

Hong Kong's Insurance Industry – Regulatory Reforms

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Facts & Figures

- Authorized insurers : 154
 - 92 – general i.e. non-life
 - 43 – long term i.e. life
 - 19 – composite i.e. life + non-life
- Contribution of insurance to the GDP:
 - 2007 – 3.2%
 - 2008 – 3.0%
 - 2009 – 2.8%
 - 2010 – 3.1%
 - 2011 – 2.9%

Facts & Figures

- Insurance intermediaries
 - 3,066 – corporate
 - 75,451 – individuals

Insurance Agents	
Individual Agents	38,920
Agencies	2,445
Responsible Officers / Technical Representatives	27,360
Insurance Brokers	
Broker firms	621
CEOs / Technical Representatives	9,171
Total	78,517

Facts & Figures – Market Performance (1992-2012)

- Total gross premium (in HK\$)
 - 1992: \$ 27.2 billion
 - 1997: \$ 52.0 billion
 - 2002: \$ 89.0 billion
 - 2007: \$197.3 billion
 - 2009: \$184.6 billion
 - 2011: \$233.8 billion
 - 2012: \$263.3 billion
- Insurance density : US\$4,544
 - 2nd in Asia ; 7th in World
- Insurance penetration : 12.44%
 - 2nd in Asia ; 4th in World

Facts & Figures – General Insurance Business

- Premium (in HK\$)
 - 1992: \$14.2 billion
 - 1997: \$19.5 billion
 - 2002: \$23.5 billion
 - 2007: \$24.3 billion
 - 2009: \$28.5 billion
 - 2011: \$34.9 billion
 - 2012: \$39.2 billion
- Average growth rate of 5.2% each year
- Account for 15% of total insurance business

Facts & Figures – Long Term Insurance Business

- Premium (in HK\$)
 - 1992: \$ 13.0 billion
 - 1997: \$ 32.5 billion
 - 2002: \$ 65.5 billion
 - 2007: \$173.0 billion
 - 2009: \$156.1 billion
 - 2011: \$198.9 billion
 - 2012: \$224.1 billion
- Average growth rate of 15.1% each year
- Account for 85% of total insurance business
- Over 10 million in-force policies (i.e. 1.48 policies per capita or 3 policies per working capita)

Global Regulatory Framework

- Financial Stability Board
 - Coordinate work of central banks & international standard setting bodies
 - Develop effective regulatory policies
 - Oversee global financial stability
 - Members include
 - 46 jurisdictions (including HK)
 - International Association of Insurance Supervisors, Basel Committee on Banking Supervision, International Organization of Securities Commissions
 - International Accounting Standards Board
 - IMF, World Bank, OECD etc

Regulatory Framework

- Hong Kong adopts an industry-based regulatory framework (IA, HKMA, SFC)
- The Commissioner of Insurance is the IA under the Insurance Companies Ordinance
- Underpinned by the OCI
 - A government department established in 1990
 - Previously part of Registrar General, alongside OCB and OCS
- Need to observe Insurance Core Principles (ICPs) issued by IAIS

Regulatory Framework

- Insurance Companies Ordinance (enacted in 1983)
- Subsidiary Legislation
 - Determination of Liabilities
 - Solvency Margin
 - Valuation
 - Fees
 - Actuaries' Qualifications and Standards
- Guidance Notes/Circulars

Regulatory Framework

- Solvency & capital requirements
- Local asset requirements
- Financial reporting
- Duty of appointed actuaries
- Internal control
- Corporate governance
- Risk management (investment, counterparty, concentration, assets, reputation etc)
- On-site inspection
- Off-site reviews
- Supervisory intervention

Regulatory Framework

- The Code of Conduct for Insurers
 - Approved by the IA, it was first published by HKFI in 1999
 - It governs insurers'
 - advising and selling practices
 - claims management
 - management of their agents and staff
 - handling procedures for complaints and disputes

Regulatory Framework

- Other Legislation
 - Anti-Money Laundering (AML)
 - AML Ordinance (Cap. 615) requirements
 - Guideline on AML (GN3) ; Guideline on Exercising Power to Impose Pecuniary Penalty (GN3A)
 - Regulation of MPF Intermediaries
 - MPF Ordinance (Cap. 485) conduct requirements
 - Frontline regulator for MPF intermediaries w.e.f 1/11/2012

Regulatory Framework

- Self-regulatory Regime for Intermediaries
 - 3 Self-regulatory Organizations
 - Registration of intermediaries
 - Issue code of conduct
 - Complaints handling
 - Disciplinary actions
- Insurance Intermediaries Quality Assurance Scheme
 - Insurance Intermediaries Qualifying Examination
 - Continuing Professional Development

Need for Reform?

- The current framework has been in place for 2-3 decades
- Adequate?
 - Substantial growth of insurance sector
 - Financial & insurance sector has become far more complex
 - Lessons from the financial crisis (unregulated entities; interconnectedness, group risks etc)
 - New ICPs and other international regulatory requirements

Need for Reform?

- **Public Aspirations**
 - Full protection of their rights
 - Access to professional, ethical and quality services
 - High level of transparency
 - Quick response
 - Justice done and seen to be done
 - Political and media influence
 - Internet & smart phones!

Regulatory Reforms

- Independent Insurance Authority (IIA)
- Risk-Based Capital (RBC)
- Policyholders' Protection Fund (PPF)
- Consumer protection
- Group-wide supervision

Independent Insurance Authority (IIA)

- Financially and operationally independent of the government
 - ICP 2: *“the supervisor....freed from undue political, governmental and industry interference.....”*
 - Most modern jurisdictions have separate and independent financial regulators
- Governing Board
 - No government representative
 - At least 2 persons with knowledge or experience in insurance industry

Independent Insurance Authority (IIA)

- **Funding Mechanism**
 - Current
 - Funded by government
 - Future
 - Levy of 0.1% on premiums for all insurance policies
 - Licence fees by insurers: fixed (\$300,000) + variable (0.0039% on liabilities)
 - Licence fees by intermediaries
 - User fees for specific services

Independent Insurance Authority (IIA)

● Functions of the IIA

Existing Functions

Regulation and supervision

Maintain general stability of the insurance market

Protect policyholders' interests

Additional Functions

Regulation of insurance intermediaries

Thematic researches & studies

Consumer education

Formulate regulatory strategies and facilitate sustainable market development

Promote competitiveness of the industry in the global insurance market

Assist the Financial Secretary in maintaining Hong Kong's financial stability

Independent Insurance Authority (IIA)

- Direct supervision of intermediaries
 - Self-regulatory system at present has been adopted since 1990s
 - Inadequate because:
 - Duplication of efforts between IA and SROs
 - Not full-fledged regulatory regime (part-time; inadequate power & sanctions)
 - Inconsistency amongst 3 SROs
 - Perceived and real conflict of interests (allegations from both complainants and intermediaries)
 - Public aspiration for more conduct regulation

Independent Insurance Authority (IIA)

- **Regulatory powers of IIA (same as all other financial regulators)**
 - Initiate inspections & investigations
 - Enter into premises of regulated entities for inspections & investigations
 - Make inquiries and have access to records and documents
 - Apply for court orders to compel compliance with requirements in relation to inspections or investigations
 - Apply for a warrant to search for, seize or remove records or documents on reasonable grounds
 - Prosecute offences summarily
 - Impose disciplinary sanctions

Independent Insurance Authority (IIA)

- Disciplinary sanctions (intermediaries)-
 - Private or public reprimand
 - A fine not exceeding the amount which is the greater of
 - \$10,000,000; or
 - Three times the amount of the profit gained or loss avoided by the licensee as a result of his misconduct
 - Prohibition from applying for a licence for a specified period
 - Suspension of a licence for a specified period
 - Revocation of a licence

Independent Insurance Authority (IIA)

- **Disciplinary Sanctions (insurers)**
 - Public or private reprimand
 - Pecuniary penalty
 - Suspension of authorization in relation to any class of insurance business
 - Revocation of authorization in relation to any class of insurance business

Independent Insurance Authority (IIA)

- **Transitional arrangements for pre-existing insurance intermediaries**
 - Pre-existing insurance intermediaries validly registered with the SROs before IIA's establishment will be deemed as licensees for 3 years starting from the commencement of the new licensing regime
 - Uncompleted investigations/disciplinary cases will be taken up by the IIA, but the old conduct requirements and disciplinary sanctions will apply
 - Licence fee for insurance intermediaries will be waived in the first 5 years after IIA's establishment

Independent Insurance Authority (IIA)

- Regulatory arrangements for banks' insurance intermediary activities
 - IIA will be the lead and primary regulator
 - IIA to have full power to issue licences, inspect, investigate, formulate regulatory standards and impose sanctions
 - IIA to delegate to HKMA inspection & investigation power
 - IIA not allowed to delegate the other powers to HKMA
 - Close liaison and coordination with HKMA for effective regulation and consistency

Independent Insurance Authority (IIA)

- Checks and balance:
 - Insurance Appeals Tribunal
 - An independent Process Review Panel to be established by the Chief Executive
 - Personal Data (Privacy) Ordinance and the Prevention of Bribery Ordinance
 - Under scrutiny of the Director of Audit & Ombudsman
 - Tabling its annual report before the Legislative Council and submitting the annual budget and corporate plan to the Financial Secretary for approval

Independent Insurance Authority (IIA)

- **Current Auditing and Assurance Standards – Practice Notes**
 - *PN620.2 Communications between auditors and the Insurance Authority*
 - *PN810.1 Insurance brokers - compliance with the minimum requirements specified by the Insurance Authority under sections 69(2) and 70(2) of the Insurance Companies Ordinance*
 - *PN810.2 The duties of auditors under the Insurance Companies Ordinance*

Independent Insurance Authority (IIA)

- 2010 First Public consultation
- 2011 Published consultation conclusions & detailed proposals
- 2012 Public consultation on key legislative proposals
- 2013 Published consultation conclusions and revised legislative proposals

Target

- Early 2014 Introduce Insurance Companies (Amendment) Bill into the LegCo
- 2015 Establishment of IIA

Independent Insurance Authority (IIA)

- So far, the most important piece of legislative amendment for the insurance industry.
- BUT the IIA is not the solution to everything, nor is it the only reform proposal

Risk-Based Capital (RBC)

- Existing Solvency and Capital Adequacy Regime
 - Rule-based framework –
 - Life: based on policy reserve and sum insured
 - Non-life: based on premiums and claims
 - Has been used since 1980s
 - ICO, Sub-legs, GNs, PS1

Risk-Based Capital (RBC)

● Considerations

- New ICPs 7, 8, 14, 15, 16, 17, 20, 23
- Experience of overseas jurisdictions (NO replicate of Solvency II)
- Hong Kong's unique market situation e.g. diverse profile of players with different sizes (group, solo, branch, subsidiary) and lines of business (life, non-life, composite, reinsurer, captive)

Risk-Based Capital (RBC)

- Considerations (cont'd)
 - Incentives to introduce enhanced risk management
 - Ease of use and ability to compute new capital requirements for such a diverse market
 - Maintain a level-playing field for all insurers in the market
 - Avoid regulatory arbitrage

Risk-Based Capital (RBC)

- Changes in accounting standards in the pipeline
 - ***Insurance Contracts ED***
 - Exposure Draft in 2010
 - Revised Exposure Draft in 2013
(comment period closed in Oct 2013)
 - Issue IFRS in 2015
 - Potential effective date: 2018

Risk-Based Capital (RBC)

- **IFRS/HKFRS 9 *Financial Instruments***
 - Replacement of IAS/HKAS 39
 - Current mandatory effective date: 1 Jan 2015
 - Interaction between the classification and measurement requirements for financial instruments and insurance contracts

Risk-Based Capital (RBC)

- Timeframe

- 2013/14 – Industry consultation on Proposed Framework
- 2014/15 – Prepare draft detailed rules and perform deep-dive quantitative impact analysis
- 2015/16 – Legislative Amendment
- 2016/17 – Start Phased Implementation with Parallel and Long Run-in

Policyholders' Protection Fund (PPF)

- A compensation fund to pay insurance claims in the event of insurer insolvency
- Currently protection funds only for motor & employees' compensation policies
- Enhance policyholder protection and consumer confidence, which in turn will benefit insurance industry

Policyholders' Protection Fund (PPF)

- Coverage
 - Two separate schemes: Life & Non-Life business
 - Individual policyholders & SMEs

Policyholders' Protection Fund (PPF)

- Compensation Mechanism
 - 100% for the first HKD100,000, plus 80% of the balance of the claim
 - Up to HKD1 million per-policy for life insurance policies and per-claim for non-life insurance policies
 - Transfer of life portfolio
 - Ex-gratia payment for policyholders who cannot use same premium to procure replacement policy (e.g. aging, guaranteed renewability)

Policyholders' Protection Fund (PPF)

- Funding Mechanism
 - Progressive funding approach
 - Levy of 0.07% on insurers
 - Asset recovery mechanism
 - Financing arrangement to bridge liquidity gap

Consumer Protection

- ICP19 : “... *customers are treated fairly*” throughout the process
 - Due regard to customer needs
 - Sell to the right customer for value
 - Clear policy terms & conditions
 - Legible format
 - Provide clear and understandable information
 - Sell in a clear, fair and not misleading manner

Consumer Protection

- ICP19 : “... *customers are treated fairly*” throughout the process
 - Proper control measure to ensure good practice implemented
 - Manage reasonable expectation of customers
 - Deal with complaints and disputes in a fair manner
 - Disclose relationship between insurer and intermediary + remuneration to avoid conflict of interest

Consumer Protection

- New Requirements for the Sale of Investment-Linked Products (ILAS)
 - Important Facts Statement
 - Post-sale Audio-recorded Telephone Confirmation Calls
 - Disclosure of Intermediaries' Remuneration if asked by client
 - Cooling-off period of 21 days
 - Prohibition of gifts

Group-wide Supervision

- ICP 23: “... supervisor supervises on a legal entity & group-wide basis”
- ICP 24: “...coordination arrangements...on cross-border issues on a legal entity & group-wide basis....”
- Common framework for the supervision of internationally active groups
 - Cooperation among supervisors to close regulatory gaps
 - Global convergence of regulatory and supervisory measures and approaches
 - Supervisory Colleges

Regulatory Reforms

- More to come.....

Thank You



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