Keynote Speech by

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Embracing Innovations and Managing Risks – a Regulatory Perspective

Distinguished guests, ladies and gentlemen. Good morning.

I am most delighted to join you here this morning at the Insurance Investment Forum. As you may be aware, the Financial Secretary in his Budget speech delivered yesterday asked the Insurance Authority (IA) to explore ways to enhance Hong Kong's competitiveness as an insurance hub, including tax arrangements and other regulatory requirements. The IA will continue to work closely with the Government and the industry on exploring ways to facilitate the sustainable development of the industry and enhance Hong Kong's competitiveness in the global insurance market. Our common goal is to promote Hong Kong as a regional insurance hub and strengthen Hong Kong's role as a risk management centre for the Mainland and the infrastructural projects under the 'Belt and Road Initiative'. I would look forward to hearing more from you on how to achieve this common goal.

It is my pleasure to update you on the latest developments in Hong Kong's insurance regulatory framework since the IA took over the regulatory functions of the former Office of the Commissioner of Insurance over eight months ago.

The IA is the most recent independent financial services regulator established in Hong Kong. In addition to serving as the prudential and conduct regulator for the protection of policy holders and potential policy holders, the IA also takes up a new statutory function for facilitating the sustainable development of the insurance industry in Hong Kong.

I would like to highlight two new policy initiatives in particular, namely, Fintech or Insurtech and the Risk-based Capital (RBC) Regime.

Insurtech

First on Fintech. Technology is no doubt a key driver for the growth of the financial sector. According to a survey conducted by a professional firm in 2016, asset managers agreed that technologically advanced solutions would bring substantial opportunities, with 69% of respondents believed that cost reduction is the number one gain. Another survey found that global Insurtech investment totaled US$1.7 billion in 2016. The application of Fintech is gaining ground in Asia, particularly in Mainland China. In terms of Insurtech, three areas of technology, namely cloud computing, block-chain (or distributed ledger technology) and advanced analytics seem to stand out as among the most promising ones for both insurers and investment managers.

Cloud computing can bring in cost reduction and scalability in computing services support. It also opens up opportunities of hosting custom-applications on platforms managed by third parties and the use of software and app applications as a service. With cloud solutions, insurers and investment managers alike would respond quickly for downscaling and upscaling usage.

Block-chain, the underlying technology of Bitcoin, offers the opportunity for insurers and investment managers to improve efficiency through providing a new approach to data management and sharing. Under this new architecture, all participants work from common datasets, in near real-time. For insurers, it can improve insurance operation from underwriting to claims management. Many expect “smart insurance contracts”, riding on the technology of block-chain, will flourish in the future. As for investment management, the process of investment settlement and valuation can be streamlined by block-chain technology. By removing manual processes and providing a trusted and shared view of data, block-chain could improve transparency, save costs and speed up the process, with fewer reconciliation and errors.

Last but not least, advanced analytics, involving such technologies like machine learning and predictive reasoning, enable insurers to analyse the habits and behaviour of policy holders so as to provide better services and improve underwriting. Data analytics will also offer great assistance to insurance fraud prevention. Indeed, with the support of the IA, the Hong Kong Federation of Insurers is developing a centralised Insurance Claims Database for the Prevention of Fraud which employs advanced analytics to examine the claims data collected, to enable the industry to detect patterns of fraudulent insurance claims and take early preventive measures where appropriate.

On the investment front, investment managers of insurers can integrate internal data with external economic information, delivering insights to address a multitude of investment variables and scenarios with precision and speed. This would help insurers evaluate the asset-liability management, improve investment strategies, and deliver better returns to their portfolios.

On the other hand, the emergence of robo-advice also provides a golden opportunity for traditional insurers and other stakeholders to re-think their business model and create a brand new digital experience for users. Employing robo-advice in distribution service would fundamentally change the way that products are sold. It can serve dual purposes: (1) to enable insurers to reach out to new client segments such as the millennials; and (2) also to enable them to obtain detailed client information and provide tailor-made individualised service more easily.

To provide further momentum to the development of Insurtech applications in the insurance industry, the IA rolled out two initiatives in late September last year, namely, the Insurtech Sandbox and "Fast Track" applications for authorisation of new insurers owning and operating solely digital distribution channels. The Insurtech Sandbox is designed to create a "safe space" in which firms can enter the financial services market and experiment with new ideas with suitable regulatory oversight and support.

Meanwhile, the Fast Track provides a dedicated queue to expedite and streamline the authorisation process for new online insurers. We believe there are advantages in encouraging new insurance companies to sell products through digital channels, such as online or mobile applications. We hope more diversified distribution channels would bring benefits to the Hong Kong consumers in terms of product development, delivery, customer service and cost efficiency.

The response of stakeholders to these two initiatives has been very positive and encouraging. So far, we have received a few dozen enquiries relating to these initiatives and held a number of meetings with potential applicants.

With these initiatives, we hope it would foster a conducive environment for Insurtech development which, in turn, would benefit both the insurers and customers and engage healthy competition in the insurance sector.

Parallel with the development of Insurtech, we should not overlook a new rising risk area, namely that of cyber risk and cybersecurity. As insurers manage huge amount of capital and personal data, we cannot underestimate the potential cost and damage arising from major cyber incidents. Accompanying the tremendous increase in digital connectivity and more widespread applications of Insurtech, insurers are being exposed to an ever-rising level of cyber threat. Apart from financial loss arising from business interruption etc, cyber incidents particularly those involving a large amount of personal data breaches, would definitely cause severe reputational damage to the companies concerned. Therefore, cyber risk management should be high on the agenda of Board meetings so as to instill a strong sense of importance and urgency among the staff at every level in managing cyber risks properly and strengthening the resilience of the company and its IT structure in facing the growing challenges.

Looking forward, the IA will issue a detailed guideline on cybersecurity to promote more prudent cyber risk management among insurers in the next few months. We will form a cybersecurity working group, engaging industry stakeholders, relevant members of our Future Task Force and other external experts from the professionals and academia, to help us map out a strategy to promote cybersecurity among insurers.

Risk-based Capital Regime

Another major initiative of the IA is the development of a Risk-based Capital (RBC) Regime for insurance companies, in line with international standards and best practices. The existing Solvency I-type or rule-based solvency regime has been in place in Hong Kong since 1995 in which solvency margin requirements were determined as a fixed percentage of insurers' liabilities. The impact of investments to the solvency margin is mainly via the valuation interest rate used for discounting the technical liabilities. Long term insurers valuate their insurance liabilities using a discount rate by reference to the moving average of the portfolio yield of assets attributable to long term business and the prospective reinvestment yield under the current solvency regime. The underlying risks of investments are not fully reflected in the calculation of capital requirements.

The new RBC Regime would embrace a more risk-sensitive approach. It would help insurers properly identify, understand, measure and manage the risks they face or likely to be exposed to. The new regime will enhance long term resilience of the insurance industry and provide better protection for policy holders.

Compared with other insurance centres, we are a latecomer in moving towards an RBC Regime. Nevertheless, the beauty of being a latecomer is that we can learn from the experiences of other jurisdictions and devise a regime that best suit our situation within a relatively short timeframe. The IA has conducted the first Quantitative Impact Study (QIS 1) and collected data from various insurance companies in the second half of 2017. We aim to start implementing the new regime in 2021 at the earliest. By comparison, it took the European Union over 10 years from their first QIS in 2005 to actual implementation of the Solvency II regime in 2016.

Currently we are analysing the data collected in QIS1 and preparing the launch of the second QIS (QIS 2) with more refined requirements in the second half of this year. We expect that the third QIS (and hopefully the last one) will be conducted in the second half of 2019. A formal consultation exercise on the detailed rules will be conducted in 2020, after the completion of the QIS exercises.

Meanwhile, we are drafting a new guideline to introduce an Enterprise Risk Management (ERM) framework and Own Risk and Solvency Assessment, so as to fulfill the Pillar 2 or qualitative requirements of the RBC Regime. We aim to conduct a consultation on the draft guideline later this year, with a view to starting implementing the ERM framework in early 2020.

There will be direct linkage between the riskiness of investments and the amount of capital required. Investments with greater risks and lesser transparency would be subject to higher charges on capital. If an insurer intend to invest in long term projects, with inherent illiquidity and cash flow uncertainty, it would have to thoroughly assess the risk impact through its asset-liability management function. The RBC Regime encourages insurers to perform better due diligence on investments and discourages them from undertaking aggressive and risky investments that they do not fully understand.

The RBC Regime also provides a good framework for insurers to quantitatively evaluate their assets and liabilities on a consistent, comparable and economic value basis. One of the topics to be discussed later today is “ALM – striking the right balance”. We all understand that asset-liability management (ALM) is the cornerstone of the investment process of insurers. It helps insurers understand the interactions between investment risks and the structure and duration of liabilities. The challenging part is how to strike the right balance.

The RBC Regime would help expose any mismatches between assets and liabilities in respect of currency, duration and yield etc., and impose appropriate risk charges. Most importantly, insurers should enhance their ALM function to avoid asset-liability mismatch risk and devise appropriate measures to address it.

Let me conclude by wishing you all an insightful and rewarding Forum. As we are in the first month of the Chinese New Year, may I also wish you all a prosperous and wonderful Year of the Dog.

Thank you very much.