

## LEGISLATIVE COUNCIL BRIEF

Insurance Ordinance (Chapter 41)

### INSURANCE (AUTHORIZATION AND ANNUAL FEES) (AMENDMENT) REGULATION 2021

### INSURANCE (AMENDMENT) ORDINANCE 2020 (COMMENCEMENT) NOTICE

### INSURANCE (SPECIAL PURPOSE BUSINESS) RULES

#### INTRODUCTION

This paper briefs Members on three pieces of subsidiary legislation that are related to the commencement of a new regulatory regime for insurance-linked securities (“ILS”) business on 29 March 2021.

2. At the meeting of the Executive Council on 5 January 2021, the Council **ADVISED** and the Chief Executive **ORDERED** that the Insurance (Authorization and Annual Fees) (Amendment) Regulation 2021 (“Fees Regulation”) (at **Annex A**) should be made under section 128 of the Insurance Ordinance (Cap. 41) (“IO”).

3. The Secretary for Financial Services and the Treasury (“SFST”) will make the Insurance (Amendment) Ordinance 2020 (Commencement) Notice (“Commencement Notice”) (at **Annex B**) under section 1(2) of the Insurance (Amendment) Ordinance 2020 (“Amendment Ordinance”).

4. The Insurance Authority (“IA”) will make the Insurance (Special Purpose Business) Rules (“SPB Rules”) (at **Annex C**) under the new section 129A of the IO.

## JUSTIFICATIONS

5. ILS is a risk management tool that enables insurers or reinsurers to offload risks that they have underwritten to the capital market by way of securitization, and are often treated as an alternative form of reinsurance. From the perspective of institutional investors, ILS offers an exposure uncorrelated to economic cycles, thereby achieving diversification.

6. Global issuance of ILS has expanded substantially in recent years<sup>1</sup> amidst a rising trend of catastrophic events caused by climate change and increased urbanization, but the risk coverage is still mainly confined to the United States and Europe.

7. Enacted in July 2020, the Amendment Ordinance aims to amend the IO to provide for, inter alia, a new ILS regulatory regime. The new regime will facilitate Hong Kong to seize the potential business opportunities in Asia, particularly those generated by the Guangdong-Hong Kong-Macao Greater Bay Area (“GBA”) development<sup>2</sup>. The Amendment Ordinance also seeks to amend the IO to expand the scope of insurable risks of captive insurers set up in Hong Kong and make some technical amendments<sup>3</sup>.

8. Having regard to the progress of preparatory work, the Government has decided to commence the Amendment Ordinance on 29 March 2021. It is necessary to make three pieces of subsidiary legislation to bring the Amendment Ordinance into operation on the same day.

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<sup>1</sup> According to the Artemis Catastrophe Bond and Insurance-linked Securities Deal Directory, the total amount of global ILS issuance increased from US\$5.4 billion (26 issuances) in 2010 to US\$11.1 billion (65 issuances) in 2019.

<sup>2</sup> After the meeting of the Leading Group for the Development of GBA held on 6 November 2019, the Central Government announced a series of policy measures, including supporting Mainland insurers to issue catastrophe bonds (a common form of ILS) in Hong Kong to facilitate development of the local bond market.

<sup>3</sup> The technical amendments aim to allow the IA to delegate to its employees the function of publishing materials relating to its performance, and to correct editorial errors and incorrect cross-references under the IO.

## PROPOSALS

9. The proposals contained in the various pieces of subsidiary legislation are set out in the ensuing paragraphs.

### (A) Commencement Notice

10. In accordance with section 1(2) of the Amendment Ordinance, SFST, via the Commencement Notice at **Annex B**, will appoint 29 March 2021 as the day on which the Amendment Ordinance comes into operation such that the ILS regulatory regime referred to in paragraph 7 above will become effective starting from that date.

### (B) Fees Regulation

11. Under the new ILS regulatory regime, special purpose insurers (“SPIs”) would be authorized to carry on special purpose business (“SPB”), which is a new class of business involving effecting and carrying out contracts of insurance that are fully funded through insurance securitization. Like conventional insurers, authorization fee and other user fees would be required from SPIs for recovering the costs of IA in regulating ILS business.

12. Section 128 of the IO stipulates, among other things, that the Chief Executive in Council may, after consulting the IA, by regulations provide for the payment to the IA of, and prescribe fees for, anything done by the IA in performing a function under the IO. The fee proposals for implementing the new ILS regulatory regime, with inputs from the IA incorporated, are set out in paragraphs 13 to 15 below.

13. At present, an insurer authorized to carry on long term or general business is required to pay a fixed annual fee of \$300,000 and a variable fee<sup>4</sup> under the Insurance (Authorization and Annual Fees) Regulation (Cap. 41C) (“Cap. 41C”), while a captive insurer has to pay a reduced annual fee of \$30,000 and a variable fee.

14. Under the new ILS regulatory regime, a SPI can carry on SPB only and has to be fully-funded, i.e. all liabilities owed to the cedant must be fully

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<sup>4</sup> The variable fee is determined by multiplying insurance liabilities of an authorized insurer by the rate as specified in Schedule 3 to Cap. 41C, corresponding to the reference period in which the payment due date falls.

backed by assets including funds raised through debt or other financing arrangements (and hence no solvency risk). Therefore, the authorization and subsequent regulation of SPIs are expected to be much simpler than that for a conventional insurer. After taking into account the practice adopted by other major jurisdictions<sup>5</sup>, the IA proposes that a fixed fee of \$15,000 be charged upon the authorization of each SPI and thereafter on an annual basis, with no variable fee.

15. Separately, the Insurance (Prescribed Fees) Regulation (Cap. 41B) (“Cap. 41B”) prescribes user items to recover the costs of providing specific services by the IA. A list of the user fee items applicable to SPIs is set out at **Annex D**. The IA does not propose to amend Cap. 41B because the fee levels of items applicable to SPIs are considered appropriate.

### **(C) SPB Rules**

16. While ILS is a useful and effective risk management tool enabling insurers (including reinsurers) to offload insured risks to the capital markets by way of securitization, they are considered unsuitable for ordinary retail investors. The Amendment Ordinance thus empowers the IA to prescribe restrictions on the sale of ILS by rules made under the new section 129A of the IO<sup>6</sup>.

17. The IA proposes that the sale of ILS should be confined to the following types of institutional investors<sup>7</sup> –

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<sup>5</sup> Bermuda and Singapore are charging a fixed and all-inclusive annual fee on SPIs formed for the issuance of ILS. The annual fee charged by Bermuda is US\$8,500 (about HK\$66,300), which will increase to US\$15,000 (about HK\$117,000) in 2021. For Singapore, the annual fee is pitched at S\$5,000 (about HK\$27,500).

<sup>6</sup> Under the new section 129A of the IO, the IA may make rules to –

- (a) prohibit the sale of, or the making of an offer to sell, ILS to any person other than an investor falling within a type to be prescribed in the rules;
- (b) prohibit the sale of, or the making of any offer to sell, ILS at an amount lower than that prescribed in the rules; and
- (c) prescribe offences for contravention of the rules in (a) and (b) above, with penalty levels not exceeding: for an offence of which a person is convicted on indictment, a fine of \$200,000 and imprisonment for two years; for an offence of which a person is summarily convicted, a fine at level 6 and imprisonment for six months.

<sup>7</sup> For the purpose of the SPB Rules, the definition of “securities” in section 1, Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) which includes derivative products and structured products applies. In other words, “repackaging” ILS into financial products such as derivative products or structured products linked to ILS for sale to ordinary retail investors is also prohibited under the SPB Rules.

- (a) banks or authorized financial institutions;
- (b) insurance companies (including reinsurance companies);
- (c) corporations carrying on business of the provision of investment services;
- (d) governments, central banks and multilateral agencies;
- (e) authorized exchange companies; and
- (f) collective investment schemes, excluding retail funds authorized by the Securities and Futures Commission, Mandatory Provident Fund (“MPF”) funds, approved pooled investment funds which can be invested by MPF funds, and occupational retirement schemes.

18. Apart from confining the sale of ILS to the types of institutional investors mentioned in paragraph 17 above, the imposition of a minimum investment size for ILS provides an additional safeguard by discouraging the re-selling or “repackaging” of ILS to less sophisticated institutional investors. Specifically, the IA proposes a minimum investment size of US\$250,000 (or the equivalent in other currencies) for each ILS transaction to achieve a balance between market development and investor protection. To provide deterrence, a person contravening the sale restrictions above commits an offence and is liable on conviction on indictment to a fine of HK\$200,000 and in the case of an individual, also to an imprisonment for two years; or on summary conviction to a fine at level 6 (i.e. \$100,000) and in the case of an individual, also to an imprisonment for six months.

## **LEGISLATIVE TIMETABLE**

19. The legislative timetable for the three pieces of subsidiary legislation is as follows –

	Fees Regulation	Commencement Notice and SPB Rules
Publication in the Gazette	15 January 2021	22 January 2021
Tabling at the Legislative Council (“LegCo”) for negative vetting	20 January 2021	27 January 2021
Commencement	29 March 2021	29 March 2021

## **IMPLICATIONS OF THE PROPOSALS**

20. The subsidiary legislation referred to in paragraphs 2 to 4 above is in conformity with the Basic Law, including the provisions concerning human rights. The subsidiary legislation does not affect the current binding effect of the IO. The subsidiary legislation has no financial or civil service implications to the Government, and no environmental, productivity, family and gender implications. The subsidiary legislation has no sustainability implications other than economic implications set out in paragraph 21 below.

21. On economic implications, the fees prescribed by the Fees Regulation would impose additional costs on SPIs, but the costs are insignificant when compared with the general issue size and issue costs of ILS.

## **PUBLIC CONSULTATION**

22. The IA consulted key industry stakeholders in the ILS market, including the Hong Kong Federation of Insurers, on the fee proposals. The stakeholders consulted were generally supportive of the proposals. The IA has also conducted a six-week public consultation exercise on the draft SPB rules. The respondents generally find the proposals acceptable but there are calls for a lower minimum investment size<sup>8</sup> to facilitate the development of the ILS market and make Hong Kong a competitive ILS domicile. Furthermore, the Financial Services and the Treasury Bureau and the IA consulted the LegCo Panel on Financial Affairs at its meeting on 2 November 2020 regarding the fee proposals and the proposed restrictions on the sale of ILS. Members were generally supportive of the proposals and there was a suggestion to lower the minimum investment size for ILS. The SPB Rules have been refined to take account of feedback received during the public consultation exercise and discussion at the aforesaid Panel meeting.

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<sup>8</sup> Under the draft SPB Rules published for public consultation, the IA proposed a minimum investment size of US\$1 million (or the equivalent in other currencies), which was set based on prevailing ILS transactions by private placement.

## **PUBLICITY**

23. We will issue a press release on 15 January 2021, and arrange for a spokesperson to answer media enquiries.

## **ENQUIRIES**

24. Enquiries may be directed to Ms Noel Tsang, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2201.

**Financial Services and the Treasury Bureau  
Insurance Authority**

**15 January 2021**

**Insurance (Authorization and Annual Fees)  
(Amendment) Regulation 2021**

(Made by the Chief Executive in Council under section 128(1) of the Insurance Ordinance (Cap. 41) after consultation with the Insurance Authority)

1. **Commencement**  
This Regulation comes into operation on 29 March 2021.
2. **Insurance (Authorization and Annual Fees) Regulation amended**  
The Insurance (Authorization and Annual Fees) Regulation (Cap. 41 sub. leg. C) is amended as set out in sections 3 to 6.
3. **Section 2 substituted**  
Section 2—  
**Repeal the section**  
**Substitute**
- “2. **Prescribed fees under section 13(1)(a) and (b) of Ordinance**  
The fees payable under section 13(1)(a) and (b) of the Ordinance are as follows—
  - (a) for an authorized insurer (other than a captive insurer or special purpose insurer)—the aggregate of a fixed fee and a variable fee set out in Schedule 1;
  - (b) for an authorized insurer which is a captive insurer—the aggregate of a fixed fee and a variable fee set out in Schedule 2;

- (c) for an authorized insurer which is a special purpose insurer—a fixed fee set out in Schedule 2A.”.
4. **Schedule 1 amended (fees payable under section 13(1)(a) and (b) of Ordinance by authorized insurer (other than captive insurer))**
  - (1) Schedule 1, heading, after “**Captive Insurer**”—  
**Add**  
“or **Special Purpose Insurer**”.
  - (2) Schedule 1, column 4, heading, after “captive insurer”—  
**Add**  
“or special purpose insurer”.
5. **Schedule 2 heading amended (fees payable under section 13(1)(a) and (b) of Ordinance by authorized insurer who is captive insurer)**  
Schedule 2, heading—  
**Repeal**  
“**Authorized Insurer who is**”.
6. **Schedule 2A added**  
After Schedule 2—  
**Add**  
**“Schedule 2A**



**Fees Payable under Section 13(1)(a) and (b) of Ordinance by Special Purpose Insurer**

Column 1 Item	Column 2 Section of Ordinance	Column 3 Fee to be paid	Column 4 Fee
1.	Section 13(1)(a)	Fee payable upon authorization	A fixed fee of \$15,000
2.	Section 13(1)(b)	Annual fee	A fixed fee of \$15,000".

Clerk to the Executive Council

COUNCIL CHAMBER

2021

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**Explanatory Note**

The main object of this Regulation is to add a new Schedule 2A to the Insurance (Authorization and Annual Fees) Regulation (Cap. 41 sub. leg. C) to prescribe the fees payable by a special purpose insurer under section 13(1)(a) and (b) of the Insurance Ordinance (Cap. 41).

**Insurance (Amendment) Ordinance 2020  
(Commencement) Notice**

Under section 1(2) of the Insurance (Amendment) Ordinance 2020 (17 of 2020), I appoint 29 March 2021 as the day on which the Ordinance comes into operation.

Secretary for Financial Services and  
the Treasury

2021

## Insurance (Special Purpose Business) Rules

(Made by the Insurance Authority under section 129A of the Insurance Ordinance (Cap. 41))

### 1. Commencement

These Rules come into operation on the day on which section 8 of the Insurance (Amendment) Ordinance 2020 (17 of 2020) comes into operation.

### 2. Interpretation

In these Rules—

**authorized financial institution** (認可財務機構) means an authorized institution as defined by section 2(1) of the Banking Ordinance (Cap. 155);

**bank** (銀行) means any institution carrying on business similar to—

- (a) the banking business within the meaning of the Banking Ordinance (Cap. 155) as carried on by an authorized financial institution; or
- (b) the business of taking deposits within the meaning of the Banking Ordinance (Cap. 155) as carried on by an authorized financial institution;

**collective investment scheme** (集體投資計劃) means a collective investment scheme as defined by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

**corporation** (法團) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

**eligible ILS investor** (合資格保險相連證券投資者) has the meaning assigned to it by rule 3;

**insurance-linked securities** (保險相連證券) has the meaning given by section 129A of the Ordinance;

**recognized clearing house** (認可結算所) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

**recognized exchange company** (認可交易所) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

**recognized exchange controller** (認可控制人) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

**recognized investor compensation company** (認可投資者賠償公司) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571).

### 3. Restrictions on sale of insurance-linked securities

- (1) A person must not enter into, or offer to enter into, an agreement with another person, or invite or induce, or attempt to invite or induce, another person to enter into an agreement, for that other person to acquire, subscribe for or underwrite insurance-linked securities, or to dispose of insurance-linked securities to that other person, unless—
  - (a) that other person is an eligible ILS investor;
  - (b) that other person is not a person mentioned in subrule (2); and
  - (c) the consideration for which the insurance-linked securities are to be acquired, subscribed for, underwritten, or disposed of under the agreement is not less than US\$250,000 or the equivalent of such amount in other currencies.
- (2) A person referred to in subrule (1)(b) is—

- (a) any collective investment scheme authorized under section 104 of the Securities and Futures Ordinance (Cap. 571), or any person in that person's capacity as an operator in relation to any such authorized collective investment scheme;
  - (b) any registered scheme or its constituent fund as defined by section 2(1) of the Mandatory Provident Fund Schemes Ordinance (Cap. 485), or any scheme which is an approved pooled investment fund as defined by section 6 of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. leg. A), or any person in that person's capacity as an approved trustee or service provider in relation to any such registered scheme as defined by section 2(1) of that Ordinance; or
  - (c) any scheme which is a registered scheme as defined by section 2(1) of the Occupational Retirement Schemes Ordinance (Cap. 426), or any person in that person's capacity as an administrator as defined by section 2(1) of that Ordinance in relation to any such registered scheme.
- (3) A person who contravenes subrule (1) commits an offence and is liable—
- (a) on summary conviction to a fine at level 6 and, in the case of an individual, also to imprisonment for 6 months; or
  - (b) on conviction on indictment to a fine of \$200,000 and, in the case of an individual, also to imprisonment for 2 years.
- (4) In this rule—
- eligible ILS investor** (合資格保險相連證券投資者) means—
- (a) any recognized exchange company, recognized clearing house, recognized exchange controller or recognized investor compensation company, or any corporation authorized to provide automated trading services under

- section 95(2) of the Securities and Futures Ordinance (Cap. 571);
- (b) any licensed corporation or registered institution as defined under the Securities and Futures Ordinance (Cap. 571), or any other corporation carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong;
- (c) any authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;
- (d) any insurer authorized under the Ordinance, or any other person carrying on insurance business and regulated under the law of any place outside Hong Kong;
- (e) any scheme which—
  - (i) is a collective investment scheme that is not the subject of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(b) of the Securities and Futures Ordinance (Cap. 571) and is not authorized, and not required to be authorized, under section 105(1) of that Ordinance; or
  - (ii) is similarly constituted under the law of any place outside Hong Kong and, if it is regulated under the law of such place, is permitted to be operated under the law of such place,
 or any person by whom any such scheme is operated;
- (f) any government (other than a municipal government authority), any institution which performs the functions of a central bank, or any multilateral agency; or
- (g) any corporation which is—
  - (i) a wholly owned subsidiary of—



- (A) a licensed corporation or registered institution as defined under the Securities and Futures Ordinance (Cap. 571), or other corporation carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong; or
  - (B) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;
- (ii) a holding company which holds all the issued share capital of—
- (A) a licensed corporation or registered institution as defined under the Securities and Futures Ordinance (Cap. 571); or other corporation carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong; or
  - (B) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong; or
- (iii) any other wholly owned subsidiary of a holding company referred to in subparagraph (ii).

Insurance Authority

2021

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### Explanatory Note

These Rules provide for restrictions on sales of insurance-linked securities (*ILS*) including the scope of eligible investors, a minimum investment size and relevant offences against the contravention of sales restrictions under section 129A of the Insurance Ordinance (Cap. 41). The Rules define—

- (a) *eligible ILS investors* to whom ILS may be sold or offered for purchase;
- (b) a minimum investment size for ILS; and
- (c) offences and penalties of contravention.

**Existing User Fee Items under  
the Insurance (Prescribed Fees) Regulation (Cap. 41B)  
that are Applicable to Special Purpose Insurers**

<b>Item</b>	<b>Section of Cap. 41</b>	<b>Matter in respect of which fee must be paid</b>	<b>Fee (\$)</b>
1	5H(3)(a)	For obtaining each page of a copy of an entry in, or extract of, the register of authorized insurers	6
2	5H(3)(b)	For obtaining a copy of an entry in, or extract of, the register of authorized insurers, certified by an authorized officer of the Authority as a true copy of the entry or extract	100
3	13A(2)(b)	For each application for approval of the appointment of a controller	18,000
4	13AC(2)(b)	For each application for approval of the appointment of a director	18,000
5	128(1)(a)(ii)	For each notification of the appointment of an auditor of an authorized insurer	5,000
6	128(1)(a)(ii)	For requesting the Authority to update the information in the register kept under section 5H(1) of the Ordinance	1,300
7	128(1)(a)(ii)	For obtaining a duplicate certificate of authorization of an authorized insurer from the Authority	200
8	128(1)(a)(ii)	For obtaining a certificate of compliance of an authorized insurer from the Authority	12,000
9	128(1)(a)(ii)	For requesting the Authority to waive the fee payable under section 13(1)(b) of the Ordinance	2,000
10	128(1)(a)(ii)	For requesting the Authority to extend the period within which the information required to be submitted under section 17(1) of the Ordinance must be deposited under section 20(1) of the Ordinance	2,000
11	128(1)(a)(ii)	For requesting the Authority to modify or vary under section 17(2) of the Ordinance the requirements of Schedule 3 to the Ordinance	30,000

Item	Section of Cap. 41	Matter in respect of which fee must be paid	Fee (\$)
12	128(1)(a)(ii)	For requesting the Authority to disclose information to an auditor of an authorized insurer to the extent permitted by section 53A(3)(f) of the Ordinance	2,000

Note – “Authority” and “Ordinance” refers to “Insurance Authority” and “Insurance Ordinance” respectively.