# 立法會
# *Legislative Council*

LC Paper No. CB(1)2600/10-11

Ref : CB1/PL/FA

**Panel on Financial Affairs**
**Meeting on 4 July 2011**

**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 2003 and 2010.

## 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. As of July 2010, OCI had an establishment of 123, comprising 95 professional (accountants, actuaries) and managerial staff, as well as 28 support staff. OCI incurred an annual operating expenditure of around $110 million and recovered some 37% of it from the annual licence fees payable by insurers at a fixed rate of $227,300 per insurer and $22,600 for captive insurer. The remaining some 60% of the regulatory cost was subsidized by the public coffer.

4. There are about 170 authorized insurers in Hong Kong. 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. Currently, there are some 70 500 insurance intermediaries in Hong Kong. They are regulated by three self-regulatory organizations (SROs)[1]. 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. 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**

7. In the light of international regulatory trends and development of the insurance industry, the Financial Secretary announced in the 2003-2004 Budget Speech the proposal to turn the Office of the Commissioner of Insurance into an agency independent of the Government. The Administration conducted a stakeholder consultation on the proposal from late May to the end of July 2003, and briefed the FA Panel on the subject on 6 November 2003.

8. According to the Administration's paper for the Panel meeting, the Administration had 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 major benefits of turning the Insurance Authority into an independent regulator included –

[1] 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.

(a) bringing Hong Kong's insurance regulatory framework in line with that of the other financial services sectors, as well as the international practice;

(b) an independent regulator would have greater flexibility in budgetary matters and manpower deployment, and thus would be more able to respond to market development quickly; and

(c) the independence exercise would provide an opportunity to review any room for enhancement in the governance and accountability of the Insurance Authority.

9. As regards the views gathered during the stakeholder consultation, the Administration advised that while respondents 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.

10. During the discussion at the FA Panel meeting on 6 November 2003, while a few members indicated that they supported in principle the proposal for the Insurance Authority to be independent from the Government, a number of 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. The specific concerns and views expressed by members are set out in the **Appendix**.

**Public consultation on the proposed establishment of an independent insurance authority in 2010**

11. The Administration engaged a consultant in 2007 to formulate proposals covering the governance structure, organization, funding and budgetary system of the IIA. The study was based on the assumption that there would be no change to the statutory functions and powers of the OCI as reported and noted at the meeting of the FA Panel on 6 November 2003. The study 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.

12. Having regard to the findings and recommendations of the extended study, the Administration drew up a set of proposals for the proposed

establishment of an IIA and launched a three-month public consultation exercise on 12 July 2010. The key proposals were set out in the following paragraphs.

13. Under the Administration's proposal, the existing OCI would be replaced by a proposed IIA empowered to -

(a) conduct inspections on regulated entities;

(b) initiate and pursue investigations;

(c) make enquiries;

(d) have access to records and documents;

(e) apply to the Court of First Instance for court orders to compel compliance with the requirements;

(f) impose supervisory sanctions such as reprimands and fines; and

(g) prosecute offences summarily.

14. 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. While the proposed IIA would administer the licensing regime and set conduct requirements for intermediaries, in light of the different client profile and sale environment in a bank, HKMA would be given powers similar to those of the proposed IIA for the regulation of bank employees selling insurance products and might impose additional conduct requirements specific to banks, on top of those set by the proposed IIA. The following changes would be made to the existing arrangement of fixed annual licence fee for insurers so that full cost of the proposed IIA could be recovered from the insurance industry and the market over time[2]:

(a) a fixed licence fee payable by all insurers and insurance intermediaries;

(b) a variable licence fee payable by insurers;

(c) user fees for specific services; and

(d) a levy of 0.1% on insurance premiums for all insurance policies.

---

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

Discussions at the Panel on Financial Affairs in 2010

15. On 19 July 2010, the Administration briefed the FA Panel on the proposals. The Panel subsequently held a special meeting on 12 October 2010 to receive public views on the subject. A total of 16 deputations (including the Consumer Council and 11 associations of the insurance industry) attended the meeting. In addition, five organizations/individuals submitted written views. The major concerns and views expressed by members and deputations during the two 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 the IIA. A member expressed the view that the merits of the self-regulatory regime should be retained. For example, 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. To facilitate Members to assess whether the Administration's proposals were in tandem with the developments in the international arena, the Panel requested the Administration to provide information on the practices in other jurisdictions for the regulation of the insurance industry.[3]

*Regulation of insurance intermediary activities of banks*

21. A number of Panel members and deputations expressed reservations over the proposal of empowering HKMA to regulate banks and their employees in selling insurance products in banks. They were concerned that the proposed arrangement might give rise to inconsistencies in the enforcement standards and practices and duplication of work and functions between the proposed IIA and HKMA. A member opined that the proposed IIA should be responsible for regulating banks in insurance business and seek the assistance of HKMA only when necessary. Another member pointed out that other non-insurance based enterprises, such as travel agents, were also involved in the sale of insurance products. The members urged the Administration to consult the relevant parties and work out the regulatory arrangements carefully with a view to ensuring a level-playing field for different service providers.

22. The Administration responded that the IIA would be the primary regulator for the registration of and issuance of licences to insurance intermediaries, including bank employees selling insurance products. The IIA would lay down the codes of conduct, investigate complaints and impose sanctions where appropriate. Given the specific client profile and sales environment in banks, HKMA might need to impose additional requirements for banks in selling insurance products. Having regard to the views expressed by members and deputations, the Administration undertook to further consider the arrangements for regulation of sale of insurance products in banks.

*Role of the insurance industry under the proposed regulatory regime*

23. 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.

24. The Administration advised that the insurance industry would be invited to participate in the formulation of policy for the future development of the

---

[3] The Administration provided relevant information in its paper for the FA Panel meeting to be held on 4 July 2011.

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 the IIA to advise on issues affecting the industry.

*Funding arrangements*

25. 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. Regarding the proposed imposition of a variable licence fee on insurers based on their liabilities and a 0.1% levy on insurance policies, members were concerned about the financial impacts of the measures on insurance companies and policyholders. Some members considered that there should be a cap on the amount of levy imposed. A member asked whether the levy would be refunded to the policyholder when an insurance policy was terminated prematurely.

26. The Consumer Council commented that the Administration's consultation paper did not spell out which parties would be responsible for paying the levy. The Consumer Council considered that the levy should not be borne by policyholders.

27. The Administration responded that the proposed establishment of 237 staff for the IIA was recommended by the independent consultant after examining the workload involved and the manpower provision of similar establishments in Hong Kong and overseas countries. The IIA would operate in a highly transparent manner and its work would be supervised by a board of directors. While the Administration considered that the 0.1% levy should have little impact on insurance premiums, the Administration undertook to further consider the levy arrangements.

*Arrangement for further consultation*

28. As a number of deputations had commented that the Administration's consultation paper did not spell out the detailed arrangements for the proposed regulatory regime, a member requested the Administration to conduct a second round of public consultation with more details to address the concerns of the industry and the public.

*Other issues*

29. During the Panel discussions, members and deputations also expressed the following concerns and views –

(a) There should be a clear demarcation of responsibilities between the proposed IIA and the Financial Services and the Treasury Bureau; the proposed IIA's main responsibilities should focus on the regulation of the industry instead of promoting the development of the insurance market.

(b) A working group consisted of representatives of insurance associations should be formed by the OCI to work out the detailed arrangements of the IIA. Thereafter, a provisional IIA with representatives of various insurance associations should be established to ensure a smooth transition from the self-regulatory regime to the proposed IIA.

(c) The Government should consider incorporating the Insurance Claims Complaint Bureau under the IIA, and empowering the IIA to handle complaints relating to the proposed voluntary Health Protection Scheme.

(d) As in the case of SFC and HKMA, the public would not be able to monitor the investigation work of the proposed IIA because such investigations would be kept confidential.

(e) The considerable increase in the staff size of the proposed IIA might result in over-regulation, as one major performance assessment criterion of the IIA staff might be the number of enforcement actions taken against insurance companies/brokers/agents.

(f) Many small and medium sized insurance companies might be forced to cease operation if the cost for compliance with the proposed IIA's requirements were excessively high.

**Recent development**

30. The Administration will brief the FA Panel on the detailed proposals for the establishment of an IIA at the Panel meeting on 4 July 2011.

**Relevant papers**

31. The relevant papers are available at the following hyperlinks-

| | |
|---|---|
| Meeting of the Panel on Financial Affairs on 19 July 2010 | Agenda<br>Minutes (paragraphs 1-34) |
| Special meeting of the Panel on Financial Affairs on 12 October 2010 | Agenda<br>Minutes |

Council Business Division 1
Legislative Council Secretariat
29 June 2011

**Appendix**

**Concerns and views expressed by members of the FA Panel regarding the review of the institutional set-up of the Insurance Authority in the Panel meeting on 6 November 2003**

(a) With regard to international regulatory trends, the Administration had only cited in its paper that the insurance regulators in the United Kingdom (UK), Australia and Singapore were all independent of their governments. The Administration should also study the arrangements in other countries, such as Canada and European countries. Besides, as UK adopted an integrated-regulator model under which the Financial Services Authority was the single regulator of all financial services, including insurance, the Administration should study the UK model in more detail as reference.

(b) The Administration should address the concerns of the insurance industry, which included the possible lack of independence of the future IA from political and governmental influence, possible expansion of the powers of the IA, and possible increase in the operating costs and licence fees for insurers and insurance intermediaries, after the IA became independent from the Government.

(c) The business sector was mainly concerned about the impact of the independence of the IA on the level of insurance premiums, and whether the IA could perform more effectively after its independence.

(d) After its independence, the IA should be subject to appropriate monitoring by the Legislative Council and the Administration, particularly in cost control matters.

(e) It was not uncommon for the senior government official who was in charge of a legislative proposal for the establishment of a statutory authority to take up the post of the head of the authority after its establishment. The same might happen in the case of the IA.