

---

***PROFESSIONAL STANDARD 1 (PS1)***

***FOR***

***FELLOW MEMBERS OF***

***THE ACTUARIAL SOCIETY***

***OF HONG KONG***

**香港精算學會**

***1 9 9 3***

---

---

# CONTENTS

---

	<u>Page No.</u>
Preamble	1
A. The Hong Kong Appointed Actuary	3
1. Introduction and Background	3
2. Considerations Affecting Acceptance of an Appointment	5
3. Extent of the Hong Kong Appointed Actuary's Responsibility	6
4. The Duties of the Hong Kong Appointed Actuary	8
5. Premium Rates and Policy Conditions	10
6. Actuarial Investigations	11
7. Insolvency	13
8. Written Reports	14
B. The Actuary as a Director or in Any Other Position of Authority in Relation to an Insurance Company	16
C. The Actuary as an External Advisor or Assessor	17

## **PROFESSIONAL STANDARD 1 (PS1)**

### **FOR**

- A. ACTUARIES APPOINTED PURSUANT TO SECTION 15 OF THE INSURANCE COMPANIES ORDINANCE OF HONG KONG 1983 (HEREINAFTER REFERRED TO AS "THE HONG KONG APPOINTED ACTUARY")**
- B. THE ACTUARY AS A DIRECTOR OR IN ANY OTHER POSITION OF AUTHORITY IN RELATION TO AN INSURANCE COMPANY**
- C. THE ACTUARY AS AN EXTERNAL ADVISOR OR ASSESSOR**

### **P R E A M B L E**

This Professional Standard for the Hong Kong Appointed Actuary is issued by the Actuarial Society of Hong Kong. Its contents follow closely the Guidance Note issued by the Faculty and Institute of Actuaries to Appointed Actuaries and Actuaries who are directors or senior employees of long-term insurance companies in the U.K., i.e. GN1. The reason is that the legislation by which insurance companies are regulated in Hong Kong, the Insurance Companies Ordinance, closely parallels the corresponding legislation in the U.K., the Insurance Companies Act 1982, in the wide role that it leaves for the Appointed Actuary in the prudential supervision of the insurer which appoints him.

Accordingly the so called "Appointed Actuary system" has evolved in the U.K. whereby the Appointed Actuary exercises that role, guided by the profession through GN1, with the full support of Government and the industry.

In Hong Kong the profession feels that it is now the appropriate time to establish formally the Appointed Actuary system as regards the insurers authorised to do business in Hong Kong, through the issuance of this Professional Standard.

PS1 however does contain some differences from GN1 which recognise corresponding differences in the applicable legislation: obviously its title and section references, as well as the slightly different determinations which the Appointed Actuary has to make, (see para. 4.1.1).

However PS1 also differs from GN1 because the circumstances under which the Hong Kong Appointed Actuary carries out his duties vary markedly from one case to another, and must be taken into account in the practical application of this Professional Standard.

Finally reference is made,

- (a) in para. 8.3.4(d)(i) to policies issued to Hong Kong residents as a distinct group, the recognition of which by the Hong Kong Appointed Actuary is an additional condition for the fulfilment of reasonable expectations; and
- (b) in para. 4.2 explicitly to a company's vulnerability to fluctuations in experience, due to the significant number of small companies with limited resources doing business in Hong Kong.

## **A. THE HONG KONG APPOINTED ACTUARY**

### **1. INTRODUCTION AND BACKGROUND**

- 1.1 The responsibilities of actuaries who are appointed in terms of Section 15 of the Hong Kong Insurance Companies Ordinance 1983 (Hong Kong Appointed Actuaries and "the Ordinance" respectively) are central to the financial soundness of long-term insurance business of their companies and the reputation of the profession, therefore, depends in no small measure on the proper discharge of these responsibilities. It is incumbent on all Hong Kong Appointed Actuaries to ensure, so far as is within their authority, that long-term business is operated on sound financial lines.
- 1.2 The essence of a profession lies in upholding its standards, technical and ethical, in the public interest. Any Hong Kong Appointed Actuary who becomes doubtful as to the proper course to adopt in relation to a potentially significant problem is strongly advised to seek help and advice from his professional body or the Council of the Actuarial Society of Hong Kong.
- 1.3 Paras. 4.1 to 4.3 below set out the duties of the Hong Kong Appointed Actuary, but the following specifics should be taken into account.
  - (a) The Hong Kong Appointed Actuary should consider carefully the most appropriate approach to his task. This will depend on the circumstances of the company, the nature of its business and how it is conducted. For the Hong Kong Appointed Actuary "to ensure .....that long-term business is operated on sound financial lines" (cf para. 1.1) in a small company for example, he should take particular care that his deliberations are sufficiently broadly based to allow him to assess the company's general financial condition and prospects including its financial and management resources and the standard of its documentation. A full discussion with the company's auditor is in any event essential before any annual report or certification is made by the Hong Kong Appointed Actuary.
  - (b) The Hong Kong Appointed Actuary must be given access on an ongoing basis to the management of the company at a level senior enough to ensure he receives full and prompt information on the company's affairs.

- (c) The Hong Kong Appointed Actuary must insist on being supplied at a minimum with a copy of the company's written business plan and budget for the coming one or more years, plus regular management accounts including revenue account, balance sheet and business movement summary. This should be shown in enough detail for him to pinpoint the variances from plan or budget and such variances should also be identified by and commented on by management. The company should also supply the Hong Kong Appointed Actuary with monthly investment summaries in enough detail to allow him to monitor the observation of investment policy.
  
- (d) Reinsurance requires particular attention since the financial health of a company may depend heavily on appropriate reinsurance arrangements. The Hong Kong Appointed Actuary should examine carefully the reinsurance treaties in force and be prepared to withhold or qualify his certificate if he believes these are inadequate to the point of posing a material threat to the company's financial condition. This may be the case for example, when the reinsurer's means seem limited.

## **2. CONSIDERATIONS AFFECTING ACCEPTANCE OF AN APPOINTMENT**

- 2.1 Any actuary, before accepting appointment as a Hong Kong Appointed Actuary, must consider most carefully in the light of his previous experience and work whether acceptance would be in line with proper professional behaviour and standards. No actuary should act as a Hong Kong Appointed Actuary if he does not have the necessary practical experience. There may be exceptional circumstances where this need not apply, but in such cases appropriate arrangements must be made for the Hong Kong Appointed Actuary to have recourse on a professional and formal basis to an actuary who has such experience.
- 2.2 A potential Hong Kong Appointed Actuary who has not already worked in close touch with his immediate predecessor has a professional duty to consult him (if this is possible) to discover whether there are any professional reasons why he should not accept the appointment. He should make this clear to his prospective principal and seek his permission to hold such consultations. If such permission were withheld it would be a material factor which would be relevant to the prospective appointee's decision as to the propriety of accepting the appointment. He must also ensure that, as a Hong Kong Appointed Actuary, he would have a right of direct access to the board of directors of the company and would have access to all relevant information to enable him to carry out his duties satisfactorily; this must be explicit from the inception of his appointment. Where there is a group structure, he should bear in mind the possible implications.
- 2.3 Where his financial interests in an insurance company by their nature and size are or become such that a conflict of interest would, in the normal course of events, arise or seem to arise, an actuary should not accept the position of Hong Kong Appointed Actuary or continue in it as the case may be. If temporarily in a special situation a conflict of interest arose, or would seem to arise, the Hong Kong Appointed Actuary before making a report should first ask the company to obtain a report from an actuary who has no conflict of interest.

### **3. EXTENT OF THE HONG KONG APPOINTED ACTUARY'S RESPONSIBILITY**

3.1 The profession's rules of conduct make it clear that every actuary acting in his professional capacity, whether remunerated by salary or fee, has a duty to his profession and his responsibility to his principal must be consistent with this. The Hong Kong Appointed Actuary is, however, in a special position in that :

- (a) he is appointed and remunerated by the company, and at the same time
- (b) he has responsibilities and obligations by reason of his statutory duties under the Insurance Companies Ordinance.

3.2 It is seldom that these two aspects of his appointment conflict. If they do, however, it is the duty of the Hong Kong Appointed Actuary to advise the company as soon as he is of the view that :

- (a) a course of action is being, or is proposed to be, followed by the company, or
- (b) a situation has arisen, perhaps outside the control of the company,

which creates a material risk that the long-term fund may be insufficient to cover its liabilities or the company may fail to meet its obligations under the Ordinance in relation to its long-term business. It is also the Hong Kong Appointed Actuary's duty :

- (i) if the company persists in following such a course of action under (a), or
- (ii) if the company fails to remedy the situation in (b) and does not report this fact to the Insurance Authority,

to advise the Insurance Authority after so informing the company.

3.3 It is part of the Hong Kong Appointed Actuary's continuing responsibility to advise the company of his interpretation of its policyholders' reasonable expectations.

When a significant change is likely to take place, the Hong Kong Appointed Actuary should take all reasonable steps to ensure that the company appreciates the implications for the reasonable expectations of its policyholders. It is also incumbent upon the Hong Kong Appointed Actuary to take all reasonable steps to ensure that the company's incoming policyholders should not be misled as to their expectations.



- 3.4 The Hong Kong Appointed Actuary, as such, has no executive authority within the company (even though he may also, in another capacity, have an executive position and authority). The responsibility for company decisions must, both in law and in practice, rest with the board of directors. The Hong Kong Appointed Actuary's duty is to advise the company on those matters relevant to his statutory duties. Having regard to the paramount importance of this advice in the context of long-term business, he must continue to have a right of direct access to the board of directors.

#### **4. THE DUTIES OF THE HONG KONG APPOINTED ACTUARY**

4.1 The statutory responsibility of the Hong Kong Appointed Actuary as required under Section 18 of the Ordinance is to carry out, from time to time, and to report on an investigation into the financial condition of the office, including a valuation of its liabilities. Although, as a statutory requirement, an investigation is to be made only at specific intervals, the profession regards it as the Hong Kong Appointed Actuary's duty to take all reasonable steps to ensure that he is, at all times, satisfied that if he were to carry out such an investigation, the position would be satisfactory, and if not to act in accordance with para. 3.2 above.

4.1.1 More precisely, Sections 18 (as amplified in the Third Schedule), and 23 make it the statutory responsibility of the Hong Kong Appointed Actuary to determine in accordance with any applicable valuation regulations any excess of the assets representing a long-term fund over the aggregate of its corresponding liabilities and such margin as is prescribed in the Ordinance. He must also state the principles upon which the valuation and distribution of profits among the policyholders are made, and whether these principles were determined by the instrument constituting the insurer or by its regulations or by-laws or otherwise.

It is the Hong Kong Appointed Actuary's professional responsibility to advise the company on the extent to which it would be appropriate to distribute any excess to policyholders or transfer it to shareholders and to make recommendations for its specific allocation in the light of such principles.

4.1.2 The profession therefore regards it as the duty of the Hong Kong Appointed Actuary to take all reasonable steps to ensure that the company's constitution or authorised procedures are or will be such that it will not make or undertake to make a specific allocation of profit in a long-term fund (whether to policyholders, shareholders or both) before the directors have obtained from him and duly considered a written report containing his observations and recommendations on the subject.

4.2 The Hong Kong Appointed Actuary must have regard to all aspects likely to affect the financial position of the company in respect of its long-term business including the possible effect of any contingent liabilities should they crystallise. Although the following list is not exhaustive, the financial position is particularly affected by :

- (a) the premium rates on which existing business has been, and current new business is being, written,
- (b) the nature of the contracts in force and currently being sold, with particular reference to all options and guarantees,
- (c) the existing investments and the continuing investment policy,
- (d) the marketing plans, in particular the expected volumes and costs of sales,
- (e) the current and likely future level of expenses,
- (f) the extent of the company's free reserves,
- (g) the reinsurance arrangements,
- (h) the company's vulnerability to fluctuations in experience,
- (i) the company's policy in regard to the nature and timing of allocations of profits to policyholders and/or shareholders, and
- (j) the current and likely future taxation position of the company.

4.3 Information on the above items and any other relevant information must be made available to the Hong Kong Appointed Actuary for him to carry out the necessary financial investigations, and to be able to be satisfied as to the continuing financial state of the company. A prospective Hong Kong Appointed Actuary must make sure that the necessity for such information is fully understood by the company, and that suitable arrangements are made to ensure that this information is forthcoming.

## **5. PREMIUM RATES AND POLICY CONDITIONS**

- 5.1 A prime responsibility must lie with the Hong Kong Appointed Actuary to satisfy himself that the premium rates being charged for new business are appropriate. That is to say they should be sufficient to enable the company in due course to meet its emerging liabilities, having regard to the items listed in para. 4.2 above, not least the extent of the company's free reserves. The Hong Kong Appointed Actuary may need to have regard to the provisions of Section 26(1) (a) of the Ordinance.
- 5.2 The statement that a premium rate will be sufficient cannot in fact be an absolute statement - it is inevitably a probability statement because it depends on such future events as mortality, the return on investments, and the expenses. The adequacy or otherwise of premium rates cannot, therefore, be other than a matter of judgement. It is the responsibility of the actuary to exercise this judgement. In exercising this judgement he may reasonably have regard to the free reserves of the company.
- 5.3 The required judgement will, of course, needs to be based on the use of sound techniques. Attention may be specially drawn to the complex questions of adequacy of provisions for expenses, and contracts involving various options, including guaranteed surrender values, particularly if financial conditions could arise in which the policyholder could gain by surrender and re-entry.
- 5.4 It may be that a practicable premium basis, whilst commercially justifiable, will involve significant new business strain. The Hong Kong Appointed Actuary must be satisfied that the company will be able to set up the necessary reserve and a prudent solvency margin, and must indicate any limits on the volume of business that may prudently be accepted.
- 5.5 He will take into account the shareholder's assets in a proprietary office. However, it cannot automatically be assumed that they are equivalent to free reserves held as part of the long-term fund because they can be used for other than long-term business.
- 5.6 The most common problem with small company is expense overrun. The Hong Kong Appointed Actuary should make clear to the board the future demands on capital for expense overrun and the necessary volume of business and degree of expense control needed to eliminate such overrun.

## **6. ACTUARIAL INVESTIGATIONS**

- 6.1 The Hong Kong Appointed Actuary must satisfy himself as to the existing business. To do so he must consider the liabilities, the corresponding assets, and their interrelationship, and satisfy himself as regards the resilience of the financial position of the company in all reasonably foreseeable circumstances which might affect that position.
- 6.2 He should take all reasonable steps to satisfy himself as to the data, and if he has any doubts, he must ask the management for written assurances as to the correctness and completeness of the data. He should satisfy himself that the appropriate valuation procedures have been correctly carried out and adequately documented.
- 6.3 The Hong Kong Appointed Actuary must use liability valuation methods that are appropriate to the contracts in question, taking into account not only the principal benefits, but any ancillary guaranteed benefits such as surrender and paid-up values, guarantees of minimum interest rate credits and any options. When assessing the liabilities of the long-term business of the company he must also have regard to policyholders' reasonable expectations.
- 6.4 Appropriate provision must be made for future expenses of continuing the existing business and the expected level of new business.
- 6.5 Subject to any statutory regulations, the responsibility for investment policy rests with the directors of the company, as also does the decision as to the value to be placed on the assets in any balance sheet.
- 6.6 The Hong Kong Appointed Actuary must decide the rates of interest to be used in the valuation of the liabilities. These are affected by his estimates of the likely future proceeds of the existing assets and of the rate at which future investment will be possible. In relation to the existing assets, he must assess the nature of the portfolio and consider what rate of return, capital and income is likely to be realised over the future period relevant to the liabilities. In addition, due allowance must be made for the current and future taxation position of the company. Any such allowance must be consistent with any allowance made for tax relief on expenses. According to his judgement of this he must decide the basis of his valuation of the liabilities.

- 6.7 The Hong Kong Appointed Actuary must also pay regard to the relationship between the nature and term of the assets and those of the corresponding liabilities and pursuant to Part 1 of the Third Schedule of the Ordinance must certify that he is satisfied that this is prudent. The importance of this will vary widely from one situation to another, but experience suggests that this can be an area of particular danger.
- 6.8 At one extreme, for example, for a company with a large portfolio of long-established with-profit (or participating) business, and where the company is transacting (and seems likely to continue to do so) a steady volume of new business which is small in relation to the existing business, the possibility of insolvency arising from mis-matching of assets and liabilities may be minimal.
- 6.9 At the other extreme, for a company transacting a volume of non-profit (or non-participating) new business which is very large in relation to the existing portfolio and which has only relatively small free reserves, matching of asset proceeds to liability outgo may be critical to solvency. The dangers are increased if there are alternative guarantees or options which could, in certain circumstances, require a different distribution of assets by term.
- 6.10 The Hong Kong Appointed Actuary must decide whether, in his judgement, the investment policy pursued by the directors is, or could become, inappropriate having regard to the nature and term of the company's liabilities. If this is the case, he must advise the company of the constraints on investment policy necessary to protect the position of policyholders.
- 6.11 The Hong Kong Appointed Actuary should have regard in his valuation to the nature of the company's re-insurance arrangements including any financing provision implicit therein. If he considers these arrangements are inappropriate or inadequate he should advise the company on the modifications necessary to protect the position of the policyholders. The Hong Kong Appointed Actuary should also have regard to the possibility of failure of a reinsurer or the possibility that reinsurance contracts may lapse or prove unenforceable in certain circumstances.
- 6.12 The Hong Kong Appointed Actuary must satisfy himself that, in aggregate, the margins in any published valuation of the liabilities, including any margins required by statute, are adequate having regard to his assessment of the risks inherent in the nature and conduct of the company's business.

## **7. INSOLVENCY**

- 7.1 It is apparent from the foregoing that most of the problems with which the Hong Kong Appointed Actuary is concerned are not capable of precise assessment but are, rather, matters of judgement. In some circumstances, this judgement may appropriately be based on the actuary's estimates of the most probable outcome - perhaps, for example in relation to a distribution of profits. If, however, judgement is required in a matter which may affect the solvency of the company, much more rigorous standards must be applied. (Two such contrasting situations are exemplified in paras. 6.8 and 6.9)
- 7.2 The possibility of insolvency, or intervention by the Insurance Authority under Section 26 of the Ordinance on the grounds of the company's being unable to fulfil the reasonable expectations of its policyholders, may arise from factors, some of which are within the control of the company and some not. To the extent that they are under the control of the company, it is the Hong Kong Appointed Actuary's duty to assess the limits within which the company must act and to advise the company of the necessity for these limits.
- 7.3 The Hong Kong Appointed Actuary must consider all external factors outside the control of the company which could lead to insolvency and must then take whatever action he considers necessary. The profession requires that any Hong Kong Appointed Actuary should pay the most scrupulous regard to prudent judgement in these matters.

## **8. WRITTEN REPORTS**

- 8.1 The Hong Kong Appointed Actuary is required as part of his statutory duties to report to the Insurance Authority in a prescribed form on actuarial investigations carried out under Section 18 of the Ordinance. It is his professional duty first to report in writing to the directors on the results and implications of any such investigation, whether or not an allocation of profits is involved.
- 8.2 If he has reason to believe that the company plans to announce or otherwise undertake to make a specific allocation of profits to policyholders and/or shareholders in anticipation of the results of a Section 18 investigation (notwithstanding that, to comply with Section 23(2), confirmation that the investigation shows a sufficient excess of assets over liabilities must precede an actual transfer of assets out of the long-term fund), the Hong Kong Appointed Actuary must take all reasonable steps to ensure that the directors will be in a position to consider a suitable written report from him on the subject before the announcement is due to be made or the undertaking given.
- 8.3 In reporting on and making recommendations in respect of any proposed allocation of profits the Hong Kong Appointed Actuary must consider the factors listed in para. 4.2 above and any others he thinks are significant, and must carry out appropriate financial investigations including an appraisal of the relevant experience. He must include in his report such information and discussion about each factor, and about the results of his financial investigations, as may be necessary to enable the directors to judge the appropriateness of the allocation and understand its implications for the future conduct of the company's long-term business. In particular, but without prejudice to the generality of this requirement :
- 8.3.1 If the report anticipates the results of a Section 18 investigation he must indicate and discuss how in the context of statutory requirements the allocation will be financed.
- 8.3.2 He must discuss the relationship between the proposed allocation and the relevant experience, and indicate whether in his opinion the continuance of a distribution policy which, in its relationship to relevant experience, was consistent with the allocation now proposed (excluding any component of the allocation that will be declared to be non-recurring), could lead in due course to an unsatisfactory position. If so, he must explain how this could appropriately be avoided.



- 8.3.3 In the case of with-profit business his comments under para. 8.3.2 must cover bonus or policyholder dividend prospects, with particular reference to the projected development of outgo on and asset cover for unreserved terminal bonus and the like in different investment scenarios.
- 8.3.4 He must justify his recommendations regarding the allocation and its consequences (if any) for the conduct of the company's business by reference as appropriate to :
- (a) his appraisal of the relevant experience;
  - (b) his understanding of the company's financial and business objectives;
  - (c) his assessment of the company's continuing ability to meet its statutory solvency requirement and desirable level of solvency margin;
  - (d) his interpretation of the reasonable expectations of the company's policyholders having regard to (a), (b) and (c). He should assume that among the conditions for the fulfilment of those expectations are
    - (i) that, in the recognition and allocation of profits in accordance with the company's terms of participation and its policy in respect of the matters referred to in para. 4.2(i) above, groups of participating policies, including policies issued to Hong Kong residents as a distinct group, are appropriately and equitably distinguished, and
    - (ii) that the company conducts its affairs, including its new business and investment strategies, with due regard for its financial resources.
- 8.4 If in his opinion issues required to be covered in a written report to the directors were fully dealt with in a comparable report made within the preceding eleven months and duly discussed by the board, the Hong Kong Appointed Actuary may report in an appropriately abridged form, as for example when interim or terminal bonus rates are being reviewed during the year.
- 8.5 If a parent of the company reserves the right to approve or vary decisions on matters which are required by this section to be covered in a report by the Hong Kong Appointed Actuary to the company's directors, he must take all reasonable steps to ensure that any such report is made available at an appropriate time to the relevant authorities within that parent.

## **B. THE ACTUARY AS A DIRECTOR OR IN ANY OTHER POSITION OF AUTHORITY IN RELATION TO AN INSURANCE COMPANY**

- 9.1 It is clearly in the public interest that actuaries should be available to act as directors of insurance companies, particularly those transacting long-term insurance, where by their professional training they are especially fitted to make a useful contribution. The actuary should, however, recognise that the public, and his fellow directors, will assume that he is satisfied as to the way in which the affairs of the company are likely to be conducted whilst he is a member of the board. It is appropriate for the actuary to make suitable enquiries before accepting appointment as a director.
- 9.2 A common situation is for the Hong Kong Appointed Actuary also to hold a managerial appointment or (whether an employee or not) to be invited to join the board. On occasions he will then be expressing views as a member of the management or as one director among many; at other times he will be advising the board as the Hong Kong Appointed Actuary. He must make sure that the other members of the management or the other directors, as the case may be, understand this position.
- 9.3 A special responsibility is owed to the Hong Kong Appointed Actuary by any other actuary who is a director. He can be of great use both to the board and to the Hong Kong Appointed Actuary, in assisting the board to a full understanding of actuarial issues. He should be careful not to act in such a way as to diminish the status of the Hong Kong Appointed Actuary.
- 9.4 A similar responsibility is owed to the Hong Kong Appointed Actuary by any other actuary who is in a managerial or other position of authority. In particular, although his responsibilities may be such as to require him to enter into discussions with the Hong Kong Appointed Actuary on matters which impinge on the latter's professional responsibility, he should at all times take care to respect the status of the Hong Kong Appointed Actuary.

### **C. THE ACTUARY AS AN EXTERNAL ADVISOR OR ASSESSOR**

- 10.1 There will be circumstances in which a member who is external to a particular insurance company is asked by the company or someone with a legitimate interest in the company to express an opinion on a valuation carried out by the Hong Kong Appointed Actuary or on a report the Hong Kong Appointed Actuary has made to the company in the context of his statutory or professional responsibilities.
- 10.2 A member engaged in such an assignment should bear in mind that, while there is room for differences of opinion in relation to actuarial advice and judgement, he should at all times take care to respect the status of the Hong Kong Appointed Actuary. However, this does not prevent him from making properly reasoned comments on the work of the Hong Kong Appointed Actuary if he feels it is appropriate or necessary to do so.