ASHK 21st Appointed Actuaries Symposium
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Keynote Speech by Mr Tony Chan
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Simon[1], Chris, Flora[2], distinguished guests, ladies and gentlemen,

Good morning. I am honoured today to deliver an opening speech at the ASHK 21st Appointed Actuaries Symposium. This year we are completely back to normal so we are able to resume our business activities normally, both locally and overseas – attending business conferences; meeting business partners; and organising regional business events. That said, the economic outlook is still filled with challenges and uncertainties, and we need to be cautious and plan for adverse scenarios.

Liquidity Risk

In financial markets, the rapidly rising interest rate since 2022 has caused a significant impact to the banking industry in the United States earlier this year, awakening the global financial market to the risk on liquidity. We have been accustomed to a long period of low interest environment, enjoying the benefits of low-cost capitals. With the hiking of interest rates which will probably maintain at a high level for a while, insurers should not underestimate its impact on liquidity. Due to the prolonged low interest rate in the past, some insurers have been focusing on writing short-term endowment products with guaranteed return. The increase of interest rate may induce policy holders to surrender their insurance policies for other form of investments with better return. This exerts stresses on liquidity of insurers as policy surrender rates may be higher than what have been assumed. Another example is the increasing use of derivatives in insurers' hedging programme against low interest rates. The increase of interest

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rate will increase the requirement for margin calls or collaterals and hence intensify the liquidity risk.

Another observation is the composition of insurers' invested assets. Under the previous low interest rate environment, there has been an increasing holding of level 3 assets in private equities and private debts. Apart from the complexity of these alternative assets and the risk arising from the valuation, these assets are illiquid and may not be able to be realised, or to meet liquidity needs at stressed times or at times of forced selling. At this juncture, perhaps we should also keep a close watch on the international regulatory measures on these evolving risks. The International Association of Insurance Supervisors ("IAIS") will be refining metrics on monitoring liquidity as part of its Global Monitoring Exercise ("GME") and thus our sector-wide monitoring data collection.

Insurers should review and refine their liquidity metrics, including those liquidity measures and various liquidity stress testing scenarios reported in own risk solvency assessment ("ORSA"), so as to cope with the changes in economic environment.

Green and sustainability

In the past three months, we have experienced extreme weather events - two strong typhoons with signal number 9 or above and a "once-in-500 years" severe rainstorm with 25% of the annual rainfall happened in one single night. These caused widespread flooding in the city. While all these events were considered remote in the past, our community is now beginning to feel the pain, or at least the irritation, from the adverse impact of climate change. While the Hong Kong Government has launched the Climate Action Plan 2050 with the aim of achieving carbon neutrality by 2050, these events are reminders that we should act together before it is too late.

Insurers can contribute to the global efforts in combating climate change and support sustainable development by playing multiple strategic roles. Besides the distinctive role of a source of data and expertise in the whole cycle of climate risk

management which may be more relevant to general insurers, long term insurers can be impact investors which are capable of shaping the behaviour of asset managers and directing funds into green assets, and responsible corporate citizens in advocating and adopting evolving environmental, social and governance ("ESG") disclosure requirements.

With the tremendous amount of assets on hand, insurers could make huge impact by embracing responsible investment practice and integrating climate risks or even broader ESG considerations in making investment decisions. It is important that consideration is given to whether there is a credible transition plan, or whether there is a climate target being set with robust governance process in place to track progress. On the other hand, insurers should also play their parts to formulate their own transition plans. These collaborative efforts would help reduce the risk of disorderly transition which may create instability.

Impact investment and transition planning require more transparent and comparable sustainability-related data and information for stakeholders to make informed decision. One significant milestone achieved is the publication of the inaugural set of sustainability disclosure standards by the International Sustainability Standards Board ("ISSB"). These standards aim to set out a global baseline for corporate disclosure of climate and sustainability-related information which has built on and expanded from the Recommendations by the Taskforce on Climate-related Financial Disclosures ("TCFD"). To further consolidate Hong Kong's role as a leading sustainable finance hub, the Green and Sustainable Finance Cross-Agency Steering Group ("CASG") of which the IA is a member welcomed the publication of the ISSB standards. The IA aims to implement climate-related disclosures for the insurance industry that align with the ISSB standards in a pragmatic and proportionate manner.

The IA and the Hong Kong Federation of Insurers ("HKFI") have been contributing to the cross-sectoral efforts in green and sustainable finance development in Hong Kong leveraging on the CASG platform with a focus on capacity building and addressing data gaps. Moreover, the HKFI is going to launch the Insurance Industry Climate Charter which offers a timely opportunity

for the industry to indicate their collective commitment towards achieving climate goals. Insurers which lag behind in sustainability transition should not underestimate the risk of being disadvantaged as compared with peers who are more advanced in this area. As such, we encourage insurers to sign up to this Climate Charter to demonstrate our efforts.

I would like to take this opportunity to thank the industry for participating in the Climate Risk Management Survey that was sent out earlier this year. We are pleased to have received a good rate of response. Overall, it is not surprising that the degree of readiness in managing climate risks among insurers varies a lot. We observed that a majority of the respondents has already embarked on the journey to develop and implement various climate risk management practices to some extent, but there is room for improvement which may require further guidance and support. For example, much attention has been paid to integrating climate risk considerations into investment and operational plans while more efforts would be required on capacity building for climate scenario analysis and disclosures. We are studying the survey responses in detail and aim to share with the industry our observations and promote good practice. By aligning our efforts, we can drive positive change and create a resilient and sustainable future for our industry, for the community and for our succeeding generations.

Updates on RBC Development

On the development of risk-based capital ("RBC") regime, the Legislative Council has passed the Insurance (Amendment) Ordinance 2023 in July. We are now in full speed preparing the subsidiary legislation of detailed rules for public consultation and promulgation of necessary Guidelines. Our target is to have the RBC regime to be implemented in July 2024 the soonest. The long-awaited adoption of RBC will bring Hong Kong on par with international standards on solvency regulation, and the required capital will be calculated more comprehensively in terms of quantifying risks possessed by the insurer.

With that in mind, the IA will launch public consultation on the two most important rules underpinning technical details of the RBC regime – draft

Insurance (Valuation and Capital) Rules (Cap. 41R) and draft Insurance (Submission of Statements, Reports and Information) Rules (Cap. 41S). The Insurance (Valuation and Capital) Rules will broadly cover RBC Pillar 1 requirements on calculation of capital adequacy, which takes into account the contents of technical specifications used in the three previous rounds of quantitative impact studies ("QIS"). The Insurance (Submission of Statements, Reports and Information) Rules will cover RBC reporting requirements on the timing and manner of filing financial statements, regulatory reporting and actuary's report. This set of rules should be read in conjunction with the updated Pillar 3 reporting templates and completion instruction released to the industry earlier this month. Please stay tuned for the public consultation.

In tandem with the commencement of the new solvency regime, we also take the chance to enhance the qualification requirement for appointed actuaries. To ensure appointed actuaries are keeping abreast of Hong Kong circumstances, newly appointed actuaries will need to possess the credential of fellow of ASHK ("FASHK"). This aligns with an increased sophistication of regulations and the greater role appointed actuaries will play in meeting public expectations. I also take the chance to clarify that as a grandfathering arrangement, existing appointed actuaries will not be affected by the new requirement and do not need to seek a fresh approval unless you are on the move after the requirement takes effect.

Participating Business

Last but not the least, I would like to talk about our proposed requirements on participating business on top of the amended Insurance Ordinance, which requires a separate statutory fund and separate account for participating business. The IA has been in rounds of discussion with the industry and the ASHK on enhancing the management of participating business. The aim is to promote the adherence to key principles of sustainability, fairness between policy holders and shareholders and meeting policy holders' reasonable expectation in managing participating business.

We would like to discuss with the industry and put forward our proposal by phases. The regulatory guidance we are going to first propose will be on the topics of participating fund set up and surplus transfers; attribution or allocation of expenses and charges; physical segregation; independent review at initial implementation of participating fund requirements as well as the related governance and disclosures. In the latest industry meeting, we have mainly covered topics related to the setting up of the separate statutory fund, and these requirements are expected to be implemented in parallel with the RBC regime.

As you may recall, in determining the discount rate when developing the RBC regime, we have considered the key product landscape of the Hong Kong insurance industry and a long-term adjustment ("LTA") has been proposed, with a view to enhancing the requirements on participating business management such that policy holders can also share the benefits.

We all note that insurers have adopted different practices in managing participating business. While our proposal does not aim to bring overwhelming changes to the dividend mechanism, we aim to enhance alignment of the interest of policy holders versus insurers. For example, high upfront charges which are profit-making in nature may cast doubt in this respect. As proposed in the setting up of the separate fund on participating business, the portion that is relevant to future transfers to shareholders are required to stay within the fund.

To further enhance assets safeguards, there will also be physical segregation for participating business. This will be implemented by requiring separate custodian account or bank account to safekeep assets for participating business. We believe physical segregation is optimal because it demonstrates fairness and transparency of profits to be attributed to policy holders related to participating business, and there will be clear segregation of assets with other products of the insurer which is managed distinctly and independently of the determination of dividends for participating policies.

Another objective relating to participating business is to enhance the transparency of the product information such that potential customers can make better

informed decisions. We fully understand that these disclosure requirements need thorough studies and the proposal will not be bundled with the implementation of RBC so that there will be enough time for industry's engagement and consultation.

On the part related to the setting up of separate participating funds, we are considering comments from industry, for example, on the necessary time for the initial independent review. In the coming months, the IA will take into account their comments in promulgating the guideline, which will be further consulted with the industry.

I am sure these upcoming safeguards will offer a pragmatic approach in governing dividend mechanism under participating business and providing greater protection to policy holders.

Closing

Ladies and gentlemen, to conclude my speech, the coming years are full of opportunities and challenges. While 2024 may be a busy year for all of you, I envisage appointed actuaries in Hong Kong would have wider scope of responsibilities as well as greater influence in years ahead, which is also instrumental for our society in Hong Kong.

I hope you will all enjoy this symposium today. Thank you very much.