

# Summary of Investor Meeting on C-ROSS II

( Jan.2022 )

## I. An overview of C-ROSS II

- **Four key changes to C-ROSS II:** **First**, more stringent standards of capital recognition to enhance capital quality. Future surplus on long-term life insurance policies is no longer treated 100% as core capital, and will be rated as different types of capital using different capital return rates. At the same time, its share of the core capital shall not exceed 35%. C-ROSS II also improves standards of recognition of investment property and long-term equity investments, and bans misappropriation of insurance funds through related-party transactions, multiple embedded financial products or complex shareholding structures to purchase capital instruments. **Second**, it raises requirements for risk computing of minimum capital, adding “look-through” computing of market and credit risks, expanding the scope of interest rate risk to all interest-sensitive assets, and adding the concentration risk, with recalibration of various risk factors and the addition of a critical illness (CI) morbidity deterioration factor. **Third**, it improves solvency-related risk management evaluation, optimising IRR standards, adding requirements for capital planning to enhance forward-looking capital management. It also increases requirements for solvency information disclosure to improve transparency. **Fourth**, the document improves standards for insurance groups to enhance

their supervision, adding “specific risk” of insurance groups in the calculation of minimum capital. In short, the new regime is a vast improvement of the risk-oriented solvency risk management system.

● **About its impact on CPIC’ s solvency margin ratios:** **With respect to Group**, comprehensive and core solvency margin ratios would decline by varying degrees due to solvency changes of our insurance subsidiaries. First, available capital shrinks considerably as a result of only partial recognition of future surplus on insurance policies of our life subsidiary. Second, minimum capital decreases slightly, mainly because of reduced capital requirement for interest rate risk of the life insurance operation. Third, the newly-added Group specific risk in the calculation of minimum capital does not have much impact on solvency. **As for P/C insurance**, both comprehensive and core solvency margin ratios would drop, mainly due to increase in minimum capital as a result of higher risk factors across the board. Minimum capital for insurance risk, market risk and credit risk all increases, albeit by varying degrees, and their share remains stable. **In terms of life insurance**, the core solvency margin ratio drops considerably, largely due to decrease in available capital as future surplus can no longer be treated as available capital in its entirety and its share of the available capital is capped at 35%. The comprehensive ratio declines modestly as a result of capital grading and the caps on proportion of supplementary capital. Minimum capital decreases slightly, largely because there would be much less capital required for interest rate risk, which is part of market risk, even though the minimum capital for insurance and

credit risks rises due to higher risk factors. Therefore, the share of market risk in minimum capital decreases.

● **In a nutshell**, the new capital rules re-calibrates, amends and adds to the previous C-ROSS framework, and going forward, capital will be a key constraint for most insurance companies. The new regime is favourable to those well prepared in capital management, business operation and asset quality. We will continue to monitor its impact, take steps based on our realities to ensure that both the quantitative and qualitative constraints on our operation can be duly considered and reflected, so as to further enhance our business management capabilities.

## **II. Q & A**

### **1. Q: What is the impact of C-ROSS II on EV and NBV?**

A: NBV is a key business metric. Under C-ROSS I, EV and VNB evaluation already covered cost of required capital. Under C-ROSS II, the impact of cost of capital on valuation may change. We have started forward-looking research into this in collaboration with consulting firms. As for impact on product margin, we still expect higher NBV margin on protection than that on savings products, though not so much as before. EV and NBV would decline slightly under C-ROSS II.

### **2. Q: Compared with your peers, are you more or less impacted by C-ROSS II in terms of solvency or valuation?**

A: We expect similar impact on key insurance players, with the exception of a small number of firms.

**3. Q: You indicated decline of solvency under the new regime, particularly for the core margin ratio of the life operation. Do you think this may cause your life insurance subsidiary to reduce its dividends to the Group, which, in turn, will affect Group shareholder dividend policy? Do you consider capital raising via shares or debt issuance?**

A: We are committed to generating long-term, stable returns for our shareholders, and would determine the dividend level considering a number of factors such as earnings, solvency, OPAT and needs of business development. The simulation testing shows that the reform is likely to have a one-off, instead of prolonged impact on our solvency, and thus would not have material impact on the shareholder dividend policy.

As C-ROSS II requires enhanced capital management, we are exploring more options in capital replenishment. In November 2021, the regulator issued the exposure draft of rules on capital bonds with indefinite terms, and we are studying this document.

**4. Q: You issued GDRs in 2020. Given negative impact of C-ROSS II on your subsidiaries, do you consider using GDR proceeds for capital injection?**

A: According to the GDR Prospectus, the proceeds will be deployed in emerging business such as fin-tech, health care, etc., supporting the core business of insurance, which we believe will boost new growth drivers going forward. This principle remains unchanged, and the company will use the proceeds based on our development strategies and in a way that would improve the efficiency of capital allocation.

**5. Q: Under the new solvency rules, for life insurance, there are caps on future surplus as a share of core capital, the addition of morbidity deterioration factor, etc.; on the P/C side, excess retrogressive mechanism was abolished, etc. Would such changes impact your business strategies for life and P/C insurance respectively?**

**A: As for life insurance,** we persist in a customer-oriented business strategy. Recent business performance seems to indicate growing demand for savings products, while protection business is yet to pick up. NBV is a key performance metric. Under C-ROSS II, though capital rules are more stringent, NBV margin on protection business would still be higher than that on savings. We will continuously review and refine the product strategy to meet business targets while ensuring compliance with capital requirements.

**With regard to P/C insurance,** under C-ROSS II, in spite of some decline, both comprehensive and core solvency margin ratios can still maintain decent levels. The new rules seek to guide for “return to the basics of insurance” and for enhanced support of the real economy, via arrangements like removal of excess retrogressive mechanisms , differentiation of credit & guarantee insurance, geographical differentiation of catastrophe risks and the addition of a regulating factor for agricultural insurance. In response to these changes, on the one hand, we will optimise mix of liabilities and step up cost management; on the other hand, we will continue to improve capabilities in risk identification and selection, enhance capital planning through operational centralisation and efficient claims management, as

well as investment decisions balancing risk and reward. In terms of product strategy, the company will look more closely at capital deployment and capital charges of different product lines under C-ROSS II, while considering net cash-flow requirements, market and customer strategies.

**6. Q: The morbidity deterioration factor is expected to lower the NBV margin of CI products. By how much? Would this change your product strategy?**

A: Our product and business strategies are customer-oriented. Despite slight adverse impact of C-ROSS II, NBV margin of CI products remains high.

**7. Q: The basic risk factors of certain asset classes like long-term equity investments are raised under C-ROSS II. Would this impact your Strategic Asset Allocation (SAA), particularly equity investment?**

A: C-ROSS II sets higher risk factors for private equity, long-term equity investments and investment property, which means higher capital charges for these assets. Our projection shows that this would not be a substantial hindrance to our investment in such asset classes. Our current allocation in them is small in the first place, and our solvency position is strong. Given decline of the interest rate, we will adhere to the “dumb-bell shaped” investment strategy, namely, increasing allocation of long-term assets and equity investments.

**8. Q: C-ROSS II sets high risk factors for long-term equity investments in non-insurance areas, and given your deployment in**

**businesses seeking to achieve synergy with insurance, would this change impact your strategy?**

A: Under C-ROSS II, the basic factor of long-term equity investment in non-insurance industries was raised from 10% to 100%. In our SAA, the share of this kind of long-term equity investment is negligible, whereas most of the investments we made for synergy with insurance do not belong to this asset class. Therefore, the new capital regime has limited impact on our solvency, and in turn would not affect our deployment in new business areas.