Chapter VI

Trade and Investment Insurance System of P.R. China

1. Brief Review of the History of Trade & Investment Insurance in China

The present international market is full of intense competition. To increase tile competitiveness of exports, encourage export and foreign investment, stimulate the domestic employment and promote tile economic development, most countries make use of the Officially Supported Export Credit System. China is no exception.

The Trade & Investment Insurance, as an international custom to promote exports, was developed gradually in China with the establishment of tile Market Economic System. Generally speaking, it underwent three phases:

Phase 1. Starting from the late 1970s', China began to reform the economic system and adopt an open door policy. To solve the contradiction of economic development and shortage of funds, China began to make use of export credits extended by the foreign countries to import the badly-needed advanced technology and equipment while attracting the foreign investment in big volume. This was proved quite successful and efficient. During this time, it was also realized that China should provide its own export credit to encourage Chinese export to earn more foreign exchange so as to hasten the steps of its reform and modernization. Then at the beginning or 1980s, Chinese government instructed Bank of China to initiate its own export supplier credit This was a medium and long-term RMB loan facility with preferential interest rate, which is mainly used to encourage export of capital goods. This showed that China had made its first step to the establishment of its own export credit system.

Phase 2: With the expansion of export and supplier credit, people had come to realize that it was not enough to provide merely low interest rate credit. In order to promote export, there was also a need of export credit insurance. At the beginning of conducting supplier credit, insurance was not considered. As a matter of fact, exporters who were financing by supplier credit were obliged to repay the principle and interest according to the loan agreements, no matter whether they could receive the payment from the buyer. That means it was the exporter who undertook the risk of nonpayment. That became an obstacle to the further development of export. After a period of probing and practice, China became aware of the need to set up a system of export credit insurance. The People's Insurance Company of China (PICC) at that time, which was the only insurance company in China, was entrusted by the government to start writing export credit insurance as from Jan. 1, 1989. In the following years, short term export credit insurance was introduced throughout the country. The government took measures to support the operation of export credit insurance and granted many preferential policies, such as exemption from premium tax and provision of funds. The introduction of export credit insurance symbolized that China's export credit system was standing on the two legs, ie., finance and insurance although they were not coordinating very well at that time. However,it was possible for the Chinese exporters to be protected against non-payment risks through their paying of premium.

Phase 3: In 1992, after the government adopted the multi market of export strategy and Bank of China started buyer credit financing, export credit insurance was paid more and more attention to. From its very beginning, buyer credit in China was incorporated with an insurance mechanism. Risks were born by the insurer and ultimately born by the government, and since then the Chinese exporters could enjoy a credit facility with no or limited recourse. For the purpose of the formation of the socialist market system, the government laid down the policy to separate policy-oriented financial activities from commercial financial business. It simultaneously announced the commercialization of the four specialized state banks and the founding of three policy banks. China Eximbank is one of the three.

2. The present situation of China's trade and investment insurance

1. Through nearly 10 years of development, China has made rapid progress in the trade and investment insurance. According to statistics, 33 branches of PICC are now writing export credit insurance. In 1989, the insured amount of PICC was only 100 million US$. 1994 saw 1.4 billion US$ insured amount. In 1996, PICC underwrote a total of US$ 1.08 billion, of which US$ 0.71 billion was short term credit insurance, US$0.37 billion was medium-long term credit insurance. In addition to that, China Exim Bank in 1996 underwrote US$0.6 billion, 275% increase over 1995, and had a premium income of US$6.5 million, 206% increase over 1995. At present, the export credit insurance has been carried out throughout the country and has become a vital tool to encourage export.

2. Improvement has been made in regulations, techniques and the variety of covers increased. The main covers include short term comprehensive export credit insurance, short term specific export credit insurance, medium and long term (deferred payment contract) insurance, contract frustration insurance, buyer credit insurance (guarantee), export bill insurance, overseas investment insurance etc. Also, the markets covered widened with the implementation of the multi-market strategy. At the same time to consolidate the markets in Europe, the United States, Japan and Southeast Asia, we have begun to expand our businesses to East Europe, the Middle East, Latin America and Africa. In addition, in line with the actual situation of export development, more and more products are covered besides machinery and electronic goods.

3. We strengthened cooperation with ECAS, private insurers and brokers all over the world. From the outset, the Chinese export credit agencies received assistance and learned a lot from them. Bilateral visits and exchanging of expertise have occurred. The agencies which helped us and provided training to us include ECGD, COFACE, US Exim Bank, EDC, EID/MITI, JITO, ECIC, KEIC, etc. In 1996, PICC joined Berne Union and became an observer. In accordance with the government's arrangement, the export credit insurers in China should enjoy a common membership and joint participation and share in rights and obligation in Berne Union meetings and activities

APEC -Trade and Investment Insurance Training Program is a grand event of cooperation between China and the world.

3. Institutional Framework and Organizational Set Up

At present, there are two organizations underwriting trade and investment insurance, China Exim Bank and PICC Property. The latter began to write export credit insurance earlier than the former.

In 1994, with the deepening of financial system reform, China began to separate the policy financial business from the commercial activities. Under such circumstances, China Eximbank was set up, with a registered capital of RMB 3.3 8 billion appropriated from the state treasury. It carries out the state industrial and foreign trade policy, provides the financial policy for the export of machinery and electronic products and complete sets of equipment. It adopts much experience from the international custom. The Board of Directors, responsible for all the activities, is just like an Inter-Ministerial Committee. It is composed of the principle ministries such as the Ministry of Foreign Trade and Economic Cooperation the State Economic and Trade commission, the Ministry of Finance, the State Planning Commission, the Ministry of Electronics Industry, Bank of China, the State Commission of Science, Technology and Industry for National Defense.

The establishment of China Exim Bank marks the termination of a history that China had no special export credit agency, a step forward towards the system of internationalized export credit support and an establishment for the improvement of Chinese export credit insurance. At present it has four functions:

1) Export finance. This includes both buyer credit and supplier credit. The former is in the currency of US Dollars while the latter both in US Dollars and RMB.

In 1996, it approved supplier credits to finance 156 projects totaling RMB12.83 billion and US$41 million, of which RMBIO.7 billion and US$27.1 million were disbursed. By the year end, the RMB loans outstanding were twice that of 1995. The Bank, also provided US$12.027 million in buyer's credit for two projects on a trial basis. The credits supported a total of US$4.3 billion worth of export with emphasis on high-tech and high value-added large mechanical and electronic products and complete sets of equipment. The loan structure was optimized and the credits were well used. The Bank contributed greatly to the nation's betterment of export composition.

2) Export credit insurance and guarantee. Insurance facilities include the short-term, medium and long-term export credit insurance. In 1996, there was a rapid growth in export credit insurance. 84 transactions were covered under export credit insurance with an insured amount totaling US$610 million, and 49 foreign exchange guarantees were issued amounting to US$320 million. The combination of export, finance and export credit insurance supplied good-quality service for the exporters and helped reduce the cost of finance. Yet, it must be noted that China Exim Bank was born in the reform of economy and financial system, and a certain period of time is needed to coordinate its relations with other agencies concerned. At present the export credit insurance system in China is still in a transitional period.

3) On lending foreign government's preferential loans to Chinese Enterprises In 1996, the Bank newly approved to on lend US$1.8 billion to 53 projects, and the outstanding reached US$15.534 billion. The number of foreign government loan providers increased from 8 countries and I bank of the previous year to 14 countries and I bank. The newly approved projects mainly focus on introducing advanced technologies and equipment so as to support infrastructural construction and improve investment environment.

4 Chinese Government's Concessional loans. Our bank firmly carried out the State Council's policy on the reform of China's foreign aid program. In the past this kind of loan was in the type of free grants, which was now changed to the present situation to cater for the foreign aid reform. It successively signed 9 agreements on Chinese government concessional loan projects including the Huake Automobile S.A. of Cote d'Ivoire in the amount of RMB850 million. Geographically, the projects are mainly located in the developing countries such as Sudan, Kenya, Botswana and Gabon, etc. The concessional loans involve the fields of oil exploration, forest felling, gold mining, fishery processing, automobile assembly, railway renovation, textile, pharmacy, etc.

4. Marketing and Products

Although as a policy-oriented bank, China Eximbank attaches much importance to marketing. As a new bank established only 3 years ago, some exporters even know little about us. Medias were used such as TV, newspaper etc. Seminars were often held with exporters to help them know more about export credit insurance.

In addition to that, frequent visits are indispensable. We often visit the potential policyholders and help them to be aware of their risks when trading with the foreign counterparts. After the policy has been issued, frequent visits become more important. Especially for the short term comprehensive insurance. We need to instruct the policyholer on the right procedures, how to apply for the credit limits, how to declare shipment, what to do with probable loss. This kind of exchange helps to create the friendly atmosphere and trust between the two parties. Sometimes, the insured can get more clients for the insurer. Some businesses are introduced by commercial banks who provide financing for the exporter.

The covers we can offer so far are the following:

1. Short Term Export Credit Insurance. It covers the exporter against the nonpayment risk including both the commercial and political risks under the contract with credit term not exceeding 180 days, in special cases not more than I year. It's a cover on specific contract and the exported goods are limited to machinery and electronic products. It's often connected with supplier credit. That is, the financing bank, when the payment term is of non-LC , will often demand the exporter take out this insurance which will be used as a collateral of finance.
2. Short Term Comprehensive Export Credit Insurance. It is a multibuyer protection, which covers the exporter against the non-payment risk under the contracts which fall into the application of the policy. The products exported are not limited to machinery and electronic products, the consumer goods such as the textile, electrical items can also be covered. With this policy, the exporter can get the easy access to finance.

3. Medium-Long Term Deferred Payment Insurance. It is similar to the first category except the credit term is 1 year or more.

4. Overseas Investment Insurance It covers Chinese investors against the expropriation, war, restriction on transfer arising during the course of investment in the foreign countries.

5. Contract Frustration Insurance The main propose of this insurance is to provide pre-shipment cover. For high-value contract under which goods are not standard but specially made, the importer's frustration of contract before the shipment of goods will cause great losses to the exporter if he has input a lot of money during production period. For instance, it is applicable to shipbuilding contracts with progressive payment terms. Sometimes post-shipment risk is also covered.

6. Buyer Credit Insurance (guarantee) It covers the financing bank which provides the buyer credit to the foreign buyer or foreign bank against the non-repayment risk. The insured amount is I 00% of the principal and the accrued interest.

5. Underwriting technique

The underwriting procedure is composed of the three parts:

1) Policyholder risk underwriting.

Three aspects will be looked at:

Volume The potential policyholder's export volume, its markets, buyers etc.

Spread The composition of its main markets and buyers, business concentration etc.

Quality This includes its internal credit control, its past overdues etc.

According to the above factors, potential policyholers will be rated in different categories and different premium rates will be applicable to the corresponding policyholers respectively.

2) Commercial risk underwriting

Commercial risk is the one involving the buyer itself. Before we commit ourselves to underwrite, it is very important to have the information about the buyer such as the starting year, past business experience, capital, sales and other main financial information. Generally speaking, we will look at the following aspects on the buyer:

- History When the buyer started to do business, its payment record.
- Financial standing. Such as the registered and paid-up capital, sales, profit. Important ratios such as quick ratio, current ratio, debt ratio will be calculated in order to help analysis.
- Business management, such as business experience of the directors , their personal history
- Market trend of the product. Whether the product is going to be out of date or vs it traditional one.
- Development trend. Is the buyer going up or down? This is quite important to make credit decisions.
- Based upon above, the underwriting decisions will be made as to whether to cover, if yes, how much our commitment will be, the percentage of indemnification and special terms and conditions.
- After issuing of the policy and credit limit, we will keep a close watch on the progressof the buyer. In case of any negative change we will inform the exporter and amend the policy terms and conditions.

3) Country Risk Underwriting

The following aspects will be looked at:

- The political and social situation of the subject country, such as political stability, policy longevity, ability to implement policy, social order.
- The economic situation of the country, such as GNP amount, economic growth rate, inflation rate, unemployment rate, fiscal deficit, balance of payment, foreign currency reserves, its dependency on the international economy, etc.
- International relationship. Such as the relationship with the international organizations, with its neighboring countries, esp. with China, whether there is a possibility of war.
- Different countries are rated by 4 categories according to above factors. For medium and long term insurance we have 8 country categories. This will be adjusted regularly once a year and subject to change upon occurrence of emergency.

<u>6. Claims and recoveries</u>

Until now, the claims lodged with us have been very little.So we are not quite experienced in this area.

<u>7. Support system</u>

<u>Information</u>

Information is very important to export credit insurance underwriting. To have a quick access to information an on line D & B information service is needed. Most of the buyers' information can be obtained in seconds. We also have business relationship with other status agencies in different countries.

For the country information, we often accumulate the important information from the newspaper and other public media. The Ministry of Foreign Trade and Economic Cooperation and Chinese embassies in foreign countries are also important resources of information.

<u>Reinsurance</u>

It is not easy for a national program to be supported by private reinsurance market at an acceptable cost. So far our insurance exposure does not have any reinsurance

From the above, you can see that we have made a lot of achievements. Yet we still face some problems. It can be noted that the need for trade and investment insurance in China which is the world largest developing country is far from satisfied in view of its rapid economic development. The insurance volume only accounts for less than 2% of the total export, far behind the average of the world. The exporters insured accounts for 2.7% in number. There are a number of reasons behind that.

(1) Lack of insurance consciousness.

Due to historical reasons, most exporters in China are the state owned companies. Generally, people there tend to have little consciousness of the trade and investment insurance.

From 1949 to 1978'before the economic reform, China was under the centralized planning economy strictly controlled by the central government. All the losses of the enterprises were born by the state as a whole. The annual export-import plan was transferred to the Ministry of Foreign Trade through the state planning commission, and then to be divided into a few professional export-import corporations. The risks during the transition were born by the government and the foreign exchange earned by them could only be submitted to the government. Though facing a highly risky international market, the exporters did not feel exposed to it at all. It was the reform, which made the enterprises the real independent entities but history still has influence upon the present.

Comparatively commercial insurance including cargo insurance and life assurance have been recognized and accepted, but export credit insurance, as a brand new and very special insurance from other commercial insurance, doesn't become so popular. Many Chinese trading companies even have not heard of it. They often confuse it with other commercial insurance.

Some Chinese export & import companies think that it is not worthwhile to buy the export credit insurance. They believe the premium outgo will increase their cost of export and decrease their profit ultimately. They ignore the fact that should they get no payment, the loss will need to be reimbursed by more sales volume, which is more difficult in the present intense competitive market.

Thus, Chinese export credit insurers will have tough task of propaganda to make more people know about this special insurance.

(2) Lack of expertise of the export credit insurance.

The history of trade and investment insurance shows that it developed from the domestic credit insurance. Before export credit insurance came into being, there had been a lot of good preparations for it in terms of personnel, information, underwriting techniques etc. But it's different in China. China has never had domestic credit insurance. The sources it could learn from were the foreign counterparts and other related insurance such as cargo insurance. Compared with its foreign counterparts, China couldn't meet the demand. as it doesn't have the data base on enough foreign buyers, doesn't have the expertise.

Also, the trade and investment insurance is a policy business which should be financially backed by the government. To meet potential claims, the government should appropriate the special fund to cater for the demand. As China is not a rich country, the limited financial resource becomes a constraint of capacity to cover more risks and more markets especially in the large number of developing countries.

At the 14th session of the Chinese Communist Party, China put the social market economy as its reform aim, which demanded the framework of the social market economy, be set up at the end of this century. Under such system, the boundary between the state and enterprise's interest must be clarified. China is now further deepening its foreign trade system reform. When the enterprise can really become the principle of the market economy, that is, to be responsible for its own operation, and the capital fund system are set up, the interest between the state and the enterprise can be defined. This will generate the demand for the protection of the non-payment risk existing during the course of trading.

At present, there are several hundred million US dollars overdue accounts and losses suffered by exporters. This indicates that export credit insurance in China is still at an initial stage, on another hand, it shows there is a great potential of development. In the long run, it can be safely predicted that, trade and investment insurance in China has a brilliant future though China has a long way to go to catch up with the advanced level.
For that purpose we think the following problems should be solved:

1. Attach more importance to draft and promulgation of LAWS ON EXPORT CREDIT INSURANCE and EXPORT IMPORT BANK including ordinance and regulations, in order to clarify the relationships between export credit agencies and other government agencies concerned. These laws will spell out the legal status of the export credit agencies and lay down the basic policies of export credit.

2. Coordinate the relationship between export credit insurance and export credit finance; combine the two functions on the basis of government's industrial and foreign trade policies. To make export credit insurance the pre-condition of export credit finance.

3. Set up our own system of credit risks assessing. We are now too dependent on outside information agencies. We have not built up our own database. It is necessary for us to have

our specialized team to gather and collect all information including that from overseas embassies and to set up information network and data bank by using electronic technology. By doing so, we can have more reliable and more cost effective information in our decision making.

4. Train and cultivate personnel in this field. The shortage of specialized personnel in this field has been the bottleneck for the development of credit insurance. Two trainings we should pay attention to: to train exporters and enhance their risk consciousness by offering credit insurance courses. Secondly, to train our insurance staff We should stick to the principle of "GOING OUT AND INVITING HOME", strengthen exchanges with established export credit agencies through lectures, seminars and training programs, to learn from the outside world.

Ladies and gentlemen, this training program is unprecedented in such a wide and deep aspect. I hope, such program could be held more frequently which is certain to benefit the ever increasing demand of trade and investment insurance in the APEC regions.

Thank you very much.