



Financial Services and the Treasury Bureau
The Government of the Hong Kong Special Administrative Region

Legislative Council Panel on Financial Affairs

Key Legislative Proposals on Establishment of an Independent Insurance Authority (“IIA”)

Consultation Conclusions

5 July 2013

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Foreword

| | |
|---------------|---|
| July 2010 | First public consultation on the policy proposals, general public support for the establishment of an IIA |
| June 2011 | Announcement of consultation conclusions and detailed proposals for engagement with the industry |
| October 2012 | Public consultation on the key legislative proposals |
| <u>Target</u> | |
| By end 2013 | Introduction of a bill to amend the Insurance Companies Ordinance into the Legislative Council |
| 2015 | Establishment of the IIA |



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Industry Overview

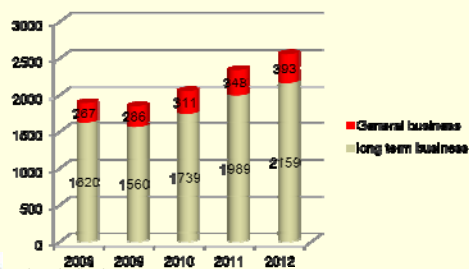
- With 154 insurers, Hong Kong is one of the most open insurance centres in the world and have the highest concentration of insurers in Asia.
- Contribution of insurance business (measured in terms of value added) to the GDP of Hong Kong –

| 2009 | 2010 | 2011 |
|------|------|------|
| 2.8% | 3.1% | 2.9% |



Industry Overview

- Gross premium in 2012: \$255.2 billion, 13.0% increase from 2011
- An average annual growth of 5.3% in the past five years
- In-force long term insurance policies in 2012: 10,611,063



May 2013

| Insurance Agents | |
|--|---------------|
| Individual Agents | 37,052 |
| Agencies | 2,423 |
| Responsible Officers / Technical Representatives | 27,744 |
| Insurance Brokers | |
| Broker firms | 615 |
| Chief executives / Technical Representatives | 9,102 |
| Total | 76,936 |

Purpose of Establishing an IIA

- To modernize the insurance industry regulatory infrastructure with a view to facilitating the stable development of the industry
- To provide better protection for policyholders
- To align with international practice that financial regulators should be financially and operationally independent of the Government



Consultation Conclusions (consultation on the key legislative proposals launched in October 2012)

- Received 558 written submissions of which 503 are copies of three templates of standard petitions. Counting all such duplicates as three submissions, there are in total 58 submissions. Respondents include –
 - the insurance industry (Hong Kong Federation of Insurers, the three self-regulatory organisations (“SROs”), insurers, other insurance intermediaries bodies, etc.) (32 submissions)
 - other bodies/organisations (Consumer Council, Law Society of Hong Kong, Hong Kong Association of Banks, etc.) (9 submissions)
 - the general public and other stakeholders (17 submissions)



Key Legislative Proposals

- Governance and funding mechanism
- Licensing regime for insurance intermediaries
- Powers of the IIA
- Conduct Requirements



Balancing Concerns from Stakeholders

- To protect the interests of policyholders
- To facilitate market innovation, improve business environment and promote the development of the insurance industry
- To ensure that the regulator will be independent, impartial and agile in responding to market developments
- To ensure that the transition will be smooth and stable



Governance and Funding Mechanism

Proposals

- The Governing Board will include **at least one but not more than two** directors with knowledge of and experience in the insurance industry
- Two Industry Advisory Committees (“IACs”) will be set up to advise the Governing Board
- To fully recover its costs from the market (via a levy and licence fees / service fees), so that the IIA would be financially independent of the Government
- Checks and balances include –
 - tabling its annual report before LegCo and submitting the annual budget and corporate plan to the Financial Secretary for approval;
 - establishing an Insurance Appeals Tribunal for reviewing IIA's decisions
 - establishing an independent Process Review Panel by the Chief Executive
 - complying with the Personal Data (Privacy) Ordinance and the Prevention of Bribery Ordinance
 - the Director of Audit may conduct value for money audit on the IIA



Governance and Funding Mechanism

Respondents' Views

- More industry participation in the Governing Board and IACs
- The IIA should be impartial in enforcing the legislation
- Diverse views on whether the levy should be paid by insurers or policyholders

Response

- The Governing Board should comprise **at least two** directors with knowledge of and experience in the insurance industry
- It will be expressly provided that both insurers and insurance intermediaries will be represented at the two IACs
- The proposed funding mechanism should be maintained as it would ensure that the IIA would have stable sources of income



Licensing regime for Insurance Intermediaries

Proposals

- Mirroring the existing registration categories of the three SROs, five types of insurance intermediary licences will be issued –

| | Insurance agent | Insurance broker |
|--------------------|---|---|
| Corporate licence | (1) licensed insurance agencies | (2) licensed insurance broker companies |
| Individual licence | (3) licensed individual insurance agents (4) licensed technical representatives ("TR") (agent) | (5) licensed TR (broker) |

- Propose a definition of "regulated activities" to define the regulatory ambit of the amendment bill and the relevant exemptions
- 3-year transitional period, licence fees will be waived for 5 years



Licensing regime for Insurance Intermediaries

Respondents' Views

- Most respondents have not raised any objection to the proposed licensing regime and the transitional arrangements
- There are suggestions to simplify the categories of licences and the definition of "regulated activities"

Response

- Re-categorization of licences may cause confusion. Our proposal could ensure a smooth transition from the current self-regulatory regime to the statutory licensing regime
- The IIA may review the categorization after the 3-year transitional period
- We are inclined to maintain the proposed definition of "regulated activities", but will further clarify the details on exemption in the legislative provisions



Power of the IIA

Proposals

- With reference to the legislation for the regulation of financial market intermediaries by relevant authorities, the IIA will be vested with appropriate inspection / investigation powers
- The IIA can delegate powers of inspection and investigation to HKMA for the regulation of banks' insurance intermediary activities
- The IIA will have the power to enter into premises of regulated entities to carry out inspection or investigation, and to search for records and documents, etc.
- As a stop-gap measure, the IIA can temporarily suspend a licensed insurance intermediary from carrying on insurance intermediary activities



Power of the IIA

Respondents' Views

- Agree that the IIA should have adequate powers for protecting policyholders' interests. On the other hand, some industry practitioners consider that the powers of the IIA could be too wide
- Strong objections to the proposed temporary suspension power on the grounds that it would compromise due process and against the principle of presumed innocence
- Regulation of bank and non-bank insurance intermediaries should be consistent

Response

- We will not pursue the temporary suspension power, but will seek to protect policyholders and effectively deter misconduct through other regulatory arrangements
- There are an appellate mechanism and other checks and balances



Conduct Requirements

Proposals

- Broad principles of conduct requirements (including the requirement of “acting in the best interest of policyholders”) will be set out in the primary legislation and details in subsidiary legislation and guidelines
- Every corporate licensee and insurer should appoint a responsible officer (“RO”) who should ensure that internal control systems and procedures are in place, so that the companies and their tied agents / employees will comply with conduct requirements
- The IIA can impose disciplinary sanctions, which include reprimand, fine, suspension or revocation of licence and prohibition of licence application in a specific period, on insurance intermediaries (and ROs)
- Disciplinary decisions by the IIA will be subject to safeguards, including possible review by the independent Insurance Appeals Tribunal (“IAT”)



Conduct Requirements

Respondents' Views

- It would be difficult for insurance agents to comply with the conduct requirement of “acting in the best interest of policyholders”, given that they need to act in the best interest of their appointing insurers in accordance with their contracts
- It would be too onerous to require ROs to use their “best endeavours” to fulfill their responsibilities
- CEOs of insurers should be allowed to delegate the duties of ROs to other senior executives
- The upper limit of disciplinary fines (\$10 million) is too high



Conduct Requirements

Response

- Since the financial tsunami in 2008, the principle of “acting in the client’s best interest” has been endorsed internationally. The same requirement has been adopted in the MPF intermediaries regulatory regime which commenced in November 2012
- We will provide that any contract term which contravenes the statutory “best interest” duty will be unenforceable by insurers, so that insurance agents can comply with the statutory requirement
- We will allow insurers and corporate licensees to appoint an additional RO. The two ROs should be jointly and severally responsible for fulfilling statutory requirements
- “Best endeavours” is a high standard which has been adopted in the MPF intermediaries regulatory regime. It is inappropriate to adopt a lower standard for the regulation of ROs in the insurance industry
- The upper limit of disciplinary fines should have adequate deterrent effect. The IIA will be required to publish guidelines on how it may impose a pecuniary penalty. The broad principles include proportionality to the severity of the misconduct and that the pecuniary penalty should not put the licensee into financial jeopardy



Way Forward

- We plan to introduce the amendment bill into LegCo in the 2013–14 legislative session
- Our target is to set up the IIA in 2015
- We will continue our dialogues with stakeholders, including insurance practitioners



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