

## CREDIT OPINION

9 November 2018

Update

✓ Rate this Research

### RATINGS

#### China Life P&C Insurance Company Limited

Domicile	China
Long Term Rating	A1
Type	Insurance Financial Strength - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# China Life P&C Insurance Company Limited

## Update following rating affirmation

### Summary

On November 9 2018, we affirmed [China Life P&C Insurance Company Limited's](#) (China Life P&C) A1 insurance financial strength rating (IFSR) with a stable outlook. The A1 IFSR reflects its solid market position as the fourth-largest property and casualty (P&C) insurer in [China](#) (A1 stable).

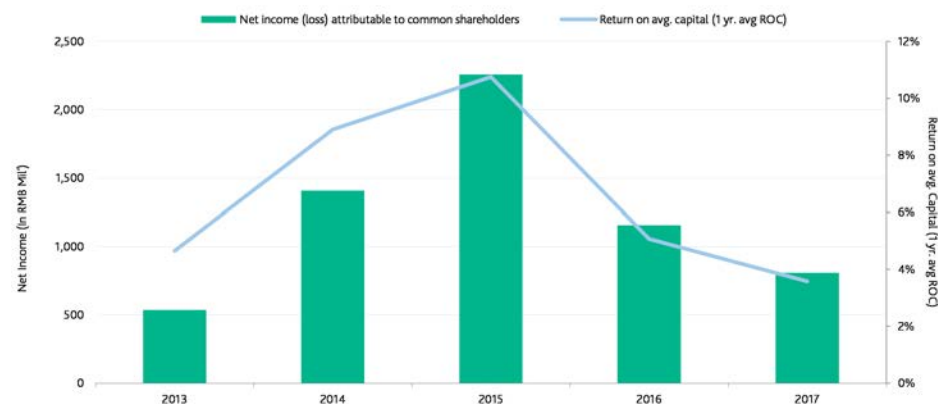
China Life P&C also has a conservative investment portfolio, with low equity exposure; its high-risk asset ratio was low at around 52% as of the end of June 2018. The insurer has good financial flexibility and benefits from the very good capital market access that one of its shareholders, [China Life Insurance Co Ltd](#) (China Life, IFSR A1 stable, Baseline Credit Assessment [BCA] a1), has.

These strengths are offset by the insurer's weaker underwriting profitability than that of its major peers, with its combined ratio further deteriorating to 101.7% in H1 2018 from 100.6% the year before. It is highly unlikely that the insurer will materially improve its combined ratio to below 100% in the next 12-18 months amid further motor pricing liberalization. In addition, the insurer's capital adequacy will remain under pressure because of premium growth and weakened profitability which contribute to weak internal capital generation.

China Life P&C's A1 IFSR incorporates a one-notch uplift from its BCA of a2, reflecting the potential support from the Chinese government, given the government's 87.36% effective ownership.

Exhibit 1

### Net income and return on capital (one-year average)



Sources: Moody's Investors Service, company data

## Credit strengths

- » Solid market position as the fourth-largest P&C insurer in China
- » Conservative investment portfolio, with low high-risk asset leverage
- » Strong financial flexibility, driven by strong capital market access and low financial leverage at China Life
- » Effective majority ownership by and support from the Chinese government

## Credit challenges

- » Weaker underwriting profitability than that of its major peers
- » Weak profitability and premium growth strain capitalization
- » Achieving profitable and consistent business diversification outside of the motor business

## Outlook

China Life P&C's rating outlook is stable, reflecting our expectation that the insurer's underwriting profitability and capitalization will not deteriorate significantly in the next 12-18 months amid pricing liberalization in the commercial (i.e. non-mandatory) motor segment and diversification into non-motor business.

## Factors that could lead to an upgrade

Given that China Life P&C's rating is already same as the sovereign rating, upward rating pressure is limited. However, its BCA could be raised if its

- » Underwriting performance improves consistently, such that its combined ratio falls below 95%.
- » Product mix becomes more diversified, without a deterioration in its overall underwriting profitability.
- » Capitalization strengthens, with its gross underwriting leverage (GUL) below 3x.

## Factors that could lead to a downgrade

The rating could be downgraded if (1) China's sovereign rating is downgraded, and (2) there are signs of weakening support from the Chinese government.

In addition, the BCA could be lowered if

- » Its combined ratio remains above 100%.
- » Its comprehensive solvency ratio falls below 175% or GUL exceeds 6x consistently.
- » Its reserve adequacy weakens as reflected in material adverse reserve development;
- » The credit profiles of its major shareholders, China Life or China Life Insurance (Group) Company (China Life Group), deteriorate significantly.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

China Life P&C Insurance Company Limited [1][2]	2017	2016	2015	2014	2013
<b>As Reported (Chinese Yuan Millions)</b>					
Total Assets	80,289	73,095	65,349	52,769	37,359
Total Shareholders' Equity	20,450	19,851	19,530	16,893	8,167
Net income (loss) attributable to common shareholders	808	1,157	2,258	1,407	535
Gross Premiums Written	66,250	59,783	50,383	40,414	31,854
Net Premiums Written	60,623	55,102	46,393	37,420	29,171
<b>Moody's Adjusted Ratios</b>					
High Risk Assets % Shareholders' Equity	50.4%	61.2%	54.2%	24.5%	34.6%
Reinsurance Recoverable % Shareholders' Equity	25.8%	21.1%	16.8%	14.3%	27.5%
Goodwill & Intangibles % Shareholders' Equity	0.5%	0.5%	0.5%	0.5%	0.8%
Gross Underwriting Leverage	4.7x	4.3x	3.6x	3.2x	5.2x
Return on avg. capital (1 yr. avg ROC)	3.6%	5.1%	10.8%	8.9%	4.6%
Sharpe Ratio of ROC (5 yr. avg)	214.4%	222.9%	245.4%	177.2%	NA
Adv./(Fav.) Loss Dev. % Beg. Reserves (1 yr. avg)	-0.2%	-6.5%	-5.2%	-2.7%	2.4%
Financial Leverage	6.5%	14.6%	12.7%	13.9%	31.9%
Total Leverage	6.5%	14.6%	12.7%	13.9%	31.9%
Earnings Coverage (1 yr.)	16.4x	15.9x	26.2x	13.7x	5.3x
Cash Flow Coverage (1 yr.)	11.6x	12.5x	24.4x	11.2x	3.8x

[1] Information based on LOCAL GAAP financial statements as of the fiscal year ending December 31.

[2] Certain items may have been relabeled and/or reclassified for global consistency.

Sources: Moody's Investors Service, company data

## Profile

China Life P&C Insurance Company Limited (China Life P&C) is 60%-owned by China Life Group, which is ultimately wholly owned by China's Ministry of Finance and 40% owned by China Life, the largest life insurer in China.

China Life P&C provides various insurance products in China, including motor, property, liability, agriculture, and accident and health.

## Detailed credit considerations

We rate China Life P&C's insurance financial strength at A1, one notch above its BCA of a2, as indicated by our IFSR scorecard, based on our assumption that the insurer will receive government support in times of stress.

### Insurance financial strength rating (IFSR)

The key factors influencing the rating and outlook are as follows:

#### Market position, brand and distribution: A - Solid market position, despite a recent decline in absolute market share

China Life P&C is the fourth-largest P&C insurer in China by premium income and held a 5.9% share of the market in H1 2018 (2017: 6.3%). The insurer has good brand recognition, benefiting from its life affiliate – China Life's leading franchise.

China Life P&C's absolute market share has declined slightly since 2016 because of slower motor premium growth, following further pricing liberalization. However, the insurer's relative market share ratio remained solid at 1.0x of an average-sized insurer in H1 2018.

China Life P&C distributes its products mainly through agency force, including tied agents, life affiliate agents and car dealers, which generated 65% of its gross premiums written in H1 2018, followed by 20% from direct sales. The insurer benefits from China Life's agency force, which is the largest in China, to expand its customer reach.

The insurer's expense ratio rose to 39.4% in H1 2018 from 37.1% a year earlier, driven by higher acquisition cost to solicit motor business. This level is considered high compared with those of its global rated P&C peers with a similar business mix, whose expense ratios tend to be in the low-to-mid 30s. We expect the insurer's expense ratio to improve in the next 12-18 months, mainly because of the industry's disciplined curb of motor commission expenses paid to intermediates started in August 2018.

#### Product risk and diversification: A - Short-tail-focused portfolio and gradual diversification outside of motor insurance

China Life P&C has gradually diversified its portfolio into non-motor lines, in particular, agriculture and liability insurance. Motor line contributed to 77.9% of the insurer's gross written premiums in H1 2018, down from 81.1% in 2017, followed by agriculture (5.9%),

liability (5.4%) and property (4.6%) insurance. We expect the agriculture business to be one of the insurer's key growth drivers because of its government background.

Nonetheless, the insurer's portfolio is still less diversified compared with its top-tier peers, as reflected in its lower non-motor premium contribution.

The insurer's geographic concentration in China exposes it to catastrophe, economic and regulatory risks. However, these risks are partially mitigated by its premium generation across the country and low insurance penetration in some of the catastrophe-prone areas.

We adjusted the Product Focus and Diversification score to A from Baa because of China Life P&C's still-dominant focus on short-tail motor insurance, which carries lower reserving risk.

**Asset quality: A - Low equity allocation and moderated allocation to alternative investments**

As of the end of June 2018, 55% of China Life P&C's invested assets were in cash, bank deposits and bonds (59% as of the end of 2017); 11% in equities and equity funds (11%); and the remaining 30% in alternative investments (32%).

China Life P&C's high-risk assets (including equities and unrated bonds) dropped to 50.4% of shareholders' equity as of year-end 2017 from 61.2% as of year-end 2016, mainly because of declined equity exposure. The ratio remained low at around 52% as of the end of June 2018. The insurer has no concentration risk to specific names in its equity exposures.

Although some of the insurer's alternative investments are associated with government-related projects or are covered by guarantees or collaterals, these assets generally exhibit lower liquidity and transparency than traditional market-traded assets. The insurer upholds strict risk management when investing in these assets.

China Life P&C's reinsurance recoverables rose mildly to 28.2% of shareholders' equity as of the end of June 2018 from 25.8% as of year-end 2017 as the business grew, but the level is still low. The insurer's reinsurance panel is of good credit quality.

We adjusted the insurer's Asset Quality score to the A level from the Aa level, indicated by the scorecard to reflect credit risk resulting from the insurer's alternative investments.

**Capital adequacy: A - Capitalization weakening because of weakened profitability**

China Life P&C's capitalization will remain under pressure because of premium growth and weakened profitability which contribute to weak internal capital generation. The insurer's GUL, which is a measure of gross premiums and reserves compared with adjusted shareholders' equity for asset risk, rose to around 5x in H1 2018 from 4.7x in 2017 (2016: 4.3x). We expect the insurer's GUL to rise above 5.5x in the next 12-18 months.

Nonetheless, the insurer's comprehensive solvency ratio was still solid at 196% as of the end of September 2018 (206% as of the end of March 2018). We expect the ratio to lower to 170-180% in the next 12-18 months, in the absence of capital replenishment bond issuance.

In September 2018, China Life P&C completed the conversion of RMB3.8 billion retained earnings into registered capital to bolster capitalization. Although the conversion does not bring any tangible solvency uplift, it anchors shareholders' commitment to support the insurer's business growth via limiting the insurer's dividend upstream capacity.

**Profitability: Baa - Weaker underwriting profitability than that of its major peers with underwriting loss**

China Life P&C continued to make underwriting losses in H1 2018, with an increase in its combined ratio to 101.7% from 100.6% a year earlier. This increase was driven by a higher expense ratio of 39.4% in H1 2018 (H1 2017: 37.1%), which offset a 1.2 percentage point improvement in its loss ratio. The expense ratio rose because of higher commission expenses, in particular within the increasingly competitive motor business.

China Life P&C's underwriting profitability is weaker than that of its major peers in China, mainly because of its higher motor loss ratio. In addition, its profitability of non-motor business is weaker than that of its major Chinese peers because of its lower premium rates and consistently unfavorable claim experience.

We believe it is challenging for China Life P&C to materially improve its combined ratio to below 100% in the next 12-18 months. The insurer's effort to contain acquisition expense growth and tighten risk selection will partially be offset by lower premium rate, following further motor pricing liberalization.

China Life P&C's net income dropped by 75% to RMB125 million in H1 2018 compared with H1 2017, mainly due to poorer underwriting results and high tax expenses stemming from the fact that part of its commission expenses are not tax-deductible. Annualized return on capital (ROC) was low at 1.1% in H1 2018 and notably below the five-year average of 6.6% between 2013 and 2017.

Given the insurer's weaker underwriting profitability than that of its major peers, we adjust the Profitability score down to the Baa level from the A level.

#### Reserve adequacy: Aa - Favorable trend of reserve development

China Life P&C's short-tail-focused portfolio and disciplined underwriting practices result in a low risk of adverse reserve development. The insurer reported a small favorable development of 0.2% compared with its net loss reserves in 2017.

Given that China Life P&C generated nearly 78% of its total premiums in H1 2018 from the motor business, we do not expect the insurer to experience significant adverse loss development.

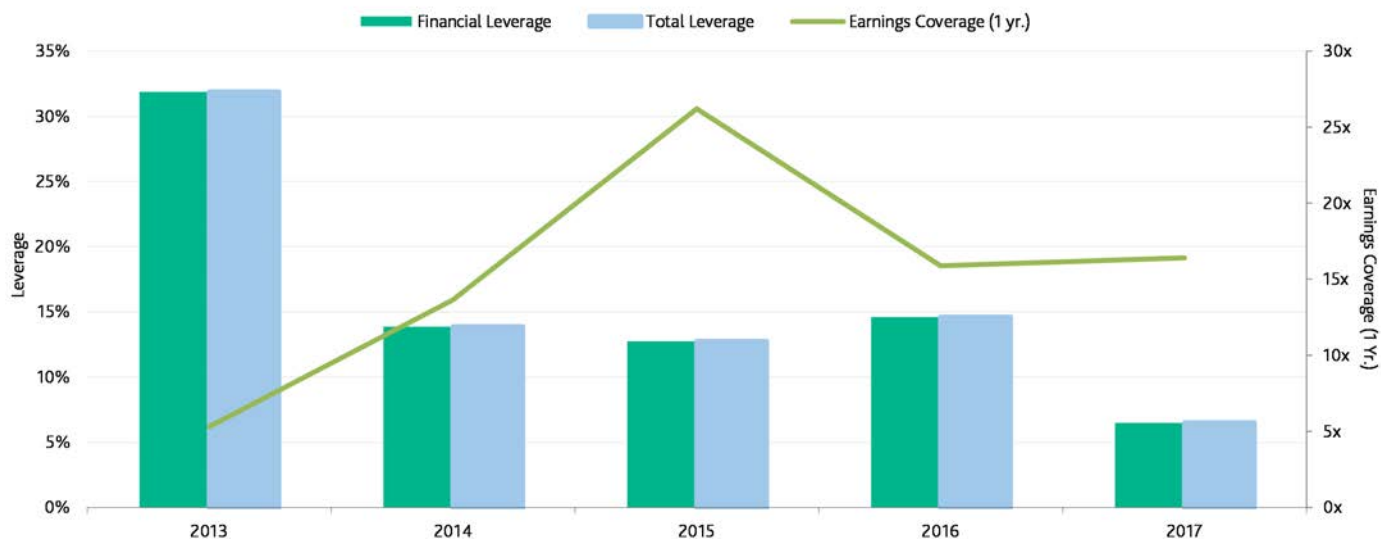
#### Financial flexibility: A - Benefits from strong capital market access and low financial leverage at China Life

As of the end of June 2018, China Life P&C's standalone adjusted financial leverage remained very low, at around 6.5%. The insurer has no outstanding bonds or borrowings and the only financial debt captured in the metrics is our standard adjustment on operating leases.

We also consider China Life P&C's financial flexibility at the China Life Group level. China Life, as the largest subsidiary of China Life Group, has low financial leverage and high earnings coverage. Also as one of China Life P&C's shareholders, China Life, has very good access to capital markets, given its listings on the New York, Hong Kong and Shanghai stock exchanges, as well as its strong brand recognition among investors. Hence, overall, we deem China Life P&C to have good financial flexibility.

Exhibit 3

#### Financial flexibility



Sources: Moody's Investors Service, company data

#### Operating environment: China: Baa

In addition to China Life P&C's own business and financial fundamentals, we consider China's operating environment in arriving at the standalone credit profile (or final rating) for the insurer. Our overall Baa score assigned for the insurance operating environment,

which carries 20% weight in the scorecard, is based on our assessment of China's very high economic strength. This strength is counterbalanced by China's moderate institutional strength, moderate susceptibility to event risk, limited penetration of the insurance market in the national economy and per capita utilization of insurance compared with those of other countries worldwide. Overall, the Baa Insurance Operating Environment score for China has a mild negative impact on China Life P&C's rating.

### **Support and structural considerations**

We apply our rating methodology for Government-Related Issuers in rating China Life P&C because of the insurer's effective ownership by the Ministry of Finance through China Life Group and China Life. We believe China Life P&C benefits from a strong level of government support based on its 87.36% effective ownership by the Chinese government and its strategic importance to China Life Group's efforts to expand its P&C business.

We also assess China Life P&C's dependence on the Chinese government to be moderate, which reflects the insurer's exposure to the domestic economy.

Consequently, China Life P&C's A1 IFSR incorporates a one-notch uplift from its BCA of a2, based on our assumption of support from the Chinese government in times of need.

## Rating methodology and scorecard factors

Exhibit 4

### China Life P&C Insurance Company Scorecard (as of year-end 2017)

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	ScoreAdj	Score
Business Profile								Baa	A
<b>Market Position and Brand (25%)</b>								A	A
- Relative Market Share Ratio			X						
- Underwriting Expense Ratio % Net Premiums Written					37.6%				
<b>Product Focus and Diversification (10%)</b>								Baa	A
- Product Risk		X							
- P&C Insurance Product Diversification					X				
- Geographic Diversification						X			
Financial Profile								A	A
<b>Asset Quality (10%)</b>								Aa	A
- High Risk Assets % Shareholders' Equity			50.4%						
- Reinsurance Recoverable % Shareholders' Equity	25.8%								
- Goodwill & Intangibles % Shareholders' Equity	0.5%								
<b>Capital Adequacy (15%)</b>								A	A
- Gross Underwriting Leverage			4.7x						
<b>Profitability (15%)</b>								A	Baa
- Return on Capital (5 yr. avg)			6.6%						
- Sharpe Ratio of ROC (5 yr. avg)			214.4%						
<b>Reserve Adequacy (10%)</b>								Aa	Aa
- Adv./(Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd avg)			-3.1%						
<b>Financial Flexibility (15%)</b>								A	A
- Financial Leverage	6.5%								
- Total Leverage	6.5%								
- Earnings Coverage (5 yr. avg)	15.5x								
- Cash Flow Coverage (5 yr. avg)	12.7x								
Operating Environment								Baa	Baa
Aggregate Profile								A2	A2

[1] Information based on LOCAL GAAP financial statements as of the fiscal year ending December 31.

[2] The Scorecard rating is an important component of the company's published rating, reflecting the standalone financial strength before other considerations (discussed above) are incorporated into the analysis.

Sources: Moody's Investors Service, company data

## Ratings

Exhibit 5

Category	Moody's Rating
<b>CHINA LIFE P&amp;C INSURANCE COMPANY LIMITED</b>	
Rating Outlook	STA
Insurance Financial Strength	A1

Source: Moody's Investors Service

## Moody's related publications

### Credit opinion:

- » [China Life Insurance Co Ltd](#)

### Industry outlook:

- » [Property & casualty insurers - China: Regulatory focus to curb aggressive risk taking underpins stable outlook, August 2018](#)

### Issuer in-depth:

- » [Chinese Listed P&C Insurers - First-half 2018 results show wide divergence between motor and non-motor lines, September 2018](#)

### Sector comment:

- » [Property & Casualty Insurance - China: Regulator imposes penalties on P&C insurance rule violations, a credit positive, March 2018](#)

### Rating methodologies:

- » [Property and Casualty Insurers, May 2018 \(1094172\)](#)
- » [Government-Related Issuers, June 2018 \(1104983\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.



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