

# 立法會

## *Legislative Council*

LC Paper No. LS106/19-20

### **Further Report by Legal Service Division Report on Insurance (Amendment) Bill 2020**

Members may recall from LC Paper No. LS94/19-20 dated 10 June 2020 that the Legal Service Division ("LSD") was scrutinizing the legal and drafting aspects of the Bill.

2. As Members may recall, the main purpose of the Bill is to amend the Insurance Ordinance (Cap. 41) to add a new class of insurance business, namely, special purpose business, under Cap. 41 for the purpose of acquiring insurance risk from another insurer or reinsurer under a reinsurance or risk transfer contract and then issuing insurance linked securities ("ILS") to institutional investors to collateralize the risk acquired, and to provide for a new regulatory regime for ILS business. LSD has sought clarifications from the Financial Services and the Treasury Bureau ("FSTB") on certain legal and drafting aspects of the Bill. LSD's enquiries and FSTB's response (at Appendices I and II respectively) are summarized below.

#### Regulation of the issuance of ILS

3. In response to LSD's enquiry on whether ILS issued by special purpose insurers under the Bill could fall within the meaning of "securities" or "structures product" under the Securities and Futures Ordinance (Cap. 571) and would therefore be subject to regulation by the Securities and Futures Commission ("SFC") under Cap. 571, FSTB has explained that, generally speaking, depending on the nature, product structure and the terms and conditions of individual ILS products, ILS products which fall within the definition of "securities" under Cap. 571 would be subject to SFC's regulation. The Bill does not intend or have the effect to exclude ILS products from the regulatory regime under Cap. 571 if such products would fall within the relevant definitions under Cap. 571.

#### Approval of key persons in control functions of certain authorized insurers

4. LSD has sought clarification from FSTB on why the existing power of the Insurance Authority ("IA") under section 13AE of Cap. 41 to approve key persons in control functions of certain authorized insurers would not apply to a special purpose insurer. FSTB has explained that a special purpose insurer is only authorized under the Bill to carry on special purpose business but not any other class of insurance business. According to FSTB, the operation of a special purpose insurer would be simpler than that of an

insurer authorized to carry on long term and/or general insurance business. As such, a special purpose insurer would only be required under the proposed new section 8A(2)(b) to appoint an administrator instead of appointing key persons in all control functions in relation to other classes of insurance business. FSTB considers that the proposed requirement on the appointment of an administrator is appropriate and sufficient for the purpose of the business operation of a special purpose insurer.

#### IA may make rules for special purpose business

5. In response to LSD's enquiry on why it would be necessary to empower IA, by the proposed new section 129A of Cap. 41, to prescribe offences for contravention of rules in relation to special purpose business while no similar power to prescribe offences is given to IA under the existing section 129 of Cap. 41 in relation to other classes of insurance business, FSTB has explained that given the nature of the underlying risk of investing in ILS and the potential loss of investment upon the occurrence of a predefined trigger event, ILS are not considered to be financial products suitable for ordinary retail investors. To provide deterrent effect for the protection of ordinary retail investors, FSTB considers it necessary to empower IA to prescribe offences for contravention of rules on sale restrictions of ILS made under the proposed section 129A of Cap. 41. This, according to FSTB, is consistent with the practice relating to business conduct of intermediaries under section 168(4) of Cap. 571.

6. FSTB also confirmed that IA will publish a draft of the proposed rules to be made under the proposed new section 129A of Cap. 41 for consultation with the public and industry stakeholders. FSTB will also consult the relevant Panel of the Legislative Council ("LegCo") on the proposed requirements on the sale of ILS before tabling the proposed rules made under the proposed new section 129A of Cap. 41 at LegCo for negative vetting.

7. Subject to Members' views on the above matters, no difficulties have been identified in relation to the legal and drafting aspects of the Bill.

#### Encls.

Prepared by

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Legislative Council Secretariat

26 June 2020



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## Appendix I

By Fax (2527 0292)

18 June 2020

Ms Noel TSANG  
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and the Treasury (Financial Services)  
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### **Insurance (Amendment) Bill 2020**

We are scrutinizing the legal and drafting aspects of the Bill.

Please clarify whether (a) insurance linked securities ("ILS") issued by special purpose insurers under the Bill could fall within the meaning of "securities" or "structured product" under Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571); and (b) the issuance of ILS by special purpose insurers under the Bill could fall within the meaning of "regulated activities" under Part 1 of Schedule 5 to Cap. 571 and subject to regulation by the Securities and Futures Commission under the same Ordinance. If not, would it be desirable to expressly provide in the Bill to exclude the issuance of ILS from the regulatory regime under Cap. 571?

In relation to the proposed new subsection 8A(2) of the Insurance Ordinance (Cap. 41), please clarify whether the applicant company has to satisfy ALL four conditions stated in that subsection in order to be authorized by the Insurance Authority ("IA") to carry on special purpose business. If affirmative, would it be desirable to add "all" before "the following conditions" in that subsection or add "and" after paragraph 8A(2)(c) of the same subsection for the purpose of clarity?

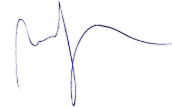
Please explain why IA's power of approval of key persons in control functions of certain authorized insurers under section 13AE of Cap. 41 would not apply to a special purpose insurer by clause 12 of the Bill.

Under section 129 of Cap. 41, no specific power is given to IA to prescribe offences for contravention of rules in relation to all classes of insurance business. Please explain why it would be necessary to empower IA, by the proposed new section 129A of Cap. 41, to prescribe offences for contravention of rules in relation to special purpose business only. Please also clarify if sections 130 (relaxation of rules) and 131 (rules may limit effect of Ordinance) of Cap. 41 would also apply to rules made by IA under the proposed new section 129A of Cap. 41.

Please confirm whether IA would first publish a draft of the proposed rules made under the proposed new section 129A of Cap. 41 for consulting the public, relevant industry organizations and the Panel on Financial Affairs of the Legislative Council in due course.

It is appreciated that your reply in both languages could reach us as soon as possible, preferably by **23 June 2020**.

Yours sincerely,



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24 June 2020

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Dear Mr Lam,

**Insurance (Amendment) Bill 2020**

Thank you for your letter of 18 June 2020. Having consulted the Insurance Authority ("IA"), our response to the matters raised in your letter are provided below.

The scope of "insurance-linked securities" ("ILS") products

2. As provided in Clause 3 of the Insurance (Amendment) Bill 2020 ("the Bill"), "insurance securitization" means any debt or other financing arrangement entered into by an insurer with an investor, under which repayment or return to the investor is linked to a contract of insurance effected and carried out by the insurer. ILS are defined in Clause 20 of the

Bill to mean securities issued through insurance securitization. Clauses 3(4) and 8 of the Bill provide for the authorization regime of special purpose business ("SPB") for special purpose insurer ("SPI") to effect and carry out contracts that are fully funded through insurance securitization.

3. The Bill does not intend or have the effect to exclude ILS products from the regulatory regime under the Securities and Futures Ordinance (Cap. 571) ("SFO"). Generally speaking, depending on the nature, product structure and the terms and conditions of individual ILS products, ILS products which fall within the definition of "securities" under the SFO would be subject to the Securities and Futures Commission's regulation.

#### Clause 8 – authorization of SPB

4. It is our policy intent that IA must not authorize a company to carry on SPB under the proposed section 8A unless all four conditions under the proposed section 8A(2) of the Insurance Ordinance ("IO") (Cap. 41) are satisfied. We consider that the wording of the proposed section 8A(2) is clear in reflecting the policy intent. In the lead-in sentence of the proposed section 8A(2), the words "unless the following conditions are satisfied" are used. The words "the following conditions" (our underlining) refer to the conditions stated in the ensuing paragraphs (a) to (d). The provision allows a company (applicant) no option but a full compliance with the four conditions, lest the words "any of" or "any one or more of" would have been added before "the following conditions".

5. Also, according to the current drafting practice, it is not necessary to use a conjunction if "as follows" or "the following" is used in the lead-in sentence. We are therefore of the view that no amendment is required to be made to the proposed section 8A(2).

#### Clause 12 – approval of key persons in control functions of certain authorized insurers

6. As prescribed in Clause 8 of the Bill, an SPI is only authorized to carry on SPB but not any other class of insurance business. In other words,

the operation of an SPI will be simpler than that of an insurer authorized to carry on long term and/or general business. In line with our policy intent to provide a simplified regulatory regime under the IO to promote Hong Kong as a domicile for issuance of ILS, we propose to require the appointment of an administrator under the proposed section 8A(2)(b), instead of requiring the appointment of key persons in all control functions specified under section 13AE of the IO. In determining whether an administrator (who is responsible for the administration of the whole business of an SPI as a controller under the proposed section 13A of the IO) is fit and proper, IA will have regard to the matters set out in section 14A of the IO, including the education or other qualifications or experience of the person, the person's ability to act competently, honestly and fairly, the reputation, character, reliability and integrity of the person, the person's financial status or solvency, etc. We consider the proposed requirement on the appointment of an administrator appropriate and sufficient for the purpose of an SPI's business operation.

Clause 20 – Authority may make rules for SPB

7. Given the nature of the underlying risk of investing in ILS and the potential for loss of investment upon the occurrence of a predefined trigger event, ILS are not considered to be financial products suitable for ordinary retail investors. Our policy intent is to confine the sale of ILS to qualified institutional investors (e.g. dedicated ILS funds and hedge funds) by private placement.

8. As such, we propose to empower IA to prescribe detailed requirements on the sale of ILS in rules to be made under the proposed section 129A. To provide deterrent effect for the protection of ordinary retail investors, we consider it necessary to empower IA to prescribe offences for contravention of sale restrictions in the rules to be made under the proposed section 129A. This is consistent with the practice relating to business conduct of intermediaries under section 168(4) of the SFO.

9. Section 130 (relaxation of rules under section 129(1)(a)) of the IO applies to rules made by IA under section 129(1)(a) that provide for the determination of the value of the assets and the amount of liabilities of an authorized insurers. Section 131 (rules may limit effect of the Ordinance)

generally concerns licensing requirements and the submission of documents to IA. In other words, the matters provided in sections 130 and 131 of the IO do not relate to the matters (i.e. sale of ILS) provided in the rules to be made under the proposed section 129A.

10. In line with established practice, IA will publish a draft of the rules to be made under the proposed section 129A for consultation with the public and industry stakeholders. We will also consult the relevant Panel of the Legislative Council ("LegCo") on the proposed requirements on the sale of ILS before tabling the rules made under the proposed section 129A at LegCo for negative vetting.

Yours sincerely,



( Ms Noel Tsang )

for Secretary for Financial Services and the Treasury

c.c. Law Draftsman (Attn: Ms Rayne Chai and Mr Salvador Tsang)  
Insurance Authority (Attn: Mr Adrian Lam)