

For discussion
on 2 December 2019

Legislative Council Panel on Financial Affairs

The Government's Initiatives to Promote the Development of the Insurance Industry in Hong Kong

PURPOSE

This paper provides an update on progress achieved by the Government and the Insurance Authority (“IA”) in promoting the development of the insurance industry in Hong Kong.

BACKGROUND

2. In March 2019, we briefed the Legislative Panel on Financial Affairs (“FA Panel”) on the budget of the IA for 2019-20¹. It was expected that the IA would 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. This target has now been achieved, and we would like to update Members on initiatives to promote the development of the insurance industry in Hong Kong.

MAJOR POLICY INITIATIVES

(A) Modernizing the insurance regulatory framework

(i) Regulation of insurance intermediaries

3. The new statutory regulatory regime for insurance intermediaries commenced smoothly on 23 September 2019 to replace the previous self-regulatory regime, representing a key milestone in modernizing the regulatory infrastructure of Hong Kong. Under the new regime, the IA has assumed the responsibility of direct regulation of some 120 000 insurance intermediaries. The IA has promulgated 13 pieces of rules, codes and guidelines that outline in a transparent and principle-based

¹ LC Paper No. CB(1)695/18-19(03)

manner the professional standards expected of insurance intermediaries. To enhance efficiency and conserve manpower, the IA has commissioned a computer system for fully automating license application and renewal, updating of personal particulars and maintenance of records kept on continuous professional development activities, while enabling the general public to access an on-line register of licensed individuals. Moreover, a holistic mechanism has been worked out that comprises investigation, disciplinary process and appeal with multiple opportunities for oral or written representations to be made.

(ii) Group-wide supervision

4. The IA has directed efforts towards developing a framework for group-wide supervision, with a view to establishing Hong Kong as a preferred base for large insurance groups in Asia Pacific. At present, the IA is responsible for overseeing the regional operations of AIA, FWD and Prudential plc through a combination of direct and indirect supervisory powers, but it is imperative to strengthen these powers in line with prevailing international standards. Having consulted the industry and this Panel earlier this year, we are proceeding full steam ahead with a legislative exercise to enhance the regulatory framework for the supervision of insurance groups where the holding company of an insurance group is incorporated in Hong Kong. Our target is to introduce the relevant amendment bill into LegCo in time for enactment within the 2019/20 legislative session.

(iii) Policyholders' Protection Scheme

5. The Policyholders' Protection Scheme ("PPS") aims to protect policyholders' interest by compensating policyholders or securing the continuity of insurance contracts in case an insurer becomes insolvent. The availability of such safety net for policyholders can help preserve public confidence and preventing spread of mass panic under stressful market conditions. The IA is actively preparing for the establishment of PPS. Our current plan is to introduce the relevant bill into LegCo in the 2020/21 session.

(iv) Risk-based Capital regime

6. To uphold the status of Hong Kong as an international financial centre, the IA has been pressing ahead with implementation of a Risk-based Capital regime which will render the requirements imposed on insurers more sensitive to their asset-liability matching, risk appetite and mix of products. A third round of Quantitative Impact Studies was launched in August 2019 to assess the outcome on solvency level

of insurers. This will be followed by consultation on the detailed capital rules in 2020 so as to pave way for the introduction of an amendment bill into LegCo in the 2021-22 session.

(B) Enhancing competitiveness and promoting market development

(i) Tax relief

7. In the light of international competition, other insurance hubs have introduced different measures including tax incentives to enhance their competitiveness. It is necessary for Hong Kong to introduce new measures to keep our business environment conducive to insurance business and help the insurance industry seize new opportunities, including those arising from the Belt and Road Initiative (“BRI”). Having consulted the industry and this Panel earlier this year, we plan to reduce profits tax rate by 50% (i.e. 8.25%) for all general reinsurance business of direct insurers, selected general insurance business of direct insurers and selected insurance brokerage business. The proposed tax relief will also promote the development of marine insurance and the underwriting of specialty risks (e.g. aviation, agriculture, catastrophe, war risk and trade credit) in Hong Kong. Our target is to introduce the relevant amendment bill into LegCo in time for enactment in the 2019-20 session.

(ii) Insurance linked securities and captive insurance

8. An insurance linked security (“ILS”) (e.g. a catastrophe bond) is an alternative risk management tool that allows an insurer to raise capital by offloading insured risks to the capital market through securitization. This could yield benefits both in terms of increased underwriting capacity for insurers/reinsurers and providing institutional investors with a type of instrument which is not correlated to economic conditions (but to insurance risk). Given a rising trend of catastrophic events caused by climate change and urbanization, global issuance of ILS has grown substantially in recent years but the risk exposure is mainly confined to the United States and Europe. To enable Hong Kong to tap into this vibrant market, we plan to facilitate the setting up of special purpose vehicles for issuance of ILS in Hong Kong.

9. A captive insurer is an insurance company set up by its parent company with the primary purpose of insuring and reinsuring the risks of the companies in the group to which the captive insurer belongs. Captive insurance provides multinationals with the ability to deploy a more holistic risk management strategy across their international business, and save insurance premium spent on an external

insurance provider. The industry considers that the existing scope of insurable risks by captive insurers is unduly restrictive and not conducive to effective global risk management strategy when multinationals expand further globally. We plan to expand the scope of insurable risks by captive insurers set up in Hong Kong in order to meet the risk management needs of multinational companies.

10. Having consulted the industry and this Panel earlier this year, we are actively preparing legislative amendments related to ILS and captive insurance. Our target is to introduce the relevant amendment bill into LegCo in time for enactment in the 2019-20 session.

(iii) Greater Bay Area development

11. Following the third meeting of the Leading Group for the Development of the Greater Bay Area convened on 6 November 2019, the Central Government announced three policy measures related to the insurance sector, namely (a) supporting Mainland insurers to issue catastrophe bonds in Hong Kong; (b) extending the preferential treatment to Hong Kong qualified reinsurers under the “China Risk Oriented Solvency System”; and (c) removing the requirement on years of operating experience restrictions for Hong Kong service suppliers to provide insurance loss adjusting services in the Mainland. We will liaise closely with the Mainland authorities and the industry to facilitate interested parties to seize the business opportunities arising from these measures.

12. Meanwhile, the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area announced in February 2019 confirms and supports Hong Kong’s status as an international asset and risk management centre. It also sets out a number of initiatives relevant to the insurance industry, e.g. promotion of cross-boundary Renminbi reinsurance business, development of innovative cross-boundary motor vehicle and medical insurance products, and provision of facilitation services for cross-boundary policy holders in such areas as underwriting, investigation and claims. We are liaising closely with the Mainland authorities to pursue early realization of these initiatives.

(iv) BRI

13. The Arrangement between the National Development and Reform Commission and the Government of the Hong Kong Special Administrative Region for Advancing Hong Kong’s Full Participation in and Contribution to the Belt and Road Initiative signed in December 2017 supports Hong Kong to provide insurance

and re-insurance for large-scale infrastructure projects under the BRI and encourages Mainland enterprises to establish captive insurance companies in Hong Kong. Apart from working with the Government on the legislative exercises to provide tax relief for relevant insurance business and expand the scope of insurable risks of captive insurers (see paragraphs 7, 9 and 10 above), the IA has taken steps to facilitate our insurance industry to capitalize on the business opportunities arising from the BRI. In December 2018, the IA established the Belt and Road Insurance Exchange Platform to promote exchange of intelligence, forge alliances and facilitate networking. It has also staged various events to showcase the strategic role of insurance in project risk management and promote Hong Kong as an ideal domicile for captives.

(v) *Products for aging population*

14. The population in Hong Kong is ageing, availing the insurance industry of an opportunity to discharge its function of mitigating longevity risks. Since the introduction of the Qualifying Deferred Annuity Policy and the Voluntary Health Insurance Scheme with tax incentives in April 2019, the encouraging response clearly demonstrates the existence of a sizable demand for retirement and medical protection. Advent of the two products also helps increase market diversity and strengthen market resilience.

(C) Insurtech development

15. InsurTech development is gaining pace, as driven by prevalence of mobile devices and soaring internet penetration rate. It could provide an alternative distribution channel to reach out to underserved or unserved customer groups as well as spurring the conception of simple and innovative products, thereby narrowing the protection gap and broadening financial inclusiveness. To promote the development of InsurTech in Hong Kong, the IA has rolled out Insurtech Sandbox² and Fast Track³ as facilitation measures. The former has already led to four products being rolled out to consumers, while two virtual insurers have been authorized under the latter thus far. The IA will make good use of the Working Group on Embracing

² Insurtech Sandbox provides a platform for authorized insurers to run pilot trials of innovative Insurtech applications in a controlled environment to demonstrate that such applications can broadly comply with the IA's supervisory requirements. It also enables authorized insurers to obtain real market data and information on user experience before formal product launch.

³ Fast Track is a pilot scheme for handling new authorization by applicants proposing to use only digital distribution channels. A dedicated queue has been set up to expedite the authorization process while maintaining all prudential regulatory requirements.

Fintech in Hong Kong underpinning the Future Task Force (formed by the IA) to sustain a close dialogue with stakeholders.

(D) Ensuring adequate resources for the IA

16. As reported at the FA Panel meeting held on 19 March 2019, the unspent operating balance of the IA will be depleted to \$104.4 million by 31 March 2020, which is equivalent to only around three months of operating expenditure. In response to Members, the IA undertook to discuss its funding needs with the Government and revert in due course.

17. After evaluating its financial projection and uncertainties in the level of future incomes, the IA expects to face a funding shortfall in 2020-21 which is likely to persist in the subsequent few years⁴. To assist the IA to tide over its projected cash shortfall in the short to medium term and maintain an appropriate level of reserve, the Government plans to provide additional funding of \$300 million⁵ to the IA in 2020-21 in accordance with the established mechanism.

WAY FORWARD

18. We will continue to explore and devise, in consultation with industry players and stakeholders, initiatives to promote and facilitate development of the insurance industry and enhance Hong Kong's status as an international insurance hub. The IA, a statutory body established under the Insurance Ordinance (Cap. 41), is expected to be financially independent from the Government and achieve full cost recovery in the longer term. The IA will continue to exercise vigilance in its budgetary process to ensure prudent use of public funds and strive to open up new sources of income to ensure long-term financial sustainability.

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⁴ This shortfall is mainly attributed to a longer time required to complete the takeover of regulatory responsibilities from the former Office of the Commissioner of Insurance that led to delayed collection of premium levies and authorization/user fees from the insurers as well as lower actual levy income as compared with the estimate adopted in preparing the indicative budget used to work out the initial capital injection of \$650 million.

⁵ To fund the establishment of the IA, 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.