

**Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2013
Follow-up to meeting on 24 February 2014**

The Administration's response to members' enquiries at the captioned meeting is appended below –

(a) the number of Mainland enterprises which have formed captive insurers to enhance their risk management, and the estimated number of Mainland enterprises which will be attracted to set up captive insurers in Hong Kong

2. As far as we are aware, at least three Mainland enterprises have set up captive insurers to underwrite their own risks.

3. Since the announcement of the proposed tax incentive in the 2013-14 Budget, the Insurance Authority ("IA") has received quite a number of enquiries from Mainland enterprises concerning the establishment of captive insurers in Hong Kong. We believe that the proposed tax incentive, together with the Central People's Government policy support for Mainland enterprises to set up captive insurers in Hong Kong, would provide impetus for Mainland enterprises to consider setting up captive insurers in Hong Kong. However, it would be difficult to estimate the likely number of applications at this juncture, as enterprises may take into account tax rates and other factors when deciding where to set up their captive insurers.

(b) details of the regulatory regime and measures to assess and monitor market risks of the local captive insurance industry, in particular the measures to mitigate risks arising from insolvency of captive insurers

4. Captive insurers authorized under the Insurance Companies Ordinance ("ICO") (Cap. 41), are subject to the prudential supervision of the IA. The major requirements, as stipulated in the ICO, include –

Capital and Solvency Margin

A captive insurer must have sufficient capital and financial resources to pre-finance its operation at all times. The minimum capital requirement is HK\$2 million. As for the solvency margin, i.e. the excess of assets over liabilities, must not be less than the greatest of (a) 5% of the net premium income; (b) 5% of the net claims

outstanding; and (c) HK\$2 million.

Fitness and Properness of Directors and Controllers

The directors and controllers of a captive insurer must satisfy the “fit and proper” criteria. In considering the fitness and properness criteria, the IA will look into their reputation, integrity, financial status and ability to perform the relevant functions efficiently, honestly and fairly.

Adequacy of Reinsurance Arrangements

A captive insurer is required to have adequate reinsurance arrangements in force for the insurance business it carries on. In considering the adequacy of reinsurance arrangements, the IA will take into account the captive insurer’s business, the financial soundness of the reinsurance companies, the level of risk retention, the diversification of risks among reinsurers as well as the maximum amount of claims to be borne by the captive insurer.

Submission of Financial Statements and Business Returns

A captive insurer is required to furnish its annual audited accounts and business returns to the IA within the prescribed period.

Guidance Notes

Apart from the ICO, a captive insurer is also subject to the requirements of various guidance notes promulgated by the IA.

5. The IA monitors insurers’ compliance with various requirements through: (a) examining their financial statements and returns; (b) analyzing critically their solvency position and risk management aspects, with due emphasis on the capital adequacy, quality of assets, reserving position and reinsurance arrangements; and (c) regular on-site inspections to monitor different areas of the insurer’s operation like underwriting, claims handling, asset management, internal control systems etc.

6. If there are any concerns in respect of a captive insurer, the IA may, depending on the nature and level of concern, require the insurer to take remedial actions or exercise powers of intervention. The IA has a wide range of statutory powers under the ICO, such as setting a limit on business volume or requiring a captive insurer to cease writing new business etc. In special circumstances, the IA may even appoint a Manager to manage the affairs, business and property of an insurer including captive insurer.

7. A captive insurer underwrites exclusively the risk of its parent or group companies or their associated companies. However, it cannot write statutory lines of business (e.g. employees' compensation insurance, motor third party insurance) which involve the general public.

Financial Services and the Treasury Bureau
26 February 2014