March 11, 2015

China's Regulator Strengthens Governance and Capitalization of the Reinsurance Sector

More reinsurance placements are expected to be diverted to onshore reinsurance companies.

The China Insurance Regulatory Commission (CIRC) officially unveiled the implementation of the second generation of its solvency regime, known as the China Risk Oriented Solvency System (C-ROSS), on February 15, 2015. Effective immediately, there will be a transitional period whereby insurance companies will be required to continue to fulfill requirements of the current solvency regime while simultaneously submitting a solvency report based on the new C-ROSS requirements.

Under C-ROSS requirements, the credit risk charge on reinsurance recoverables is expected to bring significant change to the reinsurance market. Among the new standards, this proposed credit risk charge on reinsurance recoverables received the most feedback from insurance industry stakeholders in China during the consultation period.

The final rules issued by the CIRC in February have generally resulted in lower base risk factors on reinsurance recoverables, in comparison with the factors set out in the original proposal. Nonetheless, the framework on the reinsurance credit risk capital requirement calculation remains largely unchanged. However, stricter requirements will still be imposed on placing reinsurance with offshore reinsurance companies. Direct insurers which choose to cede to onshore reinsurance companies fulfilling regulatory solvency requirements will have a lower credit risk charge imposed on their reinsurance recoverables. Offshore reinsurers will be required to post additional collateral to secure their payables to direct insurance companies in China.

As a result, A. M. Best believes direct insurers will likely revise their reinsurance programs or panel of reinsurers in order to better manage their solvency requirements arising from reinsurance credit risk under C-ROSS. More reinsurance placements are expected to be diverted to onshore reinsurance companies, with a corresponding reduction of offshore reinsurance purchases. In other insurance markets, some regulators also impose stricter requirements on reinsurance placed with offshore reinsurance companies. China's insurance industry has already anticipated that more reinsurance will be retained in the local market under the new solvency regime.

In the near term, A. M. Best expects this change in C-ROSS will trigger higher reinsurance concentration in the local market. In the longer term, more international or regional reinsurance companies will seek to build a presence in China, which will strengthen the CIRC's governance on reinsurance companies that aim to take a share in China's insurance industry as a whole.

For international reinsurance companies currently with operations in China and retroceding large volume of business offshore, capital requirements will also likely increase according to the credit risk factors for retrocession recoverables under C-ROSS. Therefore, these reinsurers may need to strengthen capitalization of their operations in China, implying better security to China's direct insurance companies transacting with these reinsurers.

Analytical Contact
Jeff Yeung, Hong Kong
+852 2827 3413
Jeff.Yeung@ambest.com

Researcher & Writer
Iris Lai

Reinsurance companies operating in China, which include China Re, Gen Re, Hannover Re,

Copyright © 2015 by A.M. Best Company, Inc. ALL RIGHTS RESERVED. No part of this report or document may be distributed in any electronic form or by any means, or stored in a database or retrieval system, without the prior written permission of the A.M. Best Company. For additional details, refer to our *Terms of Use* available at the A.M. Best Company website: www.ambest.com/terms.

Lloyd's, Munich Re, Scor, Swiss Re and Taiping Re, together reported a 35% rise in reinsurance premium to CNY 97.8 billion (USD 15.6 billion) in 2013.

For China's new solvency regime, reinsurance credit risk is only part of the many factors considered in C-ROSS's capital requirement framework. C-ROSS will provide guidance to Chinese insurance companies in understanding and linking capital requirements with three broad categories of risk underlying their operations: insurance risk, market risk and credit risk.

A.M. BEST COMPANY WORLD HEADQUARTERS	•	Oldwick, NJ	•	+1 (908) 439-2200
Washington Office	•	Washington, DC	•	+1 (202) 347-3090
A.M. Best América Latina, S.A. de C.V.	•	Mexico City, Mexico	•	+52-55-5208-1264
A.M. Best Asia-Pacific Ltd.	•	Hong Kong	•	+852 2827-3400
A.M. Best Asia-Pacific (Singapore) Pte. Ltd.	•	Singapore	•	+65 6589 8400
A.M. Best Europe Rating Services Ltd.	•	London, UK	•	+44 (0)20 7626-6264
A.M. Best Europe Information Services Ltd.	•	London, UK	•	+44 (0)20 7626-6264
Dubai Office* (MENA, South & Central Asia)	•	Dubai, UAE	•	+971 43 752 780

*Regulated by the DFSA as a Representative Office

Important Notice: A Best's Financial Strength Rating is an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. It is based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile. These ratings are not a warranty of an insurer's current or future ability to meet contractual obligations. The Financial Strength Rating opinion addresses the relative ability of an insurer to meet its ongoing insurance policy and contract obligations. The rating is not assigned to specific insurance policies or contracts and does not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of the insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder. A Financial Strength Rating is not a recommendation to purchase, hold or terminate any insurance policy, contract or any other financial obligation issued by an insurer, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser. In arriving at a rating decision, A.M. Best relies on third-party audited financial data and/or other information provided to it. While this information is believed to be reliable, A.M. Best does not independently verify the accuracy or reliability of the information. For additional information, see A.M. Best's Terms of Use at www.ambest.com/terms.html.

SR-2015-B-650