

Presentation to Pacific Rim Actuarial Club of Toronto

Update on Life Insurance Market in China

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Disclaimer

The opinion and viewpoint expressed in this Power Point belongs to August Chow. It does not represent Hannover Re or the SOA.

Agenda

Part 1 Landscape of China Life Insurance Market

- Market Players and Premium
- Channel and Product

Part 2 Proposed China Solvency II (C-ROSS)

Part 3 Other Development and Regulatory Changes

- New National 10 Opinions (新国十条)
- Free Trade Zone
- Other regulatory changes

Part 4 Future Challenges and Opportunities

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- **Channel and Product**

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- Other Regulatory Changes

Part 4 Future Challenges and Opportunities

Public WeChat Account

• 偿付能力CROSS



• 保险行业网



• 保险资讯



• 最保险



• 精算通讯



• 保监微新闻 (CIRC)



• 中保协微视界 (IAC)



• 中国精算师协会 (CAA)



Sample WeChat Group Established by IAC



- 反洗钱课题组
(AML)



- 上海再保公司
(Reinsurer/SH)



- 公司治理交流群
(Governance)



- 中保协外资专委会
(JV insurers)



Number of Life Insurance companies in China at end of 2014



60 life insurers,
of which 33
domestic and
27 JV;

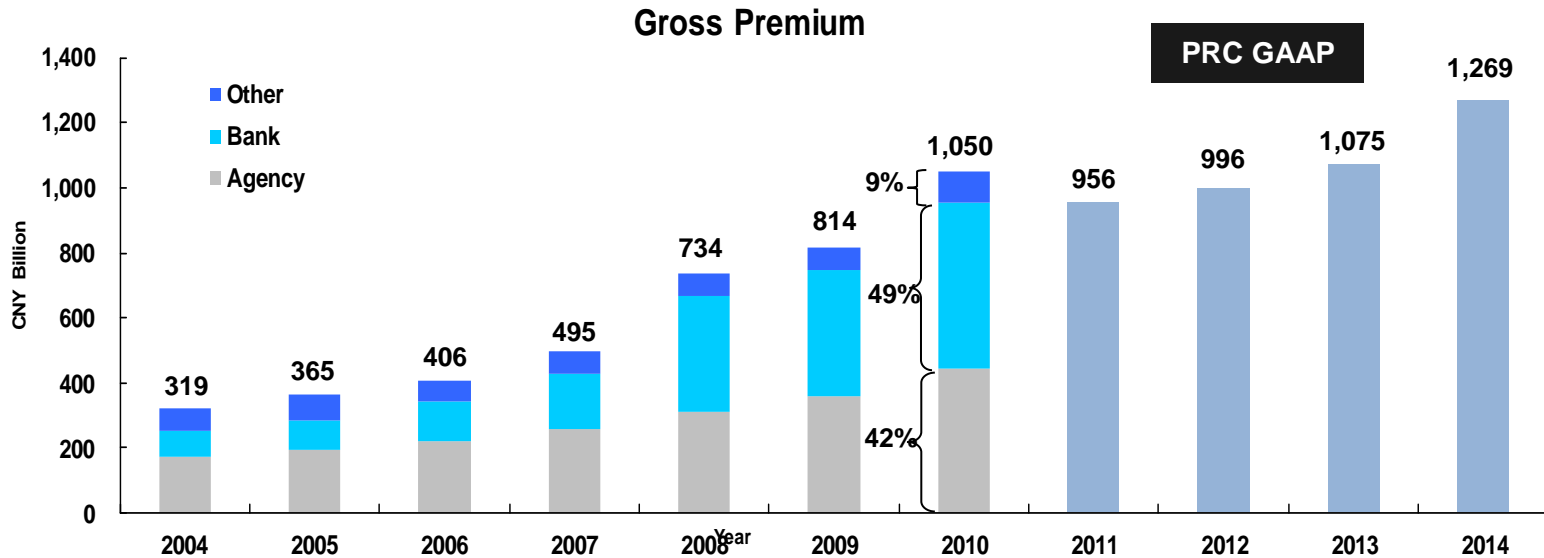
In addition,
6 pension
companies
and 4 health
companies;

Total 70 direct
companies;

7 reinsurance
companies.

Landscape of China Life Insurance Market

Gross Life Premium (2004 – 2014), CNY Billion



Source: www.circ.gov.cn

Note: the figures for 2004-2010 were on statutory basis and before unbundling, while CIRC began to release the figures under New PRC GAAP starting from 2011.

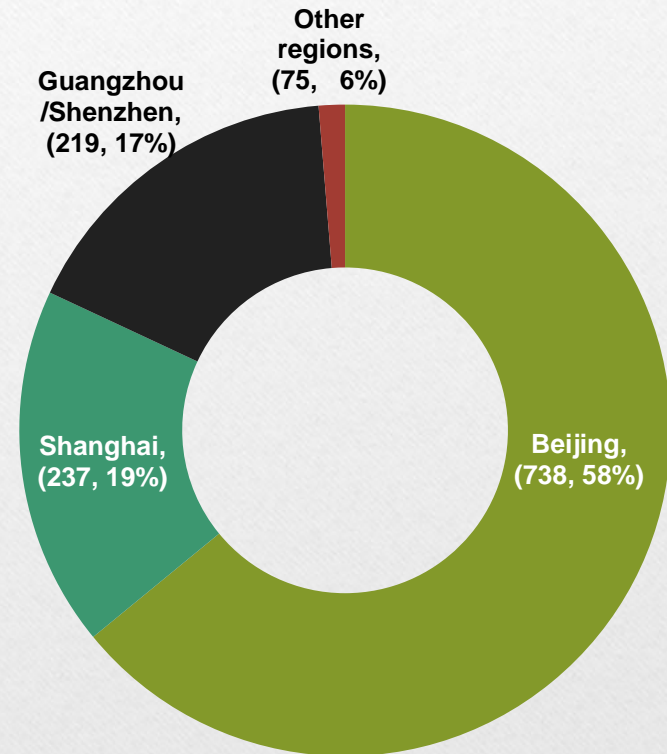
- From 2005 to 2010, premium of China life insurance industry grew at 24% p.a.
- From 2011 to 2014, premium grew at 9.9% p.a.

Landscape of China Life Insurance Market

Life Office Headquarter Geography

- Beijing, Shanghai, Guangzhou and Shenzhen are first-tier cities in which 76% headquarters of life insurance companies are located

Headquarter Location	No. of Companies	Prem in 2014 (CNY Billion)	Market Share
Beijing	28 (40%)	738	58%
Shanghai	20 (29%)	237	19%
Guangzhou/Shenzhen	5 (7%)	219	17%
Other regions	17 (24%)	75	6%
China Total	70 (100%)	1,269	100%



Landscape of China Life Insurance Market

Newly-approved Life Insurance Companies

- Since 2012, CIRC approves 12 life companies. More than half of them are located in Second Tier Cities. It may be the major direction of insurance company layout in the near future.

Newly-approved company	Headquarter Location	Tier 1	Tier 2	Preparatory
1. Hong Kang Life	Beijing	●		
2. Dong Wu Life	Suzhou		●	
3. Ji Xiang Life	Changsha		●	
4. Hua Hui Life	Shenyang		●	
5. Li An Life	Nanjing		●	
6. Prudential US Life (JV)	Shanghai	●		
7. Foresea Life	Shenzhen	●		
8. Pearl River Life	Guangzhou	●		
9. Sino Korea Life (JV)	Hangzhou		●	
10. Ergo Life (JV)	Shandong		●	
11. Guolian Life	Wuxi		●	√
12. Shanghai Life	Shanghai (FTZ)	●		(Feb 17, 2015 approved)

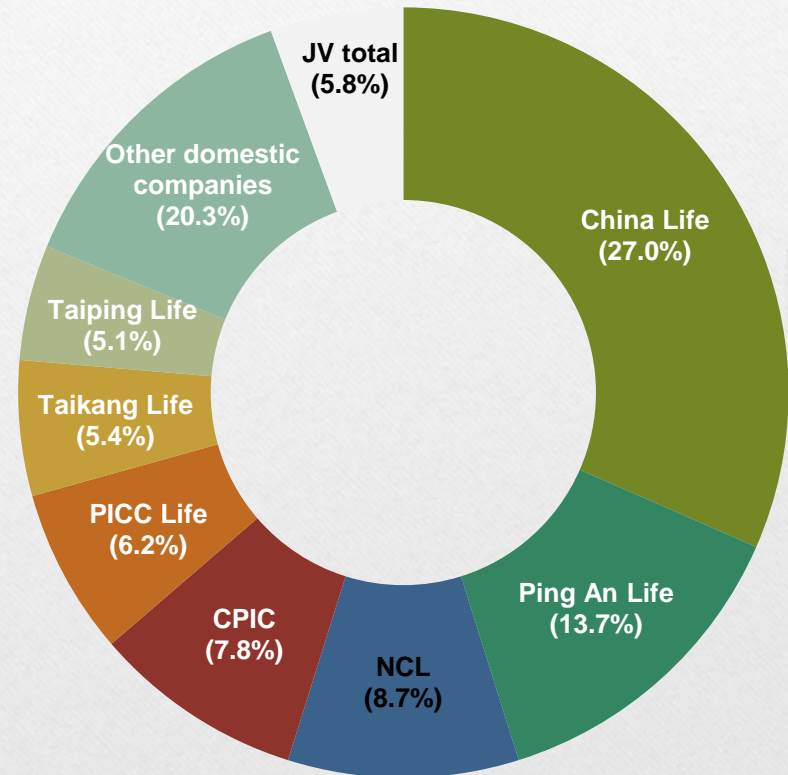
Newly-approved Life Reinsurance Company

Newly-approved company	Headquarter Location	Tier 1	Tier 2	Preparatory
1. RGA	Shanghai	●		

Landscape of China Life Insurance Market

The market share of Life Insurer in China (by premium)

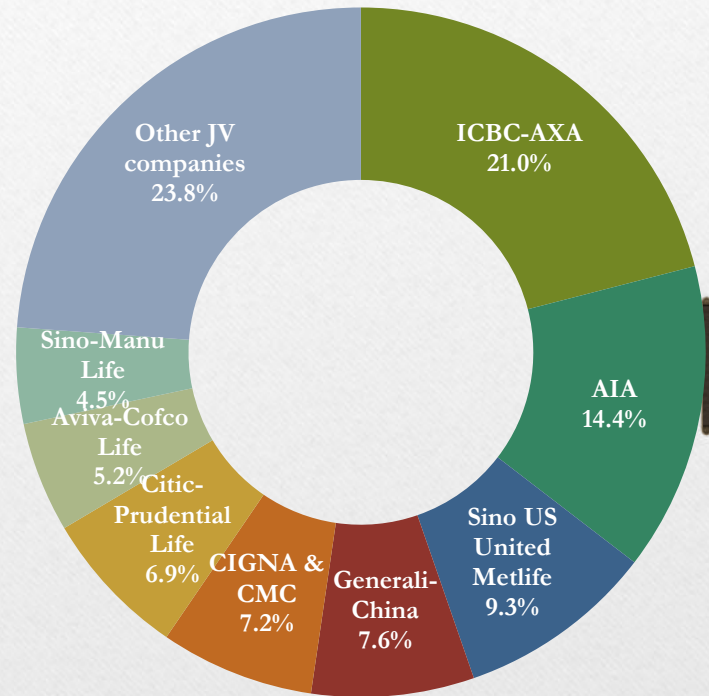
Company Name		Premium in 2014 (CNY Billion)	Market Share
China Life	Listed Co.	343	27.0%
Ping An Life	Listed Co.	174	13.7%
New China Life (NCL)	Listed Co.	110	8.7%
China Pacific Life (CPIC)	Listed Co.	99	7.8%
PICC Life		79	6.2%
Taikang Life		68	5.4%
Taiping Life		65	5.1%
Top 7 domestic companies in total		938	73.9%
Other domestic companies		258	20.3%
Domestic Company in total		1,196	94.2%
JV total		73	5.8%
China total		1,269	100%



Landscape of China Life Insurance Market

Major Joint Venture

Company Name	Foreign Shareholder	Premium in 2014 (CNY Billion)	Market Share of JV companies
ICBC-AXA	France	15.4	21.0%
AIA	USA	10.6	14.4%
Sino US United Metlife	USA	6.8	9.3%
Generali-China	Italy	5.6	7.6%
CIGNA & CMC	USA	5.3	7.2%
Citic-Prudential Life	England	5.1	7.0%
Aviva-Cofco Life	England	3.8	5.2%
Manu-Sinochem Life	Canada	3.3	4.5%
Top 8 JV companies in total		55.9	76.2%
Other JV companies		17.5	23.8%
JV total		73.4	100%



Cooperation between banks and insurance companies

1. Bancassurance channel

2. Bank investing in insurance company

Bank of Communication (BoComm)	=> BoComm Life (formerly CMG & China Life)
China Construction Bank (CCB)	=> CCB Life (formerly Pacific ING)
Agricultural Bank of China (ABC)	=> Jiahe Life
Industrial and Commercial Bank (ICBC)	=> AXA-Min Metals
Ping An of China	=> Shenzhen Development Bank
Bank of Beijing (BoB)	=> BoB ING Life
CITIC Bank	=> CITIC-Prudential Life
China Merchant Bank	=> CIGNA & CMC Life
Everbright Bank	=> Sunlife Everbright Life

3. Insurance company investing in bank

Ping An of China	=> Shenzhen Development Bank
China Life	=> China Guangfa Bank

Channel and Product - Individual Agent

Channel Feature

- Market share: 51% in terms of 2013 premium (42% in 2010)
- Rich in product line
- Agents could sell complicated products
- Risk of misleading by agents

Major Product Type

- Critical Illness Products
- Participating Whole Life
- Personal Accidental Product
- Unit Linked Product or Universal Life
- Medical Products
- Variable annuities Products

Channel and Product - Bancassurance

Channel Feature

- Market share: 37% in terms of 2013 premium (49% in 2010)
- Usually investment or saving focus products
- Higher premium size per policy
- Bancassurance was the biggest channel in life market in 2010 but had since dropped to 2nd place

Major Product Type

- 3-pay 5-year Par Endowment
- 5-pay 10-year Par Endowment
- Single Premium Par Endowment
- Juvenile Education Plan
- Deferred Annuity Certain

Channel and Product - Telemarketing Channel

Channel Feature

- Market share: 9% in terms of 2013 premium
- Outbound calls via call centre
- Simple product or package
- Simplified underwriting

Major Product Type

- Critical Illness Products
- Personal Accidental Product
- Endowment with Return of Premium
- Hospital Income Product

Channel and Product - Internet Channel

Channel Feature

- The “hottest” channel:
 - Change in consumption habit;
 - Development of e-finance;
 - Low cost;
 - Small misleading risk.
- Various channels:
 - Insurer’s website;
 - Third-party website;
 - WeChat
- Simple product or package
- Simplified questionnaire + telephone / full underwriting

Major Product Type

- Investment products with high CV:
 - 1-year investment with 5%-7% return;
 - 3-year universal life;
 - CIRC worry about the asset liability mismatch risk
- Short term accident
- Critical illness, cancer insurance

Channel and Product - Group Channel

Channel Feature

- Market with cut-throat competition
- Most premium paid by the employer
- Flexible demand

Major Product Type

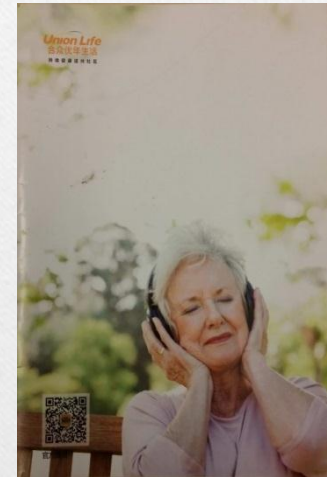
- Defined-contribution Annuity
- Short term accident and health

Pension

- With aging Chinese population, government attach high importance to the development of pension products
- In 2011 CIRC launched pilot program of variable annuity product, but it's not successful because of poor stock market performance and absence of tax incentives
- In June 2014 CIRC released the guideline for reverse-mortgage annuity insurance, but till now no insurance company has developed product
- Government will possibly announce tax-deferred policy for annuity insurance in 2015

Pension-Retirement community annuity product package

- In recent years, a few insurance companies were interested in the retirement community annuity product package
- Structure:
 - With support from government, insurance company acquires the land to build the retirement community;
 - Insurance company sells annuity policy to consumers;
 - The insured of annuity policy is entitled to live in the retirement community when the insured retires;
 - Annuity benefit of the annuity insurance policy shall be used to pay the rent and service cost in the retirement community.



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Existing Solvency I

- Solvency ratio = Actual Solvency Capital / Minimum Solvency Capital
- Actual Solvency Capital = Admitted Asset – Admitted Liability
- CIRC divide insurance companies to 3 classes according to their solvency ratios:
 - <100%: insolvent companies
 - 100%~150%: solvent companies type I
 - >=150%: solvent companies type II
- CIRC may take supervisory actions to the insolvent companies, such as:
 - require the shareholders to inject capital
 - restrict paying dividend to the shareholders
 - restrict establishing new branches
 - restrict the amount of new business written
 - take over the companies

Existing Solvency I

- Current formula (European style solvency I)
 - Introduced in 2003 and worked well in the early stage of market development in China
 - 4% of life reserves or 16% / 18% of non-life premium
- Problems with existing Solvency I calculation
 - Simple but does not cover all risk
 - Not risk oriented and not sensitive to risk management
 - Inconsistent assets and liabilities calculation
 - Asset on IFRS basis but reserve on PRC statutory conservative basis
 - leads to conservative solvency ratio
 - sensitive to market fluctuation

Proposed China Solvency II (C-ROSS)

Solvency II Project

- CIRC in April **2011** launched a research program to study the future solvency regime such as European Solvency II and US risk-based capital (RBC).
- In March **2012** CIRC released the project plan for the new solvency system.
- In May **2013** CIRC announced the framework of the new solvency system, China Risk Oriented Solvency System (C-ROSS);
- In **2014**, CIRC carried out QIS on C-ROSS starting with P&C insurers, then Life insurers and finally reinsurers
- CIRC released 17 C-ROSS consultation papers to industry by end of 2014
- In **2015**, insurance companies are required to carry out existing Solvency I and proposed Solvency II calculation
- In **2016**, Solvency II becomes effective

C-ROSS: Goals and Principles

- Goals
 - Systematically measure risks
 - Promote effective risk and capital management
 - Mechanism to enhance enterprise risk management
 - Provide useful experience to other emerging market
- Principles
 - Risk oriented
 - Reflect characteristics of Chinese market
 - Internationally comparable

Proposed China Solvency II C-ROSS

Timeline (1)

**CIRC Planning
(Released
on Mar
2012).**

Step One

Study work 2-3
years since
2012: Solvency
II in Europe,
RBC in US etc.

Step Two

Draft released
during 2014.

Step Three

Quantitative
testing basing
on the draft
released and
making
necessary
adjustment.

2012.4

CIRC new
solvency
scheme
working group
set up.

2013.5

C-ROSS
framework
released.

2014.3-4

15 P&C
companies for
sample test in
Mar, 1st round
industry test
for primary
companies in
Apr.
Reinsurance
companies not
involved.

2014.7

2nd round
industry test
and 2nd draft
policy released
for P&C primary
in July.

Reinsurance
companies
submit
comments, test
not required.

2014.7

1st drafted
policies
released
regarding
Pillar 2- non
quantified
reporting.

Proposed China Solvency II (C-ROSS)

Timeline (2)

**CIRC Planning
(Released on Mar 2012).**

Step Three

Quantitative testing basing on the draft released and making necessary adjustment.

2014.7-8

1st draft policy released for L&H primary companies in July, 1st round industry test in Aug.

Reinsurance companies submit comments, test no required.

2014.9-10

2nd round industry test and 2nd draft policy released for L&H.

1st round industry test requirement for Reinsurance companies.

2014.10-11

2nd drafted policies released regarding Pillar 2- non quantified reporting.

1st Drafted policies released regarding Pillar 3- disclosure.

2014.11

3rd round industry test and 3rd draft policy released for L&H primary.

2nd round industry test requirement for Reinsurance company.

Proposed China Solvency II (C-ROSS)

Timeline (3)

**CIRC Planning
(Released
on Mar
2012).**

Step Four

**C-ROSS
regulations and
time table
formally
released.**

2014.12-2015-1

**Formal release the
C-ROSS
SII regulations for
P&C and L&H
both. Official time
table of parallel
period for capital
injection.**

2015.1.13

**C-ROSS
regulations
were officially
passed. The
expected
parallel period
is 12 months to
end of Dec
2015.**

2015.2.17

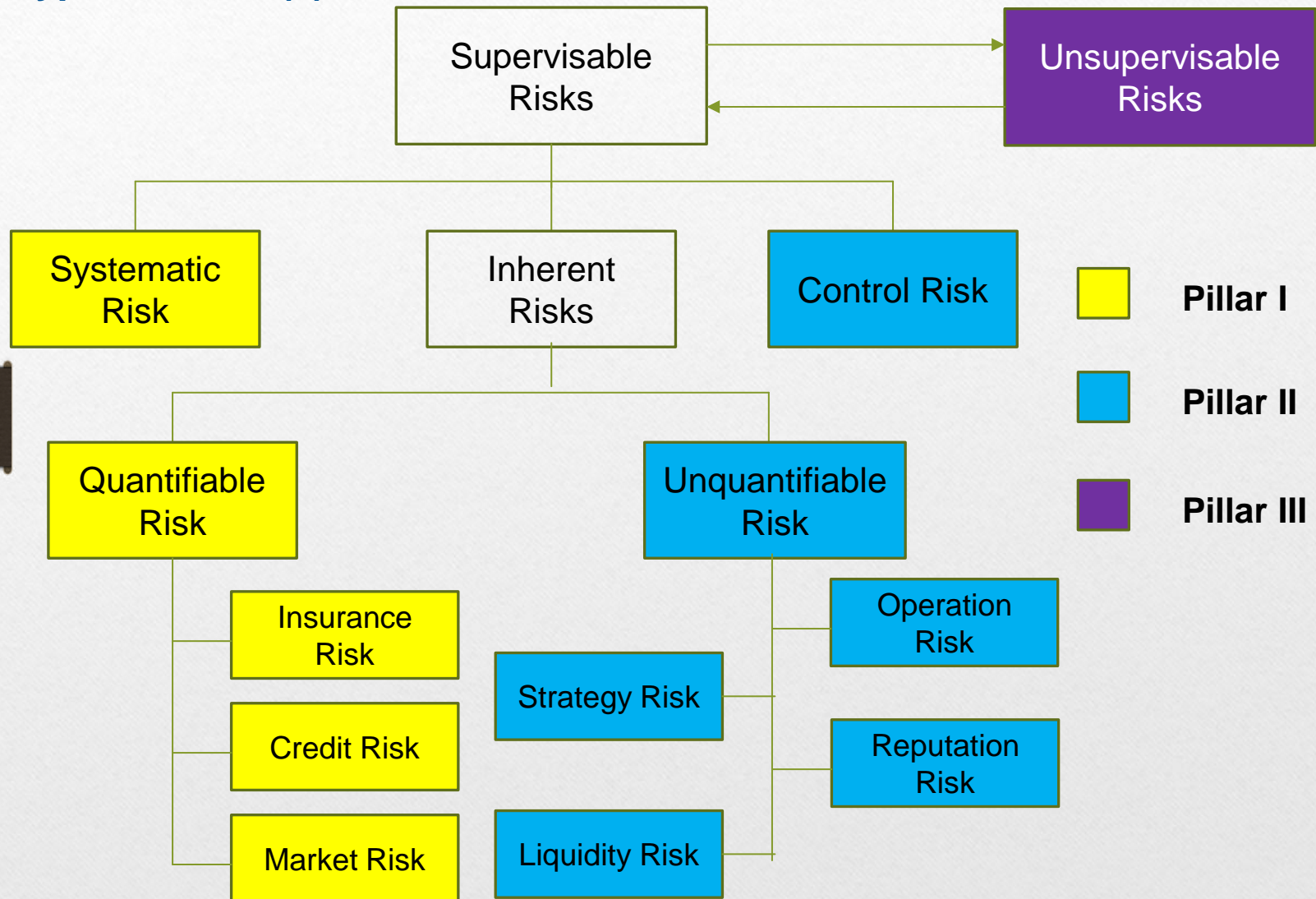
**The CIRC
formally
released C-
ROSS
regulations**

2016.1.1

**Insurance
companies pass
the parallel
period for
capital injection,
management
control risk
preparation. C-
ROSS is fully on
track.**

Proposed China Solvency II (C-ROSS)

Type of Risks (1)

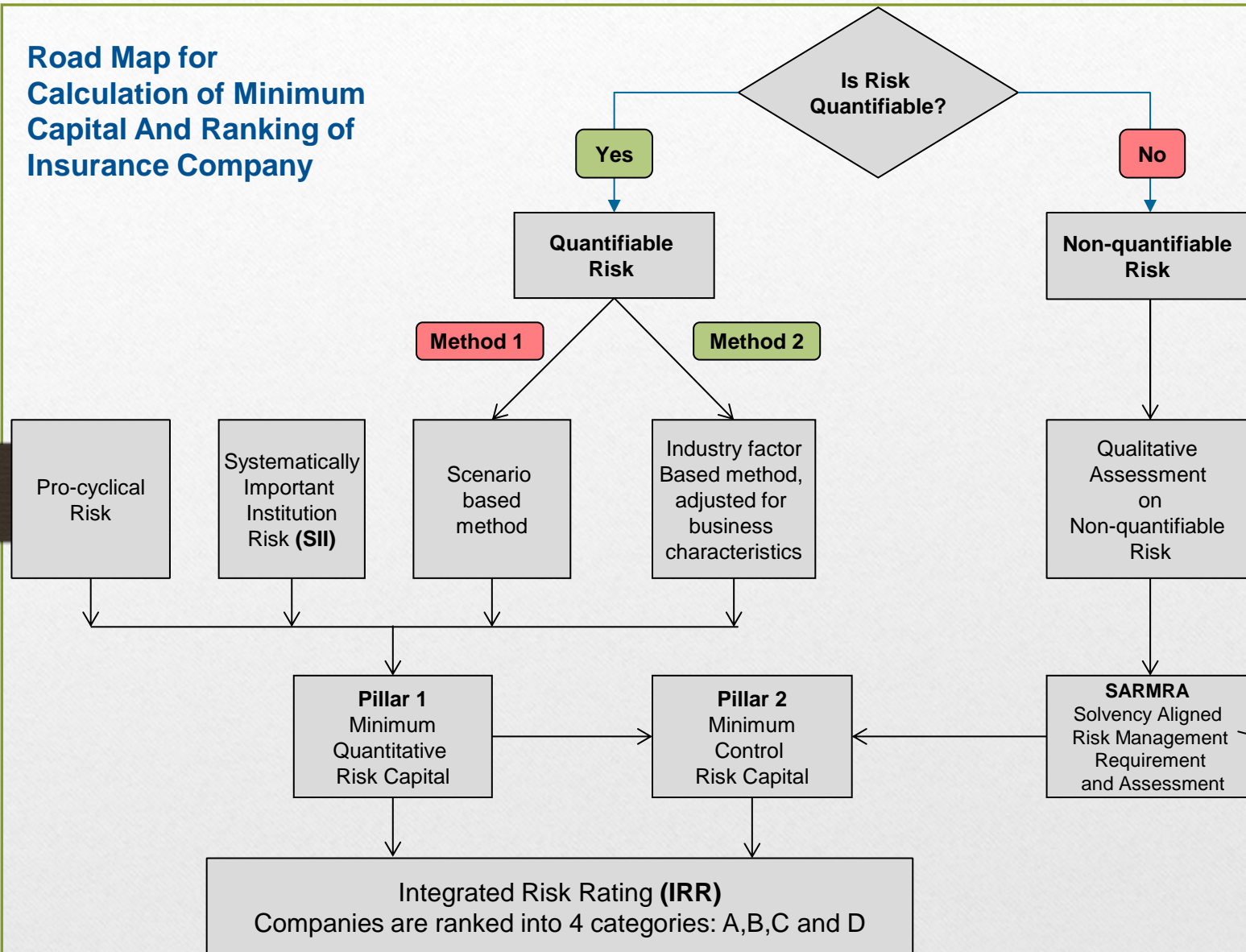


Type of Quantifiable Risks (2)

- Insurance Risk
 - Life Insurance – Mortality, Morbidity, Longevity, Expense, Surrender
 - Non-Life Insurance – Premium, Reserve, Catastrophe
 - Reinsurance – Life Reinsurance, Non-life Reinsurance
- Market Risk
 - Interest Rate, Equity, Property, Currency, Overseas Assets
- Credit Risk
 - Credit Spread, Default

Proposed China Solvency II (C-ROSS)

Road Map for Calculation of Minimum Capital And Ranking of Insurance Company



Proposed China Solvency II (C-ROSS)

Pillar 3

- Self-discipline mechanism with information disclosure to market
 - Rating agencies, analysts, investors, media

Technical aspect on C-ROSS

- Category of Capital
 - Tier 1 and 2; Core and Supplementary Capital
- Solvency Indicator
 - Core solvency adequacy ratio = core capital / minimum capital
 - Aggregate solvency adequacy ratio = (core and supplementary capital) / minimum capital
 - Integrated risk rating: a comprehensive overall evaluation of all risks, both quantitative and non-quantitative. Insurers are classified into A, B, C, D
- DST, QIS, VaR over 1-year time horizon
- Risk diversification with correlation coefficient allowed

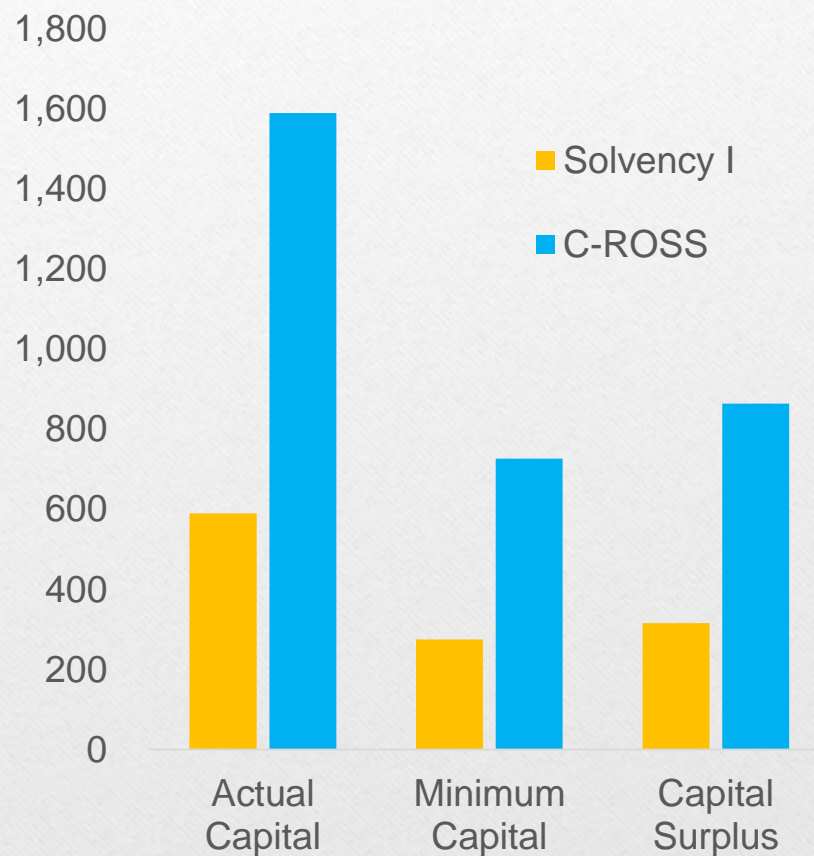
Proposed China Solvency II (C-ROSS)

QIS test results of life insurers

Average Solvency Ratios



in CNY billion



What are market implications under C-ROSS?

- Discourage sale of capital intensive product (e.g. high cash value)
- Market becoming more rational
- Companies need to develop expertise quickly on ERM, risk and economic capital modeling
- Demand on risk management and technical / modeling expertise
- More collaboration among Actuaries, Risk Management, Finance, Investment
- Reposition of reinsurance needs
- Potential more IPO
- Potential market consolidation among smaller and weaker insurers
- M&A

Reference: C-ROSS regulatory rules (released on February 17, 2015)

- Pillar 1 : Available capital (1)
 - : Minimum overall capital (2)
 - : Liability valuation for life business (3)
 - : Minimum capital for non-life insurance risk (4)
 - : Minimum capital for life insurance risk (5)
 - : Minimum capital for reinsurance companies (6)
 - : Minimum capital for market risk (7)
 - : Minimum capital for credit risk (8)
 - : Stress testing (9)
 - : Insurance Group (17)
- Pillar 2 : Integrated Risk Rating (Supervision by classification) (10)
 - : Solvency aligned risk management requirements and assessment (SARMRA) (11)
 - : Liquidity risk (12)
- Pillar 3 : Public disclosure on Solvency Information (13)
 - : Communication on Solvency Information (14)
 - : Credit rating on insurance companies (15)
 - : Solvency Reporting (16)

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New National 10 Opinions (新国十条)

- On August 10, 2014 the State Council released a document on “Accelerating the Development of Modern Insurance Service Industry” in China
- 1st time the insurance industry received such high-level attention and guidance from the State Council
- By 2020, it targets the insurance penetration ratio (premium / GDP) increased to 5% and the insurance density (premium / population) increased to CNY 3,500 in 2020
- Insurance premium (Life and Non-Life) to increase from CNY 2 trillion in 2014 to CNY 5 trillion in 2020
- The State Council also wants the insurance industry to play an increasing and bigger role in helping the society
- The opinions expressed in the document goes hand-in-hand with the C-ROSS

New National 10 Opinions (新国十条)

- Basic principles: market-oriented, industry reform, opening market
- Government to support insurance development with
 - inter-departmental communication and cooperation among regulators
 - government purchase of insurance services
 - tax incentive policies
 - guarantee of land for elderly care & health service industry
 - fiscal subsidy for agriculture insurance
 - promote public awareness on insurance

New National 10 Opinions (新国十条)

- To further develop commercial insurance
 - Life Insurance
 - Pension
 - Health insurance
 - Non-Life insurance
 - Liability insurance
 - Catastrophe insurance
 - Agricultural insurance
- To further improve
 - Insurance fund efficiency
 - Market-oriented
 - “going out” - international
 - Infrastructure and Innovation of insurance companies

Free Trade Zone

Set up

- ▶ Lead by China State Council in September 2013

Focus

- ▶ Government new platform for "reform - open policy"

Fast development

- ▶ @30.06.2014 registered more than 19,000 companies, incl. 142 of Fortune 500

Financial
Market Innovation

- ▶ All 4 supervision departments have named their supporting points, 2 already with detail operational rules

CIRC gave
first 8 rough points

- ▶ Build up Reinsurance Market, especial **International Reinsurance Centre**
- ▶ Develop key lines: Liability and Marine
- ▶ Expand investment abroad
- ▶ RMB cross-border movement

CIRC 3 new measures

- ▶ Ease supervision on new product, branch license and senior management appointment.

Insurance in FTZ

- ▶ Already open: 11 sub-branches (7 P&C, 4 Life), 3 legal entities (1 life, 1 Investment, 1 credit ins.), 1 rep-office (AIA)

Free Trade Zone

● Shanghai was already defined as “Doppel Centre” for Marine and Reinsurance

● “Government 10 Points” asks to build up Regional Reinsurance Centre. It will be on SH FTZ platform

● **Attractiveness**

- In Shanghai registered Reinsurer open sub-branch in FTZ - no approval necessary.
- Benefit of preferential cross-border RMB policy
- Benefit of preferential policy for products (Cat, Liab. , Marine etc.)
- Political Bonus: First Move to support government policy

● **Uncertainty**

- How to combine offshore and domestic business?
- CIRC is negotiating for preferential tax policy, result still unclear.
- more detailed operational rules are still in pipeline

Investment

- In recent years, insurance companies are allowed to invest in more investment vehicles, such as
 - Real estates
 - Stock index futures / financial derivatives
 - Asset-backed securities (ABS)
 - Trust plan
 - Preferred stock
 - PE (private equity) and venture capital
- Insurance Asset Management Company (AMC) are allowed to expand its entrust fund to non-insurance entities
- With the liberalization of the investment vehicles, regulator pays more attention to the insurance company's risk management

Policies to Liberalize Front End and Control Back End

- **Liberalize Front end**

- Move from rule-based to principal-based
- Curtail proactive regulation
- Reduce regulatory approval and licensing
- Change insurance product from approval-based to registration-based
- Remove restriction on maximum 2.5% pricing interest rate
- Expand areas of investment

- **Control Back End**

- C-ROSS
- ERM
- Internal Audit
- Internal Control

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Challenges and opportunities

- China ranks #2 in the world's economy, with the growth ratio of GDP over last two decades around 9.5%, and drop to 7% or lower in the future
- China life insurance market ranks fourth in the world while ranks second in the Asia as at the end of year 2013 in term of annual premium volume
- Seven largest companies dominate 75% of life market share; foreign insurers have only 5% market share
- Saving products are most popular with high premium and low embedded value
- China aims to achieve insurance penetration (premium / GDP) 5% and insurance density (premium / population) CNY 3,500 in 2020; insurance premium is expected to increase from CNY 2 trillion in 2014 to CNY 5 trillion in 2020

Challenges and opportunities

- **Product development**
 - Product homogeneity and short product cycle
 - As China grows its economy, there are many untapped products especially in medical / health, pension, annuity and wealth management products
- **Distribution channel**
 - Difficulty in recruiting new agents
 - Banks entering into insurance market
 - CBRC imposes rule that bank can sell insurance products for 3 insurers and Life insurers cannot place agents in banks to sell life insurance
 - Other direct marketing channels (telemarketing, internet, TV) are promising
- **Life insurance market in China is still full of opportunities**
 - Relatively weak awareness of insurance among Chinese people
 - Limited types of insurance coverage
 - Fast aging society
 - High savings ratio
 - Accelerate emergence of middle class and urbanization

Challenges and opportunities

- **Foreign life insurers** are losing the market share, partly due to CIRC regulatory restriction and partly due to the lack of localization of operation and lack of flexibility by home office. As China insurance market further develops, regulatory restriction could be lifted which would provide more level playing field for domestic and foreign insurers
- **The CIRC**
 - focusing on consumer protection, strengthening compliance and sales practice in order to improve insurance industry image
 - liberalizing the front end regulation (such as product pricing and investment) and controlling the back end regulation (such as C-ROSS, risk management, internal control, internal audit)
- One still need to take **long term view** on investment in China

Q & A