



Risk Management in China

The current status

**A presentation to ASHK Risk Management Regional
Conference
by Michael Ross**

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Agenda

- Background to the China life insurance market
- Regulatory environment for risk management
- What is the current state of risk management in China
- Future direction for China



Background to the China life insurance market

Background to the China Insurance market

- There are 53 life insurance companies operating in China
 - 25 of these are classified as domestic insurers
 - A number of these have foreign shareholdings
 - 28 of these are classified as foreign insurers where the foreign holding is over 25%, although recently there have been a move from JV's to domestic
- Total life premiums in the year to 30 November 2009 amounted to RMB746 billion (USD 109 billion)
 - Domestic insurers accounted for RMB 709 billion (USD 104 billion) or 95% with the foreign companies only at 5%.
 - The top 6 domestic insurers account for RMB643 billion (USD 94 billion) with or market share of 86%

Concentration in a few domestic insurers



Regulatory environment

Risk management regulatory environment in China

- Main regulation was issued in 2007 and covered
 - Principles for a sound risk management framework
 - Identified the risk categories to be assessed
 - Discusses the composition of effective risk controls.
 - Insurers are required to perform an assessment of the effectiveness of their internal risk management systems
 - Submit a risk assessment report to the CIRC disclosing any perceived risks
- Each of these requirements are discussed in the following slides

Regulatory environment in China

- Main regulation was issued in 2007 and covered
 - Principles for a sound risk management framework
 - Unification of comprehensive management and focused supervisory control
 - Unification of independent concentration and division cooperation
 - Unification of sufficiency ,efficiency and cost control
 - Identified the risk categories to be assessed
 - Insurance companies should identify and value main categories of risks in the operation process, including: insurance risk, market risk, credit risk and operation risk, etc
 - The risk management department of insurance company should share information with operation department, collecting, collating internal and external risk management related information, to build the information basis of risk valuation.
 - The measurement unit and measurement model for different categories of risks should be consistent.
 - Insurance companies should analyze the correlation between different categories of risks.
 - The management of the risk information should be dynamic to identify new risks and reevaluate original risks

Regulatory environment for risk management

- Discusses the composition of effective risk controls.
 - Risk control includes: establishing risk management overall strategy, working out risk solutions as well as organizing and carrying out the solutions
 - The overall strategy means the overall arrangement of defining focus of risk management, defining risk limit, choosing risk management tools and allocating risk management resource etc
 - Insurance companies should analyze and compare different categories of risks to define the focus of risk management, according to the occurrence possibility of risks and their effect to the operation objectives
 - According to different categories of risks, we can choose different risk management tools such as: risk elusion, reduction, transfer or remaining etc
 - Risk solution includes: the specific objectives of resolving the risk, related management process and operation process, required condition and resource, used specific measures and risk management tools etc

Regulatory environment for risk management

- Insurers are required to perform an assessment of the effectiveness of their internal risk management systems
 - Insurers should assess the effectiveness of the risk management process and improve the process
 - Every function department and operation department should perform regular assessment of risk management and report to risk management department
 - Risk management department should assess regularly the risk management of function and operation departments, and give improvement suggestions
 - Risk management department should submit risk assessment report to the managers and the board of directors at least once a year
 - Intermediaries can be employed to do the assessment of the risk management of the insurers and give an assessment report

Regulatory environment for risk management

- CIRC disclosing any perceived risks
 - Insurers should report to the CIRC disclosing significant risk events
 - Insurers should submit a risk assessment report deliberated by the board of the directors in their annual report
 - The CIRC should inspect the risk management of insurers regularly
 - The CIRC should give suggestion letter to insurers with significant problems on risk management, according to the inspection result. Insurers should submit improvement plans timely , carry out the plans and submit the improvement report

Regulatory environment for risk management

Further regulations

- In 2008 solvency administrative provisions were issued
 - This regulation requires the establishment of a risk based solvency framework and covers a number of areas including:
 - Asset management
 - Liability management
 - Management of the match between assets and liabilities
 - Capital management
 - Under each of these areas the provisions mentioned a number of actions which are required.
 - “it shall identify, prevent and eradicate the risks relating to concentration, credit liquidity, market and other asset risks mainly through the following ways...”
 - ...identify, prevent and eradicate the acceptance, guarantee, financing and other liability risks...”
 -

Regulatory environment for risk management

Further regulations

- In 2009 regulation on strengthening the management of the risks of insurance allocation with the aim to “prevent” systematic risks.
- Need to examine
 - Product pricing risks
 - Asset mismatching risks
 - Interest rate risks
 - Intensify the compliance of the business operation

**The approach is very compliance driven
talks about “eradication”**



Current risk management status

What is the current state?

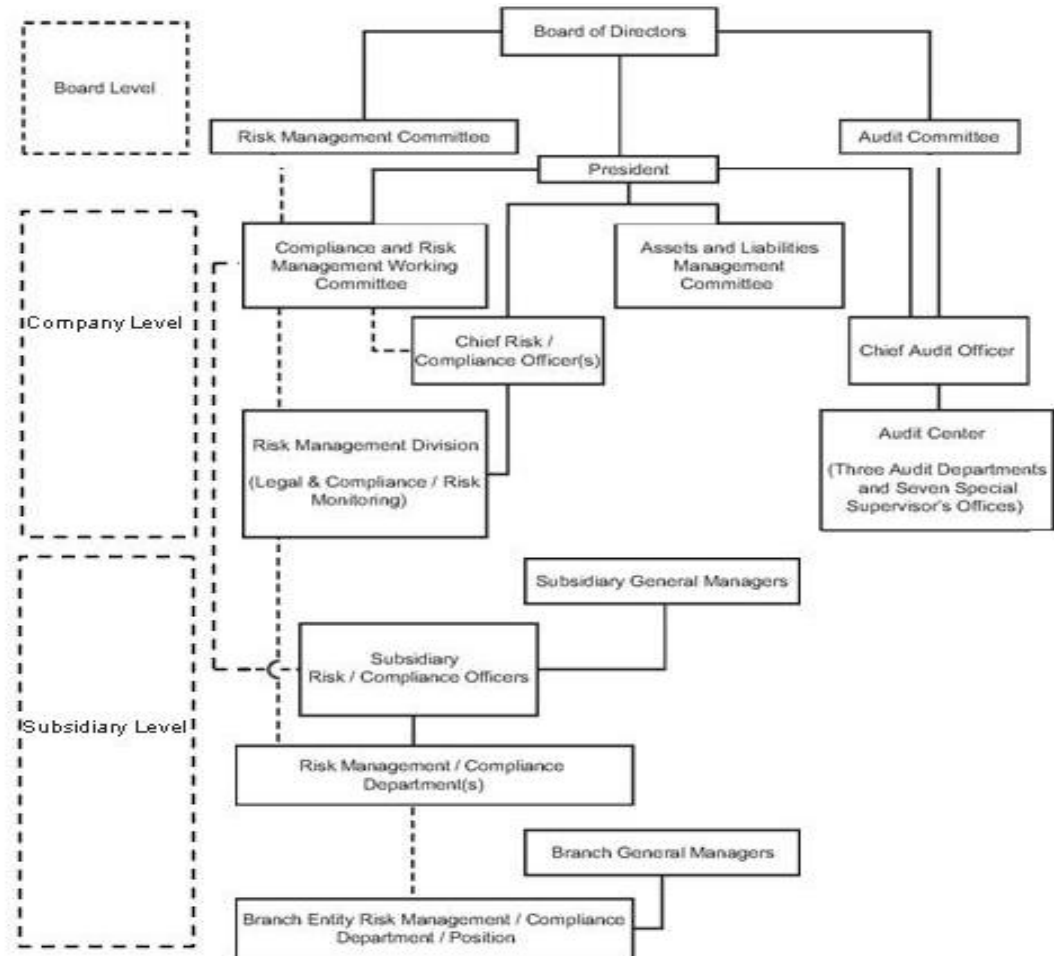
- Companies have established a “risk management” function
 - Examining the risks involved in the insurance company and looking to see what the risks are.
 - Different companies are at different stages of the process
 - The larger and more established companies are more advanced, probably because they have a more mature portfolio
 - The newer and smaller companies are less developed - probably because they have very different issues such as business growth and expenses constraints.
 - Cost of implementation and managing
 - Incompatible software technology which makes analysis difficult
 - Too many manual processes
 - Controls which are too numerous or restrictive
 - Portions of the process which are dependent on individuals who are not always available
 - Lack of visibility and accountability
 - The need to document audit trails

Ping An Risk assessment

- Ping An has reports their risk management process as covering
 - Insurance risk
 - Where they consider occurrence, severity and development risk and mention ways in which these risks are managed.
 - They mention the effect of having participating policies where the insurance risk is shared with the policyholders
 - Market risk
 - The main risks considered are currency, interest rate and price risks and the methods which these are managed
 - Financial risk
 - This considers the credit and liquidity risk and the way these are managed
 - Mismatching risk of assets and liability
 - Under this risk the company is looking to lengthen the duration of the asset portfolio to narrow the gap.
 - Operation risk
 - This is managed by better processes and well documented procedure

CPIC

- CPIC in its recent prospectus showed the following chart for its risk management process
- The process of managing the risks is complex with a number of committees
 - These include the Audit, Risk Management, Compliance and Assets and Liabilities Management committees
 - In addition there are a number of departments in the various subsidiaries for risk management and compliance matters



Other companies

- Both of these companies are listed hence the need to show investors that they are managing the risks
- The more mature companies are still developing their processes and management and are at various stages of development
 - The more mature companies will have in place many of the correct processes.
 - The smaller companies are less likely to be as well developed and have a greater focus on the more important items such as asset quality, expense control and growing the business.
 - Reinsurance to control mortality and sometimes capital constraints.
 - Is this risk management/
 - ALM is relatively simple
 - Only for the Investment committee and not overall risk management

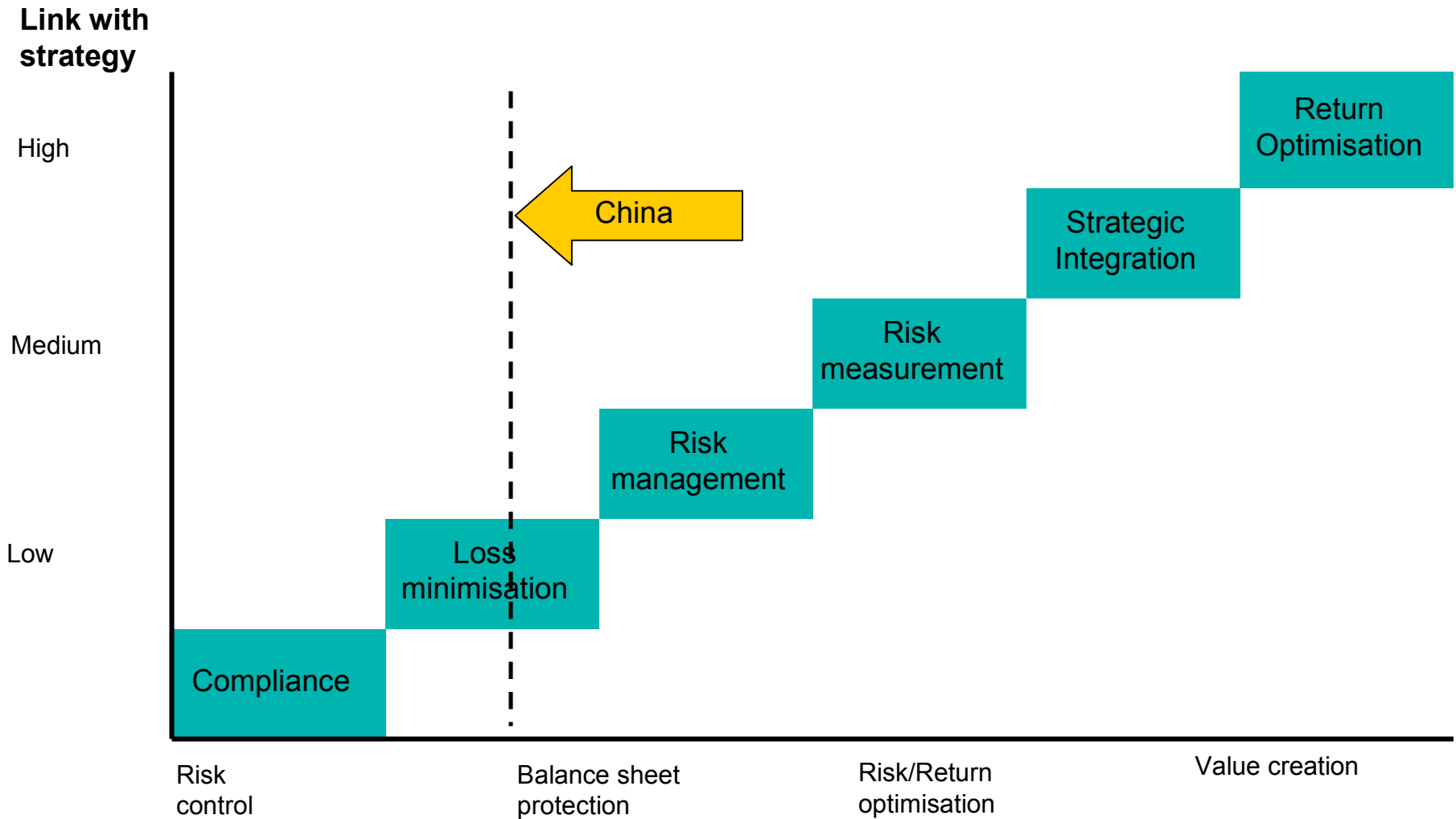
Current state - overall

- Some of the more advanced companies are at a relatively advanced stage of development
 - While others are not
- Concerns over current state
 - Do the managers believe in risk management or is this just “lip service”
 - Appears to be heavy compliance driven
 - Do companies understand the interrelationship of risk?
 - The current status looks very silo orientated
 - Have the risks been properly quantified and do companies focus on the important risks.
 - For the smaller companies the biggest risk is probably distribution risk or the ability to grow and should be a major focus, but will spend as much time on investment, liability risks.
 - Regard the “past as a good guide” to the future.



Future direction

Evolution of Enterprise Risk management



Source: International Actuarial Association

Practice note on enterprise risk management for capital and solvency purposes in the insurance industry

Future direction - drivers

- **New accounting rules**

- The variability of results will force companies to look at ways to reduce this volatility.
- Greater transparency of the results and calculation approach will change behaviours
- The current standard mentions including risk margins in the reserves. To justify these could have a reference back to the risk appetite of the company

- **Solvency changes**

- These could impact on the way the assets in particular are managed
- Solvency II is based on how well companies manage their risks and there must be “proof” of doing so.

- **Regulatory pressures**

- The CIRC has this as top of awareness at the moment and will constantly push this aspect

- **Valuation approaches**

- MCEV requires the measurement of the options and guarantees while the current traditional approach has it incorporated into the risk discount rate. If the cost of the options and guarantees is understated companies will look at ways to minimise the risk

Enterprise risk management

- China will eventually move towards the rest of the world
 - It will embrace Enterprise Risk Management (ERM) but the timing will be some way and this will happen when companies regard

ERM is as not the next step in evolution of risk management...

But ERM is the next step in evolution of business management.

Contact Details

- Michael Ross
 - +86 21 5298 6366
 - michael.ross@towerswatson.com