Q & A for 2017 Investor Day

June 26th, 2017

1. **Q: What is the amount of amortized residual margin annually? How do you choose the carrier of amortization?**

A: Profit consists of the release of residual margin and risk margin, and the return on net assets. Contribution from the return on net assets has been stable over the years, with the net assets of CPIC Life ranging from 60 to 70 billion. Residual margin constitutes the bulk of profit, while risk margin has a much smaller share. We disclosed accounting profits over the years excluding impact of discount rate curve movement, which rose from 2.4 billion in 2011 to 14.9 billion in 2016, with an annual compound growth of 44%, driven largely by amortization of residual margin.

The amortization of residual margin stretches over the entire insurance period. The choice of carriers for the amortization is based on regulations of the Ministry of Finance and CIRC in 2009, considering service types (protection or savings), and is "locked up" for the entire amortization period. The method of amortization may not be comparable across different insurers.

2. **Q: Your analysis of first-year solvency on new business is very clear. But what about the capital requirement for the same business into the second year? Does the required capital on your VIF go up over the years?**

A: The first-year required capital for new business for Q1 2017 was 12.7 billion, while the actual capital it contributed amounted to 31.6 billion, meaning a margin of 18.9 billion. Given the time difference between first-year actual capital and accounting profits, the same business will generate sufficient actual capital in the 2nd policy year. Of course, it is difficult to make a breakdown. We would recommend looking at the overall solvency. Currently, there is a healthy matching between required capital and actual capital on our in-force business, and the solvency margin ratios as of Q1 2017 slightly improved from the end of 2016.

3. **Q: How do you define long-term protection (LTP) business?**

A: Our LTP business includes whole life, term life, and long-term A/H. *Anxingbao*'s base policy offers personal accident cover, and considering consumers expectations, also features return of premiums via an endowment rider. Overall, the product provides high level of protection and is therefore included in the LTP business. *Chaonengbao* and *Aiwuyou* both combined health cover with endowment, which are primarily protection products. In short, the definition is based on the level of protection of products, irrespective of whether it's a traditional or participating product. For example, the *Jin* series product, also defined as LTP business, is a combination of a participating base policy and a non-par rider of critical illnesses. Savings products consist of endowment, annuity and participating products such as *Dongfanghong* and *Xingfu Xiangban*, which offer cash policy-holder dividend.

4. **Q: Further to the comparison of the share of the investment spread between high pricing interest rate product and low pricing rate product, could you give us more color on the mix of new business value in terms of investment margin, mortality and expense gains?**

A: First, under current Chinese GAAP and EV regime, profit release is based on comprehensive margin (residual margin+ risk margin) which covers a range of factors, and can hardly be attributed to one particular source or factor. Second, variance analysis is more important, i.e., the difference between expected profit and actual experience. The variance is a reflection of both changes of the environment and the soundness of assumptions, hence a better measure of underlying business performance. Third, China's vast insurance market can accommodate product diversity, leading to difference in profit sources among insurance companies. A market big enough with diverse customer needs is central to profit. There are not yet widely accepted methods for profit source analysis in the industry. As an international norm, the share of investment spread on long-term non-unit-linked products is over 50%.

5. **Q: You delivered fast improvement in NBV margin over the past decade. Any indication on how much the margin can improve in the future?**

A: China's insurance market still boasts huge potential, with protection business low in penetration and relatively high in NBV margin. We believe that given rising demand for risk protection, and the regulator's focus on protection, our NBV margin will continue to improve.

6. **Q: Overseas investors like your "pure player" strategy. What is your strategy in the next 3-5 years, given the election of a chairman?**

A: On June 9th the new Board of Directors of CPIC was elected, and its chairman, Mr. KONG Qingwei also got the qualification approval from CIRC recently. After joining CPIC, Mr. Kong articulated his thinking about the company's future strategy. First is adhering to the key value proposition of insurance. CPIC will continue to tap the huge potential of China's insurance market and has no intention to diversify. This strategy has been consistent, well aligned with the regulator's priorities and helped us overcome challenges of economic cycles over the past decade since our IPO. Second is to forestall major risks. Third is innovation and transformation. The company will put forward its 2nd program of transformation, an extension of the 1st 5-year customer-oriented transformation initiative.

7. **Q: Under C-ROSS, LTP business helps to boost solvency. Do you**

consider further increasing the pay-out ratio to improve your capital efficiency?

A: The company is committed to providing sustainable and stable returns to its shareholders. Since our IPO, DPS has been on the rise steadily, being 0.3 between 2007 and 2009, 0.35 between 2010 and 2012, and higher than 0.4 between 2013 and 2015. The dividend for 2016 was 0.7, with a pay-out ratio of 52.6%, much higher than the average 31% for Shanghai-listed firms. Besides, the dividend policy is also part of our capital planning strategy. We will consider other factors like business development and solvency when setting the dividend level.

8. **Q: Under C-ROSS, most insurance companies' solvency improved. Yet there may be more volatility. What is your internal target range of the solvency margin ratios?**

A: Under C-ROSS, both our actual capital and required capital have been different. Currently we boast strong solvency margin ratios. The required capital is composed of market risk, insurance risk and credit risk, with market risk accounting for 70%, consisting of equity risk and asset liability mismatch. Solvency margin ratios are closely linked to a company's risk appetite. We set 2 extra thresholds on top of the 150% of the required capital by CIRC, and split the actual capital for market risk, insurance risk and credit risk. Under the rolling stress testing scenarios, 200% level will be defined as "comfortable". A big variable is accounting profits which are heavily impacted by capital market volatility. Of course, given different investment strategy and business diversification effect, insurers with similar business volume may face quite different reserve requirements.

9. **Q: Your agency channel productivity seems less than that of your peers. Any plan or thinking to drive productivity gains?**

A: In a way our agent productivity is not entirely comparable with that of our peers. First, our average pay duration is more than 8 years, which means smaller annual premium. Second, our product portfolio focuses on protection business, which has a smaller average policy size. *Anxingbao*, for example, averages about RMB 2,000 per policy. Generally speaking, our productivity is aligned with the company's product strategy, and delivered sustained improvement in 2016 amid fast head-count growth. That being said, we are committed to further productivity gains via, among others, enhanced basic management of the sales force, such as attendance, retention and improvement in agents' skills in both new customer acquisition and up-sell.

10. **Q: Any concrete plans for the promotion of the tax-deferred pension business? By your estimate, what is the potential of the business?**

A: It is possible that the tax-deferred pension scheme will be rolled out by the end of the year. The product will be attractive, given under-supply of old-age cover by private insurance. In the context of China's demographic shift and increasing demand for protection against survival, old-age, illnesses, death and disability, this type of product holds great promise. In product design, it may take the form of universal products, combining accumulation of funds on the part of insurers and sharing of profits and risks between insurers and customers, similar to the tax-advantaged health insurance product.

11. **Q: Recently CIRC imposed restrictions on fast return products and universal life as riders. What is its impact on your product strategy for the jump-start campaign next year?**

A: There is a mismatch between consumers' strong demand for protection and the relatively short supply of such products on the market. We are working on products for next year's jump-start campaign, which may consist of upgrading the existing products and development of new products to diversify our offerings. Of course, all products will comply with the latest regulatory requirements. Tentatively, the new products could be designed as participating insurance.

12. **Q: Under C-ROSS, will a large share of protection business translate into an equally big share of insurance risk in capital requirement?**

A: The insurance risk will have a relatively small share, similar to credit risk, even for companies with a high proportion of protection business. Insurance risk is composed largely of morbidity, mortality and expense rate, and therefore is mostly manageable. On the other hand, the market risk is still the most important risk and has the biggest share of the required capital for life insurers, given the mismatch in duration of assets and liabilities.

13. **Q: With the issue of document No.134 by CIRC, do you have specific plans for the development of new products and withdrawal of existing products?**

A: The company will implement its product plan steadily in the run-up to October 1, when the new regulations, document No. 134 will come into force. Certain products will be withdrawn gradually by October 1, and the products of fast return of premiums have been withdrawn before June 30th. We target a top-line growth in line with the market, and will not seek to drive sales through hype about product termination or withdrawal.

14. **Q: Your PPT shows on slide 17 that the product with higher pricing interest rate has higher NBV margin. Why? Is it because it is a traditional product while the one with a lower rate a participating product?**

A: The two products are slightly different in NBV margin, being 27.3% and 24.3% respectively. The difference mainly stems from the impact of discounting and reserving under C-ROSS EV system. Yet there is no substantial difference for customers or insurers as they are the same in premiums.

Through the example we mainly want to highlight their difference in the share of investment spread and sensitivity to interest rate risk. The share of investment spread is 41% for the product with a higher pricing rate, while the share is 71% for the one with a lower pricing rate. Yet their exposure to interest rate risk is similar, being 5.7% and 5.8% respectively. Of course, different products may show different results. Participating insurance tends to have a smaller share of investment spread and therefore, less exposure to interest rate risk. For the purpose of comparison, both products in the example are traditional.