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Deloitte x SAS Insurance Forum on Hong Kong Risk-Based Capital

24 October 2023 | 3:00pm-4:30pm
Deloitte Digital Studio, Hong Kong

MAKING AN IMPACT THAT MATTERS since 1845

Agenda

Opening Remarks	Dhiran Dookhi, Actuarial Partner, Deloitte China
Thought Leadership Sharing: HKRBC implementation	Dhiran Dookhi, Actuarial Partner, Deloitte China
Fireside Chat: The imminent coming of risk-based capital for insurance	Jeffrey Li, Principal Industry Consultant, Risk and Finance Advisory, SAS Asia Pacific Alice So, Strategic Accounting Solutions Director, Deloitte China
Panel Discussion: Experience sharing on HKRBC Operationalization	Mike Wong, Senior Actuarial Director, Prudential Hong Kong Kenneth Yu, Strategy, Analytics & M&A Partner, Deloitte China Jeffery Li, Principal Industry Consultant, Risk and Finance Advisory, SAS Asia Pacific Jonathan Culver: International Tax Partner, Deloitte China Moderated by Fei Xie, Actuarial Director, Deloitte China
Closing Remarks	Dhiran Dookhi, Actuarial Partner, Deloitte China

Opening Remarks

Dhiran Dookhi

Actuarial Partner, Deloitte China

Thought Leadership Sharing: HKRBC Implementation

Dhiran Dookhi,
Actuarial Partner, Deloitte China

Latest Implementation progress and status

HKRBC Timeline

1. On **6th July 2023,** the Legislative Council of Hong Kong passed the Insurance (Amendment) Bill 2023 to implement RBC, which provides the legislative framework for the implementation of the RBC regime for the Hong Kong insurance industry.
2. The Insurance Authority has commenced the preparatory work to draft detailed requirements of the RBC regime which will be folowed by public consultation on subsidiary legislation. HKRBC is targeted to be effective in the second half of 2024.

Sep 2015
Consultation conclusions of RBC framework

Dec 2017 – Nov 2019
3 rounds of QIS submissions

To gain a better understanding of the likely impact on the industry, three rounds of quantitative impact study (QIS) exercises and various industry- wide data collection have taken place

Jan 2020
Effective date of GL21, Pillar 2 ERM and ORSA

Dec 2020
Issuance of RBC2020 technical specifications

Dec 2021
Issuance of RBC technical specifications for early adoption

This technical specifications incorporates updates since RBC2020, for the purpose of early adoption of the HKRBC solvency regime. They should not be interpreted as final policy decisions or final rules

Early adopters

Q2 2022
Pillar 3 guidance published

YE 2022
First Annual submission for early adopters

1 Jan 2024
Last effective date for early adoption expected

Q4 2023 to Q1 2024
Expected revised technical specifications for Pillar 1 and 3 / subsidiary legislation

Q2 2024 or later
Expected effective date depends on time spent on legislative process

Industry Update – Recent townhall meetings

Key takeaways from the HKIA on RBC updates and participating fund management meeting in August and September 2023

Aug 2023 RBC Townhall

Update in relation to subsidiary legislation

- Insurance (Valuation and Capital) update on absolute minimum Prescribed Capital Requirement (PCR), treatment on PCR if not based on standard approach, Deferred Tax Asset (DTA) / Deferred Tax Liability (DTL) treatment.
- Cap 41A Prescribed Qualification for Actuary update, Fellow Members of ASHK (FASHK) will be a prescribed credential requirement for both Life insurers and General Insurers (GI), and Casualty Actuarial Society (CAS) fellowship recognised as GI certifying actuary.
- Updates on fees and wordings under Cap 41B, 41C and 41J.

Fund maintenance

Standalone custodian account at head office's custodian for Hong Kong branches of overseas headquartered insurers.

Regulatory returns and filing portal

Covered arrangement of the HKRBC mid-year effect on FMA forms, matters relating to interfund and proposals on streamlining some of the returns. New IA portal and template introduced to enhance return submission experience.

Sep 2023 Participating fund management industry meeting

Principles for future shareholder transfer

- Par surplus shall be released to shareholders in a gradual and systematic manner over the lifetime of the contracts.
- Opening balance of segregated Par funds shall not be less than amount of assets currently identified.
- Insurers need to justify any changes to the basis for determining the amount of assets attributable to Par business since 1 Jan 2019.
- Appointed Actuary (AA) shall need to certify and report to the Board and IA at least annually on fund sufficiency.

Physical segregation of funds

- Separate custodian / bank account and books and records.
- Interfund balance should be settled within 3 months.
- Signatory sign-off (e.g. AA, Par Business Committee) on assets transfer out of the Par fund.

Enhance governance and disclosure

- Independent review required with minimum scope proposed in townhall.
- Par Business Committee to be set up.
- Enhanced disclosure on benefit illustrations and policy characteristics to enhance transparency and comparability.

Par Fund Management – Implementation Challenges

IA is finalizing proposed changes on participating fund management before the commencement of HKRBC in 2024. As the proposals will likely involve significant effort for many insurers managing Par funds, insurers should start their preparation as soon as possible

IA expectation	Industry readiness	Deloitte Point of View
Fund Structure		

• Principle based requirements to cater for different styles of participating fund management
• Sustainability , fairness between policyholders (PH) and shareholders (SH), and meeting policyholders' reasonable expectation (PRE)
• To enhance the protection of policyholders' interests , physically segregated funds shall be maintained for participating business
	• Based on IA's industry survey in 2021:
	  • 67% of (re)insurers have identifiable assets backing par liabilities. 18 (re)insurers reported to have UL products. 72% of them have identifiable assets backing UL liabilities.
	  • 20 (re)insurers have Funds on Deposit (FoD). c55% separate assets backing FoD from the base policies, while for 30%, assets backing FoD stay in the same fund as base policies.
	  • c40% of (re)insurers already have separate custodian account at Par / UL fund level, 8% of (re)insurers have custodian account for certain externally managed funds or at a higher level. 4% have trust for Par fund.
		• In-force policies: analyze and recommend Fund Structure set up considering:
		  – Regulatory compliance
		  – Cap. 41 Insurance Ordinance Section 22
		  – Product series
		  – SAA / Investment Strategies
		  – Company maintenance capability
		• New Business: recommend future sustainable fund structure
		• Propose physical segregation funds
		• Set up separate custodian accounts or trust; and re-vamp inter account fund flows and corresponding accounting / financial treatment

• Certain restrictions / limits on shareholders' entitlement to profits distributed from participating business, • This helps to align shareholders' profit objectives to policyholders' interests and prevent excessive distribution of profits to shareholders.	• Most small to medium sized companies in general do not have a shareholder profit distribution framework in place to ensure fair treatment to customers and no high upfront profit being distributed to shareholders. Some larger companies have defined sharing ratios which differ by product.	• Design distribution mechanism, including dividend rules or shareholder entitlement limits • Test for future sustainability of shareholder mechanism
• IA also expect the need for enhanced governance and disclosures to drive firms' behavior to drive better policyholder outcome.	• Most small to medium sized companies will need to set up a Par Business Committee and ensure it can form an independent view from members of management who are involved in par business management. Independent members will need to have the knowledge, skills and experience to discharge their duties.	• Set up / enhance governance structure, including preparing policies and procedures, define roles and responsibilities of different management teams, With-Profit-Committee set up and define Terms of Reference • Director and management training
Initial Fund Set Up		
• IA intend to disallow upfront or disproportionate surplus transfers to shareholders at the expense of policyholders' interests • Upon the effective date of the proposed requirements, the opening balance of the segregated participating fund shall not be less than the amount of assets that is currently identified as attributable to that participating business	• Small to medium size companies in general not ready • Independent reviews expected for large scale insurers who already implement Par Fund Management	• Define / enhance methodology to determine initial Par Fund Balance Sheet
• Initial independent review required	• Current 6-month timeline for independent review will be challenge for many companies.	• Plan for independent review and certification

Par Fund Management – Implementation Challenges (cont'd)

IA expectation	Industry readiness	Deloitte Point of View
On-going Fund Requirements & Profit Distribution		
• Profits arising from the participating business shall be released to shareholders no faster than in a gradual and systematic manner over the lifetime of the contracts, as and when services are provided , and shareholder surplus that is yet to be "earned" should stay within the participating fund • Insurers shall consider the alignment of interests between participating policyholders and shareholders from both fairness and PRE perspectives.	• Small to medium size companies in general not ready • Independent reviews expected for large scale insurers who already implement Par Fund Management	• Enhance / design distribution mechanism • Validate for future sustainability under different economic and non-economic scenarios • Perform impact studies to analyze any new distribution rules impact on RBC position, KPIs and / or financial metrics • Consider future product design principles / considerations • Perform business analysis taking into account current progress on HKRBC and knock-on impacts on other key metrics
• Sufficient assets should be maintained in each of the participating business funds under the statutory level and be allocated to cover: (a) Asset Share or (b) PV of expected future cash flows allowing for the latest illustrative dividend scale and future shareholder transfers according to the defined profit	• Small to medium size companies in general not ready • Independent reviews expected for large scale insurers who already implement Par Fund Management	• Validate future sustainability under different economic and non-economic scenarios • Choose methodology (asset share or PV of expected future cashflows allowing for latest illustrative dividend scale and future shareholder transfers according to the defined profit) while considering market practice • Perform actuarial modelling for asset share or PV expected cash flow including shareholder transfer
• The attribution / allocation is considered fair, equitable and reasonable if it is not to the detriment of interests of that particular or group of policyholders and the costs are necessary for the ongoing fund management. • A non-exhaustive list of not attributable expense provided	• Wide variation in market around attribution / allocation of expenses depending on products sold. For companies with asset share approach, expenses generally charged to asset share.	• Set methodology for expense allocation • Consider system enhancement and fine tune to cater for the updated expense apportionment and reconciliation • Perform implementation on relevant system upgrade to cater for new expense apportionment
• The Appointed Actuary shall submit a report to the Board recommending the profit distribution to shareholders annually or more frequently	• Enhancement to GL16 which requires AA's role to be strengthened around profit distribution recommendation.	• Consider changes required for the current dividend review to comply with the new regulation • Leverage market practice to design AA report format and content

Operationalization of HKRBC

A well-prepared insurer would set out an operationalization plan to be business-ready to fully embed RBC and its related metrics in all business processes

Key focus areas of HKRBC Operationalization

Timely solvency monitoring	Target Operating Model (TOM)	Capital optimization
Staying on top of RBC position to react to risks in an agile manner.	Redesign operating model around capital reporting, risk management and risk governance framework to optimize how actuaries, finance and risk teams work together as a team and maximize process efficiency.	Implement strategies / techniques to maximize return on capital, create long-term value and reduce overall risk exposure and balance sheet volatility.

Timely Solvency Monitoring

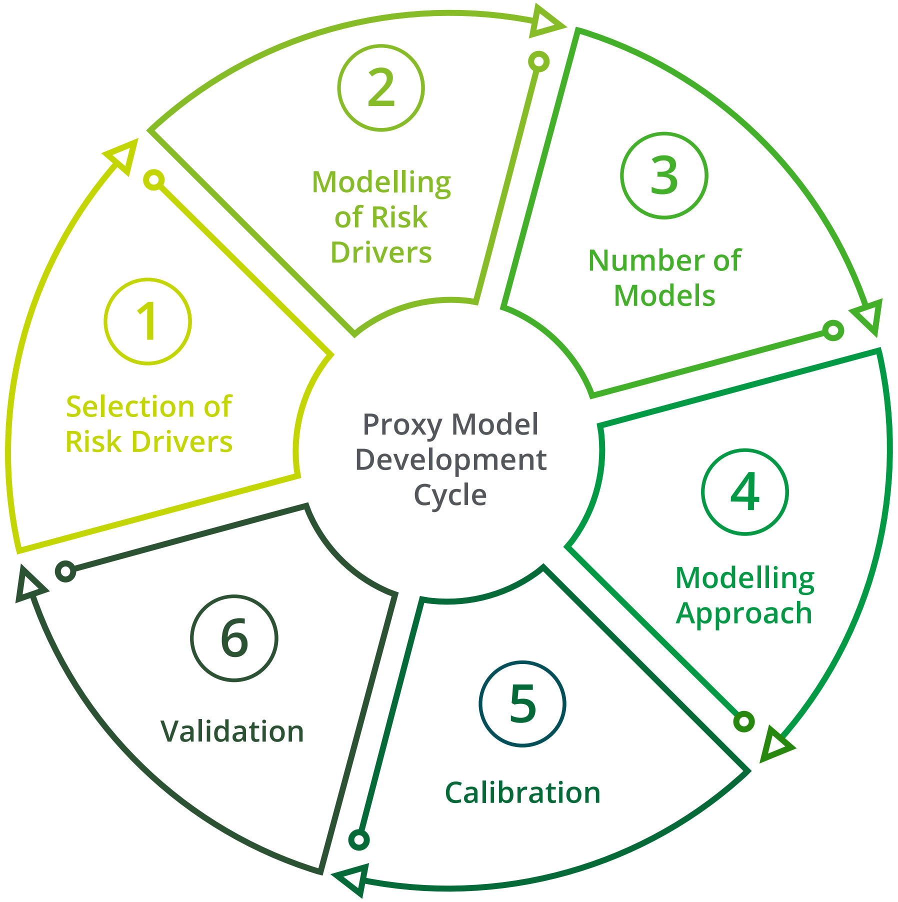
A robust, agile and timely process for solvency monitoring is critical

Proxy Model Methodology

A practical solution to enable timely solvency monitoring is through a **proxy model**.

The proxy model is built to approximate the results produced by a more complex or "heavy" model.

As a proxy model is less complicated, it can perform calculations faster and more efficiently compared to the heavy model, reducing overall model runtime and workload of the RBC team.



Proxy Model Cycle

The proxy model development cycle consists of **6 key stages**:

1. Selection of Risk Drivers
2. Modelling of Risk Drivers
3. Number of Models
4. Modelling Approach
5. Calibration
6. Validation

Various **key design decisions** need to be addressed at each stage of the proxy model development cycle, to balance the speed and accuracy to meet the business objectives.

Target Operating Model

It is necessary for companies to re-visit their operating models around capital reporting, risk management and governance framework to re-define what actuaries, finance and risk teams should do and how they work together.

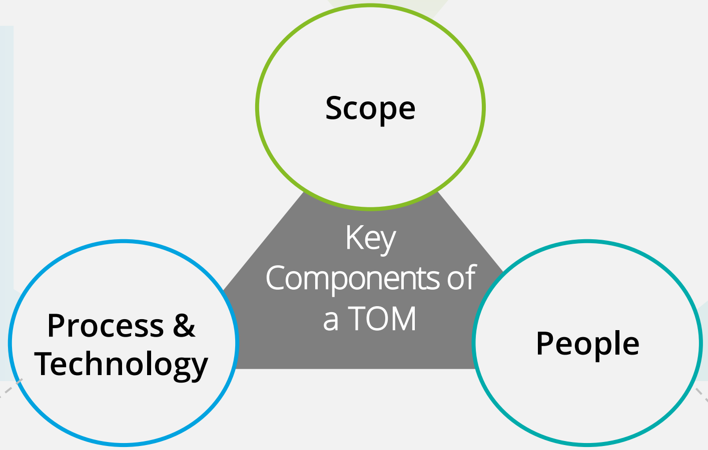
Scope within the Taxonomy

In line with the vision set out for the team, the scope covers activities which would be ideally performed by the team under an optimal operating model.

"What you do"
What do you hope to achieve within the function

Seamless and Efficient Process

Day-to-day operational activities, integrated with advanced technology, performed by an adequate number of resources efficiently.



Talent Management

Empowering talents with relevant skillsets to perform roles assigned, continuously driven by meaningful scope and contributing to the organization, hence achieving operational excellences with the right talent size .

"How you do it"
How you operate against defined processes and technologies

"Who does what"
How you structure your people effectively

Scope
Target Achievements
Governance
Activities (Taxonomy)
Key Stakeholders

People
Role and Responsibilities
Capabilities & Skills
Location
Organization Structure

Process & Technology
Process Efficiency
Technology Fit & Ownership
Working Day Timetable

Capital Optimization

It is increasingly more important for insurers to have an effective capital management framework within which decisions can be taken to optimize the balance sheet and create long-term value.

What is capital optimization?

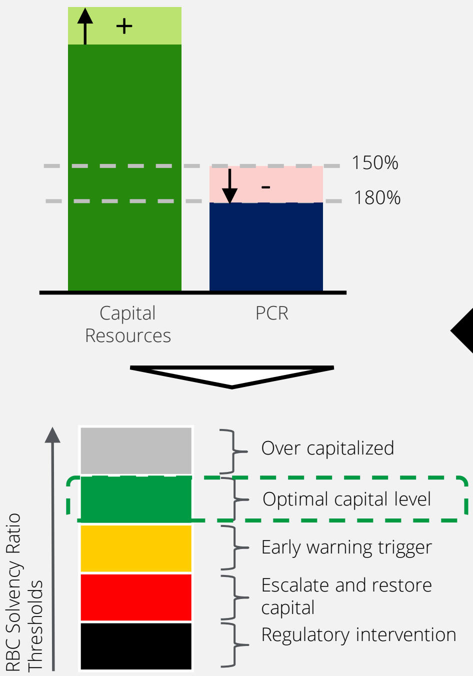
- Implementation of strategies / techniques to maximize capital efficiency
- Managing the business within an optimal target capital range helps the insurer achieve its strategic objectives

Why optimize capital?

- Maximize return on capital
- Create long-term value
- Reduce balance sheet volatility
- De-risk and reduce capital requirements
- Improve liquidity

Capital Optimization Strategies

- Select strategies to maximize capital resources / minimize capital requirements (PCR) to achieve the optimal capital range



Capital Management Framework

A holistic capital management framework is supported by:

- Objectives that are aligned with strategy, solvency, and risk appetite
- Strong governance, clearly defined roles and responsibilities
- Capital management policies and procedures
- Guidance on capital management actions

Capital Management Metrics

Select optimal strategies that can strike a balance between the below key management metrics:

Solvency	Profitability
Volatility	Liquidity

Fireside Chat

The imminent coming of risk-based capital for insurance

Jeffrey Li

Principal Industry Consultant, Risk and Finance Advisory
SAS Asia Pacific

Alice So

Strategic Accounting Solutions Director
Deloitte China

Panel Discussion

Experience sharing on HKRBC Operationalization

Jeffrey Li
Principal Industry Consultant,
Risk and Finance Advisory
SAS Asia Pacific

Jonathan Culver
International Tax Partner
Deloitte China

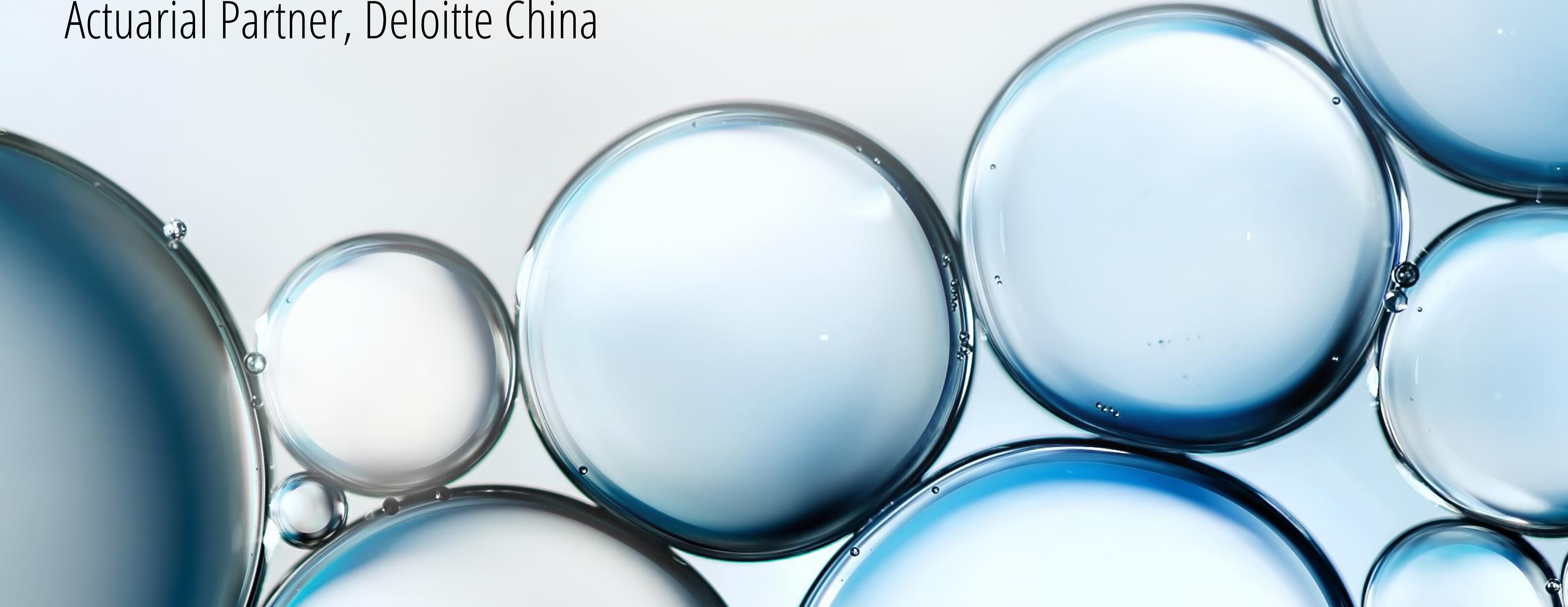
Mike Wong
Senior Actuarial Director
Prudential Hong Kong

Kenneth Yu
Strategy, Analytics & M&A
Partner
Deloitte China

Fei Xie
Actuarial Director
Deloitte China

Closing Remarks

Dhiran Dookhi,
Actuarial Partner, Deloitte China



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