

# THE BUSINESS OF INVESTMENT INSURANCE IN CHINA



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*This article has been contributed by Sinosure, China Export & Credit Insurance Corporation.*

## Background

Over the past 20 years, China has achieved tremendous economic growth. With China's integration into the global economy and entrance into the World Trade Organization, Chinese enterprises have accelerated their pace of investing overseas. According to data from the Ministry of Commerce, by the end of 2006 Chinese enterprises had launched more than 10,000 operations abroad, involving a total investment of US\$73 billion, with over US\$16 billion in 2006 alone. Some recent M&A transactions, such as Lenovo's takeover of IBM's Personal Computing Division and China National Petroleum Corporation's US\$4.2 billion acquisition of Petrokazakhstan, have attracted the attention of the business world.

In 2002, the Government of China put forward the so-called 'Going Global' strategy to encourage domestic enterprises to invest abroad, in an effort to utilize better markets and resources overseas for sustainable economic development. To encourage overseas investment, various ministries and departments developed favorable policies and initiatives, including information sharing networks, domestic tax breaks, more liberal regulations and simplified approval procedures. Financial institutions, such as China Exim Bank, China Development Bank and major commercial banks, have also come up with financial packages supporting overseas investment-related activities.

In compliance with the international practice on trade and investment promotion, Sinosure was set up by the Government in 2001, with the mandate to promote exports and cross-border investments through export credit insurance and investment insurance. As one of the fundamental components of the financial package in support of the 'Going Global' strategy, Sinosure's investment insurance acts as an effective risk management tool and as a financing facilitation platform. As such, it facilitates China's investment outflows (as well as inflows) and plays an increasingly important role in China's international economic cooperation.

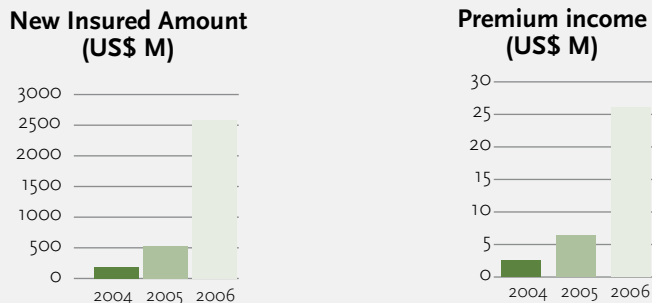
## Historical developments

During the 1990s, investment insurance was initiated and operated by the People's Insurance Company of China Group (PICC Group), established in 1949. Initially business volume was relatively low and economic development was driven primarily by exports of goods, infrastructure spending and market liberalization. Policy constraints, lack of capability and experience proved to be hurdles in expanding PICC Group's market base.

Turning to the twenty-first century, with the entry into the World Trade Organization and the gradual integration into the global economy, Chinese enterprises began their expansion overseas through foreign direct investment, exporting capital, management practices, innovation and other tangible and intangible benefits associated with international production. The newly established Sinosure assumed the sole responsibility for investment insurance, under its Medium and Long-term Underwriting department.

The year 2004 became a milestone of the investment insurance business when Sinosure decided to set up a designated unit, a separate investment insurance department, to address better risk concerns associated with China's rapidly growing overseas investments in support of the 'Going Global' strategy.

**Figure 1. Business development**



## Business overview

Since its inception, Sinasure's investment insurance business has grown significantly. Figure 1 demonstrates this growth momentum: newly insured amounts increased from US\$ 185 million in 2004 to US\$ 2,580 million in 2006, while premium income over the same period increased from US\$ 2.53 million to US\$26 million.

The rapid growth rewarded investment insurance with a much bigger share in Sinasure's overall business portfolio, which increased from 0.70 percent in 2004 to 8.7 percent in 2006 (figure 2). Together with short-term and mid/long-term export credit insurance, investment insurance has become one of Sinasure's core product lines.

Natural resources exploitation projects dominate the portfolio in liability terms, driven by incentives of raw material procurement created by rising domestic consumption. Such investment tends to be highly capital intensive and occupies the lion's share of Sinasure's portfolio (figure 3). In telecoms, with limited space for expansion in the domestic market, manufacturers, such as ZTE, Huawei and some EPC contractors, started to look beyond China for growth, engaging in massive marketing overseas, especially in developing countries. Similar developments occurred in the distribution sector.

The flow of foreign direct investment amongst developing countries,

the so-called 'South-South investment,' has been on the rise in recent years, driven by low labor costs and market-access opportunities overseas, as well as increased competition and limited growth opportunities in domestic markets. A similar trend can be found in the issuance of investment insurance (figure 4), with the number of projects underwritten in Africa in top place, followed by neighboring developing countries in Asia. This trend is expected to continue.

## Products and services

Sinasure's investment insurance program consists of overseas investment insurance, inbound investment insurance and leasing insurance, providing coverage to overseas investment, FDI into China and cross-border leasing transactions.

Overseas investment insurance is designed to support and encourage Chinese enterprises to make investments overseas by providing them with political risk insurance, covering expropriation, war and political violence, transfer restriction and breach of government undertakings. It is the core business of investment insurance, accounting for over 93 percent of total liabilities.

Inbound investment insurance is designed to encourage and promote foreign investment into China by taking on sub-sovereign risks within the

country. A strong underwriting preference is given to those sectors in the 'encouraged FDI' category issued by the State Council, such as hi-tech, infrastructure and environmental projects.

Leasing insurance was initiated in 2006 to deal with the demand arising out of the booming leasing market in China. It is designed to support enterprises to operate cross-border leasing businesses and to help lessees manage political risks in host countries, as well as lessee's credit risk.

## Operation features

There is little doubt that the fast growing business of investment insurance in China is underpinned mainly by the booming economy accompanied by the surge in cross-border investment, which have had a direct impact on the expansion of the market base. However, a bigger market does not necessarily guarantee success in business. It is Sinasure's belief that a market orientation strategy, creative underwriting practices and international cooperation are fundamental to maintaining sustainable development.

### Market orientation

(1) **GOVERNMENT:** During the transition from a centrally planned economy to a market economy, various government departments reserved certain powers in policy making, thus exerting a strong influence on investors. Therefore, forging strong ties with government departments, Sinasure, as a government-backed company, can engage in more effective market promotion. For example, by jointly holding seminars and workshops with the Ministry of Commerce, Sinasure can successfully promote its products and services among enterprises and financial institutions nationwide. Sinasure has also worked with relevant supervising departments, such as the National Development and Reform Commission and the State-owned Assets Supervision and Administration Commission, to integrate investment insurance as an important risk management tool for cross-border investments in relevant

regulations and guidelines.

(ii) **ENTERPRISES:** To date, state-owned enterprises dominate Sinosure's overseas investment portfolio. A lot of marketing effort has been devoted to companies, such as CNPC, Sinopec, MCC and Sinohydro, the leading investors overseas, to raise their awareness of political risks and the value of investment insurance. This has proved to be an effective approach as some of them have become key clients contributing a significant share of business.

(iii) **FINANCIAL INSTITUTIONS:** Another important source of business is financial institutions that provide financial support to cross-border investments. Sinosure has always kept contacts with various domestic and foreign financial institutions, updating them regularly about new products, as well as country and industry risk analyses. Regular communication has not only raised the possibility of doing business with them at some future point, but has also helped them to familiarize themselves with due process and project requirements in their own businesses. Strengthened relations with banks, especially foreign banks, has broadened the scope and potential for business while building a positive market reputation that is expected to benefit Sinosure over time.

### *Creative underwriting*

Investment insurance originated in developed countries, in which market conditions, risk perceptions and patterns are different from those in China. Often flexibility and modification in normal operations has been required. For example, China's overseas investment is at the take-off stage, when lack of experience and information, as well as difficulties in obtaining finance, can severely impede the investment process. Because of such considerations, Sinosure offers additional advisory services with regard to laws and regulations of the host country in question, the necessary approval procedures etc. If investors are confronted with financial difficulties, Sinosure will strive to mobilize financial resources, including from domestic and international banks,

and to work out prompt and effective solutions facilitating financing.

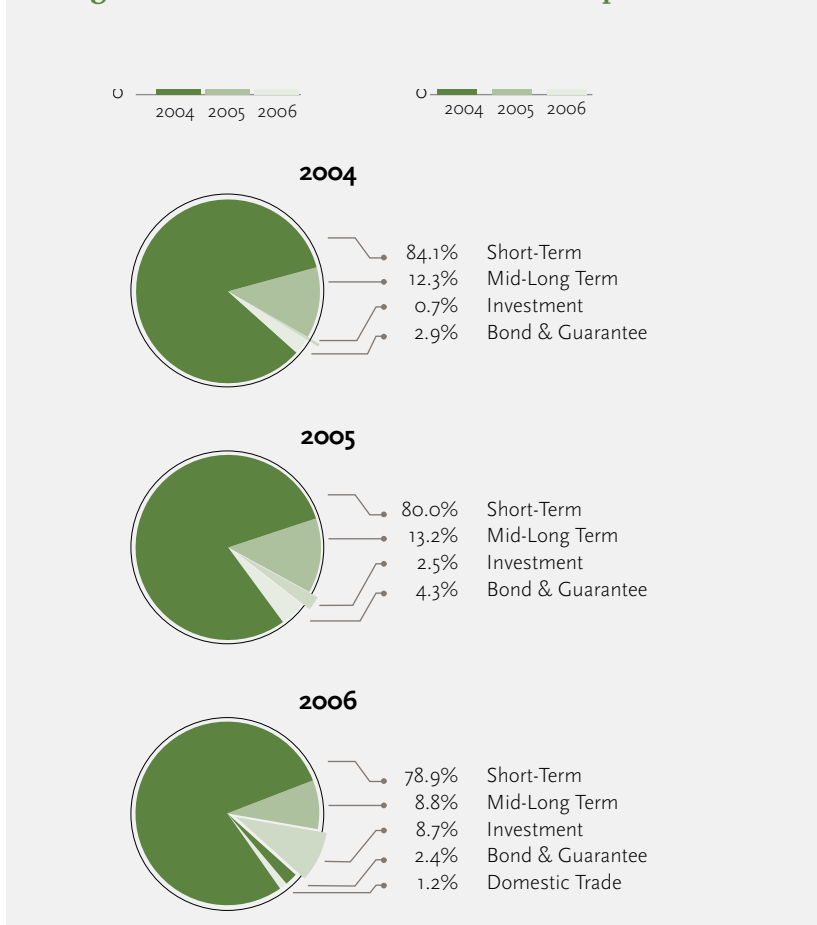
At the same time, the market for cross-border investments is evolving rapidly, and has developed various forms and modes, which in turn create demand of new coverage. For Sinosure, it is vital to always bear in mind the importance of innovation and to ensure that its products confront to market demands. This is crucial for addressing concerns and fulfilling Sinosure's mandate as an export credit agency. Stand-alone loan policy, coverage for bond issuing, leasing transactions and CDM projects are good examples of innovation experiments in practice.

### *International cooperation*

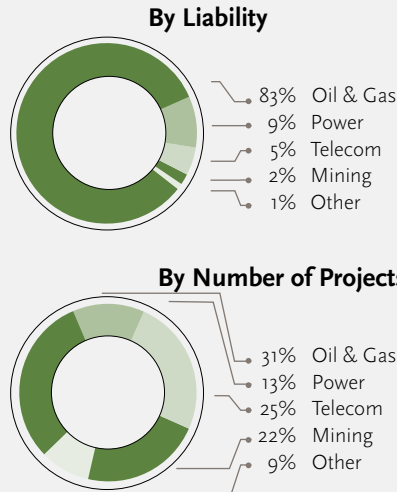
Sound underwriting of investment insurance requires a broad range of

knowledge and significant experience. Exchanging and updating information, discussing underwriting techniques with Berne Union members, or through other channels, is mutually beneficial to investment insurers and encourages business cooperation. The political risk insurance market is characterized by close relations among investment insurers, a view fully shared by Sinosure. As Sinosure's exposure keeps building up, risk sharing mechanisms among insurers through co-insurance and reinsurance becomes a necessity. To-date, Sinosure has signed cooperation agreements with MIGA, Zurich, and Chubb and has conducted joint workshops with such agencies. Several discussions on co-insurance and reinsurance cooperation with other agencies are also in process.

**Figure 2. Business shares of Sinosure's portfolio**



**Figure 3. Sinosure's portfolio: distribution by sector**



**Case studies**

**I: OVERSEAS INVESTMENT INSURANCE**—Chinese-invested power plant project in a South East Asian country

In 1997, an ongoing power plant project in a South East Asian country was suspended during the Asian financial crisis. Two Chinese enterprises were invited to engage in negotiation with the original project sponsors. In March 2000, the two sides reached an agreement on share acquisition of the project company. Given the considerable political risk and envisaged financing obstacles, the Chinese investors applied for Sinosure's Overseas Investment Insurance program. Drawing on its professional strength and frontline service principle, Sinosure made constructive propositions in the early investment and financing structuring process, and issued an insurance policy in order to rescue the project. The coverage provided was for political risk in the host country, particularly for breach of contract between the project company and the host government. This effectively alleviated concerns of the investors and financing banks, thus ensuring the success of both financing and project execution.

**II: INBOUND INVESTMENT INSURANCE**—Financing for China subway project provided by foreign banks

In 2004, a subway project in a city of Northern China was under construction. The project required debt financing and the local government issued a support letter for loan repayment in order to boost the financing bank's

confidence. Based on such support, a foreign bank that was going to provide a part of the commercial loan applied for Sinosure's Inbound Investment Insurance program. After a few site visits and prudent risk analysis, Sinosure structured a tailored insurance program, covering the potential breach of contract risk by the local government. The coverage effectively enhanced the bank's confidence and facilitated the construction of the subway improving the city's infrastructure.

**III: LEASING INSURANCE**—Foreign market exploration through a leasing transaction by Chinese enterprise

In 2005, one of the leading Chinese telecommunication suppliers was going to explore the European market through leasing. The leasing contract was reached on condition of the supplier succeeding in obtaining financing. In order to address the host country's political risks and the credit risk of a telecom operator, the supplier applied for Sinosure's Overseas Leasing Insurance program. This helped the supplier to obtain financing with a 'below-market' interest rate and improve his sales revenue and market share, thus ensuring a successful market exploration through leasing transactions.

**Figure 4. Sinosure's portfolio: distribution by region**

