For discussion
on 15 November 2016

Legislative Council Panel on Financial Affairs

Collection of Levy on Insurance Premiums and Various Fees by the Independent Insurance Authority

PURPOSE

This paper seeks Members' views on the detailed legislative proposals for the independent Insurance Authority ("IIA") to collect levy on insurance premiums from policy holders, authorization fees from insurance companies, and other fees on specific services provided by IIA ("user fees").

BACKGROUND

2. Enacted in July 2015, the Insurance Companies (Amendment) Ordinance 2015 ("Amendment Ordinance") provides for, among other things, the establishment of IIA which will take over the statutory functions of the Office of the Commissioner of Insurance ("OCI"), a government department, to regulate insurance companies and to take over the supervisory functions of the existing three Self-regulatory Organizations ("SROs")[1] to regulate insurance intermediaries.

3. To ensure a smooth transition from OCI to IIA, the Amendment Ordinance is being commenced in three stages as follows –

Stage 1: IIA was established on 7 December 2015 and was immediately renamed as the Provisional Insurance Authority ("PIA") to undertake essential preparatory work;

[1] 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.

Stage 2: PIA to be renamed as IIA to take over the functions of the existing OCI as the prudential regulator of insurance companies; and

Stage 3: IIA to implement the new statutory licensing regime and take over the regulation of insurance intermediaries from the three SROs.

4. Currently, OCI recovers around one-third of its annual operating cost from the authorization fees paid by insurance companies at a fixed rate of $227,300 (or $22,600 for captive insurance company). The fees have remained unchanged since 1996. The long-term target is for IIA to be financially independent of the Government. To provide funding for its expenditure, IIA is empowered under the Amendment Ordinance to collect levy[2] from policy holders and various fees including authorization fees from insurance companies, licence fees from insurance intermediaries and user fees on specific services provided.

5. With the support of this Panel in December 2015, the Government obtained the approval of the Legislative Council ("LegCo") for a provision of $650 million to fund the establishment and initial years of operation of IIA when IIA has yet to be able to fully recover its operating costs. The long-term target is that about 70% of IIA expenditure will be met by income from the levy and the remaining 30% by income from various fees. We anticipate that IIA will be ready to take over the statutory functions of OCI on the regulation of insurance companies in Q1/Q2 2017 (i.e. Stage 2). We therefore need to put in place the relevant pieces of subsidiary legislation on the collection of levy, authorization fees and user fees to dovetail with the commencement of Stage 2. Licence fees payable by insurance intermediaries will be dealt

[2] New section 134 of the Insurance Companies Ordinance (which will be renamed as Insurance Ordinance after the commencement of the relevant provision under the Amendment Ordinance) (Cap. 41) stipulates that if a contract of insurance relates to (a) a prescribed class of insurance business; or (b) a prescribed type of contract of insurance, a prescribed levy is payable to IIA for the contract by its policy holder. The Chief Executive in Council may, by order, specify the levy rate or amount and make regulations to provide for the payment of levy. According to the new section 135 of Cap. 41, IIA is required to review the level of levy once its reserves are more than twice its estimated operating expenses for the financial year (after deducting depreciations and all provisions) and it has no outstanding debt, with a view to recommending a reduction in levy.

with in Stage 3, when the statutory licensing regime for insurance intermediaries is in place.

PROPOSALS

A. Levy on Insurance Premiums

6. We consulted this Panel in July 2013 on the consultation conclusions of the key legislative proposals on the establishment of IIA. In the consultation document ("Consultation Document"), it is proposed that a levy of 0.1% on premiums of insurance policies will be payable by policy holders. A levy cap of $100 and $5,000 will be imposed on long term insurance policies and general insurance policies respectively[3]. To reduce the impact on the insurance industry and policy holders, an incremental approach is suggested in the Consultation Document in achieving the target level of 0.1%. Reinsurance contracts will be exempt from the levy. In-force policies which are already paid up before the implementation of levy are not subject to the levy.

Payment and remittance of levy

7. IIA will collect the levy from policy holders through insurance companies. Policy holders shall pay the levy on each premium payable, while insurance companies will remit the amount to IIA every six months.

Cap

8. The industry has pointed out that under the original proposal, group medical insurance policies issued by general insurance companies would be subject to a cap of $5,000 while group life insurance policies with medical protection are only subject to a lower cap of $100. As these two types of products are competitive products in the same market

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3 Policy holders of general insurance policies with annual premiums at or above $5,000,000 and of long term insurance policies with single or annualized premiums at or above $100,000 will have to pay the maximum levy of $5,000 and $100 respectively. In cases of premium payment by multiple instalments to be made less than once a year or flexible instalments, the cap will be adjusted as appropriate.

segment, we propose that group life insurance policies with medical protection offered by employers[4] shall be subject to the same cap of $5,000 applicable to general business to maintain a level-playing field.

Refund

9. If premiums are in whole or in part refunded by the insurance company to the policy holder, the policy holder should be refunded with the relevant proportion of the levy paid. If the amount concerned has already been remitted to IIA, insurance companies may adjust and reflect the refund in a subsequent remittance.

Penalty

10. A policy holder who fails to timely pay the levy to the authorized insurance company with which he enters into the contract of insurance commits an offence and is liable to a fine of $10,000. An insurance company which collects excessive levy from policy holders commits an offence and is liable to a fine of $10,000. An insurance company which fails to timely remit the sums of levy payable to IIA commits an offence and is liable to a fine of $10,000 or 20 times the amount remittable whichever the greater, unless he can demonstrate that he has made every reasonable endeavor to collect the levy from the relevant policy holder.

Incremental approach and implementation timeframe

11. Under the original proposal, the collection of levy will start at 0.04% once IIA takes up OCI's statutory functions, currently targeted for Q1/Q2 2017. The rate will then increase by a percentage point of 0.01 to 0.015 on a yearly basis (0.05%, 0.06%, 0.07% and 0.085%) until it reaches its target level of 0.1%.

12. When mapping out the implementation details, we have taken into account the following practical considerations –

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[4] These policies will be those which fall under Class I with a business nature of Class 2 under Schedule 1 to Cap. 41.

- minimizing disturbance and confusion to policy holders;
- minimizing administrative burden on insurance companies who collect the levy on behalf of IIA; and
- allowing sufficient time for insurance companies to notify policy holders and to upgrade their accounting and billing systems.

13. Based on the above considerations, we propose imposing a rate of 0% upon the commencement of Stage 2 until 31 December 2017 to allow more time for policy holders to get prepared and the industry to be equipped. We also propose to reduce the number of increments to minimize compliance burden. Under the refined schedule as set out in the table below, the total levy income to be collected from policy holders in the first five years will be about the same as in the original proposal.

Levy (as a % on premiums)	**Year 1** (from commence-ment of Stage 2)	**Year 2** (from 1.4.18)	**Year 3** (from 1.4.19)	**Year 4** (from 1.4.20)	**Year 5 and after** (from 1.4.21)
Revised Proposal	0%	0.04%	0.06%	0.085%	0.1%

1.1.2018

Exemption of levy on captive insurance

14. The rationale of imposing a levy on policy holders is that they benefit from prudential and conduct regulation of insurance companies and insurance intermediaries. A captive insurance company, a risk financing tool of conglomerates, is set up by the mother company to insure the risk of its group companies only. All policy holders of a captive insurance company are group companies. Since insurance policies are taken out directly by policy holders from the captive insurance company without the involvement of insurance intermediaries, it is inconceivable that policy holders of a captive insurance company will lodge complaints with IIA against the misconduct of insurance intermediaries. The conduct and financial soundness of the captive insurance company would also not be a concern for its policy holders as

in a normal service supplier-client relationship. We therefore suggest that the levy should not be imposed on captive policy holders. The financial impact on IIA is insignificant.

Exemption of levy on marine, aviation and goods-in-transits businesses

15. During the public consultation in 2012, we received views from the trade that marine, aviation and goods-in-transits businesses[5] should be excluded from the levy on reason that such businesses are highly mobile and the levy may jeopardize Hong Kong's position as a maritime centre. We also note that many overseas jurisdictions such as Singapore, the United Kingdom and a number of European countries offer tax concessions to such businesses. In line with overseas' practices, we propose to exempt marine, aviation and goods-in-transits insurance from the levy. The financial impact on IIA is also insignificant.

B. Annual Authorization Fees

16. Currently, as stipulated under the Insurance Companies (Authorization and Annual Fees) Regulation (Cap. 41C), an annual authorization fee is payable by insurance companies of general business or long term business at a fixed rate of $227,300 (for captive insurance company, $22,600; and for composite insurance company, $454,600) to OCI.

17. As set out in the Consultation Document, the new annual authorization fees will consist of two elements, namely, a fixed fee of $300,000 (for captive insurance company, $30,000; and for composite insurance company, $600,000) and a variable fee of 0.0039% on insurance liabilities[6]. An incremental approach[7] will be adopted for introducing the variable fee.

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[5] These policies will be those which fall under Classes 5, 6, 7, 11 and 12 under Schedule 1 to Cap. 41.

[6] The definition of "insurance liabilities" is –

(a) in respect of long term business, the amount of net liability reported in Form L2 of the Hong Kong Long Term Business Returns under Schedule 3 to Cap. 41, as amended from time to time. It represents the policy reserves, net of reinsurance ceded, set aside by the insurance company at the end of its financial year; and

18. Having considered the magnitude of increase as compared to the existing authorization fees and the financial impact on IIA, we propose setting a cap of $7 million annually on the variable fee. In other words, the maximum amount of annual authorization fee (i.e. the aggregate of fixed and variable fees) payable by insurance companies will be $7.3 million. For composite insurance company, the cap will be applied per long term business or general business respectively. The cap will be reviewed from time to time having regard to a number of factors including the overall market situation, financial position of IIA and affordability of the trade, etc.

C. User Fees

19. At present, OCI only charges a fee for inspecting[8] or obtaining a copy of an entry of Register of Authorized Insurers as stipulated under the Insurance Companies (Register of Insurers) (Prescribed Fee) Regulations (Cap. 41B). As set out in the Consultation Document, IIA will charge service fees to recover the cost of providing specific services.

20. According to the operational experience of OCI, we propose to handle 11 more frequently used service items at Stage 2. The proposed fee levels for these items, set with reference to the formula used by Government departments in calculating user fees, are set out in the following table. Except item 1, all user fees will only be applicable to insurance companies.

(b) in respect of general business, the aggregate of the provision for outstanding claims (net amount), provision for incurred but not reported (i.e. IBNR) and the amount of unexpired risk carried forward as reported in Forms 1A and 2A of the Hong Kong General Business Returns under Schedule 3 to Cap. 41.

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Payment Due Date	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6 and after**
Variable Fee Rate	0.0001%	0.0005%	0.0013%	0.0026%	0.0031%	0.0039%

8 Currently, $10 is charged for inspecting the register of insurers or any part thereof. Under the new section 5H(2) of the amended Cap. 41, which will come into operation upon Stage 2 implementation of Amendment Ordinance, this service will become free of charge.

	Section of Cap. 41	Service Items	Proposed Fee ($)
1.	5H(3)(b)	For obtaining a copy of an entry in, or extract of, the Register of Authorized Insurers; or a certified copy of such…*	6/page; or 100 (certified copy) **same as existing rates*
2.	13A(2)(b)	For each application for prior approval of a controller of an authorized insurer…	18,000
3.	13AC(2)(b)	For each application for prior approval of a director of an authorized insurer…	18,000
4.	13AE(2)(b)	For each application for prior approval of a key person in control function of an authorized insurer…	18,000
5.	13B(2)(ab)	For each application for prior approval of shareholder controller(s) of an authorized insurer, where - (a) the person(s) proposed is/are to hold 50% or more of shares of the insurer… (b) the person(s) proposed is/are to hold less than 50% of shares of the insurer…	 100,000 50,000
6.	15(3B)(b)	For each application for prior approval of an appointed actuary of an authorized insurer…	18,000
7.	128(1)(a)(ii)	For notifying IIA of appointment of- (a) controller (other than one to whom section 13A applies) of an authorized insurer… (b) director (other than one to whom section 13AC applies) of an authorized insurer… (c) shareholder controller (other than one to whom section 13B applies) of an authorized insurer…	 5,000 5,000 5,000
8.	128(1)(a)(ii)	For notifying IIA of appointment of- (a) auditor of an authorized insurer… (b) appointed actuary of an authorized insurer…	 5,000 5,000
9.	128(1)(a)(ii)	For updating information on the Register of Authorized Insurers...	1,300
10.	128(1)(a)(ii)	For issuing a duplicate Certificate of Authorization of an authorized insurer…	200
11.	128(1)(a)(ii)	For issuing a Certificate of Compliance of an authorized insurer…	12,000

WAY FORWARD

21. Under the Amendment Ordinance, the levels of levy, authorization fees and user fees will be prescribed by way of subsidiary legislation subject to negative vetting by LegCo. The collection of the new authorization fees and user fees will tie in with the date when IIA

takes over OCI's statutory functions (i.e. Stage 2) while the collection of levy will start on 1 January 2018.

22. According to the current progress, it is expected that IIA will be ready to take over OCI's statutory functions in Q1/Q2 2017. Accordingly, we aim to table the relevant pieces of subsidiary legislation before LegCo for negative vetting in the beginning of 2017.

23. Members are invited to comment on the proposed mechanism and implementation details for collecting the levy, authorization fees and user fees.

Financial Services Branch
Financial Services and the Treasury Bureau
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