INSURANCE COMPANIES (AMENDMENT) BILL 2014 ("the Bill")

Submission of AIA Group Limited

AIA Group Limited ("AIA") is the largest listed pan-Asian life insurance group and is incorporated, headquartered and listed in Hong Kong. AIA's principal operating subsidiaries, AIA Company Limited and AIA International Limited, are both authorized insurers in Hong Kong.

As a matter of principle AIA supports all measures designed to enhance the reputation and standing of the insurance market and protect the interests of existing and prospective policyholders in Hong Kong. We are therefore supportive in principle of the objectives of the Bill, subject to the proviso that within the proposed Insurance Authority the statutory prudential regulation of insurance companies' financial position will take precedence over, and be conducted in operational separation from, the regulation of agents, brokers and other 'conduct of business' activities.

We have reviewed the Bill and have the following comments.

1. Clause 10: Section 4AA – Composition of the Authority

Clause 10 adds a new section 4AA on the Composition of Authority. Section 4AA(3)(a) provides that not less than two of the non-executive directors are to be appointed from among persons who, because of their knowledge of and experience in the insurance industry, appear to the Chief Executive to be suitable for appointment.

We understand that the inclusion of practitioner representatives on the board is in recognition that effective regulation requires a significant level of practitioner input at the highest level, and welcome this. However we do not believe that this intention will be adequately achieved in all circumstances, in that the minimum number is fixed, but there is no maximum size specified for the Governing Board.

We can therefore envisage circumstances in which the practitioner voice would be diluted to an extent which prevents these directors exercising a due and proportionate minority influence. We therefore recommend that instead of fixing the number of industry members on the Governing Board at 2 with no protection against dilution, the Bills Committee instead **makes representation from those with current industry experience proportional to the size of the Governing Board.** We support the suggestion made previously by industry representatives that the proportion of industry members to other non-executives should be fixed at 'not less than 25%' of the total Board membership.

We also believe that the wording that the 2 non-executive directors have "knowledge of and experience in the insurance industry" is too vague to ensure the necessary level of technically expert practitioner input and propose instead a requirement that these directors be appointed from "persons who at the date of appointment and throughout the course of their membership are full-time employees or executive directors of Hong Kong authorized insurers." A strong and up-to-the-minute practical understanding of live industry issues and context is critical, and this can only be achieved by ensuring that that the requirement is made explicit in the Bill.

A further concern with the present wording is that it fails to recognise the very substantial differences in the nature of the businesses, and consequential regulatory requirements, of life / long term and general / short term insurance classes. Given the scale of the life insurance industry in Hong Kong, and its importance both to the financial prosperity and social wellbeing of the population, we believe it is essential that there should at all times be at least one member of the Governing Board drawn from the life insurance industry; and equity suggests that equivalent representation be ensured for the general insurance sector.

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We would respond to any suggestion that such appointments would create conflict of interest by pointing out that the Bill already provides for industry representation, so the principle is not at issue. Our concern is to ensure that such representation is fully effective and enhances the quality of regulation. It is sometimes assumed that there is an inherent conflict of interest between regulators and those they regulate. This is to ignore the fundamental alignment of interest between regulatory authorities and leading insurers in maintaining a sound and well-regulated market for the benefit of Hong Kong.

Effective regulation depends on the supportive contribution of leading companies and practitioners. In other words, we believe that if the right individuals are chosen to represent the industry on the Governing Board, the issue of potential conflicts of interest is in practice readily manageable and as such, a concern for conflicts should not unduly limit industry participation.

Finally, while we support the notion of appointments to the Governing Board by the Chief Executive, we would urge there be included in the appointment process a requirement that the Financial Secretary identify and recommend a panel of candidates to the Chief Executive and the Chief Executive make appointments from amongst those put forward to him by the Financial Secretary. We believe that it is entirely appropriate for the expertise of the Financial Secretary, having regard to broader policy considerations uniquely understood by the Financial Secretary, to inform the Chief Executive's decisions over appointees to the Governing Board.

2. Clause 13: Section 4C – Industry Advisory Committees

Clause 13 adds a new section 4C on industry advisory committees. Section 4C(1) provides that the Authority must appoint an industry advisory committee to advise it on any matters it refers to the committee in relation to long term business and section 4C(2) is similar in establishing another industry advisory committee to the extent it relates to the general business. The Bill does not however impose an explicit obligation on the Authority to consult either of these committees on any matter relating to the industry, though this is surely the intention underlying the provision. We would therefore suggest at a minimum that the legislation provides that the Authority is required to consult the relevant industry advisory committee(s) on all **material** matters relating to the relevant industry sector.

3. Clause 13: Section 4D – Other committees

Clause 13 adds new section 4D which authorizes the authority to establish other committees. In the Administration's consultation on key legislative proposals in October 2012, it was proposed that a Disciplinary Committee and Expert Panel be set up. The Disciplinary Committee would assist in determining disciplinary sanctions and advice could be sought from the Expert Panel on the nature of a specific product, related industry practices or experiences to facilitate deliberations during the disciplinary process. We suggest that the Bill should make specific statutory provision for the establishment of this Committee and Panel.

Our suggestion on the composition of the Expert Panel is that members should be chosen from "within the industry" so that knowledge of the industry is current. We note that procedures will be put in place to manage conflicts and we are confident that such individuals, carefully selected, can manage any conflicts that may arise. In terms of composition of the Disciplinary Committee, we suggest that the initial membership should include persons from the current disciplinary committees of the Insurance Agents Registration Board and Hong Kong Confederation of Insurance Brokers / Professional Insurance Brokers Association. The quality and experience of these members will help ensure an appropriate transition from the existing regime to the new one.

4. Clause 13: Section 4G – Delegation of Powers to the Monetary Authority

Clause 13 adds new section 4G which delegates certain powers of the Authority to the Monetary Authority. We note that it is intended that a Memorandum of Understanding ("MOU") be entered into between the Authority and the Monetary Authority regarding the supervision of sales of insurance by banks. It is our view the giving of advice leading to sale of insurance products is an activity discrete from provision of core banking services and in recognition of this the public interest and the interest of industry participants across the spectrum is best served by having all insurance advisors governed and supervised directly by the Authority as a single regulator, irrespective of the nature of their principals' core business, avoiding scope for inconsistency in standards of regulation to develop.

Should the decision to legislate for this delegation of powers be confirmed, our substantive concern is that the process for the agreement of an MOU be transparent and provide assurance to market participants that **consistent standards will be applied to insurance advisors whether they "reside" in insurance companies or banks such that the competitive playing field remains level**. To achieve this it is necessary at minimum in our view that the proposed MOU be submitted in draft to both licensed entities of the Monetary Authority and licensees under the Authority for a period of consultation.

5. Clause 40: Section 22 – Separate accounts and funds for each long term insurance class

Clause 40 amends section 22 of the Insurance Companies Ordinance (the "ICO") to require an insurer to maintain an account for each class of long term insurance business and to maintain a separate fund for each such class.

We note that this proposal was not put forward during the consultation process and therefore may well have been incorporated in the Bill without due industry technical input – underlining our concern that the new Authority has adequate practitioner input at top level. It is our view that this requirement would result in inefficiencies and unnecessary costs without significant additional benefits to policyholders or the community in terms of financial, actuarial or corporate governance. Section 22 of the ICO already requires an insurer in Hong Kong to separate the assets and liabilities attributable to the long term business of an insurer from other funds and section 23 of the ICO specifically provides that, subject to certain exceptions, the assets representing the long term fund of an insurer shall be applicable only for the purposes of that part of that business to which the fund relates.

AIA believes that the amendment under Clause 40 would not be in the best interests of policyholders or shareholders since it could result in sub-optimal investment activity and increase the administrative requirements and costs chargeable to certain classes of business. This is especially important where, for example, the amount of business conducted in some classes of business by some companies is small. In these instances the requirement to maintain a separate fund will in practice result in more assets being held in cash or cash equivalents than otherwise would be the case, leading to lower investment earnings and reduced surplus generation for policyholders. Administrative expenses will also increase as records will need to identify the class to which an asset may belong.

This confers no incremental policyholder security since all the assets of the company in the long term fund (other than those in classes G, H and I) are already available to meet the obligations of the policyholders.

An unintended consequence of such a proposal under Clause 40 may be that certain products may no longer be available to the public or there may be limited choices from providers. Additionally, the wording as drafted applies to long term business conducted by an insurer outside Hong Kong as well as domestic business, and this may conflict with the requirements under the local law of jurisdictions outside Hong Kong where such business is conducted. At a minimum, this proposal should apply to Hong Kong business only**.**

6. Clause 55: Part VA – Additional regulatory powers

Clause 55 adds Part VA to the ICO, giving the Authority additional regulatory powers over insurers. In essence, the Bill gives the Authority prosecutorial responsibility, as set out under new section 124 of Clause 84 in addition to its regulatory and investigatory roles.

This is a cause for concern since best legal practice requires the separation of regulatory, prosecution and judicial roles and gives rise to the question of whether there would be appropriate and fully effective separation of powers, and either internal regulation and policing or rigorous objective oversight on the exercise of powers. We are of the view that the Authority should not have prosecutorial responsibility, keeping the prosecution decision-making function distanced under an independent prosecution service. This would provide an important and necessary check on the powers of the Authority to act as its own judge, jury and executioner.

However, if this power is to be retained, we suggest that the Bills Committee consider the addition of an oversight committee such as the Operation Review Committee under the Independent Commission Against Corruption (“ICAC”). Perhaps this was envisioned in the October 2012 consultation when it was mentioned that the Chief Executive would set up an independent Process Review Panel to review the practice and procedures governing the use of the proposed regulatory powers. However we believe it is important to go further and set out in the Bill a specific requirement for the establishment of a committee such as the Operation Review Committee under the ICAC.

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7. Clause 55: Part VA: Section 41P – Disciplinary actions in respect of authorized insurers

Part VA Section 41P makes provision for the exercise by the Authority of disciplinary actions in respect of authorized insurers. There are similar actions the Authority may take against regulated persons under the new Part XI of the ICO. While we understand and appreciate the rationale for statutory mandating of conduct requirements, the 'rules' to be observed are more appropriately defined in guidelines or codes to be issued by the Authority after inception and consultation than in primary legislation. As an example, new section 41P(d) is worded too broadly and even subjectively and stipulates that misconduct could be any act or omission by an authorized insurer which in the Authority's opinion is or likely to be prejudicial to the interest of policy holders or potential policy holders or the public interest. The intention is no doubt to apply such powers where the acts or omissions are 'material' and the opinion of the Authority is reasonable and subject to challenge and review. However such constraints need to be spelled out in the Bill, not left to chance.

As the Bill is drafted the proposal to include a broad definition of misconduct in the legislation raises significant legal uncertainty, lacks specificity and should be removed from the ICO.

We urge that the development of guidelines including the code of conduct under new Division 4 set out in Clause 84 should take place in parallel to any proposed amendments to the ICO and that the amendments under these new Parts do not come into force until such guidelines have been finalized after appropriate consultation with all stakeholders. The guidelines in whatever form must have due regard to practicability and the ability of the insurance industry to maintain adequate penetration of the community to service effectively its need for long term insurance and protection. In our view, changes to the regulatory regime that have the unintended consequences of reducing the availability of advisory services to the mass market (by making the delivery of such services uneconomical as a result of an impractical compliance burden inherent in the conduct requirements) would be an extremely adverse result for all parties and for Hong Kong.

In addition to guidelines on conduct, we are of the view that additional guidelines should be formulated by way of public consultation outlining what situations or circumstances would attract which penalties pursuant to the subsections under new sections 41P or 80.

Currently, there is no certainty or indication as to the type of penalty to be awarded for any given infringement or misconduct and the Authority has the discretion to award any penalty it deems appropriate. The immediate revocation of a licence is a very disruptive penalty. It not only affects the writing of new business, but could also potentially affect the continuance of existing business. As such, revoking a licence could lead to an extremely adverse result and if the power is intended as a last resort that needs to be enshrined in the terms of reference of the Authority.

Another example of a potential adverse result is that the Authority has the power to publicise a decision while it is still being appealed. In these circumstances, there should be a clear and obvious public interest justification before the Authority may exercise the power to publicise. This criterion should be set out in new sections 41P (3) and 80(5).

We note that under the Bill a person is not excused from complying with any requirement to provide information or answer questions in an inspection on investigation on the grounds that their answer may incriminate them. Under Part VA, new section 41H provides that if a person objects to answering a question on the grounds that it may incriminate them, the answer may not be used as evidence in any criminal proceedings against them. However, it can still be used in criminal proceedings against other persons and in any disciplinary proceedings.

Given that there is no right of silence, it would be a substantial infringement of personal rights if an individual were not permitted to remain silent and could be convicted of an offence under the ICO. We suggest that this sweeping provision should be vetted with the Secretary of Justice and that consultation be undertaken in relation to this and related provisions with the Hong Kong Bar Association.

8. Clause 84: Parts X1 – XIV ICO – Insurance Appeals Tribunal

Clause 84 adds Parts XI to XIV to the ICO. Part XII establishes the Insurance Appeals Tribunal (the "Tribunal") and Clause 94 adds Schedule 10 which provides under section 3(1) of the Schedule 10 that the Chief Executive appoints the chairperson of the Tribunal. As the Chief Executive must appoint all the directors of the Authority under new section 4AA(1), we believe that it is wrong in principle that the Chief Executive should also have the sole discretion to appoint the chairperson of the Tribunal.

We suggest that the appointment of the Chairperson be made by the Chief Justice to ensure that there is a sufficient level of plurality.

9. Clause 84: Part XIII: Section 132 - Industry levy

Part XIII established under Clause 84 provides under new section 132 that the Chief Executive in Council may specify the rate or amount of levy payable. However, there is no reference in the legislation to caps on levies at $100 per life insurance policy and $5,000 per non-life insurance policy and that the levy on reinsurance contracts would be waived to avoid double-charging (as stated on page 3 of Annex B of the Legislative Council Brief dated 16 April 2014) and the Bill needs to make this explicit. It is also important that the structure of the fee and levy system in whatever form does not apply to business written outside Hong Kong.

We note the express rationale for the creation of the Authority includes to "reinforce Hong Kong's position as an international financial centre". It would run counter to this express objective to levy regulatory costs associated with Hong Kong domestic market regulation on non-domestic insurance business which is regulated (and often subject to levies) in other jurisdictions. Put more broadly, the system should not be set up as a financial disincentive for insurance companies to incorporate, list or headquarter themselves in Hong Kong. As such, we suggest that the caps, exemption of the levy on reinsurance contracts and the non-application of the levy to business other than Hong Kong insurance business be specifically stated in the legislation.

For this purpose, the definition of "Hong Kong insurance business" under Schedule 3 of the ICO can be used to describe the business conducted in Hong Kong and moved to section 2 of the ICO as a term of general application.

10. Clause 84: Section 89(a) – Duties of intermediaries

Section 89(a) under Clause 84 require that 'licensed intermediaries' of all types 'must act honestly, fairly and in the best interests of the policy holder..; and with integrity'.

We are concerned that the use of the word 'best' in this context has the potential to introduce a change in law that may be more substantial than intended and would, in our view, potentially introduce a degree of uncertainty in that with life insurance products which remain in force for many years, and frequently result in maturity proceeds dependent on future investment performance, it is rarely possible to know with absolute certainty at time of sale what will prove 'best' over the term of the policy. Sound regulation depends on practitioners being able to know in advance whether their actions are compliant, not exposed to the judgments of hindsight, and we suggest that this goal would be better served by emphasizing the need for honesty and integrity, as in 'act honestly, fairly and with integrity in the interests of policyholders'.

In this regard, it may be worth taking note of the standards applied elsewhere. In Singapore for example, the requirements are set out in a guideline rather than in the governing legislation itself and require that "[a] financial adviser should conduct its business with honesty, fairness, integrity and professionalism in order to maintain good faith and to preserve public trust in the financial services industry."

Our concern is that the laudable policy goal of improving the general standard of advice available to consumers should be achieved without creating scope for ambiguity and confusion. Accordingly, we would urge against introducing a term like 'best interest' where the policy goal would seem to be fully achievable without the phrase.

Clause 94: Schedule 11 – Transitional Arrangements

Clause 94 adds a new Schedule 11 which sets out transitional arrangements. We agree with the principle that any complaints against any licensed agents or brokers made or arising from events occurring before the commencement date of the legislation should be judged only in accordance with the rules in force prior to the commencement date and that disciplinary action be limited to the actions that the self-regulatory organisations could have taken. We suggest that the language be tightened to reflect this.

There also appears to be no transitional provisions regarding the manner in which complaints against authorized insurers arising prior to commencement of the Insurance Companies (Amendment) Ordinance 2014 are dealt with by the Authority.

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We suggest a similar provision be included to state that the Authority may only decide such complaints in accordance with the applicable rules in force at the time of such complaints and it may not impose any disciplinary sanctions or penalties unless the same could have been imposed by the former Authority; that any appeals in relation to such matters must be dealt with in accordance with the applicable rules in force at the time; and that no costs award be made in relation to such appeals.

11. Need for continuing consultation

It is critically important to the success of the new Authority that consultation on the Bill and implementation of the legislation should continue with leading companies and industry practitioners. Regular and ongoing engagement with the industry is integral to both the implementation and ongoing operation of the Authority and the regulatory regime overall. In our view, industry participants, many of whom operate across a host of regulatory regimes, are very well placed to contribute to any evaluation of regulatory developments elsewhere and their appropriateness for adoption in Hong Kong.

Supporting an industry that promotes long-term and retirement saving and making of provisions by individuals for adverse life and health events is important to society as a whole. If in contrast regulation were to evolve in such a way as to "choke-off" rather than promote the industry's distribution of insurance products and the spread of savings and protection habits amongst the sectors of society in greatest need, which would potentially be catastrophic for Hong Kong as a community with an aging population and limited social safety net. Government, the Authority and the insurance industry have a strong shared interest in ensuring that such is not the unintended consequence of what is overall a positive development for insurance in Hong Kong.