ASHK 19th Appointed Actuaries Symposium
"Actuaries Navigating a Changing World"
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Shaping the Future in the New Normal

Keynote Speech by Mr Tony Chan
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Dicky[1], distinguished guests, ladies and gentlemen,

Over the past two years, COVID-19 has been upending every aspect of our lives. With the increasing vaccination rate and no reported local COVID-19 cases, it allows all of us to be here, and I am happy to join you all today physically.

Despite the negative impact brought to the insurance industry in terms of restriction of face-to-face interactions and quarantine measures, there are major policy initiatives confronting the insurance industry: the forthcoming RBC regime and IFRS 17; technological empowerment; product development and green and sustainable finance.

RBC

Our friends here should be aware that the most potent change being rolled out by the IA is the RBC regime, which aims at dovetailing our solvency standards with contemporary international practices. After undergoing some years of development and completing three times of QIS, I am glad that the technical considerations under Pillar 1 have been in broad agreement with stakeholders. Thanks for ASHK's active participation throughout the development process and constructive advice given to us on technical issues. In 2020 when there had been unprecedented low interest rates and increased volatility of the capital markets, we were able to grasp the opportunity to test out the proposed parameters so as to ensure that the proposed solvency regime is resilient to adverse market scenarios.

[1] Mr. Dicky Lam, President of ASHK

Matching adjustments

In developing the RBC regime, we have all along been mindful for the market landscape and needs of the Hong Kong insurance industry for not making the regime excessive and unnecessarily burdensome to the industry. On this, we introduced the matching adjustments (MA) so that insurers are able to make reference to their investment portfolios for the determination of valuation interest rates and to promote better asset and liability management of the insurance industry. Having considered ASHK's and industry's comments, we introduced a new component to allow constant prescribed spreads to be earned for the unmatched portion, with a cap, of portfolio assets over liabilities, striking a balance between the objective to preserve financial stability and to encourage better asset-liability matching. We hope that with matching adjustments, insurers are able to offer insurance products of longer term and better yield to policyholders. This is also the reason why we impose strengthened pre-requisite conditions for insurers to enjoy Long Term Adjustment (LTA) under the MA.

Legislation

In the meantime, we are now starting to prepare the enabling legislation for implementing RBC targeted in 2024. We understand that certain insurers are keen to adopt the RBC ahead of the actual implementation. This is a welcome move to those companies which have put in place capital management based on risk exposure and are ready to adopt RBC in terms of capital management and reporting requirements. Such move will not only enable insurers to enhance their risk management processes, but will also allow the IA to fix any fatal yet unknown bugs for improvement, if there is any, before the formal implementation.

Along the implementation of RBC, we understand the needs from the industry to explore products and investments mix for improving capital efficiency under the new regime. As observed from the experience in other jurisdictions, it is expected that insurers would gradually shift towards products with investment-linked nature. We are currently working with the industry on the Protection Linked Plan, with enhanced protection elements in the early stage of the policy period when there is low fund balance. It also brings another page of product innovation journey after the two tax-incentive products – qualified deferred annuity policies (QDAP) and voluntary health insurance schemes (VHIS) launched. We hope the continuous evolution for innovative products would tap into underserved segments and narrow the protection gap.

IFRS 17

Besides RBC, I believe many of you have been putting efforts in the past years on the IFRS 17 reporting standard. The new standard would transform the views of the readers of financial statements on the measurement of insurers' business performance.

Considering the imminent implementation of IFRS 17 with the effective date on 1 January 2023, I believe insurers are in the midst of the implementation preparation, with some insurers ready for the parallel run from the beginning of next year. The implementation of IFRS 17 certainly poses challenges to insurers, say, tight timeline and resources, as well as different interpretations of the standard, it also presents opportunities for actuaries who play an important role in the transformation.

First of all, the most obvious benefit brought by IFRS 17 is the enhanced transparency and comparability. The new and enhanced disclosure requirements under IFRS 17 will provide users of financial statements, including shareholders, investors and, of course, the IA, with readily comparable data and new set of IFRS 17 Key Performance Indicators. The introduction of contractual service margin (CSM) illustrates the value brought from business during the year as well as their expected profitability. It also helps the users analyse the realization of profits of all existing contracts during the year through CSM amortization.

Secondly, IFRS 17 will also provide insurers with the opportunity to revisit the existing processes within actuarial and finance functions. IFRS 17 will require extensive use of estimation and judgement. The reliance on unmanaged spreadsheets and processes will no longer be the feasible solution. It is therefore critical for actuaries to make sure that there is a robust system of internal controls and governance over the production of these estimation and judgement, and more importantly on the data and valuation models that underpin them. Insurers should explore the greater opportunity of IFRS 17 beyond a mere compliance exercise, building a robust risk management framework that supports collaboration of various functional units to provide business insight and increase efficiency, and ultimately to enhance business value.

Participating business

In Hong Kong, participating business is one of the major products in the market, which constitutes around 60% of market insurance liabilities. This is the reason why we have included participating fund management as a key component under Pillar 1. Unlike other regimes which impose ring-fencing and gating rules, we notice different practices being adopted by insurers for the management of their participating business. As such, we have been embarking on an incremental approach in designing the framework by finalizing only those elements which have a bearing on capital requirements under Pillar 1 so that the law drafting process would not be hampered.

The framework also integrates with the matching adjustment with long term adjustment (LTA) which I have just mentioned. LTA is eligible for participating and universal life businesses and it aims to incentivize the ring-fencing of assets attributable to these businesses.

Earlier this year, we held industry meetings to lay out the areas which we would study on par fund management. It broadly covers segregation of funds, capital requirements for par business, asset transfer requirements, dividend mechanism, governance, disclosures and transitions. And so far, we have received a general agreement of the fund segregation in physical manner for participating business, but of course, we still need to work with insurers on implementation details. For example, the treatment for assets which are shared across different insurance funds, or hedging instruments with underlying hedged exposures sitting in different insurance funds. We are very much appreciated for the concerted efforts of the industry which provides an important infrastructure for participating business.

The objectives for our introduction of par fund management are to ensure fairness to policy holders and meet the Policy holders' Reasonable Expectations (PRE). We have introduced "earned" concept in respect of when the profits or surplus arising from par business can be transferred out of the fund. Based on the principle from the "earned" concept, we will work out further details. Given the different market practices in Hong Kong, we expect thorough discussions with the industry is necessary in the coming year.

ORSA observations

This year, we received the first ever set of ORSA Reports. This is an instrumental step for the whole industry to enhance their enterprise risk management (ERM) under pillar 2 requirements which is ahead of implementation of the pillar 1 statutory capital requirements. Given the ORSA is a process for forward-looking assessment of internal capital, this provides an opportune time for the industry to prepare transition for the actual implementation of the risk-based capital requirements. We notice that the industry generally demonstrates a forward-looking view and some of the insurers are also reflecting their investment strategy and product mix to cope with the forthcoming RBC regime.

Given the prolonged low interest rate environment with the fog of market uncertainties, it is crucial for insurers to have a robust enterprise risk management that is dynamic enough to cope with these changes. The ERM and ORSA are aimed to act as tools to facilitate an insurer to run its business in a sustainable manner and to achieve organic growth ultimately. This indeed is a common goal for us as the regulator as well.

We have completed the review of most of the ORSA reports. As we have communicated earlier to the industry, we recognize the ORSA as a learning process for a smooth transition from the existing regime to a more risk-sensitive regime. To facilitate the learning process across the industry, we will share with the industry the observations of best practices early next year such that the industry can improve the ERM and ORSA processes gradually and achieve the objectives of making ORSA processes as tools for capital management.

Here, I would like to share with the audience one important observation on Target Capital. We note that the industry is having a wide range of practices in determining the Target Capital. Some use a sophisticated modelling in determining the Target Capital, while others use a simplified factor approach. Whatever the approach is taken, we are expecting insurers to derive the Target Capital in a justified level which is consistent with the risk appetite. You may appreciate that Target Capital generally needs to capture risks that are not covered or not adequately covered under the regulatory capital. It also serves as a cushion to allow insurers to take actions swiftly to restore the positions and to avoid breaching the regulatory capital requirements easily. Therefore, the determination of Target Capital is expected to be aligned with the risk appetite relating to capital adequacy as set out and approved by the Board.

Another point we would like to highlight is the identification of risks. Most of you have done a pretty good job on those risks under the structure of regulatory capital requirements. Many of you have also considered the liquidity risk and even constructed stress scenarios for mitigating the liquidity risk. In the future, ORSA processes, insurers may be beneficial to start considering emerging risks. At the international arena, increasing awareness has been put on the cyber risk and climate risk. For instance, the International Association of Insurance Supervisors (IAIS) has also considered these emerging risks in the forthcoming sector-wide monitoring exercise.

Technology

Talking about a lot of regulations and compliance issues, let’s move on to another topic – technology. Technology has injected a wave of positive disruption by widening distribution channel, modernizing infrastructure, penetrating underserved segments as well as revamping the product mix to cope with rapid demographic changes and emerging risks. For instance, insurance players could make use of online platforms for remote on-boarding and claim payments. They could also utilize massive data sets available coupled with technologies, such as machine learning and data analytics.

Some insurers are using API technologies to facilitate data connectivity between their platforms and their business partners to reach a wider range of potential policyholders for customer acquisitions, policy administration and claim management, etc. We are anticipating a wider adoption of API technologies in the market to drive greater innovation and bring more opportunities for collaboration.

As a regulator of the insurance industry and a facilitator of the industry's sustainable development, we see the importance of Open APIs and are exploring the development of an Open API Framework to enable greater collaboration among insurers, third-party service providers (TSPs), and regulators. On this, we are establishing a Working Group on Open API to serve as a platform to exchange ideas on key issues, scope, pilot use cases, and implementation timeline. We believe that the implementation of Open API could facilitate data sharing within and beyond the insurance industry. We hope to see more partnership between insurers and tech companies to co-develop and deliver seamless insurance services, and ultimately give rise to a more vibrant Insurtech ecosystem.

One possible future brought by the technology, apart from the customer experience, is to provide personalized services tailored to customers' needs. With the ecosystem, to the extreme, technology may even help identify the protection needs and prompt customers before they realize.

Ultimately, we think technology will also help narrow protection gaps, promote financial inclusion, and enhance financial connectivity. In order to achieve a healthier and more sustainable insurance market, insurers may need to see how they position themselves within the ecosystem and grasp the opportunity for sustained growth.

Climate change

Last but not the least, I would like to talk about climate change. Climate change is acknowledged to be the biggest threat to mankind, entailing societal, environmental and economic impacts, which inflicted unprecedented and irreversible damages to the planet.

The adverse impacts of climate change have become increasingly significant in recent decades. In Hong Kong, it is not a coincidence for business interruption from tropical cyclones twice within one week in October. You should not forget the record-breaking wildfires in California and Australia, heat dome in Pacific Northwest as well as flooding in Belgium, Germany and the Henan Province in this summer. Extreme weather events brought about a devastating impact to our economic development, a total of US$42 billion global insured losses were estimated in Aon's recent Global Catastrophe Recap for the first half of 2021.

The global, national and local climate agenda

The Paris Agreement ratified in 2016 has been a main driver of recent international efforts related to green and sustainable finance. A set of recommendations were published by the Task Force on Climate-related Financial Disclosures (TCFD) under the Financial Stability Board in 2017 for use by companies to provide better risk disclosure to support informed decision-making.

Without prejudging the results of COP26, nations agreed to reinforce action and finalise the Paris Agreement rulebook to limit some of the most destructive impacts of climate change, such as to phasedown coal, doubling adaptation finance and finalising rules for carbon trading.

At the national level, President Xi announced a new pledge at the United Nations General Assembly for China to become carbon neutral by 2060, and prominent coverage of green finance could be found in the 14th Five-Year Plan and the development plan for the Guangdong-Hong Kong-Macao Greater Bay Area.

The Government announced Hong Kong's Climate Action Plan 2050 that targets to achieve carbon neutrality by 2050 with proactive strategies and measures to reduce carbon emissions. This Plan is appealed to all sectors to strive towards such a goal.

Insurers' role in addressing climate change

As an international financial centre, Hong Kong has a huge financial market with a robust world-class regulatory framework. With the accelerating emphasis on sustainability, the insurance industry should have a significant role to play in addressing climate change. Indeed, insurers have multiple roles to play in green and sustainable finance. They have expertise and data in managing and mitigating climate-related risks; they are sizeable institutional investors for green assets; and they are corporate citizens that participate in advocating and complying with disclosure requirements.

Insurers, as providers of appropriate and innovative products, could explore using risk underwriting and product innovation to attain climate objectives, such as by designing new lines of business targeting environmentally conscious customer groups. The insurance industry can also share expertise on risk identification, assessment and management with clients to enhance their awareness. It can also contribute to an ESG database for researchers and governments to make more informed studies and policies.

By differentiated underwriting policies, the insurance industry is able to influence client behaviour and encourage clients to adopt integrated climate risk management approaches. I notice that a major international reinsurer has announced its commitment to cease transacting with the top 10% of carbon-intensive oil and gas producers by 2023. Applying a similar approach on the demand side by designing suitable incentives for energy-efficient vehicles, buildings or businesses might bring about complementary outcomes. Under the recent development of the "Glasgow Climate Pact", the insurance industry should gear up and explore the opportunities.

The emergence of prominent demand on impact investing has risen among the investors. In late October 2021, 29 members of the UN-Convened Net Zero Asset Owner Alliance have pledged their short-term decarbonisation targets to reducing portfolio greenhouse gas emissions by 25-30% by 2025 across three asset classes and, ultimately for the Alliance, to achieve net-zero emission in investment portfolios[2] by 2050. This is a real example demonstrated that impact investors are capable of shaping the behaviour of asset managers and embedding sustainability

[2] Representing $10 trillion assets under management, the United Nations-convened Net-Zero Asset Owner Alliance shows united investor action to align portfolios with a 1.5°C scenario, addressing Article 2.1c of the Paris Agreement.

into their investment processes and strategies to actively reduce their carbon investment footprint.

In addition, as responsible corporate citizens in formulating, advocating and complying with the evolving ESG disclosure requirements. The industry should also lead by example by enhancing ESG disclosure. All insurance companies listed in Hong Kong are obliged to follow the new ESG reporting requirements imposed by the Hong Kong Exchange, and the IA will deliberate on the pragmatic means to extend the scope of application to other market players.

Insurance-linked securities

The IA is committed to promoting Hong Kong as a preferred domicile for the issuance of insurance-linked securities (ILS). ILS, such as catastrophe bonds, are widely used risk management tools in the last decade that allow insurers or reinsurers to raise capital by transferring insurance risks to the capital markets through securitization. From institutional investors' perspective, ILS offers an exposure uncorrelated to economic cycles for risk diversification.

With the growing popularity of ILS driven by the rising trend of catastrophe events caused by climate change and urbanisation, Hong Kong is also developing the ILS market to enhance the capacity of the insurance industry and strengthen the resilience to extreme climate events. The IA launched a new and bespoke regulatory regime to facilitate ILS issuance in Hong Kong through special purpose insurers in March 2021. This was complemented by the Government Pilot ILS Grant Scheme to attract insurance enterprises or organisations to issue ILS in Hong Kong. The two initiatives catapult Hong Kong as the preferred ILS domicile in Asia.

Hong Kong's first ILS in the form of a catastrophe bond was issued on 1 October 2021 by a leading state-owned reinsurer, securing protection against losses inflicted by typhoons in the Mainland. This inaugural issuance not only exemplifies the potential and attractiveness of Hong Kong as an emerging ILS hub, but also demonstrates our crucial role as a global risk management centre, playing our part in increasing underwriting capacities, enhancing financial resilience and narrowing protection gaps.

As part of our publicity, in October 2021, the IA jointly organised a webinar with APEC Business Advisory Council / Asia-Pacific Financial Forum and the World Bank Treasury to promote the use of catastrophe bonds to support financial resilience against natural disasters in Asia.

Actuaries' talent

Actuary profession is held in high esteem and a magnet for bright minds. It has been a statutory requirement since 2001 for insurers carrying on long term business in Hong Kong to appoint a qualified actuary, whose main duty is to ensure compliance with codes, rules and guidelines. The Appointed Actuary performs a pivotal role in maintaining internal control and risk mitigation functions that accord proper safeguard to the interest of policy holders – a demanding task that calls for business acumen and pragmatism, balanced by impartiality and professionalism.

As new regulations become more complex, accompanied with innovated products, and are tailored to the Hong Kong characteristics, you may agree with me that local knowledge would also be an important ingredient for appointed actuaries to provide independent opinion to meet the public responsibilities. We also see the continuous demands of the actuarial talent for our market amidst all these changes.

Maybe I stop here and close the session with a quote from Walt Disney, "Times and conditions change so rapidly that we must keep our aim constantly focused on the future."

Finally, I wish you a rewarding event today, and hope that some of you could spend time to get a fleeting glimpse of this dynamic metropolis.

Thank you.