

The Hong Kong Society of Certified Insurance Practitioners

**Comments on the Proposed Establishment of an
Independent Insurance Authority**

General Comments

We are in general support of the proposal to establish an independent Insurance Authority (IA) if it is proved necessary to align Hong Kong with international practices and it will enhance Hong Kong's competitiveness as a regional insurance centre. It is important to ensure that all problems or complexities arising from the proposal are duly considered and resolved from the outset. Specifically, we have the following comments on the different points raised in the proposal.

**Chapter 2 - Guiding Principles for the Establishment of an Independent
Insurance Authority**

Comments – Q.1 The proposal suggests that in view of the fast-changing market landscape and evolving international regulatory standards, the existing set-up of the IA and the current legislative framework are not conducive to the effective regulation of the insurance industry in the long run. It is unclear from the document how in-effective or deficient the current regulatory framework is. The current regulatory framework, in fact as stated in the document, has been subject to tests in the past, including the financial tsunami, and has been able to stand and ensure the insurance industry remains stable and operates smoothly in the midst of the crisis. We appreciate the need to update the current legislation to bring it more up-to-date with international standards but we fail to appreciate the need at this stage to overhaul the current set-up of the IA which would entail the spending of a huge amount of public money. It seems that the only reason given for the establishment of the independent IA is to give it more flexibility in staff recruitment. This, we believe, could be addressed by some other administrative means, rather than committing to the necessity of setting up another huge public organization.

Q.2 It is suggested that the proposal is to align Hong Kong with international practices. We note that the international practices are to

establish a super regulator to embrace all types of financial services, i.e. banking, insurance, securities and other related services. This is the case in most other countries including the UK, Australia, Japan, Singapore, Malaysia and Indonesia.

It is clear that the different types of financial services are merging themselves and the lines of division among them are becoming more and more blurring. Establishing a super regulator would achieve synergy while eliminating all duplication of efforts and different standards exercised by the current four regulators (namely the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Mandatory Provident Fund Authority and the IA), as evident in the recent Lehman Brothers case. Industry practitioners would also have a clear line of supervision and responsibilities to follow, thus eliminating unnecessary costs and efforts in responding to the different regulators over practically the same product.

Hong Kong is behind this international standard for many years. We wish to know whether this international practice has been given due consideration and if yes, the reasons for not following this path.

Chapter 3 – Functions of the Independent Insurance Authority

Comments – Q. 3 We agree to the proposals with the exception of a direct supervision of insurance intermediaries as discussed in more detail in our comments regarding Chapter 5.

Q. 4 To enhance the competitiveness of the insurance industry has always been one of the duties of the IA as currently set out in the ICO (also mentioned in para.3.1 of this document) and there should be no need for the current proposal to extend the IA's duties in this respect. Specifically, we have reservation in the proposal (para. 3.3 (b)) for the independent IA to indulge in organizing public education programmes regarding the features and risks of insurance products, This function should better be performed by the insurance industry, as is the current situation. The Hong Kong Federation of Insurers has been performing successfully well in this task (and will continue to do so even if it is turned into a trade body as mentioned in para. 4 of the consultation

document). The industry itself is better aware of the features and risks of individual insurance products than the independent IA as they are more close to the market while the independent IA would be staffed with people who would become more and more distant from the insurance products themselves in the long run. We would like to comment further when details on how the proposal could enhance the competitiveness of the insurance industry as compared with the current situation are known. Clearly to achieve this objective, the independent IA should be led and managed by people equipped with good practical market experience in order to better understand the problems and the way to handle them properly and efficiently.

Chapter 4 – Regulation of Insurers

Comments – Q.5 We do not agree to the proposed enlargement of the IA's power regarding fighting against Money Laundering. Fighting against money laundering is, and has always been, the work of other law-enforcement agencies, e.g. the Police or Customs. The IA might not be equipped with the relevant knowledge and expertise to investigate such suspected activities in addition to its regulatory duties. More importantly, it would, if tasked to do so, increase costs to the independent IA, which should not be borne in the first place by the industry or policyholders. We consider that the IA should focus on the prudential supervision of the insurance industry and keep its costs to the minimum necessary for this purpose alone.

Chapter 5 –Regulation of Insurance Intermediaries

Comments – Q. 6 We support strongly Option 1 (i.e. enhanced supervision by the independent IA under a strengthened SRO system). The current self-regulatory system for insurance intermediaries has been in place since 1995 and has been functioning well for the past 15 years. No significant incident has happened which seriously threatened the interests of policyholders. Significant resources and efforts have been invested by the different self-regulatory organizations (SROs) to assume this task and these should not be lightly disregarded and overturned. We therefore do not see the need for a sudden deviation from the current practice which could be improved without overturning entirely the

current system. To address regulatory gaps among the different SROs, we suggest that consideration be given to amalgamate them into one. The unified one could be placed more under the direct supervision of the independent IA to fortify public confidence. Regarding the issue of conflict of interests, the unified SRO could be managed by independent persons with representatives of the insurance industry sitting on the Governing Board only. Majority of the members of the Governing Board could also be independent. We note currently a number of professional bodies in Hong Kong are still exercising self-regulatory functions over their members, including solicitors and accountants, and we have reservation on the justification for a substantial change merely to go along with the establishment of the independent IA.

Q. 7 We strongly object to HKMA being given special treatment in the regulation of insurance intermediaries for the reason stated in the document (i.e. to allow HKMA to regulate bank employees selling insurance products given the different client profile and sale environment in banks). This would create disparities and regulatory gaps as well as duplication of efforts. If this is accepted as a good and valid reason, the same could apply to the securities or provident fund clients where exemption should similarly be given to the securities or provident fund companies. This proposal also contradicts the proposal to eliminate duplication of regulatory efforts as well as regulatory gaps among the various current self-regulating agencies, as suggested in the proposal for the direct supervision of insurance intermediaries. On the same token, given that insurers and securities companies are handling a substantial amount of insurance or securities clients and in a different sale environment, we wonder if the HKMA would agree to allow the IA or SFC to regulate the selling of bank products by the insurer or securities staff?

Chapter 6 – Organization Framework of the Independent Insurance Authority

Comments – Q. 8 We agree to the recommendation set out in paragraph 6.5 (i.e. the independent IA be organized along five main divisions, subject to adjustment in respect of direct supervision of insurance intermediaries if not performed). We however do not support the remuneration package proposed in paragraph 6.8 (i.e. including a “base pay” and an “incentive

pay”). As shown in past experience, this package is often subject to severe criticism by the public over the granting of incentive pay. Unlike private sector, a public organization is not subject to the same working conditions, pressure or **direct** supervision as in the private sector and the so-called “incentive pay” is often awarded without sufficient transparency and irrespective of any error or mismanagement by the management. The inclusion of this part of the package does not really provide an incentive, as it is intended, to the management to exceed their performance requirements or excel their performance but rather encourage them to stay within the target safely and not venturing into any uncertain course of action (i.e. a no-work-no-fault attitude) though beneficial to the industry.

Chapter 7 – Governance and Related Matters

Comments – Q. 9 We have no comments on the proposal. All check and balances would be superficial and ineffective if the Chief Executive Officer of the IA is not an ethical and professional person with a high integrity. Industry participation should be important in the Governing Board, Appeal Tribunal and the independent Process Review Panel in order to provide guidance and support.

Chapter 8 – Funding Mechanism

Comments – Q. 10 We are most concerned with this part of the document. Without details of how the 237 staff is calculated, we are unable to comment on the justification or appropriateness of this expenditure. The operating costs of the independent IA should be strictly controlled and supervised to ensure proper spending of public monies as well as avoiding scandals occurred in some other independent public organizations, like more lately the Personal Privacy Commission. In addition to the annual budget of the independent IA and corporate plan to be subject to the approval of the Financial Secretary, we suggest that the independent IA be subject also to audit by the Audit Commission. Again we would emphasize the importance of appointing a person with honesty and integrity to the Chief Executive Officer of the independent IA as he or she would be the front-line watchdog and guardian regarding proper management and cost control of this future organization. Simply tabling

an annual report before LegCo or annual budget and corporate plan be subject to the approval of the Financial Secretary, we believe with due respect, would hardly be sufficient or effective.

Q. 11 We consider that the costs should be borne wholly by the insurers and intermediaries whom the independent IA regulates and not directly by the consumers. The proposed levy of 0.1% on insurance premiums on general insurance policies would represent a relatively small amount and should be acceptable to policyholders. The same percentage, if applied to long term insurance, particularly those investment-linked, should represent a substantial amount. It might not be affordable and would discourage prospective policyholders to abandon seeking the relevant life or retirement protection, thus throwing the financial burden back to the Government. The ratio of 7:3 levy from policyholders and the licensed entities and users respectively is not acceptable from the consumers' point of view. We have seen examples of such an organization becoming uncontrollably bigger and bigger in the course of time, entailing heavier and heavier financial burden on the consumers. Further careful consideration should be given as to the rate of contribution to the cost by the different sectors of the insurance industry and how to differentiate properly the different types of products under the levy system. Most importantly, the cost of the independent IA should be properly monitored and controlled afterwards.