

立法會
Legislative Council

LC Paper No. CB(1)711/2023

Ref.: CB1/BC/3/23

Report of the Bills Committee on Insurance (Amendment) Bill 2023

Purpose

This paper reports on the deliberations of the Bills Committee on Insurance (Amendment) Bill 2023 (“the Bills Committee”).

Background

2. At present, the Insurance Ordinance (Cap. 41) (“IO”) and the guidelines issued by the Insurance Authority (“IA”) set out a rule-based capital adequacy regime for insurers¹ carrying on business in Hong Kong.² Under the existing regime, capital adequacy of an insurer’s long term business³ and general

¹ Under section 2 of IO, insurer means a person carrying on insurance business but does not include Lloyd’s. In this report, an “insurer” generally refers to an “insurance company”.

² A company which seeks to carry on any class or classes of insurance business specified in Schedule 1 to IO (e.g. long term business and general business) requires authorization by IA under IO. Under the existing rule-based capital adequacy regime, IA must not authorize a company to carry on any class or classes of long term business or general business unless the value of the assets of the company is not less than the aggregate of the amount of its liabilities and the relevant amount specified in IO or rules made under IO (e.g. the Insurance (Margin of Solvency) Rules (Cap. 41F)).

³ Long term business includes life insurance and annuity. Details of classes of long term business are set out in Part 2 of Schedule 1 to IO.

business⁴ is assessed on the basis of the insurer's solvency margin⁵. The existing solvency regime does not take into account risk factors pertinent to an individual insurer, such as the potential risks associated with the products and investments which the insurer offers and makes.

3. In 2011, the International Association of Insurance Supervisors⁶ ("IAIS") issued the Insurance Core Principles in relation to global insurance regulatory standards, which prescribe principles for a risk-based approach for the capital adequacy regime to fully reflect the risk profile of individual insurers. The Government considers it necessary to implement a practicable risk-based capital ("RBC") regime to align with international regulatory requirements.

4. With reference to international standards, the Administration's proposed framework for the RBC regime to be implemented in Hong Kong comprises the following three pillars:

- (a) Pillar 1 – Quantitative assessment, which involves the establishment of two new solvency control levels (i.e. the Prescribed Capital Amount ("PCA") and Minimum Capital Amount ("MCA")) for insurers, and amendments to the valuation method for assets and liabilities of insurers;
- (b) Pillar 2 – Corporate governance and risk management, which involves the enhancement of enterprise risk management of insurers, which is the process of identifying, assessing, measuring, monitoring, controlling and mitigating risks for solvency purposes;⁷ and
- (c) Pillar 3 – Disclosure, which involves periodic submission of information to IA and periodic disclosure of information to the public by insurers.

⁴ General business covers business in relation to accident and health, damage to property and general liability. Details of classes of general business are set out in Part 3 of Schedule 1 to IO.

⁵ Solvency margin refers to the required surplus of the value of the insurer's assets over the value of its liability. Generally speaking, the solvency margin for long term business is calculated by reference to a percentage of the mathematical reserves and capital at risk, while that for general business is calculated by reference to a percentage of premium levels and claims outstanding.

⁶ IAIS is the global standard-setter for the insurance industry.

⁷ IA has issued the Guideline on Enterprise Risk Management after consultation with the industry, and the relevant requirements took effect on 1 January 2020.

Insurance (Amendment) Bill 2023

5. The Insurance (Amendment) Bill 2023 (“the Bill”) was published in the Gazette on 6 April 2023 and received its First Reading at the Legislative Council (“LegCo”) meeting of 19 April 2023. The Bill seeks to amend IO and relevant legislation to enable the implementation of an RBC regime for authorized insurers. The major provisions of the Bill are summarized as follows:

6. Part 2 of the Bill seeks to amend IO. The main provisions include –
- (a) providing for the capital requirements, valuation method for assets and liabilities, and establishment of a regulatory framework on the maintenance of funds for various classes of insurance business, etc., and empowering IA to prescribe detailed requirements by way of subsidiary legislation, for the purpose of implementing Pillar 1 of the RBC regime (the proposed new sections 10, 13AA, 21B, 25AA and 25AAB, and the proposed amended sections 8, 129 and 130);
 - (b) adjusting the requirements on submission of information to IA and disclosure of information to the public by insurers, and empowering IA to make the relevant rules, for the purpose of implementing Pillar 3 of the RBC regime (the proposed new sections 17 and 21A, and the proposed amended sections 129 and 130);
 - (c) adjusting the requirements relating to the appointment of actuary by insurers, and setting out relevant requirements pertaining to the exercise of regulatory and intervention powers by IA, etc., so as to tie in with the implementation of the RBC regime (the proposed new sections 15AAA, 15AAAB, 32A and 35AA, and the proposed amended section 32);
 - (d) adjusting the requirements in relation to shareholder controllers of insurers, including IA’s regulatory powers to approve and object to shareholder controllers, so as to enhance the protection for policy holders (the proposed amended section 13B, and the proposed new sections 13BA and 13BB); and
 - (e) empowering IA to designate insurers incorporated outside Hong Kong but carrying on all or a majority of business in Hong Kong, so that the valuation, capital and funds requirements, and requirements

on approval of certain personnel⁸ imposed on these insurers would be aligned with those on insurers incorporated in Hong Kong (the proposed new section 3B, and the proposed amended sections 13A, 13AC and 13AE).

7. Part 3 of the Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) (“IRO”) to provide for tax issues arising from the implementation of the RBC regime. For some insurers which may face a one-off increase in assessable profits upon the implementation of the new regime, the one-off increase may be assessed spreading over a period of five years (the proposed new sections 23AAAD, 23AAAE and 23AD of IRO).

8. The main provisions of the Bill are set out in **Appendix 1**. Apart from Part 2 (i.e. the proposed amendments to IO) and Part 4 (i.e. the proposed related amendments to other Ordinances) of the Bill which would come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette, the Bill, if passed, would come into operation on the day on which it is published in the Gazette as an Ordinance.

The Bills Committee

9. At the House Committee meeting on 21 April 2023, Members agreed to form a Bills Committee to study the Bill. Hon CHAN Kin-por and Hon CHAN Pui-leung are the Chairman and Deputy Chairman of the Bills Committee respectively. The membership list of the Bills Committee is in **Appendix 2**. The Bills Committee has held three meetings with the Administration and IA, and has invited written views from the public on the Bill. A list of organizations which have given views to the Bills Committee is in **Appendix 3**.

Deliberations of the Bills Committee

10. Members of the Bills Committee in general support the Bill. The major issues deliberated by the Bills Committee are set out below:

- (a) Advantages of the RBC regime (paragraphs 11-14);
- (b) Development and implementation of the RBC regime (paragraphs 15-21);

⁸ They include directors, chief executives, managing directors, shareholder controllers, key persons in control functions and appointed actuaries.

- (c) Appointment of actuary (paragraphs 22-26);
- (d) Arrangements for designated insurers (paragraphs 27-29); and
- (e) Taxation arrangements under the RBC regime (paragraphs 30-33).

Advantages of the risk-based capital regime

11. The Bills Committee has enquired about the advantages of implementing the proposed RBC regime. Given that insurers with more solid risk management measures are usually large insurers and may shoulder lower capital requirements under the regime, members are concerned whether the implementation of the new regime will pose unfair competition to smaller insurers and potential new entrants to the insurance market.

12. The Administration has advised that under the proposed RBC regime, insurers would adopt a uniform approach in the calculation of capital requirements where their risk profile consisting of market risk, life and general insurance risks, operational risk, etc. will be assessed using a modular approach. Apart from the fact that a standardized methodology would apply across the insurance industry with consistency, the capital and funds requirement levels calculated under the modules would also be more sensitive to each insurer's risk profile. With the implementation of the new regime, insurers with solid risk management measures as well as better asset and liability management will enjoy lower capital requirements. This will incentivize insurers to strengthen their risk management culture. The Administration has stressed that the RBC regime will not pose unfair competition to insurers in their formulation of business strategies. Besides, the proposed regime has taken into consideration the landscape, needs and competitiveness of the insurance industry, with a view to promoting healthy and sustainable development of the industry for the benefits of insurers in terms of their risk management strategies, policy holders in terms of their protection and Hong Kong as an international risk management centre.

13. Members are concerned whether the implementation of the RBC regime will exert upward pressure on premiums, and hence affect the interests of policy holders.

14. The Administration has explained that there is no direct correlation between the implementation of the RBC regime and premium levels. Insurers need not inject additional capital under the new regime if they enhance their risk management. Hence, the Administration does not expect any significant impact on premiums under the new regime. On the contrary, the requirement for insurers exposed to higher risks to maintain more capital will instil market stability, thereby enhancing the protection for policy holders.

Development and implementation of the risk-based capital regime

15. The Bills Committee has examined how the proposed RBC regime would operate, including how the capital requirements for insurers under Pillar 1 (i.e. quantitative assessment) and the requirements under Pillar 3 (i.e. disclosure of information) would be stipulated in the legislation. Members have also enquired why there is no provision in the Bill requiring insurers to maintain liquidity, with a view to reducing their liquidity risks.

16. IA has explained that PCA and MCA proposed in the Bill would replace the existing rule-based capital requirements. IA would be empowered to make rules under section 129 of IO to prescribe requirements in relation to capital, and the amount of capital that insurers must maintain. IA would also be empowered to relax such requirements under section 130. Details relating to, among others, valuation method for assets and liabilities and tiering of capital resources would also be prescribed in the rules, which would be made by way of subsidiary legislation subject to LegCo's scrutiny under the negative vetting procedure.⁹

17. IA has also advised that in the period between 2017 and 2020, it conducted three rounds of Quantitative Impact Studies with the industry, collecting detailed data of individual insurers for analysis and calibration to cater for the operating environment of the industry. The outcome of the Quantitative Impact Studies shows that most insurers have met the MCA requirement with adjustments made to their asset and liability matching and asset quality. The relevant subsidiary legislation would provide for a transitional period to allow insurers to comply with the capital requirements on a progressive basis upon implementation of the new regime. IA will continue to engage with the industry in the course of making the subsidiary legislation. Regarding the disclosure requirements, IA consulted the industry in 2021 and 2022 on the financial information to be reported, and will consult the industry at a later stage on the requirements in relation to disclosure of information to the public. It is the target of the Administration and IA to implement the proposed RBC regime in 2024. Regarding the views on liquidity requirements for insurers, the Administration has reiterated that the prime consideration under the RBC regime is whether the amount of capital maintained by an insurer is commensurate with its risk profile on an economic value basis, while liquidity requirements depend on different factors, such as the nature and size of various business operated by an insurer, its mix of products and maturity

⁹ IA would be empowered to make rules under the proposed amended section 129 to prescribe requirements in relation to capital, including the amount of capital that an authorized insurer (or a company applying for authorization to carry on insurance business) must maintain, taking into account the risks associated with the company (the proposed new section 10). IA would also be empowered to relax such requirements under the proposed amended section 130.

of liabilities. Therefore, it may not be appropriate to standardize the calculation in respect of liquidity requirements under Pillar 1.

18. Members have enquired why the requirements under Pillar 2 of the RBC regime (i.e. corporate governance and risk management) would not be implemented by way of legislation for regulatory purposes.

19. The Administration has explained that Pillar 1 and Pillar 3 concern statutory minimum requirements with which all insurers must comply. Pillar 2 relates to enterprises' own risk assessment and corporate governance. As the relevant requirements would vary in the light of the business nature, complexities, sizes and strategies of enterprises, it would be more appropriate to implement such principle-based requirements through guidelines issued by IA.

20. Members have enquired about how IA would carry out its supervisory functions if an insurer fails to meet the PCA and MCA requirements.

21. The Administration has pointed out that PCA would be the level of capital that an insurer should maintain, falling below which would trigger IA to, based on the condition of the insurer's solvency, take regulatory intervention actions in accordance with the proposed new section 35AA, including requiring the submission by the insurer a plan for restoring sound financial position. If the level of capital of an insurer falls below its MCA, IA might exercise its strongest powers of intervention by requiring the insurer to submit a short term financial scheme for more immediate remedy. In addition, IA might file a winding up petition against an insurer with capital level below its MCA and thus deemed insolvent by virtue of the proposed amended section 42. Generally speaking, IA would perform supervisory duties based on the severity of deficiency in financial position of an insurer, taking pre-emptive measures for a breach of PCA and more intense regulatory intervention to restore the required capital level in a shorter time where an insurer is at risk of breaching MCA.

Appointment of actuary

22. Regarding the requirements provided in the proposed new sections 15AAA and 15AAAB under the Bill for insurers carrying on general insurance business to appoint actuaries and to obtain IA's approval for the appointment, the Bills Committee has noted the concerns of deputations that insurers may have difficulties in appointing an actuary for their general insurance business as currently actuaries in the market mainly provide services for long term insurance business. Members have enquired whether IA would allow some flexibility in the requirements on appointment of actuary.

23. The Administration has explained that to tie in with the implementation of the RBC regime, the Bill proposes to extend the requirements on appointing an actuary in relation to long term business insurers to general business insurers, such that regular actuarial reports may be submitted to IA in line with existing arrangement for long term business. For numerous general business insurers already required to submit actuarial reports in respect of specified classes of general business (such as employees' compensation or motor insurance) under IA's existing guidelines, these companies may engage their current actuaries for compliance with the new requirement. Insurers also have the flexibility of appointing actuaries in either in-house or outsourced mode. Furthermore, IA may grant exemption to general business insurers from the requirements on appointment of actuary and submission of actuarial reports on a case-by-case basis, in order to cater for the actual situation and operational needs of the insurance industry (the proposed new section 129(1)(cb)). For example, IA may grant exemption to those small insurers carrying on simple general business from the requirements on appointment of actuary and submission of actuarial reports in order to reduce their compliance costs.

24. The Administration has further advised that in view of market and regulatory developments, there has been a growing demand for actuarial expertise in the Hong Kong insurance industry. The Government has included actuaries in the Talent List for attracting professionals from all over the world, while supporting academic and training programmes to nurture local talents. Regarding the "fit and proper" criteria for appointed actuaries, IA will review its relevant Guideline (i.e. GL4) taking into account relevant provisions in IO as amended by the Bill. The assessment criteria may be expected to remain based on qualification, experience, competency, etc. as provided in existing section 14A of IO. IA will duly consult industry stakeholders and take into account their views for making any amendment to the Guideline.

25. Regarding the determination of fit and proper under section 14A of IO, members have noted that apart from the factors of consideration mentioned in paragraph 24 above, IA would also take into account "the state of affairs of any other business which the person carries on or proposes to carry on" (section 14A(1)(g)). Members are concerned whether the scope of review is too wide. In contrast, in conducting the "fit and proper" test under the Securities and Futures Ordinance (Cap. 571) ("SFO"), only the person's ability to carry on "regulated activities" competently, honestly and fairly will be taken into consideration. Members are of the view that the "fit and proper" test under IO should only cover "regulated activities".

26. In response, the Administration has pointed out that the "fit and proper" test under SFO is mainly targeted at intermediaries of "regulated activities" while the regulated subject of the "fit and proper" test under IO includes the controllers

and chief executives, etc. of the insurers. As such, the coverage of the review will be wider.

Arrangements for designated insurers

27. Members have noted the views of deputations that the proposed new section 3B of IO regarding IA's designation of insurers incorporated outside Hong Kong ("non-HK insurers") such that they will be imposed the requirements applicable to insurers incorporated in Hong Kong ("HK insurers"), such as the requirements on capital and approval of personnel, might lead to an increase in management and compliance costs for such non-HK insurers (e.g. Hong Kong branches of international insurance companies).

28. The Administration has advised that non-HK insurers are incorporated outside Hong Kong but some may conduct all or a majority of their business in or from Hong Kong, such that their risk exposures and business portfolios largely align with HK insurers. The mechanism on "designated insurers" under the Bill aims to ensure that consistent supervisory measures are imposed such that a level playing field is maintained among insurers operating in Hong Kong to achieve overall robust industry risk management. The Administration has added that designated insurers will be required to comply with regulation aligned with HK insurers, such as approval requirement of key personnel (i.e. chief executives, managing directors, directors, shareholder controllers, appointed actuaries and key persons in control functions). In terms of capital requirements of designated insurers, IA will monitor compliance under the RBC regime on entity basis, operating in a similar manner as with current basis. IA does not anticipate any material implication to the cost of on-going operations or compliance for designated insurers.

29. In response to members' enquiry on how IA will put into implementation the mechanism on "designated insurers", IA has advised that in determining whether a non-HK insurer would be designated (and whether such designation should be subsequently withdrawn), the key criterion is whether a majority of its insurance business is carried in or from Hong Kong. As a designated insurer is only required to meet the sole factor of carrying on a majority of its insurance business in or from Hong Kong, IA does not see a need for providing additional guidelines in this regard. To allow sufficient preparation time for insurers which may be designated, IA has maintained close communication with them and noted that there is sufficient readiness for designation as reflected in the Own Risk and Solvency Assessment reports of these insurers.

Taxation arrangements under the risk-based capital regime

The five-year spread-over arrangement

30. As the valuation method for determining an insurer's liabilities will change¹⁰ under the RBC regime, there is expected impact on assessable profits of some insurers. Specifically, where the assessable profits of some insurers may be affected by their insurance liabilities, these insurers are expected to face a one-off increase or decrease in assessable profits ("one-off adjustment") arising from the implementation of the RBC regime. To alleviate cash flow pressure on affected insurers, the Bill proposes to provide for the one-off adjustment to be assessed spreading over a period of five years ("five-year spread-over arrangement"). The proposed new sections 23AAD, 23AAAE and 23AD of IRO set out the formulas for calculating the one-off adjustment. In addition, sections 23, 23AAD and 23AAAE also provide for the basis for spreading over the assessable profits from life insurance and non-life long term insurance business. Member have noted the concerns of some insurers about the tax implications of such arrangement. In this connection, some insurers have suggested that the Administration allow them more flexibility in calculating the one-off adjustment and using the actual results to spread over the profits. Members have enquired whether the Administration has drawn reference from the practices of other jurisdictions in formulating the five-year spread-over arrangement.

31. The Administration has advised that it has drawn reference from the practices of other jurisdictions, including Singapore, in formulating the five-year spread-over arrangement. The tax regime in Singapore requires any one-off increase in assessable profits to be assessed in the first year of assessment but allows insurers to spread the one-off tax increase over five years. Such arrangement is different from the arrangement of spreading the one-off adjustment over five years as proposed under the Bill. The Administration has pointed out that the five-year spread-over arrangement has struck a reasonable balance between the financial burden on the affected insurers and the actual operation of tax administration. In addition, the calculation methodology proposed in the Bill will enhance tax certainty and is in line with the current arrangement under IRO, which allows deduction of certain capital expenditure over a period of five years. Moreover, a uniform approach in treating the one-off adjustment for insurers will avoid unnecessary disputes that may arise if insurers spread over the assessable profits using their own approach.

¹⁰ Prudent margins currently embedded in the insurance liabilities of some insurers will be released under the RBC regime.

Taxation arrangements for Classes G and H insurance business

32. The Bills Committee has noted the concerns of depositions that as the proposed five-year spread-over arrangement is not applicable to Classes G and H insurance business (life insurance business and non-life long term insurance business under the proposed new section 22D of IRO do not include Classes G and H), insurers carrying on these two classes of business may face cash flow pressure.

33. The Administration has explained that under the prevailing financial reporting standards, Class G (retirement scheme management category I) and Class H (retirement scheme management category II) businesses are not treated as insurance business because these contracts do not have the principal objective of provision of insurance but investment management activities. For profits tax purposes, these classes are also not regarded as insurance business, hence the assessable profits derived from which are ascertained in accordance with section 14 of IRO instead of the specific provisions for other insurance businesses. The starting point for ascertaining the profits from Classes G and H is the accounting profit or loss recognized in accordance with the generally accepted accounting principles, where the liabilities of Classes G and H are generally classified as liabilities under investment contracts where the transfers of insurance risk from the policy holders to the insurer are not significant. Before the mandatory implementation of the RBC regime, all insurers should have accounted for the assets and liabilities of Classes G and H under HKFRS 9 or HKFRS 17 of the Hong Kong Financial Reporting Standards. The change of capital regime does not affect the accounting profit or loss recognized in accordance with the generally accepted accounting principles. Accordingly, there will not be one-off increase in the accounting profits from Classes G and H business upon the implementation of the RBC regime.

Amendments to the Bill

34. Neither the Administration nor the Bills Committee will propose any amendments to the Bill.

Resumption of Second Reading debate on the Bill

35. The Bills Committee has completed scrutiny of the Bill and raised no objection to the resumption of the Second Reading debate on the Bill at the Council meeting of 5 July 2023.

Consultation with the House Committee

36. The Bills Committee reported its deliberations to the House Committee on 16 June 2023.

Council Business Division 1 and Public Complaints Office

Legislative Council Secretariat

23 June 2023

Main provisions of the Insurance (Amendment) Bill 2023

1. Clauses 10, 11 and 38 to 46 provide for amendments in the Insurance Ordinance (Cap. 41) (“IO”) relating to capital requirements of the risk-based capital (“RBC”) regime. New sections 10, 13AA, 21B and 25AA to 25AAE put in place the main framework for requiring insurers to comply with the capital requirements and to maintain funds and sub-funds for certain classes of insurance business, and empower the Insurance Authority (“IA”) to prescribe detailed requirements such as asset levels and valuation method;
2. Clauses 7, 93 and 94 amend relevant sections of IO for IA to implement the RBC regime when authorizing insurance business and by making rules and relaxations. Clauses 61 to 63 provide for application of the RBC capital requirements in such matters as determining insolvency of an insurer;
3. Clauses 4 and 12 to 14 adjust the designation of insurers that are incorporated outside Hong Kong but carrying on a majority of their insurance business in Hong Kong (by adding new section 3B to IO), and impose certain requirements on these insurers in relation to their capital and controlling personnel in line with insurers incorporated in Hong Kong under the relevant requirements in IO;
4. Clauses 5, 33, 36, 37 and 71 amend various provisions in IO to extend IA’s functions and powers in relation to obtaining, maintaining and disclosing information provided by insurers;
5. Clauses 15 to 21 amend provisions in IO relating to restrictions on shareholder controllers of insurers to provide for, among other things, the categorization of majority and minority shareholder controllers, as well as the required approval from IA for a person becoming a shareholder controller. Clauses 74 to 88 similarly adjust the requirements for shareholder controllers of designated insurance holding companies;
6. Clauses 23 to 32, 34 and 35 amend provisions in IO relating to the appointment of an actuary to provide for, among other things, the adjustment to the requirements on appointment of actuary for carrying on long term business as well as addition of requirements on appointment of actuary for general business insurers by adding new sections 15AAA, 15AAAB, 15AABA, 15AAD, 15AAE and 18A to IO;

7. Clauses 48 to 55 amend provisions in IO relating to various regulatory intervention powers of IA, including extension of IA's powers to request reports from insurers;
8. Clauses 95 to 101 make corresponding amendments to the relevant Schedules to IO, such as repealing forms that will become obsolete, and provide for savings and transitional arrangements;
9. In relation to taxation under the RBC regime, clauses 103 to 107 provide for the new arrangement on ascertainment and adjustment of assessable profits according to the categories of life insurance, non-life long term insurance, general insurance, general reinsurance and specified general insurance business under the relevant provisions in the Inland Revenue Ordinance (Cap. 112) ("IRO"), including adding new sections 23AAAB to 23AAAE and 23AD. Clause 108 provides for transitional arrangements by adding new section 23AE to IRO; and
10. Other clauses provide for amendments to relevant definitions necessary for interpretation of IO and IRO (including clause 3 on IO and clause 102 on IRO), as well as miscellaneous amendments to certain provisions in IO, the Companies Ordinance (Cap. 622) and other enactments.

Bills Committee on Insurance (Amendment) Bill 2023

Membership list

Chairman Hon CHAN Kin-por, GBS, JP

Deputy Chairman Hon CHAN Pui-leung

Members Hon YUNG Hoi-yan, JP
Hon CHAN Chun-ying, JP
Ir Hon LEE Chun-keung
Dr Hon Johnny NG Kit-chong, MH
Hon Lillian KWOK Ling-lai
Dr Hon Kennedy WONG Ying-ho, BBS, JP
Hon TANG Fei, MH

(Total: 9 members)

Clerk Ms Connie SZETO

Legal Adviser Mr Mark LAM

Bills Committee on Insurance (Amendment) Bill 2023

List of organizations which have given views to the Bills Committee

1. The Hongkong and Shanghai Banking Corporation Limited
2. Capital Markets Tax Committee of Asia
3. The Hong Kong Federation of Insurers
4. The KPMG Tax Services Limited