FINANCIAL SERVICES AND THE TREASURY BUREAU

ESTABLISHING A POLICY HOLDERS' PROTECTION SCHEME

CONSULTATION CONCLUSIONS

DECEMBER 2023

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CONTENTS

Chapter 1

Introduction

1.1 This paper summarises and discusses the comments received in respect of the Consultation Paper on Establishing a Policy Holders' Protection Scheme ("PPS") issued by the Financial Services and Treasury Bureau ("FSTB") in December 2022 (the "Consultation Paper"), and sets out our analysis and proposals on this issue.

Background

1.2 The Insurance Ordinance (Cap. 41) ("IO") provides for the regulation of the insurance industry, including functions and powers of the Insurance Authority ("IA") to supervise insurers for the protection of policy holders. Apart from prudential supervision of insurers, the IO and the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO") further prescribe protective arrangements for policy holders in case of insurer insolvency. Furthermore, sectoral protection schemes have been established in Hong Kong for motor vehicle and employees' compensation policies[1].

1.3 Since the late 1990s, there have been three insurer insolvencies in Hong Kong, all involving small-to-medium insurers in the general sector. There have not been any insolvency involving long-term insurers or large general insurers.

1.4 Nevertheless, the 2008 international financial crisis highlighted the need for a more comprehensive compensation fund for protecting policy holders with a view to offering a safety net for policy holders in case of insurer insolvency and strengthening their confidence in the insurance market. In 2010, the then Office of the Commissioner of Insurance commissioned an actuarial study to assess the optimal levy rate, target fund size and other detailed arrangements for the proposed PPS. The Government subsequently carried out a public consultation exercise in 2011 to solicit views on the proposal for establishing the PPS and received general support, but there were diverse views regarding the scope and compensation level. This was followed by a series of legislative work on the establishment of an independent regulator for the insurance industry (i.e. the IA).

1.5 Following the IA's take-over of the statutory functions from the then Office of the Commissioner of Insurance in 2017, we briefed the Panel on Financial Affairs of the Legislative Council ("LegCo") in March 2018 on the key

[1] The two sectoral schemes are administered by the Motor Insurers' Bureau of Hong Kong ("MIB") and the Employees Compensation Insurer Insolvency Bureau ("ECIIB") respectively.

legislative proposal for establishing a PPS. While Members generally welcomed the establishment of a PPS, some expressed concern that the proposed design might not provide sufficient protection for policy holders. At the same time, there was concern about covering small and medium enterprises ("SMEs") under the PPS. In 2019, we engaged the IA to commission a consultancy study to update the relevant parameters and review implications of the prevailing business environment on the design of the PPS, including the target fund size, lead time for accumulation and level of compensation.

Public consultation in 2022/23

1.6 On 30 December 2022, we launched a three-month public consultation on our latest proposal, which took into account findings of the latest consultancy study. The Consultation Paper can be found at https://www.fstb.gov.hk/fsb/en/publication/consult/doc/Consultation_PPS_Dec_2022_e.pdf.

1.7 The consultation period ended on 31 March 2023. Further submissions were received during extension of the consultation period upon requests. In total, 14 submissions were received, ranging from a simple reply showing general support to detailed submissions on the questions raised in the Consultation Paper (each "Question" and collectively "Questions").

1.8 Furthermore, on 7 February 2023, the FSTB and IA attended a briefing for the insurance industry and had direct exchange with representatives of insurers and the Hong Kong Federation of Insurers ("HKFI") on the Consultation Paper. The IA also briefed its Industry Advisory Committees on 23 March 2023 on the Consultation Paper and collected feedback. On 3 April 2023, the FSTB and IA attended a meeting of the Panel on Financial Affairs of the LegCo to provide a briefing on the PPS, where general support was received.

1.9 We are most grateful to all those who provided comments on the Consultation Paper, which included insurers, professional bodies representing the insurance, actuarial and legal sectors, the Consumer Council as well as members of the public (each "Respondent" and collectively "Respondents"). We will summarise the major comments received and our responses in Chapters 2 to 6. A list of Respondents is set out in Annex to the Consultation Conclusions.

Chapter 2

Protection against insurer insolvency in Hong Kong and international developments

Introduction

2.1 This Chapter deals with Question 2(a) as set out in the Consultation Paper –

> *2(a) Do you agree that there is a need to establish a PPS in Hong Kong to provide an additional safety for protection of policy holders in case of insurer insolvency?"*

2.2 Question 2(a) seeks comments on the basic proposition of establishing a PPS. Respondents' views on Questions in relation to the detailed mechanism of the PPS would be discussed in the subsequent Chapters.

Question 2(a) – Need for PPS

2.3 The majority of comments received were supportive of the establishment of a PPS. A number of Respondents stressed that a PPS should only serve as the last resort and the establishment of PPS should not compromise existing prudential regulation.

2.4 Nevertheless, a number of insurers[2] expressed reservation on the necessity of a PPS, as there was already robust prudential regulation of the insurance industry, especially the Risk-based Capital ("RBC") regime to be implemented in 2024, which would render the capital requirements imposed on insurers more sensitive to their asset and liability matching, risk profile and mix of products, thereby further strengthening the financial soundness of the Hong Kong insurance industry.

2.5 We are encouraged by the strong support for establishing a PPS, which will serve as an additional safety net for protection of policy holders in case of insurer insolvency and benchmark with international standards and best practices. Regarding the presence of existing prudential regulation and the upcoming RBC regime, such measures do not eliminate the possibility of insurer insolvency. The RBC regime will focus on insurers by applying new requirements on capital, risk management and disclosure, thereby fostering a robust risk management culture and strengthening insurers' financial resilience. For the PPS, it will focus on policy holders by serving as a safety net and providing compensation for policy holders in the event of insurer insolvency. In formulating the parameters of PPS, we have taken into consideration the planned

[2] Some insurers submitted comments individually, while the HKFI made a consolidated submission which included the individual and anonymous responses of the HKFI's members.

implementation of the RBC regime, e.g. the impact of the new regime on the levy mechanism (see paragraph 5.12). We believe the co-existence and synergies of these measures will enhance the protection of policy holders and the confidence in our insurance market, thus contributing to the sustainable development of Hong Kong as an international risk management centre as envisioned in the Development Roadmap for the Insurance Sector in Hong Kong announced by the Government in December 2022.

Conclusion

2.6 With a view to enhancing protection of policy holders in the event of insurer insolvency, we propose to proceed with the establishment of a PPS. As explained in later Chapters, we acknowledge the complexity of this new measure, which will require formulation of details, legislative work, establishment of the governance structure and other preparatory work. We will continue to engage stakeholders in the process.

Chapter 3

Objectives, guiding principles and coverage of the PPS

Introduction

3.1 This Chapter focuses on four Questions on the objectives, guiding principles and coverage of the PPS as set out in Chapter 3 of the Consultation Paper –

> *3(a) Do you support the objectives and guiding principles for developing the PPS?*
>
> *3(b) Do you agree with the proposed scope of eligible policy holders under the PPS?* [3]
>
> *3(c) Do you agree with the proposed compulsory membership of insurers under the PPS?*
>
> *3(d) Do you agree with the proposed scope of protected long term and general policies under the PPS?*

3.2 Question 3(a) is a question on the objective and principles and does not invite consideration of the practical problems involved. Question 3(b) to 3(d) go deeper into the coverage of the PPS in the dimensions of policy holders, insurers and policies.

Question 3(a) – Objectives and guiding principles

3.3 In general, the majority of Respondents were supportive of the following objectives and guiding principles for developing a PPS as proposed in the Consultation Paper –

<u>Objectives</u>

(i) better protecting the interest of policy holders;

(ii) maintaining market stability in the event of insurer insolvency; and

(iii) enhancing public confidence in, and competiveness of, the insurance industry of Hong Kong.

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3 Views are invited on the inclusion of SMEs as well as the definition of SMEs and the verification procedures to be adopted.

Guiding principles

(iv) the PPS should strike a reasonable balance between enhancing protection for policy holders and minimising additional burden on insurers;

(v) the PPS should enhance market stability while minimising the risk of moral hazard on insurers and policy holders;

(vi) the PPS should provide certainty on the level of compensation payment to policy holders when an insurer becomes insolvent, and a robust system should be put in place to facilitate the collection, custody, investment and administration of levy contributions to the PPS; and

(vii) the establishment of the PPS should not compromise the regulatory standards and requirements laid down by the IA under the IO.

3.4 The Law Society of Hong Kong and Consumer Council suggested the guiding principles should state that the cost on policy holders should be minimised, while the Consumer Council added that the coverage of the PPS should also be featured in the guiding principles.

3.5 As supported by most Respondents, we believe the objectives and guiding principles will serve as solid foundation for the PPS. As regards the suggestion of stating in the guiding principles that the cost on policy holders should be minimised, we reiterate that the basic premise of the PPS is that the levy will be collected from insurers and therefore borne by insurers, not policy holders. The level of levy depends on a number of factors, including the protection offered, magnitude of insurer insolvency, size of fund pooled and recovery of assets.

Question 3(b) – Scope of eligible policy holders

3.6 The majority of Respondents were in support of our proposal to focus on individual policies holders.

3.7 On the inclusion of SMEs under the PPS, while some Respondents called for early inclusion, most Respondents agreed to our proposal to include SMEs at a later stage. The Law Society of Hong Kong and some insurers particularly asked for a timeline for the inclusion.

3.8 Respondents also provided their views and suggestions on the definition and verification procedures of SMEs, which are summarised below –

Definition of SMEs

(i) the definition should be simple, clear, and quantifiable;

(ii) the definition should be based on revenue, sales, MPF contributions and/or capital scale;

(iii) the definition should be formulated by excluding large corporations instead;

(iv) companies which do not have genuine business operation should not be protected by the PPS; and

(v) stakeholder consultation, including that with the insurance industry, will be critical.

Verification of SMEs

(vi) the verification should only be conducted by the Policy Holders' Protection Scheme Board ("PPS Board") when insolvency occurs; and

(vii) SMEs should provide audit reports for their SME status, supplemented with the IA's independent verification.

3.9 The wide diversity of the views of Respondents was similar with that in the 2011 public consultation. In view of the lack of consensus on the definition of SMEs and the potentially complex verification procedures of SMEs, we see strong reasons for focusing on individual policy holders at the initial stage of implementation, and expanding the coverage of the PPS to SMEs as and when conditions are ripe. This will allow us to reap the protection on individual policy holders first without undue delay caused by the necessary steps to come up with the arrangements for SMEs. Timing-wise, we envisage that the coverage of SMEs can be discussed in a more detailed manner when the PPS has been running smoothly with a considerable level of fund accumulated, such that we will have the benefits of having actual operational experience when mapping out the way forward for the coverage of SMEs.

Question 3(c) – Membership of insurers

3.10 Regarding the compulsory membership of insurers under the PPS (except for specified types of insurers such as captive insurers, reinsurers and special purpose insurers) as proposed in the Consultation Paper, the majority of Respondents expressed support.

3.11 The major focus of Respondents was on the proposed exemption of foreign-incorporated insurers where equivalent protection afforded by a similar scheme in another jurisdiction is established. Interestingly, while some insurers called for large scale automatic exemption on the basis of equivalent protection offered elsewhere, some insurers were less supportive of the exemption, including comments from an insurer that liaison with other jurisdictions which had similar schemes in place should be conducted before exemptions are granted to relevant in-scope policies issued in Hong Kong. There were also multiple enquiries on the definition of equivalent protection. Besides, an insurer enquired whether run-off insurers and insurers with insignificant liabilities could be exempted from the PPS.

3.12 We understand the insurers' preference for a clear definition of equivalent protection and will study further to suitably address this issue when formulating the detailed mechanism of the PPS, e.g. by offering more information on the criteria of equivalent protection. Yet, we believe there are very few insurers with PPS-covered policies having equivalent protection offered by schemes in other jurisdictions, thus making a case-by-case approval process reasonable and pragmatic. Flexibility on exempting insurers with insignificant liabilities and removing the exemption status in light of loss of equivalent protection will also be considered when formulating the detailed mechanism of the PPS.

Question 3(d) – Scope of protected policies

3.13 Respondents were also generally supportive of the proposed scope of protected policies. As elaborated in the ensuing paragraphs, various Respondents offered comments on specific aspects of the scope.

3.14 A few insurers and the Actuarial Society of Hong Kong ("ASHK") sought clarification on whether group policies (e.g. life and fire insurance) would be covered by the PPS. An insurer pointed out that certain policies could be complicated and hybrid in nature as they covered various kinds of risks, creating uncertainty for the scope of protection and calculation of levy.

3.15 We believe the proposed scope of protected policies, i.e. all insurance policies in force as at the date of the establishment of PPS as well as new policies issued thereafter (except for specified exceptions), will be useful basis in determining whether certain policies are covered by the PPS. It will also be useful to consider whether the relevant policy holders are individuals, who will be covered by the PPS. Generally speaking, a policy within the scope of protected policies and with individual policy holders will be covered by the PPS[4].

3.16 Furthermore, the Consultation Paper proposed to include third party liability insurance of building owners' corporations. While the Consumer Council supported this proposal, it suggested that policies procured by owners other than building owners' corporations (e.g. owners' committee) should also be covered by the PPS, and invited consideration on whether a higher compensation limit should be applied to this type of policies, for which statutory minimum insured amount was $10 million per event.

3.17 While the Consultation Paper proposed that the PPS should only cover individual policy holders at the initial stage of implementation, it specifically proposed to include in the scope of eligible policy holders building owners' corporations (which are not individuals), as the corporations are mandated to procure such third party liability insurance under the Building Management (Third Party Risks Insurance) Ordinance (Cap. 344). We are inclined not to extend the coverage to owners other than building owners' corporations, as such owners are not subject to the said mandatory procurement of insurance, and the extension will complicate the PPS mechanism. Notwithstanding the statutory insured

[4] Group policies will not be covered at the initial stage of the PPS as they involve non-individual policy holders.

amount of $10 million per event, we are inclined not to apply a higher compensation limit to this type of policies, as this will be inequitable to other types of policies, which will enjoy a lower compensation limit with the same levy rate, and complicate the PPS mechanism. We would like to point out, despite the statutory insured amount, the PPS will offer to buildings owners' corporations a considerable level of protection which is currently absent, and in the event of excess of claims over the compensation limit, such excess can still be claimed from the assets of the insolvent insurer (if any).

3.18 The Consumer Council also recommended clear illustration of the protected value of various types of policies, which may have different levels of saving, investment, guarantee or assurance. In addition to the proposed Long Term Fund and General Fund, some insurers suggested having additional funding pools, or even compensation limits, for different types of policies, with reference to factors such as the protection and / or saving elements of the policies.

3.19 In the event of a policy holder choosing to surrender a policy after an insurer's insolvency, the policy holder should be entitled to the cash value of the policy from the PPS. We agree that the future PPS Board can consider delineating more detailed information on the protected value of various types of policies for greater transparency. As for the suggestion on having additional funding pools, we currently do not see such a need as overly segregated funds will result in smaller funding pools as well as additional design and operational complexity. Considering the inherent complexity of a PPS, we strive to have a relatively simple mechanism for transparency, ease of understanding and implementation, especially at the initial stage of implementation.

Conclusion

3.20 We note Respondents generally supported the objectives, guiding principles and coverage of the PPS as proposed in the Consultation Paper.

3.21 In taking forward the establishment of a PPS, we consider that the objectives and guiding principles set out in paragraph 3.3 should be observed.

3.22 On balance, the PPS should focus on individual policy holders at the initial stage of implementation, and be expanded to cover SMEs as and when conditions are ripe.

3.23 To ensure comprehensive protection for policy holders, the PPS should cover all insurance policies in force as at the date of the establishment of PPS as well as new policies issued thereafter, except the policies of the following types of business –

(i) reinsurance business;

(ii) long term business of managing contributions under a retirement scheme[5]; and

(iii) general business which is (a) subject to alternative protection under existing arrangements, or (b) focused on specialty risks, or lines of business which are unusual for individuals or SMEs[6].

3.24 All insurers authorized to carry on business in Hong Kong should be required to participate as members of the PPS, except –

(i) captive insurers, reinsurers, special purpose insurers and other insurers not authorized to carry on business of any policies protected under the PPS; and

(ii) foreign-incorporated insurers exempted on the grounds of equivalent protection afforded by a similar scheme in other jurisdictions on a case-by-case basis.

3.25 Given the different nature of long term and general policies, two separate funds, namely the Long Term Fund and General Fund, should be established under the PPS.

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[5] Within the meaning of Schedule 1 Part 2 of the IO, the long term business proposed to be excluded are those of Class G (Retirement scheme management category I) and Class H (Retirement scheme management category I), which include such schemes as the Occupational Retirement Schemes and Mandatory Provident Funds Schemes. We propose to exclude these policies from the PPS given that such schemes are held in trust arrangements that would protect assets in the event of the insurer concerned becoming insolvent.

[6] Within the meaning of the Schedule 1 Part 3 of the IO, the general business proposed to be excluded are as follows –

(i) Motor vehicle policies (Classes 3 and 10) which will be covered by the MIB;
(ii) Employees compensation policies (part of Class 13 General liability) which will be covered by the ECIIB;
(iii) Aviation insurance (Classes 5 and 11) which is unusual for individuals/SMEs;
(iv) Marine insurance (Classes 6 and 12), which is unusual for individuals/SMEs;
(v) Credit insurance (Class 14) which can be insured through the Hong Kong Export Credit Insurance Corporation, a statutory body guaranteed by the Government;
(vi) Risk of war and strike, riots and civil commotion in goods in transit insurance (part of Class 7); and
(vii) Offshore risks of policies other than travel, accident, sickness and goods in transit insurance.

Chapter 4

Arrangements in the Event of Insurer Insolvency

Introduction

4.1 This Chapter focuses on two Questions on the arrangements in the event of insurer insolvency as set out in Chapter 4 of the Consultation Paper –

4(a) What would be the appropriate level of protection offered under PPS? Do you prefer Option 1 ($1 million), Option 2 ($2 million) or Option 3 ($4 million) on the compensation limit?

4(b) Do you agree with the relief to be provided under PPS?
- *(i) Do you agree with the arrangement of prioritising transfer of long term policies?*
- *(ii) Do you agree with the arrangement of transitional continuity for general policies?*

Question 4(a) – Compensation Limit

4.2 We observe that the responses to this Question were correlated with the background of Respondents. Generally speaking, insurers were more likely to opt for Option 1, while Respondents more focused on consumer protection tended to opt for Option 3. The middle option, i.e. Option 2, attracted little support. For ease of reference, a table in the Consultation Paper showing the three options and their respective coverage of number of policies and claim amount is reproduced below –

	Compensation limit	Policies within the cap on claim amount[7]	
		% by count	% by claim amount
Option 1 **$1 million** (previous proposal)	Maximum of **$1 million** – 100% of the first $100,000 + 80% of the remaining amount (i.e. claim amount capped at $1,225,000)	LT: 99.1% G: 99.9%	LT: 62.5% G: 62.3%
Option 2 **$2 million**	Maximum of **$2 million** – 100% of the first $200,000 + 80% of the remaining amount (i.e. claim amount capped at $2,450,000)	LT: 99.6% G: 99.9%	LT: 72.5% G: 69.0%
Option 3 **$4 million** (Under this option, the level of protection in terms of claim amount for long term policies is comparable to the level at the 2010 study.)	Maximum of **$4 million** – 100% of the first $400,000 + 80% of the remaining amount (i.e. claim amount capped at $4,900,000)	LT: 99.9% G:100 %	LT: 81.6% G: 77.5%

7 Under Option 1, a policy within the cap on claim amount refers to one with claim amount within $1.225 million; whereas under Option 2 and Option 3, this refers to policies with claim amount under $2.45 million and $4.9 million respectively.

Take long term policies in the above Option 1 for instance, 99.1% of policies are estimated to have claim amounts within the limit of $1.225 million, and these policies take up 62.5% of claim amount in the market; whereas the 0.9% policies with claims amount above the limit of $1.225 million account for about 37.5% of claim amount in the market.

4.3 Respondents who opted for Option 1 considered the $1 million compensation limit adequate, as over 99% of policy holders would be protected, thus achieving the goal of safeguarding the public. Additionally, a lower limit could reduce moral hazard[8], reduce the burden on the insurance industry and achieve the target fund sizes within a shorter timeframe.

4.4 On the other hand, Respondents who opted for Option 3 believed that a lower limit may encourage policy holders to purchase policies within the limit or split policies into smaller ones and that a higher limit would offer stronger protection for policy holders.

4.5 As expected, this Question attracted relatively diverse views. We are of view that Option 1 will better suit our needs and circumstances, and is more aligned with the guiding principles of minimising moral hazard and striking a reasonable balance between enhancing protection for policy holders and minimising additional burden on insurers. Option 1 can already protect more than 99% of the policy holders, and it will be inequitable for these policy holders, or insurers, to subsidize additional protection for the remaining minority, who can be seen as relatively well-off. The situation of splitting policies into smaller ones to fit under the compensation limit should not be excessive, considering the relatively small number of policies involved. Furthermore, a higher compensation limit will result in the PPS taking longer time to reach the target fund size and bring along a heavier financial strain on the PPS in case of insurer insolvency. Nevertheless, we are open to the suggestion on reviewing the compensation limit at a suitable juncture after the establishment of the PPS. This will allow the PPS to make adjustments to better suit the needs and circumstances of the future.

4.6 Regarding the conditions for activating the PPS, we received limited comments and believe the proposed triggering of the use of the Long Term Fund and General Fund under the PPS upon occurrence of a "specified event" will be a suitable arrangement.

Question 4(b) – Relief

4.7 Respondents provided little or no comments on the application of the compensation limit on various types of long term and general policies and the arrangements for accident and health[9] ("A&H") policies with guaranteed renewability. Besides, we find the Consumer Council's suggestion to provide information on the available options to policy holders in the event of insurer insolvency to facilitate decision helpful. Specific arrangements for long term and general policies are discussed below.

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8 The potential moral hazard of providing a PPS includes –
(i) insurers might become more aggressive in their pricing and investment strategies, thus increasing risk for insurers to become insolvent; and
(ii) policy holders may give less weight to the financial standing or rating of insurers, being inclined to choose products with the lowest premium.

9 Schedule 1 of the IO provides at Part 4 that the group of "accident and health" business encompasses general business classes 1 (accident) and 2 (sickness).

Question 4(b)(i) – Arrangement for long term policies

4.8 Most responses agreed with the proposed arrangement of prioritising transfer of long term policies in the event of insurer insolvency. Owing to the life protection nature of long term policies, their premature encashment or surrender could lead to substantial losses for policy holders, the transfer of long term policies will therefore be prioritised considering the interest of policy holders. Yet, the PPS may set up a dedicated insurance company for running off the business of an insolvent insurer, if transfer of policies to another commercial insurer cannot be arranged. Arrangements will also be in place to cater for court orders on reduction of amount of contracts and termination of policies by liquidators.

4.9 Some insurers enquired about the detailed arrangements of such transfers, including whether insurers would be mandated to become replacement insurers, availability of information of policies involved and flexibility of offering similar products instead of running off existing policies. An insurer expressed concern on the operation cost of the dedicated insurance companies.

4.10 It will be the mandate of the PPS Board to devise detailed arrangements for the various possible courses of action to be pursued in the event of insurer insolvency, including transferring long term policies, setting up of dedicated insurance companies, making ex-gratia payments, etc., and we envisage the PPS Board will take into consideration the actual operation of the insurance industry and tap the industry's views before finalising the arrangements. The PPS Board will also have to consider and determine the most appropriate course of action according to the actual situation of individual cases.

Question 4(b)(ii) – Arrangement for general policies

4.11 The Consultation Paper proposed providing insurance coverage for protected general policies up to 60 days following the "specified event", or until expiry / termination, whichever was earlier, coupled with refund of unexpired premiums. Most Respondents agreed with the proposed transitional continuity for general policies, but were divided on the duration of the transition period.

4.12 The Consumer Council was of view that the duration of the transition period should last until expiry / termination of the policies, which was among the Government's proposals in the 2011 consultation exercise, where the Law Society of Hong Kong enquired if the duration could be longer. An individual Respondent expressed concern on exposing the PPS to excessive risks for providing the proposed transitional continuity.

4.13 General policies are usually in force for a short period (normally one year) and are likely to have expired before the liquidation process is complete. The proposed maximum of 60 days of transitional continuity has taken into consideration the practice of other jurisdictions and that alternative coverage is generally available in the market, and the need to avoid exposing the PPS to excessive and prolonged risks. It is worth noting that the 2011 consultation exercise also considered this arrangement, with emphasis on the need of refund of unexpired premiums, which was taken on board in the Consultation Paper.

Conclusion

4.14 In respect of the compensation limit and the arrangements in the event of insurer insolvency, our views and proposals are summarised below.

4.15 The use of Long Term Fund and General Fund under the PPS should be triggered upon occurrence of a "specified event" which is defined as –

(i) winding up proceedings of an insurer who is a member of the PPS have commenced; and

(ii) the IA has assessed the situation and served a written notice that the Long Term Fund or General Fund, or both as the case may be, should be used.

Once activated, compensation will be made from the respective Long Term Fund, General Fund, or both as the case may be, to claims lodged by holders of protected policies written by the insolvent insurer.

4.16 Striking a balance between cost and benefit of the PPS and minimising the risk of moral hazard, the compensation should be the first $100,000 of any claim, plus 80% of the remaining balance, up to a total compensation limit of $1 million.

4.17 For protected long term policies, the PPS should facilitate their transfer to a replacement insurer wherever possible, and be able to (i) make a payment to facilitate such transfer and (ii) settle claims and pay benefits for protected policies pending such transfer. The PPS may set up a dedicated insurance company for running off the business of an insolvent insurer, if transfer of policies to another commercial insurer cannot be arranged. For any termination of policies (whether by the liquidator or by the policy holders), the PPS may refund unexpired premiums, and settle claims and pay benefits for protected policies before termination. Where the Court has ordered reduction of amount of contracts, or where the liquidator has to terminate the policies (when neither the transfer of policies to another commercial insurer nor the setting up of a dedicated company for running off purposes can be arranged), the PPS may make "ex-gratia" payment to assist the policy holders to procure replacement policies.

4.18 For protected general policies, the PPS should provide insurance coverage for up to 60 days following the "specified event", or until expiry / termination, whichever is earlier. Any unexpired premiums will be refunded.

4.19 For A&H policies with guaranteed renewability, they should be provided relief along similar arrangement as long term policies, prioritising transfer to another insurer for continuity[10].

[10] A&H policies without guaranteed renewability, including those which are riders to a long term policy, will be treated in the same manner as other general policies.

4.20 The compensation limit should apply to long term insurance on a per-policy basis and to general insurance on a per-claim basis, except in the case of –

(i) group long term policies[11] where the compensation limit should apply on a per-life basis[12];

(ii) A&H riders to long term policies (irrespective of whether they provide for guaranteed renewability) where the compensation limit will apply on a per-claim basis; and

(iii) multiple general insurance claims arising from one insured event where the compensation limit should apply on a per-event basis.

4.21 The aggregated amount of (i) any payment to facilitate a transfer of long term policies to another insurer, to settle insurance claims and benefits or to refund unexpired premiums and (ii) any ex-gratia payment should not exceed the compensation limit.

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[11] Group policies will not be covered at the initial stage of the PPS as they involve non-individual policy holders.

[12] The proposal would protect the beneficiary of every insured individual, and prevent scenario where a relatively small amount of compensation would be divided to each claimant in case of multiple deaths. The financial impact of such proposal would be insignificant given the small number of group long term policies covered under PPS.

Chapter 5

Funding Mechanism

Introduction

5.1 We consider in this Chapter the responses to the four questions on the funding mechanism of the PPS as set out in Chapter 5 of the Consultation Paper –

> *5(a) Do you support a progressive funding model with levies collected from participating insurers for the operation of PPS?*
>
> *5(b) Do you support the borrowing mechanism for the PPS to meet any liquidity gap?*
>
> *5(c) What are your views on the proposed priority ranking of PPS with the two classes of creditors (i.e. the Employee Compensation Assistance Fund and all other direct insurance claims not met with the PPS) specified in section 265 of the CWUMPO during the winding up process?*
>
> *5(d) Do you agree with the proposed levy rate and levy cap? Do you have any views on the arrangement for levy review and adjustment?*

Question 5(a) – Funding model

5.2 We received almost universal support on the proposed progressive funding model, which consists of an initial moderate levy rate complemented by an additional levy upon occurrence of insolvency. This will ensure the availability of an upfront reserve through an affordable level of levy that will not put excessive pressure on nor affect sustainability of the insurance industry, meeting any arising liabilities while allowing flexibility to increase the levy rate to meet actual needs.

5.3 Nevertheless, we received mixed comments on which party should pay the levy. The Law Society of Hong Kong and the Consumer Council called for minimisation of additional premiums that may be imposed by insurers, while an individual Respondent called for statutory ban of transfer of levy to policy holders. On the contrary, a number of insurers called for collection of levy from policy holders or, to the same effect, explicit permission to insurers to collect levy from policy holders.

5.4 Apart from protecting policy holders, a PPS will benefit the insurance industry by maintaining market stability and promoting industry competitiveness, making it reasonable for insurers to pay the levy. Furthermore, the arrangement of insurers paying the PPS levy is commonly adopted in other jurisdictions. For the concern that some insurers may transfer all or part of the levy cost to policy holders according to market force and consideration of individual insurers, instead of barring the transfer via legislative means, which is impractical as insurers can subsume such cost under premiums, we believe it will be more practical to provide flexibility to insurers on how to handle the cost of PPS levy. That said, the proposed initial levy rate at 0.07% of the applicable premium income is not expected to pose excessive burden on insurers.

5.5 The HKFI collected views from its members on the estimated time needed to implement the necessary system changes for the implementation of the PPS. The responses were sparse, ranging from a few months to more than a year. We will take into consideration the time needed by insurers to conduct preparatory work when devising the implementation schedule of the PPS.

Question 5(b) – Borrowing mechanism

5.6 As for the borrowing mechanism which allows the PPS to borrow from a third party to bridge the liquidity gap in the event that the PPS Funds are not sufficient to meet all the liabilities arising from an insurer insolvency, Respondents were generally supportive, with some cautioning that borrowing should be done prudently.

Question 5(c) – Priority during winding up process

5.7 Diverse views on the priority ranking of PPS during the winding up process of an insolvent insurer were received. Respondents which were insurers were inclined to support the proposal of PPS having the same ranking as the Employee Compensation Assistance Fund (“ECAF”) and all other direct insurance claims not covered by the PPS, while the Law Society of Hong Kong and some individual Respondents expressed reservation from the view point of unfairness towards ordinary creditors, which were of lower rank, including other insolvency schemes such as those governed by the MIB and ECIIB.

5.8 While we see the reasons behind the above-mentioned reservation, we are inclined to provide the PPS with the same ranking as the ECAF and all other direct insurance claims not covered by the PPS. Apart from the factor that the protected element of the claim (i.e. the part met by PPS) should be subrogated to the PPS (i.e. the PPS will take over the claimants’ rights and seek recovery from the estate of the insolvent insurer), providing PPS with the same rank as ordinary creditors will lead to an increase in target fund size and levy rates, as the PPS will recover less assets from the insolvent insurer. Another factor considered is that the PPS will cover a large number of policies and policy holders, thus calls for higher ranking in asset recovery to ensure financial sustainability of the scheme. In addition, the proposed preferential ranking of the PPS is also in line with international practices and guidelines set forth by the International Forum of Insurance Guarantee Schemes, a global forum for compensation schemes in the insurance industry.

Question 5(d) – Levy rate and cap

5.9 Most Respondents agreed with the proposed initial levy rate at 0.07% of the applicable premium income. We note that a few insurers opined that the rate was on the high side or that the levy should not harm the competitiveness of insurers. Besides, an insurer suggested there should be a cap on the levy collection for policies with values exceeding the compensation limit.

5.10 The initial levy rate was proposed with reference to the proposal, which received general support, from the 2011 consultation exercise. We consider this relatively low rate provides a reasonable balance between the financial sustainability of the PPS, time to reach target fund size and burden on insurers. As for the suggestion on applying a cap on levy collection for policies carrying values that exceed the compensation limit, it will inject additional complexity into the PPS mechanism and be difficult to implement, considering the cash value of many types of policies vary frequently, which creates difficulty in monitoring whether the policies concerned carry values that exceed the compensation limit.

5.11 We note that a number of Respondents, including the Consumer Council, ASHK and some insurers, suggested to adopt a risk-based levy system. Under this system, the levy charged on insurers will vary according to the risk levels of insurers, with higher risk levels attracting higher levy rates. This will reduce cross-subsidisation among insurers with different risk levels and reduce the risk of moral hazard, as well as provide incentives to insurers to improve their risk management.

5.12 We can see the appeal of the proposed risk-based levy system. Nevertheless, we consider it will be more prudent to use a flat initial levy rate at the initial stage of the PPS. It is because it will take considerable time to forge a consensus on the detailed mechanism of the system, including the assessment criteria of risk levels and corresponding tiering of levy rates. The RBC regime, which will bring fundamental changes to the asset and liability valuation methods and capital requirements for the insurance industry, will be implemented in 2024. While this new capital regime will provide new angles for the assessment of risk level of insurers, it is expected that the industry will take some time to fully adjust. With both the PPS and RBC regime running smoothly for some time in the future, the proposal on a risk-based levy system can be explored with more information, experience and certainty. The experience of the Deposit Protection Scheme[13] will also provide useful reference in future exploration of a risk-based levy system.

5.13 Based on earlier views of the insurance industry, the Consultation Paper also proposed a cap at 1.0% on the levy to be collected from participating insurers in the event that the PPS Fund(s) were insufficient to meet all the liabilities of an insurer insolvency. While Respondents were generally receptive of this proposal, some insurers expressed concern on the possibility of quick and frequent additional increases of levy rate.

5.14 We would like to explain that the actual rate of an additional levy to be collected would depend on circumstances prevailing at the time (e.g. the amount of remaining funds and likelihood of recovering assets from the insolvent estate), and the affordability of insurers participating in the PPS will also be taken into consideration. Furthermore, a change in levy rate, as well as the proposed cap at 1%, will be subject to the scrutiny of the LegCo as the rate is expected to be prescribed in subsidiary legislation This will reduce uncertainty of the magnitude of future increase of levy rate.

5.15 Regarding the proposed suspension or reduction of levy rate when the accumulated PPS Fund(s) exceeds the target size and two years' operating expenses for the PPS, it received general support from Respondents. We also received a small number of suggestions, including new industry players continuing to pay levy on ground of fairness and refunding of levy to insurers. While we note the complexity of these suggestions, e.g. uncertain definition of fairness and administrative efforts on refunding, we would defer to the assessment and decision of the PPS Board when such a situation arises, which should be quite a few years after the implementation of the PPS.

Conclusion

5.16 On the funding mechanism of the PPS, we received robust responses and a number of useful suggestions. Our views and proposals are summarised below.

5.17 The PPS should be funded by levies to be collected from insurers which are required to participate as scheme members. A progressive funding model should be adopted, where an initial levy (to be prescribed in subsidiary legislation) will be prescribed until the PPS Funds have reached a target size. In case of an insurer insolvency, the available funds under the PPS will be deployed to meet relevant liabilities.

5.18 In the event that the PPS Funds are not sufficient to meet all the liabilities of an insurer insolvency, the PPS should be allowed to borrow from a third party (e.g. a commercial lender for which the Government may act as the guarantor, or from the Government direct) subject to the approval of the LegCo,

13 Under the Deposit Protection Scheme, the Scheme members' contributions are assessed annually using a differential levy system with reference to the supervisory rating of each Scheme member as determined by the Hong Kong Monetary Authority.

so as to bridge the liquidity gap. An additional levy (to be prescribed in subsidiary legislation) may be collected to restore the fund size back to the target level.

5.19 If there is no insurer insolvency by the time the target fund size is achieved, suspension or reduction of levy rate may be considered when the accumulated amount exceeds the target size and two years' operating expenses for the PPS.

5.20 Where claimants are compensated by the PPS in case of an insurer insolvency, the protected element of the claim (i.e. the part met by PPS) should be subrogated to the PPS. The PPS should have equal ranking with two classes of creditors (i.e. the ECAF and all other direct insurance claims not covered by the PPS) specified in section 265 of the CWUMPO during the winding up process.

5.21 The initial levy rate for both the Long Term and General Fund should be set at 0.07% of the applicable premium income, with a minimum annual levy payment of $10,000 for each insurer[14]. Levies from long term and general policies will contribute respectively to the Long Term and General Fund, and there will no cross-subsidy between the two funds. The rate of any additional levy should be capped at 1%.

[14] The amount of levy payable by a participating insurer is calculated based on the gross premium income of the protected policies issued by such insurer in a financial year.

Chapter 6

Governance, administration and related matters

Introduction

6.1 In this Chapter, we discuss the responses to the three questions on the governance and administration of the PPS as set out in Chapter 6 of the Consultation Paper –

> *6(a) Do you agree with the proposed establishment of the PPS Board and composition, and that the IA should be its administrative arm?*
>
> *6(b) Do you agree with the proposed powers and functions of the PPS Board?*
>
> 6(c) *Do you have any other suggestions on the proposed governance arrangement?*

Question 6(a) – Establishment of PPS Board

6.2 The proposed establishment of a PPS Board by statute to oversee the PPS attracted broad support from Respondents. The proposed membership of the PPS Board also received broad support. While a number of insurers suggested the IA to operate the PPS directly without a separate PPS Board, instead of being an administration arm of the latter, some other Respondents questioned whether the IA serving as an administration arm would conflict with the IA's existing regulatory functions.

6.3 We believe having a separate body to operate the PPS will better ensure a high level of certainty, transparency and accountability in the design and implementation of the PPS. This will also draw a clearer line between the existing regulatory functions of the IA and the functions of an insolvency scheme, as the IA is merely an administrative arm, where the relevant powers and decision rest with the PPS Board.

Question 6(b) – Powers and functions of PPS Board

6.4 Respondents generally agreed with the proposed powers and functions of the PPS Board, while there were suggestions on empowering the PPS Board to provide information and education to policy holders and collect feedback from the industry. We welcome these suggestions and will ensure the PPS Board have commensurate general powers for flexibility and ease of operation.

Question 6(c) – Governance arrangements

6.5 In relation to investment guidance for the PPS, there was suggestion on seeking expert opinion on establishing an investment policy or setting up an investment committee, with a view to ensuring prudent and appropriate investment. As set out in the Consultation Paper, it was recommended that the PPS Board should exercise a high level of prudence in investing the money of the PPS. In performing its investment functions, the PPS Board should make reference to the practices of other compensations funds (e.g. the Deposit Protection Scheme).

6.6 For the proposal on setting up an independent Policy Holders' Protection Appeals Tribunal to deal with appeals against relevant decisions of the PPS Board, we received almost no comments, except that the Consumer Council recommended transparency and wider public participation in the appeal process.

6.7 It is worth mentioning that the Council Consumer also called for a high level of transparency of the PPS to the public, including disclosure on whether a policy is covered by the PPS prior to purchase and accessible information on insurers and / or policies covered by the PPS. We agree with the suggestion and will ensure there is adequate transparency to the public in the operation of the PPS.

6.8 We received little or no comments in relation to the proposed governance arrangements and confidentiality of the PPS.

Conclusion

6.9 The proposed arrangements on governance and administration received general support from Respondents. Our relevant proposals are summarised below.

6.10 The PPS should be established by statute and should operate under the oversight of a statutory body named the "Policy Holders' Protection Scheme Board". The IA should serve as the administrative arm of the PPS Board.

6.11 The functions and powers of the PPS Board to be stipulated in legislation should cover, but not be limited to, the following –

(i) to manage and administer the PPS, including usage of the Long Term Fund or General Fund;

(ii) to assess and collect payment, including levy contributions, from scheme members;

(iii) to liaise with the liquidator, provisional liquidator or other relevant persons for making arrangements including to settle insurance claims and pay compensation;

(iv) to facilitate transfer of business, including making necessary payments and establishing dedicated insurance company for the specific purpose of running-off business of an insolvent scheme member;

(v) to recover compensation paid out of the PPS from assets of the insolvent scheme members;

(vi) to maintain financial position of the PPS by investing funds, or borrowing money to meet any liquidity gap; and

(vii) to issue guidelines and make regulations for managing the PPS.

Commensurate general powers should also be granted to the PPS Board for flexibility and ease of operation.

6.12 The membership of the PPS should comprise representatives from the Government and the IA, as well as professionals with relevant expertise (e.g. insurance, actuarial science, finance, accounting, law, consumer affairs). Members of the PPS Board should be appointed by the Chief Executive.

6.13 To ensure accountability and transparency of the operation of the PPS Board, we recommend that the PPS Board must submit the annual budget of the PPS for approval by the Financial Secretary ("FS"), maintain proper accounts, and prepare annual reports and audited financial statements to be tabled before LegCo. The FS may appoint the Director of Audit to or an external auditor to perform audit reviews on the PPS.

6.14 The PPS Board should exercise a high level of prudence in investing the money of the PPS. In performing its investment functions, the PPS Board should make reference to the practices of other compensation funds (e.g. the Deposit Protection Scheme).

6.15 Given their access to sensitive commercial information on scheme members, PPS Board members and any other persons engaged in the operation of the PPS should be required to keep confidential any information obtained in the course of carrying out relevant functions. Disclosure of information would be subject to conditions prescribed in law.

6.16 A person aggrieved by a relevant decision made under the PPS should be able to apply for a review of the decision. An independent Policy Holders' Protection Appeals Tribunal should be set up to deal with appeals against relevant decisions[15] of the PPS Board.

[15] The relevant decisions subject to review include a decision on whether a policy holder is an eligible person, a decision on the amount of payments to relevant policy holders, a decision to exempt an insurer from PPS membership, a decision on the level of levy payable by scheme members, etc.

Chapter 7

Summary

7.1 Having considered the comments received in respect of the Consultation Paper in depth in the preceding Chapters, we summarise our conclusions on the establishment of a PPS in Hong Kong as follows.

7.2 With a view to enhancing protection of policy holders in the event of insurer insolvency, we propose to proceed with the establishment of a PPS.

Objectives and guiding principles

7.3 In taking forward the establishment of a PPS, we consider that the following objectives and guiding principles should be observed –

Objectives

(i) better protecting the interest of policy holders;

(ii) maintaining market stability in the event of insurer insolvency; and

(iii) enhancing public confidence in, and competiveness of, the insurance industry of Hong Kong.

Guiding principles

(iv) the PPS should strike a reasonable balance between enhancing protection for policy holders and minimising additional burden on insurers;

(v) the PPS should enhance market stability while minimising the risk of moral hazard on insurers and policy holders;

(vi) the PPS should provide certainty on the level of compensation payment to policy holders when an insurer becomes insolvent, and a robust system should be put in place to facilitate the collection, custody, investment and administration of levy contributions to the PPS; and

(vii) the establishment of the PPS should not compromise the regulatory standards and requirements laid down by the IA under the IO.

Eligible policy holders

7.4 On balance, the PPS should focus on individual policy holders at the initial stage of implementation, and be expanded to cover SMEs as and when conditions are ripe.

Protected policies

7.5 To ensure comprehensive protection for policy holders, the PPS should cover all insurance policies in force as at the date of the establishment of PPS as well as new policies issued thereafter, except the policies of the following types of business –

(i) reinsurance business;

(ii) long term business of managing contributions under a retirement scheme; and

(iii) general business which is (a) subject to alternative protection under existing arrangements, or (b) focused on specialty risks, or lines of business which are unusual for individuals or SMEs.

Membership of insurers

7.6 All insurers authorized to carry on business in Hong Kong should be required to participate as members of the PPS, except –

(i) captive insurers, reinsurers, special purpose insurers and other insurers not authorized to carry on business of any policies protected under the PPS; and

(ii) foreign-incorporated insurers exempted on the grounds of equivalent protection afforded by a similar scheme in other jurisdictions on a case-by-case basis.

Triggering of use of PPS Funds

7.7 Given the different nature of long term and general policies, two separate funds, namely the Long Term Fund and General Fund, should be established under the PPS.

7.8 The use of Long Term Fund and General Fund under the PPS should be triggered upon occurrence of a “specified event” which is defined as –

(i) winding up proceedings of an insurer who is a member of the PPS have commenced; and

(ii) the IA has assessed the situation and served a written notice that the Long Term Fund or General Fund, or both as the case may be, should be used.

Once activated, compensation will be made from the respective Long Term Fund, General Fund, or both as the case may be, to claims lodged by holders of protected policies written by the insolvent insurer.

Compensation limit and relief in the event of insurer insolvency

7.9 Striking a balance between cost and benefit of the PPS and minimising the risk of moral hazard, the compensation should be the first $100,000 of any claim, plus 80% of the remaining balance, up to a total compensation limit of $1 million.

7.10 For protected long term policies, the PPS should facilitate their transfer to a replacement insurer wherever possible, and be able to (i) make a payment to facilitate such transfer and (ii) settle claims and pay benefits for protected policies pending such transfer. The PPS may set up a dedicated insurance company for running off the business of an insolvent insurer, if transfer of policies to another commercial insurer cannot be arranged. For any termination of policies (whether by the liquidator or by the policy holders), the PPS may refund unexpired premiums, and settle claims and pay benefits for protected policies before termination. Where the Court has ordered reduction of amount of contracts, or where the liquidator has to terminate the policies (when neither the transfer of policies to another commercial insurer nor the setting up of a dedicated company for running off purposes can be arranged), the PPS may make "ex-gratia" payment to assist the policy holders to procure replacement policies.

7.11 For protected general policies, the PPS should provide insurance coverage for up to 60 days following the "specified event", or until expiry / termination, whichever is earlier. Any unexpired premiums will be refunded.

7.12 For A&H policies with guaranteed renewability, they should be provided relief along similar arrangement as long term policies, prioritising transfer to another insurer for continuity.

7.13 The compensation limit should apply to long term insurance on a per-policy basis and to general insurance on a per-claim basis, except in the case of –

(i) group long term policies where the compensation limit should apply on a per-life basis;

(ii) A&H riders to long term policies (irrespective of whether they provide for guarantee renewability) where the compensation limit will apply on a per-claim basis; and

(iii) multiple general insurance claims arising from one insured event where the compensation limit should apply on a per-event basis.

7.14 The aggregated amount of (i) any payment to facilitate a transfer of long term policies to another insurer, to settle insurance claims and benefits or to refund unexpired premiums and (ii) any ex-gratia payment should not exceed the compensation limit.

Funding model

7.15 The PPS should be funded by levies to be collected from insurers which are required to participate as scheme members. A progressive funding model should be adopted, where an initial levy (to be prescribed in subsidiary legislation) will be prescribed until the PPS Funds have reached a target size. In case of an insurer insolvency, the available funds under the PPS would be deployed to meet relevant liabilities.

7.16 In the event that the PPS Funds are not sufficient to meet all the liabilities of an insurer insolvency, the PPS should be allowed to borrow from a third party (e.g. a commercial lender for which the Government may act as the guarantor, or from the Government direct) subject to the approval of the LegCo, so as to bridge the liquidity gap. An additional levy (to be prescribed in subsidiary legislation) may be collected to restore the fund size back to the target level.

7.17 If there is no insurer insolvency by the time the target fund size is achieved, suspension or reduction of levy rate may be considered when the accumulated amount exceeds the target size and two years' operating expenses for the PPS.

Priority of claims

7.18 Where claimants are compensated by the PPS in case of an insurer insolvency, the protected element of the claim (i.e. the part met by PPS) should be subrogated to the PPS. The PPS should have equal ranking with two classes of creditors (i.e. the ECAF and all other direct insurance claims not covered by the PPS) specified in section 265 of the CWUMPO during the winding up process.

Levy rate and cap

7.19 The initial levy rate for both the Long Term and General Fund should be set at 0.07% of the applicable premium income, with a minimum annual levy payment of $10,000 for each insurer. Levies from long term and general policies will contribute respectively to the Long Term and General Fund, and there will no cross-subsidy between the two funds. The rate of any additional levy should be capped at 1%.

Structure, functions and powers of PPS Board

7.20 The PPS should be established by statute and should operate under the oversight of a statutory body named the "Policy Holders' Protection Scheme Board". The IA should serve as the administrative arm of the PPS Board.

7.21 The functions and powers of the PPS Board to be stipulated in legislation should cover, but not be limited to, the following –

(i) to manage and administer the PPS, including usage of the Long Term Fund or General Fund;

(ii) to assess and collect payment, including levy contributions, from scheme members;

(iii) to liaise with the liquidator, provisional liquidator or other relevant persons for making arrangements including to settle insurance claims and pay compensation;

(iv) to facilitate transfer of business, including making necessary payments and establishing dedicated insurance company for the specific purpose of running-off business of an insolvent scheme member;

(v) to recover compensation paid out of the PPS from assets of the insolvent scheme members;

(vi) to maintain financial position of the PPS by investing funds, or borrowing money to meet any liquidity gap; and

(vii) to issue guidelines and make regulations for managing the PPS.

Commensurate general powers should also be granted to the PPS Board for flexibility and ease of operation.

7.22 The membership of the PPS should comprise representatives from the Government and the IA, as well as professionals with relevant expertise (e.g. insurance, actuarial science, finance, accounting, law, consumer affairs). Members of the PPS Board should be appointed by the Chief Executive.

Governance, investment guidance and confidentiality of PPS Board

7.23 To ensure accountability and transparency of the operation of the PPS Board, we recommend that the PPS Board must submit the annual budget of the PPS for approval by the FS, maintain proper accounts, and prepare annual reports and audited financial statements to be tabled before LegCo. The FS may appoint the Director of Audit to or an external auditor to perform audit reviews on the PPS.

7.24 The PPS Board should exercise a high level of prudence in investing the money of the PPS. In performing its investment functions, the PPS Board should make reference to the practices of other compensation funds (e.g. the Deposit Protection Scheme).

7.25 Given their access to sensitive commercial information on scheme members, PPS Board members and any other persons engaged in the operation of the PPS should be required to keep confidential any information obtained in the course of carrying out relevant functions. Disclosure of information would be subject to conditions prescribed in law.

Appeal Mechanism

7.26 A person aggrieved by a relevant decision made under the PPS should be able to apply for a review of the decision. An independent Policy Holders' Protection Appeals Tribunal should be set up to deal with appeals against relevant decisions of the PPS Board.

Way forward

7.27 With the benefits of having the views and suggestions of Respondents on the Consultation Paper, we will begin preparatory work on establishing a PPS to enhance protection of policy holders in the event of insurer insolvency. Our work will consist of formulation of detailed arrangements of the PPS and drafting of the necessary legislative amendments, coupled with further consultation with stakeholders on specific areas if necessary. We are mindful of the complexity of the PPS and that attention and resources of insurers are being deployed towards the upcoming implementation of an RBC regime in 2024, and aim to introduce a relevant bill into the LegCo afterwards. Following the passage of the bill, we envisage that the PPS will come into operation after allowing suitable time for insurers to implement the necessary system and operational changes, for the Government to set up the PPS Board and for the PPS Board to commence initial operation.

Annex

List of Respondents

Responses were received from the following Respondents, arranged in alphabetical order –

1. Actuarial Society of Hong Kong
2. Asia Insurance Company Limited
3. Consumer Council
4. FWD Life Insurance Company (Bermuda) Limited
5. Mr Chan
6. Mr Fung
7. Mr Ho
8. Mr Lam
9. Mr Lee
10. Mr Yu
11. The Hong Kong Federation of Insurers
12. The Law Society of Hong Kong
13. Zurich Insurance (Hong Kong)
14. Anonymous