

For discussion
on 16 March 2017

Legislative Council Panel on Financial Affairs

Independent Insurance Authority Budget for the Financial Year 2017-18

PURPOSE

This paper highlights the main features of the budget of the independent Insurance Authority (“the Authority”)¹ for 2017-18.

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 phases.

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.

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 December 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.

BUDGET for 2017-18

5. A copy of the Authority’s Budget for 2017-18 is at **Annex**. The main features of the Budget for 2017-18 are set out in paragraphs 6 to 9 below. In preparing the Budget, it has been assumed that the Authority will take over OCI’s statutory functions in Q2 2017 and, subject to the necessary approval of LegCo, the Authority will start in 2017-18 to receive income from a levy on premiums of insurance policies (“levy”), authorization fees payable by insurance companies (“authorization fees”) and user fees on specific services provided by the Authority (“user fees”).

Income

6. The estimated total income for 2017-18 is about \$66.5 million, as compared to the revised estimate of \$0.9 million for 2016-17 which is mainly the interest income generated from the unspent balance of the Government provision of \$450 million. The long-term target is that the Authority will be financially independent of the Government, with about 70% of its expenditure to be met by income from levy and the remaining 30% by income from authorization fees, user

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

fees, and licence fees payable by insurance intermediaries (to be collected in the last phase when the licensing regime for insurance intermediaries commences). The Government consulted this Panel on the proposed mechanism and implementation details for the collection of levy, authorization fees and user fees in November 2016 and Members did not raise any objection to the proposal. The new streams of income from levy, authorization fees and user fees have been reflected in the income projection for 2017-18.

Operating Expenditure

7. The estimated operating expenditure for 2017-18 is about \$252.7 million, which is higher than the revised estimate of \$22.2 million for 2016-17. The major expenditure items are staff costs (\$179.8 million) and office rental (\$35 million) based on the assumption that some 180 staff members of the Authority will be in post in Q2 2017 for taking up OCI's statutory functions and that the long term office will be available for occupation in the latter half of 2017.

Capital Expenditure

8. The estimated capital expenditure for 2017-18 is about \$31.6 million as compared to the revised estimate of \$0.3 million for 2016-17. The projection has taken into account the capital costs to be spent in 2017-18 for renovation and fitting-out of the long term office.

Reserve

9. With the approval of LegCo, the Government allocated a provision of \$450 million to the Authority in 2016-17. It is projected that the Authority would have an unspent operating balance of about \$240 million by 31 March 2018. The operating reserve will serve partly as seed money and partly as provision necessary to support the Authority's initial years of operation.

THE GOVERNMENT'S VIEWS

10. In 2017-18, the main operational objectives of the Authority are to ensure a smooth transition from the existing regulatory regime to the new regime to be administered by the Authority. The Authority will prepare new regulatory tools for taking up the new regulatory powers vested with the Authority. At the same time, the Authority will continue to engage stakeholders to explore the future development of the insurance industry.

11. Since the Authority is only at its initial set-up stage and has yet to acquire operational experience with the bulk of executive staff expected to assume office in Q2 2017, the estimated income and expenditure for 2017-18 are the best estimates worked out at this stage. Based on the current progress, it is expected that the Authority will be ready to take over OCI's statutory functions in Q2 2017. Further to our consultation with this Panel in November 2016, the Government will submit the subsidiary legislation on the collection of levy, authorization fees and user fees to LegCo in due course.

12. We are studying the Authority's proposed Budget for 2017-18 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 2017-18.

Financial Services Branch
Financial Services and the Treasury Bureau
March 2017

Provisional Insurance Authority

Estimates of Income and Expenditure for 2017-18

		Estimates 2016-17	Revised Estimates 2016-17	Proposed Estimates 2017-18	Variance Proposed Estimates vs. Revised Estimates
	Note	(i) HK\$ million	(ii) HK\$ million	(iii) HK\$ million	(iii) – (ii) HK\$ million
A. <u>Income and Expenditure Statement</u>					
<u>Income</u>	1				
(a) Interest income	2	0.1	0.9	1.0	0.1
(b) Levy and Fees	3	7.7	0	65.5	65.5
Total Income		7.8	0.9	66.5	65.6
<u>Operating Expenditure</u>					
(a) Staff cost	4	52.5	11.3	179.8	168.5
(b) Office rental and related expenses	5	29.4	1.1	35.0	33.9
(c) Engagement of professional services	6	12.7	4.9	12.1	7.2
(d) Remuneration to Members		2.5	2.5	2.5	0
(e) Depreciation	7	1.6	0.1	2.5	2.4
(f) Miscellaneous expenses	8	1.5	0.9	10.4	9.5
(g) Non-recurrent projects	9	0	1.4	10.4	9.0
Total Operating Expenditure		100.2	22.2	252.7	230.5
Result for the year		(92.4)	(21.3)	(186.2)	
B. <u>Capital Expenditure Statement</u>					
(a) Office set-up	10	28.7	0.3	31.6	31.3

Notes to the Proposed Estimates for 2017-18

1. Provision from the Government

According to the consultancy study¹ commissioned by the Government, the Authority will face a deficit of about \$650 million in the first four years of operation. Of the \$650 million, it is expected that there will be a deficit of \$450 million in the first two years. The Government will therefore provide the provision in two instalments to help the Authority meet the shortfall in its initial years of operation. On 13 May 2016, the Legislative Council (“LegCo”) approved the provision of \$450 million to the Authority in the context of the Appropriation Bill 2016. The provision was received in early June 2016. The remaining \$200 million will be sought in 2018-19 tentatively.

2. Interest income

With the approval of the Financial Secretary (“FS”)², the Authority has adopted an interim investment arrangement whereby funds not required for immediate use would be invested in the form of placement of Hong Kong Dollars fixed deposits to earn interest income. A long term investment strategy of the Authority’s reserve funds will be worked out when there is more certainty on the Authority’s cash flow requirements.

3. Levy and Fees

Subject to the necessary approval of LegCo, it is assumed that starting from 1 January 2018, a levy of 0.04% on premiums of insurance policies will be payable by policy holders. The levy rate will gradually increase until it reaches its target level of 0.1%. A cap will be imposed on the levy on general insurance policies with annual premiums at or above \$5 million and long term insurance policies with single or annualized premiums at or above \$100,000. Captive insurance, contracts of reinsurance and marine, aviation and goods in transits are exempt from the levy.

¹ The consultancy study was carried out by PricewaterhouseCoopers.

² Under the new section 4B(2)(h) of the Insurance Companies Ordinance (Cap. 41) added by section 13 of the Insurance Companies (Amendment) Ordinance 2015, the Authority may invest, in the manner approved by FS, its funds that are not required for immediate use.

The new annual authorization fees payable by insurance companies 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, subject to a cap of \$7 million, on insurance liabilities. The variable fee rate is initially set at 0.0001% and will increase gradually until it reaches its target rate of 0.0039%.

At this stage, the Authority will charge service fees to recover the cost of providing 11 specific services. Of them, ten will only be applicable to insurance companies.

4. Staff cost

The staff cost involves mainly salary, contributions to Mandatory Provident Fund schemes, staff insurance and employees' compensation insurance. Based on the Consultant's recommendations, the Authority will have an initial establishment of 299 staff members. The revised estimate for 2016-17 is to cover the staff cost of a core team of about ten staff members who have assumed office since July 2016 to carry out some essential administrative, legal and finance work.

The current target is for the Authority to assume the statutory functions of the Office of the Commissioner of Insurance ("OCI") in the second quarter of 2017. The estimate for 2017-18 is to cater for the staff cost of about 180 staff members (including those in the above-mentioned core team) who will form the Authority's backbone upon taking over OCI's statutory functions.

5. 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. With the assistance of a consultant, the Authority has started the process of identifying a long term office suitable for accommodating the 299 staff members. In the meantime, the Authority is working out an arrangement with the Government such that offices being occupied by OCI can be secured as

the Authority's temporary offices as an interim measure before the expected availability of the long term office in the latter half of 2017. The estimate for 2017-18 takes into account expenses related to the temporary and long term offices.

6. Engagement of professional services

This item involves mainly engagement of services providers in connection with executive search services for staff recruitment, project management of office accommodation, legal and audit services. The estimate for 2017-18 is higher than the revised estimate for 2016-17 mainly due to increased professional services engaged and additional recruitment expenses necessary for employing the remaining 120 staff members.

7. Depreciation

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.

8. Miscellaneous expenses

The revised estimate for 2016-17 mainly covers expenses on website development and administrative expenses incurred for staff working in the temporary office. The estimate for 2017-18 caters for additional requirements (such as public education and promotional programmes, system maintenance and staff training) upon the Authority taking over OCI's statutory functions.

9. Non-recurrent projects

This item involves mainly the implementation of various systems necessary for the Authority to take over its statutory functions (e.g. collection of levy and fees as well as supervising insurance intermediaries).

10. Office set-up

This item includes one-off expenses in respect of office renovation and fitting-out works, acquisition of furniture as well as office and information technology equipment for the long term office expected to be available in 2017.

December 2016