MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms ZhongAn Insurance's ratings; changes outlook to positive from stable

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Hong Kong, April 29, 2022 -- Moody's Investors Service has affirmed ZhongAn Online P&C Insurance Co., Ltd. (ZhongAn)'s Baa1 insurance financial strength rating (IFSR) and Baa2 senior unsecured debt rating.

At the same time, Moody's has changed ZhongAn's outlook to positive from stable.

RATINGS RATIONALE

The change in outlook to positive from stable reflects ZhongAn's improved market position and profitability with consistent double-digit premium growth, more diversified product mix and focus on profitable business lines. Moody's expects the insurer will continue to improve its profitability while building its scale and to maintain a solid capitalization.

The affirmation of the Baa1 IFSR reflects the insurer's market presence as the largest online insurer in China, strong capitalization, improved product diversification and low high-risk asset leverage. However, continued investments in technology and other non-insurance business could strain its capitalization and profitability. The proposed capital supplemental bond issuance could also significantly increase its financial leverage and weaken its earnings coverage.

Strong business growth has consistently increased ZhongAn's market presence. It is now the ninth largest property and casualty (P&C) insurer in China by direct premiums. The insurer's premium grew 22% in 2021, largely driven by the increase in its consumer finance segment. However, the rebound in premium growth of guarantee insurance under this segment in view of the slowdown of economic growth in China may pose a risk to its underwriting profitability. Nevertheless, the insurer's product portfolio has become more diversified and less reliant on shipping return insurance than it was a few years ago. Its online distribution model withstood well much of the coronavirus pandemic-induced disruptions faced by other insurers.

ZhongAn reported a net profit of RMB757.1 million in 2021 after it made a profit of RMB254.4 million for the first time in 2020. Its underwriting profitability has improved over the past few years and turned around to become profitable in 2021 for the first time. Its combined ratio improved to 99.6% in 2021 from 102.5% in 2020, mainly driven by the decline in the expense ratio as a result of decreased acquisition costs of its health and auto segments. Moody's expects ZhongAn's combined ratio to remain at around 100% over the next 12-18 months given its focus on profitable product lines and declining expense ratio as it builds scale but still under very competitive market conditions.

The insurer has maintained strong capitalization, with both comprehensive and core solvency ratios at 472.4% as of the end of 2021. Moody's expects the insurer's solvency ratios to decrease to around 300%-350% under the updated capital regime, that is, China Risk-Oriented Solvency System (C-ROSS) Phase II, mainly because of higher capital charges on its long-term equity investments. However, both ratios will still be well above the regulatory requirements.

ZhongAn has been making consistent investments in technology development and non-insurance businesses, such as its virtual banking and life insurance businesses in Hong Kong SAR, China. These moves will enhance ZhongAn's overall fintech franchise but could also strain the insurer's profitability and capitalization as these businesses remain loss-making and will take some time to achieve break-even. Investment income from its property & casualty insurance business remains a key contributor to its earnings, which leaves the insurer's profitability more vulnerable to the volatility in the capital market.

In addition, the proposed up to RMB7 billion capital supplemental bond issuance could increase the insurer’s leverage to above 40% on a pro forma basis based on the shareholders' equity as of the end of 2021 and strain its earnings coverage. Nevertheless, it will be ZhongAn’s first onshore bond issuance, which will further broaden its capital market access.

The senior unsecured debt rating of ZhongAn is Baa2, which is one notch below its Baa1 IFSR. Given that the senior unsecured obligations of the debt are junior to the liabilities of the insurance policyholders, the one-notch spread reflects the subordination of senior unsecured debt holders to ZhongAn's policyholders.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Moody's could upgrade ZhongAn's ratings if: (1) it achieves a track record of profitability with material reduction in losses generated from its non-insurance business and its combined ratio is consistently below 102%; (2) there is further product diversification without a significant deterioration in profitability; and (3) it maintains its comprehensive solvency ratio above 250% under C-ROSS Phase II.

Given the positive outlook, a downgrade is unlikely. However, Moody's could return ZhongAn’s outlook to stable if: (1) its improved underwriting profitability is not sustained, with its combined ratio consistently exceeding 105%; (2) its comprehensive solvency ratio drops below 150% under C-ROSS Phase II on a sustained basis; (3) its ratio of high-risk assets relative to adjusted shareholders' equity increases to more than 100%; and/or (4) there are signs of weakening partnership arrangements with its three major shareholders or a weakening of market position of its online insurance franchise.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Property and Casualty Insurers Methodology published in September 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1254163. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Shanghai, China, ZhongAn Online P&C Insurance Co., Ltd. offers a wide range of P&C insurance products and technological services. As of the end of 2021, ZhongAn's total assets amounted to RMB51.8 billion and its shareholders' equity totaled RMB19.1 billion.

The local market analyst for these ratings is Qian Zhu, +86 (21) 2057-4098.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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