

Proposed Establishment of an Independent Insurance Authority Consultation Conclusions on Key Legislative Proposals

Frequently Asked Questions

Q1 Why do we need an independent Insurance Authority (“IIA”)?

A1 The policy objectives of setting up the IIA are to modernize the insurance industry regulatory infrastructure to facilitate the stable development of the industry, provide better protection for policyholders, and align with international practice that financial regulators should be financially and operationally independent of the Government. This will help reinforce Hong Kong’s position as an international financial centre.

Q2 How many submissions have been received? Who are the respondents?

A2 We have received 558 written submissions from individuals and companies/organizations from the insurance industry, the legal sector, the banking sector, etc. Out of these submissions, 503 are copies of three templates of standard petitions. Counting all such duplicates as three submissions, there are in total 58 submissions. All submissions have been uploaded to the FSTB’s website (<http://www.fstb.gov.hk/fsb>).

Q3 What are the major issues raised in the last round of consultation?

A3 Public consultation on the proposed establishment of the IIA was first launched in July 2010. We announced the consultation conclusions and detailed proposals on 24 June 2011, and consulted the Legislative Council Panel on Financial Affairs on the aforesaid on 4 July 2011. There is general public support for the establishment of an IIA.

Based on the detailed proposals and views received from the industry, we prepared the key legislative proposals on establishing the IIA for a 3-month consultation from 26 October 2012 to 26 January 2013. Based on the views collected, the Administration is now finalising a bill to amend the Insurance Companies Ordinance (“ICO”) (Cap. 41) for establishing the IIA (“the amendment bill”). We have to emphasize that our engagement with the stakeholders will continue to ensure that the amendment bill will take into account their concerns and strike a reasonable balance between the interests of different stakeholders.

The major issues raised by the industry in the consultation on key legislation proposals include –

- (a) more industry participation in the Governing Board of the IIA while the IIA should remain impartial in performing its regulatory functions;
- (b) whether the categorization of licences for insurance intermediaries can be simplified;

- (c) concerns about the appointment of responsible officers (“ROs”) by authorized insurers and corporate licensees;
- (d) the ROs’ responsibilities to use “best endeavours” to promote conduct compliance by insurers or corporate licensees and their tied agents or employees concerned;
- (e) whether an insurance agent can comply with the conduct requirement of “acting in the best interest of policyholders” due to his contractual principal-agent relationship with appointing insurers;
- (f) the upper limit of disciplinary fines (i.e. the greater of \$10 million or three times the amount of the profit gained or loss avoided as a result of the misconduct) is too high;
- (g) objections to the specified suspension power, which is a stop gap measure to, in the interest of the public or policyholders, suspend a licensed insurance intermediary (or RO) from carrying on a regulated activity for a specified period of time; and
- (h) concerns about the regulatory arrangements for banks’ insurance intermediary activities.

Consumer interest groups point out that it is important to maintain the independence and impartiality of the IIA.

Q4 What are the major changes after considering the comments?

A4 We have all along strived to balance policyholder protection and facilitating market development and innovation. After considering the comments from the industry, we have made the following major changes to refine our proposals –

- (a) Functions of the IIA: We propose to add “promoting the competitiveness of the insurance industry in the global insurance market” as one of the functions of the IIA;
- (b) Governing Board: We propose that at least two directors (instead of no more than two as originally proposed) with knowledge of and experience in the insurance industry should be appointed to the IIA’s Governing Board;
- (c) Regulated activities: We propose to refine the legislative provisions to improve clarity on the activities to be exempted from the proposed licensing regime;
- (d) Appointment of ROs: We propose that, subject to the approval of the IIA, authorized insurers and corporate licensees should be allowed to appoint an additional RO. The two ROs appointed by the same insurer or corporate licensee will be jointly and severally responsible for fulfilling the statutory requirements on conduct compliance;
- (e) Conduct requirement for insurance intermediaries: To allay the concerns of the insurance agents, we propose to provide in the legislation that any contract term which contravenes the statutory “best interest” duty will be unenforceable; and
- (f) Specified suspension power: We decide not to pursue the introduction of this power. We will seek to enhance policyholder protection through other regulatory arrangements proposed for the IIA.

We believe that the refined proposals will help shape the proposed regulatory requirements such that they will be capable of effective enforcement by the IIA as well as compliance by the practitioners.

Q5 How will the IIA balance performing its functions impartially and tapping into industry expertise?

A5 There are calls from the industry for more participation in the Governing Board of the IIA so that the future regulator will be kept abreast of market development. Meanwhile, there are also calls from the consumer interest groups for the IIA to be, and to be seen to be, impartial for it to perform its regulatory functions without fear or favour.

We have refined our proposal to include on the Governing Board of the IIA no less than two directors (instead of no more than two directors as originally proposed) with knowledge of and experience in the insurance industry.

Insurers and insurance intermediaries will also be represented on the Industry Advisory Committees (one on life insurance and the other on general insurance) set up to advise the IIA. They will also be brought in by the IIA as members of an Expert Panel to advise the IIA on market practices for making disciplinary decisions.

Q6 What does conduct requirement of “acting in the best interest of policyholders” mean?

A6 Our policy objective of the proposed requirement is that an insurance intermediary should have regard to a policyholder’s interest before his own interest in carrying out regulated activities, and when a conflict of interest arises, the insurance intermediary should disclose such a conflict to the policyholders so that the policyholder can make an informed decision. An insurance agent should also prioritise his client’s interest over the interest of his appointing insurer in case there is any conflict.

In fact, the “acting in the client’s best interest” requirement is an internationally-endorsed principle in recent reviews of regulation of insurance intermediaries in overseas jurisdictions. For example, the European Union’s Insurance Mediation Directive II has also included the “acting in client’s best interest” requirement. In addition, the same requirement has been adopted in the regulatory regime for Mandatory Provident Fund (“MPF”) intermediaries.

After considering the comments received, we propose to provide in the legislation that any contract term which contravenes the statutory “best interest” duty will be unenforceable. This will relieve insurance agents from any potential challenge from their insurers that may arise from their contractual obligation if they put clients’ interest ahead of their appointing insurers’ interest. In addition, we propose to require the IIA to issue a guideline to help insurance intermediaries understand and comply with the requirement.

Q7 Why can't IIA regulate banks insurance intermediary activities?

A7 We have proposed that, subject to the approval of the Chief Executive in Council, the IIA will delegate its powers of inspection and investigation to the Hong Kong Monetary Authority ("HKMA") for the purpose of regulating any regulated activity carried out by a bank and licensed insurance intermediary engaged by it. That said, the IIA will be the lead regulator for the insurance industry, and responsible for setting the regulatory standards and determine all disciplinary sanctions, both for bank and non-bank insurance intermediaries.

Balancing concerns from the industry about any potential regulatory inconsistency against the need to minimise regulatory duplication, we consider that the proposed regulatory arrangement is appropriate given HKMA's role as the primary and lead regulator of banks. However, we are mindful of the need for the financial regulators to maintain close liaison and coordination to ensure effective regulation and minimise any regulatory overlap/underlap and consistency in their regulatory outcome for policyholder protection and prudential risk management.

Q8 Why is it necessary to have an RO? Who are they? What are their responsibilities?

A8 We have proposed a requirement that each and every corporate licensee (i.e. a licensed insurance agency or a licensed insurance broker company) and authorized insurer should appoint an RO. An insurer's Chief Executive Officer ("CEO") will become the RO of the insurer. This is only to preserve the statutory responsibilities of the CEO of an insurer under the existing Insurance Companies Ordinance that the CEO is responsible for the conduct of the whole of the insurer's insurance business. Existing ROs of insurance agencies and chief executives of insurance broker firms already registered with the self-regulatory organizations would be deemed to be ROs for three years after the inception of the IIA, and any subsequent RO appointments would be subject to the IIA's approval.

An RO, who will be statutorily required to be given sufficient resources and authority by the relevant corporate licensee or insurer, will have the responsibility to use his best endeavours to ensure effective internal controls and procedures to secure conduct compliance by his company as well as its tied agents or employees.

Insurers have expressed concerns that if an insurer's CEO is to become an RO, he may be overburdened and should be allowed to delegate such duties to another senior executive for operational considerations. On the other hand, there are views that the RO must be sufficiently senior to forestall the appointment of a junior executive as a scapegoat. On balance, we propose to allow the appointment of an additional RO, subject to the IIA's approval. This flexibility will also be extended to the corporate licensees. The two ROs will be jointly and severally responsible for fulfilling the statutory requirements on conduct compliance.

The industry has also suggested that it is too onerous to require ROs to use their “best endeavours” to fulfil their statutory responsibilities. They have suggested that “reasonable endeavours” should be a more appropriate standard. We recognize that “best endeavours” is a high standard. Nevertheless, we note that as established by case law, the standard of reasonableness has been introduced into the interpretation of “best endeavours”. This standard has been adopted for ROs under the statutory regime for regulating MPF intermediaries. We consider it inappropriate to adopt a lower standard for ROs for the insurance intermediaries and insurers. In fact, most of the MPF intermediaries are also insurance intermediaries.

After reviewing the practice of other regulators, we propose that the future IIA should be required to promulgate guidelines to set out examples of actions that are expected to be taken by ROs. This would assist ROs in discharging their statutory duties. The actions required to be taken by an RO may include, among other things, documenting internal policies regarding conduct compliance, providing regular training to employees to promote conduct compliance, conducting regular internal assessment of conduct compliance and authorizing officers or an internal committee to escalate conduct issues to the senior management.

Q9 What are the proposed disciplinary sanctions? Are they fair?

Q9 Disciplinary sanctions are civil, not criminal. We have proposed to empower the IIA to impose a range of disciplinary sanctions proportionate to the nature and severity of misconduct (viz. reprimand, fines, suspension of a licence, revocation of licence and prohibition of licence application within a specified period).

The industry has expressed concern about the proposed upper limit of the disciplinary fines. The upper limit 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. This is comparable to the disciplinary sanctions under the regulatory regimes for intermediaries regulated by the Mandatory Provident Fund Schemes Authority and the Securities and Futures Commission, and seeks to ensure that the sanction is proportionate to the nature of the misconduct and has adequate deterrent effect. We note that insurance intermediaries range from individual agents to banks and international insurance brokerage companies. Our proposed upper limit is appropriate to maintain an adequate deterrent effect.

Under our proposal, the IIA has to publish a guideline before it may impose any financial penalty. Drawing reference from the practices of other financial regulators, the guiding principles in determining a pecuniary penalty will include proportionality to the severity of the misconduct, whether the licensee has made financial gains, and that the penalty should not put the licensee into financial jeopardy.

We have proposed safeguards in respect of the exercise of disciplinary powers by the IIA. In considering a disciplinary case, the IIA may seek advice from

an Expert Panel, which will comprise members from the industry, on specific product nature and industry practices. Also, the IIA cannot exercise any disciplinary power on a regulated person without first giving him an opportunity to be heard. Any person who is aggrieved by the IIA's disciplinary decision may appeal to the Insurance Appeals Tribunal ("IAT") which may confirm, vary or set aside the decision or remit the matter to the regulator with directions as appropriate. The IAT will be chaired by a person eligible for appointment as a High Court judge and draw members from the industry. Our intent is that each appeal hearing will be heard by the IAT Chairman with the assistance of market practitioners.

Q10 What are the roles of Self-regulatory Organizations ("SROs") after the IIA's inception?

A10 The registration, supervisory, investigative and disciplinary functions of the SROs will be transferred to the IIA on its establishment. We believe the SROs can still perform a very important function by representing the interests and views of the insurance intermediaries, and developing training programmes for the intermediaries and promoting professionalism and best practice in the insurance industry.

Q11 What are the proposals on transitional arrangements for insurance intermediaries?

A11 We have proposed that all pre-existing insurance intermediaries and their ROs (including chief executives for insurance broker companies) validly registered with the SROs before the IIA's establishment will be deemed as licensees and their ROs under the new regime for three years starting from the date of the commencement of the legislative amendments.

We have also proposed that pre-IIA complaints and disciplinary cases which remain unresolved upon the inception of the IIA should be followed up by the IIA, with reference to the pre-IIA standards and circumstances at the time of the occurrence of the event as far as practicable.

The industry generally supports the proposed arrangements but some suggest that the IIA should take up applications and notifications not yet finished by the SROs. We consider our proposal reasonable, having regard to operational efficiency and the details of the transitional arrangements. Nevertheless, after considering some suggestions to secure a smooth transition, we propose to specifically provide in the amendment bill that –

- (a) the SROs should assist the Office of the Commissioner of Insurance and the IIA to compile the relevant records of current registration as well as existing and outstanding complaints and disciplinary cases; and
- (b) the transfer of personal data for assisting the transitional arrangements will not breach the Personal Data (Privacy) Ordinance ("PDPO") (Cap. 486).

Q12 Why is there a levy on policy premiums?

A12 The IIA should have stable sources of income and be financially independent of the Government. Given that one of the main objectives of the IIA is to protect policyholders, it is justified to recover its cost partly by collecting a levy on insurance premiums. The IIA's other sources of income are licence fees paid by insurance intermediaries, authorization fees paid by insurers, and service fees charged for use of the IIA's service.

Levy on insurance premiums is more transparent as the levy rate will be set out clearly in every insurance policy. If the levy is payable by the insurers, it is likely that the cost would be passed on to policyholders as a higher premium.

Q13 What is the next step?

Q13 Our plan is to introduce an Insurance Companies (Amendment) Bill into the Legislative Council by end 2013 with a view to establishing the IIA in 2015.

We will continue our dialogues with the stakeholders, including insurance practitioners, to ensure that the Amendment Bill will strike a reasonable balance between protecting policyholders and facilitating market innovation and sustainable development. We believe that the engagement efforts will help shape the proposed regulatory requirements such that they will be capable of effective enforcement by the IIA as well as compliance by the practitioners.

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