KPMG

Marching into the new chapter

C-ROSS 2016Q1 Disclosures

KPMG Advisory

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kpmg.com/cn

Marching into the new chapter

Executive summary

Following a one-year transitional period, the China Risk Oriented Solvency System (C-ROSS) is due to come into full force in 2016. As part of these reforms, the first set of C-ROSS public disclosures (quarterly C-ROSS solvency report summaries) took place in early May. For the first time ever, the general public was able to examine the key solvency indicators and business quality indices of all insurance and reinsurance companies operating in China. The depth of the information disclosed and the frequency of disclosure, occurring every quarter, has helped establish C-ROSS public disclosure as a leading practice globally.

It has been an exciting, albeit turbulent, year for China's insurance industry. Recent developments include motor insurance pricing reform, the extraordinary growth of some life companies fueled by high cash value products (short-term savings products with low surrender charges), the growth in merger and acquisition activities, the establishment of multiple new market players, more aggressive investment by insurers and C-ROSS implementation. All these trends are leading to profound changes in China's insurance industry. Many insurance organisations are revamping their product and investment strategies, whilst at the same time strengthening their risk management capabilities, in order to better position themselves for the future.

The new data made available by C-ROSS and strong demand among our clients for more effective benchmarking information has prompted us to launch the **KPMG China Insurance Information Service**, which will be available in multiple technology platforms including PC, iPad and WeChat. We hope this initiative will gradually help transform data analytics in China's insurance industry.

As part of these efforts, we will publish quarterly analysis reports, which will cover both industry solvency analysis and comprehensive competitiveness analysis.

This report covers C-ROSS solvency information as of 2015Q4 and 2016Q1 as well as the last batch of China Solvency I (C-SI) data as of 2015Q4.

As of 23 May 2016, **73 life insurers** (76 in total, including life, health and pension companies), **67 P&C insurers** (75 in total) and **9 reinsurers** (10 in total including Lloyds China, which is registered as a direct insurer but is primarily engaged in reinsurance business) disclosed their quarterly solvency report summaries. Some of these disclosures were incomplete or inconsistent and we have therefore made necessary adjustments in our data analysis. In the case of any conflicts between different data, we have opted for the industry C-ROSS statistics released by the China Insurance Regulatory Commission (CIRC).

Executive summary

Overall industry solvency analysis:

Integrated risk rating (IRR): as the CIRC has not formally implemented IRR under C-ROSS, companies disclosed the risk ratings under C-SI as temporary proxy information. The majority belong to ratings A or B, indicating an overall manageable industry risk level.

Actual capital, minimum capital, solvency surplus: between 2015Q4 and 2016Q1, the overall industry capital position remained stable and the quality of the actual capital did not change significantly.

Solvency adequacy ratio: the overall industry C-ROSS solvency ratio is adequate. The total life, P&C and reinsurance comprehensive solvency adequacy ratios are all above 250 per cent. However, most companies' ratios fell in Q1 and a few companies already indicated they were insolvent under C-ROSS.

Minimum capital structure: the C-ROSS minimum capital composition more accurately reflects the risk profile of the insurance industry. Compared with the previous period, the change in minimum capital structure in Q1 2016 reflects the enormous growth in life business as well as investment allocation adjustments by insurers.

Actual capital structure: actual capital structure reflects the capital composition and quality for the industry. Overall, the industry's actual capital structure is stable and of good quality.

Net Cash Flow: In 2016Q1, the net cash flow of life companies and reinsurance companies improved, whereas the P&C industry's cash flow position deteriorated. This may be partly due to the effects of commercial motor insurance pricing reform.

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Executive summary

Comprehensive competitiveness analysis:

This aims to provide an overview of **life and P&C insurers'** competitiveness through quantitative analysis of data disclosed in quarterly solvency report summaries and other public sources. Reinsurers are excluded from this analysis due to the lack of available data.

In 2015, the CIRC established a regulatory rating system, customer service quality assessment system and performance assessment system. These different rating systems cover insurers' risk profile, service quality and financial performance respectively. Based on this, we also examined companies' **IRRs** and the **key financial performance indicators** disclosed by insurers as well as insurers' **yearly service assessment indices** published by the CIRC in order to determine the competitive strengths of each company using a seven tier scoring system.

The results are broadly in line with our expectations. Around 60 per cent of the life and P&C insurers have solid ratings, while companies with adequate capital, good financial performance and high service quality received the highest scores. The analysis results also reflected companies' different business strategies, operating structures and product offerings.

1 Industry solvency analysis

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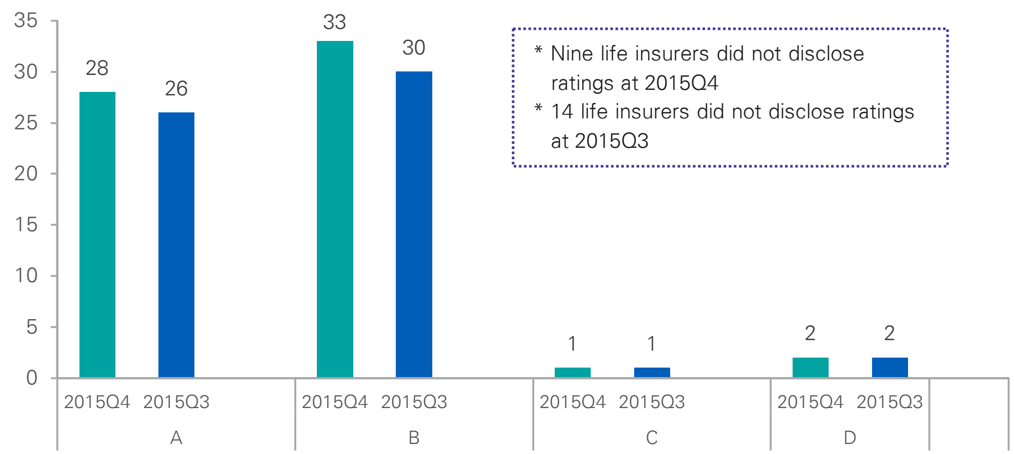
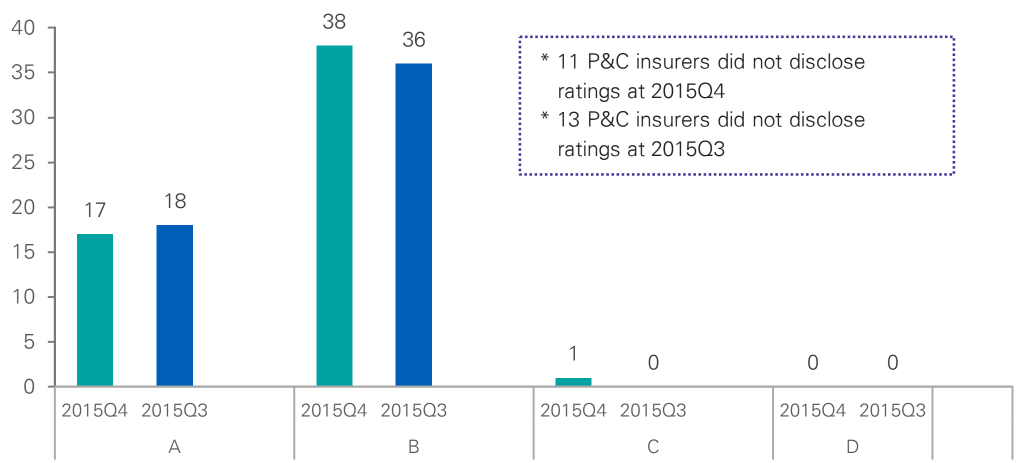
Integrated risk rating

- **The CIRC has not formally implemented C-ROSS IRR**
- As of 30 April 2016, most companies received C-SI risk ratings in either 2015Q3 or 2015Q4
- The industry's risk ratings are overall stable. Three life insurers improved from B to A, while three life insurers deteriorated from A to B.
- One P&C insurer deteriorated from A to B, while another one deteriorated from B to C.
- Most reinsurers did not receive C-SI risk ratings

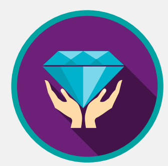
Life



P&C



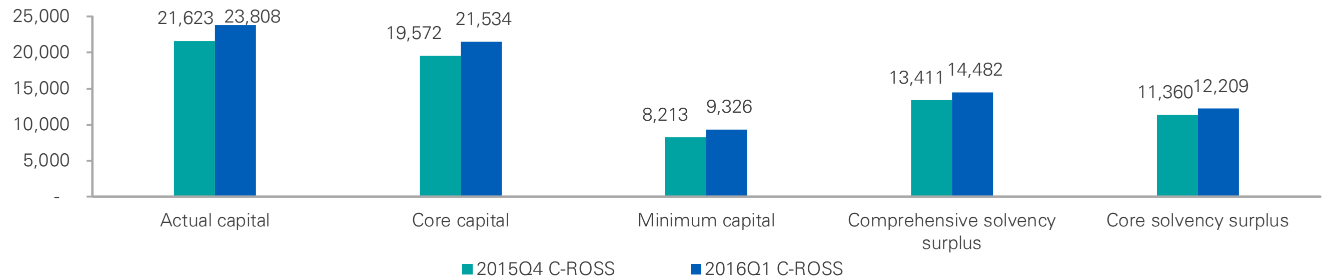
- One health insurer was rated C at both 2015Q3 and 2015Q4, while its C-ROSS comprehensive solvency adequacy ratio was above 100 per cent at both 2015Q4 and 2016Q1
- Two life companies had D ratings at both 2015Q3 and 2015Q4. One company's C-ROSS comprehensive solvency adequacy ratio was 20.7 per cent and -18.2 per cent at 2015Q4 and 2016Q1 respectively
- The other company's C-ROSS comprehensive solvency adequacy ratio was -3.91 per cent at 2016Q1



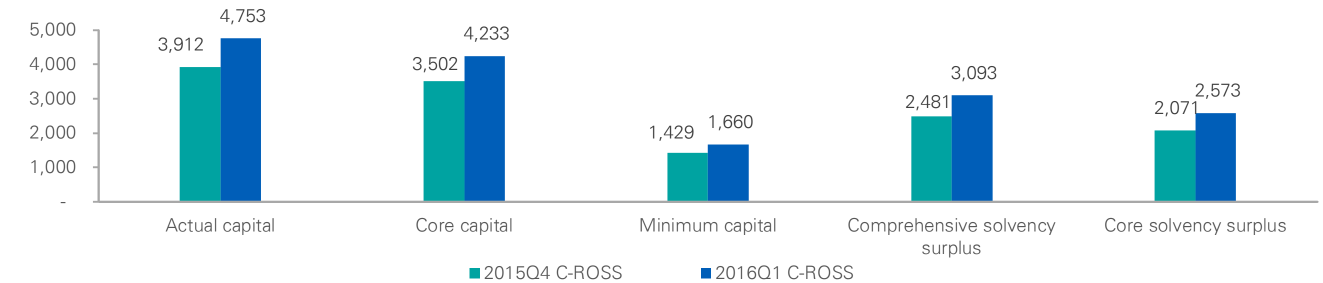
- One P&C company had a C rating at both 2015Q3 and 2015Q4. Its C-ROSS comprehensive solvency adequacy ratio was 89.1 per cent and 63.6 per cent at 2015Q4 and 2016Q1 respectively

Key solvency indicators

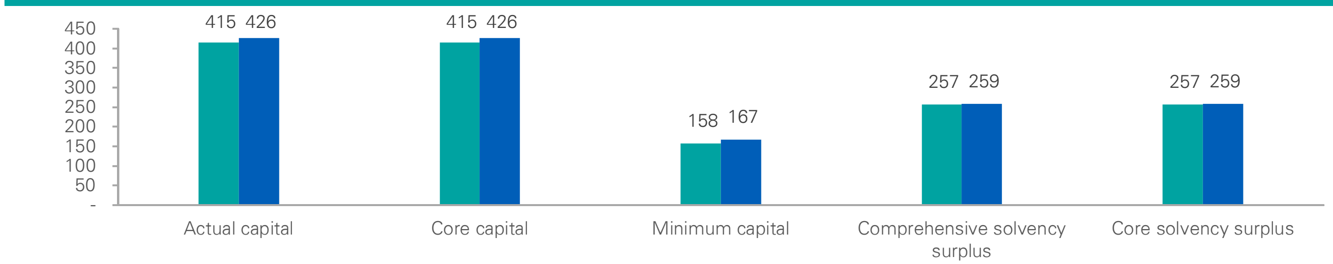
Life (in RMB hundreds of million)



P&C (in RMB hundreds of million)



Reinsurers (in RMB hundreds of million)



No conclusions on capital and free surplus trends could be reached based on available public information because the sample difference between the two quarters would have a large impact.

* 73 life insurers disclosed information in 2016Q1, whereas only 67 insurers disclosed information in 2015Q4

No conclusions on capital and free surplus trends could be reached based on available public information because the sample difference between the two quarters would have a large impact.

* 67 P&C insurers disclosed information in 2016Q1, whereas only 64 insurers disclosed information in 2015Q4.
* Three P&C insurers' disclosures appear to contain errors

No material change for each indicator for the reinsurance industry during 2016Q1.

* Nine reinsurers disclosed information in 2016Q1, while eight disclosed 2015Q4 data

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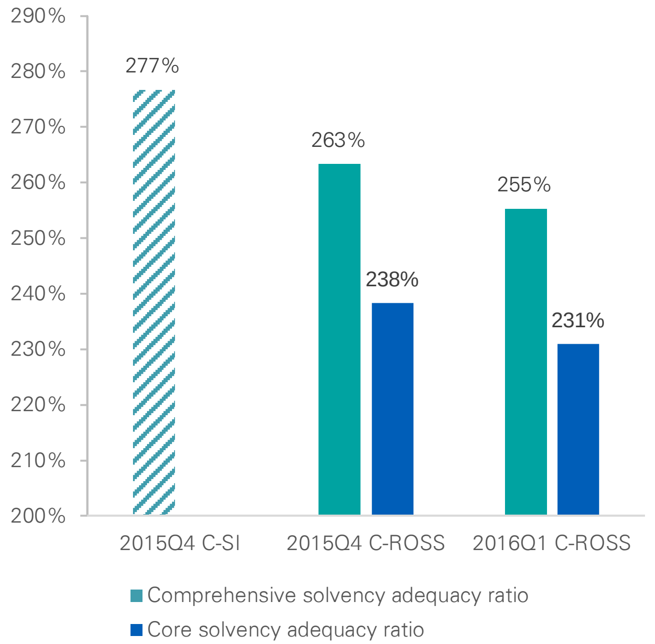
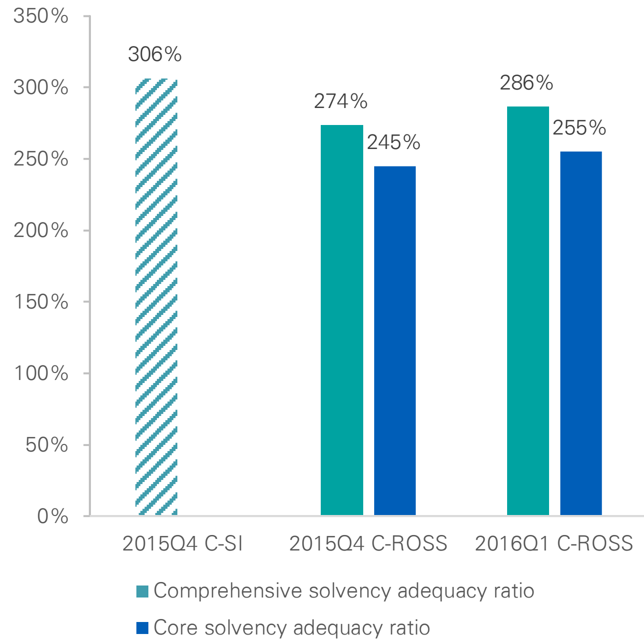
Industry solvency adequacy ratio

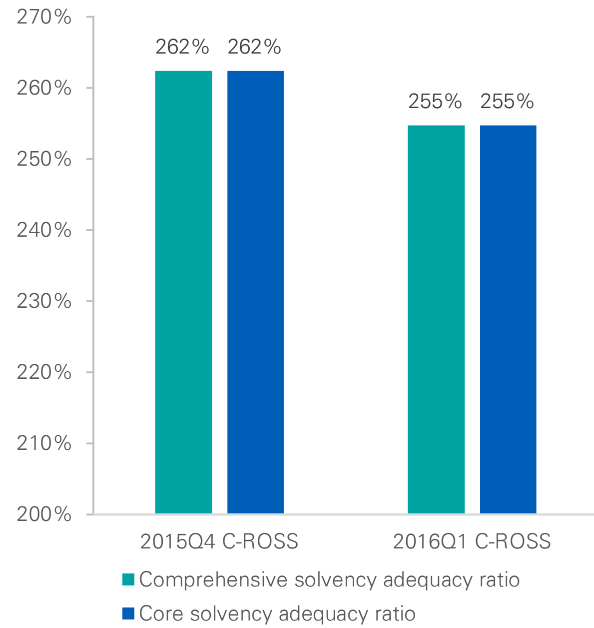
Life



P&C



Reinsurers



* Most reinsurers were not required to disclose C-SI data

- Measures to improve solvency include capital injection, bond issuance, business mix adjustment, reinsurance arrangement and investment allocation adjustment
- Capital injection impact is immediate but may not be sustainable
- RMB 60.9 billion total capital injection for life insurers during 2015, another RMB 16.1 billion in 2016Q1
- RMB 33.8 billion total capital injection for P&C insurers during 2015, no additional injection in 2016Q1
- RMB 3.3 billion total capital injection for reinsurers during 2015, no additional injection in 2016Q1

* Data includes 2015Q4 C-SI solvency ratios for 71 life insurers and 73 P&C insurers; 2015Q4 C-ROSS ratios for 67 life insurers, 64 P&C insurers and eight reinsurers; 2016Q1 C-ROSS ratios for 73 life insurers, 67 P&C insurers and nine reinsurers

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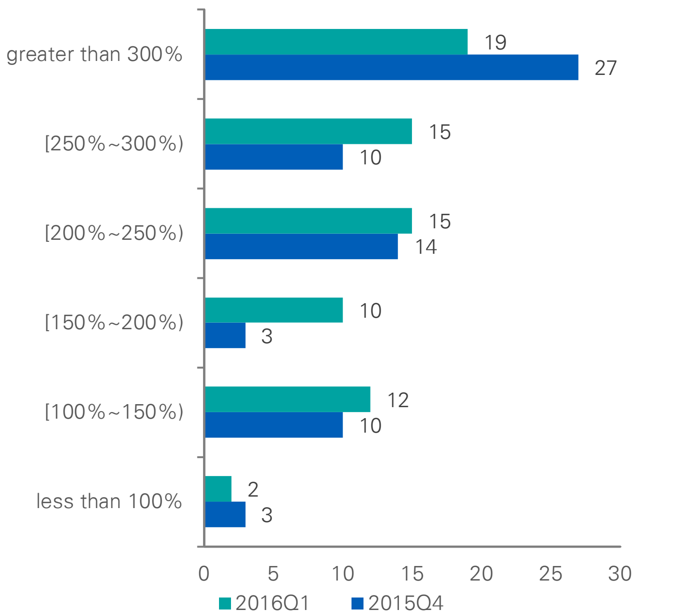
Comprehensive solvency adequacy ratio

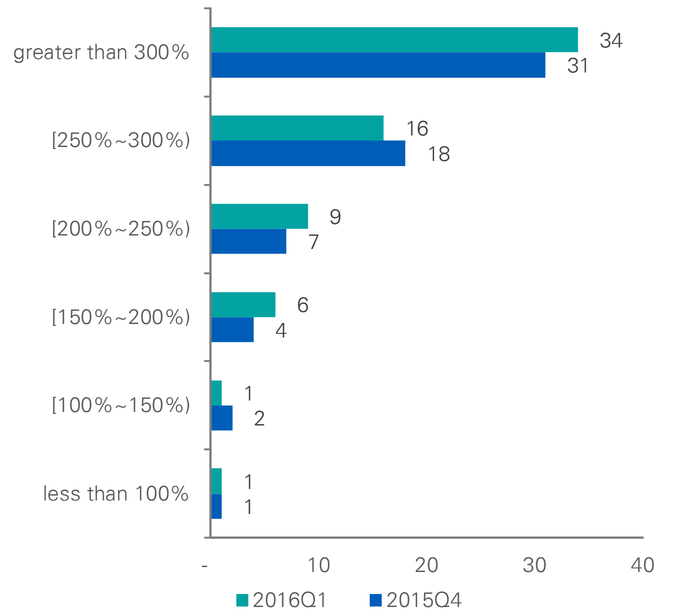
Life



12 54 1

* Data includes 73 life insurers at 2016Q1 and 67 at 2015Q4

P&C



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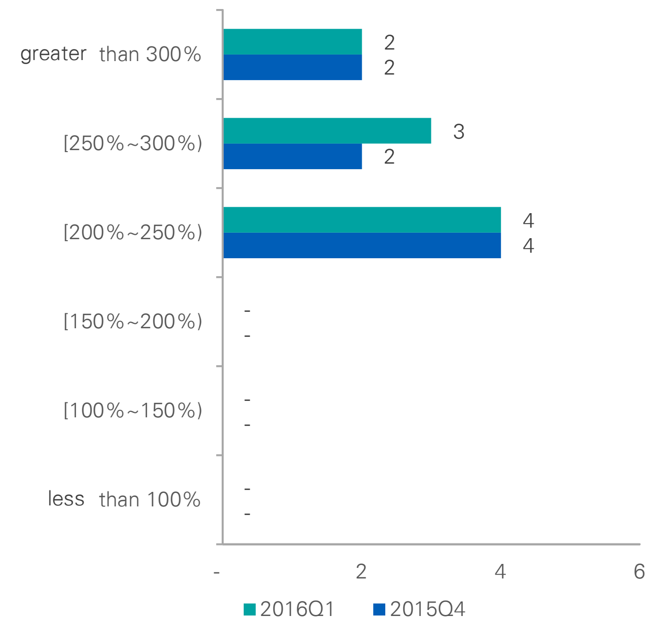
* Data includes 67 P&C insurers at 2016Q1, and 64 at 2015Q4

Reinsurers



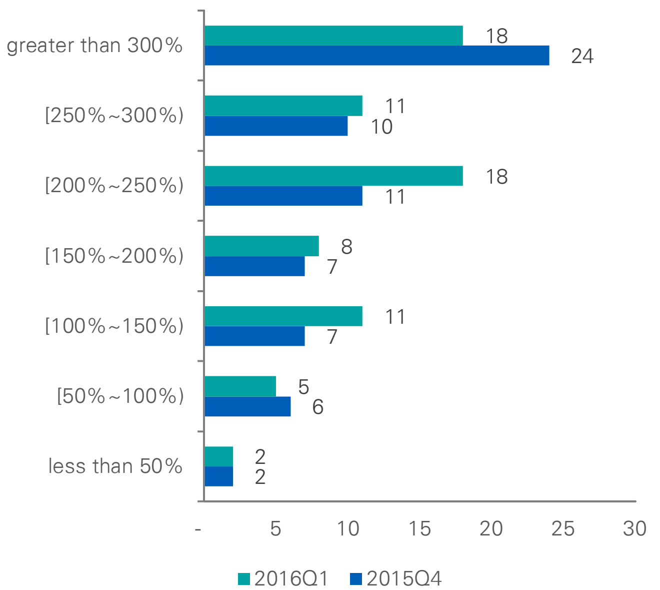
5 3 0

* Data includes nine reinsurers at 2016Q1 and eight at 2015Q4

- Solvency ratios for most life insurers decreased in 2016Q1, which may have been a result of the huge volume of ‘high cash value’ product sales during the quarter
- The change in comprehensive solvency adequacy ratios could have been affected by investment allocation adjustments as well

Core solvency adequacy ratio

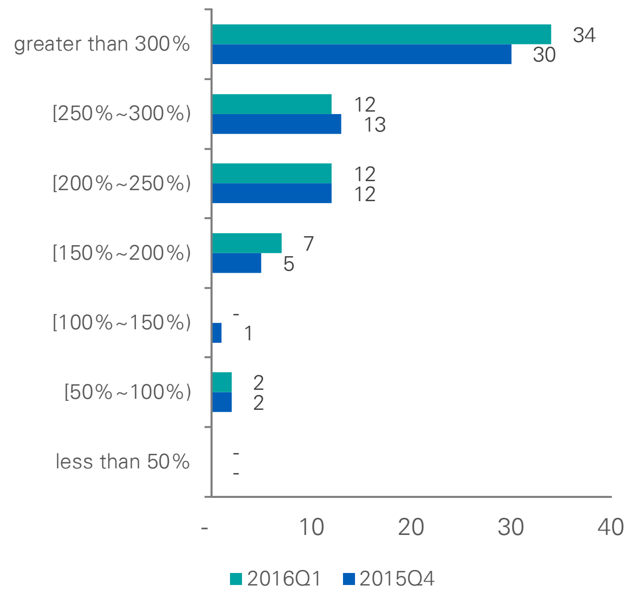
Life



16 51 0

* 73 life insurers for 2016Q1, 67 for 2015Q4

P&C



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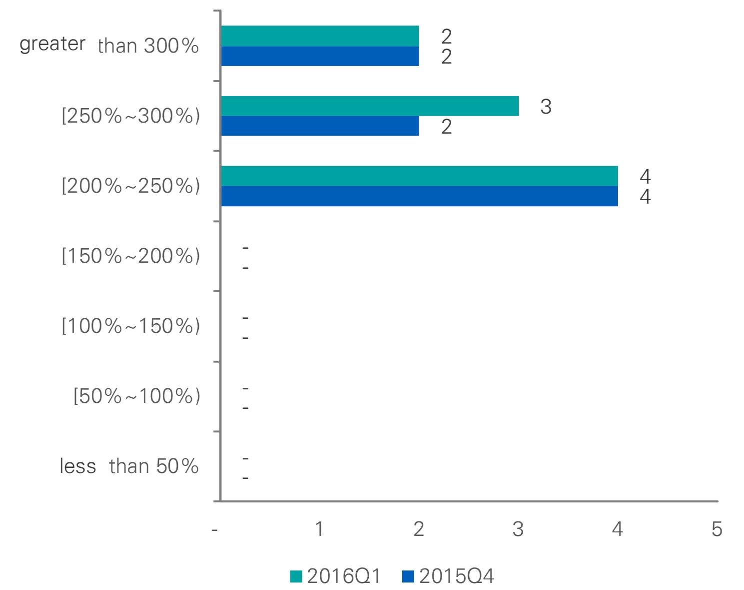
* 67 P&C insurers for 2016Q1, 64 for 2015Q4

Reinsurers



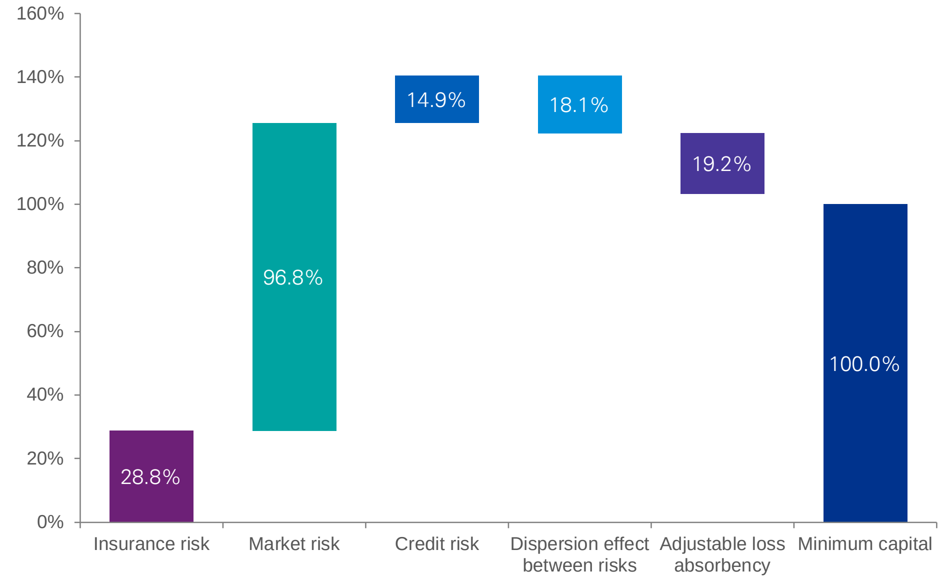
5 3 0

* Nine reinsurers for 2016Q1, eight for 2015Q4

- ❑ Differs from comprehensive solvency adequacy ratios as only the higher quality core actual capital is included in the calculation of core solvency adequacy ratio
- ❑ The change in core solvency adequacy ratios in 2016Q1 and the drivers for that change are similar to those for comprehensive solvency adequacy ratio

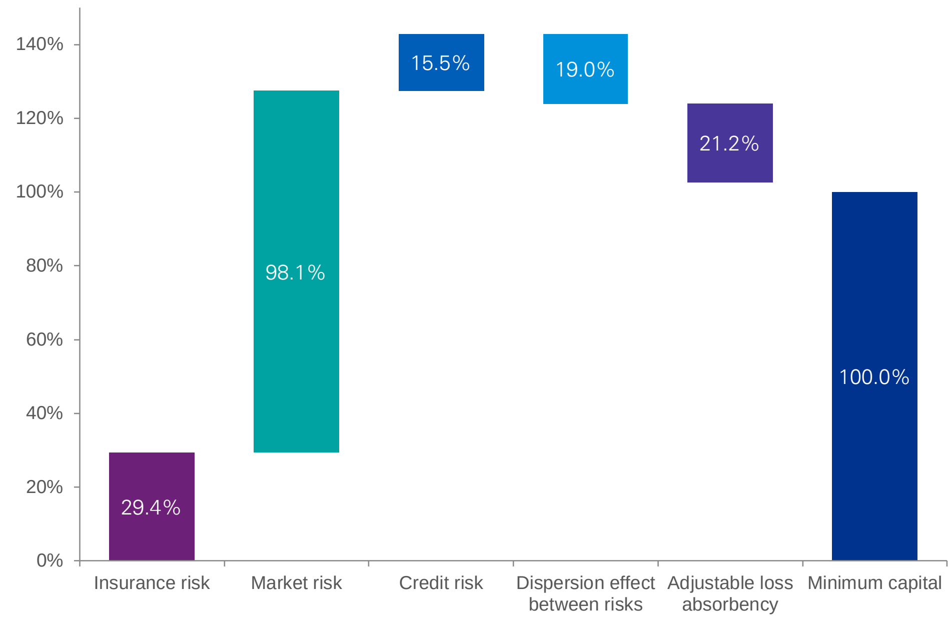
Minimum capital structure for life companies

2016Q1



* 73 life insurers disclosed minimum capital at 2016Q1
* 10 did not disclose diversification effects or loss absorbing effects
* Two did not disclose minimum capital details

2015Q4



* 66 life insurers disclosed minimum capital at 2015Q4
* Seven did not disclose diversification effects or loss absorbing effects
* Two did not disclose minimum capital details

The shift in minimum capital structure in Q1 may be due to:

- ❑ The mix of business sold during 2016Q1
- ❑ Change in investment allocation towards equities and bonds

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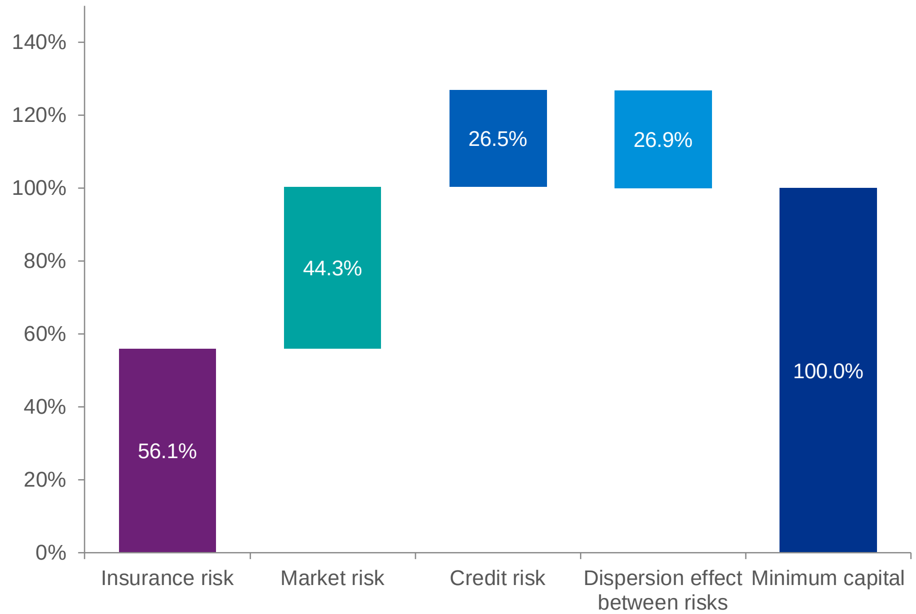
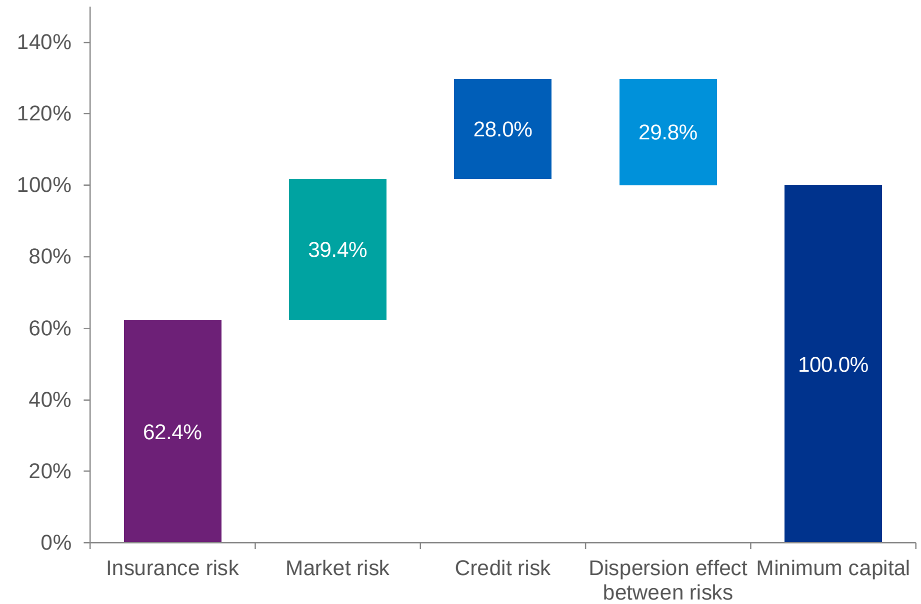
Minimum capital structure for P&C companies

2016Q1



* 67 P&C insurers disclosed minimum capital at 2016Q1

2015Q4



* 62 P&C insurers disclosed minimum capital at 2015Q4
* One did not disclose diversification effects

❑ The significant shift in minimum capital structure in Q1 may have resulted from changes in investment allocation and the data being unavailable for some companies at 2015Q4

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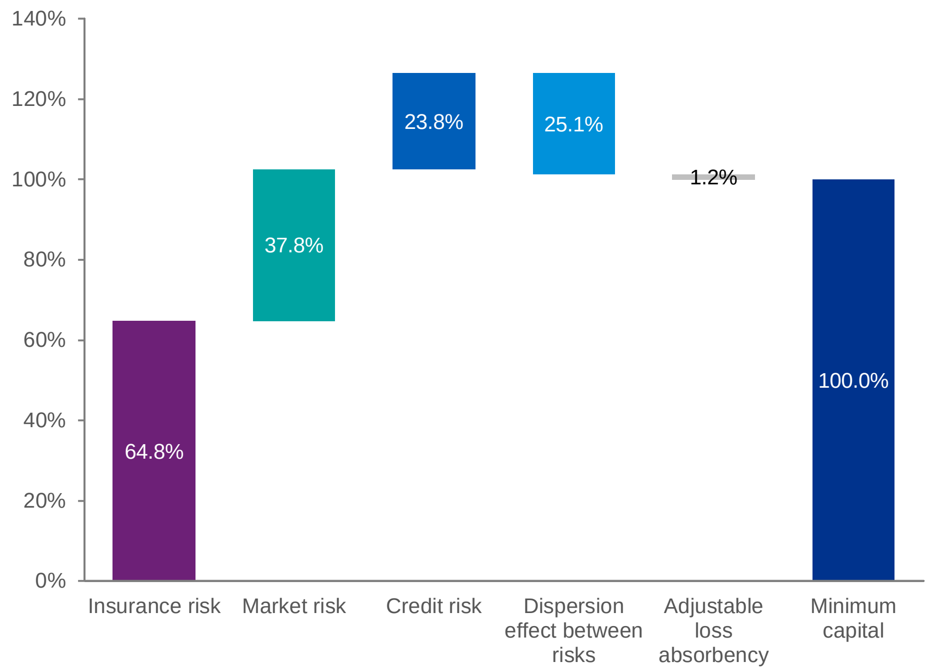
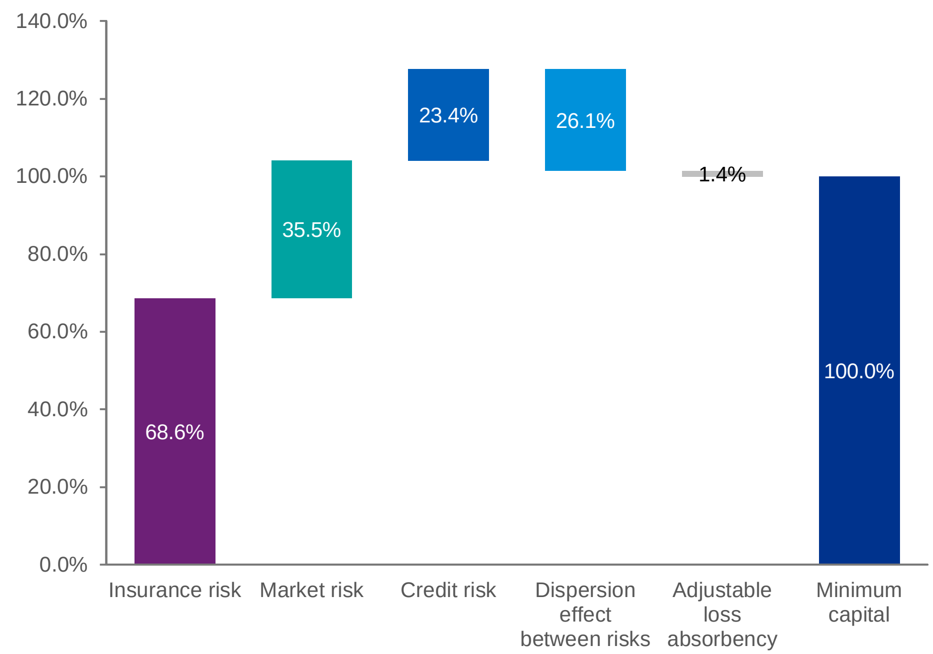
Minimum capital structure for reinsurers

2016Q1



2015Q4



❑ Insurance risk minimum capital declined, while market risk minimum capital increased. This may have been caused by some reinsurers' adjustment in investment portfolios in 2016Q1

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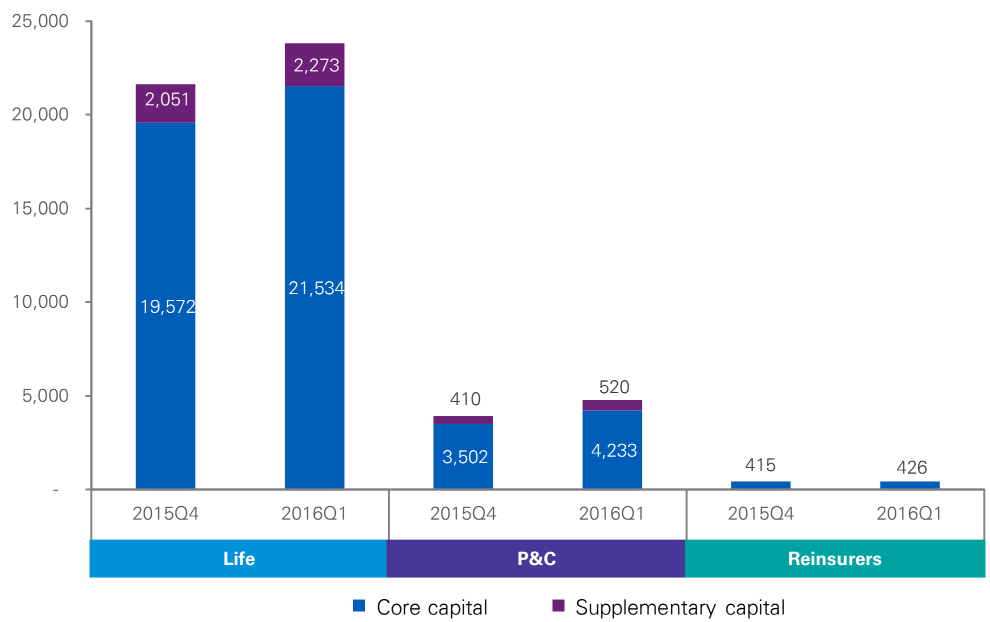
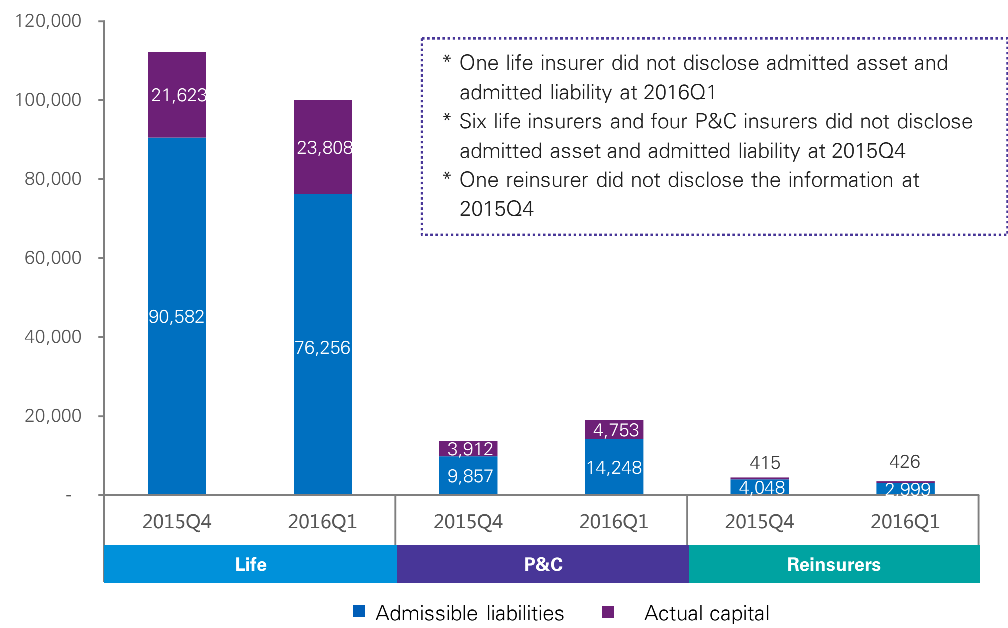
Actual capital structure

Actual capital = Core capital + Supplement capital (in RMB hundreds of million)



Actual capital = Admitted asset – Admitted liability (in RMB hundreds of million)



- Slightly lower capital quality for life insurers (core capital proportion declined)
- Slightly lower capital quality for P&C insurers (core capital proportion declined)
- Stable capital quality for reinsurers

- Reinsurers' admitted assets and admitted liabilities decreased in 2016Q1, which may be due to the reduction in financial reinsurance business post C-ROSS and more retrocession business volumes
- No clear trend for life or P&C due to lack of available data

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Net cash flow

In 2016Q1, life industry cash flow improved

- ❑ 11 companies' net cash flow became positive, while three became negative
- ❑ Higher net cash flow for 28 insurers compared with lower cash flow for 16 companies

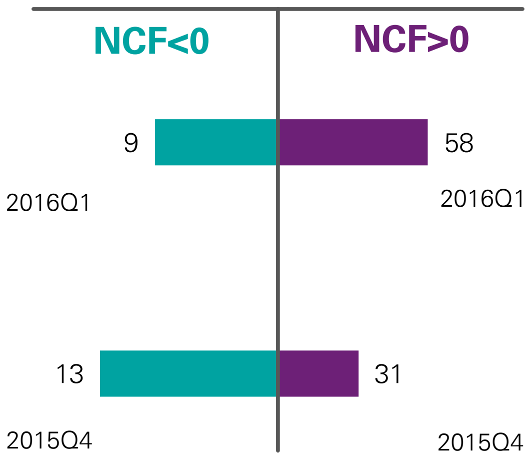
In 2016Q1, P&C industry cash flow deteriorated

- ❑ Six companies' net cash flow became positive, while 12 became negative
- ❑ Higher net cash flow for 18 insurers compared with lower cash flow for 21 companies

In 2016Q1, reinsurers' net cash flow improved

- ❑ Two companies' net cash flow became positive, while one became negative
- ❑ Higher net cash flow for four insurers compared with lower cash flow for two companies

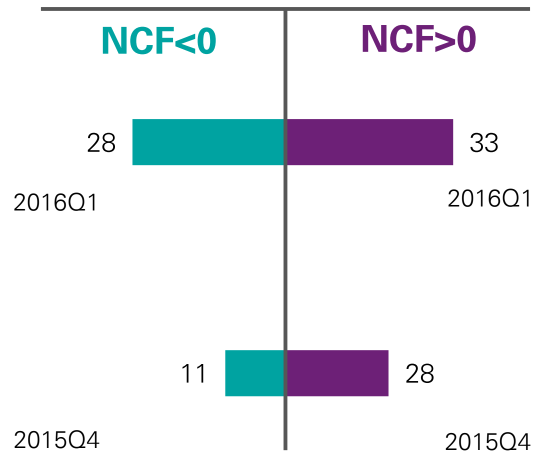
Life



* 2016Q1, no disclosed data for five life insurers

* 2015Q4, no disclosed data for 28 life insurers

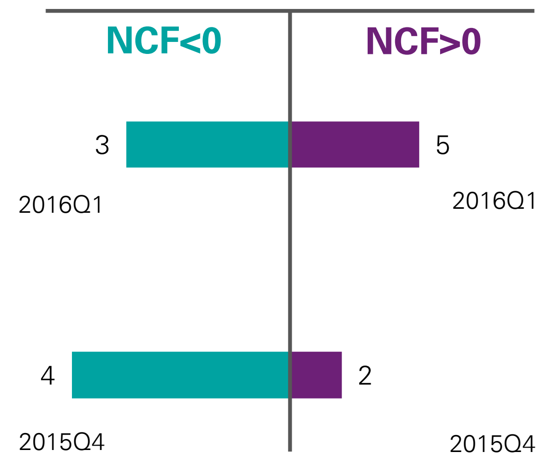
P&C



* 2016Q1, no disclosed data for six P&C insurers

* 2015Q4, no disclosed data for 28 P&C insurers

Reinsurers



* 2015Q4, no disclosed data for two reinsurers

- ❑ The improved net cash flow for life insurers may be due to high premium income from new business in 2016Q1
- ❑ Deterioration in P&C insurers' net cash flow may be due to the acceleration in claim settlements and expenses payments as well as investment activities
- ❑ Measures to improve cash flow include short-term debt financing, capital injection, reduction in operating expenses, investment adjustments, etc.
- ❑ For other regulatory liquidity risk indicators such as comprehensive liquidity ratio and liquidity coverage ratio, no comparison is made due to lack of consistency in disclosed data

2 Comprehensive competitiveness analysis

Comprehensive competitiveness analysis methodology

Comprehensive competitiveness rating matrix

Integrated risk rating (IRR) →

Operations & sustainable development index ↑	D	C	B	A
[80-100]	M6	M4	M2	M1
[60-80]	M6	M5	M3	M2
[40-60]	M7	M6	M4	M3
[0-40]	M7	M7	M5	M4

- ❑ M1 is the highest grade of competitiveness with M7 being lowest.
- ❑ M1 indicates excellent financial performance with sufficient capital, strong risk management and high quality of customer service, whereas M7 indicates the opposite

- ❑ **IRR/C-SI Risk Rating** results reflect the comprehensive risk profile of insurers in accordance with the CIRC's regulatory philosophy
- ❑ **Operation & sustainable development index** incorporates both key financial performance indicators and service quality indices, reflecting companies' operating quality and development sustainability
- ❑ The two indicators jointly determine an insurer's position in the competitiveness rating matrix

Components and weights


Operations & sustainable development index

Life	P&C
Premium income growth rate **(20%)**	Premium income growth rate **(20%)**
Return on net asset **(20%)**	Return on net asset **(20%)**
Net profit growth rate **(20%)**	Net profit growth rate **(20%)**
Service quality assessment result **(40%)**	Service quality assessment result **(40%)**

- ❑ The choice of rating components and weighting are based on the relevant CIRC guidelines as well as the availability and timeliness of public data

Operation & sustainable development index (1/2)

Premium income growth rate

Premium income growth rate

$$=\frac{\text{Current quarter premium income}}{\text{Last year same quarter premium income}}\times 100-1$$

Index	Score
-10%≤Index≤60%	100
-30%≤Index<-10%	50
60%<Index≤100%	50
Other	0

- ❑ Year-on-year quarterly premium growth rate is preferred considering seasonal fluctuations in the insurance business
- ❑ The scoring refers to the attachment included in *Matters on Insurance Company Operation Assessment Index System (Trial)*, published by CIRC (CIRC (2015) No.80)

Return on net asset

Return on net asset

$$=\frac{\text{Current quarter net profit}}{\text{Net asset}}\times 100$$

Index	Score
Industrial Median≤Index	100
Other	0

- ❑ Return on net asset measures return for shareholders
- ❑ The scoring refers to the attachment included in *Matters on Insurance Company Operation Assessment Index System (Trial)*, published by CIRC (CIRC (2015) No.80)

Net profit growth rate

Net profit growth rate

$$=\frac{\text{Current quarter net profit}}{\text{Last quarter net profit}}\times 100-1$$

Index	Score
0 ≤Index	100
-5%≤Index<0%	50
Other	0

- ❑ Net profit growth rate reflects a company's speed in creating net value, an important indicator for business performance and growth capability

Operation & sustainable development index (2/2)

Service quality assessment index

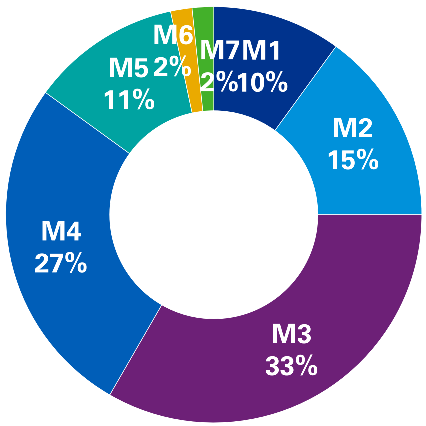
Qualitative index	Score
Policy framework	0~10
Organisational structure	0~10
Emergency response mechanism	0~10

Quantitative index	Score
Complaint rate per 10,000 policies	0~15
Complaint rate per 100 million premium income	0~15
Change in complaint rate per 100 million premium income	0~10
Others	N/A

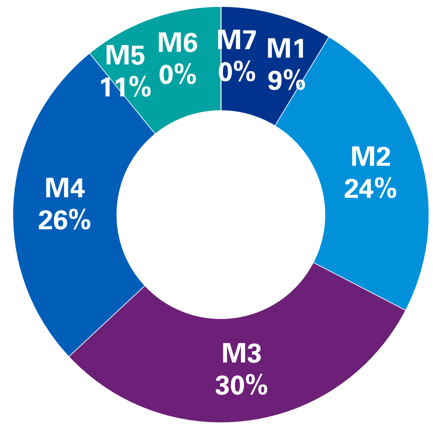
- These scores are disclosed in *2015 Life Insurance Company Complaint Handling Assessment* and *2015 General Insurance Company Complaint Handling Assessment*, which are attached in the circular of the CIRC: *2015 Assessment of Complaint Handling* (CIRCCP (2016) No.23)
- Most assessment indicators used in the CIRC's circular, *2015 Assessment of Complaint Handling*, are the same as those mentioned in *Insurance Company Service Assessment Policy (Trial)* (CIRC (2015) No.75), which indicate the level of service by insurance companies
- Assuming that there is stable service capability for most companies in the short-term, annual statistics can effectively reflect changes in customer service quality

2016Q1 Overall industry comprehensive competitiveness scoring results

Life insurers distribution



P&C insurers distribution

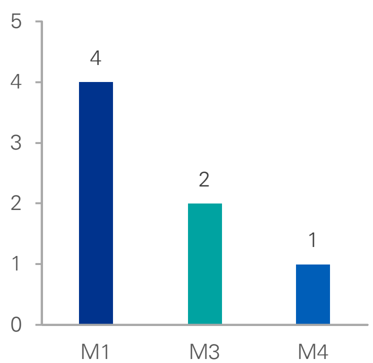


- Overall, the results are in line with our expectations
- Around 60 per cent of life and P&C insurers fall into the M3 and M4 categories, which indicates solid levels of competitiveness
- Life and P&C insurers with sufficient capital, excellent operations and a high level of service quality belong to M1 and M2
- Life insurers in M5 tend to focus on high cash value products, while P&C insurers in M5 tend to suffer from poor financial performance

Note: Using quarterly data may lead to a high variation in ratings between different quarters. We will consider smoothing methods to limit fluctuations once more data becomes available

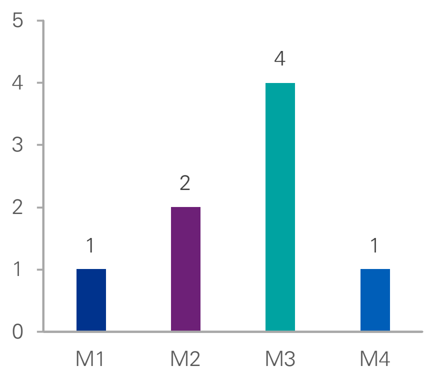
2016Q1 Life industry comprehensive competitiveness scoring results (1/2)

1 Traditional large life insurers



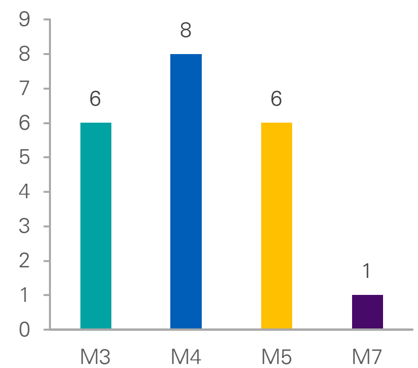
- ❑ Four insurers belong to M1
- ❑ One insurer is included in M4. This company received a B risk rating and posted a significant decline in net profit compared with the same period last year
- ❑ Two insurers are included in M3, one of which had lower premium income with large variation in net profit compared with the same period last year, while the other suffered a net loss

2 Bancassurance & postal life insurers



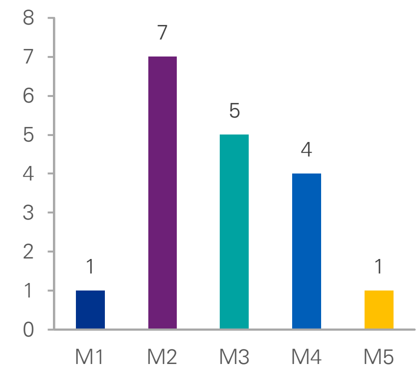
- ❑ Four insurers are included in M3. These companies experienced declining net profits and received A risk ratings
- ❑ One insurer is included in M4. This company received a B risk rating and posted a significant fall in net profit
- ❑ One insurer is included in M1. This company received an A risk rating, although its net profit increased significantly from a year ago
- ❑ One of the two insurers in M2 received a very low service quality assessment score

3 Domestic small and medium size life insurers



- ❑ Overall, 20 insurers are included in the M3, M4 and M5 categories, following an increase in premium income and a decline in net profit on average
- ❑ One insurer is included in M7 and received a D risk rating

4 Foreign owned life insurers

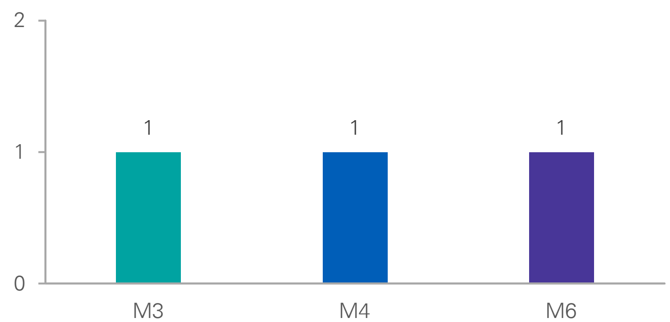


- ❑ Overall, 16 insurers are included in the M2, M3 and M4 categories, most of which benefited from stable operations with steady growth in premium income and net profit
- ❑ One insurer is included in M5. This company recently completed a change in ownership structure and received a B risk rating. It also experienced an increase in premium income as well as net loss
- ❑ One insurer is included in M1. This company performed well, obtained a good risk rating and received an excellent service quality score

❖ Note: The categorisation of life companies above are based on guidelines released by the Insurance Association of China in 2015

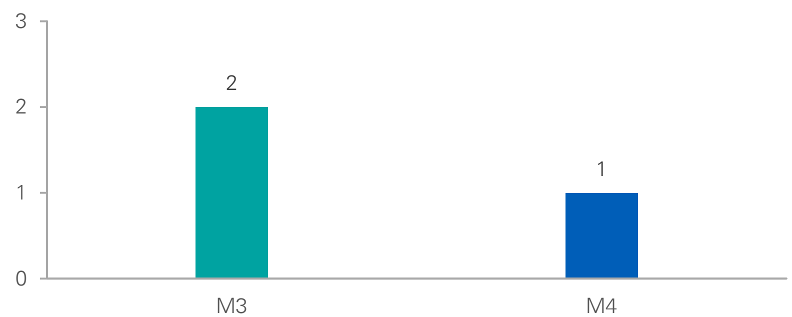
2016Q1 Life industry comprehensive competitiveness scoring results (2/2)

5 Health insurers



- Overall, the comprehensive competitiveness of specialised health insurers is relatively weak as most of them are still suffering from losses from their main business
- One insurer is included in M3, having posted a net loss despite receiving an A risk rating and a high service quality assessment score
- One insurer is included in M4, selling mainly investment type products. This company received a B risk rating and a lower than average score for service quality
- One insurer is included in M6, having posted a significant decline in net profit as well as received a C risk rating and a low score for service quality

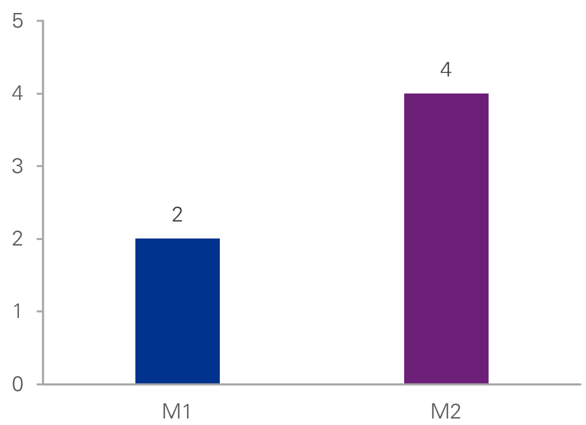
6 Pension insurers



- One insurer is included in M4, having posted a decline in net profit as well as receiving a B risk rating and a service quality score below the industry average
- Both insurers in M3 received B risk ratings, one of which had good operating indicators but received a low service quality score, while the other received a high service quality score but posted a net loss

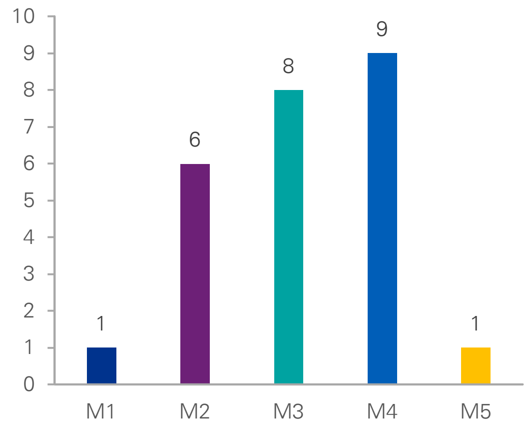
2016Q1 P&C Industry comprehensive competitiveness scoring results

Large P&C insurers



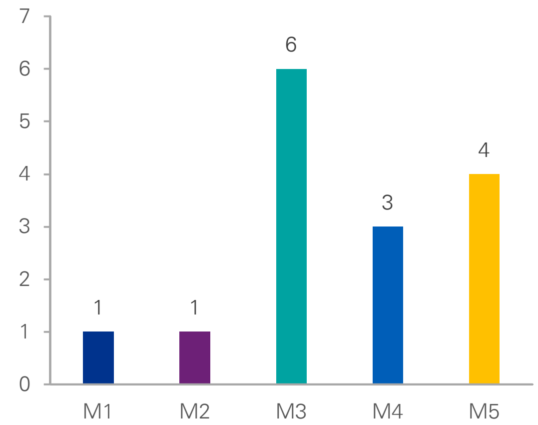
- Two out of the four insurers included in the M2 category received a B risk rating and had good operating indicators, while the other insurers received A risk rating but posted declining net profits
- Two insurers in the M1 category received A risk ratings having posted good financial results but received low service quality scores

Domestic small and medium size P&C insurers



- 23 insurers comprise the M2, M3 and M4 categories, most of which received A risk ratings. Some received B risk ratings but had good operating performances
- One insurer in M1 received an A risk rating, posted good financial results but received a low score for service quality
- One insurer in the M5 category received a B risk rating and posted lower premium income and net profit as well as a low service quality score

Type 3: Foreign owned P&C insurers



- 13 insurers are included in the M3, M4 and M5 categories, most of which received B risk ratings and posted a fall in net profit
- Four insurers are in the M5 category, one of which received a C risk rating, while the other three experienced a sizable fall in net profit
- One insurer is included in the M1 category and received an A risk rating. It posted good financial results but received a very low score for service quality
- One insurer is included in M2. It received a B risk rating with stable operating results as well as a high score for service quality

❖ Note: The categorisation of P&C companies above are based on 2015 direct premium income and ownership structures

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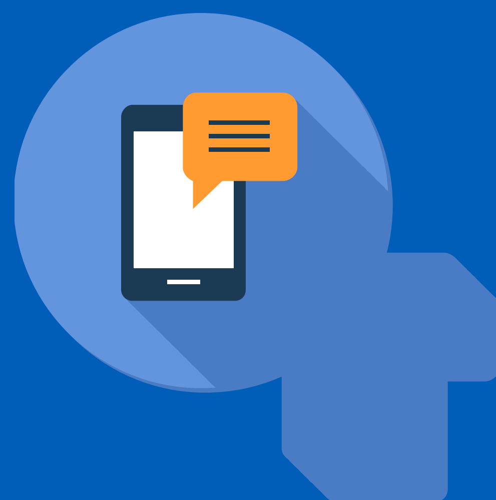

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