

Redefining Risk, Creating Value

Participating Insurance in China

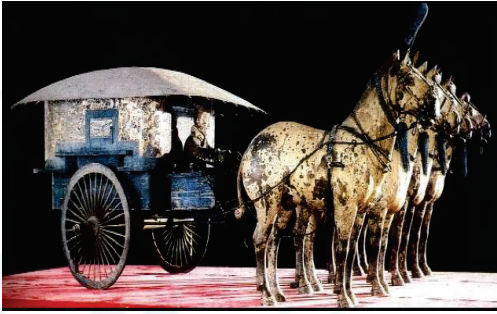
Sharon Huang, FSA
Alex Bryant, FIA



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Roadmap for Today

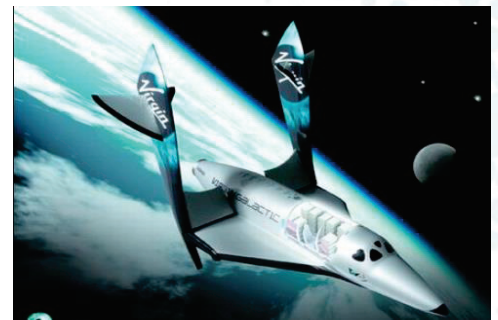


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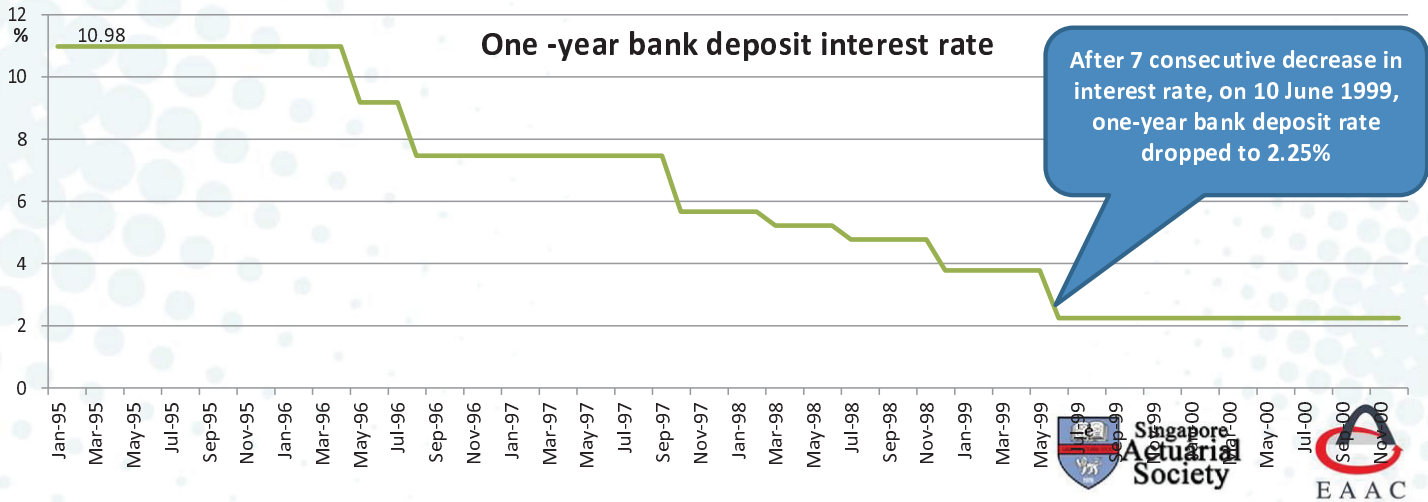
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Introduction of Par into China

Background

- Most policies issued in the 90's were priced at about 8% when the bank savings deposit rate is about 10%.
- PBOC cut interest rate 7 times in a row from 1996 to 1999.



Introduction of Par into China

Background (cont'd)

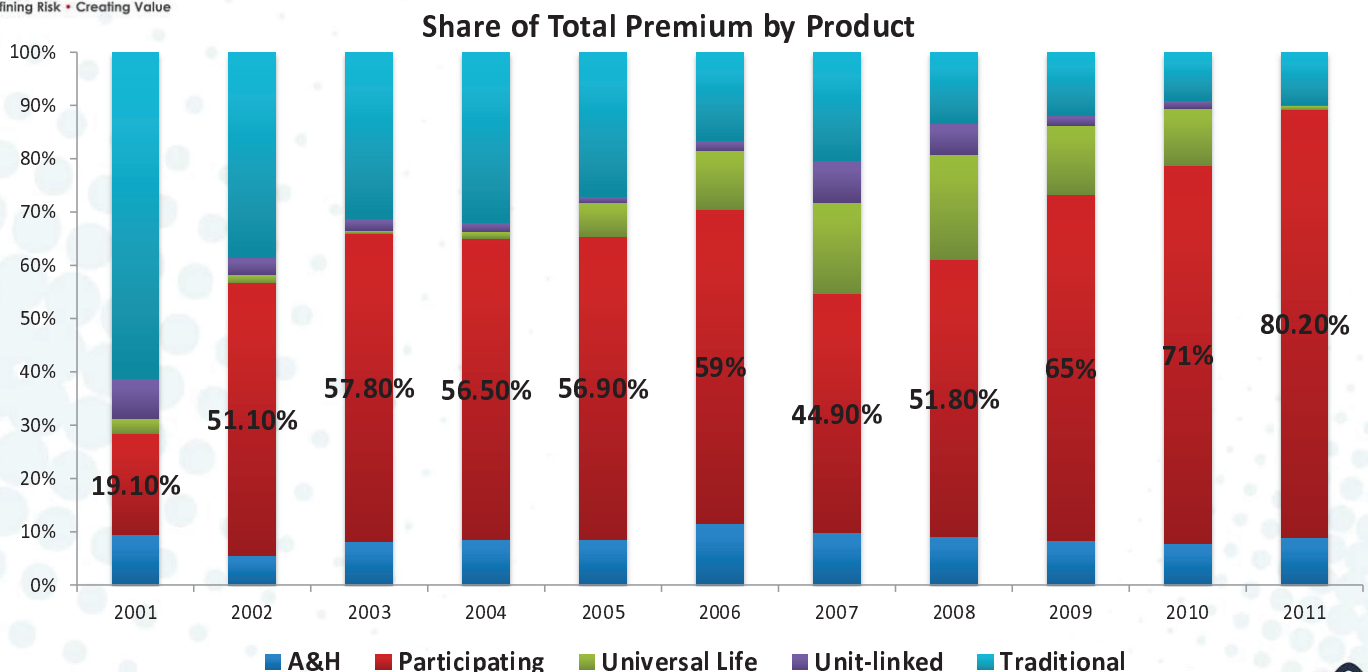
- CIRC issued urgent notice to cap the pricing interest rate at 2.5% on 10 June 1999.
- Traditional products became quite expensive
- Individuals looked for ways to replace bank savings and increase investment return

Introduction of Par into China

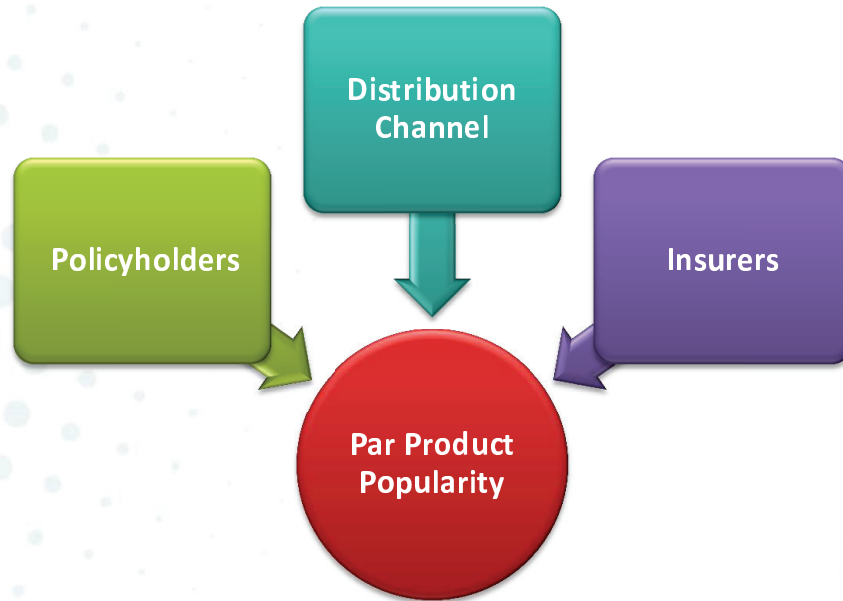
- First Par product issued in 2000
 - New story to tell policyholder that they can participate in future gains
 - Not necessary to change pricing rate when interest rate goes up
 - Provide individuals a new investment vehicle by adding investment component into insurance product



How it Became Dominant Product



How it Became Dominant Product



How it Became Dominant Product

For Policyholders

- Par product provides both guarantee and upside potential
- In line with people's psychology and purchasing habits
- Advantages over unit-linked and universal life
 - Not so complicated
 - Provide relatively stable investment return
- Wide variety of product offerings to meet various needs

How it Became Dominant Product

For Insurers

- Advantages over unit-linked and universal life
 - Product fees not transparent
 - Less pressured when compete on investment return
 - Dividend disclosed to policyholder once a year and only the existing par product policyholder would know the dividend level.
 - For unit-linked, insurers must disclose unit price at least every week to the general public
 - For universal life, insurers must disclose crediting rate at least every month to the general public
 - Generally speaking, VNB margin is relatively higher than unit-linked and universal life.

How it Became Dominant Product

For Insurers

- Product design quite flexible to meet the needs of both distribution channel and policyholder
 - Endowment, annuity, whole life
 - Easily work with various riders, such as CI, medical
- Under the new CAS rules, only a small portion of universal life/unit-linked premium is counted as premium income.

How it Becomes Dominant Product

Distribution Channel

- Less demanding to sell par product than to sell unit-linked or universal life
- Higher commission rate than unit-linked and universal life
- Widely accepted by bank which is the dominant distribution channel



Key Features of Par in China

- Product offerings
 - Conventional
 - Annual cash dividend
 - Reversionary dividend + terminal dividend
 - Unitized-with-profit
 - Most par products provide annual cash dividend

Key Features of Par in China

- Product offerings (cont'd)
 - Participating endowment
 - Participating annuity
 - Participating whole life
- Most popular par products are participating endowment

Key Features of Par in China

- Profit sharing
 - 70/30 gate: policyholder get at least 70% of distributable par fund surplus
 - Determined by investment gain/mortality gain/expense gain/lapse gain

Key Features of Par in China

- Regulatory reporting
 - Participating Insurance Financial Report
 - Need to submit to CIRC by April 15th annually
 - Need to cover:
 - Declaration of the insurer's board of directors and management team
 - External auditor's opinion
 - Summary of par products in force
 - Performance of par fund
 - Income statement and balance sheet of par fund
 - The amount of dividend payable and the process and method used to determine it

Key Features of Par in China

- Regulatory reporting (cont'd)
 - Appointed Actuary Report
 - Need to submit to CIRC by April 30th annually
 - There is a session on par insurance including
 - Declaration of appointed actuary
 - Balance sheet of par fund
 - Par fund surplus
 - Analysis of the sources of par fund surplus
 - Dividend declared

Key Features of Par in China

- Par fund management
 - Need to be managed separately from the other business
 - Can be notionally or physically segregated
 - It is not uncommon for notionally segregated par fund

Key Features of Par in China

■ Disclosure

- Point of sale disclosure
 - Policy provision
 - Insurance product specification with dividend illustration at low, mid and high level respectively
 - Investment return used for dividend illustration is capped at 3%, 4.5% and 6% for low/mid/high level of dividend respectively. For cash dividend deposited with insurer, the interest rate is capped at 3%
 - Precaution on application
- *Insurer could not disclose the investment return they use for dividend illustration*

Key Features of Par in China

■ Disclosure (cont'd)

- Post-sale disclosure
 - Insurers need to notify policyholders at least once a year on
 - Latest policy information
 - Insurer's dividend policy
 - Total par fund surplus distributable to all policyholders this year
 - Dividend payable to the policyholder specifically
 - Except for the par insurance policyholders themselves, insurers could not disclose to the general public the dividend they are going to pay the policyholders.

Key Features of Par in China

- Solvency margin
 - Formula driven based on $x\%$ of reserve + $y\%$ of sum at risk
- Embedded value report submitted to CIRC
 - on TEV basis
 - Cost of guarantee of par product is not explicitly calculated

Key Challenges and Latest Trend

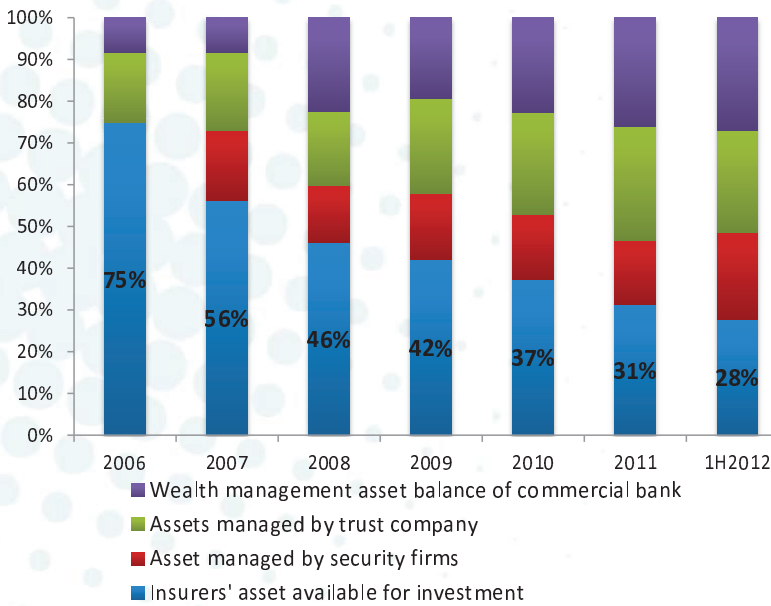


#1. Compete with products of the other financial institutions on investment yield

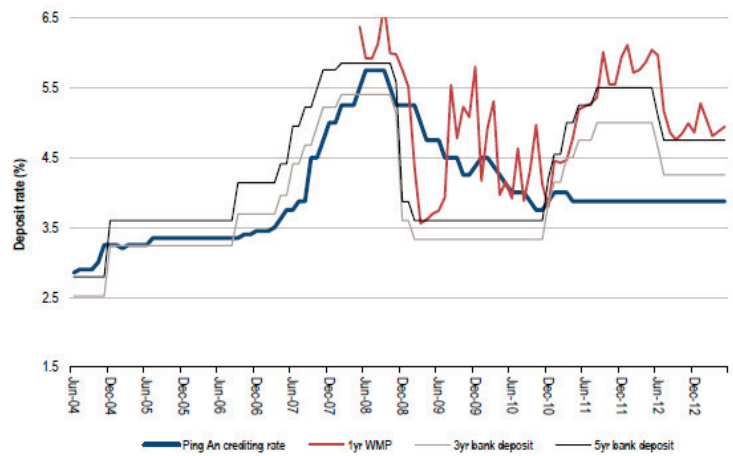
- Insurer's channel-driven product strategy targeting to re-divide consumer's deposit pie
- Deposit-replacement products are easy to sell for sales channel
- Policyholders consider it as an investment product rather than an insurance product
- ***That is not insurer's strength due to the regulatory limitations on investment and it would take time for them to catch up!***

Key Challenges and Latest Trend

Assets Managed by Insurers vs. Other Financial Institutions



Insurance Credit Rate vs. 3/5Y Term Deposit Vs. Bank WMP Yield



Source: CICC Research Report, 8 Jan 2013; Credit Suisse Research Report, 31 May 2013

Key Challenges and Latest Trend



#1.1. Insurers started to try to add more insurance component into the product

Single Pay
5-10 Yr Insurance Period



Regular Pay
Longer Insurance Period

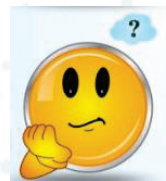


#1.2. Regulator allows insurers to get access to new investment channels

- Financial options for hedging purposes
- Credit plan on infrastructure
- Private equity
- Real estate
-



- Insurer's investment yield is expected to be increased
- New ALM business model emerging
 - Liability driven moving to asset driven



Key Challenges and Latest Trend



#2. “Too big to fail”?

- Insurers could hardly afford the increase in policy lapse and/or decrease in new business sales due to uncompetitive dividend rate.
 - Tried all their best to set dividend at the level which is competitive against bank deposit rate and also close to the mid level of dividend illustration
- However, for many insurers, their actual par fund surplus could hardly support such high dividend rate
 - Non-satisfactory investment performance
 - Expense overrun extended much longer than business plan

Key Challenges and Latest Trend



#2.1. Cut dividend rate

- Accumulated par fund smoothing reserve has been depleted even for the top insurers
- For many insurers, it is the first time for them to set dividend rate lower than 4%



#2.2. Creative product design to attract investors

- Par insurance packaged with universal life
- Universal life which provides both monthly crediting rate and terminal dividend

Key Challenges and Latest Trend

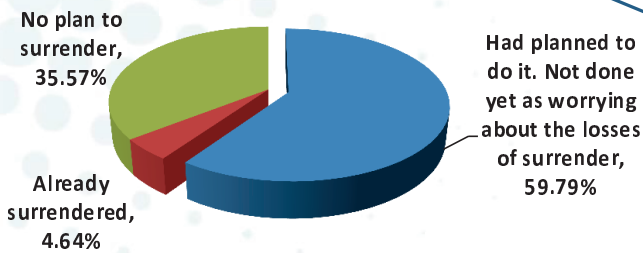


#3. Liquidity strain

Maturity:

Large volume of 5/10 Yr par endowment issued in 2001-2002 and 2007-2008 mature in 2012-2013

Do you plan to surrender*?



New business premium growth slow down

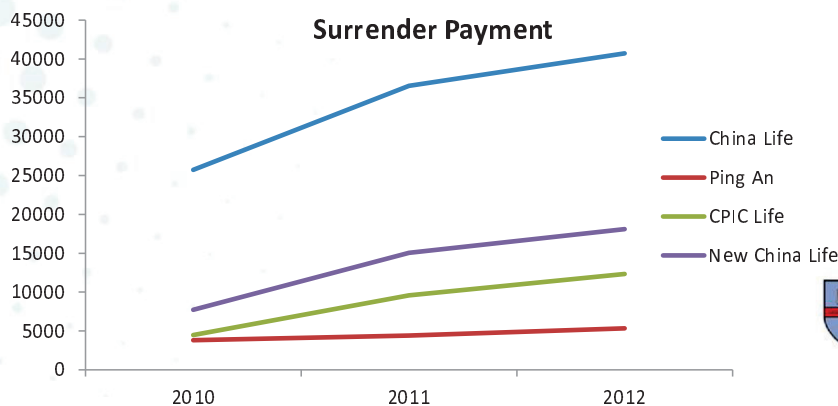
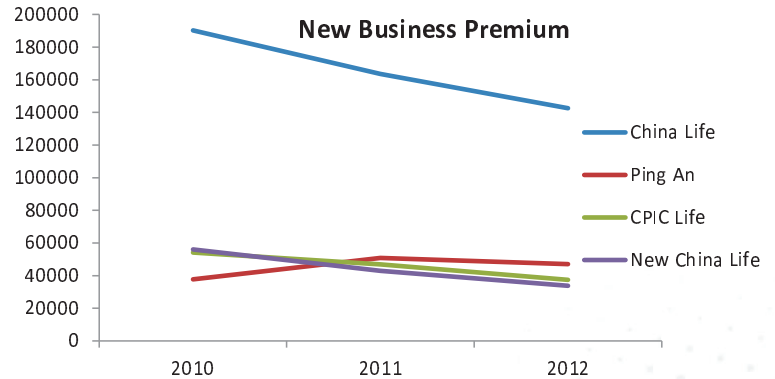
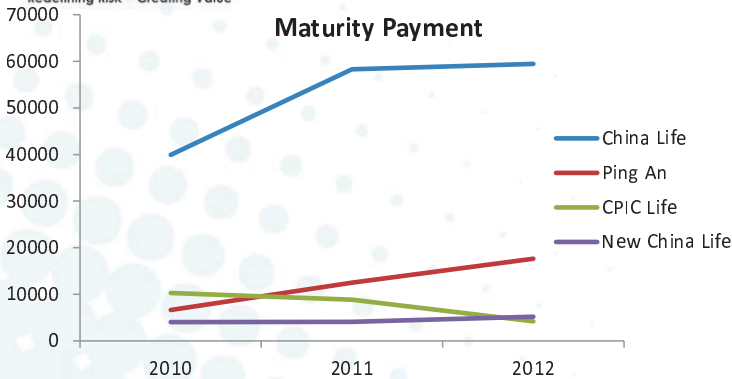


Maturity payment and surrenders jump up



*Source: Participating insurance survey, Securities Daily, April 2012

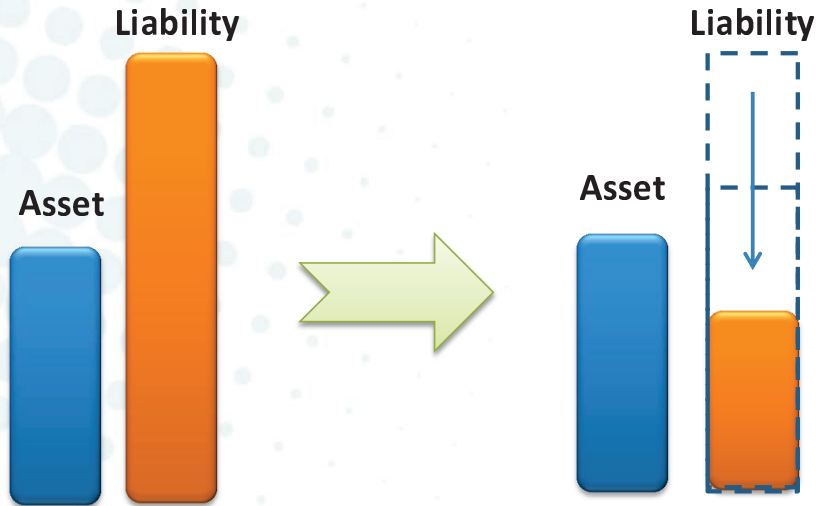
Key Challenges and Latest Trend



Key Challenges and Latest Trend



#3. Sell short-term low-margin product to bring in cash flow



- Cash surrender value
- Coupon
- Policy loan



- Competition with non-par traditional product
 - Pricing interest rate liberalization
 - Give insurers incentives to diversify product portfolio by selling more protection products

A traditional non-par providing 3.5% guaranteed rate

Which one would you prefer?

A par providing 2.5% guaranteed rate with potential of getting 4% -5%

	Pricing Rate/Minimum guaranteed rate		Reserving Rate	
	Before 5 Aug 2013	After 5 Aug 2013	Before 5 Aug 2013	After 5 Aug 2013
Traditional Non-par	Capped at 2.5%	No cap limit. But need to get prior-approval from CIRC if pricing rate higher than 3.5%	Capped at min (pricing rate, 2.5%)	Capped at min (pricing rate, 3.5%*)
Participating Ins.	Capped at 2.5%	Capped at 2.5%	Capped at min (pricing rate, 2.5%)	Capped at min (pricing rate, 2.5)

*Note: For annuity business with insurance period of no less than 10 years and the deferred annuity with payout starting no earlier than the official retirement age, the reserving rate is capped at min(pricing rate, 4.025%)

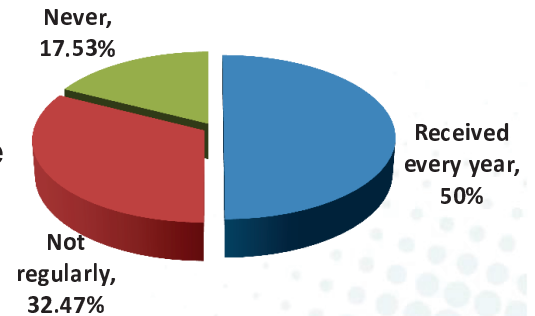
- Impact of China's new solvency regime (C-ROSS)
 - Overall framework has been released
 - Taking into consideration of the business' risk level
 - Par insurance with poor ALM, negative interest spread will be penalized

Future Prospect

Impact of customer service and distribution channel innovation

- Customer centricity
 - How often do you check your MSN, Twitter?
 - How often do you hear from your insurer?
- Digitalization and information transparency
 - In December 2012, Guohua Life collected more than RMB 105million from the universal life products within 3 days via Taobao
 - The premium income from internet sales in 2012 is about RMB 3.96 billion. The number is expected to be RMB 59 billion in 2016*.

How often did you get your notice of dividend declaration from insurer?

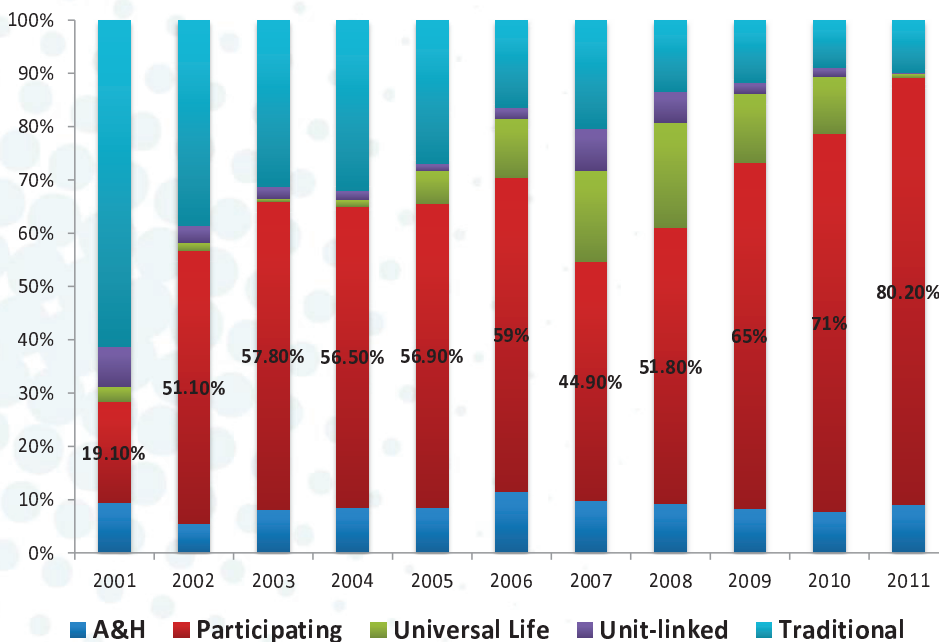


Is Par Insurance Well Positioned?



* Source: Research Report on Insurance Sales on Internet 2012-2013, i Research

Future Prospect



Where it will be in the next 10 years?



Milliman Asia Participating Business Survey 2013 – Focus on China

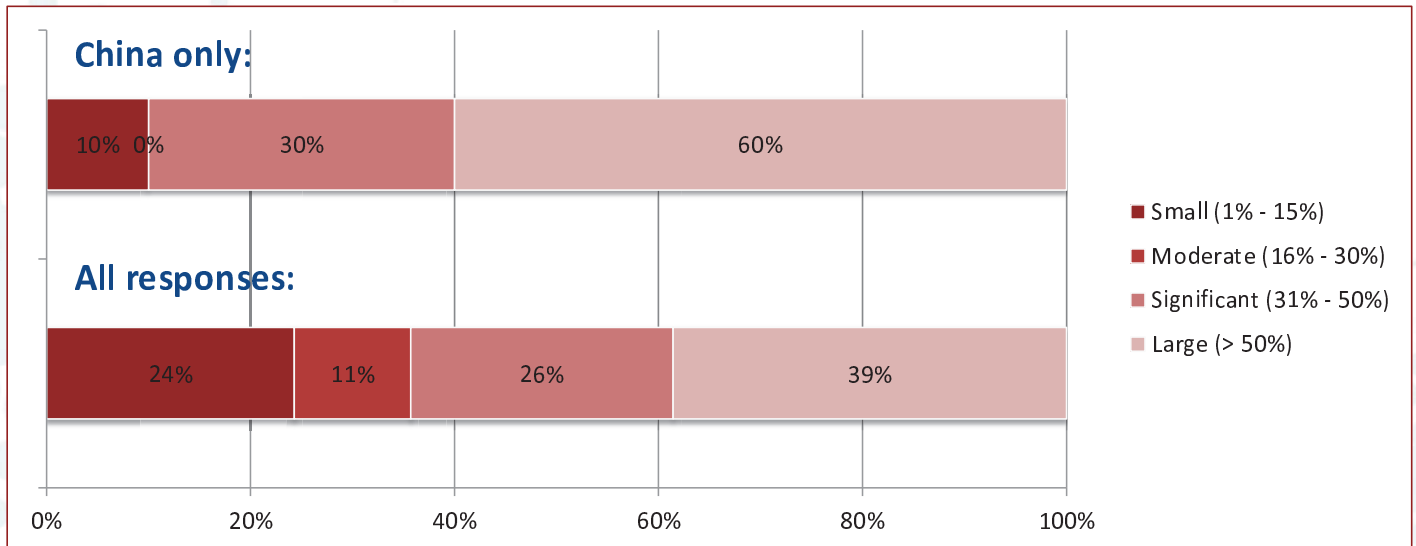


Par Business Survey

- Survey of senior life insurance executives
- Asia-wide, excluding Japan and Korea
- 82 responses in total, 72 from companies with Par business
- 11 from China, 10 with Par
- Anonymous

Significance of Par Business

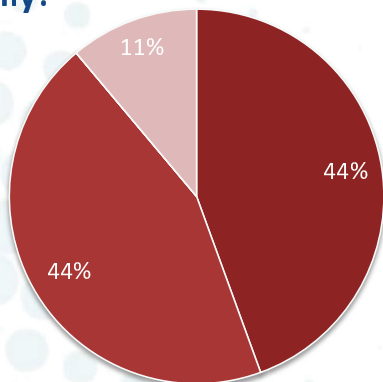
What proportion of your in-force business (by reserves) is participating?



Factors behind Par proposition

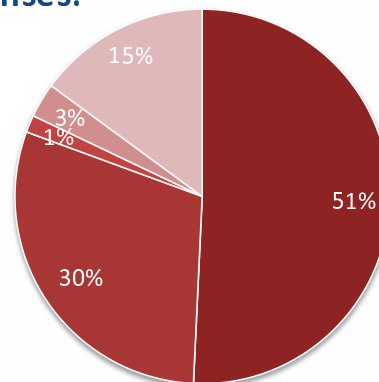
What is the most significant factor in why you offer participating business?

China only:



- Distribution channel demand (44%)
- Customer demand (44%)
- Profitability (0%)
- Capital efficiency (0%)
- None of the above (11%)

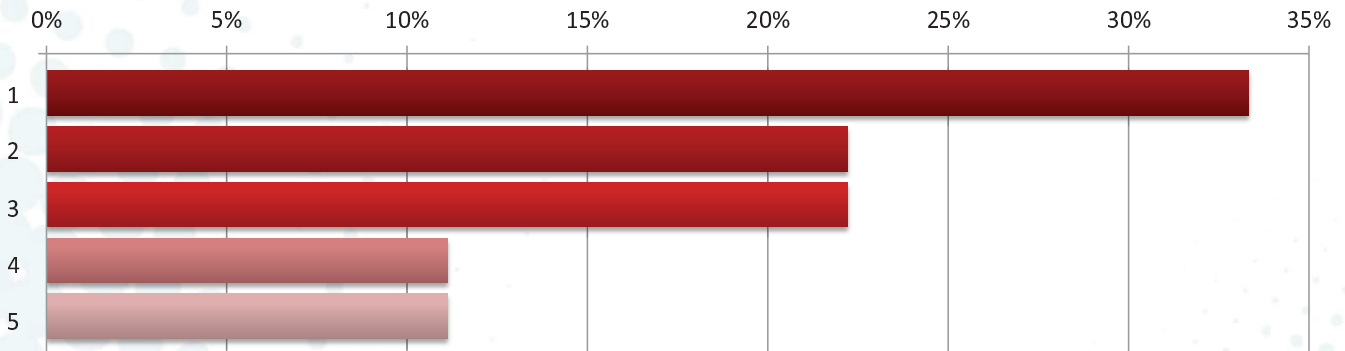
All responses:



- Distribution channel demand (51%)
- Customer demand (30%)
- Profitability (1%)
- Capital efficiency (3%)
- None of the above (15%)

Product Positioning

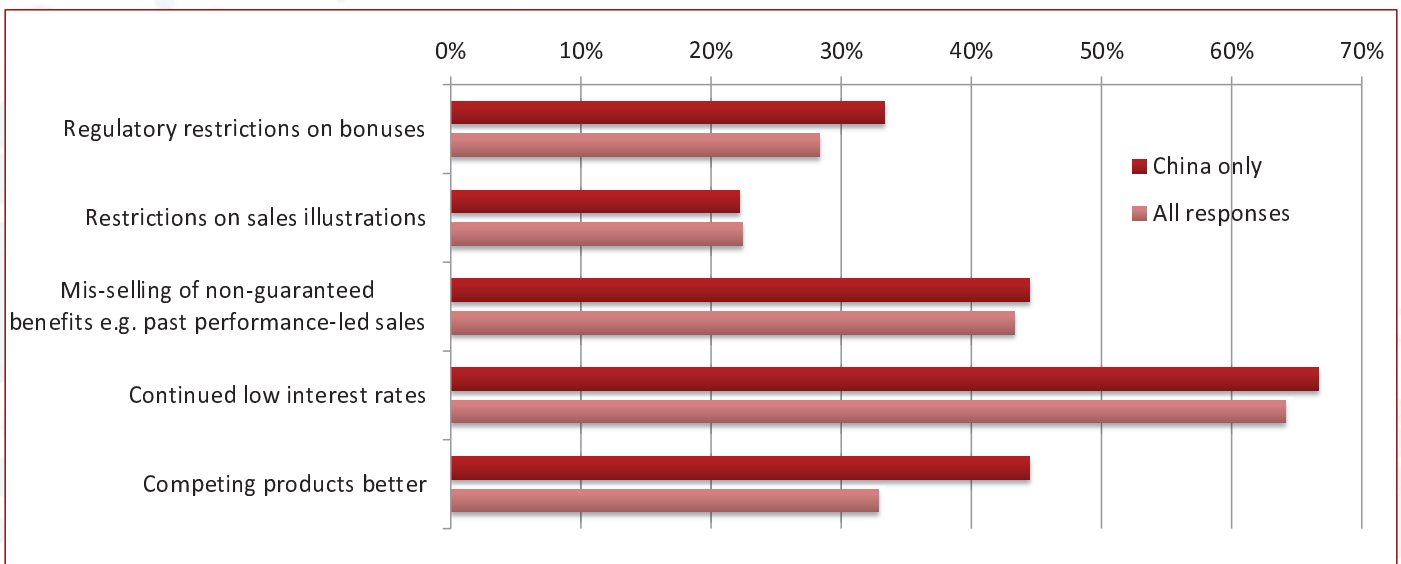
What are the key components of your product positioning? (China Only)



- 1. Product offers 'smoothed returns' (i.e., low volatility in maturity values)
- 2. Product is a lower-risk alternative to investment-linked business
- 3. Product offers attractive returns compared to alternative products like bank deposits
- 4. Product offers long-term, low-risk returns but expected to be higher than sovereign bonds
- 5. Product is positioned in different distribution channel, e.g., we offer investment-linked for channel A and par for channel B

Risks to Par offering

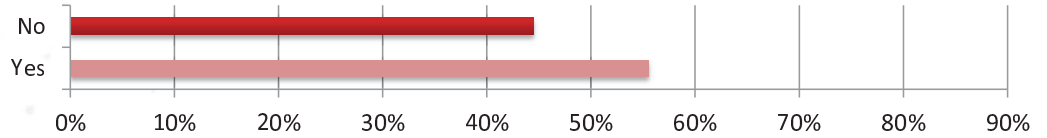
What is the biggest risk to successful participating product offering?



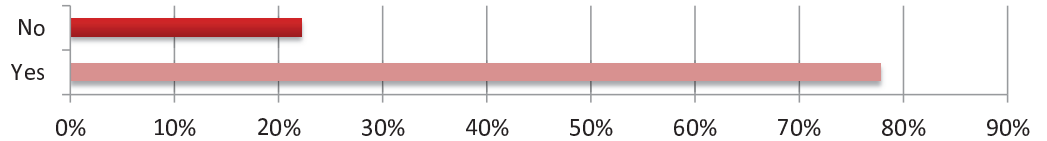
Note: Participants could give more than one answer

Policyholders Reasonable Expectations (results for China only)

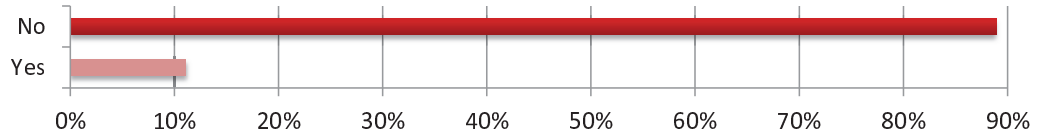
Is there a document setting out the company's understanding of PRE?



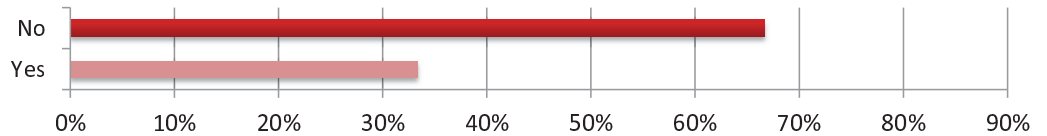
Is there a document setting out the Principles and Practices of Financial Management (PPFM)?



Have you discussed with (or received direction from) the regulator about PRE and their understanding of how it constrains the company's actions?



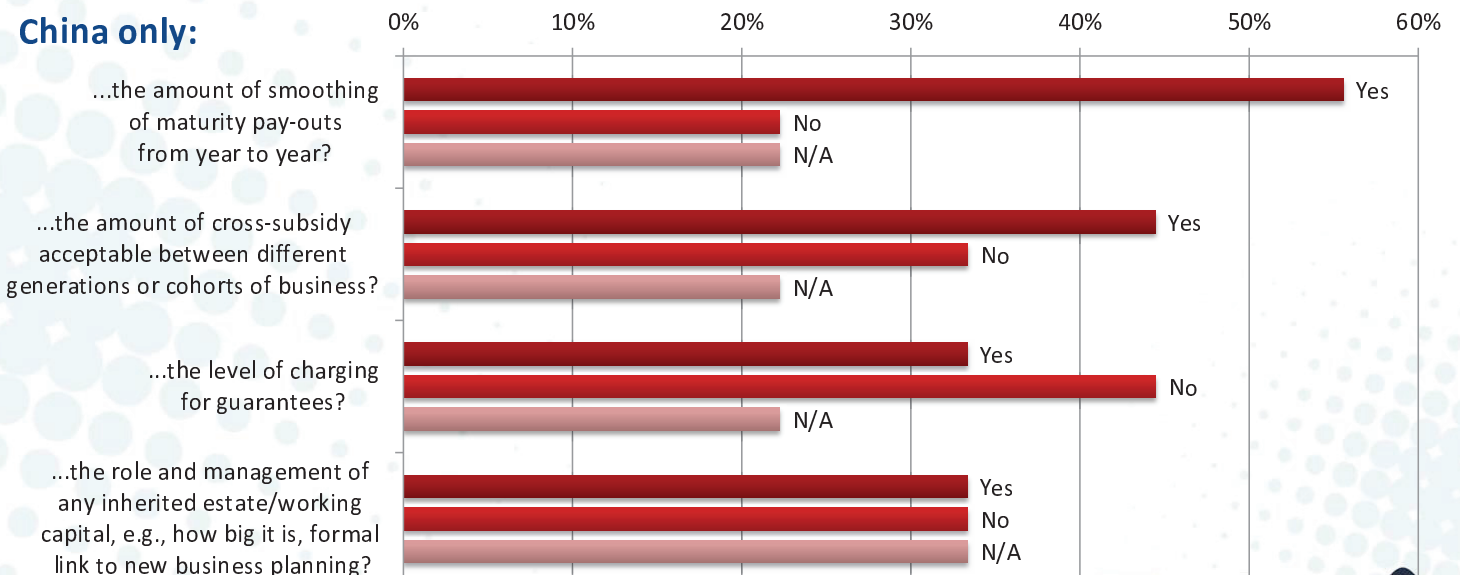
Do you believe policyholders understand how you manage the business and interpret PRE?



Policies and Practices

Do you have a clear policy/practices relating to...





China only:



Concluding Remarks



Key Takeaway

-  Par business is an important part of life industry in China
-  Its existing business model is hardly sustainable
-  Insurers have been swaying between “sales volume first” and “profitability first”.
-  That will largely determine their strategy and future development of par business in China

Thank You!

Sharon Huang, FSA, FCAA, FLMI
Consulting Actuary
Tel: +8610 8523 3189
Email: Sharon.Huang@milliman.com

Alex Bryant, FIA
Consulting Actuary
Tel: +65 6327 2309
Email: Alex.Bryant@milliman.com

