

THE INDEPENDENT INSURANCE AUTHORITY

“ The IFAA’s response to the July 2010 Consultation Paper on the establishment of an independent insurance authority ”



EXECUTIVE SUMMARY

The Independent Financial Advisors Association (“IFAA”) agrees to the establishment of an Independent Insurance Authority (“IIA”), but this is predicated on the following four principles:

[1]

That there is strong industry participation in the new IIA. The SRO’s currently drive market development, not the IA. To continue this market development the market participants must be part of the make-up of the new IIA. Market growth and progress cannot be expected to evolve from an IIA that is bereft of significant numbers of market participants.

[2]

That there is a common sense approach to the pricing of fees and levies. The proposal, as it stands, has a suspect revenue model and, as well, could drive significant and important insurance business offshore, in some cases to competing centres such as Singapore.

[3]

That there be no regulation by the HKMA of employees selling insurance. This would simply be a new, but less broad, SRO.

[4]

That there be alignment between the IIA, the HKMA, the MPFA and the SFC. Passive involvement by the FSTB in the co-ordination of activities between these four regulatory bodies should no longer continue. We are not calling for a super regulatory body. Regulatory and product arbitrage should be kept to a minimum. We are calling for convergence of regulation, which is the cornerstone of the founding of the IFAA.

The paper is a high level one which therefore calls for a high level response. As such we have answered in depth only on some aspects. We would see that the shaping of the new IIA could only occur after subsequent rounds of further consultations using an “across the table” format.

Q01:

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

ANS:

We agree that an Independent IA should be established in line with the principles set out in paragraph 2.6 subject to the conditions that the future IIA should be shaped as set out in our response to the other questions below.

Q02:

Do you think that there are other important principles in addition to those set out in paragraph 2.6 that the Administration?

ANS:

Yes we believe that there should be strong industry representation on any Independent IA across all areas of the new authority including the Governing Board and Advisory Committee.

Further, there should be alignment between the IIA, HKMA, MPFA and SFC, with product and regulatory arbitrage kept to a bare minimum.

Q03:

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?

ANS:

Yes, we agree that the Independent IA should have an expanded role and should assume the additional functions as proposed in paragraphs 3.3 and 3.4.

Q04:

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 center?

ANS:

Yes, we agree that the competitiveness of the insurance industry should be the Independent IA's duty. Additionally, it is important that the HKMA, the MPFA, the SFC and the Independent IA be in alignment with one another.

Our criteria for the future success of the IIA will be judged using the following yardsticks;

- (a) That it enhances regulation of insurance companies and insurance intermediaries to provide for better protection of insurance Policyholders and facilitate the stable development of the insurance industry
- (b) That there be a greater nimbleness in responding to new regulatory challenges and there is more effective implementation of international regulatory standards
- (c) That it facilitates market innovation and maintains competitiveness in the industry without undermining regulation
- (d) That it raises consumer confidence and POSITIVE consumer awareness in the insurance industry, especially the insurance intermediaries
- (e) That the IIA continues to assist in the development of Hong Kong as the insurance center for excellence for the Asian region

Q05:

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?

ANS:

The powers identified in paragraph 4.7 should be minimum powers given to the Independent IA because these powers alone will not allow the Independent IA to achieve the objectives as referred to in Question 1. We would like to see how these powers help the Independent IA to protect policyholders.

Q06:

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?

ANS:

Yes, we think that the existing self-regulatory arrangements for insurance intermediaries should be changed and we support Option 2 (i.e., direct supervision of insurance intermediaries by the Independent IA).

Q07:

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?

ANS:

Unequivocally, the HKMA should be given no powers to regulate bank employees selling insurance products for the following reasons.

- 1] The Hong Kong “Self Regulatory Organizations” will effectively be dissolved under the IIA. The rationale is not only that justice must be done, it must be seen to be done. There will be no more authority or regulatory responsibility outside the IIA. By allowing the HKMA to regulate bank employees justice is not being seen to be done and a Self Regulatory Organization has been created.
- 2] The rationale for creating an Independent IA is to place Hong Kong on an equal footing in terms of international practice. In no other jurisdictions where an IIA has been established are bank employees selling life insurance carved out from the IIA equivalent. Hong Kong should consistently follow international practice.

- 3] Insurance sales and insurance sales management practices take two or three generations to achieve the appropriate standards to deliver correct and honest insurance product solutions to the insuring public. Clearly this experience and expertise lies within the insurance industry and not inside the banks, which have been involved in insurance selling for only less than one generation.
- 4] A significant number of the 18,000 insurance licensed bank employees, in carrying out the duties of selling insurance, are doing so out of a sense of duty to the employer and are doing so to complete a step to further their career prospects in the banking industry. There is no intention amongst this group to sell insurance as a full time and long-term career option. Short-term objectives have a direct correlation to inferior practice standards. The IIA is better positioned, through its years of insurance selling regulatory practice, to pre-empt the bank sales peoples' potential poorer practices. Pre-emption reduces the potential harm to the insuring public.
- 5] If the HKMA is vested with regulatory powers similar to the IIA we will then have the weaker sales and sales management organization (the banks) regulating the weaker insurance sales people (the bank employees). Is this the standard of care and skill level that the Government wants to deliver to the insuring public?
- 6] In 2006 insurance selling was 80% primarily the banks responsibility (and 20% the insurance companies – with no shared responsibility). In 2009 insurance selling is 63% shared by both the insurance companies and banks. That is, there is a huge up-take by the insurance companies of a role in the selling of insurance. It is postulated that, with an increasingly higher market penetration, the market up-take of simple insurance products has reached its saturation point (banks had been primarily responsible for sales of the simple products). Now there is a shift in demand for more sophisticated insurance product solutions, meaning that the burden for delivering a quality selling performance is shouldered more and more by the insurance companies and less and less by the banks.

Please refer to the attached LIMRA (Life Insurance & Marketing Research Association) bancassurance study, which ring-fenced Hong Kong in this study.

- 7] Insurance selling is a one-time sale and often up to a fifty-year service series of interactions with the insured. In the multiple times that the Client will make an approach for service where will the Client go – to the banks or to the insurance company? The answer over the years will be primarily to the latter. The LIMRA study shows it has never been the banks primary responsibility to provide customer service. On the other hand in 2006 customer service was 40% primarily the insurance companies' responsibility and in 2009 this figure had grown to 63% primarily the insurance companies' responsibility. Only (insurance) licensed people can provide an appropriate level of customer service without abandoning a best practice approach. For the future provision of an acceptable standard of customer service (which is the long term dominating factor in the Client relationship dynamic) all insurance sales people must reside under the (sole) regulation of the IIA.
- 8] The presumption that the Client profile inside the banks is different from the Client profile inside the insurance companies is a fallacy. The only real difference is that the bank employees selling insurance know what balances the Client has in his/her bank account(s), monthly salaries and which insurance companies the Client has already bought insurance from, which in turn has the potential to lead to over selling by the bank employees or policy churning (twisting).

The presumption that the sales environment in banks is different may be correct! Certainly there is weaker selling experience inside the banks. One wonders if this weakness should be thrust upon the insuring public?

Q08:

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?

ANS:

We agree with the recommendations set out in paragraphs 6.5 to 6.8 but we would like to ensure that there is strong industry representation on any Independent IA across all areas of the new authority including the governing board and advisory boards.

Q09:

Do you agree with the proposed checks and balances and governance arrangements for the Independent IA as set out in this Chapter?

ANS:

We believe checks and balances are vital for the insurance industry, which employs, directly and indirectly, more than 68,000 insurance intermediaries (paragraph 5.4). The pivotal economic role our insurance industry plays is well evidenced by the gross annual premiums of HK\$188.7 billion received in 2008, accounting for about 11.3% of the Hong Kong GDP for the year (HKSAR Statistics). Effective checks and balances are key to the continuous success not only for the insurance industry but the whole financial industry of Hong Kong.

Despite areas of possible improvements, paragraph 1.3 does recognize the effectiveness of the existing self-regulatory structure, which is constituted by mainly industry practitioners. On the contrary, the proposed governing structure does not recognize the insurance practitioner as a relevant professional and therefore be excluded from the Governing Board under paragraph 7.2. In other words, the current proposal precludes insurance practitioners from the ultimate decision making process. Instead, insurance practitioners are assigned with a rather subordinated role under the proposed Advisory Committee. This will in our view limit the voice of more than 68,000 men and women and hence unacceptable.

Additionally, no attempt in the paper is made to differentiate between Life agents and Brokers. Both categories are “lumped” together. It is extremely important going forward for this distinction to be made and the eventual structure of the IIA be organized to recognize and manage this critical difference.

We therefore propose that senior personnel under the existing SROs or some individuals with similar industry backgrounds should be appointed directly by the Government in order to achieve effective checks and balances and continue the strengthening of the quality of our industry.

Q10:

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?

ANS:

Yes, we agree the Government should provide a lump sum to support the independent IA in its initial years of operations with a target of 5 years with a review and possible extension for up to 8 years.

Q11:

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

ANS:

8.2 (a) Agree, subject to a sensible (on average no more than four percent (4%) of the five (5) year holiday period) rise in licensing fee for intermediaries, and subject to an extension of the five (5) year holiday to a maximum of eight (8) years should there be too severe a short fall in overall revenues into the IIA over the proposed transition period. [Please also refer to the answer to Question 10.]

8.2 (b) We assume here that general insurance and life insurance companies will be treated differently in terms of the formula for calculating the variable license fee. Life insurance companies build greater liability positions than do general insurance companies so equitable treatment should be put in place with the life insurance companies not burdened by the nature of their product types.

8.2 (c) Agree.

8.4 (d) Insurance premium levy will not work on some product types. For example, it will drive marine hull and cargo, aviation and professional indemnity business off-shore (to Singapore?). Additionally, international accounts will then be placed in alternative offshore insurance centers. Some product exemptions will have to be put in place.

Additionally, a levy on reinsurance companies will see a double levy on that part of the risk taken up by the reinsurance company. Instead of a levy on reinsurance policies, perhaps there might be a designated (variable) license fee especially for reinsurance companies.

The levy could only be applied to new insurance policies. Since life insurance policies are long term (and not renewed each year) and since there is a fair degree of market saturation in the life insurance industry, the growth in revenues from levies on this product type will be slow. On the other hand, general insurance policies are renewed each year so it would appear the insurance premium levy would be unfavourable to the general insurance side of the industry.

8.3 Neither premium revenue size nor liability size of an insurance company necessarily reflect complexity nor a need for increased supervisory efforts. Once a critical mass of size has been reached time requirements remain the same. With computers much of the work on liabilities has been taken away. Additionally, it can be argued that some small sized insurance companies present greater supervisory challenges than companies several times their size. Again, life companies and general insurance companies demand different formulas. [Please see the comments in answer 11 8.2 (b), above.]

8.4 (a) Agree, as long as the increase after the holiday period expires is not excessive. [Please refer to the answer to Question 10 and the answer 11 8.2 (b), above.]

8.4 (b) Again, this build up does not correct the imbalance of revenues from general insurance versus life insurance policies. [Please refer to answer 11 8.4 (d).]

8.5 Agree, subject to a three (3) year extension of the holiday period, should the gross revenues calculations prove to have been over ambitious.

8.6 This ratio objective is one that is better to be adopted internally within the IIA, so that it might be adjusted as the source of revenues becomes clearer over the earlier years of implementation of the IIA.

The Council Members - **Independent Financial Advisors Association Limited**

9 September 2010

Bancassurance Products and Marketing — Hong Kong

Table 4 — Trend in Functional Responsibilities — 2006 to 2009
(Percent of Companies)⁺

Function	Primarily insurer's responsibility		Primarily bank's responsibility		Shared responsibility	
	2009*	2006**	2009	2006	2009	2006
Product development	63%	80%	0	0	38%	20%
Training	63	80	25%	20%	13	0
Customer service	63	40	0	0	38	60
Sales support	50	60	13	0	38	40
Technology support	50	60	13	0	38	40
Advertising	25	20	13	20	63	60
Marketing	13	40	0	0	88	60
Referrals	13	0	63	75	25	25
Sales	0	20	38	80	63	0
Lead generation	0	0	75	75	25	25
Cross selling	0	20	38	0	63	80

⁺Numbers may not total to 100 percent due to rounding

* (n=8)

** (n=5)