# Fitch Ratings 2020 Outlook: China Insurance

## Ongoing Profit-Driven Growth

### Life Sector Outlook: Stable

Fitch Ratings maintains a stable sector outlook, reflecting our expectations of moderate premium growth and stable surplus generation as a result of an improving business mix and sustainable margins, which leads to moderate capitalisation. Nonetheless, reinvestment rates lag investment yields, which is likely to prompt insurers to invest in more high-yielding assets – including stocks and long-term equity investments. We expect insurers to exercise caution on asset allocation with respect to their liability risks under the latest asset-liability management (ALM) rules.

### Non-Life Sector Outlook: Stable

The sector outlook remains stable. We expect the expense ratio of motor insurance to stabilise in view of regulatory initiatives to control acquisition costs under the competitive market landscape. Nonetheless, smaller insurers are still under pressure to improve underwriting results, and rely on reinsurance to support underwriting capacity.

### Rating Outlook: Stable

Fitch maintains a stable rating outlook for Chinese insurers over the next 12 months. This reflects the mix of Outlooks on individual rated insurers and their capital positions, resilient business profile and financial performance.

### Rating Distribution Weighting

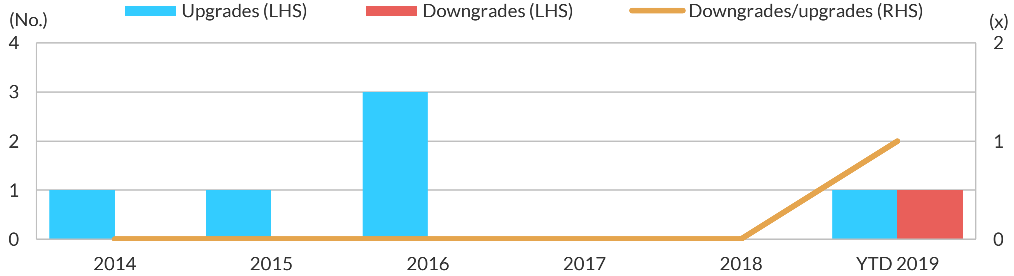
The Insurance Financial Strength (IFS) ratings on Chinese insurers range from 'AA-' to 'BBB', with concentration in the 'A' to 'A-' levels, depending on capital strength, profitability and business profile. One life insurer was downgraded and one non-life upgraded during 2019. The downgrade was driven by weakened capitalisation, increased exposure to risky assets, and challenges to sustaining value-driven business growth and margins.

### Stella Ng, Director

"Fitch forecasts an ongoing shift in business mix for Chinese insurance in 2020, which is credit positive. Life insurers have been repositioning their business to cope with low interest rates and to implement active ALM. We believe scale advantage for non-life insurers will still enable larger insurers to sustain favourable underwriting margins."

### China Insurance Sector - Rating Changes

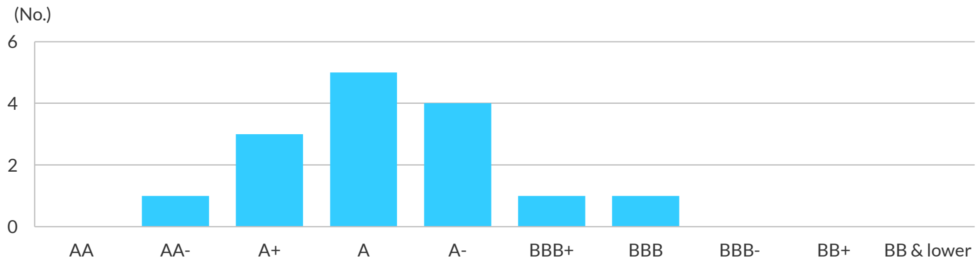
(As of November 2019)




Note: Based on IFS Rating
Source: Fitch Ratings

### China Insurance Sector - Rating Distribution

(As of November 2019)




Note: Based on IFS Rating
Source: Fitch Ratings

### What to Watch

- Evolution of life insurers' margins after business mix shift to long-term, protection products
- ALM impact
- Underwriting stability of non-life insurers amid a continued, competitive motor insurance sector
- Ongoing capital needs for smaller non-life insurers to maintain their financial stability against catastrophe losses

## China/Life

### Moderate Headline Growth Amid Lower Economic Dynamism

Fitch expects life premium growth to remain resilient – stemming from structural changes and aging demography – despite continuing US-China trade disputes and lower anticipated economic metrics in China that could weaken growth in new business. Statistics and a broader assessment of activity indicators support our view that GDP growth will fall below 6.0% in 2020. Growth slowed to 6.2% in 2Q19, down from 6.4% in 1Q19.

Deepened business transformation towards more long-term regular premiums supports sustainable premium growth. This development is more evident for the six listed life insurers, which collectively accounted for an approximately 57% market share by original premium in 1H19. We expect the industry to have a double-digit premium growth in the next 12 months. Original premium grew by 14% in 3Q19 from a low base a year earlier, resulting from regulatory constraint on the sales of short-term saving products.

### Resilient Health Insurance Growth Prospect

We expect health insurance to become a larger contributor to the industry's premiums, in view of rising health awareness and an aging population. The growing demand for a longer and healthier life, coupled with regulatory initiatives, leads us to view health insurance as a significant opportunity for growth. Health insurance generated 22% of total original premiums in 3Q19 – up from 15% in 2015 – with a yoy growth of 31%, compared with 20% and 24%, respectively, in 2018.

On 12 November 2019, the China Banking and Insurance Regulatory Commission (CBIRC) released new guidelines on sales, management services and product development and differentiation for health insurance products, including medical, critical illness, disability, accident and health, and long-term care products. The new rules, effective 1 December, promote broader product diversification for life insurers and allow a premium adjustment in their long-term care contracts, susceptible to regulatory approval. This will boost margins amid rising medical costs.

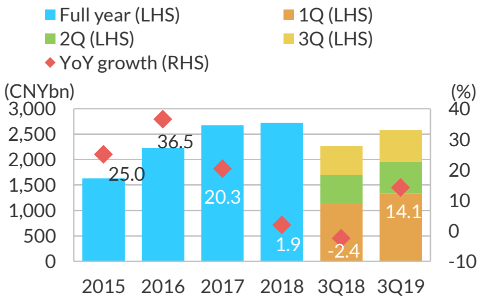
### Profitability Commensurate with Improving Business Mix

Fitch sees evident progress in larger life insurers' business shift to long-term products and regular-premium and higher-margin products with higher protection components. This will alleviate their interest-rates risk, and propel mortality and morbidity gains. We view sustainable product strategies and productive distribution capabilities as reinforcing long-term profitability.

We expect investment returns for life insurers to remain under pressure over the intermediate term as high-yield alternative investments are maturing and proceeds are reinvested at lower yields, which are partially offset through active management of 'crediting rates' (rate declared to policyholders, which is generally higher than minimum guarantee rate).

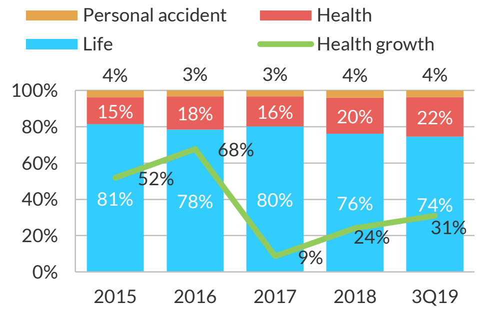
The revised tax rule, effective 1 January 2019, with the tax deductible of commission and expenses increased to 18% from 10%, will benefit life insurers' bottom lines. In addition, we anticipate the implementation of IFRS 17 in 2022 to have less of an impact on capitalisation than that of insurers in South Korea and Taiwan. This is because Chinese life insurers have used market rates instead of historical rates in discounting insurance liabilities.

**Original Premium Growth Trend**



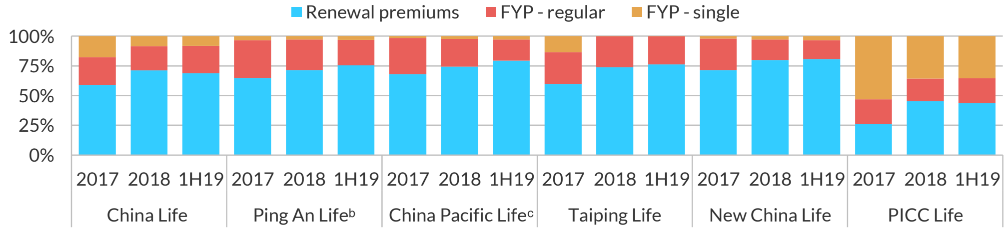

Source: Fitch Ratings, China Banking and Insurance Regulatory Commission (CBIRC)

**Product Mix by Original Premium**



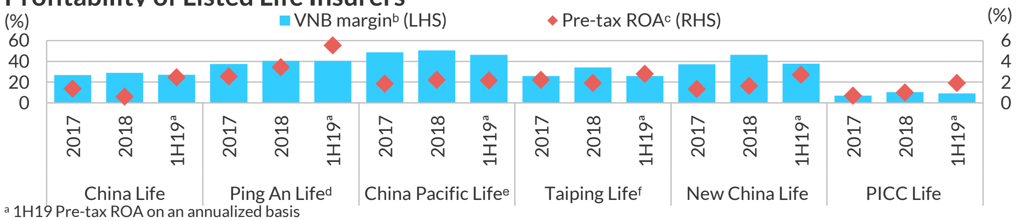

Source: Fitch Ratings, CBIRC

**Premium Structure of Listed Life Insurers[a]**




[a] Premium refers to original premium inocme and excludes group insurance. Figues for Ping An Life and Taping Life are based on gross written premium. Single premium includes premiums from short-term accident and health insurance
[b] Ping An Life's figures refer to Ping An Group's life and health insurance segment
[c] China Pacific Life's figures include premiums from agency channel only
Source: Fitch Ratings, Company data

**Profitability of Listed Life Insurers**




[a] 1H19 Pre-tax ROA on an annualized basis
[b] VNB margin = Value of new business/first-year premiums (FYP) FYP on original premium, while Ping An Life's and Taiping Life's FYP on gross written premium
[c] Pre-tax ROA = Pre-tax operating earnings/average total assets net of reinsurance assets
[d] Ping An Life's figures refer to Ping An Group's life and health insurance segment
[e] China Pacific Life's FYP Includes premiums from agency channel and renewal premiums from group insurance as no detailed split
[f] Taiping Life's FYP includes renewal premium from group insurance
Source: Fitch Ratings, Company data

## Lower Rates Push Equity Assets, Albeit Manageable

Fitch believes life insurance investments are trending more toward risky assets – namely, stocks and funds as well as alternative investments (including debt schemes, trust products and long-term equity investments), which generate higher yields than traditional fixed-income securities while interest rates are low.

Apart from higher investment returns, we expect life insurers to increase long-term equity investments to match their lengthening liabilities duration resulting from a shift in business focus. The risk profiles of some of the non-standard assets, such as debt schemes and trust plans, are opaque because of less-transparent and illiquid underlying assets.

We expect life insurers will continue to invest in more stocks and funds, and alternative assets, which had grown by 8.6% and 14.5%, respectively, by end-3Q19 from end-2018, yet the pace is unlikely to escalate significantly under tightening ALM requirements.

## Improving ALM to Oversee Insurers' Risk Profiles

Fitch expects the appetite for investment risk to remain moderate because of the new regulatory ALM requirements, which were announced in March 2018 and fully implemented in July 2019. The rules introduced quantitative risk-adjusted measurements to help insurers capture the risks of duration mismatch, negative spreads and liquidity strain more accurately. The CBIRC evaluates and ranks the competence of insurers' ALM against peers on a regular basis.

Consequently, we anticipate life insurers to be cautious about asset allocation, despite a series of regulatory initiatives to encourage them to invest in alternative assets over the past 12 months.

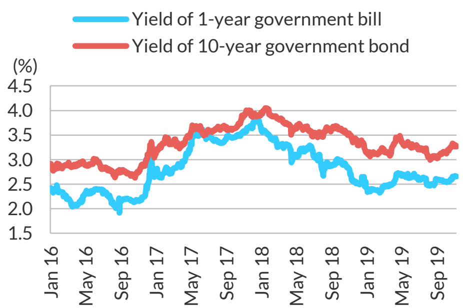
## Capital Buffer to Remain Adequate

Fitch believes the solvency position of life insurers will remain moderate, supported by surplus generation from a value-focused business shift that eases their exposure to potential volatility in capital markets. We expect the average comprehensive solvency ratio of life industry under C-ROSS to remain above 200%, which is well above the "Adequate II" level of 150%. The ratio stood at 240% as of end-June 2019, compared with 235% as of end-December 2018.

The adoption of C-ROSS Phase II will improve the industry's capital management, which applies a wider scope to identify and evaluate insurance, market and credit risks more accurately, hence improving capital standards. The exact timing of C-ROSS Phase II remains uncertain, but most of the updated quantitative requirements are likely to be released before end-2019.

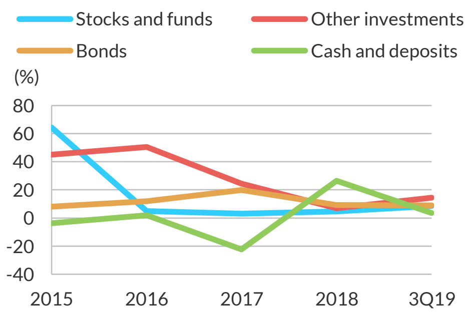
We see some insurers preparing for the coming modified capital regime, and have strengthened their capital positions through debt issuance. For instance, PICC Life and China Life issued capital supplemental bonds of CNY12 billion and CNY35 billion in 2018 and 2019, respectively. The financial leverage of most major life insurers remains moderate, at below 30% at end-1H19.

### China Interest Rate Trend



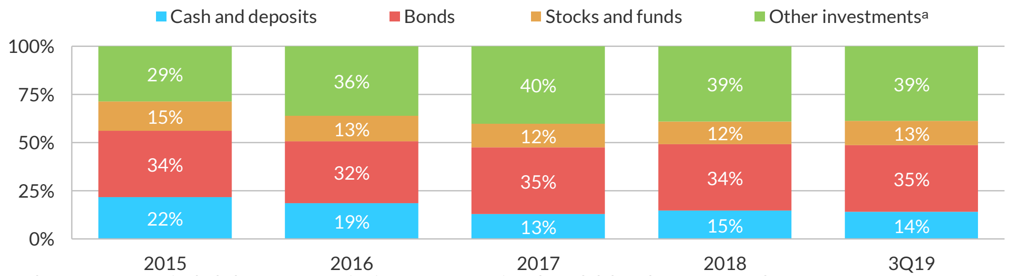

Source: Fitch Ratings, China Money

### Assets Growth by Class




Source: Fitch Ratings, CBIRC

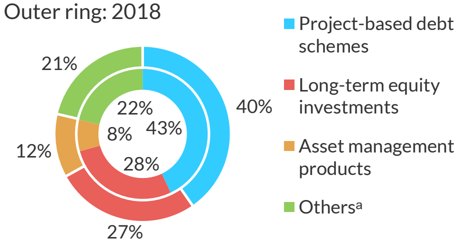
### Chinese Insurance Sector's Investment Mix




[a] Other Investments include long-term equity investment, project-based debt schemes, trust plans, asset management products and investment properties
Source: Fitch Ratings, CBIRC

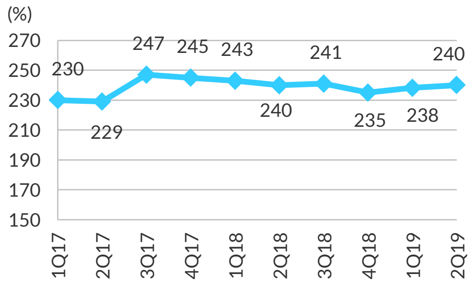
### Alternative Investments Mix

Inner ring: 2015
Outer ring: 2018




[a] Others include investment properties
Source: Fitch Ratings, Insurance Asset Management Association of China

### Life Industry Average Comprehensive Solvency Ratio




Source: Fitch Ratings, CBIRC

## China / Non-Life

### Change in Tax Rules to Lift Non-Life Insurers' Earnings

Fitch expects non-life insurers to benefit from the change in tax regulation associated with the effect from an increase in the tax deductibility of commissions. The tax rule change will boost non-life insurers' after-tax earnings as most auto insurers raised commissions in the last few years when they competed for motor policies.

The China's Ministry of Finance and State Administration of Taxation announced a change in the policy for the pre-tax deduction of handling charge and commission expenditures by insurance companies in May 2019. The pre-tax deduction limit of non-life insurers' commissions and handling fees has been revised to 18% of gross written premiums from the original 15%. The new deduction policy was effective from 1 January 2019.

### Underwriting Margin of Smaller Motor Insurers to Remain Weak

Ongoing market competition will consistently constrain motor insurers' ability to improve their underwriting margins. Fitch expects the claims ratio to remain volatile after the third round of auto-pricing reform in March 2018. Motor insurers with limited operating scale will still face challenges in achieving break-even in their underwriting results.

However, the imposition of regulatory controls on the acquisition expense associated with motor insurance since August 2018 has somehow curbed the escalation in motor-acquisition costs. Major listed non-life insurers reported a reduction in the expense ratio in 1H19. Fitch expects that the top three players will be still the key earnings contributors to the motor line.

### Increasing Focus on Non-Motor Insurance Business

Fitch expects non-life insurers to steadily shift its product focus to non-motor insurance, given low insurance penetration and ongoing regulatory initiatives. Major insurers are likely to continue to report higher premium growth in non-motor insurance business such as liabilities, credit and surety, as well as accident and health insurance. Motor premium growth will remain stagnant as the slowdown in new auto sales will exacerbate the demand for motor insurance policies.

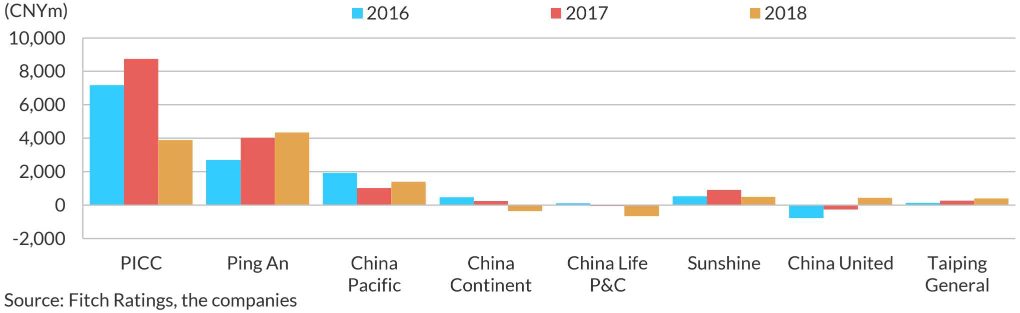
Underwriting results, however, could be volatile for smaller insurers as many are still in a stage of building up the scale of their non-motor book. Fitch believes that competition in non-motor insurance is likely to intensify if the motor segment slows further. The portion of non-motor business to total non-life business has risen to 39% by 3Q19 from 28% in 2017.

### Ongoing Capital Infusion Inevitable for Non-life Insurers

Fitch believes that it is inevitable for non-life insurers, especially smaller insurers, to depend on fresh equity to support their ongoing premium growth and to strengthen their solvency adequacy. Business expansion is likely to consistently outpace the velocity of insurers' surplus generation, given thin underwriting margins. Fitch does not expect non-life insurers to increase their dependence on capital supplementary bonds to support their solvency stability as the potential underwriting volatility could hinder insurers' debt-servicing capability.

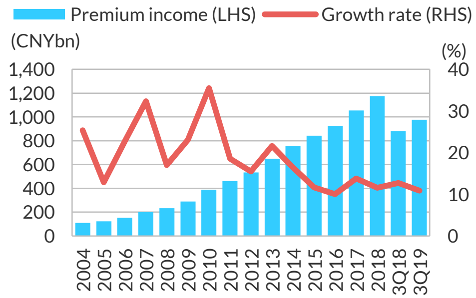
The solvency position of the non-life sector remains healthy, while the net premium leverage of major insurers rose in 2018. High growth has undermined smaller insurers' solvency stability. Based

**Underwriting Results of Motor Class**
(Based on PRC GAAP)



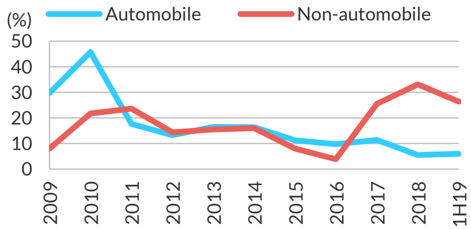

Source: Fitch Ratings, the companies

**Non-Life Sector's Premium Income and Growth**



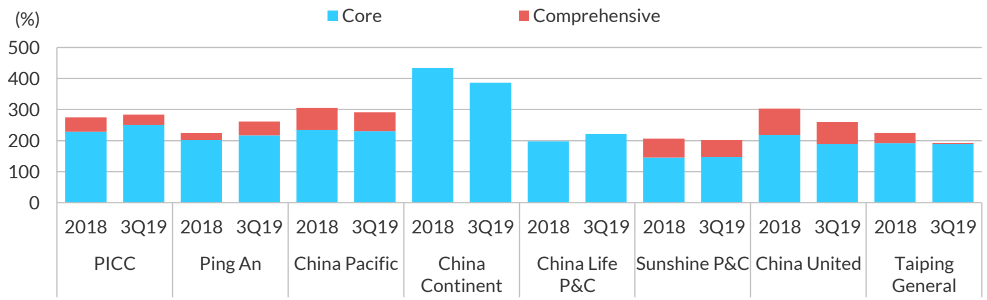

Source: Fitch Ratings, CBIRC

**Average Growth Rate of Top 3 Non-Life Insurers[a]: Automobile vs. Non Automobile**




[a] Top 3 non-life insurers include: PICC, Ping An and China Pacific
Source: Fitch Ratings, the companies

**Solvency Position of 8 Major Insurers in China**




Source: Fitch Ratings, the companies

on the latest statistics from the Chinese regulator, the comprehensive solvency ratios of the non-life insurance sector at end-1H19 amounted to 279%, still well in excess of the regulatory 100% minimum.

## Catastrophe Loss to Hurt Insurers' Financial Stability

Catastrophe losses are likely to remain a key element that could jeopardise the soundness of non-life insurers' solvency adequacy. The insured losses associated with Typhoon Lekima in August 2019 could cost at least CNY6 billion, according to AIR Worldwide.

Insurers will continue to manage the catastrophe risk through active monitoring and modelling of catastrophe exposure. In consideration of the requirement to include catastrophe in insurers' solvency adequacy calculation, non-life insurers with limited underwriting capacity will need to rely on reinsurance to mitigate the exposure to extreme catastrophe risks.

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### Selected Major Natural Disasters in China

| Event | Date | Affected area | Insured or economic loss |
|---|---|---|---|
| Typhoon Mitag | Oct 19 | China, Taiwan, Korea Peninsula | Above USD816m[a] |
| Typhoon Lingling | Sep 19 | China, Japan, Korea | Above USD165m[a] |
| Typhoon Lekima | Aug 19 | China | Above CNY6bn[b] |
| Typhoon Mangkhut | Sep 18 | China, Philippines, Hong Kong, Taiwan and Macao | USD1bn to USD2bn[b] |
| Typhoon Rumbia | Aug 18 | China | Above USD5.4bn[c] |
| Tropical Storm Bebinca | Aug 18 | China, Vietnam | Above USD236m[c] |

[a] Based on economic losses from Aon Benfield's Global Catastrophe Recap
[b] Based on insured losses from AIR Worldwide
c Based on economic losses from Aon Benfield's Weather, Climate Catastrophe Insight – 2018 Annual Report
Source: Fitch Ratings

## Optional: Appendix

### Fitch-Rated Insurers in China

| Company name | Sector | IFSR/L-T IDR | Outlook |
|---|---|---|---|
| Aviva-COFCO Life Insurance Company Limited | Life | A-/- | Stable |
| BoCommLife Insurance Company Limited | Life | A/- | Stable |
| China Life Insurance Company Limited | Life | A+/A | Stable |
| China Taiping Insurance Group Ltd. | Composite | -/A | Stable |
| China United Property Insurance Company Limited | Non-life | A-/- | Stable |
| Huatai Property & Casualty Insurance Co., Ltd. | Non-life | A/- | Stable |
| Lloyd's Insurance Company (China) Limited | Non-life | AA-/- | Negative |
| New China Life Insurance Company Limited | Life | A/- | Stable |
| PICC Life Insurance Company Ltd. | Life | A+/- | Stable |
| Sunshine Life Insurance Corporation Limited | Life | A-/BBB+ | Stable |
| Sunshine Property and Casualty Insurance Company Limited | Non-life | A-/- | Stable |
| Taiping Life Insurance Company Limited | Life | A+/- | Stable |
| Taikang Life Insurance Co., Ltd. | Life | A/- | Stable |
| Taikang Insurance Group Inc. | Life | -/A- | Stable |
| Taishan Property & Casualty Insurance Co., Ltd | Non-life | BBB+/- | Stable |
| Urtrust Insurance Co., Ltd. | Non-life | BBB/- | Stable |
| Yingda Taihe Property Insurance Co. Ltd | Non-life | A/- | Stable |

Note: As of 29 November 2019
IFSR is Insurance Financial Strength Rating and Long-Term IDR is Long-Term Issuer Default Rating
Source: Fitch Ratings

## Outlooks and Related Research

Credit Outlooks 2020
Global Economic Outlook (September 2019)
Hong Kong-Listed Chinese Life Insurers' 1H19 Profit Rises; Solvency Resilient (September 2019)
China Life Insurance: 2018 Results Dashboard (May 2019)
China Non-life Insurance: 2019 Dashboard (June 2019)
China's New Rules Unlikely to Increase Insurers' Appetite for Trust Products (July 2019)
Lifting of Foreign-Ownership Cap to Have Little Impact on China Life Insurers (July 2019)

## Analysts

**Stella Ng**
+852 2263 9615
stella.ng@fitchratings.com

**Terrence Wong**
+852 2263 9920
terrence.wong@fitchratings.com