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**Legislative Council**

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**Paper for the House Committee Meeting  
on 12 June 2020**

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

**I. SUMMARY**

- 1. The Bill**

The Bill seeks to amend the Insurance Ordinance (Cap. 41) to:

  - (a) provide for the regulation of a new class of insurance business for which the liability of an insurer under a contract of insurance to the person insured is fully funded;
  - (b) expand the scope of insurable risks of captive insurers;
  - (c) remove a non-delegable function of the Insurance Authority ("IA") specified in Schedule 1D to Cap. 41; and
  - (d) make miscellaneous amendments.
  
- 2. Public consultation**

IA has consulted its two industry advisory committees and the relevant industry organization and stakeholders in formulating the legislative proposals to facilitate the issuance of insurance-linked securities ("ILS") in Hong Kong and expand the scope of insurable risks by captive insurers.
  
- 3. Consultation with LegCo Panel**

The Panel on Financial Affairs was consulted on 3 June 2019 and members supported the introduction of the Bill.
  
- 4. Conclusion**

The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. Since the Bill seeks to introduce a new regulatory regime for ILS business in Hong Kong, Members may wish to form a Bills Committee to study the Bill in detail.

## **II. REPORT**

The date of First Reading of the Bill is 10 June 2020. Members may refer to the Legislative Council ("LegCo") Brief (File Ref.: INS/2/3/2C) issued by the Financial Services and the Treasury Bureau on 18 March 2020 for further details.

### **Object of the Bill**

2. The Bill seeks to amend the Insurance Ordinance (Cap. 41) to:
  - (a) provide for the regulation of a new class of insurance business for which the liability of an insurer under a contract of insurance to the person insured is fully funded;
  - (b) expand the scope of insurable risks of captive insurers;
  - (c) remove a non-delegable function of the Insurance Authority ("IA") specified in Schedule 1D to Cap. 41; and
  - (d) make miscellaneous amendments.

### **Background**

3. According to paragraphs 2 and 6 of the LegCo Brief, insurance-linked securities ("ILS") are risk management tools that enable an insurer or a reinsurer to transfer insurance risks to the capital markets through securitization. The core feature of ILS business is that it is fully funded, which means the assets held at all times are no less than prospective liabilities under the reinsurance or risk transfer contract by which it acquires insurance risk.

4. At present, a company which seeks to carry on any class or classes of insurance business specified in Schedule 1 to Cap. 41 requires authorization by IA under Cap. 41. According to paragraph 7 of the LegCo Brief, ILS business falls within the regulatory ambit of Cap. 41. However, the purpose and nature of ILS business is essentially the transfer of risks to the capital markets, making it totally different from the conventional class or classes of insurance business specified in Schedule 1 to Cap. 41. According to paragraph 3 of the LegCo Brief, the operation of ILS involves the setting up by an insurer or reinsurer of a dedicated special purpose vehicle ("SPV") to which its insurance risk may be transferred through a reinsurance or risk transfer contract. The SPV then issues financial instruments to investors to raise capital to finance the full amount of the risk assumed by it under the reinsurance or risk transfer contract. In that regard, the Chief Executive and the Financial Secretary announced in the 2018 Policy Address and the 2019-2020 Budget Speech<sup>1</sup> respectively that the Government would make relevant legislative

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<sup>1</sup> Paragraph 118 of the 2018 Policy Address and paragraph 57 of the 2019-2020 Budget Speech.

amendments to allow for the formation of SPV companies for issuing ILS in Hong Kong with a view to enriching the risk management tools available in the Hong Kong financial market.

## **Provisions of the Bill**

5. The main purpose of the Bill is to amend 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 ILS to institutional investors to collateralize the risk acquired, and to provide for a new regulatory regime for ILS business. The major provisions of the Bill are set out in the ensuing paragraphs.

### Proposed definition of "special purpose business"

6. Under the proposed section 2(1) of Cap. 41:

- (a) "special purpose business" means insurance business of effecting and carrying out contracts of insurance that are fully funded through insurance securitization; and
- (b) "insurance securitization", in relation to an insurer, means any debt or other financing arrangement entered into by the 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.

### Proposed regulatory regime for ILS business

7. Clause 8 of the Bill seeks to add new sections 8A, 8B and 8C to Cap. 41 to empower IA to regulate ILS business.

8. Under the proposed new section 8A of Cap. 41, IA would be empowered to authorize a company to carry on special purpose business if certain requirements are met. These requirements include the appointment by the company of two or more directors and an administrator (as a controller of the company) all of whom appear to IA to be fit and proper persons to hold the positions, the company's compliance with the relevant financial requirements prescribed by rules made by IA under Cap. 41, and the intention of the company to carry on special purpose business only but not any other class of insurance business. Under the proposed section 6 of Cap. 41, a person would commit an offence if he carries on special purpose business without IA's authorization under Cap. 41.

9. The proposed new section 8B specifies the form in which an insurer authorized under the proposed section 8A to carry on special purpose business only ("special purpose insurer") would submit information to IA under Cap. 41.

10. The proposed new section 8C seeks to empower IA to modify or vary any requirement on, among others, submission of financial information to IA or deposit of financial documents with the Registrar of Companies under certain provisions of Cap. 41 in relation to a special purpose insurer.

11. Part V of Cap. 41 confers certain powers of intervention on IA in relation to an authorized insurer. These include the powers to impose requirements relating to investments and maintenance of assets in Hong Kong. Section 26 of Cap. 41 sets out various grounds on which these powers of intervention are exercisable by IA. Clause 15 of the Bill seeks to amend section 26(1)(e) of Cap. 41 to provide a new ground on which IA's powers would be exercisable, i.e. where there exists a ground on which IA would be prohibited by the proposed new section 8A(2) from authorizing a company to carry on special purpose business.

12. Under the proposed new section 129A, as added by clause 20 of the Bill, IA would be empowered to make rules to:

- (a) prohibit any sale of, or the making of any offer to sell, ILS to any person other than an investor falling within a type prescribed in the rules;
- (b) prohibit any sale of, or the making of any offer to sell, ILS at any amount lower than that prescribed in the rules; and
- (c) prescribe offences for contravention of the rules, punishable by a fine or imprisonment or both. Under the proposed new section 129A(3) of Cap. 41, the maximum penalty that may be prescribed under the rules is: (i) a fine of \$200,000 and imprisonment for two years for conviction on indictment; and (ii) a fine at level 6 (\$100,000) and imprisonment for six months on summary conviction.

#### Proposed amendments relating to captive insurers

13. Under section 2(7)(a) of Cap. 41, "captive insurer" means a company ("relevant company") which is authorized to carry on business which is restricted to the insurance and reinsurance of risks of the companies within the same grouping of companies to which the relevant company belongs. The Bill seeks to amend the meaning of captive insurer in section 2(7) of Cap. 41 in order to widen the scope of insurable risks of a captive insurer by including the following risks:

- (a) risks of the bodies corporate within the relevant company's corporate group (which is made up of a relevant company and one or more specific members (e.g. a body corporate that belongs to the group of companies of the relevant company or is a subsidiary of the holding company of the relevant company ("first tier member"), or a body

corporate which the relevant company or a first tier member has the control of certain percentage of voting rights or holding of the issued share capital)) to which the relevant company belongs;

- (b) the proportional share of risks of another body corporate to which the relevant company, or a first tier member in the relevant company's corporate group, is exposed directly through controlling (in terms of the percentage in directorship appointment, voting rights in general meetings or holding of the issued share capital) the other body corporate; and
- (c) any other risks of which the relevant company, or a first tier member in the relevant company's corporate group, has control, oversight or management or is otherwise sufficiently connected.

According to paragraph 16 of the LegCo Brief, the amendments to section 2(7) of Cap. 41 are proposed in light of the comments from the insurance industry that the existing scope of insurable risks by captive insurers is too restrictive and not conducive to effective global risk management strategy when multinational insurance companies expand further globally.

#### Removal of a non-delegable function of IA

14. Clause 25 of the Bill seeks to amend Schedule 1D to Cap. 41 by removing the function of publishing or otherwise making available materials relating to the performance by IA of any of its functions from the list of non-delegable functions of IA so that IA would be allowed to delegate to its employees such function. According to paragraph 18 and footnote 8 of the LegCo Brief, the function to publish or otherwise make available materials relating to the performance by IA of any of its functions is of technical nature which should be made delegable to its employees so as to improve IA's operational efficiency.

#### Miscellaneous amendments

15. Clauses 26 to 32 of the Bill seek to make textual amendments to certain provisions of Cap. 41.

#### **Commencement**

16. The Bill, if passed, would come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

## **Public Consultation**

17. According to paragraph 23 of the LegCo Brief, IA has consulted its two industry advisory committees and the relevant industry organization and stakeholders in formulating the legislative proposals to facilitate the issuance of ILS in Hong Kong and expand the scope of insurable risks by captive insurers.

## **Consultation with LegCo Panel**

18. As advised by the Clerk to the Panel on Financial Affairs, the Administration and IA briefed the Panel on 3 June 2019 on a number of initiatives to strengthen Hong Kong's competitiveness as an insurance hub, including the proposals to facilitate the issuance of ILS in Hong Kong and expand the scope of insurable risks by captive insurers set up in Hong Kong. Members discussed various issues including the benefits of the proposals for policy holders, measures to prohibit the "repackaging" and subsequent sale of ILS which were high risk investment products to retail investors, as well as restrictions for Mandatory Provident Fund Schemes to invest in ILS.

## **Conclusion**

19. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. Since the Bill seeks to introduce a new regulatory regime for ILS business in Hong Kong, Members may wish to form a Bills Committee to study the Bill in detail.

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