

For discussion  
on 19 March 2019

**Legislative Council Panel on Financial Affairs**  
**Insurance Authority**  
**Budget for the Financial Year 2019-20**

**PURPOSE**

This paper highlights the main features of the budget of the Insurance Authority (“IA”) for 2019-20.

**BACKGROUND**

2. The IA was established in December 2015. It took over the regulation of insurance companies from the former Office of the Commissioner of Insurance in June 2017. It plans to take over the regulation of insurance intermediaries from the three Self-Regulatory Organizations (“SROs”)<sup>1</sup> and administer a statutory licensing regime for insurance intermediaries in the second half of 2019.

3. Section 5B of the Insurance Ordinance (Cap. 41) stipulates that the IA 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”).

**FUNDING OF THE IA**

4. The IA is expected to be financially independent of the

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<sup>1</sup> 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.

Government. In order to achieve full cost recovery in the long run and with the approval of LegCo, the IA has been receiving income from annual and authorization fees payable by insurance companies (with effect from 26 June 2017), user fees for specific services (with effect from 26 June 2017) and a levy on insurance premiums payable by policy holders (with effect from 1 January 2018). The levy rate, currently at 0.04%, will increase gradually until it reaches the target level of 0.1% in 2021-22. There is a cap on the levy<sup>2</sup>. The IA will also charge licence fee for insurance intermediaries five years after the statutory licensing regime for insurance intermediaries commences operation. To help the IA meet the shortfall in its initial years of operation, the Government has provided seed money of \$650 million to the IA in two phases, i.e. first tranche of \$450 million in 2016-17 and second tranche of \$200 million in 2018-19.

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

## **BUDGET FOR 2019-20**

6. A copy of the Budget for 2019-20 is at **Annex**, the main features of which are set out in paragraphs 7 to 10 below.

### ***Income***

7. The estimated total income for 2019-20 is about \$243 million, which is \$69.9 million (40.4%) above the revised estimate for 2018-19 (\$173.1 million), derived largely from the levy on insurance premiums. This level of income has taken into account the revision of levy rate with effect from 1 April 2019 (from 0.04% to 0.06%) and the projected growth in insurance premiums.

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<sup>2</sup> The cap will increase with the levy rate. At present, the caps are \$40 (for long term insurance) and \$2000 (for general insurance). When the levy rate reaches 0.1% from 1 April 2021 onwards, the corresponding caps will be \$100 (for long term insurance) and \$5000 (for general insurance).

## *Operating Expenditure*

8. The estimated operating expenditure for 2019-20 is about \$446.6 million, which is \$90.2 million (25.3%) above the revised estimate for 2018-19 (\$356.4 million), mainly attributable to the following –

- (a) “Staff costs” – the estimated expenditure for 2019-20 is about 331.4 million, which is \$63.8 million (23.8%) above the revised estimate for 2018-19 (\$267.6 million). The IA now has about 270 staff and is expected to reach full strength of about 300 staff in 2019-20 after taking on new functions such as regulation of insurance intermediaries and supervision of international insurance groups;
- (b) “Office rental and related expenses” – the estimated expenditure for 2019-20 is about \$23.1 million, which is \$2 million (9.5%) above the revised estimate for 2018-19 (\$21.1 million), mainly reflecting rentals for additional office area;
- (c) “Engagement of professional services” – the estimated expenditure for 2019-20 is about \$10.4 million, which is \$5.4 million (108%) above the revised estimate for 2018-19 (\$5 million), taking into account anticipated increase in fees for engagement of legal and consultancy services;
- (d) “Information Technology (“IT”) expenses” – the estimated expenditure for 2019-20 is about \$14.3 million, which is \$6.8 million (90.7%) above the revised estimate for 2018-19 (\$7.5 million), mainly related to commissioning of the electronic Document Management System;
- (e) “External relations expenses” – the estimated expenditure for 2019-20 is about \$7.1 million, which is \$0.9 million (14.5%) above the revised estimate for 2018-19 (\$6.2 million), mainly due to enhanced publicity for the new licensing regime for insurance intermediaries and corporate promotion;
- (f) “Other operating expenses” – the estimated expenditure for 2019-20 is about \$18.1 million, which is \$2.7 million (17.5%) above the revised estimate for 2018-19 (\$15.4 million), mainly resulting from training and development cost and

other incidental expenses for new staff; and

- (g) “Depreciation” – the estimated expenditure for 2019-20 is about \$35.4 million, which is \$11.2 million (46.3%) above the revised estimate for 2018-19 (\$24.2 million), factoring in the depreciation of new IT systems to be acquired.

### ***Capital Expenditure***

9. The estimated capital expenditure for 2019-20 is about \$21.8 million, which is \$5.5 million (20.1%) below the revised estimate for 2018-19 (\$27.3 million), arising from the completion of major IT systems in the previous year.

### ***Reserve***

10. It is projected that the IA will retain an unspent operating balance of about \$104.4 million by 31 March 2020.

## **COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 2018-19**

### ***Income***

11. The revised total income for 2018-19 (\$173.1 million) is \$9.8 million (5.4%) less than the approved budget (\$182.9 million), mainly driven by a downward trend of premium growth based on latest market data.

### ***Operating Expenditure***

12. The revised operating expenditure for 2018-19 (\$356.4 million) is \$61.7 million (14.8%) less than the approved budget (\$418.1 million), mainly attributable to the following –

- (a) “Staff costs” – the revised expenditure for 2018-19 is \$267.6 million, which is \$47 million (14.9%) less than the approved budget (\$314.6 million), largely due to unfilled vacancies;
- (b) “Office rental and related expenses” – the revised expenditure for 2018-19 is \$21.1 million, which is \$2.9

million (12.1%) less than the approved budget (\$24 million), mainly benefiting from reduced utility charges;

- (c) “Engagement of professional services” – the revised expenditure for 2018-19 is \$5 million, which is \$4.2 million (45.7%) less than the approved budget (\$9.2 million), mainly due to change in the cost estimate for outsourcing of legal services (from \$5 million to \$1 million);
- (d) “Depreciation” – the revised expenditure for 2018-19 is \$24.2 million, which is \$3.1 million (11.4%) less than the approved budget (\$27.3 million), based on the inventory of fitting-out works and IT systems; and
- (e) “Non-recurrent projects” – the revised expenditure for 2018-19 is \$6.8 million, which is 5.2 million (43.3%) less than the approved budget (\$12 million), reflecting updated expenditure on the risk-based capital (“RBC”) regime.

### ***Capital Expenditure***

13. The revised estimate (\$27.3 million) largely accords with the original estimate (\$27 million), dedicated towards IT systems and technical equipment as well as minor office fitting-out works.

## **THE GOVERNMENT’S VIEWS**

14. The IA is actively preparing for the establishment of a statutory licensing regime for direct regulation of insurance intermediaries in the second half of 2019, and the proposed Budget for 2019-20 is the best estimate worked out based on operational experience.

15. We are studying the Budget for 2019-20 having regard to the progress of key activities and major initiatives. We trust that the IA will strive to deploy its resources and control its expenditures in a prudent manner to achieve long-term financial sustainability.

16. We note that the IA is projected to retain an unspent operating balance of \$104.4 million by 31 March 2020, equivalent to only about three months of its operating expenditure. Such a thin reserve is caused by the combined effect of several interrelated factors including

moderated growth of insurance premium, phasing in of levy income and effect of the levy cap. Together with the IA, we will continue to monitor the situation closely and ensure its long-term financial sustainability.

## **ADVICE SOUGHT**

17. Members are invited to take note of the Budget for 2019-20 drawn up by the IA.

Financial Services Branch  
Financial Services and the Treasury Bureau  
March 2019

**Insurance Authority**  
**Estimates of Income and Expenditure for 2019-20**

		<b>Estimates 2018-19</b>	<b>Revised Estimates 2018-19</b>	<b>Proposed Estimates 2019-20</b>	<b>Variance Proposed Estimates vs. Revised Estimates 2018-19</b>
	<u>Note</u>	(i) HK\$ <u>million</u>	(ii) HK\$ <u>million</u>	(iii) HK\$ <u>million</u>	(vi)=(iii)-(ii) HK\$ <u>million</u>
<b>A. <u>Income and Expenditure Statement</u></b>					
<b><u>Income</u></b>	1				
(a) Interest income	2	0.7	5.3	3.2	(2.1)
(b) Levy and fees	3	182.2	167.8	239.8	72.0
<b>Total Income</b>		<b>182.9</b>	<b>173.1</b>	<b>243.0</b>	<b>69.9</b>
<b><u>Operating Expenditure</u></b>					
(a) Staff costs	4	314.6	267.6	331.4	63.8
(b) Office rental and related expenses	5	24.0	21.1	23.1	2.0
(c) Engagement of professional services	6	9.2	5.0	10.4	5.4
(d) Information Technology (“IT”) expenses	7	7.2	7.5	14.3	6.8
(e) External relations expenses	8	4.4	6.2	7.1	0.9
(f) Remuneration to Members		2.5	2.6	2.6	-
(g) Other operating expenses	9	16.9	15.4	18.1	2.7
(h) Depreciation	10	27.3	24.2	35.4	11.2
(i) Non-recurrent projects	11	12.0	6.8	4.1	(2.7)
<b>Total Operating Expenditure</b>		<b>418.1</b>	<b>356.4</b>	<b>446.6</b>	<b>90.2</b>
<b>Result for the year</b>		<b>(235.2)</b>	<b>(183.3)</b>	<b>(203.6)</b>	<b>(20.3)</b>
<b>B. <u>Capital Expenditure Statement</u></b>					
(a) Office set-up	12	3.8	2.0	4.8	2.8
(b) IT systems and equipment	13	23.2	25.4	17.0	(8.4)
<b>Total Capital Expenditure</b>		<b>27.0</b>	<b>27.3</b>	<b>21.8</b>	<b>(5.5)</b>

## Notes to the Proposed Estimates for 2019-20

### 1. Income

According to the consultancy study<sup>1</sup> commissioned by the Government, income of IA in the first four years of operation was insufficient to fully meet its expenditure, resulting in a total deficit of about \$650 million. Two lump-sum instalments have been received from the Government to help the IA bridge this shortfall. On 13 May 2016, LegCo approved the provision of \$450 million to the IA, followed by the second portion of \$200 million on 10 May 2018<sup>2</sup>. They were recognized as capital upon receipt in the statement of financial position.

### 2. Interest income

With approval given by FS, the IA has adopted an interim investment strategy where funds not required for immediate use are placed into Hong Kong dollar fixed deposits.

### 3. Levy and Fees

Starting from 1 January 2018, a levy of 0.04% on insurance premiums is payable by policy holders. This levy rate will gradually increase until it reaches the target level of 0.1% in 2021- 22. However, a cap has been imposed on the levy for 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. Insurance policies related to captives, contracts of reinsurance, marine, aviation and goods-in-transit are exempted from the levy.

The annual and authorization fees payable by insurance companies effective from 26 June 2017 consist of two elements, namely, (a) a fixed fee of \$300,000 (\$30,000 for captives and \$600,000 for composite insurers); and (b) a variable fee subject to a cap of \$7 million on insurance liabilities (\$14 million for composite insurers). The variable fee rate will rise gradually from the original 0.0001% to 0.0039%.

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<sup>1</sup> The consultancy study was carried out by PricewaterhouseCoopers.

<sup>2</sup> Before obtaining funding approval from LegCo, the Government approved in February 2016 a small sum of \$3 million in 2015-16 for IA to meet mainly the cash flow requirement of the essential consultancy services. The allocation was received by IA in early-March 2016.



Since 26 June 2017, the IA has been charging user fees to recover the cost of providing 11 specific services, 10 of which are applicable to insurance companies.

**4. Staff costs**

Salaries, Mandatory Provident Fund contributions, health insurance scheme and employees' compensation insurance. The estimate for 2019-20 is predicated on full strength of about 300 staff.

**5. Office rental and related expenses**

Office rentals, management fees, utility charges, government rent/rates as well as other associated expenses such as general office insurance and telephone rental.

**6. Engagement of professional services**

This item mainly covers executive search services, consultancy, legal and audit services. The estimate for 2019-20 is higher than the revised estimate for 2018-19 mainly due to the anticipated increase in fees for legal advice and consultancy.

**7. IT expenses**

IT expenses include maintenance of server infrastructure, cybersecurity protection systems and IT applications. The estimate for 2019-20 exceeds the revised estimates for 2018-19 mainly due to the Document Management System.

**8. External relations expenses**

The revised estimate for 2018-19 is spent on public relations campaigns, the Asian Insurance Forum, online news and social media engagement, while the higher estimate for 2019-20 is aimed mostly at launching publicity for the new licensing regime of the insurance intermediaries.

**9. Other operating expenses**

Covers mainly staff training and development, travelling costs, social events and other incidental expenditure. The estimate for 2019-20 rose in step with the number of staff.

**10. Depreciation**

Depreciation is calculated to write off the cost of fixed assets (such as furniture and fixtures, office equipment, IT systems) using straight-line method over a period of three or five years.

**11. Non-recurrent projects**

This item mainly caters for consultancy studies related to the RBC regime<sup>3</sup>. Despite that the second Quantitative Impact Study has been completed in 2018-19, we will have to conduct further consultancy studies in 2019-20.

**12. Office set-up**

The estimate for 2019-20 represents mostly minor fitting-out works.

**13. IT systems and equipment**

Given the completion of several major IT systems in 2018-19 such as those for collection of levies and supervision of insurance intermediaries, the estimate for 2019-20 has decreased accordingly.

December 2018

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<sup>3</sup> The RBC regime seeks to strengthen the prudential regulation of insurance companies with a view to aligning their capital requirements with risk exposures and enterprise risk management.