

For discussion
on 1 March 2021

**Legislative Council Panel on Financial Affairs
Insurance Authority
Budget for the Financial Year 2021-22**

PURPOSE

This paper highlights the main features of the proposed budget of the Insurance Authority (“IA”) for 2021-22.

BACKGROUND

2. The IA is an independent regulator established under the Insurance Ordinance (Cap. 41) (“the Ordinance”) in December 2015. It took over the responsibility of supervising insurance companies from the former Office of the Commissioner of Insurance in June 2017 and assumed direct regulation of insurance intermediaries in September 2019.

3. Section 5B of the Ordinance requires the IA to submit a corporate plan for the next financial year (including the estimates of its income and expenditure (“the budget”)) to the Financial Secretary (“FS”) for approval. FS must lay a copy of the approved budget on the table of the Legislative Council (“LegCo”). In line with past practice, the Government has prepared this paper to brief Members on the main features of the IA’s proposed budget for 2021-22, a copy of which is at Annex.

FUNDING OF THE IA

4. In order for the IA to attain financial independence from the Government, approval has been given by LegCo for the IA to collect annual and authorization fees payable by insurance companies (from 26 June 2017), user fees payable for specific services (from 26 June 2017) and a levy on insurance premiums payable by policy holders (from 1 January 2018). In addition, with the enactment of the related subsidiary legislation in December 2020, the IA will collect fees for recovering the cost of the IA in carrying out group-wide supervision (“GWS”) after the GWS framework commences operation on 29 March 2021. The IA also plans to resume

collecting licence fees five years after commencing direct regulation of insurance intermediaries¹.

5. 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. Subsequently, 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 has provided an additional funding of \$300 million to the IA in 2020-21.

BUDGET FOR 2021-22

Income

6. The estimated total income for 2021-22 is about \$479.4 million, which is \$151.4 million (46.2%) above the revised estimate for 2020-21 (\$328 million), arising from increase of the premium levy rate from 0.085% to the target level of 0.1% on 1 April 2021 subject to a cap², increase of the variable fee rate (which affects the amount of annual and authorization fees payable) from 0.0026% to 0.0031% on 1 June 2021 and charging of fees under the new GWS framework in the second quarter of 2021.

Operating Expenditure

7. The estimated total operating expenditure for 2021-22 is about \$536.9 million, which is \$76.3 million (16.6%) above the revised estimate for 2020-21 (\$460.6 million), mainly attributable to the following –

- (a) “Staff costs” – with a headcount and pay freeze, the estimated staff costs for 2021-22 is about \$377.6 million, which is \$38 million (11.2%) above the revised estimate for 2020-21 (\$339.6 million), mainly due to the full year effect of those staff newly hired or to be hired in 2021-22. The estimated staff costs account for about 70% of the total estimated operating expenditure for 2021-22;

¹ As pledged by the Government in the LegCo Brief for the Insurance Companies (Amendment) Bill 2014, which provided for, inter alia, the establishment of the independent IA and the statutory licensing regime for insurance intermediaries, licence fees for insurance intermediaries would be waived in the first five years after the commencement of the statutory licensing regime.

² The existing cap of \$85 (for long term insurance) and \$4,250 (for general insurance) will increase to \$100 and \$5,000 respectively when the levy rate reaches the target level of 0.1% on 1 April 2021.

- (b) “Office rental and related expenses” – the estimated expenditure for 2021-22 is about \$30.3 million, which is \$3.3 million (12.2%) above the revised estimate for 2020-21 of \$27 million, mainly caused by rentals of the new sub-office in North Point;
- (c) “Engagement of professional services” – the estimated expenditure for 2021-22 is about \$29.3 million, which is \$9.9 million (51%) above the revised estimate for 2020-21 of \$19.4 million, largely due to legal and consultancy support for GWS;
- (d) “Information Technology expenses” – the estimated expenditure for 2021-22 is about \$26.3 million, which is \$4.4 million (20.1%) above the revised estimate for 2020-21 of \$21.9 million, mainly led by regular maintenance, IT services and systems support;
- (e) “External relations expenses” – the estimated expenditure for 2021-22 is about \$11.4 million, which is \$4.5 million (65.2%) above the revised estimate for 2020-21 of \$6.9 million, largely because of public education initiatives;
- (f) “Other operating expenses” – the estimated expenditure for 2021-22 is about \$33.3 million, which is \$18.1 million (119.1%) above the revised estimate for 2020-21 of \$15.2 million, mainly resulting from resumption of duty travels, operation of the new sub-office in North Point as well as equipment maintenance upon expiry of warranties; and
- (g) “Non-recurrent projects” – the estimated expenditure for 2021-22 is about \$1 million, which is \$0.3 million (23.1%) less than the revised estimate for 2020-21 of \$1.3 million, largely on account of less consultancy studies related to development of the risk-based capital (“RBC”) regime³.

Capital Expenditure

8. The estimated capital expenditure for 2021-22 is about \$24.3 million, which is \$9.5 million (28.1%) less than the revised estimate for 2020-21 (\$33.8 million), reflecting the completion of the renovation works

³ For ease of monitoring, the Government will invite the IA to capture all expenses related to consultancy studies, including those for the RBC consultancy studies, under “Engagement of professional services” in preparing the annual budgets in future.

for the new sub-office in North Point.

Reserve

9. The IA estimates that it will have an unspent operating balance of about \$287 million on 31 March 2022, i.e. about six months of its operating expenses for 2021-22.

COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 2020-21

Income

10. The revised total income for 2020-21 (\$328 million) is less than the approved budget (\$339.7 million) by \$11.7 million (3.4%), as the income from premium levies, being the principal source of income of the IA, is less than the original estimates owing to a reduction of new business derived from Mainland visitors.

Operating Expenditure

11. The revised operating expenditure for 2020-21 (\$460.6 million) is \$74.2 million (13.9%) less than the approved budget (\$534.8 million), mainly due to the following changes—

- (a) “Staff costs” – \$50.9 million (13%) less than budgeted (\$390.5 million), mainly due to unfilled staff vacancies at the time of preparing the revised estimates in September 2020;
- (b) “Office rental and related expenses” – \$4.2 million (13.5%) less than budgeted (\$31.2 million), largely because of reduction in rentals upon lease renewal for the main office in Wong Chuk Hang;
- (c) “Engagement of professional services” – \$5.3 million (21.5%) less than budgeted (\$24.7 million), mainly attributable to lower consultancy and legal fees for GWS;
- (d) “External relations expenses” – 3.6 million (34.3%) less than budgeted (\$10.5 million), largely explained by reduced spending on publicity campaigns due to impact of COVID-19

and rescheduling of campaigns ;

- (e) “Other operating expenses” – \$10.3 million (40.4%) less than budgeted (\$25.5 million), mainly arose from fewer duty travels and staff training activities; and
- (f) “Non-recurrent projects” – the increase of about \$1.3 million in revised expenditure for 2020-21 was related to consultancy studies for development of the RBC regime.

Capital Expenditure

12. The revised estimate (\$33.8 million) is very close to the approved budget (\$33.7 million), catering for IT systems and equipment as well as renovation works of the new sub-office in North Point.

Reserve

13. The IA estimates that it will have an unspent operating balance of about \$355.2 million on 31 March 2021, mainly due to the Government’s provision of additional funding of \$300 million in 2020-21.

THE GOVERNMENT’S VIEWS

14. We have examined the proposed budget of the IA for 2021-22 having regard to the progress of core activities and major initiatives. It is noteworthy that the IA, after reviewing the market conditions, has proposed a headcount and pay freeze. Meanwhile, the IA’s principal source of income (i.e. income from premium levies) is subject to market fluctuation. We consider that the IA, as a publicly-funded organisation, should deploy its resources and control its expenditures in a prudent manner. We will remind the IA to closely monitor its expenditure position in the face of market volatility, and to continue to exercise vigilance in its budgetary process to ensure prudent use of public funds and thereby its long-term financial sustainability. We will also remind the IA to strive to maintain a reserve level of about six months of operating expenses to cater for contingencies and market volatility that might affect income.

ADVICE SOUGHT

15. Members are invited to note the proposed budget of the IA for 2021-22.

**Financial Services Branch
Financial Services and the Treasury Bureau
February 2021**

Estimates of Income and Expenditure for 2021-22

		Estimates 2020-21 (i) HK\$ <u>million</u>	Revised Estimates 2020-21 (ii) HK\$ <u>million</u>	Proposed Estimates 2021-22 (iii) HK\$ <u>million</u>	Proposed Estimates 2021-22 vs. Revised Estimates 2020-21 (vi) = (iii) - (ii) HK\$ <u>million</u>
A. <u>Income and Expenditure Statement</u>					
<u>Income</u>					
	1				
(a)	2	4.5	2.3	3.2	0.9
(b)	3	335.2	325.7	476.2	150.5
Total Income		339.7	328.0	479.4	151.4
<u>Operating Expenditure</u>					
(a)	4	390.5	339.6	377.6	38.0
(b)	5	31.2	27.0	30.3	3.3
(c)	6	24.7	19.4	29.3	9.9
(d)	7	21.1	21.9	26.3	4.4
(e)	8	10.5	6.9	11.4	4.5
(f)		3.7	3.7	3.7	-
(g)	9	25.5	15.2	33.3	18.1
(h)	10	27.7	25.6	24.0	(1.6)
(i)	11	-	1.3	1.0	(0.3)
Total Operating Expenditure		534.8	460.6	536.9	76.3
Result for the year		(195.1)	(132.6)	(57.4)	75.2
B. <u>Capital Expenditure Statement</u>					
(a)	12	13.7	13.6	3.1	(10.5)
(b)	13	20.0	20.2	21.2	1.0
Total Capital Expenditure		33.7	33.8	24.3	(9.5)

Notes to the Proposed Estimates for 2021-22

1. Income

According to the consultancy study¹ commissioned by the Government, income received by the IA in the first four years of operation will not be sufficient to cover its expenditure and will generate a deficit of \$650 million. On 13 May 2016, LegCo² approved an allocation of \$450 million to the IA, followed by another \$200 million on 10 May 2018. These two sums provided by the Government, without related costs, were received in June 2016 and June 2018 respectively.

On 14 May 2020, LegCo approved a capital injection of \$300 million to the IA for meeting its expected cash shortfall in the short to medium term and maintaining an appropriate level of reserve. The sum provided by the Government, without related costs, were received in June 2020.

2. Interest income

With approval of FS, the IA has adopted an interim investment strategy whereby funds not required for immediate use could be invested in the form of Hong Kong Dollars fixed deposits. A long-term investment strategy will be worked out when there is more certainty on cash flow requirements of the IA.

3. Levy and Fees

Starting from 1 January 2018, a levy of 0.04% on insurance premiums is payable by policyholders. This levy rate has been adjusted upward progressively and will reach the target level of 0.1% in 2021-22 subject to a cap applicable to general policies with annual premiums at or above \$5 million and long term policies with single or annualized premiums at or above \$100,000. Captive insurance, contracts of reinsurance and marine, aviation and goods in transit are not subject to levy.

¹ The consultancy study was carried out by PricewaterhouseCoopers.

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

The annual authorization fees payable by insurance companies with effect from 26 June 2017 consist of two elements, (a) a fixed fee of \$300,000 (\$30,000 for captive insurers and \$600,000 for composite insurers); and (b) a variable fee capped at \$7 million on insurance liabilities (\$14 million for composite insurers) set initially at 0.0001%, rising gradually to the target level of 0.0039% in 2022-23.

Since 26 June 2017, the IA has been charging user fees to recover the cost of 11 services. The number of these items expanded to 23 on 27 May 2019, 22 of which are applicable to insurance companies. Furthermore, the IA will start to recover cost by charging fees on designated insurance holding companies under the GWS framework in 2021-22.

4. Staff costs

The staff costs involve mainly salary, contributions to Mandatory Provident Fund and corporate insurance cover. The revised estimate for 2020-21 is worked out based on actual staff profile of about 330 permanent staff, taking into account full- year effect of new recruits who joined in the last financial year.

5. Office rental and related expenses

This item includes mainly office rentals, building management fees, utility charges, government rent/rates as well as other items such as general office insurance and telephone rentals. The estimate for 2021-22 is higher due to setting up of the new sub-office in North Point.

6. Engagement of professional services

Professional services comprise legal and consultancy support, executive search services and external audit etc. The estimate for 2021-22 exceeds the revised estimate for 2020-21 mainly because of professional services associated with the GWS framework.

7. IT expenses

IT expenses mainly cover maintenance fees of server infrastructure, security protection system and various application systems.

8. External relations expenses

This item caters for publicity campaigns, production of the Asian Insurance Forum, media and social media expenses etc. Increased estimate for 2021-22 is mainly attributable to public education initiatives.

9. Other operating expenses

This item covers mainly staff training and development, duty travel, official events and incidental outlays. The estimate for 2021-22 has gone up due to the resumption of duty travels, new sub-office in North Point and equipment maintenance upon expiry of warranties.

10. Depreciation

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

11. Non-recurrent projects

This item makes provision for consultancy studies related to development of the RBC regime³.

12. Office set-up

The estimate for 2021-22 represents mostly minor renovation costs.

13. IT systems and equipment

The estimate for 2021-22 includes systems implementation, IT refreshment and cybersecurity.

December 2020

³ The RBC regime is developed in phases to enhance prudential regulation by aligning the capital requirements of insurance companies with the risks to which they are exposed and by strengthening their enterprise risk management system.