



The Hong Kong Federation of Insurers' submission to The Bills Committee on Insurance Companies (Amendment) Bill 2014

Introduction

- ♦ The insurance industry plays a vital role in Hong Kong's financial sector and economy. In 2013, total gross premiums for the industry amounted to HK\$290.7 billion. The insurance industry contributes close to 3% of Hong Kong's GDP (added value). Currently, there are more than 10 million in force individual life insurance policies and approximately 10 million general insurance policies issued by the insurers every year.
- ♦ As at 31 May 2014, there were 159 authorized insurers in Hong Kong:
 - 96 pure general insurers;
 - 44 pure long-term insurers; and
 - 19 composite insurers.
- ♦ The insurance industry employs a workforce of about 100,000 people including:
 - 67,857 registered insurance agents;
 - 9,530 chief executives and technical representatives of insurance brokers; and
 - about 20,000 employees of insurers, reinsurers, loss adjusters and other professional insurance service providers.
- ♦ The HKFI currently represents 130 authorised insurance companies in the territory (representing more than 90% of the gross premiums written in the Hong Kong market). Set up under the HKFI is the self-regulatory organisation, Insurance Agents Registration Board (IARB), which is authorised by the Insurance Authority to register and regulate the conduct of insurance agents. To ensure the credibility and impartiality of the IARB, it consists of eight members, the majority of whom are independent non-industry professionals.
- ♦ We are supportive of the establishment of the IIA as a matter of priority and firmly believe that in the right legislative framework, i.e. one that is based on a set of sensible regulations and legislation, the establishment of the IIA will help improve and strengthen the present regulatory regime for better consumer protection and bring positive changes for the healthy and sustainable development of the insurance industry in the long term.
- ♦ If Hong Kong is to remain and elevate its premier position as a vibrant financial centre in Asia, it is imperative that regulatory framework works and achieves its intended objectives, and that the legislation underpinning the establishment of the IIA is sound and robust.

- ♦ We have been actively working with the Government in an effort to improve the legislative proposals and ensure the legislation is fit for purpose. Whilst progress has been made, there remains a number of issues of fundamental importance which are not entirely fit for the purpose and are likely to bring detrimental effects to the industry as well as the insuring public. They relate to:
 - ~ Industry knowledge on the Board;
 - ~ Consultation with the Industry Advisory Committees;
 - ~ Internal oversight of disciplinary functions;
 - ~ Inappropriate new civil claims;
 - ~ Preventing excessive financial penalties;
 - ~ Publication of disciplinary decisions under appeal;
 - ~ Accessibility of the appeals mechanism
 - ~ Undue restrictions on insurance agent;

1. Industry knowledge on the Board

Concerns -

- ♦ The new IIA Governing Board will comprise a minimum of two non-executive directors with knowledge of and experience in the industry. We think this is not good enough.
- ♦ The insurance industry encompasses a wide range of different areas of business and participants - 9 different classes of long term business and 17 different classes of general insurance business; 4 types of insurers and 5 categories of intermediaries. As it presently stands, the proposed legislation does not ensure sufficient industry knowledge and experience on the Board of the IIA.
- ♦ What the IIA needs is industry knowledge at the Board and experienced executives in the staff force to ensure effective management and professional development of the new organisation in the light of increased workloads. In addition to prudential supervision on insurance companies, the IIA will also assume additional duties such as direct supervision of insurance intermediaries, thematic researches and studies, consumer education and promoting Hong Kong as an insurance centre and regional captive insurance hub.
- ♦ Adopting a higher minimum threshold of industry representation on the Board will not only allow due consideration to be given to industry experience before decisions are made without compromising the independence of the IIA, but also greatly assist the IIA in understanding and promoting the healthy development of the industry.

Solution -

- ♦ Increase the number of industry representation on the Board
- ♦ Maintain the right minimum proportion of directors on the Board with knowledge of and experience in the industry as, say 25%.

2. Consultation with the Industry Advisory Committees (IAC)

Concerns -

- ♦ Two IACs will be established to advise the IIA on matters relating to long term and general business. They are an important mechanism to ensure the IIA may obtain the views of the industry on relevant matters and to allow the industry to bring concerns to the IIA's attention.
- ♦ However, there is no guarantee that the IACs will be consulted by the IIA on significant matter and it will only meet four times a year.

Solution -

- ♦ IACs to meet at least once every two months and be duly consulted on all important matters before they are presented to the Board.
- ♦ In addition to issues referred to by the IIA, the IACs be allowed to suggest items for inclusion in the meeting agenda.

3. Internal oversight of disciplinary functions

Concerns -

- ♦ The proposed legislation is modelled on the disciplinary regimes established under the Securities and Futures Ordinance. If the IIA is of the opinion that an insurer or insurance intermediary is guilty of "misconduct" or is not a "fit and proper" person, the IIA is empowered to impose a range of penalties (including a fine of up to HK\$10 million or 3 times the profit gained or loss avoided as a result of the misconduct, whichever is the greater).
- ♦ The definition of "misconduct" is very broad and confers considerable discretion on the IIA to decide what particular activities constitute "misconduct".
- ♦ The IIA may act as investigator, prosecutor and judge without any independent oversight. In the absence of proper checks and balances, there will be the potential for inappropriate or arbitrary decision-making.

Solutions -

- ♦ Establishing an independent internal committee with responsibility for reviewing and approving the IIA's disciplinary decisions at first instance, identical in substance to the Operations Review Committee of the ICAC. The committee will be responsible for overseeing investigations and approving disciplinary decisions.
- ♦ The Key Legislative Proposals on Establishment of an IIA published in October 2012 indicated that there would be an Expert Panel to provide advice to "facilitate its deliberation during the disciplinary process". The composition, function and advisory procedures of this Expert Panel should be formalised, i.e. the IIA must seek the Panel's views during the disciplinary procedure and before a decision is made on each and every case. The IIA will have final and absolute decision making power but to ensure transparency and checks and balances, should its final decision deviate from or override the recommendation made by the Expert Panel, IIA must provide clear and specific explanation to substantiate its decision.

4. Inappropriate new civil claims

Concerns -

- ♦ Insurance intermediaries comprise insurance agents and insurance brokers. Insurance agents act as the agent of the insurer and have a duty to act in the insurer's best interests. Insurance brokers act as the agent of the policyholder and have a legal duty to act in the policyholder's best interests.
- ♦ The new conduct requirements for intermediaries are set out in new section 89, which provides amongst other things that insurance intermediaries must:
 - Act honestly, fairly and in the best interests of the policyholder or potential policy holder concerned;
 - Use best endeavours to avoid a conflict of interests between the intermediary and the policy holder and to disclose any such conflict that exists.
- ♦ The conduct requirements particularly conflict with the legal duty of insurance agents to act in the best interests of the insurer for whom they act. It is difficult for insurance agents to understand and comply with the requirement.
- ♦ The requirement that all intermediaries must act in the "best interests" of policyholders is also framed as a broad, unqualified principle and if it were to be applied literally, it may lead to adverse consequences. For example, insurance agents may be required to waive conditions and notice periods, offer discounts, or accept claims upon request, because such request is in policyholder's "best interests" – notwithstanding that the request may be unreasonable and uncommercial.
- ♦ The legal uncertainties in the new conduct requirements give rise to a risk that policyholders may attempt to use the conduct requirements as a basis for bringing wide ranging new civil claims against insurers and intermediaries, potentially exposing insurers and insurance agents to new and uncertain liabilities.
- ♦ The fact that the IIA may issue a code of conduct narrowing and qualifying the obligations will not assist, as any code will not override the express words of the legislation as a matter of law.

Solutions -

- ♦ The proposed legislation must make it clear that the new conduct requirements for intermediaries do not give rise to new and inappropriate civil claims, which might create legal uncertainties for insurers and intermediaries.
- ♦ We propose the addition of a new section below proposed section 91, stating:

"92. For the avoidance of doubt, a failure on the part of a licensed insurance intermediary, licensed insurance agency or responsible officer of a licensed insurance agency, or licensed insurance broker company or responsible officer of a licensed insurance broker company to observe any conduct requirement set out in sections 89 to 91 does not of itself render that party or the relevant insurer liable to any civil or criminal proceedings or affect the validity of any policy entered into by any policyholder."

5. Preventing excessive financial penalties

Concerns -

- ♦ Many parties have raised concerns that the HK\$10 million upper limit of the disciplinary fines may be oppressive, particularly in the case of insurance intermediaries with limited financial resources.
- ♦ The Government's response to these concerns is that:
"... the IIA has to publish a guideline before it may impose any financial penalty. Drawing reference from the practices of other financial regulators, the guiding principles in determining a pecuniary penalty will include proportionality to the severity of the misconduct, whether the licensee has made financial gains and that the penalty should not put the licensee into financial jeopardy."

Solutions -

- ♦ If this is the intention of the Government, this condition should be expressly stated in the legislation. It is not appropriate to leave the question to the discretion of the regulator - the party with the power to impose the fines - which may or may not adopt such requirement.

6. Publication of disciplinary decisions under appeal

Concerns -

- ♦ If the IIA has exercised its disciplinary powers in relation to an insurer or insurance intermediary, it may disclose to the public details of its decision, the reasons for which the decision was made, and any material facts relating to the case.
- ♦ The adverse disciplinary decisions may result in significant adverse publicity for an insurer or intermediary and consequential damage to their business and reputation.

Solutions -

- ♦ Disciplinary decisions should not be publicised until appeal rights have been exhausted.

7. Accessibility of the appeals mechanism

Concerns -

- ♦ The proposed legislation provides that persons who are aggrieved by certain decisions of the IIA including disciplinary decisions may appeal the decision to the Insurance Appeals Tribunal, which is modelled very closely on the Securities and Futures Appeals Tribunal, i.e. the Tribunal may make costs orders in respect of the proceedings and the losing party must pay a proportion of the successful party's legal costs, usually approximately two thirds of actual costs.

- ♦ Unsuccessful appellants may find themselves liable to pay a substantial proportion of the IIA's legal costs, which could run to millions of dollars. Insurance intermediaries with limited resources may be prevented by costs considerations from appealing disciplinary decisions, denying them a real right of redress.
- ♦ Example - the HKFI's legal advisers recently concluded a case in the Securities and Futures Tribunal involving an appellant who had admitted guilt and was appealing only against the penalty imposed on the basis of agreed facts. The Securities and Futures Commission instructed counsel to appear on its behalf. The HKFI's legal advisers estimate that the appellant's likely liability for costs if she lost would have amounted to in excess of HK\$400,000. This would be prohibitive for an individual intermediary with limited financial resources.

Solutions -

- ♦ The IIA will be responsible for regulating approximately 80,000 insurance intermediaries. It is essential that changes are made to the appeals mechanism to ensure that individuals who appeal are not at risk of excessive costs orders if they lose and their right of appeal will not be deprived simply because of the risk of being bankrupt.
- ♦ Section 104(3) of the proposed legislation should be amended to include a schedule with specified cap of cost payable by each type of insurance intermediaries to the IIA. For instance, the cost payable by any appellant who is an individual should be capped at HK\$20,000.

8. Undue restrictions on insurance agent

Concerns -

- ♦ There is no restriction preventing director or employee of a broker being a director of any other company of whatever nature, including an insurance agency, provided he/she does not undertake agency business. However, Clause 64J and 64 K of Clause 71 impose stricter restrictions to insurance agents.
- ♦ This will not only create an unlevel playing field but also limit the professional growth and career development of the insurance agents, threaten the survival of the insurance agents and insurance agencies and hinder market development as acquisition or phased acquisition of another insurance agency, transformation from general insurance agency into life insurance agency or vice versa will be virtually prohibited.

Solutions -

- ♦ After initial discussion with the FSTB, we are given to understand that the Bureau would consider revising these sections in the Bill. We look forward to seeing the full details of the revised draft.

- ♦ On a final note, we are mindful of the technical and legalistic language used in the Bill, which is very difficult for laypeople to understand and apply. We found this inappropriate given that the legislation must be referred to and applied by around 80,000 insurance intermediaries, almost all of whom have no legal training. To follow the successful example of the revision of Companies Ordinance and make the legislation as user friendly as possible, we are of the view that the legislation should be reviewed and where possible revised so that plain and readily understandable language is used.

The Hong Kong Federation of Insurers
June 2014