

8 May 2018

Our Ref: INS/TEC/6/20/6

By **email** only

To: Chief Executives of all authorized insurers

Dear Sirs,

### **Consultation on Draft Guideline on Enterprise Risk Management (“ERM Guideline”)**

This letter seeks your comments on the attached draft new ERM Guideline as part of the Pillar 2 (i.e. qualitative) requirements under the Risk-based Capital (“RBC”) regime.

The Insurance Authority (“IA”) is developing the RBC regime, with a view to aligning the capital requirements for insurance companies with the risks to which they are exposed and strengthening their ERM system. As reflected in the Consultation Conclusions on the RBC framework<sup>1</sup> issued by the former Office of the Commissioner of Insurance (“OCI”) in September 2015, the respondents generally agreed with the introduction of Pillar 2 requirements ahead of Pillar 1 (i.e. quantitative) requirements. In 2016-17, the OCI actively engaged with a number of representatives of the insurance industry through the Industry Focus Groups (“IFGs”)<sup>2</sup> to discuss various technical issues concerning the RBC regime. In particular, the IFGs on Pillar 2 and Groups helped identify best risk management practices that should be adopted by the insurance industry and provided valuable inputs in developing the draft ERM Guideline under the risk management supervision framework.

The International Association of Insurance Supervisors (“IAIS”), the global standard setter, has reviewed and conducted public consultations<sup>3</sup> in early 2018 on the revision of relevant IAIS Insurance Core Principles on ERM. The proposals in the draft ERM Guideline also takes into account the latest international standards.

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<sup>1</sup> [https://www.ia.org.hk/en/infocenter/files/rbc\\_consultation\\_conclusions.pdf](https://www.ia.org.hk/en/infocenter/files/rbc_consultation_conclusions.pdf)

<sup>2</sup> Four IFGs were established on Pillar 1 (Life Insurance), Pillar 1 (General Insurance), Pillar 2 and Groups.

<sup>3</sup> IAIS Public Consultations on Revision ICPs 8, 15 and 16

<https://www.iaisweb.org/page/consultations/closed-consultations/2018/revision-icps-8-15-and-16>

## Objective and Key Requirements

The key objective of the draft ERM Guideline is to nurture a strong risk culture in the Hong Kong insurance industry that would be reflected in the values, attitudes and norms of business behaviour. The Board of Directors and Senior Management should take ownership in shaping the risk culture of insurers as business practices and decisions are ultimately driven by the risk culture.

In view of the diverse nature of authorized insurers, the draft ERM Guideline adopts the principle of proportionality such that the requirements would be appropriately applied, taking into account the nature, scale and complexity of an insurer's business operations.

The key requirements of the draft ERM Guideline on insurers include, among others -

- (a) Establishing an ERM framework with sufficient governance to ensure safe and sound operation;
- (b) Setting a risk appetite statement that is supported by clear and well-documented risk limits structure and risk management policies and procedures;
- (c) Encompassing regular activities of risk identification, risk quantification, risk monitoring and reporting, and management review and actions. These activities would include stress and scenario testing, continuity analysis and business failure analysis, as appropriate;
- (d) Review of the ERM framework regularly in tandem with a robust feedback loop mechanism to ensure continued effectiveness of the framework; and
- (e) Performing an Own Risk and Solvency Assessment ("ORSA") at an appropriate level on an annual basis to assess the risk profile, the adequacy of risk management and also the current, and likely future, solvency and liquidity positions, such that the insurer remains viable under both normal and stressed situations.

## Three-tier Group-wide Supervisory Approach

The IA also proposes a three-tier group-wide supervisory approach to enhance our supervisory framework of insurance groups. In assessing the scope and tier of groups, we are mindful to avoid duplication of supervisory oversight on authorized insurers being members of insurance groups which are already subject to group-wide supervision by their home supervisors.

Therefore, the draft ERM Guideline proposes different requirements for (i) insurance groups that are supervised by the IA as the home regulator; (ii) insurance sub-groups that have insurance operations significant to the Hong Kong insurance market or to its whole group; and (iii) other insurers that are part of groups supervised by their home supervisors. The proposed three-tier group-wide supervisory approach had been discussed at meetings of the IFGs on Pillar 2 and Groups and generally well received.

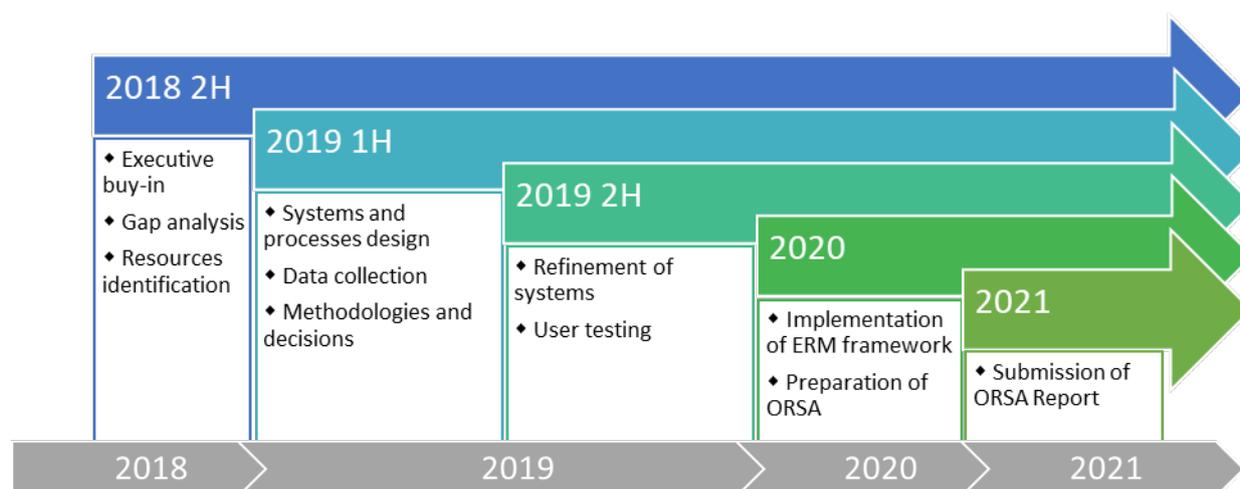
### Interaction with GL10

The current Guideline on the Corporate Governance of Authorized Insurers (“GL 10”) provides high level principles on risk management and internal controls as well as some other business activities relevant to ERM. We intend to take out those duplicative requirements in GL10 after the ERM Guideline is finalised and comes into effect.

### Implementation Timeframe

We aim to finalise the ERM Guideline by late 2018 and propose that the ERM Guideline should take effect from 1 January 2020. The tentative implementation roadmap is outlined below -

<b><u>Timeline</u></b>	<b><u>Milestone</u></b>
1 January 2020	Effective date of the ERM Guideline
31 December 2020 onwards	Insurers start preparing their ORSA Report on an annual basis
30 April 2021 onwards	Insurers should submit their ORSA Report to the IA within four months after the end of each financial year



In case any insurers find the above illustrative implementation roadmap not achievable, they should demonstrate to the IA the practical difficulties encountered and discuss with the IA an action plan for phased implementation within a reasonable timeframe in due course.

### Submission of Comments

Any comments on the draft ERM Guideline and the ORSA reporting requirements should be submitted -

By email to: [rbcphase2@ia.org.hk](mailto:rbcphase2@ia.org.hk)

Subject: Draft ERM Guideline

Deadline: on or before **6 July 2018**.

Should you have any enquiries on the above, please email us at [rbcphase2@ia.org.hk](mailto:rbcphase2@ia.org.hk) or contact Miss Kay Szeto at 3899 9980 or Mr Timothy Shih at 3899 9529.

Yours faithfully,

John Leung  
Chief Executive Officer  
Insurance Authority

Encls.

c.c. Chairman, The Hong Kong Federation of Insurers  
President, The Actuarial Society of Hong Kong  
Chief Executive, The Hong Kong Institute of Certified Public Accountants  
Members, Industry Advisory Committees  
Members, Working Group on Risk-based Capital Regime, Future Task Force  
Members, IFG on Pillar 2  
Members, IFG on Group