

Development of Risk-based Capital Regime for Insurance Industry of Hong Kong

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Agenda

1. Status of Development
2. Challenges
3. Engagement with the industry
4. Major discussion topics
5. Principles for Data Collection

Status of Development

We are here



- Conceptual framework developed
- Consultation Conclusions published in September 2015

- Conduct QIS
- Develop detailed rules
- Consultation exercise

- Amendment of legislation

- Implementation

Engagement with the industry

Status of Development – Phase I

◎ Objectives

- To align Hong Kong's regime with international requirements
- To make capital requirements more sensitive to the level of risk that insurers are bearing
- To foster a cultural change among insurers for enhanced corporate governance and better risk management
- Not to be excessive & to be broadly consistent across financial services sectors in Hong Kong



Status of Development – Phase I (cont'd)

◎ Conclusions

- General agreement on the high level principles
 - Total balance sheet approach
 - Two solvency control levels
 - Standardized approach
 - Broad risk categories
 - Approaches for risk assessment
- Mixed views on some of the technical aspects and details
 - Subject to further analyses and QIS at Phase II

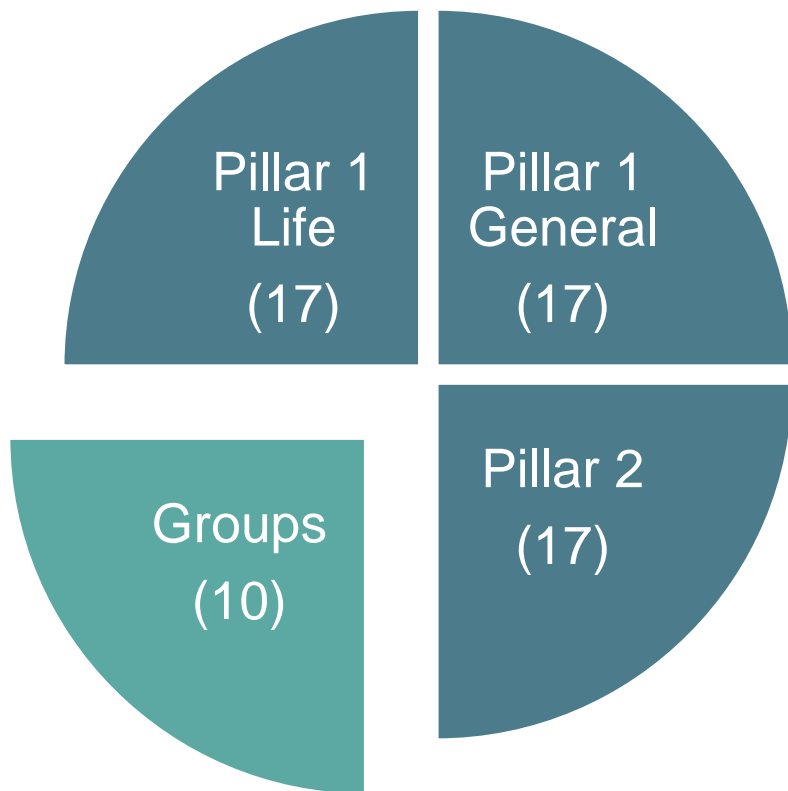
Status of Development – Phase II

- ◎ Commissioned a Consultancy Study on Formulation of Risk-based Capital (RBC) Rules for the Insurance Industry of Hong Kong
 - Industry engagement and discussions
 - Final deliverables
 - Initial recommendations
 - QIS proforma, technical specifications and completion instructions

Challenges

- ◎ Actuarial resources
- ◎ Economic valuation
 - Lack of experience
 - Reserving and modelling capabilities
 - Approach to gain consistency across the industry
- ◎ Data collection
 - Granularity of data required
 - Capability and resources of smaller sized insurers to generate data
 - Stressed balance sheet

Engagement with the Industry



- Set up of 4 **Industry Focus Groups (IFGs)**
- Nomination by HKFI and ASHK
 - IFG on Groups – nomination by OCI and ASHK

Engagement with the Industry (cont'd)

- ◎ Representatives from:
 - Large, medium-sized and small insurers
 - International groups and local corporations
 - Direct insurers and professional reinsurers
- ◎ IFG meetings approximately every 3 weeks
- ◎ Views on technical papers, QIS proforma, technical specifications and completion instructions

Engagement with the Industry (cont'd)

◎ Soft consultation

- Explore different approaches / methodologies
- Assess industry capability and data availability
- Avoid industry being caught by surprise and get prepared for data collection earlier

Major Discussion Topics (cont'd)

1. Pillar 1 – Economic Reserves

- ⦿ Different approach from the current practices
- ⦿ General insurers – lack of data and actuarial support
 - Discounting of liabilities
 - Explicit risk margin
- ⦿ Contract boundaries

Major Discussion Topics (cont'd)

2. Pillar 1 – Market Consistent Approach vs Combined Approach

Market consistent approach

- Reflect the current solvency position more accurately
- Foster better asset-liability matching



Combination of market consistent and amortized cost approaches

- Reduce volatility
- Reflect the management intention to hold the investment vehicles



Major Discussion Topics (cont'd)

3. Pillar 1 – Discount Rate

- ⦿ Lack of liquid long-dated bonds in Hong Kong market
- ⦿ To be explored
 - Ultimate forward rate (UFR)

Major Discussion Topics (cont'd)

4. Pillar 1 – Cash Value Floor

- ⦿ Not consistent with the principle of economic valuation
- ⦿ Alternative to be explored:
 - Mass lapse risk
 - Cash value floor applied at the aggregate of technical provisions and required capital

Major Discussion Topics (cont'd)

5. Pillar 1 / Pillar 2 – Operational Risk

◎ Pillar 1

- Adopt a simple approach

◎ Pillar 2

- Size or volume-based methodology may not reflect the actual operational risk

◎ To be explored

- Grading or scaling concept
- Capital add-ons

Major Discussion Topics (cont'd)

6. Group Supervision – Group-wide Capital Requirement

- ⦿ Group and subgroup concept and definition
- ⦿ Consolidation method vs aggregation method
- ⦿ Capital fungibility especially at time of volatility

Principles for Data Collection

- ◎ Information to be collected:
 - Total balance sheet approach
 - Appropriate, sufficient and necessary for further analysis
 - Uniform data from participating insurers regardless of their legal form for comparability across industry
 - Representative of participating insurers
- ◎ Guidance / completion instruction:
 - Implemented reliably by participating insurers to avoid exercise of significant judgment

Principles for Data Collection (cont'd)

◎ Consistency with:

- Existing insurance regulations in Hong Kong
- IFRS/HKFRS
- Other regulators in Hong Kong to avoid regulatory arbitrage

◎ Take reference:

- Insurance Capital Standard (ICS)
- Experience of other jurisdictions

END