

**For discussion on  
4 July 2011**

**Legislative Council Panel on Financial Affairs**

**Proposed Establishment of an Independent Insurance Authority  
Consultation Conclusions and Detailed Proposals**

**Purpose**

This paper briefs Members on the consultation feedback and conclusions on the proposed establishment of an independent Insurance Authority (“IIA”) and sets out the Administration’s detailed proposals, including the functions, powers, funding mechanism, governance and organization of the proposed IIA. We welcome views from Members on the detailed proposals set out in **Annex A** to this paper.

**Background**

2. The Administration published a public consultation document on 12 July 2010 to solicit views from the public and stakeholders on the broad framework of proposals for the establishment of an IIA. The proposed IIA is intended to bring the following benefits to the industry and the public :

- (a) enhanced regulation of insurance companies and insurance intermediaries which can provide for better protection of insurance policyholders and facilitate the stable development of the insurance industry;
- (b) greater nimbleness in responding to new regulatory challenges and more effective implementation of international regulatory standards;
- (c) facilitating market innovation and maintaining competitiveness of the industry without undermining regulation; and
- (d) raising consumer confidence in the insurance industry.

The above will help reinforce Hong Kong's position as an international financial centre.

3. Apart from posting the consultation document on the website and distributing copies to the public and stakeholders, we have organized four public forums and attended meetings/forums of trade/professional bodies during the three-month consultation period to brief the industry and stakeholders of the proposals and collect their views. We attended the meeting of the Legislative Council Panel on Financial Affairs ("the Panel") on 19 July 2010 to brief Members on the proposed framework of proposals, and also the public hearing session organized by the Panel on 12 October 2010 to listen to views of representatives of stakeholder groups.

### Outcome of Consultation

4. We have received 1,719 written submissions from individuals and companies/organizations. Of the 1,719 submissions, 1,634 submissions are derived from four versions of identical letters. Counting each version as a single submission, there are in total 89 submissions. The consultation findings together with our response are set out in the consultation conclusions at **Annex B**.

5. We note that there is general public support for the establishment of an IIA. We have taken into account the views received on the various elements of the broad framework of proposals in formulating detailed proposals for the establishment of an IIA. A gist of the detailed proposals is set out in the ensuing paragraphs.

## **Detailed Proposals**

### Roles and Functions of the Proposed IIA

6. Under section 4A of the Insurance Companies Ordinance ("ICO"), the principal function of the Insurance Authority ("IA") is to perform the role as a prudential regulator of the insurance industry with a view to promoting the general stability of the insurance industry and protecting existing and potential policyholders. On a review of local and international practices, and having regard to the experience in financial market regulation, we propose that the IIA should assume the

following additional functions :

- (a) to perform direct regulation on the conduct of insurance intermediaries;
- (b) to organize public education programmes;
- (c) to conduct thematic researches and studies concerning the industry; and
- (d) to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the insurance industry.

Proposals (a) to (c) were set out in the consultation document. There was positive public response to proposals (b) and (c) during the consultation exercise. We also received considerable public support to proposal (a) above, but noted that some respondents, notably the insurance intermediaries, have raised concerns or objection. We will explain our detailed proposals in this regard in paragraphs 9 to 12 below. With reference to the functions of other financial regulators in Hong Kong, we further propose to pursue proposal (d) to highlight the IIA's function to help maintain the financial stability of Hong Kong. The proposed functions of the IIA are set out in paragraphs 1 and 2 of **Annex A**.

## Powers of the Proposed IIA

### A. Regulation of Insurers

7. At present, the IA is empowered by the ICO to regulate authorized insurers through examination of their financial statements and business returns, as well as on-site inspections. The IA may impose intervention measures on insurers, such as restricting their underwriting and investing activities, as well as petitioning for winding up.

8. For more effective regulation of insurers and to better safeguard the interests of policyholders, we proposed in the consultation document to provide the IIA with express powers to initiate investigations, search and seize materials upon warrant, prosecute offences summarily, and impose a range of regulatory sanctions in use of misconduct

committed by insurers. Detailed proposals are at paragraphs 3 to 5 of **Annex A**.

*B. Regulation of Insurance Intermediaries*

9. The three self-regulatory organisations (“SROs”)<sup>1</sup> currently perform the supervisory role for some 70,500 insurance intermediaries in accordance with requirements stipulated in non-statutory codes approved by the IA. The SROs are also responsible for handling all complaints against the insurance intermediaries, carrying out investigations and taking disciplinary actions on substantiated cases.

10. While we fully acknowledge the good efforts and valuable contribution of the SROs to the stable development of the insurance industry, the existing self-regulatory framework does not align with local or international practices for financial market regulation; and more importantly, it gives rise to issues with perceived or real conflict of interest. We note that many respondents expressed support of direct regulation of insurance intermediaries by the IIA, and there were suggestions that the existing SROs should be actively engaged, and their experience leveraged, to ensure a smooth migration to the new regime.

11. Under the proposed new regime, the IIA would be responsible for the licensing and direct regulation of insurance intermediaries. This would enhance public confidence in their professionalism and align industry developments with international practices. In this connection, we would like to emphasize that whilst the professional standards for insurance intermediaries would require regular reviews in light of local and international insurance market developments and consumer expectation, it is not our intention to introduce any changes to the eligibility requirements on establishing the proposed IIA. To minimize the impact on pre-existing insurance intermediaries, we propose to provide in the legislation that the pre-existing insurance intermediaries validly registered with the SROs would be deemed to be licensed with the

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<sup>1</sup> The three SROs are the Insurance Agents Registration Board under the Hong Kong Federation of Insurers, the Confederation of Insurance Brokers and the Professional Insurance Brokers Association.

IIA for three years upon its establishment before the IIA grants new licences, so that they can carry on their business while applying for licences from the IIA. Detailed proposals on the licensing regime, transitional arrangements and the IIA's regulatory powers with respect to insurance intermediaries are at paragraphs 6 to 21 of **Annex A**.

12. We envisage that under the proposed regime, the existing SROs could continue to contribute to the industry as trade associations, representing the interest of their members, and organizing continuous professional development programmes, training courses, roadshows and other trade promotion activities, etc. We will continue to engage the industry and the existing SROs in formulating the detailed transitional arrangements and licensing requirements.

### *C. Regulation of Insurance Intermediary Activities of Banks*

13. Given the different clientele and sale environment in banks, we have proposed in the consultation document that the Hong Kong Monetary Authority ("HKMA") should be vested with powers similar to those for the IIA such that it would be allowed to regulate bank employees selling insurance products in banks.

14. We noted that both the insurance and banking industries have expressed views on this proposal. Having regard to their views and comments from the public, we have developed a revised proposal for the conduct regulation of insurance intermediaries who are bank employees selling insurance products in banks.

15. To ensure consistency of regulation, we propose that the IIA should be the primary and lead regulator for all insurance intermediaries, including banks and their employees, and be the sole regulator to set conduct standards and requirements.

16. On the other hand, we note the substantial difference of the client base of bancassurance activities from that of insurance business, the operation of retail banks on an integrated business basis, as well as HKMA's role as the primary and lead regulator of banks. Therefore, it

would be logical and necessary for IIA to work closely with HKMA on the regulation of insurance intermediary activities of banks. Details of the arrangement are set out at paragraphs 22 to 30 of **Annex A**.

17. To achieve this, it will be necessary for IIA to delegate specified powers to the HKMA. To enhance transparency and certainty, such delegable powers should be stipulated in the statute. In exercising such delegated powers, HKMA would be accountable to the IIA which may withdraw the delegation. Both the delegation of specified powers and withdrawal of such delegation by the IIA would be subject to procedures specified in the statute and approval of the Chief Executive (“CE”) in Council. Disciplinary powers would be vested with the IIA, with HKMA’s active participation in the disciplinary process, such as representation in the Disciplinary Committee (as in paragraph 20 of **Annex A**).

18. Under the proposed arrangement, we aim to address the stakeholders’ concern and maintain regulatory consistency between bank and non-bank insurance intermediary activities, as well as minimize duplication in regulatory efforts.

#### *D. Appellate Mechanism*

19. To enhance the accountability of the IIA in the exercise of its powers, we also propose to modernize the existing appeal mechanism by establishing an independent Insurance Appeals Tribunal. This statutory tribunal will operate on a full-time basis and have jurisdiction to review decisions by the regulator including all disciplinary decisions. The proposed tribunal will be chaired by a person who is eligible for appointment as a judge of the High Court and is expected to include a number of market practitioners and others with appropriate knowledge and experience of the insurance industry, all appointed by the Chief Executive. The tribunal may confirm, vary or set aside the decisions, as well as direct the regulator to make a decision afresh in respect of any specified matter. Detailed proposals of the tribunal and other checks and balances are set out in paragraph 35 of **Annex A**.

## Funding Mechanism

20. OCI currently recovers some 37% of its annual operating costs from fixed annual licence fees paid by insurers. The fees have remained unchanged since 1996. To ensure financial independence, we proposed in the consultation document that the IIA should have stable sources of revenue to fully recover its cost from the market under the following new fee structure :

- (a) fixed licence fees payable by all insurers and intermediaries;
- (b) a variable licence fee payable by insurers on the basis of their individual liabilities;
- (c) user fees for specific services (such as application for transfer of business, change of shareholding structure or change in key personnel); and
- (d) a levy of 0.1% on insurance premiums for all insurance policies.

The long-term target is to have about 70% of the expenditure of the IIA met by the levy and the remaining 30% by the various licence and user fees.

21. To reduce the impact on the insurance industry and policyholders, we also proposed in the consultation document that in the initial five years after the establishment of the IIA :

- (a) the licence fee for insurance intermediaries be waived; and
- (b) an incremental approach be adopted in achieving the target levels of variable licence fee on insurers and levy on insurance policies.

In addition, we proposed that the Government should provide a lump sum of HKD500 million to the IIA on its inception to help meet part of its expenses in the initial five years before achieving the target levels of variable licence fee on insurers and levy on insurance policies, and as

contingency reserve.

22. The public response to the proposal of full recovery of the IIA's operational cost in the sixth year of its operation, as well as the proposed lump sum subsidy from the Government, was generally positive. We note the views from some respondents that the levy may be a financial burden on policyholders or the insurance industry, and in particular it might drive high premium policies offshore. We also note suggestions to exempt reinsurance contracts from the levy to avoid double-charging.

23. From industry statistics, high premium policies account for only a small part of the total pool of policies<sup>2</sup>. To maintain Hong Kong's competitiveness, we propose to apply a cap on the 0.1% levy on non-life insurance policies with annual premiums at or above HKD5 million and life insurance policies with single or annualized premiums at or above HKD100,000. We also propose to exempt reinsurance contracts from the levy. We estimate that the shortfall arising from the levy forgone (estimated to be a total of HKD78.1 million for the first five years and HKD26.7 million in the sixth year) could be absorbed by the contingency reserve portion of the lump sum seed money from the Government for the first five years and the recurrent income from fixed licence fees thereafter.

24. Detailed proposals of the funding mechanism are at paragraphs 31 to 33 of **Annex A** and an indicative six-year budget of the IIA is at **Annex C**.

## Governance

25. We proposed in the consultation document that the IIA should be a statutory body subject to checks and balances for proper exercise of

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<sup>2</sup> According to industry data of 2009, the number of non-life policies with gross premiums of HKD5 million or above accounted for 0.007% of the total number of non-life policies and 18.8% of premiums. Life policies with single or annualized premiums of HKD100,000 or above accounted for 1.6% of the total number of life policies and 25.7% of premiums.



powers. The Government will appoint a Governing Board (“the Board”) which may establish committees to support its work. The Board will include members who are broadly based and representative of IIA’s key stakeholders, but free from any conflict of interests with IIA’s licencees, and be equipped with knowledge of the industry. The Government will also appoint Industry Advisory Committees to provide expert advice and recommendations to the Board in respect of life and non-life insurance activities. The Industry Advisory Committees will include insurance practitioners and users from the market. In light of industry’s views that we could tap expertise from the industry, we further propose that the Board should be empowered to appoint an expert panel for IIA to seek advice during the disciplinary process as appropriate. Detailed proposals are at paragraph 34 of **Annex A**.

### Organization

26. We maintain our proposal in the consultation document that the IIA be organized along five main divisions and have an initial workforce of 237 staff. The proposed organization chart is at **Annex D**. We also propose that the IIA should recruit from the open market and adopt a market-driven approach in setting the remuneration package. The Board will consider the remuneration packages with advice from a Remuneration Committee.

### **Next Steps**

27. With the publication of the detailed proposals at **Annex A** on 24 June 2011, we have embarked on the next phase of engagement with the industry and relevant stakeholders, with a view to refining the detailed proposals for the drafting of legislation. We aim to make available draft key legislative provisions for engaging the general public and stakeholders in early 2012.

Financial Services and the Treasury Bureau  
24 June 2011

**Detailed Proposals  
for the Proposed Independent Insurance Authority**

**I. Functions**

The principal function of the independent Insurance Authority (“IIA”) should be to regulate the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policyholders. Specifically, the IIA shall:

- (a) be responsible for regulating insurers and insurance intermediaries, including their compliance with the prudential and conduct requirements stipulated under legislation;
- (b) consider and propose reforms relating to insurance business;
- (c) promote and encourage proper standards of conduct, as well as sound and prudent business practices amongst insurers;
- (d) promote and encourage proper standards of conduct for insurance intermediaries and, where necessary, review and revise the regulatory system for the same;
- (e) cooperate with and assist financial services regulatory authorities of Hong Kong or of any place outside Hong Kong, whenever appropriate, to the extent permitted by the relevant legislation;
- (f) perform a direct, and hence more effective role in regulating the conduct of insurance intermediaries, including licensing, inspection, handling complaints, investigation into misconduct, and imposing disciplinary sanctions;
- (g) organize public education programmes to raise literacy among potential and existing insurance policyholders regarding the features and risks of insurance products, in order to facilitate informed decision-making by policyholders;
- (h) conduct thematic researches and studies into the latest market

development trends, regulatory concerns both at the local and international levels, issues of policyholders' interests, etc. with a view to formulating effective regulatory strategies and facilitating sustainable market development; and

- (i) assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the insurance industry.

2. Items (f) to (i) in paragraph 1 above are functions in addition to those being performed by the existing Insurance Authority ("IA") under the Insurance Companies Ordinance ("ICO") (Cap 41). Details of item (f) are elaborated in paragraphs 6 to 21 below.

## **II. Powers**

### **A. Regulation of Insurers**

3. We propose to retain the existing regulatory requirements on insurers prescribed in the ICO. The ICO stipulates requirements for prudential regulation of insurers by the existing IA, including those in respect of capital adequacy, solvency margin, handling of assets and liabilities, proper keeping / preserving and submission of financial information, as well as fitness and properness of directors and controllers. The IA is also empowered under Part V of the ICO to take interventionary actions for protecting the interests of existing and potential policyholders where causes of concern are identified in respect of an insurer. The powers of intervention include:

- (a) requirements for production of documents and actuarial investigations;
- (b) restrictions on scale of operation and premium income;
- (c) requirements on the types of investments that may be held;
- (d) requirements for bank deposits to be held in the name of the IA;
- (e) requirements for maintaining assets in Hong Kong and placing of assets in the IA's custody;

- (f) appointment of a manager to assume control of an insurer; and
- (g) petition for winding-up of an insurer.

Apart from paragraph 3(a) to (g) above, the IA also has the residual power to require an insurer to take such actions in respect of its affairs, business or property as he / she considers appropriate. The ICO provides for criminal sanctions for breach of the above requirements.

4. We propose that the IIA should be given the following additional express powers for more effective regulation of insurers:

- (a) At any reasonable time, the IIA may appoint authorized persons to conduct inspections by :
  - (i) entering into the premises of the insurer;
  - (ii) inspecting and making copies or recording details of any records or document relating to the business, transaction or activity conducted by the insurer; and
  - (iii) making inquiries of the insurer or any other person whom the IIA has reasonable cause to believe that he has information that cannot be obtained from the insurer.
- (b) The IIA may initiate investigation if it has reasonable cause to believe that obligations under the legislation may have been breached by appointing one or more persons as investigators. The investigator may require the person under investigation or a person whom he has reasonable cause to believe has in his possession any record or document which contains, or which is likely to contain, information relevant to the investigation to :
  - (i) produce any record or document relevant to the investigation;
  - (ii) give explanations or further particulars in respect of records / documents produced;

- (iii) attend before the investigator at the time and place required and answer any questions related to the matters under investigation; and
  - (iv) give the investigator all assistance in connection with the investigation which he is reasonably able to give, including responding to any written question raised by the investigator.
- (c) The IIA may make an application to the Court of First Instance for court orders to compel compliance with the requirements in the course of inspection and investigation. Failure to comply with the order will be a contempt of court.
- (d) To enforce the inspection and investigation powers of the IIA, the following criminal offences will be provided under the legislation :
  - (i) failure to comply with the requirements imposed by the relevant authority without reasonable excuse;
  - (ii) knowingly or recklessly providing false or misleading information in purported compliance with a requirement imposed; and
  - (iii) failure to comply with a requirement or providing false or misleading information or causing/allowing a corporation to do the above, with an intent to defraud.
- (e) The IIA may apply to a Magistrate for a warrant to search for, seize and remove any records or documents required to be produced if there are reasonable grounds to suspect that there is, or is likely to be, on the premises specified any record or document required to be produced.
- (f) The IIA may prosecute offences under this legislation in its own name summarily.

5. The IIA will be empowered to impose a range of proportionate disciplinary sanctions to deal with misconduct of varying nature and severity committed by insurers, including :

- (a) to issue a reprimand;
- (b) to impose fines;
- (c) to suspend the licence;
- (d) to revoke the licence; and
- (e) to prohibit the insurer concerned from applying to be licensed within a specified period.

## B. Regulation of Insurance Intermediaries

### Licensing

6. The IIA will establish and maintain a list of licensed insurance intermediaries (viz. insurance agents, insurance brokers and responsible persons / technical representatives of corporate agents / brokers), containing relevant information in relation to each licence of an intermediary, including its particulars, any licence conditions imposed by the IIA and a record of any insurance-related disciplinary actions taken against it by the IIA / SROs within a period of five years.

7. Before commencement of the new licensing regime, the IA would obtain inputs from the SROs so as to establish a list of insurance intermediaries who are validly registered with the SROs for transfer to the IIA upon its establishment, as well as to monitor the changes to membership of the SROs before the transfer.

8. To ensure compliance with the conduct requirements by the insurance intermediaries, the legislation will specify the eligibility criteria for licensing with reference to pre-existing conditions determined by the IA under the ICO, and by the SROs before the new legislation commences, on the following areas:

- (a) Insurance agents
  - fitness and properness (e.g. qualifications, integrity, continuing professional development (“CPD”) etc.)
- (b) Insurance brokers

- (i) fitness and properness (e.g. qualifications, integrity etc.);
- (ii) capital and net assets;
- (iii) professional indemnity insurance;
- (iv) keeping of separate client accounts; and
- (v) keeping of proper books and accounts.

In granting licences to the insurance intermediaries, the IIA may also impose conditions as appropriate.

9. The insurance intermediaries would also be required to pay an annual licence fee to the IIA. The fee would be waived in the first five years after the inception of the IIA.

#### Transitional arrangements

10. We intend to provide for a transitional arrangement whereby insurance intermediaries already validly registered with the SROs prior to the establishment of the IIA will be allowed to continue to carry on their insurance business within a specified period after commencement of the new legislation and before they receive a licence issued by the IIA.

11. We intend to provide in the legislation that the pre-existing insurance intermediaries validly registered with the SROs would be deemed to be licensed with the IIA for three years upon its establishment before the IIA grants new licences. For better management of applications, the IIA may consider mandating the pre-existing intermediaries to submit their application within a fixed period upon IIA's establishment (say the first year) if they wish to carry on their business under the new regime. All new insurance intermediaries would need to submit applications to the IIA and their applications would be processed under the new regime after the establishment of IIA.

12. Such transition should be subject to specified conditions e.g. the pre-existing intermediaries continuing to fulfill the on-going CPD requirements and comply with the conduct requirements and relevant obligations as provided in the new legislation. At the same time, they will be subject to the IIA's inspection, investigation and disciplinary powers (including reprimand, fines, suspension and revocation of licences, and prohibition from applying for licences) (see paragraph 18 below).

### Complaints handling

13. The IIA would maintain a central register of all public complaints against insurers and insurance intermediaries. The IIA would be responsible for handling all such complaints. As for those relating to insurance intermediary activities of banks, the IIA would refer them to the Hong Kong Monetary Authority (“HKMA”) for follow up and investigation. HKMA would inform IIA of its follow-up action and the investigation result.

### Conduct regulation of intermediaries

14. The scope of intermediary activities which are subject to conduct regulation (“regulated activities”) would be defined in the legislation. Any person who performs such regulated activities would have to be licensed by IIA.

15. The legislation will set out broad conduct requirements with which intermediaries are obliged to comply. The broad principles are to be set out in the primary legislation whilst the details would be laid down in :

- (a) subsidiary legislation, breaching of which will carry statutory consequences (criminal or supervisory sanctions); and
- (b) non-statutory codes / guidelines to facilitate understanding of the statutory conduct requirements and promote compliance, and provide evidential value if any provision set out therein appears to the court to be relevant to any question arising in judicial or other proceedings.

The legislation will empower the IIA to promulgate (a) and (b), except in areas like fees and charges for which the Chief Executive (“CE”) in Council will be the appropriate authority. The making of (a) and (b) will be subject to prior consultation with the industry.

### Standard Setting



16. As the licensing body of all corporate / individual insurance intermediaries, the IIA will be the authority to set standards and requirements, after consultation with the industry, for the conduct of insurance intermediary activities. The IIA may impose additional requirements as different business environments and clientele may so require. HKMA may make recommendations to the IIA regarding regulation of insurance intermediary activities of banks, which the IIA should take into account in setting the relevant standards and requirements.

### Inspection and investigation

17. The IIA will be vested with inspection and investigation powers for insurance intermediaries similar to those proposed for the regulation of insurers (see paragraph 4 above), including the following :

- (a) to initiate inspection / enter into premises of regulated entities to conduct inspection;
- (b) to initiate investigations;
- (c) to make enquiries and have access to records and documents;
- (d) to make an application to the Court of First Instance for court orders to compel compliance with requirements;
- (e) to apply to a Magistrate for a warrant to search for, seize or remove records or documents on reasonable grounds;
- (f) to impose disciplinary sanctions (see paragraphs 18 to 21 below);  
and
- (g) to prosecute offences summarily.

### Disciplinary powers

18. The IIA will be empowered to impose a range of proportionate disciplinary sanctions to deal with misconduct of varying nature and severity committed by insurance intermediaries, including :

- (a) to issue a reprimand;

- (b) to impose fines;
- (c) to suspend the licence;
- (d) to revoke the licence; and
- (e) to prohibit the insurance intermediary concerned from applying to be licensed within a specified period.

19. Before exercising such disciplinary power, the IIA shall inform the person concerned in writing of its intention and give the person a reasonable opportunity of being heard.

20. The IIA will consider all investigation reports completed and those by the HKMA (see paragraph 30 below) and decide whether and if so, what disciplinary sanctions (viz. reprimand, fines, suspension and revocation of licence, and prohibition from applying for licences) are warranted. In exercising its disciplinary power, the IIA would be supported by a Disciplinary Committee (“DC”) chaired by a senior IIA executive with members from both IIA and HKMA.

21. The IIA will be empowered to establish an expert panel with members having industry knowledge to provide advice on the nature of a specific product, related industry practices or experiences in previous cases of similar nature. The IIA may seek advice from the expert panel as appropriate to facilitate its deliberations during the disciplinary process.

### C. Regulation of Insurance Intermediary Activities of Banks

22. The legislation will stipulate that all powers to regulate the insurance intermediary activities, whether in banks or otherwise, are to be vested with the IIA. On the other hand, we note the substantial difference of the client base of bancassurance activities from that of insurance business, the operation of retail banks on an integrated business basis, as well as HKMA’s role as the primary and lead regulator of banks. Therefore, it would be logical and necessary for the IIA to work closely with HKMA on the regulation of insurance intermediary activities of banks. The broad modus operandi is set out in paragraphs 23 to 30 below.

23. To achieve this, it will be necessary for IIA to delegate specified powers to the HKMA. To enhance transparency and certainty, such delegable powers should be stipulated in the statute. Delegation of any powers and withdrawal of such delegation to HKMA would be subject to the approval of CE in Council on the recommendation of the IIA. CE in Council may impose conditions in approving the recommended delegation.

24. The IIA and HKMA will sign a Memorandum of Understanding (“MoU”) setting out the detailed arrangements for the two authorities to cooperate to ensure consistency in regulation, minimize regulatory gap or overlap in powers, as well as facilitate exchange of information.

25. The IIA and HKMA will put in place arrangements to facilitate reciprocal staff secondment, as and when appropriate, to get involved in inspection and / or investigation work related to insurance intermediary activities of banks or other intermediaries with a view to facilitating experience sharing and promoting consistency in regulation between the two regulators.

### Inspection

26. Inspection of banks’ insurance intermediary activities will be carried out jointly by IIA and HKMA. Inspections by HKMA are necessary as such activities may be part and parcel of the banks’ overall business strategy and marketing policy, and joint inspections will facilitate the IIA in performing its functions as the primary and lead regulator of the insurance intermediary activities and promote consistency in the inspection approach of the two regulators.

27. On top of these joint inspections, HKMA will also carry out its own inspections (regular or thematic) in relation to general banking activities. While the IIA will not be involved in these inspections, HKMA and IIA will agree on the annual supervisory focus in respect of insurance intermediary activities of banks and any subsequent material changes. HKMA will also share with the IIA inspection findings in relation to the banks’ insurance intermediary business.

28. In addition, as IIA and HKMA will have their own mystery shopper programmes, it will be desirable for the two regulators to jointly design and implement composite mystery shopper programmes in relation to insurance intermediary activities of banks.

### Investigation

29. IIA, as the primary regulator, will have the primary power to investigate into complaints and suspected non-compliance of relevant legislation / codes. The IIA will delegate investigatory power in respect of insurance intermediary activities of banks to HKMA. Where the IIA considers necessary, e.g. in cases where the principal insurer is involved, it may carry out investigation, take over investigation from HKMA, or send staff to participate in HKMA's investigation team. IIA and HKMA should exchange information at their regular liaison meetings, share information relating to their investigation, and keep each other posted of their investigations and follow-up actions for cases with mutual regulatory concerns.

### Disciplinary process

30. If the investigation is carried out by the HKMA, upon receipt of the investigation report from HKMA, the IIA with the support of the DC will conduct hearing and make decisions on whether, and if so, what disciplinary sanctions should be imposed. As set out in paragraph 20 above, HKMA will be represented in the DC in handling all cases.

## **III. Funding Mechanism**

31. We propose to set out in the legislation the following fee structure comprising:

- (a) a fixed licence fee of HKD300,000 payable by all insurers, and HKD30,000 payable by captive insurers;
- (b) a variable licence fee of 0.0039% payable by insurers only and calculated on the basis of their individual liabilities;
- (c) user fees for specific services, including but not be limited to:
  - (i) application for authorization / de-authorization of insurers / class of business;
  - (ii) renewal of authorization;

- (iii) appointment / cessation / retirement / change of particulars of controllers, directors, auditors or appointed actuaries;
  - (iv) notification in relation to changes of particulars of insurers;
  - (v) transfer of business;
  - (vi) application for accounting concession, relaxation of regulations or issue of compliance certificate, etc.; and
  - (vii) inspection of register or issuing a copy / certified copy of register etc.
- (d) a levy of 0.1% on insurance premiums for all insurance policies (subject to further arrangements in paragraph 32(c) and (d) below), collected from policyholders via insurers / intermediaries; and
- (e) a fixed licence fee payable by all insurance intermediaries, the level of which would be specified before expiry of the five-year waiver period (see paragraph 32(a) below).

32. Further to paragraph 31 above, we propose the following measures :

- (a) the licence fee for insurance intermediaries be waived in the first five years after the establishment of the IIA;
- (b) an incremental approach be adopted in achieving the target levels of variable licence fee on insurers and levy on insurance policies in the first five years after the establishment of the IIA<sup>1</sup>;

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	<b>Proposed Rate</b>					
	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>	<b>Year 6</b>
Variable fee (as a percentage on insurance liabilities)	0.0001%	0.0005%	0.0013%	0.0026%	0.0031%	0.0039%
Market levy (as a percentage on insurance premiums)	0.04%	0.05%	0.06%	0.07%	0.085%	0.1%

- (c) a cap be imposed on the levy on non-life insurance policies with annual premiums at or above HKD5 million and life insurance policies with single or annualized premiums at or above HKD100,000; and the level of cap would be subject to review by the IIA; and
- (d) exemption of premiums of reinsurance contracts from the levy.

33. The IIA will be required to review the levy / fee levels once its reserve has reached a level equivalent to 24 months of its operating expense, after deducting depreciation and all provisions. The IIA may, after consultation with the industry, make recommendation to CE in Council for making rules to provide for the payment of fees and prescribe the fee levels. The rules would be subject to negative vetting by the Legislative Council.

#### **IV. Governance**

##### *Governance structure*

34. We propose to provide in the legislation for the following governance structure for the IIA :

- (a) Governing Board (“the Board”): The Governing Board should be appointed by the CE to provide leadership and direction and to guide the IIA in the development of a corporate strategy to achieve its objectives and perform its functions effectively. It should comprise predominately non-executive directors from a cross-section of the community including but not limited to:
  - (i) One to two members with knowledge of the insurance industry (but not “representing” insurance companies or industry bodies to ensure the independence of the Board);
  - (ii) relevant professional fields (e.g. actuarial, accountancy, legal);
  - (iii) the Consumer Council;
  - (iv) the academia; and

- (v) the Government.
- (b) Supporting Committees: The Board should be empowered to form supporting committees designated to oversee specific areas of the IIA's work and make recommendations to the Board. The supporting committees should include but not be limited to:
- (i) an Audit Committee;
  - (ii) a Finance Committee;
  - (iii) a Remuneration Committee; and
  - (iv) a Management Committee.
- (c) Industry Advisory Committees: There should be at least two Industry Advisory Committees, one for Life insurance and the other for Non-life insurance, to advise and make recommendations to the Board on industry-related issues and policies. The Industry Advisory Committees are suggested to be appointed by the Financial Secretary and may comprise insurance practitioners, industry body representatives and user / consumer groups.
- (d) Disciplinary Committee: As set out in paragraph 20 above, IIA shall form a DC, as an internal administrative arrangement, to assist IIA in hearing and advising on investigation reports compiled by IIA / HKMA executive.
- (e) Expert Panel: The Board should be empowered to appoint an expert panel. Individual members of the panel may be invited by IIA to assist in the disciplinary process by way of providing expert advice on the nature of a specific product or related industry practices, or experiences in previous cases of similar nature, if IIA considers that such advice would be desirable for its deliberations in the process. The expert panel may include, but not be limited to:
- (i) lay members of existing SROs;
  - (ii) senior executives from insurers with cross-jurisdictional operations;

- (iii) senior executives from insurers with only local operations;
- (iv) agents in life business (ILAS, non-ILAS, MPF);
- (v) agents in non-life business (corporate and consumer business);
- (vi) senior executive of brokers with cross-jurisdictional operations;
- (vii) senior executive of brokers with only local operations;
- (viii) senior executives from banks with insurance intermediary business;
- (ix) senior executives from travel agencies with insurance intermediary business; and
- (x) representatives from consumer interest bodies (e.g. the Consumer Council and the proposed Investor Education Council).

35. We also propose to put in place the following checks and balances to enhance the accountability of the IIA in the exercise of its powers –

- (a) the IIA should table its annual report before the Legislative Council;
- (b) the annual budget and corporate plan of the IIA should be subject to the approval of the Financial Secretary;
- (c) making some powers non-delegable (i.e. must be executed by the Board, or IIA executive);
- (d) where the IIA has exercised its disciplinary power against an insurer / insurance intermediary, it should disclose to the public details of the decision including the reasons and any material facts relating to the case;
- (e) an independent Insurance Appeals Tribunal should be established to handle appeals from insurers and insurance intermediaries



against relevant decisions made by the regulator under the legislation including disciplinary decisions. The statutory tribunal will operate on a full-time basis and chaired by a person who is eligible for appointment as a judge of the High Court and include a number of market practitioners and others with appropriate knowledge and experience of the insurance industry, all appointed by the CE. The tribunal may confirm, vary or set aside the decisions made as well as direct the regulator to make a decision afresh in respect of any specified matter. A party who is dissatisfied with a decision of the tribunal may appeal to the Court of Appeal against the decision on a point of law;

- (f) an independent Process Review Panel should be established by the CE to review internal operating procedures of the IIA and HKMA in respect of regulation of insurer and insurance intermediary activities; and
- (g) Complaints against the IIA may be lodged with the Office of the Ombudsman. The Director of Audit and the Independent Commission Against Corruption should also be empowered to oversee the practices and procedures of the IIA. The use of personal data by the IIA should be in compliance with the Personal Data (Privacy) Ordinance.

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## Summary of Major Comments Received with the Administration’s Response

Issues	Comments Received <sup>1</sup>	Response from the Administration
<p>Guiding principles of the proposed independent Insurance Authority (“IIA”)</p>	<ul style="list-style-type: none"> <li>● The majority of respondents supported the establishment of IIA along the guiding principles outlined in paragraph 2.6 of the consultation paper. Most respondents had no further views on other important principles to be adopted.</li>   <li>● Some respondents did not indicate a clear stance on the establishment of an IIA. On the other hand, some respondents indicated objection on grounds that:               <ul style="list-style-type: none"> <li>❖ the existing regime had been working satisfactorily;</li> <li>❖ the proposal failed to support the long-term sustainable development of Hong Kong’s regulatory system or the stability of the insurance industry;</li> <li>❖ the consultation paper did not contain sufficient details and justifications on the proposal; and</li> <li>❖ the resulting high compliance costs would put small and medium size insurers at a disadvantage.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● We are pleased to note that the majority of respondents support the establishment of an IIA. We shall continue to engage the general public and relevant stakeholders in our next phase of preparatory work for establishing the IIA.</li>   <li>● The objectives of setting up the IIA are not only to comply with the international regulatory principle that all financial regulators should be operationally and financially independent from the government, but more importantly, also to improve our flexibility and agility in coping with future regulatory challenges, particularly in light of the fast-changing financial landscape. We cannot be complacent, and maintaining the status quo will not be conducive to the long-term sustainable development of the insurance industry nor to the upholding of Hong Kong’s position as a global financial centre.</li> <li>● We have taken into account the comments received in the consultation exercise in developing detailed proposals, and will continue to engage the general public and relevant stakeholders during the next phase of work in drafting the legislation.</li> <li>● We are mindful of the need to ensure that the detailed proposals would help enhance the operational standards of the industry and thus our international competitiveness, whilst minimizing the impact on compliance costs.</li> </ul>

<sup>1</sup> We have received a total of 1,719 written submissions, of which 1,634 submissions are derived from four versions of identical letters. Counting each version as a single submission, there are in total 89 submissions.

	<ul style="list-style-type: none"> <li>● Amongst the respondents who recommended other important principles the major suggestions are on the following areas: <ul style="list-style-type: none"> <li>❖ governance and accountability (e.g. IIA should facilitate transparency of the regulatory regime; and promote fairness and a level playing field for the industry);</li> <li>❖ regulatory strength and practice (e.g. IIA should adopt international best practice in prudential supervision; and should be proactive in regulating the operation and conduct of insurers and intermediaries including standard setting of qualification of intermediaries at different stage of their business); and</li> <li>❖ industry engagement (e.g. there should be strong industry representation on the governing board and advisory committees of IIA).</li> </ul> </li> <li>● Some respondents would like to seek more information on the practices of overseas independent regulators.</li> </ul>	<ul style="list-style-type: none"> <li>● We note the suggested principles and these have been covered, as appropriate, in the detailed proposals mentioning conduct regulation of intermediaries and standard setting, governance structure as well as the checks and balances at paragraphs 14 – 16 and 34 - 35 of <b><u>Annex A</u></b> to this paper.</li> <li>● A comparison table on the regulatory set up of some major overseas jurisdictions is attached at <b><u>Appendix</u></b> for reference.</li> </ul>
Expanded roles of IIA	<ul style="list-style-type: none"> <li>● Respondents generally supported expanding the IIA’s role beyond the existing functions or had no comments.</li> <li>● A few respondents suggested other roles for the IIA, including:- <ul style="list-style-type: none"> <li>❖ to address public concern on the reasonableness of insurance premium increases;</li> <li>❖ to study the suitability of offering high risk insurance products to consumers; and</li> <li>❖ to formulate and promote standard insurance contracts to balance the interests of consumers and the insurance industry.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● Noted, and we will proceed based on the consultation proposal.</li> <li>● With reference to the functions of other financial regulators in Hong Kong, we further propose IIA should also assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the insurance industry.</li> <li>● The terms and premiums of insurance contracts vary according to individual needs and are market driven. Nonetheless, the IIA will enhance public education on the essential terms and risks of insurance policies to enable existing and potential policyholders to make informed decisions. IIA will also promote and encourage proper standards of conduct among insurers.</li> </ul>

<p><i>To organize public education programmes to raise financial literacy amongst policyholders</i></p>	<ul style="list-style-type: none"> <li>● Half of the respondents made no comments. Most of the remaining respondents generally supported the proposal.</li> <li>● A few respondents disagreed with this proposal because: <ul style="list-style-type: none"> <li>❖ there is potential conflict of interests if IIA has dual roles as a regulator and an educator;</li> <li>❖ it would increase the regulatory costs; and</li> <li>❖ there are practical difficulties in educating the public on insurance matters in isolation from other aspects of personal finance.</li> </ul> </li> <li>● Some suggested that education programmes should be run by, or in collaboration with, trade associations / other education bodies / the Investor Education Council.</li> </ul>	<ul style="list-style-type: none"> <li>● Noted, and we will proceed based on the consultation proposal.</li> <li>● From local and international experience, the role to educate policyholders has become an increasingly important tool for insurance regulators to promote product knowledge and risk awareness among the public, as well as to identify areas of systemic concerns and facilitate healthy industry growth. We therefore propose that the IIA should be given an explicit role.</li> <li>● IIA will seek to collaborate closely with the industry, other financial regulators and the proposed Investor Education Council in enhancing the financial literacy of potential and existing insurance policyholders.</li> </ul>
<p><i>To conduct thematic researches and studies.</i></p>	<ul style="list-style-type: none"> <li>● About two-thirds of the submissions had no comments on the proposal, and the majority of the remaining respondents agreed to IIA assuming such function, whilst some did not indicate a clear stance.</li> </ul>	<ul style="list-style-type: none"> <li>● Noted, and we will proceed based on the consultation proposal.</li> </ul>
<p><i>IIA's duty to enhance the competitiveness of the insurance industry.</i></p>	<ul style="list-style-type: none"> <li>● The majority of respondents concurred or had no comments on such duty, whilst a few respondents disagreed as they felt that this function was not relevant to the IIA's prudential regulatory work.</li> <li>● Some respondents doubted whether the IIA could perform this role effectively and opposed to the proposed role on the premise that IIA's prime responsibility should be regulation and enforcement.</li> </ul>	<ul style="list-style-type: none"> <li>● Noted. We will ensure that these functions will not affect the IIA's primary duty of prudential regulation as we proceed with the consultation proposal.</li> <li>● The IIA will strike a reasonable balance between regulation and enhancing competitiveness of the industry to allay the concerns of respondents.</li> </ul>

<p>Additional powers to regulate insurers</p>	<ul style="list-style-type: none"> <li>● Most respondents had no comments on this proposal. The majority of those who provided comments supported the proposal with a general remark that these powers should be subject to appropriate checks and balances, particularly in regard to the power to enter into premises. On the other hand, some respondents expressed concern on the possibility of over-regulation.</li>   <li>● Some respondents proposed other additional powers for the IIA, including: <ul style="list-style-type: none"> <li>❖ powers to take lighter sanctions (such as issue warnings); and</li> <li>❖ powers to make detailed rules and requirements in respect of prudential matters such as capital adequacy etc.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● Noted. We fully acknowledge the need for appropriate checks and balances on the IIA in exercising the proposed powers. The proposed establishment of the Independent Insurance Appeals Tribunal and independent Process Review Panel are intended for this purpose. Regarding the power to enter into premises of the insurer to conduct inspections, it would only be exercised in circumstances where IIA has reasonable cause to believe that there has been or likely to be a breach of compliance requirements.</li>   <li>● In the consultation proposal, we have proposed to impose regulatory sanctions such as fines, reprimands, suspension and revocation of licenses. We would also include an additional sanction to prohibit the concerned insurer from applying to be licensed within a specified period. In light of these comments, we shall draw reference to other local and overseas financial market regulators to see how the range of sanctions could be refined. We agree that IIA should be empowered to make rules and requirements in respect of prudential matters, similar to the existing arrangements under the existing Insurance Authority (“IA”) regime.</li> </ul>
<p>Direct regulation of insurance intermediaries</p>	<ul style="list-style-type: none"> <li>● Many respondents supported the proposal that IIA should assume the function of direct supervision of insurance intermediaries. Some respondents opposed to this proposal on the ground that the existing self-regulatory regime had been operating smoothly and any changes would be unnecessary and would only stifle development of the industry and affect interests of policyholders, and they proposed reconsideration of Option 1 in the consultation paper, viz. enhanced supervision by IIA under a strengthened self-regulatory organizations (“SROs”) system, and merge the three insurance</li> </ul>	<ul style="list-style-type: none"> <li>● We fully acknowledge the good efforts and valuable contribution of the three SROs to the stable development of the insurance industry since their set-up. We envisage that after the IIA is established, the existing SROs would continue to contribute to the industry as trade associations. On the other hand, a self-regulatory framework, no matter whether it is in its present form or under a merged SRO under Option 1 (even if it is feasible to merge the two SROs for insurance brokers and the SRO for insurance agents), is no longer in keeping with international practices</li> </ul>

	<p>self-regulatory bodies.</p> <ul style="list-style-type: none"> <li>● Some respondents recommended that the IIA should leverage the experience of the existing SRO members. One respondent proposed to merge the three SROs into one and place it under the direct supervision of the existing IA in the near term and eventually integrate it with the IIA.</li> <li>● There should be more discussion between the Administration and the industry to better align the interests of the relevant parties, and to ensure a smooth and gradual migration to the new regime, with active engagement of the industry to formulate the detailed implementation arrangements.</li> <li>● A few respondents were concerned whether the IIA would introduce stricter licensing requirements on the insurance intermediaries.</li> </ul>	<p>and, more importantly, it fails to address the fundamental problem of perceived or real conflict of interest. Having considered the comments received in the consultation exercise, we will proceed with the consultation proposal that IIA should assume the function of direct regulation of the insurance intermediaries.</p> <ul style="list-style-type: none"> <li>● We intend to provide in the legislation that the pre-existing insurance intermediaries validly registered with the SROs would be deemed to be licensed with the IIA for three years upon its establishment before the IIA grants new licenses. We will actively engage the industry in formulating the detailed transitional arrangements.</li> <li>● While the professional standards for insurance intermediaries would require regular reviews in light of local and international insurance market developments and consumer expectation, it is not our intention to introduce any changes to the eligibility requirements on establishing the proposed IIA.</li> </ul>
<p>Provide HKMA with powers to regulate bank employees selling insurance products</p>	<ul style="list-style-type: none"> <li>● Some respondents supported the proposal that the Hong Kong Monetary Authority (“HKMA”) should be vested with powers similar to those for the IIA to conduct proper regulation of insurance intermediary activities of banks given the different client profile and sale environment in banks. Some proposed that HKMA should remain as the sole regulator of banks adopting a uniform set of licensing, conduct and regulatory requirements for both banks and non-bank intermediaries in accordance with a uniform enforcement standard agreed with the IIA, given that: <ul style="list-style-type: none"> <li>❖ HKMA is well placed to perform the regulatory role with its experience and expertise in the regulation of both the banking and insurance activities of banks;</li> <li>❖ this would avoid the chance of having</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● We note the views of respondents on the proposed vesting of power in HKMA and have refined our proposal to address the concerns.</li> <li>● To ensure consistency of regulation, we propose an over-riding principle that IIA should be the primary and lead regulator for all insurance intermediaries, including those who are bank employees, and be the sole authority to set conduct standards and requirements. On the other hand, we note the substantial difference of the client base of bancassurance activities from that of insurance business, the operation of retail banks on an integrated business basis, as well as HKMA’s role as the primary and lead regulator of banks. Therefore, it would be logical and necessary for IIA</li> </ul>

	<p>certain activities falling between the ambit of both regulators; and</p> <ul style="list-style-type: none"> <li>❖ as bancassurance is one of the key activities carried out by banks, with a view to achieving HKMA’s objective of promoting general stability and effective working of the banking system through supervision of banks, HKMA needs to exercise its own supervision of bancassurance activities and have a holistic oversight of banks’ operations and financial situation.</li> </ul> <ul style="list-style-type: none"> <li>● Those respondents who objected the proposal and indicated preference for insurance intermediary activities at banks to be put under the direct purview of the IIA as the sole insurance regulator have expressed the following concerns: <ul style="list-style-type: none"> <li>❖ unlevel playing field between banks and other insurers / insurance agents;</li> <li>❖ duplication in regulation and resources;</li> <li>❖ inconsistencies in regulatory standards;</li> <li>❖ different vigor in enforcement by different regulators; and</li> <li>❖ create confusion to consumers.</li> </ul> </li> <li>● On the other hand, a few respondents offered some other suggestions: <ul style="list-style-type: none"> <li>❖ Passing the responsibility for all financial intermediation to the SFC with HKMA and IIA concentrating their efforts on prudential supervision.</li> <li>❖ HKMA should take on a policing role whilst disciplinary sanctions are to be decided by IIA.</li> </ul> </li> </ul>	<p>to work closely with HKMA on the regulation of insurance intermediary activities of banks. Accordingly, IIA will delegate specified powers to HKMA. To enhance transparency and certainty, such delegated powers should be stipulated in the statute.</p> <ul style="list-style-type: none"> <li>● In response to concerns on duplication of resources, possible inconsistencies and differences in the vigor in enforcement, we propose that inspections of banks’ insurance intermediary activities will be carried out jointly by IIA and HKMA. Whilst IIA will delegate investigatory power in respect of insurance intermediary activities of banks to HKMA, when considered necessary, it may initiate its own investigations, take over investigation from HKMA or send staff to participate in HKMA’s investigation team. IIA and HKMA will put in place arrangements to facilitate exchange of information and promote consistency in regulation between the two regulators.</li> <li>● To ensure fairness and consistency of disciplinary decisions, we propose that the sanctioning power should rest with IIA with the support of a Disciplinary Committee (“DC”) to be chaired by a senior IIA executive with members from the executives of IIA and HKMA. The IIA will be empowered to establish an expert panel comprising inter alia members with industry knowledge. The IIA may seek advice from the expert panel as appropriate to facilitate its deliberations during the disciplinary process. Any aggrieved insurance intermediary can lodge an appeal against a decision of the regulator to an independent Insurance Appeals Tribunal to be established by statute. A Process Review Panel will be formed to review the internal procedures of IIA and HKMA.</li> <li>● Please see paragraphs 22 – 30 of <b><u>Annex A</u></b> to this paper for the detailed proposals.</li> </ul>
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<p>Funding mechanism – Full cost recovery principle and initial funding by the Government</p>	<ul style="list-style-type: none"> <li>● The majority of the respondents agreed or had no comments on the proposed full recovery of IIA’s operational costs in the sixth year of its operation.</li> <li>● Over half of the respondents had no comments on the proposed lump sum government subsidy, with the majority of the remaining respondents agreeing to the proposals.</li> <li>● Some suggested lengthening the proposed timeline for full-cost recovery by 3 to 5 years.</li> <li>● Some respondents recommended a higher level of pre-funding or a continuous public funding of IIA over its first 10 or 20 years of operation, or to extend the period of government subsidy (e.g. to 8 years) to alleviate the impact on the industry. While a few respondents queried the need for providing such substantial amount of subsidy to IIA. One respondent suggested a decreasing annual government subsidy to IIA over five years instead of an upfront lump sum subsidy upon IIA’s inception.</li> </ul>	<ul style="list-style-type: none"> <li>● Noted. In line with international regulatory principle, IIA needs to be financially and operationally independent from government. The regulators in most major jurisdictions recover their costs of operation from the industry. Continuous government funding contradicts this principle. We consider that before achieving full cost recovery in the sixth year of the IIA’s operation, the Government’s lump sum subsidy of \$500 million would, on balance, help alleviate the impact on the industry as well as meet the objective to have a financially and operationally independent IA. As such, we will proceed on the basis of the consultation proposal.</li> <li>● We will continue to engage the industry and other stakeholders and endeavour to provide further details as necessary to facilitate their understanding of the proposed funding mechanism.</li> </ul>
<p>Market levy</p>	<ul style="list-style-type: none"> <li>● A few respondents agreed to the proposed fee structure while some respondents did not have any particular comments on the proposed 0.1% market levy on insurance policies. On the other hand, some respondents raised various questions on it, including: <ul style="list-style-type: none"> <li>❖ who to pay (insurers or policyholders);</li> <li>❖ whether the calculation basis is fair;</li> <li>❖ who can be exempted to pay (e.g. excluding re-insurance and low-premium travel insurance policies);</li> <li>❖ overseas examples and experience in administration of the market levy; and</li> <li>❖ whether the premium would be capped to alleviate the impact on insurers, insurance practitioners and policyholders.</li> </ul> </li> <li>● Some respondents opposed the levy which they considered as de facto sales tax creating financial burden on the policyholders / industry. They also worried that Hong Kong would set to lose its competitiveness as large enterprises took</li> </ul>	<ul style="list-style-type: none"> <li>● Stable sources of revenue are needed to enable the IIA to recover full cost from the market. Besides collecting licence and user fees from the industry, a modest levy on all policy premiums would be a necessary and equitable source of income for meeting IIA’s regulatory costs in safeguarding policyholders’ interests. We believe that the proposed levy of 0.1% will not have a significant financial impact on policyholders.</li> <li>● After carefully considering the views of respondents and the current portfolio of large premium policies held by insurers, we propose to cap the market levy on non-life insurance policies with annual premiums at or above \$5M and life insurance policies with single or annualized premiums at or above \$100,000. We also propose to exempt re-insurance contracts from levying. This would address the concerns about impact on the competitiveness of our insurance industry.</li> </ul>



<p><i>Variable licence fee</i></p>	<p>out high premium policies offshore to avoid the levy.</p> <ul style="list-style-type: none"> <li>● There are some comments on the proposed variable fees, including the calculation basis (i.e. whether using liability as calculation basis is fair) and possible caps to alleviate the financial impact on large insurers.</li> </ul>	<ul style="list-style-type: none"> <li>● We recommend using “insurance liability” as the calculation basis because it allows greater comparability across different insurers. It also has the benefit of providing incentives to insurers to reduce their risks (e.g. to reduce the level of liability for lower annual fees).</li> <li>● Variable fees are proposed to reflect the higher regulatory costs for large insurers. We do not consider it justified to set any fee cap which in itself would lead to claims of unfairness.</li> </ul>
<p>Corporate governance</p>	<ul style="list-style-type: none"> <li>● Most of the respondents agreed or made no comment on the proposed governance arrangements. Amongst the respondents who made other comments, many of them requested for industry representation on the Governing Board, functional committees, complaints and appeals panels to provide professional input and reflect industry’s interest. On the other hand, there are views that overwhelming industry representatives on the advisory committee could undermine its effectiveness; and that industry practitioners appointed to the advisory committees should not hold any management position in insurance companies to avoid conflict of interest.</li> </ul>	<ul style="list-style-type: none"> <li>● It is relevant to note that most major jurisdictions do not have industry representatives on the governing board.</li> <li>● Having considered all views received, we propose the Governing Board would include members who are broadly based and representative of IIA’s key stakeholders, but free from any conflict of interests with IIA’s licencees, and be equipped with knowledge of the industry.</li> <li>● We propose that the governance structure should include a Governing Board (to decide on corporate strategy) and its supporting committees, one or more Industry Advisory Committees (e.g. for Life insurance / Non-life insurance respectively), and an expert panel : <ul style="list-style-type: none"> <li>❖ the Governing Board (and its supporting committees) to comprise members from a cross-section of the community, including those with good knowledge of the industry (but not representatives of insurance companies or industry bodies);</li> <li>❖ the Industry Advisory Committees to include, inter alia, insurance practitioners and industry body representatives; and</li> <li>❖ the expert panel would comprise a</li> </ul> </li> </ul>

	<ul style="list-style-type: none"> <li>● Other comments raised by individual respondents include: <ul style="list-style-type: none"> <li>❖ establishing a public appointments commission or committee to appoint the CEO and the Chairman and members of the Governing Board along clear objective criteria;</li> <li>❖ enhancing the structure with technical advisory or working committees to provide professional advice to the governing board and functional committees;</li> <li>❖ setting up mediation and arbitration mechanisms to resolve commercial disputes among insurers, intermediaries and policyholders;</li> <li>❖ close alignment between the financial regulators to avoid product and regulatory arbitrage etc.</li> </ul> </li> </ul>	<p>broad spectrum of insurance practitioners and consumer affairs experts for the IIA to seek advice as appropriate in disciplinary process.</p> <ul style="list-style-type: none"> <li>● The proposed appointment of the Chairman, CEO and members of the Governing Board by the Chief Executive is in line with the practices for other financial regulators, both local and overseas.</li> <li>● Noted. The idea of establishing Industry Advisory Committees is included in current proposal.</li> <li>● The claims complaint handling mechanism operated by the Insurance Claims Complaints Bureau (“ICCB”) is currently in place. We will liaise closely with HKFI in considering the future roles of ICCB and the Financial Disputes Resolution Centre (“FDRC”), as well as their interface with the IIA.</li> </ul>
<p>Organization structure</p>	<ul style="list-style-type: none"> <li>● The majority of respondents made no comment or agreed to the proposed organization structure.</li> <li>● Some respondents suggested re-aligning the responsibilities of individual business divisions, e.g. placing human resources, finance and consumer education &amp; protection under the Policy and Development Division instead of the Corporate Services Division.</li> <li>● Some respondents would like to have more clarifications and justifications on the substantive increase in staff and operating costs of the IIA as compared to the existing OCI.</li> </ul>	<ul style="list-style-type: none"> <li>● Noted. We will consider respondents’ suggestions on the re-alignment of responsibilities in finalizing the organization structure of IIA.</li> <li>● The increase in staff is mostly related to the IIA taking up the additional functions e.g. direct supervision of insurance intermediaries, and other supportive services currently provided to OCI by other government departments, e.g. legal, human resources management, finance, public relations, etc.</li> <li>● The IIA has a duty to exercise cautious control over its operating expenses and to ensure prudent use of its resources.</li> </ul>

		There will be proper checks and balances on the IIA's performance of functions. For example, the Director of Audit would be empowered to oversee the practices and procedures of the IIA.
Recruitment and remuneration	<ul style="list-style-type: none"> <li>● Most respondents agreed or made no comments on the proposed market-driven remuneration package for open recruitment of IIA staff.</li> <li>● Some respondents expressed reservations on the proposed incentive pay which they conceived an inducement of over-regulation and ethical hazards by IIA staff. Besides, one respondent considered inappropriate to give bonus to only 50% of staff as this may lead to either staff being over-zealous or unwilling to take risks; and further suggested that staff bonus should be based on overall performance of staff, with some weighting for good performance.</li> </ul>	<ul style="list-style-type: none"> <li>● Noted.</li> <li>● To enable the IIA to attract, retain and motivate people with the right skills, calibre and experience, we propose a market-driven approach in setting the remuneration package, which includes an incentive pay for staff that exceed the performance requirements. This is in line with other financial market regulators.</li> <li>● We note that performance bonus is a common practice with many international enterprises and financial institutions to incentivize meritorious performers. In light of the keen competition for professional expertise in the market, IIA would need a sufficiently attractive remuneration package to entice and retain experienced personnel. We believe that in making recommendations on staff remuneration to the Governing Board in due course, the Remuneration Committee will take all factors into consideration, including whether and how incentive pay should be awarded.</li> </ul>
Change of regulatory regime	<ul style="list-style-type: none"> <li>● A few respondents asked the Government to consider adopting other international regulatory approaches, such as having one super-regulator or twin peaks, or subsuming insurance regulation under the Securities and Futures Commission (SFC) or the HKMA.</li> </ul>	<ul style="list-style-type: none"> <li>● There is no international consensus on which regulatory approach is more effective, and whether the single- or dual- regulator system would better meet regulatory challenges than an institution-based system.</li> <li>● We have no intention at this stage to change the existing institution-based approach which is effective and has been adopted for years.</li> </ul>

Transitional arrangements	<ul style="list-style-type: none"> <li>● Some respondents asked for details of the future regulatory principles, standards and administrative processes to be proposed in the legislation and the transitional arrangements. One respondent suggested setting up a working group between the Office of the Commissioner of Insurance (“OCI”) and the industry to formulate the details of the re-structuring process and a provisional IIA during the transition.</li> </ul>	<ul style="list-style-type: none"> <li>● We propose to provide in the legislation that the pre-existing insurance intermediaries validly registered with the SROs would be deemed to be licensed with IIA for three years upon its establishment before new licences are granted. This will ensure smooth transition and allow time for the IIA to grant new licences.</li> <li>● We will continue to engage the existing SROs in formulating the detailed transitional arrangements and licensing requirements.</li> </ul>
Relationship among IIA, ICCB and FDRC	<ul style="list-style-type: none"> <li>● A few respondents highlighted the need to examine the future role of the ICCB and the interface between IIA and the future FDRC.</li> </ul>	<ul style="list-style-type: none"> <li>● We will liaise closely with HKFI in considering the future roles of ICCB and FDRC, as well as their interface with IIA.</li> </ul>
Sales of ILAS products	<ul style="list-style-type: none"> <li>● There were also some specific comments on the regulation of investment-linked assurance scheme (“ILAS”) products, including : <ul style="list-style-type: none"> <li>❖ enhanced protection of policyholders through increasing transparency in the policy terms, brokers’ commission, method for calculation of insurance premiums etc. by proper disclosure requirements;</li> <li>❖ more detailed scrutiny on the regulation of ILAS products; and</li> <li>❖ whether the regulation should come under IIA or another regulator en bloc.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● IA has implemented a series of improvement measures to improve regulation of sale of ILAS products (including conducting a Financial Needs Analysis and Risk Profile Questionnaire on the applicant, requirement for insurers to make post-sale telephone confirmation for vulnerable groups and extending the cooling-off period from 14 days to 21 days) with positive results. IA will continue to monitor the situation and introduce further improvements, where necessary.</li> <li>● The terms and premiums of insurance contracts vary according to individual needs and policyholders have a free choice. IIA will take on the important responsibility of ensuring adequate public education on the terms and risks of insurance policies to enable policyholders to make informed decisions. IIA will also promote and cultivate higher standards of business conduct among insurers.</li> </ul>
OCI staff-related matters	<ul style="list-style-type: none"> <li>● Some staff have conveyed their views on the exit arrangements and employment in the new IIA. Suggestions include: <ul style="list-style-type: none"> <li>❖ option to remain as civil servants seconded to IIA with a longer option</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● OCI will continue to discuss with Civil Service Bureau and its staff on relevant matters.</li> </ul>

	<ul style="list-style-type: none"><li>❖ period to take up the exit package;</li><li>❖ guaranteed employment in IIA; and</li><li>❖ exit package with enhanced pension and non-statutory payments as granted in previous voluntary exit exercises e.g. Housing Department's Voluntary Departure Scheme, Voluntary Retirement 1 Scheme and Urban Services Department's Abattoir Exit Scheme.</li></ul>	
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**Comparison with Overseas Financial Regulators**

Name of Regulators	Proposed Independent Insurance Authority in HK	Australian Prudential Regulation Authority	Australian Securities and Investments Commission	Financial Services Authority, United Kingdom	Monetary Authority of Singapore	The China Insurance Regulatory Commission
<b>Sectors under Supervision</b>	<ul style="list-style-type: none"> <li>• Insurance</li> </ul>	<ul style="list-style-type: none"> <li>• Banking</li> <li>• Credit unions</li> <li>• Building societies</li> <li>• Insurance</li> <li>• Friendly societies</li> <li>• Superannuation</li> </ul>	<ul style="list-style-type: none"> <li>• Financial markets</li> <li>• Financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit</li> </ul>	<ul style="list-style-type: none"> <li>• Banking</li> <li>• Mortgage and home finance</li> <li>• Insurance</li> <li>• Investment Exchanges and Recognised Clearing Houses</li> <li>• Funds and bonds</li> <li>• Credit Unions</li> <li>• Credit rating agencies</li> <li>• Banks’ and building societies</li> <li>• Small friendly societies</li> <li>• Oil market participants</li> </ul>	<ul style="list-style-type: none"> <li>• Banking</li> <li>• Insurance</li> <li>• Securities, Futures and Funds</li> <li>• Trusts</li> </ul>	<ul style="list-style-type: none"> <li>• Insurance</li> </ul>
<b>Source of Powers</b>	<ul style="list-style-type: none"> <li>• By legislation</li> </ul>	<ul style="list-style-type: none"> <li>• By legislation</li> </ul>	<ul style="list-style-type: none"> <li>• By legislation</li> </ul>	<ul style="list-style-type: none"> <li>• By legislation, but the body is a company limited by guarantee</li> </ul>	<ul style="list-style-type: none"> <li>• By legislation</li> </ul>	<ul style="list-style-type: none"> <li>• By legislation</li> </ul>

<b>Name of Regulators</b>	<b>Proposed Independent Insurance Authority in HK</b>	<b>Australian Prudential Regulation Authority</b>	<b>Australian Securities and Investments Commission</b>	<b>Financial Services Authority, United Kingdom</b>	<b>Monetary Authority of Singapore</b>	<b>The China Insurance Regulatory Commission</b>
<p><b>Conduct Regulation of Insurance Intermediaries</b></p>	<ul style="list-style-type: none"> <li>• Direct licensing of insurance intermediaries</li> <li>• Sets conduct standards and requirements</li> <li>• Possesses powers of inspection and investigation</li> <li>• Enforces disciplinary powers on assistance / recommendation by a Disciplinary Committee.</li> <li>• Disciplinary sanctions on misconduct include reprimand; fines; suspension and revocation of licence and prohibition of licence application for a specified period.</li> </ul>	<ul style="list-style-type: none"> <li>• Does not supervise intermediaries</li> </ul>	<ul style="list-style-type: none"> <li>• Direct licensing of insurance intermediaries</li> <li>• Issues regulatory guides and information sheets.</li> <li>• Possesses powers of inspection and investigation .</li> <li>• Disciplinary sanctions may include warning letter; fines; removal, withdrawal, suspension or revocation of licence. May institute proceedings for certain offences and may apply for injunctions from Court to restrain improper act by a person.</li> </ul>	<ul style="list-style-type: none"> <li>• Direct authorization of insurance brokers. Insurance agents are “Appointed Representatives” and are exempt as their principal is authorized.</li> <li>• Possesses powers of inspection and investigation.</li> <li>• Disciplinary powers enforced by the Regulatory Decisions Committee which reports directly to the Board.</li> <li>• Disciplinary sanctions include warnings, public censures, fines, withdrawal of authorization, variation and cancellation of authorization. May institute proceedings for certain offences.</li> </ul>	<ul style="list-style-type: none"> <li>• Direct authorization of insurance brokers. Insurance agents are bound by agreements with the insurance companies.</li> <li>• Possesses powers of inspection and investigation.</li> <li>• Disciplinary sanctions include reprimand and fines.</li> </ul>	<ul style="list-style-type: none"> <li>• Direct licensing</li> <li>• Formulates rules and regulations</li> <li>• Conducts investigations into irregularities and imposes penalties accordingly</li> </ul>

<b>Name of Regulators</b>	<b>Proposed Independent Insurance Authority in HK</b>	<b>Australian Prudential Regulation Authority</b>	<b>Australian Securities and Investments Commission</b>	<b>Financial Services Authority, United Kingdom</b>	<b>Monetary Authority of Singapore</b>	<b>The China Insurance Regulatory Commission</b>
<b>Fees and Levies</b>	<ul style="list-style-type: none"> <li>• Fixed licence fees and variable licence fee from insurers based on liabilities</li> <li>• Fixed licence fees from insurance intermediaries</li> <li>• A market levy of 0.1% of all policies</li> </ul>	<ul style="list-style-type: none"> <li>• Levy ( based on a percentage of an insurance company’s Asset Value) on Insurer plus a Fixed Licence Fee</li> </ul>	<ul style="list-style-type: none"> <li>• Licence Fees from intermediaries</li> </ul>	<ul style="list-style-type: none"> <li>• Fixed minimum fee and variable fee based on gross premium income and gross technical liabilities (for general insurers) and adjusted gross premium income and mathematical reserves (for long-term insurers)</li> <li>• Authorization fees for intermediaries</li> </ul>	<ul style="list-style-type: none"> <li>• Fixed annual fees from insurers and brokers.</li> </ul>	<ul style="list-style-type: none"> <li>• Annual fees from insurers ( based on a percentage of an insurance company’s retained premium income)</li> <li>• Annual fees from intermediary companies ( based on a percentage of an intermediary company’s agency business income)</li> </ul>



**Indicative Budget for the Independent Insurance Authority**
**Annex C**

	Year 1 (\$m)	Year 2 (\$m)	Year 3 (\$m)	Year 4 (\$m)	Year 5 (\$m)	Year 6 (\$m)
<b>(A) IIA's estimated operating costs</b> <sup>Note 1</sup> (assuming a constant staff size of 237)	240.2	248.3	257.1	279.1	288.6	298.5
<b>(B) IIA's estimated cashflow</b> <sup>Note 2</sup>	271.2	248.7	257.6	280.1	289.1	299.0
<b>(C) Government subsidy (% of cashflow)</b> <sup>Note 3</sup> Total \$397.3m (Year 1 - Year 5):	135.6	99.5	77.3	56.0	28.9	0.0
<b>(D) IIA's operating income to be recovered from the industry = (B) - (C)</b>	135.6	149.2	180.3	224.1	260.2	299.0
<b>(E) Estimated income to be recovered from the industry</b>	143.8	166.4	194.8	229.2	267.4	333.2
(i) Fixed fee (assuming no increase) <sup>Note 4</sup> \$300,000 for General/Long Term insurers \$600,000 for Composite insurers	55.2	55.2	55.2	55.2	55.2	55.2
(ii) Variable fee (as a % on liabilities) <sup>Note 5</sup> (assuming 2% annual growth of liabilities)	0.8	4.1	10.8	22.1	26.9	34.5
(iii) User fee (5% of cashflow)	13.6	12.4	12.9	14.0	14.5	15.0
(iv) Levy (as a % on premiums) <sup>Note 6</sup> (assuming 2% annual growth of premiums)	74.2	94.7	115.9	137.9	170.8	204.9
(v) Registration fee <sup>Note 7</sup>	0.0	0.0	0.0	0.0	0.0	23.6
<b>(F) Estimated Income foregone with proposed concessions on levy</b> <sup>Note 8</sup>	9.8	12.5	15.3	18.2	22.5	26.7
<b>(G) Estimated Surplus/(Deficit) = (E) - (D) - (F)</b> Total (\$18.9m) (Year 1 - Year 6):	(1.6)	4.7	(0.8)	(13.1)	(15.3)	7.2

Note 1: Based on estimated operating costs provided by PricewaterhouseCoopers, consultant appointed by OCI to carry out the consultancy study on establishing an independent IA.

Note 2: The estimated cashflow includes capital expenditure (IT etc.), increase in working capital and rental deposit.

Note 3: Assuming a subsidy descending by 10% each year from 50% of the estimated cashflow in Year 1 to 0% in Year 6.

Note 4: Based on no. of insurers as at 31.3.2011.

Note 5: Based on the total net liabilities (long term business) and outstanding claims provision (general business) of 2009 and the proposed rates below as set out in the Consultation Document.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Variable Fee (as a % on insurance liabilities)	0.0001%	0.0005%	0.0013%	0.0026%	0.0031%	0.0039%

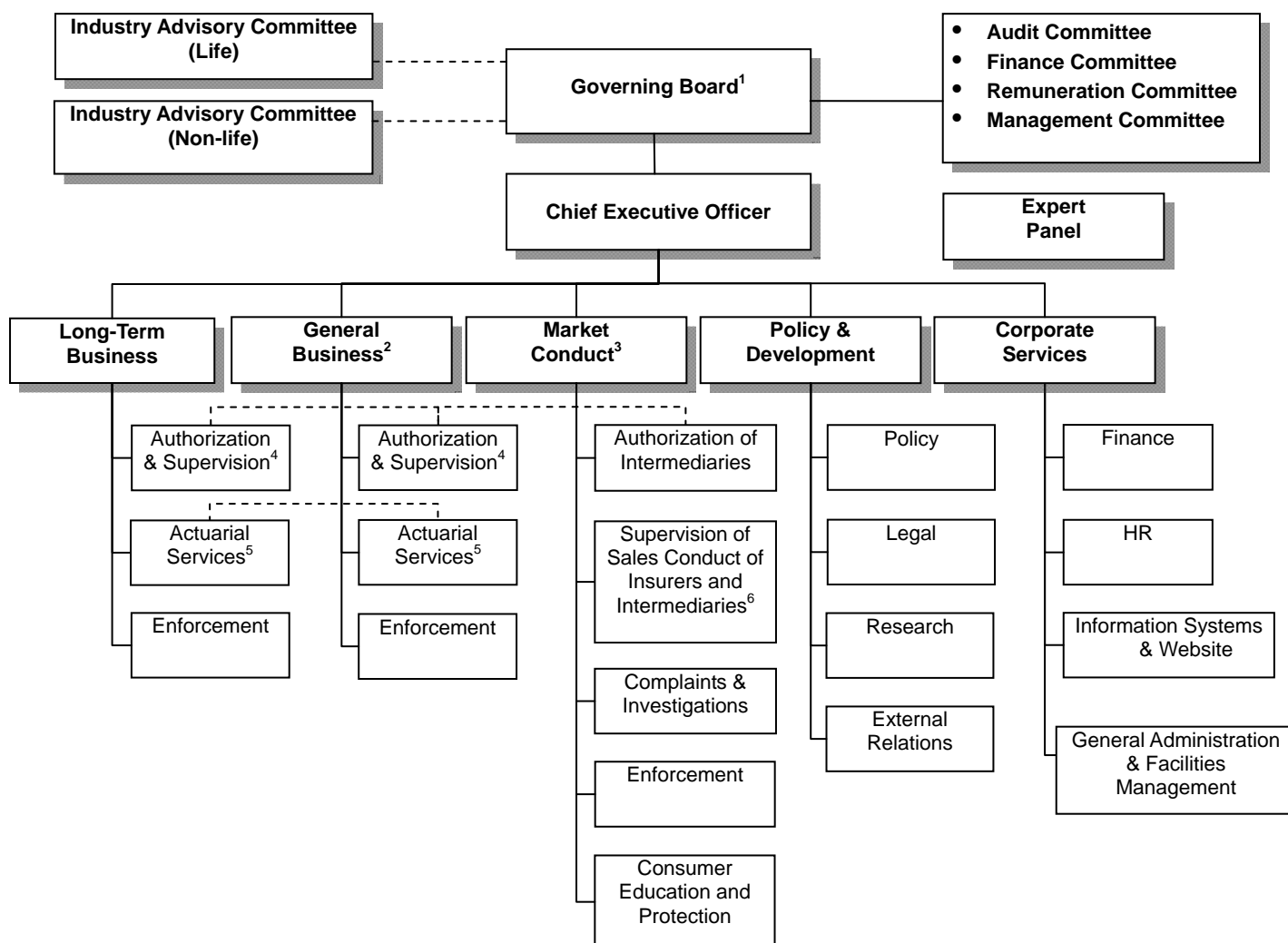
Note 6: Based on the total office premiums (long term business) and gross premiums (general business) of 2009 and the proposed rates below as set out in the Consultation Document.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Market Levy (as a % on insurance premiums)	0.04%	0.05%	0.06%	0.07%	0.085%	0.1%

Note 7: Registration Fees for intermediaries to be waived in Year 1 to Year 5. The Registration Fee for Year 6 is based on the assumption that the level of fees as at 2011 is adopted.

Note 8: Levy capped at long term policies with premiums  $\geq$  \$0.1m and general policies with premiums  $\geq$  \$5m and waiver of levy on re-insurance premiums.

## Proposed Organization Structure of the Independent Insurance Authority



### Notes

- (1) Governing Board comprises predominantly non-executive directors selected from a cross-section of the community including one or two members with knowledge of the insurance industry and members from relevant professional fields, the Consumer Council, the academia and Government; a Chairman appointed from amongst them and the Chief Executive Officer of the independent IA.
- (2) Might include the operation of the current Government Terrorism Facility in relation to employees' compensation insurance.
- (3) Supervision of market conduct of insurers (Long-Term Business and General Business) and insurance intermediaries.
- (4) The dotted-line denotes that one of the team leaders will take on an additional role of overseeing the continuous professional development needs of the Authorization & Supervision staff across the independent IA.
- (5) The dotted-line denotes that one of the team leaders will take on an additional role of overseeing the continuous professional development needs of the Actuarial Services staff across the independent IA.
- (6) Includes the implementation of the Insurance Intermediaries Quality Assurance Scheme.