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Division 3, Financial Services Branch
Financial Services and the Treasury Bureau
18/F., Tower I
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sirs

Consultation Paper on the Proposed Establishment of an Independent Insurance Authority

We refer to the Consultation Paper on the Proposed Establishment of an Independent Insurance Authority (“**IIA**”) published by the Financial Services and the Treasury Bureau (“**FSTB**”) in July 2010 (“**Consultation Paper**”).

General

The Consultation Paper discusses various proposals as to how the current regulatory framework governing the insurance industry may be enhanced going forward. The Hong Kong Association of Banks (“**HKAB**”) and its members, as insurance intermediaries, welcome this discussion and seek to provide our collective views through this submission.

We are generally supportive of enhancing the current supervisory regime to improve market efficiency and competitiveness that should ultimately benefit the insuring public. From the perspective of bancassurance, we see merit in having the Hong Kong Monetary Authority (“**HKMA**”), which is the primary regulator of the banks, supervise the activities of the banks in selling insurance products, based on the same rules and regulations applicable to the selling activities of non-bank intermediaries.

Specifically, we have the following comments on the issues set out in questions 6 and 7 in the Consultation Paper in connection with the regulation of insurance intermediaries going forward.

Chairman Standard Chartered Bank (Hong Kong) Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Secretary Rita Liu

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秘書 廖碧瑩

Question 6

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?*

We generally support a regulatory regime for the insurance industry that can cope with the changing market environment, maintain market stability and protect the insuring public. However, it is equally important that any reforms or changes to the insurance regulatory regime should not restrain market innovation, efficiency and diversity. In this regard, we note that the Consultation Paper primarily focused on the rationale and objectives of the reform, and does not contain much details as to how such objectives can be achieved. Without such specifics, it is uncertain as to how market efficiency and diversity could be reasonably preserved, and how the insuring public will ultimately benefit from the reform.

In our view, a level playing field across the industry is imperative in promoting market efficiency and healthy market development, thereby enhancing Hong Kong's competitiveness as an international financial centre. However, currently bank and non-bank intermediaries are not uniformly regulated. A notable example is the different conduct requirements imposed by the HKMA and the Hong Kong Federation of Insurers ("HKFI") in respect of the selling of investment-linked assurance scheme products ("ILAS"). While the HKMA has imposed mandatory requirements on the banks to audio record the selling process, the HKFI has not imposed corresponding requirements on non-bank intermediaries. Further, whereas banks may sell investment products including ILAS only in designated areas in their branches, non-bank intermediaries may sell ILAS in public settings like restaurants and cafes. The differences potentially confuse the insuring public as to whether, by purchasing insurance products from one channel, they will be less protected than purchasing insurance products from another channel.

In view of the foregoing, we consider that the Consultation Paper did not put forward a clear case for reform, including how the current inconsistent regulatory approaches may be addressed. We would therefore urge the Government to engage in more dialogue with market practitioners, industry organizations and other stakeholder groups in the further review of the current regulatory framework. We consider the following to be core considerations in any reform in respect of the regulation of bank and non-bank intermediaries:

- (i) To minimize inconsistencies (in terms of regulatory gaps or overlap) and instil greater public confidence in the professionalism of insurance intermediaries, there should be a uniform set of licensing, conduct and regulatory requirements (be they set out in codes, guidelines or circulars) for both bank and non-bank intermediaries in conducting insurance agency activities. Any additional requirements on bank or non-bank intermediaries

will likely create confusion to the market and unfairness to either the bank or non-bank intermediaries.

- (ii) To avoid “duplicated” regulation, bank intermediaries should be supervised by the HKMA based on the same conduct, enforcement and supervision requirements as those imposed on non-bank intermediaries. In this role, the HKMA should have the sole power and responsibility over the bank intermediaries in terms of enforcement, disciplinary actions and supervision (including on-site inspection and power of request for production of documents). We strongly believe that this harmonized regulation of bank and non-bank insurance intermediaries can only be achieved through “seamless interface” among the regulators involved by communicating with each other on an on-going and regular basis as well as working closely together in ensuring a uniform enforcement standard.

Question 7

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?*

As stated above, we see merit in having the HKMA, which is the primary regulator of the banks, supervise the activities of the banks in the selling of insurance products, based on the same rules and regulations applicable to the selling activities of non-bank intermediaries. However, we have concern with the proposal in the Consultation Paper to allow the HKMA to impose additional conduct requirements on bank intermediaries, on top of what the IIA may stipulate under Option 2 (see pages 20 and 21 of the Consultation Paper), as this may create an unlevel playing field.

Following the financial crisis, the banking industry has implemented various regulatory changes and new guidelines, and is making preparations to comply with additional investor protection requirements in the next nine months. We believe that this collective effort of the banking industry will further significantly enhance financial stability and investor protection. While we are supportive of the policy objective of aligning our financial regulatory regime more closely with international practices, we also believe that it is important to balance investor protection and the needs of maintaining an efficient distribution.

With the above in mind, we do not see any need to impose additional conduct requirements on bank intermediaries in the selling of insurance products regardless of whether Option 1 or Option 2 is pursued. Instead, we would reiterate that the intermediary regulators should apply the same rules and regulations consistently across their respective regulatees, thereby maintaining a level playing field and

minimizing inconsistencies across the industry going forward.

Other consultation questions

Our comments on the other questions set out in various chapters of the Consultation Paper are contained in the Appendix of this submission. The responses should be read in conjunction with the comments set out in this submission.

Way forward

The insurance sector is one of the pillars of the financial services industry in Hong Kong. It is important that the future regulations maintain a balance between protection of the insuring public and market efficiency in the long-term interests of Hong Kong. We need to adopt the best approach supported by the industry and the insuring public. We would therefore encourage the Government to undertake further market studies in light of comments received in response to this Consultation Paper, with a view to laying out the details of its concrete proposals for a second round of public consultation, instead of proceeding directly to preparing legislation as proposed in the Consultation Paper.

HKAB and its members will be much honoured to meet with or provide further input to the FSTB in its deliberation in such regard. Please contact us for any questions or assistance required.

Yours faithfully



Rita Liu
Secretary

Enc.

Appendix

Other HKAB Responses to Consultation Questions

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

In principle, we agree that enhancement should be made to the existing regulatory regime to maintain market stability. However, we consider that under the existing regulatory framework, the IA has already had reasonably extensive powers under Part V of the Insurance Companies Ordinance (“ICO”) to supervise insurers, and the existing self-regulatory regime on the insurance agents is reasonably effective and efficient in ensuring the fitness and properness as well as the conduct of insurance agents. At such, although it is an international practice for financial regulators to be financially and operationally independent of the Government, it is essential that further details be worked out and provided to the public for further consultation before any decision is made.

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?*

As highlighted in our submission, we consider that the following principles should be taken into account:

- (i) a level playing field should be maintained between bank and non-bank insurance intermediaries;
- (ii) bank and non-bank intermediaries should offer the same level of customer protection to the insuring public;
- (iii) consistency should be maintained in the regulation of bank and non-bank insurance agents and in the standard at which they are supervised; and
- (iv) each type of insurance intermediaries should be regulated by only one supervisory and enforcement body who possesses the relevant expertise in the insurance industry. As the primary regulator for banks, the HKMA should be the sole regulator for the bank intermediaries.

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?

In respect of product regulation, we do not see an immediate need for additional regulation on insurance products and their selling process, in particular, given that intermediaries must observe the existing HKFI guidelines, as well as the common law duty of utmost good faith and the statutory requirement under section 56 of the Insurance Companies Ordinance, which prohibits any person from making misleading and deceptive representations in selling insurance products. In the Consultation Paper, however, it was mentioned that there are potential problems associated with particular insurance products. It will therefore be helpful if the Government can share with the industry the nature of such problems, so that a better assessment can be made.

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?

We are generally in support of enhancing the competitiveness of the insurance industry in Hong Kong.

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?

In relation to the power to enter into premises of the regulated entities, our view is that the powers of the IIA should only be restricted to non-bank intermediaries and that the bank intermediaries should only be subject to the inspection and investigation powers of the HKMA based on the same set of conduct requirements applicable to non-bank intermediaries. Further, in respect of non-bank intermediaries, the scope of powers of the IIA and the circumstances under which such powers may be exercised should be carefully considered. We note that paragraph 4.7(e) of the Consultation Paper also proposed that in the course of inspection and investigation, the IIA may apply to the Court to compel compliance. We therefore suggest that the same principle be applied and that the Court's directions be sought before the IIA may exercise any power of entry, so that a balance can be maintained between regulation and interest of the regulated entities.

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?*

In principle, we support that the current supervisory regime be enhanced so that the IA can be more responsive to changes in market dynamics. However, we submit that the following considerations should be taken into account in pursuing the recommendations:

- (i) in order to maintain Hong Kong to be one of the key financial centres in Asia, a balance should be maintained between regulation and autonomy of insurers and intermediaries in market development and innovation;
- (ii) we do not see an immediate need for additional regulation on insurance products.

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

Should the IA become an independent body, we agree in principle that the proposed checks and balances and governance arrangements be put in place. However, we submit that further details should be provided to the public and a second consultation should be carried out.

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?*

The Consultation Paper does not contain a breakdown of the lump sum of HK\$500 million. We therefore suggest that a second consultation be carried out and more details in relation to funding be provided for public discussion.

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

We are of the view that the 0.1% market levy and other fees imposed on insurers and intermediaries will, eventually, be borne by the insuring public. Given that insurance has become a basic necessity of the public, caution should be exercised before any fee structure should be finalised.