

**For discussion on  
7 July 2008**

**LEGISLATIVE COUNCIL PANEL  
ON FINANCIAL AFFAIRS**

**Feasibility Study on the Establishment of Insurance Policyholders'  
Protection Funds in Hong Kong**

**Purpose**

This paper reports on the latest development of the feasibility study on establishing policyholders' protection funds (PPFs) in Hong Kong.

**Background**

2. In order to ensure better protection for policyholders and promote general market stability in the event of insurer insolvency, the Office of the Commissioner of Insurance ("OCI") commissioned in 2002 a consultancy study ("the Study") on the feasibility of establishing PPFs in Hong Kong. The Study comprises a review of local and overseas practices, an evaluation on the feasibility of establishing PPFs in Hong Kong and identification of options for scheme design.

3. The Administration carried out a public consultation exercise between December 2003 and April 2004, during which mixed feedback was received from a wide spectrum of stakeholders including insurers, practitioners, consumer advocate groups and professional bodies. Those voicing support for PPFs considered it as a safety net for policyholders and thought that an appropriately structured PPF could help to boost consumer confidence. On the other hand, many respondents affiliated with the insurance industry were concerned that establishing a PPF might encourage consumers and insurers to take greater risks, hence creating a "moral hazard" problem. They argued that resources could be spent more gainfully in

strengthening the present regulatory regime as a direct means to mitigate the risk of insolvency. Other concerns cited were resulting impact on the level of premiums, undue stress on other insurers being asked to inject funding into PPFs in the aftermath of a major insolvency, and the equity of instituting an element of cross-subsidisation between policyholders.

4. The Study concludes that the feasibility and success of a PPF in Hong Kong would depend heavily on its scope and nature as well as the extent of industry and public support for it. In the light of the consultation feedback, the Study recommends that the Government should engage relevant parties in deliberating on options for scheme design and mitigating factors to some potential pitfalls before contemplating development of a PPF for Hong Kong. It is also observed that while the scope of coverage and level of protection tend to vary between PPFs in many developed countries, industry levy is their common source of funding. It is therefore imperative to reach a broad understanding with the industry on the need for PPF and the framework governing its establishment before detailed planning could take place.

5. With this in mind, OCI has engaged in a close dialogue with industry stakeholders with a view to addressing the issues mentioned in paragraph 3 above, taking into account the enhancement measures made to the present regulatory regime to reduce “moral hazard” risk.

### **Latest Development**

6. After much discussion and deliberations, the Hong Kong Federation of Insurers (“HKFI”), a trade association representing insurers operating in Hong Kong, has recently indicated its agreement in principle to explore the establishment of a contingency plan to protect policyholders in case of insurer insolvency. To this end, HKFI has set up a task force to take things forward, drawing experience where appropriate from compensation funds currently in place catering for banking depositors, security investors and members of Mandatory Provident Fund schemes, the Employees Compensation Insurer Insolvency Scheme as well as the two existing funds administered by the Motor Insurance Bureau. In doing so, focus will be

placed on the rationale for establishing those funds and their mode of operation, and in particular whether their considerations would apply to the insurance industry.

7. The task force set up by HKFI has identified a number of main issues to be addressed which include –

- (a) whether all types of insurance policies should be covered by the contingency plan and, if so, whether policies with bonus sharing or investment returns should be treated alike in a uniform manner;
- (b) whether a limit should be imposed on the amount of compensation to be received by each policyholder and, if so, what form it should take;
- (c) whether the contingency plan should be funded on a pre-event or post-event basis, balancing the need for certainty of funding and the administrative cost involved; and
- (d) whether flexibility should be introduced to allow for a charging scale based upon the relative size and financial strength of individual insurers .

8. OCI will continue to work in partnership with HKFI with a view to developing an appropriate framework for introducing PPF in Hong Kong taking into account the above issues. Upon development of a draft framework, OCI will engage a wider group of stakeholders to solicit their views. In parallel, OCI will place increased vigor on prudential supervision that constitutes the first line of defense against insolvency by strengthened monitoring of underwriting discipline, capital adequacy and investment strategy of insurers.

## **Advice Sought**

9. Members are invited to comment on the planned next steps outlined in paragraphs 7 and 8 above.

**Financial Services and the Treasury Bureau/  
Office of the Commissioner of Insurance  
June 2008**