AA+
2	Tokio Marine	3,001.87	0.19%	Shanghai	AA-
3	Min An	2,414.23	0.15%	Shenzhen Haikou	BB+
4	Mitsui Sumitomo	1,822.35	0.12%	Shanghai	AA-
5	Samsung Fire	1,566.45	0.10%	National-wide	A+
6	Allianz	1,227.41	0.08%	Guangzhou	AA-
7	BOC Group	1,217.73	0.08%	Shenzhen Beijing	NR
8	Royal SunAlliance	1,035.98	0.07%	Shanghai	A-
9	Federal Ins. (Chubb)	645.12	0.04%	Shanghai	AA-
10	Winterthur	593.62	0.04%	Shanghai	A-

China Reinsurance Market

Licensed reinsurers

- China Re
- Munich Re (July 2003)
- Swiss Re (December 2003)
- Gen Re (July 2004)
- Lloyd's (2006)
- Scor

Other reinsurers active

- Everest Re
- Allianz Re
- Transatlantic Re
- Partner Re
- Toa Re
- Odyssey Re
- AXA Re
- ...

Business Restrictions within China

- Non-admitted insurance is not allowed
- Branches are not allowed to cover risks outside their designated area
- Nationwide policies may only be issued for:
 - Large Commercial risk: defined as investment value in excess of RMB150m (Euro 15 million) and annual premium expenditure in excess of RMB400,000 (Euro 40,000)
 - Inland cargo
 - Coinsurance
 - Master policy (not applicable to motor, credit, guarantee and nuclear power risk)
- Insurance intermediaries are not allowed to operate in China without a licence and not allowed to place business with non-admitted insurers

Market Security

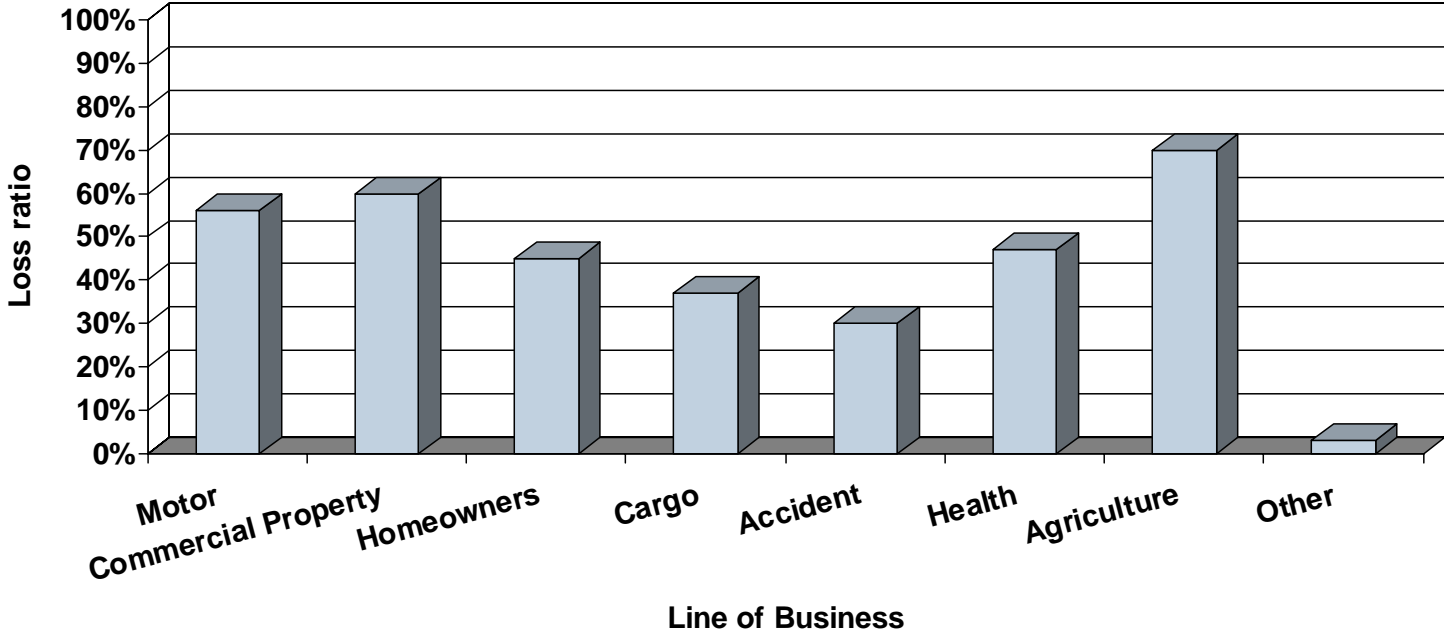
- Security of Main Domestic Insurance Companies
 - No Rating by Rating Agencies like A. M. Best, Standard & Poor, Moody etc.
 - Security Mechanism Developing
 - Internally,
 - Corporate governance change
 - Shareholding and IPO driven
 - Profit Orientation
 - Tightening operation control over independent regional offices
 - Professionalism - managerial & technical
 - Extensive network/market domination
 - Expanding capacity/assets
 - Reinsurance stabilization

Market Developments

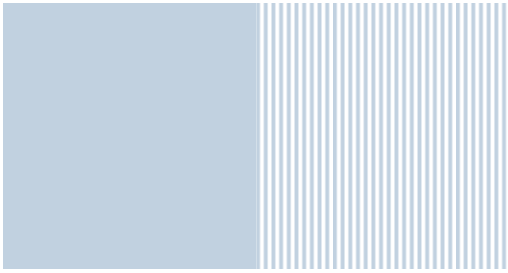
- Fiercely Competitive
 - Rates up to 50% below international levels for PD/BI
 - Regulator now pushing Insurer Association to impose minimum premium rates
- Liberalization
 - More new entries
 - Business scope
 - Geographical limit
 - larger insurers start to be interested in risk offshore (very cautiously)
 - Investment (certain Life insurers now being permitted to invest offshore) and Asset Management
- Expanding Underwriting Capacity
 - Property US\$ 1 billion,
 - Casualty US\$ 1-10 million locally then Umbrella

Loss ratios

Average Market Loss Ratios



Source: CIRC 2005 report



Some Discussion Items on Insurance Arrangements

Cost Saving Opportunities

- Reducing Insurance Costs

- Global program vs local carve-out
- China Property insurance best candidate
 - Plenty of capacity
 - Highly competitive (rates significantly below international averages)
- Whilst premiums are cheap, local markets lack S&P ratings (or similar)
 - PICC, CPIC & PAIC (the top 3 insurers) meet Marsh guidelines
- Marsh can work to ensure best possible coverage is obtained (i.e. not using local standard wordings) though some coverage such as CBI is limited
- Liability limits and coverage still quite restricted in China

Other Insurances for Consideration

- Other insurances that are valid for MNCs operating in China
 - Fidelity Guarantee
 - White collar crime is a high frequency loss issue
 - D&O
 - Two issues to consider:
 - Ability of company to indemnify a Director
 - Ability for a non-admitted policy to pay a claim
 - What is the ABC Co global approach to indemnifying Directors?
 - What does the global D&O policy cover (Side A & B)?
 - Chinese companies law allows for indemnification, however regulations against non-admitted insurance make paying a claim from offshore a complicated and not strictly compliant process (i.e. cannot be seen as insurance proceeds)

Other Insurances for Consideration

- Other insurances that are valid for MNCs operating in China
 - Local Transit
 - But only if values at risk are sufficient to be of concern to ABC Co
 - Risk Management and Loss Control might be better investments of time & money

Non-Controlled JVs

- A potential minefield if JV participant is local Chinese company and they control the insurance purchasing:
 - May not actually buy insurance
 - If they do, they view it as a “favor” to the insurer
 - Off-the-shelf coverage based on 20 year old PICC wordings
 - Will be limited to Fire of Property All Risks insurance, possibly Public Liability, plus the mandatory insurances (i.e. WC & Auto Liability) with minimal or non-existent deductibles
 - Probably direct with insurer and not entirely transparent
 - Highly likely that the insurer is local, has no S&P rating, and possibly a relatively new start-up with no track record
 - D&O – only if firmly dictated by the MNC participant

Loss Control - Property

- HPR and similar loss control measures receive little, if any, recognition by Chinese insurers
- Local insurers love to survey their insured risks but it's restricted on the whole to a “check box” walk around of the site
- Primary benefit will be to ABC Co's own assessment of risk, though it may allow ABC Co to make more informed decisions on:
 - Loss Limits
 - MFL
 - Risk Retention levels

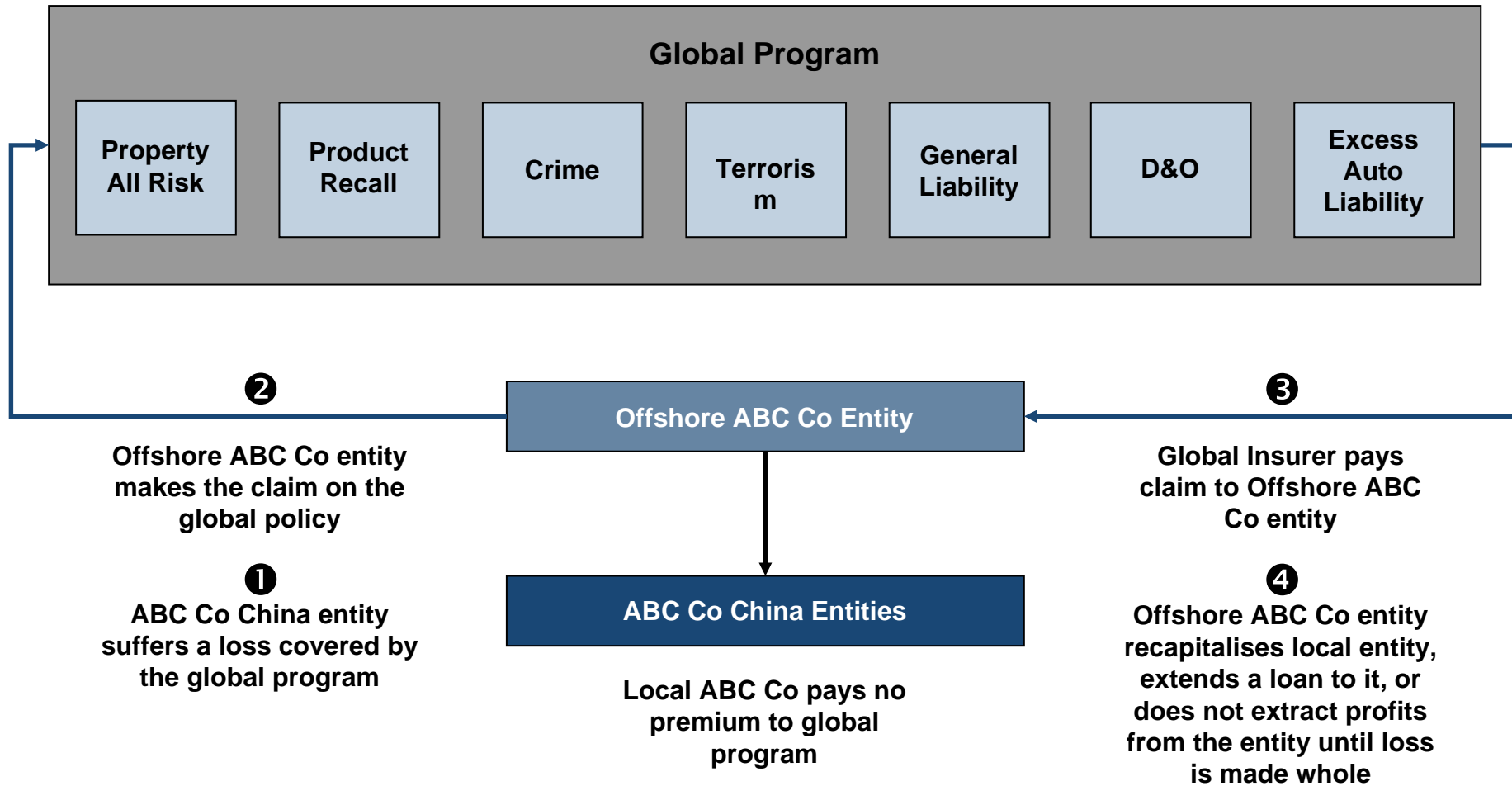
Loss Control - Logistics

- Does ABC Co have an understanding of its loss record in China?
 - If so, has any analysis been done on the frequency, nature and quantum?
- Logistics in China are very much founded on owner/driver carriage with the international freight-forwarders focused on Import/Export
 - Local carriers' standards are mixed at best
 - A sure fire way for your product to wind up on the commercial black market
 - The consumer black market is well known, but there is a thriving black market for commercial goods
- Tight logistics controls are vital (both inwards & outwards)

Master Insurance Program

- Master Insurance Program for China
 - Objectives:
 - Consistent coverage & pricing
 - Centralised leverage with insurance market
 - Reduce potential for gaps across entities
 - Apply ABC Co global philosophies to risk retention/coverage
 - Reduce administration for ABC Co & Marsh
 - Requirements:
 - Entity buy-in
 - Central focal point within ABC Co China with appropriate authority

Program Structure Option 1

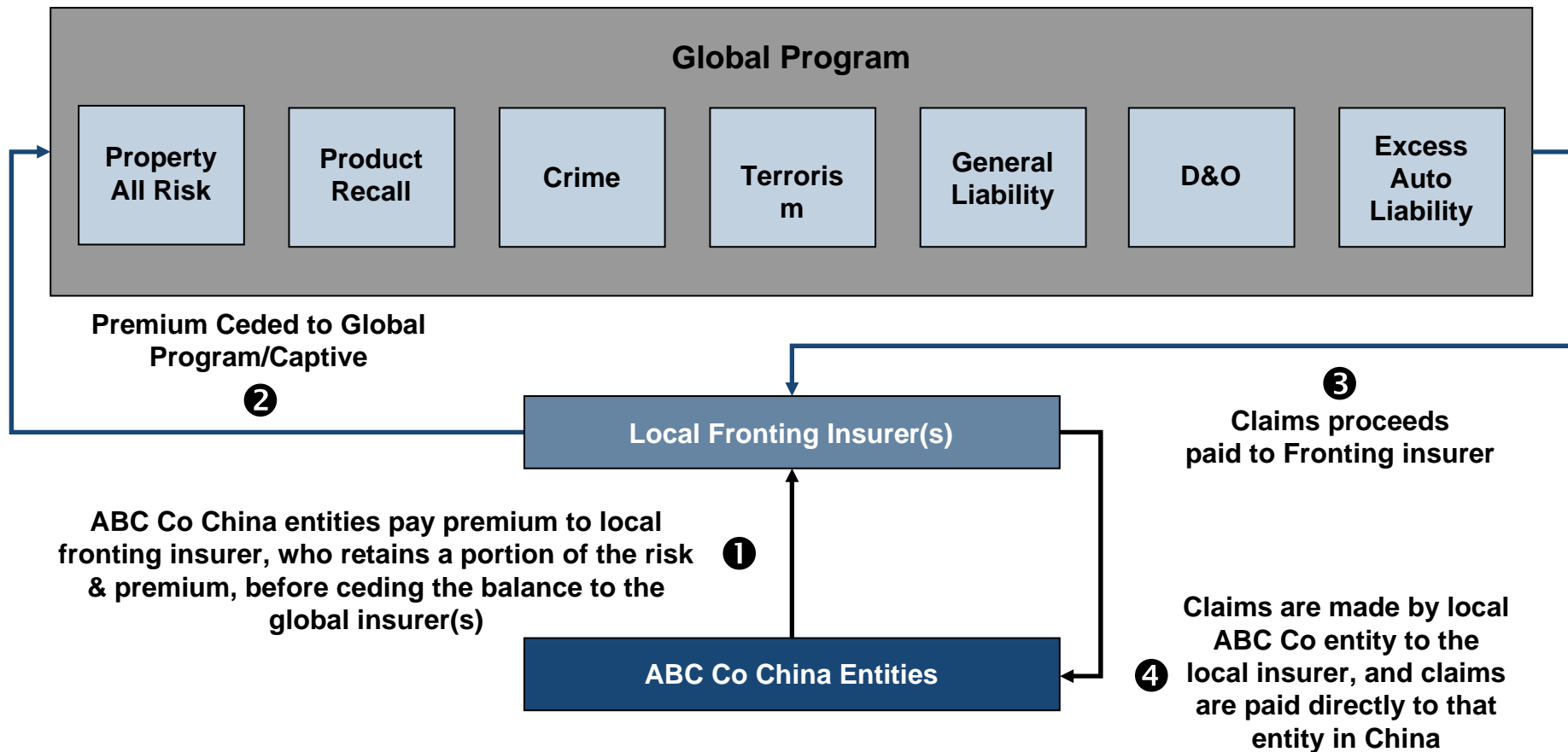


Program Structure Option 1

Advantages & Disadvantages

- Advantages:
 - Full coverage of the global Programme applies to the China entities
 - Maximum purchasing power of ABC Co is brought to bear with the global insurers
 - Premium efficiencies by eliminating the need to purchase additional local policies
 - Insurers with acceptable security ratings
- Disadvantages:
 - Not strictly compliant with Chinese insurance regulation, though the same regulation does not mandate that a company must purchase insurance (other than WC & Auto Liability)
 - Cannot provide proof of insurance showing local entities as the Insureds (i.e. a certificate could only show the parent company)
 - Sometimes this is not acceptable to the party requiring the certificate
 - ABC Co cannot charge global policy premiums to the China companies
 - The local ABC Co companies cannot make a claim directly on the global policies. Instead, the claim needs to be lodged by a ABC Co company outside of China, and the claims proceeds will be paid to that company
 - How to repatriate the funds into the Chinese operations?
 - Recapitalisation
 - Inter-company loan with favourable terms
 - ABC Co not extracting profits from the affected operation until its revenues make it whole again
 - Tax issues on the above?

Program Structure Option 2

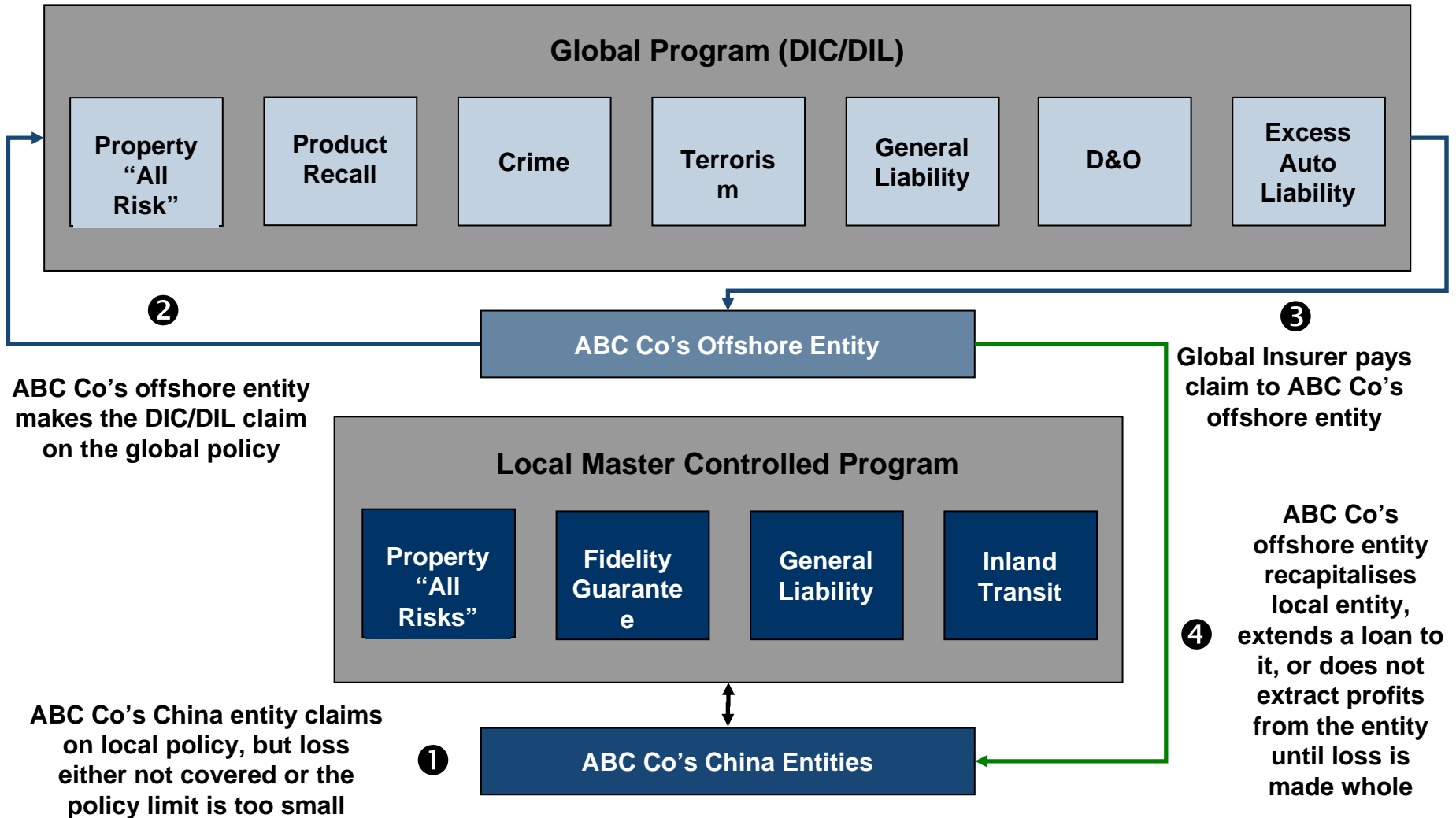


Program Structure Option 2

Advantages & Disadvantages

- Advantages:
 - Full coverage of the global Programme applies to the China entities
 - ABC Co still maintains a high level of control over its market leverage
 - Insurer security on the Programme maintained depending on local fronting partner
 - Claims can be made by and paid to the local ABC Co companies
 - Premium can be allocated to & paid by the local ABC Co companies
- Disadvantages:
 - Frictional costs such as fronting fees are incurred
 - Premium that could be in the global Programme is retained locally by the fronting partner
 - If the fronting partner is a Chinese insurer then that company will not have a security rating (i.e. S&P, AM Best, Fitch or Moody's)
 - The regulations on reinsurance could apply

Program Structure Option 3



Program Structure Option 3

Advantages & Disadvantages

- Advantages:
 - Full coverage of the global Programme applies to the China entities
 - ABC Co can enjoy the premium rate levels available in China (particularly for Property All Risks). Claims can be made by and paid to the local ABC Co companies
 - Premium can be allocated to & paid by the local ABC Co companies
- Disadvantages:
 - If the global DIC/DIL coverage attracts a high premium charge it could render the local China premium levels inefficient
 - Premium that could be in the global Programme is retained in the Chinese market (i.e. global leverage diluted slightly)
 - ABC Co cannot charge any DIC/DIL premiums to the China companies
 - The local ABC Co companies cannot make a DIC/DIL claim directly on the global policies. Instead, the claim needs to be lodged by a ABC Co company outside of China, and the claims proceeds will be paid to that company
 - How to repatriate the funds into the Chinese operations?
 - Recapitalisation
 - Inter-company loan with favourable terms
 - ABC Co not extracting profits from the affected operation until its revenues make it whole again
 - Tax issues on the above?
 - Whilst the Chinese insurers are currently imposing very low premium rates, totally out-of-step with the international market, they also do not have independent security ratings

Captive Use

- Captive use
 - Refer to Admitted/Non-admitted regulations plus Reinsurance regulations
 - Potential ceding effectively limited to 20% of risk
 - Some insurers hinting at methods to broaden this

