TO SERVE & PIBA TO PROTECT Est. 1988
香港專業保險經紀協會
PROFESSIONAL INSURANCE BROKERS ASSOCIATION

Ref. No. : LT2574/2014

23 June 2014

By hand and by email (bc_06_13@legco.gov.hk)

Hon Wong Ting Kwong, SBS, JP
Chairman of the Bills Committee on Insurance Companies (Amendment) Bill 2014
Legislative Council
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Hon Wong, SBS, JP

Re: Insurance Companies (Amendment) Bill 2014 ("the Bill")
Establishment of the Independent Insurance Authority

Our behalf our Executive Committee, we would like to forward our preliminary written submission, as attached, on the Bill introduced by the Financial Services and the Treasury Bureau. We sincerely urge the Bills Committee to take into account of our comments and suggestions raised therein when considering the Bill.

You may wish to note that as one of the three self-regulatory organizations authorized by the Insurance Companies Ordinance (Cap 41), Professional Insurance Brokers Association is an insurance broker body, representing 377 member companies and 5,241 registered individual members.

If you have any questions regarding our submission, please do not hesitate to contact Mr Jase Yiu, the Chief Administrative Executive of our Secretariat at 2139 1368.

Yours sincerely,

Johnson Chow
Chairman

Encl. Our Submission

Preliminary Written Submissions on

the Insurance Companies (Amendment) Bill 2014

by

The Professional Insurance Brokers Association

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INTRODUCTION

1. On 25 January 2013, Professional Insurance Brokers Association ("**PIBA**") submitted its responses (the "**Response**") to a proposal titled "*Key Legislative Proposals on Establishment of an Independent Insurance Authority*" (the "**2012 Legislative Proposals**") issued by the Financial Services and Treasury Bureau ("**Administration**") in October 2012 in relation to the Administration's intention to establish an "independent" Insurance Authority (the "**Proposed IIA**").

2. Notwithstanding the strong and reasoned oppositions to the 2012 Legislative Proposals and the Proposed IIA by market participants and the general public, the Administration has since introduced the Insurance Companies (Amendment) Bill 2014 (the "**Bill**") on 25 April 2014 which provides for, amongst others, the establishment of the Proposed IIA to replace the existing Office of the Commissioner of Insurance ("**OCI**") and the self-regulatory regime.

3. PIBA regrets that the Administration has to date chosen not to heed the observations of the Legislative Council ("**LegCo**") during the Lehman mini-bond inquiry on the fundamental problems arising out of a SFC-HKMA dual regulatory regime.

4. On 4 June 2014, PIBA received a letter from the Clerk to Bills Committee, by which PIBA was invited to, amongst others, give its views on the Bill by providing its written submissions within 14 days i.e. on or before 18 June 2014.

5. By the Bill the Administration seeks to introduce very extensive amendments to the Insurance Companies Ordinance (the "**ICO**") which, if passed as it now stands, will bring about a major change to the insurance industry. The Administration has itself stated in the Legislative Council ("**LegCo**") Brief dated 16 April 2014 that "*[t]he establishment of the IIA is the most important regulatory reform in the insurance sector in the past 30 years since the passage of the Insurance Companies Ordinance... in 1983*".[1]

[1] Financial Services and the Treasury Bureau, *Legislative Council Brief on Insurance Companies (Amendment) Bill 2014*, April 2014, para. 2 at page 1.

6. However, PIBA notes with concern that limited time has been made available, namely a period of only 14 days to respond. In the circumstances, while PIBA appreciates the opportunity to make submissions to the Bills Committee, it must be stressed that within the limited time it is not practicable to put forward full written submissions. Accordingly, the submissions herein are necessarily preliminary. PIBA may, where necessary or appropriate, supplement its views on the Bill whether by way of further submissions or otherwise. The Bills Committee will appreciate that the stakeholders and the general public will require further and a reasonable time to consider the Bill and provide a fuller response, in view of the importance and potential impact of the changes to the insurance industry and the interests of customers. It should not be overlooked that according to OCI's provisional statistics for 2013, Hong Kong's total gross premiums represented 13.7% of the city's GDP. The insurance industry is closely connected with virtually all trades and businesses in Hong Kong.

7. Unless otherwise defined, capitalized terms used hereinbelow shall have the same meanings as those used in the Bill.

PIBA'S PRELIMINARY VIEWS ON THE BILL

8. PIBA notes that the Administration has considered only some of the issues / concerns previously raised by PIBA in the Response and/or submissions made by other stakeholders. Whilst PIBA welcomes the Administration's decisions to completely discard the controversial specified suspension power[2], as well as extend the period of deemed revocation of license from 90 days to a period of 180 days[3], PIBA urges the Administration to adopt a similar approach and give serious consideration to the other concerns in the Response and those set out in this submission.

AREAS OF CONCERNS THAT REMAIN

[2] *Id*, Annex B, page 2.

[3] *Id*, Annex B, page 3.

9. Upon a review of the Bill, it has come to PIBA's attention that LegCo's observations / concerns on dual-regulatory regime and a wide range of other concerns raised by the market participants and general public (including but not limited to PIBA's Response) have been ignored by the Administration. To the extent possible given the limited time available, these issues of real concern are highlighted in these preliminary submissions.

10. Members of the Bills Committee are invited to make reference also to:-

(a) LegCo's "Report of the Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products" issued in June 2012 (the "**Lehman Report**"); and

(b) PIBA's Response.

I. Lack of justification for replacing the existing system

11. At the outset, PIBA notes the Administration's decision to have the Bill introduced notwithstanding the concerns expressed by various stakeholders on the apparent lack of cogent justification or basis for implementing such a robust reform which will, in essence, wholly replace the entire insurance system that has over the years been well functioning in Hong Kong.

12. The Administration would not deny that the insurance sector has been developing steadily and operating smoothly over the past decades, for which the efforts and the contributions of the OCI and the Self-regulatory Organizations ("**SROs**") should be recognised. Against this background, having carefully considered the Bill and the related documents (including the LegCo briefs) issued by the Administration, PIBA still fails to see any compelling urgency to introduce such fundamental and controversial changes without fully engaging and addressing the views and concerns raised.

II. Introduction of "dual-regulatory regime" into the insurance industry

13. Members of the Bills Committee will no doubt be familiar with the Lehman Report,[4] which comprehensively reviews and heavily criticizes the SFC-HKMA dual-regulatory regime. PIBA does not propose to repeat the detailed analysis for present purposes and would respectfully refer to LegCo's observations on the fundamental defects of a dual-regulatory regime. The dual-regulatory regime was ineffective and contributed to the Lehman incident, and in turn resulted in substantial losses being suffered by members of the public.

14. With such recent issues arising and extent of damage, PIBA is concerned to learn that the Administration sees fit to disregard LegCo's Lehman Report and introduce, by the Bill, the much criticized "*dual-regulatory regime*" into the insurance industry.

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[4] LegCo's *Report of the Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products*, June 2012.

15. In addition to references to the conclusions in the Lehman Report, PIBA has in its Response set out extensive grounds / reasons for its objection to the introduction of any dual-regulatory regime into the insurance industry.[5] Regrettably, none of these have been addressed by the Administration and/or taken care of in the Bill.

16. Whilst the Administration has sought to downplay the widespread concerns arising out of the proposed introduction of a "*dual-regulatory regime*" by claiming that the Proposed IIA will be the "*primary and lead regulator*" for all insurance intermediaries (including banks and their employees),[6] such argument does not address the problems. Members of the Bills Committee will no doubt be aware that the SFC has similarly been labelled as the "*lead regulator*" for securities matters but labelling did not change the true nature of and underlying flaws inherent in a dual-regulatory regime, which contributed to the Lehman incident. A simple comparison of the Bill and the Securities and Futures Ordinance (Cap. 571) (the "**SFO")** will demonstrate that the Proposed IIA-HKMA regime is simply a replicate of the SFC-HKMA regime.

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[5] The Response, paras. 101-138 at pages 52-69.

[6] *Supra*, note 1, para. 16 at page 6.

17. Under the Bill,

(a) the Proposed IIA "*must consult the Monetary Authority before the [Proposed IIA] directs any of its employees, or appoints a person to investigate a matter in respect of [an authorized institution, an employee or agent thereof, or person appointed thereby]* (collectively the "**authorized institution**")";[7]

(b) the Proposed IIA "*must consult the Monetary Authority*" before exercising a disciplinary power under Section 80 over an authorized institution;[8] and

(c) the Proposed IIA "*must consult the Monetary Authority*" before publishing any guideline for the exercise of power to impose pecuniary penalty under Section 80.[9]

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[7] Section 64ZZH(2) of the Bill.

[8] Section 81(4) of the Bill.

[9] Section 82(3) of the Bill.

18. According to the Bill, HKMA will have the powers of day-to-day inspection and investigation whereas the conduct of disciplinary action will be in the hands of the Proposed IIA, after having consulted HKMA.[10]

19. Further, any findings made by the HKMA during its inspection / investigation will have to be referred to the Proposed IIA for disciplinary action, and where the Proposed IIA, during the course of considering or exercising its disciplinary powers, requires further inspection or investigation, such will need to be referred back to the HKMA.[11] The proposed "*division*" of regulatory functions is wholly unnecessary and excessively complicated. Such operational complexities could not have been conducive to having an efficient or effective regulatory framework, and are undesirable.

20. In addition, inherent in the entire Proposed IIA-HKMA dual-regulatory regime are the following further risks:

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[10] Sections 4G(1) and 83(4) of the Bill.

[11] Section 4G(1) of the Bill.

(a) The HKMA has its own distinct and different statutory functions, namely to promote the general stability and effective working of the banking system and operations of banks in Hong Kong.[12] Against this, a question arises as to the importance that the HKMA will, or can, attach to the distribution of insurance products by bank intermediaries.

(b) As the HKMA has never undertaken the duty of overseeing the insurance industry, its staff establishment is understandably not equipped with the relevant specialised knowledge. If the HKMA is to recruit additional staff possessing relevant knowledge of the industry, this will not only result in duplication of work, additional costs, competition of talents (between HKMA and the Proposed IIA) but also a waste of public funds.

(c) Where the sole purpose of establishing the Proposed IIA is to regulate the insurance industry and insurance intermediaries, having some insurance intermediaries overseen by another

[12] Section 7(1) of the Banking Ordinance (Cap. 155).

regulator will raise questions on whether bank intermediaries will receive different treatment in their distributing of the very same insurance products.

(d) Further, on the basis of provisions in the Bill in the case of intermediaries working for banks, the Proposed IIA will be obliged to first consult the HKMA before exercising any such disciplinary powers. Such arrangement already demonstrates different treatments over regulated activities of a similar or even the same nature. The whole arrangement runs a real risk of leading to, or at least being perceived as, being unfair.

21. For the above reasons, PIBA continues to object to the proposed dual-regulatory structure, which has been proven to be ineffective, and will generate inherent unfairness amongst intermediaries within the same industry. If the Proposed IIA is to be established at all, banks too should be also placed under the regulation of the Proposed IIA and not the HKMA, insofar as the sale of insurance products is concerned. This is the only way to ensure consistent and fair regulation.

22. Against the aforesaid, it is also noted that the Administration has failed to specify any compelling or cogent reason for the need to insist on a dual-regulatory regime.

23. The Administration has only sought to argue that HKMA possesses experience and expertise in the overall regulation of banks. This cannot be a sufficient reason to repeat the mistake of setting up a dual-regulatory regime already proven to be inefficient and ineffective. Even if experience in the regulation of banks is considered helpful, the Proposed IIA can establish an advisory panel comprising representatives from the HKMA to tap in the latter's experience. Such advisory panel could facilitate the exercise of powers by the Proposed IIA by leveraging on the experience of the HKMA without creating a dual-regulatory regime.

PIBA's Recommendation:

If the Proposed IIA is established, all insurance intermediaries should be placed under the regulation of the Proposed IIA in its

capacity as the sole regulator. "Delegation" of inspection and investigation powers to the HKMA should not be adopted and in its place, an advisory panel comprising representatives from HKMA can be established to render advice or views to the Proposed IIA on any matters involving bank intermediaries.

III. Absence of statutory objectives to promote fair competition

24. PIBA notes with disappointment that notwithstanding the strong views from different sectors of insurance intermediaries, the requests for an express provision on the duty to promote fair competition in the insurance industry has still not been incorporated into the Bill.

25. PIBA strongly feels that the Proposed IIA should take up the responsibility of promoting fair competition amongst the different types of market participants in the insurance industry.

PIBA's Recommendation:

To make it a statutory objective of the Proposed IIA to promote fair competition in the insurance industry.

IV. Composition of the Proposed IIA

26. PIBA welcomes the Administration's decision to remove the cap placed on the number of insurance professionals to be appointed to the Governing Board of the Proposed IIA.

27. As the Bill now stands, the Governing Board will comprise a chairman, a chief executive officer and not less than six directors, of which *at least two* are to be appointed from among persons due to their knowledge of and experience in the insurance industry.[13]

[13] Section 4AA of the Bill.

28. Notwithstanding the aforesaid difference from the 2012 Legislative Proposals, PIBA remains of the view that the composition should be further enhanced to address market concerns.

29. PIBA could not stress more that insurance is a highly specialised industry. It goes without saying that the Governing Board must comprise people with sufficient practical experience, understanding, knowledge and insights into the insurance business before it could properly discharge its distinct and important functions of regulating the entire insurance industry.

30. On this, one of the Administration's concerns in introducing market practitioners into the Governing Board is said to be the need to ensure the "*independence*" of the Proposed IIA[14] and to guard against any potential "conflict of interests". With respect, PIBA finds it difficult to accept this as a valid reason for not having sufficient representation of market participants onto the Governing Board.

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[14] Financial Services and the Treasury Bureau, *Bills Committee on Insurance Companies (Amendment) Bill 2014 Background brief*, May 2014, para. 11 at page 5.

31. Presence of market participants as members of a board are common-place in both governmental and public bodies as there are well-established mechanisms in place to safeguard any situations of conflicts of interest. There is no reason to sacrifice the public interest or undermine the strength of the Governing Board by limiting the number of market participants when any "*fear*" of potential risk of conflicts could indeed be easily addressed with appropriate measures put in place.

32. Lastly, the wealth of experience of the SROs in terms of insurance regulatory matters cumulated over the past decades will undoubtedly bring insights and contribute meaningfully to the newly established Proposed IIA. Appointing representatives from the SROs onto the Governing Board, in particular at the initial stage of the Proposed IIA's establishment, will bring the regulatory experience into the new regulatory body. Further, to ensure that the voices of different branches of insurance intermediaries, i.e. agents and brokers, can be heard, PIBA remains of the view that at least one representative appointed from amongst insurance brokers should be appointed and included onto the Governing Board.

PIBA's Recommendations:

- ***The minimum number of insurance professionals on the Governing Board should be no less than one-third;***
- ***at least one member appointed among insurance brokers should be appointed to the Governing Board; and***
- ***the SROs should have the right to nominate directors to be appointed onto the Governing Board.***

V. Unclear role of the "Industry Advisory Committee"

33. We note the provisions in the Bill regarding the appointment of two industry advisory committees (the "**IACs**") on matters that the Proposed IIA may need to refer them to in relation to long term business and general business.[15]

34. At the moment, the exact nature and functions of the IACs remain unclear.

[15] Sections 4C(1) and (2) of the Bill.

35. With a view to ensuring that the views and opinions of market participants will be adequately reflected and considered by the Governing Board, there should be provisions involving the IACs at the operational level as well as the decision-making process, failing which the IACs' appointment will be rendered artificial and superficial.

36. PIBA reiterates that the IACs must comprise (amongst others) representatives of SMEs, insurance agents and brokers so that their views and opinions would be heard and taken into account. This will, in the long-term, help promote healthy competition.

PIBA's Recommendation:

- ***Members of the IACs must comprise insurance brokers(s);***
- ***the IACs must be included at the operational level and decision-making process of the Governing Board;***
- ***the IACs must meet every month, as opposed to the proposed 3 monthly meetings;***[16]
- ***it must be expressly stated in the proposed amendments to the ICO that the Proposed IIA must consider any representations that have been made to it by the IACs; and***
- ***if any resolution is passed at the IACs, the same must be discussed at the Governing Board level. In the event any resolution passed by the IACs is not adopted by the Governing Board, reasons must be given, properly recorded and made available to the IACs.***

VI. The coverage of "Regulated Activities" being too wide

37. PIBA has serious concerns on the substantial extension of the scope of insurance activities as defined under the Bill.

[16] Schedule 1C(3) of the Bill.

38. The current definition of "*regulated activity*" covers situations where a person invites or induces, or attempts to invite or induce, another person to enter into a contract of insurance or to make a "*material decision*".[17]

39. It should, however, be noted that under the current ICO, the only relevant definition is that of '*insurance broker*' which refers to a person who "*carries on the business of negotiating or arranging contracts of insurance ... or advising on matters related to insurance*".[18]

40. The proposal to substantially extend the scope of regulated activities is undesirable noting, in particular, the fundamental difference between:

(a) "*carries on the business of negotiating or arranging contracts of insurance*"[19] (under the current ICO); and

[17] Schedule 1A, Part 1(1) of the Bill.

[18] Section 2(1) of the Insurance Companies Ordinance (Cap 41).

[19] *Id.*

(b) "*carry on a regulated activity ... in the course of the person's business or employment; or... for reward*",[20] whereas "*regulated activity*" is defined as including

- the act of negotiating or arranging a contract of insurance,[21]

- the act of inviting or inducing, or attempting to invite or induce, a person to enter into a contract of insurance or to make a "*material decision*",[22] or

- the act of giving "*regulated advice*".[23]

(Parts 1, 2 and 3 of Schedule 1A)

41. Uncertainty arises from the inherent ambiguity in the new definition of regulated activity. By way of example, it is unclear if a travel or employment agency distributing to its customers promotional materials of

[20] Section 64G(1) of the Bill.

[21] Schedule 1A, Part 1(1)(a) of the Bill.

[22] Schedule 1A, Part 1(1)(c) of the Bill.

[23] Schedule 1A, Part 1(1)(d) of the Bill.

travel insurance or employee insurance packages will be treated as carrying on "*regulated activities*" as his act may, at least technically, be argued as amounting to an *invitation* to enter into a contract of insurance in the course of his business / employment. Various stakeholders have expressed concerns on this uncertainty but regrettably the Administration has ignored these comments and is still seeking to change the scope of regulated activity.

PIBA's Recommendation:

To refine the definition of "regulated activity" in line with that in the current ICO.

VII. Uncertainty concerning licensing criteria / criteria for renewing licenses

42. PIBA notes the Administration's repeated assurances that if the Proposed IIA is established, it will ensure that the impact thereof on brokers is

minimised.[24] In this regard, PIBA welcomes the Administration's proposal that all pre-existing intermediaries validly registered with the SROs will be deemed as licensees under the new regime for three years.[25]

43. Stemming from the above, however, is the uncertainty on the position of renewal after the expiry of the aforesaid 3-year period. Under the existing regime, a broker company (or on technical representative thereof) who is duly licensed by PIBA (and we trust the position is similar for other SROs) may apply for a renewal of license upon attending to the requisite procedures (essentially the completion of an application form and payment of licensing fee). Upon completion of the simple procedures, the licenses will be automatically renewed unless any potential or possible non-compliance or breach on the part of the licensee has been brought to the attention of PIBA. In other words, there is no form of any re-assessment on the renewal application, but an automatic renewal save for any form of non-compliance aforementioned.

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[24] The 2012 Legislative Proposals, para. 2.5.3 at page 17.

[25] *Supra*, note 1, para. 10 at page 4.

44. As the licence renewal mechanism has however not been stipulated in the Bill, PIBA would strongly request for a confirmation, preferably by way of legislation, that an approach similar to that currently adopted will continue to apply. In particular, there should be provisions to the effect that a licence will be renewed unless any potential or actual non-compliance or breach is noted.

45. In the absence of some form of confirmation that the Proposed IIA would not tighten the licensing criteria, it is understandable for market participants, in particular the smaller ones, to have concerns as a tightening of licensing criteria could have a profound impact on their survival. This situation could eventually hurt market competition.

46. Whilst PIBA does not see any need, at least in the foreseeable future, to tighten the licensing or eligibility criteria, to minimise the uncertainty of regulatory risks PIBA would propose that a *grandfathering arrangement* be put in place under which any new licensing requirements (if such are to be introduced) will not be applicable to market practitioners who, as at the time of introduction of the new requirements, are already duly

licensed (whether by the SROs previously, or by the Proposed IIA). In other words, any newly-introduced licensing criteria or requirements should only be applicable to new entrants applying for a license for the first-time but not those already licensed (whose license continues to be renewed on the basis of the criteria previously applicable thereto).

PIBA's Recommendation:

- ***Express provisions that renewal of license will be automatic without the need for any fresh re-assessment of the licensee's position; and***
- ***grandfathering arrangement be put in place should any new licensing or eligibility criteria be introduced.***

VIII. Powers of IIA to amend or impose new licensing criteria being too wide

47. On licencing conditions, the Administration had in its 2012 Legislative Proposals proposed that: "*the IIA may, at any time, by notice in writing,*

amend or revoke any condition imposed, or impose new conditions, as may be reasonable in the circumstances".[26]

48. PIBA, in its Response, opined among other things, that the provision "*as may be reasonable in the circumstances*" is too vague, and recommended the use of the term "*as may be necessary in the circumstances*" coupled with the factors which the Proposed IIA would be duty-bound to take into account when proposing any amendments etc. to the licensing conditions, to be incorporated into any amendments to the ICO (including factors like proportionality, impact on or disruption to services provided to policyholders, impact on or disruption to the business of brokers etc.).[27]

49. PIBA is disappointed to note that not only have the abovementioned proposals been rejected by the Administration, Section 64ZG(3) of the Bill now provides that:

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[26] The 2012 Legislative Proposals, para. 4.3.3(4)(d) at page 44.

[27] The Response, para. 34 at pages 23-24.

"The [Proposed IIA] may impose any conditions that it considers appropriate on the licence or approval after the [Proposed IIA] has granted the licence or approval."

50. The position has been made worse since the power under the Bill is even wider than that set out in the 2012 Legislative Proposals, in that the previous objective test in the 2012 Legislative Proposals has now become a subjective test, namely "*as the Proposed IIA considers appropriate*". PIBA cannot see any basis for or the need to confer such power on the Proposed IIA to be able to unilaterally change the licensing conditions as "*it considers appropriate*", bearing in mind that the survival of market participants and continuity of services are at stake.

PIBA's Recommendation:

To amend the provision by adopting the proviso "as may be necessary in the circumstances".

IX. Restrictions and Licencing

51. While it is noted that the proposed sections 64H (marketing insurance services outside Hong Kong) and 64G (holding out as carrying on regulated activities) are to be read together, there are concerns as to whether section 64H is too wide and whether there is sufficient legal basis to cover acts outside the Hong Kong jurisdiction. Subject to the Administration's clarification, it would appear that section 64H should be substantially amended with appropriate proviso, bearing in mind that section 64(G) creates a criminal offence for "holding out" and it will be most unsatisfactory if the new offence is unduly or unnecessarily wide or its scope is uncertain and/or ambiguous.

52. Reference is also made to the proposed section 64K, which applies to a person who is a director or an employee of a broker company and "*deals with **any matter that relates to** a regulated activity of the company*" (emphasis added). According to the proposed section 64K(2), that person must not and cannot also be e.g. director or employee of an agency.

53. It is important to confirm that common directorship for two or more broker companies is not prohibited. Further, the use of formulation "*any matter that relates to a regulated activity*" in both sub-sections (1) and (2) could be unduly wide, and may in effect cover all directors and employees of intermediaries. As it is not uncommon for one to hold positions in more than one intermediary, the Administration should clarify the intent of this provision, consult the stakeholders further and make necessary amendments to this and the other relevant provisions (including the proposed section 64J on personnel of agencies).

54. As for the maintenance of a register to be kept by the Proposed IIA, there is concern on whether it is sufficient to merely require the Proposed IIA to amend the relevant particulars in the register "*as soon as practicable*" (see the proposed section 64P(5)). By analogy, there is a prescribed deadline (14 days) for intermediaries to notify the Proposed IIA of any change. It will be in the public interest if the statutory requirement for the Proposed IIA to update the register is a fixed period of time, say, 7 days, or a reasonable time.

55. The Administration further proposes that "*at least one month before*" a broker company appoints a broker, the company must notify the Proposed IIA of the intended appointment (see the proposed section 64Q(4)). There seems no justification for fixing such a long notice period, which will have an adverse impact on both the broker company (because of the lack of flexibility of human resources management) and the individual broker (due to the need to wait for a whole month, possibly without any income before the commencement of the new appointment). PIBA proposes 10 days which should be more than adequate.

56. On grant of licence to broker company, the proposed section 64ZA(4) provides that the Proposed IIA "*must not grant the licence unless it is satisfied that ... (b)* ***each director*** *of the applicant is a* ***fit and proper person to be associated with the carrying on of regulated activities*** *in those lines of business*" (emphasis added).

57. At present, the "*fit and proper*" test is (and is correctly) applicable to persons who actually carry on a regulated activity, in respect of which there is adequate regulation and supervision. In most cases there is a division of labour amongst board members and a director may not

necessarily be "*fit and proper*" in the sense this term is used for licenced persons. A simple example is that being not a licenced person, he does not have the ability to carry on a regulated activity (being one of the determining factors of "*fit and proper*" according to the Bill). Further, the formulation "*to be associated with*" is extremely wide. The Administration is urged to explain why the "*fit and proper*" test should be extended to persons who are not licenced persons and in the absence of a very good explanation the "*fit and proper*" test should not be applicable to directors generally.

X. Unclear "*fit and proper*" determining factors

58. The "*fit and proper*" test is recognized as the pillar of the entire licensing regime and it is of profound importance that market participants are able to fully understand how this test is to be interpreted and applied. However, under the Bill, in addition to an already extensive list of factors (the proposed Section 14A(1)(a) to (f)), the Proposed IIA can also take into account "*any other matter that the [Proposed IIA] considers relevant*

in making the determination".[28] This is neither desirable nor justified. With a view to ensuring transparency and eliminating any unwarranted uncertainties, any statutory definitions or factors to be considered when determining whether an applicant is "*fit and proper*" should be full and exhaustive.

59. Section 64ZZA of the Bill is largely modelled on section 129 of the SFO and the requirements thereunder are practically the same.

60. Convenient as it may seem for the Administration to simply "*copy and paste*" the SFO and impose a very similar "*fit and proper*" test upon insurance intermediaries, such approach is inappropriate because of the inherent differences between the securities and insurance businesses.

61. An apparent example is that a securities brokerage firm or securities broker will, by nature of its/his work, be expected to regularly and frequently hold and handle client's funds. This feature is, however, not common in the insurance industry. It is therefore inappropriate and,

[28] Section 14A(2) of the Bill.

indeed, oppressive for the Administration to impose the test applicable in the securities industries upon insurance intermediaries.

62. Section 64ZZA(1)(f) extends to information relating to a "*company in the group of companies*" when determining whether a person is "*fit and proper*". This is neither reasonable nor proportionate. Even if any information of other companies within the group is relevant, it is submitted that only the information of the holding company (being the sole or majority shareholder) of the licenced broker company should be taken into account.

PIBA's Recommendation:

To remove the arbitrary proviso of "any other matter".

To replace the reference to "company in the group of companies".

63. Similarly, the proposed Section 80(1)(c) and Section 80(6) provide that in determining whether a regulated person was / is a fit and proper person,[29]

[29] Section 80(1)(c) of the Bill.

the Proposed IIA "... *may, among other matters... take into account the present or past conduct of the person*".[30]

64. In line with the aforesaid, with the Bill already stipulating a long list of factors to be taken into account when determining "*fit and proper*", there is simply no basis for the Proposed IIA to take into account any further matters beyond those already stated in the context of disciplinary actions.

PIBA's Recommendation:

To clearly set out all factors that would be taken into account when determining the "fit and proper" criteria, and remove the proviso of the Proposed IIA being entitled to consider "the present or past conduct of the person".

[30] Section 80(6) of the Bill.

XI. "Business days" as opposed to "days" be adopted

65. A relatively smaller, though not necessarily less important, point is the Administration's failure to adopt "business days" in the computation of time. By way of examples,

Section 64P(3) – *"The licensed insurance intermediary must notify the Authority in writing of any change of particulars within 14 days after the date on which the change takes place."*

Section 64R(1) – *"Within 14 days after the date on which an authorized insurer terminates the appointment of a licensed insurance agency or licensed individual insurance agent, the insurer must notify the Authority in writing of the termination."*

66. It is noted that some of the time limits as stated in the 2012 Legislative Proposals were expressed in the form of "*business days*".[31] However, in the Bill, these have all been changed to "*days*"[32]. It is stressed adopting

[31] The 2012 Legislative Proposals, paras. 4.4.3(5)(a) to (d) at pages 55-56.

[32] Sections 64R(1) to (4) of the Bill.

the drafting in the Bill there will be practical difficulties to comply with the various requirements during the public holidays. By analogy, the formulation "*working days*" is adopted in the Mandatory Provident Fund Schemes Ordinance (Cap.485).

PIBA's Recommendation:

To adopt "business days" throughout the Bill for any periods of 14 days or below.

XII. Blurring of the traditional distinction between insurance agents and insurance brokers

67. The proposed Section 89(a) titled "*Conduct requirements for licensed insurance intermediaries*" provides that:

> "*[w]hen carrying on regulated activity, a licensed insurance intermediary— (a) must act honestly, fairly, in the best*

interests of the policy holder concerned or the potential policy holder concerned, and with integrity".

68. Under the Bill, licensed insurance intermediaries include both licensed insurance brokers and licensed insurance agents. PIBA remains concerned that the above provision would blur the traditional difference in role between an insurance agent and an insurance broker.

69. On the one hand, the Bill acknowledges the tradition that an insurance agent is an "*agent of an authorized insurer*"[33] whereas an insurance broker is an "*agent of an existing or potential policy holder*"[34], the Bill, on the other hand provides that an insurance agent is obliged to act in the best interests of a policy holder or a potential policy holder.[35]

70. This not only gives rise to uncertainty but also has the effect of blurring the traditional difference in role assumed by insurance agents and insurance brokers. Notwithstanding requests by both agents and brokers

[33] The 2012 Legislative Proposals, para. 4.2.3(1)(a) at page 31.

[34] The 2012 Legislative Proposals, para. 4.2.3(1)(b) at page 32.

[35] Section 89(a) of the Bill.

for clarification, PIBA regrets that none of the much-needed clarification has been forthcoming. The Bill simply repeats the 2012 Legislative Proposals in this regard.

71. PIBA reiterates that this is an area which requires immediate clarification by the Administration.

PIBA's Recommendation:

To clarify the confusion stemming from the requirement that a licensed insurance agent is to act in the best interests of policy holders (or potential policy holders), and to give proper regard to the traditional distinction in role between insurance agent and insurance broker.

XIII. Failure to fully specify all conduct requirements expected of insurance intermediaries

72. The proposed Section 89(a) to (h) sets out a long list of conduct requirements expected of an intermediary. In addition to the said long list,

the proposed Section 89(i) further provides that "*a licensed insurance intermediary ... must comply with other requirements that are prescribed by rules made under sections 92 and 127.*"

73. Sections 92 and 127 will confer on the Proposed IIA extremely wide, and close to unfettered, powers and discretion to add further conduct requirements on essentially any matter. It is again unsatisfactory for the Proposed IIA to have such a wide discretion rather than having all statutory requirements subject to the scrutiny of the public (through LegCo).

74. Amongst the conduct requirements, PIBA notes with concern that the Proposed IIA may "*prohibit the receipt by a licensed insurance intermediary of any property or services from another licensed insurance intermediary in consideration of directing business to that other licensed insurance intermediary, except in specified circumstances and under specified conditions*" (section 92(2)(k)). While the prohibition will probably be subject to the proviso of "*specified circumstances*" and "*specified conditions*", the Administration will no doubt appreciate that it is not uncommon for referrals of business which are perfectly legitimate

to be made from time to time. Indeed, such is necessary in the best interests of policyholders or potential policyholders. By way of example, where there is an international element in any insurance or reinsurance, it is necessary for a Hong Kong intermediary to work with other intermediaries in order to meet the needs of its customers. The Administration should clarify the scope of this proposed restriction and revise the draft legislation to remove any uncertainty.

PIBA's Recommendation:

The Bill should be specific on the "conduct requirements" and ensure that all relevant requirements are fully set out in the legislation so as to eliminate any potential ambiguity.

XIV. Excessive powers of inspection and investigation

75. PIBA notes with concern the extremely wide and extensive powers of inspection that have been conferred upon the Proposed IIA under Section 64ZZF. The position is particularly alarming in the absence of

appropriate safeguards despite vigorous objections during the consultation stage.

76. Section 64ZZF in essence empowers the Proposed IIA to, at any time, enter the business premises of a licensed insurance intermediary to inspect, make copies, otherwise record, and/or make enquiry of any business record and/or transaction or activity undertaken by an intermediary. What makes it worse is that such wide powers can be exercised by the Proposed IIA at any time even for the mere purpose of *"ascertaining whether a licensed insurance intermediary is complying with, has complied with, or is likely to be able to comply"*[36] with the Ordinance or any licensing condition etc. Before exercising such draconian and intrusive powers, there is not even a requirement that the Proposed IIA needs to have a reasonable suspicion of there being a breach or possible contravention.

77. It follows that the Proposed IIA has indeed been given an unfettered power to, at any time, with or without any valid basis, with or without

[36] Section 64ZZF(1) of the Bill.

any prior notice, enter the business premises of any intermediaries for inspection as it, in its absolute discretion, deems appropriate. This is not acceptable, especially when no reason has been offered to justify the need for such wide powers.

78. PIBA strongly objects to the above unfettered powers which could amount to an abuse in the absence of appropriate and necessary safeguards.

PIBA's Recommendation:

- ***Usual or routine inspection should only be conducted upon giving reasonable and sufficient advance written notice to the intermediary in question;***
- ***the power to enter the business premises of an intermediary without notice for the purpose of inspection should only be exercised with the approval of the [Governing Board] upon receipt of a written report from the inspector in question setting out grounds / reasons for to proceed with the inspection otherwise, i.e. with advance notice, would defeat the purpose of***

the inspection or render it ineffective; and

- ***express provisions should also be incorporated into the Bill to ensure that any privileged communication, whether oral or written, will be exempted from any inspection by the Proposed IIA as well as provisions on the general inadmissibility in criminal proceedings of answers given to an inspector.***

79. Insofar as investigation powers are concerned, again, Section 64ZZH provides that if the Proposed IIA "*has reasonable cause to believe that a provision of [the proposed Ordinance] may have been contravened*", extensive investigatory powers could then be exercised. We observe here that the threshold is extremely low, as it would theoretically mean that non-compliance of any nature, even a technical or minor one, would suffice to trigger the very wide investigation powers.

PIBA's Recommendation:

Safeguards be included to ensure that the powers of investigation would only be triggered in appropriate cases.

XV. Absence of any information on the Disciplinary Committee

80. PIBA is surprised that despite its strong views expressed in the Response,[37] the Bill is completely silent on the Disciplinary Committee, whether on its appointment, composition or any other details thereto. Even the piecemeal information that was previously mentioned in the Consultation Paper is completely missing from the Bill. For instance, statements such as:

> *"The Disciplinary Committee will be chaired by a senior IIA executive with members from both the IIA and HKMA"*;[38] and

[37] The Response, paras. 81-84 at pages 43-44.

[38] The 2012 Legislative Proposals, para. 5.3.1(d) at page 83.

"the IIA will establish an Expert Panel from which it may seek advice on the nature of a specific product, related industry practices or experiences to facilitate its deliberation during the disciplinary process. The Expert Panel will comprise members with industry knowledge and necessary measures will be in place to avoid any conflict of interest".[39]

81. Now that the Bill is completely silent on the Disciplinary Committee, and the proposed Expert Panel is nowhere to be seen in the entire Bill, the public and the industry are simply left in the dark as to whether or not the said Expert Panel is still part of the disciplinary regime, and if it is not, whether, and if so, how the Proposed IIA will ensure that the Disciplinary Committee will be provided, or equipped with the requisite knowledge, experience or practice on insurance-related matters when it comes to disciplinary action in respect of matters stemming from the highly specialized insurance industry.

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[39] The 2012 Legislative Proposals, para. 5.3.1(e) at page 83.

82. It is inconceivable that the Bill contains nothing on the Disciplinary Committee, which should be indispensable as one of the major functions of the Proposed IIA is the exercise of disciplinary powers over market practitioners.

83. The public and market participants would need to know the exact composition of the Disciplinary Committee since it will not only possess the powers to adjudicate and impose disciplinary sanctions (and will, in effect, be a quasi-judicial body), but will at the same time have the duties and powers of investigation. A legitimate question which follows is how the Proposed IIA will guard against any potential conflict of interest. Without any provisions governing the appointment or composition of the Disciplinary Committee, there is simply no means whereby the public and other stakeholders can be assured that such risk will be taken care of.

84. Further, the Administration will be aware that during the Consultation stage, there was clear and strong opinion that the Disciplinary Committee should comprise representatives of the industry so that the Committee will possess the requisite expertise and knowledge on all fronts of the

insurance profession. Regrettably, these fundamental issues have been left unattended.

PIBA's Recommendation:

To provide sufficient and detailed information on the Disciplinary Committee and Expert Panel to ensure that the Disciplinary Committee has sufficient market representation.

XVI. Unnecessarily wide definition of "misconduct"

85. Section 79(1) provides that disciplinary powers can be exercised if an intermediary or RO thereof is guilty of misconduct which is defined as covering —

"(a) a contravention of a provision of this Ordinance;

(b) a contravention of a term or condition of a licence granted under this Ordinance;

(c) a contravention of any other condition imposed under a provision of this Ordinance; or

(d) an act or omission relating to the carrying on of any regulated activity which, in the Authority's opinion, is or is likely to be prejudicial to the interests of policy holders or potential policyholders or the public interest".

86. PIBA reiterates its objection to the above wide definition of "misconduct".

87. It should be appreciated that since not all provisions in the Bill are of equal importance, it will not be reasonable to adopt a broad-brush approach and simply equate any and all non-compliance or contravention of the provisions as "*misconduct*". This is especially the case when it comes to technical or minor non-compliance of certain procedural requirements which do not in any way impact upon or prejudice the interests or position of policyholders. To adopt such broad-brush approach only renders the definition of misconduct unnecessarily wide, and subjects an intermediary and/or the RO too lightly to disciplinary action which itself is a serious step.

PIBA's recommendation:

To define "misconduct" as "act or omission relating to the carrying on of any regulated activity which, in the opinion of the IIA, is or is likely to be prejudicial to the interest of policyholders.

XVII. Unreasonably and unjustifiably high cap on pecuniary penalty

88. Notwithstanding the strong objection raised by different market participants in their responses to the 2012 Legislative Proposals, PIBA regrets that the same cap remains, namely, the greater sum of $10,000,000 or three times the amount of the profit gained or loss avoided by the regulated person as a result of misconduct.[40]

89. The proposed fine is grossly excessive for intermediaries. As previously submitted, most insurance brokerage firms are SMEs with relatively limited financial resources with many individual licensees living on

[40] Section 80(4)(e) of the Bill.

moderate income. There can be no justification to impose the same maximum pecuniary fine for both intermediaries and insurers, when the latter are in a much stronger financial position which is beyond comparison.

90. PIBA invites the Administration to review the above bearing in mind that whilst an insurance broker is required to maintain a minimum net asset value and a minimum fully paid up share capital of HK$100,000 at all times, the minimum paid-up capital required of an insurer is HK$10 million (or HK$20 million for a composite insurer).[41]

(a) With a 100 times' difference in terms of the minimum requirement on paid-up capital, it is inconceivable that anyone would consider it fair or justified to impose the same level of capped pecuniary penalty to both groups of market participants.

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[41] Office of the Commissioner of Insurance, *Authorization Requirements*, http://www.oci.gov.hk/framework/index_01_01.html (last revised 8 April 2014).

(b) The Administration needs to take into account the fact that the maximum financial penalty imposed by other professionals, including accountants, solicitors and barristers in disciplinary proceedings are all capped at HK$500,000 with the Medical Council having no power at all to impose any financial penalty in respect of disciplinary offences by medical practitioners. A further distinction (i.e. an even lesser cap) is necessary in the case of individual brokers (technical representatives) since there is no justification to have them to face such a huge financial risk.

PIBA's recommendation:

The proposed cap on pecuniary penalty in the case of insurance brokers is overly excessive by any standards. The maximum financial penalty for brokers should not exceed the level of HK$500,000, with an even lesser cap in the case of individual brokers (technical representatives).

XVIII. Appellate mechanism and checks and balances

91. It is noted that the Bill has now provided for the establishment of an Insurance Appeal Tribunal (the "**Proposed IAT**").[42] PIBA is however concerned as to whether this appeal avenue, which is intended to provide sufficient checks and balances against the powers of the Proposed IIA (whether in relation to licensing, quasi-judicial or other decisions made) would be accessible to all market participants who feel aggrieved by the decisions of the Proposed IIA.

92. Section 104 provides that the Proposed IAT may, in relation to a review, award to any party "*a sum that it considers appropriate in respect of the costs reasonably incurred by the person or party in relation to the review and the application for the review*",[43] that "*the costs awarded must be paid by, and are recoverable as a civil debt*",[44] and that "*...Order 62 of the Rules of the High Court... applies to the award of costs, and to the taxation of any costs awarded, by the [Proposed IAT]*".[45] There are real

[42] Section 95 of the Bill.

[43] Section 104(1) of the Bill.

[44] Section 104(2) of the Bill.

[45] Section 104(3) of the Bill

concerns on whether the appeal avenue is genuinely going to be accessible to brokers.

93. Allowing costs to be awarded in essentially the same manner as in High Court civil proceedings could make the Proposed IAT available only to bigger market players, and not brokers, as many of the latter are SMEs or individuals with relatively limited financial resources. To face potential costs consequences similar to those in a civil claim, despite the very different nature of the two and without the benefit of legal aid (which is available to litigants in civil proceedings), the Proposed IAT is unlikely to be an accessible review avenue for brokers. Brokers who wish to seek a review by the Proposed IAT will inevitably have to first take into account the risks of having to bear substantial costs (which could easily outweigh the amount at stake). Such potentially substantial adverse costs consequence will result in stifling genuine appeals by insurance brokers with limited financial resources and render the appeal procedure nugatory.

PIBA's Recommendation:

The Administration should introduce a mechanism to ensure that no party is discouraged from filing an appeal / review due to costs. The costs provisions should not have the effect of stifling a potential appeal. Measures to consider include introducing a cap on the maximum costs that can be ordered against an unsuccessful applicant.

XIX. Unnecessarily harsh consequences of non-compliance of orders given by the Proposed IAT

94. Section 100(2) provides that "[a] person commits an offence if the person, without reasonable excuse – (a) fails to comply with an order, notice, prohibition or requirement of the [Proposed IAT] made, given or imposed under subsection (1)" which include orders relating to the "procedure to be followed in the review"[46] or "orders that may be necessary for or ancillary to the conduct of the review".[47] This apparently covers procedural orders, the non-compliance of which (without reasonable excuse) could amount to a criminal offence under the Bill. This again is

[46] Section 100(1)(j) of the Bill.

[47] Section 100(1)(k) of the Bill.

unreasonable and oppressive. It is in effect more stringent than non-compliance with procedural orders in civil proceedings.

PIBA's Recommendation:

The Administration is urged to draw a distinction between a procedural breach and a breach of a nature that is serious enough to constitute an offence.

CONCLUSION

95. The above represent some of PIBA's main concerns on the Bill.

96. PIBA urges the Administration to give serious consideration to the issues highlighted. In this regard, PIBA will be pleased to consider appropriate revisions to the existing Bill and to work with the Administration so that the concerns raised can be attended to with sufficient details properly and adequately.

Dated this 23rd day of June, 2014

The Professional Insurance Brokers Association