Financials

China

China Insurance Sector

Sailing Through a Policy Year

POSITIVE *[Unchanged]*

Maintain POSITIVE; CPIC is a laggard quality lifer

Chinese lifers have re-rated YTD on higher rates. We believe the recent macro tailwinds have been largely factored in, and earnings quality will play a key role in driving future sustainable re-rating. In our view, CIRC's regulatory scrutiny could help push forward product upgrades, and we have already seen this happening since 2011. Compared with banks and brokers, insurers have little involvement in the leveraging process and should bear lower systemic risks. We maintain a POSITIVE sector view and suggest sticking with quality lifers. Ping An/CPIC remain our top picks, and we see CPIC's laggard share performance YTD unjustified.

Further regulations to push forward upgrades

Since April, CIRC has published over 10 sets of announcements to suppress irregularities, including the curbs on "quick cash-back" bundled products. This may affect listed lifers' near-term sales, but VNB impact is limited given the low margin of such products (17-34%) vs LT protection (83%). While high WMP yields may lead to more competition, demand for LT savings life products remains huge given Chinese residents' high deposit level (CNY62.5t as of Apr17). In the long term, we believe CIRC's regulatory scrutiny could help redirect lifers' focus to protection business and push forward their product upgrades. AIA China serves as the best role model for Chinese lifers to follow, in our view.

Better quality could drive a sustainable re-rating

In fact, listed players (except China Life) have been increasing their focus on protection since 2011 with the aid of growing their agency force. Such product upgrades help boost mortality earnings, which have high margins and low macro sensitivity. Besides, more disclosures on residual margins also help improve EV creditability. In the long term, we expect Chinese lifers to catch up with AIA's valuation amid improving earnings quality. Hence, better quality should help sustain the re-rating.

Systemic risks remain low amid the deleveraging

Insurers' funding costs are less impacted by tighter liquidity, as they mainly source funding from policyholders and have little involvement in the leveraging process. While stricter product rules will put pressure on emerging insures' near-term cashflows, risk is still manageable given their sufficient liquidity coverage under stressed scenarios. Contagion risk remains low as they only form a small part of the system (i.e. 1% of banks' on-B/S assets as of Dec 2016). In addition, we notice a general decline in their equity allocation to reduce concentrated risk exposure.

Analyst

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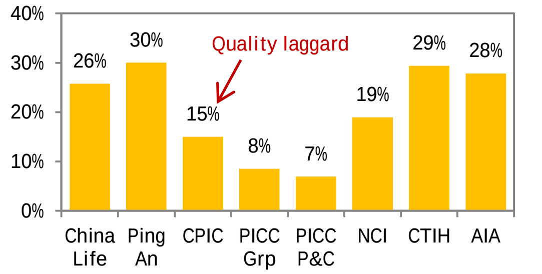
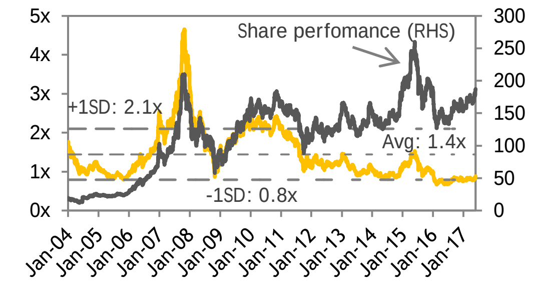
Fig 1: Stock performance YTD*



*Source: Bloomberg. *As of 1 Jun 2017*

Fig 2: Chinese lifers' 12-month fwd P/EV*



Source: Company data, Bloomberg, Maybank Kim Eng
**Market-cap weighted average as of 1 Jun 2017*

Fig 3: HK/China insurers - stocks pecking order

#	Stock	Rating	Investment thesis
1	CPIC	BUY	Shr px lags YTD; agency-led quality lifer
2	Ping An	BUY	Best-in-class lifer; protection mkt leader
3	CTIH	BUY	Undemanding valuation; strong VNB
4	AIA	BUY	Strong China growth; lower policy risks
5	NCI	BUY	Visible business upgrades; asset mix risk
6	China Life	HOLD	Yield proxy; concerns on product quality
7	PICC Grp	HOLD	Weak life/health; more like a P&C play
8	PICC P&C	SELL	Auto COR concerns; slower new car sales

Source: Maybank Kim Eng

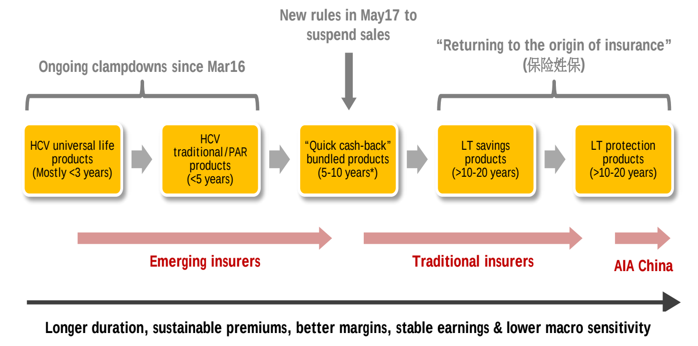
Valuation summary *(as of 1 Jun 2017)*

Name	Ticker	Rating	TP	Last price	Upside	PB (x) FY16	PB (x) FY17E	PB (x) FY18E	P/EV (x) FY16	P/EV (x) FY17E	P/EV (x) FY18E	EV growth# FY16	EV growth# FY17E	EV growth# FY18E	VNB (x) FY16	VNB (x) FY17E	VNB (x) FY18E	VNB growth# FY16	VNB growth# FY17E	VNB growth# FY18E
China Life	2628 HK	HOLD	26.50	25.40	4%	2.17	2.09	1.95	0.99	0.87	0.74	7%	16%	17%	(0.2)	(1.7)	(3.3)	57%	20%	18%
Ping An	2318 HK	BUY	57.00	50.45	13%	2.15	1.94	1.70	1.30	1.11	0.93	25%	19%	19%	3.7	1.3	(0.8)	49%	27%	23%
CPIC	2601 HK	BUY	38.50	31.10	24%	1.92	1.86	1.59	1.03	0.91	0.72	13%	16%	16%	0.3	(1.1)	(3.3)	57%	24%	21%
PICC Group	1339 HK	HOLD	3.30	3.32	-1%	1.02	1.00	0.91	0.90	0.87	0.77	10%	15%	14%	(4.4)	(4.2)	(7.6)	47%	14%	15%
PICC P&C	2328 HK	SELL	11.00	12.92	-15%	1.44	1.30	1.16	na	na	na	na	na	na	na	na	na	n/a	na	na
NCI	1336 HK	BUY	46.50	42.35	10%	2.00	1.89	1.73	0.91	0.78	0.66	17%	19%	19%	(1.1)	(2.6)	(4.2)	30%	22%	18%
CTIH	966 HK	BUY	25.00	20.70	21%	1.45	1.34	1.21	0.73	0.65	0.56	9%	12%	15%	(3.1)	(3.7)	(4.4)	50%	21%	20%
AIA	1299 HK	BUY	61.00	55.30	10%	2.46	2.26	2.09	2.04	1.82	1.62	10%	12%	12%	15.9	11.9	8.5	25%	18%	19%

Source: Company data, Bloomberg, Maybank Kim Eng. #FY16 EV/VNB growth for Chinese insurers are underlying growth ex. C-ROSS impact and EV assumption changes

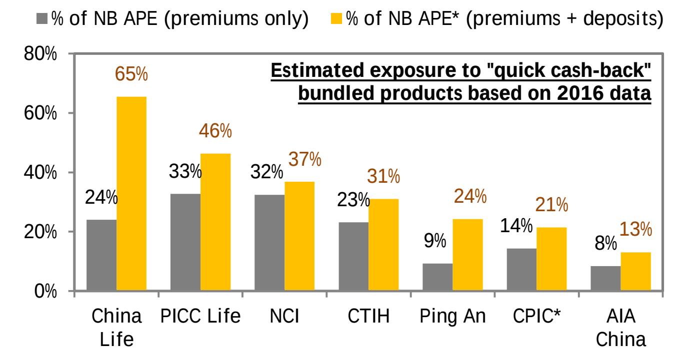
SEE PAGE 44 FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

Fig 4: Curbs in ST savings to push forward product upgrades



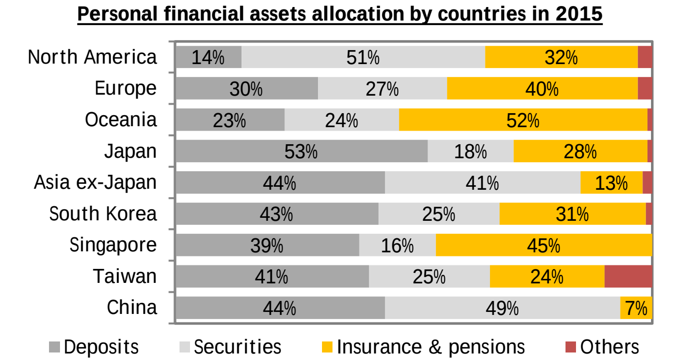
Source: Maybank Kim Eng. *Slightly above 5 years for emerging insurers

Fig 5: Ping An/CPIC would be least affected by the curbs



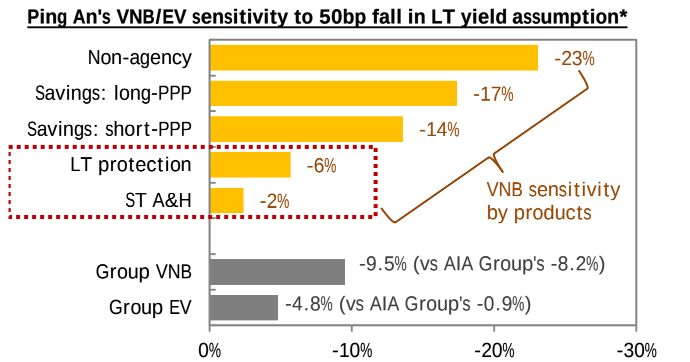
Source: Company data, CIRC, Maybank Kim Eng est. *As of GWP or GWP + deposits

Fig 6: LT savings could attract fund flows from deposits



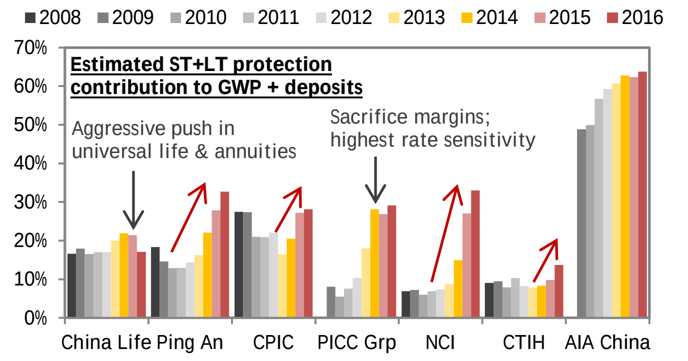
Source: Allianz Global Wealth Report

Fig 7: Selling protection could improve earnings quality



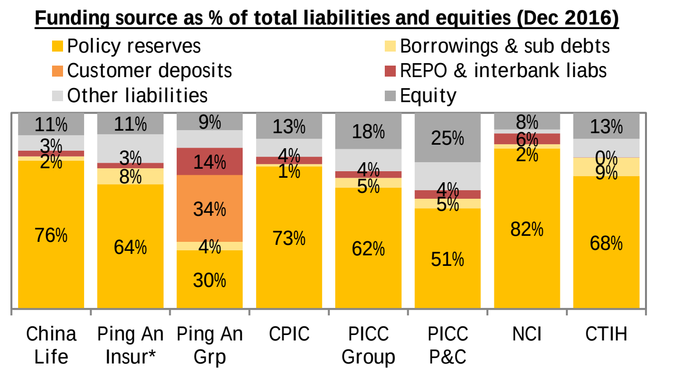
Source: Company data, Maybank Kim Eng. *FY16 for group data,1H16 for products

Fig 8: Listed lifers have been raising protection contribution



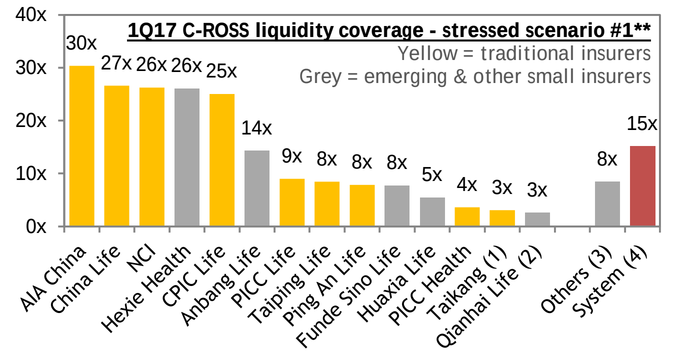
Source: Company data, CIRC, Maybank Kim Eng estimates.

Fig 9: Funding cost driven by product yields, not ST rates



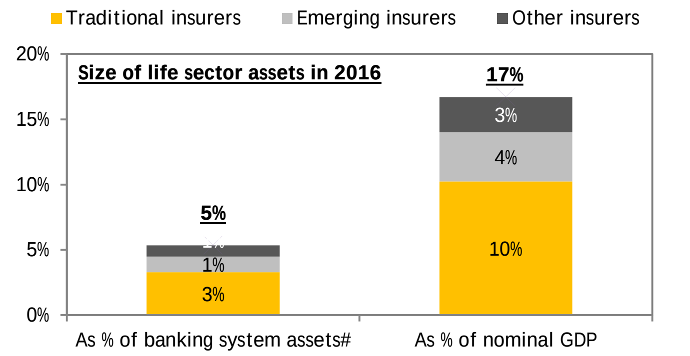
Source: Company data, Maybank Kim Eng *Excluding PAB

Fig 10: Emerging insurers' liquidity risk still manageable



Source: Company data, Maybank Kim Eng. Figure 85 for detailed footnotes
**Premiums -80% YoY & surrender assumption is 2x of base case (capped at 100%)

Fig 11: System's contagion risk remains low



Source: SBRC, CIRC, NBS, Maybank Kim Eng. #On-B/S assets only

Table of Contents

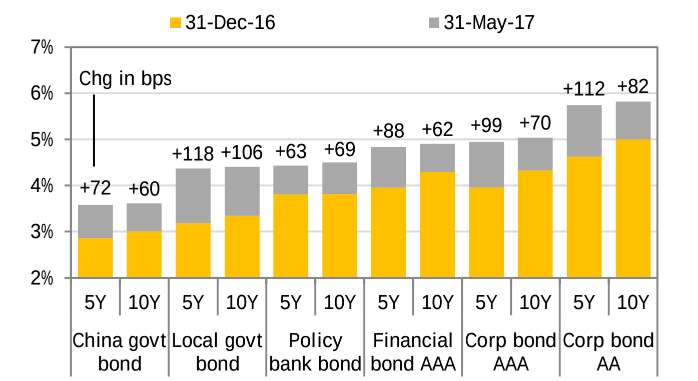
1. Maintain POSITIVE; CPIC is a laggard quality lifer

Chinese lifers have re-rated YTD on higher rates. We believe the recent macro tailwinds have been largely factored in, and earnings quality will play a key role in driving future sustainable re-rating. In our view, CIRC's regulatory scrutiny could help push forward product upgrades, and we have already seen this happening since 2011. Compared with banks/brokers, insurers have little involvement in the leveraging process of the financial system and should bear lower systemic risks. We maintain a POSITIVE sector view and suggest sticking with quality lifers. Ping An/CPIC remain our top picks, and we see CPIC's laggard share performance YTD unjustified.

1.1 Chinese insurers have benefited from higher yields YTD

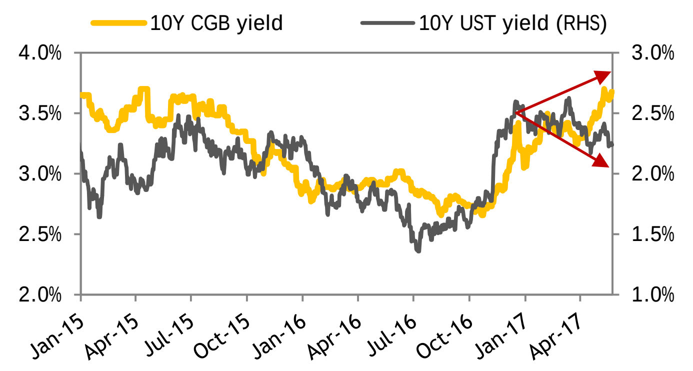
As the direct result of China's financial deleveraging, domestic bond yields have trended higher YTD despite the recent decline in US bond yields. Chinese lifers should continue to benefit from higher new money yields and better EV creditability. While the future trend could be hard to predict amid uncertainties in deleveraging, economic growth and US rate hike timetable, our TP assumptions (4.1-4.5% LT investment yield vs insurers' own 5-5.25%) should fairly reflect the interest rate environment in 2017.

Fig 12: China's bond yields trend higher amid deleveraging



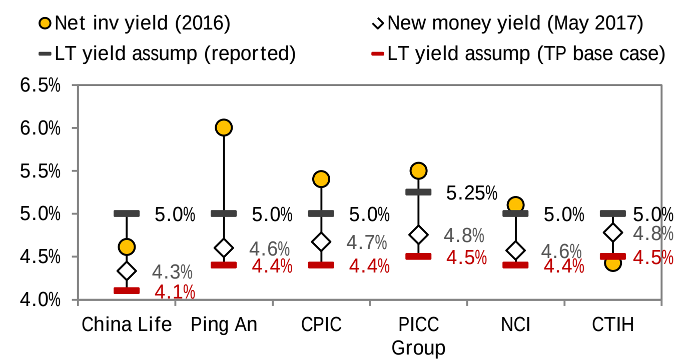
Source: Wind, Maybank Kim Eng ^As of 31 May 2017

Fig 13: Trend of China and US bond yields has diverged



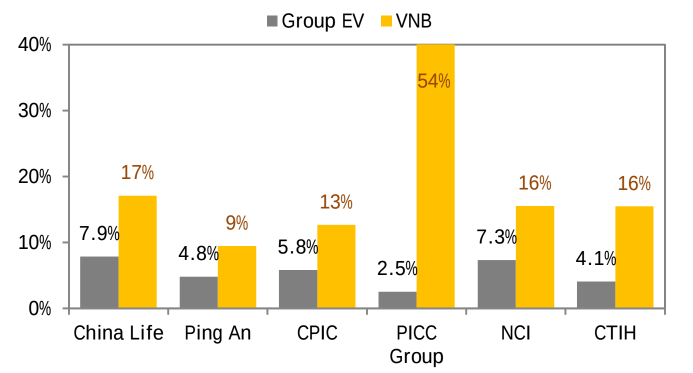
Source: Bloomberg ^As of 31 May 2017

Fig 14: New money yield vs LT yield assumptions*



*Source: Company data, Wind, Maybank Kim Eng *As of 31 May 2017*

Fig 15: Sensitivity to 50bp rise in LT yield assumption*



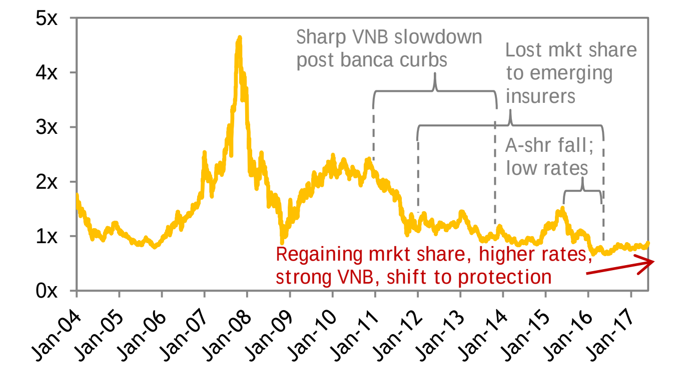
*Source: Company data, Maybank Kim Eng *Based on 2016 data*

To recap, prior to the valuation recovery this year, the life sector has de-rated over the last decade due to different fundamental reasons:

- **2011-2013:** Regulatory curbs in banca business led to a sharp VNB slowdown.
- **2012-1H16:** Emerging insurers' aggressive expansion led to significant market share loss of listed players. Pricing competition was intense in 2014-1H16, as emerging insurers promoted high-yield HCV universal life products.
- **2H15-1H16:** A sharp correction in the A-share market and continuous decline in bond yields led to concerns on potential negative spread issue.

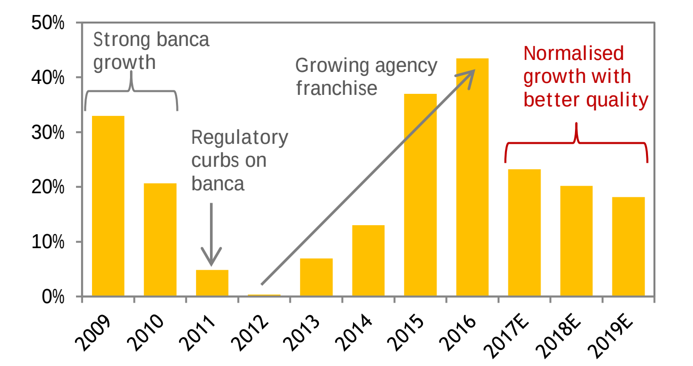
Chinese insurers' valuation re-rating YTD has been mainly driven by higher bond yields. However, we believe investors have largely factored in the recent interest rate tailwinds, and more fundamental justifications are required for Chinese lifers to enjoy a sustainable re-rating given more macro uncertainties in 2H17.

Fig 16: Chinese insurers still trade at near historical lows…
12-month forward P/EV band of H-share lifers*



*Source: Bloomberg, company data, Maybank Kim Eng *Market cap weighted avg.*

Fig 17: … despite their strong VNB growth
Aggregate VNB growth of listed Chinese insurers

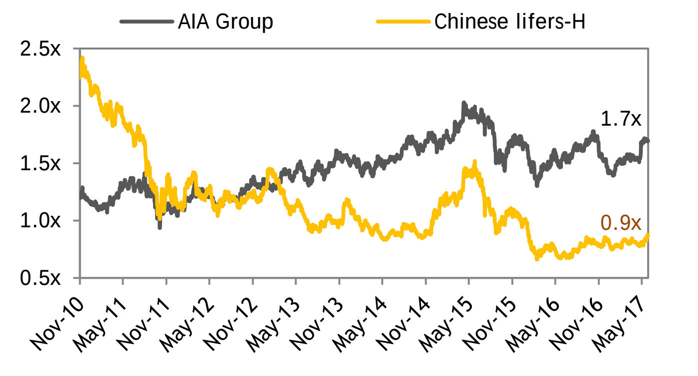


Source: Company data, Maybank Kim Eng

1.2 Earnings quality will play a key role in driving sustainable re-rating

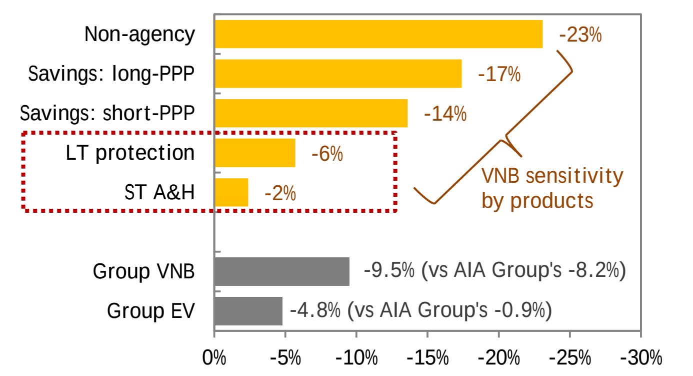
In our initiation report *"Bridging the Quality Gap"* on 2 Jan 2017, we pointed out that Chinese lifers are more than yield proxies given their strong growth prospects and improving earnings quality. Despite tapping into a similar secular story, their valuations (0.9x 12-month forward P/EV) have been significantly lower than AIA Group's (1.7x), due to their heavy reliance on rate-sensitive investment spreads.

Fig 18: We expect Chinese lifers to catch up with AIA…
12-month forward P/EV band of H-share lifers* vs AIA Group



*Source: Company data, Bloomberg, Maybank Kim Eng. *Market cap weighted avg.*

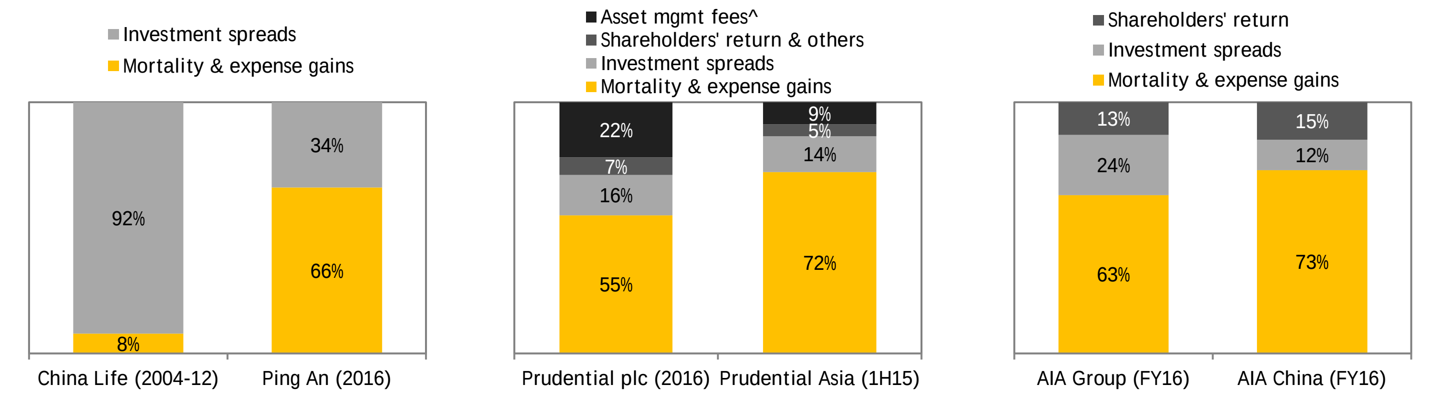
Fig 19: …with more protection sales to improve quality
Ping An's EV/VNB sensitivity to 50bp fall in LT yield assumption*



*Source: Company data, Maybank Kim Eng. *1H16 for product sensitivity data; FY16 data for Ping An/AIA Group's overall group EV/VNB sensitivity data.*

In our view, CIRC's regulatory scrutiny could help push forward product upgrades, and we have already seen this happening since 2011. While we only forecast a normalised sector VNB CAGR of 20% in 2016-19E, this would come with earnings quality improvement. Given Chinese lifers' huge valuation gap vs AIA, we believe more share price upside could come sustainable valuation re-rating amid protection upgrades. Protection business generates strong VNB with high margins, sustainable earnings stream and low macro sensitivity (i.e. interest rates and equity prices), which could significantly improve Chinese lifers' earnings visibility.

Fig 20: Source of earnings breakdown – Ping An is catching up with rising mortality earnings



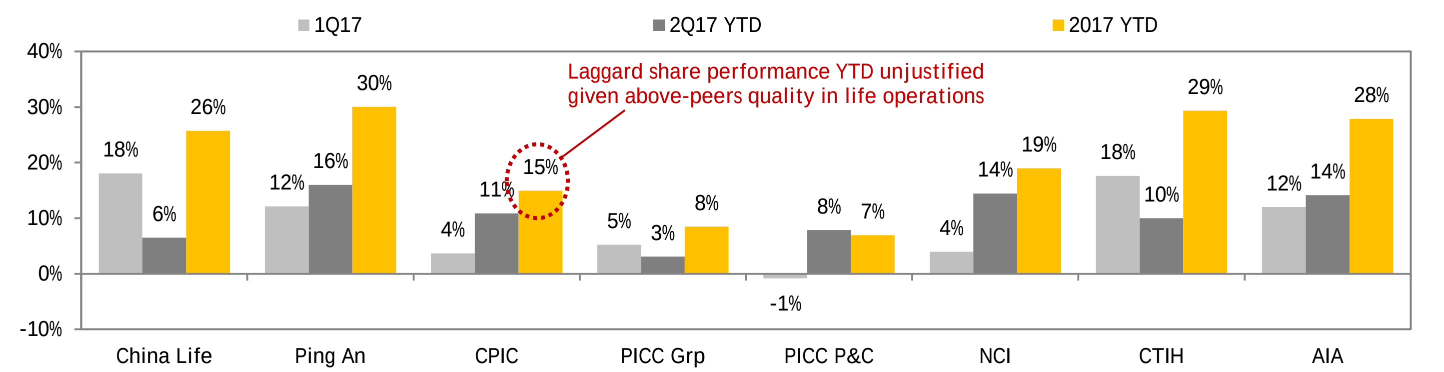
Source: Company data, Maybank Kim Eng. ^Mainly from Eastspring; Prudential plc (PRU LN) is not rated by Maybank Kim Eng
**China Life's data was avg. earnings mix in 2004-12; Ping An's data in terms of C-ROSS VNB; Prudential and AIA's data in terms of IFRS operating earnings*

1.3 Stick with quality names amid tighter regulations

Given the CIRC's recent product tightening regulations and more macro uncertainties in 2H17, we suggest investors to stick with quality lifers with a strong agency franchise and consistent focus on the protection business. Compared with banks/brokers, insurers have little involvement in the leveraging process and should bear lower systemic risks.

Ping An/CPIC remain our top picks, <u>and we see CPIC's laggard share price performance YTD as unjustified</u>. We maintain SELL on PICC P&C due to concerns about auto combined ratios and weak new car sales. However, we are not an aggressive seller of the stock, as tougher regulations may eventually spill over to the P&C segment to clamp down irrational pricing in the auto insurance market.

Fig 21: Share performance YTD – H-share insurers *(as of 1 Jun 2017)*



Source: Bloomberg, Maybank Kim Eng

2. Further regulations to push forward upgrades

Since April, CIRC has published over 10 sets of announcements to suppress irregularities, including the curbs on “quick cash-back” bundled products. This may affect listed lifers’ near-term sales, but VNB impact is limited given the low margin of such products (17-34%) vs LT protection (83%). While high WMP yields may lead to more competition, demand for LT savings life products remains huge given Chinese residents’ high deposit level (CNY62.5t as of Apr17). In the long term, we believe CIRC’s regulatory scrutiny could help redirect lifers’ focus to protection business and push forward their product upgrades. AIA China serves as the best role model for Chinese lifers to follow, in our view.

2.1 China has set a hawkish stance to suppress irregularities

The Chinese government has made “preventing systemic risks” its top priority in the financial sector this year. Since April, we have seen more regulations and direct interventions by all regulatory parties, including the PBOC, CBRC, CSRC and CIRC, with the aim of deleveraging unnecessary leverage in the sector, as well as suppressing market irregularities introduced by aggressive players.

In our report *“More Regulated Life Markets Favour Listed Players”* on 16 Jan 2017, we already foresaw there would be more regulations in the insurance sector in 1H17. Since Apr 2017, the CIRC has published more than 10 comprehensive sets of new regulations or documents, with the primary focus on product designs, insurance fund investments and risk inspection on policy implementation. In **Appendix I**, we list the major regulations and documents published by the CIRC.

Fig 22: Recent regulatory sanctions on emerging insurers*

Date	Company	Area of violation	Major sanctions
5-Dec-16	Qianhai Life	Investment, customer information verification	Banned new universal life product issuance until further notification.
9-Dec-16	Evergrande Life	Investment	Banned entrusted stock investment business.
28-Dec-16	Soochow Life and Huaxia Life	Customer information verification	Banned new product issuance for 3 months. Banned Internet channel sales until further notification.
24-Feb-17	Qianhai Life	Product design, investment, risk management	Banned chairman Yao Zhenhua from insurance sector for 10 years.
25-Feb-17	Evergrande Life	Stock investment, risk management	Banned stock investment for one year and reduced equity cap to 20%. Banned two responsible persons from insurance sector for 3 and 5 years.
7-Mar-17	Pramerica Fosun Life	Product design	Banned new product issuance for 3 months.
5-May-17	Anbang Life	Product design	Banned new product issuance for 3 months.

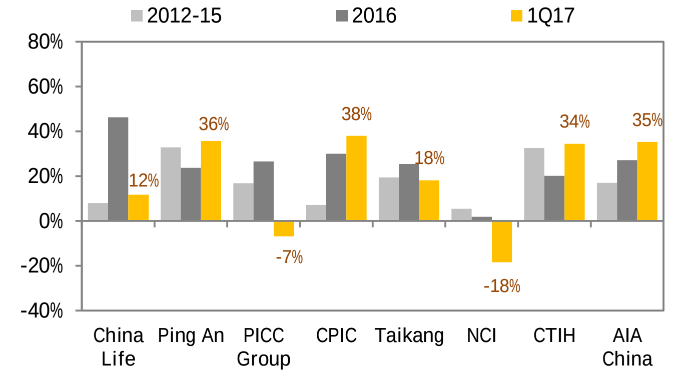
*Source: CIRC, Maybank Kim Eng. *The companies listed are not rated by Maybank Kim Eng.*

2.2 Stricter regulations have reshaped the competitive landscape

The CIRC has published a series of tightening measures to curb ST savings products since 2H16. We observe four positive trends in the life sector YTD:

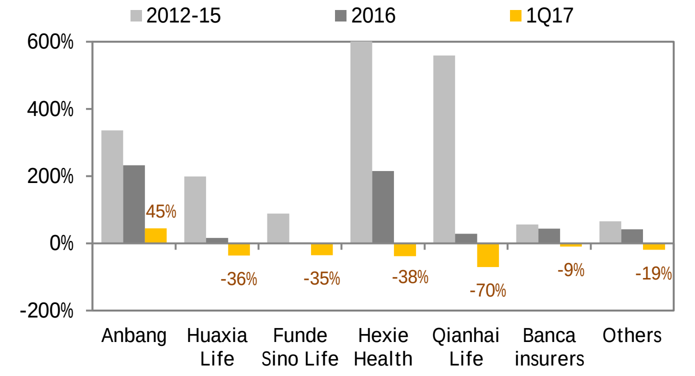
1) **Sales momentum:** Traditional insurers have achieved strong new premium growth, supported by growing agency franchise, whereas emerging insurers have experienced sharp sales slowdown/contraction amid regulatory curbs.
2) **Market share:** Traditional insurers have regained market share from emerging insurers as they are less impacted by the tighter regulations.
3) **Product pricing:** Both traditional and emerging insurers have actively lowered their universal life crediting rates; traditional insurers no longer offer 4.025%-guaranteed annuity products in 2017 open-year sales campaign.
4) **Product/channel mix:** Traditional insurers have reduced their reliance on the low-margin banca channel, while emerging insurers have significantly lowered their new sales exposure to universal life products.

Fig 23: Sales momentum* – traditional insurers staying strong



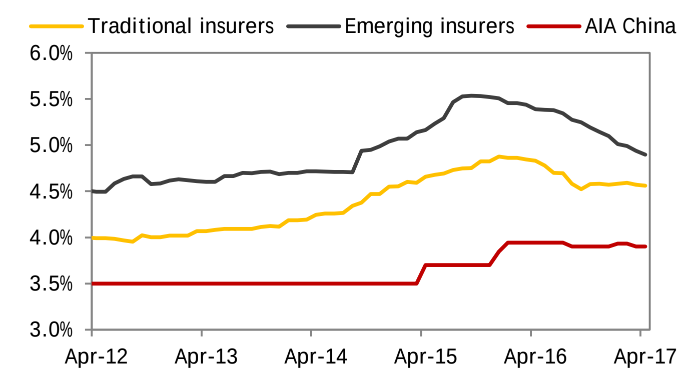
*Source: CIRC, Maybank Kim Eng. *Growth of GWP + deposits; CAGR for 2012-15*

Fig 24: Sales momentum* – emerging insurers running out of steam



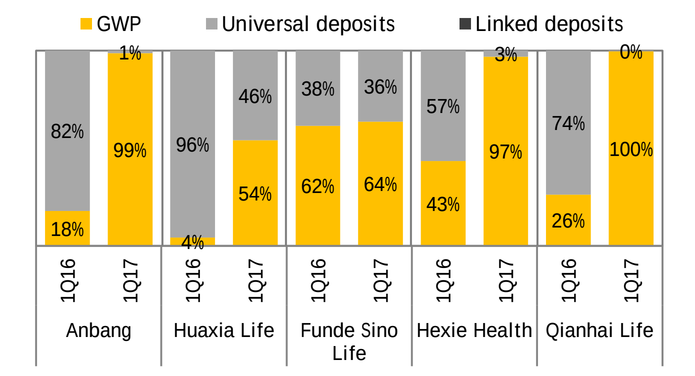
*Source: CIRC, Maybank Kim Eng. *Growth of GWP + deposits; CAGR for 2012-15*

Fig 25: Product pricing* - Lower universal life crediting rates



*Source: Company websites, Maybank Kim Eng. *Estimated from over 300 products*

Fig 26: Product mix* - Shifting away from universal life



*Source: CIRC, Maybank Kim Eng. *Sales breakdown in terms of GWP + deposits*

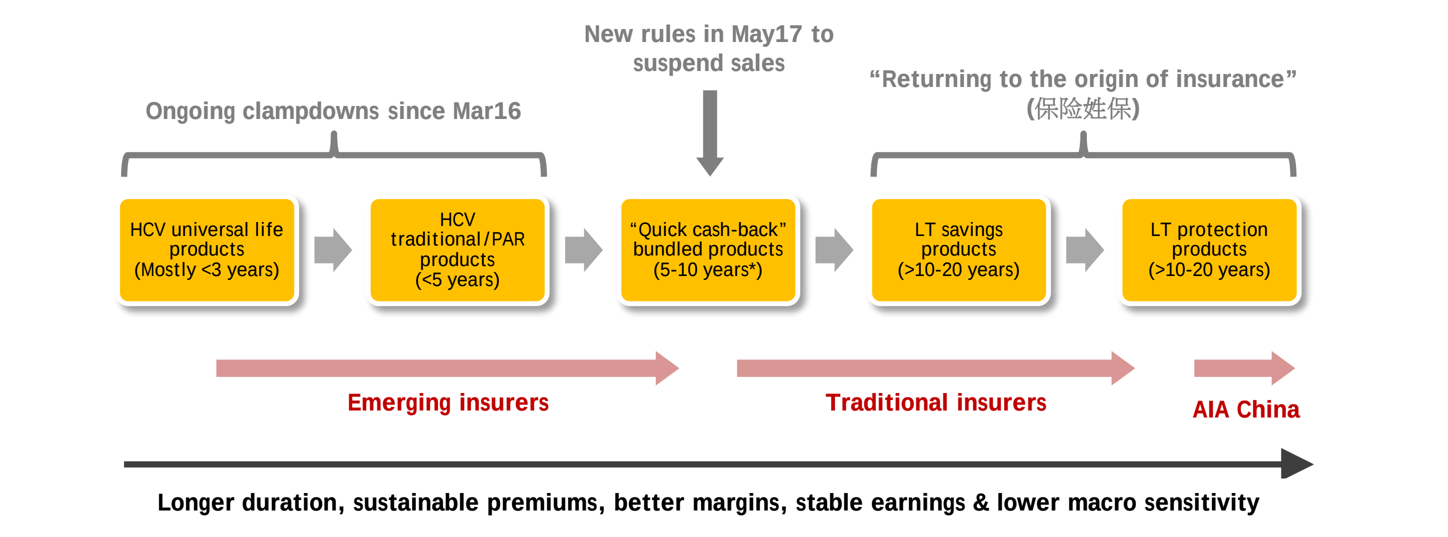
2.3 New rules to close the loopholes in ST savings products

Tightening measures on "quick cash-back" bundled products

Due to the ongoing clampdown on HCV and universal life products, emerging insurers shifted their product mix towards other product types in 1Q17. We *understand* they have started to use "quick cash-back policy + universal life rider" bundled products to attract volume during the open-year sales period. As these products generally have policy duration of slightly above five years and their sales are mostly booked as GWP instead of deposits, this helps emerging insurers get around CIRC's regulations on HCV products (i.e. policy duration below five years). However, as "quick cash-back" products still have relatively short durations, earn low margins and heavily rely on investment spreads, they are unlikely to help emerging insurers to improve earnings quality and resolve their asset-liability mismatch problem.

To close the regulatory loopholes, the CIRC published a set of new rules on 16 May to suspend the sale of these "quick cash-back" bundled products. However, as listed players also add "quick cash-back" and "universal life rider" features to their open-year products (but with longer policy duration), they also need to redesign their existing products before Oct 2017 to comply with the rules.

Fig 27: Sales suspension of "quick cash-back" products aims to close the regulatory loopholes and promote product upgrades



*Source: Maybank Kim Eng. *Products offered by emerging insurers generally have effective policy duration of slightly above five years*

Fig 28: CIRC has suspended the sale of "quick cash-back policy + universal life rider" bundled products

The extract of Document 134 [2017]: Notice on Standardising the Design of Life Products

Product type	Key tightening measures
Endowment & annuity	▪ The first survival benefit payout shall only occur after the 5th policy year. ▪ Annual survival benefit payout cannot exceed 20% of total premiums paid.
Universal life & linked	▪ Policyholders should have flexibility in adjusting payment frequency, payment amount and amount of sum assured. ▪ Insurers cannot package universal life and linked products as riders.
Product name	▪ Product name should specify their insurance features. Insurers cannot use "wealth management" or "investment plan" in product name, brochures and relevant marketing materials.
Bundled product	▪ Insurers should clearly inform customers that the product belongs to "insurance product package" (保险产品组合) or "insurance product plan" (保险产品计划) on sales and marketing materials.

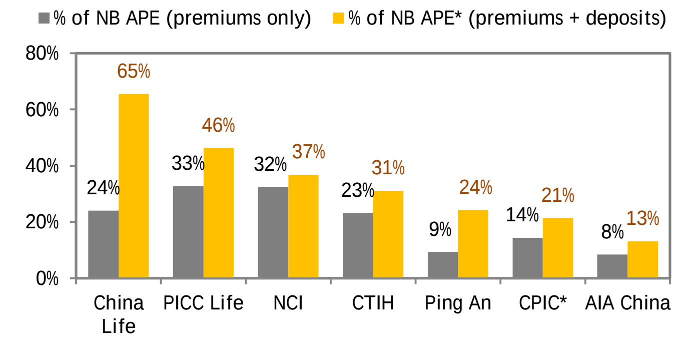
Source: CIRC, Maybank Kim Eng.

We provided our initial thoughts on the clampdown on "quick cash-back" bundled products in our earlier report *"Further Tightening in Savings Products"* on 18 May 2017. We believe listed players will be less affected than emerging insurers, thanks to their diversified product mix and strong agency distribution capacity. Based on our study of listed insurers' 2016 premiums from their top five best-selling products and universal life products (**Appendix II**), we estimate that "quick cash-back" bundled products accounted for 21-65% of listed lifers' NB APE + new deposits in 2016. As premiums from universal life products are mostly classified as deposits (a non-P&L item), NB APE impact would only be 9-33%.

Among listed players, Ping An and CPIC would be the least affected (following AIA China) given their consistent focus on LT protection, whereas China Life and PICC Group would be the most impacted given the former's aggressive push in universal life sales and the latter's high exposure to banca and ST products. NCI should be positioned well amid its significant channel/product mix upgrades.

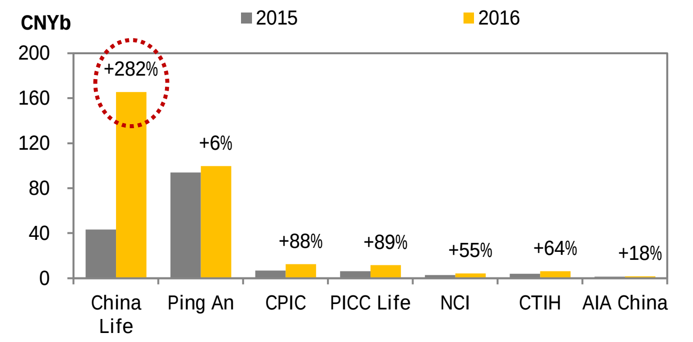
We believe listed players have sufficient time (before Oct 2017) to redesign their existing product portfolio to mitigate any regulatory impact. As they usually push LT protection products in 2H to boost VNB and margins, the growth uncertainties would be mainly in 1Q18. Savings products have much lower margins (17-34% for Ping An) than LT protection products (83%). With that said, we believe investors are willing to accept slower but higher-quality growth, as Chinese lifers' open-year sales campaigns have not been very VNB accretive in the past.

Fig 29: Ping An/CPIC would be least affected by new rules, …
Products being affected by Document 134 [2017] as % of 2016 NB APE



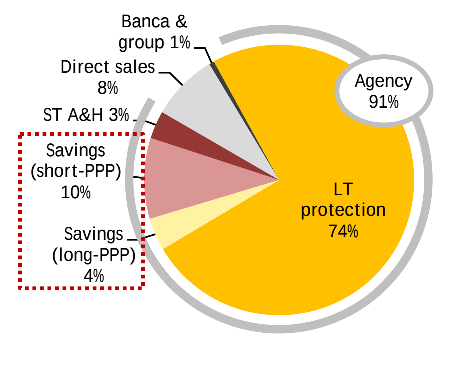
Source: Company data, CIRC, Maybank Kim Eng estimates (Appendix II for details)
**As % of GWP or GWP + deposits*

Fig 30: … whereas China Life would be the most impacted
Policy deposits received from universal life products in 2015-2016



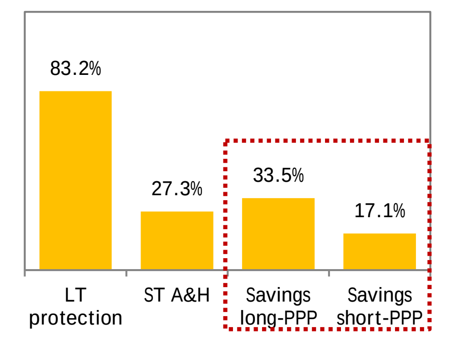
Source: CIRC, Maybank Kim Eng

Fig 31: Savings - low VNB impact, …
Ping An's VNB by products in 2016*



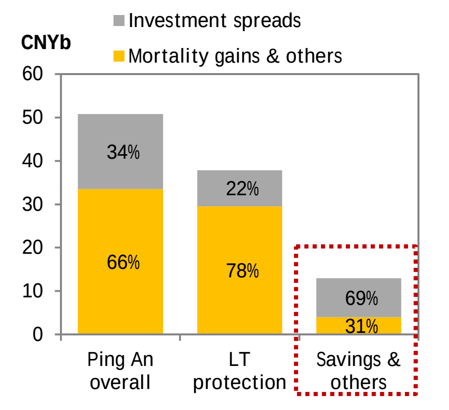
Source: Company data, Maybank Kim Eng
**On C-ROSS basis; PPP = premiums payment period*

Fig 32: … low margins, …
Ping An's VNB margins by products in 2016*



Source: Company data, Maybank Kim Eng
**On C-ROSS basis; PPP = premiums payment period*

Fig 33: … and low earnings quality
Ping An's VNB by source of earnings in 2016*

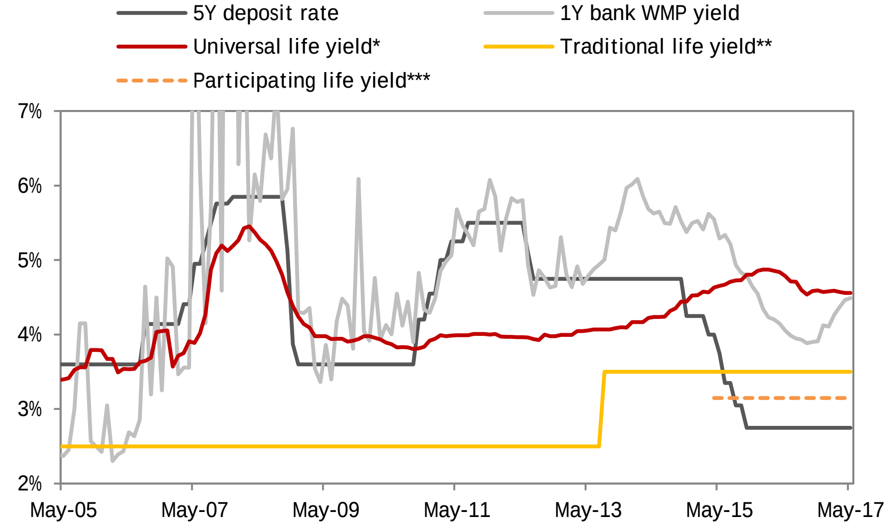


Source: Company data, Maybank Kim Eng
**On C-ROSS basis*

2.4 Structural demand for LT savings remains despite high WMP yields

Bank WMP yields could remain high in the near term due to the escalating funding costs among small and medium-sized banks amid China's financial deleveraging. As the unbundling of universal life riders would affect the overall yields of bundled insurance products, bank WMPs may return as a competitive substitute and steal volume from lifers' ST savings products. With that said, the recent implementation of Macro Prudential Assessment (MPA) on banks may constraint new WMP sales, as banks are subject to higher capital charges on their WMP exposure.

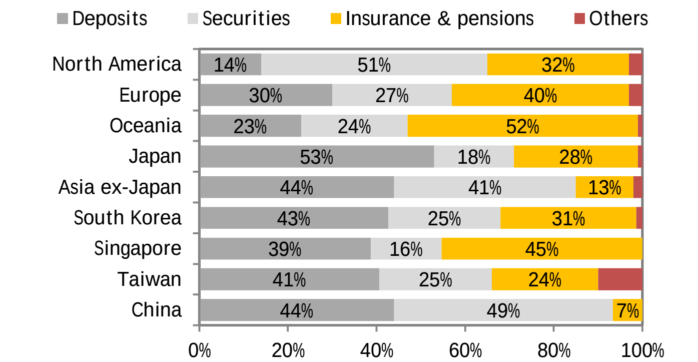
Fig 34: ST savings products would be more affected by WMP competition
Yield comparison of life products and other deposit substitutes



*Source: Wind, CIRC, PBOC, Maybank Kim Eng. *Avg crediting rate offered by traditional insurers **Fixed guaranteed rate on traditional life products; ***All-in return on PAR products, assuming 4.5% gross investment yield, 70% policy dividend payout, and no contribution from mortality & expense gains*

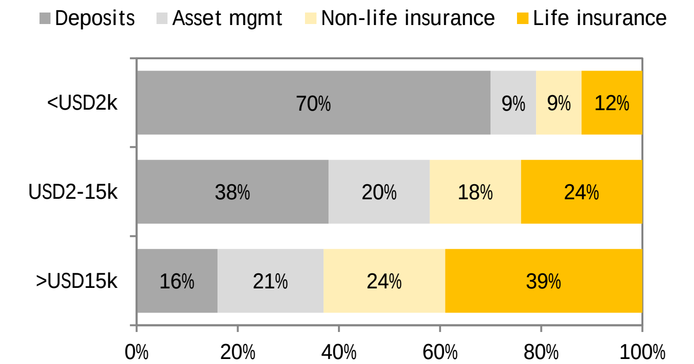
On the other hand, a high-rate environment may lead to more capital outflows from bank deposits to other financial assets given the low interest rates Chinese banks currently offer to depositors. As of April 2017, household RMB deposits amounted to CNY62.5t, which was 18.1x larger than the life sector's total premiums (GWP + policy deposits) in 2016. Given the high household savings level in China and rising demand for asset diversification among the growing middle-class population, LT savings products could continue to attract capital flows from deposits in the long term. Besides, as WMPs generally have product duration of below one year, they are not direct substitutes to lifers' LT savings products.

Fig 35: Chinese households have high savings level, …
Personal financial asset allocation by countries in 2015



Source: Allianz Global Wealth Report

Fig 36: … which could translate into life insurance demand
Asians' financial asset allocation by income level per capita



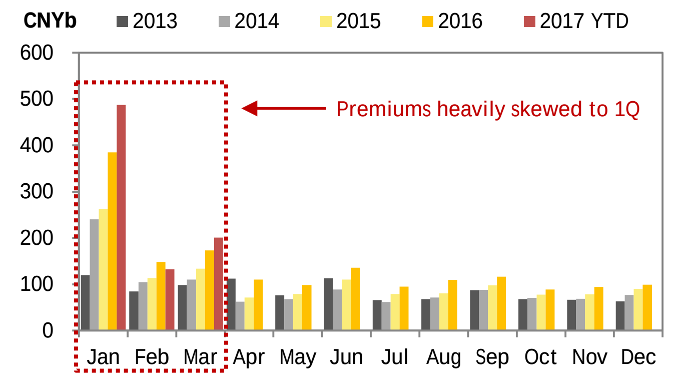
Source: Oliver Wyman, Prudential plc

2.5 Regulatory scrutiny to redirect focus towards protection

China's life sector has its unique open-year sales tradition, during which insurers rush to sell low-margin savings products to boost volume with limited value creation to shareholders. In our view, such campaigns are designed to serve two primary purposes: 1) achieve sales targets to defend market share; and 2) receive fast premium inflows to relieve cashflow pressure from surrenders and maturity of existing ST savings products. We observe an increasing seasonal variation of the sector's sales distribution the past few years amid intense competition and aggressive push of single-pay HCV products by emerging insurers.

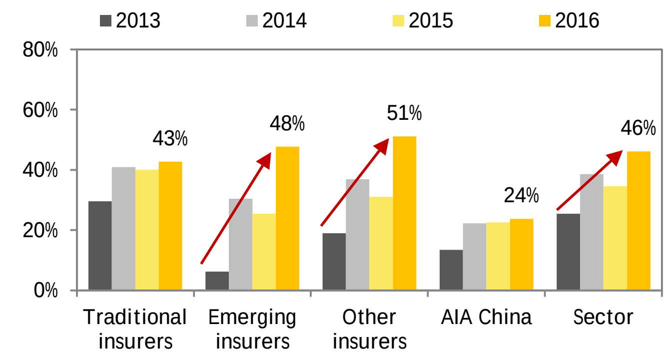
In the long term, we believe CIRC's regulatory scrutiny on ST savings products could help redirect the sector's focus towards LT business (especially LT protection) and push forward its product upgrades. This could lengthen lifers' average policy duration to ease short-term liquidity pressure and reduce earnings sensitivity to macro market volatility. AIA China serves as the best role model for Chinese lifers to follow, in our view.

Fig 37: Chinese lifers' sales are skewed to 1Q, …
Traditional insurers' 1Q contribution to full-year GWP + deposits



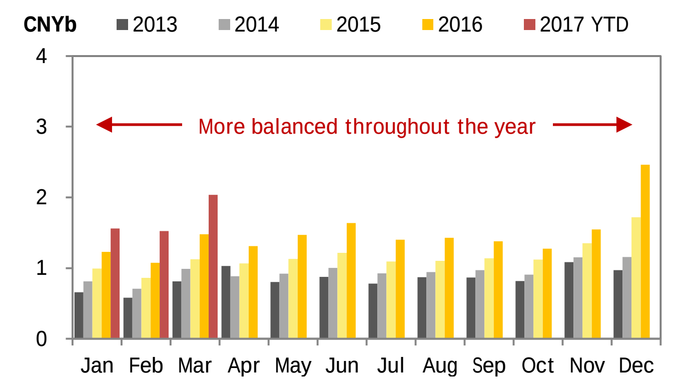
Source: CIRC, Maybank Kim Eng

Fig 38: … with increasing seasonal variation in recent years
Life sectors' 1Q contribution to full-year GWP + deposits



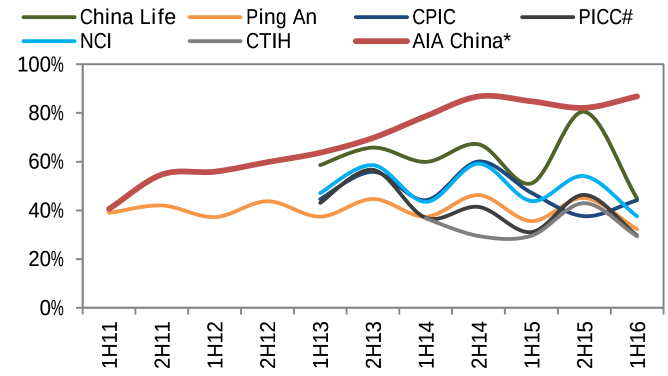
Source: CIRC, Maybank Kim Eng

Fig 39: AIA China has a more balanced sales pattern …
AIA China's 1Q contribution to full-year GWP + deposits



Source: CIRC, Maybank Kim Eng

Fig 40: … and stable margins, due to its focus on protection
Agency VNB margins^ (as % of NB APE)



*Source: Company data, Maybank Kim Eng. #Incl. Life & Health; *Overall margins; ^Excl. 2H16 data due to the change in VNB reporting basis from C-SI to C-ROSS*

3. Better quality could drive a sustainable re-rating

Listed players (except China Life) have been increasing their focus on protection since 2011 with the aid of growing their agency force. Such product upgrades help boost mortality earnings, which have high margins and low macro sensitivity. Besides, more disclosures on residual margins also help improve EV creditability. In the long term, we expect Chinese lifers to catch up with AIA's valuation amid improving earnings quality. Hence, better quality should help sustain the re-rating.

3.1 Protection upgrades have already happened since 2011

Protection upgrades have not been well recognised due to poor disclosures

Listed players' product mix upgrade has been encouraging since 2011, but this has yet been well recognised by investors due to their poor product mix disclosures. In this section, we look at the total premiums breakdown (GWP + deposits) to assess their product upgrades. In general, we see rising protection trend since 2011 for all Chinese lifers, except China Life. Ping An and CPIC remain as high-quality players, while others have also been boosting protection sales with NCI showing the most significant progress. The analysis echoes our earlier study on VNB/VIF sensitivity trends (in our initiation report), which hinted to listed players' significant progress in lifting mortality earnings.

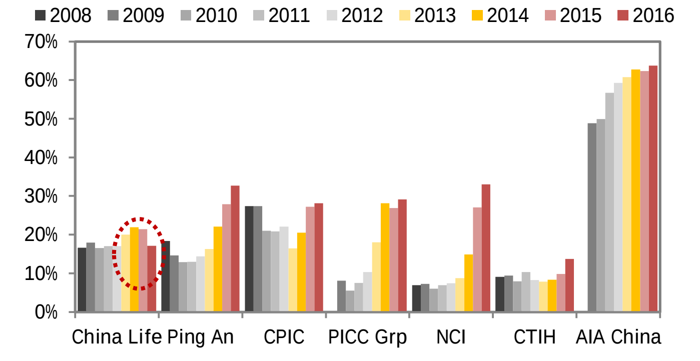
We standardise product mix to facilitate apple-to-apple comparison

To facilitate apple-to-apple comparison, we make the following adjustments to the company-disclosed total premiums breakdown:

- We use CIRC monthly "GWP + deposits" statistics to as the base for our analysis. While policy deposits could be earned from some participating products with low protection content, we simply assume all deposits come from either universal life or linked products.
- We estimate the product mix breakdown based on: 1) company-disclosed product mix, 2) company-disclosed top five best-selling products, and 3) CIRC's Insurance Statistics Yearbooks.
- We define LT protection as products with primary focus on LT insurance risk protection, such as whole life, term life and LT health (e.g. critical illness).
- We define ST A&H (or ST protection) as products with primary focus on ST insurance risk protection and maturity of below one year.
- We define savings as products with primary focus on wealth accumulation, such as annuity, endowment, participating, universal life and linked products.
- While the majority of life products in China are bundled products, we do not unbundle the protection portion from savings products due to lack of disclosure. This may underestimate the actual protection contribution.

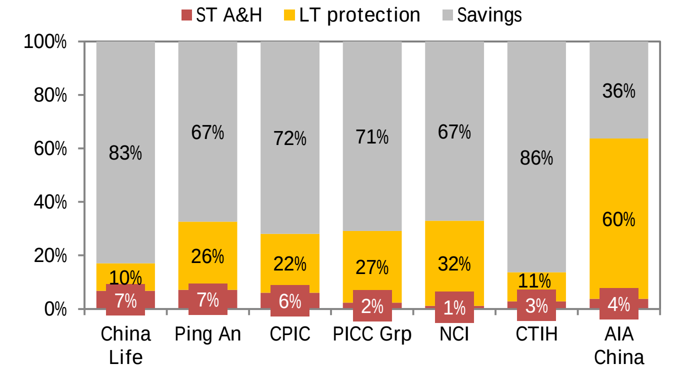
Investors should keep in mind that our analysis is not perfect, since product definitions could vary from company to company. With that said, this analysis should serve as a good starting point to assess the sector's product mix upgrades.

Fig 41: Lifers have been raising protection contribution …
Estimated protection* contribution to GWP + deposits



Source: Company data, CIRC, Maybank Kim Eng estimates.
**Including both ST A&H and LT protection products.*

Fig 42: … despite more time is needed to catch up with AIA
Estimated breakdown of 2016 GWP + deposits



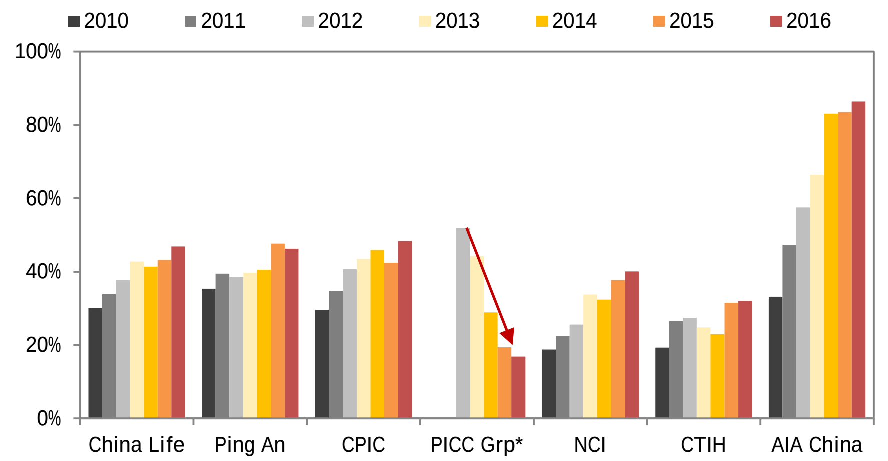
Source: Company data, Maybank Kim Eng estimates.

Ping An/CPIC have been the leading protection players; NCI is catching up

To summarise, we see a general rising protection contribution (including both LT and ST protection) from all listed Chinese lifers in the past five years:

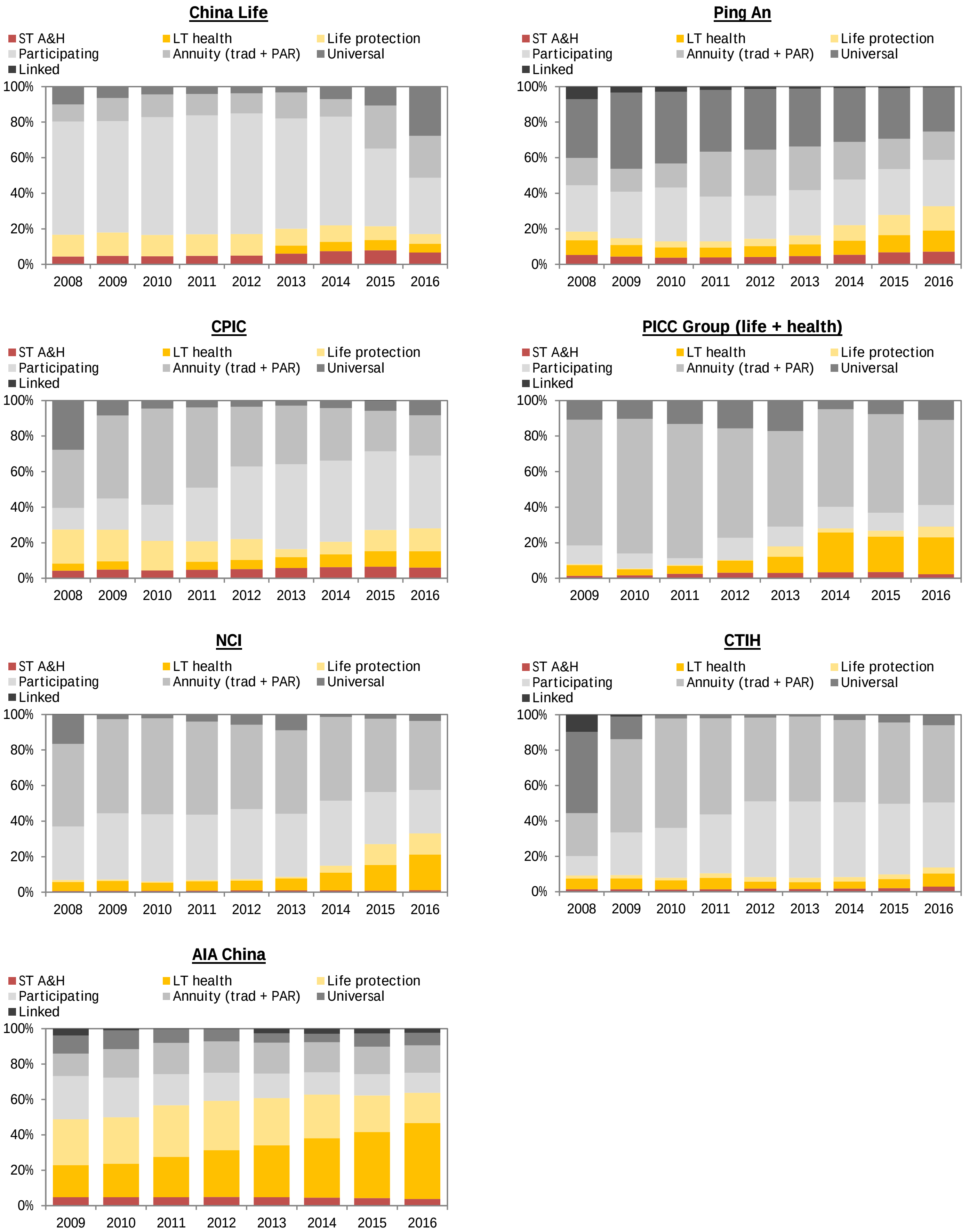
- **China Life** is the only insurer with declining protection exposure. It is due to its more aggressive push in annuity and universal life products in 2015-16, and its more emphasis on sales volume to defend market share.
- **Ping An/CPIC** have long been the leading quality players with above-peers protection exposure. CPIC's improvement was mild in 2016, as it launched 4.025%-guaranteed annuities due to competitive pressure. We expect it to return to protection this year amid easing competition.
- **NCI**'s substantial upgrade was mainly driven by LT health products. This trend is in-line with its rising VNB sensitivity to mortality/morbidity claims, as well as its highest VNB uplift in the new C-ROSS-based EV/VNB reporting.
- **CTIH**'s lowest valuation reflects its weak product quality. However, with a rapid built-up in agent headcounts (up 4.7x from only 46k in 2011 to 262k in 2016), the insurer has started to boost protection sales since 2015.
- **PICC Group**'s rising protection sales came at the expense of profitability, as it was the only lifer suffering from margin deterioration in the past few years. Meanwhile, its VNB sensitivity to interest rates is also significantly higher than peers. We do not see this as a quality growth.

Fig 43: Unlike peers, PICC's sacrifices margins for better product mix
VNB margin as % of NB APE (as % of NB APE + new deposits for Ping An)



*Source: Company data, Maybank Kim Eng. *PICC Life & Health*

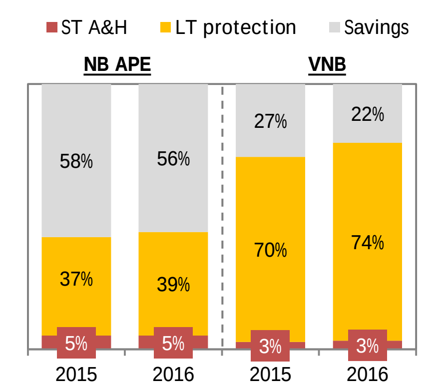
Fig 44: Estimated product mix in terms of total premiums (GWP + deposits)



Source: Company data, CIRC, Maybank Kim Eng estimates

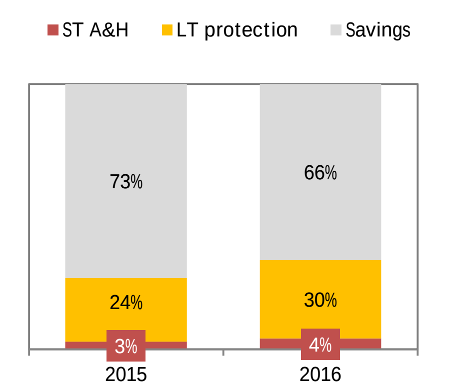
A better approach to analyse the protection contribution is to look at the source of earnings or product mix in terms of NB APE or NB FYP. As only a few lifers provide such disclosures, this makes apple-to-apple comparison not possible. According to available disclosures, we observe that the protection uptrend has been more significant from a new business perspective.

Fig 45: Ping An's NB APE & VNB mix*



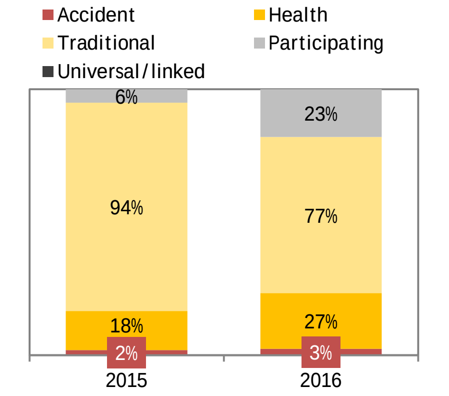
Source: Company data, Maybank Kim Eng estimates
*Assume 100% savings in non-agency channels

Fig 46: CTIH's NB APE mix



Source: Company data, Maybank Kim Eng estimates
*Assume 100% savings in non-agency channels

Fig 47: NCI's NB FYP mix



Source: Company data
*Breakdown based on reported numbers

3.2 Productive agents will support quality VNB growth

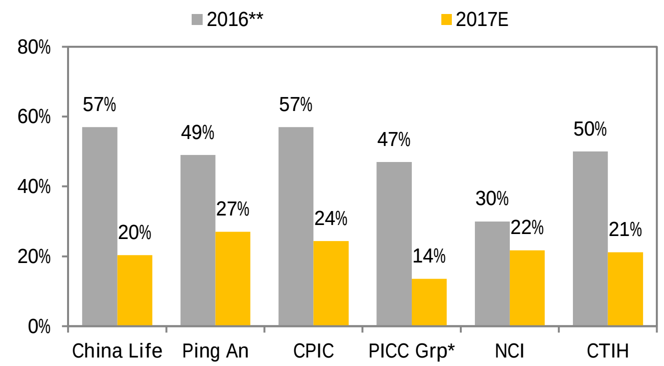
To recap, listed Chinese lifers delivered impressive new business growth in 1Q17 on top of the high base last year, and this was mainly supported by strong agency momentum. Among peers, Ping An, CPIC and CTIH achieved the highest agency FYP growth of over 60% YoY in 1Q17. Their strong growth came with more disciplined product pricings and prudent EV assumptions this year, which should bode well to achieve our undemanding 2017E VNB growth forecasts of 21-27%.

Fig 48: Strong NB growth in 1Q17 despite high base last year
2009-16 life sector VNB growth - listed insurers only*

Company	Premium type	1Q17 growth
China Life	NB APE	15%
Ping An	VNB	60%
CPIC	Agency NB FYP	68%
PICC Group*	GWP	-7%
NCI	Agency NB FYP	35%
CTIH	In-force APE	66%

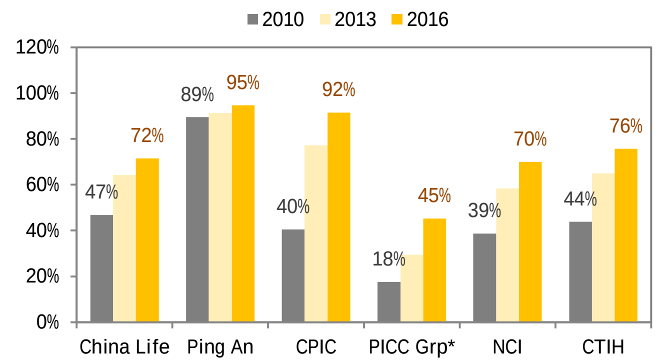
*Source: Company data, Maybank Kim Eng. *PICC Life & Health*

Fig 49: We only project slower VNB but with higher quality
2016-17E VNB growth by insurers



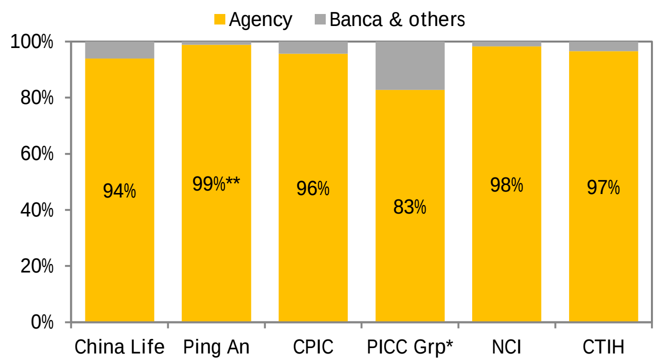
*Source: Maybank Kim Eng. *PICC Life & Health*
***2016 underlying VNB growth excl. VNB impact and EV assumption changes*

Fig 50: Agency channel dominates listed insurers' NB APE...



Source: Company data.

Fig 51: ... as well as VNB *(2016 data)*

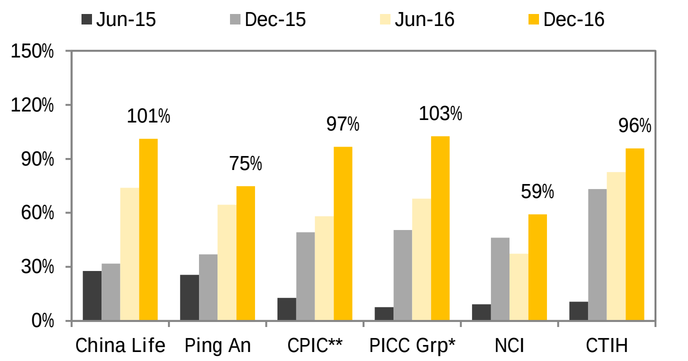


*Source: Company data. *PICC Life & Health; **91% excluding direct sales*

Agent headcounts of listed Chinese lifers rapidly grew by 59-103% in 2014-16, with China Life, Ping An and CPIC remaining as the leading market players. According to *media reports*, the insurance sector had a total of 6.57m agents as of end-2016, which suggests that listed Chinese lifers already dominated 63% (4.14m agents) of the industry's agency force. Even if the pace of headcount expansion slows down this year, the sizable new agents recruited in the past two years should continue to drive new business sales, in our view.

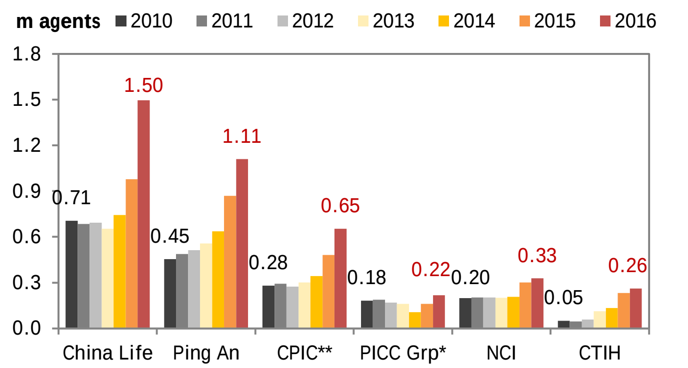
On the other hand, emerging insures will face difficulties in penetrating the protection market given their lack of meaningful agency franchise. According to CIRC data, the five emerging insurers together had a total of 215k agents by end-2015, similar to the smallest listed player PICC Group's scale.

Fig 52: Most listed lifers have doubled their agency force
Agent headcounts – cumulative growth since Dec 2014



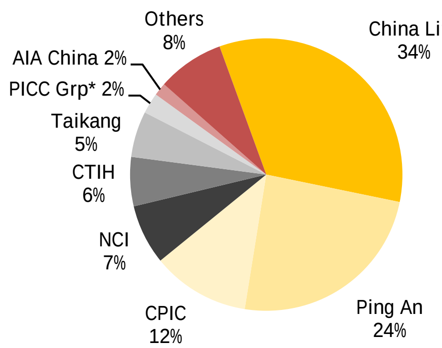
*Source: Company data. *PICC Life & Health; **Based on monthly avg. number*

Fig 53: China Life, Ping An and CPIC are the market leaders
Agent headcounts – absolute number



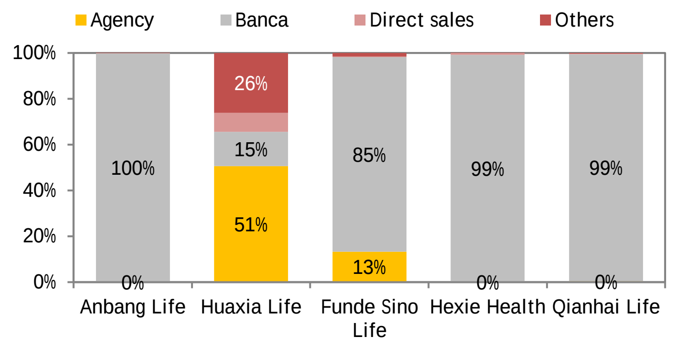
*Source: Company data. *PICC Life & Health; **Monthly avg. number*

Fig 54: Traditional insurers monopolise agency channel
Agency channel market share in terms of 2015 GWP



Source: CIRC Insurance Statistics Yearbook

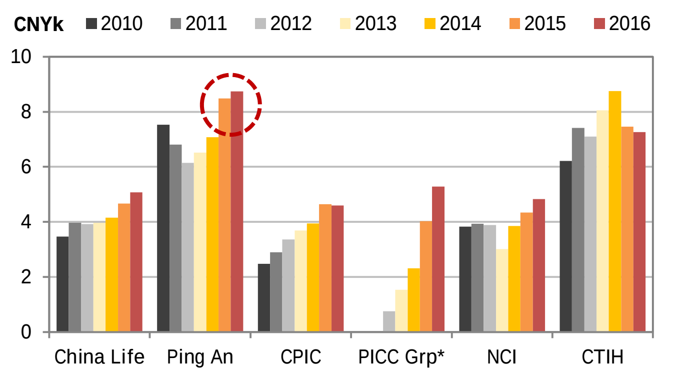
Fig 55: Emerging insurers heavily rely on banca channel
Channel mix of emerging insurers in terms of 2015 GWP



Source: CIRC Insurance Statistics Yearbook

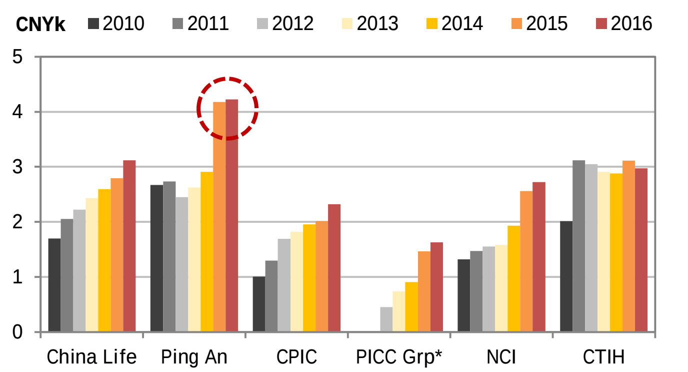
Despite rapid headcount expansion, listed lifers continue to improve their agent productivity in terms of both sales volume (NB APE) and value creation (VNB). Ping An stands out as a dominant agency leader, as its unparalleled agency franchise achieves the highest monthly VNB per agent among peers. We believe Ping An's financial conglomerate status and strong fintech presence will continue to create more synergies and cross-selling opportunities to its agents.

Fig 56: Ping An's agents produce the highest sales volume…
Monthly agent productivity in terms of NB APE



*Source: Company data, Maybank Kim Eng estimates. *PICC Life & Health*

Fig 57: … as well as VNB
Monthly agent productivity in terms of VNB



*Source: Company data, Maybank Kim Eng estimates. *PICC Life & Health*

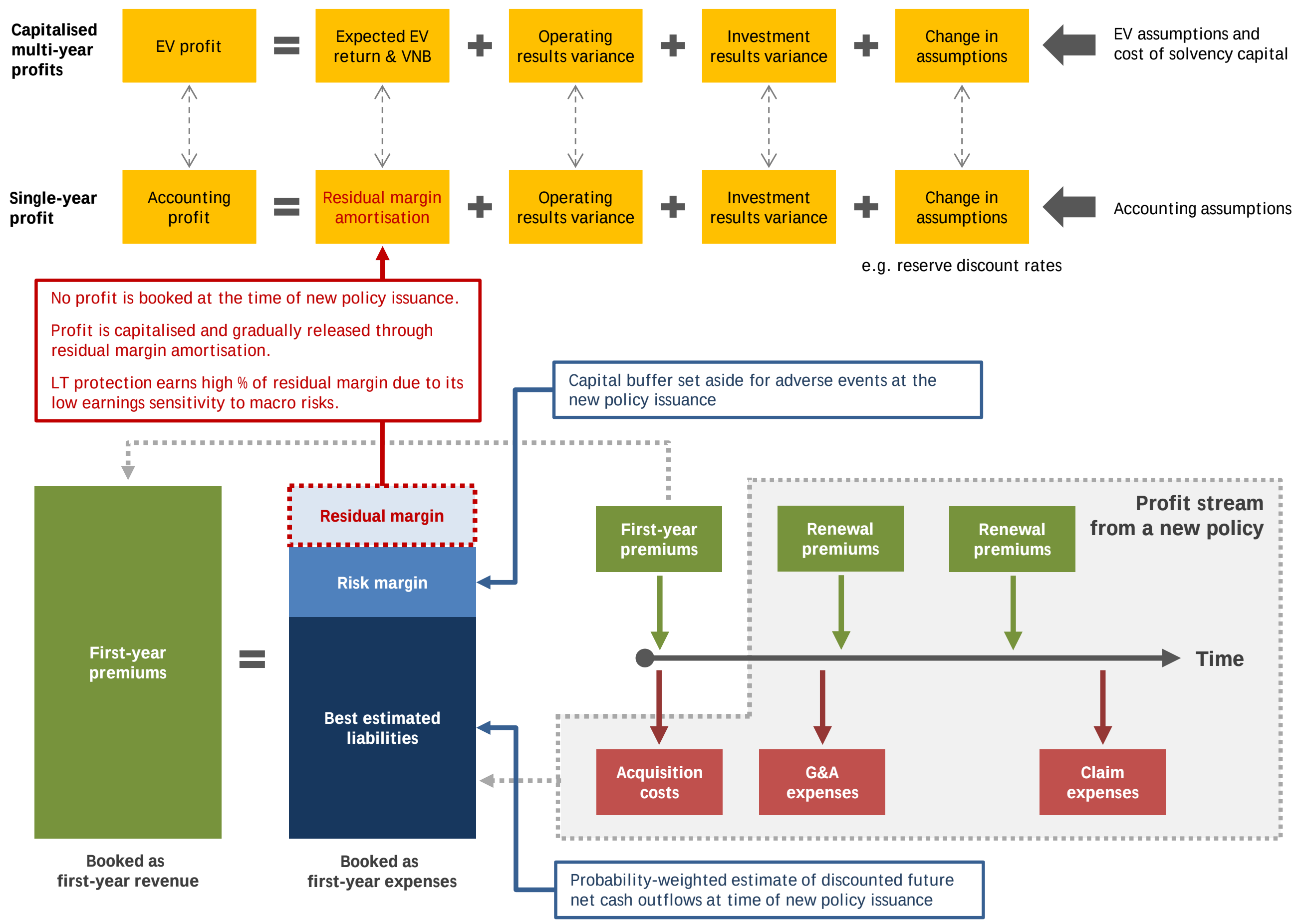
3.3 Residual margin connects VNB to future IFRS earnings

Although Chinese lifers have lower their LT yield assumptions to improve EV/VNB creditability, some investors still find it difficult to understand the linkage between IFRS results and EV/VNB growth. Thanks to Chinese lifers' increasing disclosure on "residual margin" (only Ping An has made it regular so far), investors could have a better understanding on individual insurers' value creation process. This could improve the visibility and forecast-ability of IFRS earnings, as well as EV/VNB creditability, in our view.

In **Figure 58**, we visualise the basics of "residual margin" for investors who are not familiar with the concept. Briefly speaking, residual margin is a P&L expense item to eliminate the profit generated from a new life policy at the time of issuance, as insurer has not yet fulfilled any contract obligation at that moment. Increase in residual margin is booked as liabilities, and the amortization of residual margin will release profit to the insurers' P&L over years. Since the amount of residual margin is locked in at issuance, this serves as a stable source of future earnings stream. However, since residual margin is an offsetting item to eliminate first-year profit, it cannot be negative.

While residual margin is classified as liabilities under IFRS, it is recognised as actual solvency capital under C-ROSS. Therefore, profitable businesses with high residual margin contribution would have low new business strain under C-ROSS.

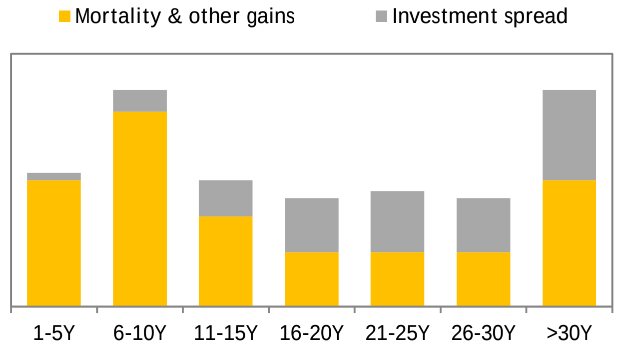
Fig 58: Visualisation of the concept of "residual margin"



Source: IFRS, Maybank Kim Eng

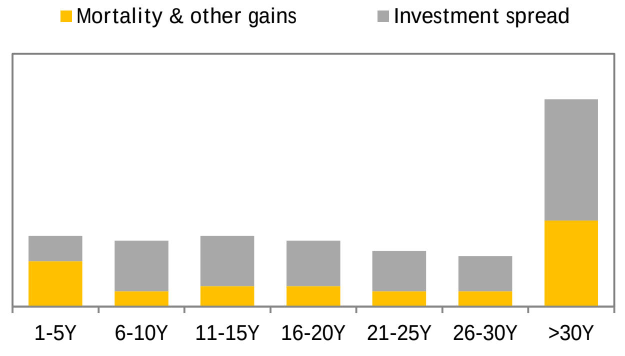
In general, mortality/morbidity assumptions are more stable than macro assumptions such as interest rates. LT protection generate more residual margin than savings products, as less capital buffer is set aside for adverse events.

Fig 59: LT protection earns more stable mortality gains…
Distributable profit of a typical LT protection product



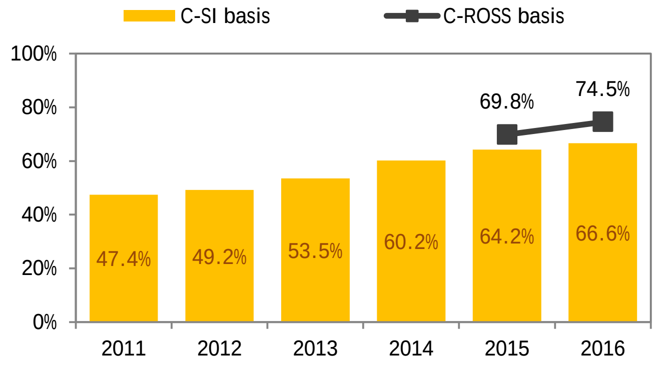
Source: Ping An disclosure.

Fig 60: … whereas savings product rely on investment spread
Distributable profit of a typical short-PPP savings product



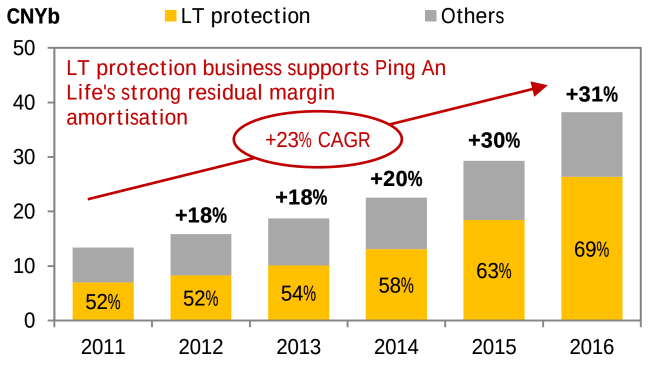
*Source: Ping An disclosure. *PPP = premium payment period*

Fig 61: Ping An has boosted sales in LT protection products…
Ping An's VNB contribution from LT protection



Source: Company data, Maybank Kim Eng

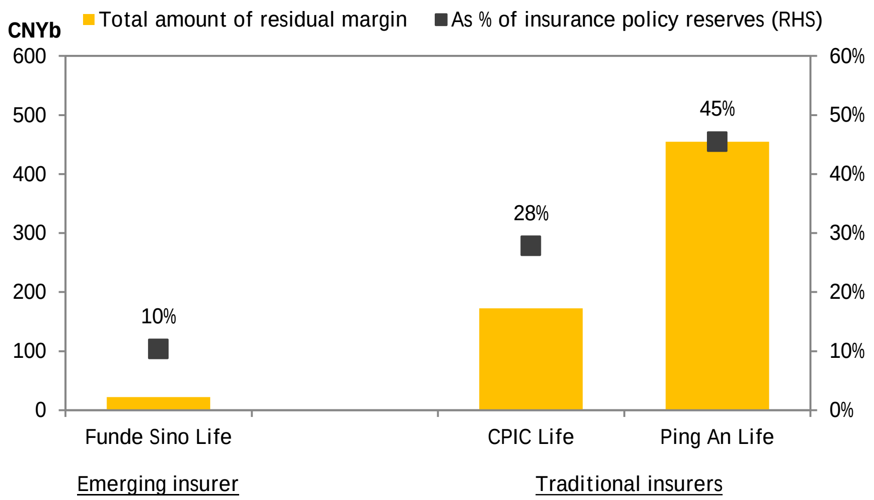
Fig 62: … and this has translated into stable accounting profit
Ping An Life's residual margin amortisation



Source: Company data, Maybank Kim Eng

We estimate that residual margin accounted for 45% and 28% of Ping An Life and CPIC Life's insurance policy reserves as of Dec 2016, compared with an emerging insurer Funde Sino Life's of only 10%. This suggests protection business could not only boost VNB growth but also generate more visible IFRS earnings. While we still believe EV/VNB framework would be the best way to value Chinese lifers, residual margin could serve as supportive evidence to improve EV creditability.

Fig 63: Protection-focused insurer generates more residual margin



Source: Company data, Maybank Kim Eng

4. Systemic risks remain low amid the deleveraging

Insurers' funding costs are less impacted by tighter liquidity, as they mainly source funding from policyholders and have little involvement in the leveraging process. While stricter product rules will put pressure on emerging insures' near-term cashflows, risk is still manageable given their sufficient liquidity coverage under stressed scenarios. Contagion risk remains low as they only form a small part of the system (i.e. 1% of banks' on-B/S assets as of Dec 2016). In addition, we notice a general decline in their equity allocation to reduce concentrated risk exposure.

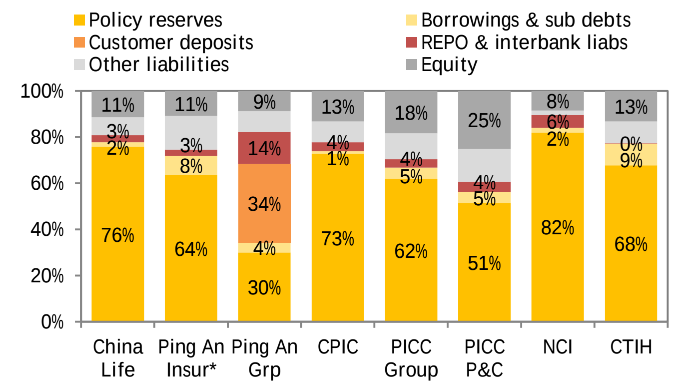
4.1 Funding cost not affected by liquidity tightening

The hikes in PBOC's ST policy rates (such as MLF and SLF) since 2H16 and stricter Macro Prudential Assessment (MPA) rules in 1Q17 have accelerated the unwinding of financial institutions' leveraged positions in the bond market, shrunk shadow credits and pushed up ST funding costs.

While small banks generally suffer from NIM pressure due to their role as net borrows in the REPO/interbank markets, insurers' funding costs are much less impacted by the deleveraging process as they mainly source funding from policyholders. As of Dec 2016, REPO and interbank liabilities accounted for only 0-6% of insurers' total funding, compared with 51-82% from insurance policies.

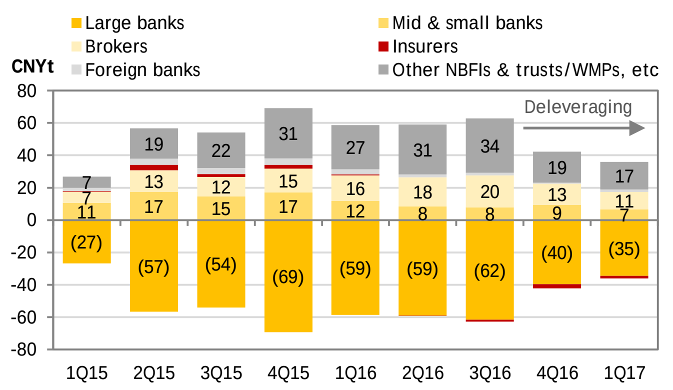
PBOC data shows that insurers have been net lenders in REPO/interbank markets since 2Q16 with a small exposure, while the biggest participants are mainly trusts and WMPs. With that said, a squeeze in system liquidity may impact insurers' investments in non-standard assets (especially trusts/WMPs with multiple layers), and they generally face lower B/S risks than banks in the case of credit events, as they are only investors, not guarantors, of these products.

Fig 64: Insurers do not rely on REPO and interbank funding…
Funding source as % of total liabilities and equities (Dec 2016)



*Source: Company data, Maybank Kim Eng *Excluding PAB*

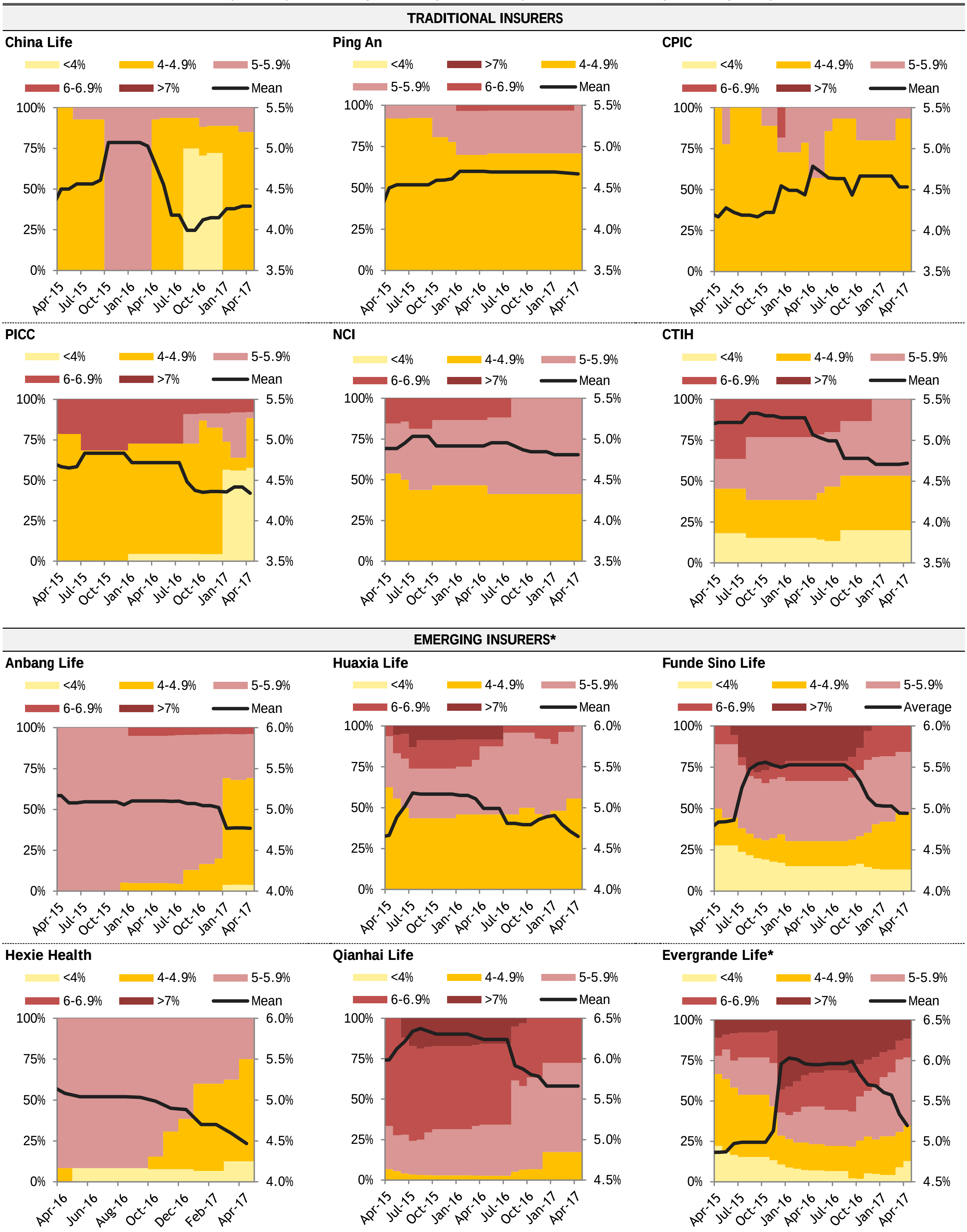
Fig 65: … and are less impacted by financial deleveraging
Net borrowers* in China onshore REPO and interbank markets



*Source: PBOC, Maybank Kim Eng *Negative value = net lenders*

Fig 66: Traditional insurers' liability costs have stabilised amid easing competition

Statistics of over 300 universal life policies *(RHS = average crediting rate; LHS = product distribution by crediting rates)*

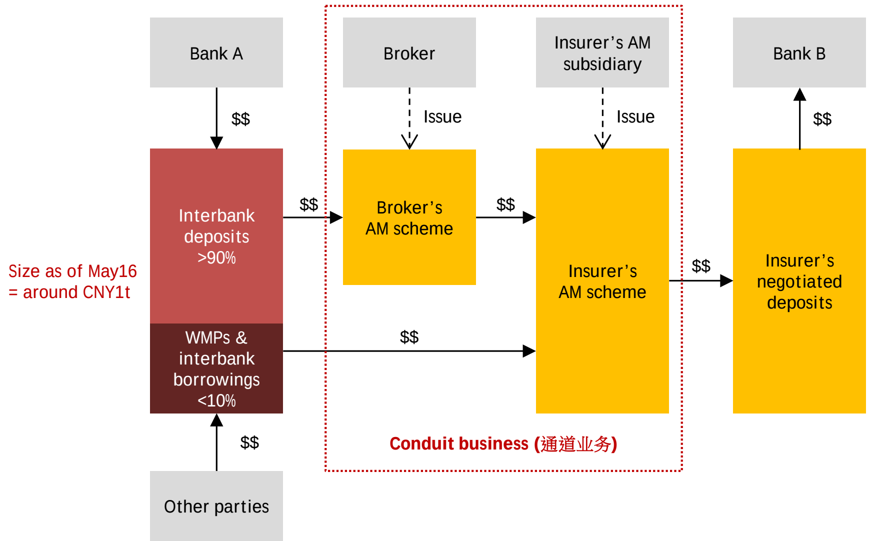


*Source: Company websites, Maybank Kim Eng. *We define emerging insurers as Anbang Life, Huaxia Life, Funde Sino Life, Hexie Health and Qianhai Life*

4.2 Little involvement in leveraging up the financial system

Insurers have limited off-B/S exposure compared with banks, as their exposures to non-standard assets (aka shadow credits) are reflected in investment assets. Insurers' asset management subsidiaries used to provide conduit business (通道业务) for banks to repackage interbank liabilities and WMPs as negotiated deposits for regulatory arbitrage purposes. In this structure, insurers' asset management subsidiaries only manage the entrusted portfolio and charge fees (around 5-30bps), while banks bear the credit risks.

Fig 67: Chinese banks repackage interbank deposits through conduit business



Source: Media reports, Maybank Kim Eng

As of May 2016, the market size of insurance AM schemes was CNY1.41t, of which around CNY1t or 85% of AUM was used for conduit business. We understand that this accounted for only around 5% of the total scale of conduit business in the financial system (over CNY20t as of end-2015). In addition, over 90% of the underlying assets for conduit business were interbank deposits with low risks.

In May 2016, the CIRC suspended insurers' conduit business and required them to self-check and rectify their business. In Jun 2016, the CIRC further suspended the issuance of insurance asset management products with fund-pooling (资金池) or multi-layer (嵌套) features. The size of such business was even smaller at around CNY100b as of early 2016, accounting for only 7% of total insurance AM schemes.

CIRC's recent announcements also reiterate its stance of prohibiting insurance fund investment in financial products with multi-layers or "under-the-table" terms to bypass the current regulations. We believe insurers' off-B/S risks could be contained amid stricter regulatory enforcement.

Fig 68: Regulation on insurance asset management products

Date	Regulation	Highlights
End May-16	Suspension of insurance AM subsidiaries' conduit business (Doc 97 [2016])	▪ Suspended insurance AM subsidiaries' conduit business (通道业务) from end-May and require insurers to self-check their business by 31 July 2016.
22-Jun-16	Strengthening regulations on insurance AM products (Doc 104 [2016])	▪ Prohibit insurance AM subsidiaries from launching products with fund-pooling (资金池) or multi-layer (嵌套) features. ▪ Restrict insurers from selling structured AM products to individual investors. For institutional investors, the leverage cap is 1x for equity/hybrid-type structured products and 3x for other structured products. ▪ Ban insurers from entrusting the investment function to external parties or managing AM products in a parent/sub-account format. Besides, insurers are required to specify the asset allocation of their AM products.

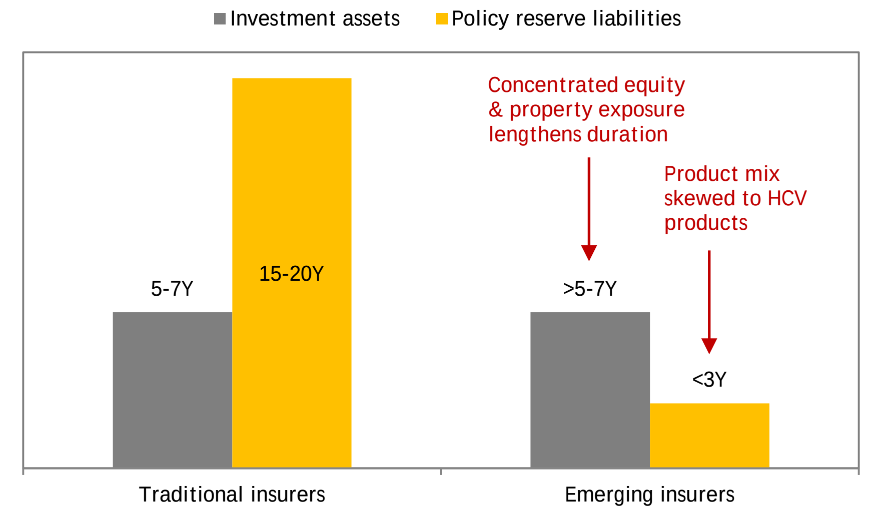
Source: CIRC, media reports, Maybank Kim Eng

4.3 Emerging players' liquidity risk is manageable

Different B/S structures face different risks

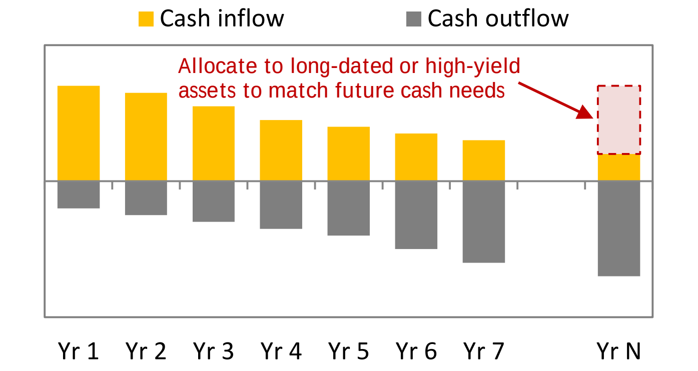
To recap, traditional insurers face reinvestment risks given their negative duration B/S structure (i.e. duration of assets < liabilities), whereas emerging insurers are more vulnerable to liquidity squeeze because of their positive duration B/S structure. Of the two, liquidity risk is usually more lethal as near-term cash shortages will immediately hit insurers' capital positions.

Fig 69: Different B/S structures subject to different risks



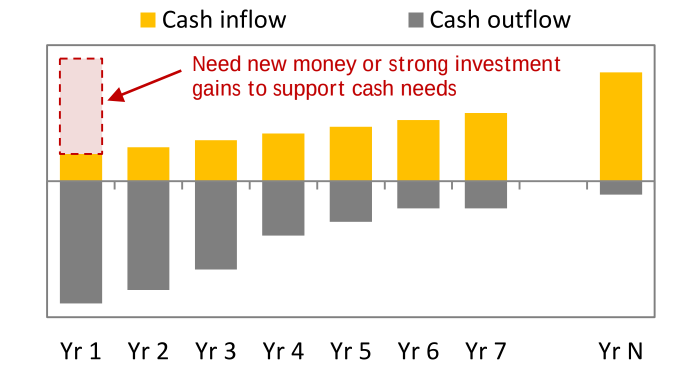
Source: Maybank Kim Eng

Fig 70: Traditional insurers face reinvestment risk, …



Source: Maybank Kim Eng

Fig 71: … whereas emerging insurers face liquidity risk



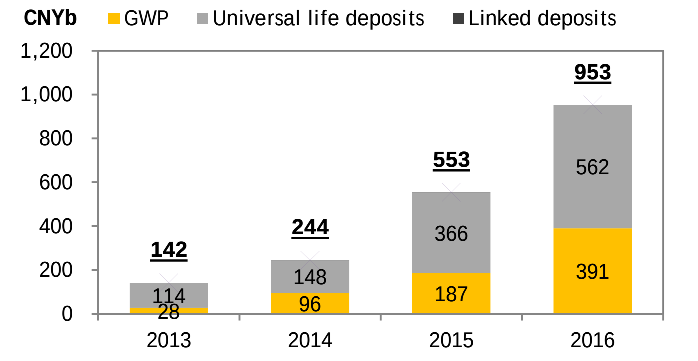
Source: Maybank Kim Eng

Emerging insurers will start to feel the pain of tighter liquidity…

We understand that the majority of universal life products emerging insurers sold in the past few years were HCV products with an average effective duration of only three years or below. This means that a large portion of their back-book policies will gradually be surrendered or will mature in the coming three years. Together with the sharp decline in new business sales, emerging insurers will start to feel the pain of tighter liquidity.

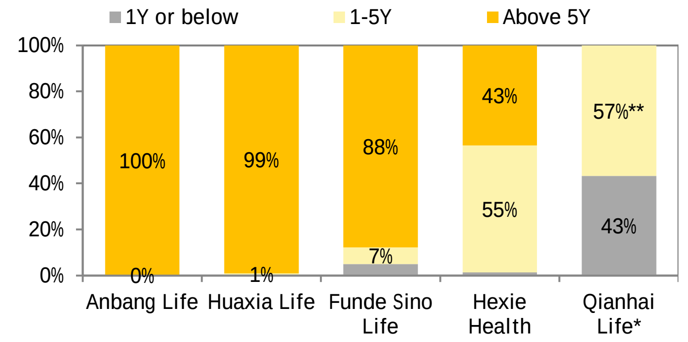
While some emerging insurers classify most of their policy reserves with policy duration of above five years, we believe the actual duration would be much shorter as most back-book policies were designed with HCV features.

Fig 72: GWP + deposits of emerging insurers in 2013-16



Source: CIRC, Maybank Kim Eng

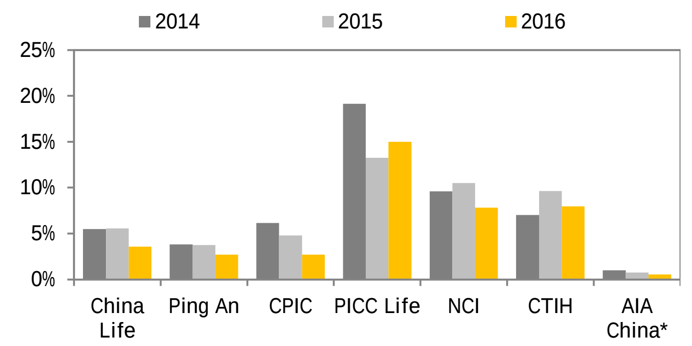
Fig 73: Maturity profile of policy reserves



Source: Company data, Maybank Kim Eng.
**Excluding investment policy reserves due to lack of disclosure*
***Maturity in 1Y or above*

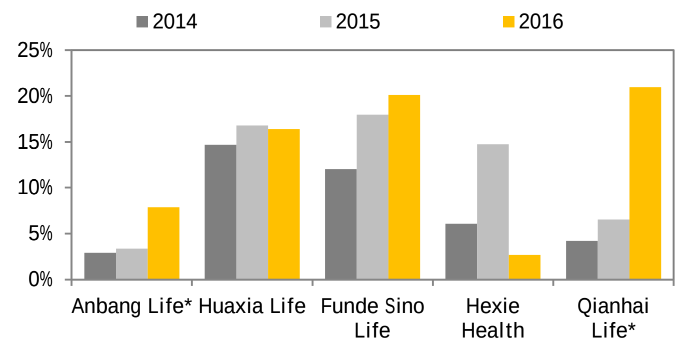
We fine tune the calculation methodology of surrender rate to include the withdrawal rate on policy deposits. Traditional insurers have generally done well in the past three years with improving surrender rates due to product mix upgrades towards LT business, whereas most emerging insurers recorded very high surrender rates in 2016, probably due to the sharp cuts in product yields amid tighter regulations.

Fig 74: Traditional insurers face fewer surrenders…
Adjusted surrender rate (incl. deposit withdrawals)



Source: Company data, Maybank Kim Eng
**Surrender rate excl. deposit withdrawals due to insufficient disclosure*

Fig 75: … whereas emerging insurers face more
Adjusted surrender rate (incl. deposit withdrawals)



Source: Company data, Maybank Kim Eng
**Unconsolidated basis to exclude overseas insurance operations*
***Surrender rate excl. deposit withdrawals due to insufficient disclosure*

… but C-ROSS liquidity ratios suggest manageable risks

According to C-ROSS regulations, insurers are required to report their comprehensive liquidity ratio and liquidity coverage ratio on quarterly basis. We list out the definition of the ratios in the below figure.

Fig 76: Definition of C-ROSS liquidity ratios

$$\textit{Comprehensive liquidity ratio} = \frac{\textit{Expected cash inflows of existing assets}}{\textit{Expected cash outflows of existing liabilities}}$$

$$\textit{Liquidity coverage} = \frac{\textit{Book value of high quality liquid assets}}{\textit{Expected net cash outflows of next quarter}}$$

$\textit{Expected net cash flows} = \textit{Expected outflows} - \textit{Expected inflows}^{\wedge}$

$^{\wedge}$*Capped at 75% of expected cash outflows*

Stressed scenario #1: *Premiums fall 80% YoY and surrender rate assumption is 2x of the base scenario (capped at 100%).*

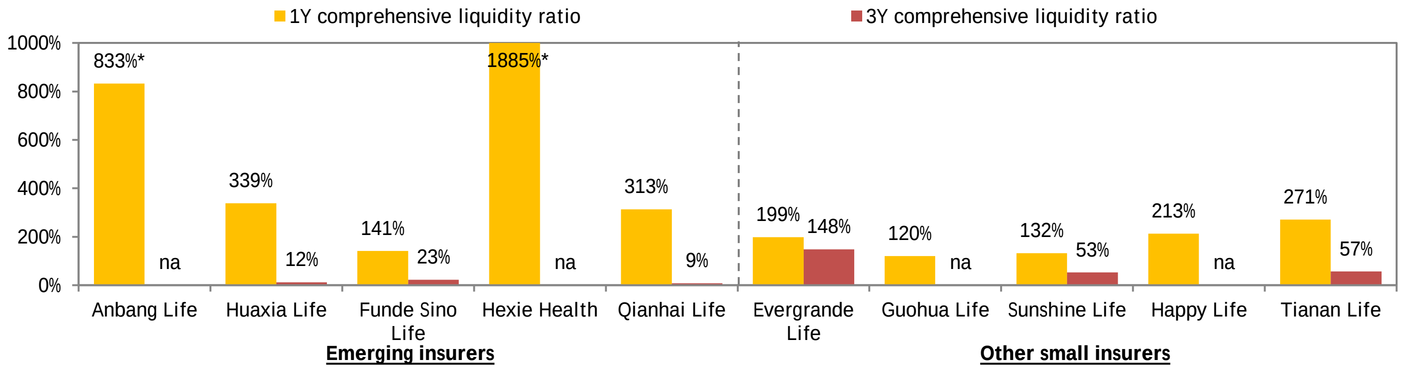
Stressed scenario #2: *20% of maturing fixed-income assets default.*

Source: CIRC

Based on emerging insurers and selected small players' average C-ROSS comprehensive liquidity ratio in 1Q16-1Q17, they were able to fund the expected cash outflows within one year. Thus, risk of immediate liquidity pressure is limited. Since most of their back-book policies will be surrendered or will mature within three years, the three-year ratios were significantly lower.

However, the calculation of comprehensive liquidity ratio would underestimate the actual liquidity situation, as it only considers cashflow generation from existing assets. Insurers could continue to grow new business to attract premium inflows to replenish their cash positions.

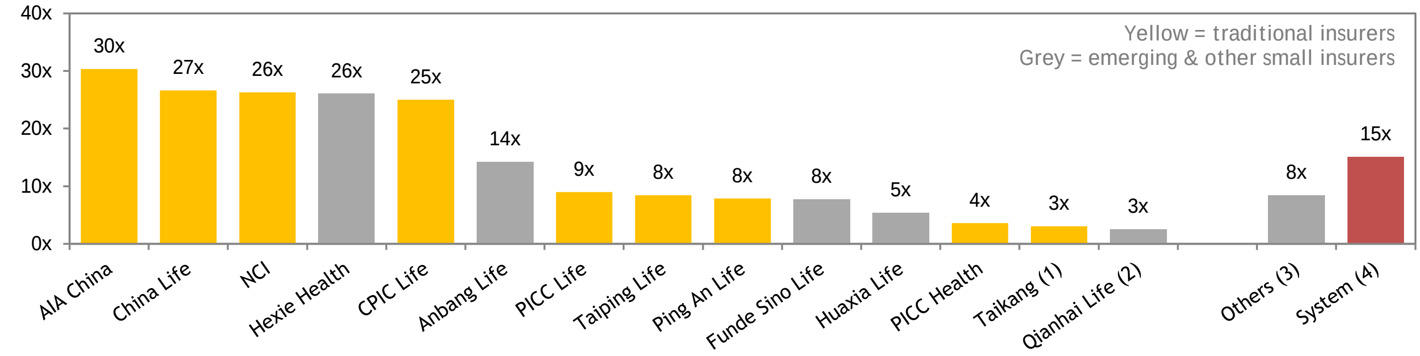
Fig 77: C-ROSS comprehensive liquidity ratios *(1Q16-1Q17 average)*



*Source: Company data, Maybank Kim Eng. *3M comprehensive liquidity ratio is used*

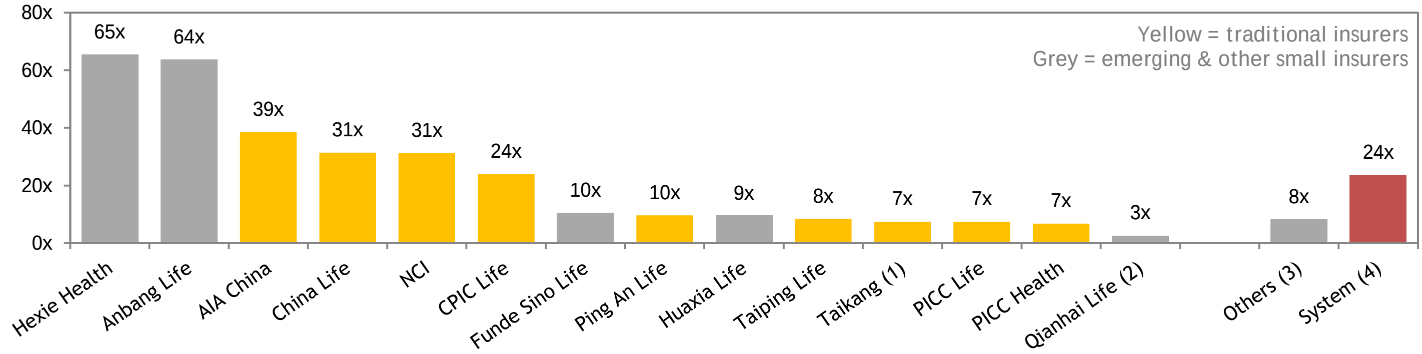
C-ROSS liquidity coverage ratios measure insurers' vulnerability under different stressed scenarios. 1Q17 data shows that insurers were able to cash out part of their liquid assets to fund the expected net cash outflows even at operational difficulties. We notice that a 50% book value discount is applied to stock holdings for the calculation of liquidity coverage ratios. We believe this approach should be fairly prudent for assessing emerging insurers' risks given their high exposure to the stock market.

Fig 78: 1Q17 C-ROSS liquidity coverage – stressed scenario #1



Source: Company data, Maybank Kim Eng. (1) 4Q16 figure; (2) Qianhai Life does not specify which Scenario it uses for the calculation; (3) Using the average ratio of five largest insurers in this category in terms of 2016 GWP + deposits as a proxy (i.e. Evergrande Life, Guohua Life, Sunshine Life, Happy Life and Tianan Life); (4) Total assets weighted average

Fig 79: 1Q17 C-ROSS liquidity coverage – stressed scenario #2



Source: Company data, Maybank Kim Eng. (1) 4Q16 figure; (2) Qianhai Life does not specify which Scenario it uses for the calculation; (3) Using the average ratio of five largest insurers in this category in terms of 2016 GWP + deposits as a proxy (i.e. Evergrande Life, Guohua Life, Sunshine Life, Happy Life and Tianan Life); (4) Total assets weighted average

Fig 80: Book value discounts in calculation of C-ROSS liquidity coverage

High-quality liquid assets	Book value discount
Cash	0%
Government bonds	0%
Central bank notes/central bank guaranteed bonds	0%
Time deposits with advanced withdrawal right	10%
Negotiated deposits with advanced withdrawal right	10%
Policy financial bonds (AAA)	10%
Commercial bank financial bonds* (AAA)	15%
Corporate/enterprise bonds (AAA)	15%
Listed stocks	**50%**

*Source: CIRC *Excluding financial bonds for replenishing supplementary capital*

C-ROSS regime adequately factors in high surrender rates for HCV products

Under C-ROSS regime, insurers are required to reserve high capital charges on HCV products as CIRC sets the floor lapse rate (surrender + maturity) assumptions on such products which are significantly higher than other products.

For example, for calculating capital charges on HCV products with 2-3 year effective duration, insurers are required to assume 20%/60% lapse rates on the 2nd/3rd policy year, which is well above the 3-5% lapse rate assumption used for traditional single-pay banca products and should fairly reflect the actual cases. As such, we believe the current C-ROSS regime adequately factors in high surrender rates for HCV products.

On 23 May, CIRC *announced* it will start an investigation on the actual implementation of C-ROSS regime and identify the loopholes and shortcomings of the current framework for future optimisation. We think this move could help enhance the creditability of the C-ROSS regime among investors.

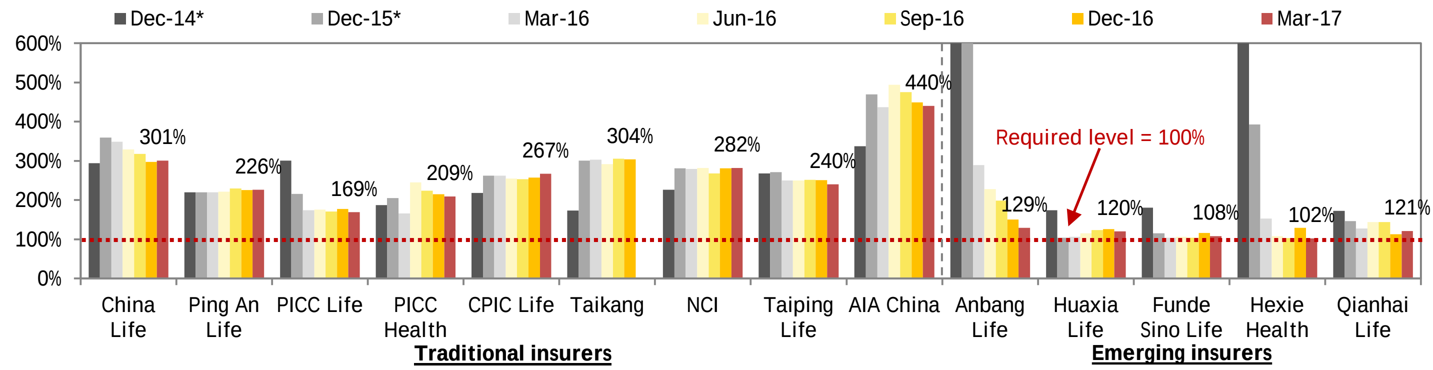
Fig 81: HCV products are subject to higher capital charges

Lapse rate (surrender + maturity) assumptions of major life insurance products set by C-ROSS

				Policy year			
Lapse rate assumptions	**1st year**	**2nd year**	**3rd year**	**4th year**	**5th year**	**6-10th year**	**11th year+**
High-cash-value type							
Effective duration (0Y, 1Y]	60%	3%	3%	3%	3%	3%	3%
Effective duration (1Y, 2Y]	3%	60%	3%	3%	3%	3%	3%
Effective duration (2Y, 3Y]	3%	20%	60%	3%	3%	3%	3%
Effective duration (3Y, 4Y]	3%	3%	20%	60%	3%	3%	3%
Traditional							
Agency single pay	2-5%	2-5%	2-5%	2-5%	2-5%	2-5%	2-5%
Agency regular pay	15-25%	7-15%	5-10%	4-6%	3-5%	2-5%	2-5%
Banca single pay	3-5%	3-5%	3-5%	3-5%	3-5%	3-5%	3-5%
Banca regular pay	10-20%	6-10%	5-8%	3-5%	3-5%	2-5%	2-5%
Participating - whole life							
Agency single pay	2-5%	2-5%	2-5%	2-5%	2-5%	2-3%	2-3%
Agency regular pay	13-25%	7-15%	5-8%	5-8%	3-5%	3-5%	3-5%
Banca single pay	3-5%	3-5%	3-5%	3-5%	3-5%	3-5%	3-5%
Banca regular pay	10-15%	4-8%	3-5%	3-5%	3-5%	3-5%	3-5%
Participating - endowment							
Agency single pay	2-5%	2-5%	2-5%	2-5%	2-5%	2-5%	2-3%
Agency regular pay	10-25%	5-10%	4-8%	3-5%	3-5%	2-5%	2-5%
Banca single pay	3-5%	3-5%	3-5%	3-5%	3-5%	3-5%	3-5%
Banca regular pay	10-15%	5-10%	4-8%	3-5%	3-5%	2-5%	2-5%
Universal life							
Agency single pay	3-15%	3-15%	3-15%	3-15%	3-15%	3-15%	3-15%
Agency regular pay	5-20%	5-10%	5-8%	5-8%	5-8%	3-7%	3-7%
Banca single pay	2-5%	2-5%	3-15%	5-25%	5-25%	5-25%	5-25%
Banca regular pay	10-20%	5-10%	5-8%	5-8%	5-8%	5-8%	5-8%

Source: CIRC, Maybank Kim Eng

Fig 82: C-ROSS comprehensive solvency ratio by insurers



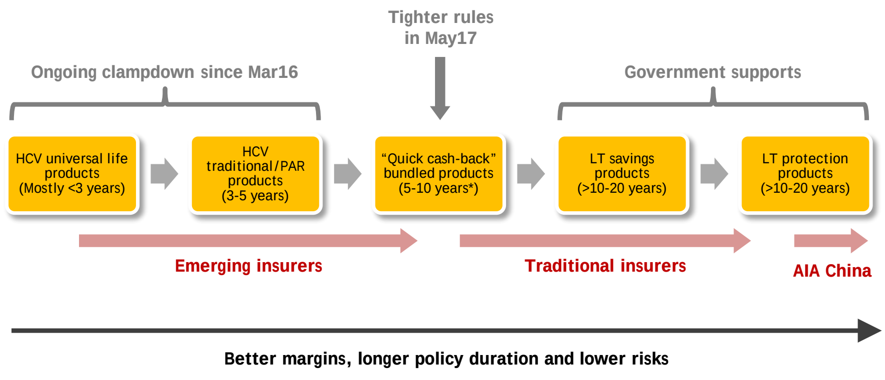
*Source: Company data, Maybank Kim Eng. *C-SI solvency ratio is used in: 1) Dec14 for all insurers; and 2) Dec15 for Anbang Life & Hexie Life*

Product upgrades should gradual ease liquidity pressure in the long term

As discussed in the previous section, CIRC's tighter regulations should accelerate emerging insurers' product upgrading cycles and de-risk their back book:

- On the liability side, boosting sales of LT savings and protection products could lengthen emerging insurers' liability duration and thus ease near-term policy surrender and liquidity pressure.
- On the income side, promoting more regular-pay products could smoothen emerging insurers' cash inflows to avoid sudden liquidity events.

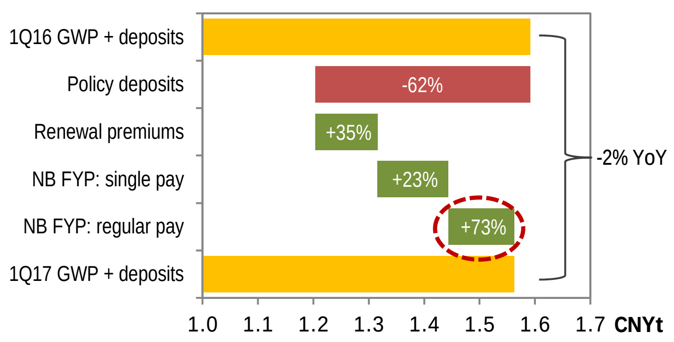
Fig 83: Life sector's product upgrades amid tighter regulations



*Source: Maybank Kim Eng. *Mostly slightly above 5 years for emerging insurers*

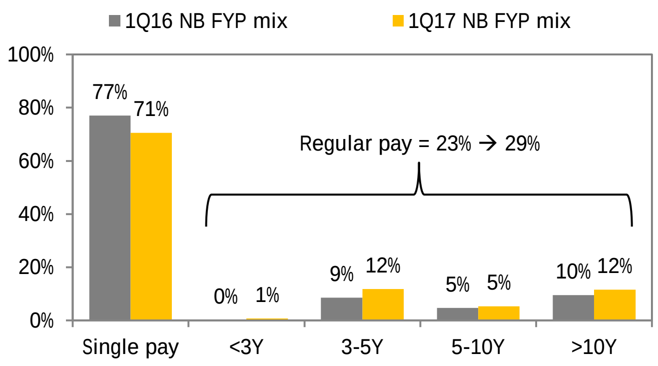
According to [media reports](), the life sector's NB FYP from regular-pay products surged 73% YoY in 1Q17 compared with single-pay products' 23%. We also notice higher NB FYP contribution from life products with longer premium payment period. This is an encouraging sign that CIRC's tighter regulations are speeding up emerging insurers' product mix upgrade.

Fig 84: Life sector pushed regular-pay products in 1Q17…
Decomposition of 1Q17 sector GWP + deposits growth (unofficial data)



Source: Media reports, Maybank Kim Eng

Fig 85: … to boost future income stream and margins
Sector NB FYP mix by premium payment period (unofficial data)



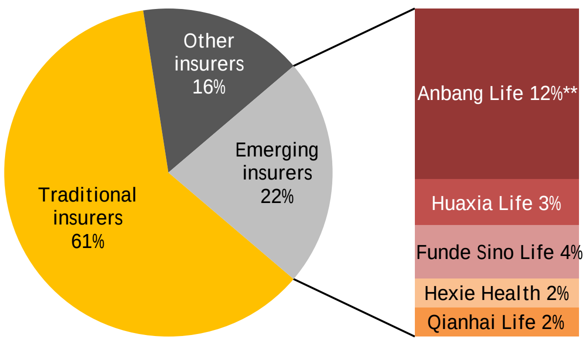
Source: Media reports, Maybank Kim Eng

4.4 System's contagion risk remains low

Emerging insurers only form a small part of the financial system

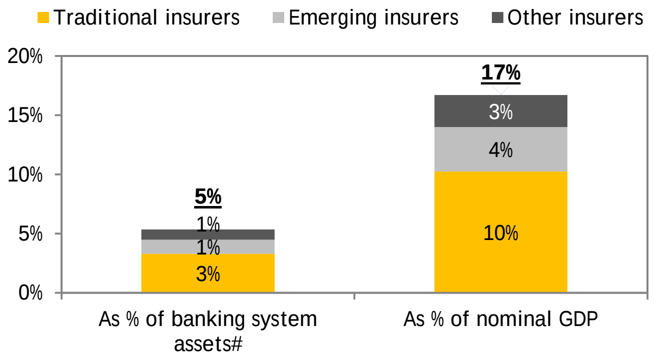
Although emerging insurers aggressively took up market share from traditional insurers in the past few years, they only accounted for 22% of the life sector's assets as of Dec 2016. Their presence will be insignificant if we compare their assets with China banking system's on-B/S assets (1% as of Dec 2016) and normal GDP (3% in 2016). Given emerging insurers' relatively small scale and bleak growth outlook, their systemic impact should be contained.

Fig 86: Emerging insurers' balance sheets are still small…
Share of life insurance sector assets in 2016



Source: Company data, CIRC, Maybank Kim Eng
***5% from domestic assets and 7% from overseas assets based on MKE estimation*

Fig 87: … and they only form a small part of the system
Relative size of life insurance sector assets in 2016



Source: CBRC, CIRC, NBS, Maybank Kim Eng #On-balance-sheet assets only

They are starting to unwind concentrated stock investments…

We notice a general decline in emerging insurers' equity exposure in 2016, which should partially alleviate investors' concerns on their concentration risk. With CIRC's tightening stock investment rules in place (please refer to our earlier report: *"Putting the Brakes on Aggressive Stock Investments"*), we expect continuous unwinding of excessive stock positions. Since a two-year grace period is given to emerging insurers to comply with the new rules, we do not expect this to trigger panic selling.

Fig 88: Emerging insurers have started to trim equity exposure amid CIRC's stricter stock investment rules

Asset allocation	Anbang Life (consolidated)		Anbang Life (unconsolidated)		Huaxia Life		Funde Sino Life		Hexie Health		Qianhai Life	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Low to medium risk	**60%**	**56%**	**37%**	**35%**	**30%**	**41%**	**27%**	**27%**	**57%**	**43%**	**34%**	**46%**
Cash & deposits	18%	19%	34%	31%	15%	20%	12%	12%	49%	14%	19%	23%
Bonds	40%	33%	1%	1%	14%	16%	8%	7%	4%	27%	4%	2%
Policy loans	1%	2%	0%	1%	0%	0%	1%	1%	0%	0%	3%	2%
Debt schemes	1%	0%	2%	1%	0%	1%	0%	0%	4%	2%	0%	0%
Properties	1%	1%	1%	1%	1%	4%	6%	7%	0%	0%	8%	20%
High risk	**40%**	**44%**	**63%**	**65%**	**70%**	**59%**	**73%**	**73%**	**43%**	**57%**	**66%**	**54%**
Equities	21%	18%	48%	32%	52%	37%	68%	56%	25%	20%	30%	27%
- Funds & stocks	*11%*	*11%*	*11%*	*12%*	*40%*	*19%*	*13%*	*5%*	*14%*	*14%*	*20%*	*11%*
- Associates & JVs	*10%*	*8%*	*37%*	*20%*	*11%*	*15%*	*53%*	*49%*	*12%*	*6%*	*11%*	*16%*
- Unlisted equities	*0%*	*0%*	*0%*	*0%*	*1%*	*4%*	*2%*	*2%*	*0%*	*0%*	*0%*	*0%*
WMPs & trusts	0%	6%	0%	12%	16%	21%	5%	18%	1%	4%	6%	3%
REPOs	6%	10%	14%	20%	2%	1%	1%	0%	16%	33%	5%	4%
Others	13%	10%	0%	0%	0%	0%	0%	0%	1%	0%	25%	20%

Source: Company data, Maybank Kim Eng

… and allocation to ST assets to match liabilities

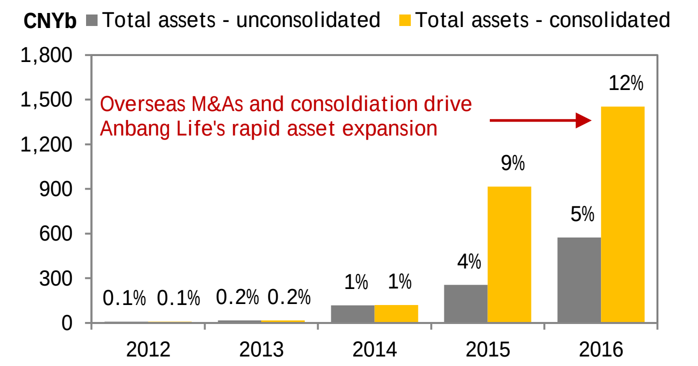
To mitigate the pressure from lower investment yields, emerging insurers have allocated more into REPO assets and WMPs/trusts to lock in higher rates. While the asset quality risk of such assets may still be high, we believe such move is good for emerging insurers because: 1) this helps diversify their investment portfolio; and 2) these assets have short duration and generate recurring interest income to better match policy reserve liabilities.

In the long term, we expect emerging insurers to further diversify their allocation to less risky fixed-income assets such as bonds and debt schemes when they overcome their near-term liquidity pressure and lengthen liability duration through selling more LT products.

Impact from Anbang Life's potential failure is less than feared

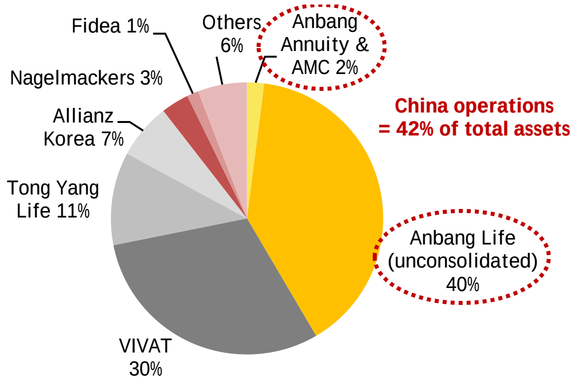
Among emerging insurers, Anbang Life (and Anbang Group) would attract the most attention from investors given its unique political background, large operational scale, rapid asset growth, and aggressive overseas acquisitions. Anbang Life's total assets grew 177x from only CNY8.1b in 2012 to CNY1.45t in 2016, only slightly behind Ping An Life's CNY1.86t. However, we believe investors have overestimated the scale of its domestic operations given that a large part of its asset expansion has been supported by overseas M&As.

Fig 89: Overseas M&As drive Anbang's rapid expansion…
Anbang Life's share of life insurance sector assets in 2012-16



Source: Company data, CIRC, Maybank Kim Eng

Fig 90: … and have low contagion impact on the system
Breakdown of Anbang Life's consolidated total assets in Dec 2016

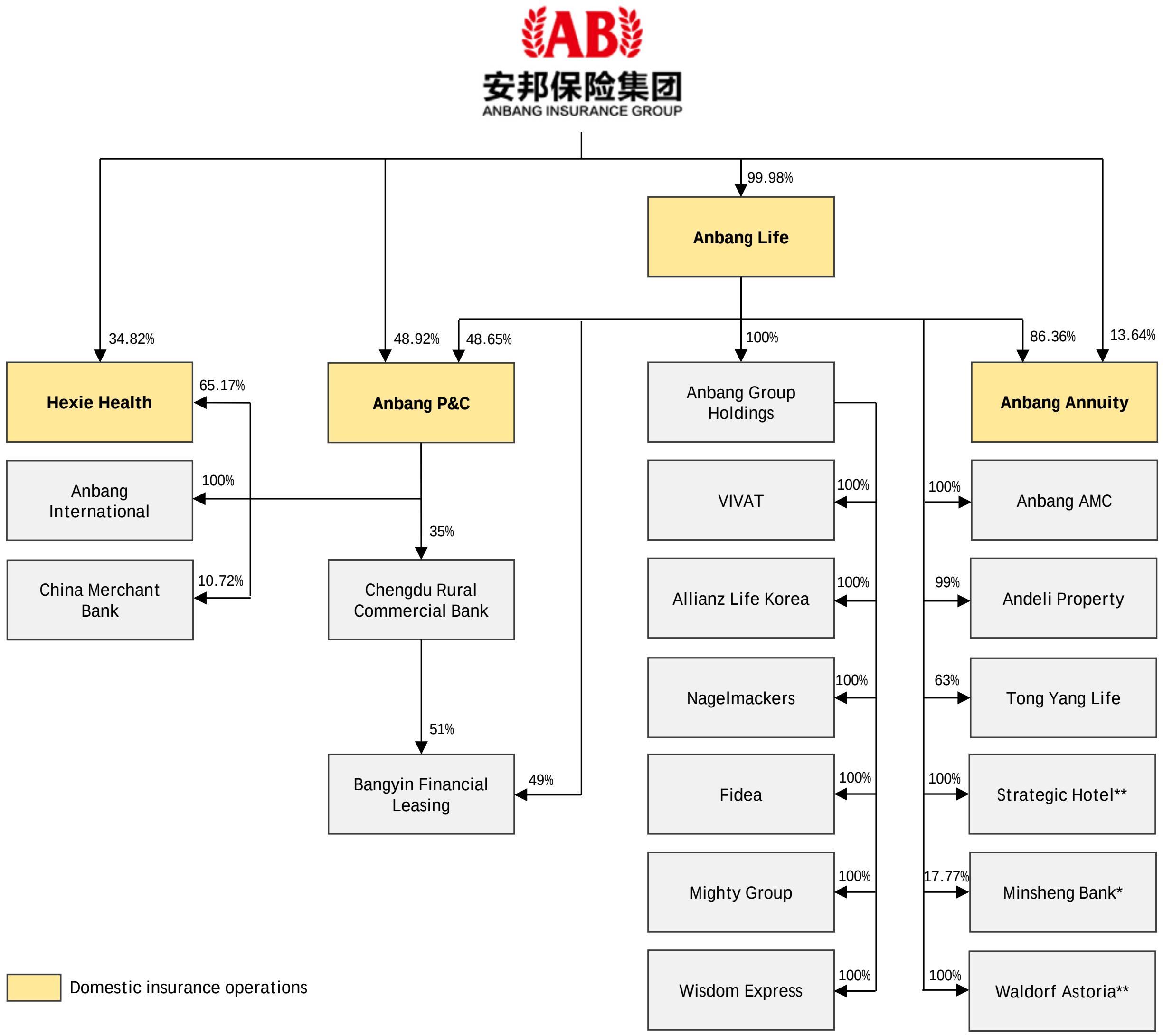


Source: Company data, media reports, Maybank Kim Eng

We estimate that China operations only accounted for 42% of Anbang Life's total assets as of Dec 2016. Its domestic assets only amounted to CNY603b as of Dec 2016 (similar to NCI's CNY699b), which represented only 5% of the life sector's assets. Since its overseas subsidiaries have nearly no operations in China, they are unlikely to impact the stability of the financial system.

However, the key concern for Anbang Life is whether the company holds enough cash at the group level to pay off surrenders and maturing policy contracts, as its overseas subsidiaries may not be able to freely remit cash to the group level given that most of them are operating in the financial sector with strict regulations on the use of capital. We notice that Anbang Life allocated 31% of its investment assets as of Dec 2016 on unconsolidated basis (i.e. at the group level), which was the highest among emerging insurers. Therefore, we believe the risk should be manageable.

Fig 91: Organisation structure of Anbang Insurance Group



*Source: Company data, Maybank Kim Eng. *Jointly held by Anbang Insurance Group, Anbang Life and Anbang P&C; **Insufficient disclosure on the ownership structure*

Fig 92: Major subsidiaries of Anbang Life *(2016 figures)*

Major subsidiaries	Region	Business	Ownership	Currency	Registered capital	Total assets	Net assets	Net profit
Directly controlled								
Tong Yang Life	South Korea	Insurance	63%	KRWb	538	26,721	1,836	12
Anbang Annuity	China	Insurance	86%	CNYm	3,300	28,525	4,368	222
Anbang AMC	China	Asset mgmt.	52.5%	CNYm	600	916	778	67
Anbang Group Holdings	Hong Kong	Investment	100%	HKDm	15,000	na	na	na
Andeli Property	China	Property	99%	CNYm	10	na	na	na
Indirectly controlled								
VIVAT	Netherlands	Insurance	100%	EURm	0.24	60,328*	3,451*	109*
Allianz Korea	South Korea	Insurance	100%	KRWb	12	16,650*	9,900*	(87)*
Nagelmackers	Belgium	Banking	100%	EURm	391	6,598*	358*	na
Fidea	Belgium	Insurance	100%	EURm	221	2,744*	382*	42*
Mighty Group	Hong Kong	Investment	100%	HKD	1	na	na	na
Wisdom Express	Hong Kong	Investment	100%	HKD	1	na	na	na

*Source: Company data, media reports, Maybank Kim Eng *2015 figures*

4.5 Our TPs have factored in EV discount on B/S risks

To recap, our TPs have already factored in EV write-offs on a potential market crash scenario to happen, assigning 20% probability. This produces around 6-11% EV discount on our TP valuation.

Fig 93: TP discount on B/S risks - we assign 20% probability for our market crash scenario

2017E	China Life	Ping An Group	CPIC	PICC Group	PICC P&C	NCI	CTIH
Cash & deposits	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bonds	-4.4%	-2.5%	-4.1%	-3.9%	-3.3%	-2.5%	-3.1%
Policyholders' loans	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bank loans	0.0%	-1.4%	0.0%	0.0%	0.0%	0.0%	0.0%
Debt schemes	-0.1%	-0.3%	-0.3%	-0.6%	-0.3%	0.0%	-0.6%
Properties	0.0%	-0.3%	-0.3%	-0.4%	-0.4%	-0.2%	-1.2%
Equities	-5.6%	-2.7%	-3.2%	-8.7%	-8.1%	-5.1%	-4.3%
WMPs & trusts	-0.5%	-0.3%	-0.6%	-0.7%	-0.4%	-1.8%	-0.2%
REPOs & others	-0.3%	-0.3%	-1.2%	0.0%	0.0%	-0.2%	-0.4%
Sub-total	**-11.0%**	**-7.9%**	**-9.6%**	**-14.3%**	**-12.6%**	**-9.8%**	**-9.8%**
Share of MI & participating	3.3%	3.5%	3.9%	5.7%	0.0%	3.0%	3.9%
Impact on investments	**-7.7%**	**-4.3%**	**-5.8%**	**-8.6%**	**-12.6%**	**-6.8%**	**-5.9%**
Impact on book value	**-69%**	**-54%**	**-44%**	**-53%**	**-39%**	**-77%**	**-58%**
Impact on EV	**-38%**	**-39%**	**-31%**	**-55%**	**-39%***	**-48%**	**-36%**
Solvency ratio (before)	301%	210%	294%	292%	302%	278%	na
Solvency ratio (after)	153%	127%	184%	158%	192%	143%	na
Impact on solvency ratio	**-149%**	**-83%**	**-110%**	**-134%**	**-110%**	**-135%**	**na**
Impact on EV	**-38%**	**-39%**	**-31%**	**-55%#**	**-39%***	**-48%**	**-36%**
Assigned probability	20%	20%	20%	20%	20%	20%	20%
TP discount on B/S risks	**-8%**	**-8%**	**-6%**	**-11%#**	**-8%**	**-10%**	**-7%**

*Source: Maybank Kim Eng *Book value is used #We apply 9% blended discount on PICC Group's SOTP valuation (11% for Life & Health and 8% for P&C)*

Fig 94: Assumptions in our market-crash stress test

Asset class	Key assumptions
Cash & deposits	▪ No defaults
Government bonds	▪ **Trading/AFS bond MTM:** 200bp parallel yield spike, equivalent to a 10% price drop (5Y avg duration * 200bps) ▪ **HTM bond impairments:** 100% recovery rate even in a default
Financial bonds	▪ **Trading/AFS bond MTM:** 300bp parallel yield spike for 33% of bonds, equivalent to a 15% price drop (assuming these are issued by policy banks); 350bp parallel yield spike for 67% of bonds, equivalent to a 17.5% price drop ▪ **HTM bond impairments:** 100% recovery rate for 33% of bonds even if in a default (assuming these are issued by policy banks); 11.05% default rate for 67% of bonds with 49% recovery rate
Corporate bonds	▪ **Trading/AFS bond MTM:** 400bp parallel yield spike, equivalent to a 20% price drop ▪ **HTM bond impairments:** 11.05% default rate with 49% recovery rate
Policyholders' loans	▪ 100% recovery rate even in a default
Bank loans & debt schemes	▪ **Corporate loans/mortgages/debt schemes:** 11.05% default rate with 63% recovery rate ▪ **Consumer loans:** 5% NPL write-off with no recovery
Properties	▪ 30% drop in prices
Equities	▪ **Stocks & funds/other equities:** 30% drop in prices ▪ **Associates & JVs:** marked to market, assuming a 30% drop in share prices
WMPs & trusts	▪ 22.1% default rate with 63% recovery rate
REPOs & other debts	▪ 11.05% default rate with 49% recovery rate

Source: Maybank Kim Eng
Key assumptions:
***Default rate**: We set an 11.05% default rate for non-sovereign debts; we double the default rate assumption (22.1%) for WMPs and trusts given their higher risk. 11.05% = peak default rate of global high-yield corporate bonds during 1981-2015 according to S&P, which is close to the "real NPL ratio" implied by Chinese bank valuation.*
***Recovery rate**: We set a 63% recovery rate for corporate loans, debt schemes, WMPs & trusts; 49% recovery rate for bonds, REPOs and other debts. 80%/63%/49% = the average ultimate recovery rate of global corporate loans/senior secured bonds/senior unsecured bonds during 1987-2015, according to Moody's.*

5. Valuation and recommendation

We maintain our POSITIVE sector view and continue to prefer lifers over P&C players. Despite the strong share price performance YTD, Chinese lifers still trade at an ex-growth valuation of below 1x 2017E P/EV (Ping An slightly above 1x), which is unjustified given their strong VNB and accelerating protection upgrades. However, given the CIRC's recent product regulations and more macro uncertainties in 2H17, we suggest investors to stick with quality lifers with a strong agency franchise and consistent focus on the protection business.

Ping An/CPIC remain our top picks, and we see CPIC's laggard share price performance YTD as unjustified. We maintain SELL on PICC P&C due to concerns about auto combined ratios and weak new car sales. However, we are not an aggressive seller of the stock, as tougher regulations may eventually spill over to the P&C segment to clamp down irrational pricing in the auto insurance market.

Fig 95: HK/China insurance sector – stock pecking order

#	Stock	Ticker	Rating	TP	Valuation	Investment thesis
1	CPIC	2601 HK	BUY	38.50	SOTP	We think its below-peers YTD share price performance is unjustified given its high quality and strong growth in life operations. 1Q17 new sales remained strong with agency regular FYP growth of 67%, which should adequately support its full-year VNB growth. While the P&C segment could remain muted, it accounts for only 9% of valuation vs life's 86%.
2	Ping An	2318 HK	BUY	57.00	SOTP	Ping An remains our sector top BUY given its best-in-class life franchise with strong focus on protection. In the long term, we expect the valuation gap between AIA and Chinese lifers to narrow as the latter's earnings quality improve, and Ping An will be the first to close the gap. Besides, PAB's retail transformation and stabilising asset quality could help alleviate concerns, in our view. We pegged PAB to only 0.64x 2017E P/EV (7% of valuation vs life's 73%).
3	CTIH	966 HK	BUY	25.00	SOTP	Having the sector-low valuation and a strong VNB outlook, CTIH remains an attractive laggard with limited downside risks, in our view. Meanwhile, its "H-share only" listing status could continue to draw attention from future southbound fund flows. Its 84% agency in-force APE growth in 1Q17 should easily support our 2017E VNB growth forecast of 21%.
4	AIA	1299 HK	BUY	61.00	AV*	AIA achieved a strong VNB growth of 53% YoY on actual FX basis in 1QFY17E. Such exceptional growth could indicate that HK's sales momentum extended into Jan and Feb 2017 and onshore China new business growth accelerated. With lower capital control fears YTD and rising VNB contribution from China operations, we see upside catalysts emerging.
5	NCI	1336 HK	BUY	46.50	P/EV	We see more visible operational improvements from NCI's business transformation. Agency new business sales were promising in 1Q17, which supported a 22% NB APE growth. We also observed better trends in agency force, surrender rate and VNB sensitivity metrics. However, NCI's high B/S risks remain our major hesitation on this BUY call.
6	China Life	2628 HK	HOLD	26.50	P/EV	China Life is the best proxy for rising yields. Share price has led peers YTD amid reflation expectation, but concerns remain on its less prudent EV assumptions and product strategy. Meanwhile, potential consolidation of Guangfa Bank could limit the share price upside. Given CIRC's tighter rules on savings products, we suggest investors to shift to quality lifers.
7	PICC Group	1339 HK	HOLD	3.30	SOTP	PICC trades at close to the market value of its PICC P&C stake, suggesting the market awards a low value to its life/health units. However, the quality of its life/health operations is still far behind peers, and a deep restructuring is necessary for the group to justify a re-rating. It is still too early to anticipate its A-share IPO given the uncertain timing and scale.
8	PICC P&C	2328 HK	SELL	11.00	P/BV	We still keep our SELL rating on PICC P&C due to the concerns on auto combined ratio deterioration and slower new car sales. However, we are not an aggressive seller of the stock as policy risks have eased YTD. As risk prevention plays a more significant role in policymakers' agenda, it is unlikely to see dramatic deregulation in the near term even if the new auto pricing rules come in place in 2H17, in our view.

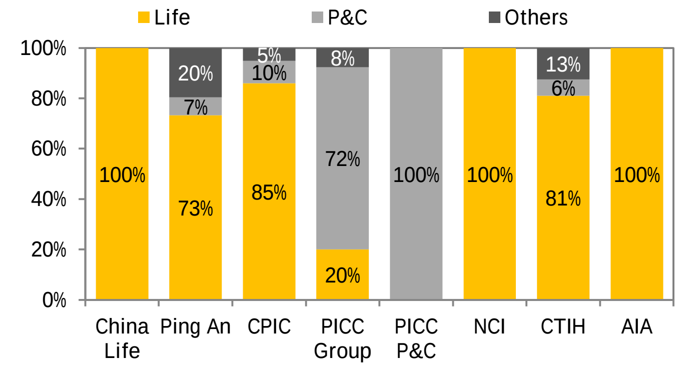
*Source: Maybank Kim Eng. *AV = Appraisal value methodology*

Fig 96: Valuation summary *(as of 1 Jun 2017)*

				Last		PB (x)			P/EV (x)			EV growth#			VNB (x)			VNB growth#		
Name	Ticker	Rating	TP	price	Upside	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
China Life	2628 HK	HOLD	26.50	25.40	4%	2.17	2.09	1.95	0.99	0.87	0.74	7%	16%	17%	(0.2)	(1.7)	(3.3)	57%	20%	18%
Ping An	2318 HK	BUY	57.00	50.45	13%	2.15	1.94	1.70	1.30	1.11	0.93	25%	19%	19%	3.7	1.3	(0.8)	49%	27%	23%
CPIC	2601 HK	BUY	38.50	31.10	24%	1.92	1.86	1.59	1.03	0.91	0.72	13%	16%	16%	0.3	(1.1)	(3.3)	57%	24%	21%
PICC Group	1339 HK	HOLD	3.30	3.32	-1%	1.02	1.00	0.91	0.90	0.87	0.77	10%	15%	14%	(4.4)	(4.2)	(7.6)	47%	14%	15%
PICC P&C	2328 HK	SELL	11.00	12.92	-15%	1.44	1.30	1.16	na	na	na	na	na	na	na	na	na	n/a	na	na
NCI	1336 HK	BUY	46.50	42.35	10%	2.00	1.89	1.73	0.91	0.78	0.66	17%	19%	19%	(1.1)	(2.6)	(4.2)	30%	22%	18%
CTIH	966 HK	BUY	25.00	20.70	21%	1.45	1.34	1.21	0.73	0.65	0.56	9%	12%	15%	(3.1)	(3.7)	(4.4)	50%	21%	20%
AIA	1299 HK	BUY	61.00	55.30	10%	2.46	2.26	2.09	2.04	1.82	1.62	10%	12%	12%	15.9	11.9	8.5	25%	18%	19%

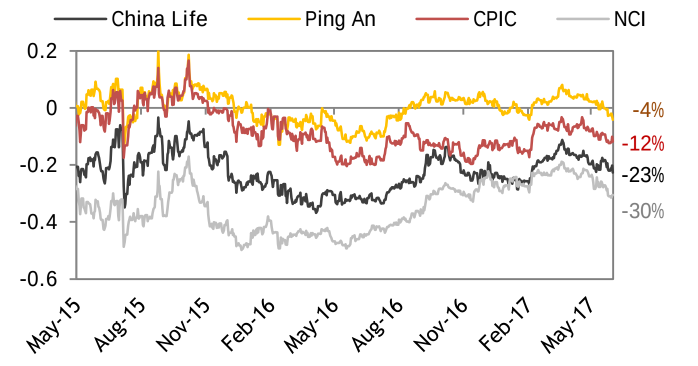
Source: Company data, Bloomberg, Maybank Kim Eng #FY16 EV/VNB growth for Chinese insurers are underlying growth excl. C-ROSS impact and EV assumption changes

Fig 97: TP valuation breakdown



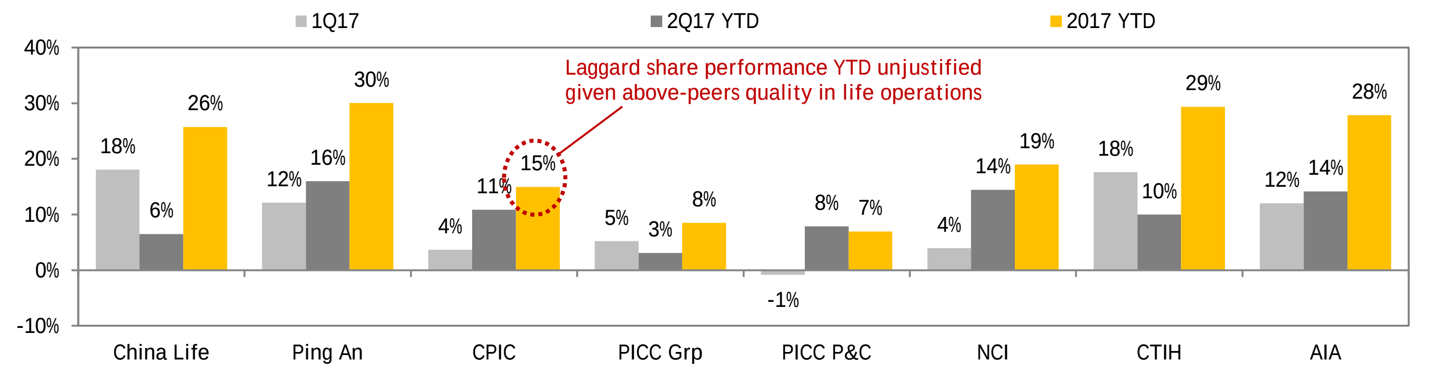
Source: Maybank Kim Eng

Fig 98: H-to-A share discount *(as of 1 Jun 2017)*



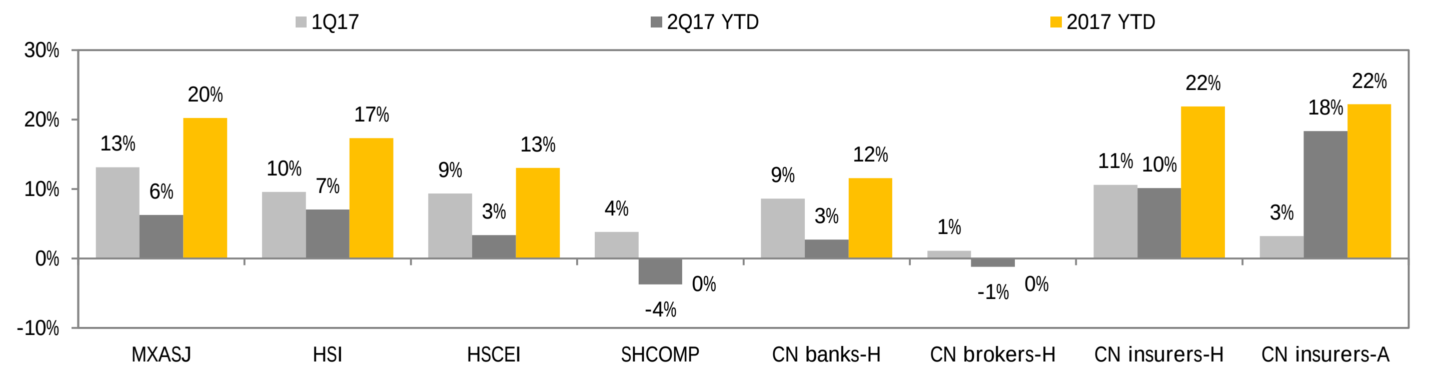
Source: Bloomberg

Fig 99: Share performance YTD – H-share insurers *(as of 1 Jun 2017)*



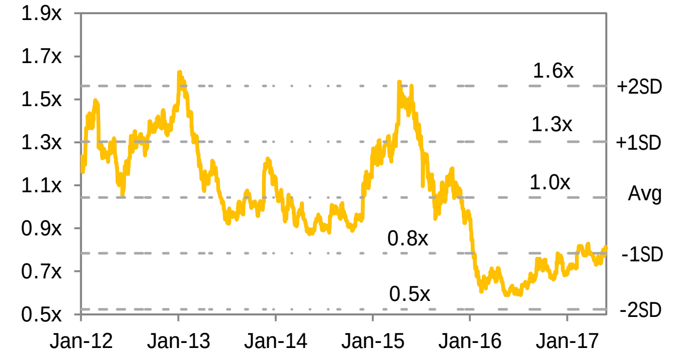
Source: Bloomberg, Maybank Kim Eng

Fig 100: Share performance YTD – China financial sector* vs the market *(as of 1 Jun 2017)*



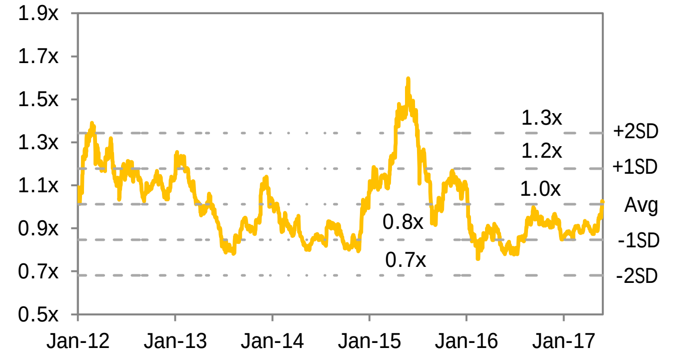
*Source: Bloomberg, Maybank Kim Eng *Market cap weighted sector performance*

Fig 101: China Life – 12-month forward P/EV



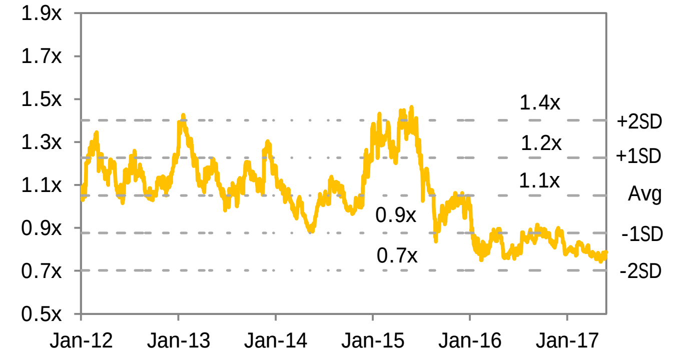
Source: Bloomberg, company data, Maybank Kim Eng

Fig 102: Ping An – 12-month forward P/EV



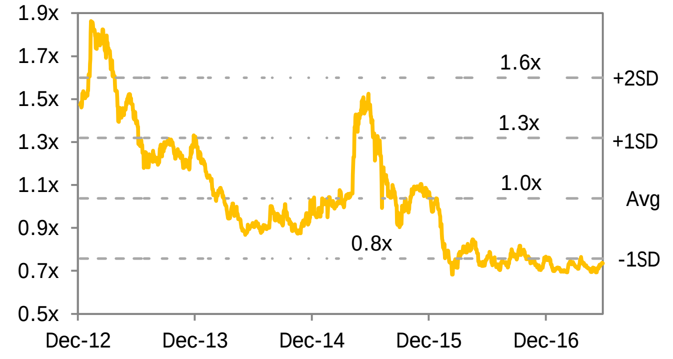
Source: Bloomberg, company data, Maybank Kim Eng

Fig 103: CPIC – 12-month forward P/EV



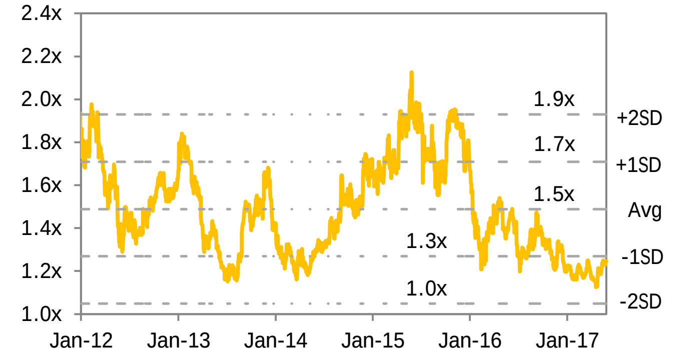
Source: Bloomberg, company data, Maybank Kim Eng

Fig 104: PICC Group – 12-month forward P/EV



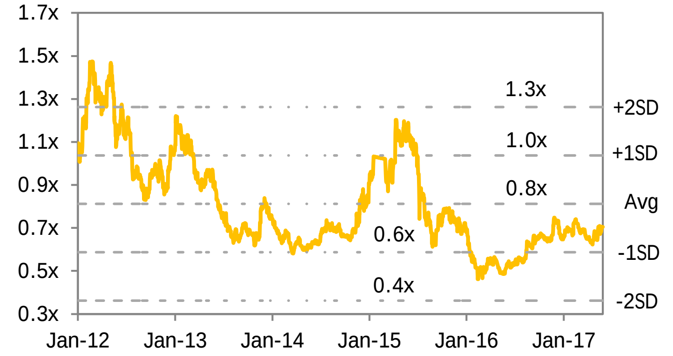
Source: Bloomberg, company data, Maybank Kim Eng

Fig 105: PICC P&C – 12-month forward P/BV



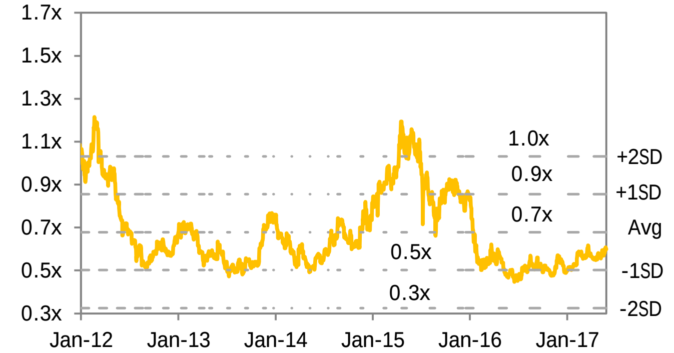
Source: Bloomberg, company data, Maybank Kim Eng

Fig 106: NCI – 12-month forward P/EV



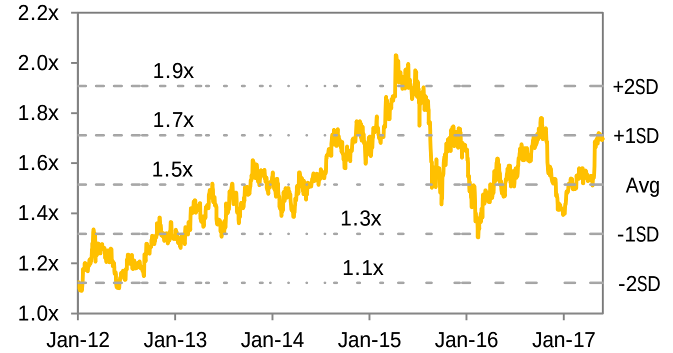
Source: Bloomberg, company data, Maybank Kim Eng

Fig 107: CTIH – 12-month forward P/EV



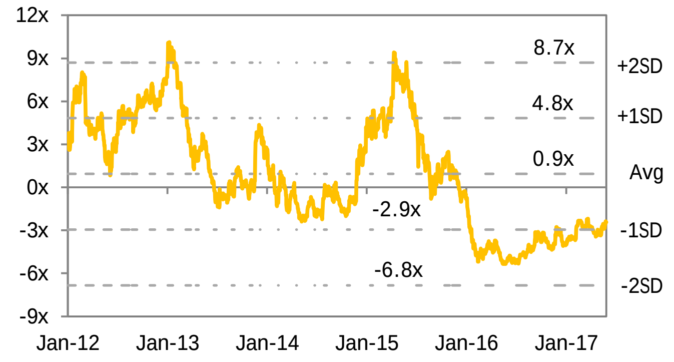
Source: Bloomberg, company data, Maybank Kim Eng

Fig 108: AIA Group – 12-month forward P/EV



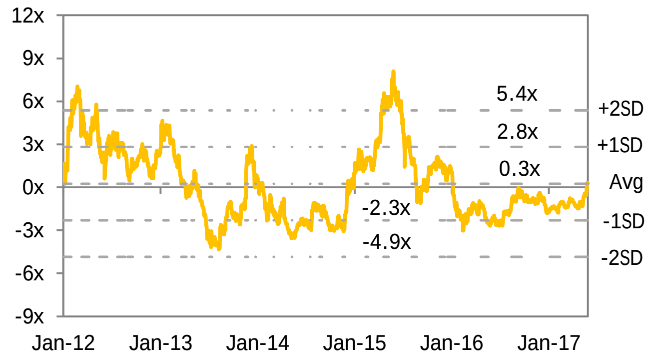
Source: Bloomberg, company data, Maybank Kim Eng

Fig 109: China Life – 12-month forward NB multiple



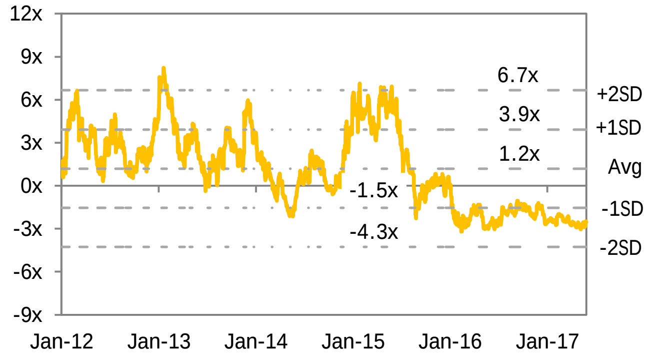
Source: Bloomberg, company data, Maybank Kim Eng

Fig 110: Ping An – 12-month forward NB multiple



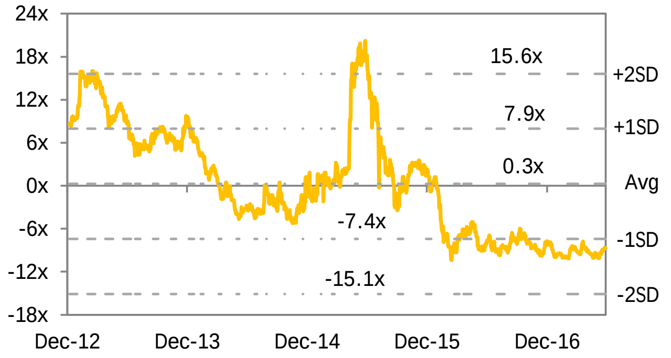
Source: Bloomberg, company data, Maybank Kim Eng

Fig 111: CPIC – 12-month forward NB multiple



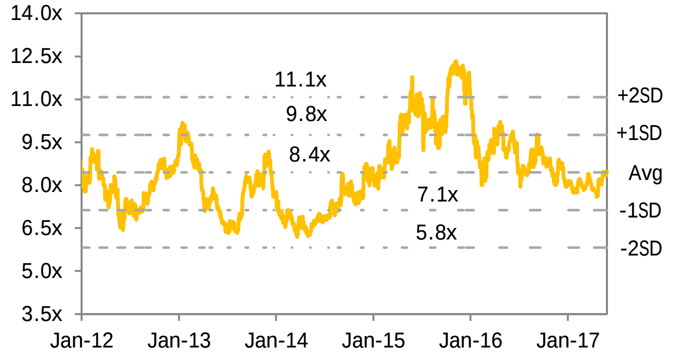
Source: Bloomberg, company data, Maybank Kim Eng

Fig 112: PICC Group – 12-month forward NB multiple



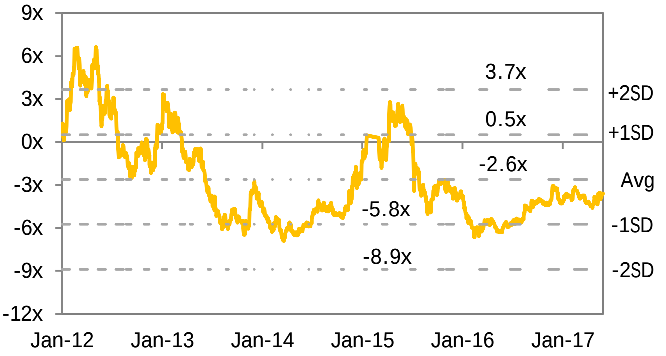
Source: Bloomberg, company data, Maybank Kim Eng

Fig 113: PICC P&C – 12-month forward P/E



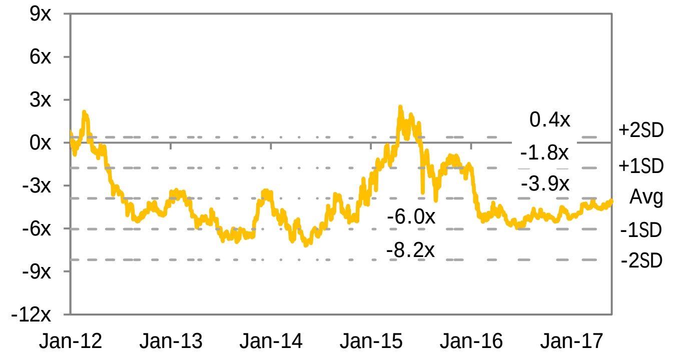
Source: Bloomberg, company data, Maybank Kim Eng

Fig 114: NCI – 12-month forward NB multiple



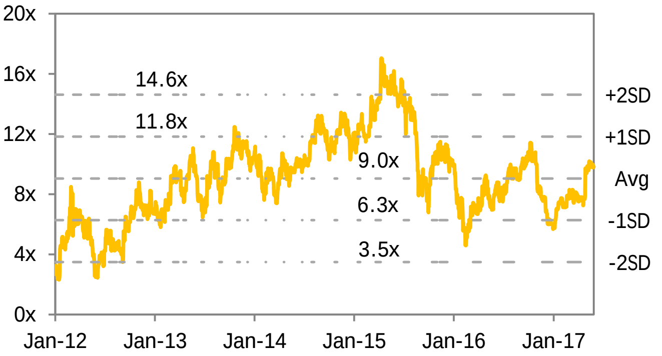
Source: Bloomberg, company data, Maybank Kim Eng

Fig 115: CTIH – 12-month forward NB multiple



Source: Bloomberg, company data, Maybank Kim Eng

Fig 116: AIA Group – 12-month forward NB multiple



Source: Bloomberg, company data, Maybank Kim Eng

Appendix I: Recent regulatory developments

Fig 117: Major regulations/documents published by the CIRC

Date	Regulation/document	Highlights
PRODUCT DESIGN		
18-Mar-16	Regulations on high-cash-value (HCV) life products (Doc 22 [2016])	▪ Defines HCV as 1) survival benefits exceeding premiums paid in first 4 years; and 2) 60% expected lapse ratio in 5 years. ▪ Impose sales quotas on HCV products with 5-year transition period: 1) aggregate quota on all products set at 2x the net assets or registered capital (whichever is higher); 2) quota on 1-3 year products set at 90%/70%/50% of the aggregate quota in 2016/17/18+; 3) sales suspension on all <1 year products. ▪ Introduces solvency requirements on HCV products: comprehensive/core ratio > 100%/50%. ▪ *MKE comments: "Bridging the Quality Gap" (page 18-21)*
6-Sep-16	Strengthening regulations on life products and actuarial system (Doc 76 & 199 [2016])	▪ Tightens pricing regulations in universal life products: 1) lower guaranteed rate cap to 3% from 3.5%; 2) require crediting rate to not exceed gross investment yield if actual yield falls short for 3 months. ▪ Prohibits designing whole life, annuity and LT care products as HCV products from 1 Jan 2017. Raise death benefit of these products to at least 120-160% of premiums paid/cash value (vs previously 120%). ▪ Imposes new sales quota on 1-3Y HCV products at 50%/40%/30% of total premiums (GWP + deposits) in 2019/20/21+. ▪ Caps policy loan size at 80% of cash value/account balance. Prohibit new product issuance with negative VNB. ▪ *MKE comments: "Bridging the Quality Gap" (page 18-21)*
30-Dec-16	Further strengthening regulations on life products (Doc 113 [2016])	▪ New insurers starting operation from 1 Jan 2017 can only sell traditional life products in the first year. ▪ Suspends insurer from opening new branches for one year for aggressive sales behaviours: 1) quarterly HCV product sales exceeding 50% of total premiums (GWP + deposits); 2) quarterly GWP accounting for <30% of total premiums (GWP + deposits); 3) experience of abnormal surrender events last year; or 4) non-compliance with the current regulations. ▪ Requires insurers to submit a self-check report before 20 Jan 2017 and monthly HCV sales report from 1 Jan 2017. ▪ *MKE comments: "Bridging the Quality Gap" (page 18-21)*
Mid Jan-17	Suspension on non-life savings products (*Media reports*)	▪ Suspend the pilot program on non-life savings products.
16-May-17	Standardising the design of life products (Doc 134 [2017])	▪ Suspends the sale of 1) "quick cash-back" endowment/annuity products (i.e. distributing survival benefit within first 5Y; annual survival benefit exceeding 20% of premiums paid); and 2) bundled products with universal/linked riders. ▪ New products need to follow the rules immediately. A grace period is given to existing products until 1 Oct 2017. ▪ *MKE comments: "Further Tightening in Savings Products" and the section "New rules to close the loopholes in ST* savings products" in this report.
19-May-17	Strengthening supervision on the sales of life products (Doc 136 [2017])	▪ Requires life insurers to self-check the compliance issues on the sales of life products before 30 Jun 2017, focusing on product management, information disclosure, marketing and promotion, customer reviews and policy renewals, etc. ▪ CIRC will suspend local insurance branch's new business for 3-12 months if it seriously violates regulations, such as: false advertising, hunger marketing on to-be-suspended life products, verbal promise on non-guaranteed returns, promoting life products as bank WMPs/deposits or funds, occurrence of abnormal surrender events due to mis-selling and offering products on unqualified third-party online platforms, etc. ▪ CIRC will suspend insurer's new business at the group level for 3-12 months if more than two branches get suspended. ▪ Direct responsible persons will be penalised in the form of salary freeze, demotion, suspension of duty or dismissal.
INVESTMENT		
End May-16	Suspension of insurance AM subsidiaries' conduit business (Doc 97 [2016])	▪ Suspended insurance AM subsidiaries' conduit business (通道业务) from end-May and require insurers to self-check their business by 31 Jul 2016.
22-Jun-16	Strengthening regulations on insurance AM products (Doc 104 [2016])	▪ Prohibits insurance AM subsidiaries from launching products with fund-pooling (资金池) or multi-layer (嵌套) features. ▪ Restricts insurers from selling structured AM products to individual investors. For institutional investors, the leverage cap is 1x for equity/hybrid-type structured products and 3x for other structured products. ▪ Bans insurers from entrusting the investment function to external parties or managing AM products in a parent/sub-account format. Besides, insurers are required to specify the asset allocation of their AM products.
24-Jan-17	Strengthening supervision on stock investments (Doc 9 [2017])	▪ Lowers equity allocation cap to 30% from 40% and single-stock cap to 5% from 10%; allow for 2Y transition period. ▪ Classify stock investments as ordinary investments (<20% stake), major investments (≥20% stake), and takeovers (controlling stake), with different solvency requirements. ▪ Prohibits the use of insurance fund for major stock investments/takeovers; ban joint takeovers with non-insurance parties acting in concert; require pre-approval for takeovers; prohibit takeovers funded by stock-pledged loans. ▪ *MKE comments: "Putting the Brakes on Aggressive Stock Investments"*
5-May-17	Notice on insurance fund investment in PPP projects (Doc 41 [2017])	▪ Allows insurers to invest in public-private-partnership (PPP) projects in the form of debt, equity or debt-equity hybrid investment schemes; specify requirements on PPP project investments. ▪ Speeds up approvals for PPP project investments in strategic areas, including One Belt One Road initiatives, Beijing-Tianjin-Hebei co-development, Yangtze River economic zone, Xiongan new district development and poverty-alleviation projects.
22-May-17	Notice on debt schemes investing in major projects (Doc 135 [2017])	▪ Exempts credit enhancement requirement for debt schemes in water conservancy, energy, transportation, hi-tech and advanced manufacturing from AAA-rated projects. Speed up approvals for debt schemes in strategic areas.

CORPORATE GOVERNANCE		
8-Jul-16	Disclosure on related-party transactions (Doc 52 [2016])	▪ Requires disclosure on related-party transactions of >CNY30k with natural persons and >CNY300k with legal persons.
28-Dec-16	Notice on the establishment of a public inquiry system (Draft for comments)	▪ Specifies that the scope of public inquiry should cover matters that involve public interests or are likely to result in major risks, such as corporate governance, business operations and insurance fund investments, etc.
29-Dec-16	Administrative measures for shareholders of insurers (Draft for comments)	▪ Reduces the single-shareholder ownership cap on insurers to 33.3% from 51%. ▪ Defines shareholders as financial, strategic or controlling shareholders, and impose stricter criteria for shareholders and their funding source.
12-Jan-17	Guidance on article of association (2nd draft for comments)	▪ Strengthens shareholders' rights and obligations, and clarify the voting mechanism; enhance the role of independent directors and the board of supervisors; and introduce a "living will" system to prevent governance risks. ▪ Emphasise shareholders' duty to take action in the case of insurer's insolvency or any risk events.
RISK INSPECTION		
13-Oct-16	Risk inspection on Internet insurance products (Doc 31 [2016])	▪ Starts inspection on the risks of Internet-channel universal life products, especially HCV products. ▪ Starts inspection on illegal cooperation with unqualified third-party online platforms, such as P2P platforms with illegal credit enhancement, pool-funding and fund-raising activities; inspect guarantee insurance on online financing. ▪ Penalises the illegal use of the name of insurance to raise money on Internet.
24-Jan-17	Requiring insurers to reduce the cost of liabilities (*Media reports*)	▪ Requires 15 insurers to maintain pricing discipline during the open-year sales period and lower their cost of liabilities.
1-Mar-17	Inspection on systemic risks (*Media reports*)	▪ Starts inspection on 182 insurers from 20 Feb to end-Apr 2017, focusing on ownership structure, corporate governance, operations, strategy, internal control, related-party transactions and remuneration system, etc. ▪ Anbang, the largest emerging insurer, is also being investigated.
20,23-Apr-17	Strengthening risk prevention in insurance industry (Doc 34 & 35 [2017])	▪ Alerts 9 key risks facing the insurance industry, including liquidity risk, investment risk, strategic risk, new insurance business risk, external contagion risk, public event risk, data accuracy risk, illegal capital risk, and reputational risk. ▪ *MKE comments: "Lifers' Fundamentals Remain Intact Despite Policy Overhangs"*
28-Apr-17	Further regulations to rectify market irregularities (Doc 40 [2017])	▪ Starts a large-scale inspection on improper use of insurance fund, fake capital injection, insufficient corporate governance, aggressive investments, unregulated product innovation, mis-selling, poor customer services, fraudulent sales practices and financial frauds.
7-May-17	Building a prudent and effective supervision system (Doc 44 [2017])	▪ Reiterated CIRC's determination in closing the current regulatory loopholes.
9-May-17	Inspection on insurance fund (Doc 128 [2017])	▪ Starts inspection on insurance fund investments, focusing on compliance risk, regulatory arbitrage, transfer of benefits, asset quality issue and asset-liability mismatch.
15-May-17	Inspection on customer services (Doc 133 [2017])	▪ From Jun to mid-Oct 2017, local CIRC units will conduct on-site inspections (亮剑行动) on 16 insurers' 46 local branches and 7 bancassurance units with poor ranking for customer complaints in the past two years. ▪ The inspections will focus on mis-selling behaviours, invalid customer information and poor claim services.
23-May-17	Inspection on C-ROSS implementation (Doc 111 [2017])	▪ Starts inspection on the implementation of C-ROSS regime and identify the loopholes and shortcomings of the current solvency framework for further optimisation.

Source: CIRC, media reports, Maybank Kim Eng

Appendix II: Products affected by CIRC's new rules

Fig 118: Most 2017 open-year bundled insurance packages have "universal life rider" and "quick cash-back" features

	Open-year insurance package #1		Open-year insurance package #2	
	Main policy	**Rider**	**Main policy**	**Rider**
Traditional insurers				
China Life	Xin Fu Ying Jia (鑫福赢家) Traditional (3.5%) or PAR annuity (2.5%) Survival benefit: 1) 20% of FYP in 1st year; 2) 20% of sum assured p.a.	Xin Account x2 (鑫账户) Universal life (2.5%/3%)		
Ping An	Ying Yue Ren Sheng (赢越人生) PAR annuity (2.5%) Survival benefit: 1) 30% of FYP in 1st year; 2) 20% of sum assured p.a.	Ju Cai Bao (聚财宝) Universal life (1.75%)	Cai Fu Tian Ying (财富天赢) PAR annuity (2.5%) Survival benefit: 1) 30% of FYP in 1st year; 2) 35% of sum assured p.a.	Ju Cai Bao (聚财宝) Universal life (1.75%)
CPIC	Zhuan Yuan Hong (东方红-状元红) PAR annuity (2.5%) Survival benefit: 1) 53% of FYP in 1st year; 2) 20% of sum assured p.a.	Cai Fu YingJia (财富赢家) Universal life (2%)	Man Tang Hong (东方红-满堂红) PAR annuity (2.5%) Survival benefit: 1) 17% of FYP in 1st year; 2) 20% of sum assured p.a.	Cai Fu YingJia (财富赢家) Universal life (2.5%)
PICC Life	Xin Xiang Zhi Zun (鑫享至尊) PAR annuity (3%) Survival benefit: 30% of sum assured p.a.	Pin Zhi Sheng Huo (品质生活) Universal life (3.5%)	Mei Hao Ying Jia (美好赢家) PAR annuity (2.5%) Survival benefit: 30% of sum assured p.a.	Pin Zhi Sheng Huo (品质生活) Universal life (3%)
NCI	Mei Li Ren Sheng (美利人生) PAR endowment (2.5%) Survival benefit: 30% of sum assured p.a. year from 3rd year	Sui Yi Ling (随意领) Universal life (2.5%)	Fu Xiang Yi Sheng (福享一生) PAR annuity (2.5%) Survival benefit: 20% of sum assured p.a.	
CTIH	Zhuo Yue Zhen Xiang (卓越臻享) PAR annuity (2.5%) Survival benefit: 1) 30% of sum assured p.a.; 2) benefits > premiums paid in 4-5Y*	Cai Fu Account (财富金/钻账户) Universal life (2.5%)	Sheng Shi Jin Xiang (盛事金享) PAR annuity (2.5%) Survival benefit: 30% of sum assured p.a.	Cai Fu Account (财富金/钻账户) Universal life (2.5%)
AIA China	Chuan Shi Jin Sheng (传世金生) PAR annuity Survival benefit: 12% of sum assured p.a.	Zhi Zun Account (智尊账户) Universal life (2%)	Quan You Yi Sheng (全佑一生) / Quan You Zhi Zheng (全佑至珍) Critical illness	
Emerging insurers				
Anbang Life	Chang Shou An Xiang (长寿安享)** Traditional annuity (3.5%) Survival benefit: 1) 200% of sum assured p.a. in 1st & 2nd year; 2) 10% of sum assured p.a. from 3rd year			
Huaxia Life	Fu Lin Men (福临门) Traditional annuity Survival benefit: 1) 20% of FYP in 1st year; 2) 20% of sum assured p.a.	Jin Guan Jia (金管家) Universal life (3.5%)	Chang Qing Shu (常青树) Critical illness	Jin Guan Jia (金管家) Universal life (3.5%)
Funde Sino Life	Xin Xiang Shi Cheng (鑫享事成) Traditional annuity (4.025%) Survival benefit: 1) 23% of FYP in 1st year; 2) 5% of sum assured p.a.	Jin Guan Jia (金管家) Universal life (2.75%)		
Qianhai Life	Li Cai Bao (理财宝) Traditional annuity Survival benefit: 1) 10% of FYP in 1st year; 2) 20% of sum assured p.a.			

Source: Company websites, media reports, Maybank Kim Eng
**Based on the return illustration table assuming base case product yields; **New product issuance suspended by CIRC*

Fig 119: The clampdown on "quick cash-back" bundled products would have 9-33% NB APE impact on listed insurers

Products affected by the clampdown on "quick cash-back" bundled products as % of 2016 NB APE + new deposits#

China Life	
New Xin Feng Endowment (Type A) 鑫丰新两全保险 (A 款)	3,806
Xin Annuity 鑫年金保险	3,094
Xin Fu Nian Nian Annuity 鑫福年年年金保险	18,372
Xin Ru Yi Annuity* (Platinum Ver.) 鑫如意年金保险 (白金版)	-
Kang Ning Whole Life* 康宁终身保险	-
Universal life + linked deposits**	126,538
Products affected	**151,810**
2016 NB APE + new deposits**	231,789
As % of 2016 NB APE + new deposits	**65%**

Ping An	
Zun Hong Ren Sheng Endowment (Par) 尊宏人生两全保险	7,019
Ping An Fu Whole Life 平安福终身寿险	9,268
Zun Yu Ren Sheng Endowment (Par) 尊御人生两全保险	-
Xin Li Endowment (Par) 鑫利两全保险	2,317
Xin Sheng Whole Life (Par) 鑫盛终身寿险	3,189
Universal life + linked deposits**	15,072
Products affected	**24,408**
2016 NB APE + new deposits	100,769
As % of 2016 NB APE + new deposits	**24%**

CPIC Life	
Jin You Ren Sheng Whole Life A (Par) 金佑人生终身寿险 A 款	14,212
Xing Fu Xiang Ban Endowment 幸福相伴两全保险	7,744
Li Ying Nian Nian Annuity (Par) 利赢年年年金保险	6,403
Hong Fa Nian Nian Annuity (Par) 鸿发年年全能定投年金	5,523
An Xing Bao Endowment 安行宝两全保险	5,272
Universal life + linked deposits**	12,399
Products affected	**32,069**
2016 NB APE GWP + deposits**	149,811
As % of 2016 GWP + deposits	**21%**

PICC Life	
Xin Li Annuity (Type B) 鑫利年金保险	4,415
Xing Fu Bao Annuity 幸福保年金保险	1,619
Wu You Yi Sheng Critical Illness 无忧一生重大疾病保险	1,462
Xin Ding Annuity 鑫鼎年金保险	878
Xin Xiang Zhi Zun Annuity (Par) 鑫享至尊年金保险（分红型）	855
Universal life + linked deposits**	6,030
Products affected	**13,796**
2016 NB APE + new deposits**	29,759
As % of 2016 NB APE + new deposits	**46%**

NCI	
Hui Fu Bao Annuity (2nd Generation) 惠福宝二代年金	1,991
Fu Xiang Yi Sheng Annuity (Par) 福享一生终身年金保险（分红型）	4,588
Jiang Kang Wu You Critical Illness (Type C) 健康无忧 C 款重大疾病保险	4,545
Hui Xin Bao Annuity (2nd Generation) 惠鑫宝二代年金保险	1,882
Jian Kang Fu Xing Critical Illness 健康福星增额重大疾病保险	687
Universal life + linked deposits**	1,789
Products affected	**10,250**
2016 NB APE + new deposits**	27,854
As % of 2016 NB APE + new deposits	**37%**

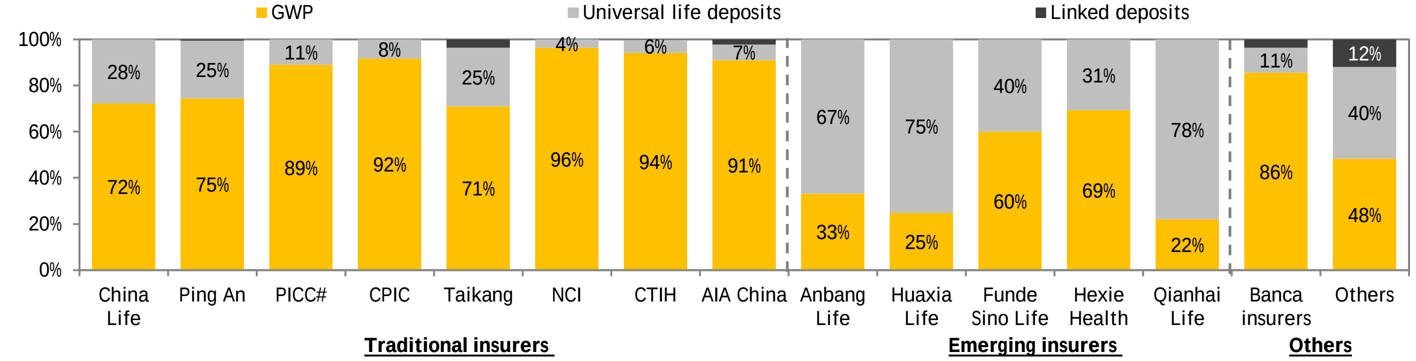
CTIH	
Wen Ying Yi Sheng Annuity (Type A) 稳赢一生 A 款年金保险	1,778
Chang Xiang Shi Jia Endowment (Par) 畅享世家两全保险 (分红型)	2,270
Jin Sheng Heng Ying Annuity (Par) 金生恒赢年金保险 (分红型)	1,590
Ying Sheng Endowment* Type C (Par) 盈盛两全保险 C 款(分红型)	-
Zhuo Yue You Xiang Annuity* (Par) 卓越优享终身年金保险（分红型）	-
Universal life + linked deposits**	2,780
Products affected	**8,419**
2016 NB APE + new deposits**	27,099
As % of 2016 NB APE + new deposits	**31%**

AIA China	
Quan You Bei Zhi Critical Illness 全佑倍至重大疾病保险	428
Quan You Yi Sheng "6-in-1" Illness 全佑一生六合一疾病保险	17
Chuan Shi Jin Sheng Annuity (Par) 传世金生年金保险(分红型)	580
Quan You Zhi Zhen Critical Illness 全佑至珍重大疾病保险	620
Quan You Yi Sheng (Health) Critical Illness 全佑一生(倍健康)重大疾病保险	302
Universal life + linked deposits**	373
Products affected	**953**
2016 NB APE + new deposits**	34,207
As % of 2016 NB APE + new deposits	**3%**

*Source: Company data, CIRC, Maybank Kim Eng. #Based on individual insurers' disclosed NB APE from top five best-selling products and CIRC monthly premium data; *These insurance products had no new business contribution in 2016 (only renewal premiums); **We estimate new deposits (i.e. new sales) from universal life/linked products based on CIRC's monthly premium statistics, assuming 10% lapse ratio for back-book policies.*

Fig 120: Listed insurers have low universal life exposure vs emerging insurers

2016 sales breakdown in terms of GWP + deposits



Source: CIRC, Maybank Kim Eng. #Including PICC Life & PICC Health

Appendix III: Recent research reports

Fig 121: Recent research reports on HK/China insurance sector

Date	Report title
1 Jun 17	*AIA (1299 HK): Growing Broker Channel to Avoid Slowdown in HK VNB*
18 May 17	*China Insurers: Further Tightening in Savings Products*
17 May 17	*PICC Grp (1339 HK): Listing in the Home Market*
5 May 17	*China Insurers: Strong Agency Sales to Support 2017 VNB Growth*
28 Apr 17	*China Life (2628 HK): Business in Better Shape But Quality Risks Remain*
28 Apr 17	*Ping An (2318 HK): Impressive VNB Growth Sustained into 1Q17*
27 Apr 17	*AIA (1299 HK): Big VNB Surprise to Shift Focus to China Growth; U/G to BUY*
24 Apr 17	*China Insurers: Lifers' Fundamentals Remain Intact Despite Policy Overhangs*
21 Apr 17	*AIA (1299 HK): Divergent Views Could Persist, But Risks Have Decreased YTD*
30 Mar 17	*CPIC (2601 HK): 2016 Results – Strong VNB and Better P&C Profitability*
30 Mar 17	*NCI (1336 HK): More Visible Progress in 2H16 But Concerns Remain*
27 Mar 17	*AIA (1299 HK): HK Regulator Discontinued Disclosure on Offshore Sales*
27 Mar 17	*PICC Grp (1339 HK): 2016 Results – VNB Beat, But Life Quality & P&C Did Not*
27 Mar 17	*PICC P&C (2328 HK): Weak Underwriting Results Offset by Huaxia Bank Gains*
24 Mar 17	*China Life (2628 HK): 2016 Results – Strong VNB But Concerns on Assumptions*
24 Mar 17	*CTIH (966 HK): 2016 Results – Exceptional VNB Growth and First-time Dividend*
23 Mar 17	*Ping An (2318 HK): Expect Share Price to Catch Up Post Strong 2016 Results*
17 Mar 17	*Ping An (2318 HK): Bank 2016 Results – Kitchen Sinking For New Leadership*
28 Feb 17	*AIA (1299 HK): Regulatory Risks Remain Despite Better 1Q17 Visibility*
8 Feb 17	*AIA (1299 HK): Low Near-term VNB Visibility Caps Valuation Upside*
26 Jan 17	*China Life (2628 HK): Profit Warning Indicates Better 4Q16 Net Profit*
25 Jan 17	*China Insurers: Putting the Brakes on Aggressive Stock Investments*
25 Jan 17	*NCI (1336 HK): Waiting for Fundamentals to Catch Up*
23 Jan 17	*China Insurers: Marketing Feedback: Strong Interests in Lifers*
16 Jan 17	*China Insurers: More Regulated Life Markets Favors Listed Players*
12 Jan 17	*China Insurers: PICC Group's Vice Chairman under Investigation*
5 Jan 17	*AIA (1299 HK): Onshore Banks Refuse to Accept Cheques by HK Insurers*
2 Jan 17	*China Insurers: Initiation - Bridging the Quality Gap*
2 Jan 17	*AIA (1299 HK): Capital Control Fears Persist*

Source: Maybank Kim Eng

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