

## **For Information**

### **Legislative Council Panel on Financial Affairs Insurance Authority Budget for the Financial Year 2022-23**

#### **PURPOSE**

This paper highlights the main features of the proposed budget of the Insurance Authority (“IA”) for 2022-23.

#### **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 the proposed budget of the IA for 2022-23, a copy of which is at **Annex**.

#### **FUNDING OF THE IA**

4. In order to enable the IA to achieve financial independence from the Government, approval has been given by LegCo for it 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). Furthermore, the IA has started to collect fees from designated insurance holding companies under the group-wide supervision (“GWS”) framework since May 2021 and intends to resume charging licence fees on insurance intermediaries in 2024-25, five years

after the direct regulatory scheme came into play<sup>1</sup>.

5. To address the funding shortfall in its initial years of operation, the IA received seed money of \$650 million from the Government in two phases, i.e. the first tranche of \$450 million in 2016-17 and the second tranche of \$200 million in 2018-19. Subsequently in 2020-21, an additional injection of \$300 million was provided by the Government to assist the IA in tiding over cash flow requirements and maintaining an appropriate level of reserve.

## **BUDGET FOR 2022-23**

### ***Income***

6. The estimated total income of the IA for 2022-23 is \$509.3 million, which is \$3.5 million (0.7%) more than the revised estimate for 2021-22 of \$505.8 million, attributable to a moderate growth in premium levies<sup>2</sup> and variable fees<sup>3</sup>, offset by reduced income derived from GWS fees.

### ***Operating Expenditure***

7. The estimated total operating expenditure of the IA for 2022-23 is \$587.2 million, which is \$103.1 million (21.3%) more than the revised estimate for 2021-22 of \$484.1 million, attributable to the following –

- (a) “Staff costs” – the estimate for 2022-23 is \$404.2 million, which is \$61.8 million (18%) more than the revised estimate for 2021-22 of \$342.4 million, mainly due to –
  - (i) the full-year effect of new recruits and staff to be hired in

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<sup>1</sup> As pledged by the Government in the LegCo Brief for the Insurance Companies (Amendment) Bill 2014 which provided for inter alia, establishment of the independent IA and the direct regulatory regime for insurance intermediaries, licence fees for insurance intermediaries will be waived in the first five years after the commencement of the direct regulatory regime. As the regime commenced on 23 September 2019, IA intends to resume charging licence fees in 2024-25.

<sup>2</sup> The levy rate which started at 0.04% of insurance premiums on 1 January 2018 has gradually moved to its target level of 0.1%, subject to a cap of \$100 (for long term policies) and \$5,000 (for general policies), from 1 April 2021.

<sup>3</sup> It consists of two elements, namely, (a) fixed fee of \$300,000 (\$30,000 for a captive insurance company and \$600,000 for a composite insurance company); and (b) variable fee subject to a cap of \$7 million on insurance liabilities (a cap of \$14 million for composite insurance companies). The variable fee is pitched initially at 0.0001% and will gradually move to the target level of 0.0039% in 2022-23.

2021-22;

- (ii) annual salary adjustment. The IA has made a provision equivalent to 3% of base pay for budgetary purpose, and will decide the actual level of annual salary adjustment later;
  - (iii) an increase in headcount of 21 to enhance internal support and meet prevailing workload; and
  - (iv) upgrading of one post to reflect its evolving job nature;
- (b) “Engagement of professional services” – the estimate for 2022-23 is \$39.3 million, which is \$12.7 million (47.7%) above the revised estimate for 2021-22 of \$26.6 million, mainly due to increased emphasis placed on investigation, enforcement and prosecutions, consultancy support for the GWS framework and launching of Mystery Shoppers Programmes;
- (c) “Information Technology (“IT”) expenses” – the estimate for 2022-23 is \$32.6 million, which is \$6.3 million (24%) above the revised estimate for 2021-22 of \$26.3 million, mainly due to adjustment for inflation, regular maintenance, IT and system services;
- (d) “External relations expenses” – the estimate for 2022-23 is \$12.3 million, which is \$1.2 million (10.8%) above the revised estimate for 2021-22 of \$11.1 million, mainly due to continued efforts to step up public education;
- (e) “Remuneration to Members” - the estimate for 2022-23 is \$4.1 million, which is \$0.4 million (10.8%) above the revised estimate for 2021-22 of \$3.7 million, catering for an expanded pool of Non-Executive Directors;
- (f) “Other operating expenses” – the estimate for 2022-23 is \$34.3 million, which is \$13.5 million (64.9%) above the revised estimate for 2021-22 of \$20.8 million, taking into consideration possible normalization of duty travels and staff training during the year; and
- (g) “Depreciation” – the estimate for 2022-23 is \$28.3 million, which is \$4.8 million (20.4%) above the revised estimate for 2021-22 of \$23.5 million, based on straight-line method over the expected lifespan of fixed assets.

### ***Capital Expenditure***

8. The estimated capital expenditure of the IA for 2022-23 is \$38.3 million, which is \$14.9 million (63.7%) above the revised estimate for 2021-22 of \$23.4 million, incorporating an allocation of \$20 million for the revamp of the Insurance System<sup>4</sup>.

### ***Reserve***

9. The IA projects that it will have an unspent operating balance of \$338.7 million on 31 March 2023, equivalent to over six months of estimated operating expenses for 2022-23 of \$587.2 million.

## **COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 2021-22**

### ***Income***

10. The revised total income of the IA for 2021-22 of \$505.8 million is \$26.4 million (5.5%) more than the approved budget of \$479.4 million, attributable to updated data on premium levies and annual authorization fees.

### ***Operating Expenditure***

11. The revised operating expenditure of the IA for 2021-22 of \$484.1 million is \$52.8 million (-9.8%) less than the approved budget of \$536.9 million, attributable to the following –

- (a) “Staff costs” – \$35.2 million (-9.3%) less than the approved budget of \$377.6 million, mainly due to the lead time required to fill vacancies;
- (b) “Engagement of professional services” – \$3.7 million (-12.2%) less than the approved budget of \$30.3 million, mainly due to lower provision for legal and consultancy support for the GWS framework; and
- (c) “Other operating expenses” – \$12.5 million (-37.5%) less than the approved budget of \$33.3 million, mainly due to fewer duty trips and

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<sup>4</sup> It is a two-year project to revamp the Insurance System developed in the 1990s which is grossly inadequate to underpin the risk-based capital regime.

staff training courses amidst the pandemic.

### ***Capital Expenditure***

12. The revised capital expenditure for the IA of \$23.4 million roughly tallies with the approved budget of \$24.3 million, which is used mainly for procurement of IT systems and equipment.

### ***Reserve***

13. The IA projects that it will have an unspent operating balance of \$419.6 million on 31 March 2022, factoring in the additional injection of \$300 million provided by the Government in 2021-22.

## **THE GOVERNMENT'S VIEWS**

14. We have examined the proposed budget of the IA for 2022-23 and note that after freezing the headcount in 2021-22, it is planning to create 21 posts to cope with workload associated with the risk-based capital regime, the GWS framework, green finance and IT strategy, and to upgrade one post to reflect its evolving job nature.

15. As a primary source of the IA's income, premium levies could be volatile and difficult to predict with accuracy. We will advise the IA to continue to deploy resources prudently and control expenditure vigorously in the interest of its long-term financial sustainability. We will also remind the IA to continue to maintain its reserve at a level of about six months of operating expenses in order to cater for market contingencies.

## **ADVICE SOUGHT**

16. Members are invited to note the contents of this paper.

**Financial Services Branch  
Financial Services and the Treasury Bureau  
March 2022**

## Estimates of Income and Expenditure for 2022-23

		<b>Estimates 2021-22</b>	<b>Revised Estimates 2021-22</b>	<b>Proposed Estimates 2022-23</b>	<b>Proposed Estimates 2022-23 vs. Revised Estimates 2021-22</b>
		(i)	(ii)	(iii)	(vi) = (iii) - (ii)
		HK\$	HK\$	HK\$	HK\$
<u>Note</u>		<u>million</u>	<u>million</u>	<u>million</u>	<u>million</u>
<b>A. <u>Income and Expenditure Statement</u></b>					
<b><u>Income</u></b>					
	1				
(a)	2	3.2	0.9	1.0	0.1
(b)	3	476.2	504.9	508.3	3.4
		<b>479.4</b>	<b>505.8</b>	<b>509.3</b>	<b>3.5</b>
<b><u>Operating Expenditure</u></b>					
(a)	4	377.6	342.4	404.2	61.8
(b)	5	30.3	29.7	32.1	2.4
(c)	6	30.3	26.6	39.3	12.7
(d)	7	26.3	26.3	32.6	6.3
(e)	8	11.4	11.1	12.3	1.2
(f)		3.7	3.7	4.1	0.4
(g)	9	33.3	20.8	34.3	13.5
(h)	10	24.0	23.5	28.3	4.8
		<b>536.9</b>	<b>484.1</b>	<b>587.2</b>	<b>103.1</b>
		<b>(57.5)</b>	<b>21.7</b>	<b>(77.9)</b>	<b>(99.6)</b>
<b>B. <u>Capital Expenditure Statement</u></b>					
(a)	11	3.1	2.6	2.5	(0.1)
(b)	12	21.2	20.8	35.8	15.0
		<b>24.3</b>	<b>23.4</b>	<b>38.3</b>	<b>14.9</b>

## Notes to the Proposed Estimates for 2022-23

### 1. Income

According to the consultancy study <sup>1</sup> 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, LegCo <sup>2</sup> approved the provision of \$450 million to IA, followed by the remaining provision of \$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 an additional funding injection of \$300 million to the IA for meeting the cash shortfall that it is expecting to face. The sum provided by the Government without related costs were received in June 2020. Government funding received is recognized as capital in the statement of financial position.

### 2. Interest income

With the approval of the Financial Secretary, the IA has adopted an interim investment strategy whereby funds not required for immediate use could be invested in the form of placement 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 premiums of insurance policies will be payable by policy holders. The levy rate gradually increased to its target level of 0.1% in 2021-22. A cap has been imposed on the levy on general insurance policies with annual premiums at or above \$5 million and long term insurance policies with single or annualized premiums at or above \$100,000. Captive insurance, contracts of reinsurance and marine, aviation and goods in transits are exempt from levy.

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<sup>1</sup> The consultancy study was carried out by the PricewaterhouseCoopers.

<sup>2</sup> Before obtaining LegCo's funding approval, the Government approved in February 2016 a small sum of \$3 million in 2015-16 for IA to meet mainly the cash flow requirement of the essential consultancy services. The allocation was received by IA in early March 2016.

The new annual authorization fees payable by insurance companies effective from 26 June 2017 consist of two elements, namely, (a) a fixed fee of \$300,000 (for captive insurance company, \$30,000; and for composite insurance company, \$600,000); and (b) a variable fee subject to a cap of \$7 million on insurance liabilities (\$14 million for composite insurer). The variable fee rate pitches at 0.0001% and will increase gradually until it reaches its target rate of 0.0039% in 2022-23.

With effect from 26 June 2017, the IA has been charging user fees to recover the cost of providing 11 specified services. The number of user fee items has been increased to 23 starting from 27 May 2019, of which 22 are applicable to insurance companies. Since May 2021, the IA has started to recover cost by charging fees on designated insurance holding companies under the Group-wide Supervision (“GWS”) framework.

**4. Staff costs**

The staff costs involve mainly salary, contributions to Mandatory Provident Fund contribution, staff insurance and employees’ compensation insurance. The revised estimate for 2021-22 is derived based on the actual staff profile, and we are expecting to reach full strength of 331 permanent staff by end of the financial year. There will be increase in staff cost in 2022-23 arising from additional staff for new initiatives.

**5. Office rental and related expenses**

This item includes mainly office rental, building management fees, utility charges, government rent/rates as well as other expenses such as general office insurance and telephone rental.

**6. Engagement of professional services**

This item represents mainly legal and consultancy fees, executive search services for staff recruitment, audit services etc. The estimate for 2022-23 is higher than the revised estimate for 2021-22 mostly because of the increase in the provisions for legal and consultancy services.

**7. IT expenses**

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



**8. External relations expenses**

The revised estimate for 2021-22 comprises mainly PR campaigns, the Asian Insurance Forum, monitoring of online news and social media. Increase in the estimate for 2022-23 is mainly due to public education initiatives.

**9. Other operating expenses**

Other operating expenses covers mainly expenses on staff training and development, travelling expenses, events and other incidental expenses. The estimate for 2022-23 is higher mainly due to systems maintenance and machines rental after expiry of warranties, and catering for duty travel and events such as GWS supervisory colleges.

**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. Office set-up**

The estimate for 2022-23 represents mostly the minor renovation costs of office premises.

**12. IT systems and equipment**

The estimate for 2022-23 includes the revamp of the Insurance System.

December 2021