

China Insurance

Optimized solvency measurement opens room for insurance funds participation in equity investment

The National Administration of Financial Regulation (NAFR) issued the “Notice on Optimizing the Solvency Standards for Insurance Companies” (《关于优化保险公司偿付能力监管标准的通知》) on 10 Sep against the backdrop of relatively declining solvency ratios under the CROSS-II, especially for the mid-and-small sized insurance companies. The notice promoted four pivots incl. 1) differentiate minimum capital measurement based on companies’ total assets; 2) encourage long-term protection products giving increased proportions to be included in core capital from future surplus of policies whose remaining terms were 10yrs+; 3) downgrade risk factors for insurance funds participating in equity investments to boost the market’s liquidity; and 4) guide the long-and-stable capital to provide support for technological innovations and real economy. With optimized solvency ratios measurement and eased equity investment regulations, we believe the industry is poised for high-calibre growth amid the recovery trend of Chinese capital markets, with RMB190-200bn funds to be free for capital investments, based on our estimation.

■ RMB 190-200bn transferring to 14-15% increase in industry solvency.

The NAFR eased risk factors for insurance companies’ investments in CSI 300 Index and the Sci-Tech Innovation Board from 0.35 to 0.3 and from 0.45 to 0.4 respectively. Based on 6M23 NAFR stats on insurance funds usage, RMB 3.46tn was invested in stocks and securities funds, taking 13% of total investment assets. Among which, stocks took ~60% presumably giving a bal. of RMB2.08tn by 6M23 (using 6M23 data to match the latest industry solvency print). We assumed 40%-50% of RMB2.08tn invested into CSI 300, with 5% increase per interval, and 5% into Sci-Tech Innovation Board, and returned with minimum capital (MC) results as of RMB467bn/519bn/571bn, before any risk diversification effect. If adjusted with risk factors, the total release of this single pivot would range b/w RMB 151bn-186bn. 5% increase in allocation to CSI 300 implies 10%+ upside in long-term capital released, conducive to attracting insurance funds coming into equity markets given the shortage in high-yielded assets. The industry solvency would raise by 14%-15%, in our estimate, as shown in [Fig 2](#).

■ Minimum capital (MC) differentiation benefits mid-and-small players.

The notice allowed differentiation factors for solvency calc. focusing on the companies’ total assets. For P&C and reinsurance companies with total assets at RMB10bn-RMB200bn, the adjusted MC can take as 95% of prior level, implying a coefficient of -0.05. For P&C and reinsurance less than RMB10bn, MC can lower to 90% of prior level, indicating a coefficient of -0.1. For personal life insurers of total assets at RMB50bn-RMB500bn or less than RMB50bn, the MC can be computed as 95%/90% of prev. state. The pivot leaves room for mid-and-small players to make more efficient use on their capital and better fulfil the industry-wide regulatory requirements. By 6M23, the disclosed total assets of personal life and P&C insurers increased to RMB25.03tn/RMB2.88tn. The industry total assets incl. reinsurance and AMC hit RMB29.20tn. If assumed same proportions for the net assets of life and P&C as of their total assets to the industry level, we would derive a balance of RMB2.68tn, translating to RMB140.5bn long-term funds release.

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- **Increasing weights for future surplus of policies to be included in core capital backing long-term protections.** The maximum weights to be included into core capital for future surplus of policies with remaining terms over 10yrs increased from 35% to 40%, broadening ways for life insurers on core capital replenishment. The pivot backed the long-persisted life product strategy advocating for the development in LT protection-based businesses.

Given the life net asset amounted to RMB2.41tn and core life solvency at 106.5% by 2Q23, we end up in ~RMB 290bn minimum capital funds to be released with the release rate at 12.8%. We believe the pivot will be more skewed towards helping the life insurers who exceeded the prev. level of 35% in CROSS II transition period, and will show evident effects on capital alleviation.

- **Constructive over growth prospect given incremental funds to capital markets conducive to insurers' asset performance.** With a series of release on capital market boosters, we remain constructive over growth prospect given the long-and-stable nature of the insurance funds injected into capital markets, shoring up equities and market sentiment. As the backbone of long-term funds, the investment performance of insurance companies is indivisible to that of capital market, where the RMB190-200bn incremental funds, in our view, can act as a prop-up for the insurers' investment returns. Heading to 2H23, we continue like China Life (2628 HK) and Ping An (2318 HK), and look positive on CPIC (2601 HK).
- **Risks:** continued downward trend in CN long-term treasury yields; weaker-than-expected market sentiment awaiting for more stimuli; the estimate on long-term insurance funds significantly varied from actual results.

Figure 1. Notice on Optimizing the Solvency of Insurance Companies

Field	Content	Standards prior to the Notice	Implications
	[RMB10bn, RMB 200bn): 95% * MC requirement, risk factor = -0.05	Minimum capital is calc.= 100% * MC requirement, risk factor = 0	1. Benefit more to mid-and-small sized insurance companies
Differentiated minimum capital requirements (差异化资本监管)	(0, RMB 10bn): 90% * MC requirement, risk factor = -0.10	Minimum capital is calc.= 100% * MC requirement, risk factor = 0	1) increase solvency ratios; 2) enable to make better use of capital
	[RMB50bn, RMB 500bn): 95% * MC requirement, risk factor = -0.05	Minimum capital is calc.= 100% * MC requirement, risk factor = 0	2. Expect to release ~RMB 140bn from minimum capital funds
	(0, RMB 50bn): 90% * MC requirement, risk factor = -0.10	Minimum capital is calc.= 100% * MC requirement, risk factor = 0	
	1) If the arithmetic mean of retrospective deviation of unearned premiums reserve (after-reinsurance) for all non-life insurance business at the end of the previous two fiscal years calc. at the most recent quarter is less than or equal to -5% ($\sigma \leq -5\%$), the MC requirement for premiums and reserve risks * 95%, risk factor = -0.05	Additional risk factor = 0	1. Broaden channels for life insurers to replenish core capital w/o needs of external pressure
Guide insurance companies to return to the protection roots (优化资本量化标准, 回归保障本源)	2) If the arithmetic mean of retrospective deviation of outstanding claims reserve (after-reinsurance) for all non-life insurance business at the end of the previous two fiscal years calc. at the most recent quarter is less than or equal to -5% ($\sigma \leq -5\%$), the MC requirement for premiums and reserve risks * 95%, risk factor = -0.05	Additional risk factor = 0	2. Benefit more to life insurers who exceeded the previous level of 35% within the CROSS-II transition period; may result in more evident capital alleviation effect
	3) Increase the proportion to be included in core capital for future surplus of policies with remaining term of more than 10 years from 35% to 40% (max.=40%);	1) Future surplus of policies $\leq 35\%$ * Core capital (max = 35%); 2) Supplementary capital $\leq 100\%$ * Core capital; 3) Core tier-2 capital $\leq 30\%$ * Core capital; 4) Supplementary tier-2 capital $\leq 25\%$ * Core capital	3. Expect to release ~RMB 290bn minimum capital funds
	4) encourage life insurance companies to develop long-term protection products		
Guide insurance companies to provide support for stable and healthy development in capital markets (优化风险因子, 释放权益投资空间)	1) Risk factor for investing stocks listed on CSI 300 Index: 0.3 (-0.05) ; 2) Risk factor for investing stocks listed on the Science and Technology Innovation Board (科创板): 0.4 (-0.05) ; 3) Risk factor for investments in publicly offered infrastructure securities investment funds (REITS), non-penetrated: 0.5, (-0.1)	1) Risk factor for investing stocks listed on CSI 300 Index: 0.35; 2) Risk factor for investing stocks listed on the Science and Technology Innovation Board (科创板): 0.45; 3) Risk factor for investments in publicly offered infrastructure securities investment funds (REITS), non-penetrated: 0.6	1. Reduced risk factors indicate lower capital employed for investments and business operations, leaving room for capital investments; 2. Expect to release more than RMB 151bn - RMB 186bn long-term funds, depending on the allocation percentiles (%) in CSI 300 Index.
Guide insurance companies to support technological innovation (引导保险资金服务科技创新)	1) Risk factor for investing unlisted equity related to national security and strategic emerging industries: 0.4 (-0.01) 2) Apply risk factors of P&C insurance companies to Technology insurance entities operated by insurance companies; 3) Minimum capital is calc. = 90% * MC requirement, risk factor = -0.1	1) Risk factor for investing unlisted equity related to national security and strategic emerging industries: 0.41 2) Advanced technology insurance companies risk factor = 0.9, Others = 1.0	Unleash potential for long-term funds entering into primary equity markets and capture high-yielded opportunities

Source: National Administration of Financial Regulation (NAFR), CMBIGM

Figure 2: Estimate on insurance MC fund release to capital markets

Industry-level statistics (RMB bn):		1H23
Life total assets		25,031
P&C total assets		2,879
Industry total assets, incl. reinsurance & AMC		29,200
Industry net assets		2,808
Life total assets as a % of industry total		85.7%
P&C total assets as a % of industry total		9.9%
Differentiated minimum capital requirements based on total assets scale		
Life net assets		2,407*
P&C net assets		277*
Industry minimum capital in 2Q23		2,684
Risk factors:		
P&C total assets [RMB10bn, RMB 200bn]		-0.05
P&C total assets (0, RMB 10bn)		-0.1
Personal Life companies in [RMB50bn, RMB 500bn]		-0.05
Personal life companies in (0, RMB 50bn)		-0.1
No. of P&C companies in [RMB10bn, RMB 200bn]		35.7%
No. of P&C companies in (0, RMB 10bn)		64.3%
No. Personal Life companies in [RMB50bn, RMB 500bn]		66.7%
No. of Personal life companies in (0, RMB 50bn)		33.3%
Industry MC funds release ratio %		5.2%
Minimum capital release (RMB bn)		140.5
Increase the proportion to be included in core capital for future surplus of policies with remaining term of more than 10 years from 35% to 40%		
Life comprehensive solvency ratio in 2Q23		178.7%
Life core solvency ratio in 2Q23		106.5%
Life core capital release rate max from 35% to 40%		12.8%*
Life insurance net assets		2,407
Minimum capital release (RMB bn)		289.8
Downgrade risk factors for insurers' investments in stocks and REITs free up capital		
Insurance funds invested in stocks (RMB bn)		2,078
Chg in risk factors for investing in CSI 300 & STAR Market*		-0.05
Risk factor for investing in CSI 300 index		0.3
Risk factor for investing in STAR Market		0.4

LT capital funds release given risk factors chg. to 0.3 / 0.4

Allocation to CSI 300 (%)	CSI 300 Index	Investment allocation to CSI 300 (%)	Allocation to STAR Market (%)	LT capital funds release with risk factors of 0.3 / 0.4 (RMB bn)	Chg. %
40%	41.55	5%	5.19	151.49	12.9%
45%	46.75	5%	5.19	168.80	11.4%
50%	51.94	5%	5.19	186.11	10.3%
55%	57.13	5%	5.19	203.43	9.3%

Figure 2: Estimate on insurance MC fund release (Continued))

Downgrade risk factors for insurers' investments in stocks and REITs free up capital		
Minimum capital release (RMB bn):		
With 40% invested in CSI 300 & 5% in STAR market (RMB bn)	46.75	
With 50% invested in CSI 300 & 5% in STAR market (RMB bn)	57.13	
Total released minimum capital (RMB bn), before risk diversification	477.1 (=140.5 + 289.8 +46.75)	487.5 (=140.5 + 289.8 +57.13)
Risk diversification and loss absorption effect	40%	
Total adj. minimum capital released (RMB bn)	190.8	195.0
Insurance companies comprehensive solvency in 2Q23	188.0%	
Chg. in industry-wide solvency improvement under the Notice	14.4%	14.7%

Source: National Administration of Financial Regulation (NAFR), Wind, CMBIGM

Note: 1) STAR Market represents the Science and Technology Innovation Board; 2) Texts in **BLUE** imply quoted statistics from external sources, mostly from the NAFR monthly disclosed industry data; 3) Life core capital release rate $12.8\% = (1-0.35/0.65) - (1-0.4/0.6)$ showing the effect of increasing proportions of future surplus to be included in core capital from 35% to 40% under the Notice; 4) We assume the Personal Life and P&C net assets share in same proportions as of their total assets to the industry sum. 5) We intentionally chose 6M23 statistics to stay in line with the most up-to-date industry solvency read.

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