



**AIA International Limited**

**Financial Condition Report**

**For the year ended 30 November 2017**



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## 1 GENERAL INFORMATION

AIA International Limited (the “Company”) was incorporated in Bermuda on 16 January 1959. The Company is licensed by the Bermuda Monetary Authority (the “Authority”) as a Class 3 insurer and a Class E insurer. As described in greater detail below, the Company’s core business is to offer Asian households products and services that enhance their financial security and provide them with peace of mind as their financial needs evolve over their lifetimes. The Company is a member of the AIA Group and has branches in Hong Kong, Macau, Taiwan and New Zealand and wholly-owned subsidiaries in Korea, Indonesia, Vietnam and Cambodia as well as a 49 per cent joint venture in India. In addition to the Authority, the Company is subject to supervision in the jurisdictions in which it operates as a branch.

The Company maintained a strong capital position for the financial year ended 30 November 2017 and the table below shows the current ratings of the Company by leading credit rating agencies:

Rating Agency	Financial Strength Rating	Counterparty Credit Rating	Latest Rating Date
S&P	AA- / Stable / --	AA- / Stable / --	30 June 2016
Moody’s	Aa2/ Stable	NA	27 March 2017
Fitch	AA / Stable	NA	23 November 2017

The Company is a wholly-owned subsidiary of AIA Group Limited which together with its subsidiaries (collectively “AIA” or the “Group”) comprises the largest independent publicly listed pan-Asian life insurance group with a presence in 18 markets in Asia-Pacific. The business that is now AIA was first established in Shanghai almost a century ago. It is a market leader in the Asia-Pacific region (ex-Japan) based on life insurance premiums and holds leading positions across the majority of its markets.

AIA meets the long-term savings and protection needs of individuals by offering a range of products and services including life insurance, accident and health insurance and savings plans. The Group also provides employee benefits, credit life and pension services to corporate clients. Through an extensive network of agents, partners and employees across Asia-Pacific, AIA serves the holders of more than 30 million individual policies and over 16 million participating members of group insurance schemes.

AIA Group Limited is listed on the Main Board of The Stock Exchange of Hong Kong Limited under the stock code “1299” with American Depositary Receipts (Level 1) traded on the over-the-counter market (ticker symbol: “AAGIY”).

The Group’s lead insurance regulator is the Hong Kong Insurance Authority.

For more information on the Group including to the latest Annual Report, please refer to the following link:

<http://www.aia.com/en/investor-relations.html>



## 2 BUSINESS AND PERFORMANCE

### Name of Insurer

AIA International Limited

### Supervisors

*Insurance Supervisor*  
Bermuda Monetary Authority  
BMA House  
43 Victoria Street, Hamilton  
Bermuda

*Group Supervisor*  
Insurance Authority  
19/F, 41 Heung Yip Road  
Wong Chuk Hang  
Hong Kong

### Approved Auditor

Statutory Reporting  
PricewaterhouseCoopers  
Washington House  
4/F 16 Church Street  
Hamilton HM11  
Bermuda

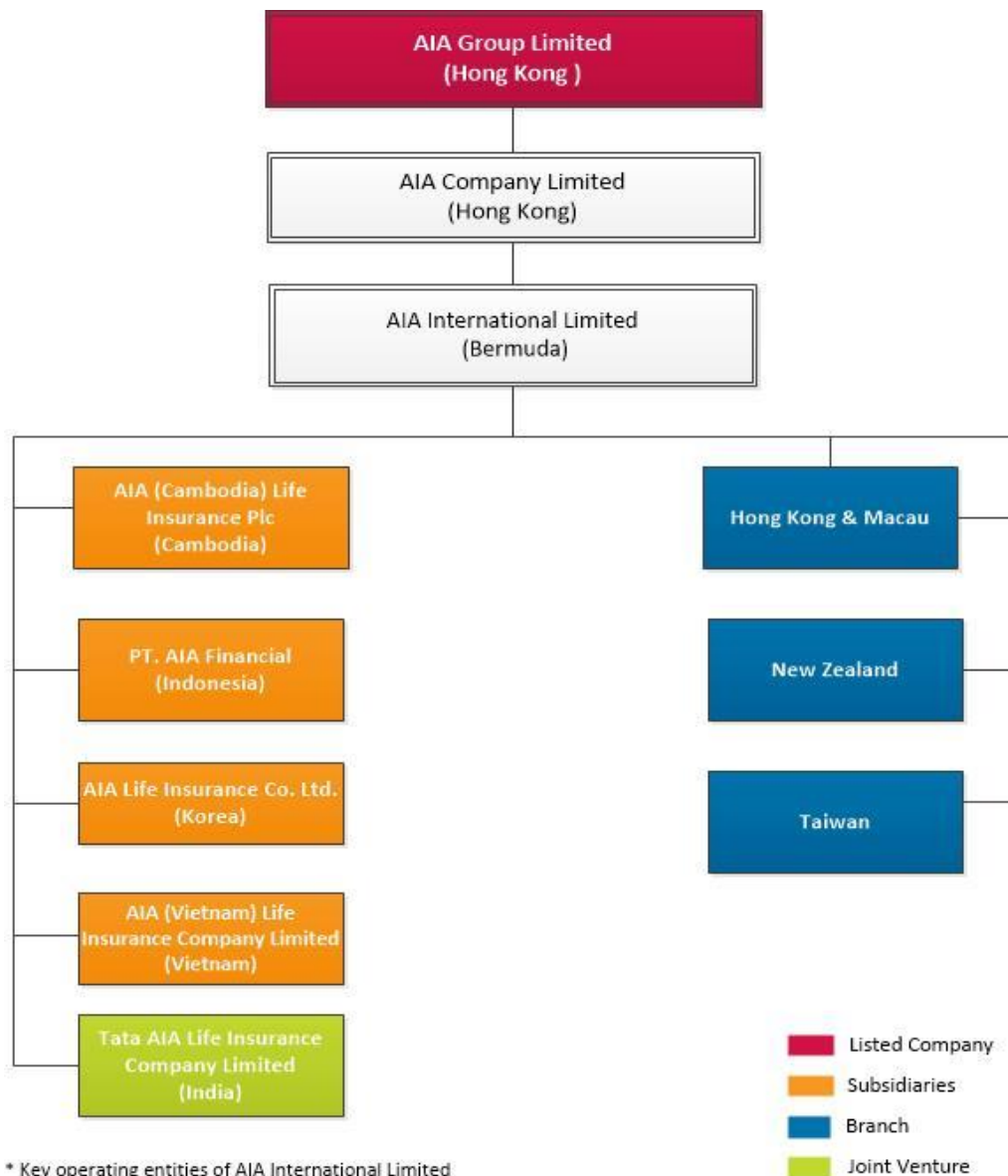
GAAP Reporting  
PricewaterhouseCoopers  
21/F, Edinburgh Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong

### Ownership Details

The Company is a direct wholly-owned subsidiary of AIA Company Limited, a company incorporated in Hong Kong, which in turn is a direct wholly-owned subsidiary of AIA Group Limited, a company incorporated in Hong Kong and listed on The Stock Exchange of Hong Kong.



**Group Structure\***  
 (as at 31 May 2018)



Please also refer to Events after the Reporting Period as disclosed in the notes of the financial statements of the Company for changes to the corporate structure of the Company after 30 November 2017.



## Insurance Business Written by Business Segment and by Geographical Region

The Company writes insurance business through its branches in Hong Kong, Macau, Taiwan and New Zealand and its subsidiaries in Korea, Indonesia, Vietnam and Cambodia. Below is information on the insurance business of the Company written by business segment and by geographical region:

### Gross Premium Written by Business Segment for the Reporting Period

Line of Business (amounts * USD 1m)	2017 Gross Written Premium	2016 Gross Written Premium
Long-term Business	13,235	9,382
General Business	<u>197</u>	<u>172</u>
<b>Total</b>	<b>13,432</b>	<b>9,554</b>

### Gross Premium Written by Geographical Region for the Reporting Period

Region (amounts * USD 1m)	2017 Gross Written Premium	2016 Gross Written Premium
Hong Kong	10,880	7,183
Other	<u>2,552</u>	<u>2,371</u>
<b>Total</b>	<b>13,432</b>	<b>9,554</b>

Please refer to the Financial and Operating Review of the Annual Report 2017 of AIA Group Limited for more information on the financial performance of the Group.

## Performance of Investments & Material Income & Expenses for the Reporting Period

### Performance of Investments for the reporting period:

As of 30 November 2017, the Company has policyholder and shareholder investment assets (including unit-linked assets) of USD 77,260 million. Of these, 75% were invested in fixed-income investments, 21% in equity securities and 4% in properties.

The fixed income portfolio is of good quality with an average rating of “A” and 97% rated “BBB” or higher as of 30 November 2017. A significant portion was held in corporate bonds. While investment in fixed income is generally weighted towards highest rated issuers with the longest available tenor in each market, it is also constrained by factors such as availability, concentration risks, their respective sovereign rating and market demand.

The equity portfolio is mostly held in participating funds to provide for discretionary bonus and dividend payments to participating policyholders. As of 30 November 2017, the largest portion was held in Hong Kong (80%), followed by Indonesia (14%) and Korea (5%).

The real estate portfolio is about 4% of total investment assets. The investment properties are mainly located in Hong Kong.



<b>Investment return</b> (amounts * USD 1m)	<b>2017</b>	<b>2016</b>
Interest income	2,354	2,125
Dividend income	248	205
Rental income	<u>93</u>	<u>86</u>
Investment income	2,695	2,416
Net gains / (losses) of Available for Sale financial assets	115	(20)
Net gains of financial assets measured at fair value	3,139	389
Other investment income	<u>349</u>	<u>131</u>
Investment experience	3,603	500
Investment return	6,298	2,916

Material Income and Expenses for the Reporting period:

The Company's main revenue source is premiums and fee income. Net premium written for the period significantly increased due to continuous expansion (mainly) in Hong Kong.

<b>Expense type</b> (amounts * USD 1m)	<b>2017</b>	<b>2016</b>
Net Insurance and Investment contract benefits	12,843	8,217
Other	<u>2,623</u>	<u>2,022</u>
<b>TOTAL</b>	15,466	10,239

Please refer to the Financial Highlights, Financial and Operating Review and Financial Statements of the Annual Report 2017 of AIA Group Limited for more information on the financial performance of the Group.

### **3 GOVERNANCE STRUCTURE**

The Company is committed to high standards of corporate governance and sees the maintenance of good corporate governance practices as essential to its sustainable growth. The Company also recognises the importance of sound risk management in every aspect of its business and for all its stakeholders.

#### **Board and Senior Executive**

##### ***Board and Senior Executive Structure, role, responsibilities and segregation of responsibilities***

The role of the Board of Directors (the "Board") is to exercise oversight in relation to the Company. The Board provides leadership to the Company in respect of operational issues through the Group Chief Executive and other executives who are authorised to act on behalf of the Board in the operational management of the Company. Any responsibilities not so delegated by the Board to the Group Chief Executive and other executives remain the responsibility of the Board. The Group Chief Risk Officer is responsible for risk oversight.

The Company's corporate governance is implemented through a structure hierarchy, which includes the Board, the Audit Committee, the Risk Committee and any other committees of the Board established by resolutions of the Board. The Board meets on a regular basis (or ad hoc if required). Committee reports are presented to the Board.



The Board consists of six directors, which are four executive directors and two independent non-executive directors, and their roles and responsibilities are outlined in the Company's Bye-Laws and comply with the regulatory requirements of Bermuda.

### ***Remuneration Policy***

The Company's Remuneration Policy is designed to attract, retain and motivate talent, reward performance, and ensure compliance with relevant regulations. Remuneration arrangements take into account the Group's business priorities and performance, market practices, the regulatory environment as well as risk management considerations. In particular, senior executives receive variable remuneration and a significant proportion of total remuneration awarded is subject to multi-year performance-based vesting conditions. Non-executive directors of the Company do not receive any bonuses or share based compensation.

### ***Pension or Early Retirement Schemes for Members, Board and Senior Executives***

The Company operates funded and unfunded defined benefit plans that provide participating employees with life and medical benefits after retirement and a lump sum benefit on cessation of employment. The locations covered by these plans include Hong Kong, Korea, Indonesia, Taiwan and Vietnam. The Company also operates a number of defined contribution pension plans, whereby employees and employer make monthly contributions equal to 1 per cent to 22 per cent of the employees' monthly basic salaries. The Company does not have any early retirement schemes.

### ***Material Transactions with Shareholder Controllers, Persons who Exercise Significant Influence, the Board and Senior Executives***

During the financial period, the Company declared two dividends to its sole shareholder, AIA Company Limited. The first dividend of US\$500 million was declared in May 2017 and the second dividend of US\$590 million was declared in November 2017.

### **Fitness and Proprietary Requirements**

#### ***Fit and Proper Process***

The Company appoints members of the Board and hires senior executives based on the individual's expertise and work experience as well as professional judgment. The individual's assessment covers competence and capability as well as honesty, integrity, reputation and financial soundness. Before directors are appointed to the Board, all candidates must undergo a rigorous recruitment and background screening. Certain regulated positions (e.g. a key person in a control function) must also be approved by local regulators.

#### ***Board and Senior Executives Professional Qualifications, Skills and Expertise***

Details of the qualifications, skills and expertise of the current Board are set out below:

**Mr. Keng Hooi Ng** (appointed 10 April 2012) is an Executive Director and the Group Chief Executive and President of AIA Group Limited, appointed on 1 June 2017. He joined AIA Group Limited in October 2010. Prior to his current role, Mr. Ng was the Group Chief Executive and President Designate from March 2017 and was a Regional Chief Executive for the Group since his initial appointment in 2010. During that time he was responsible for a number of the





Company's businesses, including most recently those operating in Mainland China, Thailand, Indonesia, Singapore, Brunei and Taiwan as well for the Group's Agency Distribution channel. Prior to joining AIA, Mr. Ng was the Group Chief Executive Officer and director of Great Eastern Holdings Limited from December 2008 to 2010. Mr. Ng worked for Prudential plc from 1989 to 2008, serving as a Managing Director of Insurance of Prudential Corporation Asia Limited from 2005 to 2008, was responsible for its operations in Malaysia, Singapore, Indonesia and the Philippines. He has been a fellow of the Society of Actuaries since 1985.

**Mr. Jacky Wing Shing Chan** (appointed 1 June 2017) is the Regional Chief Executive of the Group, responsible for the Group's businesses operating in Hong Kong and Macau, Singapore and Brunei, Indonesia, the Philippines and Cambodia as well as the Group Agency Distribution. Mr. Chan has extensive experience having worked at AIA for the past 29 years. Prior to becoming a Regional Chief Executive, Mr. Chan has been Chief Executive Officer of AIA Hong Kong and Macau since 2009. Mr. Chan is a fellow of the Society of Actuaries, a member of American Academy of Actuaries (MAAA) and a fellow of the Canadian Institute of Actuaries (CIA).

**Mr Garth Brian Jones** (appointed 30 April 2013) is the Group Chief Financial Officer of AIA Group Limited responsible for leading the Group in all aspects of capital and financial management, as well as managing relationships with all key external stakeholders, including independent auditors and actuaries, rating agencies and international accounting and regulatory bodies. He joined AIA in April 2011. Prior to joining the Group Mr. Jones was the Executive Vice President of China Pacific Life Co Ltd., the life insurance arm of China Pacific Insurance (Group) Co. Ltd. Mr. Jones is a fellow of the Institute of Actuaries in the United Kingdom.

**Mr. Mitchell David New** (appointed 17 January 2017) is the Group General Counsel and Company Secretary of AIA Group Limited responsible for the provision of legal advice and company secretariat services for the Group and provides leadership to legal and corporate governance functions within country operations. He joined AIA in April 2011. Prior to joining the Group Mr. New was a member of the law firm Fasken Martineau and occupied various senior roles with Manulife Financial, including Senior Vice President and Chief Legal Officer for Asia, based in Hong Kong and Senior Vice President and General Counsel to Manulife's Canadian division. He is a qualified barrister and solicitor and member of the Law Society of Upper Canada and holds a Bachelor of Commerce Degree and Master Degree in Business Administration from McMaster University and a Bachelor of Laws Degree from the University of Western Ontario.

**Mr. Timothy Carrick Faries** (appointed 17 January 2017) is the Managing Partner of the Bermuda Office of Appleby and has an overall responsibility for managing the operations of Appleby's Bermuda office. He is also the Bermuda Group Head of the Corporate department and the Insurance and Reinsurance sector leader. He leads a team of lawyers who specialise in all manner of non-contentious corporate insurance work. Mr. Faries has extensive experience of public and private insurance company capital raising, mergers and acquisition activities, public listings on US, UK and European securities exchanges, the establishment and licensing of alternative risk financing vehicles and captive insurance companies in established and emerging markets. Mr. Faries joined Appleby in 1993 and has been the Managing Partner since 2015.

**Mr. Shelby Ross Weldon** (appointed 17 January 2017) is a Senior Vice President and Team Leader and member of the firm's senior management team of Marsh Captive Solutions. He is managing a team of accounting and insurance professionals providing management and administration services to a portfolio of captive and commercial insurers. Prior to that, Mr. Weldon has served as the Director of Licensing & Authorization, Director of Compliance and Deputy Director, Insurance Supervision with the Bermuda Monetary Authority. Mr. Weldon has more than 30 years of experience in Bermuda financial services and began his career as an auditor at an international audit firm. Mr. Weldon is a Certified Public Accountant.



Please also refer to the section on Corporate Governance of the Annual Report 2017 of AIA Group Limited for more information on the Executive Committee of the AIA Group including on the biographies of the Group Chief Risk Officer, Group Chief Investment Officer, Group Chief Strategy and Corporate Development Officer, Group Chief Technology and Operations Officer, Group Chief Human Resources Officer and Group Chief Marketing Officer.

## **Risk Management and Solvency Self-Assessment**

The Company recognises the importance of sound risk management in every aspect of its business and for all stakeholders. For its policyholders, it provides the security of knowing that the Company will always be there for them. For investors it is key to protecting and enhancing the long-term value of their investment. Finally, for regulators sound risk management supports industry growth and enhances the public's trust in the industry.

While effective risk management is vital to any organisation, it goes to the core of a life insurance business where it is a fundamental driver of value. The Company's risk management framework does not seek to eliminate all risks but to identify, understand and manage them within acceptable limits in order to support the creation of long-term value.

The Company's risk governance framework is built on the 'Three Lines of Defence' model. With regards to risk management, the objective is to ensure that an appropriate framework is in place, including an independent system of checks and balances, to provide assurance that risks are identified, assessed, managed and governed properly. The framework clearly defines roles and responsibility for management of risk among the Executive Management, Risk & Compliance and Internal Audit functions. While each line of defence is independent from the others, they work closely to ensure effective oversight.

The Company has a robust Risk Management Process that provides sufficient information, capability and tools to manage its key risks. To that end, the Company has developed the following key processes to identify, quantify, manage and monitor the risk exposures.

**Identification.** Timely and complete identification of risks is an essential first step to the risk management process. The Risk & Compliance function has developed a systematic process to identify existing and emerging risks in the business units.

**Quantification.** Quantification of risk is important in establishing the level of exposure and in determining the appropriate management actions within the Company's Risk Appetite. Specific risk metrics are adopted to support the quantification process.

**Escalation and Mitigation.** Following the risk quantification process, the executives working in the First Line are responsible for the timely identification and escalation of material risk developments and for the implementation of risk mitigation actions, as appropriate.

**Reporting and Monitoring.** The Second Line is responsible for monitoring First Line activities and reporting to the appropriate Risk Committees the performance of the First Line against risk metrics and limits defined in the Risk Appetite.

The Company's solvency is assessed and monitored regularly by the actuarial and finance function. Stress testing is conducted to assess the solvency under specified stress events according to the Company's Risk Tolerance. Management information arising from the solvency assessment and stress testing is used to complete Solvency Self-Assessments of the capital required to support the Company's business objectives given the amount of risk the Company has taken on (or plans to take on) and environmental factors. The Solvency Self-Assessment is reviewed by executives and the Risk Committee to ensure that the Company operates within its risk appetite.



The solvency position is reviewed by the Audit Committee and ultimately approved by the Board. The Company's solvency is also assessed based on the stress scenarios specified by the risk management function in the Commercial Insurer's Solvency Self-Assessment report. The Commercial Insurer's Solvency Assessment report together with the stress testing results are reviewed by the Risk Committee and approved by the Board to ensure the Company's adherence to its Risk Tolerance when executing its business strategy.

For more information on the Group's Risk Governance framework, please refer to the Risk Management section of the Annual Report 2017.

## **Internal Controls**

### ***Internal Control System***

The Board of Directors is responsible for the Company's internal control system, as well as reviewing its effectiveness. The Company has an internal audit function. The Board of Directors has, through the Audit Committee, oversight on the Company's financial reporting system and internal control procedures. This oversight includes reviewing the Company's financial controls and internal controls, discussing with management any matters in relation to the Company's internal control system and ensuring that management has discharged its duties in establishing and maintaining an effective internal control system.

### ***Compliance Function***

The Group's compliance function has the responsibility within the 'Three Lines of Defence' model (that is explained in the 'Risk Mitigation' section of this report) to monitor adherence to applicable regulations central to the Group's role as an authorised insurer in relevant jurisdictions. The compliance function monitors adherence to organisational compliance policies and procedures and conformity to the Group's Code of Conduct. All material violations are reported to the Board, or its Committees, and addressed. The Company uses internal audits to review the compliance function and would report any material deficiencies or weaknesses to the Board, or applicable Committee.

## **Internal Audit**

The mission, scope and responsibilities of AIA Group Internal Audit ("GIA"), including arrangements for ensuring GIA's independence and objectivity, are set out in the AIA Group Internal Audit Charter as approved by the AIA Group Limited's Audit Committee.

Within AIA's governance framework, GIA operates as the third line of defence. The primary role of GIA is to assist the Board, AIA Group Limited's Audit Committee and executive management to protect the assets, reputation and sustainability of the Group. GIA's mission is to provide independent and objective assessment and reporting of the overall effectiveness of risk management, internal controls and governance processes across the Group and appropriately challenge executive management to improve the effectiveness of these processes.

GIA is independent from management at all times in order to be effective in performing its activities. The Group Head of Internal Audit reports directly to AIA Group Limited's Board of Directors, through the Audit Committee of AIA Group Limited, on the audit programme, its status, and the condition of the control environment. This reporting relationship which also includes audit plans, financial budgets and staffing considerations is designed to ensure the ongoing independence of GIA in order to provide for the objectivity of its findings, recommendations and opinions. For administrative purposes, the Group Head of Internal Audit reports to the Group Chief Financial Officer.



The Group Head of Internal Audit is authorised by the BAC to have complete and unrestricted access, on request, to any of the Group's records, properties and personnel. The Group Head of Internal Audit is also authorised to designate members of GIA staff to have such access in discharging of their responsibilities.

## **Actuarial Function**

The Actuarial Function is responsible for the valuation and monitoring of the Technical Provisions. There are actuarial staff based in each local office of the Company's business units to support the Actuarial Function.

Key objectives of the Actuarial function are to:

- develop and maintain appropriate methodology for valuation of the Technical Provisions, in compliance with regulatory requirements outlined by the Authority.
- monitor the Company's actual experience and set the best estimate assumptions on a regular basis.
- perform the valuation of the Technical Provisions and ensure its reasonableness with consideration of the nature, scale and complexity of the Company's business.

## **Outsourcing**

### ***Outsourcing Policy and Key Functions that have been Outsourced***

The Company has outsourcing policies in each jurisdiction in which it operates to comply with local regulatory requirements. The policies outline the criteria for the selection of third party service providers and the due-diligence procedures to be undertaken to monitor performance and provide oversight of such arrangements.

The Company does not outsource key functions outside the AIA Group and leverages the expertise within the Group through intra-group arrangements.

### ***Material Intra-Group Outsourcing***

The Company makes use of several affiliated service companies which perform a range of services for it. These affiliated companies are fully owned by the Group. In terms of material intra-group outsourcing, the operation of various information technology systems has been outsourced to a fellow-subsiary of AIA Company Limited in Malaysia.

## **4 RISK PROFILE**

The Company is exposed to a variety of risks including but without limitation insurance risk, investment risk, asset-liability mismatch (ALM) risk, operational risk and strategic risk. For more details of these risks, please refer to the Risk Management section of the Annual Report 2017.

### **Material Risks the Insurer is Exposed to During the Reporting Period**

Material risks the Company is exposed to are financial risks, operational risks and strategic risks. The Company maintains a detailed risk taxonomy to ensure all risks are identified and systematically managed. The principal risks and their definitions are summarised below:



FINANCIAL RISKS			OPERATIONAL RISKS		
INVESTMENT	INSURANCE	ALM			
CREDIT	LAPSE	INTEREST RATE	DISTRIBUTION	INFORMATION TECHNOLOGY	FINANCE & ACTUARIAL
EQUITY PRICE	EXPENSE	FOREIGN EXCHANGE RATE	FRAUD & FINANCIAL CRIME	INFORMATION SECURITY	PRODUCT MANAGEMENT
PROPERTY PRICE	MORBIDITY	FINANCIAL LIQUIDITY	LEGAL & REGULATORY	OPERATIONS	THIRD PARTY
CREDIT SPREAD	MORTALITY		INVESTMENT OPERATIONS	KEY PROJECTS	
INVESTMENT LIQUIDITY			PEOPLE	BUSINESS INTERRUPTION	
<b>STRATEGIC RISKS</b>					

Risks	Definition
Investment	Investment risk is the risk arising from the Company's investment portfolio due to (i) counterparties defaulting on obligations - "Credit Risk"; (ii) market movements - "Market Risk"; or (iii) reduced liquidity in markets.
Insurance	Insurance risk is the risk arising from changes in claims experience as well as more general exposure relating to the acquisition and persistency of insurance business. This also includes changes to actuarial and investment assumptions regarding future experience for these risks.
Asset-Liability Mismatch (ALM)	ALM risk is the risk arising from the difference in duration between the Company's assets and liabilities. This mismatch is mainly caused by differences in timing and size of the respective asset and liability cash flows.
Operational	Operational risk is the risk arising from internal processes, personnel and systems or from external events which may result in direct or indirect business impact.
Strategic	Strategic risk is the risk arising from the potential impact of the business strategy on the Company's earnings, capital and reputation. This also takes into consideration the wider social, economic, political, regulatory, competitive or technological trends that could impact the business strategy within a set time period.

### Financial Risks – Investment

- **Credit.** The risk arising from the uncertainty of third parties meeting their obligations to the Company when they fall due.
- **Equity Price.** The risk arising from changes in the market value of equity securities.
- **Property Price.** The risk arising from the volatility of real estate market value due to general or specific factors.
- **Credit Spread.** The risk arising from changes in the market value of securities as a result of a change in perception as to their likelihood of repayment.
- **Investment Liquidity.** The risk arising from the Company's ability to buy and sell investments subject to market availability and pricing.



### Financial Risks – Insurance

- **Lapse.** The rate of policy termination deviating from the Company's expectation.
- **Expense.** The risk of the cost of selling new business and of administering the in-force book exceeding the assumptions made in pricing and/or reserving.
- **Morbidity and Mortality.** The occurrence and/or amounts of medical/death claims are higher than the assumptions made in pricing or reserving.

### Financial Risks – Asset-Liability Mismatch (ALM)

- **Interest Rate.** The risk arising from the impact of interest rate movements on the value of future asset and liability cash flows.
- **Foreign Exchange Rate.** The risk arising from foreign exchange rate movements on the value of future asset and liability cash flows, and the translation of business units' balance sheets to the Company's reporting currency.
- **Financial Liquidity.** The risk arising from the availability of cash resources to meet payment obligations to counterparties as they fall due.

### Operational Risks

Operational risk arises from internal processes, personnel and systems or from external events which may result in direct or indirect business impact.

Operational risk is categorised into a common taxonomy which is adopted across the Group. The Company's operational risks arise in the following key areas:

- **Distribution Risk** – This involves intermediary misconduct such as churning, mis-selling / product suitability, fraud and other market conduct-related issues.
- **Regulatory Compliance Risk** – This concerns compliance with the relevant laws and regulations.
- **Financial and Operational Process Risk** – This involves the controls in key processes in business functions such as product management, investment, finance, actuarial, underwriting, claims, and policy administration
- **Systems and Information Security Risk** – This includes system performance, disaster recovery, and cyber and information security standards.

Each operational risk is assessed against four defined impacts that such risk could have on the business, namely financial loss, regulatory breach, reputation damage and business disruption.

### Strategic Risks

Strategic risk is identified as part of the business plan process and is defined as the potential impact of the business strategy on the Company's earnings, capital and reputation. This also takes into consideration the wider social, economic, political, regulatory, competitive or technological trends that could impact the business strategy within a set time period.

### Risk Mitigation in the Organisation

Under the 'Three Lines of Defence' model, the executives working in the first line are responsible for the timely identification and escalation of material risk developments and for the implementation of risk mitigation actions, as appropriate.

The Company mitigates financial risk in the organisation through a variety of ways, including but not limited to product design or repricing, asset allocation, hedging, reinsurance, experience study, etcetera.

The Company uses various techniques to manage operational risks, including:

- Appointment of First Line Risk Owners and Risk Champions.



- Risk and Control Assessments (RCAs) for each key operational risk.
- Key Risk Indicators (KRIs) monitoring.
- Internal Incidents reporting
- Operational risk checklists for material projects and key processes such as product management.

AIA Group Limited also protects itself against financial losses by purchasing insurance cover against a range of operational loss events including business disruption, property damage and internal fraud. The coverage is determined after taking into consideration the Group's Operational Risk Profile.

## **Material Risk Concentrations**

The Company has established risk policies and limits governing concentrations risk arising mainly from its investment activities in single name obligor, sector and cross-border exposures. Any potential activity that may breach the concentration limits has to be reviewed by the Risk Management function and approved by the designated executives in the first line according to the Company's Activity Approval and Monitoring Process.

## **Investment in Assets in accordance with the Prudent Person Principles of the Code of Conduct**

The Group's investment portfolio is managed by the insurance group's investment team in accordance with the Company's investment policy guidelines. The guidelines require that highly liquid and low volatility fixed income securities support technical provisions to ensure that claims can be paid on a timely basis. The size of the high-quality investment portfolio is determined by the amount of technical provisions recorded for the quarter plus a large safety buffer.

These guidelines are reviewed on an annual or ad hoc basis if any significant deviation have occurred that affect the financial markets.

## **Stress Testing and Sensitivity Analysis to Assess Material Risks**

Stress testing provides assurance that the Company and the business units are adequately capitalised to maintain regulatory solvency and withstand adverse financial risk events. The Company performs regular stress testing to monitor the potential impact of the changing investment and economic environment on the regulatory capital and liquidity adequacy of the Company and each of the business units. These tests show the financial impact the risks identified above are likely to have when considered individually and collectively. The stress test results are reviewed regularly by Risk Committees.

## **5 SOLVENCY VALUATION**

### **Valuation Bases, Assumptions and Methods to Derive the Value of Each Asset Class**

The Company has considered the valuation principles outlined by the Authority's "Guidance Note for Statutory Reporting Regime" for the reporting period's statutory filing. The economic valuation principles outlined in this document are to measure assets and liabilities on a fair value basis (which is the value that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between open market participants at the measurement date). The fair value principles used for the assets are as follows:



- Cash and Cash Equivalents are measured at amortised cost using the effective interest method. This approximates the fair value.
- Fixed Interest Securities are valued based on quoted market prices, where available. For those securities not actively traded, fair values are estimated using values obtained from brokers, private pricing services or by discounting expected future cash flows using a current market rate applicable to the yield, credit quality and maturity of the investment.
- Equity Securities are valued based on quoted market prices or, if unquoted, on estimated market values generally based on quoted prices for similar securities.
- Hedge Funds and Limited Partnerships are measured based on the net asset values provided by the general partner or manager of each investment.
- Property held for own use and investment property are valued based on external property valuations.
- Mortgage loans on real estate and collateral loans are valued by discounting expected future cash flows using interest rates currently being offered in respect of similar loans to borrowers with similar credit ratings.
- Investments in associates and joint ventures are accounted for using the equity method of accounting.
- Policy loans with fixed rates are valued by discounting expected future cash flows at the interest rates charged on policy loans of similar policies currently being issued. Policy loans with variable rates are carried at amortised cost using the effective interest method. This approximates the fair value.
- Accounts Receivable, premium receivable and investment income due and accrued are initially recognised at fair value plus transaction costs. Subsequently they are carried at amortized cost using the effective interest method less any impairment losses. This is not considered materially different to the fair value.
- Derivative Financial Instruments are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency.

## Valuation Bases, Assumptions and Methods to Derive the Value of Technical Provisions

Insurance technical provisions are valued based on best estimate cash flows, adjusted to reflect the time value of money using the Volatility Adjusted Discount Curve (“VADC”). The VADC is a rate the Company can reasonably be expected to earn in the financial markets at the valuation date, with appropriate adjustments for investment risks.

The data used to measure the insurance reserves in the audited financial statements are also used to value the insurance technical provisions. Cash flows are projected based on best estimate assumptions without provision for adverse deviations.

In addition there is a risk margin to reflect the uncertainty contained inherent in the underlying cash flows, which is calculated using the cost of capital approach and the rate prescribed by the Authority for each reporting period.

At 30 November 2017, the total Technical Provisions amounted to USD 46,115m comprising the following:

• Total Gross Long-Term Business Insurance Provisions	USD 44,758m
• Reinsurance Recoverable Balance	USD (105m)
• Risk Margin	USD 1,462m





## **Description of Recoverables from Reinsurance Contracts**

Reinsurance contracts mainly take the form of surplus and quota share arrangements. Receivables from reinsurance contracts are valued using the same methodologies and principles that are also used to value the insurance technical provisions.

## **Valuation Bases, Assumptions and Methods to Derive the Value of Other Liabilities**

Similar to the valuation principles for assets, the Company's liabilities follow the valuation principles outlined by Authority's "Guidance Note for Statutory Reporting Regime" which values liabilities on a fair value basis. Other liabilities are valued at quoted market prices, observable market inputs or on an IFRS basis where appropriate.

## **6 CAPITAL MANAGEMENT**

### **Eligible Capital**

#### ***Capital Management Policy and Process for Capital Needs, How Capital is Managed and Material Changes During the Reporting Period***

The capital management objective of the Company is to maintain sufficient capital to ensure that the Company operates within its risk appetite while achieving its strategic objectives.

The Risk Appetite Statement of the Company is supported by five Risk Principles: regulatory capital, financial strength, liquidity, earnings volatility and business practice. The first two Risk Principles define the capital requirements of the Company.

- Regulatory capital: "The Company has no appetite for regulatory non-compliance and as such will ensure that we hold sufficient capital to meet our current statutory minimum solvency in all but the most extreme market conditions."
- Financial strength: "The Company will ensure the Group's ability to meet future commitments to our customers, terms of the promise we make to them. The Company will maintain sufficient capital to support a Financial Strength Rating that meets our business needs."

There were no material changes to the capital management policy of the Company during the reporting period.

#### ***Eligible Capital Categorised by Tiers in Accordance to the Eligible Capital Rules Used to Meet ECR and MSM Requirements of the Insurance Act***

Only Tier 1 capital is held by the Company at the end of the reporting period.

### **Regulatory Capital Requirements**

#### ***ECR and MSM Requirements at the End of the Reporting Period***

At the end of the reporting period, the Company's regulatory capital requirements were assessed as follows:



Requirement	Amount
Minimum Margin of Solvency ("MSM")	USD 1,133m
Enhanced Capital Requirement ("ECR")	USD 4,397m

### ***Identification of Any Non-Compliance with the MSM and the ECR***

The Company was compliant with the MSM and ECR requirement at the end of the reporting period.

### **Approved Internal Capital Model**

The Company has not applied an internal capital model to determine regulatory capital requirements.

## **7 SUBSEQUENT EVENTS**

On 21 September 2017, the Company reached an agreement, subject to securing all necessary regulatory and governmental approvals, to acquire Commonwealth Bank of Australia's ("CBA") life insurance business in Australia and life and health insurance businesses in New Zealand. In addition, the Company will also enter into 20-year strategic partnerships with CBA and ASB Bank Limited in New Zealand with exclusivity in the bancassurance channel in both markets.

On 1 January 2018, the Company completed the transfer of its insurance business in Korea from a branch to a wholly-owned subsidiary, AIA Life Insurance Co. Ltd.

In February 2018, the Board resolved to change the financial year-end date from 30 November to 31 December. Accordingly, the next financial year-end date of the Company will be 31 December 2018 and the next audited financial statements of the Company will cover a 13-month period from 1 December 2017 to 31 December 2018.

  
Keng Hooi Ng  
Chairman and Chief Executive

  
Garth Jones  
Director