Credit Opinion: China Life Insurance Co Ltd

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Ratings

Category	Moody's Rating
Rating Outlook	POS
Insurance Financial Strength	A1

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Key Indicators

China Life Insurance Co Ltd[1]

	2010	2009	2008	2007	2006
Total Assets ($ Mil.)	$ 1,410,579	$ 1,226,257	$ 987,493	$ 933,704	$ 764,395
Shareholders' Equity ($ Mil.)	$ 208,710	$ 211,072	$ 173,947	$ 205,500	$ 139,665
Net Income ($ Mil.)	$ 33,811	$ 33,036	$ 19,274	$ 39,060	$ 20,051
Total Revenues ($ Mil.)	$ 385,838	$ 339,290	$ 300,385	$ 191,372	$ 147,311
High Risk Assets % Shareholders' Equity	103.0%	88.3%	47.4%	97.7%	72.4%
Goodwill & Intangibles % Shareholders' Equity	0.0%	0.0%	0.0%	19.8%	28.0%
Shareholders' Equity % Total Assets	13.6%	16.1%	17.0%	20.4%	17.2%
Return on Capital (1 yr.)	16.0%	17.0%	10.1%	22.5%	18.1%
Sharpe Ratio of ROC (5 yr.)	374.3%	313.8%	---	---	---
Adjusted Financial Leverage [2]	1.7%	1.6%	1.6%	1.1%	1.6%
Total Leverage [2]	1.7%	1.6%	1.6%	1.1%	1.6%
Earnings Coverage (1 yr.) [2]	204.0x	212.2x	125.2x	349.3x	197.5x
Cashflow Coverage (1 yr.) [2]	N/A	N/A	N/A	N/A	N/A

[1] Information for 2008-2010 is based on IFRS; 2006-2007 is based on HKFRS [2] At China Life Insurance Co level only, not at China Life Insurance (Group) Company level

Opinion

SUMMARY RATING RATIONALE

China Life Insurance Co Ltd is the largest life insurance company in China. It offers term life, whole life, endowment, annuities, universal life, accident, and health insurance products. It is 68.37%-owned by The China Life Insurance (Group) Company (CLIC), which is ultimately wholly owned by the Ministry of Finance (MoF) of the People's Republic of China.

Because of the 68.37% effective ownership by the MoF, Moody's applies not only its Global Rating Methodology for Life Insurers, but also its Rating Methodology for Government-Related Issuers (GRIs), to rating China Life. This involves assessing the probability of support from, and the company's dependence on, the government.

The A1 insurance financial strength (IFS) rating on China Life reflects the following inputs:

- A baseline credit assessment (BCA) of 5 (on a scale of 1 to 21, where single A level assessments are equivalent to a range of 5 to 7)

- The Aa3 local currency rating of the Chinese government

- A "high" level of dependence, reflecting China Life's exposure to China's economic environment (especially in light of its large investment portfolio of equities and fixed-income securities)

- A "strong" level of support, reflecting the strategic importance of China Life as the flagship company in the life insurance industry and its majority ownership by the state.

China Life's BCA reflects its exceptional market position and a vast distribution network throughout the country. Its long-term premium growth prospects are also favorable in light of strong economic growth in China and low insurance penetration.

China Life also has a strong and stable profitability track record unencumbered by a legacy negative spread burden - a result of the transfer of high guarantee policies at its listing in 2003 to CLIC. Further, China Life's capitalization is solid, its financial leverage minimal, and its investment strategy conservative. Many of its financial metrics compare very well with those of its global peers.

Nonetheless, China Life needs to maintain a high level of capitalization to support its strong growth, for which it may have to cut its cash dividends. In addition, its profitability is still very sensitive to changes in the investment market.

China Life also faces the challenge of maintaining its market share as competition heats up in the life insurance sector, due to regulatory changes affecting distribution channels and to the growth of domestic and foreign players.

Moody's A1 rating on China Life is the same as its BCA, and does not incorporate any uplift from potential support due to its government ownership. This is because Moody's has taken into account China Life's significant exposure to the banking sector through its investments in equities, financial bonds, and corporate bonds guaranteed by the banks. The Chinese banks have played an important role in supporting government policy initiatives. In Moody's view, however, asset quality is likely to deteriorate, as we believe the banks' current levels of non-performing loans are at or near cyclical lows. Given the year over year double digit premium growth at China Life, any strain on its capitalization from external pressures such as losses from its bank investments would weaken its financial profile. As a result, Moody's has kept China Life's rating at the single A level.

In addition, China Life has stated that it intends to invest further in the banking industry, through both financial investments and direct shareholdings. Moody's will evaluate the impact of any investments - particularly any sizeable ones - on the rating in light of the company's strategic direction, capitalization, and leverage, as well as potential synergies.

Credit Strengths

- Formidable market position and vast distribution network in the Chinese life insurance market, which is growing rapidly due to robust economic growth and low penetration

- Strong and stable profitability

- Lack of a legacy negative spread burden as old policies remain with its parent, CLIC; the burden is supported by resources from the MoF

- Solid capitalization and minimal financial leverage

Credit Challenges

- Need to maintain strong capitalization to support its strong premium growth

- Profitability (including investment results) that is subject to volatility and depends highly on the economic conditions of China

- Significant exposures to the banking sector through its investment in equities, financial bonds, and corporate bonds guaranteed by the banks

- Intense competition in the life insurance sector

Rating Outlook

The rating outlook is positive, given the company's very strong business and financial profiles, and the growing credit strength of the sovereign.

What Could Change the Rating - Up

- Maintaining capital adequacy with an adjusted capital to assets ratio consistently above 16% or a local solvency ratio above 250%

- Successful diversification of its distribution channels and product offerings

- Improved asset quality helping narrow the asset/liability gap, which could be achieved via prudent overseas investments and a reduction in equity investments

- Continued improvement in risk management

What Could Change the Rating - Down

The rating currently carries a positive outlook, which could be changed to stable for the following reasons:

- A significant weakening in capitalization, with an adjusted capital to assets ratio below 12%, or a significant drop in its solvency ratio, as a result of poor profitability, high premium growth relative to capital growth, depressed investment valuations, or losses from investments through its exposure in the banking sector

- A sharp deterioration in profitability due to volatile investment income, underwriting missteps, or regulatory risk (for example, a return on capital consistently in the range of 8% to 12%, or even lower)

- An increase in holdings of high-risk assets to more than 150% of its shareholders' equity

- A material increase in the company's adjusted financial leverage to above 30% and a significant rise in the holding company's financial leverage

Recent Results and Company Events

For 2010, China Life's gross written premiums reached RMB 318.2 billion, for a 15.3% increase over 2009, attributable to an increase in first year premiums and renewal premiums. Net profit attributable to shareholders of the company RMB 33.6 billion, versus RMB 32.9 billion in 2009, and up 2.3%, which was lower than the rate of premium growth. This is due to the higher claims provisions made in 2010, as the company sold a greater proportion of longer-term products.

DETAILED RATING CONSIDERATIONS

Moody's rates China Life A1 for insurance financial strength (equivalent to a BCA of 5), which is the same as the rating indicated by Moody's IFS rating scorecard.

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook follow:

Factor 1 - Market Position and Brand: Aaa

As the largest insurance company in the country, China Life had a relative market share of 4.6x in 2010, up from 4.0x in 2009. Nonetheless, its absolute market share declined from 36.2% in 2009 to 31.7% in 2010. This indicates that the market has become more fragmented amongst the low- to mid-tier players, and yet China Life still maintained its top-tier market position.

Because of its long history as the state-owned insurer, its brand recognition and market positions in almost all cities and rural areas remain strong. Therefore, Moody's regards China Life's market position as being more in line with its Aaa-rated peers.

Factor 2 - Distribution: A

China Life's two main distribution channels are bancassurance and captive insurance agents. Diversification into other channels such as cross-selling or telemarketing will take some time as these channels are still fairly new in China. As a result, its distribution diversification will be limited for the near to medium term.

Bancassurance is one of the company's largest distribution channels, contributing around 50% of its premium income in 2010. However, new regulations issued by the China Banking Regulatory Commission will limit the stationing of insurance personnel at bank branches. In addition, each bank outlet will be allowed to sell life insurance products from only three insurance companies. Bancassurance sales will thus be adversely affected by the restrictions, but Moody's believes that China Life is well positioned in this channel, as its brand recognition and market position gives the insurer an advantage when negotiating bancassurance distribution agreements with banks.

Still, the productivity of China Life's captive agents has room for improvement, due to its young agency force.

Overall, Moody's believes China Life's distribution is consistent with expectations for an A-rated company.

Factor 3 - Product Focus and Diversification: A

China Life's product profile is in line with those of its A-rated peers. Its product risk is good given that it does not have any negative spread burden from high guarantee policies. (These policies remained with its parent company when China Life was listed in 2003.) The large block of participating policies has low guarantee rates, which does not make for significant interest rate risk.

However, the company's product diversification is limited, mostly because of its marketing strategy to focus on only two segments: traditional life and participating products. Overall, Moody's sees China Life's product focus and diversification as being consistent with those of A-rated companies.

Factor 4 - Asset Quality: A

As of December 31, 2010, China Life's high-risk assets (including equities and other loans) as a percentage of shareholders' equity came to 103.0%, up from 88.3% in 2009. The rise was due to the company's increased investments in Guangdong Development Bank and Sino-Ocean Land, in the form of equity investments in associates.

Moody's believes that China Life's capital position and income are still vulnerable to volatility given that equity will remain one of the company's important investment channels, due to the limited availability of fixed-income investment opportunities. The company has also indicated an appetite for alternative investment channels once regulatory restrictions are lifted. Therefore, Moody's regards China Life's asset quality as being at the A level.

Any significant increase in its holdings of high-risk assets such as equity investments or real estate would be a credit negative.

Factor 5 - Capital Adequacy: Aa

At end-2010, China Life's solvency ratio had declined to 212.0%, from 303.6% the previous year, although still well above the regulatory minimum of 100%. The reduction was due to premium growth, payment of shareholder dividend, as well as a relatively lower capital base resulting from lower unrealized gains in its equity portfolio resulted from volatility of the capital market.

The company's ratio of adjusted capital to total assets declined to 13.6% at end-2010 from 16.1% at end-2009. Even though these figures correspond to the Aaa category in our rating scorecard, Moody's has adjusted the final score to the Aa level, in light of our expectation that China Life's capital adequacy will decline gradually over the medium term due to double digit premium growth.

In addition, China Life's exposure to the banking sector (through its investments in equities, financial bonds, and corporate bonds guaranteed by the banks) is significant. Since the financial crisis, the Chinese banks have played an important role in supporting government policy initiatives. In Moody's view, asset quality is likely to deteriorate, as we believe that the banks' current levels of non-performing loans are at or near cyclical lows. Given the year over year double digit premium growth at China Life, any strain on its capitalization from external pressures such as investment losses on its bank investments would weaken its financial profile.

Factor 6 - Profitability: Aa

China Life, unlike other peers in Asia Pacific, does not have any negative spread burden, as it transferred any high guarantee policies issued prior to 1999 to CLIC when it was listed in 2003. The lack of negative spread burden has helped produce stable and consistent profitability.

Because of this and its steady investment performance, China Life had a five-year return on capital of 16.8%, mapping to our Aaa level. Volatility in profitability is relatively low; hence, Moody's considers its profitability one of the company's credit strengths, comparable to a Aa-rated company.

Nonetheless, Moody's notes that China Life's operating and investment performance will depend highly on economic conditions in China.

Factor 7 - Liquidity and Asset Liability Management: A

China Life's liquidity is sufficient to meet its policy maturities, especially considering its good premium growth. Its investment portfolio is highly liquid, with only a very small portion in real estate and loans. As a result, it fares very well under Moody's liquidity stress test, with its liquid assets to liquid liabilities ratio above 4x.

However, its investment strategy is somewhat inflexible, due to the limited number of investment channels available - the result of regulations and the lack of a deep, regional fixed-income market. This has brought about duration mismatches. Nonetheless, this situation should improve over time as regulations ease.

Overall, Moody's views China Life's liquidity and ALM to be more consistent with that of A-rated companies, in light of asset/liability duration mismatches and the lack of a sophisticated asset/liability management model. Moreover, some of its debt securities investments are somewhat vulnerable to market liquidity risk, given its large portfolio relative to the overall market.

Factor 8 - Financial Flexibility: A

Currently, China Life does not have any debt outstanding. Its adjusted financial leverage is minimal, with a very small portion of operating lease debt adjustments. Its listings on the Hong Kong, Shanghai, and New York stock exchanges provide it with some flexibility should it need to raise capital. This indicates a good level of financial flexibility, with minimal needs for interest coverage.

Moody's also considers China Life's financial flexibility at the CLIC's. Although CLIC still bears the negative spread burden from old policies, these policies are segregated in a separate fund and its liabilities are supported by the MoF. Nonetheless, Moody's notes that CLIC relies mainly on China Life's dividend payouts as well as support from the MoF (see the "Other Considerations" section). In addition, other affiliates of CLIC are in their growth phases, which may require additional capital support, thereby affecting China Life and CLIC's capital management policies.

Overall, Moody's regards China Life's financial flexibility as being more in line with that of its A-rated peers, than with the Aaa rating indicated by the IFS scorecard.

Operating Environment: China: Baa

In addition to the company's own business and financial fundamentals, Moody's takes into consideration the country's operating environment in arriving at the final rating for China Life. Our overall Baa for the insurance operating environment is based on our assessment of China's generally high economic strength, moderate institutional strength, and low susceptibility to event risk (in accordance with Moody's published sovereign rating indicators), which is counterbalanced by the limited penetration of the insurance market in the national economy and the per capita utilization of insurance in comparison to other countries worldwide. Overall, the Baa insurance operating environment for China exerts a only a mildly negative influence on China Life.

Other Considerations

Moody's applies its Rating Methodology for Government Related Issuers to China Life because of the 68.37% effective ownership by the MoF. The application involves assessing the probability of support from, and the insurer's default dependence on, the Chinese government.

Moody's believes that the likelihood of support is "strong", given the MoF's majority ownership and China Life's flagship status in the country's life insurance industry. The dependence level, however, is "high", reflecting the company's exposure to China's economic environment, especially with regard to its large investment portfolio of equities and fixed-income securities.

Moody's A1 rating on China Life is the same as its BCA. Therefore, it does not incorporate any uplift from potential support due to its government ownership. This is because Moody's has takes into account China Life's significant exposure to the banking sector, given the level of its investments in equities, financial bonds, and corporate bonds guaranteed by the banks.

Rating Factors

China Life Insurance Co Ltd

Financial Strength Rating Scorecard [1][2]	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**	**Caa**	**Score**	**Adjusted Score**
Business Profile								**Aa**	**Aa**
Market Position and Brand (14%)								**Aaa**	**Aaa**
Relative Market Share Ratio	X								
Distribution (9%)								**Baa**	**A**
Distribution Control			X						
Diversity of Distribution				X					
Product Focus and Diversification (9%)								**A**	**A**

Product Risk			X						
Life Insurance Product Diversification			X						
Financial Profile								**Aa**	**Aa**
Asset Quality (9%)								**A**	**A**
High Risk Assets % Shareholders' Equity				**103.0%**					
Goodwill & Intangibles % Shareholders' Equity	**0.0%**								
Capital Adequacy (14%)								**Aaa**	**Aa**
Shareholders' Equity % Total Assets	**13.6%**								
Profitability (14%)								**Aa**	**Aa**
Return on Capital (5 yr. avg)	**16.8%**								
Sharpe Ratio of ROC (5 yr. avg)		**374.3%**							
Liquidity and Asset/Liability Management (9%)								**Aaa**	**A**
Liquid Assets % Liquid Liabilities	**X**								
Financial Flexibility (14%)								**Aa**	**A**
Adjusted Financial Leverage	**1.7%**								
Total Leverage	**1.7%**								
Earnings Coverage (5 yr. avg)	**217.6x**								
Cashflow Coverage (5 yr. avg)				**N/A**					
Operating Environment (10%)								**Baa**	**Baa**
Aggregate Profile								**Aa3**	**A1**

[1] Insert appropriate footnote regarding accounting (see below) [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis