



Trends and Developments in Potential Financial Reporting Requirement in China

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Agenda

- A quick review of insurance financial reporting regulation in China
- Recent discussion/updates of financial reporting
- Projection of the development

Review of the history

- 1984 PICC accounting principle (PICC)
- 1993 Insurance Enterprises Accounting regulation (MOF)
- 1998 Insurance Company Accounting Regulation (MOF)
- 1999 First identify calculation method of life insurance liability (CIRC)
- 1999 First China Mortality table officially implemented
- 2002 Financial report on par and unit-linked business (CIRC)
- 2002 Specific detailed requirements on annual financial report (CIRC)
- 2003 Solvency requirement (CIRC)
- 2003 Valuation of non-traditional products (Par, unit-linked, & UL) (CIRC)
- 2004 Insurance Guaranteed fund regulation (CIRC)
- 2004 Solvency report detailed requirements (CIRC)
- 2004 Broker financial reporting (CIRC)
- 2005 Annual actuarial report--Comprehensive financial reporting for life insurance companies (CIRC)
- 2005 Non-life insurance reserve regulation implemented (CIRC)
- 2006 Life insurance Embedded Value principle (CIRC)
- 2006 Updated Enterprises Accounting Principle (MOF)

Current Implementation

- Liability valuation – Life Insurance
 - Regulation
 - 1999 (Jun) Notification of Actuarial regulation
 - 2003 (May) Notification of Actuarial regulation on non-traditional products
 - 2004 (Dec) Insurance Companies Non-life business reserve regulation
 - 2005 (Jan) Notification of Actuarial Report Regulation
 - Implementation
 - Prospective method (1999)
 - Policy basis (1999)
 - Calculation method
 - A&H reserve similar to P&C (2004)
 - Long-term life policy: FPT & revised net level premium (1999)
 - Deficiency reserve requirement (1999)
 - Valuation should not be less than CSV (1999)
 - Claim reserve (2004)
 - Assumption
 - Max valuation interest rate (1999)
 - mortality & morbidity requirements (2005)
 - Dividend booking and reserve (2003)
 - Assets valuation on unit-linked products (2003)

Current Implementation

- Liability Valuation – P&C
 - Regulation
 - 2004 (Dec) Insurance Companies Non-life business reserve regulation
 - Implementation
 - Un-earned premium: 1/24 method or 1/365 method
 - Deficiency reserve should be considered
 - Claim reserve:
 - Reported claims: case basis
 - IBNR, at least 2 form listed 4 methods
 - Claim expense reserve
 - Valuation report should be submitted regularly

Current Implementation

- Specified non-traditional products
 - Regulation
 - 2000 (Feb) par insurance provisional regulation
 - 2000 (Feb) Unit-linked insurance provisional regulation
 - Implementation
 - Insurance companies should submit specific financial reporting to CIRC on par insurance, including balance sheet, income statement, allocation of revenues & expenses, etc. The report should be signed off by appointed actuary, and audited by registered auditor
 - Ins companies should submit annual par insurance financial report to CIRC before Apr 1, every year
 - Insurance companies should submit annual financial report on investment account of unit-linked products to CIRC before the end of each Mar

Current Implementation

- Solvency requirement
 - Regulation
 - 2003 (Mar) Insurance Companies' solvency Margin and regulatory index regulation
 - 2005 Solvency report guide principles (No 1-9)
 - 2006 (Feb) Notification of Editing the solvency report on 2005
 - Implementation
 - P&C companies: max of the below 2:
 - $18\% * \text{min (net prem after reins last year – prem tax, 100M)} + 16\% * \text{max (net prem after reins last year-prem tax-100M, 0)}$
 - $26\% * \text{min (average claim payment of recent 3 years, 70M)} + 23\% * \text{max (average claim payment of recent 3 years – 70M, 0)}$
 - Life companies:
 - Long term life insurance: Sum of A & B
 $A = 1\% * \text{EOP stat reserve of unit linked products} + 4\% * \text{EOP stat reserve of other products}$
 $B = 0.1\% * \text{NAAR of term policy with term} < 3 \text{ years} + 0.15\% * \text{NAAR of term policy with term} \geq 3 \text{ yrs but} < 5 \text{ yrs} + 0.3\% * \text{NAAR of term policy with term} \geq 5 \text{ yrs}$
 - Short term life insurance: same as P&C
- Insurance companies should submit solvency report every year before Apr 30
- Actual solvency margin = admitted assets – admitted liability
- Solvency adequacy ratio = actual solvency margin / required solvency margin
- Admitted asset = book value of asset * admitted ratio
- If solvency adequacy ratio < 100%, relevant regulator actions will be taken.

Recent Implementation

- Other actuarial valuation and reporting
 - Regulation
 - 2005 (Jan) Notification of Actuarial Report Regulation
 - 2005 (Sep) Life Insurance Embedded Value report guidance Principles
 - Implementation
 - Embedded Value report
 - Asset adequacy testing & report

Recent Implementation

- Enterprises Accounting Principle (2006)
 - Raise the definition of “insurance risk” and differentiate it from “non-insurance risk”
 - Add reserve adequacy test requirement
 - Separate insurance contract and reinsurance contract
 - Some previous discussion of trends became clear:
 - Revenue identification and confirmation
 - Acquisition cost fully booked in first year (not deferred)
 - Reserve calculation principle reflects the effect of high acquisition cost

Recent Implementation

- Reserve/Assets adequacy Analysis
 - In force business projected to end of policy mature
 - UL & unit-linked not included
 - Grouping is acceptable
 - Liability Valuation
 - Method
 - Gross Premium method with defined discount rate
 - Or sound verification that the operation risk being analyzed has been strictly controlled or the calculation of reserve is conservative enough
 - CF projection
 - Best estimated assumption for cash flow other than inv income
 - Listed analyzing method for inv income projection
 - At least 7 int rate scenarios for testing

Trends Projection

- Some topics
 - Do UL and VUL belong to insurance contract or not?
 - One system or two systems?
 - The current one is statutory or GAAP?
 - Who should take the ownership on the GAAP reporting of insurance besides CIRC?
 - Which way will probably be followed
 - US GAAP or IAS?
 - To what extent the “Chinese characteristics” be built in?

Trends Projection

- A separate insurance GAAP system still takes more time to be introduced
 - No insurance companies plan to be listed recently in mainland China
 - The ownership is not clear so far
- The current solvency requirement is expected to be maintained
- A parallel system of financial reporting born inside insurance industry
 - Closer to IAS
 - Deferrable expense is still not accepted according to recent “Accounting Guidelines” published by MOF
 - MOF’s efforts to be closer to IAS
 - Some expected differences such as disclosure of TPT
 - EV report will start from Jan 2007
 - A trend to fair value report, echo the most recent accounting Guidelines
 - The assumptions need further discussion & verification
 - The reserve/Assets adequacy analysis is a good practice
 - Where and how to use EV report will be clarified gradually
 - Based on EV report, a valuation system comparable with general industry is foreseeable

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