

# Future investment value of China's listed life insurance companies' H shares from the perspective of secondary market

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**Abstract**—China's life insurance industry has just started in the 1990s after the reform and opening up, and its development experience is obviously insufficient, and it has not gone through a very complete life insurance development cycle. No matter from the actuarial technology, the professional level of the agent, the popularization time of the agent system, or the management experience, it is far from the developed areas of the world's life insurance industry. In addition, many professional investors are worried about the future prospects of China's life insurance industry because of the long-term existence of a low interest rate environment.

However, after reading detailed materials (research papers, books, reviews, etc.), the final conclusion of this report is different from that of other too cautious investors. This report holds that: the current situation and prospect of China's life insurance H shares meet the conditions of Davis double-click, and the main investors in the secondary market will encounter a unique opportunity to obtain excess returns by investing in domestic insurance H shares. On the level of objective factors, we analyze from the following four aspects: (I) the potential demand for life insurance in China will continue to increase significantly in the future; (II) most of the representative life insurance companies in China have low valuations; (III) the possible style switching in China's secondary market is conducive to the rise of blue chips such as life insurance companies; (IV) from the long-term perspective of history, the insurance index has significantly outperformed the Shanghai Composite Index, which represents the market. In terms of subjective factors, we consider them from the following four perspectives: (I) the development and problems of life insurance industry in Japan and Taiwan; (II) on the liability side, China's life insurance industry vigorously develops new products with high business value, so as to resist the impact of low interest rates; (III) the diversification of asset allocation at the investment end of China's life insurance industry can make the profit of life insurance industry not limited by the interest rate; (IV) the change of service quality at the supply side is conducive to the life insurance companies to tap the potential market demand in China.

## 1 THE DEMAND FOR LIFE INSURANCE IN CHINA WILL GROW RAPIDLY IN THE FUTURE

### 1.1 Per capita GDP of more than 10000 US dollars means a new growth point is coming

According to the Statistics Bureau, China's GDP is still growing at a high speed, only second to the United States, reaching 100 trillion yuan, or about 14.4 trillion US dollars (according to the annual average exchange rate). At the end of 2019, China's per capita GDP has also exceeded the node of 10000 US dollars. (the life insurance industry in the United States, Japan, Taiwan and other places has achieved more rapid development after the per capita GDP exceeds \$10000) 1.

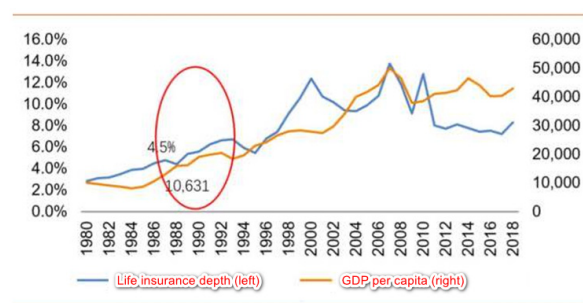
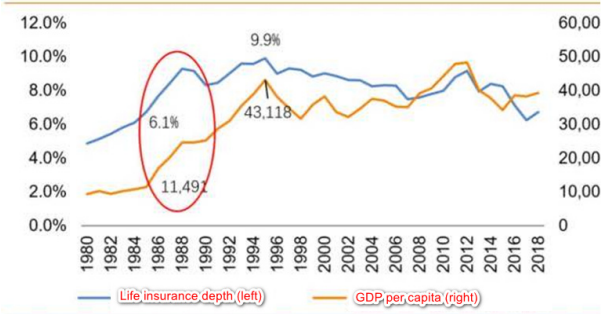


Figure 1. British life insurance industry accelerated its growth after per capita GDP exceeded \$10000

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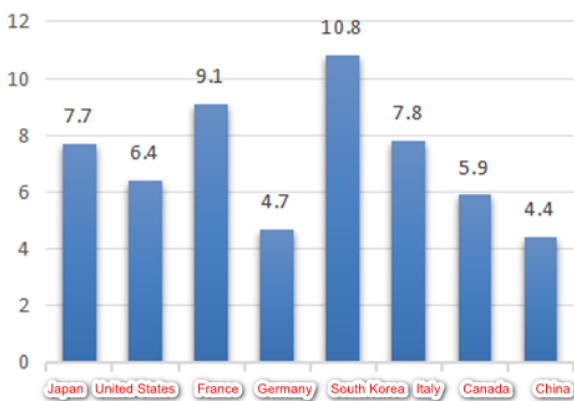


**Figure 2.** Japan's life insurance industry accelerated its growth after its per capita GDP exceeded \$10000

### 1.2 From the perspective of premium depth and density, China's life insurance industry still has a huge space for development

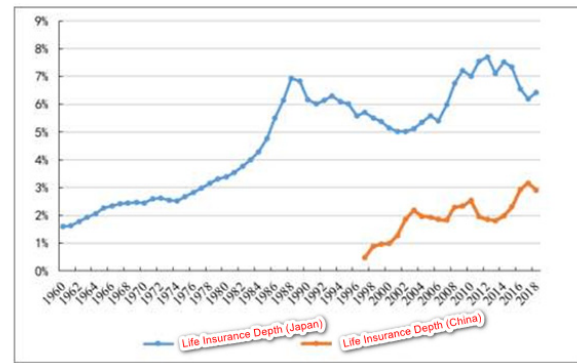
According to the report of Swiss Re in 2019, China's life insurance depth is only 2.3%, ranking 38th in the world. In addition, the density of life insurance ranked 44th in the world, with US \$221. Statistics from Swiss Re research institute show that the density of life insurance in the United States has reached US \$1674 in 2017, which is more than seven times more than that in China. It can be seen that with the long-term sustainable economic development, the rising prospect of life insurance business in China is still very certain. The number of insurance policies per capita in mainland China is 0.13, which is far from 3.8 in Japan and 2.5 in Taiwan. Figure 3 shows the comparison of insurance depth in 2018 among the regions with more developed insurance industry in the world.

Insurance depth of major countries in 2018

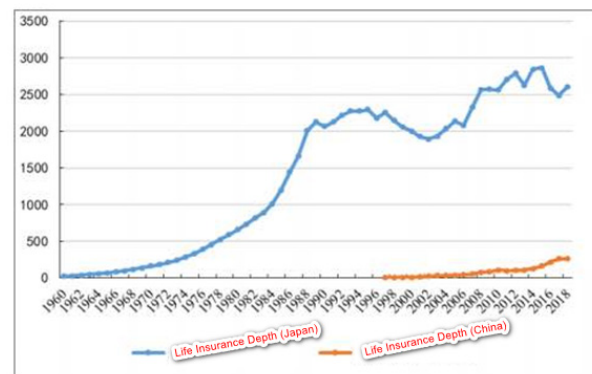


**Figure 3.** insurance depth of major countries in 2018 2

Compared with neighboring Japan, the density of life insurance in Japan is ten times that of China, and the insurance depth is two times that of China. Figure 4 and 5 below show the comparison of insurance depth and density between China and Japan.



**Figure 4.** depth comparison of life insurance between Japan and China



**Figure 5.** comparison of life insurance density between Japan and China

In addition, China's current market environment and economic recovery after the epidemic are conducive to a new round of premium income growth. Statistics show that China's GDP recovery trend is obvious in the second quarter, with a year-on-year growth of 3.2%. The prospect of China's sustained GDP growth in the future is fully reflected in the speed of economic recovery this time, and constitutes a strong contrast with some other countries that are not conducive to the fight against the epidemic. The resilience of the economy also indicates the possible increase of the premium income of the life insurance industry in the future 3.

### 1.3 Since social welfare can't afford most of the expenditure, there are still many potential customers of endowment insurance and high-end health insurance in China

According to statistics, the proportion of China's GDP used for health and health care is only 5%, which is far from that of the United States and other developed countries. This shows that the state's expenditure on health care for individuals is not high. Corresponding to this, China's statistical data show that in 2018, 28.8% of health expenditure is still from individual payment. Figure 6 shows the proportion of medical and health expenditure in GDP of various countries in the world.

At the same time, these two factors show that the state's medical security is too little, and the individual's expenditure on medical treatment is too high. There are three main factors sharing the national medical

expenditure, which are: 1. National funding; 2. Personal expenditure on health care; 3. Commercial medical insurance expenditure. The lack of state expenditure and the increase of individual expenditure indicate the absence of commercial medical insurance. In line with this analysis, the growth rate of health insurance business in China's life insurance industry has reached more than 30% per year. The following figure shows the trend of health insurance premium income in China, and figure 8 shows the changing trend of the depth and density of health insurance premium in China.

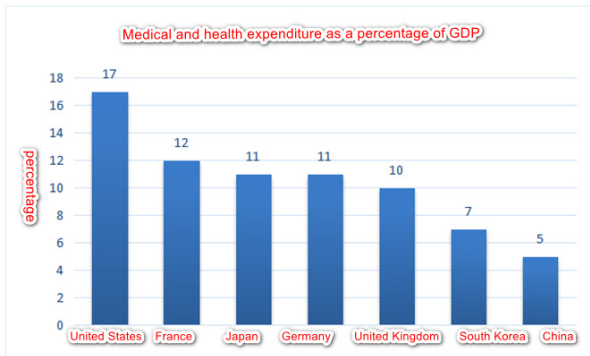


Figure 6. health insurance premium income

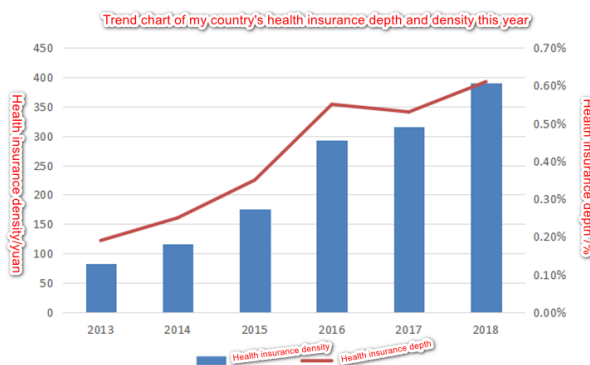


Figure 7. Trend of depth and density of health insurance in China in recent years

#### 1.4 The absence of the third pillar of pension in China leads to the increasing demand for commercial insurance in the future.

China first promulgated and determined the feasibility of the three pillars in 1991, and these three pillars are: 1. Enterprises must pay certain fees to the government every year, which will be used to provide pension for retirees in the future. 2. The company directly withdraws the enterprise annuity from the employee's salary at present and pays in the future. 3. Endowment insurance provided by commercial insurance companies.

At present, China's first and second pillar structures account for 74.7% and 25.3% respectively, and the third pillar is absent. Compared with the United States: the first, second and third pillars account for 10.15%, 58.14% and 31.71% respectively (the second and third pillars account for more than 90% in total), which can reflect the huge development space of China's commercial endowment insurance in the future (source: China Enterprise Industry Research Institute).

At present, in the United States, these three pillars account for about 10%, 60% and 30%. China's three pillars are 75% and 25%, and the third pillar is almost zero. This can also explain the huge potential demand of endowment insurance in China in the future. The figure below shows the Pension Structure of China in 2018.

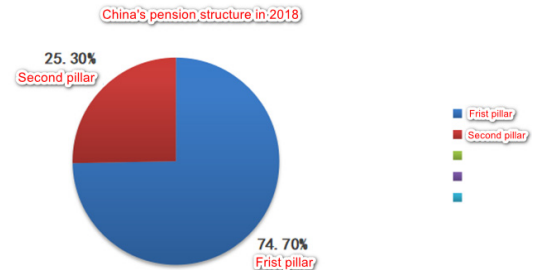


Figure 8. China's Pension Structure in 2018

#### 1.5 potential customers of insurance are increasing

According to statistics, the main insurance consumer group around the world is 35-54 years old, while in China, this age range will increase in the next five years. This was the first baby boom in China from 1982 to 1982. The babies born in these two periods of extremely high number of newborn babies coincide with the population aged 35-54 between 2018 and 2025, which is the main consumer group of insurance. This indicates that the demand of insurance industry will increase in the next five years 4.

#### 1.6 the accelerated aging of China's population and the declining birth rate will also become an important factor in the outbreak of commercial endowment insurance in the future.

According to the data released by the National Bureau of statistics, the number of people aged 65 and older will reach 12.6% in 2019, indicating that the society will reach the level of deep aging. In 2022, according to the forecast, this figure will reach 14%, and then rapidly rise to 20% in 2033 and 35% in 2060. It can be seen that the scale and speed of aging in China are unprecedented.

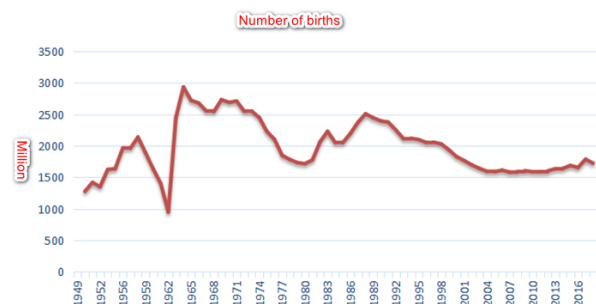
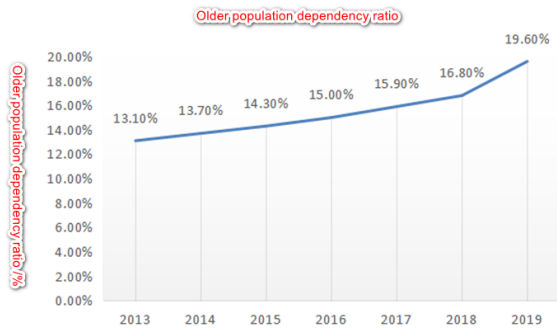


Figure 9. number of births (from 1949 to 2018)

Moreover, the dependency ratio of the elderly population in China is rising rapidly. This is mainly due to the two factors mentioned above: the increasing aging and the declining number of newborn babies. This means that in China in the future, the average number of young

people bearing to support the elderly will increase. Therefore, the future young people in our country will face more heavy pressure on supporting the aged. Endowment insurance will become the choice of many families 5.



**Figure 10.** dependency ratio of the elderly population

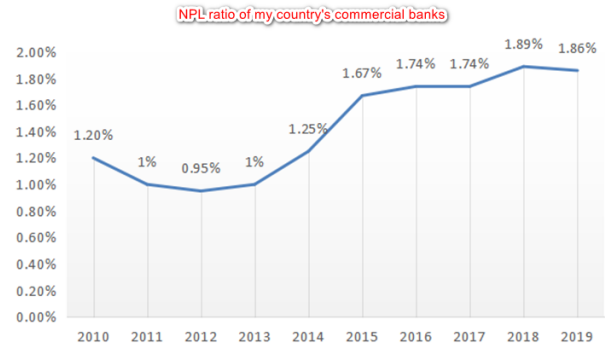
**1.7 Even in the long period of economic recession, the policy sales of life insurance companies still have the characteristics of resisting the downward trend in the short and medium term**

**1.7.1** Under the economic downturn environment, the increase of credit risk in other industries will enhance the relative competitiveness of insurance products

There are two factors. In the past two or three years, Chinese investors (individuals, companies) are facing the increasing risk of credit default. Internationally, the situation is grim. In order to curb China's development, the United States has adopted severe economic sanctions and technical blockade of some high-end industries, which has led to great challenges for some Chinese enterprises. At the same time, with the economic development of our country, there is no the advantage of cheap labor. Instead, there has been a sharp rise in the cost of human resources. As a result, some low-end industries tend to migrate from China to Southeast Asia. The above reasons make many Chinese companies face increasing business risks.

In addition, many Chinese enterprises will face greater repayment pressure in the future, which is mainly due to the increase of financing rate. According to statistics, except for finance, the average leverage ratio of Chinese enterprises in the first quarter of this year has reached 161.1%, an increase of 6.7% year-on-year. These financing balances can help enterprises increase cash flow in the near future and resist the adverse effects of the epidemic. However, in the long run, the debt repayment pressure of Chinese enterprises has also increased greatly.

Correspondingly, the possibility of credit default continues to rise. According to statistics, the non-performing loan ratio of China's commercial banks reached 1.91%, up 0.11% year-on-year, the highest value in ten years. Moreover, the average recovery time of China's industrial enterprises also increased by 4.7 days 6.



**Figure 11.** non-performing loan ratio of China's commercial banks 7

**TABLE 1.** SOLVENCY OF MAJOR LISTED LIFE INSURANCE COMPANIES IN CHINA

The sufficient solvency of China's major listed life insurance companies		
Company's Name	Core solvency adequacy ratio	Comprehensive risk rating
PingAn Insurance	225%	A
AIA	453%	A
China Taibao	259%	A
China Life	210%	A
Xinhua Insurance (data for 2019 only)	284%	A

In this case, insurance products have more advantages 8.

This is mainly because the solvency of insurance companies is very sufficient, which is suitable for prudent investors to avoid risks.

It can be seen that China's major insurance companies have very low risk and high solvency adequacy ratio, which is suitable for all kinds of stable and cautious investors to allocate.

**1.7.2** Under the environment of low interest rate, the comparative advantage of insurance investment compared with bank financial investment increases

**1.7.2.1** Once again, the new low return rate of bank financial products makes its attractiveness gradually decline: according to the statistical data, by the end of July 2020, the average income of commercial banks' non institutional financial management projects dropped by 2 basis points again, to 3.78%, which was the lowest point in 44 months. Bank financial management itself has the characteristics of non breakeven, and with the declining rate of return, the comparative advantage of bank financial management is decreasing 9.

**1.7.2.2** In insurance financing, the interest rate of some universal insurance products is still above 5%. Even if the interest rate drops, there will be a certain lag in the decline of the yield of such products. It can be seen that the future demand rate of life insurance industry will

increase year by year, which indicates that the steady development of life insurance industry has certainty.

## 2 THE OVERALL VALUATION OF LIFE INSURANCE INDUSTRY IS AT A HISTORICAL LOW, AND IT IS EXPECTED TO REALIZE DAVIS DOUBLE-CLICK IN THE FUTURE

### 2.1 Domestic insurance stocks in Hong Kong: PEV close to record low

**TABLE 2.** VALUATION OF INSURANCE SHARES

Stock name	Static PE (Net profit in 2019)	Static PE (Operating profit in 2019)	Static PEV (Annual report 2019)	Dividend yield (%)	Lowest in history PEV	2017-18 highest PEV	Highest in 2015 PEV
China Taiping H	5.75		0.32	2.12	0.25	1.03	1.65
Xinhua Insurance H	6.42		0.48	4.7	0.28	1.07	1.63
China Life Insurance H	8.37		0.53	4.25	0.32	0.98	2.01
China Taibao H	7.21	7.17	0.52	5.44	0.37	1.09	1.96
China Ping An H	8.85	9.95	1.16	2.75	0.83	1.79	1.92
Xinhua insurance a	13.38		0.99	2.26	0.58	1.60	2.58
China Taibao a	10.47	10.4	0.75	3.75	0.59	1.64	2.03
China life a	20.89		1.31	1.70	0.71	1.43	2.64
China Ping an a	9.30	10.45	1.21	2.62	0.81	2.01	1.83

It can be seen from this table that most of the static PEVS of domestic insurance stocks in Hong Kong stock market are close to the historical low point, which is expected to usher in valuation repair 10.

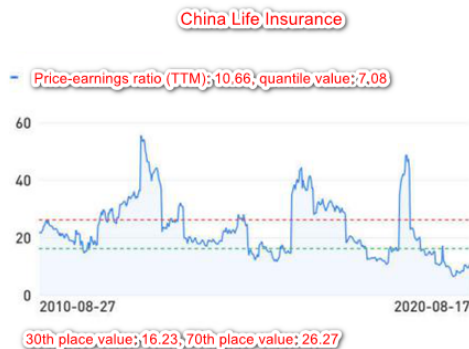
### 2.2 From the PE valuation point of view, the main life insurance companies are in historical low



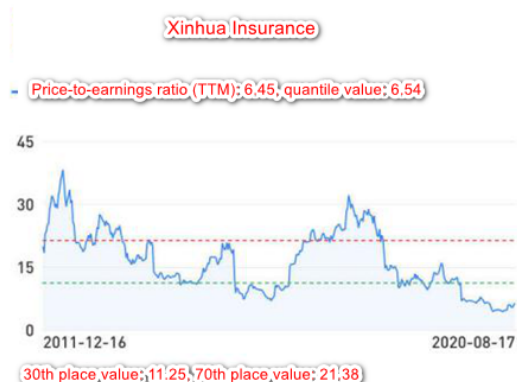
**Figure 12.** Ping An Insurance of China



**Figure 13.** China Pacific Insurance



**Figure 14.** China Life Insurance



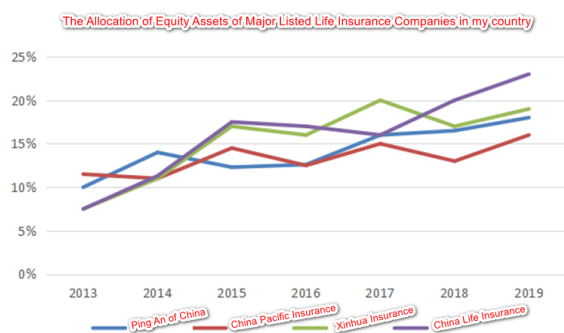
**Figure 15.** Xinhua Insurance

It can be seen from the chart that the current domestic insurance H shares are very close to the historical most undervalued value from the perspective of PE, and it is expected to realize value regression in the future.

### 2.3 If the bull market trend continues, the substantial increase in investment income of major listed life insurance companies can stabilize the performance

Insurance industry commonly known as the "three difference" (interest, death, fee difference) is the main source of profit for each company. In recent years, China Insurance Regulatory Commission (CIRC) has issued documents to vigorously develop products with high and new business value ratio and promote insurance, thus effectively reducing the impact of interest spread on the overall income. However, at present, the proportion of interest margin in total profit is still very high. For example, in 2019, China's leading insurance industry, Ping An still accounts for 35.1% of the interest margin Ping An, as a mixed property and life insurance group, still has such a high interest margin, while China Life Insurance, a pure life insurance company, is not inferior to it. This is because the design of life insurance depends on the difference between the return on investment and the interest rate of products. At present, as the interest rate of ten-year Treasury bonds continues to decline, in order to hedge risks, most insurance companies have increased the allocation of equity assets, among which pure life insurance companies are the most.

Therefore, if the bull market continues, the investment income of insurance companies on equity assets can hedge the risk of the decline of treasury bond yield 11.



**Figure 16.** The changing trend of equity asset allocation of China's listed life insurance companies

Therefore, when the company's net profit is growing steadily and the market valuation itself is undervalued, Davis double-click is in the pipeline 12.

### 3 USING THE TEMPLATE IN THE FUTURE, A LARGE-SCALE SHIFT OF STOCK MARKET STYLE PREFERENCE MAY CAUSE THE STOCK PRICE OF BLUE CHIPS (INCLUDING INSURANCE, BANKS, ETC.) TO RISE

**3.1 A large number of funds from public funds are concentrated in medicine, technology, media, consumption (liquor, dairy, pork) and other sectors. Once the warehouse is transferred, it can only flow out of these sectors**

Industry classification	Total number of stocks	Fund holding ratio	Total market value	Fund holdings (10 million)	holding ratio	Increase or decrease of the second quarter	Market value increase or decrease of July
IT (Total)	62	31	85,274	18988	88	0.48%	117
IT (Medicine)	170	64	37,604	21482	1470	6.85%	300
IT (Technology)	199	56	26,098	21818	493	2.09%	86
IT (Media)	213	18	36,274	5209	3199	6.09%	-340
IT (Consumption)	129	42	25,812	11892	4329	2.09%	23
IT (Finance)	84	19	20,624	2951	21	0.23%	-125
IT (Other)	3	44	28,250	8131	1460	2.09%	-46
Non-bank finance (Total)	159	26	66,674	5209	120	1.92%	185
Non-bank finance (Medicine)	59	28	26,214	15128	747	1.92%	-165
Non-bank finance (Technology)	249	103	28,274	5209	3212	4.42%	283
National defense industry (Total)	39	39	43,398	32039	2511	1.72%	-24
National defense industry (Medicine)	113	85	44,198	32031	1124	2.84%	172
National defense industry (Technology)	42	29	43,398	3214	143	2.73%	79
Household appliances (Total)	90	31	25,698	13613	149	2.04%	-20
Household appliances (Medicine)	117	43	26,464	24213	1202	3.36%	246
Household appliances (Technology)	112	44	25,812	13613	149	2.09%	-19
Household appliances (Media)	117	42	26,274	10013	397	2.09%	40
Household appliances (Consumption)	132	47	26,812	9982	243	2.05%	69
Household appliances (Finance)	96	24	20,604	9197	20	0.26%	44
Household appliances (Other)	107	36	46,624	49709	1372	3.06%	133
Light industry (Total)	101	33	20,324	12009	438	2.43%	-12
Light industry (Medicine)	47	35	22,324	12009	438	2.43%	-12
Light industry (Technology)	35	30	20,324	12009	438	2.43%	-12
Light industry (Media)	18	25	44,404	4440	117	0.26%	30
Light industry (Consumption)	24	31	46,114	9497	4436	4.07%	-81
Light industry (Finance)	46	46	45,274	15113	312	2.07%	16
Light industry (Other)	34	16	20,814	2204	416	3.09%	18
Total (Total)	2201	1418	327,204	666096	272067	3.92%	1203

**Figure 17.** Summary of positions of public funds in the second quarter of 2020

Most of the indicators in this chart have no guiding role, because many of them are static indicators and can not point out new trends. Only the amount of the increase can show a certain problem - which sectors were favored by these mutual funds in the second quarter.

Therefore, it can be seen that in the second quarter of 2020, the largest amount of capital withdrawn from cemeteries is the banking sector, mainly including China Merchants Bank and the four traditional banks. And these fund managers add the biggest fund is the transportation and transportation plate. In addition, medical and biological subjects, food, beverage and media, computers are also popular. From here, we can see that the style of the market in the second quarter is more inclined to overvalued growth stocks, rather than large market value, stable blue chips. The trend shown in the figure below is also consistent with our point of view 13:

Stock code	Number of fund holders	Total number of shares	Holdings	Change index	Change rate
600519	1237	5779.70	642.12	-75.29	-1.29
600276	868	33631.78	309.51	534.28	1.61
601318	811	60025.79	415.20	-16995.52	-22.07
600036	724	84021.23	271.22	-26394.23	-23.90
002475	627	75892.65	288.44	-13516.21	-15.12
600887	577	69439.30	207.35	-16622.23	-19.31
000858	574	28251.79	325.46	-2533.89	-8.23
000651	542	38162.45	199.21	-20137.18	-34.54
000661	499	3816.26	208.85	-921.63	-19.45
000002	483	93635.23	240.17	-16743.48	-15.17
600030	472	79198.33	175.50	-4571.17	-5.57
601166	455	87443.99	139.12	-31755.12	-26.64
300750	452	8008.00	208.95	141.70	1.80
600048	433	114314.75	169.99	-49302.83	-30.13
600585	407	14549.31	80.17	-8191.06	-36.02
000333	399	37737.57	182.73	-15381.97	-28.96
600031	382	84435.31	146.07	-34300.97	-28.89
300750	341	11120.95	133.89	-2610.23	-19.01
000063	340	46491.50	196.74	10497.44	29.16
601398	325	89419.56	46.05	-101803.94	-53.24
603259	258	7945.56	71.90	-10193.53	-56.20
002555	255	20387.60	66.44	-9242.41	-31.19
002714	252	8109.07	99.10	-3488.01	-30.08

**Figure 18.** the increase and decrease of stocks with the largest institutional positions from January to March 2020

Stock code	Number of fund holders	Total number of shares	Holdings	Change index	Change rate
600519	1360	5752.79	841.56	-26.91	-0.47
002475	1096	105847.65	542.89	29956.01	39.47
000858	896	31984.65	547.32	3732.86	13.21
600276	837	41987.84	387.55	8356.07	24.85
601318	731	51397.84	366.98	-8627.95	-14.37
600036	641	71871.93	242.35	-12149.30	-14.46
300750	603	14280.92	249.00	3159.97	28.41
000661	580	8149.24	354.37	4332.98	113.54
000333	513	42164.17	252.10	4426.60	11.73
000651	502	32574.10	184.27	-5588.35	-14.64
300750	471	8123.36	248.33	115.36	1.44
600887	434	51779.08	161.19	-17660.22	-25.43
603259	411	18439.18	178.12	10493.61	132.07
600030	410	70836.37	170.79	-8361.96	-10.56
000002	404	78639.43	205.56	-14995.80	-16.02
001888	387	16075.50	247.61	12699.00	378.10
300059	383	77197.96	155.94	24256.69	45.82
600570	366	16757.23	180.48	8471.71	102.25
601012	365	55802.05	227.28	15513.27	38.51
601166	358	65097.50	102.72	-22346.49	-25.56
002555	310	21869.16	102.08	1481.56	7.27
600048	301	90736.26	134.11	-23578.49	-20.63
600031	259	57670.58	108.19	-26764.73	-31.70

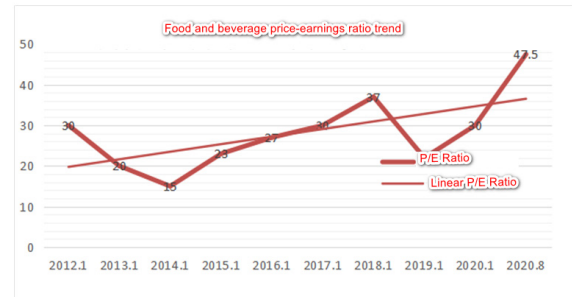
**Figure 19.** increase and decrease of stocks with the largest institutional positions in April June

In the first quarter of this year, the leading companies in blue chip stocks ranked first, and in the second quarter, these stocks were still reduced. Although the above discussion is enough to explain part of the problem, the seriousness of the matter and the irrationality of some funds have not been fully demonstrated.

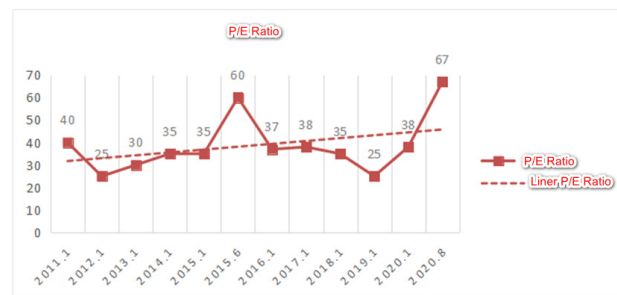
This is because, unlike in the past, the situation is not the entire market has been sold, investors' confidence is low. On the contrary, from April to June of 2020, public funds were snapped up enthusiastically. In three months, there were nearly 400 new funds, and the total amount reached an astonishing 500 billion yuan, approaching the highest single quarter issuance amount in recent years. With so much capital entering the market, leading companies in blue chip stocks, which have been regarded as core assets and stable assets, are still being reduced, which proves that there is a certain irrationality in the market.

Therefore, once the market returns to rationality and rediscover the stability of blue chips and the current undervalued value is of great attraction, a large amount of capital will flow in, resulting in the value regression effect of blue chips 14.

**3.2 The valuation of stocks with themes of consumption, technology and medicine is close to the highest point in history, and the attraction is slowly disappearing with the increase of stock price.**



**Figure 20.** Trend of price earnings ratio of food and beverage



**Figure 21.** P / E ratio

As can be seen from the above two figures, both the medicine and consumption indexes have reached unprecedented overestimation. Once the market returns to rationality, radical investors will face the risk of losing a large part of their funds at any time 15.

**3.3 there is no strong performance support behind the soaring medicine, consumption and other stocks.**

Next, we will select the stocks that are popular and discussed in medicine, consumption, media and other industries this year: Hengrui pharmaceutical Haitian flavor industry, Guizhou Maotai Wuliangye Shuanghui development focus media, and compare the changes between the growth rate of their interim report performance and the valuation at the beginning of 2020 and the valuation before the opening of the market on Monday, September 7, 2020. The purpose is to show that the soaring of these stocks in 2020 is irrational and does not have strong performance support.

**TABLE 3.** THE GROWTH RATE OF VARIOUS STOCKS

<i>corporate name</i>	<i>Semi annual net profit</i>	<i>Year on year growth</i>	<i>PE valuation at the beginning of the year</i>	<i>9.7 PE (TTM)</i>	<i>Year on year growth</i>
Hengrui medicine	26.62 Billion	10.34%	72.65	88.97	19.1%
Maotai, Guizhou	226.02 Billion	13.29%	36.06	50.70	40.6%
Wuliangye	108.55 Billion	16.28%	29.67	47.23	59.2%
Shuanghui development	17.42 Billion	-0.74%	18.48	32.21	74.3%
Haitian flavor industry	32.53 Billion	18.27%	54.48	94.46	73.4%
Focus Media	8.23 Billion	5.85%	38.96	55.40	42.2%

It can be seen that the profit growth of these representative companies is much worse than the growth of valuation, indicating that their stock price growth is not supported by performance, so it is an irrational rise. A callback is likely to occur.

**3.4 the premium rate of A-share to h-hong Kong stock of China's Insurance shares has been close to the highest in history. When investors' sentiment for insurance stocks turns better, the premium rate will decrease.**



**Figure 22.** A-share and Hong Kong stock market trend comparison of representative insurance companies, red and green for a share, yellow for H share



**Figure 23.** same as figure 22



**Figure 24.** same as figure 22

**TABLE 4.** AH VALUATION DIFFERENCE CHANGES OF CHINA TAIBAO, XINHUA INSURANCE AND CHINA LIFE INSURANCE FROM 2015 TO THE PRESENT

<b>ah valuation difference changes of China Taibao, Xinhua insurance and China Life Insurance from 2015 to the present</b>			
<i>Company</i>	<i>2015 high premium (H/A)</i>	<i>19 August 2020 premium (H/A)</i>	<i>Valuation change (2020 minus 2015 high)</i>
China Taibao	17.2%	-31.96%	-49.16%
Xinhua Insurance	-28.4%	-50.75%	-22.35%
China Life Insurance	It's about zero	-62.04%	-62.04%

It can be seen from the above table that the premium rates of A-share to H-share of the three companies including life insurance have increased significantly. It shows that Hong Kong stock investors are worried about life insurance companies. Is this worry rational? Let's look at the next part.

**3.5 the over undervalued value of Hong Kong Insurance shares does not match the performance of the performance**

**TABLE 5.** GROWTH RATE OF NET PROFIT OF THREE LISTED INSURANCE COMPANIES WITH LIFE INSURANCE BUSINESS FROM 2015 TO 2020

<b>growth rate of net profit of three listed insurance companies with life insurance business from 2015 to 2020</b>			
<i>time</i>	<i>Net profit growth rate of China Taibao</i>	<i>Net profit growth rate of Xinhua Insurance</i>	<i>China Life's net profit growth rate</i>
2015	60.45%	34.26%	7.72%
2016	-31.99%	-42.54%	-44.88%
2017	21.61%	8.92%	68.63%
2018	22.90%	47.17%	-64.67%
2019	53.95%	83.78%	411.51%

As can be seen from the above figure, the performance of these insurance stocks which are not optimistic about by the Hong Kong stock market has shown a long-term upward trend since the bull market in 2015, and the



performance has increased rapidly. There is no trend of performance stagnation or long-term decline.

#### 4 IN THE LONG RUN, THE INSURANCE INDEX IS FAR BETTER THAN THE SHANGHAI STOCK INDEX



Figure 25. Insurance index and Shanghai Composite Index

As can be seen from the chart, the insurance index has far outperformed the market in the long run.

Above, we have finished the objective analysis of the future performance of H shares of life insurance companies. Next, we will look at the subjective factors.

First of all, it introduces the special analysis method of subjective level: comparing with the new scheme adopted by life insurance companies in Japan and Taiwan, which have experienced a complete cycle, to clarify that the subjective adjustment of China's life insurance industry is conducive to long-term sustainable development.

#### 5 BACKGROUND OF SUBJECTIVE FACTORS

Therefore, both the advanced countries and the developed countries have taken part in the whole process of life insurance creation.

Several thousand years ago, the embryonic form of insurance industry appeared along the Mediterranean coast, mainly for maritime insurance. After that, fire insurance, earthquake insurance and other early insurance products have also appeared. Insurance commercialization, the establishment of the earliest insurance joint stock company in Britain, Germany and other countries can also be traced back to the industrial revolution period.

It can be said that after the founding of the people's Republic of China, China's insurance industry tends to be planned, resulting in the failure of the insurance industry for decades. After the 1980s, China's insurance industry has been rapid recovery and development, but many of the main insurance products are directly "foreign for China". However, it is difficult for China's life insurance companies to form a set of life insurance operation and product mode independent of other countries in a short time

Therefore, if we want to know whether the current development and reform of China's insurance industry is healthy, we should compare the new adjustment direction of major representative life insurance companies in China with those of Japan, Taiwan and other developed regions, so as to draw a strong conclusion. following:

### 6 ENLIGHTENMENT FROM JAPAN AND TAIWAN

#### 6.1 Overview of Japan and the development stage of commercial life insurance

In the past 18 years, Japanese insurance companies have become the most mature pioneers in the world, not only in the depth of life insurance, but also in the premium income and the average number of insurance policies purchased by each family

Commercial life development stage:

1) In the take-off stage, after the Second World War, Japan's national economy began to recover from collapse. In the past few decades, the depth of insurance increased from 1% to 9% in 1988.

2) Depression stage: after the financial crisis in 1990, the interest rate has entered a downward phase, and the yield of 10-year Treasury bonds dropped from more than 8% to 1.8% in 1998. In the period of rapid economic development in Japan, the competition of insurance industry gradually tends to be saturated, so in the game of seizing customers, Japanese insurance companies sell a large number of products with high risk and high interest rate. Insurance companies can still get good pay in good times. But with the collapse of the economic bubble, the huge loss of interest caused by the fall in the interest rate of the national debt will make the insurance company continue to digest the pain in ten or even twenty years.

3) Adjustment stage: in the early 21st century, due to the aggravation of the aging trend of the population, insurance companies quickly launched a new type of insurance to adapt to this trend. After 2000, with the dramatic change of population structure, Japan has rapidly entered a society of high aging and few children. And Japanese insurance companies have also rapidly developed insurance types to adapt to this trend. At the same time, we should vigorously develop the bancassurance channel, increase the proportion of insurance with protection type, and ban insurance products with high predetermined interest rate. At the same time, the insurance industry has also been restructured. Therefore, even if the impact of the 2008 subprime mortgage crisis, the insurance industry still maintained a good depth of insurance.

4) Maturity period: since 2010, the economy tends to decline. Insurance companies have increased high NBV products, increased the allocation of overseas assets, and increased high-risk investment strategies. Japan's insurance industry tends to be stable.

#### 6.2 Taiwan Info

Taiwan is also one of the best and most experienced regions in the world's life insurance industry. Its total economic volume is less than 10% of the mainland's total, but the total insurance accounts for 1/3 of China's mainland, ranking tenth in the world. In addition, Taiwan's insurance industry has been well known for its current 20.9% penetration rate in the insurance consumer

market (the first in the world).6.2.1Different stages of commercial life insurance in Taiwan.

First, after World War II, Taiwan returned to China's management. The government took over and integrated the insurance companies previously operated and established government insurance companies. In 1962, the "insurance law" and "detailed rules for the implementation of the insurance law" were promulgated, and the private insurance enterprises such as Cathay Pacific Life Insurance and Xinguang Life Insurance Co., Ltd. gradually took root. During this period, Taiwan people focused on saving. Therefore, the survival insurance for savings is still dominant. Since then, due to the acceleration of industrialization, people's risk awareness has been strengthened. Death insurance has become a hot topic.

In the 1970s and 1980s, due to the high interest rate in the market environment, insurance products with a predetermined yield below 8% were forced to pay dividends to customers every year.

In the 1990s, foreign capital began to enter the Taiwan market, making competition increasingly fierce. Therefore, in this relatively prosperous period of economy, high interest rate insurance policies continue to accumulate and lay hidden dangers for insurance companies, which makes the insurance industry hover on the edge of interest rate spread loss in the following 20 years of economic slowdown. At the same time, people's health awareness is generally enhanced, and health insurance began to get initial development in this period. After the financial crisis in 2000, the investment type insurance (linked investment, annuity, etc.) which transferred the risk to customers gradually developed.

Because of the huge interest margin loss saved before, the government has launched some short-term (6-year deposit type fixed-term products, investment floating insurance) and so on. From the investment side, the aging population makes the public have a stronger investment demand. From the liability side, the insurance company can transfer part of the risk to the policyholder. But even so, the spread problem has not been completely solved.

In addition, there are two trends that cannot be ignored. On the one hand, although Taiwan implemented the universal insurance system in 1995. However, the total amount of health insurance in Taiwan has increased from 19.6 billion in 1995 to about NT \$380 billion. Another trend is that the traditional savings insurance continues to grow, which is mainly due to three aspects: (1) the aging of the population, the elderly need endowment insurance; 2) Taiwanese have a strong desire to save, and the insurance interest rate is higher than banks. 3. Preferential tax policy, the deduction of insurance income per person per year shall not exceed NT \$24000).

### **6.3 Problems exposed through the development of Japan and Taiwan.**

It is not difficult to see from the above that the insurance industry in Japan and Taiwan has a complete and rich experience in life insurance due to its early development.

But China's insurance industry is still in the growth period, so it is slightly inexperienced. But it is always right to learn from history. By analyzing the problems experienced by the life insurance industry in Japan and Taiwan, we can evaluate whether the current decision-making of China's life insurance industry is reasonable and whether it will ensure that life insurance companies will survive a period of low interest rate.

For the life insurance industry of Japan and Taiwan, both of them have developed Japan and Taiwan into one of the most developed life insurance areas in the world. Both of them have achieved long-term growth in terms of life insurance depth, density and number of insured units per capita. However, until more than ten years or even twenty years after the financial crisis, the life insurance industry of these two regions still bear heavy interest rate spread loss. For example, the return on investment of Cathay Pacific Life Insurance in 2010 was 3.5%, while the cost of liabilities was 4.83%. Although it can be barely maintained through fee difference and dead spread, the profit margin loss accumulated ten years ago still leads to the unstable growth of its profits in these years.

For a smart investor, we don't care how much a company's sales (that is, the number of policies or premium income of a life insurance company) in a certain period of time. Rational investors care whether such a large amount of premium can bring investors (shareholders) a stable annual net profit growth.

Therefore, why is it worthwhile to invest in the stocks of China's life insurance industry, which is a latecomer and has little practical experience, please see the next part.

Summary: after learning the lessons from the history of Japan and Taiwan, China's life insurance industry has made strategic adjustments in the development of debt side, investment side and agent system, so as to smoothly pass the low interest rate period and achieve stable profits.

## **7 THE DIVERSIFICATION OF CHINA'S LIFE INSURANCE INDUSTRY AT THE LIABILITY SIDE AND THE RETURN GUARANTEE MAKE THE INTEREST RATE SENSITIVITY DECREASE.**

### **7.1 The first big interest spread loss in China's life insurance industry has been digested**

From 1997 to 1999, China's insurance industry appeared the first large-scale spread loss. At that time, the successive sharp interest rate cuts in the late 1990s (from the peak of 10% to the current 2.25%) led to the insurance companies' stock business liabilities far greater than the investment income. However, because the insurance industry was still in a very immature stage, the amount of premium in the three years was large, but it did not cause a devastating blow.

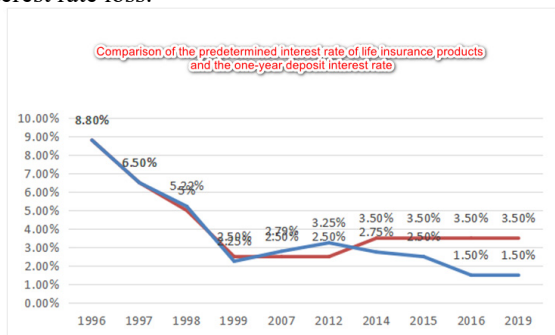
After that, the insurance industry, which came out of the crisis, introduced new debt side products such as linked investment, dividends and variable annuity to alleviate the impact of accumulated high interest rate insurance policies. And a series of reform measures have

been taken. Therefore, with the rapid growth of the total amount of premium, and more and more, the problem of interest spread loss in 1997-1999 was almost solved after ten years 16.

**7.2 At present, the expected interest rate of life insurance industry in China is not high, which is unlikely to cause interest spread loss.**

After experiencing the huge and heavy loss spread loss crisis from 1997 to 1999, the regulation has long suppressed the expected interest rate of life insurance products at a conservative level (the expected interest rate will be reduced again to 3.5% in 2019).

The interest rate difference between the expected interest rate of 3.5% and the expected long-term investment rate of 5% is 1.5%, which is unlikely to cause interest rate loss.



**Figure 26.** comparison between the yield curve of China's banks and the expected yield curve of China's life insurance products

**7.3 Changes in the product structure of China's life insurance industry**

China's life insurance industry returns to security, and the proportion of premium difference and dead spread to income contribution is increasing.

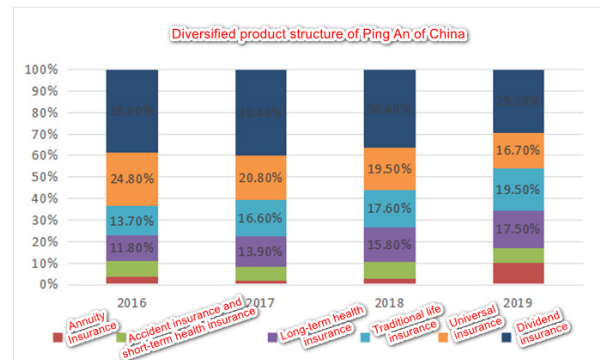
1) Since the CIRC issued the "1 + 4" series of documents in 2017, China's major insurance listed companies have shifted their focus to focus on the growth of NBV and the development of security products. The proportion of health insurance increased from 4.2% in 1999 to 22.8% in 2019. Because the security products are more dependent on dead profit and fee differential benefit. This ensures that in the low interest rate environment, these insurance companies can also rely on diversified products to resist risks.

In the case of interest rate continuing to be in place, China's insurance companies have made adjustments to the product structure at the liability end.

2) China's insurance companies, such as health insurance, universal insurance, annuity insurance and dividend insurance, have a balanced and prudent allocation. The latest products guarantee interest rates are not high. With the balanced development of these new products, the liability side of China's life insurance industry has become increasingly resistant to risk. As mentioned above, China's life insurance industry has begun to return to security and rely less on interest spread.

Moreover, not only the new health insurance, but also the investment linked insurance, dividend insurance and universal insurance introduced in China since the 21st century have made the liability side of China's life insurance industry more diversified.

In addition, the new products enable insurance companies to reduce the dividend and the current interest rate of products in the period of low market interest rate, which makes insurance companies effectively resist the low interest rate environment of the market. Figure 32 shows the diversified products of Ping An in China.



**Figure 27.** product structure diversification of Ping An in China7.4 Summary

First of all, the spread loss crisis accumulated in 1997-1999 did not cause a huge impact on China's new insurance industry, and then the rapid development of the insurance industry in the next two decades has offset the impact of the spread loss.

Second, China's regulatory system has set the predetermined interest rate at a very low level for a long time, which has been maintained at 2.5% for 13 years after 1999. Even though it was raised from 2.5% to 4.025%, last year, in the tide of global interest rate reduction, China's Insurance Regulatory Commission (CIRC) quickly reduced the predetermined interest rate to 3.5%. It is unlikely that there will be any more spread losses at the moment.

Third, since 2017, since then, insurance companies have not been concerned about achieving the goal of premium growth, but have focused on the development of high NBV products, making the insurance industry as a whole less sensitive to interest rates 17.

From the above three points, we can see that the debt side of China's insurance industry is developing steadily, and the crisis of Japan and Taiwan will not be repeated in the near future.

**8 THE DIVERSIFICATION OF INVESTMENT SIDE ASSET ALLOCATION IN CHINA'S LIFE INSURANCE INDUSTRY CAN MAKE THE PROFIT OF LIFE INSURANCE INDUSTRY NOT LIMITED BY THE INTEREST RATE**

The government relaxed the restrictions on the subject matter of insurance investment

In 2012, the regulation promulgated new regulations on the use of insurance assets, allowing insurance companies to invest in more diversified investment

varieties, and liberalized the allocation of non-standard products. Since then, the investment structure of insurance companies has changed greatly after the revision of the regulations on capital utilization management in 2014. Since then, alternative asset investment has surpassed bond investment for the first time, becoming the investment variety with the largest proportion of insurance capital allocation. As a result, the return on investment of listed insurance companies increased from 4.8% in 2013 to 5.28% in 2016

In addition, insurance companies also allocate a large number of local bonds with maturities of more than 10 years, which can ensure that the insurance companies will not be disturbed by the downward interest rate in the long run. In recent years, the number of long-term local and government bonds and special bonds has also increased significantly. By increasing the allocation of these 10-year and other long-term local debts, Ping'an's debt duration has decreased from 8 years to 6 years. The following is the change of China's debt issuance, cited from future think tanks.

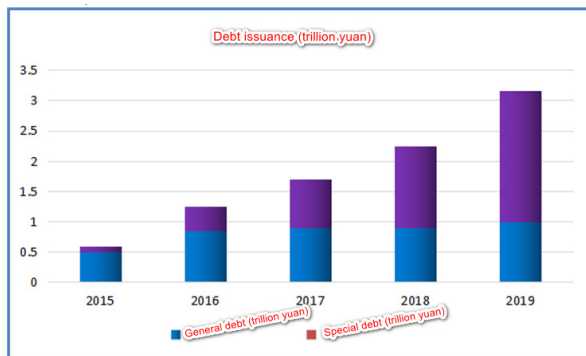


Figure 28. debt issuance (general and special)

## 9 CHINA'S SUPPLY SIDE CHANNEL REFORM: DEEPENING THE CULTIVATION OF HIGH-QUALITY AGENTS.

### 9.1 After the change of insurance business structure, the complexity of new security products is high, which makes most life insurance companies begin to adjust and update the old agent system.

This year, China's insurance industry pays special attention to the reform of the agent channel, which is due to the need of product structure adjustment. In the next five to ten years, China's most important insurance sales channel will return to the insurance agent channel 18.

Before 1999, China's main insurance products were traditional life and death insurance, life insurance and term life insurance. Therefore, in 1992, the agent system which has been used for a long time in the world has been popular in China, and the number of agents has developed rapidly. However, in the early development process of life insurance agent system, due to the increasingly fierce competition, the first very high-quality agent team left the life insurance industry one

after another. Most of the people who came after 1997 were not as good as before. Therefore, at that time, the impression of Chinese people on the life insurance industry was low quality.

After 1999, in order to alleviate the influence of interest spread loss and survive the period of low interest rate, China's life insurance industry has introduced annuity insurance, universal insurance, dividend insurance and other advanced foreign insurance. At this time, bancassurance channels are popular. At the highest time, bancassurance channels account for 50% of the total premium sales. After 2008, due to the big bear market in the stock market and the regulations issued in 2011 (the premium income of insurance companies in financial statements does not include the fees paid by customers who purchase omnipotent insurance and link the two types of insurance). After that, the insurance industry continued to keep low interest rates, which forced regulators to open up the insurance investment channels.

However, after the release of the "4 + 1" document in 2017, the development of high NBV products has become the primary goal of the entire insurance industry. At this time, because of the high complexity of the new type of security products (high NBV products), the original agents with poor overall knowledge and quality do not meet the requirements of the insurance industry for the quality of new agents. Therefore, each company began to develop the transformation and upgrading of agent channel.

A high-quality agent team is conducive to tapping into the needs of customers and changing the public's previous attitude towards the insurance industry.

### 9.2 Since then, in 2014-2016, high interest rate and low renewal policies have become popular, and the proportion of Bancassurance channels has risen again.

Although there are many potential insurance users in China, they are not just needed for some indemnificatory health insurance or some complicated and expensive insurance types. Therefore, a professional insurance agent team can dig into the needs of potential customers and provide them with one-on-one consulting services. This is conducive to improving the sales revenue of security products and the sales of complex types of insurance (all of which are high marginal value insurance).

In addition, in the early development of the insurance industry, most of the insurance companies are oriented to increase the premium income, without considering the service quality of customers or the public's evaluation of the insurance industry. Therefore, the public's early impression of the life insurance industry is: low quality, low quality, in order to achieve the purpose of "cheating" customers. For example, after ping an introduced the investment linked insurance at the beginning of the 21st century, many internal agents claimed that the annual return rate of investment linked insurance could reach 20% in order to enable customers to buy new type of

investment linked insurance. It can be seen that there were many sales chaos in the insurance industry at that time, which affected people's comprehensive evaluation and cognition of the insurance industry. At present, improving the quality of agents can help customers to meet their real needs, instead of attracting customers by cheating and hiding risks. In this way, the overall reputation of the insurance industry will be gradually restored. When people believe in insurance companies more, the potential purchase demand will be tapped out, and the insurance industry will get more profits. Therefore, it can be seen that the domestic insurance stocks in China's H-share market will usher in huge investment opportunities in the future.

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