

3 January 2019

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

By **email** only

To: Chief Executives of all authorized insurers

Dear Sirs,

### **Consultation on the Revised Draft Guideline on Enterprise Risk Management**

The Insurance Authority (“IA”) conducted a consultation on the draft Guideline on Enterprise Risk Management (“Guideline”) in May 2018 and received comments from the insurance industry and professional bodies. We have carefully studied all comments received and revised the draft Guideline for further consultation (see **Annex**).

The revised draft Guideline, proposed to be effective on 1 January 2020, has also taken into account the overarching principles of developing the Risk-based Capital (“RBC”) regime that include, amongst others, compliance with the Insurance Core Principles published by the International Association of Insurance Supervisors; market landscape and needs of the insurance industry; financial health and resilience of the insurance industry for the protection of policyholders; and not being excessive and unnecessarily burdensome.

### **Key Feedback and Enhancements to the Revised Draft Guideline**

The following key feedback from the consultation and proposed enhancements should be read in conjunction with the revised draft Guideline and texts in brackets indicate the referenced paragraphs.

#### 1. Principle-based approach

The principle-based approach has been further elaborated. An insurer may adopt other appropriate ways to comply with the requirements of the Guideline rather than

follow the same Enterprise Risk Management (“ERM”) processes and procedures as set out in the Guideline. It provides flexibility for an insurer to design the ERM framework to accord with its own specific circumstances. An insurer is however expected to be able to demonstrate to the IA’s satisfaction how the objectives set out in sections 3 to 9 of the Guideline are achieved. (*See paragraph 1.6*)

## 2. Three-tier Group-wide Supervisory Approach

Given the IA will develop a holistic Group-wide Supervisory framework for insurance groups in Hong Kong and detailed proposals would be consulted later in 2019, this Guideline has been revised to focus, in relation to group risk, on requirements at the solo level. (*See paragraphs 2.3, 6.5.1 to 6.5.5, Annex A and Annex B*)

## 3. Introduction of “Pillar 2 Capital amount”

The industry would like to seek further guidance and expectation on “internal economic capital” and expressed their concerns over the complexities involved. Some insurers have misinterpreted it as a substitute for regulatory capital requirements. With emphases on insurers’ own processes on risk quantification and risk management techniques, the revised draft Guideline replaced “internal economic capital” with “Pillar 2 Capital amount”. The revised draft Guideline sets out the following expectations on Pillar 2 Capital amount:

- (a) should reflect an insurer’s full range of risks not adequately reflected or captured in regulatory capital requirements;
- (b) is drawing an insurer’s attention to maintain sufficient capital to cover risks not captured or not adequately captured under regulatory capital requirements, such as capital charge on specialty risks; and
- (c) is not an alternative to the standard method used to calculate regulatory capital requirements of an insurer under the future RBC regime.

(*See paragraphs 6.2.1 to 6.2.5 and definition of Pillar 2 Capital amount in Glossary*)

## 4. Preparation of the Own Risk and Solvency Assessment (“ORSA”) Report

Applicable insurers are required to prepare and submit an ORSA Report to the IA. Regardless of the insurer’s mode of operations in Hong Kong (i.e. either as a branch or as a Hong Kong-incorporated company), we would like to clarify that the ORSA Report should cover the entire company and must include specifics to cover Hong Kong operations. (*See paragraph 9.1.1*)

5. ORSA of Hong Kong branches of overseas insurers

We have taken on board the comments from Hong Kong branches of overseas insurers on reliance placed on its head office or company to conduct an ORSA. Hence, the Guideline allows more flexibility for Hong Kong branches to leverage its head office or company ORSA for submission to the IA of the ORSA Report in relation to Hong Kong operations, provided that the part of the company ORSA Report in relation to Hong Kong operations must meet the minimum requirements of the Guideline. (*See paragraph 9.1.2*)

6. Prescribed scenarios in Stress and Scenario Testing (“SST”) in ORSA

For SST, insurers carrying on long term insurance business should perform scenarios as provided in the Actuarial Guidance Note 7 (“AGN7”) on Dynamic Solvency Testing issued by the Actuarial Society of Hong Kong as prescribed scenarios and include the results in the ORSA Report. The prescribed scenarios for long term insurance business would initially be those set out in AGN7. For general insurance business, we will work with the industry and professional bodies to prepare details on prescribed scenarios in 2019. (*See paragraph 9.5(j)*)

7. Regulatory capital requirements referred to in the ORSA Report

With an aim at enabling insurers to be more familiar with the regulatory capital requirements under the forthcoming RBC regime, insurers should apply the whole set of calculation methodology in the most recent Quantitative Impact Study ( or “QIS Capital Requirements”) as benchmark for their “regulatory capital requirements” in their ORSA Report during the Initial period.

Therefore, for the first ORSA Report to be submitted to IA in 2021, insurers should adopt the methodology in the third QIS as the benchmarked regulatory capital requirements. (*See paragraph 11.3*)

8. Relief measures in early years of implementation of the Guideline

To respond to insurers’ comments on resource constraint, we propose the following measures in early years of implementation of the Guideline. The period between (a) 1 January 2020 and (b) the date on which the RBC regulatory capital requirements come into force and become applicable to insurers (currently expected in 2022), shall be referred to as the “Initial Period”. During the Initial Period, an insurer may:

- (a) submit its ORSA Report using a valuation date other than its financial year-end date, but in no event more than three months earlier than the financial year-end date; and/or
- (b) submit its ORSA Report within six months (instead of four months) of the valuation date.

*(See paragraphs 10.1, 11.1 to 11.2)*

### **Implementation timeline of the Guideline**

This second consultation is a very important and critical step towards the finalization of the Guideline expected in 2019. We strongly encourage insurers to execute gap analysis, implement action plans to enhance their ERM framework and to put in place an ORSA as soon as practicable.

Apart from the relief measures mentioned above, we reiterate our support to those insurers facing practical difficulties in complying with the Guideline. These insurers should contact their case officers and demonstrate to the IA the practical difficulties encountered and formulate an action plan for phased implementation within a reasonable timeframe. We would pay due regard to the implementation progress when reviewing the ERM framework and the ORSA Report.

### **Submission of Comments**

The IA welcomes written comments on or before 24 January 2019 by either mail or email under the subject of “Consultation on Guideline on Enterprise Risk Management”: -

Mail: Insurance Authority  
19/F, 41 Heung Yip Road  
Wong Chuk Hang, Hong Kong  
(Attn: Policy and Development Division)

Or

Email: [rbcphase2@ia.org.hk](mailto:rbcphase2@ia.org.hk)

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

Yours faithfully,

Raymond Tam  
Executive Director, Policy and Development Division  
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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, Industry Focus Group on Pillar 2  
Members, Industry Focus Group on Groups