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The Life Insurance Industry in China

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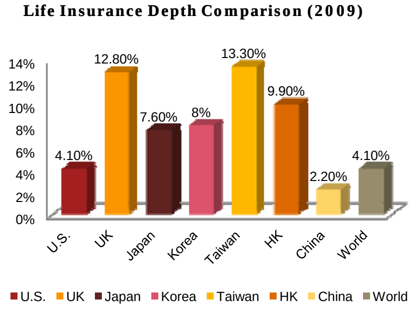
Data from published sources, mainly China Insurance Regulatory Commission

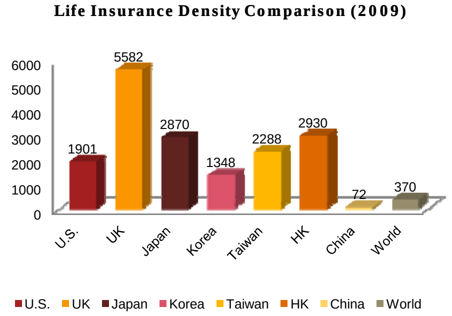
Agenda

- Overview of life insurance market in China
- Product offering
- Distribution channels
- Competitive landscape
- Current challenges and possible changes

Overview of Life Insurance Market in China

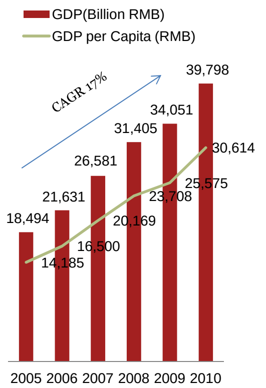
Life insurance in China still has huge potential even after rapid growth over the past ten years.





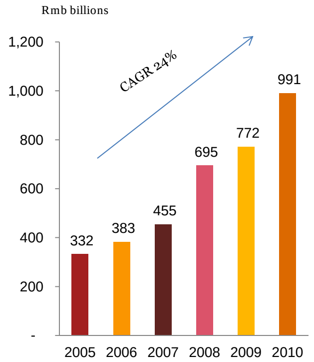
Drivers of China Life Insurance Market

GDP and GDP per Capita Growth in China



Source: China Insurance Statistic Year Book

Life Insurance Premium Growth in China



Source: CIRC

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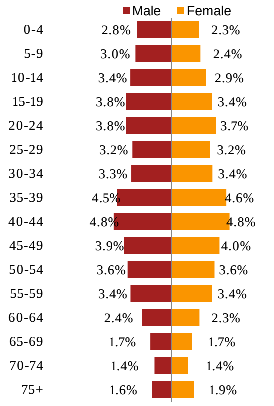
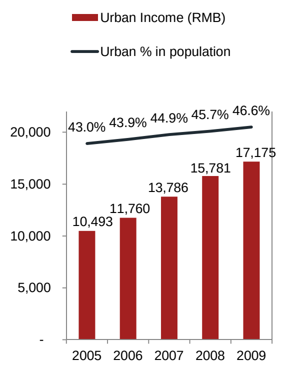
Drivers of China Life Insurance Market

China Age Distribution (2009)



Source: China Insurance Statistic Year Book

Population and Annual Income of Urban Households



Source: National Bureau of Statistics of China

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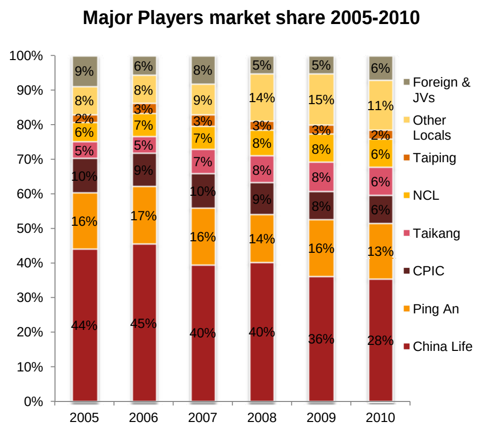
Chinese life insurance market is relatively concentrated



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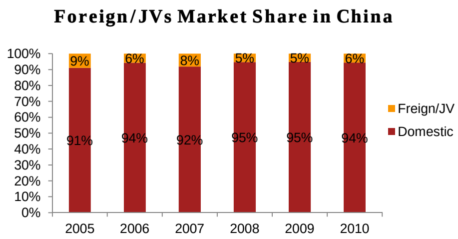
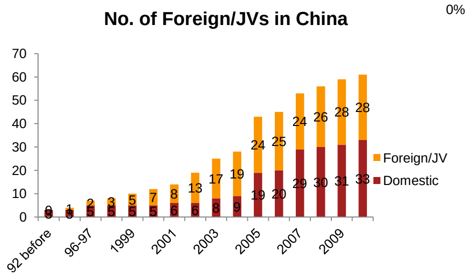
Foreign/JV Companies in China





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Product Offering

Participating business dominates Life Market in China

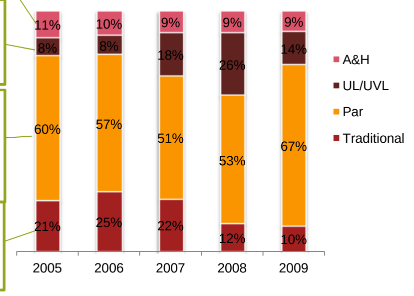
Market In-Force Product Mix

- •Accident and Health products

- •Including both insurance protection and investment, flexible premium payments for clients
- •Relatively unstable cash flows and higher lapse rate
- •Much different from the traditional products due to higher risks

- •Competing on dividends as pricing rates are restricted by CIRC
- •Relatively stable cash flows, lower lapse rate and better profitability
- •Including both insurance protection and investment
- • Bonuses based on not less than 70% of distributable earnings

- •Strong insurance protection with simple product features
- •Relatively stable cash flows and higher profitability
- •Insurers credit no more than 2.5% for pricing rate and investment return need not to be shared



Profitability Analysis

Indicator		Traditional	Participating	Unit Link & Universal	Accidental & Health
Profit Margin		20 - 30%	Bancassurance: 0 - 3% Agent:3 -10%	0– 5%.	10 - 25%
Surrender rate		Low	Low	High	High
Growth Potential		Relatively low	Relatively high	High	Relatively high
Capital Requirement	**Percent of reserve**	4 %	4 %	For Unit link, 1 percent; for Universal, 4 percent	4 %
	Percent of NaR	NaR is the maximum benefit minus reserve. For term less than 3 years, 0.1% of NaR; For term less than 5 and higher than 3 years, 0.15% of NaR; For term higher than 5 years, 0.3% of NaR.			

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Distribution Channels

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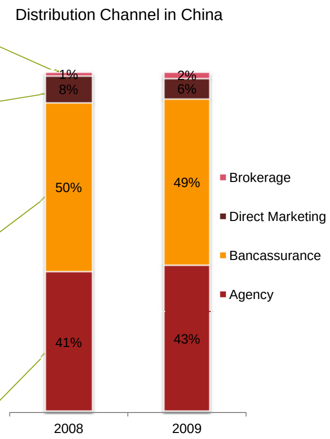
Agency and Bancassurance are the two main distribution channels

- •One broker can represent multiple insurance companies
- •More suitable for group insurance
- •Size of brokers are generally small with limited value-added services

- Sales persons are employees of companies,
- Companies are developing new telemarketing and website channels.

- Mainly used to gain market share in a short time (eg. PICC Life)
- Large networks
- One bank branch can sell products for 3 insurers, which leads to fierce competition and higher commissions
- Similar and simple product features. Major product type is single premium par products with low profitability
- Low levels of selling skills

- Sells products for one insurer, not an employee, and earns commission Relatively higher profitability, but still a great challenge to new-entry and small-scale insurers
- Low retention rate
- Low productivity



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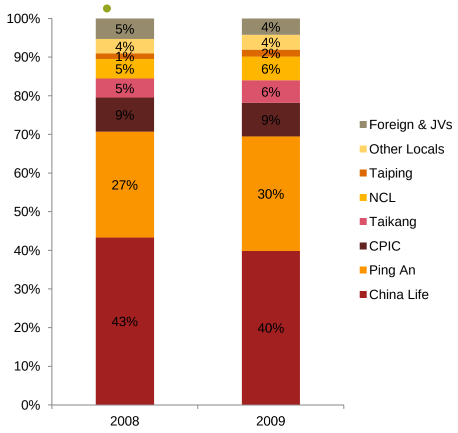
Companies in Agency Market



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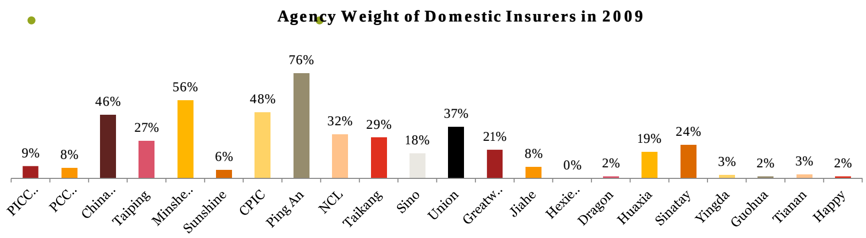
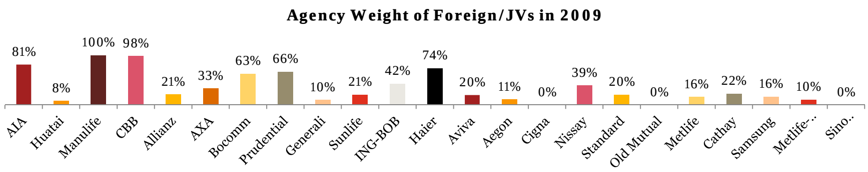
Agency channel dependence





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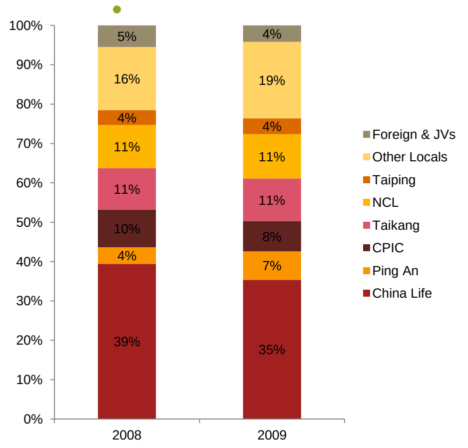
Companies in Bancassurance Market



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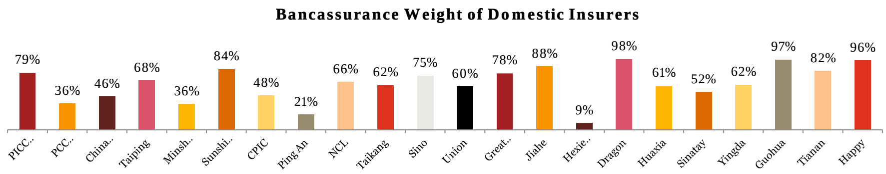
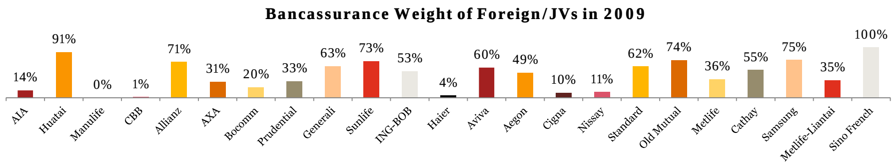
Bancassurance channel Dependence





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Competitive Landscape

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Competition Between Foreign Insurers and Domestic Insurers - Domestication Trends

- China entered the World Trade Organization and promised to open its financial service market. With technology, talent and capital advantages, foreign companies caused great concern among Chinese insurers when they entered Chinese insurance market.
- But as of 2010, insurance premium income for foreign insurers in China accounts for less than 6% of the market. For property and casualty, the figure is only 1%.
- Issues for Foreign Insurers
  - ✓ Foreign insurance companies have great advantage in risk management. But this can be only reflected in long-term operation, not short-term competition for market share.
  - ✓ Foreign insurers focus on profitability when pricing, but because of their limited business, the cost overruns make their profitability goal difficult to achieve. In contrast, Chinese companies strive to enlarge their business in the first place. Different strategies put foreign insurers on a poor position when competing with domestic players.
  - ✓ Domestic insurers have far better sales networks compared to foreign insurers.
  - ✓ Foreign insurers turn out to be less flexible in response to market change because of their rigid control of their Chinese partners.
  - ✓ It takes relatively long time for the joint venture companies to acquire branch approval.
  - ✓ Cultural integration between foreign and Chinese management is not easy.

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Current Condition of the Foreign Life Insurers in China

- Although some foreign insurance companies have reduced their investment or even withdrawn from China, there are still many foreign investors that remain interested in Chinese insurance market.
- A relatively new trend is that foreign insurance companies are relaxing their control over local management.
- Chinese insurers are no longer afraid of their foreign competitors, and some Chinese insurers even believe that they enjoy higher investment premium.

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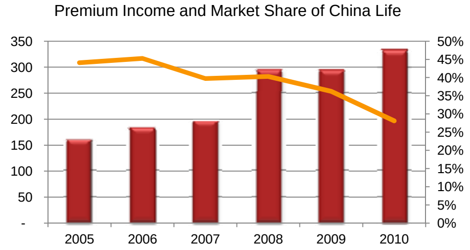
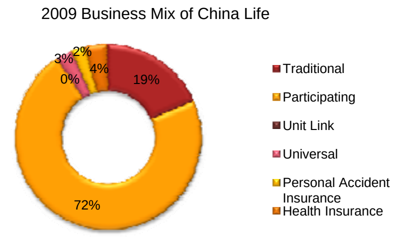
Major Player – China Life

- In 2010, China Life premium income was 333 billion, accounting for 28% of total market volume. China Life keeps its dominant place in the life insurance market although the market share is declining slowly.
- China Life took the lead in promoting participating products.
- Over 70% of the premium income is participating.
- China Life has over 600 thousand agents to promote its products, taking the first place among Chinese insurance companies.
- China Life is supported by the government and its development is of concern to the State Council, as it represents the development of national insurance industry.

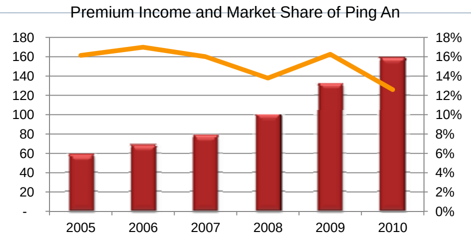


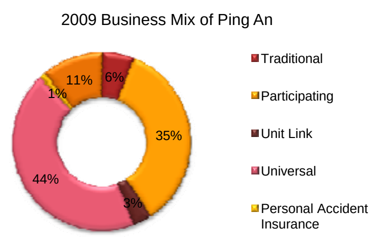


Data Source: CIRC data *Unit: RMB Billion*

Major Player – Ping An

- In 2010, Ping An premium income was 159 billion, accounting for 13% of total market volume.
- Ping An is the second listed insurer in the mainland and it maintains a market share larger than 10%.
- Participating and Universal are both major lines taking around 30% of the premium.
- The implementation of New Chinese Accounting Standards has had a negative impact on Ping An.

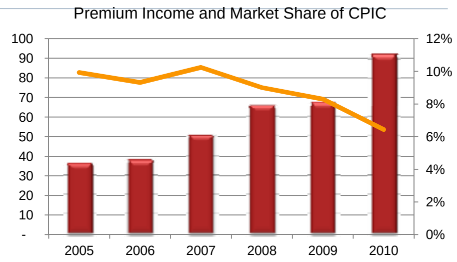


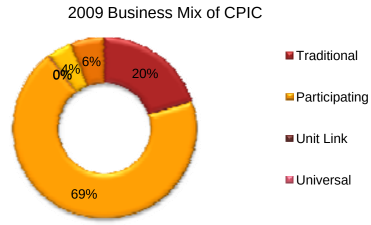


Data Source: CIRC data *Unit: RMB Billion*

Major Player – CPIC

- In 2010, CPIC premium income was 92 billion compared to 68 billion in 2009.
- CPIC is the third listed insurer in the mainland, but the market share decreased by 2% in 2009 with ranking 4th in the total market.
- Participating made up almost half of the premium.





Data Source: CIRC data *Unit: RMB Billions*

Comparison of margins

VNB/FYP

Company	2010 As disclosed	2010 Adjusted to 11%	2009 As disclosed	2009 Adjusted to 11%	2008 As disclosed	2008 Adjusted to 11%
China Life	10.43%	10.43%	10.39%	10.39%	6.67%	6.67%
PingAn	20.39%	20.39%	18.17%	18.17%	18.80%	19.92%
CPIC	11.26%	11.91%	13.11%	13.91%	7.82%	6.86%

VNB/APE

Company	2010 As disclosed	2010 Adjusted to 11%	2009 As disclosed	2009 Adjusted to 11%	2008 As disclosed	2008 Adjusted to 11%
China Life	24.97%	24.97%	27.06%	27.06%	26.14%	26.14%
PingAn	31.33%	31.33%	32.12%	32.12%	31.37%	33.22%
CPIC	29.61%	31.32%	32.74%	34.74%	33.74%	29.60%

- Source: CIRC, published accounts and pwc analysis
- While CPIC used risk discount rate of 11.5% in year 2010, 2009 and 12% in year 2008, VNB of all companies has been approximately adjusted to 11% for comparison.
- Premium of China Life and CPIC in 2009 and 2010 are data subjected to New CAS requirement
- FYP = First Year Regular Premium; APE = Regular Premium + Single Premium * 10%

Current Themes

Current Themes

- Regulation of Bancassurance has tightened at the same time as banks have been entering the market on their own account
- As domestic investment markets mature and regulation relaxes, insurance firms have more investment options
- Product and Pricing Regulation is being loosened to stimulate innovation….
  - …..but emphasis on governance and regulation of sales practices is tightening
- Capital demands are constant and thus capital raising and merger and acquisition activities are frequent
- Solvency Regulation behind the curve
- Financial reporting aligned with IFRS

Decline of Bancassurance Channel

- Drawing on overseas examples, bancassurance has delivered large sales volumes since its inception a decade or so ago. However, the beneficiaries in terms of profits have been the banks.
- At the end of 2010, the CBRC promulgated a new supervision rule for bank agent insurance business (CBRC [2010] No.90). The major effects of the new rule on the insurance business include:
  - ✓ Insurance company personnel are not allowed to be placed as sales people in the commercial bank outlets
  - ✓ In principle, each commercial bank branch can cooperate with no more than 3 insurance companies.
- China's economic environment has undergone great changes. Interest rates are high and People's Bank of China raised the deposit reserve ratio 7 times in 2010 to reduce money market liquidity. Banks no longer have a great passion for selling insurance products, they turn more to sales of their "financial products."
- As a result, the premium income of each Chinese Insurance company suffered severe negative influence since the end of 2010.

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Banks Enter the Insurance Industry

- Bigger changes in the future possibly lie in bank-owned insurance companies, reducing opportunities for stand alone life insurers further.
  - ✓ The Construction Bank, Band of Communication and the Everbright Bank already have their own insurance company.
  - ✓ Industrial and Commercial Bank and Agricultural Bank of China have acquired insurance companies, but are still awaiting regulatory approval.
- Life Insurance companies which are part of wider financial groups also seek to exploit synergies.
  - ✓ Cross-selling between life insurance and property and casualty insurance
  - ✓ The insurance companies with enough financial resources try owning banks to achieve a greater degree of cross-selling
  - ✓ Create a shared service centre for greater cost savings

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Banks and Insurers

Bank	Insurance Company before transition	New Insurance Company	Shareholders Summary
China Everbright Bank	Sun Life Everbright Life	Sun Life Everbright Life	Everbright: 75.01%, Sun Life: 24.99%
Bank of Communications	China Life-CMG	Bo-Com Life	CMG: 63.5%, Commonwealth Bank of Australia: 37.5%
Bank of Beijing	ING-CAP	ING-BoB Life	BoB: 50%, ING: 50%
China Construction Bank	Pacific-Antai Life	CCB Life	CCB: 51%, CCB Investment: 19.35%, JinJiang International Holdings Co., Ltd.: 4.9%, Huaxu: 4.85%, ChinaLife Taiwan: 19.9%
China Post	China Post Life	China Post Life	China Postal holds 100% of shares
Industrial and Commercial Bank of China	AXA - Minmetals	ICBC-AXA	ICBC: 60%, AXA: 27.5%, Minmetals: 12.5%
Citic Group	Citic Prudential Life	Citic Prudential Life	Citic and Prudential each holds 50%
China Merchant Bank	Signa - CMB	Signa - CMB	CMB and Signa each holds 50%

Investment Regulation

- ✓ In the past, insurance companies in China were only allowed to invest in government bonds, financial bonds, corporate bonds, deposits, stocks and funds. Some domestic insurers enjoyed the right to invest in infrastructure project debt. In recent years, China Insurance Regulatory Commission has gradually relaxed the restrictions on the investment.
- ✓ August 2010, the CIRC promulgated the "Interim Measures on Management of insurance funds", and allowed insurance funds to be invested in real estate and unlisted shares for the first time.
- ✓ ALM remains a major issue with most companies having significant interest rate risk exposure

Product and Pricing Regulation

- Variable Annuity Trial
  - ✓ Chinese life insurance market is currently dominated by participating insurance. Other types include traditional insurance, universal insurance and unit-linked insurance. This year regulators allowed sales of variable annuity insurance, although on a one-by-one company approval basis.
  - ✓ Those that are most interested in variable annuity insurance are foreign insurers because they have advantage in techniques and risk management.
  - ✓ Variable annuity is a breakthrough in China, because in China unit-linked insurance is not allowed to have a guaranteed return, but the variable annuity insurance can have GMXB.
- CIRC is open for comments on pricing interest rate.
  - ✓ Chinese life insurance industry has set an upper limit of pricing interest rate of 2.5% since June 1999. This regulation bought time to offset losses inherent in high interest rate guarantee business. Given that the current five-year saving account's interest rate has reached 5.5%, this regulation has seriously weakened the attractiveness of traditional non-participating insurance.
  - ✓ Large insurance companies are resisting change, while small insurance companies are keen to see a relaxation.
- At the same time as relaxing these aspects of regulation, the regulatory commission has also emphasized compliance checks and penalties, with intensified focus on sales compliance, eradication of fraud and corporate governance.

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Increasing Demand for Capital and Frequent M&A Transactions

- Product mix is capital intensive
- New insurance companies need shareholder's capital injection every one or two years, and listed companies' abundant capital has almost run out.
- Some Insurance companies are preparing initial public offerings (IPO) to obtain greater funding.
- Many insurance companies have gained additional capital through issuing subordinated debt,but their extensive use of subordinated debt has caused great concern to CIRC.

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Solvency Regulatory System

- The current solvency regulatory system in China consists of a simplistic capital formula combined with limited scope Dynamic Solvency Testing
- Changes in solvency regulatory system in other countries (Taiwan, Thailand, Singapore, Hong Kong etc.) have caused concerns to the China Insurance Regulatory Commission that Chinese regulatory system may be far behind other countries. The banking supervision system has updated to Basel II system, which also makes CIRC feel behind other financial services sectors.
- CIRC has been looking at the solvency regulatory system for a while; however, there seems little drive for change soon.
- CIRC has yet to make a decision on whether to back the Asian RBC style model or Solvency II type approach.

Changes in Chinese Insurance Accounting Standards

- In November 2005, Chinese Accounting Standards Board and International Accounting Standards Board signed a joint statement which confirms the convergence of Chinese Accounting Standards with International Financial Reporting Standards.
- In 2007 Chinese new corporate accounting standards was first implemented in listed companies' reporting.
- In December 2007, Chinese Accounting Standards Board and the Hong Kong Society of Accountants signed the joint statement of the equivalence of Accounting Standards for Enterprises on the Mainland to Hong Kong Financial Reporting Standards (HKFRS).
- But, China Life and Ping An, two listed companies both in Hong Kong and Shanghai, published significantly different financial results for premium income and profits in the two places . The main reasons include:
  - ✓ China's insurance accounting standard did not have the significant insurance risk transfer requirement like IFRS 4. Hong Kong's HKFRS 4 had not been implemented when these Chinese companies were listed in Hong Kong, and China Life and Ping An have been following US GAAP accounting standards or referring to US GAAP practice;
  - ✓ Chinese accounting standards does not allow any deferred policy for acquisition costs;
  - ✓ Reserves are calculated based on different standards.

Changes in Chinese Insurance Accounting Standards

- 2008 China Ministry of Finance issued the Explanation II of Accounting Standards, emphasizing that companies listed in Hong Kong and China at the same time should adopt consistent accounting standards. However, this requirement failed to be implemented because of technical problems at the time.

- To deal with the problem, in 2009 Chinese Ministry of Finance in 2009 developed accounting rules related to insurance contracts. The regulation texts were sent to insurance companies in the December 30, 2009 and were required to be applied to their financial reports in 2009 immediately!

Characteristics of the New Rules

- Main ideas and principles originate from the preliminary decision of the new insurance accounting standards by the International Financial Reporting Standards Boarding.
- The introduction of the requirements of significant insurance risk transfer led to different treatment of universal insurance products and unit-linked insurance products from the other products.
- For non-participating insurance products, market interest rate plus risk margin is used as the discount rate. For participating insurance products, the discount rate used is the best estimated investment yield.
- Acquisition costs can be deducted in the reserve.
- Reserve is basically:
  - ✓ The best estimated reserve, plus
  - ✓ The risk margin, plus
  - ✓ The residual margin
- The residual margin is used to amortize the first-day profit in the following years.

Review of Implementation

- The implementation of principles-based accounting standards in China is a new thing. Guidance provided by industry associations will lead to increased comparability between financial statements.

- The mismatch of assets and liabilities in terms of accounting measurement remains a major problem:
  - ✓ Prior to 2007, liabilities are locked, from the market fluctuation; assets except short-term investment are measured at book value, unless a provision for impairment. Was deemed necessary.
  - ✓ During 2007 to 2009, assets except the held to maturity category, are measured at market value; liabilities are still not subject to market factors, unless the reserve adequacy test is not satisfied.
  - ✓ In 2009, the debt began to lean toward market value. However, because of the use of 750 days moving average curve, the market yield curve on the balance sheet date can be fully reflected in the value of fixed-income assets but not in the value of liabilities.