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INSURANCE REGULATION IN HONG KONG: A PARADIGM SHIFT

Hong Kong's Insurance Companies (Amendment) Bill 2014 was gazetted on Friday 25 April 2014 and presented to the Legislative Council (LegCo) for a first reading on 30 April 2014.

The Legislative Council Brief and Bill are available from the LegCo website at: Brief and Bill.

This new legislation, which follows several years of consultation and drafting, represents a paradigm shift for insurance regulation in Hong Kong in that it will introduce (likely in 2015) a new Independent Insurance Authority (IIA) that will take over the role currently undertaken by three self regulatory bodies (HKFI, CIB and PIBA) in licensing, regulating and disciplining insurance intermediaries. Indeed, the Legislative Council Brief clearly states: *"The establishment of the IIA is the most important regulatory reform in the insurance sector in the past 30 years since the passage of the Insurance Companies Ordinance (ICO) in 1983."*

The Legislative Council Brief lists two objectives of the IIA: prudential regulation – to ensure that insurers are financially sound; and conduct regulation – to ensure that sale and after-sale of insurers and insurance intermediaries are conducted honestly, fairly and professionally. As regards prudential regulation, the Legislative Council Brief notes: *"the challenges in the coming years are to implement a Risk-based Capital framework for insurers and observe the IAIS's [International Association of Insurance Supervisors'] requirements on macro-prudential surveillance, group-wide supervision and corporate governance of insurers."* As regards conduct regulation, the Legislative Council Brief notes: *"there has been rising public expectation of robust oversight of insurance intermediaries, especially when insurance products are getting more sophisticated and diversified (such as … annuities for retirement planning …)."*

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Some intermediaries, in particular insurance agents, have been apprehensive about the upcoming IIA legislation as the level of regulation of intermediaries is expected not only to be put on a statutory footing, but also to increase with the IIA's supervisory and investigation powers having been lifted from securities legislation.

Further, during the consultation process there was considerable concern voiced, again in particular by insurance agents, about the maximum level of fines for misconduct – which nonetheless has been fixed in the Bill at the greater of HK$10 million or three times the profit gained or loss avoided, with no requirement that proportionality be taken into account.

The Bill also introduces a requirement on all licensed insurance intermediaries to act *"in the best interest of policyholders"* (Art. 89). During the consultation process, it was pointed out that as a matter of Hong Kong law insurance agents owe a duty to insurers, not policy holders. The Legislative Council Brief has addressed this concern as follows: *"To allay insurance agents' concern on a possible conflict of loyalty to the insurer and the client, it is specified that any term in an agreement between the insurer and its agent which contravenes the statutory "best interest" duty will be unenforceable"* (Art 68A(1)). If this provision of the Bill is passed into law unaltered, it would be a departure from the current law, go over and above the requirement in other jurisdictions of agents to act fairly to their customers, and would have to be taken into account when drafting agency agreements going forward.

The Bill includes three year transitional arrangements relating to how the transition of licences and regulations from the self regulatory organisations to the IIA will be handled in practice – however much of the detail of the transitional arrangements has been left to a Working Group to develop.

Annexe E to the Bill records that at present, there are 150 staff members in the Office of the Commissioner of Insurance (OCI), including the Commissioner of Insurance, 48 Insurance Officers (IOs), 22 officers of the general grades and 79 non-civil service contract (NCSC) staff. It is proposed that to achieve the desired institutional independence and operational flexibility, the IIA should recruit its own staff, with the OCI's current staff being retired, redeployed to other departments or otherwise (it is expected that some OCI staff will apply for IIA roles). The IIA is likely to have over 50% more staff than OCI currently has (around 240 staff). This increase is in part explained by the fact that the IIA will take over the regulatory roles of HKFI, CIB and PIBA.

The IIA is to be self-financed (giving rise to savings to the public coffer of HK$110 million per annum, being the recurrent funding for the OCI). The proposal is that the government will make a lump sum provision of HK$500 million to the IIA to facilitate its initial operations and that the IIA will eventually be financed solely by fees payable by insurers and insurance intermediaries, user fees for providing specific services by the IIA, and a levy of 0.1% on insurance premiums. The levy will be introduced over a five year period (Y1 0.04%; Y2 0.05%; Y3 0.06%; Y4 0.07%; Y5 0.085%; Y6 0.1%), subject to caps of HK$100 per life insurance policy and HK$5,000 per non-life insurance policy in a year.

Commentary

We have been following the evolution of this Bill over the past few years. There is no doubt that the IIA will lead to more regulation of the insurance industry in Hong Kong and may well have repercussions on the structure of the Hong Kong insurance market, in particular if risk-based capital, referred to in the Legislative Council Brief, is introduced by the new IIA, this may trigger a wave of consolidation. That said, IIA is an inevitable development in light of the global trend of increased insurance regulation and in particular the Insurance Core Principles issued by the International Association of Insurance Supervisors (of which Hong Kong is a member). Further, an independent and professional insurance regulator whose statutory functions include "Promoting competitiveness of the insurance industry in the global insurance market" should bring Hong Kong into line with modern supervisory standards and practice and will enhance the standing and stability of the jurisdiction.

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