ASHK 20th Appointed Actuaries Symposium
"Driving sustainable success in a new era"
30 November 2022

Keynote Speech by Mr Tony Chan
Associate Director, Policy and Development, Insurance Authority

Chris[1], distinguished guests, ladies and gentlemen,

I am glad to join you all here face-to-face at the ASHK 20th Appointed Actuaries Symposium. The theme of the symposium is "Driving sustainable success in a new era". First of all, let us rewind backward to three years ago and recap what had been happening during this period. First and foremost, we had been experiencing an unprecedented infectious disease for almost three years resulting in intermittent shutdown of business and economic activities. The intensified geopolitical tension between China and the US caused frictions between the two nations in technological and financial interests. The Russia-Ukraine war has disrupted global supply chain and accelerated the pace of inflationary pressure and rising interest rates. Record-breaking heat waves in India, Pakistan and Europe seemed to feature one climate-related disaster after another. All these incidents tell us that we are facing with tremendous uncertainties and we need to get prepared for the worst in our business planning processes. Still and all, we should look into business opportunities arising from these evolving risks.

Hong Kong is seen to be back to normal after we have lifted the quarantine requirement for inbound persons to "0+3" arrangement, and have recently hosted numerous physical events with proven success to relaunch Hong Kong. These are encouraging milestones after past years of fight against COVID-19. Obvious to many of you here today who are appointed actuaries, it is an opportune time to have

[1] Mr Chris Hancorn, Co-Chairman, Life Committee, Actuarial Society of Hong Kong

all actuarial professional gathered together to bring in new thoughts and rebuild Hong Kong as an international financial centre.

I remember when we worked with insurers and actuaries a few years ago on calibrating risk factors during our Risk-based Capital Regime ("RBC") development, some of you suggested measures that would ease the solvency burden in times of low interest rate environment. We had advised that one of the principles of our RBC regime should be resilient to all scenarios of market conditions. While we still discussed low interest rate environment over the past few years, there had been an aggregate increase of US interest rates by 3.75% in the past eight months since March this year (2022). This is a good illustration to all of us that market situation can be reversed very quickly and we need to have robust stress testing in our risk management processes.

The heightened geopolitical tension coupled with Russia-Ukraine war has led to a series of undesirable consequences, for example agricultural and energy supply shortage. The intensified geopolitical environment has further led to increased move of decoupling globalization and trade protectionism by some jurisdictions, leading to enormous challenges to the global supply chain, and thus the economic growth. According to the latest International Monetary Fund report in October 2022, global economic growth is projected to slow down from an estimated 6.0% in 2021 to 3.2% in 2022, and 2.7% in 2023 respectively[2]. The global economic environment is becoming increasingly complex, and the near-term outlook is rather cautious.

What insurers / actuaries should be aware of under such market situation

After a decade of low interest rate environment which was challenging for life insurers to look for investments meeting the projected cash flow requirements of the underlying liabilities under policy holders' reasonable expectations principle

[2] https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022

whereby fixed income investments are important earning stream, bond yields are finally increasing under the recent interest rate normalization.

Compared with the current capital requirements, the RBC regime would take a total balance sheet approach on an economic basis and should better reflect foreseeable and relevant risks. It is also more responsive to asset and liability management ("ALM") measures. Hence, for insurers with better ALM, it is generally expected the solvency position would be less volatile under such market movements. Increasing interest rates could have a positive or negative impact on RBC solvency positions, depending on the insurers' asset and liability duration matching. Moreover, higher inflation may imply, for example, the cost of medical claims or other operational expenses will increase.

In fact, the RBC framework suggests that dynamic policy holder behaviour should be considered as appropriate. Such policy holder behaviour could have impact towards lapse assumptions and perhaps new business growth in times of high inflation and high interest rates. Apart from the potential impact on financial or solvency position, we should not miss out the liquidity implication. As a regulator, we also put emphasis on the liquidity risk which is not prescribed under the RBC's risk modules but is expected to be considered in your Own Risk and Solvency Assessment ("ORSA") processes. While we are glad to see that many insurers have considered liquidity risks, a few of them are seen to have specifically designed stress scenarios, for example massive surrender event coupled with implication on illiquidity in investment portfolios under market stresses. It is crucial for insurers to assess liquidity risk and develop liquidity planning, and we hope to see more insurers would embed liquidity risk management into ORSA processes towards the implementation of the RBC.

Latest RBC legislative progress and early adoption

As regards the update of the RBC legislative progress, the Insurance Authority ("IA") is working with the Government on the drafting of amendments to the Insurance

Ordinance for enabling the IA to prescribe detailed requirements under rules. We aim at introducing the amendment bill into the Legislative Council in the 2022-23 session. After the passage of the amendment bill, we will conduct consultation on the draft rules together with necessary guidelines for implementing the RBC, with a view to commence implementation of the RBC in 2024. We believe that all of you here are also making a forward-looking view on the capital projection and have started considering how to manage the business and optimize capital efficiency under the forthcoming RBC regime.

Given the merit in enabling the early adoption to promote better ALM, we issued the circular in December 2021 to allow early adoption of the RBC ahead of the legislative amendments for insurers carrying on long term business if they are at an advance stage in implementation. While early adoption may help relevant insurers develop risk management culture, report and make business decisions in a more coherent manner, it would also allow the IA to understand the actual practices in a pilot run so that we are able to make improvement before the formal implementation.

Evolvement of business strategy under RBC cum IFRS 17

I believe IFRS 17 is another driver of fundamental change to the business, which is to be implemented in a month's time. As revealed by our earlier survey on implementation status of IFRS 17, many of you are working towards the final stage of the implementation. With the new measurement of business performance and enhanced transparency under IFRS 17, and the new capital requirement based on risk exposure under the RBC, insurers will need to manage the business both under the RBC and IFRS 17 simultaneously.

We expect insurers to revisit their investment and ALM strategies, for instance, in asset allocation, hedging strategies, and reinsurance philosophy. Over previous years of low interest rate environment, we are aware that insurers are seeking for yield improvement and investing in private equities. With interest rate hikes, insurers may need to review the risk-adjusted return of the investment profile.

It is naturally that insurers would also review product strategies. The IA has been collaborating with the industry as well as our fellow regulators to put forward the Protection Linked Plan ("PLP"), which offers increased level of protection to policy holders while enabling capital efficiency. With the fundamental social role of insurance to society, we hope the industry plays a pivotal role in product innovation for customers' needs with a view to providing peace of mind and bridging the protection gap.

Green and sustainability

In March this year (2022), the IA issued observations of good market practice towards the first set of ORSA reports. Amongst all, one area for improvement is that insurers should consider climate risk within the business. We just had the No 8 typhoon warning signal hoisted early this month, the first No 8 alert in the month of November in 50 years. These climate changes remind everyone on the globe of immediate attention to promoting green and sustainability.

The Hong Kong financial regulators, including the IA, and relevant government bureaux have formed the Green and Sustainable Finance Cross-Agency Steering Group ("the Steering Group"). The Steering Group aims to co-ordinate the management of climate and environmental risks to the financial sector, accelerate the growth of green and sustainable finance in Hong Kong and support the Government's climate strategies.

In July last year (2021), the Steering Group established the Centre for Green and Sustainable Finance ("the Centre") which is a cross-sector platform with participation of industry stakeholders and academia in building capacity and addressing data gaps, thereby supporting the transition to a more sustainable development pathway. With the collaboration of the industry and the Government, the Centre successfully launched the GSF Data Source Repository. This Repository contains various Government data sources relevant to the assessment of physical risks in Hong Kong, including historical data on catastrophe damages, district level micro-climate conditions such as tropical cyclones, flooding, landslides and storm surges as well as geographic data.

With the accelerating emphasis on sustainability, the insurance industry should have a significant role to play in addressing climate changes. Life insurers, in particular, are sizeable institutional investors. There is room for insurers to look into how they can incorporate green assets in their strategic asset allocation. Over the past few years, coping with International Association of Insurance Supervisors ("IAIS")'s data collection, we have started to collect certain information on green assets and carbon-intensive assets. We observed that some major market participants have started developing mitigation strategies against climate risk and integrating ESG factors into investment planning via divesting equities and fixed-income products from carbon-intensive businesses, setting exposure limit and green investment target, and incorporating climate-related performance into compensation framework.

Being supportive to initiatives for sustainability, we will formulate initiatives on green assets within the RBC framework. The preliminary idea would be, for example, for insurers with certain investment mix with green bonds fulfilling a defined taxonomy would be allowed some capital relief.

Actuarial talent

Actuaries continue to play a vital role in ensuring compliance with codes, rules and guidelines, as well as mapping out corporate strategies on ALM and product design. As we come closer to the implementation of the RBC, it is no doubt that there is a high demand from the industry for experienced actuaries.

You may agree with me that the 2022 Policy Address makes it clear that the Government views talent being the top priority. A series of measures including the creation of a Talent Service Unit to be led by the Chief Secretary for Administration, launch of the Top Talent Pass Scheme, and extension of stay for work visas are in place to ensure that local and global talent are actively nurtured and retained. As an insurance regulator who shoulder the responsibility to elevate competitiveness of Hong Kong in the global insurance market, we welcome and will strongly support these initiatives by working closely with the Government, aiming to inject impetus into our economic recovery.

Ladies and gentlemen, looking ahead, despite many challenges and uncertainties in the current global economic situation, the Asian insurance market is still full of opportunities. I am sure all the expert speakers will further share insights on how to unlock the next phase of growth.

May I wish you all a successful and rewarding event today. Thank you very much.