INDUSTRY OPINION

# Massive potential but far to go

China and India will not save us ... at least not any time soon. Independent consultant **ROSANNE BACHMAN** gives her views on emerging markets

Not quite ready yet: the insurance market in China has enormous potential but is still lacking established patterns of people, risk management and processes

Although non-life growth rates of 20% (China) and 60% (India) underline the dynamic pace in these emerging markets, the per capita spend of $46 in China, for example, points to the industry's reliance on more familiar turf.

Large infrastructure risks and other capacity-hungry exposures will undoubtedly beat a path to London and beyond, but one basic truth still rings true. Despite the lure of giant emerging markets and the need to be a part of their development, the global insurance industry could achieve growth more effectively. We can do this by investing more time on improving our perceived value and managing the cyclical swings in our own backyard.

### Significant challenges

Stellar growth in China, India and other emerging markets can largely be explained by burgeoning life and motor markets. However, poor results in China's motor sector point to significant challenges, as described by a recent McKinsey report. Cut-throat pricing, high commissions and growth goals before underwriting selection contrive to destroy value. So do a lack of historical data, poor risk understanding and poor clarity of risk.

Similarly, recent removal of tariffs in India brought a sharp decrease in prices as insurers chased market share, causing the government to step in and limit the level of price reductions. Worldwide the same tenets of insurance apply; underwriting and operational discipline should be adhered to in order to deliver profitability.

As the underwriting director for a major Greater China insurer, entering the country a decade ago, I saw first hand the difficulties the local market had in shifting from a state-run operation to a somewhat open market.

It is not surprising to see that the market is still working at finding its way to the best practices long utilised in mature markets, though we may have memory lapses now and then. We should not forget that the same fundamental shifts are needed by potential insurers. Low insurance penetration in rapidly expanding economies of upwards of a billion inhabitants appears fantastic, and so it is. However, consumers will need an abrupt change of mentality to discover the value of insurance, those who can afford it preferring life cover above other lines.

### Developing risk potential

As China's insurance potential develops, so do the risks we might be asked to take on. The great floods of 1998 affected 240m people and generated US$37bn in economic damage. An earthquake of 7.8 on the richter scale in 1976 killed at least 250,000 people.

The recent explosion of construction development has never been tested by a modern catastrophe. Today's climatic challenges pose further threats such as sandstorms (from deserti- fication), hailstorms, typhoons and floods.

In 2005 China saw five typhoons, of which three caused economic damage in excess of $1bn. The trend continued with record flooding in Chongqing in July this year, causing $4.3bn of damage. This, as the country is only beginning the rainy season.

Similarly, India holds many of the same nat cat exposures evidenced by the massive unprecedented floods in 2005, which caused severe disruption and $3.5bn in damage.

Man-made calamities can be equally devastating. With 20 out of the 30 most polluted cities in the world, China witnesses close to 750,000 pollution-related deaths annually.

### Desire for retribution

The Centre for Legal Assistance to Pollution Victims has come to the public's defence since 1999. Awards to date have been small but demonstrate the desire for retribution.

The recent advent of class action-style cases is further evidence of the potential for expanding claims cost and desire for compensation.

Trends in the liability market will evolve unpredictably while the legal framework in China struggles to handle them appropriately. Amid enormous levels of industrial deaths and accidents, society grows increasingly litigious, pointing to the need for increased risk management of people and property.

Given the present level of industrial accidents in China, the desire for retribution will continue to grow and so too may damages awarded. With the unwinding of the "iron rice bowl" safety net that the Chinese were accustomed to, demands for compensation for medical malpractice and wrongful death are on the increase.

### New liability issues

Further, corruption and inadequate safety controls in China have given rise to wide-reaching liability issues beyond its borders.

Recently, north American firms that distributed defective or contaminated Chinese products are being sued with little chance of recourse against companies in China. A distributor of tyres in the US was recently forced into bankruptcy due to the magnitude of awards related to the defective Chinese tyres he sold.

The Chinese population is also transforming dynamically. On the one hand, in insurance as in other sectors, the quest for talent is fiercely competitive.

On the other hand, massive migrations to mega-cities could paint a different picture of the country's future. If the 150m to 250m migrants looking for work in the cities do not integrate successfully and join the growth in prosperity, instability could result. If they do integrate, then new issues arise, such as an accumulation of assets and a strain on resources.

### No established patterns

From an insurer's perspective, therefore, China currently lacks the long-established patterns of people, risk management and processes that underpin underwriting profit. The difficulties experienced by western banks in China are an indication of the need for a longer view.

India, too, holds similar complexities and development issues, as evidenced by its financial markets' development to date.

In developing markets we cannot overlay past progress on exposures and cultures that move more quickly, more slowly or just differently from our own. Massive potential exists and will be captured by long-term strategies, not short-term stampedes.

Potential in emerging markets should not overshadow the machinations of developed markets. Today, price all too often speaks louder than value. The industry should seize the opportunity to advertise the value of its expertise and advice, given the world's increasing complexity and uncertainty.

### Loss understanding key

Our understanding of future losses, not just prior losses, is key in providing valuable risk management and loss mitigation to clients.

Recent floods in the UK demonstrate the complexity and uncertainty, as well as the growth in magnitude of losses.

By communicating our ability to manage exposures and de-emphasising price, the industry can better manage the cycle and our future. The near future may well see China and India support better growth rates for the industry than we have seen lately, but in the meantime Birmingham and Boston outweigh Beijing and Bangalore.

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