Snapshot of Chinese Non-Life Insurance Sector & Overview of Fitch's rating methodology

FitchRatings

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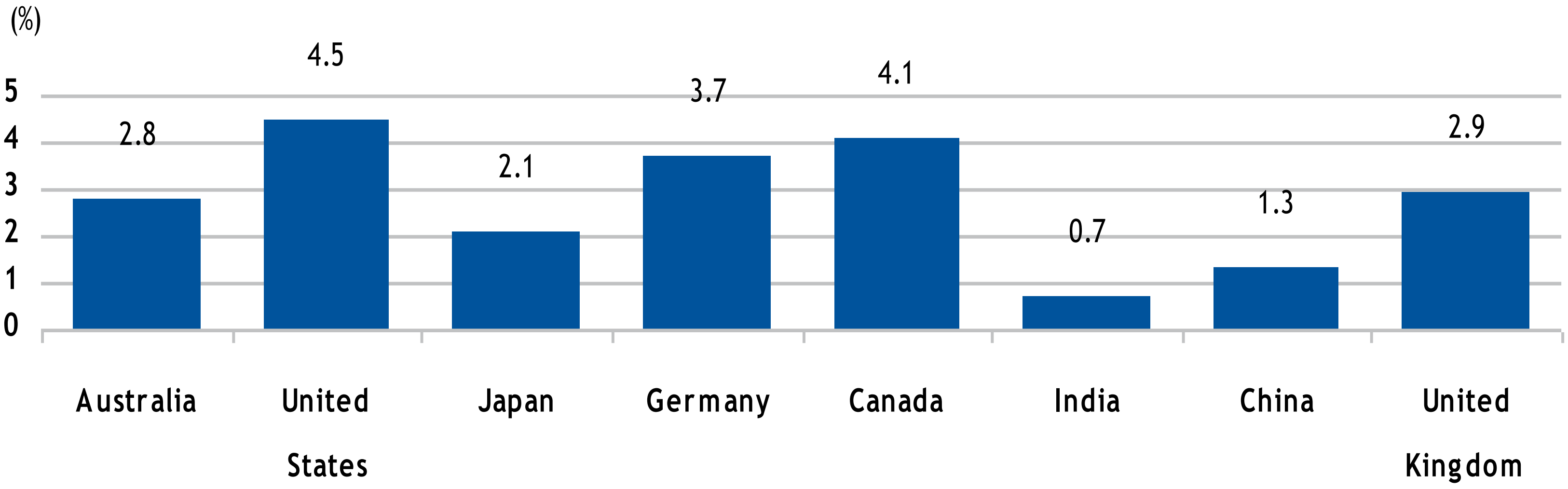
26 – 27 January 2012

Agenda

- **Credit Snapshot of Chinese Non-Life Insurers**
- Overview of Fitch's rating methodology for insurers

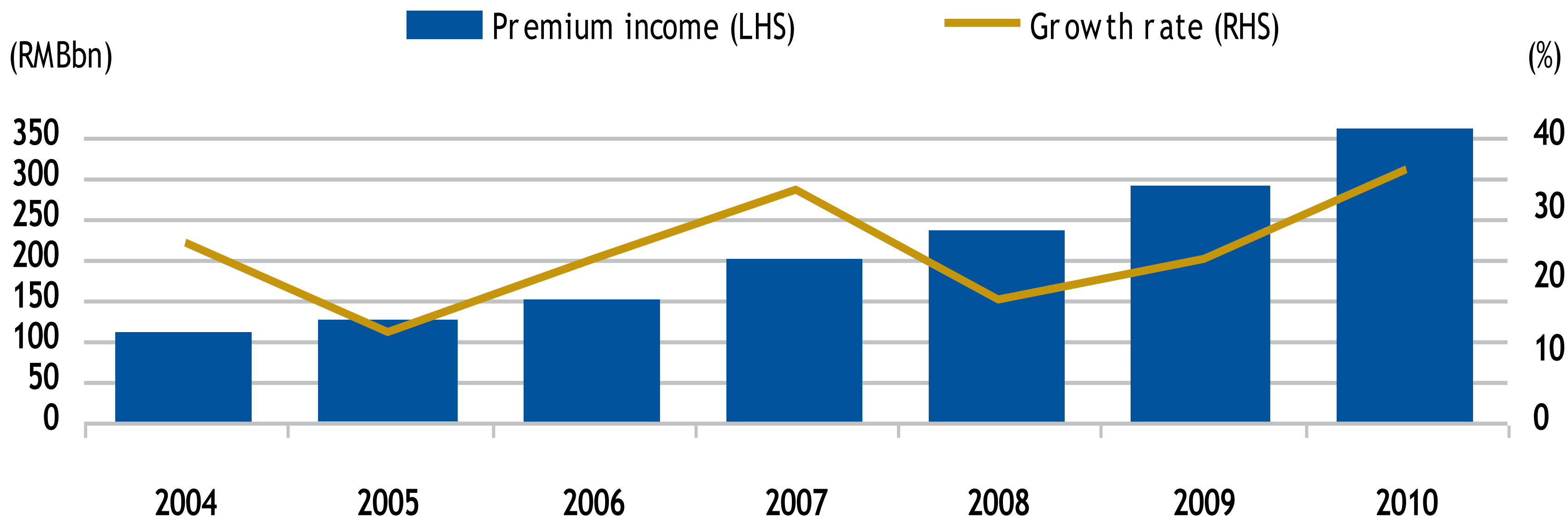
2010 Non-Life Insurance Penetration



Note: Premiums in % of GDP in 2010

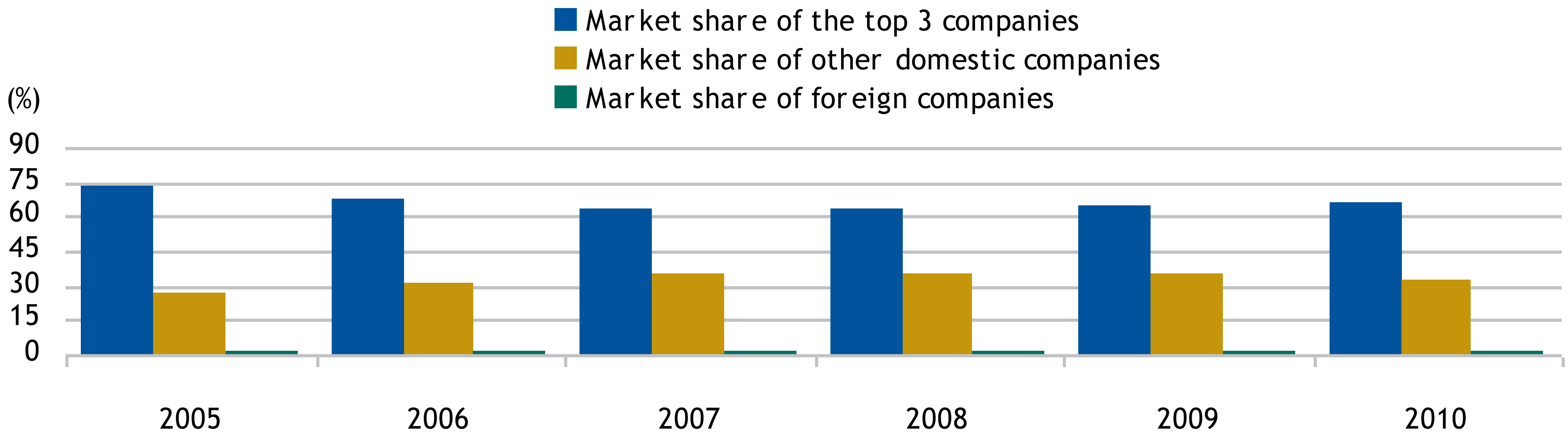
Source: Sigma Report No. 2 (2011)

Non-Life Sector's Premium Income and Growth



Source: CIRC

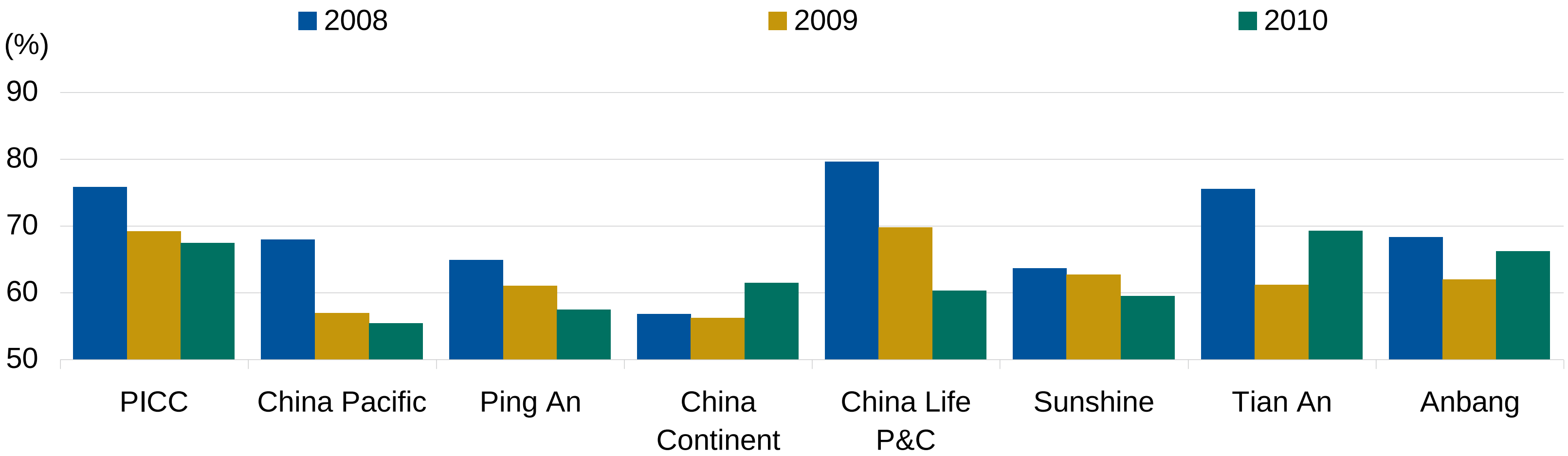
Market Share of Premiums 2005-2010



Source: CIRC

Improved Margins Due to Regulatory Reform and Operating Efficiency (I)

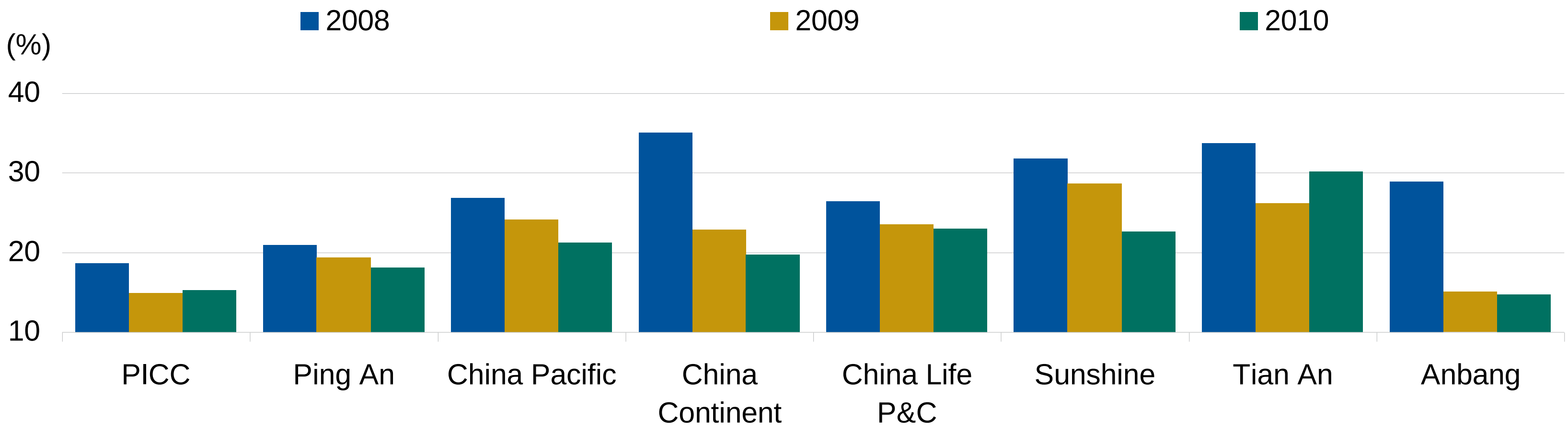
Incurred Claim Ratio of Major Non-Life Insurers



Source: The companies (based on PRC GAAP), Fitch's calculation

Improved Margins Due to Regulatory Reform and Operating Efficiency (II)

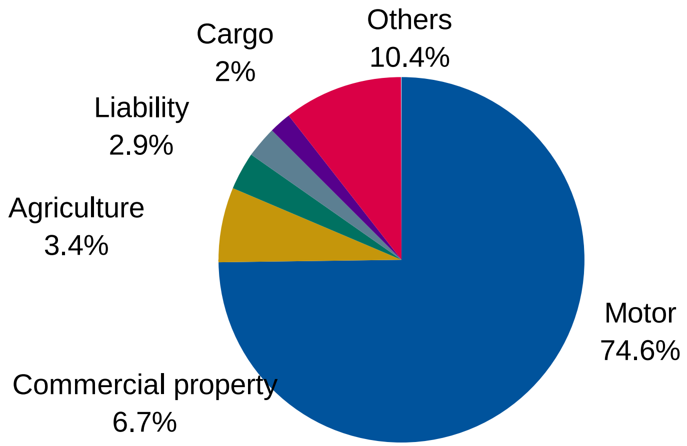
Major Insurers' Operating Efficiency: Administrative and Management Expense to Net Written Premium



Source: The companies, Year book of China's Insurance and Fitch's Calculation (based on PRC GAAP)

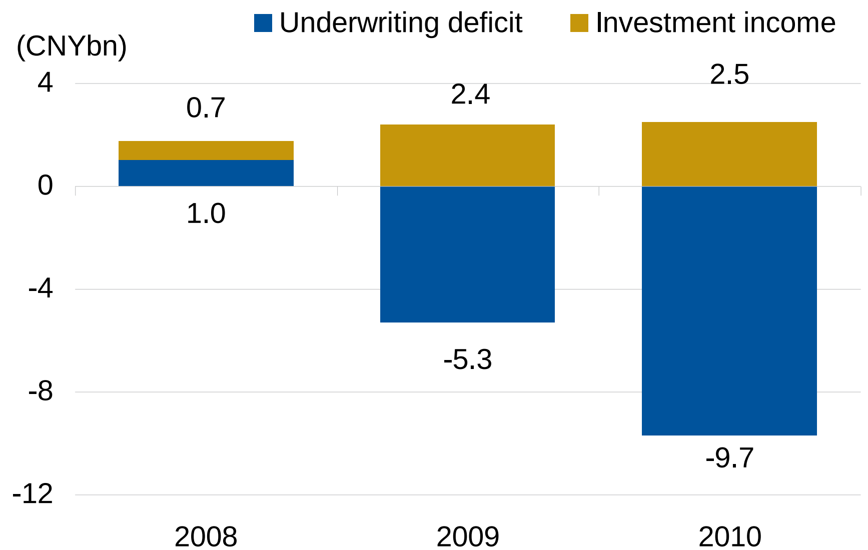
Underwriting Cycle Likely to Peak in H211 (I)

2010 Premium Breakdown by Product Type



Source: CIRC

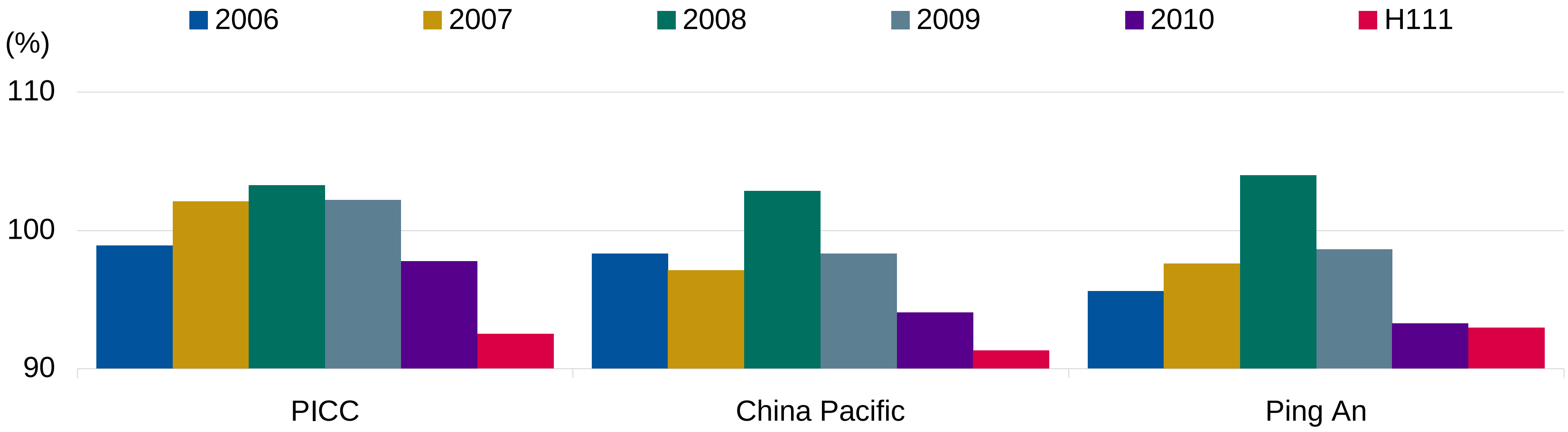
Underwriting Performance of Compulsory Third Party Motor Insurance



Source: CIRC

Underwriting Cycle Likely to Peak in H211 (II)

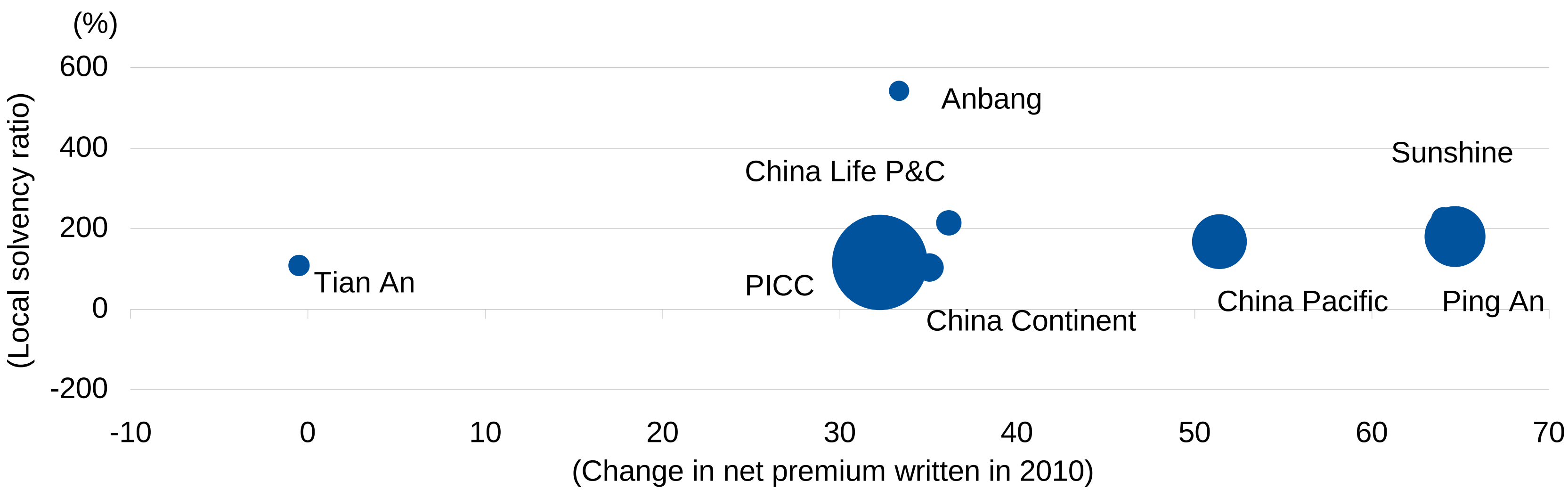
Combined Ratio of the Three Largest Non-Life Insurers



The combine ratio is based on net earned premium
Source: The companies, based on HKFRS

Premium Growth Continues to Exert Solvency Pressure

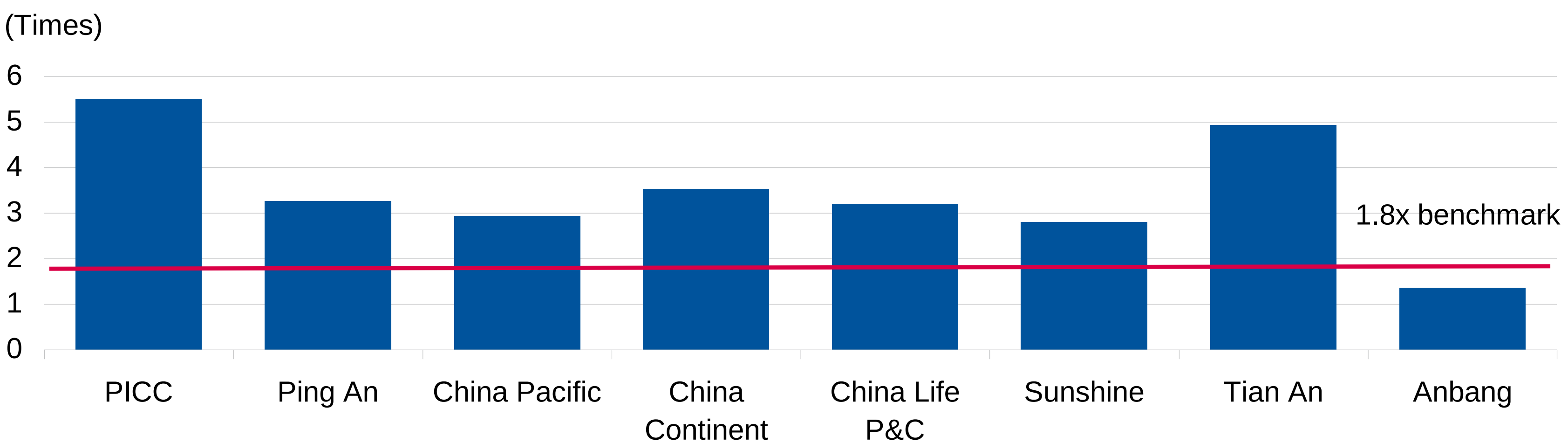
Solvency, Market Share and Net Premium Growth of Major Insurers in FY10



Source: The companies and Fitch's calculation

Net Premium Leverage Remains High

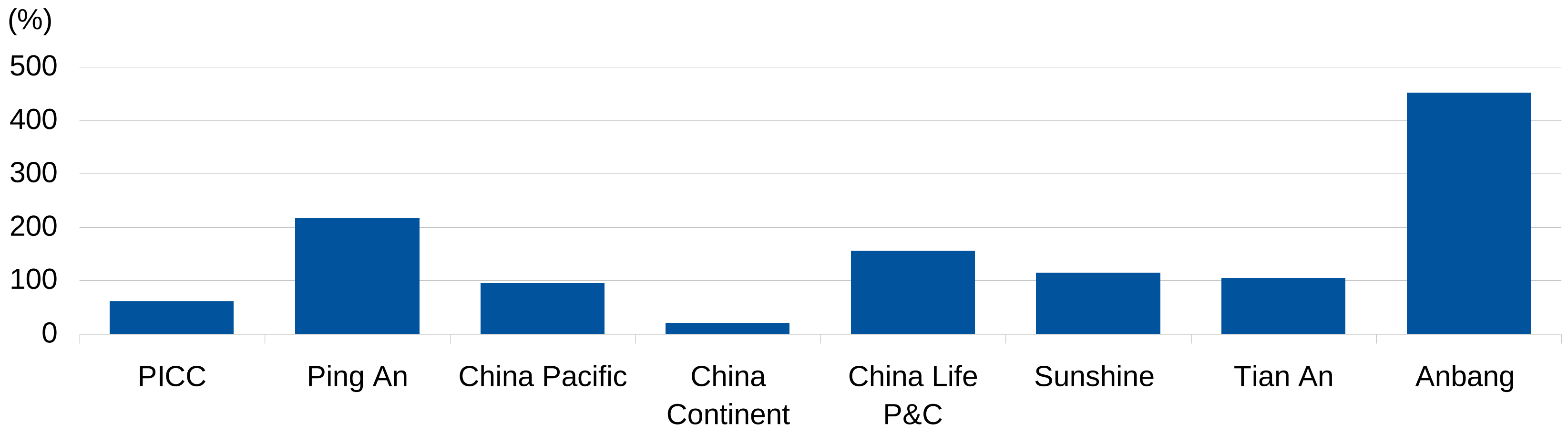
Net Premium Leverage of Major Insurers in FY10



Net premium leverage = Net premium written to shareholders' equity
Source: The companies and Fitch's calculation

Solid Liquidity; Market Volatility Could Affect Solvency

Major Insurers' Ratio of Cash and Deposit to Net Claim Reserves at FYE10



Source: The companies and Fitch's calculation (based on PRC GAAP)

Stable Outlook in 2012

Non-Life Insurance

- Ongoing regulatory supervision
- Market discipline
- Inflationary pressure

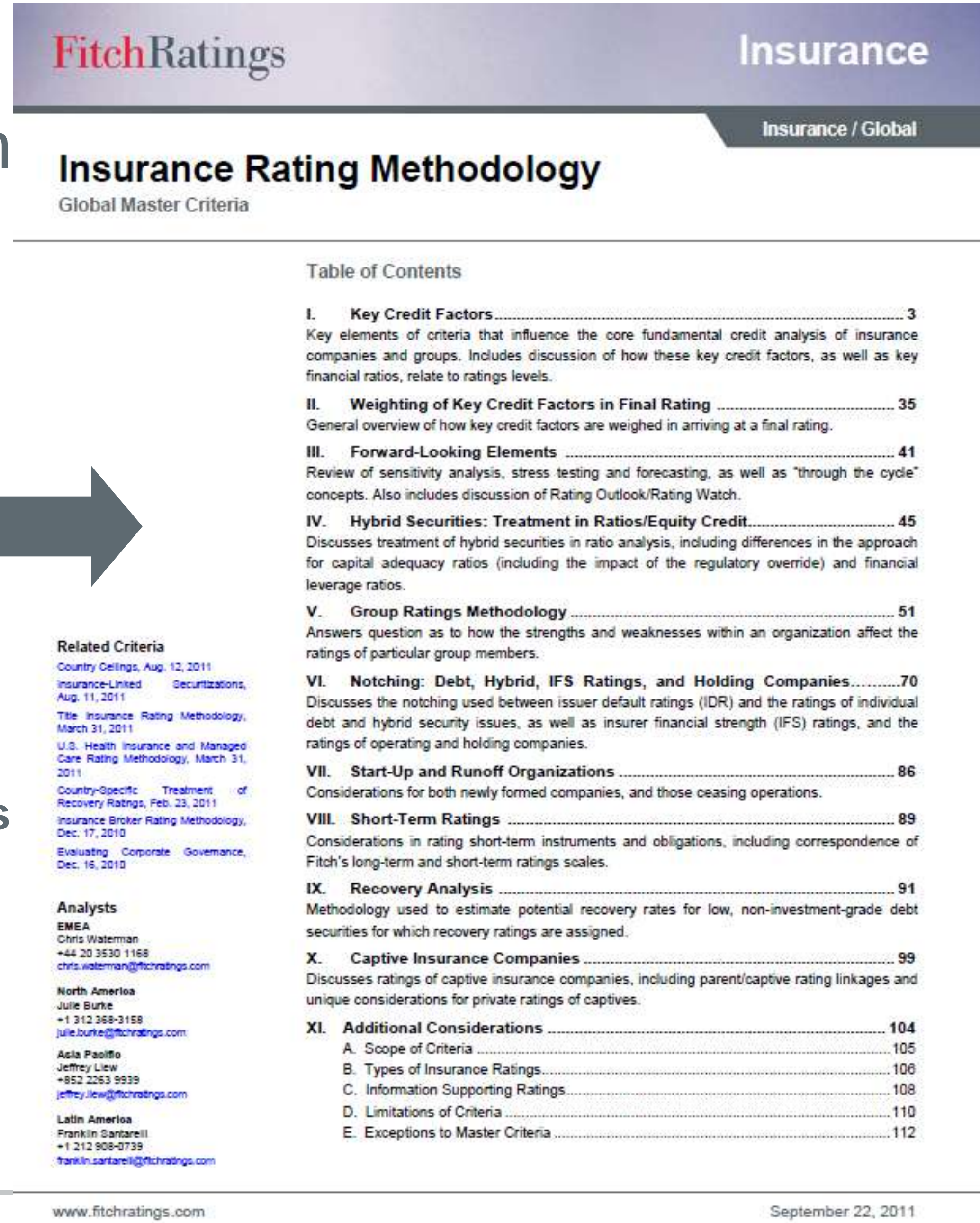
Related Research
2012 Outlook: China Non-Life Insurance – Preparing for the Downswing (Dec 2011)

Agenda

- Credit Snapshot of Chinese Non-Life Insurers
- **Overview of Fitch's rating methodology for insurers**

Criteria Being Withdrawn

- **Insurance Rating Methodology**
- **Life Insurance Rating Methodology (Global)**
- **Non-Life Insurance Rating Methodology (Global)**
- **Fitch's Approach to Rating Insurance Groups**
- **Insurance Industry: Global Notching and Recovery Analysis**
- **Treatment of Hybrids in Insurance Capital and Leverage Ratios**
- **Takaful Rating Methodology**



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Insurance

Insurance / Global

Insurance Rating Methodology

Global Master Criteria

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Related Criteria

Country Ceilings, Aug. 12, 2011
Insurance-Linked Securitizations, Aug. 11, 2011
Title Insurance Rating Methodology, March 31, 2011
U.S. Health Insurance and Managed Care Rating Methodology, March 31, 2011
Country-Specific Treatment of Recovery Ratings, Feb. 23, 2011
Insurance Broker Rating Methodology, Dec. 17, 2010
Evaluating Corporate Governance, Dec. 16, 2010

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Master Criteria Overview

- Section I. – Key Credit Factors
  - Main Aspects of Our Fundamental Analysis
    - ***Much Greater Focus on Relating Key Factors to Rating Levels***
- Section II. – Weighting of Credit Factors in Rating
  - Illustrates How We Develop a Final Rating
- Section III. – Forward Looking Elements
  - Forecasting, Sensitivity Analysis, Stress Testing
- Section IV.-XI. – Various "Technical" Topics
  - i.e. Notching, Group Ratings, Hybrids, etc.

Key Credit Factors

1. Qualitative factors:

- Sovereign and country-related constraints
- Industry profile and operating environment
- Market position and size/scale
- Ownership
- Corporate governance and management

2. Quantitative factors

- Capitalization and leverage
- Debt service capabilities and financial flexibility
- Financial performance and earnings
- Investment and asset risk
- Asset/liability and liquidity management
- Reserve adequacy
- Reinsurance, risk mitigation and catastrophe risk

Key Credit Factors: Qualitative factors

Sovereign and Country-Related Constraints

- Greater clarity on sovereign/country constraints on the ratings
- When acceptable to rate above sovereign
- When to treat IFS as LC vs. FC

Basic constraints	Impact on Rating
Country Ceiling (CC)	FC rating: Capped by CC due to T&C risks; LC rating: Not subject
Sovereign Rating	Entities can be rated above must be able to withstand sovereign crisis and has low exposure to government debts. Insurers are less likely to be rated above due to high levels of government bonds
IFS Rating	When policyholder obligations are mostly in LC, IFS is treated as LC rating

Key Credit Factors: Qualitative factors

Industry Profile and Operating Environment

- Insurers operating in a higher risk segment tend to be rated lower

IFS:	AAA	AA	A	BBB	<BBB
Debt:	AA	A	BBB	BB	<BB
Life Insurance/Annuities					
Non-Life					
Reinsurance					
Accident and Health					

Key Risks for Major Types of Insurance

Non-Life Insurance

- Cyclicality of financial results due to large low frequency, high severity losses
- Intense competition in most sectors leading to commodity pricing

Life and Annuity Insurance

- Competitive pressure on pricing and profitability due to overcapacity and competition from other financial institutions
- Increased regulatory and operational risk

Reinsurance

- Potential exposure to pandemics or other mortality catastrophe

Accident and Health

- Exposure to political and regulatory risks (especially in the U.S.)

Key Credit Factors: Qualitative factors

Market Position and Size/Scale

- Larger companies with major scale and market position and product/market diversification and can achieve higher ratings
- Also consider brand strength and market share
- Distribution capabilities: volume, productivity and diversification

IFS:	AAA	AA	A	BBB	<BBB
Debt:	AA	A	BBB	BB	<BB
Major position and scale					
Modest position and scale					
Small, narrow focus					

Key Credit Factors: Qualitative factors

Ownership

- Goal: Assess if Neutral, favourable, or unfavourable to the ratings
- **Mutual / stock (public):** Neutral, but mutual ownership can have higher ratings as there is greater incentives to hold excess capital, liquidity or use conservative ERM approach
- Public ownership tends to focus more on return on capital
- **Private ownership:** neutral, positive or negative
- Private – eg. Hedge fund, private equity firm, bank/corporate
- Positive when private owner is highly rated, expectation of support or perceived synergies, e.g. bancassurance

IFS:	AAA	AA	A	BBB	<BBB
Stock					
Mutual					

Key Credit Factors: Qualitative factors

Corporate Governance and Management

- Good CG will not increase ratings but poor CG could result in lower ratings
- CG: board independence, audit issues, related party transactions
- Risk management: risk appetite, understanding of and involvement in risk management function; effectiveness of risk management process/ tools

IFS:	AAA	AA	A	BBB	<BBB
Effective or adequate					
Generally effective, but some weakness noted					
Weak/ ineffective/ inadequate					

Key Credit Factors: Quantitative factors

Capitalization and Leverage

- Capital adequacy ratios (CARs) include:
  - Regulatory solvency
  - Operating leverage (net premium/ shareholders funds)
  - Fitch's risk-based capital model (Prism)
- Financial leverage ratio

Median Ratio Guidelines

IFS	AAA	AA	A	BBB
Capital Adequacy				
RBC (%)	450	375	270	200
Solvency I (EU) (%)	220	175	150	125

Key Credit Factors: Quantitative factors

Financial Performance and Earnings

- Premium growth trend – compared to industry
- Profitability – underwriting and investing
- Expense efficiency

(Refer to financial ratio definitions in criteria)

Median Ratio Guidelines

IFS	AAA	AA	A	BBB
Profitability				
Combined ratio (Non-Life) (%)	80	95	103	110
Operating ratio (Non-Life) (%)	67	82	90	97
Pretax return on assets - Life (%)	1.4	1.1	0.9	0.4

Key Credit Factors: Quantitative factors

Investment and Asset Risk

- 4 key areas: Credit risk, market risk, interest rate risk, and liquidity risk
- Consider composition and credit quality of fixed income portfolio
- Investment in risky assets, e.g. equities, properties, foreign assets
- Hedging strategy and tools/instruments used

Median Ratio Guidelines

IFS	AAA	AA	A	BBB
Risk assets to surplus/equity (Non-Life) (%)	25	50	75	100
Equities to surplus/equity (Life) (%)	15	27	45	60
Below IG bonds to surplus/equity (Life) (%)	20	40	55	70

Key Credit Factors: Quantitative factors

Asset/Liability and Liquidity Management

- **Life**: Important due to high investment leverage, business nature and product features; also for management of earnings
- **Non-life**: Ability to generate cash flow is higher; liquidity is important for short-tail business and in event of high catastrophe losses
- **Consider**: Marketability of investments, alternative sources of liquidity, and local market-specific factors

Median Ratio Guidelines

	AAA	AA	A	BBB
Liquid assets to technical reserves (Non-life) (%)	200	150	125	100
Liquid assets to policyholder liabilities (Life) (%)	85	75	60	45

Key Credit Factors: Quantitative factors

Reserve Adequacy

- Critical for non-life (re)insurers
- Challenge is availability and data interpretation – statutory filing, actuarial report certified by registered actuaries
- Trends can be influenced by various factors: business mix, acquisitions/divestments, underwriting and claim practices, reinsurance arrangements and inflation
- When data is limited, Fitch relies more on basic ratio analysis, eg. trends in reserve to premiums

Median Ratio Guidelines

	AAA	AA	A	BBB
Long-Term Average Reserve Development to Surplus/Equity (Non-Life) (%)	(5)	(2)	0	5

Key Credit Factors: Quantitative factors

Reinsurance, Risk Mitigation, and Catastrophe Risk

- Reinsurance contracts that help reduce risk materially - Positive
- Over-reliance on specific forms of risk mitigation (eg. quota-share, hedging) – Negative
- Higher rated insurers tend to use less reinsurance due to strong financial position and less concentrated portfolio
- Factors considered: sufficient amount/type, cost of reinsurance, financial strength/ratings of reinsurers

Median Ratio Guidelines

	AAA	AA	A	BBB
Reinsurance recoverable to Surplus/equity (Non-Life) (%)	**25**	**45**	**65**	**100**

Fitch Ratings

Thank You

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