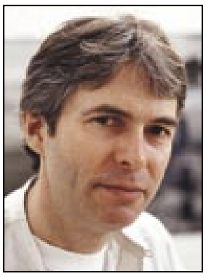

The China Syndrome

Recently in China for the official opening of the Lloyd's Chinese reinsurance operation, **Mr Alex Letts**, Chief Executive of electronic trading service RI3K, gives his insight on what might lie ahead for the Middle Kingdom.

As the digital readout reaches 431kmh, the MagLev train is an immediate analogy for the economic G-forces that are a fact of life in China. Rocketing along the 30km stretch from Shanghai Airport into the outskirts of the city in a breathtaking seven minutes, the thought strikes you that if the MagLev were to come off the rails, it might cause quite a mess. Or is that the Chinese economy? In all the reports of the miracle of consecutive years of 10%+ gross domestic product (GDP) growth, the commentary glosses over the train smash ahead for the global economy if the fast-inflating Chinese bubble were to burst.

The numbers after all are quite terrifying. Wherever you look, China is gobbling up market share: 10% of the world's total manufacturing output; 80% of the world's orange juice; 50% of the world's shoes; and so on. One in five people on earth live in China. The biggest city in the world, Chongqing, has 30 million people and nobody in the West has ever heard of it. Shanghai itself houses the equivalent of one-quarter of the entire UK population. Meantime, Shanghai is like Manhattan-on-steroids, with a skyline at night that takes the breath away, and which by daylight has a skyscraper density that stretches for as far as the eye can see in all directions.

Growing Insurance Industry

Within this blazing environment, the insurance industry is its own astonishing Triffid. The game at hand is vast even by Chinese standards, as the industry itself is undeveloped relative to the economy. Hence, you have both the 10% GDP annual growth engine with an immature market sitting on top. Double whammy.

Mr Chuck Poujian is Chairman/CEO of Tianan Insurance. He founded Tianan in 1995. With US$1 billion of premium, Tianan may not be large today on a European scale, but it is already the fifth-largest non-life insurance company in China and in the top 500 Chinese companies. Mr Poujian told us that the industry is growing at 25% per annum, and we got the impression that Tianan is growing ahead of that pace. He hopes that Tianan will be in the top 500 companies in Asia "very soon", and after that, the thought which was left hanging in the air was that the Top 500 corporations in the world was a realistic goal.

Reinsurance Risks

In truth, for reinsurance, the figures are today still less than spectacular. Benfield reported a non-life insurance market of around $16 billion in 2005, of which one Chinese insurer said that about 20% was ceded as reinsurance ($3-$4 billion). Expect that to be $10 billion ceded in seven years' time. For some years, only small bits of this have been ceded to markets such as Lloyd's in London through the global broker networks.

Today the restrictions on exporting currency in the form of ceded reinsurance premium have been lifted. You have only to see the size of the Chinese trade surplus to understand why – in 2005, it was $140 billion just with the US, and heading northwards: $25 billion in October 2006 alone. Reinsurance is a useful tool in the economic balancing act ahead for the Chinese.

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The Chinese are working hard to attract world-class western financial institutions, and insurance companies and reinsurance companies are included as a big component of this policy. Marsh was recently granted its national licence to operate in China. Most interestingly of all perhaps, Lloyd's has put down its roots in Shanghai and has recently obtained its reinsurance licence.

The Truth is out There

Opinion is divided about the quality of the Chinese reinsurance business on offer. The armchair economists tell chilling stories about one of the biggest reinsurers being hammered on a major proportional treaty deal. "Crap business" will be the only export. The canny locals will cynically manipulate reinsurers. One broker also explained that property fac rates were happily written locally at 0.01% rate on line, suggesting that the overseas reinsurers will spurn such a low-value, high-risk game.

However, converts to the inevitability of the Sino-economic hegemony take a more cerebral view. Catlin has apparently had representatives in Shanghai for the past seven years, quietly and patiently laying the foundations for a new epoch and new markets.

Lloyd's, under local CEO Ian Faragher, a long-time veteran of Asian markets, is planning to integrate itself into the local insurance community. This is not a bubble-chasing gamble but a determination to invest for the long term, to get one's feet on the streets of Shanghai, Beijing, and the outlying areas, to learn the way to make money in this new economy.

None of these have the greedy eyes of gold prospectors, but rather the opposite, a calm assurance and a realistic set of expectations. They understand that those fac rates are low for some reason, and they intend to find out how it is that the local reinsurers run these accounts with healthy margins. You cannot do that from an office in London or a box on Lime Street.

As the MagLev decelerates smoothly down to 300kmh, you cannot help but wonder if the Chinese authorities will manage to slow down their economy with such control. Our train ride was unbelievably bump-free, but life and economies are never that predictable. The ever-present threat of Severe Acute Respiratory Syndrome (SARS) and Avian flu would suggest potential derailments ahead as the population flow to the cities streams endlessly on.

More pressingly, and as the Government has recognised, the imbalance of wealth in China has seen the rural areas remain disadvantaged and potentially restless. An easy passage through the next few years is unlikely for the Mainland, but its problems are good ones to have. For the reinsurance companies that buy their ticket today, the ride, though turbulent and at times both scary and expensive, will almost certainly prove to be the best investment they ever made.