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29 January 2020

Clerk to Panel
Legislative Council Panel on Financial Affairs
Legislative Council Complex
Legislative Council Road, Central
Hong Kong
(Attn : Ms Sharon Lo)

Dear Ms Lo,

Panel on Financial Affairs
Follow-up to the Meeting on 2 December 2019

Thank you for your letter of 2 December 2019 regarding the follow-up actions arising from the Panel's discussion at the meeting on 2 December 2019 on Agenda Item VI "The Government's initiatives to promote the development of the insurance industry in Hong Kong". Having consulted the Insurance Authority, our consolidated response is attached at Annex.

Yours sincerely,

Noel

(Ms Noel TSANG)
for Secretary for Financial Services and the Treasury

c.c. Insurance Authority (Attn : Mr Ryan Chiu)

Annex

Follow-up to the Panel on Financial Affairs on 2 December 2019

Response from the Government and the Insurance Authority

Background

Arising from its discussion at the meeting on 2 December 2019 on Agenda Item VI "The Government's initiatives to promote the development of the insurance industry in Hong Kong", the Panel on Financial Affairs has requested the Government, in collaboration with the Insurance Authority ("IA"), to provide information on –

(a) the respective impacts on IA's financial position if the proposed additional funding of $300 million to assist IA to tide over its projected cash shortfall is to be provided by the Government in the form of (i) an interest bearing loan; or (ii) a direct funding injection; and

(b) IA's projected financial position after its levy rate reaches the target level of 0.1% in 2021, in particular, when IA is expected to break even in operation.

Response from the Government and the IA

2. The IA is an independent regulator that derives its income mainly from (a) premium levies, subject to an upper limit per policy and a schedule of phased increase between 2018 to 2021; (b) authorization/annual fees payable by insurers, subject to an upper limit; and (c) licence fees payable by insurance intermediaries from 2024-25. The IA has been exercising financial prudence in containing expenditure and exploring new sources of revenue. Notwithstanding these efforts, based on its best estimate, the IA could achieve breakeven in operation only in 2022-23. The cumulative deficits will lead to a cash shortfall of about $69 million and $99 million in 2020-21 and 2021-22 respectively.

3. Meanwhile, as a matter of good financial discipline and to ensure that policyholders are properly protected, the IA also needs to maintain a buffer

amounting to about six months of operating expenses (i.e. around $220 million based on the IA's budget for 2019-20) to cater for contingencies and market volatility that might affect income from premium levies.

4. Against the above background, the Government plans to provide additional funding of $300 million[1] to the IA in 2020-21 in accordance with the established mechanism, so as to assist the IA to tide over its projected cash shortfall in the short to medium term and maintain an appropriate level of buffer.

5. On the feasibility of obtaining a government loan instead of capital injection, the IA's best estimate shows that its repayment ability is very limited. Assuming an interest rate of 2.9% per annum[2] and four equal annual instalments to repay the principal starting from 2026-27, cash reserves of the IA will be depleted in 2028-29. An interest-free loan bearing the same terms does not help either as the IA's cash reserves in 2029-30 will still be far below the level (i.e. about six months of operating expenses) that is required to cater for contingencies and market volatility. Under both circumstances, the IA would not be able to maintain an appropriate level of buffer.

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1 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.

2 This is the interest rate of the Government's fiscal reserves placed with the Exchange Fund for 2019 according to the 2019-20 Budget.