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# PROPOSED REFORMS:
## AN INDEPENDENT INSURANCE REGULATOR FOR HONG KONG?

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The Financial Services and the Treasury Bureau in Hong Kong has recently issued a public consultation paper in relation to a proposal to establish an independent insurance authority, aimed at bringing the Hong Kong regulatory regime into line with the international practice of financial regulators being financially and operationally independent of government. The main objectives of the proposal include improving the regulation of insurers and insurance intermediaries in Hong Kong and enhancing policyholder protection, thereby strengthening Hong Kong's competitiveness as an international financial centre. The purpose of this article is to provide a brief overview of the proposal and its current status and to consider the possible implications for the Hong Kong insurance market.

### The current position

The Insurance Authority is the regulatory body presently responsible for protecting the interests of policyholders or potential policyholders and promoting the general stability of the insurance industry in Hong Kong. The Office of the Commissioner of Insurance, which the Commissioner of Insurance heads, was set up by the IA in 1990 to administer the Insurance Companies Ordinance (Cap. 41), which sets out the regulatory framework applicable in Hong Kong to insurers and insurance intermediaries. The staff of the IA and the OCI are public servants. The OCI is the only financial services regulator in Hong Kong that operates as a government department.

The IA has the following significant duties and powers:

a. Authorisation of insurers to carry out insurance business in or from Hong Kong.
b. Regulation of insurers, primarily through the examination of annual audited financial statements and business returns submitted by the insurers.
c. Liaison with the insurance industry.

Hong Kong differs from other major financial centres in that insurance intermediaries in this jurisdiction, such as agents and brokers, are presently subject to a self-regulation framework under which they are registered with, and supervised by, designated industry bodies, namely the Insurance Agents Registration Board, the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association. The self-regulation of insurance intermediaries in Hong Kong has given rise to some concerns in the insurance industry. It has been suggested that the self-regulatory bodies have a conflict of interest in handling complaints against insurance intermediaries, given that they are funded by such firms. Another concern that has been expressed is that the disciplinary procedures, levels of sanctions and complaints-handling mechanisms of the three self-regulatory bodies are not fully aligned and such bodies have limited powers to impose sanctions over their members.

### The proposed reforms

On July 12, 2010, KC Chan, the Secretary for the Financial Services and the Treasury Bureau, released a public consultation paper proposing the establishment of an independent insurance authority and invited the public to give their views on the proposal by October 11, 2010. The main features of the proposal are set out below:

a. To establish an IIA with regulatory, operational and financial independence that will assume all the duties and responsibilities of the IA. The IIA's functions will be similar to that of the Securities and Futures Commission. It will be designated to act as the sole independent regulatory body to monitor and facilitate the development of Hong Kong's insurance industry and will be given wide powers, including powers to enter premises and carry out inspections, initiate and pursue investigations, obtain access to books and records, seek assistance from the court to ensure compliance with IIA requirements, impose sanctions, including fines and public reprimands, and prosecute offences summarily.

b. To abolish the current self-regulation regime applicable to insurance intermediaries and replace it with direct supervision by the IIA, including the implementation of a licensing regime for insurance intermediaries, inspections, handling complaints, investigation into misconduct and imposing disciplinary sanctions. The self-regulatory bodies would continue to perform the functions of trade bodies such as industry promotion and training.

c. To give the Hong Kong Monetary Authority similar powers to the IIA for regulating the sale of insurance products by bank employees (who will need to be licensed by the IIA), given that more than 30 per cent of insurance products sold in Hong Kong are sold by employees of banks.

d. To establish adequate checks and balances to ensure that the IIA operates in a fair and transparent manner. These include the establishment of: (i) a governing board that comprises predominantly independent non-executive directors from a cross section of the community (e.g., insurance practitioners, accountants, lawyers, government officials, academics and representatives from consumer groups) to provide leadership, direction and guidance to the IIA; (ii) a statutory appeals tribunal to hear appeals from insurers and intermediaries against relevant decisions made by the IIA and HKMA (insofar as they relate to the sale of insurance products); and (iii) an independent process review panel to review internal operating procedures of the IIA and HKMA (insofar as they relate to the sale of insurance products). The IIA will also be required to table an annual report before the Legislative Council and prepare an annual budget and corporate plan for approval by the Financial Secretary.

e. To ensure financial independence of the IIA by formulating a funding mechanism to pass the cost onto the insurance market over time. This will include the introduction of fixed licensing fees for insurers and intermediaries; variable licensing fees for insurers based on individual liabilities; user fees for specific services such as transfer of business, change of shareholding or change in key personnel; and a levy of 0.1 per cent on insurance premiums for all insurance policies. Some government support will be provided during the first five years to reduce the impact on insurers and policyholders.

## Next steps and anticipated timing

The consultation process is scheduled to be completed by October 11, 2010. Anyone who wishes to comment on the proposal should send written submissions to the Financial Services and the Treasury Bureau by that date. The Financial Services and the Treasury Bureau plans to introduce a draft bill to the Legislative Council in 2011 with a view to establishing the IIA in 2012 or 2013.

## Implications for the Hong Kong insurance industry

It remains unclear to what extent, if any, the IIA, if established, will overhaul the current legislative framework applicable to the insurance industry. The transitional arrangements for licensing and other regulatory matters also remain unclear. At present, it is, therefore, impossible to articulate with any certainty the precise implications of the proposals for insurers and intermediaries. On a practical level, however, it seems clear that the 170 authorised insurers and 68,000 insurance intermediaries in Hong Kong will need to apply considerable resources to adapt their internal compliance procedures should the new regulatory regime become effective. This will be particularly so for insurance intermediaries given the fundamental changes proposed to the regulatory framework that currently applies to them. Insurers and intermediaries may also need to re-examine their pricing structures in the light of the proposed fees and charges to be imposed on the insurance market to fund the IIA.

Perhaps the most significant impact of the reforms will be on the self-regulatory bodies themselves, which will, in many ways, become redundant. Such bodies will need to undergo a significant restructuring in the light of the limited roles that the current proposals envisage for them.

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