Moody's Insurance Summit

"Unlocking the Next Phase of Growth"

Keynote Address by Mr Raymond Tam

Executive Director (Policy and Development) of Insurance Authority

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Tianwei[1], Wendy[2], distinguished guests, ladies and gentlemen,

Good morning. I would like to first thank Moody's for inviting me to this Insurance Summit. It is indeed my pleasure to join you all here. The theme for today is *"Unlocking the Next Phase of Growth"*. With the ever-changing global economic and business environment today and in the era of disruptive innovation, this is a timely topic for the insurance industry. On this very occasion, I would like to share with you from the perspective of a regulator.

Market Outlook

You may be aware that the growth of the Asian insurance market has decelerated a bit recently. Contributed by the slowdown in the life insurance markets in China and South Korea, which together made up about 40% of the total regional premium pool, the growth in insurance premiums of Asia (excluding Japan) was 2.3% in 2018, compared with 10% in 2017, according to the statistics from Allianz Research. Also, quoting from a report by Capgemini, wealth of high net worth individuals in the Asia-Pacific region decreased by 4.8% in 2018, which was the first decline noted in 10 years.

[1] Mr Tianwei Zhu, Managing Director and Head of North Asia, Moody's Analytics

[2] Ms Wendy Cheong, Managing Director and Regional Head of Asia Pacific, Moody's Investor Service

Although there are signs of slowing down in growth, it is encouraging that the Asian insurance sector is expected to stay strong. Experts from Munich Re expect an average annual growth rate of 7% and 7.6% in the insurance premiums of Asia for general insurance and life insurance respectively from now towards 2030. The emerging markets in Asia will be the growth engines and are expected to have a rapid growth till 2030. In particular, the experts estimated that insurance premiums of China will triple from 2018 to 2030.

To ride on the next wave of growth and capture opportunities, insurance companies are adopting various strategies to enhance productivity and sustain growth. As we are now in the era of FinTech, insurers have of course also been investing more substantially in innovative technology.

The Insurance Authority ("IA") took over the regulatory functions from the then Office of the Commissioner of Insurance, which was a government department, and started regulating insurance companies in June 2017. While we carry principal functions to promote general stability of the insurance industry and to protect policy holders, under these overarching functions, we are also tasked with facilitating the sustainable development and promoting the competitiveness of the insurance industry of Hong Kong in the global market. The two objectives are complementary to each other – while effective regulation ensures soundness of the industry and protects the interests of the insuring public, deepened public trust enables the insurance market to grow and flourish.

Technology and innovation

Technology, or more specifically FinTech and Insurtech, continues to have a growing impact on the insurance industry. In fact, Insurtech is the fastest growing segment of Cyberport, the digital flagship of Hong Kong which has over 370 FinTech start-ups. Insurance companies are also seen to increase their spending in automation and digitalisation. Insurtech is the catalyst for growth of the industry by creating consumer benefits, investment opportunities, while also comes with challenges.

From the perspective of a regulator, the IA adopts a three-pronged strategy in response to the fast development of Insurtech which has been applied to the entire value chain of insurance business.

First, we encourage positive disruption. Insurtech creates opportunities for both the industry and consumers. For example, artificial intelligence and machine learning could improve underwriting capacity, and robotic process automation could streamline back office operations. Meanwhile, we believe that the development of Insurtech could promote inclusiveness by delivering insurance products to the traditionally underserved or unserved segments, and facilitate the development of a more balanced market with higher demand for protection-type insurance products. Consumers will also be empowered with more product choices and easier access, and provided with improved customer experience such as compressed application and claims handling time.

To facilitate the development of Insurtech, the IA strikes a balance carefully – while life insurance products offered through digital channels must be simple and contain high protection elements, we are also mindful that innovation should not be stifled by over regulation.

Second, we endeavour to cultivate a healthy ecosystem for Insurtech development. The IA has been engaging in two-way communication with fellow regulators (such as the Hong Kong Monetary Authority and the Securities and Futures Commission) as well as insurance industry to develop the appropriate infrastructure, to support insurers and insurance intermediaries. We encourage financial institutions to explore scope for collaboration with technology start-ups. For example, we are working with the insurance industry about an open-API framework for the development of Insurtech applications. The industry also started to adopt big data analytics, artificial intelligence and block-chain technology to detect insurance fraud, improve insurance persistency and other areas.

Finally, Insurtech will help reduce compliance burden of the industry and induce greater supervisory efficiency, in particular upon the implementation of the Risk-Based Capital or RBC solvency regime expected to be in place by 2022, under which more comprehensive and granular data will be collected from insurers. With the appropriate application of technology, insurers are expected to be more cost- and time-effective in adapting to the new reporting requirements, while our internal capability to detect and manage risks both at macro and company levels would be strengthened.

Under our Insurtech blueprint, the IA has rolled out concrete measures which have been positively received by the market. The Insurtech Sandbox provides a safe and controlled environment to test innovative solutions using real market data. Another initiative is Fast Track, a pilot scheme for new insurers seeking to operate solely through digital distribution channels based on a robust business model that satisfies all prevailing regulatory requirements. We authorized the first long-term virtual insurer via Fast Track in December last year and the first general virtual insurer last month, and there are more applications in the pipeline.

On the regulatory front, as part of our effort to mitigate risks arising from Insurtech development, the IA issued a new Guideline on Cybersecurity earlier this year. Drawing reference from the Group of Seven’s Fundamental Elements on

Cybersecurity for the Financial Sector, the guideline provides insurers with guiding principles for developing their cybersecurity framework.

Later this morning, there will be a keynote presentation by Ping An as well as a panel discussion on Insurtech. I am sure you will all hear real insights from the market perspective and I am very much looking forward to that.

<u>Hong Kong as a regional insurance hub and global risk management centre</u>

With a robust insurance market, top-notch technical expertise and world-class professional services, Hong Kong is well-positioned as a global risk management centre for China. With a population of 70 million and GDP of US$ 1.5 trillion, the development of the Guangdong-Hong Kong-Macao Greater Bay Area ("GBA") will promote better financial connectivity as well as closer economic collaboration within the region.

The Outline Development Plan for GBA announced by the State Council earlier this year suggested initiatives for the insurance industry. These include the promotion of cross-border Renminbi reinsurance business, developing innovative cross-border motor and medical insurance products, as well as after-sales service for cross-border policy holders. These no doubt will open new horizons and gain new momentum for our insurance industry, in terms of product range, level of innovation and depth of expertise.

In addition to development of GBA, the Belt and Road Initiative or BRI also bolsters Hong Kong's role of a regional insurance hub and a global risk management centre. BRI project owners are exposed to a multitude of bespoke specialty risks given the high complexity of projects. Our insurance industry is well-prepared to play a key role in helping prevent, manage or transfer such risks. In December 2018, the IA established the Belt and Road Insurance Exchange Facilitation (also known as "BRIEF") to provide a platform to promote the exchange of intelligence, foster alliances and facilitate networking for capturing opportunities arising from BRI projects. The recent extension of preferential treatment to Hong Kong reinsurers by the China Banking and Insurance Regulatory Commission under the C-ROSS solvency regime of China further strengthened Hong Kong reinsurers' competitiveness to participate in BRI projects.

<u>Enhancing market breadth and depth</u>

Amidst keen competition on an international level, the IA has been rolling out measures to enhance the breadth and depth of our insurance industry. For example, a 50% profits tax relief will be introduced to promote the development of marine insurance and the underwriting of specialty risks, such as catastrophe, trade credit and political risks. The unprecedented launch of two tax-deductible products, namely the Voluntary Health Insurance Scheme and the Qualifying Deferred Annuity Policy which have been very well-received by the public, not only energised the insurance market but also offered protection alternatives for our aging population and the underinsured.

We are also keen to facilitate the issuance of insurance-linked securities ("ILS") in Hong Kong. Catastrophic risks due to the extreme weather conditions have become more significant. The recent strong typhoons in the region such as Hato in 2017, Mangkhut in 2018, as well as Mitag and Hagibis in 2019 are among the examples. Also, according to the latest report issued by the Intergovernmental Panel on Climate Change[3], if greenhouse gas emissions continue to rise and result in 2°C or more of global warming, the global average sea levels could rise by 61 to 110 cm by year

[3] Intergovernmental Panel on Climate Change (IPCC) Special Report issued on 25 September 2019

2100. Even if greenhouse gas emissions were reduced dramatically to stave off 2°C of global warming, sea levels could still rise by 30 to 60 cm above current levels. In other words, scientists forecast that there will be more extreme weather conditions due to global warming. This would pose a challenge to insurance industry and we should strive to increase the ability and capacity of the market to respond to the impacts of natural catastrophes.

Alternative capital in insurance industry has grown over the years in the American and European markets as a complement to traditional reinsurance and retrocession for insurance and reinsurance companies. Meanwhile, the ILS market in Asia is still in more of a developing stage and relatively small. We are actively working on legislative amendments to make Hong Kong a more conducive domicile for ILS, in particular catastrophe bonds. This will enable insurers to capture business opportunities and, more importantly, improve the capacity of our industry and in turn enhance its sustainable development.

RBC solvency regime

As mentioned earlier, the IA is working with the industry on an RBC solvency regime. The first two rounds of quantitative impact study (QIS1 and QIS2) had been completed in 2017 and 2018 respectively. The IA launched the final round QIS3 in August 2019 and data will be received by end of November 2019. We are planning to conduct a consultation on detailed rules of the regime in 2020, which should pave the way for implementation of the regime by 2022 with an appropriate transition period.

In QIS3, we introduced matching adjustment ("MA") to life insurers for products with portfolios where investment assets are identified and managed separately to match with their liabilities. The purpose of MA is to allow insurers with good asset and liability management practice and commitment to hold fixed income assets for maturity, to have a less volatile solvency position, and be less affected by the changes in the values of these assets that are not related to defaults and downgrades.

Under the new regime with MA mechanism, insurers may expect to earn the risk-adjusted yield of the supporting fixed income assets and should be less affected by short-term market volatility. They will invest, in larger proportions, long-term debt securities such as bonds, as fixed income assets. As such, it will create ample opportunities for the development of the domestic bond market.

As announced in the 2018-19 Budget, the Hong Kong Government planned to launch an array of measures to enhance our competitiveness in developing the bond market. According to the latest SIFMA Capital Markets Fact Book[4], total of US$ 17 trillion new long-term bonds were issued in the global markets last year with Hong Kong representing only less than 0.3%. In other words, there is a lot of room for development in our long-term bond market and the implementation of our RBC solvency regime can serve as a catalyst for more Hong Kong dollar bond issuances.

New regulatory regime for insurance intermediaries

Last but not least, I would like to talk a bit about another significant milestone of the IA. In September this year, we took a major step forward to take over the regulation of over 110,000 insurance intermediaries from the Self-Regulatory Organisations. The IA is now the sole authority for granting licences to insurance intermediaries, and is equipped with statutory powers to conduct inspections and investigations as well as imposing disciplinary sanctions in appropriate cases.

[4] https://www.sifma.org/wp-content/uploads/2019/09/2019-Capital-Markets-Fact-Book-SIFMA.pdf (page 31)

Notwithstanding the rapid development in technology and hence more diversified distribution channels, in Hong Kong, insurance intermediaries remain the frontline practitioners of the insurance industry and the vital bridge between insurers and policy holders. Their professionalism has a direct impact on our insurance sector, and we are confident that the new regulatory regime will help enhance the professional standard, encourage good conduct and facilitate insurers' oversight of insurance intermediaries.

Conclusion

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

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