

Proposed Establishment of an independent Insurance Authority ("IIA")

Key Legislative Proposals

Consultation Conclusions

A summary of major issues raised by respondents and the Administration's response are as follows –

- Functions of the IIA: The insurance industry advocated that the IIA should promote industry development. We agree that in discharging its regulatory functions, the IIA should also give due regard to market innovation and the competitiveness of the insurance industry of Hong Kong. We have refined the legislative provisions by including "promoting the competitiveness of the insurance industry in the global insurance market" as one of the IIA's statutory functions.
- Governing Board of the IIA ("the Board"): To strike a balance between tapping industry expertise and ensuring the impartiality of the IIA as well as maintaining flexibility in appointing a mix of talents to the Board of the IIA, we have refined the legislative provisions to include in the composition of the Board no less than two directors (instead of no more than two as originally proposed) with knowledge of and experience in the insurance industry.
- Licences for insurance intermediaries: We have proposed that there should be five categories of licensees under the statutory licensing regime, namely insurance agency, insurance agent, insurance broker company, technical representative (agent) and technical representative (broker). Our proposal seeks to mirror the existing types of registered persons under the self-regulatory regime. Despite suggestions to streamline the proposed categorization of licensees, we consider our proposal desirable as it would ensure a smooth transition from the existing self-regulatory arrangements to a statutory licensing regime. We are concerned that any re-categorization of intermediaries would result in possible confusion on the inception of the IIA. We, however, agree that the licensing system should be capable of evolving with changing market needs

over time, and have prepared the legislation with this objective in mind.

- Regulated activities: Persons who carry on regulated activities (selling and after-sale administration of insurance policies) are required to be licensed. In light of respondents' comments, we shall refine the legislative provisions to improve clarity on the activities to be exempted from the proposed licensing regime.
- Appointment of Responsible Officers ("ROs"): Each and every insurer, insurance agency, and insurance broker company is required to appoint an RO to ensure the operation of an effective internal control system for conduct compliance. In response to the industry's concern that an RO's aforesaid statutory responsibilities could be onerous, we have refined our proposal by allowing the appointment of an additional RO subject to the approval of the IIA. The two ROs will be jointly and severally responsible for fulfilling statutory requirements. This seeks to preserve the statutory responsibilities of the chief executive officer of an insurer under the existing Insurance Companies Ordinance.
- Responsibilities of ROs: There are views that the requirement for ROs to use "best endeavours" to fulfill their responsibilities in ensuring the operation of effective internal controls and procedures to secure conduct compliance is too onerous. We note that recent court cases have established that the test of reasonableness has been introduced in the interpretation of "best endeavours". We have conveyed this to the industry practitioners. Also we note that this standard has been recently adopted in a similar context under the statutory regulatory regime for Mandatory Provident Fund ("MPF") intermediaries. We believe that insurance intermediaries should not be subject to a lower regulatory standard.
- Conduct requirement of insurance intermediaries: Some industry practitioners consider that the requirement of "acting in the best interest of policyholders" is impractical for an insurance agent who has to act in the best interest of his appointing insurer under the contractual principal-agent relationship. Our objective is that an

insurance agent should have regard to a policyholder's interest before his own (or the insurer's) interest. The proposed requirement is also an internationally-endorsed principle. It has been adopted in the statutory regulatory regime for MPF intermediaries. To provide assurance to the insurance agents, we propose to provide in the legislation that any contract term which contravenes the statutory "best interest" duty will be unenforceable.

- Inspection and investigation powers: Some industry practitioners consider that the powers to be given to the IIA could be too wide. Such powers are similar to those for local and overseas financial regulators. We will seek to improve the statutory safeguards governing the use of these powers.
- Disciplinary sanctions: The industry has expressed concerns about the proposed upper limit of the disciplinary fines which is \$10 million or three times the amount of the profit gained or loss avoided by the regulated person as a result of his misconduct. Disciplinary fine is only one of the disciplinary sanctions that may be imposed by the IIA (other sanctions include reprimand, suspension of a licence, revocation of licence and prohibition of licence application within a specified period). Our proposal is comparable to the disciplinary sanctions under other regulatory regimes for financial intermediaries. To address industry's concerns, we have proposed that the IIA would need to publish a guideline before it may impose any disciplinary fine. A disciplinary sanction by the IIA will be subject to appeal by an aggrieved party to an independent Insurance Appeals Tribunal. We propose that an appeal hearing would be heard by a person who is eligible for appointment as a High Court judge with the assistance of two market practitioners.
- Specified suspension power: This is a stop-gap consumer protection to allow the regulator to suspend a regulatee from carrying on regulated activities when a timely decision on disciplinary sanction is unavailable. There are strong objections to the introduction of this power on the grounds that such a suspension, which has the effect of a punishment before a disciplinary decision, would compromise due process. Others demand more clarifications

on the circumstances under which this power will be exercised, the procedures of exercising this power and safeguards against any abuse in exercising this power. After detailed consideration, we have decided not to pursue the introduction of this power. We will seek to enhance policyholder protection through other regulatory arrangements proposed for the IIA.

- Regulatory arrangements for banks' insurance intermediary activities: We have proposed that the IIA should delegate inspection function and investigate function to HKMA for regulating banks' insurance intermediary activities. But the IIA will remain the lead regulator for the insurance industry for setting conduct standards and imposing disciplinary sanctions. The insurance industry is concerned about potential regulatory inconsistency. Balancing this against the need to minimize regulatory duplication, we believe that our proposed arrangement is appropriate given HKMA's role as the primary and lead regulator of banks. We are also mindful of the need for financial regulators to maintain close liaison and coordination to ensure effective regulation and minimise any regulatory overlap/underlap.
- Transitional arrangements for insurance intermediaries: We have proposed the arrangements for handling complaints, appeal cases and regulatory applications not yet concluded by the self-regulatory organizations upon inception of the IIA. The industry generally supported the proposed transitional arrangements and put forward practical suggestions to ensure a smooth transition. We have refined our proposals accordingly.
- Appellate mechanism: Some industry practitioners have proposed that the Insurance Appeals Tribunal should include representatives of the industry and the appointing authority should be the Chief Justice instead of the Chief Executive. We consider our proposal reasonable as it is in line with the operation of appeal tribunals established under other local financial regulatory regimes. Our policy intent is that the Tribunal chairperson (who is a person eligible for appointment as a High Court judge) should be assisted by two market practitioners in an appeal hearing.

- Levy and fees: We have proposed that the IIA be financed by licence fees paid by insurance intermediaries, authorization fee paid by insurers, service charges and levy on insurance policies. There are diverse views on whether insurers or policyholders should pay the levy, and various suggestions on levy exemptions. Some have also suggested that the IIA should be financed by the Government entirely. We consider it desirable to ensure that the IIA has stable sources of income so as to be financially independent of the Government.

Financial Services Branch
Financial Services and the Treasury Bureau
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