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Panel on Financial Affairs

Meeting on 6 June 2016

**Background brief on the
Establishment of and financial arrangements for
the independent Insurance Authority**

Purpose

This paper provides background information on the establishment of and financial arrangements for the independent Insurance Authority ("IIA"). It also gives a brief account of the major views and concerns raised by Members in the 2014-2015 and 2015-2016 sessions relating to the financial arrangements for IIA.

Background

Establishment of the independent Insurance Authority

2. Currently, the Office of the Commissioner of Insurance ("OCI"), which is a government department, is responsible for the regulation of Hong Kong's insurance industry. OCI regulates insurance companies to ensure their financial soundness, while conduct regulation of insurance intermediaries are taken up by three Self-Regulatory Organizations ("SROs").¹

3. The Legislative Council ("LegCo") passed the Insurance Companies (Amendment) Bill 2014 on 10 July 2015 (the Bill was enacted as the Insurance Companies (Amendment) Ordinance 2015 ("the Amendment Ordinance"))² to

¹ The three Self-Regulatory Organizations 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.

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

provide for the establishment of IIA to take over the duties of OCI and administer an independent regulatory regime for insurance intermediaries to replace the existing self-regulatory regime.

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

Stage 1: To establish the Provisional Insurance Authority ("PIA") (without regulatory functions and co-exists with OCI)	December 2015
Stage 2: PIA becomes IIA to replace OCI by taking over its regulatory functions (the self-regulatory regime for insurance intermediaries remains unchanged)	By end 2016
Stage 3: IIA to implement the statutory licensing regime and take over the regulation of insurance intermediaries from the three SROs	Two to three years from the establishment of PIA

5. PIA was established on 7 December 2015 through tabling of the Insurance Companies (Amendment) Ordinance 2015 (Commencement) Notice 2015 before LegCo³ at the meeting of 14 October 2015. PIA is not vested with any regulatory powers before it becomes the IA to take over the duties of OCI. On 28 December 2015, the Chief Executive ("CE") announced the appointment of the Chairperson and seven Non-executive Directors of PIA for a term of three years from 28 December 2015 to 27 December 2018.

Financial arrangements for the independent Insurance Authority

6. The new sections 5A to 5G⁴ of the Insurance Companies Ordinance (Cap. 41) set out the accounting and financial arrangements of IIA. The main provisions include requirements for IIA to prepare and submit its annual corporate plans (including the estimates of income and expenditure) to the Financial Secretary ("FS") for approval and submit annual reports to FS; FS to table IIA's estimates, annual reports and audited financial statements before LegCo; the Government to pay IIA out of the general revenue the monies

³ No subcommittee was formed for scrutiny of the Commencement Notice. 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 IIA 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 Office of the Commissioner of Insurance ("OCI").

⁴ The sections, which are added by section 15 of the Amendment Ordinance, have come into operation by virtue of the Commencement Notice.

appropriated by LegCo. As a check and balance, the Director of Audit may conduct value for money audit on IIA.

7. To enhance transparency in the preparation of IIA's annual estimates, the Administration has, during the scrutiny of the Bill, taken on board the Bills Committee's suggestion to brief the Panel on Financial Affairs ("FA Panel") on the main features of IIA's proposed budget prior to seeking approval by FS.

8. The Administration's policy objective is for IIA to fully recover its costs via income from the market and become financially independent of the Government. In this connection, it is the long-term target that about 70% of the expenditure of IIA will be met by levy and the remaining 30% by various authorization/licence and user fees⁵ ("the proposed 70:30 split"). In respect of the levy, IIA will impose a levy of 0.1% on insurance premiums for all insurance policies (capped at \$100 for life policies and \$5,000 for non-life policies), which will be implemented through an incremental approach,⁶ and exempt premiums of reinsurance contracts from the levy. As regards licence and user fees, they will be payable by all insurers and licensed intermediaries. To help meet part of IIA's expenses in the initial five years before it achieves the target levels of fees and levy, the Administration's proposal is to provide a lump sum provision to IIA on its inception.

9. On 7 December 2015, the Administration briefed FA Panel on its funding proposal for the establishment of IIA and the exit arrangement for the existing Insurance Officers in OCI. A lump sum provision of \$650 million⁷ was proposed for meeting the first four years of operation of IIA. During the

⁵ Authorization fees are payable by insurance companies, licence fees are payable by insurance intermediaries and user fees are charged for provision of specific services. Levies are collected from insurance premiums. All fees and levies of IIA will be prescribed in regulations and orders to be made by the Chief Executive which are subsidiary legislation subject to the Legislative Council's scrutiny.

⁶ IIA's target level of levy in the first five years after its establishment will be in accordance with the following schedule –

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Market levy as a % on insurance premiums	0.04%	0.05%	0.06%	0.07%	0.085%	0.1%

⁷ Based on a consultancy study conducted by the Administration in 2010, a lump sum of \$500 million was required as seed money and contingency reserve to support IIA's initial years of operation. The Administration updated the estimates in November 2015 and revised the lump sum to \$650 million having regard to the additional regulatory functions of OCI (including enforcement of the anti-money laundering regulatory regime) since the study in 2010 to be taken over by IIA. The Administration also advised that based on 2010 consultancy study, IIA would have an establishment of about 250 staff members at its inception. As for OCI, the number of staff members was 150 as in mid-2014. As indicated in the updated consultancy study in November 2015, IIA will have an initial establishment of 299 staff members.

examination of the Estimates of Expenditure 2016-2017 in April 2016, the Administration explained that \$450 million of the lump sum provision for meeting the shortfall of IIA's budget for the first two years had been included in the Estimates of Expenditure 2016-2017. The Administration plans to provide the remaining \$200 million to IIA tentatively in 2018-2019, subject to the progress of the transitional work from the existing regulatory regime to the new one.

Concerns and views expressed by Members

10. The major views and concerns expressed by members of the Bills Committee and members of FA Panel relating to the financial arrangements for IIA and the funding proposal for the establishment of IIA are summarized in the ensuing paragraphs.

Financing mechanism and estimates of the independent Insurance Authority

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

12. The Administration explained that IIA would have a larger establishment than OCI mainly because IIA would take up the additional responsibility of administering the licensing system for insurance intermediaries. The Amendment Ordinance required that IIA's annual estimates, which included estimated staff costs and professional service fees, to be approved by FS and the approved estimates must be tabled before LegCo. These measures would provide an effective check and balance. The Administration stressed the need to provide IIA with operational flexibility in employing and engaging suitable talents and determining the appropriate level of remuneration having regard to the actual circumstances and prevailing market situations in order to cope with regulatory challenges effectively and respond swiftly to market changes. This was in line with the practice of other financial regulators, such as the Securities and Futures Commission ("SFC") and the Mandatory Provident Fund Schemes Authority ("MPFA"). The Administration also took note of Members' suggestion that part of the proposed start-up funds for IIA should be provided in

the form of a loan, and undertook to consult FA Panel before seeking funding approval from the Finance Committee.

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

Funding proposal on the establishment of an independent Insurance Authority

14. During the briefing on the Administration's funding proposal for the establishment of IIA at FA meeting on 7 December 2015, some Panel members enquired whether the Administration would top up the shortfall if the proposed lump sum provision of \$650 million for IIA was insufficient. There was also concern about the propriety of the proposed 70:30 split given that the expenditure to be recovered from the market should be borne mainly by insurers and insurance intermediaries who would benefit from the new regulatory regime.

15. The Administration advised that if the proposed lump sum provision turned out to be inadequate, the Administration might consider different options including the provision of additional funding to IIA in the form of a loan. There were provisions in the Amendment Ordinance enabling IIA to borrow money with the approval of FS. Given the healthy and stable development of the insurance industry in the previous years on which basis the income projection of IIA had been worked out, it was envisaged that the proposed \$650 million would be sufficient to support the operation of IIA in the initial five to six years. As regards the proposed 70:30 split, the Administration reiterated that the proposed arrangement, which was set out in the consultation paper on the establishment of IIA published in 2010, aimed to enable IIA to have stable sources of income for achieving financial independence after several years of operation.

16. As regards the recruitment policies of IIA, the Administration advised that IIA would decide the matters on its own. While IIA might engage a human resources consultant for advice, it was envisaged that similar arrangements as with other statutory regulatory bodies (like SFC and MPFA) would be adopted. Such measures might include recruitment of staff on contract terms.

Examination of the Estimates of Expenditure 2016-2017

17. During the examination of the Estimates of Expenditure 2016-2017 in April 2016, Members raised a number of written questions relating to progress of the establishment of IIA, funding and expenditure of IIA in the initial years of its operation, exit arrangement for the existing staff of OCI, etc. Hyperlinks to the questions and the Administration's responses are in the **Appendix**.

Latest development

18. The Administration will brief FA Panel on the main features of IIA's proposed budget for 2016-2017 at the meeting to be held on 6 June 2016.

Relevant papers

19. A list of relevant papers is in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
1 June 2016

List of relevant papers

Date/Period	Event	Paper/Minutes of meeting
May 2014 to July 2015	The Bills Committee on Insurance Companies (Amendment) Bill 2014 was in action	Report of the Bills Committee (LC Paper No. CB(1)1055/14-15) Legislative Council Brief (File Ref: C2/2/50C) Legal Service Division report (LC Paper No. LS50/13-14)
10 July 2015	The Legislative Council ("LegCo") passed the Insurance Companies (Amendment) Bill 2014	Hansard
14 October 2015	The Insurance Companies (Amendment) Ordinance 2015 (Commencement) Notice 2015 gazetted on 9 October 2015 was introduced into LegCo	Legislative Council Brief (File Ref.: INS/2/3C(2015)) Legal Service Division Report (LC Paper No. LS2/15-16)
7 December 2015	The Panel on Financial Affairs was briefed by the Administration on its funding proposal relating to the establishment of an independent Insurance Authority	Administration's paper (LC Paper No. CB(1)209/15-16(04)) Minutes (LC Paper No. CB(1)540/15-16)
28 December 2015	The Chief Executive announced the appointment of the Chairperson and seven Non-executive Directors of the Provisional Insurance Authority	Press release

Date/Period	Event	Paper/Minutes of meeting
5 April 2016	Special meeting of the Finance Committee for examination of Estimates of Expenditure 2016-2017	<u>Written questions raised by Members and Administration's replies for the session on "Financial Services"</u> (Reply serial numbers: FSTB(FS)001, 009, 010, 011, 012, 013, 014, 024, 033, 035, 037, 038, 039, 044, 060, 092, 098, 099 and 103)