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Panel on Financial Affairs

Meeting on 7 December 2015

Background brief on the funding proposal relating to the establishment of an independent Insurance Authority

Purpose

This paper provides background information on the establishment of the independent Insurance Authority ("IIA"). It also gives a brief account of the major views and concerns raised by the Bills Committee on Insurance Companies (Amendment) Bill 2014 ("Bills Committee") relating to the financial and funding arrangements for IIA during scrutiny of the Bill.

Background

2. Currently, the Insurance Authority ("IA")[1] is the regulator of Hong Kong's insurance industry. IA, viz. the Commissioner of Insurance ("CI"), is supported by the Office of the Commissioner of Insurance ("OCI") which is a government department. The two major aspects of the regulatory functions of an insurance regulator are prudential regulation of insurers to ensure their financial soundness, and conduct regulation of insurance intermediaries to ensure that the sale and after-sale administration of insurance policies are conducted honestly, fairly and professionally. OCI does not regulate the insurance intermediaries in Hong Kong direct which are regulated by three Self-Regulatory Organizations.

3. In order to modernize the insurance industry regulatory infrastructure and to comply with the requirement of the International Association of Insurance Supervisors that insurance regulators should be financially and operationally independent of the government and industry, the Government introduced the

[1] Under sections 4(1) and 4A(1) of the Insurance Companies Ordinance (Cap. 41), the Chief Executive ("CE") appoints a public officer to be IA.

Insurance Companies (Amendment) Bill 2014 ("the Bill") into the Legislative Council ("LegCo") in April 2014 to establish an IIA to take over the duties of OCI and administer an independent regulatory regime for insurance intermediaries to replace the existing self-regulatory regime. The Bill was passed by LegCo on 10 July 2015 and enacted as the Insurance Companies (Amendment) Ordinance 2015 ("the Amendment Ordinance")[2].

4. The Administration plans to commence the Amendment Ordinance in three stages to allow for a smooth transition from the existing regulatory regime to the new one. Its latest target timeline is as follows:

Stage 1:	To establish the Provisional Insurance Authority ("PIA") (without regulatory functions and co-exists with OCI)	By end 2015
Stage 2:	PIA becomes IIA to replace OCI by taking over its regulatory functions (the self-regulatory regime for insurance intermediaries remains unchanged)	About one year after the commencement of Stage 1
Stage 3:	IIA to implement the statutory licensing regime and take over the regulation of insurance intermediaries from the three SROs	Two to three years after the commencement of Stage 1

5. The Administration tabled the Insurance Companies (Amendment) Ordinance 2015 (Commencement) Notice 2015 ("the Commencement Notice") at LegCo on 14 October 2015[3]. The Commencement Notice appoints 7 December 2015 as the day on which provisions of the Amendment Ordinance necessary for the establishment of PIA (i.e. Stage 1 in paragraph 4) come into operation. According to the Administration, PIA will not be vested with any regulatory powers before it becomes the IA to take over the duties of OCI.

Concerns and views expressed by Members

6. The major views and concerns expressed by the Bills Committee relating to the financial and funding arrangements of IIA, and transition from OCI to IIA are summarized in the ensuing paragraphs.

[2] The Insurance Companies (Amendment) Ordinance 2015 provides for, inter alia, the establishment of IIA, the enforcement powers of IIA, the establishment of the Insurance Appeals Tribunal and a statutory licensing regime for insurance intermediaries.

[3] No subcommittee was formed for scrutiny of the subsidiary legislation.

<u>Financial and funding arrangements of the independent Insurance Authority</u>

Financing mechanism and estimates of IIA

7. On the financing mechanism for IIA, the Administration informed the Bills Committee that according to the recommendations of the consultancy commissioned by OCI in 2009, it was the long-term target that about 70% of the expenditure of IIA would be met by levy and the remaining 30% by various licence and user fees[4]. In respect of the levy, IIA would impose a levy of 0.1% on insurance premiums for all insurance policies (capped at $100 for life policies and $5,000 for non-life policies), which would be implemented through an incremental approach[5], and exempted premiums of reinsurance contracts from the levy. As regards licence and user fees, they would be payable by all insurers and licensed intermediaries. To help meet part of IIA's expenses in the initial five years before it achieved the target levels of fees and levy, the Government's proposal was to provide a lump sum of $500 million to IIA on its inception.

8. Noting that IIA was empowered under the Bill to appoint its staff and consultants, and determine their remuneration and terms and conditions[6], the Bills Committee stressed the need to put in place a mechanism for regulating the size of IIA to prevent over-expansion, and suggested specifying clearly in the Bill that IIA must decide on the above matters according to its "actual needs" and in a "reasonable manner". There were also views that the levy should not be borne by policy holders on concern that this might increase the price of insurance products. Moreover, with a view to enhancing financial prudence and discipline of IIA, the Bills Committee considered that part of the proposed start up funds from the Government to IIA should be provided in the form of a loan.

9. The Administration explained that IIA would have a larger establishment than OCI mainly because IIA would take up the additional responsibility of administering the licensing system for insurance intermediaries. The

4 All fees and levies of IIA would be stipulated in regulations and orders to be made by CE which were subsidiary legislation subject to LegCo's scrutiny.

5 IIA's target level of levy in the first five years after its establishment would be in accordance with the following schedule –

	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%

6 The Administration advised that based on the consultancy study commissioned in 2009, IIA would have an establishment of about 250 staff members at its inception. As for OCI, the number of staff members was 150 as in mid-2014, including CI, 48 Insurance Officers ("IO"), 22 officers of the general grades and 79 non-civil service contract ("NCSC") staff.

Amendment Ordinance required that IIA's annual estimates, which included estimated staff costs and professional service fees, to be approved by the Financial Secretary ("FS") and the approved estimates must be tabled before LegCo. These measures would provide an effective check and balance. The Administration stressed the need to provide IIA with operational flexibility in employing and engaging suitable talents and determining the appropriate level of remuneration having regard to the actual circumstances and prevailing market situations in order to cope with regulatory challenges effectively and respond swiftly to market changes. This was in line with the practice of other financial regulators, such as the Securities and Futures Commission ("SFC") and Mandatory Provident Fund Schemes Authority.

10. On the collection of levy from policy holders, the Administration responded that one of the main objectives of IIA was to protect policy holders, hence based on the "user-pay" principle, it would be justified to collect levies from policy holders. It was also important for IIA to be financially independent to perform its statutory regulatory functions in an equitable and impartial manner.

11. To enhance transparency in the preparation of IIA's annual estimates, the Administration had taken on board the Bills Committee's suggestion to adopt the existing arrangement agreed between the Administration and LegCo regarding SFC's budgetary process for IIA. Under the arrangement, the Administration would brief the Panel on Financial Affairs ("FA Panel") the main features of IIA's proposed budget prior to seeking approval by FS. The Administration also took note of Members' suggestion that part of the proposed start up funds for IIA should be provided in the form of a loan. It undertook to consult FA Panel before seeking funding approval from the Finance Committee.

Levy reduction

12. There are provisions in the Amendment Ordinance which provide for a reduction mechanism for IIA's levies. Under the mechanism, when the reserves of IIA are more than twice its estimated operating expenses for the financial year (after deducting depreciations and all provisions) and that IIA has no outstanding borrowing, IIA is required to consult FS with a view to recommending to CE in Council that the rate or amount of a levy be reduced. The Bills Committee was of the view that the concept of "net reserves of IIA" for considering the need of levy reduction should be expressly stipulated in the legislation, in particular to prevent the situation where IIA might raise debt unnecessarily in order to avoid triggering the mechanism for levy reduction. The Administration explained that the wording of the relevant provisions had clearly reflected the concept of "net reserves". Furthermore, IIA could only borrow money with the approval of FS, and IIA was required to submit its estimates to FS for approval and the approved estimates would be tabled at

LegCo. There would be sufficient safeguards against IIA making unnecessary borrowings simply to avoid triggering the mechanism for the reduction of levies.

Transition from the Office of the Commission of Insurance to the independent Insurance Authority

13. Noting that IIA would take over the duties of the existing OCI, the Bills Committee emphasized the need to make proper arrangements for existing employees of OCI and retain the valuable experience for ensuring a smooth transition to the new regulatory regime. The Administration advised that in order for IIA to achieve the desired institutional independence and operational flexibility, IIA would recruit its own staff. The dissolution of OCI would follow government's established policies for abolition of offices[7]. Existing staff members of OCI could apply for jobs in IIA and it was envisaged that they would have edges in applications due to their regulatory experience in OCI.

14. The Bills Committee also stressed the importance for OCI and IIA to conduct the record transfer process in a prudent manner in order to protect the relevant records, and to put in place measures to protect secrecy of the personal data contained therein. Some Members considered that there should be clear provisions on when the transfer process would be regarded as completed so that IIA's legal obligations for the transferred records under the Personal Data (Privacy) Ordinance ("PDPO") (Cap. 486) would officially commence.

15. The Administration advised that all relevant records (in hardcopy or electronic form) in OCI's custody must be transferred to IIA on the date of commencement of the statutory licensing regime or as soon as practicable after that date in a proper and prudent manner. Besides, PDPO would continue to apply as if the personal data contained in the records were received by IIA, and IIA must ensure that the data was used, disclosed and retained for the purpose for which the data was to be used at the time of the collection. Having considered the views of the Bills Committee, the Administration had amended the relevant provisions in the legislation to clarify the completion date for the data transfer process and the exercise of power by the Privacy Commissioner for Personal Data in relation to IIA under PDPO.

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[7] According to the Administration, IOs who are pensionable civil servants would be retired on the Abolition of Office terms after the establishment of IIA. Officers of the general grades would then be redeployed to other Government bureaux/departments in accordance with the normal posting arrangements by the Director of General. As for the NCSC staff, their contracts would be mutually resolved or terminated as appropriate.

Latest development

16. The Administration will brief FA Panel on the funding proposal relating to the establishment of IIA and arrangements for dissolving OCI at the meeting to be held on 7 December 2015.

Relevant papers

17. A list of relevant papers is in **Appendix**.

Council Business Division 1
Legislative Council Secretariat
3 December 2015

Appendix

List of relevant papers

Date/Period	Event	Paper/Minutes of meeting
May 2014 to July 2015	Bills Committee on Insurance Companies (Amendment) Bill 2014	Report of the Bills Committee (LC Paper No. CB(1)1055/14-15) Legislative Council Brief (File Ref: C2/2/50C) Legal Service Division report (LC Paper No. LS50/13-14)
10 July 2015	The Legislative Council ("LegCo") passed the Insurance Companies (Amendment) Bill 2014	Hansard
14 October 2015	The Insurance Companies (Amendment) Ordinance 2015 (Commencement) Notice 2015 gazetted on 9 October 2015 was introduced into LegCo	Legislative Council Brief (File Ref.: INS/2/3C(2015)) Legal Service Division Report (LC Paper No. LS2/15-16)