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**IFPHK's Response to the Consultation Paper
Issued by the Financial Services and Treasury Bureau
on Proposed Establishment of an Independent
Insurance Authority**

September 2010

Contents

| | | |
|-----------|--|-----------|
| 1. | IFPHK Profile | 2 |
| 2. | Executive Summary | 5 |
| 3. | The FSTB Consultation | 9 |
| 4. | IFPHK Response Methodology | 10 |
| 5. | IFPHK Submission and Recommendation | 12 |


IFPHK Profile


Background

The Institute of Financial Planners of Hong Kong (IFPHK), set up in 2000, is the premier professional body in Hong Kong representing financial planners who uphold the highest standards in the financial planning industry. It is the sole licensing body for the testing and certification of CFP¹ professionals in Hong Kong and Macau, and for issuing the CFP¹ certification marks to qualified financial planning professionals in Hong Kong.

IFPHK is supported by 64 corporate members who are leading firms in Hong Kong's financial services industry and is an affiliate member of an international assembly of financial planning bodies called Financial Planning Standards Board² (FPSB). The organization currently represents over 14,000 individual members of whom over 4,000 hold the CFP professional designation.

To develop and maintain its high professional standards and self-discipline, IFPHK has put in place a vigorous certification process to ensure that all its CFP professionals satisfy the requisite standards known as the 4Es, namely education, examination, experience and ethics. It would normally take at least 2 years to complete the CFP certification.

¹ CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  are certification marks owned outside the U.S. by Financial Planning Standards Board Ltd. (FPSB). The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks in Hong Kong and Macau, through agreement with FPSB.

² FPSB was established in October 2004 by 17 non-profit associations that together certify over 45,000 individuals outside the U.S. to use CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  marks and that have joined FPSB as members. FPSB will protect financial planning consumers and foster professionalism in financial planning through the ongoing development and enforcement of relevant international competency and ethics standards. FPSB will also promote greater global recognition of CFP certification and its related marks as the international hallmarks of financial planning professionals.

Its CFP professionals are also required to follow the FPSB 6-step financial planning process in their front-line activities that is designed to provide suitable advice to clients:

Step 1: Establishing and defining the relationship with the client

Step 2: Gathering client data

Step 3: Analyzing and evaluating the client's financial status

Step 4: Developing and presenting the financial planning recommendations

Step 5: Implementing the financial planning recommendations

Step 6: Monitoring

Promotion of professionalism

Since its inception, IFPHK has been striving to promote public awareness of the financial planning industry in Hong Kong and uphold the standard of CFP professionals. In addition to consumer seminars, IFPHK has also joined hands with regulators on various projects, including developing educational literature and organizing pro bono financial clinics. In 2006, with contributions from the patrons of leading industry practitioners and experts, IFPHK published the *IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners to practise in Hong Kong. To supplement this effort, IFPHK also launched the first Guidance Notes, *Suitability of Advice Obligations: Documenting your Financial Advice* for members. In the near future, we will continue providing more practical support to members and will target to roll out more guidance notes for practitioners' daily references.

Earlier this year, IFPHK had also participated in a global job analysis review and international studies on financial planning job skills analysis. Through this process, IFPHK had gained professional insights into core characteristics and practice *vis-à-vis* Hong Kong's financial planning practitioners and international CFP professionals.

IFPHK's interest in this consultation

Insurance is considered the cornerstone of financial planning. Effective and proper use of insurance products help spread risks, which otherwise would often have devastating results for families. Insurance is therefore an important part of all our financial planning education and certification programme. Having knowledgeable insurance practitioners, proper consumer understanding of what insurance policies are for, effective products and financially sound underwriters is therefore essential for those who need and seek financial planning. IFPHK takes a strong interest in ensuring that this could be achieved.

IFPHK's representation

IFPHK had 30 founding members who contributed to its inception and foundation. These members believed in raising the standard of financial planners and the importance of sound financial planning. Out of these 30 founding members, 8 were insurance companies which include the following:

- American International Assurance Company (Bermuda) Limited
- AXA China Region Insurance Company Limited
- Ageas Insurance Company (Asia) Limited (Formerly Fortis Insurance Company (Asia) Limited)
- Manulife (International) Limited
- New York Life Insurance Worldwide Limited
- Sun Life Hong Kong Limited
- The Prudential Assurance Company Limited
- Zurich Life Insurance Company Limited

We currently have 64 corporate members which include a total of 32 insurance companies and brokerage firms. These corporate members employ over 33,000 insurance practitioners. IFPHK therefore is well positioned to understand the needs, concerns and aspirations of the long term insurance market players. When formulating its response to the consultation, it has sought the views of many of its corporate members who are active in the market.

Executive Summary

The Financial Services and Treasury Bureau ("FSTB") issued the Consultation Paper on Proposed Establishment of an Independent Insurance Authority (the "Consultation Paper") on 12 July 2010 inviting comments from the insurance industry and the public on the relevant proposals set out in the Consultation Paper.

The Consultation Paper explains the Government's concerns over the current set-up of the Office of the Commissioner of Insurance ("OCI") which stands out to be the only one financial services regulator still operating within the Government machinery and also over the existing self-regulatory regime for supervising the insurance intermediaries in Hong Kong. To address these concerns, the Consultation Paper provides for various proposals focusing on the set-up of the Independent Insurance Authority ("IIA"), the funding mechanism of the IIA and the functions of the IIA including direct supervision and licensing of the insurance intermediaries.

In considering the proposed changes in the Consultation Paper, IFPHK felt that there would be two important objectives which the suggestions need to achieve.

- A regulatory framework which would deliver measurable benefits to the insurance industry in the medium and long term and enable a healthy and sustainable business environment for the industry to thrive as well as further development.
- A regulatory system which would facilitate delivering better insurance products and services to benefit the members of public as well as protecting them.

With the above-mentioned two objectives in mind, IFPHK first of all undertook an independent study to assess the merits of the proposals based on its understanding of best practices and experience of some overseas markets deemed relevant to the situation of Hong Kong, including Australia, Singapore and United Kingdom. Then it consulted extensively with industry leaders representing large and medium size insurance companies, insurance brokers, actuarial consultants, legal practitioners as well as individual insurance practitioners. It also met with representatives of various trade associations. Overall, a total of 15 practitioners who hold senior positions in these corporations/organisations were interviewed. It was found that IFPHK's views were largely aligned with that of the industry represented by the group it consulted.

In addition, IFPHK thought it important to consider the landscape of the market unique to Hong Kong. There are many aspects of the insurance

industry which are seen to be positive and competitive. Any new measures should try to preserve what has worked well for the local market and ensure that they further enhance areas of strength and not destroy them. At the same time, it was felt that the proposed changes should help to address current inadequacies and further improve areas which have been moving in the right direction.

In any society, for an insurance market to thrive and develop, one would require sound legal and financial systems that provide proper protection for business, fair and free market, banking and finance infrastructure. Hong Kong's market has managed to grow relying on a well developed financial system, growing and stable economy, liberal market legislations, and strong rule of law. Compared to its neighbours in Asia, the insurance industry players, both local and international, have largely enjoyed a free market and fair competition. There have been no major collapse of insurance companies for a few decades although there have been a few incidents related to insurance brokers. An independent insurance regulator is well positioned to embrace the positive aspects of the market, strengthen them and allow the insurance industry to grow further.

On the other hand, the insurance industry has at times suffered due to varying standards of sales practice and professionalism, which unfortunately and unfairly tarnish the reputation of the industry. This is one aspect which IFPHK felt that the new proposed changes should try to address.

In principle, IFPHK agreed to the setting up of an independent regulator for the insurance industry with the appropriate powers, structure, well defined objectives with appropriate checks and balances and sufficient resources. The proposed IIA should not only act as a supervisor of the market but have an explicit role in facilitating and promoting a healthy and sustainable insurance market. IFPHK also concurred with the proposal that the supervision of the insurance intermediaries be brought under the proposed IIA to ensure uniform standard, efficient use of resources and facilitate the raising of professional standard. It was felt that such measures could further enhance Hong Kong's position as a free, competitive market in the insurance industry. An independent regulator with clearly defined roles, accountability and resources should help the industry to grow further and improve standards to benefit the consumers.

IFPHK's view in this is largely supported by the members of the industry it interviewed. However it was also felt that whilst the principles were sound, the ultimate success of the IIA would depend on the way the principles would be interpreted and adhered to. In order for the endorsement of the IIA to happen, one would need to study the details of how each area was to be implemented including accountability, funding, structure, objectives, etc. IFPHK would strongly support another round of consultation for the industry and members of public to understand in practice how the new IIA would function and be made accountable. More details of how some of the

proposals will be put into effect including the transitional arrangements for the migration of the existing self-regulatory regime for the supervision of the insurance intermediaries to the direct supervision of the IIA was felt to be desirable. In addition, it was felt that there needed to be measures in place to ensure that the new arrangement would not result in over-regulation of the market, in the near future or in the long run.

Moreover, IFPHK had concerns over the proposal that the Hong Kong Monetary Authority ("HKMA") should be vested with powers to conduct inspection and investigation as well as to impose disciplinary sanctions in respect of the conducts of the relevant bank employees in selling insurance products whereas the IIA remains the licensing authority for these bank employees. Although such a separation is already in place for security products sold through banks, this system has proven to be more and more inappropriate and problematic as products get more complex and sophisticated. Whilst this may have worked in the past when products offerings were a lot more straightforward, it was obvious that the system needed to change as product features converge across different industries and consumers needs also change. On top of that, the different standards in licensing and enforcement by the various regulators are not only seen to be a problem by consumers but by financial institutions and intermediaries. Many of the insurance and banking practitioners whom we interviewed were of the view that this proposed regulatory arrangement would not work in practice and believed that that this would lead to confusion as to the division of powers between the HKMA and IIA and also about whose instructions/decisions should be followed in cases where there are conflicting views or discrepancies in the interpretation of the regulations or rules between the two regulators.

In conclusion, IFPHK supports the following

- Establishment of an IIA to ensure a healthy and sustainable insurance market which would benefit the public.
- Bring the regulation of insurance intermediaries under the proposed IIA so that consumers could be better served through a uniform standard in enforcing the code of conduct, raising of professional standard and efficient use of resources.

IFPHK also proposes the following

- There should be a high level of transparency and market engagement with regards to the details of how the IIA would work, be financed, structured and held accountable as well as all the transition arrangements.

- In working out such details, the government should make clear how the various regulators of financial markets and instruments be aligned to ensure a comparable professional standard and consumer protection.
- There should be mechanisms to ensure that the competitiveness of the market, one of the current strengths be preserved and not destroyed by over-regulation.
- The supervision of insurance product sales through banks be brought under the proposed IIA.

The statements given in IFPHK's response to the Consultation Paper are based on an objective and independent analysis of the market and consumer needs. Industry view has been proactively sought through extensive interviews with its corporate members, professional bodies and experts in the insurance field to ensure that IFPHK understood the concerns and sentiment of the market. They have all been considered by IFPHK. The views of IFPHK are largely aligned with those collected from the market but it should be noted that not all members agreed with the views expressed in this paper.

The FSTB Consultation

To address the concerns over the independency of the OCI and the current self-regulatory regime for supervising the insurance intermediaries, the FSTB issued a Consultation Paper on Proposed Establishment of an Independent Insurance Authority on 12 July 2010. The Consultation Paper sets out the proposals for establishing the IIA which will be operationally and financially independent from the Government and replace the current OCI and will also take over the supervision of the insurance intermediaries from the SROs.

The Consultation Paper contains eleven questions relating to the following areas for the industry or public to provide comments:-

Guiding Principles for the Establishment of the IIA (Chapter 2);
Functions of the IIA (Chapter 3);
Regulation of Insurers (Chapter 4);
Regulation of Insurance Intermediaries (Chapter 5);
Organization Framework of the IIA (Chapter 6);
Governance and Related Matters (Chapter 7); and
Funding Mechanism (Chapter 8).

IFPHK Response Methodology

IFPHK is a professional body, seeking to promote higher professional standards in the financial planning practice. It feels that it is important to respond to consultation and policy papers which have significant impact on the financial planning sector. When formulating its response to such papers, it takes a systematic approach which includes the following:-

- I. An independent and objective study of the proposals on the overall impact, positive and negative, on the industry and consumers based on theoretical and critical analysis
- II. Study of international practices of markets which are either more developed or similar to Hong Kong to understand how similar proposals may have succeeded or failed and the reasons why that happened
- III. Collection of comments and opinions from the relevant sector in the industry, ensuring that views sought represented all the different segments of the industry categorized by size and business model.

Independent study of the Consultation Paper

The Secretariat of IFPHK has studied the proposals stipulated in the Consultation Paper as well as practices in other countries with well developed insurance markets and regulatory framework. It has sought to understand the background of some of the changes in the regulatory landscape overseas and try to ascertain objectively whether they could be applied to Hong Kong. In considering the proposals in the Consultation Paper, it has consulted and studied the markets of Australia, Singapore and United Kingdom through its international network of Financial Planning Standards Board's global affiliates.

Interviews with Insurance Industry Leaders

During the three-month consultation period, IFPHK had conducted interviews and discussions with the Chief Executive Officers or legal and actuarial representatives of some of the largest insurance companies/banking group as well as medium-sized insurance companies in Hong Kong. Most of these industry representatives are industry leaders and professionals having ample work experiences in the insurance or re-insurance businesses. IFPHK would like to thank them for their strong support and invaluable advices.

Views sought from Individual Members

IFPHK had also invited comments from our individual members on the various proposals set out in the Consultation Paper. Communications had been made to each of our individual members to highlight the changes proposed in the Consultation Paper and invite our members to send their

feedbacks to IFPHK direct if they want to express their concerns through IFPHK's Response to the Consultation Paper. IFPHK received quite a few valuable comments from our individual members and some of which have been reflected in this submission paper.

IFPHK's Independent Response

After collecting and consolidating the industry views from various levels, IFPHK analyzed the information obtained together with the data collected from its own research and from its overseas affiliates on the relevant markets including the Australia, Singapore and United Kingdom. IFPHK then came up with the responses to the various questions raised in the Consultation Paper as well as the recommendations on the practical application and effectiveness of the relevant proposals taking into account the likely impact on the industry. **As such, the views expressed in this submission paper are not necessarily summaries of views from the industry but one which had undergone more independent and critical analysis and consideration by IFPHK as a professional institute. As a result, not all the views collected by IFPHK are recorded in this submission paper and neither have all the views expressed in this submission paper been directly endorsed by the industry representatives or members consulted.**

IFPHK's Submission

The submission set out below is the result of IFPHK's view-seeking process in addition to its own independent internal analysis. IFPHK endeavored to consider as the first priority the impact on the retail consumers as well as the practical implication on the business of the financial planners who also advise on and provide professional services in respect of insurance planning in Hong Kong. As in any consultation process in a free market, complete consensus on all matters is rarely achieved but IFPHK had worked together with our members to come up with the following responses and recommendations which take into account the majority views of the industry.

Consultation Questions raised in the Consultation Paper

Guiding Principles for the Establishment of an Independent Insurance Authority ("IIA")

Consultation Questions in Chapter 2 of the Consultation Paper:

- 1) Do you agree that an Independent IA should be established along the principles set out in paragraph 2.6?***

IFPHK's Response

IFPHK agreed that an independent insurance authority should be established for the medium to long term benefit of the industry. IFPHK also agreed with the principles set out in paragraph 2.6 which ensured that the IIA would have the appropriate powers, structure, resources, checks and balances to perform its duties.

IFPHK felt that there would be value which, in principle, independence could bring. As an independent regulator, it would be able to

- Recruit skilled and experienced expertise from the market as its remuneration policy could be closer to the market
- Have a more transparent mechanism of checks and balances subject to public and industry scrutiny
- Have a structure which can allow market players to participate
- Have a stable and reliable source of funding to ensure independence and effectiveness

Most of the industry players and experts interviewed by IFPHK agreed in principle that an independent insurance authority should be set up.

The principles stipulated in paragraph 2.6 included the following :

- (a) the IIA should be given regulatory, operational and financial independence subject to reasonable safeguards;
- (b) the IIA should be given the necessary powers to discharge its statutory functions effectively;
- (c) the exercise of powers by the IIA should be subject to adequate checks and balances, including an independent appeal mechanism against its major decisions;
- (d) apart from prudential of insurers and conduct regulation of insurance intermediaries for the purpose of maintaining general stability of the insurance industry and protecting policyholders, the IIA should also play a role in facilitating compliance and promoting healthy market development, with a view to enhancing the competitiveness of Hong Kong as an international financial centre;
- (e) the organization structure of the IIA should enable it to respond effectively to changing market needs and new regulatory requirements;
- (f) the IIA should eventually operate on a full-cost recovery basis.

However, although the principles outlined above were sensible ones, there could be a variety of ways in interpreting and implementing these high level rules. IFPHK appreciated that the current round of consultation may be intended to be on a high level, but it would strongly recommend another round of consultation to ensure that there would be deeper transparency and market engagement on what these details would look like. The success of the IIA would very much depend on the way these principles would be implemented and how the transition arrangement could ensure least disruption to the industry. It would be important that the industry be given enough time to scrutinize and discuss them in the next round of consultation.

2) Do you think that there are other important principles in addition to those set out in paragraph 2.6 that the Administration should adopt in working out the detailed legislative proposals for the establishment of the independent IA? If so, what are they?

IFPHK's Response

It is recommended that it be made explicit under the task of regulation of insurance intermediaries that this be aligned with that of the others for different financial products and markets.

IFPHK has always stipulated that any reforms in the financial market should be adopted consistently by all financial intermediaries servicing retail consumers and operating in the IFA, banking and insurance sectors. IFPHK believes that failure to implement a consistent approach across the industry could result in significant negative consumer and industry consequences. The industry has also specifically expressed concerns that the lack of a consistent

set of standards across financial services intermediaries would expose Hong Kong consumers to regulatory arbitrage.

It is recommended that the Government should also take into account the following when working out the legislative proposals:

- To ensure effective planning of policies and regulations, the Governing Board of the IIA should consist of members with insurance industry experience who have more in-depth understanding of the issues and needs of the industry practitioners and how the industry operates.
- To ensure the cost-effectiveness and efficiency of the IIA, the running costs of the IIA should be transparent and adequate checks and balances for monitoring the operation of the IIA should be put in place.
- To ensure proper and fair disciplinary actions, the IIA should maintain a high level of transparency and accountability in handling disciplinary cases relating to any misconduct of the industry practitioners.

Functions of the IIA

Consultation Questions in Chapter 3 of the Consultation Paper:

- 3) *Do you agree that the independent IA should have an expanded role beyond the existing functions of the IA as set out in paragraph 3.1? If so, do you agree that the independent IA should assume the additional functions as proposed in paragraphs 3.3 and 3.4?*

IFPHK's Response

It is agreed that the IIA should assume additional functions in directly supervising the code of conduct of insurance intermediaries, educating the public, conducting market studies and striking a reasonable balance between prudential regulation and market development.

Although the industry has introduced a number of self-regulatory measures over the years, including practice at point of sale, better disclosure, continuous professional development requirement, the regulation of sales practice is deemed to be relatively lax when compared to that for other types of retail financial products, although the structure of insurance products is anything but less complex and transparent than other financial offerings. This in the long run would affect the perception of the consumer and hamper the growth of the market. IFPHK has proposed before that proper job analysis to be conducted to ascertain the competence matrix including knowledge, skills and experience, required of a professional financial intermediary. The

education, licensing and continuous education requirement should be aligned with the results of the job analysis. A better resourced IIA with the right level of industry participation and engagement could ensure that this could be implemented. Furthermore, an independent regulator would be in a better position to ensure that there would be similar requirements for granting to financial intermediaries across the different products and comparable standards in enforcement.

Despite the relatively high penetration of insurance products in the Hong Kong market and reasonable growth of premium over the years, the general understanding of insurance products and how they could be used effectively in one's financial plan remain nebulous. For a market to perform effectively and consumers to be protected properly, a fundamental understanding of how these products work is essential. It would make sense for the IIA to champion this for the medium to long term benefit of the market and of consumers.

As an effective regulator, it has to have an intimate understanding of the market, locally, regionally and internationally. It can then formulate the right regulatory framework and more importantly, put in place measures which could help drive growth for the market. As a well resourced independent regulator, it will be appropriate for it to ensure it has the right expertise to come up with the appropriate policies, strategies and plans.

The IIA should not only be progressive and adhere to international standards when formulating its supervisory principles and details but have an explicit responsibility to strike a balance between prudential regulation and market growth. Hong Kong has always prided itself on its ability to allow markets to grow and thrive whilst ensuring consumer protection. Not all markets have managed to achieve that, especially when changes in legislation were a direct result of some market scandal. The IIA needed not only to bear that in mind but build appropriate mechanisms into its structure to ensure that over-regulation would not occur.

Most of the members whom IFPHK interviewed also agreed with such expanded functions. It would be preferred if more details on how this would work in practice be made available at another round of consultation.

4) *Do you agree the independent IA should also have a duty to enhance the competitiveness of the insurance industry, which will help to reinforce Hong Kong's status as an international financial centre?*

IFPHK's Response

IFPHK agrees that the IIA should have a duty to enhance the competitiveness of the insurance industry.

The insurance sector performs an important role in both driving growth and spreading risk in any market economy. In order for Hong Kong to remain as an international financial centre, there need to be a proactive approach towards enhancing competitiveness, driving innovation and raising professionalism. The IIA would be well positioned to ensure that is done properly. There should be objective and transparent measures to gauge the effectiveness and success in this respect by the proposed IIA.

The members interviewed by IFPHK mostly agree that the proposed IIA should have this responsibility but would like to see how it is going to be measured.

Regulation of Insurers

Consultation Questions in Chapter 4 of the Consultation Paper:

- 5) *Do you agree that the independent IA should be vested with additional powers as proposed in paragraph 4.7 to enable it to regulate insurers more effectively?*

IFPHK's Response

IFPHK supports the introduction of additional provisions in order for the proposed IIA to effectively combat illegal financial transactions such as money laundering, along the same premises as the Securities & Futures Commission.

To have an effective financial system would mean that it is free from the interference of illegal activities. IFPHK supports the introduction of reasonable measures to combat money laundering in line with best practices. It would also appear to be sensible to model on the provisions of other regulators in the market who are deemed to be sufficient. IFPHK would also suggest that the details be communicated and discussed at another round of consultation.

The views received by IFPHK generally concurs with the proposal that the IIA should be vested with additional powers to enable it to regulate more effectively.

Regulation of Insurance Intermediaries

Consultation Questions in Chapter 5 of the Consultation Paper:

- 6) *Do you consider that the existing self-regulatory arrangements for insurance intermediaries should be changed, and if so, do you support that Option 2 (i.e. direct supervision of insurance*

intermediaries by the independent IA) should be pursued? If not, why?

IFPHK's Response

IFPHK supported Option 2, that the IIA should assume the responsibility of direct supervision of the insurance intermediaries.

Although the insurance industry, with the help of the self-regulatory organisations ("SROs"), introduced code of conduct, licensing, client disclosure, continuous education, etc, the licensing requirement and general enforcement are seen to be less onerous than those required for other retail financial products, sold to essentially the same segment of the market. There are many professional insurance practitioners in the market who have provided invaluable insurance and financial planning advice to their clients. Unfortunately, the standard is not uniform and quality of advice can vary significantly. Insurance products on the other hand have become more sophisticated and client needs have moved from merely covering survivors' needs to a whole range of retirement and living requirements. IFPHK believes that there need to be proactive review of the licensing, examination, education requirements of practitioners in order to ensure that proper advice has been rendered. An independent regulator with adequate resource would be better positioned to ensure that this is done in an objective and efficient manner. The IIA would also be in a better position to be empowered to deal with those who breach the regulation but fall outside the ambit of the SROs because the offending parties were not members of the SROs.

IFPHK would also stress that the best regulations would need proper enforcement to yield results. Some of the members we have interviewed expressed concern about the frequent abuse of a loophole in the regulations in marketing insurance products. There are currently no regulations supervising the conduct of a group of unregulated people who act as an "introducer" between the insurance intermediaries and the prospective clients. These "introducers" would typically introduce potential clients to the insurance intermediaries for purchasing insurance products and would receive a commission for doing the introduction. Although these "introducers" are not meant to make any representation of products or provide insurance advice, it is common for them to breach these rules, according to the feedback IFPHK received from the market. As these individuals are not licensed and may not have the relevant product knowledge, mis-representation can easily occur. As the SROs do not have power to discipline these individuals who are not their members, policyholders get little protection or safeguard from such malpractice. It is urged that the IIA either address the problem proactively or close the loophole to ensure that this would not continue to occur.

The industry would also like to see the details of how the existing self-regulatory regime would be migrating to the new direct supervision regime

under the IIA. A smooth transition with minimal disruption would be of utmost importance to protect the interest of policyholders and the industry players. It was felt that the success of the transition would rely on effective engagement of the industry.

Conduct of insurance intermediaries selling insurance products in banks

Consultation Questions in Chapter 5 of the Consultation Paper:

- 7) ***Do you consider that in relation to the sale of insurance products in banks, the HKMA should be vested with powers similar to those for the independent IA to allow HKMA to regulate bank employees selling insurance products given the different client profile and sale environment in banks?***

IFPHK's Response

IFPHK does not agree with the proposal to vest powers on the HKMA in regulating the bank employees selling insurance products.

The reason given in the Consultation Paper for the proposal to separate the regulation was that bank customers differed from those of insurance agents and brokers. Not only was there no empirical evidence to support the statement, it was believed by the industry that the customer segments of banks and insurance agents as well as brokers overlap significantly, if not identically. Furthermore, it was not clear why customer protection should be different just because they were of a different background. This lack of equity would normally be frowned on except on special circumstances such as professional or expert investors provided for in other financial regulations. The Consultation Paper does not provide adequate justification for proposing the changes but instead raise a number of practical issues regarding the operation of the proposed dual regulation by IIA and HKMA. The issues include the confusion that may arise in the division of powers between the HKMA and IIA and in cases where there are conflicting views or discrepancies in the interpretation of the regulations between the two regulators. It is also suggested that the relevant proposal is contradictory in principle to the purpose of establishing the IIA as an independent supervising authority.

The industry is also concerned that the relevant proposal would create a regulatory structure for the banks' insurance businesses similar to the current regulatory regime for banks' securities dealing activities where the SFC is responsible for registering the banks for carrying out the regulated securities activities while the HKMA remains the primary regulator responsible for supervising the selling conduct of the bank staff. The industry is of the view that the current SFC/HKMA regulatory regime does not appear to be a very ideal regulatory structure in view of the fact that the

relevant regulatory system did not appear to have been able to prevent the happening or solve the issues of the Lehman Brothers cases which resulted in widespread concerns from the public over the selling conduct of the bank staff. IFPHK's concern is shared by members from both the insurance and banking sectors.

Organization Framework of the Independent Insurance Authority

Consultation Questions in Chapter 6 of the Consultation Paper:

- 8) Do you agree that the recommendations as set out in paragraphs 6.5 to 6.8 should be pursued for the independent IA to operate as an independent entity? Any other views?**

IFPHK's Response

IFPHK agreed in general a structure which would enable the proposed IIA to supervise, develop market competitiveness, collect data and educate consumers. The structure should also provide for strong governance with checks and balances. However there appeared to be a lack of formal structure to engage the industry in its work which IFPHK would deem to be extremely important for any regulator to be effective.

It was felt that IIA would need to have the right resource and power to decide on remuneration packages to ensure that competent and suitable staff be recruited. It would however be difficult to comment on the exact number of staff required without understanding the details of the underlying thinking.

The feedback which was received from the industry also stressed the importance of having experienced insurance practitioners in the organization to help in policy making as well as execution of the functions of the new IIA. In addition, to ensure that the IIA would receive valuable market information, committees with more involvement in developing particular insurance fields should be set up with input from the market, whilst the Advisory Committee remain focused on more high level governance and policies of the IIA. This would enable the IIA to receive more up-to-date information from those who would be still active in the market.

Governance and related matters

Consultation Questions in Chapter 7 of the Consultation Paper:

- 9) Do you agree with the proposed checks and balances and governance arrangements for the independent IA as set out in Chapter 7?**

IFPHK's Response

IFPHK agreed with the structure proposed to ensure the proposed IIA would be subject to strong governance, accountability and sustainability based on international best practice. In addition, IFPHK would recommend formal working committees be built into the structure for specific subject matters through which expertise from the market could be tapped. For these committees to add value, members should be expected to contribute and participate actively and not just rubber stamp proposals.

For any organization to sustain its success, a strong governance structure supported by adequate resources would be important. IFPHK felt that the structure proposed would help to achieve that. At the same time, it was felt strongly that the right level of expertise should include amongst finance, legal, actuarial experts, experienced insurance practitioners. This view is strongly supported by members of the industry which IFPHK interviewed.

Funding Mechanism

Consultation Questions in Chapter 8 of the Consultation Paper:

- 10) Do you agree that the Government should provide a lump sum to support the independent IA in its initial years of operation and the independent IA should seek to reach full cost recovery in six years?**

IFPHK's Response

IFPHK agreed that there should be a reasonable time frame within which an independent regulator reaches a full cost recovery basis.

In order for any regulator to act objectively without undue influence, it would require an independent and sustainable source of funding. IFPHK therefore agrees that the proposed IIA should be run on a full cost recovery basis. Initially, it would need support from the government and a lump sum grant would be a reasonable arrangement. It was however thought that there should be conditions to be met by the proposed IIA during the 5-year period to ensure that reasonable progress was being made and significant problems, if any, would be detected early.

The feedback received by IFPHK indicated that there were no strong views on this subject matter.

11) Do you agree with the proposed fee structure as set out in paragraphs 8.2 and 8.6?

IFPHK's Response

IFPHK agreed that there should be an independent, regular and sustainable source of income to support the operations of the proposed IIA. It supported the principle that the money came from those who directly benefit from the work of the IIA. However it has reservations about item (d) where a policyholder levy was proposed.

The market levy proposed to be imposed on the policyholders is considered to be unfair and inappropriate. The proposal is not only inconsistent with the funding policies of the other financial regulators in Hong Kong but is also in conflict with the government's policy to encourage investments and savings by Hong Kong public.

There are currently no similar levies imposed on the other consumers or investors for generating the funding for the regulators of the securities or banking industries. Assuming that the market levy would be calculated based on the total insurance premiums paid by the policyholders, the levy would in effect impose a tax on the savings and investment portions of the insurance premiums. This would discourage the public in Hong Kong from investing or saving money through insurance products as there are currently no similar tax imposed on the investments made through other investment instruments including mutual funds or securities or on the savings deposits made with the banks. The levy may also reduce the competitiveness of the Hong Kong insurance products in the international markets.

In addition, the market levy may be an issue for corporate policies in view of the significant amount of insurance premiums involved although it might not be the case for individual policies. It is also not fair to calculate the market levy on the basis of the premium amounts only as different insurers might have different actuarial methods to calculate the premium amounts for their respective insurance policies. There is also a concern that the market levy to be payable by the policyholders will increase automatically every year as the insurance premiums may also increase annually in line with the inflation rate. It is therefore suggested that a cap should be imposed on the market levy for each insurance policy when it reaches certain level. There is also concern on the heavy administration costs involved in handling small insurance policies, namely those relating to household and travel insurances.

IFPHK supports in principle a licensing fee system which aptly reflects the size and nature of the licensee and the practices which the licensee has put in place to mitigate and control risks. Such a risk-based approach can help to ensure that the licensing fee is applied on a fair and transparent basis. It would also encourage those with less satisfactory risk controls to improve. In

addition, it may be a sensible idea to put a cap on the license fee so that major players are fairly charged and not penalized for its size.

The industry felt that remuneration package tied with effective performance would encourage the appropriate behavior and results. However, care should be taken to ensure that the indicators measuring success encourage a balance between effective supervision and market growth. The wrong indicators may end up with over-zealous prosecution and over-regulation.

Other Comments

To ensure that the Hong Kong market is in line with the international standards, we may take into account the financial regulatory regimes in the other overseas international financial centres including the United Kingdom, Australia and Singapore in formulating the regulatory structure for the supervision of the financial intermediaries in Hong Kong. As we understand, the financial activities in all the three aforesaid overseas financial markets are subject to the supervision of a single regulator which oversees the services provided in the investment, banking and insurance sectors in the respective countries. One of the advantages of this single regulator system is that it provides clarity to the investors/consumers in the regulatory functions/powers of the different financial sectors which may be considered as complicated by the general public.

As the financial products get more complex and sophisticated nowadays, it is of utmost importance that the investors/consumers will be provided with proper and adequate protection under a sound and effective regulatory system. Therefore, a prudential regulator taking a holistic approach to overseeing the different financial sectors and addressing investors' and consumers' needs is considered to be the best way to protect the investors/consumers. However, there are some schools of thought that a single financial regulator may not suit the local market. Notwithstanding this, there should be at least more conscious effort amongst the regulators to ensure that the selling practices/conducts in respect of all financial and insurance activities including the sale of investment and insurance products as well as the provision of banking services in Hong Kong be monitored according to the same standard. Similarly, the handling of investors/consumers' complaints against all financial firms, financial intermediaries, insurers and insurance intermediaries as well as for deciding on any disciplinary actions against these parties should be aligned. This may not be achievable through a mere memorandum of understanding in the absence of more explicit and accountable measures of success for each regulator.

Conclusion

In principle, IFPHK supports the setting up of an IIA with the appropriate powers, structure, resource as well as checks and balances, accountability and responsibility. However, the critical factors for success do not lie with only the high level principle and structure but in its execution. The only reservation which IFPHK would like to express would be the separation of supervision power of bank employees in relation to the sales of insurance products. The changes proposed in the Consultation Paper will undoubtedly have far-reaching implications on the insurance companies, insurance practitioners as well as the future roles and operation of the existing three SROs in particular. It is therefore understandable and apparent that a majority of the industry practitioners, including the insurance companies, had expressed their concerns, on several occasions including during the public consultation sessions organized by FSTB and IFPHK's interviews with the industry, about the tight schedule proposed in the Consultation Paper for introducing a bill into the LegCo and also about the lack of substance and details in the Consultation Paper for implementing the various proposals.

To address the public concern, it is considered necessary for a second round of consultation to be carried out to provide sufficient time for the industry to review and voice out their concerns about the relevant issues arising from the various changes proposed in the Consultation Paper. To ensure that useful comments will be obtained in the second phase of the consultation, it is recommended that the Government should work out a detailed plan for implementing the various proposals including the transitional arrangements to be provided, the actions and measures to be taken and any alternative method of adopting the proposals that the industry may consider and comment.

It is also considered necessary to have a second round of consultation to collect views from the industry on the details of the necessary arrangements to be put in place for implementing the proposals. To ensure a smooth and effective transition from the existing SROs regime to the direct supervision of the IIA, it is necessary for the government to work with the insurance industry on a detailed plan for implementing and preparing for the changes including the transitional arrangements for transferring the regulatory functions from the SROs to the IIA. The industry does not see any compelling reasons to rush the draft bill through the LegCo in 2011.