

立法會
Legislative Council

LC Paper No. CB(1)1401/12-13(03)

Ref: CB1/PL/FA

Panel on Financial Affairs
Meeting on 5 July 2013

Background brief on proposed
establishment of an independent Insurance Authority

Purpose

This paper provides background information on the proposed establishment of an independent Insurance Authority ("IIA"), and summarizes the concerns and views expressed by members when the subject was discussed by the Panel on Financial Affairs ("FA Panel") in 2010, 2011 and 2013.

Existing regulatory framework

2. Pursuant to section 4 of the Insurance Companies Ordinance (Cap. 41) ("ICO"), the Chief Executive shall appoint a public officer to be the Insurance Authority. The principal function of the Insurance Authority 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. The Commissioner of Insurance has been appointed as the Insurance Authority for administering the ICO, and is supported by the Office of the Commissioner of Insurance ("OCI"), which is a government department.

3. At the meeting of the Establishment Subcommittee on 29 May 2013, the Administration advised that the existing establishment of OCI was 133, including 63 non-civil service contract staff, 48 insurance officers and 22 general grade staff. OCI currently recovered some 37% of its annual operating costs from fixed annual licence fees paid by insurers. The remaining some 60% of the regulatory cost was subsidized by the public coffer.

4. According to OCI, there are 154 authorized insurers¹ in Hong Kong as at 31 March 2013. The Insurance Authority regulates them through examination of their financial statements and business returns, and also by on-site inspections. Under the ICO, the Insurance Authority can impose intervention measures on insurers, such as restricting their underwriting and investing activities, removing their directors/controllers, taking over the company, and petitioning to the Court for winding up etc. However, unlike other overseas and local regulators, the Insurance Authority does not have explicit powers to enter into the premises of insurers to conduct inspections and investigations, issue reprimands, impose fines or prosecute offences summarily.

5. As at 31 March 2013, there are some 76 800 insurance intermediaries² in Hong Kong. They are regulated by three self-regulatory organizations ("SROs")³. While the Insurance Authority has certain powers over these SROs, such as instructing them to issue and amend codes of practices and requiring them to produce information, she does not regulate the intermediaries direct. The SROs handle complaints against individual intermediaries, and conduct investigations and impose disciplinary sanctions as appropriate.

6. According to the Administration's paper for FA Panel meeting on 19 July 2010, of the insurance intermediaries, about 18 000 are bank employees. They are registered with the Insurance Agents Registration Board ("IARB") for engaging in the sale of insurance products in banks. According to market statistics, over 30% of insurance products sold in Hong Kong are distributed through banks. The IARB monitors their compliance with conduct requirements and handles complaints referred by the Hong Kong Monetary Authority ("HKMA") via OCI. HKMA does not have direct power to discipline those bank employees.

Review of the institutional set-up of the Insurance Authority in 2003 and consultancy studies in 2007 and 2009

7. In the light of international regulatory trends and development of the insurance industry, the former Financial Secretary announced in the 2003-2004 Budget Speech the proposal to turn OCI into an agency independent of the Government. The Administration conducted a stakeholder consultation on the

¹ Under ICO, an insurer is a person carrying on insurance business. An insurer has to apply to IA for authorization to carry on insurance business in or from Hong Kong.

² Under ICO, an insurance intermediary means an insurance agent or an insurance broker. The former is a person who holds himself out to advise on or arrange contracts of insurance in or from Hong Kong as an agent or subagent of one or more insurers while the latter is a person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policy holder or potential policy holder or advising on matters related to insurance. It is an offence under the ICO for an insurer to effect a contract of insurance through, or accept insurance business referred to it by, an insurance intermediary who has not been properly appointed (for insurance agent) or authorized (for insurance broker).

³ 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.

proposal from late May to the end of July 2003, and briefed FA Panel on the subject on 6 November 2003.

8. According to the Administration's paper provided for the Panel meeting on 6 November 2003, there was no intention to expand the Insurance Authority's regulatory powers or effect any other framework changes to insurance regulation in the context of the independence exercise. The Administration pointed out that while respondents to the stakeholder consultation who were not market participants generally supported the proposal, market participants were cautious about the powers and governance of the future Insurance Authority as well as its funding and any cost implications for the insurance industry. While a few Panel members indicated support in principle for the Insurance Authority to be independent from the Government, some other members expressed reservations about the proposal. Some members pointed out that the information provided by the Administration was inadequate for them to comprehend the practical difficulties encountered under the existing institutional arrangement, and the justifications for turning the Insurance Authority into an independent regulator were unconvincing.

9. The Administration subsequently decided to consider the proposed establishment of IIA further. In 2007, it engaged a consultant to formulate proposals covering the governance structure, organization, funding and budgetary system of IIA. The study, which was based on the assumption that there would be no change to the statutory functions and powers of OCI as reported and noted at the meeting of FA Panel on 6 November 2003, was largely completed in mid-2009. In the light of the global financial crisis in late 2008/early 2009, the Administration commissioned an extended study in October 2009 to examine whether the present insurance regulatory regime, particularly regarding the regulation of insurers and insurance intermediaries, should be strengthened.

Public consultation on the proposed establishment of an independent insurance authority in 2010 and its consultation conclusions in 2011

10. Having regard to the findings and recommendations of the extended study in October 2009, the Administration drew up a set of proposals on the broad framework for the proposed establishment of an IIA and launched a public consultation exercise in July 2010.

11. Under the Administration's proposal, the existing OCI would be replaced by a proposed IIA empowered to conduct inspections on regulated entities, initiate and pursue investigations, make enquiries, have access to records and documents, apply to the Court of First Instance for court orders to compel compliance with the requirements, impose supervisory sanctions such as reprimands and fines, and prosecute offences summarily.

12. The Administration also proposed to change the existing regime of self-regulation by self-regulatory organizations to direct licensing and supervision by the proposed IIA. Furthermore, changes would be made to the existing arrangement of fixed annual licence fee for insurers to recover full cost of the proposed IIA from the insurance industry and the market over time⁴. The proposed fee structure comprised a fixed licence fee payable by all insurers and insurance intermediaries, a variable licence fee payable by insurers, user fees for specific services, and a levy of 0.1% on insurance premiums for all insurance policies.

13. Taking into account the feedbacks of the public consultation conducted in 2010, the Administration put forward the detailed proposals of the proposed establishment of IIA in June 2011. Major amendments to the original proposals are highlighted as follows:

- (a) The principal function of IIA is to perform the role of the prudential regulator of the insurance industry. It would have additional functions, including performing direct regulation on the conduct of insurance intermediaries, and assisting the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the insurance industry;
- (b) To minimize the impact on pre-existing insurance intermediaries, the pre-existing insurance intermediaries validly registered with SROs would be deemed to be licensed with IIA for three years upon its establishment before the IIA granted new licences;
- (c) Regarding the regulatory framework of insurance intermediary activities of banks, contrary to the consultation paper's original proposal that HKMA would be given powers similar to those of the proposed IIA for the regulation of bank employees selling insurance products, the proposed IIA would 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. It would work closely with HKMA on the regulation of insurance intermediary activities of banks and delegate specified powers to HKMA. Disciplinary powers would be vested with IIA, with HKMA's active participation in the disciplinary process, such as representation in the Disciplinary Committee;

⁴ The Administration estimated that income from the levy would cover about 70% of the annual operating cost of the proposed IIA while the remaining 30% would be come from the variable licence and user fees to be imposed on insurers.

- (d) An independent Insurance Appeals Tribunal would be established to enhance the accountability of IIA and modernize the existing appeal mechanism; and
- (e) A cap on the 0.1% levy on non-life insurance policies with annual premiums at or above HK\$ 5 million and life insurance policies with single or annualized premiums at or above HK\$100,000 would be applied with exemption provided for reinsurance contracts.

Consultation on the key legislative amendments for establishment of independent Insurance Authority in 2012

14. Based on the detailed proposals announced in June 2011, the Administration prepared the draft legislation for establishing IIA and launched a three-month public consultation on the key legislative amendments to ICO in October 2012. The major legislative amendments are as follows:

- (a) Governance structure: to establish IIA as a body corporate, consisting predominately of non-executive directors from across-section of the community including members with knowledge of the insurance industry and other professionals;
- (b) Licensing of insurance intermediaries: to define insurance intermediary activities as "regulated activities" which can only be carried on by IIA's licensees, and stipulate in ICO the eligibility criteria of the five categories of licensees. The proposed eligibility criteria for obtaining a licence are modelled on the existing eligibility criteria for registration with the three SROs;
- (c) Conduct regulation: to lay down in ICO the broad principles of conduct requirements of insurance intermediaries. Breaches of such conduct requirements would be subject to proportionate disciplinary sanctions by IIA;
- (d) Regulatory powers: IIA would be vested with powers of inspection, investigation and imposing disciplinary sanctions for the regulation of authorised insurers and insurance intermediaries. To enhance consumer protection, IIA would also be empowered to suspend a licensee/responsible officer from carrying on a regulated activity for a specified period before a disciplinary decision was available if IIA considered that it was in the interest of policyholders or the public to do so;

- (e) Regulation of banks' insurance intermediary activities: to empower IIA to delegate, subject to approval of the Chief Executive-in-Council, to HKMA specified functions for effective regulation of banks' insurance intermediary activities, including inspection, investigation and suspension of licence;
- (f) Appellate mechanism and checks and balances: to establish an Insurance Appeal Tribunal to consider appeals against regulatory decisions, including disciplinary decisions, of IIA (or HKMA in respect of banks' insurance intermediary activities);
- (g) Financing: IIA should be self-financed with income streams from licence fees, service charges to insurers and licensees, and a levy of 0.1% on premiums of all insurance policies. The Chief Executive-in-Council might specify the fees and levy by regulation and order respectively. Both the regulation and order were subsidiary legislation subject to negative vetting by the Legislative Council ("LegCo"); and
- (h) Transitional matters: to deem pre-existing insurance intermediaries and their responsible officers validly registered with the SROs as licensees and responsible officers under the new licensing regime for three years.

Discussions by the Panel on Financial Affairs

Establishment of the proposed independent Insurance Authority

15. On 19 July 2010, the Administration briefed FA Panel on the proposals for the establishment of an IIA. FA Panel subsequently held a special meeting on 12 October 2010 to receive public views on the subject. FA Panel was briefed on the conclusions of the 2010 consultation and the Administration's detailed proposals at the meeting on 4 July 2011. The major concerns and views expressed by members and deputations during the three Panel meetings and the Administration's responses are summarized below.

The proposed regulatory approach

16. Some deputations from the insurance industry expressed the view that given that the self-regulatory regime had operated well in the past, the existing regulatory regime or certain elements of it should be retained. For example, the three existing SROs could be merged into one organization under the oversight of IIA. A member expressed the view that the merits of the self-regulatory regime should be retained. For instance, adequate

representation from the insurance industry should be maintained in the supervisory and disciplinary committees of the proposed IIA.

17. The Administration responded that the existing self-regulatory regime was set up in the 1990s. Given the development of the insurance market and insurance products, the significant increase in insurance intermediaries and insurance premiums, and the public concern regarding possible conflict of interest, the self-regulatory mode might no longer be appropriate for the future development of the industry. In many overseas jurisdictions, such as the United States, the United Kingdom, Canada, Australia, the Mainland and Taiwan, insurance regulators all practised direct regulation of insurance intermediaries.

18. Some members expressed concern about the efficacy of the existing arrangement whereby different financial sectors were regulated by different regulators, and asked whether the Administration would further explore the proposal of establishing a single regulatory authority to oversee the various financial sectors.

19. The Administration responded that it was not suitable under the present situation to set up an overarching authority to oversee the financial sectors, in view of the risks involved and the doubtful efficacy of the arrangement. However, the Administration would continue to refine the existing regulatory regimes to maintain the stability of the financial markets and enhance the competitiveness of the financial sectors.

20. Some members were of the view that there should be a clear demarcation of responsibilities between the proposed IIA and the Financial Services and the Treasury Bureau ("FSTB"). Moreover, the proposed IIA's main responsibilities should focus on the regulation of the industry instead of promoting the development of the insurance market. The Administration responded that while FSTB was responsible for policy initiatives to enhance market development, the relevant regulatory bodies had to draw up the relevant regulatory guidelines/rules correspondingly. Hence there was a division of labour between the Government policy bureau and the relevant regulatory bodies.

21. Some members expressed concern that since investigations by IIA would be kept confidential as in the case of those carried out by the Securities and Futures Commission and HKMA, it would be difficult for the public to monitor IIA's investigations. The Administration responded that a balance had to be struck between transparency and fairness as it would be unfair to the subject of investigation if a regulatory body disclosed the identity of the subject before completion of its investigation. It was also the international practice that a financial regulatory organization would abide by the confidentiality principle when it conducted investigation.

Regulation of insurance intermediary activities of banks

22. Some members expressed support for the changes introduced by the Administration in the arrangements regarding the regulation of insurance intermediary activities of banks in order to address the concern of Panel members and the stakeholders about subjecting banks' insurance intermediary activities to both IIA and HKMA. However, some members considered that instead of empowering HKMA to investigate complaints relating to insurance intermediary activities of banks, IIA should be responsible for investigating such cases. The Administration pointed out that retail banks operated as an integrated business. HKMA as the statutory authority to regulate banks had to maintain an overview of their operation and thus had been carrying out inspections of banks and investigating into complaints of malpractices in banks. The Administration added that the financial regulatory bodies might, through the mechanisms provided in the relevant legislation and/or Memoranda of Understanding, exchange confidential information for enforcement purposes. Given that HKMA had the expertise and the responsibility to inspect banks, it would be more efficient for IIA to carry out joint inspections with HKMA on the insurance intermediary activities of banks and for the two regulators to exchange information regarding the investigation of complaints. This could also avoid duplication of efforts between HKMA and IIA.

23. In response to a member's suggestion that the Administration should provide more detailed information about how IIA and HKMA would jointly regulate the insurance intermediary activities of banks in order to fully allay the concern that the insurance industry would be subject to supervision by two regulatory bodies, the Administration stressed that IIA would be the primary and lead regulator for all insurance intermediary activities, including those of banks. It would be necessary for HKMA to play an active role in IIA's enforcement actions relating to insurance intermediary activities of banks, based on the standards and guidelines set by IIA. The Administration also pointed out that it would be necessary to ensure that all participants in the insurance market would comply with the same set of standards and code of conduct.

Role of the insurance industry under the proposed regulatory regime

24. Some Panel members asked about the role of the insurance industry under the proposed regulatory regime, e.g. whether representatives of the insurance companies and intermediaries would be allowed to participate in formulating the codes of practice, and the investigation and disciplinary functions of the proposed IIA. Some deputations from the insurance industry expressed the view that there should be adequate protection for the interests of insurance practitioners and effective channels for them to put across their views.

25. The Administration advised that the insurance industry would be invited to participate in the formulation of policy for the future development of the insurance market, and the views of the insurance industry would be taken into account in the setting up of the proposed IIA. Under the proposed regulatory regime, representatives of the insurance industry would be appointed as members of the advisory committee of IIA to advise on issues affecting the industry.

26. Some members emphasized that steps should be taken to ensure that IIA would exercise its disciplinary powers in a fair and impartial manner, and suggested that the IIA Governing Board and the Disciplinary Committee should include relevant representatives from the insurance industry. The Administration took note of the views and advised that similar to the arrangements of other statutory regulatory bodies, the subject of a disciplinary case would be given an opportunity to be heard before the authority had come to a disciplinary decision.

Funding arrangements

27. Noting that the number of staff to be employed by the proposed IIA would double the establishment of the existing OCI, some members expressed concern about the cost-effectiveness of the IIA. Some members also considered that the levy, which stood at 0.1% on insurance premiums for all insurance policies, should not be borne by policyholders.

28. The Administration responded that the proposed establishment of 237 staff for the IIA set out in the 2010 consultation paper was recommended by the independent consultant after examining the workload involved and the manpower provision of similar establishments in Hong Kong and overseas countries. IIA would operate in a highly transparent manner and its work would be supervised by a board of directors. As for the levy, the Administration responded that the funding proposal was based on the "user-pay" principle. The feedback from the respondents to the public consultation showed that the public generally accepted the proposed levy in order to finance the operation of IIA for the better protection of policyholders' interests. The Administration also advised that in accordance with regulatory principle, it was important for IIA to be financially independent to perform its statutory regulatory functions in an equitable and impartial manner.

Staffing proposal relating to the establishment of the proposed independent Insurance Authority

29. The Administration briefed FA Panel at its meeting on 8 April 2013 on the proposal to extend a supernumerary Administrative Officer Staff Grade C

post⁵ in FSTB for about 24 months from 15 October 2013 to 31 October 2015 for undertaking duties of, among other things, establishing IIA and a Policyholders' Protection Fund. Members did not oppose to the staffing proposal. During the discussion, some members urged that the Administration should carefully consider the views and concerns of the insurance industry, including ensuring adequate representation of the industry in the proposed IIA and its committees and heavy pecuniary penalty of \$10 million on insurance intermediaries. The Administration should refine the proposals as appropriate so as to enhance protection for policyholders and at the same time ensure the viability of the insurance industry.

30. The Administration advised that it was considering the views and concerns raised by the industry, and would review the legislative proposals in the light of the comments where appropriate. The Administration also pointed out that there was a wide spectrum of licensed insurance intermediaries ranging from individuals to large corporations, such as multinational banks and international insurance broker companies, and it was imperative to ensure that the pecuniary penalties would have adequate deterrence to non-compliance and misconduct.

31. In response to members' enquiry about the implementation schedule of the proposed establishment of IIA, the Administration advised that its plan was to introduce the bill into LegCo before the end of 2013, with a view to setting up IIA by 2015.

Recent development

32. The Administration published the consultation conclusions on the key legislative proposals for the proposed establishment of IIA on 26 June 2013 and will brief FA Panel on the details at the meeting on 5 July 2013.

Relevant papers

33. A list of relevant papers is given in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
3 July 2013

⁵ The Finance Committee approved the creation of the post for a period of three years at its meeting on 15 April 2011.

List of relevant papers

Date/Period	Event	Paper/Minutes of meeting
6 November 2003	The Panel on Financial Affairs (FA Panel) was consulted on the review on the institutional set-up of the Office of the Commissioner of Insurance	Discussion paper (LC Paper No. CB(1)212/03-04(03)) Minutes (LC Paper No. CB(1)672/03-04) Administration's follow-up letter (LC Paper No. CB(1)500/04-05(01))
19 July 2010	FA Panel was consulted on the proposed establishment of an independent Insurance Authority (IIA)	Discussion paper (LC Paper No. CB(1)2525/09-10(01)) Minutes (LC Paper No. CB(1)2933/09-10)
12 October 2010	FA Panel discussed the proposed establishment of IIA with deputations	Discussion paper (LC Paper No. CB(1)2525/09-10(01)) Minutes (LC Paper No. CB(1)827/10-11)
4 July 2011	FA Panel was consulted by the Administration on the detailed proposals for the establishment of an IIA	Discussion paper (LC Paper No. CB(1)2590/10-11(01)) Minutes (LC Paper No. CB(1)324/11-12)
26 October 2012	The Administration launched consultation on the key legislative amendments for establishment of IIA	Consultation Paper Press Release
8 April 2013	FA Panel was consulted on the extension of a supernumerary Administrative Officer Staff Grade C Post for the establishment of an independent Insurance Authority and a Policyholders' Protection Fund	Discussion paper (LC Paper No. CB(1)781/12-13(04))

Date/Period	Event	Paper/Minutes of meeting
26 June 2013	The Administration published the consultation conclusions on the key legislative proposals for the establishment of IIA	Press release Consultation conclusions