Introduction

About this report

This Asia-Pacific (APAC) Chief Risk Officer (CRO) survey has been undertaken with the aim of gaining insights into the role that CRO/Risk functions play within insurers and reinsurers and the key priorities of CROs in the short and medium term.

The survey has been designed to qualitatively understand the changing dynamics in the outlook of the Risk function and the manner in which the role of CROs is evolving. To that extent, we assessed the ability of CROs to contribute directly to value creation, identifying the key challenges they face, their priorities as a result of changing regulatory requirements and unstable economic environment, and collecting their views on the evolving role of technology in the industry and how they manage the risks associated with it.

Our respondents

We spoke to a spectrum of leading life and non-life insurance companies, reinsurers and prominent groups headquartered in APAC, which specialize in multi-line insurance business generating sizeable premiums or with an extensive global reach.

Each of these firms have their own unique proposition to offer and are market leaders or trend-setters in their respective area of speciality.

We have interviewed 12 group or regional CROs.

EY sincerely thanks the CROs and companies that shared their time and insights for this year’s survey.
Background

The challenge for the CRO/Risk function is to create a more advanced and more efficient function, capable of responding to greater industry sophistication.

► C-suite executives and senior leaders are under intense pressure to navigate a wide range of megatrends and market forces, ranging from increased regulatory requirements and low interest rates to globalization and the disruption caused by new market entrants.

► The role of the CRO/Risk function is critical in navigating through this.

► This document aims to provide a point-in-time snapshot and insights of the current state and changing dynamics of CRO/Risk functions, and the evolving role of CROs.
Industry consolidation
Conglomeration

Increased restructuring and M&A activity

Social demographic
Environmental changes and natural catastrophe

Efficiency
Capital usage and optimization

Margin erosion and cost pressure

Financial and operational impact
Global and local expectations

Mass migration

Globalization and new market entrants

Innovation and disruptive change

Technological changes
Robotics
Internet fragmentation

Source: Achieving convergence of finance, risk and actuarial functions: beyond transformation (EY, 2016)
Key Themes

1. CRO/Risk function has become highly relevant at the executive table.

   Financial market volatility in the first half year, ongoing regulatory and strategic pressures on insurers' business models demand CRO/Risk function to be a visible contributor at the executive table – Page 7

2. CROs are increasingly defining their role as a “strategic enabler”.

   There is no single position taken on the fundamental role of Risk. This is partly driven by the board, CRO and regulator attitude, but mainly it is reflective of a business maturity. However there is still much focus on the downside risk – Page 10

3. However CROs are still grappling with demonstrating how they add value.

   Many CROs mention a ‘seat at the table’ as the only key indicator of value created that Risk brings, but this is a question that the business often asks and it is more important than ever that a strong case is made to attract investment – Page 12

4. Now that the “lines of defence” are established, the focus is on efficiency and effectiveness.

   Although a lot of work has been done to evidence compliance with the “three lines of defence” principles, more work is needed to ensure the model works in practice – Page 14
CROs have taken steps to communicate and embed risk appetite throughout the business. More work is needed to strengthen risk accountability and understanding of risk appetite across the entire workforce. - Page 18

A growing emphasis on personal accountability and the complexity of insurance operations are driving the need for the adoption of a systematic approach to operational risk management - but what is the right level of focus? - Page 22

CROs recognise the need to continuously improve their existing IT capability; however we see CROs being hesitant to increase their investment in new technologies. There are many stages of maturity still required in headcount, structure and wider skills of second line teams. - Page 24

Strengthening risk accountability and understanding of risk appetite across all risks is still a challenge for CROs

CROs recognize shortcomings particularly in operational risk management and seek to improve its effectiveness

In the battle between investment in people and in technology, it is people that win every time

Other notable findings

► Model risk management
► Stress and scenario testing
► Regional differences
► Country case study: Australia
► What’s next
► Eight questions to ask yourself
- Page 28
CRO/Risk function has become highly relevant at the executive table.
Top insurers’ earnings slump in Q1!...
...Q2 got worse

From reviewing all APAC insurers who have built CRO/Risk functions, with direct access to the board and top management, it is clear that the CRO/Risk function is now much more than a compliance role. CRO/Risk alongside finance (and the wider business) has had to play a key role during 2016 in:
► reacting or responding to fresh fires
► complying with the regulatory wave
► business planning
► contributing to the long-term strategy

We see the CRO/Risk function increasingly being considered the backbone for a successful value-centric insurer.

Low rates are tormenting insurers...

Ongoing regulatory pressure

Increase in competition challenges insurers’ business models

...and their customers
Whilst the CRO/Risk function plays a leading role in “traditional” processes (e.g. risk appetite and tolerance setting) there are still many processes where Risk only has an influence over the decisions such as model governance and validation. We observe a greater maturity in Europe in this area and would expect the role of insurance CROs in the region to evolve in that direction too.

Risk has to mature into a more strategic role. Some risk functions have recently moved towards taking a more active role in strategic processes and decisions (e.g. product approval, merger and acquisitions). We would expect this trend to amplify and apply to all insurers in the years to come.

As these evolutions continue to shape the role of the CRO, how do CROs themselves define their fundamental role?

Time allocation of Risk to regulatory vs. business matters

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<thead>
<tr>
<th>Time Allocation</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>70% regulatory/30% business</td>
<td>50%</td>
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<tr>
<td>50/50</td>
<td>30% regulatory/70% business</td>
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</table>

Role of Risk in the following processes:

- Appetite setting
- Risk tolerance and limit setting
- Stress and scenario testing
- Capital management
- Risk mitigation
- Model governance
- Model validation
- Investments
- Product approval
- Reinsurance
- Business strategy
- Strategic decisions (e.g. M&A)
- Risk mitigation
- Model governance
- Model validation
- Reserving
- Technical provision

Although CROs devote a significant proportion of time to managing the regulatory agenda, we increasingly see CROs focusing more on the business agenda.
CROs are increasingly defining their role as a "strategic enabler"
There is no single position taken on the fundamental role of Risk. This is partly driven by the board, CRO and regulator attitude, but mainly it is reflective of the degree to which the business environment is mature and stable. However there is still much focus on the downside risks.

What is your fundamental role?

- The sole role of Risk is to avoid exposing the Board to adverse events
- Risk as a horizon regulator scanner, making risk transparent, educating
- Risk as the flipside of strategy enabling opportunity within bounds
- Anticipated trend

What do CROs say:

“Risk has an advisory role to the first line of defence”
“Risk has a regulatory role when it comes to compliance with Solvency II”
“Risk cannot just look at downside risk but should enable the business to write more profitable business”
“Modelling is done together with the business to ensure driving profitable and sustainable growth”

A common theme arising from CROs’ responses is the need to be a close strategic partner to both board and the business.
However CROs are still grappling with demonstrating how they add value
Given risk is not immune from cost reduction pressures impacting other business functions, it is more important than ever that a strong case is made to attract investment.

What do CROs say:

“Risk now forms a part of ‘business as usual’ processes and consequently the risk function is more frequently invited to participate throughout the course of an activity or initiative etc. as opposed to being invited to comment at the end. Furthermore Risk is more often than not invited to have a seat at the table evidencing the value Risk is providing to its stakeholders”

“Recent indicators of value-add:
- Better engagement with business
- Risk is invited to decision meetings (rather than notified of decisions)
- Risk discipline introduced to investments or treasury
- External validation
- Feedback from Board Risk Committee”

What if CROs do not define clear metrics to measure and monitor value creation?
Now that the “lines of defence” are established, the focus is on efficiency and effectiveness.
CROs are becoming increasingly aware that these challenges demand they work in the coming years on optimizing the risk governance and fostering the risk culture within their companies.

There is a slight gap with Europe in that space, which should be closed in the coming years.

Key practical challenges include:

► the buy-in by and “education” of board and management
► the clarification of roles and responsibilities among the three lines
► the lack of ownership by the first line

What are Risk functions doing in practice to make it work?

► Improve education among board and management on risk topics
► Identify overlaps and areas of inefficiencies across second and third line functions when scoping and performing assurance activity
► Link regularly with other control functions where interdependencies exist, such as the compliance function
► Continually reiterate ownership in first line through training and by setting the right tone at the top
► Define the timing of CRO/Risk’s involvement in key decisions and improve understanding of accountabilities across the three lines
Focus on EY’s “risk governance 2020” framework

EY believes financial services firms face a sea of change ahead in how they approach risk governance. The transformation required will take a comprehensive multiple-year effort to substantively complete. To remain at the forefront of today’s market, firms should adopt an integrated approach that capitalizes on the value gained from upgrading risk governance; placing an equal focus on financial and nonfinancial risks in the short and long term, embedding evolving regulatory and supervisory expectations, and delivering tangible results in a cost-effective manner.

We call it Risk Governance 2020: From satisfactory to effective and sustainable.
Risk culture is the behaviors of an organization’s people, individually and in groups, which influence risks and impact outcomes—it is a critical enabler for operationalizing a firm’s risk management framework.

Risk culture is being driven into focus by stakeholder and regulatory pressure, higher consumer protection standards and public opinion of financial services firms.

Continued failures on controls and conduct have led regulators to conclude that fundamental cultural flaws exist within financial services companies. A strong risk culture is no longer a “nice to have” but a must-have. Firms have long depended on tone-at-the-top messaging to influence culture, which has not been successful. A more systematic approach is required at all levels—from the board down through the first line business units.

It is critical that these efforts towards a stronger risk culture align and resonate with the organizational wide culture within the insurance companies.

To deliver an appropriate risk culture, a variety of mechanisms need to be in place and effective.

When in place and effective, the mechanisms contribute to deliver the desired behaviors outcomes.

**Attributes of a sound risk culture**

**Leadership** - tone from the middle aligned with tone from the top and desired risk behaviors are established

**Organization** - governance and business model support the delivery of desired risk behaviors and enable strong accountability and effective challenge

**Risk framework** - risk management framework is embedded in the way the business manages risk and enables effective challenge

**Incentives** - employee lifecycle and incentives support the delivery of desired risk behaviors
Strengthening risk accountability and understanding of risk appetite across all risks is still a challenge for CROs
There is a general sense that senior management understands their risk accountability, though there is still more work to be done to cascade an understanding or accountability across the entire workforce.

Unsurprisingly, regulatory capital and liquidity remain the most common metric used within corporate risk appetite statements.

Whilst operational risk metrics do not feature in many corporate risk appetites, most insurers have set some quantitative limits. The link between operational risk and capital impact is not always clear. As a result, the direct understanding of risk appetite accountability and ultimately bottom line ownership is not always strong.

Emerging practice
Insurers continue to enhance their risk appetite to better inform decision-making including risk oversight.

There are clear examples of where risk appetite has been used to inform reinsurance purchase, business acquisition and underwriting.

This reflects greater alignment of the risk management infrastructure and the business drivers.

Mature organizations recognize the need to align behaviors and culture with risk appetite - this remains work in progress.
Surprisingly APAC respondents position themselves ahead of their European and US counterparts in terms of quantitative limits set across the different risk categories. Quantitative approaches have been around for some time in Europe and the US where insurers have now become fully aware this is more challenging than expected, especially for operational risk where the capital impact is not clear.

We expect insurers in the region to become increasingly aware of this challenge as they operationalize risk appetite into a more granular limit system.

Whilst the survey results indicate APAC insurers have put in place more quantitative limits than European and US insurers, we observe a greater level of maturity within the European and US markets. European and US insurers have enhanced their approach over time to better suit their environment. We observe many APAC insurers only having recently established quantitative limits and expect these to continue to be enhanced over time.

What proportion of CROs has set quantitative limits on the following risks?

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<th>Risk</th>
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<th>US</th>
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<td>Operational</td>
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CROs recognize shortcomings particularly in operational risk management and seek to improve its effectiveness.
Increasing financial consequences, a growing emphasis on personal accountability and the complexity of insurance operations are driving the need for the adoption of a systematic approach to operational risk management.

Insurers in the region remain split in terms of focus on operational risk. They can be characterized as too much or not enough. Very few have the right balance.

Penalties for operational failings have reached a level where they are having a material impact on firms’ profitability and often lead to significant reputational damages.

The majority of insurers adopt both a top-down and a bottom-up approach to risk and control assessment with recognition that this needs to align to broader risk management activities such as scenario analysis and risk appetite setting.

A large proportion of respondents mentioned cyber and conduct as some of their biggest concerns and they should be a key area of operational risk focus, even more so in markets with strong conduct regulators.

Approaches to operational risks and controls identification and collation

What proportion of time do you spend on operational risk management?
In the battle between investment in people and in technology, it is people that win every time.
CROs recognise the need to continuously improve their existing IT capability; however we see CROs being hesitant to increase their investment in new technologies.

There are many stages of maturity still required in headcount, structure and wider skills of the second line teams.

Despite strong cost pressures, insurers are increasingly focusing on replacing aging systems, consolidating IT systems and infrastructure, deploying new technologies and piloting emerging technologies.

However, partly as a result of IT budgets typically sitting outside the Risk function, CROs have not expressed the same level of appetite for investment in new technologies.

The focus of our respondents remains on ensuring multi-disciplinary skills are in place within their function, ranging from actuarial competence to data analytics, in order to manage complex risks such as cyber and other risks in light of the impact of appropriate data governance, evolving regulatory requirements and ethics.

What technology constraints do they want to tackle through IT spending:

- Manually intensive and time-consuming activities in production of MI
- Data quality and availability
- Holistic view of exposure
- Integrity of systems

“First I need the right people and processes in place, then I’ll think about automation”
Compared to a year ago, has the size of your department increased, stayed the same or decreased?

- Decreased: 42%
- Increased: 58%
- Stayed the same: 34%

Compared to a year ago, would you say that hiring and retaining good talent is harder, easier or about the same?

- Harder: 58%
- Easier: 8%
- About the same: 34%

Given the new risks and opportunities impacting the insurance industry as a result of the ever increasing role of technology e.g., big data & analytics, cyber, etc., what additional skills do you feel are needed to the Risk function and why?

- Anti-money laundering - Counter terrorism financing
- Market conduct
- Emerging risks
- Data analytics
- IT & cyber
- Data protection
- Underwriting
- Market and credit
- ALM
- Claims
- Claims
The demands on a CRO require different capabilities and innovative thinking on building this beyond the traditional Actuarial, Finance, Risk and Audit resource pool. What is the CRO role in educating and training the industry to support and grow future demands? How will CROs get them to understand the role and importance of a CRO/Risk function, transition and build a career in this space?

► Investment in people means much more than just headcount but “weightier” individuals. The time has come to instil professionalized development programs for individuals, and to address the structural deficiencies that are holding some people back from their potential.

► Views may differ on the value of rotation programs – a good second line person is not necessarily a strong first line candidate and vice versa. But there does need to be a career path in order to attract and retain strong talent, and it isn’t always obvious that that career can start and end within the Risk function.

► A Risk function that has achieved “strength-in-depth” is in a good position to consider whether the risk technology suite is holding back the team from achieving its purpose.

Even if the main focus is on talent, it is important that someone is tasked with establishing the “RiskTech” strategy:

► What gaps need addressing?
► What options exist to enable Risk?
► What are the pros and cons?
► How are you scanning the rapidly changing market?
Other notable findings
Do you have a formal model risk program in place?

APAC insurers are split 50/50 in terms of having in place (or not) model governance and validation programs.

As they mature they could benefit from the progress observed in the European market in that respect:

- CROs of major European insurers seem now to have laid down the groundwork for internal models framework and have developed dedicated risk management program teams, with a trend to have a centralized structure.

- All European respondents with a risk management program in place have attributed its primary responsibility to the CRO.
Stress and scenario testing

What would you like to do more of around stress and scenario testing?

- Refine and/or implement stochastic modelling
- Test broader issues outside capital
- Expand current suite of scenarios, increase frequency and ensure a clear link with capital
- Improve the risk parameters and models used
- Do fewer, less complicated scenarios!

- Stress testing is an important component in an insurer’s risk management system (especially under Internal Capital Adequacy Assessment Process (ICAAP) and ERM/ORSA). Most insurers believe more can be done in this area.

- Not surprisingly, regulatory capital is the primary driver. Regulators in the region have embarked on industry exercises to test the industry’s resilience. This should not be seen as one-off exercises and lessons learned should be sought.

- Stress and scenario testing beyond capital resilience and for management purposes are seen as a key value-add area. There is a need to focus on multi-year and emerging risks areas.

- Attributes of leading practice stress testing include:
  1. Results are integrated into decision-making
  2. Strong understanding of limitations, assumptions and uncertainties
  3. Confronts realistic adversity, includes realistic management response
  4. Data and IT sufficiently integrated, flexible, reliable and complete
  5. Credible modelling and forecasts
Regional differences

► When comparing results for the APAC region to other regions such as Europe and the US, the main differences reside in the following:

► Access to talent
► Lack of familiarity of local boards with enterprise risk management (ERM)
► A less developed three lines of defense model
► A strong need for cultural change
► Still-forming operational risk management models
► Lack of formality around model risk

► Also there are some differences within the APAC region as a whole: Australia seems most mature compared to ASEAN and Greater China.
Country Case Study

Australia

1. **Risk has become highly relevant at the executive table**

The Australian regulation has mandated that the role and stature of the CRO to be senior, a member of the executive and cannot be dual hatted with a number of other functions such as the CFO or Appointed Actuary. This has led to a number of significant developments including:

- All major insurers have revisited their risk operating model and structure over the last 18 months
- A number of senior risk positions have been re-appointed
- Operating model changes (moving from functional to value chain) has also impacted the risk operating model
- Investment in resources beyond traditional frameworks and compliance have taken place

2. **Now that the lines of defence are established, the focus is on efficiency and effectiveness**

In Australia the three lines of defence model has been embedded in the regulators prudential guidance notes. This along with the desire to strengthen risk maturity has led to a number of embedding three lines of defence initiatives such as:

- Clarifying roles and responsibilities for key risk activities across the value chain
- Clarifying the role of the risk function through the changes in the risk operating model
- Greater focus on controls and compliance obligations

3. **Strengthening risk accountability and understanding of risk appetite across all risks is still a challenge for CROs**

Many of the large Australian insurers have undertaken, or are undertaking, material changes to risk appetite to better reflect the current environment, desire to better use it in decision making and increase risk maturity. Leading insurers are clear in how they cascade risk appetite from group to business units and can cite clear examples where decisions were made with regard to risk appetite (scheme renewal, reinsurance, investment business case etc.)
4. **CROs recognise shortcomings particularly in operational risk management and seek to improve its effectiveness**

Operational risk remains a key area of focus for Australian insurers. Many general insurers’ approach to operational risk has been subject to regulatory scrutiny and we are starting to see this emerge in the life insurance sector. Current focus on conduct and culture have also driven this (e.g. product design and claims management). Historical focus on insurance and financial risk are also likely contributors to the relatively small focus on operational risk. Issues surrounding controls and compliance obligations continue to emerge.

5. **In the battle between investment in people and in technology, it is people that win every time**

Without a doubt, investment in people has been a big area of focus in Australia. There has been spend on governance, risk management and compliance (GRC) systems but due to the large spend involved and implementation time, this investment is less frequent. Business and core systems still remain an issue for insurers.
What’s next?

New priorities and challenges are lying ahead of CROs

The CRO of the future will be

► A strategic advisor to the board by being actively involved in business and strategy decisions
► Fully engaged with the business and aligned to Finance, Actuarial and Compliance, taking business responsibility when necessary and empowering the first line at the same time
► Digitally aware and actively involved in digital transformation programs aiming at automating processes in the Risk function, effectively using data and analytics to improve quality and timeliness of reporting
► On top of operational risk management, more specifically an increased focus on conduct and cyber risks

What CROs say:

“Looking three to five years out, CRO will need to be a lot more forward looking and strategic. Regulatory will become a process. CEO will engage more with the Risk function.”

“The dynamic pace of change will demand a dynamic and ever evolving approach towards risk management with greater use of data analytics required to support increased expectations. Greater focus & sophistication will also be required in relation to the management of strategic risks”

“Merging of compliance and risk increase integration with Actuarial: with an actuarial hub the CRO should be linked in to add more value”

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“Merging of compliance and risk increase integration with Actuarial: with an actuarial hub the CRO should be linked in to add more value”

“Scaling back and push towards the first line. Be more passive and provide more insight”

“Higher integration between strategy and risk. CRO involved in terms of risk performance, more influence on future business”

“CRO will take responsibility on investment risk”

“CRO will have rounded capabilities and not be a traditional risk person. The CRO will be more strategic and data/analytics informed. Focus will be on tangible value generation”
# Eight questions to ask yourself

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<tbody>
<tr>
<td>1.</td>
<td>Do your colleagues in the business share your view of the role of Risk?</td>
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<tr>
<td>2.</td>
<td>Is Risk as close a contributor as it could and should be to all the strategic change projects within the business?</td>
</tr>
<tr>
<td>3.</td>
<td>Do your best people have a clear career path with you?</td>
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<tr>
<td>4.</td>
<td>How can I contribute to an agile global business whilst ensuring suitable cascading of information and decision making?</td>
</tr>
<tr>
<td>5.</td>
<td>Who have I asked to ground the ‘RiskTech’ question?</td>
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<tr>
<td>6.</td>
<td>Where should we aim to influence further with other functions/initiatives within the business?</td>
</tr>
<tr>
<td>7.</td>
<td>How much more should Risk focus on operational risk and cyber in particular?</td>
</tr>
<tr>
<td>8.</td>
<td>How am I going to close the talent gap? Training and retaining? Who do I want in my team in three years time and how do I build to that?</td>
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</table>
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