

For discussion
on 6 June 2016

Legislative Council Panel on Financial Affairs

Independent Insurance Authority Budget for the Financial Year 2016-17

PURPOSE

This paper highlights the main features of the budget of the independent Insurance Authority (“the Authority”)¹ for 2016-17.

BACKGROUND

2. On 7 December 2015, the Authority was established with the commencement of the relevant provisions added by the Insurance Companies (Amendment) Ordinance 2015 (“IC(A)O”) and was immediately renamed as the Provisional Insurance Authority. The Authority is a new insurance regulator independent of the Government. At present, the Office of the Commissioner of Insurance (“OCI”), a government department, regulates insurance companies and oversees three Self-Regulatory Organizations (“SROs”)² in supervising insurance intermediaries. The Authority will eventually assume the statutory functions of OCI and take over the regulation of insurance intermediaries from the three SROs through a statutory licensing regime. To allow for a smooth transition from the existing regulatory regime to the new regime administered by the Authority, the IC(A)O is being implemented by

¹ The new section 4AAA(2) of the Insurance Companies Ordinance (Cap. 41) added by section 9 of the Insurance Companies (Amendment) Ordinance 2015 provides that when the Authority is established, it is automatically renamed as “Provisional Insurance Authority” in English and “臨時保險業監管局” in Chinese for the period from its inception to the disbandment of the Office of the Commissioner of Insurance.

² The three SROs are the Insurance Agents Registration Board established under the Hong Kong Federation of Insurers, the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association.

phases.

3. The new section 5B of the Insurance Companies Ordinance (Cap. 41)³ added by section 15 of IC(A)O stipulates that the Authority must, no later than 31 December⁴ in each financial year, submit to the Financial Secretary (“FS”) for approval a corporate plan (including the estimates of its income and expenditure (“the Budget”)) for the next financial year. The law requires that FS must lay a copy of the budget on the table of the Legislative Council (“LegCo”).

4. As undertaken by the Government during LegCo’s scrutiny of the Insurance Companies (Amendment) Bill 2014, the Authority will brief the LegCo Panel on Financial Affairs (“the Panel”) on the main features of its Budget prior to seeking FS’ approval.

5. A copy of the Authority’s Budget for 2016-17 is attached at Annex. In preparing the Budget, it has been assumed that the Authority will take over OCI’s statutory functions in end 2016. Since the Authority is only in its inception stage, the Budget is the best estimates that could be worked out with reference to the findings of the consultancy study⁵.

FUNDING OF THE AUTHORITY

Income

6. In the long run, the Authority is financially independent of the Government, with income streams from a levy on premiums of

³ The ICO will be renamed as the Insurance Ordinance when section 4 of IC(A)O takes effect.

⁴ As the appointments of the Chairperson and Members to the Authority only took effect on 28 December 2015, FS’ approval has been sought to extend the statutory deadline for the submission of the Authority’s first Corporate Plan for six months (i.e. to 30 June 2016).

⁵ The consultancy study and the subsequent updating exercise were commissioned by the Government to work out, inter alia, the staffing and cashflow requirements of the Authority. Details of the indicative budget recommended under the consultancy study could be found at Annex A to the paper discussed at the meeting of the LegCo Panel on Financial Affairs held on 7 December 2015 (ref.: CB(1)209/15-16(04)).

insurance policies⁶, authorization fees payable by insurance companies⁷, licence fees payable by insurance intermediaries and user fees on specific services provided by the Authority. To help the Authority meet the initial shortfall in its first few years of operation, we propose to provide the Authority with a lump sum of \$650 million on its inception. We have consulted the Panel on the funding proposal and Members were supportive. Of the total \$650 million, it is expected that there will be a deficit of \$450 million in the first two years. We have therefore included a non-recurrent commitment of \$450 million in the 2016-17 Estimates, as the first instalment of funding for the Authority to meet its shortfall in the first two years, which has been approved by LegCo in the context of the Appropriation Bill 2016.

7. The estimated income for 2016-17 is \$457.8 million (including the \$450 million approved by LegCo as mentioned in paragraph 6 above). In calculating the estimated income, it has been assumed that the relevant pieces of subsidiary legislation to enable the collection of the proposed levy, authorization fees and user fees by the Authority will only take effect in 2017-18 and the Authority will in the meantime continue to charge insurance companies the existing authorization fee being charged by OCI.

Operating Expenditure

8. The estimated operating expenditure for 2016-17 is \$100.2 million. The estimated expenditure mainly comprises staff cost, office rental and related expenses. It is assumed that some 180 staff members will be recruited in phases during the year.

⁶ As set out in the consultation document on the Key Legislative Proposals on Establishment of the Authority published in 2012 ("Consultation Document"), a levy of 0.1% on premiums of insurance policies will be payable by policy holders and a cap will be imposed. An incremental approach will be adopted for introducing the levy.

⁷ As set out in the Consultation Document, the new annual authorization fee will consist of two elements, namely, a fixed fee of \$300,000 (for captive insurer, \$30,000; and for composite insurer, \$600,000) and a variable fee of 0.0039% on insurance liabilities. An incremental approach will be adopted for introducing the variable fee.

Capital Expenditure

9. The estimated capital expenditure for 2016-17 is \$28.7 million which will be used for office set-up.

Reserve

10. It is projected that there would be an operating reserve of some \$350 million for 2016-17. The reserve is required partly as seed money and partly as provision necessary to support the Authority's initial years of operation.

THE GOVERNMENT'S VIEWS

11. In 2016-17, the Authority will mainly undertake administrative tasks to make preparation for taking over the statutory functions of OCI, such as securing office accommodation, recruiting staff, engaging legal and other essential services for the Authority's operation, as well as setting up internal administrative and financial systems. Moreover, the Authority will formulate and update, if necessary, regulatory tools including regulations, guidelines or codes for smooth transition from the existing regime to the new regime. The Authority will also start exploring with its stakeholders how to facilitate the sustainable development of the insurance industry, including the risks and opportunities associated with the application of financial technology. Whether the target of assuming the statutory functions of OCI by end 2016 could be achieved would depend on the progress of the preparatory work. We have set up a small preparatory team of civil servants to assist the Authority to take forward the essential tasks before the Authority has recruited its own staff.

12. We are studying the Authority's proposed Budget for 2016-17 having regard to the progress of the preparatory work for the year. We trust that the Authority would deploy its resources and control its expenditures in a prudent manner to achieve long term financial sustainability.

ADVICE SOUGHT

13. Members are invited to note the proposed Budget of the Authority for 2016-17.

Financial Services Branch
Financial Services and the Treasury Bureau
June 2016

Provisional Insurance Authority

Estimates of Income and Expenditure for 2016-17

	<u>Note</u>	<u>HK\$ million</u>
A. <u>Income and Expenditure Statement</u>		
<u>Income</u>		
(a) Provision from the Government ¹		450.0
(b) Interest income	1	0.1
(c) Fees	2	7.7
Total Income		<u>457.8</u>
 <u>Operating Expenditure</u>		
(a) Staff cost	3	52.5
(b) Office rental and related expenses	4	29.4
(c) Engagement of professional services	5	12.7
(d) Remuneration to Members		2.5
(e) Depreciation	6	1.6
(f) Miscellaneous expenses	7	1.5
Total Expenditure		<u>100.2</u>
Reserve	8	<u><u>357.6</u></u>
 B. <u>Capital Expenditure Statement</u>		
(a) Office set-up	9	<u><u>28.7</u></u>

¹ The provision to be allocated to the Authority is \$450 million in 2016-17.

Notes to the Estimates for 2016-17

1. Interest income

An annual interest rate of 0.02% is assumed in the calculation of the estimated interest income on the provision to be allocated in 2016-17.

2. Fees

Assuming the relevant pieces of subsidiary legislation to enable the collection of the proposed levy, authorization (fixed and variable) fees and user fees by the Authority take effect in the 2017-18 financial year, the Authority will in the meantime continue to collect the existing authorization fee (\$227,300) payable by insurance companies to the Office of the Commissioner of Insurance (“OCI”) when it takes over the functions of OCI in end 2016.

3. Staff cost

The staff cost covers mainly salary, contributions to Mandatory Provident Fund schemes, medical insurance and employee compensation insurance. Based on the recommendations of a consultancy study earlier commissioned by the Government with the estimated staffing requirement and budget updated by the Consultant in November 2015², the Authority will have an initial establishment of 299 staff members (including the Chief Executive Officer). It is assumed that key personnel will be recruited in phases in 2016-17 and the total staff cost is estimated on a pro-rata basis.

4. Office rental and related expenses

This item includes office rental, management fees, utility charges, government rent/rates as well as other related expenses such as general office insurance and telephone rental.

5. Engagement of professional services

This item involves mainly engagement of services providers in connection with executive search services for staff recruitment, project

² The consultancy study was carried out by the PricewaterhouseCoopers.

management of office accommodation, legal and audit services.

6. Depreciation

With reference to the Consultant's recommendations, the estimated depreciation is calculated to write off the cost of fixed assets (such as furniture and fixtures as well as office and information technology equipment) using the straight-line method over their estimated useful lives of either three or five years.

7. Miscellaneous expenses

This item includes mainly expenses on website development and system maintenance.

8. Reserve

The reserve is required, partly as seed money and partly as provision necessary to support the Authority's initial years of operation. Based on the Consultant's findings, the Authority will face a shortfall of about \$450 million in the first two years of operation.

9. Office set-up

The cost estimate includes office renovation and fitting-out works, acquisition of furniture as well as office and information technology equipment on a one-off basis.