

**Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000**

**Roles Played by Authorised Institutions in
the Insurance and MPF Businesses**

At the Bills Committee meeting held on 16 February 2001, we undertook to provide Members with more information on the roles played by Authorised Institutions (“AIs”) in the insurance and mandatory provident fund (MPF) industries. This paper provides a detailed analysis on this subject. It also shows that the regulatory framework proposed in the Securities and Futures Bill for the securities business of AIs is in line with the practice adopted for the insurance and MPF industries.

Insurance

2. There are three different roles an AI can assume in the insurance business : as an insurer (i.e. the underwriter of risk), as an agent (i.e. an agent for an insurer), and as a broker (i.e. effectively an agent for the customer - the insured). AI operating securities business is akin to AI acting as an insurance broker or agent.

3. An **insurer** must be authorized by the Insurance Authority (“IA”). Some bodies are exempt e.g. the Hong Kong Export Credit and Insurance Corporation. Pursuant to s.51(f) of the Insurance Companies Ordinance (“ICO”), AIs are exempt from the provisions of the ICO to the extent only that they carry on certain specified insurance business solely for the purpose of their banking or deposit taking business. For those insurance products not falling under this exemption, AIs would need to be authorized for conducting business as an insurer. They will be subject to prudential return requirements and periodic visits, etc. So far, no AIs have applied to the IA for licensing as an insurer. The market practice is for AIs to form subsidiaries to engage in insurance business, although this is not a requirement imposed by the IA. This reflects the fact that insurance business is very different from banking business. As an indication of this, under the Basel Committee’s New Capital Accord, which will revise the capital adequacy requirements for banks, insurance

companies are not to be consolidated for the purpose of determining a banking group's capital ratio.

4. An **agent** has to be appointed by a principal (i.e. an insurer) and this appointment has to be registered with the Insurance Agent Registration Board which is a Board under the HK Federation of Insurers, a self-regulatory industry body. In terms of number, the majority of agents are individuals i.e. the life insurance agents. AIs are also subject to the registration requirement. All agents have to comply with the Code of Practice issued by the industry body. The responsible officer and technical representatives of a corporate agent (as in the case of an individual agent) have to register with the Board. These individuals are required to meet certain fit and proper criteria including passing an examination administered by the Vocational Training Council. These criteria are set by a steering committee comprising industry participants and chaired by the IA. However, any vetting, assessment of fitness and properness, compliance monitoring, etc, is done by the secretariat supporting the Board and/or the industry body. The Office of the Commissioner of Insurance does not require any prudential return. It only oversees the operation of the system.

5. A **broker** can either be authorized by the IA directly or by a member of an approved body of insurance brokers (two approved bodies at the moment). AIs have to obtain the requisite authorisation to be an insurance broker. The regime is again self-regulatory as far as members of the approved bodies are concerned. Brokers have to comply with certain requirements on capital, professional indemnity, etc, imposed by their industry body but the minimum requirements are prescribed by the IA. The persons in charge, technical representatives, etc, have to register with the relevant approved bodies. They are also required to meet certain examination requirements and the approved bodies will assess whether registration requirements are met. The approved bodies submit returns to the Commissioner of Insurance for all their members collectively. The self-regulatory regime for both agents and brokers is set out in the ICO.

6. There is no inconsistency between the insurance regime and the existing/proposed securities regime regarding AIs' involvement. The role of AIs as insurance agents or brokers is similar to that of a securities dealer (i.e. an agent for soliciting business for Stock Exchange participants). There is no requirement for such agent business to be subsidiarised. AIs and their staff are only required to register with the relevant industry body and comply with regulations made for that purpose.

MPF

7. An AI may assume one or more of the following roles in conducting its MPF business –

- (a) MPF Intermediary (Corporate) – selling and advising on the MPF schemes;
- (b) Custodian – providing custodial services on the MPF scheme assets and must be independent of the investment manager and its associates;
- (c) Guarantor – providing investment guarantee to MPF products;
- (d) Financial supporter – providing undertaking to the Mandatory Provident Fund Schemes Authority (MPFA) on continuous financial support to trustee/custodian;
- (e) Investment manager – must be a locally incorporated investment management company and must have the appropriate exemption/registration from SFC.

8. Two of the above roles are comparable to the role of AIs in respect of securities dealing, i.e. (a) **MPF Intermediary** which is the primary role of AIs; and (b) **custodian**. For (a), AIs normally perform marketing and advisory functions. They must be registered with the MPFA while the HKMA remains the front-line regulator. Individual staff of AIs also need to be registered with the MPFA, and have to pass the requisite examinations for this purpose. The MPFA conducts basic vetting on such staff (such as vetting with the Official Receiver). For (b), any AI is eligible for performing the role of custodian, and such activities are regulated by the HKMA.

9. For (e), investment management activity falls within the definition of “investment advisory activity” of the Securities Ordinance. Any AI which is not a licensed bank and wants to be an investment manager for MPF products must be either granted exempt investment adviser status by or registered as investment adviser with the SFC (licensed banks enjoy the exempt investment adviser status at present). Under the regime stipulated in the SF Bill, licensed banks will no longer be statutorily excluded from the definition of “investment adviser”. It should nevertheless be noted that, as at end-September 2000, no bank took up the role of investment manager for MPF schemes.

10. While there are no legal restrictions on AIs performing the role of trustee for MPF schemes, the Mandatory Provident Fund Schemes Ordinance (MPFSO) requires that such trustees must be registered trust companies. AIs normally choose other routes for doing so, such as subsidiarisation or formation of joint ventures. Under these arrangements, banks cannot administer MPF products – the MPFSO requires that every MPF scheme shall be administered, managed and maintained by an approved trustee, which is also responsible for securing scheme registration.

11. There is again no inconsistency between the regulatory regime for AIs acting as MPF Intermediaries/custodians and that for AIs involved in securities dealing. AIs are not required to subsidiarise their MPF business in their capacity as MPF Intermediary or custodian, and the HKMA remains the front-line regulator for such business. This is also the situation in respect of the securities dealing business of AIs.

Financial Services Bureau
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