STUDY AID

Hong Kong Practical Education Module

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GENERAL INSURANCE

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ACTUARIAL SOCIETY of HONG KONG
香 港 精 算 學 會

3.4 General Insurance

3.4.0 Introduction

This section provides practical information relevant to General Insurance (GI) actuaries practicing in Hong Kong, as well as GI actuaries supporting firms with exposures for risks domiciled in Hong Kong.

For the avoidance of doubt, the words “insurance company” and “insurer” in the following sections may be taken to mean direct insurers, reinsurers and captives in equal measure. Where a distinction is relevant, this will be outlined clearly.

3.4.1 Role of actuaries in GI market

3.4.1.1 Statutory roles

The Insurance Authority (IA) requires insurers that carry on Employees’ Compensation (EC) and Motor Insurance business to commission an annual review of the reserves of these two lines of business. An annual actuarial report should be prepared and certified by an actuary. The review should be conducted according to the criteria as specified in **GL9 – “Actuarial Review of Insurance Liabilities in respect of Employees’ Compensation and Motor Insurance Businesses”** (https://ia.org.hk/en/legislative_framework/files/GL9.pdf) issued by IA[1, 2].

The report needs to be submitted to the IA for review. It is the responsibility of the Chief Executive of the insurer to ensure that the report and certificate is submitted to the Board of Directors of the insurer, or the regional headquarters in the case of a non-Hong Kong incorporated insurer, for information. The actuary shall be given opportunity to raise matters arising out of the preparation of the report directly with the Board or the regional headquarters. This includes matters that may already have been raised with the management of the insurer but have not been dealt with to the satisfaction of the actuary. The actuarial review report and certificate prepared are to be submitted to the IA within 4 months after the close of the financial year.

There are minimum requirements of qualifications and work experience with regard to the certifying actuary, to ensure the actuary is familiar with the legal, judicial and social trends in Hong Kong that may impact upon the valuation of the liabilities. Insurers may seek approval from IA in case they wish to appoint actuary that possess qualifications and experience other than prescribed.

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[1] The new Independent Insurance Authority (IIA) took over the statutory duties of regulating insurance companies from the Office of the Commissioner of Insurance (OCI) on 26 June 2017.

[2] All Guidance Notes promulgated by the OCI have been renamed as Guidelines, and the abbreviation have been changed from “GN” to “GL”.

3.4.1.2 Non statutory roles

Although the lines of business other than EC and motor are not statutorily regulated in Hong Kong, the reserves are usually determined by an actuary using actuarial methodologies including but not limited to chain ladder methods, the Bornhuetter-Ferguson (BF) method, expected loss ratio method amongst other statistical methods.

Actuaries also often play a leading role in the determination of premium rates for direct insurers and in the pricing of reinsurance contracts.

Traditional roles for GI actuaries are in pricing and reserving within insurance companies or consulting firms providing such services. These roles have in recent times expanded into enterprise risk management (ERM), in particular, capital allocation. Capital allocation is critical for an insurance company's success and many actuaries have been making significant contributions in this area by leveraging their technical skills and commercial acumen.

GI actuaries have also moved into the rapidly evolving data analytics space, being well placed to apply their skills to customer and data analytics. They are making contributions in many fields, including the retail and telecommunications markets, and to loyalty schemes.

3.4.2 Main types of products in Hong Kong market

The statutory class descriptions of GI products can be found in Part 3 of Schedule 1 to the Insurance Companies Ordinance (Cap. 41) (ICO): https://www.elegislation.gov.hk/hk/cap41.

The industry body, Hong Kong Federation of Insurers (HKFI), also maintains its own classification of different types of General Insurance business (which is focused on products for individuals) as follows:

- **Accident Insurance**:
  http://www.hkfi.org.hk/#!/consumer-zone/types-of-insurance?id=22

- **Medical Insurance**:
  http://www.hkfi.org.hk/#!/consumer-zone/types-of-insurance?id=23

- **Personal Liability Insurance**:
  http://www.hkfi.org.hk/#!/consumer-zone/types-of-insurance?id=24

- **Travel Insurance**:
  http://www.hkfi.org.hk/#!/consumer-zone/types-of-insurance?id=25

- **Household Contents & Building Insurance**:
  http://www.hkfi.org.hk/#!/consumer-zone/types-of-insurance?id=26

- **Motor Insurance**:
  http://www.hkfi.org.hk/#!/consumer-zone/types-of-insurance?id=27

- **Employees' Compensation Insurance**:
  http://www.hkfi.org.hk/#!/consumer-zone/types-of-insurance?id=28

The Hong Kong Mortgage Corporation (HKMC) launched the **Mortgage Insurance Programme** (MIP) in March 1999, with a view to promoting home ownership in Hong Kong. According to the guideline issued by the Hong Kong Monetary Authority, banks have to comply with a 60% loan-to-value (LTV) requirement on owner-occupied residential mortgage lending for properties valued below HK$7 million. Yet, with the MIP providing mortgage insurance to banks, banks can provide mortgage loans more than 60% of the property value without incurring additional credit risk. As long as an application meets the relevant eligibility, the bank can provide a mortgage loan of up to 80% LTV ratio under the MIP. Details about HKMC can be found here: http://www.hkmc.com.hk/eng/

Currently, both GI companies and life insurers offer a variety of **health insurance** products. The Hong Kong government has been conducting consultation with the public in relation to Voluntary Health Insurance Scheme (VHIS) since 2008 (www.vhis.gov.hk), with no conclusion thus far.

3.4.3 Overview of market landscape in Hong Kong

As at 30 September 2016, there were 161 authorised insurers in Hong Kong, of which 94 were pure general insurers, 48 were pure long term insurers and the remaining 19 were composite insurers.

3.4.3.1 General insurance market statistics

The Hong Kong GI market wrote about HK$46 billion gross premiums in 2015 and was dominated by the Accident and Health line of business, which made up 30% of the market. Details of the quarterly and annual performance of the GI market can be found in the following link: https://www.ia.org.hk/en/infocenter/statistics/annual_general_business_statistics.html. Selected exhibits including underwriting results are provided, giving an indication of the performance of individual insurers.

3.4.3.2 Code of conduct

The HKFI has developed a Code of Conduct for Insurers that is applicable to all General Insurance members and Life Insurance members of the body (http://www.hkfi.org.hk/pdf/en/download/e_abt.code.pdf). It applies to insurance contracts effected in Hong Kong by individual policyholders resident in Hong Kong and insured in their private capacity only.

3.4.3.3 Best practice for GI intermediaries

The regulation for insurance intermediaries has been in operation since 30 June 1995. It defines the distinct roles of insurance agents and insurance brokers and requires them to be appointed or authorised respectively in accordance with the relevant provisions of the ICO.

To act as an insurance agent, a person is required to be appointed by an insurer and registered with the Insurance Agents Registration Board ("IARB") set up by HKFI. An appointed insurance agent shall not represent more than four insurers, of whom no more than two shall be long term business insurers.

To act as an insurance broker, a person shall either seek authorisation from the Insurance Authority (IA) or apply to become a member of a body of insurance brokers approved by the IA; both are subject to the same statutory requirements. For an insurance broker who is a member of an approved body of insurance brokers, he is also subject to the membership regulation of his own professional body which is approved by the IA.

The IA has developed some resources primarily geared towards intermediaries. They help provide some insight into the general risk management and processes for GI companies:

- IIQA Principal and Practice Exam Study Notes – https://ia.org.hk/en/supervision/reg_ins_intermediaries/files/sn-p&p-2013.pdf

- IIQA General Insurance Exam Study Notes – https://ia.org.hk/en/supervision/reg_ins_intermediaries/files/sn-general-2008.pdf

3.4.4 Regulations and guidelines

Similar to many other jurisdictions, the regulation of the insurance industry and the actuaries, in particular, is handled at three levels:

- **Statutory** – As promulgated in the ICO
- **Regulatory** – This is captured in a series of Guidelines (GLs), issued and periodically revised by the IA.
- **Actuarial** – This is captured in a series of Professional Standards and Actuarial Guidance Notes (AGNs), issued and periodically updated by the Actuarial Society of Hong Kong (ASHK). Members of the ASHK are not bound to comply with the guidance. However it is incumbent upon the actuary to make timely written and reasoned disclosure to the intended users of the actuarial investigation if for any reason he or she does not comply fully with the professional standards and/or actuarial guidance notes.

There is a Hong Kong-specific feature whereby, Motor and Employees' Compensation (EC) businesses are subject to particular focus. This is primarily a function of the size of these portfolios in the context of the overall market. Only the reserves of these two lines of business are required to be certified by an actuary. For other classes of GI business, the reserves are determined by reasonable methodology and judgement, subject to the sign-off by the auditor on the financial statements.

3.4.4.1 Guidelines

Following are Guidelines and Actuarial Guidance Notes applicable to GI actuaries, issued by the IA and the ASHK:

- **GL2 – "Insurance Companies (General Business) (Valuation) Regulation"**
  This regulation aims at providing a standard and prudent valuation basis for the assets and liabilities of a GI company and ensuring a prudent spread of its investment for solvency purposes. GL2 primarily addresses the different valuation principles of assets commonly found in the balance sheet of an insurer and establishes that discounting of claim liabilities is disallowed except with prior approval from the IA. https://ia.org.hk/en/legislative_framework/files/GL2.pdf

- **GL6 – "Reserving for Mortgage Guarantee Business"**

  Mortgage guarantee insurance protects the lending bank from the risk of loss arising from default in payment by a mortgagor in respect of that portion of the mortgage loan which exceeds a certain pre-determined ratio of the value of the property. This business differs from majority of the GI business written in HK, in that it is of a longer tail nature and strongly correlate with the local macro economy. In view of this, the IA has issued a guideline setting out the minimums standard for setting technical reserves of this line of business.

This Guideline applies to insurer as well as reinsurer in respect of its mortgage guarantee business carried on in or from Hong Kong.
https://ia.org.hk/en/legislative_framework/files/GL6.pdf

- **GL9 – "Actuarial Review of Insurance Liabilities in respect of Employees'** Compensation and Motor Insurance Businesses"
  Where Motor and/or EC portfolios exceed certain premium or reserve thresholds, it is necessary to provide a certified opinion in connection with the actuarial valuation. https://ia.org.hk/en/legislative_framework/files/GL9.pdf

- **AGN4 – "Outstanding Claims In General Insurance Note On Professional Practice"**
  This document provides guidance to GI actuaries responsible for estimating outstanding claims liability or for advising on outstanding claims provision. http://www.actuaries.org.hk/upload/File/AGN4.doc

- **AGN9 (D4) – "Best Estimate Assumptions"**
  This document outlines the general principles to be considered when setting best estimate assumptions. AGN9 is meant to be generic and applicable to all actuarial investigations regardless of field. Nevertheless, there are two sections of particular relevance to GI practitioners regarding claims ratios and large and catastrophic losses. http://www.actuaries.org.hk/upload/File/AGN9%28Effective20160401%29.pdf

Typically, when the IA issues a new Guideline, a circular will be sent to the Chief Executives of the affected authorised insurers. Similarly, the ASHK will notify its members of any new Actuarial Guidance Notes or revision to existing ones. In any case, practicing actuaries are encouraged to regularly check these websites for new development.

3.4.4.2 Tax

In Hong Kong, all corporations including general insurance companies are subject to profit tax. The tax rate is the same as that applied to other industries.

3.4.5 Reinsurance and captives

3.4.5.1 Reinsurance

Under the ICO, an insurer is required to arrange adequate reinsurance protection unless there are justifications not to do so. A sound reinsurance management framework is commonly found within an insurance company's risk management toolkit. The IA sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programs.

GL17 – "Guideline on Reinsurance" was released by the OCI in 2016 and provides best practice recommendations and mandatory requirements in respect of reinsurance arrangements.
https://ia.org.hk/en/legislative_framework/files/GL17.pdf

When reinsurance is effected with related companies, there may be higher risk of financial vulnerability to a company, and the IA has a separate guideline, **GL12 "Guideline on Reinsurance with Related Companies"** in relation to the treatment of such reinsurance arrangements.
https://ia.org.hk/en/legislative_framework/files/GL12.pdf

The guideline stipulates a number of criteria that should be satisfied for the related reinsurer to be considered adequate. In the event that the related reinsurer does not satisfy these criteria, the insurer must then either limit the net reinsurance recoverable due from such related reinsurers, or may be required to hold collateral securities for the recoveries included in excess of the limit set by the guideline.

3.4.5.2 Captive

The scope of operation of a captive may differ from one to another depending on the purposes for which it is formed. In Hong Kong, a captive is legally defined under the ICO as an insurer which is formed by its parent company to underwrite exclusively the insurance business of the parent or group companies or their associated companies.

Hong Kong government encourages establishment of captives in Hong Kong and wishes to promote Hong Kong as a captive center in Asia. Regulatory concessions are provided in the Insurance Companies Ordinance (Cap 41) to provide incentives for multinational companies to establish their captive insurers in Hong Kong. An example of the concessions available is a lower minimum capital requirement for a captive insurer as compared to a typical GI company.

Additional details are available on the IA website –
https://www.ia.org.hk/en/supervision/reg_insurers_lloyd/requirements_captive_insurers.html

3.4.6 Recent industry developments

3.4.6.1 Independent Insurance Authority (IIA)

The insurance industry will be affected by upcoming changes in the regulatory environment. Specifically, there was the establishment of the Independent Insurance Authority (IIA), which has become a new insurance regulator independent of the government.

The IIA has replaced the Office of the Commissioner of Insurance (OCI) in regulating insurance companies, effective 26 June 2017. The OCI was disbanded on the same day.

The IIA will also take over the supervision of insurance intermediaries within two years following its inception. This includes the three current self-regulatory organisations: Hong Kong Confederation of Insurance Brokers (CIB), Professional Insurance Brokers Association (PIBA) and Insurance Agents Registration Board (IARB) under Hong Kong Federation of Insurers (HKFI).

Besides being the regulatory body, IIA's other responsibilities include promoting a healthy and sustainable insurance industry in Hong Kong.

3.4.6.2 Risk-based capital

The OCI released a consultation paper in 2014, in which it announced plans to develop a risk based capital (RBC) framework for Hong Kong insurance industry. This represents a shift from rule-based capital adequacy framework to a risk-based approach. In recent years, it has been recognized globally that the capital adequacy framework should take into account different risk factors of different insurers, and be conducive to enhancing the corporate governance, enterprise risk management (ERM) and public disclosure practices of insurers. The International Association of Insurance Supervisors (IAIS) – the global standard-setter for the insurance industry – has issued new Insurance Core Principles (ICPs) in relation to RBC requirements in late 2011. All insurance supervisors, including the IA, are obliged to comply with these new ICPs as soon as practicable.

- **Consultation paper on risk-based capital framework**
  This document provides high level description of the RBC framework, which is anticipated to follow a "Three-Pillar" format. The proposed three pillars are: **Pillar 1 – Quantitative aspects**. The primary purpose of imposing capital adequacy requirements is to ensure that an insurer's obligations to policyholders will be met. The centerpiece of an RBC framework is to make capital requirement risk-sensitive such that higher risks carry more capital; **Pillar 2 – Qualitative aspects**. An integral part of an RBC framework is to encourage increased standards of corporate governance and ERM, therefore, encourage insurers to manage risk appropriately; **Pillar 3 – Disclosure**. It includes disclosure both to the supervisor and the public. Disclosure is a general feature of modern systems of financial

services supervision. This document also provides proposals regarding capital supervision on a locally-incorporated insurer or a Hong Kong branch of an overseas insurer. https://www.ia.org.hk/en/infocenter/files/rbc_consultation_paper.pdf

- **Consultation conclusions on risk-based capital framework**
  This document summarises the responses received by the OCI following the consultation period in 2015: https://www.ia.org.hk/en/infocenter/files/rbc_consultation_conclusions.pdf.

3.4.6.3 Policyholder Protection Fund (PPF)

At present, if an insurer becomes insolvent, compensation funds are in place to cover EC and motor vehicle third party claims only. There are no compensation funds for life insurance and other types of general insurance should an insurer become insolvent. However, the Companies Ordinance (Cap. 32) (CO) and ICO contain provisions for dealing with insurer insolvency. For insolvent GI companies, policyholders have a preferential claim against the remaining assets of the insurer (direct insurance claims have a higher level of preference than reinsurance claims) under the CO. These preferences apply to claims, but do not apply to premium refunds.

The OCI has been conducting studies, dialogue with industry stakeholders, briefing of Legco and public consultation around the feasibility and design of a Policyholder Protection Fund (PPF) since 2002. Some segments of the society are supportive of a compensation fund which would help boost consumer confidence, while some members of the insurance industry were concerned about possible moral hazards. A finalized scheme was published in early 2012.

- The public consultation paper on the PPF proposals can be found here: http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_ppf_e.pdf
- Responses to the consultation and the final outcomes are documented here: http://www.fstb.gov.hk/fsb/ppr/consult/ppf_conclusion.htm

Establishing a PPF requires legislative changes and this task will be championed by the newly established IIA. As a result, the establishment of a PPF is likely to get underway from 2018 onwards.

3.4.6.4 IFRS 4 Phase 2

Historically, Hong Kong Financial Reporting Standards (HKFRS) have followed the International Financial Reporting Standards (IFRS) with limited variation. IFRS 4, which provides guidance for the accounting of insurance contracts, was released by the

International Accounting Standards Board (IASB) in March 2004. Since then there has been extended consultation around upgrading of the standard – i.e. IFRS 4 Phase 2.

Consultations and responses appear to be close-to-final now and the IASB has suggested that an implementation date of 2020 is likely. To the extent that HKFRS continues to adopt IFRS with limited change, it may be expected that IFRS4 Phase 2 will be the basis for insurance contract valuation in Hong Kong.

News and latest development on IFRS 4 Phase 2 can be found here: http://www.ifrs.org/current-projects/iasb-projects/insurance-contracts/Pages/insurance-contracts.aspx

3.4.6.5 Facility for terrorism risks

The events of 9/11 in the US highlighted a potential protection gap due to insurer exclusions for terrorism events. For the Motor and EC statutory lines, industry level cover has been developed to reduce /remove the potential impact of a similar shortfall in Hong Kong. Details of the two facilities can be found here: https://www.ia.org.hk/en/supervision/reg_insurers_lloyd/regulatory_requirements.html

3.4.6.6 Latest legislative developments on ICO

The ICO, which prescribes the regulatory framework for insurers and insurance intermediaries, is being continuously reviewed and updated to keep up with changing market conditions and international practices. The latest updates can be found on the IA website: https://www.ia.org.hk/en/legislative_framework/overview/latest_legislative_developments.html.