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Business Management

Cover story: Put as much energy into selling your business as you do running it

By ANTHONY DAVIES

If you're a successful business owner or at least aim to be one, you need to face the fact that one day you and your business will need to part company...

THE DAY WILL COME when you want to move on to another business, or retire and put your feet up. And, if you manage the sale process properly, you could make a lot more from selling your business than you do from running it. That's the irony, says Richard Parker, chief executive of Florida-based online business brokerage Diomo Corporation. Business owners tend to put most of their energy into running their business and little into selling it. "People just don't prepare their businesses properly to sell," he says.

"The key to selling anything is to make it easy for someone to buy. This is especially true when it comes to a business," Parker says. "If there's something in your business that would turn off a potential buyer, chances are it's also hurting your business today. Typical examples are high customer concentration, the possibility of losing a key supplier or employee, contingent liabilities, past claims, leases due to expire, poor monitoring systems, and so on," he says. "While trying to build your business, even if you have no plans to sell it, look at it through the eyes of a possible buyer. By simply identifying possible issues, and fixing them, your business will improve immediately. Likewise, these matters will not come back to haunt. They'll stick around and hurt you today and down the road."

Buddle Findlay partner Andrew Simmonds says any would-be vendor must ask what the things are that make their business valuable

and then ensure they are properly in place. For example, if the business has high brand value, are its trademarks and intellectual property protection all properly in place? If it is highly reliant on some key staff, how are they contracted or incentivised?

"Sometimes you may have to change the structure of the business to take out some of the risks," he says. A classic example was the sale of the Bank of New Zealand to National Australia Bank. Before it could be sold it was split into the "good bank" and the "bad bank" with the bad bank – which was retained – comprising all the unsaleable problem areas.

Simmonds says he uses the "sniff test" to assess the state of a business. That is, he looks for warning signs that alert to the possibility of bigger issues. For example, one warning sign is poor documentation and record-keeping such as an out-of-date share register or incomplete board minutes. "If they're sloppy with the basics, it makes you worry that they've been sloppy with important things such as tax filing," he says.

At the end of the day, a buyer wants a clean business, and Simmonds' job when he's acting for the vendor is to ensure that is clean.

"The lawyer's job is to make sure that the things that drive the earnings stream are going to be there for the long term."

But, prevention is always better than cure. "Get your housekeeping in order now and keep it in order," is his advice to all business owners.

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Auckland accountant Craig Fisher, director of Hayes Knight, says his job is to help the vendor ensure the financials and accounting systems can pass muster. "Most people have 60% to 70% of the issues taken care of, but there's a couple of things they've overlooked or aren't on their radar screens at all," he says. "One of the keys to success is having all of your ducks in a row."

He says there is a lot business owners can do to get their business well-dressed, but they need to be sure they don't go too far. There's a big difference between enhancing and misrepresenting, he stresses. For anyone tempted to try the latter, the Fair Trading Act is all-powerful and gives misled buyers a range of remedies. Paint too rosy a picture of the business or fudge the books, and the buyer could seek redress for misleading or deceptive behaviour under section nine or alternately for misrepresentation under section 13.

He likes to put himself in the shoes of a potential buyer when looking over a business to be sold. That includes asking the hard question: "Do they really have a business to sell?" And in some cases the answer will be no. It may be just the owner's income structured as a company.

"You're generally reasonably hard on them," he says. Once he's finished playing Devil's Advocate and pointed out all the problem areas – and assuming there is a business there which can be sold – the question of price then arises. He generally starts off by giving the vendor a "back of the envelope" figure which generally disappoints people, he says. He then walks them through what they need to do to get the business closer to the figure they have in mind – providing theirs is a realistic, albeit optimistic, one.

KPMG partner Tony McNaught also likes to see potential vendors as early on in the piece as possible. If a sale is planned within the next

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two years, he says an audit is usually a good idea. The point is to find out what the books look like, address any issues and focus on maximising profitability. So eliminating non-essential expenses is crucial. "They probably need to stop spending discretionary money such as taking overseas trips," he says. "Every dollar they spend will end up costing them four or five." The reason is the price they get for the business will almost certainly be a multiple of the net profit – so claiming unnecessary tax deductions becomes counter-productive.

In general, the earlier an owner thinks about selling and what needs to be done to get the business ready for sale, the better the chance of getting a good price and the more informed choice they can make about sale options, he says. Those options can include a management buyout, selling to family, a trade sale or even franchising it. Which option is best will depend on a variety of factors. For example, if the owner wants to make a complete break, then a float is unlikely to work, as

investors would usually want him or her to retain a strategic stake for at least a few years.

Then there are management and practical issues. If the business employs a number of family members, it may be worth easing some of them out and putting in a general manager. Getting the intellectual property out of the owner is also crucial. This can be as simple as giving the staff a thorough training and/or writing detailed procedures manuals so someone else could step in and run it – which is the owner's ultimate plan.

McNaught says if there are no major problems, the sale process should take around four to six months. The owner will need to be clear what he or she is selling. It's not as obvious as it might seem. They will usually not be able to effect a clean sale and sell everything lock, stock and barrel. Unless there are compelling legal issues, the buyer will want to buy the business and all the assets – both tangible and intangible – required to run it, but he's unlikely to want to buy the shares. A major reason is that with the shares can come the likes of

tax liabilities or long-tail warranty problems.

Getting down to the business of selling, one of the first things McNaught will do is draft an Information Memorandum (IM) for prospective buyers. It will describe the business in general terms, give an indicative price range and include some financial information but not the full accounts. The IM can either make or break the sale, so a lot of work needs to go into compiling it. Arriving at a valuation is a major exercise in itself.

As well as not liking to put too much detail in the IM, McNaught is selective about who he will show it to. He prefers that prospective buyers first sign a confidentiality agreement. "That's really to protect the ultimate buyer. It's the buyer who stands to lose if 20 other parties have seen the same information." As Simmonds puts it, you want to give people a reasonably good taste without giving the crown jewels away."

The objective is to get potential buyers to the stage where they can make an informed bid prior to doing due diligence. **fa**

The value of due diligence

By JANENE BONE

The due diligence process can make or break a business sale, according to a survey conducted by the Chartered Public Accountants Association...

BUYERS NEED TO THINK with their head, not their heart, and guard against "falling in love" with a business. Vendors need to ensure that there's no skeletons in the closet or fudged numbers the due diligence process will uncover. The Chartered Public Accountants Association of Australia (CPA) recently conducted a survey asking its 15,000 accountants and auditor members to comment on clients' decisionmaking after undertaking the financial due diligence process when purchasing a business. The survey results were published last month. CPA Australia was particularly interested in whether, once they'd been through due diligence, prospective business owners changed their minds about buying – either reducing the price they were prepared to pay, or not going ahead at all.

It found the results "clearly show that buyers of due diligence services found their investment to be valuable, and in some cases resulted in them avoiding financial disadvantage. Most

users of due diligence services also said they would undertake these services again in the future. The sample of respondents showed that small businesses are big users of due diligence services and have a keen interest in these types of engagements."

The survey asked members their perceptions of clients' business decisions after having undertaken the due diligence process. Of the 93 respondents, 18.9% reported more than 50% of their clients chose not to proceed with buying the prospective business after due diligence. While 43.1% said fewer than 10% of their clients decided not to go ahead, 19% said between 11% and 30% of clients decided against proceeding with a purchase. The survey clearly indicates "many clients might have been out of pocket – and indeed may have faced serious financial disadvantage – had they not undertaken the financial due diligence."

An even bigger proportion of clients reduced

the price paid, with 35.7% of respondents saying more than half their clients would have paid too much if they had not undertaken financial due diligence. "An additional 28.6% reported between 31%-50% of clients would have paid too much, and an additional 16.1% said that 11%-30% of clients would have paid too much had they not undertaken due diligence."

This gives an overall 80.4% indicating "the majority of their clients would have suffered financially had they not undergone the financial due diligence before proceeding with buying their prospective business. Only 19.6% said that less than 10% of clients would have paid too much had they not undertaken the process."

Regardless of the outcome of the business decision, nearly three quarters of respondents said most of clients thought the due diligence process was useful. Most (54.2%) said that more than 70% of clients found due diligence useful and an additional 20.3% said at least 51%-70% of their clients found it useful.

More than half (55.2%) of respondents believe more than 70% of clients would use the financial due diligence process again. An additional 17.2% said that 50%-70% of their clients would use it again while only 12.1% thought less than 10% would undertake financial due diligence in future. **fa**

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Comment

Regulation: welcome – but beware

By DAVID WHYTE

With NZ in the throes of developing a comprehensive regulatory framework for financial services, it's well worth casting an eye overseas to see what has worked and what hasn't...

WHILE THE DEVELOPMENT of a regulatory environment has undoubtedly attracted for many stakeholders in New Zealand, experience from overseas suggests that the shape, structure, and parameters of the proposed regulations should be very carefully considered.

There have been a number of occasions in the past when hasty and ill-considered drafting has caused as many problems as it has solved. Financial services regulation has the potential to do likewise, if insufficient attention is given to the implications, impact, and inevitable interactions which arise when regulatory proposals are implemented.

In the UK, the original notion of self-regulation that underpinned the 1986 Financial Services Act was abandoned by Gordon Brown, the Chancellor of the Exchequer, in 2001. It was replaced by the wider-ranging Financial Services and Markets Act later that year.

Was the original Act properly thought through and subjected to rigorous scrutiny and debate? From an industry standpoint, the answer is "probably not".

But the intensity of examination, evaluation, and assessment since the original measures were introduced contains some clues for the likely prospects for New Zealand.

Regulation theory has developed rapidly in the UK and analytical frameworks, benchmarking strategies, and a whole host of research articles, books, and journals have emerged, partly as a result of the introduction of the second stage of evolution of regulation in the British market. With such a complex subject, it is to be expected that much attention would be paid to the consequences and potential outcomes of the initiatives. The intricate interplay between politicians, regulators, industry participants, and consumer representatives was – and perhaps

still is – bound to give rise to analysis, debate, conjecture and, on some occasions, significant disagreement.

Thus far in New Zealand, the progress has been relatively smooth and untroubled. Long may this continue.

I welcome the optimism expressed in my old friend David Pine's recent article ["Will regulation be good for your health?" *financialalert* magEzine, 23 November 2006].

But I also took note of the subsequent report from the ASFONZ Conference in Wellington late last year. Mai Chen from the Securities Commission suggested that the regulatory train had only just left the station and that there was much more to anticipate than had yet been tabled. However, the open discussions, the information interchange, and the spirit of co-operation that has eventuated are to be welcomed.

The alternative of an adversarial and acrimonious regime being dropped on an industry that has, by and large, served the community well, would be distasteful to most New Zealanders. Despite the occasional wrinkle, there has been nothing in the New Zealand experience to match the HIH scandal in Australia, or the stakeholder pensions mis-selling scandal in the UK.

But the lessons from territories like Britain and Australia are apparent.

For the British, self-regulation proved to be a false start and was abandoned after a relatively short space of time. Why? Well, without sending the readers to sleep, capture theory proposes that in a self-regulatory environment, those who are the subjects of regulation ultimately acquire control of the instruments of regulation, and the application of the rules becomes prejudiced. In other words, particularly for the UK, self-regulation became the barrier to an effective and acceptable regulatory regime.

Here in Australia, capture theory has yet to be tested. But the Australian Securities and Investments Commission can hardly be regarded as an industry-friendly body. In fact, many industry participants would hold quite the opposite. But, as many have found to their detriment, the regulators take their responsibilities very seriously, and continue to pursue rigorous application of the measures. The regulators and most observers would reject the premise of capture theory relative to the Australian experience, but that does not suggest that the Australian regulatory model is without controversy either.

Nevertheless, the Australian government and the regulatory bodies would likely be more comfortable subscribing to public interest theory, claiming that the benefit to the greater majority outweighs any sense of indignation expressed by aggrieved industry practitioners discomfited by prescriptive regulatory measures.

Some cynics have suggested that were the financial services industry scandals in Australia less prominent (that is, less vote-worthy), political interest in the development of a regulatory regime would have been significantly less intense.

However, this is not intended to be a critique of the UK or Australian regulatory models.

It is merely the suggestion of a note of caution to be retained by all parties when considering the implications and consequences of proposals, unintended or otherwise, before adopting measures that may affect the industry and New Zealand society for many years to come. *fa*

David Whyte has worked in the financial services industry for 30 years. After starting out as an adviser in the UK, he has since worked in senior management for New Zealand and Australian life insurers.

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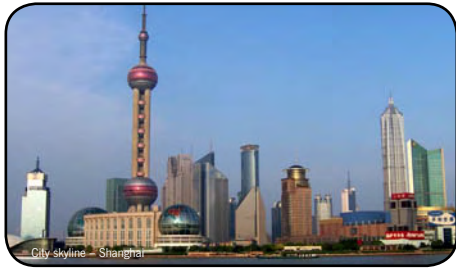
Investment advisers and brokers will have to give investors more information about

themselves, the fees they receive and how they handle investors' money.

The Securities Commission is preparing a guide explaining the new requirements. Ring 04 472 9830 or e-mail seccom@sec-com.govt.nz to order a copy of the guide.

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Investment

A day in a BRIC Study Tour to China

By DEIRDRE KEOWN

In 2005, PortfolioConstruction Forum and Think Global Consulting created the Think Global BRIC Study Tours – highly tailored, week-long study programs to BRIC markets...

Think Global BRIC Study Tours are designed to give participants vital on-the-ground exposure and materially increase their understanding of each BRIC market and its role in portfolio construction. The first BRIC Study Tour was to China in April 2006. I attended the second Tour in October 2006. This is a synopsis of the lessons learned on our first day...

China didn't feature on my "must see" list until recent times. As a little girl, it was a place where millions of starving children would be grateful for my dinner. As a teenager with a father in the military, communist states were quite literally the enemy, an impression reinforced by four years in the US. The icing on the cake was the 1989 Tiananmen Square uprising. In fact, I don't recall learning anything positive about China until the 2003 Goldman Sachs BRIC report showing that the BRIC economies will have a key influence on investment markets this century.

We flew into Shanghai on a Sunday evening. What I didn't expect was that the airport would be more modern than Sydney's, that we would breeze through customs in under five minutes(!), travel into the city on the world's fastest train at just over 300 km/hr (to save energy, it doesn't run at its 430 km/hr maximum speed after 6pm), and arrive at a modern luxury two-year old hotel. We could have been in any modern city in the world – in truth, it was an anti-climax.

Monday, we were up early, to travel by bus to our venue for the day, a restored Chinese building in the old French concession (finally, it looked like we were in China), for a day of briefings about China's economy, business environment and social structure, by those who live and work there. We had an incredible calibre of speaker: Austrade Shanghai's senior trade commission, Christopher Wright on China's economy past, present and future; Clinton Dines, head of BHP Billiton China, on The BHP story in China (unfortunately, Chatham house rules prevailed for this session); Richard Williamson, Commonwealth Bank's GM Asia Strategy on China's financial services sector; and, perhaps most interesting of all, Wang Yong, Assistant Editor in Chief of *Shanghai Daily* on how the Chinese live.

The first thing everyone tells you when they realise you're new to China is that it's BIG, that you'll find it impossible to get your mind around the numbers (they're so right).

There are 1.4 billion people, including 700-800 million peasants. This became a running Tour joke. Every speaker gave us an estimate of the number of peasants, but each was different. In the words of one Tour member "is it 600 million, 700 million, 800 million, 900 million – hey, what's a few hundred million people either way?" It's important to realise that in China, any farmer is

a peasant. Yes, for the most part, they're poor, but even the wealthy are called "peasants".

More numbers – 14 million engineers, 600 cities (33 are home to over 2 million people). Over 35,000 kilometres of highway has been laid in the last 10 years, and another 85,000 will be laid in the next 30 years, all part of China's Expressway Network Plan to connect all cities with populations of greater than 200,000.

I heard this at the start of the week-long Tour, and I didn't really believe it. But I did by the end of the week. One of the key lessons I took away with me from the Tour is that China thinks long term – there is a 30 year plan for just about everything. As one speaker put it: "Western governments plan to the next general election. China's officials plan for the next 30 years (because there are no elections)." And the 30 year plans are implemented on schedule. I came away understanding there's nothing like a dictatorship to get the job done!

All that concrete had me wondering whether there would be any green left in China once all the concrete was poured. The consensus across all the week's presenters was that the environment is a very real concern to the Chinese government, albeit only a recent one. However as with anything it turns its collective mind to, there is a robust plan to reduce environmental damage.

But back to the big numbers. Each year, China brings on "a UK and a bit" of power, as one speaker put it. Some 70% of China's power is currently coal generated, complimented by gas and hydro. In the next decade, coal generation is expected to account for 60% (on a growing base keeping in mind the rate of urbanisation) with natural gas and nuclear energy picking up the slack (the plan includes 32 nuclear power plants). However, it's not possible for China to concentrate all its energy in just coal, gas or nuclear plants, because it would exhaust the worldwide supply of the raw ingredients! In the next decade, China will bring on more energy in each area – water, nuclear, wind, gas, coal, etc – than the rest of the world combined.

One number that's not big is the number of lawyers. Many would say this is not a bad thing. There are just 120,000 for a country of 1.4 billion people. "The legal system has good architecture but poor implementation," one speaker opined.

And of course, the economic numbers are big. GDP has grown at 8%-10% per annum on average through the 1990s and 2000s. Exports are growing at 25%-35% per annum. There was a lot of discussion around that on Tour, particularly the threat posed if the US economy comes off the boil. As one speaker noted, China's exports are well diversified and what is exported is low value. If the US economy slows, the US consumer will still shop at the low value end of

town. Another question was how much of the GDP growth is dependent on foreign investment. One speaker noted that domestic demand is such that if all foreign investment pulled out, China's GDP would fall by only about 1% per annum. Another question that came up again and again during the week was "is growth sustainable?" Not one person we spoke with doubted it was (and they weren't all bulls, some were decidedly bearish about other issues). One presenter recommended we think of China in the same light as the US in the 1880s and 1950s – going through massive economic revolution fuelled by industrialisation, urbanisation, and an emerging middle class.

There was a lot of focus on the urban/rural wealth inequity. Austrade's Christopher Wright put up an interesting chart, showing the gap is closing slowly. Following 74,000 protests by the people in 2004, the gap halved in 2005 – not by halving anyone's income, rather than as a result of urbanisation. This was a shock. I'd thought protesting was a one way street to prison in China. But protests are very common. Economic protest is allowed. Political freedom, choice, elections, human rights remain strict no-go areas.

As expected, the Central Party has a 30 year plan to reduce the urban/rural divide. In 2004, 80% of households were "poor", defined as earning less than 25,000 yuan pa. This is about \$A4,166 per annum. Only 10% of households are currently "upper middle class", earning 40,000 to 100,000 yuan (\$A6,666 to \$A16,666 pa). By 2025, poor households are expected to be just 10%, with the upper middle class at 60% and lower middle class at 20%. The mass affluent (earning greater than 100,000 yuan) will be just under 10%.

Another myth dispelled on Tour was that China is only a manufacturing success story. Wrong – there is a growing services sector. The financial services market is growing twice as fast as the rest of the world and, by 2020, will be larger than Germany's. China is already the world's largest consumer of international education, and the largest telecommunications market. By 2020, it is expected to be the largest tourism destination, and the fourth largest source of tourists.

Richard Williamson gave a detailed overview of the financial services market. More huge numbers. China's banking assets in \$Abn are over four times the size of Australia's and only marginally behind those of the UK. The banking industry is critically important – banking assets form 77% of the country's financial assets, and the industry has undergone rapid reform in the past several years. (For a detailed description of China's financial market reform refer to "Gugai and other reforms" in the Summer 2006/07

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Financial Planning

The core principle

By BOB VERES

Right now, all of us have to hold ourselves to high standards on our own, because nobody out there seems particularly interested in doing it for us...

JUST ABOUT A WEEK ago, I participated in a panel discussion at an FPA annual career day. Two of the panelists – me and Mike Haubrich – were the grizzled, fossilised veterans hailing back to the Cro-Magnon era of the profession, recalling in rambling reveries how real planners used to create their investment projections using crude flint tools, and how important it was for the broker-dealer to provide exceptional due diligence on limited partnership investments. The other three panelists were bright-eyed recent graduates of financial planning programs, all women, all working on the staff of respected firms, all charming in their lack of confidence about their experience and capabilities.

The interesting thing was that, despite experience levels measured in hours, the younger panelists were already professionals as I define the term. They each said in a different way that what they were doing was important because it was having an impact on the lives of real people, real clients. Therefore, it wasn't acceptable to do B-level work, as it is in the classroom. People deserve the best you have to offer, and the consequences of letting them down is, somehow, a diminished or mis-advised life – which these younger planners regarded as, by definition, unacceptable.

As young as they were, as naive and unconfident as they were about their experience, they had totally mastered the most important thing: that what they did mattered, that it was

more than just a commercial transaction.

This, of course, is the bright core that shines into and through all the debates about fiduciary standards and codes of conduct and practice standards. What we hope to achieve, some day, is a profession-wide recognition that financial planning work and investment advice are, in a real sense, a sacred duty insofar as they can have a powerful and positive (or, done badly, negative) impact on peoples' lives.

Phrased this way, you would think there would be broad agreement on these points,

But look around you. You realise how far we are from living in that world. The wirehouse organisations have stubbornly resisted fiduciary standards, embraced conflicts of interest in their business model, and have created an environment where providing investment and financial advice is a commercial, transactive enterprise, a little like selling shoes, only at a higher markup. The quality of advice given by the broker might matter to the broker and client, but to the wirehouse, it's a commodity that is sold by the barrel.

The CFP Board, meanwhile, has endlessly waffled on about how, exactly, to codify this idea that planning advice matters in a fundamental and important way, and therefore that advice should always be of the highest quality.

I had a conversation with a member of the CFP Board of Governors not long ago, and asked pointedly whether there weren't a few too many

compromises in the proposed Code of Conduct. The answer was not reassuring. It went something like: Well, yeah, you and I can agree in principle that planning advice is really kind of important, but there are business realities we have to consider here, and a lot of CFP certificants don't want to be held to those legal standards..!

All of us are professionals to the extent that what we do is held to much higher standards than a simple commercial transaction.

Right now, all of us – writers as well as planners – have to hold ourselves to these higher standards on our own, because nobody out there seems particularly interested in doing it for us. This, I think, is the missing ingredient in all the debates over regulatory initiatives, fiduciary and practice standards or codes of conduct: recognising that the work we're talking about impacts peoples' lives, and the quality of peoples' lives is, in the final analysis, the most important thing. If we can't talk about that, and make it the centre of every regulatory discussion, we don't have a clear idea of what it means to be a professional. **fa**

Bob is one of the most respected and influential financial services industry commentators in the US. In NZ, *financialalert* has exclusive access to and distribution rights for Bob's full *Inside Information* e-newsletter service reviewing the most important articles published in US financial planning trade and business magazines, and summarising the best thinking from 10 US industry conferences a year. Subscribe at www.financialalert.co.nz/tools

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PortfolioConstruction Journal.) Interest rates are low, as a way of subsidising Chinese corporations, however retail mortgages are still very profitable at around 400 basis points (compared to 100 basis points in Australia). The problem is that the Chinese pay off their mortgages too quickly – in around three to five years! They save more than 50% of their salary. Internet banking has not yet taken off, as the infrastructure is not yet robust enough to support it. The credit card market is small at just \$US700 million, but this is growing at such a rate that China will be the fourth largest credit card market in non-Japan Asia in 2006. Share market capitalisation is only just behind Australia. Total debt securities are 50% higher than Australia, and about half of the UK.

The life insurance and funds industries are fledgling at around \$A180bn. The current environment is dominated by local players. The top five fund managers are all local and relatively young, having started in 1998/99. They control over 45% of FUM, but between them offer just 47 funds. While the industry experienced strong growth between 1999 and 2001, Chinese investors

tried to stag early fund IPOs, causing FUM to halve very early on. As a result, since 2002, fund managers have stopped offering closed-end funds.

Finally, we were amazed and delighted to hear that "tax is almost voluntary" in China. Private tax collection is around 2%, and while the corporate tax rate is 30%, it drops considerably to 15% if you set up business in a special economic zone such as Pu Dong (an area across the river bank in Shanghai). And, we heard, corporate tax is totally negotiable for local companies! Of course, by now, we were considering moving to China.

Our last presenter of the day brought us back down to earth. Wang Yong is Assistant Editor in Chief of the *Shanghai Daily*. He wanted to show us "the other China". His numbers were also big. He estimated there are 900 million peasants at present. Six million migrate to the cities every year for jobs, and over 40 million have left the land in the last ten years. In the next five years, a further 15 million will move to the cities. However, there are not enough cities to absorb the flow, and as fast as housing and other infrastructure is being built, it is not fast enough to keep pace. The environment has been neglected in favour of fast development. The

land is very dry in many parts, with drought caused by land clearings and diversion of rivers. What water remains is often tainted – some 70% of lakes and rivers are seriously polluted with the resulting loss of bird life, and 400 million people do not have access to clean water. The Yangtse, which ten years ago was very clean, is now green and at the current rate will be ruined within ten years. Many trees near rivers have been chopped down by the peasants to earn money to live, exacerbating the drought conditions and pollution (the government has responded by paying the peasants to protect the trees). Despite this gloomy picture, Wang Yong clearly believed the government will succeed in tackling the environmental problems.

So my first day in China came to a close: eight hours of presentations, discussions and debate. The rest of the week was similarly jam-packed. It's impossible to describe how your knowledge of China increases during a week-long BRIC Study Tour. You learn a vast amount, but only scratch the surface. But finally I have an open mind. **fa**
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Insurance

Insurance complaint case studies

By INSURANCE AND SAVINGS OMBUDSMAN

The issue central to the first of these case studies is the exclusion of pre-existing conditions. The second issue is non-disclosure...

Case Study 1

In May 2003, C applied for health insurance with P. On 22 May 2003, cover commenced, subject to the terms and conditions of P's policy document and product brochure. On 15 November 2005, C applied for pre-approval for a hip replacement to be performed on 5 December 2005. On 5 December 2005, the surgery was performed.

P declined the claim, on the basis the surgery related to a pre-existing condition. P believed C had osteoarthritis before the commencement date of the policy and, therefore, it believed osteoarthritis was an excluded pre-existing condition.

The relevant exclusion excluded pre-existing conditions for three years. Having regard to the policy wording, P was entitled to decline the claim if C was "aware of", or had "sought treatment or medical advice" for a pre-existing condition, prior to the commencement date of the policy on 22 May 2003.

The medical evidence indicated C had sought treatment or medical advice for osteoarthritis of his right knee and left ankle, prior to the commencement date of the policy.

The [Insurance and Savings Ombudsman] Case Manager discussed C's medical history with C's orthopaedic surgeon, X, and she explained that the condition of osteoarthritis must be associated with the relevant joint/s, or the person can have generalised osteoarthritis. In this instance, X did not believe that C had generalised osteoarthritis; rather, X believed that he had osteoarthritis in his left ankle and right knee.

On this basis, the Case Manager believed C had a pre-existing condition for osteoarthritis in his left ankle and right knee. However, X said the osteoarthritis in C's hip did not medically relate to, was not traceable to, or did not arise from, the osteoarthritis in his left ankle and right knee. Having regard to the expert evidence of X as an orthopaedic surgeon, the Case Manager did not believe P had proven, on the balance of probabilities, that the exclusion applied to the claim. Therefore, the Case Manager did not believe P could decline the claim.

Other issues

The policy provided that P "will process your pre-approval within five working days of receiving it unless it is necessary to obtain further information." C completed the pre-approval application on 15 November 2005, for the surgery which was to be performed on 5 December 2005. According to P's records, it had 10 working days within which to process the pre-approval. However, the claim was not declined until 9 January 2006. According to C, he contacted P on numerous occasions to

determine whether the claim had been accepted and at no time was he provided with a decision.

C said the surgery was not urgent and, if he had been told the claim was declined, he would have elected to go on the public waiting list.

On 30 November 2005, P's medical adviser, wrote a file note and made the following comments:

"With respect to this... claim, if we consider the disease process, osteoarthritis, then [C] is not able to claim until May 2006 anything related to osteoarthritis as it was a pre-existing disease. He has been booked to have a THR on 5th Dec therefore we cannot accept the claim."

The Case Manager understood from this file note that P's medical adviser believed the claim could and should be declined on the basis of the exclusion. However, if C was to claim after May 2006, the claim could be payable. Having regard to the above file note and other relevant file notes, the Case Manager believed P had processed the pre-approval application and did not require further information before making a decision to decline the claim.

The Case Manager believed that P should have alerted C to the fact his claim was to be declined or, at the very least, indicated the likelihood that the claim would be declined. Also, the policy provided that P would process the pre-approval application within five working days and, implicitly, communicate the outcome of this process to the insured. Because P did not do so, the Case Manager believed it was in breach of the terms and conditions of the policy.

Accordingly, even if the Case Manager believed P was entitled to apply the exclusion to the claim on a fair and reasonable basis, the Case Manager did not believe it would be entitled to decline the claim.

Complaint upheld

Case Study 2

In September 2004, C arranged insurance for his 1989 Nissan 300ZX ("the vehicle") with P. The policy was arranged at a car sales yard. In August 2005, the vehicle was stolen and C made a claim to P for the vehicle.

P avoided the policy and declined to consider the claim, on the basis C did not disclose that the vehicle had been modified, with a new stereo and mag wheels ("the modifications"). C argued that the Car Sales Manager ("B") spoke to P and notified P of the modifications. B wrote to P on C's behalf and confirmed he had discussed the modifications with P's representative when the policy was arranged. Therefore, C believed P had been notified of the modifications. However, P was unable to retrieve the telephone call to

confirm this and maintained its decision to avoid the policy.

At law, if P was put on notice about the modifications by B, C would not have breached his duty of disclosure and P would not be able to avoid the policy.

P provided the ISO Office with its vehicle insurance underwriting guidelines ("the guidelines"), on which it relied to justify its decision to avoid the policy. The guidelines listed the Nissan 300 ZX Twin Turbo as a "High Theft Risk Vehicle... and must be fitted with an immobiliser". More specifically, the guidelines listed the Nissan 300 ZX Twin Turbo in the "Sports and High Performance Vehicles" category which, according to the guidelines, were "a higher than average underwriting risk because they are specifically designed to go fast and can be attractive to thieves and joyriders."

The guidelines stated that, where factors combine to worsen the risk (such as use by a young driver or driving offences connected with speed), such applications should be declined. The policy schedule provided to the ISO Office showed that C was 23 years old; C held a restricted licence; and he had three traffic convictions (one for breach of licence and two for speeding) and the vehicle had no immobiliser.

The Case Manager believed P had made a commercial decision to accept a risk which, on the basis of the guidelines, was unacceptable in a number of respects. Consequently, the Case Manager did not believe P was entitled to rely on the guidelines as evidence it regarded the modifications as material information.

The Case Manager believed the risk presented by the vehicle (both the driving risk and the theft risk), taken together with C's age, restricted licence and his traffic convictions, was always an unacceptable risk in terms of the guidelines. However, P elected to offer C cover.

In this context, the Case Manager believed it was significant that, even without considering the modifications, two independent underwriters had commented they would have declined to offer cover for the vehicle, merely because of the age, traffic convictions, inexperience of the driver and the performance of the vehicle. The Case Manager believed P elected not to rely on disclosed information when it accepted the risk and issued the policy. The evidence given by B indicated information about the modifications was provided to P when the policy was arranged and, therefore, P was on notice about the modifications.

Accordingly, the Case Manager did not believe P was entitled to avoid the policy.

Complaint upheld

