

Proposed Establishment of a Policyholders' Protection Fund
List of Submissions

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1	Liberty International Insurance Ltd.
2	MSIG Insurance (Hong Kong) Limited
3	Zurich Insurance Company Limited
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6	Hong Kong Society of Certified Insurance Practitioner (HKCIP)
7-21	Same submission from: Hong Kong Confederation of Insurance Brokers (HKCIB) Expat Services Limited Lockton Companies (Hong Kong) Ltd Jane Poon and Company Limited Nova Insurance Consultants Limited International Reinsurance Management Limited (IRM) Willis Hong Kong Limited Altruist Financial Group Limited Aon Hong Kong Limited Financial Partners Ltd. Lambert Brothers Insurance Brokers (Employee Benefits) Ltd. Accette Insurance Brokers (HK) Ltd Pacific World (Asia) Limited Bartlett Asia Limited Father Financial Planning Services Limited
22	Dah Sing Insurance Company Limited
23-24	Same submission from: Motor Insurer's Bureau of Hong Kong (MIB) Employees Compensation Insurer Insolvency Bureau (ECIIB)
25	Compagnie Francaise D'assurance pour le Commerce Extérieur - Hong Kong Branch (Coface Hong Kong Branch)
26	Lee Wing Ka
27	民主黨
28	The Hong Kong General Insurance Agents Association Ltd (HKGIAA)
29	Hong Kong Chamber of Insurance Intermediaries (HKCII)
30	Hong Kong Insurance Practitioners General Union (HKIPGU) 香港保險業總工會
31	Economic Synergy

Encl. No.	Respondents
	經濟動力
32	Institute of Financial Planners of Hong Kong (IFPHK)
33	Lloyd's International Regulatory Affairs
34	Ho Tak On
35	American International Assurance Company, Limited (AIA) and American International Assurance Company (Bermuda) Limited (AIAB)
36	Liberty Mutual Insurance Europe Limited – Hong Kong Branch (Liberty International Underwriters)
37	The Life Underwriters Association of Hong Kong Limited (LUAHK) 香港人壽保險從業員協會
38	Ernst & Young
39	General Agents and Managers Association of Hong Kong Limited (GAMAHK) 香港人壽保險經理協會
40	Hang Seng General Insurance (Hong Kong) Company Limited
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47	Hong Kong Institute of Certified Public Accountants (CPA)
48	The Hong Kong Federation of Insurers (HKFI)
49	中西區區議會文化康樂及社會事務委員會



Liberty
InternationalTM
Member of Liberty Mutual Group

Encl. 1

11th April 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir/Madam,

Re: Proposed Establishment of a Policyholders' Protection Fund Consultation Paper

We refer to your recent communication on this subject to our HKFI.

Whilst we wish such a fund was not necessary, it is clearly in the Industry's interest to support its creation. The Financial Tsunami and the Anglo-Starlite fiasco are strong reasons to do so.

Whilst Liberty has a composite licence, we will only comment on this consultation paper from a Non-Life perspective.

Coverage

(c) We strongly suggest that this PPF only focus on individual policyholders.

SME policyholders, as businesses, nearly always place their insurance protection through insurance intermediaries. It is the responsibility of these registered professionals that they only place their clients accounts with Non-Life Insurance Companies who are able to meet their future financial obligations.

Sure, there is no certainty in this, but we do not want our registered intermediaries to ignore this important selection process and only to place with the cheapest insurer, knowing that there is a high level of recovery if they collapse.

Beside this, it will be difficult in deciding which SME qualifies and costly to set the administrative systems to support.



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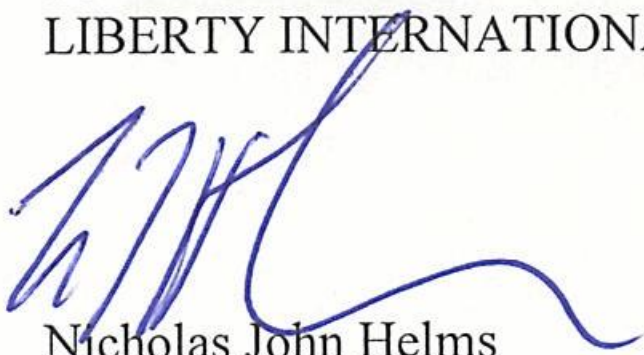
Level of Compensation

- (d) To a lesser degree, individual policyholders should also shoulder a responsibility as to who they place their business with.

We therefore suggest they should suffer some financial loss if their Insurer collapses and suggest an 80% claim repayment from bottom up.

- (g) We do not really understand why such a high amount is set in the policy transfer process?

Yours faithfully,
For and on behalf of
LIBERTY INTERNATIONAL INSURANCE LIMITED



Nicholas John Helms
President

11th April 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sirs,

Re: Proposed Establishment of a Policyholders' Protection Fund Consultation Paper

We refer to your recent communication relating to the above with the HKFI.

As a well capitalized, conservative and prudent underwriter we are not totally in favour of the implementation of a Policyholders Protection Fund (PPF). However we understand it is in the Industry's interest to support the introduction of this fund.

We would like to comment further as follows:

1. We would prefer that the PPF focus on individual policyholders.

Most SME's place their business through Brokers or other registered intermediaries and it is the duty of the appointment that these intermediaries make recommendations that best protect policyholder's interests by placing policies with Insurance companies who are considered financially sound.

Furthermore if SME's are to be included there needs to be a clear definition in the PPF. It should also be noted that it is very difficult for General Insurers to extract information on SME's from their systems in order to pay the levy. The information obtained by underwriters does not always provide the number of employees in a company to be insured or the turnover of the company. The definition of the SME's therefore needs to be clear and simple in order for General Insurers to remit payment to the PPF.

2. We would like further clarification on why the PPF will be required to provide 'continuity of coverage until expiry of the policies'.



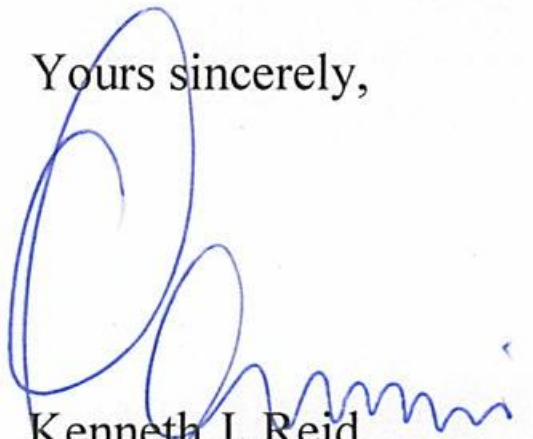
We appreciate there would be a burden of additional costs to a policyholder following any liquidation. However in the early stages of the PPF this may bring added pressure on the fund to meet financial obligations to policyholders. This means the PPF is acting as the Insurer for the un-expired portion of any policy issued by the liquidated company. Would it not be better for policyholders to be encouraged to affect a new policy with another reputable insurer.

3. We are comfortable with the proposed rate of the levy.

However as a company who insure many SME's we are not clear on the definition of SME's for the purpose of the PPF and therefore the financial burden upon our company is unknown if we are to pay a levy on behalf of policyholders. The provision to impose a 'Stepped up' levy rate as necessary upon the insolvency of an insurer also gives us some cause for concern if the levy is increased to a level that may become a serious burden. In this instance any increase in the levy may necessitate an increase in rates to policyholders.

I trust these comments are of assistance.

Yours sincerely,



Kenneth J. Reid
Chief Executive Officer

KR/ct



Special Duty Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F., Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Your reference

Our reference

Date

LC/JL
6 May 2011

Re : Submissions on Proposed Policyholders' Protection Fund

Dear Sir,

In response to your invitation for comments on the subject Policyholders' Protection Fund, we enclose our comments for your consideration.

As a general insurance provider, it is alarming that the proposed Fund will cover a rather large extent of general insurance products. We therefore strongly suggest you to re-consider the proposed coverage of the types of products that will fall under the ambit of the Fund.

If you have any question concerning our attached comments, please do not hesitate to contact us. We look forward to hearing from you soon.

Yours faithfully
For and on behalf of
Zurich Insurance Company Limited

A handwritten signature in black ink, appearing to be 'Allan Yu', written over a light blue horizontal band.

Allan Yu
Director, General Business

Encl.

cc. The Hong Kong Federation of Insurers
(By fax only :)

**Submissions on Proposed Policyholders' Protection Fund
by Zurich Insurance Company**

1. Need to limit the types of personal insurance products

The proposed PPF intends to focus on individual policyholders against Life and Non-life Schemes. Due to the vast varieties of general insurance products, the Non-life Scheme should protect only specific types of personal insurance products and not all classes of general insurance business as defined in the Insurance Companies Ordinance (Cap.41). For example, not all types of general insurance products would normally be taken out by individuals, eg. aircraft, ships, credit and financial loss. If the PPF is aimed to protect policyholders against personal insurance, it should be restricted to protect individual policyholders of insurance products such as accident, sickness, travel and home contents.

2. SME should be excluded

Despite the attaching of a definition on SME, it is in practice, extremely difficult to monitor each SME's internal changes through time. The size of a company varies as it develops, and a SME may no longer be a SME (within the present definition) at the time a claim arises. Moreover, large corporations may still establish SME as service companies and such so-called SME are strictly speaking, not SME. Therefore, the number of employees of a SME may not reflect the genuine size of the company.

3. OC Policyholders should be excluded

If PPF is intended to protect individuals, an owners' corporation should not be included. Similar to employees' compensation and motor insurance, owners' corporation insurance is mandatory by law. It is a third party liability insurance and protection should not be subjected to a limit. Should protection be offered to owners' corporation, such protection should adopt the schemes established for statutory insurance, eg. MIB and ECIIB.

4. Initial Fund

The Consultation Paper suggests 15 years to establish an initial funding of HK\$75 M. What is the rationale behind a period of 15 years? Similarly, what is the rationale for fixing a levy at 0.07%?

31 May 2011

Special Duties Division,
Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sirs,

**Proposed Establishment of
Policyholders Protection Fund
Consultation Paper**

I refer to the above and enclose my detailed comments.

I am writing in an individual capacity and my comments cannot therefore be construed as coming from my company or any professional body of which I am a member. Consequently, I request expressly that my name and affiliations are **not** disclosed nor is the content of this letter as I can be identified from this. As stated, I am writing in a personal capacity so I would add that my experience is unique making me well qualified to speak on this subject.

(來信人要求不具名，以及不公開其意見)



Special Duty Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F., Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Your reference

Our reference

Date

LG/LC
7th June 2011

Re : Submissions on Proposed Policyholders' Protection Fund

Dear Sir,

In response to your invitation for comments on the subject Policyholders' Protection Fund, we would like to advance our opinion as follows.

As a life insurance company incorporated in Isle of Man, our policies issued in Hong Kong already covered by the Isle of Man Life Assurance Compensation of Policyholders Regulations 1991. We trust that this regulation should give sufficient protection to the policyholders. It is therefore suggest that life policies which are covered by any policyholder protection scheme in other jurisdiction should be exempted from the Proposed Policyholders' Protection Fund to be implemented in Hong Kong. Alternatively, we opine that at least the Fund should only cover policyholders resident in Hong Kong and should not covered any Isle of Man or overseas policyholders.

With similar thoughts, for any levies or fees collected for the Fund, it should also be related to the size of the premium of the policies issued by Hong Kong branch only and should not be covering the whole company.

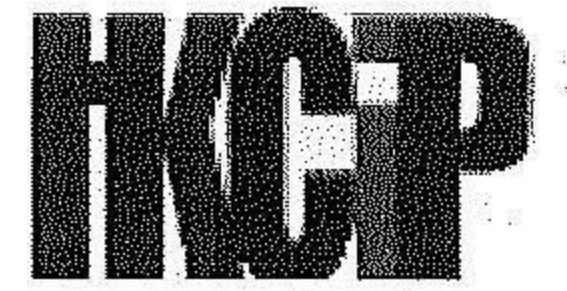
If you have any question on the above comments, please do not hesitate to contact us.

We look forward to hearing from you soon.

Yours faithfully
For and on behalf of
Zurich International Life Limited


Andy Robinson
Regional Director, Asia

c.c. Hong Kong Federation of Insurers.



香港保險師公會

THE HONG KONG SOCIETY OF CERTIFIED INSURANCE PRACTITIONERS

To : Special Duties Division, Financial Services Branch,
Financial Services and the Treasury Bureau,
18/F, Tower 1,
Admiralty Centre,
18 Harcourt Road,
Hong Kong.

Dear Sir / Madam,

Proposed Establishment of a Policyholders' Protection Fund (PPF)

Introduction

We, the Hong Kong Society of Certified Insurance Practitioners, are a professional body formed over 10 years ago for the promotion and enhancement of professionalism in the insurance industry of Hong Kong. All of our members are professionally qualified insurance practitioners. Currently we have about 200 members.

Views

Our views on the proposal are as follows.

Executive Summary

We are in general support of the proposal to set up the PPF which aims, among other things, to better protect policyholders' interest and enhance public confidence in the insurance industry. We have the following specific comments on the particulars of the proposed scheme.

1. *Level of Compensation and the Application*

- (a) We consider that the limit of compensation up to a total of HKD 1 million is low, particularly in respect of retirement and statutory liability insurance businesses.
- (b) For non-life insurance policies, we have reservations on the proposal to provide for continuity of coverage until expiry of the policies as such will increase the burden, both financially and otherwise, of the PPF...
- (c) We have reservations on the proposal to pay an “ex-gratia” payment for the premature termination of life insurance policies and for facilitation of the transfer of accident and health policies with guaranteed renewability as such seem amounting to superfluous benefits which are difficult to quantify.

2. *Funding Mechanism*

- (d) We have reservation on the proposal for an option to impose a “stepped-up” levy rate as necessary as such would create uncertainty to both the insurers and policyholders.
- (e) A uniform flat rate of 0.07% for both life and non-life policies seems unfair to those policies with a higher amount of sum insured as they are subject to the same compensation limit of HKD 1 million.

3. *Governance Arrangement*

- (f) We suggest that the powers of the independent PPF Board be extended to include the approval of the set-up and expenditure of the statutory body for the administration of the PPF.

*Specific Comments**1. Level of Compensation and the Application*

1.1 We consider that the limit of compensation up to a total of HKD 1 million is too low to provide adequate support to policyholders of some classes of business including retirement and liability insurance businesses (particularly statutory liability insurance businesses other than motor and employees compensation) which normally have an insured amount of much higher than HKD 1 million. The compensation provided by the current two schemes in respect of statutory motor and employees compensation insurance businesses is unlimited. Policyholders under other statutory classes, for example, Building Owners Corporation and marine liabilities will find the limit seriously inadequate to protect their potential liabilities under statute, not to mention those exceeding the statutory requirements. Such policyholders are not put on par with those under the two current schemes. The PPF, as well as the insurance industry, will be under serious attack if innocent victims do not have their judgments met by those statutory insurance policies.

1.2 For non-life insurance policies, we have reservation on the proposal to provide for the continuity of coverage until expiry of the policies. This is a duty of the Liquidator and not the Insolvency Fund, although it has been common practice for the Liquidator to cancel those in-force policies in order to avoid incurring unforeseen liabilities and taking on substantial administrative burden. Providing for the continuity of coverage effectively means the PPF assuming the position of an insurer, thus involving extensive workload on policy administration and therefore cost. It is more convenient and less cumbersome for the PPF to focus on meeting claims prior to the insolvency of the insurer, allowing the policyholders to purchase alternative cover from the market. The policyholders should then be in a better and secured position to protect their liabilities exceeding HKD 1 million.

1.3 We understand the reasons behind the proposal to pay an “ex-gratia” payment for the premature termination of life insurance policies and for facilitation of the transfer of accident and health policies with guaranteed renewability. We have reservation on this proposal as, apart from the difficulties in quantifying the amount of such payments, other policyholders with similar loss of continuity of cover will be prejudiced. This aspect of loss (which should not be significant) by the two proposed classes of policyholders should be borne by them as part of their duty to minimize moral hazard in the selection of insurers.

2. *Funding Mechanism*

2.1 We have reservation on the proposal to impose a “stepped-up” levy rate after the occurrence of an insurer insolvency as such will create uncertainty to both the insurers and policyholders. This also adds administrative burden, and therefore costs, to the PPF and the industry. We note that the PPF will be empowered to bridge any liquidity gap from borrowing from a third party or even from the Government. We also note that there is a queuing system under the two current schemes for motor and employees compensation.

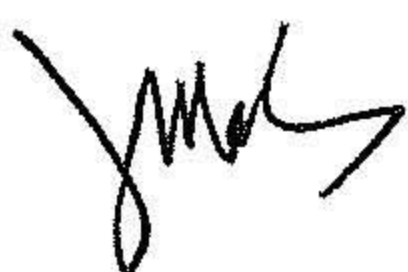
2.2 A uniform flat rate of 0.07% for both life and non-life policies seems unfair to those policies with a higher amount of sum insured. Such policyholders will be similarly subject to the same compensation limit of HKD 1 million although they will be making a higher amount of contribution to the PPF.

3. *Governance Arrangements*

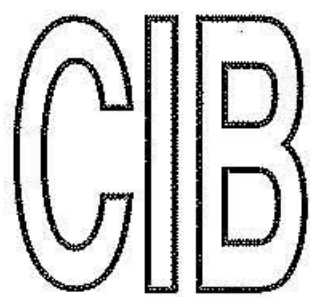
3.1 We agree that the operations of the PPF should be subject to a high level of transparency and accountability. We suggest that the functions and powers of the independent PPF Board be extended to include the approval of the set-up and expenditure of the statutory body administering the PPF. This should ensure a more effective use of public monies.

Finally we are of the view that it is important for the Government to keep a close dialogue with the industry on this issue before finalizing the details of the Scheme. We are always happy to provide feedbacks as and when invited.

Yours faithfully,



Tony Mak
President



香港保險顧問聯會

THE HONG KONG CONFEDERATION
OF INSURANCE BROKERS

Encl. 7

私人密件 PRIVATE & CONFIDENTIAL

Our Ref: LM1106118/jc

16 June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

**RE : RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND (PPF)
FROM THE HONG KONG CONFEDERATION OF INSURANCE BROKERS (CIB)**

We have pleasure in enclosing our formal Response Paper setting out comments and considerations on the proposal.

This Response Paper is submitted on behalf of the 255 corporate Members of CIB who between them have some 4,100 professional insurance broking practitioners.

CIB will be happy to provide any further clarification or advice on issues which you may find useful.

Yours sincerely,
Hong Kong Confederation of Insurance Brokers

Ronald Lai
Chairman

Encl : 3 copies

c.c. Office of the Commissioner of Insurance – Ms. Annie Choi, JP (1 copy)

**RESPONSE BY THE HONG KONG CONFEDERATION OF INSURANCE BROKERS
TO THE CONSULTATION PAPER ON THE
PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND**

The Respondent

The Hong Kong Confederation of Insurance Brokers (CIB) is a Self Regulatory Organisation (SRO) authorised by the Insurance Authority (IA) to regulate its insurance broker Members. CIB has 255 Corporate Members with 4,100 professional practitioners (registered Chief Executives and Technical Representatives). CIB was formed in 1993 and authorised by the IA in 1995.

Introduction

CIB is in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from who they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, CIB has concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. CIB sees the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

CIB sees a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. CIB draws a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIBB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
- 1.8 The PPF is to cover policies "written" in Hong Kong. "Written in Hong Kong" and "Issued in Hong Kong" sometimes mean the same thing and sometimes mean different things, depending on the insurance company which uses these terms. There is a need to clearly spell out the difference between "written in Hong Kong" and "issued in Hong Kong", and how the PPF is applied to the subsequent definitions.

2. Funding and Basis of Levy

The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.
- 2.2 CIB believes in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

- 2.3 If the levy is to be charged “across the board”, CIB sees potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
- 2.4 The PPF is with an insurer levy model, while both ECIB and MIB adopt the policy levy model. There may be a repercussion on ECIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.
- 2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.
- 3. No Substitute for Solvency**
It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.
- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.
- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
- 3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.
- 3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).
- 3.4.1 Internal discussions within the IAIS (International Association of Insurance Supervisors) are being held to determine if Solvency II or RBC will be promulgated by this body as the gold standard for the IMF to judge insurance companies by. This could well be introduced in the short to medium term.
- 3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.
- 4. Insurance Company Insolvencies**
Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.

4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

5. Structure of the Fund

The draft proposals for PPF in the Consultation Paper provide for “the Fund” to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.

5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.

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Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIIIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.

6.2 MIB and ECIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

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We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

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The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

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should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

- 8.2 We have commented previously on the inadequacy of PPF relative to the death benefit levels required to support a family and the proposed limit provides only a token compensation and not a meaningful contribution. In the event of a life company insolvency, we can envisage public outrage and heavy criticism of HKSARG for allowing the collapse to happen and providing only token compensation along the lines of the public demonstrations over the Lehman Brothers Mini Bonds unless a more meaningful level of compensation is provided.
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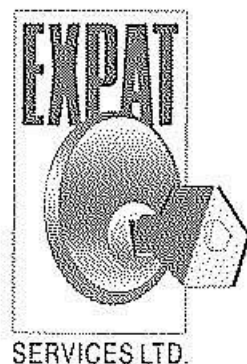
Conclusions

1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

Consultation on Policy Holders Protection Fund

4. It is considered that the proposal to levy insurers across their whole account rather than a "user pays policy levy" may have a seriously detrimental effect on the Hong Kong insurance market by virtue of certain classes of business to be written offshore and therefore not appear as levyable Hong Kong premium income.
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11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?

The Hong Kong Confederation of Insurance Brokers
June 2011



PETER McTAVISH-Insurance Broker

Encl. 8

17th June, 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

RE: REPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND

We attach hereto our views and comments in response to the captioned consultation.

Yours sincerely,
Expatriate Services Limited

Peter McTavish

Encl: Response to Consultation

c.c. The Hong Kong Confederation of Insurance Brokers



Member

The Hong Kong Confederation of Insurance Brokers

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from who they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIBB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
- 1.8 The PPF is to cover policies "written" in Hong Kong. "Written in Hong Kong" and "Issued in Hong Kong" sometimes mean the same thing and sometimes mean different things, depending on the insurance company which uses these terms. There is a need to clearly spell out the difference between "written in Hong Kong" and "issued in Hong Kong", and how the PPF is applied to the subsequent definitions.

2. Funding and Basis of Levy

The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.
- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

- 2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
- 2.4 The PPF is with an insurer levy model, while both ECIB and MIB adopt the policy levy model. There may be a repercussion on ECIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.
- 2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.
- 3. No Substitute for Solvency**
It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.
- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.
- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
- 3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.
- 3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).
- 3.4.1 Internal discussions within the IAIS (International Association of Insurance Supervisors) are being held to determine if Solvency II or RBC will be promulgated by this body as the gold standard for the IMF to judge insurance companies by. This could well be introduced in the short to medium term.
- 3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.
- 4. Insurance Company Insolvencies**
Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.

4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

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The draft proposals for PPF in the Consultation Paper provide for "the Fund" to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.

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By Post

20 June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

**RE : RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND**

We attach hereto our views and comments in response to the captioned consultation.

Yours Sincerely,

A handwritten signature in black ink, appearing to read "Iain Finch".

Iain Finch
Chief Operating Officer

Encl: Response to Consultation

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We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from who they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

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C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIIB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
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- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

- 2.3 If the levy is to be charged “across the board”, we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
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- 2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.
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It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.
- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.
- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
- 3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.
- 3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).
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- 3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.
- 4. Insurance Company Insolvencies**
Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

- 4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.
- 4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

5. Structure of the Fund

The draft proposals for PPF in the Consultation Paper provide for “the Fund” to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

- 5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.
- 5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.
- 5.3 We recommend that rather than defining what a claim basis for payment should be under the PPF, all claims should be settled as per the claim definition in the original policy.
- 5.4 We are concerned that PPF seems to be proposed to take over part of the normal responsibilities of a liquidator. We believe that the normal liquidation process should be followed with the PPF simply left to pay whatever is the PPF contribution to any claim as presented to it by the liquidator. We propose that a practical study should be made by FSTB to ascertain the responsibilities and working mechanisms as applicable under the Anglo Starlite receivership of the liquidators and MIB to establish a role model.

6. Asset Recovery Mechanism

Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

- 6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.

6.2 MIB and ECIIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

6.3 It is noted that in the examples of claims set out in the Consultation Paper that policyholders have the right to pursue recovery of any balance not paid by PPF from the remaining assets of the insolvent insurer. If the PPF is given equal preferential creditor status as are the aggrieved policyholders, then policyholder recovery of their remaining loss beyond the PPF payment limit will only rank with the PPF's right to recover the amount paid to policyholders in discharge of the purpose of the fund. As such these statements of the ability of the policyholders to recover the excess amount are seriously misleading and will enrage the public when they realise that they cannot in fact recover because the PPF having handed out with its right hand is taking that payment back from the insurer's residual assets with its left hand which undermines the purpose of the PPF and negates the concept of only low limits of compensation.

7. Limit under the Fund

We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principal is recognised under the MIB structure where liability claims are paid in full.

7.2 We believe special consideration needs to be given to the issue of compulsory insurance for building owners' incorporations (or ship-owners as well) where for good reasons a limit of HK\$10 million has been mandated. While we have been told that an amount of HK\$1m would cover 84% of all such claims incurred over the past ten years, it is the higher ones where relief is needed and both the public and the owners need to be protected. Again, the MIB principle should apply.

7.3 Life policies intended to provide family protection in the event of the death of the breadwinner will fall far short of the necessary family support benefit if the limit of HK\$1 million applies.

8. Continuation or Transfer

The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

8.1 In the case of continuation, the PPF would effectively act as an insurance company with all the attendant liabilities but with no premium income. We believe it is unrealistic for the Fund to assume such ongoing liability for the balance of the period which could be up to a year in the case of non-life policies. We believe that cover

should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

- 8.2 We have commented previously on the inadequacy of PPF relative to the death benefit levels required to support a family and the proposed limit provides only a token compensation and not a meaningful contribution. In the event of a life company insolvency, we can envisage public outrage and heavy criticism of HKSARG for allowing the collapse to happen and providing only token compensation along the lines of the public demonstrations over the Lehman Brothers Mini Bonds unless a more meaningful level of compensation is provided.
- 8.3 We believe that only a transfer or re-write of life policies with all "transfer" costs met by the PPF will satisfy the problem described above but this leaves the serious issue of a policyholder whose health has become seriously impaired in the period since the policy was written so as to become unacceptable to a new insurer and thus uninsurable. We believe a higher benefit should be provided to these deserving cases.
- 8.4 The same problem arises with medical benefits policies which provide coverage for pre-existing conditions. Particularly where a policyholder has developed a serious medical condition in the meantime, a new insurer will normally exclude all pre-existing conditions leaving the policyholder unprotected thereafter in respect of that newly developed medical condition, coverage for which was the intention for purchasing the first policy.
- 8.5 The most satisfactory resolution to these issues would be to task the PPF with arranging a full portfolio transfer to another insurer or pool of insurers who would take the "good with the bad".

Conclusions

1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

4. It is considered that the proposal to levy insurers across their whole account rather than a "user pays policy levy" may have a seriously detrimental effect on the Hong Kong insurance market by virtue of certain classes of business to be written offshore and therefore not appear as levyable Hong Kong premium income.
5. The ranking of PPF as a preferred creditor of the insolvent insurance company's assets runs counter to the general procedure of liquidations under Hong Kong law and places proven successful institutions such as MIB in a disadvantaged status undermining their ability to fund such successful rescue operations in the future as they have done in the past. It is also noted that "benefits" to policyholders include the right to recovery against the insolvent insurer but as they rank only at the same "preferred creditor" level as the PPF, any meaningful recovery is unlikely.
6. It is desirable that levels of supervision of insurance companies with provision for active intervention be introduced and that the outcome of IAIS deliberations on adoption of solvency standards under RBC or Solvency II be incorporated in this process.
7. In the light of past experience with ECAS, it is critical that the PPF organisation has the authority to challenge and to defend claims, particularly liability claims where litigation may be required.
8. We recommend that PPF should not have any preferential creditor status and that it should not usurp any of the role of the liquidators.
9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?

By Post

20 June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

**RE : RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND**

We attach hereto our views and comments in response to the captioned consultation.

Yours Sincerely,

For and on behalf of
JANE POON & COMPANY LIMITED

.....
Authorized Signatory

Encl: Response to Consultation

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The draft proposals for PPF in the Consultation Paper provide for “the Fund” to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.

5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.

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6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.

6.2 MIB and ECIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

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We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principal is recognised under the MIB structure where liability claims are paid in full.

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should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

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- 1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
- 2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
- 3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

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7. In the light of past experience with ECAS, it is critical that the PPF organisation has the authority to challenge and to defend claims, particularly liability claims where litigation may be required.
8. We recommend that PPF should not have any preferential creditor status and that it should not usurp any of the role of the liquidators.
9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
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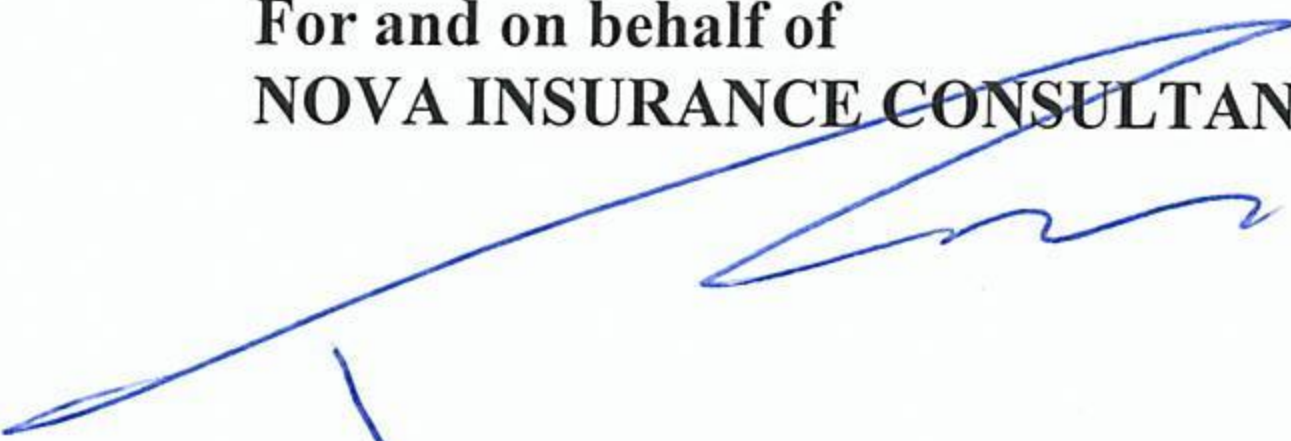
Special Duties Division, Financial Services Branch
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18/F Tower 1
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Hong Kong

Dear Sir

**RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND**

We attach hereto our views and comments in response to the captioned consultation.

Yours faithfully
**For and on behalf of
NOVA INSURANCE CONSULTANTS LIMITED**



Patrick Chan
Director and Chief Executive

Encl.

cc: HKCIB (By facsimile:)

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from whom they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIIB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
- 1.8 The PPF is to cover policies "written" in Hong Kong. "Written in Hong Kong" and "Issued in Hong Kong" sometimes mean the same thing and sometimes mean different things, depending on the insurance company which uses these terms. There is a need to clearly spell out the difference between "written in Hong Kong" and "issued in Hong Kong", and how the PPF is applied to the subsequent definitions.

2. Funding and Basis of Levy

The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.
- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.

2.4 The PPF is with an insurer levy model, while both ECIB and MIB adopt the policy levy model. There may be a repercussion on ECIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.

2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.

3. **No Substitute for Solvency**

It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.

3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.

3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.

3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.

3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).

3.4.1 Internal discussions within the IAIS (International Association of Insurance Supervisors) are being held to determine if Solvency II or RBC will be promulgated by this body as the gold standard for the IMF to judge insurance companies by. This could well be introduced in the short to medium term.

3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.

4. **Insurance Company Insolvencies**

Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.

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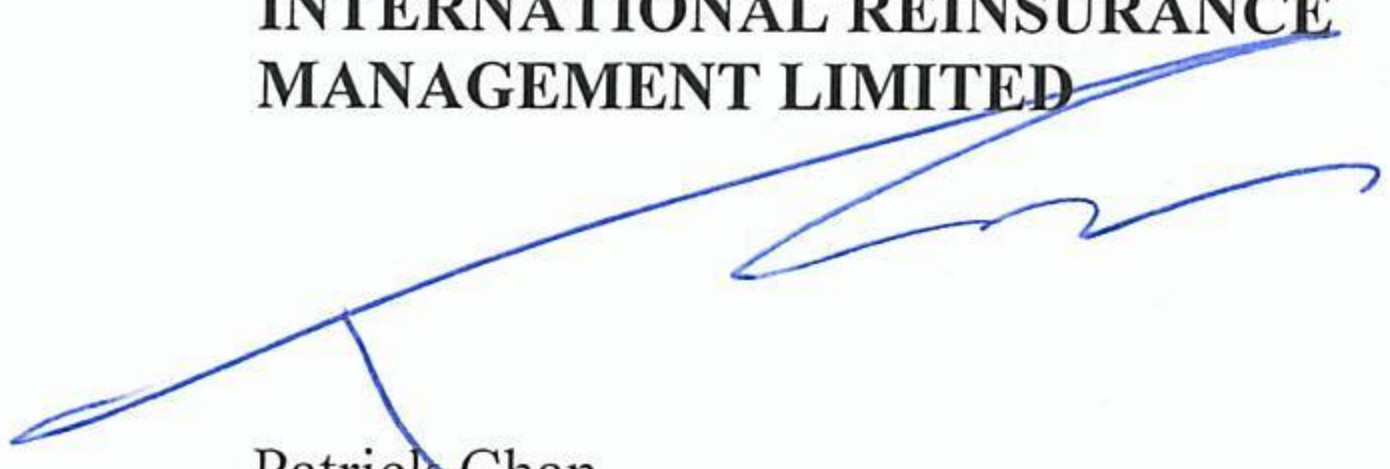
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Director and Chief Executive

Encl.

cc: HKCIB (By facsimile:)

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from whom they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIIB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
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The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.
- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

- 2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
- 2.4 The PPF is with an insurer levy model, while both ECIB and MIB adopt the policy levy model. There may be a repercussion on ECIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.
- 2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.

3. No Substitute for Solvency

It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.

- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.
- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
- 3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.
- 3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).
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- 3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.

4. Insurance Company Insolvencies

Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.

4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

5. Structure of the Fund

The draft proposals for PPF in the Consultation Paper provide for "the Fund" to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.

5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.

5.3 We recommend that rather than defining what a claim basis for payment should be under the PPF, all claims should be settled as per the claim definition in the original policy.

5.4 We are concerned that PPF seems to be proposed to take over part of the normal responsibilities of a liquidator. We believe that the normal liquidation process should be followed with the PPF simply left to pay whatever is the PPF contribution to any claim as presented to it by the liquidator. We propose that a practical study should be made by FSTB to ascertain the responsibilities and working mechanisms as applicable under the Anglo Starlite receivership of the liquidators and MIB to establish a role model.

6. Asset Recovery Mechanism

Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.

6.2 MIB and ECIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

6.3 It is noted that in the examples of claims set out in the Consultation Paper that policyholders have the right to pursue recovery of any balance not paid by PPF from the remaining assets of the insolvent insurer. If the PPF is given equal preferential creditor status as are the aggrieved policyholders, then policyholder recovery of their remaining loss beyond the PPF payment limit will only rank with the PPF's right to recover the amount paid to policyholders in discharge of the purpose of the fund. As such these statements of the ability of the policyholders to recover the excess amount are seriously misleading and will enrage the public when they realise that they cannot in fact recover because the PPF having handed out with its right hand is taking that payment back from the insurer's residual assets with its left hand which undermines the purpose of the PPF and negates the concept of only low limits of compensation.

7. Limit under the Fund

We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principal is recognised under the MIB structure where liability claims are paid in full.

7.2 We believe special consideration needs to be given to the issue of compulsory insurance for building owners' incorporations (or ship-owners as well) where for good reasons a limit of HK\$10 million has been mandated. While we have been told that an amount of HK\$1m would cover 84% of all such claims incurred over the past ten years, it is the higher ones where relief is needed and both the public and the owners need to be protected. Again, the MIB principle should apply.

7.3 Life policies intended to provide family protection in the event of the death of the breadwinner will fall far short of the necessary family support benefit if the limit of HK\$1 million applies.

8. Continuation or Transfer

The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

8.1 In the case of continuation, the PPF would effectively act as an insurance company with all the attendant liabilities but with no premium income. We believe it is unrealistic for the Fund to assume such ongoing liability for the balance of the period which could be up to a year in the case of non-life policies. We believe that cover

should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

- 8.2 We have commented previously on the inadequacy of PPF relative to the death benefit levels required to support a family and the proposed limit provides only a token compensation and not a meaningful contribution. In the event of a life company insolvency, we can envisage public outrage and heavy criticism of HKSARG for allowing the collapse to happen and providing only token compensation along the lines of the public demonstrations over the Lehman Brothers Mini Bonds unless a more meaningful level of compensation is provided.
- 8.3 We believe that only a transfer or re-write of life policies with all "transfer" costs met by the PPF will satisfy the problem described above but this leaves the serious issue of a policyholder whose health has become seriously impaired in the period since the policy was written so as to become unacceptable to a new insurer and thus uninsurable. We believe a higher benefit should be provided to these deserving cases.
- 8.4 The same problem arises with medical benefits policies which provide coverage for pre-existing conditions. Particularly where a policyholder has developed a serious medical condition in the meantime, a new insurer will normally exclude all pre-existing conditions leaving the policyholder unprotected thereafter in respect of that newly developed medical condition, coverage for which was the intention for purchasing the first policy.
- 8.5 The most satisfactory resolution to these issues would be to task the PPF with arranging a full portfolio transfer to another insurer or pool of insurers who would take the "good with the bad".

Conclusions

- 1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
- 2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
- 3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

4. It is considered that the proposal to levy insurers across their whole account rather than a "user pays policy levy" may have a seriously detrimental effect on the Hong Kong insurance market by virtue of certain classes of business to be written offshore and therefore not appear as levyable Hong Kong premium income.
5. The ranking of PPF as a preferred creditor of the insolvent insurance company's assets runs counter to the general procedure of liquidations under Hong Kong law and places proven successful institutions such as MIB in a disadvantaged status undermining their ability to fund such successful rescue operations in the future as they have done in the past. It is also noted that "benefits" to policyholders include the right to recovery against the insolvent insurer but as they rank only at the same "preferred creditor" level as the PPF, any meaningful recovery is unlikely.
6. It is desirable that levels of supervision of insurance companies with provision for active intervention be introduced and that the outcome of IAIS deliberations on adoption of solvency standards under RBC or Solvency II be incorporated in this process.
7. In the light of past experience with ECAS, it is critical that the PPF organisation has the authority to challenge and to defend claims, particularly liability claims where litigation may be required.
8. We recommend that PPF should not have any preferential creditor status and that it should not usurp any of the role of the liquidators.
9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?

Willis

20th June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1, Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir

**RE: RESPONSE TO CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT
OF A POLICYHOLDERS' PROTECTION FUND**

We attach hereto our views and comments in response to the captioned consultation.

Yours sincerely
Willis Hong Kong Limited



Kurt Schreiber
Managing Director

encl: Response to Consultation

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The draft proposals for PPF in the Consultation Paper provide for "the Fund" to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.

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Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

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6.2 MIB and ECIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

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We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principal is recognised under the MIB structure where liability claims are paid in full.

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The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

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should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

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Conclusions

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2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

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9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?

21 June 2011

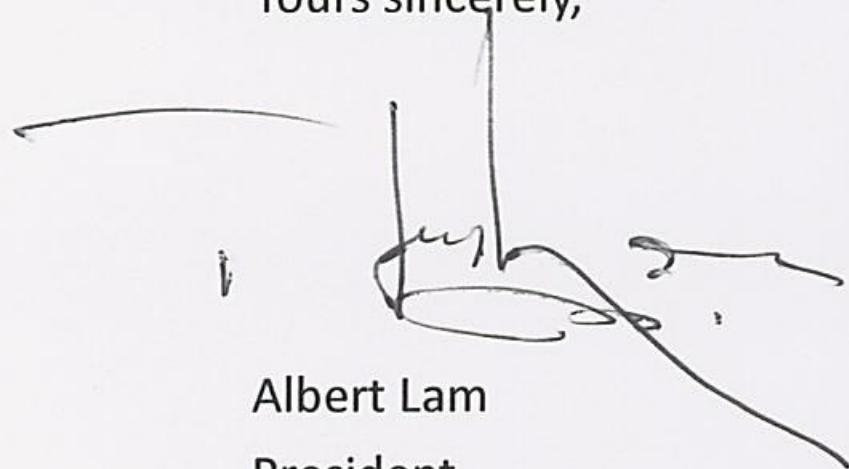
Special Duties Division
Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

RE: RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND

We attach hereto our views and comments in response to the captioned consultation.

Yours sincerely,



Albert Lam
President
Altruist Financial Group Limited

Encl: Response to Consultation



專業服務客為本
保險理財一站通

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from who they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIBB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
- 1.8 The PPF is to cover policies "written" in Hong Kong. "Written in Hong Kong" and "Issued in Hong Kong" sometimes mean the same thing and sometimes mean different things, depending on the insurance company which uses these terms. There is a need to clearly spell out the difference between "written in Hong Kong" and "issued in Hong Kong", and how the PPF is applied to the subsequent definitions.

2. Funding and Basis of Levy

The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.
- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.

2.4 The PPF is with an insurer levy model, while both ECIB and MIB adopt the policy levy model. There may be a repercussion on ECIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.

2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.

3. No Substitute for Solvency

It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.

3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.

3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.

3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.

3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).

3.4.1 Internal discussions within the IAIS (International Association of Insurance Supervisors) are being held to determine if Solvency II or RBC will be promulgated by this body as the gold standard for the IMF to judge insurance companies by. This could well be introduced in the short to medium term.

3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.

4. Insurance Company Insolvencies

Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.

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Aon Hong Kong

Our Ref. RL/2011/024

RONALD C. S. LAI
Chief Executive Officer
Aon Hong Kong Limited

Jun 22, 2011

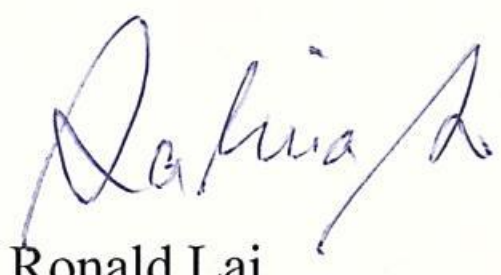
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Yours sincerely,
Aon Hong Kong Limited


Ronald Lai
Chief Executive Officer

RL/ss
Encl. Response to Consultation

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from who they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIBB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
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The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

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- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

- 2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
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- 3. No Substitute for Solvency**
It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.
- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.
- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
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- 4. Insurance Company Insolvencies**
Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.

4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

5. Structure of the Fund

The draft proposals for PPF in the Consultation Paper provide for "the Fund" to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.

5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.

5.3 We recommend that rather than defining what a claim basis for payment should be under the PPF, all claims should be settled as per the claim definition in the original policy.

5.4 We are concerned that PPF seems to be proposed to take over part of the normal responsibilities of a liquidator. We believe that the normal liquidation process should be followed with the PPF simply left to pay whatever is the PPF contribution to any claim as presented to it by the liquidator. We propose that a practical study should be made by FSTB to ascertain the responsibilities and working mechanisms as applicable under the Anglo Starlite receivership of the liquidators and MIB to establish a role model.

6. Asset Recovery Mechanism

Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.

6.2 MIB and ECIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

6.3 It is noted that in the examples of claims set out in the Consultation Paper that policyholders have the right to pursue recovery of any balance not paid by PPF from the remaining assets of the insolvent insurer. If the PPF is given equal preferential creditor status as are the aggrieved policyholders, then policyholder recovery of their remaining loss beyond the PPF payment limit will only rank with the PPF's right to recover the amount paid to policyholders in discharge of the purpose of the fund. As such these statements of the ability of the policyholders to recover the excess amount are seriously misleading and will enrage the public when they realise that they cannot in fact recover because the PPF having handed out with its right hand is taking that payment back from the insurer's residual assets with its left hand which undermines the purpose of the PPF and negates the concept of only low limits of compensation.

7. Limit under the Fund

We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principal is recognised under the MIB structure where liability claims are paid in full.

7.2 We believe special consideration needs to be given to the issue of compulsory insurance for building owners' incorporations (or ship-owners as well) where for good reasons a limit of HK\$10 million has been mandated. While we have been told that an amount of HK\$1m would cover 84% of all such claims incurred over the past ten years, it is the higher ones where relief is needed and both the public and the owners need to be protected. Again, the MIB principle should apply.

7.3 Life policies intended to provide family protection in the event of the death of the breadwinner will fall far short of the necessary family support benefit if the limit of HK\$1 million applies.

8. Continuation or Transfer

The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

8.1 In the case of continuation, the PPF would effectively act as an insurance company with all the attendant liabilities but with no premium income. We believe it is unrealistic for the Fund to assume such ongoing liability for the balance of the period which could be up to a year in the case of non-life policies. We believe that cover

should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

- 8.2 We have commented previously on the inadequacy of PPF relative to the death benefit levels required to support a family and the proposed limit provides only a token compensation and not a meaningful contribution. In the event of a life company insolvency, we can envisage public outrage and heavy criticism of HKSARG for allowing the collapse to happen and providing only token compensation along the lines of the public demonstrations over the Lehman Brothers Mini Bonds unless a more meaningful level of compensation is provided.
- 8.3 We believe that only a transfer or re-write of life policies with all "transfer" costs met by the PPF will satisfy the problem described above but this leaves the serious issue of a policyholder whose health has become seriously impaired in the period since the policy was written so as to become unacceptable to a new insurer and thus uninsurable. We believe a higher benefit should be provided to these deserving cases.
- 8.4 The same problem arises with medical benefits policies which provide coverage for pre-existing conditions. Particularly where a policyholder has developed a serious medical condition in the meantime, a new insurer will normally exclude all pre-existing conditions leaving the policyholder unprotected thereafter in respect of that newly developed medical condition, coverage for which was the intention for purchasing the first policy.
- 8.5 The most satisfactory resolution to these issues would be to task the PPF with arranging a full portfolio transfer to another insurer or pool of insurers who would take the "good with the bad".

Conclusions

1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

4. It is considered that the proposal to levy insurers across their whole account rather than a "user pays policy levy" may have a seriously detrimental effect on the Hong Kong insurance market by virtue of certain classes of business to be written offshore and therefore not appear as levyable Hong Kong premium income.
5. The ranking of PPF as a preferred creditor of the insolvent insurance company's assets runs counter to the general procedure of liquidations under Hong Kong law and places proven successful institutions such as MIB in a disadvantaged status undermining their ability to fund such successful rescue operations in the future as they have done in the past. It is also noted that "benefits" to policyholders include the right to recovery against the insolvent insurer but as they rank only at the same "preferred creditor" level as the PPF, any meaningful recovery is unlikely.
6. It is desirable that levels of supervision of insurance companies with provision for active intervention be introduced and that the outcome of IAIS deliberations on adoption of solvency standards under RBC or Solvency II be incorporated in this process.
7. In the light of past experience with ECAS, it is critical that the PPF organisation has the authority to challenge and to defend claims, particularly liability claims where litigation may be required.
8. We recommend that PPF should not have any preferential creditor status and that it should not usurp any of the role of the liquidators.
9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?



**FINANCIAL
PARTNERS**

Encl. 16

22nd June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

**RE : RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND**

We attach hereto our views and comments in response to the captioned consultation.

Yours sincerely,
Financial Partners Ltd

**Howard Clark-Burton
CEO**

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4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

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The draft proposals for PPF in the Consultation Paper provide for "the Fund" to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.

5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.

5.3 We recommend that rather than defining what a claim basis for payment should be under the PPF, all claims should be settled as per the claim definition in the original policy.

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Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.

6.2 MIB and ECIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

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We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principal is recognised under the MIB structure where liability claims are paid in full.

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should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

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Conclusions

- 1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
- 2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
- 3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

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9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
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Lambert Brothers Insurance Brokers

華寶保險顧問

Encl. 17

22nd June 2011

Special Duties Division
Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1 Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

Re: Response to Consultation Paper on the proposed establishment
of a policyholders' protection fund

We attach hereto our views and comments in response to the captioned consultation.

Yours faithfully,

Michael Haynes
Managing Director

Lambert Brothers Insurance Brokers (Employee Benefits) Ltd
華寶（僱員福利）有限公司

Duty of Disclosure

It is a legal requirement world-wide that anyone seeking a new policy of insurance/reinsurance or cover for additional risks or renewal under an existing policy, must disclose any information that might influence the insurers/reinsurers in fixing the premium or determining whether to accept the risk. Under Hong Kong law, failure to do so may entitle insurers/reinsurers to avoid cover from inception and seek repayment of paid claims. If you are in any doubt as to whether information is material, you should disclose it.



Hong Kong Confederation
of Insurance Brokers

A member of the Wells Fargo
Global Broker Network

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from whom they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIIB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
- 1.8 The PPF is to cover policies "written" in Hong Kong. "Written in Hong Kong" and "Issued in Hong Kong" sometimes mean the same thing and sometimes mean different things, depending on the insurance company which uses these terms. There is a need to clearly spell out the difference between "written in Hong Kong" and "issued in Hong Kong", and how the PPF is applied to the subsequent definitions.

2. Funding and Basis of Levy

The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.
- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

- 2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
- 2.4 The PPF is with an insurer levy model, while both ECIB and MIB adopt the policy levy model. There may be a repercussion on ECIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.
- 2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.
3. **No Substitute for Solvency**
It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.
- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.
- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
- 3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.
- 3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).
- 3.4.1 Internal discussions within the IAIS (International Association of Insurance Supervisors) are being held to determine if Solvency II or RBC will be promulgated by this body as the gold standard for the IMF to judge insurance companies by. This could well be introduced in the short to medium term.
- 3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.
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Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

- 4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.
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23 June 2011

Special Duties Division, Financial Services Branch
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18/F Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

RE : RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND

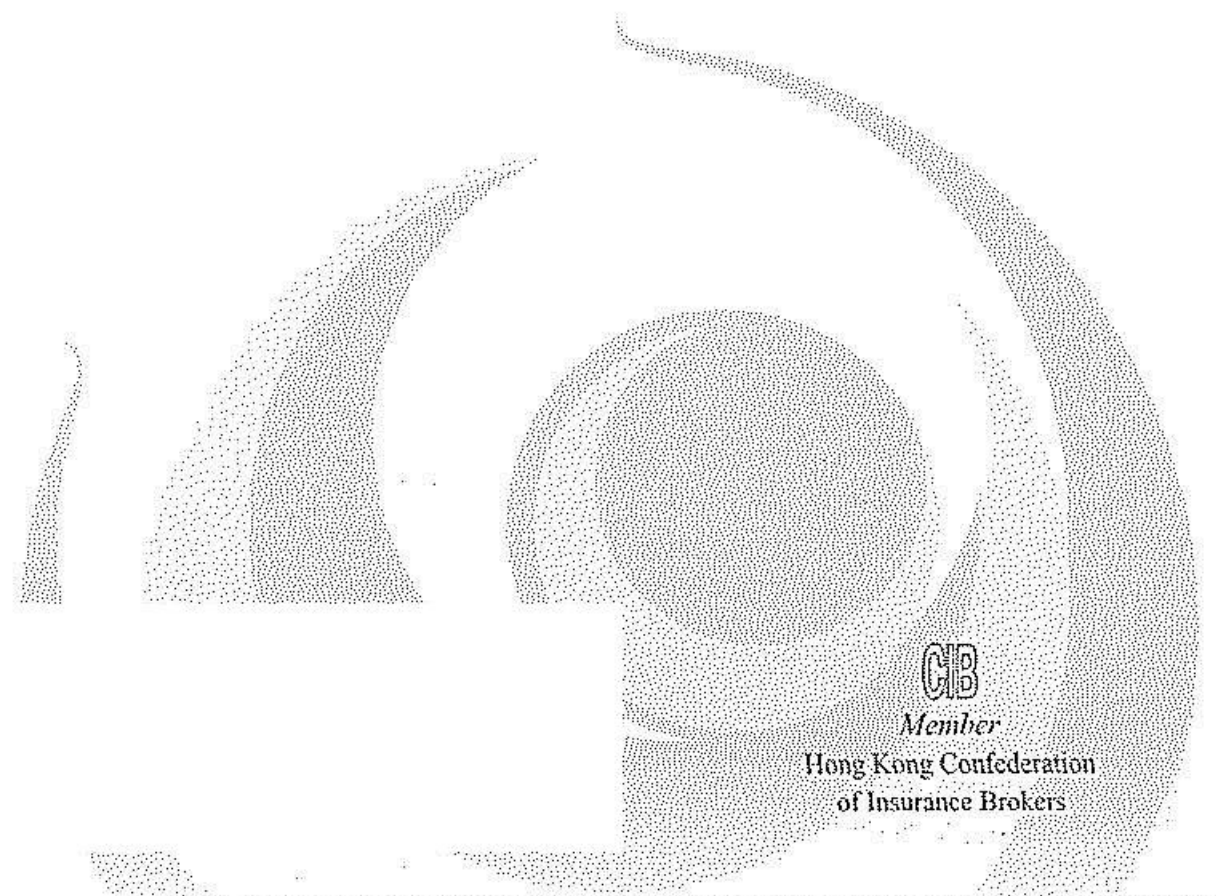
We attach hereto our views and comments in response to the captioned consultation.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Jimmy Hung".

Jimmy Hung
General Manager

Encl : Response to Consultation"



RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from whom they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

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- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
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insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

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The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

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- 2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
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- 2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.
3. **No Substitute for Solvency**
It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.
- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.
- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
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- 3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).
- 3.4.1 Internal discussions within the IAIS (International Association of Insurance Supervisors) are being held to determine if Solvency II or RBC will be promulgated by this body as the gold standard for the IMF to judge insurance companies by. This could well be introduced in the short to medium term.
- 3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.
4. **Insurance Company Insolvencies**
Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

- 4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October 2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.
- 4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

5. Structure of the Fund

The draft proposals for PPF in the Consultation Paper provide for “the Fund” to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

- 5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.
- 5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.
- 5.3 We recommend that rather than defining what a claim basis for payment should be under the PPF, all claims should be settled as per the claim definition in the original policy.
- 5.4 We are concerned that PPF seems to be proposed to take over part of the normal responsibilities of a liquidator. We believe that the normal liquidation process should be followed with the PPF simply left to pay whatever is the PPF contribution to any claim as presented to it by the liquidator. We propose that a practical study should be made by FSTB to ascertain the responsibilities and working mechanisms as applicable under the Anglo Starlite receivership of the liquidators and MIB to establish a role model.

6. Asset Recovery Mechanism

Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

- 6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.

6.2 MIB and ECIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.

6.3 It is noted that in the examples of claims set out in the Consultation Paper that policyholders have the right to pursue recovery of any balance not paid by PPF from the remaining assets of the insolvent insurer. If the PPF is given equal preferential creditor status as are the aggrieved policyholders, then policyholder recovery of their remaining loss beyond the PPF payment limit will only rank with the PPF's right to recover the amount paid to policyholders in discharge of the purpose of the fund. As such these statements of the ability of the policyholders to recover the excess amount are seriously misleading and will enrage the public when they realise that they cannot in fact recover because the PPF having handed out with its right hand is taking that payment back from the insurer's residual assets with its left hand which undermines the purpose of the PPF and negates the concept of only low limits of compensation.

7. Limit under the Fund

We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principal is recognised under the MIB structure where liability claims are paid in full.

7.2 We believe special consideration needs to be given to the issue of compulsory insurance for building owners' incorporations (or ship-owners as well) where for good reasons a limit of HK\$10 million has been mandated. While we have been told that an amount of HK\$1m would cover 84% of all such claims incurred over the past ten years, it is the higher ones where relief is needed and both the public and the owners need to be protected. Again, the MIB principle should apply.

7.3 Life policies intended to provide family protection in the event of the death of the breadwinner will fall far short of the necessary family support benefit if the limit of HK\$1 million applies.

8. Continuation or Transfer

The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

8.1 In the case of continuation, the PPF would effectively act as an insurance company with all the attendant liabilities but with no premium income. We believe it is unrealistic for the Fund to assume such ongoing liability for the balance of the period which could be up to a year in the case of non-life policies. We believe that cover

should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

- 8.2 We have commented previously on the inadequacy of PPF relative to the death benefit levels required to support a family and the proposed limit provides only a token compensation and not a meaningful contribution. In the event of a life company insolvency, we can envisage public outrage and heavy criticism of HKSARG for allowing the collapse to happen and providing only token compensation along the lines of the public demonstrations over the Lehman Brothers Mini Bonds unless a more meaningful level of compensation is provided.
- 8.3 We believe that only a transfer or re-write of life policies with all "transfer" costs met by the PPF will satisfy the problem described above but this leaves the serious issue of a policyholder whose health has become seriously impaired in the period since the policy was written so as to become unacceptable to a new insurer and thus uninsurable. We believe a higher benefit should be provided to these deserving cases.
- 8.4 The same problem arises with medical benefits policies which provide coverage for pre-existing conditions. Particularly where a policyholder has developed a serious medical condition in the meantime, a new insurer will normally exclude all pre-existing conditions leaving the policyholder unprotected thereafter in respect of that newly developed medical condition, coverage for which was the intention for purchasing the first policy.
- 8.5 The most satisfactory resolution to these issues would be to task the PPF with arranging a full portfolio transfer to another insurer or pool of insurers who would take the "good with the bad".

Conclusions

1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

4. It is considered that the proposal to levy insurers across their whole account rather than a "user pays policy levy" may have a seriously detrimental effect on the Hong Kong insurance market by virtue of certain classes of business to be written offshore and therefore not appear as levyable Hong Kong premium income.
5. The ranking of PPF as a preferred creditor of the insolvent insurance company's assets runs counter to the general procedure of liquidations under Hong Kong law and places proven successful institutions such as MIB in a disadvantaged status undermining their ability to fund such successful rescue operations in the future as they have done in the past. It is also noted that "benefits" to policyholders include the right to recovery against the insolvent insurer but as they rank only at the same "preferred creditor" level as the PPF, any meaningful recovery is unlikely.
6. It is desirable that levels of supervision of insurance companies with provision for active intervention be introduced and that the outcome of IAIS deliberations on adoption of solvency standards under RBC or Solvency II be incorporated in this process.
7. In the light of past experience with ECAS, it is critical that the PPF organisation has the authority to challenge and to defend claims, particularly liability claims where litigation may be required.
8. We recommend that PPF should not have any preferential creditor status and that it should not usurp any of the role of the liquidators.
9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?



Pacific World (Asia) Limited

Your Innovative Partners in Risk and Insurance Management

23 June 2011

Special Duties Division, Financial Services Branch
Financial Services and The Treasury Bureau
18/F, Tower 1, Admiralty Centre
18 Harcourt Road
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Ricky W K So
Managing Director

Encl. Response to Consultation

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The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

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- 8.5 The most satisfactory resolution to these issues would be to task the PPF with arranging a full portfolio transfer to another insurer or pool of insurers who would take the "good with the bad".

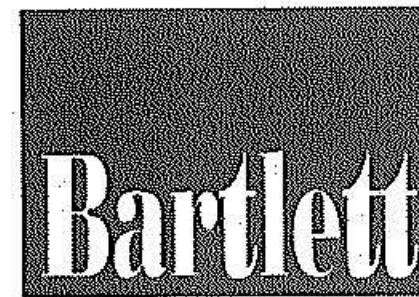
Conclusions

1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.
2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.

4. It is considered that the proposal to levy insurers across their whole account rather than a "user pays policy levy" may have a seriously detrimental effect on the Hong Kong insurance market by virtue of certain classes of business to be written offshore and therefore not appear as levyable Hong Kong premium income.
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6. It is desirable that levels of supervision of insurance companies with provision for active intervention be introduced and that the outcome of IAIS deliberations on adoption of solvency standards under RBC or Solvency II be incorporated in this process.
7. In the light of past experience with ECAS, it is critical that the PPF organisation has the authority to challenge and to defend claims, particularly liability claims where litigation may be required.
8. We recommend that PPF should not have any preferential creditor status and that it should not usurp any of the role of the liquidators.
9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?

23 June 2011

Special Duties Division, Financial Services Branch
Financial Services and The Treasury Bureau
18/F, Tower 1, Admiralty Centre
18 Harcourt Road
Hong Kong



BARTLETT ASIA LTD
INSURANCE BROKERS

Dear Sir,

**Re : RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND**

We attach hereto our views and comments in response to the captioned consultation.

Yours sincerely
BARTLETT ASIA LIMITED

A handwritten signature in black ink, appearing to read "Ricky W K So". The signature is fluid and cursive, with a large loop at the end.

Ricky W K So
Managing Director

Encl. Response to Consultation

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from whom they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIIB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the

insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.

- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.
- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
- 1.8 The PPF is to cover policies "written" in Hong Kong. "Written in Hong Kong" and "Issued in Hong Kong" sometimes mean the same thing and sometimes mean different things, depending on the insurance company which uses these terms. There is a need to clearly spell out the difference between "written in Hong Kong" and "issued in Hong Kong", and how the PPF is applied to the subsequent definitions.

2. Funding and Basis of Levy

The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.
- 2.2 We believe in the "user pays" principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees' Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)

2.3 If the levy is to be charged "across the board", we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.

2.4 The PPF is with an insurer levy model, while both ECIB and MIB adopt the policy levy model. There may be a repercussion on ECIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.

2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.

3. No Substitute for Solvency

It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.

3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting performance and their capital and solvency margins to prevent insolvencies occurring.

3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.

3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.

3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).

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11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?

Date: 24 June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir,

RE : RESPONSE TO CONSULTATION PAPER ON THE PROPOSED
ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND

We attach hereto our views and comments in response to the captioned consultation.

Yours sincerely,
Father Financial Planning Services Limited


Cheng Kar Choi Ronald
Chief Executive

Encl : Response to Consultation

Father Financial Planning Services Limited

RESPONSE TO THE CONSULTATION PAPER ON THE PROPOSED ESTABLISHMENT OF A POLICYHOLDERS PROTECTION FUND

The Respondent

We are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund. We are an independent firm of professional insurance brokers registered by our membership of the Hong Kong Confederation of Insurance Brokers (CIB).

Introduction

We are in principle supportive of the proposal of the Financial Services and The Treasury Bureau (FSTB) of the Government of the Hong Kong Special Administrative Region (HKSARG) to establish a Policyholders Protection Fund (PPF) subject to the comments and considerations set out hereunder.

Comments and Considerations

A. Potential Negative Implications

While recognising that many jurisdictions have established PPF and that HKSARG would wish to be counted in that group and that there is concern by HKSARG and the Hong Kong Federation of Insurers (HKFI) to give the insuring public confidence in the insurance industry, there is a potential negative implication which should be recognised and addressed.

There exists or should exist in every commercial transaction a degree of mutual responsibility in the principle of "caveat emptor" or "buyer beware". With the implementation of PPF there is a danger that purchasers of insurance will no longer feel any responsibility to investigate or to have any concern for the financial standing or security rating of an insurance company from who they will buy on the assumption that should any problem arise they can rely on the PPF.

This principle was clearly demonstrated under Employees' Compensation where brokers could warn their clients of the potential solvency risk to them of certain insurance companies offering cheap rates and prudent employers would then opt for a more expensive but securely solvent

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insurer. With the advent of the Employees' Compensation Insurers' Insolvency Bureau (ECIIB) this argument was lost and employers can now place their insurance with the cheapest insurer irrespective of its security or solvency standing knowing that in the event of a problem the ECIIB will step in.

While we support the establishment of the ECIIB and the Motor Insurers' Bureau (MIB) to protect policyholders under the statutory classes, the result of their presence is that marginal insurers underwriting for cash flow at uneconomically low rates are boosted to receiving more premium from less than responsible clients with worse than average loss ratios thus compounding the solvency problem for the insurer. The result of this vicious circle is a downward pressure on rates across the market and increasing the potential for insolvency.

In launching PPF the HKSARG should issue strong publicity warning that the PPF may not and is not intended to fully reimburse policyholders for their losses due to insolvency and that they bear a responsibility to check and ensure their own confidence in the security and solvency of companies with whom they insure.

B. Definition and Delineation

While recognising that the Consultation Paper represents a first draft of high level principles for consultation, we have concerns at the lack of clear definition of many aspects and many broad assumptions which oversimplify and brush over a number of complex issues without recognising the difficulties which they do not, and in some cases are not able to address. We see the need for HKSARG to investigate and state specifically how the PPF will be able to cope with these issues in practice and whether there is any practical resolution.

C. Specific Issues of Concern

1. Clarity of Definition

We see a need for clarity of definition of both the beneficiaries of PPF and of the circumstances under which it will respond. We draw a parallel to the difficulties being experienced in the implementation of the Minimum Wage Ordinance where HKSARG did not provide clear definitions of scope over issues such as rest days, meal breaks, toilet breaks etc.

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- 1.1 The PPF needs to clearly define the scope of beneficiaries beyond purely natural persons in areas such as professional firms, sole proprietorship and partnerships as well as unregistered businesses. Clear delineation of coverage for registered SME companies is needed and there is the further complication where a large (non-SME) company and a private individual are jointly named insureds and policyholders under the same policy.
- 1.2 The undefined scope of PPF appears to indemnify for any class of insurance other than Motor or Employees' Compensation which are protected by the MIB and ECIIB respectively. Is the intention to protect individual persons in a personal capacity or will this expand into the area of complex business insurances such as professional indemnity and medical malpractice?
- 1.3 What will be the standing under the PPF of individuals insured under corporate group policies purchased by their employers, e.g. group life or group medical?
- 1.4 When the PPF is to cover Owners Corporations on account of the mandatory nature of the insurance requirements, what will be the standing under the PPF of ship-owners who are also statutorily required to take out insurance under the Merchant Shipping (Local Vessels) Ordinance?
- 1.5 A comment made on behalf of the FSTB at a public seminar suggests that it is the consideration of high administrative cost incurred to insurers that premium income of personal lines is not segregated for the purpose of levy collection. There is another comment made at the public seminar that the PPF should be able to identify SME policyholders and to offer them the protection, e.g. a new requirement at the point of underwriting to collect information of their headcount. It is argued that the administrative cost to insurers for doing the latter may be as high as the former. When the Government considers that the industry can afford the cost to identify SMEs at point of underwriting and to maintain such identification throughout the insured period, the industry should also be able to afford to segregate the premium income of personal lines for collecting the levy.
- 1.6 SME's are included in the safety net provided by PPF. The SME policy types covered by PPF will essentially be group life and group medical policies, which may consist of both the employee and

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various family members [spouses and siblings]. On the one hand they look like a commercial line and hence on the surface are excluded from the PPF coverage, but on the other hand they are carved back in, being SME's. To be carved back in, insurance companies will need to carefully track all the various individuals who are covered by these two policy types. This creates in effect a third category of "PPF covered/not covered product types" (a) individual lines covered, (b) commercial lines not covered and (c) commercial lines covered by PPF. This effectively increases administration costs of the insurance companies providing the "(c) types" of policies to the insuring public.

- 1.7 A number of life policies, in particular those ILAS policies, are issued by "offshore" insurers via their office in Hong Kong. These insurers are domiciled in other jurisdictions, e.g. Isle of Man, where there are similar protection schemes (The Life Assurance (Compensation of Policyholders) Regulations 1991 Act in the Isle of Man provides up to 90% protection to Policyholders should the company become unable to meet its liabilities). There should be provisions to safeguard the PPF or to align the protection by different schemes afforded to policyholders globally. Equally if those insurers are also liable to pay levy to the jurisdictions they are domiciled, this will amount to "double PPF taxation". Other examples may exist, so the IA needs to affirm that all "double PPF taxation" cases will be brought to the attention of the insuring public, should the IA indeed implement this "double PPF taxation" proposal element.
- 1.8 The PPF is to cover policies "written" in Hong Kong. "Written in Hong Kong" and "Issued in Hong Kong" sometimes mean the same thing and sometimes mean different things, depending on the insurance company which uses these terms. There is a need to clearly spell out the difference between "written in Hong Kong" and "issued in Hong Kong", and how the PPF is applied to the subsequent definitions.

2. Funding and Basis of Levy

The Consultation Paper proposes to levy on the whole of the office premiums of life companies and the gross written premium of general companies.

- 2.1 The Consultation Paper suggests that Insurers will meet the levy without passing it on to customers. Given the pressure on insurers' costs from rising reinsurance premiums in the light of recent

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catastrophe losses from storms, floods and earthquakes in the USA, Japan and New Zealand in particular, such absorption may not be practical.

- 2.2 We believe in the “user pays” principal and considers it wrong morally and in principle to apply the levy to classes of insurance which will not benefit from the PPF provisions, in particular Motor and Employees’ Compensation which are effectively double charged and specialist lines of commercial insurance. Insurance companies already segregate these in their accounts for treaty reinsurance and statistical purposes. (While a comment had been made on behalf of FSTB at a public seminar that Motor and EC business will not be levied, this is not spelt out in the Consultation Paper.)
- 2.3 If the levy is to be charged “across the board”, we see potential significant damage to the Hong Kong insurance industry and its contribution to the Hong Kong economy and tax base as insurers are likely to transfer their non-benefitting specialist commercial lines such as Marine, Aviation, Specialty Liabilities, Multi-national Corporate and Group and Investment-linked Life to other markets where they have offices such as Singapore so that they are not included in their Hong Kong written gross premiums or office premiums and as such would not attract the levy.
- 2.4 The PPF is with an insurer levy model, while both ECIIB and MIB adopt the policy levy model. There may be a repercussion on ECIIB and MIB if EC and motor policyholders feel aggrieved for being charged a policy levy but other classes not.
- 2.5 In the Singaporean model, their levies are on protected liabilities (life) and protected classes of business (non-life). The PPF should consider to adopt similar measures.

3. No Substitute for Solvency

It appears that under the proposals to establish an Independent Insurance Authority (IIA) and now with PPF that HKSARG is looking to absolve itself from its responsibility to prudentially supervise the insurance companies.

- 3.1 It is the responsibility of HKSARG to ensure adequate prudential supervision of the insurance companies, their underwriting

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performance and their capital and solvency margins to prevent insolvencies occurring.

- 3.2 Not just individuals protected by PPF but also corporate insureds, have the right to assume that if HKSARG authorises a company to undertake insurance business in Hong Kong that it monitors its security and suitability to remain authorised which authorisation gives a seal of respectability and certainty as to its performance.
- 3.3 What is needed is not a hiving off of responsibility to other parties and protective funds but a series of realistic and practical regulations which provide for positive intervention by the Regulator, not at a too late stage but when trouble starts to become apparent.
- 3.4 There is a global movement towards insurance companies adopting Solvency II standards [Solvency II = a risk based capital framework and its related capital requirements) or an alternative model of RBC (Risk Based Capital) - the latter sometimes being quoted by Hong Kong insurance authorities as the preferred model, and IFRS (IFRS = International Financial Reporting Standards).
 - 3.4.1 Internal discussions within the IAIS (International Association of Insurance Supervisors) are being held to determine if Solvency II or RBC will be promulgated by this body as the gold standard for the IMF to judge insurance companies by. This could well be introduced in the short to medium term.
 - 3.4.2 The PPF paper makes no attempt to clarify that they have evaluated the possible contradictions of the co-existence of these regulatory requirements (Solvency II or RBC) or any potential hardship to insurance companies that these models might bring when used in combination with PPF.

4. Insurance Company Insolvencies

Comment has been made on behalf of FSTB at public seminars that insurance company failures are not likely and that multiple failures are unimaginable.

- 4.1 Contrary to that belief, multiple failures are possible and have occurred. Likely causes are poor economic circumstances or where companies have similar corporate natures and respond to similar causes. A clear example is that of HIH (in March 2001), the Independent (in June 2001) and Reliance National (in October

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2001), all three of which were A rated companies specialising in long-tail liabilities and which went down within the space of a few months.

- 4.2 There has also been inference that insurance company failures are immediate and unexpected. The reality is that the situations of HIH and Anglo Starlite were predicted and known by the industry well in advance which is why we underline the need for positive intervention by the Regulator at an early stage.

5. Structure of the Fund

The draft proposals for PPF in the Consultation Paper provide for "the Fund" to undertake many and varied actions over an extended period of time and we question how and by whom this will be done.

- 5.1 The administration requirements would seem to call for an insurance company structure with experienced insurance qualified staff but it would be impractical and extremely costly to establish such an organisation with nothing to do possibly for many years until the next insolvency occurred.
- 5.2 It is critical that whoever undertakes the claims administration has the right to defend and if necessary involve litigation to ensure that claims payments are not excessive and are not more than would have been paid by an insurer. A case by example here was the Employees Compensation Assistance Scheme (ECAS) which had no provision to defend claims and so paid out amounts pursued as common law claims which would have been significantly reduced by the normal litigation process. The result was significant depletion of the fund.
- 5.3 We recommend that rather than defining what a claim basis for payment should be under the PPF, all claims should be settled as per the claim definition in the original policy.
- 5.4 We are concerned that PPF seems to be proposed to take over part of the normal responsibilities of a liquidator. We believe that the normal liquidation process should be followed with the PPF simply left to pay whatever is the PPF contribution to any claim as presented to it by the liquidator. We propose that a practical study should be made by FSTB to ascertain the responsibilities and

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working mechanisms as applicable under the Anglo Starlite receivership of the liquidators and MIB to establish a role model.

6. Asset Recovery Mechanism

Paragraphs 4.12 to 4.14 of the Consultation Paper set out the rights of the PPF to overstep the normal creditor ranking under the principles of Hong Kong liquidation law.

- 6.1 The PPF should not have preferential creditor status. The constitution and purpose of the PPF is such that it should rank behind policyholders and any subrogated insurers and at the same level as the other two insolvency funds who could be responding to the same insurance company insolvency case, i.e. the MIB and the ECIIB. It is not realistic to parallel the PPF with the ECAS Fund as that is not involved with insolvencies and is a first and only line of relief for victims of the failure of their employers to insure at all.
- 6.2 MIB and ECIIB have been established to deal with the issue of insolvency related to the statutory classes of insurance and any limitation on their ability to take their fair recovery of the assets of the insolvent insurance company would seriously harm their financial ability to discharge their important statutory functions. It will be noted that MIB and ECIIB are responsible for the full amount of legal liabilities awarded which may run to many millions of dollars per claim as opposed to the small amount of only HK\$1 million to be assumed by PPF.
- 6.3 It is noted that in the examples of claims set out in the Consultation Paper that policyholders have the right to pursue recovery of any balance not paid by PPF from the remaining assets of the insolvent insurer. If the PPF is given equal preferential creditor status as are the aggrieved policyholders, then policyholder recovery of their remaining loss beyond the PPF payment limit will only rank with the PPF's right to recover the amount paid to policyholders in discharge of the purpose of the fund. As such these statements of the ability of the policyholders to recover the excess amount are seriously misleading and will enrage the public when they realise that they cannot in fact recover because the PPF having handed out with its right hand is taking that payment back from the insurer's residual assets with its left hand which undermines the purpose of the PPF and negates the concept of only low limits of compensation.

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7. Limit under the Fund

We note the structure and the limit of the benefit at HK\$1 million under PPF as imposing some moral obligation on the insured parties but while this limit may reasonably relate to household property, there are other areas where it may be quite inadequate.

7.1 We suggest that consideration be given to increasing the limit at least to HK\$5 million in respect of claims for death or bodily injury under Public Liability policies and the liability sections of domestic policies. This will protect not only the policyholder but also the innocent third party claimant who may be left with no other recourse. This principle is recognised under the MIB structure where liability claims are paid in full.

7.2 We believe special consideration needs to be given to the issue of compulsory insurance for building owners' incorporations (or ship-owners as well) where for good reasons a limit of HK\$10 million has been mandated. While we have been told that an amount of HK\$1m would cover 84% of all such claims incurred over the past ten years, it is the higher ones where relief is needed and both the public and the owners need to be protected. Again, the MIB principle should apply.

7.3 Life policies intended to provide family protection in the event of the death of the breadwinner will fall far short of the necessary family support benefit if the limit of HK\$1 million applies.

8. Continuation or Transfer

The Consultation Paper provides that in certain cases the PPF should continue the policy coverage and meet any claims until the normal expiry date of the policy and in other cases that the PPF and/or the liquidator should facilitate the transfer of policies to a new insurer with cost of transfer up to HK\$1 million being met by the PPF.

8.1 In the case of continuation, the PPF would effectively act as an insurance company with all the attendant liabilities but with no premium income. We believe it is unrealistic for the Fund to assume such ongoing liability for the balance of the period which could be up to a year in the case of non-life policies. We believe that cover should terminate on the date of the insolvency and the insured should make his own arrangements to replace the policy with another insurer. Thus the PPF is responsible only for claims

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incurred but not settled up to the date of the insolvency. This mirrors the current situation pertaining for Motor and Employees' Compensation policies relative to the MIB and the ECIIB. It is significant that paragraph 2.10(f) of the Consultation Paper comments that overseas jurisdictions generally "provide for continuation and transfer of life policies" but there is no mention of non-life policies in this context reflecting the difficulties enumerated herein.

- 8.2 We have commented previously on the inadequacy of PPF relative to the death benefit levels required to support a family and the proposed limit provides only a token compensation and not a meaningful contribution. In the event of a life company insolvency, we can envisage public outrage and heavy criticism of HKSARG for allowing the collapse to happen and providing only token compensation along the lines of the public demonstrations over the Lehman Brothers Mini Bonds unless a more meaningful level of compensation is provided.
- 8.3 We believe that only a transfer or re-write of life policies with all "transfer" costs met by the PPF will satisfy the problem described above but this leaves the serious issue of a policyholder whose health has become seriously impaired in the period since the policy was written so as to become unacceptable to a new insurer and thus uninsurable. We believe a higher benefit should be provided to these deserving cases.
- 8.4 The same problem arises with medical benefits policies which provide coverage for pre-existing conditions. Particularly where a policyholder has developed a serious medical condition in the meantime, a new insurer will normally exclude all pre-existing conditions leaving the policyholder unprotected thereafter in respect of that newly developed medical condition, coverage for which was the intention for purchasing the first policy.
- 8.5 The most satisfactory resolution to these issues would be to task the PPF with arranging a full portfolio transfer to another insurer or pool of insurers who would take the "good with the bad".

Conclusions

1. The PPF purports to provide "protection" to policyholders in the event of the insolvency of their insurers but on close scrutiny the

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offering under the Consultation Paper falls far short of what will be the public's expectation and will create a significant public reaction against HKSARG similar to the furore over the Lehman Brothers Mini Bonds whether justified or not.

2. It is considered desirable to have absolute clarity of definition in all aspects to avoid disputes and misunderstandings in the application of PPF. The lessons of the Minimum Wage Ordinance show the need for this. Our earlier comments reveal many areas in this Consultation Paper where the intention is not clearly defined.
3. It is considered that the proposed PPF scheme is too far-reaching and complex and that it should be restricted to apply to personal domestic activities and exposures only and not to include any business or professional risks.
4. It is considered that the proposal to levy insurers across their whole account rather than a "user pays policy levy" may have a seriously detrimental effect on the Hong Kong insurance market by virtue of certain classes of business to be written offshore and therefore not appear as levyable Hong Kong premium income.
5. The ranking of PPF as a preferred creditor of the insolvent insurance company's assets runs counter to the general procedure of liquidations under Hong Kong law and places proven successful institutions such as MIB in a disadvantaged status undermining their ability to fund such successful rescue operations in the future as they have done in the past. It is also noted that "benefits" to policyholders include the right to recovery against the insolvent insurer but as they rank only at the same "preferred creditor" level as the PPF, any meaningful recovery is unlikely.
6. It is desirable that levels of supervision of insurance companies with provision for active intervention be introduced and that the outcome of IAIS deliberations on adoption of solvency standards under RBC or Solvency II be incorporated in this process.
7. In the light of past experience with ECAS, it is critical that the PPF organisation has the authority to challenge and to defend claims, particularly liability claims where litigation may be required.
8. We recommend that PPF should not have any preferential creditor status and that it should not usurp any of the role of the liquidators.

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9. We believe that the limits provided by PPF should be reviewed particularly in relation to the statutory classes, liabilities and life.
10. It is considered impractical to provide continuation of non-life policies and they should be allowed to terminate on liquidation with claims up to that date only being met as is adopted by all other jurisdictions.
11. It is of concern that the Consultation Paper proposes that the PPF Organisation will undertake to offer replacement or continuity of life policies to the extent apparently of compensation for what has been lost in terms of both benefit and coverage. At best this will be unrealistically and unsustainably expensive and at worst will prove not possible thus exposing the PPF and HKSARG to extensive criticism for failure to deliver as promised.
12. The IA should seriously examine whether to exempt those companies and their policies which are already covered by parallel PPF arrangements in home countries in which these companies are domiciled. Hong Kong should avoid antagonising the global insurance market by introducing a "double PPF taxation" regime?

Father Financial Planning Services Limited

Special Duties Division,
Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I,
Admiralty Centre
18 Harcourt Road,
Hong Kong

17 June 2011

Dear Sirs,

Proposed Establishment of a Policyholders' Protection Fund

I refer to the captioned and would like to provide my detailed comments as follows:

Regarding payment of claim following an insurer's insolvency:

As highlighted in the consultation paper any sum payable to a person in respect of any claim (other than a claim for premium refund) made under or in accordance with a contract of insurance effected by the insolvent insurer as part of its general business, subject to conditions, is preferential against the assets of the insurer under the current Company Ordinance.

However, there are cases in which banks, or any other financial institutions, being the creditors of the insured, are assigned with the topmost priority in receiving any claim payment under the corresponding insurance policies (by virtue of the loss payee clause), throughout the entire insurance period. We would wonder if the same priority will apply following the insolvency of the insurer or claim payment will go direct to the insured instead. Ideally the consultation paper should give much clearer guideline on how such situation can be dealt with.

Regarding mandatory insurance classes:

There are a few numbers of mandatory insurance classes in Hong Kong but only those with regard to the third party liability of motor vehicle and employees' compensation are fully protected with compensation schemes which provides compensation to the policyholders or third party claimants if the corresponding insurer of such policies becomes insolvent. Other mandatory classes such as pleasure craft insurance and third party liability insurance for building owner's corporation are basically left to a very large extent unprotected on insurer's insolvency even if PPF is launched as it only covers the first HK\$1M of any one claim (limit of liability under pleasure craft insurance and building owner's corporation insurance being HK\$5M and HK\$10M respectively). To adequately bridge up the gap yet reasonably alleviate the burden of PPF, we may consider having compulsory levies (like what we have being adopting for motor and employees' compensation insurance) imposed on these mandatory classes of insurance as one of the alternatives, if applicable.



大新保險有限公司

DAH SING INSURANCE COMPANY LIMITED

(Member of Dah Sing Financial Group)

Cases involving claims under different policies:

In reality there will be cases in which multiple claims may occur in a single event. An example is the accidental collapse of an advertising sign originally mounted on the outer surface of a building, which concurrently injures ten people on the street. Merely from TPL insurance point of view there can be totally ten claims (with each injured person making one claim). If PPF is to intervene following the insolvency of the corresponding insurer and quantum of each claim is adjusted and finalised at more than HK\$1M, the total amount payable under PPF will in theory be 10 times the maximum level of compensation per claim (HK\$1M) which yields a total of HK\$10M. If another coincidence occurs such that all these injured people concurrently hold a PA policy with the same insurer, the situation will become rather questionable as each of them may submit two claims (one in respect of third party claim and the other one under PA), and PPF is on a per claim basis so in principle each injured person will be able to receive totally HK\$2M as compensation (again provided that his PA claim is adjusted and finalised at more than HK\$1M). Following this logic we would wonder if the PPF will really function this way or further refinement of the criteria for compensation is needed.

Applicability of PPF on SME policyholders:

Point 3.4 of the consultation paper highlights that PPF is not primarily designed to protect SMEs upon an insurer's insolvency despite their relatively lower sophistication and smaller scale of operation as compared to large corporates. Realistically this sounds legitimate as the level of compensation provided under the PPF is indeed still very minimal in comparison to the full sum insured value under most of their policies, whereas the inclusion of SMEs in the PPF's pool may certainly result in a much higher demand to be dealt with by the fund following the insolvency of any insurer(s). The burden of which will inevitably, and eventually, be borne by the insurance industry. We therefore agree that PPF should not be extended to cover SMEs at this stage.

General insurance policies with longer period:

According to point 3.20 transfer of non-life insurance policies following the insolvency of the corresponding insurer is not recommended under PPF considering most of such policies being of a yearly basis. The statement is not perfectly correct in reality as certain policy classes do require a much longer period of coverage (e.g. contractor's all risks insurance, project professional liability insurance). If all non-life policies are not allowed to transfer tremendous burden will certainly be imposed on the fund (for instance, if an insurer goes insolvent one month after the inception of a PII policy which lasts 10 years the fund has to take care of the policy for the remaining 9 years and 11 months). This again is eventually borne by the entire insurance industry. We therefore suggest having the PPF guideline slightly modified such that the mechanism of transfer for non-life policies with policy period more than 12 months is retained.

Should you have any question or wish to discuss in detail please do not hesitate to contact the undersigned on

Yours sincerely,

Jimmy Poon
Chief Executive Officer
Dah Sing Insurance Company Limited



Motor Insurers' Bureau of Hong Kong
香港汽車保險局

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F., Tower I, Admiralty Centre
18 Harcourt Road
Hong Kong.

17 June 2011

Dear Sirs,

Proposed Establishment of a Policyholders Protection Fund

The Motor Insurers' Bureau of Hong Kong (MIB) in relation to its mandate and agreements with the HKSAR Government and the insurance industry of Hong Kong, is pleased to comment on the proposal to establish a Policyholders' Protection Fund (PPF).

The MIB represents all insurers authorised by the Insurance Authority to carry on motor vehicle insurance business in Hong Kong, currently 64, to operate currently two funds for the protection of innocent third parties injured in road accidents who cannot receive recompense in the normal course, including those disadvantaged by insurer insolvency thus establishing a direct relevance with the proposed Policyholders' Protection Fund.

The MIB sees an established requirement for a level playing field to be developed between it, the other existing Hong Kong insolvency fund the Employees Compensation Insurance Insolvency Bureau (ECIIB) and the proposed PPF to avoid confusion or the potential for dissatisfaction by the public.

In this regard MIB has identified only two key areas of concern from the Consultation Paper and some subsidiary points which appear to us possibly only matters of clarification. We would be grateful for the Financial Services and the Treasury Bureau (FSTB) to give serious consideration to these matters in its deliberations on the establishment of the PPF.

It is proposed that PPF will have preferential creditor status in seeking recovery from an insolvent insurer (clause 4.14 on page 22) whereas MIB and ECIIB are classified as ordinary creditors under their agreements with the HKSAR Government. This divergence would place the two existing insolvency funds in a most unenviable position in relation to the same insolvency, where PPF for its capped compensation would rank ahead of the established full protection funds, undermining their financial position and credibility. Although it might seem logical for the level playing field to be established by requesting that MIB and ECIIB gain preferential creditor status, we would respectfully suggest the solution be that PPF is not accorded this status as it would seem inequitable to us for fund recovery to take precedence from claims by employees for their wages or the general public for their non-funded insurance claims against the estate of an insolvent insurer. The two classes of creditor specified in section 265 of the CO (clause 4.14 on page 22) are the Employees Compensation Assistance Fund (which provides uncapped compensation and on a non-defended basis so there is nothing further for the public to claim) and other direct insurance claims not met by the PPF. This would not rank them above PPF if holding preferential creditor status (or MIB/ECIIB if accorded preferential status) thus reducing



Motor Insurers' Bureau of Hong Kong

香港汽車保險局

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau

17 June 2011

their chances of recovery against the insolvent insurer above PPF payment limits, an issue which we note to be championed by PPF, to be unlikely or at best a small percentage.

It is proposed that the PPF non-life scheme provides continuity of coverage until the expiry of all policies post insolvency and meets all claims before or after insolvency (clauses 3.20 and 3.21 on page 17). This is apparently not coverage included in overseas PPF schemes per comment under (f) on page 10 of the Consultation Paper which only refers to Life policies. Also MIB and ECIIB are not empowered to provide such facility, restricted as they are to the settlement of claims, which would effectively mean that PPF (and by extension MIB/ECIIB) would for all intents become insurance companies with requirements for fit and proper persons, underwriting staff, statistical provision etc. Such duties are to our knowledge currently both locally and internationally the normal responsibility of the liquidator to administer policies or issue notice of cancellation to policyholders as non-life replacement insurance should easily be found in most cases, in considering the liquidation and the public interest. The MIB see this well meaning extension of the basic aim of non-life PPF to include policy administration, can only drive up cost to modest public benefit. Having said this, there is at times a case for handling run-off claims (not policy administration) to policy expiry under insolvency funds and MIB/ECIIB have accommodated such a benevolent request in the public interest and at their discretion with Anglo Starlite Insurance Company Ltd. (ASI) being the case in point. Currently ASI estimated claims falling to the MIB are substantial at HK\$1.2 billion including the run off.

In terms of clarification and in furtherance of our views on provision of a level playing field, PPF proposes to calculate its levy on non-life insurers from gross written premiums (clause 4.8 on page 20). We assume this calculation will exclude motor and employees compensation premiums as the two existing funds are to be excepted from PPF (clause 3.7 on page 14) and are already subject to levy which would not appear to us to be equitable to duplicate.

We assume PPF will be empowered to defend claims and reach settlements per policy definition and net of policy deductibles (clauses 3.11 and 3.14 on page 15) as MIB and ECIIB are able to do. This has always seemed essential to us in maintaining our fund solvency and in line with insurance policy provision and equity.

MIB and ECIIB are noted in the Consultation Paper as being subject to a queuing system (clause 2.4 on page 9) whereas PPF, and we can see the real need in a start-up organization, is to be entitled to borrow funds (clause 4.16 on page 23). We assume the existing insolvency funds (MIB/ECIIB) could be offered this benefit should need arise.

Annex C on page 40 of the Consultation Paper lists proposed conditions for activating the PPF which appear to go further than existing common law provision for declarations of insolvency and we are not clear on the need to override the normal liquidation process which may again fuel cost. In any event, MIB and ECIIB will need to be a position to respond to the finally agreed PPF triggers or a gap in insolvency fund protection would be evident.



Motor Insurers' Bureau of Hong Kong

香港汽車保險局

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau

17 June 2011

Trusting these views will be of assistance to FSTB in its deliberations.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'K. P. Cheng', is written over a horizontal line. The signature is fluid and cursive.

K. P. Cheng
Chairman
Motor Insurers' Bureau of Hong Kong

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F., Tower I, Admiralty Centre
18 Harcourt Road
Hong Kong.

17 June 2011.

Dear Sirs,

Proposed Establishment of a Policyholders Protection Fund

The Employee Compensation Insurer Insolvency Bureau (ECIIB) in relation to its mandate and agreements with the HKSAR Government and the insurance industry of Hong Kong is pleased to comment on the proposal to establish a Policyholders' Protection Fund (PPF).

The ECIIB represents all insurers authorised by the Insurance Authority to carry on employees' compensation insurance business in Hong Kong, currently 69, to operate a fund for the protection of those disadvantaged by insurer insolvency thus establishing a direct relevance with the proposed Policyholders' Protection Fund.

The ECIIB sees an established requirement for a level playing field to be developed between it, the other existing Hong Kong insolvency fund the Motor Insurance Bureau of Hong Kong (MIB) and the proposed PPF to avoid confusion or the potential for dissatisfaction by the public.

In this regard ECIIB has identified two key areas of concern from the Consultation Paper and some subsidiary points which appear to us possibly only matters of clarification. We would be grateful for the Financial Services and the Treasury Bureau (FSTB) to give serious consideration to these matters in its deliberations on the establishment of the PPF.

It is proposed that PPF will have preferential creditor status in seeking recovery from an insolvent insurer (clause 4.14 on page 22) whereas ECIIB and MIB are classified as ordinary creditors under their agreements with the HKSAR Government. This divergence would place the two existing insolvency funds in a most unenviable position in relation to the same insolvency, where PPF for its capped compensation would rank ahead of the established full protection funds, undermining their financial position and credibility. Although it might seem logical for the level playing field to be established by requesting that ECIIB and MIB gain preferential creditor status, we would respectfully suggest the solution be that PPF is not accorded this status as it would seem inequitable to us for fund recovery to take precedence from claims by employees for their wages or the general public for their non-funded insurance claims against the estate of an insolvent insurer. The two classes of creditor specified in section 265 of the CO (clause 4.14 on page 22) are the Employees Compensation Assistance Fund (which provides uncapped compensation and on a non-defended basis so there is nothing further for the public to claim) and other direct insurance claims not met by the PPF. This would not rank them above PPF if holding preferential creditor status (or ECIIB and MIB if accorded preferential status) thus reducing their chances of recovery against the insolvent insurer above PPF payment limits, an issue which we note to be championed by PPF, to be unlikely or at best a small percentage.

It is proposed that the PPF non-life scheme provides continuity of coverage until the expiry of all policies post insolvency and meets all claims before or after insolvency (clauses 3.20 and 3.21 on page 17). This is apparently not coverage included in overseas PPF schemes per comment under (f) on page 10 of the

EMPLOYEES COMPENSATION INSURER INSOLVENCY BUREAU

保險公司(僱員補償)無力償債管理局

Consultation Paper which only refers to Life policies. Also ECIIB and MIB are not empowered to provide such facility, restricted as they are to the settlement of claims, which would effectively mean that PPF (and by extension ECIIB and MIB) would for all intents become insurance companies with requirements for fit and proper persons, underwriting staff, statistical provision etc. Such duties are to our knowledge currently both locally and internationally the normal responsibility of the liquidator to administer policies or issue notice of cancellation to policyholders as non-life replacement insurance should easily be found in most cases, in considering the liquidation and the public interest. The ECIIB and MIB see this well meaning extension of the basic aim of non-life PPF to include policy administration, can only drive up cost to modest public benefit. Having said this, there is at times a case for handling run-off claims (not policy administration) to policy expiry under insolvency funds and ECIIB/MIB have accommodated such a benevolent request in the public interest and at their discretion with Anglo Starlite Insurance Company Ltd. (ASI) being the case in point.

In terms of clarification and in furtherance of our views on provision of a level playing field, PPF proposes to calculate its levy on non-life insurers from gross written premiums (clause 4.8 on page 20). We assume this calculation will exclude motor and employees compensation premiums as the two existing funds are to be excepted from PPF (clause 3.7 on page 14) and are already subject to levy which would not appear to us to be equitable to duplicate.

We assume PPF will be empowered to defend claims and reach settlements per policy definition and net of policy deductibles (clauses 3.11 and 3.14 on page 15) as ECIIB and MIB are able to do. This has always seemed essential to us in maintaining our fund solvency and in line with insurance policy provision and equity.

ECIIB and MIB are noted in the Consultation Paper as being subject to a queuing system (clause 2.4 on page 9) whereas PPF, and we can see the real need in a start-up organization, is to be entitled to borrow funds (clause 4.16 on page 23). We assume the existing insolvency funds (ECIIB and MIB) could be offered this benefit should the need arise.

Annex C on page 40 of the Consultation Paper lists proposed conditions for activating the PPF which appear to go further than existing common law provision for declarations of insolvency and we are not clear on the need to override the normal liquidation process which may again fuel cost. In any event, ECIIB and MIB will need to be in a position to respond to the finally agreed PPF triggers or a gap in insolvency fund protection would be evident.

Trusting these views will be of assistance to FSTB in its deliberations.

Yours faithfully,



M R Raines

Chairman

Employee Compensation Insurer Insolvency Bureau



Submission of Comment on the Consultation Paper on Establishment of a Policyholders' Protection Fund ("PPF") issued on March 2011

Submission by Compagnie Francaise D'assurance pour le Commerce Extérieur - Hong Kong Branch ("Coface Hong Kong Branch") to the Financial Services and the Treasury Bureau of Hong Kong

21 June 2011

Part A – Statement of Interest

Coface's mission is to facilitate global business-to-business trade by offering its 135,000 customers solutions to fully or partly outsource trade relationship management and to finance and protect their receivables: credit insurance, factoring, business information and receivables management. Coface is a subsidiary of Natixis whose share capital (Tier 1) was 16.8 billion Euros end December 2010.

Coface Hong Kong Branch was set up as a representative office in Hong Kong in 1996 and became a branch office in 1999. We are one of the market leaders in credit insurance sector. In 2010, the written premium came from credit insurance and related services reached HK\$ 279 million, 34% increase compared with 2009.

With consideration to our premium portfolio in 2010, less than half came from SMEs.

Part B – Specific Comments

1. The idea of establishment of the PPF as a safety net, in addition to prudential regulations, for insurer insolvency is good; nevertheless we suggest reconsidering the type of insurance being covered with reference to the international practice.
2. Coface Hong Kong Branch is not a separate legal entity in HK, for the case that the Branch is insolvent; the liability will be fully bore by Coface head office which is based in France.
3. On the coverage of the PPF, we agree the PPF comprises two separate and independent schemes, Life Scheme and Non-Life Scheme. As credit insurance does not cover individual policyholder, if individual policyholder is the focus of the PPF, we suggest excluding credit insurance from the PPF. In the second case that the PPF also covers SMEs, as more than half of our premium comes from non-SMEs, we also suggest reconsidering whether credit insurance should be covered under the PPF.
4. We consider the initial levy rates for the PPF sets at 0.07% of the applicable premiums with 15 years target funded period is reasonable and acceptable.
5. We suggest imposing a cut-off date for the submission of claims. All claims submitted before or after the insolvency but within the time limit specified should go through the normal claims verification and assessment process and be met by the PPF up to the compensation limit.
6. We support the proposed compensation of 100% for the first HK\$ 100,000 of any claims, plus 80% of the balance up to a total compensation limit of HK\$ 1 million.
7. We agree the PPF should be established by legislation and should operate under the oversight of an independent governing body. We also agree the PPF should exercise a high level of prudence in investing the money. Money which is not immediately required should be invested in low-risk vehicles, such as deposits with banks, Exchange Fund Bills and sovereign bonds with good credit rating.

Part 3 – Summary

Whereas Coface Hong Kong Branch is welcome the establishment of the PPF with a view to strengthening public confidence in the insurance market, Financial Services and the Treasury Bureau are advised to re-consider the type of insurance should be included in the PPF, particularly with reference to the international practice.

The less sophisticated funding mechanism should be welcomed by all insurers, the proposed funding mechanism and target funding period looks simple and straight forward. We are also in favor of the current proposed legal and organizational structure of the PPF.

PPF Consultation

From: wingka Lee [mailto:wingka_lee@fsta.gov.hk]
 Date: Jun 21, 2011 20:22
 To: <ppf_consultation@fsta.gov.hk>
 Cc:
 Attachments: OCI-2011-06151- (24.5 KB)
 FSTB-2011-06201-PPF Consultation.docx (21.4 KB)

To: Financial Service and Treasury Bureau - ppf_consultation@fsta.gov.hk
 From: Lee Wing Ka
 Re: Establishment of Policyholder Protection Fund
 Date: June 21, 2011
 End: OCI-200106151-1 (OCI Ref: L/M(1) in F-14411 (INS) Sub-file III)

As a policyholder, we should be pleased to see the Government is looking at further protection of policyholders. However, with personal experience as per attached we are afraid that the establishment will further give an illusion that insurance, especially life insurance in Hong Kong, are well regulated and monitored when the independency of OCI or IA is questionable.

- 2) We do not see the independency of OCI towards the protection of Policy holders despite IA is assigned the responsibility under **Section 4A of ICO** to regulate and supervise Insurers for a proper standards of conducts, sound and prudent business practice. We do not think OCI should repeatedly asking Policyholder to seek reply from Insurer when
- The Insurer has repeatedly failed to response properly within reasonable time.
 - The Policy holder is seeking advice from OCI on legal points of a Policy and standard procedures or practices.
 - There are obvious doubts of misrepresentation or misconduct.
 - OCI failed to advise what should be the proper standard of Insurer towards a enquiry or complaint.
- 3) We are doubtful
- if OCI cares to see their responsibility because asking Policy holder to refer back to Insurer.
 - If they feel obliged to consider the logic of
 - an Universal Life ended up with only death benefit and nothing else, which is practically a Term Life?
 - when the premium paid is more than doubled? (USD2,050 instead of USD849.12)
 - after 19 years of regular premium payment?
 - Yet, premium have to increase by more than 60%? USD3,265.
 - And, to start the increase on the 20th years when the policy was said to be designed to be good for 23 years up to age 63?
 - If OCI realizes they have at least four main categories of Life Insurance to monitor, Term Life, Whole Life, Endowment and the so called Universal Life? Any premium in excess of Term Life should deem to be for other benefits and to be reported in their Form L2 accordingly? Is our Universal Life being properly reported? Are they individually accountable?
- 4) Briefly through ICO, we do not see the law is obstructing OCI or IA in practice of Independency. However, we do not see OCI has published any rules and regulations that could regulate the Standard or proper conduct of business that specifically protect the Policyholders. We do not think a set up of a so called Independent IA will turn IA into Independent if the existing one does not feel an obligation to do so.

Conclusion: We welcome the suggestion for a PPF but not under the existing IA which is not practicing Independency for the protection of Policy Holders with no specific Rules & Regulations.

--- On Thu, 6/16/11, wingka Lee <wingka_hk@yahoo.co.uk> wrote:

From: wingka Lee <wingka_hk@yahoo.co.uk>
 Subject: Re: FW: T...
 To: iamail@oci.gov.hk
 Cc: info@fsta.gov.hk
 Date: Thursday, June 16, 2011, 6:10 PM

To: Office of the Commissioner of Insurance - iamail@oci.gov.hk
 From: Lee Wing Ka
 Re: Yr Ref: L/M(1) in F-14411 (INS) Sub-file III
 Date: June 15, 2011
 Cc: info@fsta.gov.hk
 Encl: consult_ppf_e

Dear Mr Fung,

Thanks your kind reply dated June14.

1) We believe our OCI-2011-06101 is our enquiry to OCI for legal elucidation and our consent for OCI to pursue our complaint to Transamerica to be on basis of our Transa-2011-06031 sent to Transamerica with copy to you. Our consent to release our correspondences to other parties, including OCI-2011-06101 should be deemed for the case of investigation, if needed. We did not consent and expect your release of our other correspondences to Transamerica, prior to further consent.

2) We have not received your answer to our enquiry to you on June 3, rephrased on June 10 the followings:

- Can a practically Term Life policy be marketed as Universal Life? Where
 - the premium is more than double of a Term-life
 - there is no Dividend or Cash value, nor bonus or interest.
 - After 18-19 years with the overcharging, a more than 60% increase of premium is imposed.

2) Should the Insurer provide at least a copy of the signed Application of the Policy, (that comes with the proposal of the Policy) when requested, or, to justify their claim for a premium increase.

- 3) As in our OCI-2011-06031:
- the premium was USD2,050 since 1942 (age 41). It was mentioned recently that it was designed for protection up to age 63 only (2013, a term of 23 years).
 - Yet we are asked to pay NOW a premium of USD3265, which is more than 60% increase. So, the last premium is only valid for 19 years).
 - The premium for a 20-year Term Life (from Transamerica website) is USD849.12

- d) Therefore, the accumulated overcharged for (1991-2011) is
 $19 \times (2,050-849.12) = \text{USD } 22816.72$.
- 3) We believe Term Life, Whole Life, Universal Life and Endowment Policy carry specific interpretation in the Insurance Industry. Such as those listed under the Glossary of the Consultation papers issued by FSTB Financial Service and Treasury Bureau on the establishment of Policyholder Protection Fund and Independent Insurance Authority, attached herein.
- 4) Therefore, are we (as well as OCI as regulator of Insurers) entitled to query:
 (a) Should a practically Term Life be marketed as Universal Life ending with practically nothing but death benefit?
 (b) Where are those overcharge USD 24017.6 gone?
 (c) From where is Transamerica qualified and quantified for the premium increase? From USD2050 to USD3,265.
- 5) We believe it is a case of Misrepresentation, or misconduct, or, falling out of proper standard. We believe OCI has the responsibility under **Section 4A of ICO** where it is stipulated as:

Functions of Insurance Authority

- (1) The principal function of the **Insurance Authority** shall be to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders.
- (2) Without limiting the generality of subsection (1), the **Insurance Authority** shall-
 (a) be responsible for supervising an insurer's and an **Insurance Intermediary's** compliance with the provisions of this Ordinance;
 (b) consider and propose reforms of the law relating to insurance business;
 (c) promote and encourage proper standards of conduct and sound and prudent business practices amongst insurers;
- 6) Should OCI or IA be silent when Misrepresentation, or/and, misconduct, or/and, improper standard of conduct of business practices are there? And, thereby, be justified to be appointed as Regulator of Insurers by law?
- 7) We believe, under the law, the Insurer is accounted for the overcharged of **USD 22816.72**. We believe IA is empowered under Section 27 to 35 of the ICO to do the necessary to provide an explanation on what are those overcharged for and how the premium increase is to be qualified and quantified.
- 8) We do not believe IA and OCI are limited to act only as a messenger in our complaint of possible Misrepresentation, or/and, misconduct and at least improper operation standard, which are or could affect all policy holders of "Universal Life" with Transamerica.

We hope to receive your answer to the specific questions above.

Meanwhile, please note that our policy anniversary falls on May 19. We were informed by Transamerica via their email of June 2, that the Grace period is two months. So, please advise how we can avoid lapsing the policy when we are awaiting feedback from Transamerica since early May as well as you advice to sort the matters.

Regards/

— On Tue, 6/14/11, iamail@oci.gov.hk <iamail@oci.gov.hk> wrote:

From: iamail@oci.gov.hk <iamail@oci.gov.hk>
 Subject: Re: FW: ...
 To: wingka_...
 Date: Tuesday, June 14, 2011, 10:03 AM
 Re: Transamerica Life (Bermuda) Ltd. ("Transamerica")

Our Ref: L/M(1) in F-14411 (INS) Sub-file III

Dear Mr. Lee,

Thank you for your email of 10 June 2011. We note your query about the nature of the policy issued by Transamerica and your request for a copy of the related policy application.

You shall appreciate that our powers and responsibilities as the Insurance Authority relate mainly to the supervision of the financial condition of authorized insurers and their compliance with the provisions of the Insurance Companies Ordinance (the "Ordinance"). Under the Ordinance, we have no statutory power to enter into specific disputes that arise between individual policyholders and an insurer under an insurance policy.

As mentioned in our email of 9 June 2011, your complaint relates to the policy terms and commercial operations of the captioned insurer and should be better dealt with by it. After obtaining your consent, we have referred copies of your emails of 3 June 2011 and 10 June 2011 with enclosures to Transamerica requesting it to reply you direct in writing as soon as possible, with a copy to us for information.

Yours sincerely,

(Derrick Fung)
 for Commissioner of Insurance
 (Insurance Authority)

----->
 | From: |
 |----->

[wingka Lee <wingka@oci.gov.hk>]

To:

iamail@oci.gov.hk

Date:

10/06/2011 14:35

Subject:

[Re: FW: ...]

To: Office of the Commissioner of Insurance - iamail@oci.gov.hk
 From: Lee Wing Ka
 Re: Life Policy - ...
 Date: June 10, 2011

Dear Mr Fung,

This refers to your reply of June 9, with thanks.

We hope to draw your attention that besides the complaint on the Insurer, there is also an enquiry to OCI as in Point 3 of our complaint. In simple words,

- 1) Can a practically Term Life policy be marketed as Universal Life? Where
 - a) the premium is more than double of a Term-life
 - b) there is no Dividend or Cash value, nor bonus or interest.
 - c) After 18-19 years with the overcharging, a more than 60% increase of premium is imposed.
- 2) Should the Insurer provide at least a copy of the signed Application of the Policy, (that comes with the proposal of the Policy) when requested, or, to justify their claim for a premium increase.

We hope to have your elucidation on how laws, Rules & Regulations are applied in this matter. And, we hope insurer will stick to rules not only when we go through OCI.

Since we have already forwarded our complaint to Transamerica, with copy to you in our first email, we believe your reminder to Transamerica that you have received same and pressed for a reply will be sufficient on the point with the Insurer.

We agree your release of our correspondences to other parties, if investigation is to be conducted by such parties.

Regards/

— On Thu, 6/9/11, iamail@oci.gov.hk <iamail@oci.gov.hk> wrote:

From: iamail@oci.gov.hk <iamail@oci.gov.hk>
 Subject: Re: FW: ...
 To: wingka_
 Date: Thursday, June 9, 2011, 9:59 AM

Re: Transamerica Life (Bermuda) Ltd. ("Transamerica")

Our Ref: L/M(1) in F-14411 (INS) Sub-file III

Dear Mr. Lee,

We refer to your email of 3 June 2011 complaining against Transamerica.

We have considered the content of your complaint. It appears that your complaint relates to the policy terms and commercial operations of an insurer. It will be better dealt with by the insurer concerned. As such, we are intending to refer your complaint to the insurer concerned for replying to you as soon as possible, a copy of its reply will be forwarded to us for information. In this connection, we should be grateful if you would let us have your consent by completing the attached form and returning it to us by post, fax or email as soon as possible.

(See attached file: comp_en_consent.pdf)

Yours sincerely,

(Derrick Fung)
 for Commissioner of Insurance
 (Insurance Authority)

----->
 | From: |
 |----->
 |wingka Lee <|
 |----->
 |----->
 | To: |
 |----->
 |iamail@oci.gov.hk|
 |----->
 |----->
 | Date: |
 |----->
 |03/06/2011 15:51|
 |----->
 |----->
 | Subject: |
 |----->
 |----->
 |Re: FW:|
 |----->

To: Office of the Commissioner of Insurance - iamail@oci.gov.hk

From: wingka Lee

Re: L

Date: June 3, 2011

Encl:

Dear sirs/mamdams,

We hope the attachment T 's self explanatory to draw our feeling that.

1. After 18-19 years of payment, we find it to be NOT more than a Term Life Policy but with a much higher premium but "Flexible" for higher premium (from USD2050 to USD3,260) with probably no fixed period.
2. We are declined to be provided with a copy of Policy and signed Application Form that goes together with the Policy to verify its "flexibility" in premium and was "designed" for up to age 63.
3. From their websites, http://www.transamerica.com.hk/financial_planning/financial_tools/term_quote_calculator.aspx
 We understand, a Term Policy at age 41, non-smoker for 20-years' is USD\$849.21 annual or USD1,309.02 for a 30 years'. Therefore,
 - a) should a Life Policy charging 2,050 annually be non-participating or without dividend? Or,
 - b) should a practically Term Life Policy be called otherwise, just for the sake of higher premium? And, with "flexibility" of increasing premium and with probably no fixed period?
 - c) Should the overcharging (2050-849.21)/year (=21614.22 for 18 years) be deemed to be a kind of investment to receive interest or dividend. Or, some 3% per annually as in their http://www.transamerica.com.hk/products/universal_life/transace_elite_II.aspx
 In another words, should a premium higher than Term life after 18-19 years to end up with nothing but tremendous increase of Premium.
4. We feel being dragged to accept the illogical increase or to be lapsed despite of having paid a much higher premium for the last 18-19 years.

We hope to seek your kind assistance in the matter.

Regards

--- On Fri, 6/3/11, wingka Lee <

wrote:

From: wingka Lee <

Subject: Re: FW:

To: "Ocean Wong" <[redacted]>
 Co: [redacted]
 Date: Friday, June 3, 2011, 2:42 PM

To: Mr Ocean Wong
 From: Lee Wing Ka
 Re: [redacted]
 Date: June 3, 2011
 CC: [redacted]
 Encl: your 3 files [redacted] enforce ILS

1. On May 9, 2011, in reply to our request for a copy of the Policy, we had received from you a copy of Summary and Statement, namely [redacted] and [redacted] as attached herein. Your reply in the email was:

"The policy you bought is a Universal life product means it can protect you up to the age 100, but when you bought this plan at age 42, your agent only design it to protection you to age 63 only! Means that the premium you pay now can protect to age 100, please call me if you have any further concern, thanks!"

(Highlight added)

2. On May 10, 2011, we repeatedly and specifically asked for a copy of the Policy with reminder on May 20, 2011.

3. On May 20, 2011, you resend the two files.

4. On May 21, 2011, from your 2 files, we explicitly asked the following:

"1. Should there be an application form that I had signed to form part of the policy?

2. From your latest Policy Summary and your statement below, does it mean that 2,050 should be valid for the policy up to age 100?

3. When it is mentioned as being non-participating, no dividend and no cash value at age 100, does it mean it is more or less a Term Life up to age 100?

5. On May 27 & June 2, we have sent 2 reminders.

6. So far, we had not received a copy of the Policy, including the Application and answers to the enquiries.

7. Today, we received your reply with attachment, [redacted], which indicates a premium of USD3,260 instead of USD2,050 which contradicts with your Statement and reply as in Point 1 above.

8. Since it is a non-participating and no dividend policy as mentioned in your [redacted] and exhibited in the Summary (after 18-19 years of enforcement!),

a) Should it be considered as no more than a Term Policy up to age 100? (as enquired in our email of May 21, Point 4-3 above).

b) When you mentioned it was designed to protect up to age 63, then, should it be considered as the premium was set according to a Term Life of 20 years which should at least be good until 2013?

c) Then what is the Premium Rate for a Term Life of 20 years or 30 years at age 41 Non-Smoker?

9. Meanwhile, please confirm my rights to a copy of Policy with the signed application form and document to justify your email of May 9, as in Point 1. Since we feel being dragged by your delayed proper reply to our enquiry, please confirm grace period will be extended accordingly.

Regards

--- On Thu, 6/2/11, Ocean Wong <[redacted]> wrote:

From: Ocean Wong <[redacted]>

Subject: FW: [redacted]

To: "Wingka Lee" <[redacted]>

Date: Thursday, June 2, 2011, 2:55 PM

Dear Mr. Lee, Please call me if you have any concern, thanks!

From: Ocean Wong [mailto:]
Sent: Friday, May 27, 2011 11:08 AM
To: '
Subject: Re:

Dear Mr. Lee,

Thanks for your e-mail, please find the attached in force illustration for your request.

- 1) For any claims, at the moment we do not need an original policy, copy is good(i.e.: most of our client just give us the policy no and name)
- 2) Grace period is only two month for your policy.

Please arrange your payment asap if you still need this policy, thanks!

Best regards!

Ocean Wong

Tel:

From: wingka Lee [mailto:]
Sent: Friday, May 27, 2011 7:01 AM
To: Ocean Wong
Subject: Fw: Re: FW:

Missing your reply.

1. Should a full copy of the policy be provided when it was requested? And, not a Statement of Summary and Statement?
2. I believe payment is due on May 19, therefore, can you speed up to sort out the matter? Or, please confirm grace period will be provided until copy of policy was provided and matter sorted out?.

Regards/Lee Wingka

--- On Sat, 5/21/11, wingka Lee < > wrote:

From: wingka Lee < >

Subject: Re: FW: T

To: "Ocean Wong" < >

Date: Saturday, May 21, 2011, 9:26 AM

Thanks for the copy.

1. Should there be an application form that I had signed to form part of the policy?
2. From your latest Policy Summary and your statement below, does it means that 2,050 should be valid for the policy upto age 100?
3. When it is mentioned as being non-participating, no dividend and no cash value at age 100, does it means it is more or less a Term Life upto age 100?

Regards/Lee Wingka

--- On Fri, 5/20/11, Ocean Wong < > wrote:

From: Ocean Wong

Subject: FW:

To: < >

Date: Friday, May 20, 2011, 2:50 PM

Resend! Ocean Wong

From: Ocean Wong [mailto: >]

Subject: THE CONSTITUTION OF THE UNITED STATES

Ocean Wong

(See attached file: OCI-2011-06101.

To: Office of the Commissioner of Insurance - iamail@oci.gov.hk
From: Lee Wing Ka
Re: Universal Life Policy – ~~Transamerica~~ with Transamerica
Yr Ref: L/M(1) in F-14411 (INS) Sub-file III
Date: June 15, 2011
Cc: info@fstb.gov.hk
Encl: consult_ppf_e

Dear Mr Fung,

Thanks your kind reply dated June14.

- 1) We believe our OCI-2011-06101 is our enquiry to OCI for legal elucidation and our consent for OCI to pursuit our complaint to Transamerica to be on basis of our Transa-2011-06031 sent to Transamerica with copy to you. Our consent to release our correspondences to other parties, including OCI-2011-06101 should be deemed for the case of investigation, if needed. We did not consent and expect your release of our other correspondences to Transamerica, prior to further consent..
- 2) We have not received your answer to our enquiry to you on June 3, rephrased on June 10 the followings:

 - 1) Can a practically Term Life policy be marketed as Universal Life? Where
 - a) the premium is more than double of a Term-life
 - b) there is no Dividend or Cash value, nor bonus or interest.
 - c) After 18-19 years with the overcharging, a more than 60% increase of premium is imposed.
 - 2) Should the Insurer provide at least a copy of the signed Application of the Policy, (that comes with the proposal of the Policy) when requested, or, to justify their claim for a premium increase.

- 3) As in our OCI-2011-06031-
 - a) the premium was USD2,050 since 1942 (age 41). It was mentioned recently that it was designed for protection up to age 63 only (2013, a term of 23 years).
 - b) Yet we are asked to pay NOW a premium of USD3265, which is more than 60% increase. So, the last premium is only valid for 19year).
 - c) The premium for a 20-year Term Life (from Transamerica website) is USD849.12
 - d) Therefore, the accumulated overcharged for (1991-2011) is $19 \times (2,050 - 849.12) = \text{USD } 22816.72$.
- 3) We believe Term Life, Whole Life, Universal Life and Endowment Policy carry specific interpretation in the Insurance Industry. Such as those listed under the Glossary of the Consultation papers issued by FSTB Financial Service and Treasury Bureau on the establishment of Policyholder Protection Fund and Independent Insurance Authority, attached herein.
- 4) Therefore, are we (as well as OCI as regulator of Insurers) entitled to query:

- (a) Should a practically Term Life be marketed as Universal Life ending with practically nothing but death benefit?
 - (b) Where are those overcharge USD 24017.6 gone?
 - (c) From where is Transamerica qualified and quantified for the premium increase? From USD2050 to USD3,265.
- 5) We believe it is a case of Misrepresentation, or misconduct, or, fallying out of proper standard. We believe OCI has the responsibility under **Section 4A of ICO** where it is stipulated as:

Functions of Insurance Authority

- (1) The principal function of the **Insurance Authority** shall be to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders.
- (2) Without limiting the generality of subsection (1), the **Insurance Authority** shall-
- (a) be responsible for supervising an insurer's and an insurance intermediary's compliance with the provisions of this Ordinance;
 - (b) consider and propose reforms of the law relating to insurance business;
 - (c) promote and encourage proper standards of conduct and sound and prudent business practices amongst insurers;
- 6) Should OCI or IA be silent when Misrepresentation, or/and, misconduct, or/and, improper standard of conduct of business practices are there? And, thereby, be justified to be appointed as Regulator of Insurers by law?
- 7) We believe, udner the law, the Insurer is accounted for the overcharged of USD 22816.72. We believe IA is empowered under Section 27 to 35 of the ICO to do the necessary to provide an explanation on what are those overcharged for and how the premium increase is to be qualified and quantified.
- 8) We do not believe IA and OCI are limited to act only as a messenger in our complaint of possible Misrepresentation. or/and, misconduct and at least improper operation standard, which are or could affect all policy holders of "Universal Life" with Transamerica.

We hope to receive your answer to the specific questions above.

Meanwhile, please note that our policy anniversary falls on May 19. We were informed by Transamerica via their email of June 2, that the Grace period is two months. So, please advise how we can avoid lapsing the policy when we are awaiting feedback from Transamerica since early May as well as you advice to sort the matters.

Regards/

民主黨對保單持有人保障基金(保障基金)意見

民主黨立法會議員 李華明 涂謹申 2011 年 6 月 22 日

1. **成立保障基金：**由於保險往往是市民生活保障的最後一道防線。在 2008 年金融海嘯事件中，亦曾經發生國際級大型保險公司出現財政困難。這些現象使人擔憂萬一保險公司倒閉，市民在極惡劣情況下所倚靠的保險計劃有可能失去效用。因此民主黨支持盡快成立保障基金，加強保障保單持有人的利益。
2. **保障範圍：**我們同意政府建議保障基金主要對象是個人保單持有人，以及涵蓋大廈業主立案法團保單持有人(諮詢文件 3.3 及 3.5 段)。
3. **最高賠償限額：**政府建議的賠償限額最高總額為 100 萬元。我們認為 100 萬元的水平偏低，很有可能不能應付市民的保障需要。因此我們建議，人壽保險每份保單賠償限額最高總額需要達到約 300 萬元(諮詢文件 3.14 段)。
4. **保單轉移：**我們同意政府建議，人壽計劃應在可行的情況下促成保單轉移，以及容許人壽計劃在有需要時，靈活地支付款項以促成保單轉移，但金額上限為每份保單需要由 100 萬元提高至約 300 萬元(諮詢文件 3.18 段)。
5. **檢討最高賠償限額和轉移金額上限：**由於經濟狀況和物價水平不斷改變，我們建議政府每 3 年檢討 1 次人壽保險保單賠償限額最高總額及保單轉移金額上限，並且在有需要時按物價水平和市民人壽保險保單平均保障額來調整，以確保保障基金能夠追上經濟變化和市民需要。
6. **啟動條件：**我們同意啟動保障基金的條件(保單持有人保障基金諮詢文件附件 C)。
7. **徵費模式：**為使保障基金盡快成立，我們同意政府建議保障基金的徵費模式採用漸進式徵費模式(諮詢文件 4.3 段)。
8. **資產追討機制：**為加強保障基金協助保單持有人取得應有的利益，我們同意政府建議保障基金應與《公司條例》第 265 條所指明的兩類債權人(即僱員補償援助基金及未獲保障基金賠償的所有其他直接保險申索)享有同等權益(諮詢文件 4.14 段)。
9. **墊付流動資金不足之數的融資安排：**為確保保障基金在任何時間都可為保單持有人提供保障，我們同意政府建議，當保障基金流動資金不足夠時，容

許保障基金由政府作擔保向第三方貸款人借款，以墊付流動資金不足之數，或直接向政府貸款。無論採用那一種方法，都必須得到立法會批准(諮詢文件 4.16 段)。

10. **其他：**若保障基金的資金足夠應付賠償需要時，保障基金應暫停徵費，直到評估環境後認為需要為保障基金加添資金才恢復徵費，可參考旅遊業賠償基金的做法。

—完—

To ppf_consultation@fstb.gov.hk

23/06/2011 11:30

Subject 建議成立保單持有人保障基金的公眾諮詢

林詩農財經事務及庫務局助理秘書長，您好。

關於題述事宜，本會經過多番探討和詢徵各理事之後，有以下之見識，請參閱附檔。



Comments of Proposed Establishment of a Policyholders.doc

如有任何查詢，請與我司聯絡。謝謝。

香港一般保險代理協會秘書長

潘康寧啟

From: ppf_consultation@fstb.gov.hk [mailto:ppf_consultation@fstb.gov.hk]

Sent: Tuesday, June 07, 2011 3:39 PM

To: Jack Ng

Subject: 建議成立保單持有人保障基金的公眾諮詢

吳會長：

我們在2011年3月25日致函 貴會，邀請 貴會就成立保單持有人保障基金("保障基金")的諮詢發表意見。我們已於過去數月舉辦了多場諮詢會，向業界從業員和公眾人士簡介建議。

我們懇切期待於2011年6月24日諮詢期完結之前，收到 貴會的意見。貴會及閣下的寶貴意見將有助我們制訂最終建議方案，作為成立保障基金的立法基礎。如有任何查詢，歡迎致電2528 9076直接與本人聯絡，或2527 0619與鍾兆婷小姐聯絡。



2010 - 2011
Committee Members

I. P. Chairman
Tony Mak

Acting Chairman
Jack Ng

2nd Vice Chairman
K. K. Wong

Honorary Secretary
Jackson Pun

Treasurer
Ronald Chung

Director of Trade Issue
William Leung

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Director of Education
Eric Yiu

Director of Admin.
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William Ng
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Thomas Fung

Hon. Advisers :

Chan Kin Por
Bernard Chan

Legal Adviser :

Christine Koo

Hon. Auditor :

Ellen Tsang

**Comments of Proposed Establishment of a Policyholders'
Protection Fund (PPF) by HKGIAA**

In principle our Association has no objection to the Administrator to set up the PPF but should under the following criteria:-

- A) To provide better protection to policyholders' interest.
- B) To maintaining market stability in the event of Insurer insolvency.
- C) To enhancing public confidence in and competitiveness of the Insurance industry.

Base on the above concerns we have the following comments for your consideration:-

Coverage

We have the opinion that the SMEs should not include under the PPF, we believe SMEs are able to protect their interests in buying policies and manage their risks or we would consider extending the coverage to all sole proprietors limited to not exceed 10 employees which can serve the same purpose to enhancing their risk management

Compensation Limit

For non-life insurance, the compensation limit would be applied on a per-claim basis with the total compensation limit of HK\$ 1 million. Base on the consultation paper of PPF paragraph 3.15, the proposed limit only able to meet claims of some 96% of non-life policies (Industry Data by end of 2009). We proposed that we should increase the compensation limit and achieve the higher percentage level of protected liabilities of nearly to 100% which would enhance the public confidence of Insurance industry.

Initial Target Fund Size and Levy Rate

The initial levy rates for both the Life Scheme and Non-life Scheme should be set at 0.07% of the applicable premium and the administrator proposed the levy contribution from insurers. We believe the impact of the premium level must be increased and also it will affect our products which are less competitive when comparing with other Asian countries especially in Life products. We recommend the levy rate should be lower and extend to build up the target fund in 20 to 25 years instead of within 15 years

RE: 建議成立保單持有人保障基金的公眾諮詢

From: Ivan Chiu (HKCII) |
Date: Jun 23, 2011 18:23
To: <ppf_consultation@fstb.gov.hk>
Cc: "HKCII Admin"

Dear Sirs,

We, the Hong Kong Chamber of Insurance Intermediaries, are responding to the Consultation Paper on the proposed establishment of a Policyholders Protection Fund.

Comments and Considerations

We are in principle supportive of the proposal of the financial Services and the Treasury Bureau (FSTB) of the Government of the HKSAR to establish a Policyholders Protection Fund (PPF). However we would suggest that at the time being the PPF only limited to individual policyholder for life and long terms business only. The reason is that it will be more simply, less complex and practical in the first stage.

We would also suggest that the limit is not sufficient (only HK 1Million) and recommend increasing the limit upto reasonable level based on the average policy sum insured.

Best regards,

Ivan Chiu

Ivan Chiu
President of HKCII
(Year 2011)



From: ppf_consultation@fstb.gov.hk [mailto:ppf_consultation@fstb.gov.hk]
Sent: Tuesday, June 07, 2011 5:25 PM
To:
Cc:
Subject: 建議成立保單持有人保障基金的公眾諮詢

趙會長：

我們在2011年3月25日致函 貴會，邀請 貴會就成立保單持有人保障基金("保障基金")的諮詢發表意見。我們已於過去數月舉辦了多場諮詢會，向業界從業員和公眾人士簡介建議。

我們懇切期待於2011年6月24日諮詢期完結之前，收到 貴會的意見。 貴會及閣下的寶貴意見將有助我們制訂最終建議方案，作為成立保障基金的立法基礎。如有任何查詢，歡迎致電2528 9076直接與本人聯絡，或2527 0619與鍾兆輝小姐聯絡。

財經事務及庫務局助理秘書長
林詩農 啓

保單持有人保障基金建議書

From: hkipgu07
Date: Jun 24, 2011 14:25
To: <ppf_consultation@fstb.gov.hk>
Cc:
Attachments:  建議書.doc (57.5 KB)

致財經事務及庫務局：

附件為本會就保單持有人保障基金的建議書，如有查詢歡迎致電 與本會職員黎小姐聯絡。

香港保險業總工會

Information from NOD32
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香港保險業總工會

Hong Kong Insurance Practitioners General Union

(香港工會聯合會、香港文職及專業人員總會屬會)

保單持有人保障基金建議書

二零零八年金融海嘯後，市民對購買保險失去信心，擔心保險公司面對金融危機時，無力為保單持有人提供賠償及保障，令消費者承受一無所有的風險。因此，我們早於那時向政府提出設立「保單持有人保障基金」，一方面挽回公眾對業界的信心，另一方面使保險從業員的生計得以維持。直至今年三月，政府就成立「保單持有人基金」進行公開諮詢。保險業總工會對此感到歡迎。以下是保險業總工會對上述基金的建議：

首先，根據¹政府的諮詢文件，人壽保險的賠償上限為每份保單港幣 100 萬元。就該賠償水平，本會建議可將賠償上調至三百萬元，以便更符合香港的實際情況及市民和業界的訴求。因為假如有保險公司倒閉，而持有該公司保單的投保人需要就投保事項索賠，基金將向投保人賠付申索額首十萬元及餘額的八成，上限為一百萬元，額度不能起到充分保障。本會相信基金能保障保單持有人的同時，亦可增加保險從業員收入。

其次，諮詢文件又提到²保障基金應授權向保險公司徵費，非人壽保險的基金金額計劃為七千五百萬元。本會建議將非人壽保險規模增至一億五千萬元。設立保障基金，就像在銀行存款、股票、基金、強積金等方面的保障制度一樣，保護消費者，進而維持保險市場的穩定。若不幸發生保險公司倒閉事件時，能夠為投保人提供賠償。諮詢文件中建議的徵款比例與保障上限都略低，預期建議的基金規模也較小。未足以全面保障消費者。

總而言之，「保單持有人保障基金」能保障消費者，維護保險業信譽，穩定香港金融中心的地位。但基金的規模則要有擴大的需要，使更全面保障消費者。

香港保險業總工會

¹建議設立保單持有人基金諮詢文件 p2

²建議設立保單持有人基金諮詢文件 p3

致： 財經事務及庫務局

對《保單持有人保障基金》諮詢文件的意見

1. 香港保險業的發展迅速，2010 年的保費總額突破 2000 億元，雖然本地保險業的運作穩健，但金融海嘯的經驗突顯國際性的大型保險公司，在經濟逆轉時亦可能出現財政困難，若沒有相應的保障機制，保單持有人可能損失應得的賠償，亦會打擊保險業界的信譽。
2. 為保障保單持有人的權益，經濟動力認同設立「保單持有人保障基金」(下稱「保障基金」)的理念，為投保者提供賠償的「安全網」，提升公眾對保險業界的信心，增加保險市場的穩定性，促進保險業的健康發展，亦有利鞏固香港作為國際金融中心的地位。
3. 我們對「保障基金」的計劃細節有以下的關注及意見，謹予 貴局作出考慮：

保障範圍應涵蓋中小企

4. 由於人壽與非人壽保險的性質、年期、風險及賠償方式均有甚多差異，我們贊同諮詢文件建議，在「保障基金」分設兩項獨立的計劃，以保障人壽與非人壽的保單。
5. 保障範圍方面，我們認為，除了保障個人的保單持有人及大廈業主立案法團的第三者保險，「保障基金」亦應涵蓋中小型企業的保單。大型企業有足夠的資源去評估及管理其營運風險，部分集團式企業更能自行成立再保險公司，但中小企的人力及財力有限，主要依靠各類保險產品作為風險管理工具，在遇到意外事故時，亦十分依賴賠償金額作為補救及應急之用。
6. 香港九成八企業為中小企，一旦出現經濟逆轉，有保險公司出現財政困難而未能向中小企作出賠償，其影響並非只限於保險及金融行業，更將牽連中小企及其經營伙伴，引發連鎖效應。因此，把中小企列入「保障基金」範圍，亦有助減輕金融市場波動對整體經濟及中小企業的衝擊，此外，這可加強中小企對保險業界的信心，有助促進工商企業保險的市場發展。

中小企設較高的賠償限額

7. 諮詢文件建議，人壽與非人壽保單的賠償限額均為 100 萬元，並指該賠償額足以涵蓋約 90% 人壽保單所引致的申索的 90% 至 100%，以及 96% 非人壽保單所引致的全數申索。為平衡道德風險及避免徵費水平過高，我們認同，建議的賠償水平屬合理，讓保單持有人可得到大部分的索償額保障。
8. 然而，若「保障基金」涵蓋中小企的保單，例如財物保險、專業責任保險等，100 萬元的賠償限額則可能遠低於保單的賠償額，未能予中小企保單足夠保障，建議「保障基金」為中小企保單另設較高的賠償限額，可考慮定於 1000 萬元水平，相信能涵蓋大部分的中小企保單。由於中小企保單的保費水平，亦相應高於個人保單，相信「保障基金」對個人與企業保單採同一徵費百分比，可應付賠償需要。
9. 由於人壽保單的賠償按每張保單計算，徵費以整體保費水平計算，但賠償上限為 100 萬元，投保人為獲得最多保障，可能引致「拆單」情況，如投保 300 萬元的人壽保險，則分為 3 張保單，這將引致保險公司的行政成本上升，若「拆單」情況普遍，將對保費構成加價壓力，期望當局留意「拆單」問題。

出現索償後的徵費水平

10. 諮詢文件建議，人壽與非人壽「保障基金」首 15 年的目標基金總額分別為 12 億元及 7500 萬元，初期徵費率為適用保費的 0.07%。鑑於香港保險業的運作穩健，即使金融海嘯期間，亦未有出現嚴重財政困難，加上「保障基金」可透過借貸融資應付賠償需要，相信目前的徵費水平，足以應付基金的初期需要，亦同意採「漸進式徵費模式」，是較平衡及切實的做法。
11. 然而，我們關注將來若有保險公司無力償債，以 2010 年毛保費總額已逾 2000 億元估計，牽涉的賠償金額將超出基金儲備，「保障基金」徵費難免需大幅調高，屆時保險公司將會把徵費轉嫁至保單持有人，令保費水平上升。由於「保障基金」牽涉大部分市民與企業的保單，我們認為，將來若調整徵費比率，應先進行諮詢，並經立法會審議。

12. 此外，我們期望，當局可提供相關的估算資料與數字，讓市民作出進一步的考慮，包括估算不同的個案與賠償金額之下，徵費的增幅將會上升多少？徵費水平若設定一定上限，能否應付索償的需要？

須一併考慮保監局徵費

13. 政府正計劃成立「保險業監管局」，需要從保費中收取 0.1% 的徵費，以應付保監局 70% 的開支。我們關注，「保障基金」加上保監局的徵費水平合共已達 0.17%，雖然仍屬較低水平，但隨著基金出現索償，或保監局未來的架構和成本膨脹，可能需提升徵費率，對保費加價的壓力增加，不但加重市民及中小企的投保成本，亦會削弱香港的保險產品的對外競爭力。
14. 因此，我們期望局方在考慮「保障基金」的徵費時，需一併考慮將來保監局的徵費，對整體保費及成本的影響，並再次促請局方考慮設定徵費的上限水平，以免投保人負擔過重。

提供基金行政成本資料

15. 諮詢文件建議，成立法定機構管理「保障基金」，並估計其營運開支佔初期預定的基金金額 0.2%¹，以人壽及非人壽基金分別 12 億元及 7500 萬元規模，即營運開支分別為 240 萬元及 15 萬元。我們質疑，有關金額有否被低估。
16. 以性質相近的「存款保障計劃」為例，該基金在 2009/10 年度的開支總額超過 6500 萬元²，佔存保基金總額 12.84 億元約 5%，佔同年供款額 3.77 億元更高達 17%，單是僱員成本亦達 575 萬多元。另外，負責管理僱員補償保險的「保險公司(僱員補償)無力償債管理局」，2009/10 年的行政及雜項開支亦達 243 萬多元³。

¹ 見諮詢文件第 18 頁註釋 14 的假設(g)項

² 資料來源：香港存款保障委員會 2009-2010 年年報

³ 資料來源：保險公司(僱員補償)無力償債管理局 2009-2010 年年報

17. 保險業界的運作複雜性並不比銀行業為低，「保障基金」涵蓋的保單種類及數目亦較僱員補償保險大為增加，諮詢文件估計「保障基金」管理機構每年只需約 255 萬的營運開支，是否現實與可行？
18. 因此，我們促請局方就「保障基金」的營運成本提供更詳盡的資料，讓公眾作出仔細考慮。

研究合併各保險賠償基金

19. 現時保險業已設立僱員補償保險及汽車第三者保險的賠償基金，分別由「保險公司(僱員補償)無力償債管理局」及「香港汽車保險局」管理，再加上諮詢文件提出的「保障基金管理委員會」，本地將來會有三個管理保險業賠償基金的獨立機構，這是否符合最佳的運作與成本效益？
20. 我們建議政府借設立「保障基金」的機會，作出研究及諮詢，能否把各項保險業賠償基金，歸於統一機構作出管理，但分為不同的獨立帳目，以節省行政成本開支，相信有助降低上調徵費的壓力，亦是善用資源的做法。

與保險業監管局協調

21. 預防勝於治療，除了在保險公司無力償債後作出賠償，有關制度若能及早就保險公司的財政情況作出監察，避免保險公司陷入財政困難，相信較出事後付出大額賠償更理想。此外，目前市民對保單的細則與條款欠缺了解，亦有不少憂慮，過往有不少個案因不了解保單條款，影響其賠償額，或與保險公司出現糾紛。
22. 因此，我們期望新設的「保障基金」能與計劃中的保監局加強協調，建立提前監察與預警制度，及早發現並輔助財政不善的保險公司，同時推動保險公司提升保單條款的透明度與可讀性，並加強公眾教育，讓市民認識保單的賠償機制與條款，相信較被動地作出賠償，更為治標與治本。

經濟動力
2011 年 6 月 24 日

The proposed establishment of a Policyholders' Protection Fund

From: Daphne So [
Date: Jun 24, 2011 15:27
To: "ppf_consultation@fstb.gov.hk"<ppf_consultation@fstb.gov.hk>
Cc:
Attachments:  Signed cover letter.pdf (45.6 KB)
 IFPHK's Response on proposals for Policyholder Protection Fund_final_June 2011.pdf (214.6 KB)

Dear Sir/Madam,

Please find the attached documents represent IFPHK's submission to the captioned consultation paper, hard copies of the submission paper will be sent to your office.

Should you have any queries, please feel free to contact me.

Thanks & regards,

Daphne So
Senior Manager
Policy and Regulatory Affairs
The Institute of Financial Planners of Hong Kong



The global symbol
of excellence in
financial planning



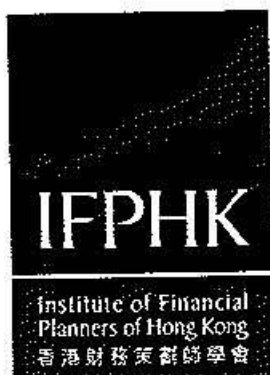
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23 June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I
Admiralty Centre
18, Harcourt Road
Hong Kong

Dear Sir/ Madam,

**IFPHK response to the consultation paper on
the proposed establishment of a Policyholders' Protection Fund**

On behalf of the Institute of Financial Planners Hong Kong (IFPHK), I have attached herewith our Submission Paper that outlines our formal response to the Financial Services and the Treasury Bureau (FSTB) consultation paper on the proposed establishment of a Policyholders' Protection Fund.

IFPHK sincerely welcome the opportunity to be involved in the in this consultation paper. We hope that the FSTB will find the suggestions outlined in our contained response paper useful.

We are happy to discuss the details of our submission document with you at your convenience.

Thank you!

Yours faithfully,

Eleanor Wan
Chief Executive Officer
Institute of Financial Planners of Hong Kong
Encl.



IFPHK's Response to the Consultation Paper on the Proposed Establishment of a Policyholders' Protection Fund

June 2011



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IFPHK Profile

Background

The Institute of Financial Planners of Hong Kong ("IFPHK") was established in June 2000 as a non-profit organisation in response to the rapid expansion of the personal insurance industry. It aims to be recognised as the region's premier professional body, representing those financial planners who uphold the highest professional standards for the benefit of the general public.

The Institute is the sole licensing body in Hong Kong authorised by Financial Planning Standards Board Limited¹ to grant the much-coveted and internationally-recognized CFP² certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 14,000 financial planning practitioners in Hong Kong from diverse professional backgrounds including banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are over 133,000 CFP professionals in 24 countries/regions; the majority of these professionals are in the U.S., Canada, Australia and Japan, with more than 4,300 CFP professionals in Hong Kong.

IFPHK's interest in this consultation

Insurance is considered the cornerstone of financial planning. Effective and proper use of insurance products help spread risk, which can minimise its impact on families should events take a downturn. Insurance is therefore an important part of IFPHK's financial planning education and certification programme. Having knowledgeable insurance practitioners, proper consumer understanding of what insurance policies do, effective products, and financially sound underwriters is essential for those who seek financial planning. As the leading professional institute representing the interests of the financial planning industry, IFPHK has a duty to respond to any consultation paper that may impact its members and their clients. As such, IFPHK has taken a strong interest in the Consultation Paper and wishes to express its views on the proposed changes.

¹ FPSB was established in October 2004 by 17 non-profit associations that together certify over 45,000 individuals outside the U.S. to use CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  marks and that have joined FPSB as members. FPSB will protect financial planning consumers and foster professionalism in financial planning through the ongoing development and enforcement of relevant international competency and ethics standards. FPSB will also promote greater global recognition of CFP certification and its related marks as the international hallmarks of financial planning professionals. CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  are certification marks owned outside the U.S. by Financial Planning Standards Board Ltd. (FPSB). The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks in Hong Kong and Macau, through agreement with FPSB.

² CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  are certification marks owned outside the U.S. by Financial Planning Standards Board Ltd. The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks in Hong Kong and Macau, through agreement with FPSB.



IFPHK's representation

IFPHK has 30 founding members who contributed to its inception and foundation. These members believe in raising the standard of financial planners and increasing awareness around the need for sound financial planning. Of these 30 founding members, 8 are insurance companies. They are:

- American International Assurance Company (Bermuda) Limited
- AXA China Region Insurance Company Limited
- Ageas Insurance Company (Asia) Limited (Formerly Fortis Insurance Company (Asia) Limited)
- Manulife (International) Limited
- New York Life Insurance Worldwide Limited
- Sun Life Hong Kong Limited
- The Prudential Assurance Company Limited
- Zurich Life Insurance Company Limited

We currently have 64 corporate members, including 32 insurance companies and brokerage firms. These corporate members employ over 33,000 insurance practitioners. Therefore IFPHK is well positioned to understand the needs, concerns and aspirations of the long term insurance market practitioners. When formulating its response to the consultation, IFPHK has sought the views of its corporate members who are active in the market.



Executive Summary

The Financial Services and the Treasury Bureau ("FSTB") issued the Consultation Paper on Proposed Establishment of a Policyholders' Protection Fund (the "Consultation Paper") in March 2011. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper.

The Consultation Paper explains FSTB's proposals to establish a Policyholders' Protection Fund ("PPF") as a safety net to better protect policyholders' interests, to maintain market stability in the event of insurer insolvency, and increase public confidence and competition in the insurance industry. To this end, the Consultation Paper provides for various proposals on the objectives of the PPF, its coverage, the level of compensation and application, a funding mechanism, and governance arrangement.

In considering the proposed changes outlined in the Consultation Paper, IFPHK feels the following principles should be strictly adhered to;

- The PPF should deliver measurable benefits to the insurance industry in the medium and long term, and enable a healthy and sustainable business environment for the industry to thrive in by maintaining the stability of the market.
- The PPF should support the delivery of better insurance products and services to benefit and protect members of the public.
- The PPF should not operate at a cost that exceeds the benefits delivered to the industry and the investing public.

Due to differences within the industry, Hong Kong lags behind in the development of a comprehensive protection scheme for policyholders. In the wake of the financial crisis there is an urgent need to enhance consumer protection and restore public confidence by establishing a PPF. However, it is inevitable that costs will be incurred in setting up and administering such a compensation fund. The IFPHK believes the challenge will be to ensure that the limited resources available are used to help maintain high levels of consumer confidence in the insurance industry, and to compensate policyholders in the event of an insurer's insolvency.

In conclusion, IFPHK supports most of the proposed changes set out in the Consultation Paper including:

- A PPF should be established by statute with the objective of providing **last resort to policyholders**. The PPF should be complementary to the regulatory standards and requirements laid down by the Insurance Authority under the Insurance Companies Ordinance.
- The PPF should **comprise two separate schemes** for life and non-life insurance products. The PPF should **cover all individuals and SMEs**, but should exclude professional policyholders on the basis that they have more resources to perform due diligence on insurers and insurance products.
- The activating conditions of the PPF should be clearly stated in the legislation, and **compensation limits** should be applied to the PPF in order to mitigate the risk of moral hazard.



- The primary objective for the Life Scheme should be to facilitate a transfer of insurance policies in case of insurer's insolvency. On the other hand, the primary objective for the Non-life Scheme is to pay out compensation to claimants. Therefore, the **operation procedure** of the PPF should clearly align with the above objectives, and it should be clearly defined in the legislation.
- The PPF should apply the **progressive funding model** to accumulate fund size gradually. In case of shortfall, the PPF is empowered to borrow money from third party with the approval of the legislative council. This approach strikes a balance between the need for visibility of sufficient funds to protect policyholders, and the demand of insurers for keeping costs low.
- The PPF should apply the simplest method of calculating contributions by setting a **levy rate on the premium**.
- The PPF should be **administered by a small independent body with low overheads**. The independent body should have the flexibility to engage additional staff or experts in cases of insolvency.

While IFPHK agrees with the principles and rationale of setting up a PPF, IFPHK shares the industry's concerns regarding the possibility of high cost incurred in the operation and administration of the fund. IFPHK believes it is important to build a scheme that is simple and cost-effective. As such, IFPHK proposes the following suggestions:

- The Government should provide a **defined list of insurance classes, eligible persons and eligible claimants** to the industry and the public in order to avoid any confusion or misunderstanding that may arise.
- The Government should consider **fully guaranteeing the third party risk insurance by owner's corporation** in order to align it with other compulsory schemes such as the Motor Insurer's Bureau of Hong Kong, and the Employees Compensation Insurer Insolvency Bureau.
- A **detailed payout procedure** which will be administered by a small operation should be established, and it should be constantly tested and reviewed in order to maintain and enhance its readiness and effectiveness in paying claims to eligible claimants.
- The Government should establish and obtain consensus from the industry on the **mechanism of charging a stepped-up levy** in order to ensure that it will not add onerous cost to the industry
- The administration of the PPF Board shall be kept to a minimum by **sharing resources** with the Insurance Authority and integrating it with the operation of the two existing schemes.

The statements given in IFPHK's response to the Consultation Paper are based on an objective and independent analysis of the market and consumer needs. To ensure that IFPHK understands the concerns and practicality of the issue, it sought comments from active industry practitioners who deal with this issue on a regular basis. It should also be noted that the views and recommendations outlined herein represents the collective views of both IFPHK management team and selected industry representatives.



The Consultation

The Financial Services and the Treasury Bureau ("FSTB") issued the Consultation Document on the proposed establishment of a Policyholders' Protection Fund (the "Consultation Paper") on 25 March 2011. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper.

The Consultation Paper sets out the key features of the proposed Policyholders' Protection Fund ("PPF"), including its principles, coverage and level of compensation to policyholders or claimants, its funding mechanism and governance arrangement.

The PPF is intended to (a) better protect policyholders' interest; (b) maintain market stability and (c) enhance public confidence in and the competitiveness of the insurance industry.

The PPF will be comprised of two separate and independent schemes, namely the Life Scheme and the Non-Life Scheme. Both schemes are focused on individual policyholders, but may extend to small and medium enterprises ("SME") based on the results of this Consultation Paper. The limit of the compensation is proposed to be set at 100% for the first HKD100k, plus 80% of the remaining balance, up to a total of HKD1m. The compensation will be paid on a per-policy basis for life insurance and a per-claim basis for non-life insurance.

The PPF will adopt a progressive funding model under which an initial target fund will be built up with the option to impose a "stepped-up" levy rate in the event of an insurer's insolvency. To ensure that the PPF can make timely compensation payments and discharge its function, it should be allowed to borrow from a third party to bridge any liquidity gap.

In relation to governance and administration arrangements of the PPF, a governing body appointed by the Financial Secretary will be established by statute to administer the PPF and to handle appeals against relevant decisions made by the PPF.

The Consultation Paper contains five chapters relating to the following areas for the industry or public to provide comments:-

- Guiding Principles of the PPF;
- Coverage of the PPF;
- Level of Compensation and the Application;
- Funding Mechanism of the PPF; and
- Governance Arrangements of the PPF.



IFPHK Response Methodology

IFPHK is a professional body that seeks to promote higher professional standards in the financial planning industry. It feels that it is important to respond to consultation and policy papers that significantly impact the financial planning sector. When formulating its response to such papers, it takes a systematic approach that includes:

1. An independent and objective study of the proposals and their overall impact, both positive and negative, on the industry and consumers, based on theoretical and practical analysis.
2. Study of international practices in markets that are either more developed or similar to Hong Kong to understand how similar proposals may have succeeded or failed, and the reasons why that may have happened.
3. Collection of comments and opinions from industry participants, including legal and compliance professionals whose business practices may be impacted by the proposals in the Consultation Paper.

After collecting and consolidating the views of the industry, IFPHK analysed the information together with its own research in markets deemed relevant to the situation in Hong Kong, including Japan, European Union, the United Kingdom and Singapore, Canada and United States. The result enabled IFPHK to formulate responses to the various questions raised in the Consultation Paper, as well as make recommendations on the practical application and effectiveness of the relevant proposals and their likely impact on the industry.

The views expressed in this submission paper are not necessarily summaries of views from the industry, but the result of independent critical analysis and consideration by IFPHK as a professional body. As a result, not all the views collected by IFPHK are recorded in this submission paper and neither have all the views expressed in this submission paper been directly endorsed by the industry representatives or members who were consulted.



IFPHK Submission

This submission is the result of IFPHK's own independent internal analysis after seeking the views of its Members.

1. *Guiding Principles of the PPF*

The proposed PPF aims to better protect policyholders' interests, maintain market stability, and enhance public confidence. In order to achieve these objectives, the PPF should be established and designed based on the following four guiding principles:

- To strike a reasonable balance in enhancing protection for policyholders and minimising any additional burden to the insurance industry
- To enhance market stability while minimising the risk of moral hazard
- To provide certainty on the level of compensation payment to policyholders
- To align and complement the regulatory standards and requirements laid down by the Insurance Authority ("IA") under the Insurance Companies Ordinance ("ICO")

The ultimate purpose of the PPF is to provide a safety net in addition to the existing prudential regulation.

IFPHK Response

Insurance is a risk management business. Insurance products are essentially making a promise to deliver money in the future. For life insurance, policies have a long term horizon. Hence the soundness of an insurer is one of the key factors an individual considers when choosing an insurance policy. Although policyholders are the creditors of an insurance company and can recover claims through the insolvency procedure, the winding up and insolvency proceedings are often complex and time-consuming. Even if they can recover money from the insolvency procedure, the cancellation of insurance contracts can result in a loss of risk transfer as policyholders may find it difficult to take on a similar policy due to reasons such as a change in personal circumstances. In light of the above, it is not practical and sufficient to rely solely on the insolvency procedure to protect the interests of policyholders.

Failure of an insurer, especially a large one, can have a far reaching impact. If an insurance company goes bankrupt and its policyholders suffer losses, the general public may lose confidence in the soundness of other insurers and may be discouraged from seeking insurance, which would result in broader negative implications across the industry and society as a whole. In consideration of this domino effect, it is pertinent to establish a safety net to protect the interests of policyholders in addition to the prudential regulation which governs the financial soundness of insurers.

Over the past decade industry views have been mixed on the launching of a PPF in Hong Kong. A consultancy study conducted in 2003 on the feasibility of establishing a PPF indicated that several insurers and insurance intermediary associations did not believe a PPF should be implemented as they were concerned that 'moral hazard risk' would encourage some consumers and insurers to take greater risk. They were also concerned about the additional cost of a PPF scheme³. Some argued that a PPF was not a cure for insolvency, and Hong Kong has sound regulator to maintain

³ PricewaterhouseCoopers, Feasibility of Establishing Policyholders' Protection Funds in Hong Kong, December 2003.



the soundness and stability of the insurance industry. Because of these diverse views, Hong Kong has been sluggish in the development of a PPF, despite a compensation scheme having been established for compulsory class of insurances⁴.

The global financial market and the international regulatory environment have changed significantly since the last consultation in 2004. It is evident that insurance companies are not immune from financial crisis. Insurance and reinsurance companies are major investors in capital markets, and their investment portfolios include exposure to sub-prime residential mortgaged-backed and related securities. The credit rating outlook for the US life insurance sector was revised to “negative” from “stable” during Q3 2008 by at least one of the three major rating agencies⁵. The impact of the “nationalization” of American Insurance Group (“AIG”) spilled over to other countries. In Hong Kong the insurance regulator ring-fenced the assets of the local subsidiary of AIG in order to protect local policyholders⁶. According to the annual report of Office of the Commissioner of Insurance (“OCI”), consumer confidence plummeted to an all time low in Q1 of 2009 and office premiums for new individual life business fell, mostly due to substantial decreases in investment-linked business. The number of complaints also skyrocketed⁷. In 2009 the industry witnessed the fall of a general insurer. Anglo-Starlite made the local headlines owing to allegations of fraud contributing to the insolvency. Anglo-Starlite insured a large share of the taxi market. Fortunately many policyholders were protected under the MIB. In the aftermath of the financial crisis there was general recognition that in spite of supervisory measures, it is inevitable that some insurance companies will encounter serious financial difficulties which could seriously harm the confidence of policyholders. As such, there is urgency to developing a policyholder compensation scheme similar to the deposit protection⁸ and the securities investors’ compensation arrangements⁹ already established in Hong Kong, in order to regain consumer confidence. Some industry participants have already urged the Government to accelerate the process of establishing a PPF.

Indeed, Insurance policyholder protection schemes are becoming more widespread in financial system around the world and are fairly common among advanced economies. For example, at least 21 OECD countries are reported to have in place or are implementing schemes for life and general insurance products¹⁰. Though many focus on protecting claimants under compulsory classes of insurance, 9 of the 21 schemes extend beyond compulsory classes. These include Canada, France, Ireland, Japan, Korea, Norway, Poland, the United Kingdom and the United States.¹¹

The financial crisis has awakened the industry and the public to the importance of having some kind of protection scheme for insurance policies. The benefits of a PPF to the economy include;

- Helps to maintain public confidence in, and foster development of, the insurance industry.

⁴ Hong Kong already has compensation schemes in place for non-life insurance policies covering third party motor vehicle accident victims and employees’ work related injuries. These types of insurance policies are compulsory under law. Motor third-party liability insurance and employee’s compensation insurance are covered by the Insolvency Fund are administered by the Motor Insurers’ Bureau of Hong Kong respectively

⁵ Sebastian Schich, Insurance Companies and the Financial Crisis, OECD Journal 2009/2

⁶ IMF, People’s Republic of China – Hong Kong Special Administrative Region: 2008 Article IV Consultation Discussion – Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, December 2008.

⁷ OCI annual report 2009

⁸ Following bank runs in Hong Kong after the failure of BCCI, the Hong Kong Deposit Protection Scheme (DPS) was established in 2004. It will pay compensation up to HK\$100,000 per depositor if a bank is insolvent.

⁹ The Investor Compensation Fund was established under the Securities and Futures Ordinance (Cap. 571). It pays compensation of up to HK\$150,000 per investor if there is loss caused by a default by a broker dealing in securities and futures products traded in Hong Kong Stock Exchange.

¹⁰ Gillian Garcia and Henriette Prast, Depositor and investor protection in the EU and the Netherlands: a brief history

¹¹ Takahiro Yasui, Policyholder Protection Funds: Rationale and Structure, 2001 OECD



- Makes it possible to handle bankruptcy cases without exposing policyholders to risk of severe loss.

Hong Kong is behind the curve with respect to developing a PPF. In 2003 the IMF noted Hong Kong's lack of a compensation mechanism in the context of insurance, albeit protection schemes for compulsory insurance already in place. Hence, IFPHK supports the proposal of establishing a PPF by statute, with the primary objective of protecting the interests of policyholders. However, costs should be kept low for both insurers and policyholders.

2. Coverage of the PPF

Considering that the majority of compensation funds in other jurisdictions cover only natural persons and corporates are normally excluded because of their ability to protect their interests and manage their risks when buying policies, the FSTB proposes to focus on individual policyholders. However, the coverage may be extended to small and medium enterprise ("SME") depending on the result of the Consultation Paper. As PPFs normally cover all compulsory classes of insurance, the proposed PPF will include building owners' ("OC") as policyholders as defined under the mandatory requirement in place since 1 January 2011.

In light of the different nature of life and non-life policies, the PPF will consist of two separate schemes – the Life Scheme and the Non-life Scheme. The Life Scheme will cover all **direct** life policies written in Hong Kong. The Non-Life Scheme will cover all **direct** non-life insurance policies written in Hong Kong, except those that are already covered by the MIB and the ECIB.

There will be no cross subsidiaries for the two Schemes, and the levies collected are to be kept in separate accounts. The coverage will be based on a per policy basis. All in-force policies as at the date of the introduction of the PPF as well as new policies issued thereafter will be covered by the two Schemes.

The proposed definitions of life policies and non-life insurance policies are provided in the Consultation Paper, in which;

- Life policies: insurance policies that pay benefits related to the life status of the policyholders, such as term life policies, whole life policies, endowment policies, annuities, investment-linked policies and permanent disability policies.
- Non-life policies: direct non-life insurance policies written in Hong Kong, except those that are already covered by existing schemes, common types including accident and health policies, home insurance policies, fire insurance policies, travel insurance policies, and third party risk liability insurance policies held by owner's corporations.

IFPHK Response

Covering all types of insurance, and natural and legal persons, might be excessively costly and increase the risk of moral hazard. In order to reduce the cost and risk, eligibility should be restricted to insurance business and persons who satisfy certain criteria. IFPHK's views on the proposed restrictions as stipulated in the Consultation Paper are as follows:



Scheme structure of the PPF

IFPHK acknowledges that life insurance and non-life insurance are of totally different nature and structure. The former is usually long-term while the latter is generally short-term. Thus it would be sensible to separate the PPF into two Schemes. Despite general agreement on the scope of life and non-life insurance, there should be a defined list of insurance business covered under the two schemes. The list should use terms that align with those stipulated in Part 2 and Part 3 of Schedule 1 of the Insurance Companies Ordinance (“ICO”), which uses terms like “classes of long term business” and “general business”.

Insurance classes covered by the PPF

Most existing non-life schemes in other jurisdictions are not general scheme and do not cover all products. Professional business class is normally excluded because these products are designed particularly for corporations. In the UK the PPF does not cover policies written by Lloyd's as the insurer has its own enactment¹². IFPHK noted that general business classes stated on Part 3 of Schedule 1 of the ICO include professional insurance business such as aircraft, credit, etc. Although the policyholders of these professional insurance classes are usually large corporations which are excluded from the proposed PPF, a defined list of insurance business covered by the PPF is still desirable to gain widespread understanding and to avoid confusion.

Eligible persons covered by the PPF

There is general consensus that professional policyholders (e.g. large corporations) shall be excluded from the PPF as these policyholders have the financial resources and internal expertise to assess the risks of an insurer and an insurance product. However, opinion is split on whether the PPF should cover small and medium enterprises policyholders. Depending on the agreed definition of small and medium enterprises (“SME”), IFPHK considers it fair to extend PPF coverage to SMEs. The insolvency of Anglo Starlite Insurance indicated that SMEs can also be vulnerable to loss resulting from the failure of insurance companies¹³. To qualify as an SME, the Government proposes to use the definition in the SME¹⁴ Loan Guarantee Scheme. While IFPHK agrees the simplest method to classify a SME is by the number of employees, such a method might pose administrative difficulties to the insurers, especially if they are obliged to ascertain the eligibility of a client upon each policy renewal. As such, the Government should engage active dialogue with the insurers and the professional bodies to come up with an agreeable definition of SME. Agreement should be reached before finalizing the PPF proposals. IFPHK suggests the following items be included in the discussion with insurers and professional bodies:

- The time reference of qualifying a policyholder as SME (e.g. at the start date of the policy)
- The obligations of the insurers on ascertaining and confirming whether a client fulfills the requirement to be a SME
- The evidential requirements of proving a policyholder's eligibility of being a SME (e.g. self declaration)
- The definition of number of persons and whether they include full-time, part-time and contract staff.

¹² G V Rao, Policyholders' Protection Fund – Rationale for its Creation

¹³ Anglo-Starlite insured a large share of the taxi market and policyholders were protected under the MIB

¹⁴ In accordance to the eligibility criteria of the SME Loan Guarantee Scheme, the definition of SME is as follows:

- A manufacturing business¹⁴ which employs fewer than 100 persons in Hong Kong;
- Non-manufacturing business which employs fewer than 50 persons in Hong Kong.



Apart from the definition of SME, some industry players would like to seek greater clarification on the distinction between policyholder, claimant and beneficiary. Some consumers would use an investment company or trustee as the policyholder. Since eligibility of the PPF is based upon the status of the policyholder and not the claimant or beneficiary, if the investment company or trustee is not qualified to be a SME, these consumers are not entitled to the protection of the PPF under the existing proposal. Since insurance intermediaries have the responsibility of disclosing to clients a loss of protection, the Government should provide clear guidance and training to the industry in order to avoid unnecessary disputes.

In summary, defining and designing eligible coverage of the PPF would require special attention, and the Government should hold more rounds of discussions with the industry. To eliminate doubt and confusion, IFPHK suggests any legislation should clearly define and set out the following:

- Eligible persons (e.g. natural persons, SME)
- Eligible claimants
- Type of insurance covered under the Life Scheme of the PPF
- Type of insurance covered under the Non-Life Scheme of the PPF
- Exclusions of the PPF

3. *Level of Compensation and the Application*

To ensure transparency and certainty, the Consultation Paper provides a list of conditions for activating the PPF. These conditions include a winding up order in Hong Kong, or when insurers are unable to pay their debts or relevant claims, or similar events concerning the insurer have occurred in any jurisdiction outside Hong Kong.

To curb any moral hazard the PPF applies a percentage limit as well as a dollar cap on compensation amounts. The compensation limit proposed in the Consultation Paper is 100% for the first HKD100k of any claim, plus 80% of the balance up to a total compensation limit of HKD1m. For life insurance the compensation limit would be applied on a per-policy basis. For non-life insurance the compensation limit would be applied on a per-claim basis. FTSB suggests that there should not be any cut-off date for the submission of claims.

In the event of insolvency of an insurer, a manager/provisional liquidator/liquidator (collectively referred as the “liquidator”) will be appointed to carry on the business of the insurer concerned. The liquidator will liaise closely with the proposed PPF Board in managing the policies and claims of the insolvent insurer. Different courses of action for different types of policies have been suggested in the Consultation Paper.

a. Life Scheme

Owing to the long term nature of life insurance products, the first priority of the liquidator will be to seek to transfer life policies from the insolvent to solvent insurer. The Life Scheme would facilitate the transfer of policies to a replacement insurer, and be given the flexibility to make a payment to facilitate the transfer up to the compensation limit. Policyholders will have a choice to terminate their policy(ies) and be entitled to the cash, account value, or accumulated benefits, up to the compensation limit, but without the “ex-gratia” payment. In case of transfer not being available, the policies will either continue until expiry and the Life Scheme will settle any claims arising subject to the compensation limit, or policies will be terminated and the Life Scheme would pay the affected policyholders the cash or account value of the policy, plus a dividend or bonus and ex-gratia payment, subject to the compensation limit.



b. Non-life Scheme

As non-life insurance contracts are of a shorter period, the Non-Life Scheme would provide for continuity of coverage until the expiry of all policies. The Non-Life Scheme will meet the claims arising from all covered policies, subject to the compensation limit. Certain accident and health policies (A&H) provide for guaranteed renewability. The PPF will seek to transfer such policies to another insurer and allow the PPF to make a payment to facilitate the transfer, up to the compensation limit. If transfer is not possible, the PPF may pay to the affected policyholders an “ex-gratia” payment having regard to the premium differential if the policy holder wants to procure a similar policy from another insurance company subject to the compensation limit.

IFPHK Response

Since the compensation amounts and the actual application of the PPF have direct impact on the effectiveness of the PPF to enhance public confidence, it should be properly designed to ensure the visibility of a safety net, but not so prominent to stimulate risky behavior by consumers and insurers. IFPHK’s views on the compensation level and the proposed application process of the PPF are as follows:

Activating conditions

Sometimes policyholders in Hong Kong are affected by the failure of insurers in other jurisdictions, as was seen with the collapse of HIH, Australia’s second largest insurer. In 2001 the main HIH companies in Hong Kong entered into an insolvent scheme of arrangement where some policyholders were entitled to receive compensation from the MIB and the EC insurance claims. However, other policyholders were not eligible to receive compensation. In view of the HIH insolvency and the recent “nationalisation” of AIG as mentioned in (1), IFPHK believes it pragmatic and reasonable to include insolvency events outside Hong Kong that have an impact on policyholders in Hong Kong into the activating conditions of the PPF.

Compensation limits

Where there is a safety net consumers may be less inclined to perform due diligence when selecting an insurer, and seek out the cheapest products regardless of the risk. The lack of risk adverse behavior among consumers is likely to give incentives to insurance companies for increased risk-taking. A PPF might subsidise mismanagement by one insurance company at the expense of another that runs its business in a prudent manner. It is unfair for prudently managed insurers to have to contend with reckless competitors that adopt aggressive management and pricing strategies. This situation could seriously undermine sound and fair competition in the industry. To curb the potential for moral hazard risk arising from the PPF, most jurisdictions do not compensate consumers for the full amount, except for compulsory insurance. The PPF will be used for bridging the timing gap between the failure of an insurer to pay a claim and the claimants finally obtaining money from the insolvency procedure, and is not intended to compensate policyholders’ for risk taking behavior. Ultimately, it is the policyholder’s responsibility to select an insurer and insurance policy in a prudent manner. As such, IFPHK considers it appropriate to establish compensation limits on the claims to the PPF in order to contain cost, and to mitigate against moral hazard risk.

Consistent approach towards compulsory insurance

As mentioned in (1), compulsory insurance is generally fully guaranteed because compulsory insurance is intended to provide a secure fund of compensation for the victims of accidents. If government demands that people buy certain insurance, they also have a special responsibility to



ensure the soundness of these insurers. At present, there are two compensation schemes on compulsory insurance running in Hong Kong:

1. Insolvency protection for motor vehicle policies is provided by the Insolvency Fund Scheme ("IFS") administered by the Motor Insurers' Bureau ("MIB"). The MIB is a limited liability company established by the insurance industry. All insurers authorised by the Insurance Authority to carry on motor vehicle insurance business in Hong Kong are required as a condition of authorisation to become members of the MIB. The MIB Insolvency Fund levies are currently 2% of premiums on motor vehicle policies. The IFS is to satisfy any claim where the policy of insurance is ineffective due to the inability of an insurer to pay its debts by reasons of its insolvency.
2. The Employees Compensation Insurer Insolvency Scheme ("ECIIS") is administered by a limited liability company the Employees Compensation Insurer Insolvency Bureau which is established by the insurance industry. Insurers contribute ECIIS at a rate of 2% of EC premiums. The ECIIS is responsible for protecting EC policyholders from insurer insolvency.

Presumably the establishment of PPF in Hong Kong would not warrant any change to existing compensation schemes. The mandatory requirement for owners' corporation ("OC") to procure third party risk insurance took effect on 1 January 2011. IFPHK noted it was proposed that OC be included in the PPF, and thereby claims from this insurance are subject to the compensation limits of the PPF. To be consistent with the existing schemes for compulsory insurance, compensation for all building owner's corporation should be fully guaranteed. It might therefore be viable and economical to consolidate the operations of the three compulsory insurances. The governance arrangement of the PPF will be further discussed in (5).

Application of the PPF

Even if policyholders are able to recover part of their savings from the judicial procedure, they may not succeed in finding similar coverage because of changes in personal circumstances. Owing to the long-term nature of life products, policyholders are often considered better off by continuing with their contracts rather than having contracts immediately terminated and receiving cash compensation. In contrast, non-life insurance is generally short-term. Therefore, the continuation of contracts is considered less important than the efficient handling of the insolvency case and settlement of the outstanding claims. Therefore the proposed course of action is pertinent to the objectives of the PPF.

Payout procedure of the PPF

The fundamental objective of PPF is to compensate losses to policyholders in the event of insolvency of an insurer before they can recover their money from the judicial process. The basic operation of the PPF is to efficiently compensate eligible claimants. The PPF then recovers payments from the judicial insolvency procedure. In order to minimize claims handling costs and to ensure the smooth running of the payout process, a detailed payout procedure should be drafted, and a small dedicated team within the proposed PPF Board shall be established to familiarise with the payout procedure. The PPF can also adopt the queuing system used by MIB and ECIB in handling outstanding claims, if claims against the scheme exceed the amount of funds available at a given date and claims are paid out in the order in which they were presented to the scheme. IFPHK also suggests the government adopt the practice of the Deposit Protection Board ("DBP") by having a small operation department to conduct regular payout rehearsals and simulation tests in



order to maintain and enhance the readiness of its payout infrastructure, and effectiveness of the PPF's payout procedure.

4. Funding Mechanism of the PPF

Having considered three possible funding models, FTSB considers the progressive funding model a more pragmatic approach as it ensures the availability of an upfront reserve and maintains the flexibility to increase the levy rate to meet actual needs. FTSB proposes an initial levy of 0.07% of the office premium and the gross written premium until the PPF has reached its target size. The target fund size for Life Scheme and Non Life Scheme are HKD1.2b and HKD75m respectively. FTSB anticipates building up the initial target fund in 15 years. The target fund size and the levy rate will be reviewed on a regular basis.

If the funds are not sufficient to meet all such liabilities, a "stepped-up" levy may be collected to bridge the liquidity gap. The PPF is also allowed to borrow from a third party to bridge any liquidity gap. The approval of the Legislative Council would be required.

The Consultation Paper also contains an asset recovery mechanism in order to enable the PPF to make claims against the estate of the insolvent insurer. The PPF should have equal ranking with the two classes of creditors specified in section 265 of the Company Ordinance i.e. the Employee Compensation Assistance Fund, and all other direct insurance claims not met by the PPF.

IFPHK Response

The funding model of PPF varies across different jurisdictions and each is unique. Despite the differences most people would recognize that the funding mechanism is crucial for building an effective PPF. The funding mechanism not only determines the level of protection, but can have important implications on the cost to the industry. It should be mindful that the levies imposed on insurers might translate into costs for policyholders.

Funding mechanism

Lessons learned from international experience show that the final cost of a given failure can be difficult to predict, and can vary widely in each case. The value may not materialise until after the failure of the insurer. This makes determining the level of potential exposure of a failure problematic, and therefore there is no perfect funding model where one size fits all. Each funding mechanism has advantages and shortfalls. Pre-funding allows for better predictability for member companies concerning future financial burdens, but bear higher setup and operational costs than post-funding. Post-funding has the advantage in that it requires virtually no administration cost until insolvency, but may hinder prompt pay-out to policyholders, and may increase pro-cyclical effect as insurers are more likely to fail in economic difficulties¹⁵. One of the objectives of the PPF is to provide a safety net that should enhance public confidence. To this end, the existence of a sufficient amount of funds for policyholder protection ensures the visibility of a safety net and thus contributes to the maintenance of public confidence in the industry¹⁶. IFPHK prefers to adopt the progressive funding approach to balance the need to ensure visibility of sufficient funding and to avoid adding onerous costs to insurers. When a larger company fails, a large amount of funds needs to be used to protect the interests of policyholders. In order to deal with the case swiftly, IFPHK concurs with the

¹⁵ European Commission, White paper on Insurance Guarantee Schemes, COM(2010)370.

¹⁶ Hato Schmeiser & Joel Wagner, The impact of introducing insurance guaranty schemes on pricing and capital structures



proposal of equipping the PPF with the power to borrow from credit institutions given that the approval procedures are properly stated in the legislation. However, IFPHK would like to seek more clarification on the option of charging “stepped-up” levy. IFPHK and the industry player who IFPHK interviewed worries that empowering the PPF with a “stepped-up” levy option without laying down a detailed calculation mechanism, a detailed approval and collection process and a cap on the stepped-up levy would be onerous to the industry and is also unfair to other policyholders. As such, the Government should establish a detailed mechanism on the “stepped-up” levy, and such mechanism should be agreed by the industry prior to finalizing the proposal.

Target level

To address industry concerns regarding additional costs arising from the PPF, the government needs to introduce a target fund size to the two Schemes. Levies will be collected from member insurers until the target fund size is reached. Some industry players are concerned about whether the proposed target fund sizes, particularly the fund size of Non-life Scheme, will be adequate to meet the obligations resulting from an insurers’ failure. For example, the target fund size of the Non-life Scheme is HKD75m, but the amount of outstanding claims from the failure of Anglo-Starlite amounted to HKD272m. Yet this only represents 0.5% of the general insurance market and 4.9% of the motor vehicle business in Hong Kong. IFPHK believes that compensation from PPF should only cover the payments at the initial stage to bridge the timing gap during lengthy judicial procedures. It is crucial to minimize costs to insurers so the target fund size should not be excessive. As of 31 December 2010, the retained surplus of the IFS and ECIS were HKD921m and HKD591m respectively. Indeed, many policyholders were able to recover losses from MIB and ECIB¹⁷ in the case of Anglo-Starlite, and the remaining became preferential creditors.

Nonetheless, the recommendation of HKD75m as the initial target fund size for Non-life Scheme should be reconsidered with a revised actuarial modeling using more current data that includes OC since OC was only become effective as another compulsory insurance since January 2011. To alleviate the risk of funding shortfalls should a large insurer fail, IFPHK envisages that the PPF will have complementary post-funding arrangements and external credit facilities as mentioned earlier, in order to finance the shortfalls. Moreover, mechanism and procedures should be in place to constantly assess and monitor the sufficiency of PPF to meet its obligations, and the target fund size shall be adjusted accordingly.

Contributions calculation model

PPFs are typically funded by the industry. The contributions of insurance companies are normally calculated based on gross or net premiums as proposed in the Consultation Paper. The magnitudes of levies and calculation models are different across jurisdictions. Globally, there is no consensus on the adequate level of charge against the risk of insurer insolvency. The levy ranges from 0.125% (e.g. Malta) to a cap of 5% (hunters’ liability insurance of Italy). For pure life business under the PPF scheme, the charge is calculated as a fraction of the net reserves of insurers e.g. Germany 0.02%, and France 0.05%¹⁸. Some countries apply risk-adjusted contributions in an endeavor to avoid placing an unfair burden on soundly managed companies and to give incentive to member companies to improve their financial soundness. In Korea, the assessment takes the risk factor into account. Insurance companies are categorised into three groups according to their respective financial soundness. The companies in the least risky group enjoy 5 percent discount to

¹⁷ About 16,000 policyholders are involved, of which 15,906 being motor insurance policies and 32 employees compensation policies. Only 62 policies are not covered by any compensation scheme.

¹⁸ Hato Schmeiser & Joel Wagner, The impact of introducing insurance guaranty schemes on pricing and capital structures



their contributions, while the contributions for those in the most risky category are increased by 5 percent¹⁹. Germany applies basic risk adjustment on the charges. The annual contribution of each firm is increased or decreased depending on the firm's equity capital relative to its solvency margin²⁰. There are, however, arguments against the above approach, which include that it may increase insolvency cases by imposing a heavier burden on less profitable companies. IFPHK stresses that contributions from insurance companies should be mandatory, and the contribution rate must be assessed in a fair manner and collected in such a way as to avoid imposing excessive burden on the companies. As such, the levy framework and the organisation of the PPF should be relatively simple, and IFPHK concurs that the proposed calculation model based on premiums is the simplest way of collecting contributions from insurers. To further enjoy economies of scale for operation and administration of PPF, IFPHK recommends that resources should be shared among the existing agencies such as the Insurance Authority and the existing compensation scheme for compulsory insurance (i.e. MIB and ECIB). The governance arrangement will be elaborated in (5) below.

5. Governance Arrangement of the PPF

FSTB proposed the PPF be established by legislation and administered by a statutory body. The PPF will be operated under the oversight of an independent governing body appointed by the Financial Secretary ("PPF Board"). The PPF Board will comprise professionals from different disciplines. Two industry committees, one for Life Scheme and one for the Non Life Scheme will be established. They will offer advice to the PPF Board on industry-related issues, such as the collection of levies and management of claims in the event of insurer insolvency. The functions and powers of the PPF Board will be stipulated in the statute. The annual budget of the PPF will be subject to approval by the FS. The FS would have the power to appoint the Director of Audit or an external auditor to perform audit reviews on the PPF.

The PPF Board is empowered to invest PPF funds that are not immediately required in low-risk vehicles such as deposits with banks, exchange fund bills, and sovereign bonds with good credit rating.

The PPF Board will maintain a small team of staff for daily operations and be empowered to engage additional staff or advisers in the event of insurer insolvency. The PPF Board and its staff should be required to keep confidential any information obtained in the course of carrying out their functions. Disclosure of information would be subjected to clear conditions as prescribed in law.

Similar to other statutory bodies, any person who is aggrieved by relevant decisions made under the PPF can file an application for a review of the decision with an Appeal Board. The Chairman and members of the Appeal Board will be appointed by the Chief Executive.

IFPHK Response

The PPF will be legally obliged to provide protection for policyholders in the event of insolvency of member insurers. When necessary to carry out their duties, they may enter into contracts to commission some operations, take legal actions and make concessions to recover their funds,

¹⁹ Takahiro Yasui, Policyholder Protection Funds: Rationale and Structure, 2001 OECD

²⁰ Hato Schmeiser & Joel Wagner, The impact of introducing insurance guaranty schemes on pricing and capital structures



employ staff, and so on. IFPHK agrees that the PPF Board shall be established to perform the following functions:

- To manage and administer the PPF;
- To assess and collect contributions from insurers
- To recover from the assets of the insolvent insurer the compensation paid to policyholders or claimants;
- To invest the money of the PPF;
- To borrow money, after obtained approval from Legislative Council, to fill any funding gap;
- To make statutory rules, after consultation with the Financial Secretary, relation to the procedures for making compensations.

The ultimate objective of the PPFs is to provide a final safety net to policyholders and should only be complementary to prudential and regulatory supervisions. Therefore the PPF Board needs to be operated in close co-ordination with other relevant supervisory authorities. As the IFPHK repeatedly advocates in its submissions to Consultation Paper, the government should avoid duplicating and accumulating supervisory functions at a cost to taxpayers. The challenge to the government is to ensure that limited resources are used to help maintain high levels of consumer confidence in the insurance industry, and to compensate policyholders efficiently in the event of an insurer's insolvency. To this end, IFPHK recommends the PPF Board to share part of the resources with the proposed independent Insurance Authority. Similar arrangements exist between the deposit protection board ("DPB") and the Hong Kong Monetary Authority ("HKMA"). Pursuant to section 6 of the DPS Ordinance, the DPB shall perform its function through the HKMA unless indicated otherwise by the Financial Secretary. This means the HKMA assigns staff to assist the DPB in discharging its functions. An Executive Director of the HKMA is designated as the CEO of the DPB. The HKMA also supports the DPB on aspects such as accounting, administration, human resources, dealing and settlement of the DPB fund and information technology while the DPB has a full-time operation department to ensure the smooth running of the payout procedure. Such arrangement is different from the structure of the two existing compensation schemes. Both MIB and ECIB were established by the insurance industry as non-profit making companies limited by guarantee. Both pledge to perform their functions as prescribed in the agreement they entered into with the Government. It should be mindful that running several offices for different compensation schemes can be costly, the operating expenses of IFS and ECIS are HKD18m and HKD2m respectively for the year ended 31 December 2010. The Consultancy study in December 2003 suggested that it may be cost-effective to combine the supervision of non-life schemes with the existing MIB and ECIB schemes²¹. To optimise resource allocation and minimise administration costs, IFPHK recommends the Government revisit the proposals with the industry and the relevant professional bodies to explore the feasibility of combining the operation of existing schemes into the proposed PPF Board.

Regarding the composition of the PPF Board, a typical PPF based on international experience is usually administered by a board of directors or governors. The boards usually consist of directors who represent member insurance companies. Many boards include independent directors who are expected to represent public or consumer interests. In some cases, the insurance commissioner or his representative sits on the board. IFPHK recommends the PPF Board apply the board composition of the DPB. The DPB currently comprises nine members who come from different professions, including two ex-officio members representing the HKMA and the Secretary for Financial Services and the Treasury. Similar to the practice of the DPB, members of the PPF Board

²¹ PricewaterhouseCoopers, Feasibility of Establishing Policyholders' Protection Funds in Hong Kong, December 2003.



and its Committees should be subjected to a Code of Conduct which governs the confidentiality and conflicts of interest obligations of the board and committee members.

Two industry committees for the PPF Board will be established, one for the Life Scheme and one for the Non-life scheme. Since the PPF Board will be given power to invest the funds of the PPF, IFPHK agrees that the PPF Board should exercise a high level of prudence when investing with a prime objective of capital preservation, IFPHK thinks it is important to establish an investment policy which clearly list out the type of investment vehicles to be used for the PPF. IFPHK also recommends an investment committee with members having investment background be established to make recommendations on the investment policy of the PPF, to monitor the investment performance, and to establish proper controls on PPF's investment activities. The committee should be given appropriate power to exercise investment decisions that maximize investment returns provided they are in compliance with the investment policy.

IFPHK agrees with the establishment of an appeal board. The type of decision by the PPB Board that can be the subject of an appeal should be clearly defined in the legislation.



Conclusion

In principle, IFPHK welcomes the establishment of a policyholder protection fund. Most industry participants who IFPHK interviewed also see it as a positive development in enhancing the standard of the insurance industry.

Hong Kong is characterised by a large number of international insurers that compete with each other to offer a large variety of products giving consumers a lot more choice. In 2009, Hong Kong had 87 locally incorporated insurers. This is more than the UK (12), US (13) and Bermuda (14). The total gross insurance premium amounted to HKD189b in 2008, but slightly down to HKD186b in 2009 due to the financial crisis²². Whilst IFPHK believes the Government should provide a regulatory system and framework that allows the insurance industry to thrive in size and number of insurers, it is equally critical to establish a PPF that provides last-resort protection to safeguard the interests of consumers.

To this end, IFPHK recommends the protections system to be

- Clearly laid out in law and regulation
- Compulsory requirements for authorization
- Offer limited coverage so that professional investors can exercise market discipline and mitigate against moral hazard risk
- Maintain low setup and on-going administration costs
- Understood by member insurers and the public

The aim of having the proposals in the Consultation Paper is to provide more protection to policyholders and to enhance the stability of the insurance industry. The establishment of PPF will not replace any prudential and supervisory regulations. With the PPF, the insurance authority may feel less pressure for strict supervision to avoid any possibility of insolvency. IFPHK stresses that effective risk management and comprehensive governance structures are cornerstones of the insurance system. It should work in tandem with the PPF to create a level playing field between insurance companies and to ensure stability of the insurance market.

Finally, the economy and market is still recovering from the financial crisis. Therefore it is a good time for industry, regulators and professional bodies to work together to improve the regulatory regime and infrastructure. This will provide for better corporate governance, strengthening consumer confidence, and enhancing the quality and standard of the insurance market.

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²² OCI, OECD-Asia Regional Seminar: Enhancing Transparency and Monitoring of Insurance Markets, Regional Experience: Hong Kong, September 2010.

PPF consultation

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Date: Jun 24, 2011 15:45
To: <ppf_consultation@fstb.gov.hk>
Cc:
Attachments:  2011 Hong Kong PPF Consultation_OCI_Final.pdf (40.9 KB)

Please find attached Lloyd's response on the consultation.

Please do not hesitate to contact us if you have any questions on this.

Kind regards
Alex

<<2011 Hong Kong PPF Consultation_OCI_Final.pdf>>
MS ALEX FARIS
Lloyd's General Representative for Hong Kong

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From Lloyd's International Regulatory Affairs

Date June 2011

Subject **Establishment of a Policyholders' Protection Fund**

Lloyd's welcomes the opportunity to comment on the consultation paper issued by the Financial Services and the Treasury Bureau ("the FSTB") on the proposed establishment of a Policyholders' Protection Fund ("the PPF"). Lloyd's kindly requests the FTSB take account of the following observations.

Proposed establishment of a Policyholders' Protection Fund

Lloyd's supports the proposed establishment of a PPF which we believe will enhance consumer protection and improve market stability in the event of insurer insolvency.

Scope of Coverage of Proposed Policyholders' Protection Fund

Lloyd's supports the proposal to focus the PPF on natural persons, as is the practice with the majority of compensation funds internationally, and we agree that corporate insurance buyers should be excluded from the PPF.

We also believe that this exclusion should extend to SMEs as they are able to adequately protect their interests in buying insurance policies and managing their risks. This is recognised in other major insurance centres in the region such as Singapore, and indeed in several other PPFs internationally, which limit coverage to natural persons.

We understand that the scope of the PPF will not extend to wholesale retirement schemes and to reinsurance, captive, motor and EC business. We would propose that Marine, Aviation and Transport ("MAT") business should also be excluded from the PPF. MAT insurance is primarily provided to commercial policyholders transacting international business. This being the case, it would be unfair for insurers to pay a levy on premium to a PPF from which the corresponding insureds will not benefit. Indeed, this is recognised by the Financial Services Compensation Scheme in the United Kingdom, which does not levy on premiums for MAT business.

Similarly, as offshore insureds will not be able to benefit from the coverage provided under the PPF, offshore policies should be excluded from the scope of this scheme.

Funding Mechanism

Post-Funding Model

The structure of PPF's funding model will have important implications for the cost to the local insurance industry, bearing in mind that the levies imposed on insurance industry can be expected to be passed on to and ultimately borne by customers.

Building up a large progressively funded scheme may enhance the speed and certainty of access to funds for the PPF, but it may impose disproportionate costs if the frequency and size of failures are expected to be small, which would be the case in a developed, well regulated and strongly capitalised insurance market such as that of Hong Kong.

Equally, in order to implement an equitable progressive funding model whereby insurers would contribute to the PPF on the basis of their personal lines GWP alone, insurers would need to put into operation onerous and expensive processes to segregate the reporting of their commercial and personal lines business, specifically for use in their PPF calculations. The governing body of the PPF would also need to commit further resources to audit insurers to ensure that this segregation is being administered correctly and the PPF is being appropriately funded. Such a model would add additional and considerable expenses for both insurers and the PPF.

Therefore, and considering that post-funded schemes can be operated at virtually no direct cost to the industry, up to the point of an insurance failure occurring, we would support the adoption of a post-funded model for the PPF, which is the model adopted in the UK.

Levy Calculation

The most efficient model in terms of calculating insurers' contributions would be to base the PPF levy on the gross written premiums ("GWP") reported in non-life insurers' audited returns, with adjustments made to address the issues outlined below. We consider this to be the simplest and most cost-effective model, as it makes use of the returns that insurers already produce, which segment business by General Classes of Business. These audited returns do not, however, segment business by commercial and personal lines, which is why we propose the following adjustments should be made.

Exemption for Commercial Lines Insurers

In line with our view that the PPF should only extend to natural persons, as opposed to corporate insurance buyers (inclusive of SMEs), we believe that it would be inequitable for insurers who only write commercial lines of business to be required to contribute to a PPF which provides coverage for consumers buying personal lines of business.

Therefore, insurers who can demonstrate that they only write commercial lines of business should be exempted from the PPF.

Adjustment to PPF levy calculation based on insurers' GWP

The PPF should make provisions to exclude MAT business from its funding model in addition to reinsurance, offshore policies, wholesale retirement schemes, captive, motor

and EC business. MAT can easily be identified in the non-life insurers' audited returns, and discounted from the total GWP figure reported in these statements¹.

Large Risks Adjustment

We are concerned that should an insurer write an exceptionally large risk, the GWP base figure from which their PPF levy contribution will be calculated will be distorted.

We would thus propose that there should be a Large Risks adjustment, which would apply to risks with a premium value in excess of HKD 2,000,000. Where insurers are able to demonstrate that they have underwritten a Large Risk, which can be evidenced to the PPF with the relevant policy documentation, they should be permitted to discount the corresponding premium from the GWP figure being used for their PPF funding contribution calculation.

This would allow for the employment of the most efficient levy collection and administration model for the PPF, without disadvantaging insurers who do not write personal lines business in Hong Kong.

Lloyd's appreciates the opportunity the FSTB have provided for us to share our views. Please do not hesitate to contact us, if you have any questions, or would like any clarification.

¹ MAT business is reported in non-life insurers' audited returns under the following class categories:

- Aircraft, Damage & Liability
- Ships, Damage & Liability
- Goods in Transit

Proposed Establishment of a Policyholders' Protection Fund
Public Consultation - Comments Form

To : Financial Services and the Treasury Bureau
 Fax : 2527 0292
 Email : ppf_consultation@fstb.gov.hk
 Post : 18/F, Tower 1, Admiralty Centre, 18 Harcourt Road, Admiralty, Hong Kong.

Name: Ho Tak On <H.K. Citizen>

Company name: _____

Post: _____

Company address: _____

Telephone number: _____ Fax: _____

Email address: _____

(The above personal data is solely used by the HKSAR Government and relevant agencies for the purpose of consultation follow-up)

Thank you for taking time to read the consultation document, grateful if you could provide your valuable views and comments on the consultation of the Proposed Establishment of a Policyholders' Protection Fund:

I basically support the proposals raised concerning the above Fund. I however suggest a 100% protection from the Fund be provided to individual policy-holders up to single claim of \$1 million. Claims easily exceed the \$100,000 100% protection as currently proposed. A higher claim amount being afforded with 100% protection is warranted. Ho.

☐ Your views may be published in the website or printed documents of the Financial Services and the Treasury Bureau. If you do not wish your name and/or affiliation to be disclosed, please put a ✓ in the box.



American International Assurance
Company, Limited

Facsimile

Attention:
Special Duties Division, Financial Services Branch
Company:
Financial Services and the Treasury Bureau
Fax:
(852) 2527 0292
Date:
24 June 2011

From:
John Yeung, Associate General Counsel
Dept:
Group Law
Tel:
Total page:
12 pages including this cover

Subject:
Proposed Establishment of a Policyholders' Protection Fund

Dear Sirs,

Please see attached.



AIA Group Limited

24 June 2011

Special Duties Division, Financial Services Branch
Financial Services and Treasury Bureau
18/F, Tower I
Admiralty Centre
18, Harcourt Road
Hong Kong

Dear Sirs,

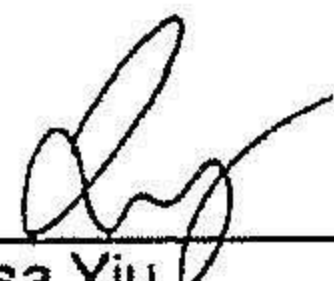
Proposed Establishment of a Policyholders' Protection Fund

We refer to the Consultation Paper on the "Proposed Establishment of a Policyholders' Protection Fund" released by the Financial Services and the Treasury Bureau ("FSTB") on 25 March 2011 (the "Consultation Paper").

In response to the invitation of the FSTB to submit written comments on the Consultation Paper, we are pleased to enclose a Joint Paper of American International Assurance Company, Limited ("AIA") and American International Assurance Company (Bermuda) Limited ("AIAB") on the Proposed Establishment of the Policyholders' Protection Fund dated 24 June 2011.

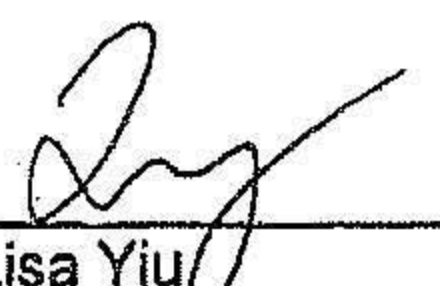
AIA and AIAB are pleased to have had the opportunity to provide its comments on the proposed establishment of the Policyholders' Protection Fund and would welcome further participation once more details are available. Should you have any questions or require any further information, please do not hesitate to contact Mark Tucker, Group Chief Executive and President at or Mitch New, Executive Vice-President and Group General Counsel at

Yours faithfully,
For and on behalf of
American International Assurance Company, Limited



Lisa Yiu
Secretary

Yours faithfully,
For and on behalf of
American International Assurance Company (Bermuda) Limited



Lisa Yiu
Deputy Secretary

**JOINT PAPER OF AMERICAN INTERNATIONAL ASSURANCE COMPANY, LIMITED
("AIA") AND AMERICAN INTERNATIONAL ASSURANCE COMPANY (BERMUDA)
LIMITED ("AIAB") ON THE PROPOSED ESTABLISHMENT OF
A POLICYHOLDERS' PROTECTION FUND
24 JUNE 2011**

EXECUTIVE SUMMARY

The Financial Services and Treasury Bureau ("FSTB") issued a paper on 25 March 2011 ("the Consultation Paper") to launch a 3 month public consultation on the proposed establishment of a policyholders' protection fund ("PPF").

This paper sets out the views of American International Assurance Company, Limited ("AIA") and American International Assurance Company (Bermuda) Limited ("AIAB") on the proposed establishment of the PPF.

Key comments contained in this paper are as follows:

- a) **This proposal as contemplated will increase the financial burden on soundly managed insurers including AIA and AIAB particularly if other proposals such as the establishment of an independent insurance authority are implemented and additional levies are imposed on insurers. As a result, it would likely become more difficult to conduct insurance business in Hong Kong. In order to reduce any burden, a discount on the levy for the PPF should be considered for soundly managed insurers. For instance, Singapore imposes risk-based levies.**
- b) **The levy should only be collected in respect of premiums on new and in-force policies issued in Hong Kong after the establishment of the PPF. Since the levy would increase the financial burden on insurers, we suggest that insurers either receive a tax credit to offset the amount paid for levies for a certain amount of years (e.g. the 15 years required to build up the target fund) or insurers should be explicitly permitted to collect the cost of the levy from policyholders. In particular, the ability of insurers to collect the levy from policyholders on premiums paid after the establishment of the PPF in respect of:**
 - (i) in-force policies; and
 - (ii) newly issued policies**should be set out in legislation.**
- c) **It should be made clear in any legislation that the levy should only be collected in relation to the Hong Kong business of insurers but not in respect of any of the businesses carried out by their branches which operate and underwrite business outside of Hong Kong.**
- d) **The levy should not be retroactive. In other words, the levy should only cover premiums after the establishment of the PPF.**

- e) **The amount of levy collected from premiums should be consistent with the total compensation limit of HKD1 million. That is, the levy should be applied against the premium paid amount for up to HKD1 million in coverage in respect of each policy.**
- f) We support in principle the adoption of progressive funding. However, we respectfully do not support the specific arrangements for operation of progressive funding as set out in the consultation document in the current form in that the proposals allow too much discretion to the PPF Board in determining the occasion for and terms of any change from standard to additional levy. We see a need to ensure that such decisions are taken with transparency and after a clear articulation of the case for such a change has been submitted for consultation.
- g) We suggest that any liquidity gap in the PPF be bridged from the Government direct. This would increase public confidence in the PPF.
- h) **Payment under the PPF should be viewed as a last resort and we agree that compensation should only be triggered after an attempt has been made to transfer the policy of an insolvent insurer to another insurer.**
- i) Except as mentioned below, the PPF should cover only natural persons. Corporate entities should be excluded on the presumption that these policyholders are sophisticated and can manage their risks. Accordingly, it is not necessary that protection be afforded to SMEs under the PPF. However, there may be certain circumstances for public policy reasons where insurance is not held by a natural person and coverage may be warranted (e.g. certain trusts with individual beneficiaries or when a company owns a policy for a key employee). Additional consultation should be made on this.
- j) We agree that inward reinsurance arrangements, wholesale retirement schemes (Class G, H and I retirement management schemes) and captive insurers should be excluded from the scope of the PPF.
- k) **We support the compensation limits to reduce the risk of moral hazard as set out in the consultation viz 100% up to \$100K and 80% between 100K and \$1 million.**
- l) We agree that in order for claim to be paid, the claimant must assign their claim against the insolvent insurer to the PPF.
- m) **Given the complexity of the insurance business, we support significant representation by the insurance industry on the PPF board. In particular, there should be representation from the life insurance industry in respect of the management of the Life Scheme and representation from the general insurance industry in respect of the management of the Non-Life Scheme.**

- n) We suggest the Government explore if any cost efficiency can be achieved by administering the deposit protection scheme, the PPF and the existing compensation schemes for motor vehicle policies and employees' compensation policies together.

INTRODUCTION AND BACKGROUND

In principle, AIA and AIAB are both supportive of the proposal for the establishment of a PPF. If implemented properly, it can help maintain the public's confidence in insurance companies operating in Hong Kong particularly in the event of a financial crisis. In implementing a PPF, it is important to consider the risk of any moral hazard, the additional financial burden on soundly managed insurers, the coverage covered under the PPF and the risk of creating unfair competition across jurisdictions.

COMMENTS ON CONSULTATION PAPER

Following the chapter headings outlined in the Consultation Paper, our comments are outlined as below:

CHAPTER 1 – INTRODUCTION

Purpose and Background

1. We have no particular comments on these sections as the key proposals in respect of the PPF are dealt with in Chapters 3, 4 and 5.

Recent Developments

2. We would be interested if the actuarial consultancy study referred to in this section addressed any of the considerations we raise below in this paper and in particular on how the levy to fund the PPF and the levies to be made under the recent proposal for an independent insurance authority will impact insurers conducting business in Hong Kong.

Consultation and Next Step

3. Before finalizing the proposal to establish a PPF, we would suggest that the Government conduct another round of consultation after taking into account the views and comments from this consultation.

CHAPTER 2 – CURRENT PROTECTION AGAINST INSOLVENCY IN HONG KONG AND OTHER JURISDICTIONS

Existing Schemes in Hong Kong and Overseas Experience

4. We have no particular comments on this section as the key proposals in respect of the PPF are dealt with in Chapters 3, 4 and 5.

Protection Under the CO and the ICO

5. We agree the reserve should not be too high as there is already protection under the Companies Ordinance (Chapter 32) and Insurance Companies Ordinance (Chapter 41) (the "ICO"). We note that for insolvent non-life insurers, there is a preferential claim against the assets of the insurer and for insolvent life insurers, the ICO provides for conditions on the use of assets under the long term business fund, the transfer of policies to another insurer and the reduction of

liability of insurance contracts.

CHAPTER 3 – OBJECTIVES, COVERAGE AND LEVEL OF COMPENSATION

Objectives

6. If implemented properly, we agree that the PPF would better protect policyholders' interest and help maintain market stability in the event of insurer insolvency. Public confidence may also be enhanced and there would be no need for new and stringent regulations to achieve the same purpose, which may restrict competition in the market.

Guiding Principles

7. We agree that the PPF should strike a reasonable balance in enhancing protection for policyholders and minimizing any additional burden to the insurance industry. The Government should also take into regard any other burdens to insurers including levies to be paid to establish an independent insurance authority as proposed in the FSTB's consultation paper dated 12 July 2010.
8. We agree that measures should be implemented to avoid moral hazard for policyholders and insurers. We support the compensation limits to reduce the risk of moral hazard as set out in the consultation viz *100% up to \$100K and 80% between 100K and \$1 million.*

Coverage

Individual and SME policyholders

9. Except as mentioned below, we agree with the statement in paragraph 3.3 that the PPF should cover only natural persons. Corporate entities should be excluded on the presumption that these policyholders are sophisticated and can manage their risks. However, there may be certain circumstances when an insurance policy is not held by a natural person but coverage may be warranted for public policy reasons such as for certain trusts with individual beneficiaries or when a company owns a policy for a key employee.
10. It is our view that protection is not necessary for SMEs with respect to paragraph 3.4. Regardless of whether a corporation is a SME, corporations should be able to gather sufficient information on products and companies and assess the risks appropriately. In the event the PPF is to cover SMEs, we would seek clarification on the definition of what SMEs would be covered, additional criteria should be set out on applicability and a lower compensation limit may also be considered. As well, we suggest that further consultation should be made at the appropriate time with all interested parties.

Life and Non-Life Schemes

11. In respect of paragraph 3.6, we agree that inward reinsurance arrangements, wholesale retirement schemes (Class G, H and I retirement management

schemes) and captive insurers should be excluded from the scope of the PPF. In respect of inward reinsurance arrangements, a levy should not be imposed on these premiums as this would lead to a double-counting and the collection of levies in respect of a single coverage.

12. We support the proposal that there be a separate Life Scheme and Non-Life Scheme and no cross-subsidy between the two Schemes.
13. In relation to the coverage under the Life Scheme, life policies, whole life policies and permanent disability policies should be included. However, given that endowment policies, annuities and investment-linked policies generally have an investment component, a consideration be undertaken as to whether lower compensation limits may be more appropriate. We understand in Singapore, the Monetary Authority of Singapore has taken this approach with the Policy Owners' Protection Fund and similarly lower limits are applicable in Canada under Assuris for certain annuity products.

Policies that pre-date the PPF

14. We support the proposal that the PPF would cover all in-force policies as at the date of introduction as well as new policies issued thereafter provided that any levies on premiums are not retroactive and only apply to any premiums paid after the date of introduction of the PPF.

Conditions for Activating the PPF

15. We agree that the PPF should only be activated when an insurer is not able to meet the claims of policyholders. Under the proposal, we understand the Insurance Authority ("IA") determines whether an insurer is able to meet the claims of policyholders. Accordingly, we suggest as a check and balance, there also be an appeal mechanism to the PPF Board or other appropriate body on such decisions. Similarly, there should be an appeal mechanism for determination of such events by the IA in other jurisdictions.

Compensation Limit

16. As previously mentioned, we agree that there should be compensation limits to mitigate the risk of moral hazard.

Arrangements in the Event of Insurer Insolvency

Life Scheme

17. We are supportive of the proposal for the appointment of a manager / provisional liquidator / liquidator upon the insolvency of an insurer with a priority to first seek the transfer of life policies of the insolvent insurer to another insurer.
18. Similar to the principle in the United Kingdom that payment under the Financial Services Compensation Scheme is a last resort, we agree that compensation under the PPF should only be triggered after an attempt to transfer a policyholder's policy to another insurer has been made. We agree that a transfer

of a life insurance policy is preferable given that coverage is continued for a policyholder.

CHAPTER 4 – FUNDING MECHANISM

Funding Model

19. We agree that a post-funding model would be unfair as the insolvent insurer triggering funding would not contribute to the PPF. In many jurisdictions, a pre-funding model is used and although a progressive funding approach may ensure the availability of an upfront reserve, it may also pose a financial burden on soundly managed insurers particularly if other proposals such as the establishment of an independent insurance authority are implemented and additional levies are imposed on insurers.
20. We support in principle the adoption of progressive funding. However, we respectfully do not support the specific arrangements for operation of progressive funding as set out in the consultation document in the current form in that the proposals allow too much discretion to the PPF Board in determining the occasion for and terms of any change from standard to additional levy. We see a need to ensure that such decisions are taken with transparency and after a clear articulation of the case for such a change has been submitted for consultation.
21. As discussed in this paper, the proposal as contemplated will increase the financial burden on soundly managed insurers including AIA and AIAB particularly if other proposals such as the establishment of an independent insurance authority are implemented and additional levies are imposed on insurers. As a result, it would likely become more difficult to conduct insurance business in Hong Kong. A discount on the levy for soundly managed insurers should be considered to reduce the burden. For instance, Singapore imposes risk-based levies. A criteria that may be used for measuring the soundness of an insurer may be a specific rating from Standard and Poor's or Moody's Rating Services or if an insurer has no rating, a specific solvency ratio to be maintained in respect of its Hong Kong business.

Collection of Levy

22. The levy should only be collected in respect of premiums on new and in-force policies issued in Hong Kong after the establishment of the PPF. For example, policies issued in other Asian jurisdictions may already benefit from policyholder protection schemes. Moreover, it should be made clear in any legislation that the levy should only be collected in relation to the Hong Kong business of insurers but not in respect of any businesses carried out by their branches which operate and underwrite business outside of Hong Kong.
23. Since the levy would increase the financial burden on insurers, we suggest that insurers either receive a tax credit to offset the amount paid for levies for a certain amount of years (e.g. the 15 years required to build up the target fund) or insurers should be explicitly permitted to collect the cost of the levy from policyholders. In particular, the ability of insurers to collect the levy from policyholders on premiums paid after the establishment of the PPF in respect of:

- a) in-force policies; and
- b) newly issued policies

should be set out in legislation.

Initial Target Fund Size and Levy Rate

24. The amount of the levy must not be a financial burden on soundly managed insurers. Also, the amount of the levy must not be of such a burden that it would affect the competitiveness of insurers relative to insurers located in other jurisdictions which do not have such a policyholder protection fund or scheme. The proposed levy will substantially increase the financial burden of certain insurance companies, in particular to large insurance companies with a large in-force portfolio such as AIA and AIAB. The following summarises the projected annual levy for each of AIA and AIAB using business statistics in 2010 and a levy of 0.07%:

HK\$ '000

General business

	Estimated Premiums	Estimated Annual Levy
AIA	27,493	19
AIAB	753,303	527

Long Term business

	Estimated Premiums	Estimated Annual Levy
AIA	406,817	285
AIAB	24,723,570	15,382

Total Impact (General business and Long Term business)

	Estimated Premiums	Estimated Annual Levy
AIA	434,310	285
AIAB	25,476,873	15,909
Total	25,911,183	16,194

When the above levy for the PPF is coupled with the potential increase in fees and levies under the recent proposal for the establishment of an insurance authority, there is a financial burden to both AIA and AIAB which over time is not insignificant, particularly in respect of AIAB.

Insurers should be expressly permitted to pass the cost of the levy to their policyholders. For new and renewable policies, insurers should be permitted to make arrangements to charge policyholders any cost of the levy. Additionally, in regards to participating policies, insurers should be permitted to take into account the cost of levies on the amount if any declared for dividends and bonuses. Finally, consideration should be made to legislatively permit insurers to charge the levy on policyholders for in-force policies.

25. Moreover, the target fund size should balance the requirement for available funds in the PPF to compensate policyholders with funds being available to insurers for

use in their business.

26. The amount of levy collected from premiums should be consistent with the total compensation limit of HKD1 million. That is, the levy should be applied against the premium amount paid for up to HKD1 million in coverage in respect of each policy. For example, if a life insurance policy has coverage for HKD10 million and premiums are paid in respect of the entire coverage, the levy rate should only be applied on premiums in respect of a coverage amount of HKD1 million. The remaining amount of premium paid for coverage for the remaining HKD9 million of the HKD10 million policy should be levy free. Although it may take longer to build up the initial target fund size, we suggest this would be a more fair approach to policyholders in assessing the amount of levy to be paid.
27. There should be a mechanism whereby the levy rate is suspended in the event that the target fund of the Life Scheme or Non-Life Scheme is met subject to a consideration as to whether new entrants to the insurance market after the target fund is achieved need to contribute for a specified period of time so that there is more equality among insurers as to the amounts of their respective funding to the PPF.

Asset recovery mechanism

28. We agree that in order for claim to be paid, the claimant must assign their claim against the insurer to the PPF.

Financing Arrangement to Bridge Liquidity Gap

29. We support the proposal that there should be a mechanism to bridge any liquidity gap under a progressive funding model. We suggest that this liquidity gap be bridged from the Government direct. This would increase public confidence in the PPF.

CHAPTER 5 – GOVERNANCE ARRANGEMENTS AND RELATED MATTERS

Legal and Organizational Structure

30. The Monetary Authority of Singapore recently reviewed their Deposit Insurance and Policy Owners' Protection Scheme and on consultation, proposed for cost efficiency and to leverage on existing resources that the Singapore Deposit Insurance Corporation also administers the Policy Owners' Protection Scheme. Another example is the United Kingdom where protection schemes for both deposits and insurance policies are also administered by the same body. Consideration should be made as to whether any cost efficiency can be achieved by administering the deposit protection scheme, the PPF and the existing compensation schemes for motor vehicle policies and employees' compensation policies together.

31. We support significant representation by the insurance industry on the PPF board given the highly technical and complicated nature of insurance business and operations. In particular, there should be representation from the life insurance industry in respect of the management of the Life Scheme and representation from the general insurance industry in respect of the management of the Non-Life Scheme.

Functions and Powers of the PPF Board

32. The PPF Board should have the power that if it considers that benefits are excessive, it can, upon the written recommendation of an actuary, recommend that a policy may be reduced or disregarded. We propose this mechanism used by the Financial Services Compensation Scheme in the United Kingdom be adopted to provide the PPF Board with flexibility and discretion in its operations.

Governance Arrangements, Guidance on Investment, Daily Operations, Confidentiality

33. We agree that the PPF Board should exercise a high level of prudence in investing the money of the PPF and in this respect, there should be expertise on the PPF Board to ensure that investments on behalf of the PPF are managed conservatively.

OTHER COMMENTS

There is an additional issue of importance that requires, in our considered view, additional consultation from the Government. Specifically, the design of the current PPF proposal is based on Hong Kong's previous experience with insurance failures which have tended to involve smaller insurers. In more recent times, the global trend in the insurance industry including Hong Kong is towards consolidation, leading to generally larger insurers. In such scenarios where there are insurers which are substantial in size (and indeed perhaps deemed "too big to fail") and who may fail, the PPF may not be sufficient. It is our considered view that such a failure would be the result of a host of factors and it would be unduly burdensome to fill any "gap" in the PPF by way of any stepped up levy. In particular, this burden will fall upon those participating insurers who have been prudently managed. In such circumstances, the impact would be felt by the remaining insurers in such a way as to potentially increase rather than reduce the industry impact of any such failure.

Under these circumstances, we would view implementation of a scheme in the nature of the proposed PPF scheme without detailed consideration the handling of a potential failure of a substantial institution as premature. We therefore seek consultation on this issue and in particular the role that the Government would play in tandem with the PPF in such a scenario.

AIA and AIAB are pleased to have had the opportunity to provide comments on the proposed establishment of a PPF and would welcome further participation once more details of the PPF are available. If you have any questions concerning this paper, please do not hesitate to contact Mark Tucker, Group Chief Executive and President at Tel: _____ or Mitch New, Executive Vice President and Group General Counsel at Tel: _____



Liberty
International
Underwriters®

Member of Liberty Mutual Group

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I
Admiralty Centre
18, Harcourt Road
Hong Kong

24 June 2011

Dear Sir,

Liberty Mutual Insurance Europe Limited – Hong Kong Branch trading as Liberty International Underwriters (Liberty) makes the following comments and submissions in response to the Consultation Paper on the Proposed Establishment of a Policyholders Protection Fund released by the Financial Services and the Treasury Bureau.

Liberty supports the insurance industry funding the Policyholders Protection Fund through a fair, balanced funding regime without cross-subsidisation within sections of the industry.

Liberty acknowledges the attempt to address pitfalls raised by stakeholders in the Feasibility of Establishing a Policyholder Protection Fund Consultation Paper in 2003. These concerns were:

- moral hazard risk;
- increased cost;
- distortion of free market competition (and potential to exclude types of business dealt with by large multinational consumers); and
- weakening of insurance industry (as result of moral hazard and because when an insolvency occurs the resulting PPF will reduce the capital of the surviving insurers).

The proposals appear to substantially mitigate a number of these issues however these concerns remain valid.

Liberty supports the recommendation in the consultation paper that coverage of the Policyholders Protection Fund should focus on individual policyholders. More specifically we support the PPF covering personal insurance of individual policyholders rather than commercial insurance. The possible extension of the Policyholders Protection Fund to

also cover small and medium enterprises (SMEs) due to a perceived lower sophistication is not recommended as business persons in all areas of business are able to engage professional advice if deemed necessary. Insurance is no different from seeking legal, taxation or accounting advice from a professional and advice could be sought from the broker market to determine insurance needs which also mitigates the risk of insurance insolvency through placement of risks with less sound insurance companies.

Liberty also attended the consultative session arranged by the Office of the Commissioner of Insurance on 11 May 2011. At the session, the topic of proposed classification of SME was raised and proposed to be dependent on the number of staff employed by the entity. Liberty contends that extending the PPF to cover commercial insurance is also problematic from a cost / benefit, definition and application perspective.

Liberty contends that extending the PPF to commercial insurance for SMEs is not necessary and the costs involved in changing industry practise to obtain information for classification and reporting purposes, as well as amending business systems for commercial insurance far outweigh the amount of additional levy generated and protection provided.

We noted that the consultation paper indicated a SME could be defined as a manufacturing business which employs fewer than 100 persons in Hong Kong, or a non-manufacturing business which employs fewer than 50 persons in Hong Kong.

Liberty are concerned that this definition would extend the PPF beyond the focus on individual policyholders to the commercial insurance market. This would include a number of large companies as the number of employees in Hong Kong is not always representative of size of the insureds under the policy. Other concerns that arise with this definition include:

- If there are multiple insureds or additional insureds (details of which not are always advised to the insurer) it is unclear whether or how the levy should be applied. e.g. policy covering more than one non-manufacturing SME having less than 50 staff each but with more than 50 staff collectively.
- If a policy covers multiple risk locations outside Hong Kong does the levy and PPF apply in whole or part and hence does the number of employees that all prospective insured companies have in Hong Kong need to be determined.
- The definition of risk location and application of the levy in relation to Marine, Professional Indemnity and Directors and Officers insurance is unclear. The application of the levy to these classes of business under the above definition could be quite extensive and extend well beyond entities that could truly be considered SMEs including listed companies and members of large corporate groups.

It was also noted that the consultation paper recommended that all in-force policies as at the date of the introduction of the PPF be covered by the scheme. The consultation paper was not clear whether the levy would apply to gross written premium for policies in-force prior to the introduction of the PPF. Liberty contends that applying the levy to policies underwritten prior to the introduction of the scheme would be problematic as

information on the number of employees would not have been collected or incorporated in business reporting systems. The application of the levy to instalment, adjustment or returns premiums is unclear and further guidance would be appreciated if the PPF was to be extended to cover commercial insurance for individual business persons or SMEs.

Liberty would welcome any opportunity to discuss the proposed changes further and is willing to participate in further industry consultation or working groups to ensure that regulatory goals are met, whilst maintaining an efficient and productive business operating environment in Hong Kong.

Yours Sincerely



Richard Head
Chief Executive
Liberty Mutual Insurance Europe Ltd – Hong Kong Branch
Phone:



香港人壽保險從業員協會有限公司
The Life Underwriters Association of Hong Kong Limited

關於建議設立保單持有人保障基金

——保協提交財經事務及庫務局意見書

前言

就二零一一年三月貴局發表「建議設立保單持有人保障基金」的諮詢文件(下稱「諮詢文件」)，建議成立保單持有人保障基金(下稱「保障基金」)，以維持保險市場的穩定及增強公眾對保險業的信心和提高保險業的競爭力。為此，現謹陳明本會之立場如下。

贊同大方向

本會贊成設立基金的大方向，認同有關做法可以增強公眾對保險業的信心。並且，本會讚賞政府在制定保障基金這政策過程中，積極和主動引入業界參與，讓業界能充分發揮專業知識以完善方案。並希望這良好的作風能貫徹至各個涉及保險業範疇的政策制定中。

在諮詢文件中當局勾劃出數項原則，包括：(i) 平衡業界的負擔與對保單持有人的保障；(ii) 兼顧道德風險（機制被濫用的可能）；以及(iii) 相關的徵費制度和行政與《保險公司條例》的要求並行不悖等等。這些原則合情合理。整體而言，本會同意保障基金的設立有助於增加公眾對保險業的信心，並維持市場穩定，對保單持有人有著「安全網」的作用。

保障範圍

本會贊成將保障基金劃為人壽計劃及非人壽計劃，以分別處理兩項性質迥異的計劃。另外，政府建議涵蓋業主立案法團，至於是否涵蓋中小型企業，則視乎公眾的共識。對此，本會亦不持異議。



香港人壽保險從業員協會有限公司
The Life Underwriters Association of Hong Kong Limited

賠償水平及基金的管理和投資

簡單而言，政府的整體建議，是支援(人壽)每張保單及(非人壽)每宗申索以 100 萬港元為上限。其中涉及的是，一旦發生保險公司無力償債的情況，無論是促進轉移、延續、賠償，抑或支付特惠金，保障基金都是以所支付的款項總額 100 萬為上限。

在本會舉行的簡介會上，保監專員一如在立法會上，重申本港有約 94% 的壽險保額介乎 100 萬至 120 萬元，故相信逾九成的索償人都可獲九成或以上的賠償，強調可以保障絕大部分投保人。本會認為，有關數據只是反映以往多年簽下的保單保額狀況，屬滯後數據；二來，據本會前線的經驗所知，目前不少訂定的人壽保單保額一般是 200 或 300 萬，因此本會認為賠償水平訂為 100 萬，是缺乏前瞻性的。試想想，以通脹以及市民的追求更高保障的角度而言，一旦不幸的情況多年後發生，100 萬的保額保障，是不足應付任何香港家庭的長期需要。因此，本會建議，以人壽而言，將有關保障提昇至 200 或 300 萬。另外，賠償水平(包括非人壽部分)亦須不時檢討，以確定有關數額合乎實際情況，切合現實所需。

本會擔心，保障基金可能帶來了過高的公眾期望，現時提出的賠償水平只是杯水車薪，一旦基金要真正操作而無法有效回應公眾期望，屆時政府只會左支右絀。

由於該行政架構工作量有限，本會深切期望有關架構真正做到「小而精」，以減省不必要的人力和開支，對行業的財政負擔長期維持在最低限的水平，力求徵費率維持在(佔適用保費的) 0.07% 水平以下。另外，以政府的保守運算，保障基金須累積徵費 15 年才滾存至 12 億(人壽計劃部分)及 7 千 5 百萬(非人壽部分)，其投資回報率估算偏低。政府須謹慎而善作投資，以免浪費業界的資源，並應確保保單持有人不會因保障基金的成立而增加負擔。



香港人壽保險從業員協會有限公司
The Life Underwriters Association of Hong Kong Limited

一如以往，本會希望，在涉及保險政策的制定和推行，保險業界的專業意見能被充足反映及表達，甚至被吸納於政策的制定和推行之中。諮詢文件表明，將有獨立的法定組織(「保障基金管理委員會」)以及轄下兩個(人壽及非人壽)業界委員會的成立，以就管理及處理基金事宜提供監督和建議。本會強烈要求，保險專業的各方賢達，應被羅致於保障基金的架構之中，出謀獻策，為公眾利益作出業界的貢獻。

總結

本會明白保險業市場上不穩定因素難以預料，因此透過公共權力的介入來維繫公眾信心，在確保有關行政開支和向業界徵費維持在最低限度的情況下，設立保單持有人保障基金來提升公眾信心，本會是贊成的。

香港人壽保險從業員協會背景資料

香港人壽保險從業員協會(『保協』)成立於 1973 年，是一個歷史悠久的保險界專業團體，會員人數超過 8000 人，是全港會員人數最多的保險業組織。『保協』主要宗旨是推動及提高人壽保險從業員之專業水準，並訂立和執行有關專業守則；舉辦教育課程與會議，提供機會給業內人士學習和交流經驗，以提高業者水平和成就；鼓勵從業員參與公益和公眾事務，回饋社會。香港人壽保險從業員協會有代表出席「保險代理登記委員會」委員之一。於 2009 年，『保協』成立「行業事務委員會」，藉以積極發表專業的行業意見。

— 完 —



June 24, 2011

Special Duties Division
Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir

Proposed Establishment of a Policyholders' Protection Fund

Thank you for the opportunity to respond to the Consultation Paper (CP) on the proposed Policyholders' Protection Fund (hereinafter referred to as the PPF, fund or scheme as the context requires). The CP does not set out specific questions to be answered by respondents, and accordingly we set out below our principal areas of concern as to the proposals set out in the CP.

1. Whilst acknowledging the simplicity of the overall approach, we have a concern that the proposed scheme may act counter to one of the stated guiding principles set out in paragraph 2, viz. (b) being to "enhance market stability while minimizing the risk of moral hazard." Our concern is that, as proposed, the arrangements may rather increase systemic risk, exposing soundly run companies to the risk that less prudent ones fail while disincentivising prudence and therefore increasing moral hazard. PPFs operate by mutualising risk and we are concerned that the proposed design does not appear to address the systemic risk that this entails.
Our principal concern lies with the proposed pricing structure. The pricing of the levy is set at a flat rate based on premiums (paragraphs 4.8 and 4.11). A flat rate levy has the perverse impact that an insurer that underprices compared to its peers and that is therefore at greater risk of failure other things being equal, pays less in levy than its more prudent peers. This (a) is unfair to the more prudent insurers; and (b) tends to enhance moral hazard since the insurers know when making pricing and reserving decisions that the policyholders are protected come what may (and the policyholders know when comparing prices that whatever happens they are protected up to the limits of the proposed scheme). There is little incentive for insurers to price prudently or for policyholders to question whether bargains are too good to be true. If anything a competitive advantage is handed to the least provident insurers. We have raised this concern previously, with respect to the proposed funding structure for the proposed independent Insurance Authority.

Risk rating would seem necessary to ensure that those insurers at higher risk of ruin pay proportionately toward the cost of the scheme, notwithstanding that this will increase the complexity of the scheme. Deposit insurance rating systems attempt to achieve this, and we note that Singapore proposes risk rating for the levy for its insurance policy owner protection fund.¹ The CP does not explain why risk rating has not been proposed.

Whether or not risk rating is adopted (but particularly if it is not), it would seem highly desirable to have minimum standards for insurance capital adequacy based on risk of ruin, to place a floor on the riskiness of insurers and mitigate the systemic risk that way. At present Hong Kong does not have a risk-based capital regime for insurance, which places it at a minority among nations in the region.

We therefore recommend that:

- (i) the levy should be determined on a risk pricing basis, similarly to the Singapore proposals; and
- (ii) the policyholder protection fund should not be introduced until Hong Kong has established a risk-based capital requirement, including consistent requirements for valuation of technical provisions.

2. We are concerned that the CP does not clearly identify the scope of the proposed Fund, and that on one interpretation that scope includes risks that are not located in Hong Kong. In view of the potential impacts on insurer behaviour of different scopes, clarity is essential for proper assessment.

Paragraph 3.7 of the CP refers to the scope of the PPF as covering direct life and non-life contracts that are “written in Hong Kong”, but this term is not defined. There are definitions of Hong Kong insurance business and Hong Kong long-term insurance business set out in Part 1 of the Third Schedule to the Ordinance, which are the basis for regulatory reporting. These include non-Hong Kong risks written from Hong Kong, with a range of criteria any of which determines the contract as being Hong Kong business. If “written in Hong Kong” is meant to follow the definitions of Hong Kong business in the Third Schedule, the proposed Fund will compensate policyholders in respect of risks that are not situated in Hong Kong.

Exposure of the PPF to non-Hong Kong risks raises a number of issues, reflecting both the additional liability that this may represent² and the possible impact on the behaviour of insurance companies, which is hard to predict, as there may be incentives both to route non-Hong Kong business through Hong Kong offices and to divert Hong Kong risks away from Hong Kong offices. These questions of coverage are tested only when something goes wrong. For example:

¹ See most recently the Monetary Authority of Singapore’s Third Consultation Paper on Policy Owners’ Protection Fund, May 2011 (the risk rating has been a feature of the Authority’s proposals for some years).

² It may be noted that the UK equivalent scheme referred to in Annex A is subject to limitations based on the location of risk (see COMP 5.4 in the FSA Handbook of Rules and Guidance; in general the risks must be EEA risks due to mutually recognised minimum European compensation scheme standards, though in other cases the risks must be UK risks). The proposed Singapore scheme does however cover offshore risks of the designated types.

- (i) Insurers with operations in more than one country could issue policies for Hong Kong customers on paper of a different branch, so that the insurers will then not be subject to the levy for that business. Hong Kong policyholders might buy cover for Hong Kong risks from insurers who are authorised in Hong Kong, but not be protected by the PPF.
- (ii) International business may be diverted away from Hong Kong, to the detriment of the local market.
- (iii) On the other hand, some insurers could seek to divert business to Hong Kong, making the existence of the Fund a selling point for their non-Hong Kong customers. This could have impacts if competitors or regulators in the countries of the risk take exception to the offshoring of what they see as local business.

We suggest that the Administration consider limiting the PPF to risks that are located in Hong Kong at the time of the contract, and monitor the risk of diversion of business by requiring Hong Kong authorised insurers to report periodically Hong Kong risks that are written by that insurer through establishments outside Hong Kong.

3. We are similarly concerned that the basis for the levy is not clear. It is proposed (at paragraph 4.8) that the levy should be based on premiums as set out in insurers' audited returns. Since many foreign insurers do not submit the audited return under Parts 3-5 of the Third Schedule of the Insurance Companies Ordinance it is assumed that this is a reference to the audited returns under Part 8 (Forms 1-9 and Form HKL1) of that Schedule. However, none of these returns distinguishes between contracts that would be protected by the proposed PPF and those that would not be. The proposal at paragraph 4.8 does not mention this practical problem. If the proposal is carried forward, it will presumably require expansion of the audited returns so that insurers record separately those insurance contracts that are covered by the PPF and those that are not. As a consequence, time will be needed to allow insurers to modify their systems and processes so as to classify contracts between those covered by the proposed PPF and those not covered. As it is intended (paragraph 3.9) to cover contracts in force at the date of commencement, this will involve checking the back book and potentially collecting additional information from policyholders. A significant lead time should therefore be allowed. It is not unreasonable to expect a year's notice of a change of this nature.

The audit will also involve additional time and cost, as controls over these more detailed analyses will need to be audited, and the integrity of the more detailed forms validated.³

An alternative interpretation of the proposal in paragraph 4.8 is that policies which are not covered by the proposed Fund (for example, contracts where the insured is a large corporate), should be levied. In the absence of explicit

³ It may be noted that the equivalent returns of information by UK insurers for the purposes of the Financial Services Compensation Scheme are not subject to audit.

articulation in the CP, it seems unlikely that such a potentially controversial approach is proposed, however we are aware of suggestions that this is the case. Such a proposal would raise an evident issue of fairness, in that insurers writing more non-protected business will be paying more than their fair share of the levy, and the likelihood of diversion of non-protected business away from Hong Kong would be increased, to the detriment of Hong Kong as an insurance centre (and to the disadvantage of Hong Kong incorporated insurers without foreign branches to diversify their clients' business to).

Although we see no explicit statement in the CP that policies not covered by the Fund are to be within the scope of the levy, and we would have serious reservations at the fairness of introducing the scheme on that basis and at the failure to spell this out in the CP, if that is indeed the proposal certain other matters need to be considered.

- (i) We would in those circumstances recommend modification of the levy rate for different classes of business, such that the total levy 'take' approximates to the appropriate share of the Fund's income for that class that represents policies within scope, having regard to the riskiness of the insurer as recommended in 1.(i) above. Although every class may include some policies within scope (this will definitely be the case if SME corporate lines are included), it may be cost-effective to exclude some classes altogether.
- (ii) For the sake of fairness, consideration should also be given to a mechanism for insurers to declare that they have no contracts protected by the Fund, and therefore not to be subject to the levy, or to opt for a levy calculated at the full rate on the basis of their actual exposure to protected policies.

There is clearly a trade-off since charging the levy on unprotected policies means that the charge is spread over a larger pool, but at the cost of unfairness and possible impact on behaviour.

Lastly on this subject of the levy, we note that the CP does not contain any provisions for the application of a levy to run-off business, even though such business is proposed to be covered by the PPF. We recommend that run-off insurers should still be expected to pay towards the maintenance of the PPF.

- 4. We are also concerned at the potential practical implications of the proposal that the PPF should be able to pay up to HKD 1 million per policy to facilitate a transfer of life insurance business to another insurer. The circumstances under which such a payment would be made are not fully explored in the CP. The impact on the normal dynamics of a transfer of business need to be considered.

Blocks of insurance business have an attraction to potential transferees, which is reflected in their appraisal value. A transfer of business does not just represent the transfer of technical liabilities and assets to back them, but

also acquisition of, and payment for, identifiable intangibles and goodwill. Under the proposals, potential transferee insurers may end up having their acquisition of blocks of business subsidised by the PPF, rather than making proper payment for the appraisal value of the business. There is potentially an incentive in that case for potential transferees to bargain with the PPF for capital contribution, to the benefit of their shareholders and to the detriment of the Fund and of the shareholders of the transferor who would normally be entitled to any surplus value arising from those intangible assets. While in a "fire sale" scenario shareholders frequently do lose the value of intangibles and purchasers do acquire a bargain, it does not appear appropriate that the proposed PPF should increase the probability of that outcome.

The existence of the payment mechanism may make solvent transfer of business more difficult since potential transferees may wait until the compensation mechanism kicks in, rather than purchasing the business from the failed insurer. Such brinkmanship would not be conducive to market stability and may make it more likely that the PPF is called upon.

Furthermore, it is not clear to us from the CP how any payment from the PPF to facilitate a transfer would be quarantined within the overall transfer of business if both protected and unprotected contracts are involved. Neither is it clear on what basis any such payment would apply to the risk element of contracts where claims have not yet arisen.

Finally, transfer of business as a going concern may also be a solution for general insurance, and the argument for not providing assistance for a transfer of general insurance policies seems to depend on an assumption that all exposure ceases on expiry of the policy. That would not be a correct assumption, particularly for classes of longer tail where claims may remain unsettled and even undetected, years after the expiry of the policy. The scope includes Building Owners Corporation Third Party liability insurance, it (presumably) includes payment protection insurance including mortgage protection, which may be long-term in nature, and it may include small and medium enterprises (SMEs) thus expanding the scope into public liability, products liability, professional indemnity and similar long-tail classes. Blocks of non-life business are periodically transferred between non-life insurers, under Part IVD of the Ordinance. The analysis supporting the statement at paragraph 3.20 that "Transfer of non-life policies would not be cost-effective" is not presented. We would suggest that if the proposed PPF is prepared to facilitate the transfer of life policies, it should also be prepared to consider facilitating the transfer of non-life policies.

5. We note that the initial fund target size for the non-life Scheme is HKD 75 million, which is equivalent to 75 total losses to the Scheme. Some triggers for insurer insolvency may derive from catastrophic events (typically for Hong Kong, windstorm, but if offshore business is also included, potentially earthquake) if the insurer has inadequate reinsurance or the reinsurers fail. The actual loss to the insurer and potential policyholders could then be considerable, particularly if several insurers are affected by the same event

or series of events. We would query whether the aim of a 99% confidence level has been achieved in this case by this level of funding. This is particularly the case if as we comment below, the PPF would effectively continue policies in force after the insolvency event.

At paragraphs 4.15 to 4.17, the CP discusses the possibility of a liquidity gap. In addition to the borrowing proposal set out in those paragraphs, the designers of the Scheme should consider whether other mechanisms such as reinsurance in the international markets, or the issue of contingent capital instruments, might be used. While this would involve an annual charge on the revenues of the Fund, it would reduce the need for negotiation of borrowing in the aftermath of a natural disaster when the Administration might itself be seeking reconstruction finance.

6. We note the suggestion that SMEs should be covered by the PPF, and the invitation, particularly to SMEs, to comment on whether they should be covered. We would be surprised if SMEs did not wish to be covered. However, as we have noted above, inclusion of SMEs would be likely to expand the exposure of the PPF to longer-tail non-life risks. It may be queried whether it is appropriate to mutualise SMEs' exposure to insurer insolvency with that of individuals, who are the primary focus of the scheme. The pattern of insurance risk is likely to be different, and the pattern of exposure to insurer insolvency may well be also. Therefore, if SMEs are to be included, consideration should be given to whether a third Scheme should be established, for SMEs alone.
7. We note from the Examples that, in the event of a claim on risk business occurring after the insurer has become insolvent, it is proposed that the policyholder should have the right to claim against the estate of the insolvent insurer for the amount of the claim in excess of the indemnity from the Fund. This raises difficult questions. An insurer that has become insolvent is unable to perform on its insurance contracts, and one would expect the policyholder to become a creditor for the unearned portion of any premium paid rather than enforcing performance. Furthermore, short-term insurance contracts are normally cancellable prospectively by notice. An insolvent insurer would have little choice but to cancel those contracts that it could, to avoid continuing to trade while insolvent. The proposal appears to compel an insolvent company to continue to trade. If a claim occurring after insolvency is intended to be ultimately recoverable from the insurer's estate, the impact could be quite dramatic.

Consider the following scenario. An insurer becomes insolvent, and shortly thereafter Hong Kong is hit by a major typhoon. Many claims occur on contracts that were in force at the date of the insolvency. However, the insurer's reinsurance policies will almost certainly have been cancelled by reason of the insolvency (this is a common *ipso facto* term in reinsurance contracts), so it is unable to recover from its reinsurers to fund the claims. In effect, from the date of the insolvency the insurer has not only been forced to

carry on providing insurance cover while it is insolvent, but to do so in violation of section 8(3)(c) of the Insurance Companies Ordinance.

Paragraph 4.13 also suggests that compensation paid by the PPF in respect of claims incurred after insolvency will be sought for recovery from the estate of the insolvent insurer. Paragraph 4.14 proposes to place the PPF in equal standing with the Employee Compensation Assistance Fund so far as concerns section 265 of the Companies Ordinance. We note that under section 265(1)(cb) amounts in respect of employee compensation are preferential only if “accrued at the relevant date”, and refunds of premium are not preferential. Similarly at section 265(1)(e), whilst it is not stated that liabilities must exist at the date of insolvency to be preferential, as noted above that would seem implicit, and refunds of premium are explicitly not preferential. The proposals for the PPF seem therefore to be altering the normal course of insolvency.⁴

Possible impacts on behaviour might include that insurers facing insolvency issue cancellation notices for policies in order to avoid liability for claims arising from events occurring after insolvency has occurred, and that insurers seek to include *ipso facto* cancellation clauses in insurance policies, to be triggered by the insurer’s insolvency.⁵ Neither of these appears a particularly desirable development as they would obstruct an orderly resolution.

It is not clear from the CP whether the Administration has considered an alternative approach, that of the UK’s Financial Services Compensation Scheme (FSCS), where the priority for non-life insurance contracts is to secure continuing coverage for the policyholder by either transfer of the contract to another insurer, or procurement of a substitute policy from another insurer. The unexpired portion of the premium remains a claim against the insolvent insurer and is protected by the FSCS.⁶ We recommend consideration of this approach as a preferable alternative to that set out in the CP.

We note that according to the examples given in the CP it seems in practice that funding of a replacement policy is the intention in cases of life insurance,

⁴ We also note from the current wording of section 265(e)(ii) of the Companies Ordinance that the policyholder will apparently cease to be a preferential creditor of the insurer, seemingly even for that amount that is not covered by the PPF. Some clarification of the Companies Ordinance wording may consequently be necessary.

⁵ Such action might be considered necessary in self-defence; if an insurer is to be exposed, without benefit of reinsurance, to insurance events occurring after the balance date, there must be a greater likelihood that the assets will be insufficient to meet the liabilities and that personal liability of directors will be invoked under the relevant sections of the Companies Act.

⁶ The point may also be made that if the insured has not paid the premium, the insurer has a counterclaim for the unpaid premium and should be expected to retain the right to cancel the policy (prospectively) for non-payment; the intervention of the PPF should not relieve policyholders of the obligation to pay for the cover they receive. The PPF should also be required to recover, and to account to the estate of the insolvent insurer for, outstanding premiums from any compensation payments made.

though this is expressed in the CP as *ex gratia* payment. Rather than being *ex gratia* (and therefore presumably not recoverable from the insurer), we suggest that this should be an explicit priority for the PPF in all cases where contracts are not transferred.

8. Regarding the proposed conditions for activating the PPF⁷, we note that these include a range of circumstances of inability to pay debts, rather than being triggered by actual default. We note that under section 42(1) of the Insurance Companies Ordinance, for the purposes of sections 177 and 327, an insurer is deemed to be unable to pay its debts if it has not maintained surplus assets of at least the relevant amount. This could appear to trigger proposed condition (a) or possibly (e) for activating the PPF. It does not seem appropriate to activate the PPF under such circumstances, as there is at that time no evidence that the insurer is as a matter of fact in default of any of its claim obligations.

Indeed, probable responses to a company failing to maintain the prescribed level of surplus assets include the injection of additional capital such that the company is no longer in breach (particularly in the case of a subsidiary of a multinational whose capital is managed globally). The conditions triggering activation of the PPF may therefore be only temporary; no manager or liquidator or receiver will be appointed, and the PPF should not be activated if that is the case.

Levels of reserving are also relevant here in determining whether a company is solvent or not. The prescribed valuation method under the Ordinance for life insurance liabilities is generally considered to be conservative by design, such that in-force business provisions include economic profits that are not permitted to emerge until a later date. For non-life liabilities, there are no prescribed valuation rules other than what is effectively a ban on discounting, and in our experience the conservatism of companies' reserving varies considerably. This is another reason that, as we recommend in 1.(ii) above, the PPF should be introduced only in tandem with a risk-based capital requirement system involving consistent valuation requirements for liabilities.

9. We suggest that the proposed introduction of the PPF provides an opportunity for a more general examination of compensation for consumers of financial products in Hong Kong. At present, bank deposits are protected under one scheme, and investments under a second; the current proposal would create a third. Each has its own infrastructure and its own limits on indemnification, and these are not all consistent. For example, losses due to default of a securities company are capped at HKD 150,000, yet the proposed limit for an investment linked assurance scheme is HKD 1,000,000. In order to avoid duplication of infrastructure and inconsistency in approach, we suggest that consideration be given to development of an integrated scheme covering all sectors. We appreciate that this would require

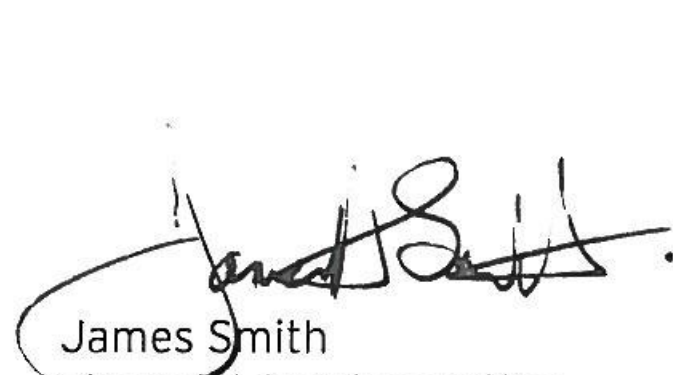
⁷ It is implicit in the CP that 'activating' the PPF would effectively mean that the PPF steps in and takes over from the insurer the responsibility for settling its insurance claims.

amendment to other legislation however we perceive potential benefit in centralising the governance structures of these schemes not only to avoid duplication but also to help prevent regulatory arbitrage, and regulatory capture (undue influence from the market).

In summary, we are concerned that the proposals as set out in the CP appear to be inadequately articulated and may if implemented increase moral hazard rather than reduce it, with the potential impact that systemic risk is introduced unnecessarily into the system. We suggest that it would be preferable to concentrate on managing the risk of failure of insurers through a proper risk-based capital requirement, compelling insurers to maintain own funds to cover the risk of failure, rather than mutualising the risk of the weaker among the stronger.

We hope that the above observations are helpful.

Yours faithfully



James Smith
Financial Services Office
Ernst & Young



Kieren Cummings
Financial Services Office
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本會對財經事務及庫務局建議設立「保單持有人保障基金」諮詢文件之意見如下:

1) 徵費機制及模式

1.1 徵費不會轉嫁消費者及業界從業員

諮詢文件建議「保障基金」應獲授權向保險公司徵費，徵費率為保費的 0.07%，「保障基金」如何確保此徵費不會轉嫁給消費者及業界從業員？加重投保人或從業員的負擔？另本會偏向以事後徵費模式。

1.2 預定基金金額不足夠時之處理方法

是否會加收徵費？當通脹率高於 2%時，基金金額是否足夠應付開支及賠償？

1.3 基金投資項目的透明度

預計投資回報為 2%，此投資內容大致如何及有否設立合適規管制度？可否增加透明度讓投保人了解？

1.4 融資安排

「保障基金」可向外借款，由政府作擔保，或直接向政府貸款，都必須得到立法會批准，如果不獲貸款或不獲批資，如何保障「保障基金」運作正常？

2) 管治安排

2.1 「保障基金」委員會

由財政司司長委任的「委員會」架構及分工如何安排？人手及開支如何？諮詢文件沒有詳細說明？可否讓市民多些資料了解委員會的運作？如何提高諮詢文件中提及的「高度透明度和問責性」？

2.2 「保障基金」上訴委員會

由行政長官委任的「上訴委員會」主席及成員，其權力及職能為何？如何保障任何人因保障基金管理委員會的有關決定感到受屈，都可以得到公平，公正的處理。



GAMA
INTERNATIONAL HONG KONG



香港人壽保險經理協會
General Agents & Managers Association of Hong Kong

本會對諮詢文件內包括保障範圍，賠償水平可作適度提高，令投保人的保障可提高，日後更可跟市場提升。對於「保障基金」委員會及上訴委員會中，我們建議應增設前線之業界代表，在此委員會中前線從業員可以給予相關之經驗，提出意見，對外來說可以提高透明度，對於投保人來說，有前線從業員參與，可以起溝通及緩和作用，因一旦保險公司無力償債，前線從業員都需為保單持有人提供處理申請服務，因保險業務及運作較為專門及複雜，所以希望保障基金能夠真正保障全港不同階層的市民。



恒 生 保 險

Hang Seng Insurance

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24th June 2011

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F., Tower I, Admiralty Centre
18 Harcourt Road
Hong Kong.

Dear Sirs,

Proposed Establishment of a Policyholders Protection Fund

In response to the Consultation Paper issued in March 2011, Hang Seng General Insurance (Hong Kong) Company Limited (hereinafter called "Hang Seng General Insurance") is pleased to comment on the proposal to establish a Policyholders' Protection Fund (PPF).

Hang Seng General Insurance is in general supportive of the establishment of the PPF and appreciates the efforts made by the Government for developing the proposed structure of the PPF. We believe that the proposed PPF will not only improve protection to the policyholders but also enhance the market stability. On the other hand, the key comments and concerns from Hang Seng General Insurance on the proposed PPF are shown below:

Small and Medium Enterprises

A clear definition of Small and Medium Enterprises (SMEs) should be developed as the current definition of SMEs may be regarded as too broad to include some professional firms of which the insurance needs are quite diversified and can be even more complicated than non SMEs. For example, some professional firms are required to take out insurance coverage for professional indemnity which will be covered by the PPF based on the current proposal but may not match the aim of the PPF. Furthermore, other types of insurance coverage such as marine cargo may also require further consideration to be included under the PPF as the ultimate beneficiaries of these types of insurance may be neither individual nor SME policyholders. Hence, it is also recommended that for SMEs only group life, group medical, group personal accident, property damage protection for company belongings, and general public liability insurance policies should be covered under the Non-Life Scheme of the PPF;



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Maximum Amount of Levy

We believe that there should be a maximum amount of levy being imposed on each insurance policy. Under the current proposed Limit of Compensation, individual policyholders who have decided to take out insurance policy with a significant amount of coverage will subsequently be imposed a larger amount of levy but with only a limited amount of protection under the PPF. To ensure fairness and equity among the policyholders, we propose that a maximum amount of levy should be developed and it is believed that the limit on the levy should be based on the limit of coverage under the PPF;

Determination of Levy

Under the current Deposit Protection Scheme, the contributions payable by the members are determined by the amount of protected deposits held with the members and the supervisory ratings assigned to them by the Hong Kong Monetary Authority. Based on the same principle, similar approach should be adopted for determining the levy for PPF and the calculation should also take into account the rating of the insurance companies. For those companies with a better rating, they should be allowed to pay a lower level of levy as they have made every effort to ensure their own financial security. Furthermore, by determining the levy based on the rating of the insurance companies, it will minimize the cross subsidization between stronger and weaker insurers. It is also worth noting that this approach will encourage the insurers to strengthen their balance sheet which in turn improve the overall stability of the insurance industry;

Protection on Riders

Pursuant to the Consultation Paper, the compensation from the PPF will be applicable on a per-policy basis for life insurance and on a per-claim basis for non life insurance. However, it is not uncommon that medical coverage could be purchased as riders in addition to a life insurance policy. In the event of the life insurer becoming insolvent, the medical rider will follow the per-claim basis but the life element will be covered by the per-policy basis. Therefore, it will merit a more elaborated definition on the treatment of insurance riders under the PPF for both coverage and compensation;

Treatment of Paid-up Policy

It is inevitable that insurance companies which have been operating in Hong Kong for a considerable period of time will have a significant number of paid-up insurance policies under



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their portfolio. It is observed that the current proposal will cover these paid-up policies but the levy will be determined base on the applicable premiums and no levy will be paid for these policies. Hence, it is advisable that a clear methodology should be developed to determine the levy on the paid-up policies so as to ensure the PPF will be adequate to cover all eligible policies in the event that an insurer becomes insolvent;

Protection to joint name policy

The current proposal stipulates that only individual and/or SMEs policyholders will be benefited from the PPF but insurance policies jointly purchased by a company (not necessarily SMEs) and an individual do exist in the market. Therefore, it may be required to develop a systematic approach to handle the joint ownership of an insurance policy such that the coverage of the individual policyholders could be broadened;

Targeted Fund Size

The proposed targeted fund size of Non-Life Scheme is significantly smaller than the Life-Scheme. We propose additional study on feasibility to increase the fund size be conducted so as to ensure the longevity of the Non-life Scheme in view of the likelihood that multiple claims under one single event might easily cost millions to settle; and

Consumers Education

To maximize the coverage from the PPF, it is natural that individuals will purchase a number of insurance policies instead of taking out only one insurance policy with a large amount of coverage. It is essential to accentuate that the general public will need to be educated that while splitting insurance policy may maximize their coverage under the PPF, there could also be additional fees and expenses.

Trusting these views will be of assistance to FSTB in its deliberations.

Yours faithfully,

Andrew Y M Chow
General Manager and Chief Underwriting Officer

Dear Sirs,

While we appreciate the growing needs in Hong Kong to provide a safety net like many advanced economies with compensation funds similar to PPF, the following are comments from our company:

- a. Disclosure & Client Protection– Since currently when there is any change affecting the product features of ILAS products, insurance companies will have to revise their offering documents, etc and seek for the SFC's approval accordingly. If you think the PPF will result to material changes of offering documents, we would suggest that the SFC or other appropriate parties should give clear guidelines on PPF related drafting and provide the support such that the impact to insurers could be minimized. For non-ILAS products it seems the same concern arises but just that there is no dependency on the SFC's approval process (but OCi's) in respect of the marketing materials.
- b. Education to the Public – When the PPF establishment comes to a later stage with more details we hope that the government can provide all-rounded education to the public. For instance, after all, as indicated in the PPF Consultation Paper (PPF Paper), there have not been any insolvencies involving life insurers or large non-life insurers in Hong Kong.
- c. PPF – According to the PPF Paper, the PPF should operate under the oversight of an independent governing body (viz. the PPF Board) appointed by the Financial Secretary. If so we hope that there should be very close communication and clear separation of duties among this governing body, IA and SFC so that the insurers may know which one should be approached for different issues.
- d. PPF Board & Appeal Board – The Boards when making a rule and decision may potentially affect insurers to different extents. We hope that when formulating the Boards there should be control measures to ensure a level playing field between large and small insurers.

Many thanks & regards,

Ken Ma

Risk Analyst, Asia (International)

Standard Life (Asia) Limited

This confidential e-mail is for the addressee only. If received in error, do not retain/copy/disclose it without our consent and please return it to us. We virus scan all e-mails but are not responsible for any damage caused by a virus or alteration by a third party after it is sent.

Standard Life (Asia) Limited is a subsidiary of Standard Life plc.

Dear Sirs

Please find below my comment on the proposed PPF.

1. Transfer of life insurance policies

To continue a life policy involves extremely high administrative cost.

"Ex-gratia" payment should be clearly defined to avoid disputes.

It is complicated for the Court to reduce the insurance liabilities of an insolvent insurer.

2. Non-life policies

Multi-year policies should be excluded.

To provide cover until expiry involves extremely high liquidation fees, which will ultimately erode the remaining assets of the insolvent insurer. HIH and Anglo Starlite are good examples to show the huge costs for scheme of arrangement and liquidation.

Termination of policies within a certain period, say 3 months, is more appropriate. This makes the PPF a sustainable scheme.

3. Medical policies

The "ex-gratia" payment for medical policies is subject to complicated arguments, e.g. higher risks arising from pre-existing conditions

4. Subrogation

The assets of the insolvent insurer will be much eroded by liquidators' fees.

Preferential status should be accorded to claims paid by PPF like EC insolvency fund.

PPF should be able to seek direct recovery from reinsurers of the insolvent insurer.

5. Governance

As huge funds will be built up, the investment control, appointment of management of PPF should be under close watch. Though industry representatives are always preferred, independence and integrity are the prerequisite quality. The management should be able to set up a system which can be subsequently modified to manage sudden influx of claims against an insolvent insurer.

To avoid conflict of interest, the representatives from the accounting field should not be participating in insolvency field. The remuneration of the PPF's head should be subject to critical review.

6. Insolvent insurers' assets

Cases in Hong Kong show that the estate of an insolvent insurer should normally NOT be adequate to meet all or most of the claims arising from its insurance contracts.

Life funds are not required to be matched by local assets. Local assets for non-life funds may not be adequate.

7. Coverage

Personal insurance policies should be the top target to be covered under PPF.

If policies issued to companies are considered to be covered, exclusion by reason of form of companies may not be appropriate. Partnership may be a much bigger company than a limited company.

The definition of SME is also subject to manipulation. Is the employment related to the point of time the relevant insurance policy was issued or at the time of declaration or the average number of staff employed during the policy period? Is part-time staff included? There are firms that can be classified as both manufacturing and non-manufacturing.

8. Non-Life Scheme

The proposed coverage of direct non-life insurance policies written in Hong Kong except motor third party and EC policies is satisfactory. But the levy calculation is based on the gross written premiums reported in insurers' audited returns may cause mis-matching issue.

The scope of direct business to be reported in audited returns are based on specified criteria under the insurance law of Hong Kong. In some cases, they may not related to risks of Hong Kong citizens.

In addition, for those insurers with substantial commercial business and the policyholders concerned will likely be big corporates which will not be covered by PPF, the charging of levy on the premiums for such business is unfair.

Cases where a policy is to be covered by PPF but no levy on such policy is collected should be eliminated.

To be fair, the levy imposed by MIB and ECIB are better. Policyholders to be covered by PPF bear their own cost and pay the levy, whose amount will be clearly stated on the policy schedule as a proof of their eligibility of cover. All personal insurance policies are subject to the PPF levy. This is rather straight-forward for life policies. For commercial policies, the policyholders have an option to pay the levy or not. Where a levy is paid on a particular policy, it is covered by the PPF.

9. Commissioner of Insurance in charge of the proposal

Without a capable Commissioner like Annie, the proposal cannot be put forward and a workable scheme be implemented. God blesses her.

Regards

PPF



消費者委員會 CONSUMER COUNCIL

來函檔號 YOUR REF.

本函檔號 OUR REF. CC 1/186

24 June, 2011

Financial Services Branch
Financial Services and The Treasury Bureau
18/F, Admiralty Centre Tower 1
18 Harcourt Road
Hong Kong

Attn : Ms. Jennifer CHAN
Secretary for Financial Services and the Treasury

Dear Ms. Chan,

**Public Consultation on the
Proposed Establishment of a Policyholders' Protection Fund**

The Consumer Council would like to submit its views on the captioned consultation paper for consideration of the FSTB. We shall be happy to address any query you or your colleagues may have regarding the submission.

Yours sincerely,

Connie LAU
Chief Executive
Consumer Council

Encl.

CONSUMER COUNCIL

Submission to the Financial Services and the Treasury Bureau on the Proposed Establishment of a Policyholders' Protection Fund

1. The Consumer Council (the Council) is pleased to submit its response to the Financial Services and the Treasury Bureau (FSTB) regarding the consultation paper on the proposed establishment of a Policyholders' Protection Fund (PPF) in Hong Kong.
2. This paper sets out the Council's response to the recommendations made in the consultation paper in respect of the key aspects of the proposed PPF, including its coverage and level of compensation, funding mechanism and governance arrangements.

The Establishment of a PPF

3. The Council welcomes the establishment of a PPF in Hong Kong for reasons that it will act as a 'safety net' for better protection of policyholders' interest in the event of insurer insolvency and enhance public confidence in the insurance industry.
4. As protection schemes are already in place for other financial sectors in Hong Kong, the Council considers it equally important that policyholders' funds should have similar protection, given that they could represent a major source of liquidity for many consumers.
5. Having said that, the Council has concern over the issue of cost shifting to policyholders under the proposal of collecting levies for the PPF from insurers. The Council is of the view that there should be safeguards in place to ensure that the cost would not be directly passed on to policyholders.
6. The Council also urges that the regulatory standards and requirements for supervision of insurers should not be in any way relaxed notwithstanding the establishment of the PPF in Hong Kong.

Key Features of the PPF Scheme

7. The following sets out the Council's response to the recommendations as to the proposed PPF that have direct implications on consumer interests.

Coverage

Individual and SME policyholders

8. The Council fully supports focusing the coverage of the PPF on individual and SME policyholders who are generally less capable of protecting their own interests in respect of insurance. This proposal also matches a policy objective of protecting vulnerable policyholders which is also adopted for some overseas protection schemes.

Life and Non-life schemes

9. As regards the form of participation, the Council considers that mandatory participation of all authorized life and non-life insurers in the PPF is crucial. A voluntary system is unlikely to provide universal protection to policyholders. Rather, it may give rise to the undesirable scenario whereby insurers will refrain from joining the PPF to reduce the costs associated with the levy, hence leaving the vulnerable insured at risk of loss upon insurer insolvency. The Council therefore fully supports the proposal of making it a mandatory requirement for all insurers to participate in the PPF.

10. The consultation paper also proposes that the PPF will accept claims in respect of all life and non-life policies, with exceptions for policies in respect of reinsurers, wholesale retirement schemes, captive insurers, and those that are already covered by the Employees Compensation Insurer Insolvency Scheme and the Motor Insurers' Bureau's Insolvency Fund Scheme. The Council has no objection to this arrangement provided that there are some safeguards to ensure that correct representation regarding PPF membership and coverage can be ensured.

11. In addition to the proposed exceptions, the Council wonders whether exemption from the PPF would be provided, for instance, where an overseas insurer is already subject to similar protection scheme in another jurisdiction. The Council considers it important for the Government to clarify this and provide detailed information on the basis for granting such exemption (for example, circumstances under which an overseas insurer can apply for exemption from participation in the PPF).

12. Another issue the Council would like to raise is related to the proposal that the PPF will cover all life and non-life policies written in Hong Kong, which would exclude offshore policies from the scope of the PPF. As the consultation paper lacks information on the amount of offshore policies in Hong Kong, the Council suggests the Government to explore if the exclusion would substantially lessen the level of policyholder protection.

13. In any case, consumers should be made aware of whether insurers they are dealing with or policies concerning them are eligible for protection. The Council considers that for insurers (or policies) not covered in the PPF, there should be some safeguards to ensure that consumers are not led into believing that protection exists when it does not. Moreover, rules should be made to require scheme members' disclosure of the nature and extent of PPF protection applicable to their policyholders, and such information should be made available to existing and potential policyholders.

14. As to the setting up of two separate and independent schemes (i.e. the Life Scheme and Non-life Scheme) under the PPF, the Council supports this proposal given the different nature of life and non-life policies.

Policies that pre-dated the PPF

15. The Council supports the proposed coverage of the PPF to include all in-force policies as at the date of the introduction of the PPF as well as new policies issued thereafter.

Conditions for activating the PPF

16. In relation to the proposed conditions for triggering the activation of the PPF, the Council supports laying down specific circumstances under which the PPF may be triggered in the event of insurer insolvency. The Council would welcome disclosure of such information to the public to enhance general awareness.

Eligible claims

17. The Council welcomes the proposal of not setting any cut-off date for the submission of claims, to provide better protection for policyholders.

Level of Compensation and Application

Compensation limit

18. It is proposed in the consultation paper that a 100% compensation cover for the first HK\$100,000 and 80% of the balance, with a maximum limit of HK\$1 million for an eligible claim, be adopted.

19. A question regarding the above proposed percentages and cap on the level of compensation is whether policyholders should bear a share of any loss or whether 100% cover should be provided for a claimant. The Council has concern if the compensation limit of HK\$1 million would provide adequate policyholder protection, and views that a scheme providing 100% compensation

could give full protection to policyholders and promote market confidence.

20. Notwithstanding that, the Council recognizes that a higher cap could increase the costs of participation in the PPF which might be passed on to policyholders. Considering the Government estimation that the proposed coverage would meet over 90% of the claims, the Council has no objection to the proposed tapering method (i.e. claim of a certain amount met in full and remaining balance met to a lesser extent) with a compensation cap of HK\$1 million for claiming the PPF at an introductory stage.

21. The Council also suggests that a review of the full payment amount, the percentage for the balance and the compensation cap be conducted at a later stage, to ensure they will remain effective in protecting the interest of policyholders in Hong Kong.

Basis of compensation

22. The consultation paper proposes that compensation should be applied on a 'per-policy' basis for life insurance policies and a 'per-claim' basis for non-life insurance policies. The Council supports the proposed approach as this would be simpler to administer and could provide certainty to policyholders.

Arrangements in the event of insurer insolvency

23. For continuity of protection in the event of insurer insolvency, the Council supports the proposals that the PPF should be able to transfer a policy to a replacement insurer wherever possible, and pay to affected policyholders an "ex-gratia" payment having regard to the losses arising from premature surrender of the policy concerned or procuring a similar policy from another insurer.

24. In allowing consumer choice, the PPF Board should make clear to affected policyholders that they can choose to terminate the policy concerned or accept transfer of policy to another insurer. The Council urges the PPF Board to ensure that information to facilitate policyholders' decision making will be properly and effectively brought to their attention.

Funding Mechanism

Funding model

25. In the consultation paper, a progressive funding approach for the PPF is proposed for consideration, i.e. a combination of the pre-funding and the post-funding models, with an initial moderate levy rate complemented by a stepped-up levy rate upon occurrence of insolvency. The consultation paper remarks that the progressive funding model is a more pragmatic approach.

26. The Council is disposed to favour a pre-funding approach as this will provide certainty to policyholders that funds are already available to compensate them in the event of insurer insolvency.

27. However, the Council notes the major drawback of the pre-funding approach of locking up a huge amount of levy the initial accumulation of which may in turn put pressure on the premium levels. Moreover, the Government has indicated that back-up funding would be provided under the progressive funding approach to bridge the liquidity gap to ensure the prompt reimbursement of policyholders' claims in case funds are not sufficient to meet liabilities in the event of insurer insolvency. The Council therefore accepts the progressive funding approach.

28. Apart from the provision of back-up funding, the Council suggests that there should be a mechanism for triggering reinstatement or suspension of the levies when the PPF falls below a minimum prudent level or exceeds the self-funding level. A similar mechanism can be found with the Deposit Protection Scheme in which a target range with upper and lower limits is set up to provide an adequate buffer to the scheme.

29. From the perspective of policyholder protection, the Council considers that a re-instatement mechanism is of particular importance in ensuring that there is no significant reduction in the funding level below what is required to provide sufficient protection to policyholders.

Collection of levy

30. The Council strongly supports that the cost of financing the PPF should be borne by insurers. The Council is of the view that industry participants should have the responsibility of contributing to the PPF in case of insurer default, instead of having compensation funded by policyholders.

31. As for other protection schemes, the Council believes that the main intention of the PPF regulation should be to have insurers accountable for problems associated with their own industry. Insurers are experts in assessing risks and they should be knowledgeable to avoid undue risk-taking. On the other hand, raising levy directly from policyholders would not pose an incentive to or have any impact on reducing insurer default.

32. The Council is aware that the source of compensation funding for similar local protection schemes is mainly industry-based. For example, funds under the Deposit Protection Scheme are collected from banking institutions.

33. For an industry-funded compensation scheme, some may argue that

the costs of the levies although initially borne by insurers, are likely to be passed on to policyholders through higher premiums. As a result, the benefits of not requiring direct payment from policyholders may be partially reduced through the transfer of costs by insurers.

34. In this regard, the Council considers that the PPF Board has a role to play in monitoring the situation to prevent unreasonable cost transfer to policyholders upon the inception of the PPF, given that the impact on the premium levels would be minimal as remarked in the consultation paper.

35. With regard to the method of levy assessment, the Council notes the Government proposal of using premiums as the calculation basis on which levy can be assessed.

36. Under this assessment method, insurers make contribution in proportion to the amount of premiums they receive. The Council considers that imposing levy based on liabilities, instead of basing levy for PPF on premium, would be more reflective of the exposure of the PPF to each insurer as it is more directly linked to the amount of payouts that will need to be made by the PPF in the event of insurer default.

37. In considering the method of levy assessment, the Council urges the Government to ensure that it is appropriately set and that the approach to be adopted will not materially affect the effectiveness of the PPF.

Initial target fund size

38. The Council understands that there is no single answer to the question of what the appropriate initial target fund size should be, because a trade-off is involved. That is, too large a fund implies a higher levy rate which may affect the financial integrity of the insurance industry with cost implications to policyholders, whereas too small a fund may provide inadequate funding in meeting claims from policyholders in case of insurer default.

39. The Council therefore considers that smaller starting fund sizes of HK\$1.2 billion for the Life Scheme and HK\$75 million for the Non-life Scheme, are acceptable in the early stage of development. However, it is necessary to regularly review the fund sizes in the light of market developments and the changes in the risk profiles of insurers.

40. The Council is of the view that as a small target fund size is set on the assumption that the PPF would be able to recoup against the assets of insolvent insurers, it is important for the PPF Board to work closely with the regulatory authority to ensure that any insolvent insurers would be prohibited from transferring assets overseas (asset flight) in case of cessation of their business.

41. The consultation paper has not provided supportive information or scenario analysis on how the Government has come up with the estimation of the target fund size and the fund build-up period which would be able to provide adequate protection to policyholders. The Council suggests that detailed information on such estimation should be disclosed to the public for the sake of transparency.

Levy rate

42. The consultation paper suggests that the initial levy rates for both the Life Scheme and the Non-life Scheme should be 0.07% of the applicable premium. The Council accepts the proposed introduction of a levy rate of 0.07% at the early stage of the PPF, but an annual review should be conducted to check whether it remains appropriate, or whether the rate need to be increased or reduced. This is important to ensure the PPF has sufficient resources to meet claims; and that the levy is not excessive resulting in a financial burden for insurers which might ultimately be passed on to policyholders, notwithstanding the competition among insurers.

43. In addition, the Council considers that a more sophisticated approach should be adopted at a later stage taking account of experience and the availability of the insurer's supervisory risk rating. The Council suggests that a risk-based levy system should be adopted to calculate levies for individual insurers. Using a risk-based approach would reduce moral hazard and avoid implicit cross-subsidization among insurers.

Financial arrangement to bridge liquidity gap

44. Whilst accepting that the PPF should not be accumulating assets beyond the amounts it needs, the Council sees it crucial for policyholder protection to have a mechanism in place to bridge any liquidity gap so that the PPF will be able to effect immediate release of funds to affected policyholders at the time of an insurer failure. The availability of back-up funding is particularly important at time of failure as there will be confusion and alarm on the part of policyholders.

45. In this regard, the Council supports the proposal that the PPF Board may resort to borrowing from a third party to bridge any liquidity gap, for purposes of protecting policyholders and maintaining public confidence in the insurance industry.

Governance Arrangements

Legal and organizational structure

46. To safeguard the interest of the consuming public and the public at large, the Council supports that the PPF should be established by legislation and be administered by an independent statutory body to ensure transparency and accountability of its operation.

47. With regard to the composition of the PPF Board, the Council supports having a majority of professionals from various sectors instead of industry participants, to ensure sufficient independence. The Council suggests that consumer representation be included on the PPF Board to speak for the wider community interest.

48. Furthermore, the Council considers the two industry committees to be set up under the PPF Board should be of advisory nature and include professional members as appropriate.

Functions and powers of the PPF Board

49. The Council suggests that the PPF Board should have the responsibility of promoting the PPF to the public.

50. For instance, it should be made clear to the public what rules and procedures will be used when the PPF is applied in case of insurer insolvency to reassure policyholders that at the time of insurer insolvency, the PPF will be able to effect a speedy and accurate payout to lessen the burden on policyholders. The PPF Board will also need to give guidance to policyholders on how to file claims for reimbursements. This will be important in helping to avoid potential financial hardship for policyholders and maintain public confidence in the insurance industry.

Governance arrangements

51. As regards the proposed governance arrangements of the PPF Board, the Council supports the proposals of having annual budgets submitted for the Financial Secretary's approval, publication of annual reports for vetting of the LegCo, and appointment of auditor to perform reviews on the PPF.

52. However, the consultation paper has not mentioned any interface arrangement between the PPF Board and the supervisory authority. It is noted that international best practice seems to be in favour of a degree of separation in terms of governance between protection fund scheme and supervisory authority. The Council therefore suggests that the Government should explore the degree of separation in terms of governance between the PPF Board and the supervisory authority, with a view to avoiding conflict of interest and providing greater accountability and transparency to the public.

Daily operations

53. Given the comparative rarity of insurer insolvencies in Hong Kong and the cost saving consideration, the Council supports that the PPF Board should maintain a small team of staff for carrying out the daily operations of the PPF.

Confidentiality

54. The Government proposes in the consultation paper that confidentiality provisions would need to be written in the PPF legislation to ensure that the PPF Board including its staff should be duty bound to keep sensitive information obtained in carrying out their delegated functions confidential.

55. The Council understands the rationale behind keeping sensitive information about insurers confidential because the disclosure of such sensitive information, substantiated or otherwise, may put market stability at stake. However, as a matter of general principle, consumers should have access to sufficient information in order to make an informed choice. The manner in which a balance is to be achieved in maintaining confidentiality and meeting the need for transparency is a matter that should be addressed by the Government.

56. A searchable database accessible to consumers would assist them in tracing an insurer in order to determine its status as participating insurers, its financial situation and its position relative to other insurers. This may meet consumers' information needs. In this connection, the Council recommends that a database containing comparative financial and non-financial information on insurers should be provided.

Appeal mechanism

57. The Council welcomes the proposed setting up of an Appeal Board to allow policyholders to appeal against the decisions made by the PPF Board, for instance, about compensation payment or refusal to make payment. The Council suggests that the procedures and rulings of the Appeal Board should be documented and made transparent to the public and consumer representation should be provided for in the mechanism.

Conclusion

58. In regard to the proposed establishment of a PPF in Hong Kong, the Council's overall stance is that Hong Kong policyholders should have a protection scheme that will advance the limited protection currently available, and having such a scheme will bring Hong Kong in line with the world's best practice.

59. The Council urges that the future PPF Board keeps under review the scope and level of coverage, the fund sizes and levy rates for the PPF, taking into account changes in the market and the expanding range of products developed by insurers.

Consumer Council
June 2011



恒 生 保 險

Hang Seng Insurance

24 June 2011

Special Duties Division
Financial Services Branch
The Financial Services and the Treasury Bureau
18/F, Tower I, Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir

Re: Proposed Establishment of a Policyholders' Protection Fund (PPF)

With regard to the consultation paper issued by the Financial Services and the Treasury Bureau on the establishment of a policyholder's protection fund (PPF), we are pleased to make our response to the consultation exercise in order to facilitate the finalization of the proposals.

Please kindly refer to the attachment for the details of our response. Thank you for your kind consideration.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Wilson Tang', written over a horizontal line.

Wilson Tang
Chief Executive

Encl.

RESTRICTED

恒生保險有限公司 Hang Seng Insurance Company Limited

**Response to Proposed Establishment of a
Policyholder's Protection Fund**

By

Hang Seng Insurance Company Limited

June 2011

1. Introduction

The Financial Services and the Treasury Bureau (FSTB) has recently issued a consultation paper (the Consultation Paper) on the establishment of a policyholder's protection fund (PPF) and commenced a three-month consultation on 25 March 2011. The proposed PPF will provide the following coverage:

- (a) The PPF will comprise two separate and independent schemes, namely the Life Scheme and the Non-Life Scheme, to cover life and non-life insurance policies respectively;
- (b) The PPF will mainly focus on individual policyholders; and
- (c) Subject to public views, the PPF may also cover small and medium enterprises.

As per the coverage of the proposed PPF, there will be a limit on the compensation to be paid by the PPF. In the Consultation Paper, it has proposed that the limit will be set at 100% for the first HKD100,000 plus 80% of the balance of the claim, up to a total of HKD1 million. Moreover, the limit will be applied on a per-policy basis for life insurance policies and a per-claim basis for non-life insurance policies.

On the other hand, the PPF will be empowered to collect the levy from insurers. Based on the actuarial consultancy study, the initial target fund size will be HKD1.2 billion for the Life Scheme and HKD75 million for the Non-Life Scheme. On this basis, the initial levy rates for both Schemes will be at 0.07% of the applicable premiums and it is expected to take 15 years to build up the initial target fund.

The paper will summarize our key comments and concerns in relation to the proposal included in the Consultation Paper.

2. General View

We are in general supportive of the establishment of the PPF and appreciate the efforts made by the Government for developing the proposed structure of the PPF. We believe that the proposed PPF will not only improve protection to the policyholders but also enhance the market stability.

We recognize that the PPF will strengthen the public confidence in the insurance industry in Hong Kong as well as stimulate market competition. As one of the leading insurance providers in Hong Kong, we would also like to take this opportunity to provide comments on the various proposed features of the PPF under the Consultation Paper.

3. Key Comments

3.1 Small and Medium Enterprises

In the Consultation Paper, the definition of small and medium enterprises (SMEs) has been defined as a manufacturing business which employs fewer than 100 persons in Hong Kong and fewer than 50 persons for a non-manufacturing business.

Notwithstanding the good intention to provide the coverage to SMEs under the proposal, the current definition of SMEs may be regarded as too broad. It is understandable that the proposal to cover the SMEs is due to the impression that SMEs are in general less sophisticated than larger corporates and may be benefited from the protection of the PPF. However, a lot of the SMEs, for example smaller size professional firms such as accounting and law firms, may not project the same impression.

Hence, in order to lighten the burden on the PPF, it may also be beneficial to define the types of insurance policy that will be covered by the PPF for SMEs. To illustrate the likely excessive coverage, small professional firms are required to take out insurance coverage for professional indemnity which will be covered by the PPF based on the current proposal but may not match the aim of the PPF. Furthermore, other types of insurance coverage such as marine and aviation insurance may also require further consideration to be included under the PPF as the ultimate beneficiaries of these types of insurance may be neither individual nor SME policyholders.

In view of the above possible scenarios of disproportionate coverage, it is recommended that for SMEs, only group life, group medical, property damage protection for company furnishing and equipment, and public liability insurance policies should be covered under the Non-Life Scheme of the PPF.

3.2 Maximum Amount of Levy

Although the current levy has been set at 0.07% of the applicable premiums for the Life and Non-life Schemes, we would like to propose that a maximum amount of levy should be maintained on individual policies so as to ensure fairness and equity among the policyholders.

Under the current proposal, there will be a limit on the compensation to be paid by the PPF with the proposed limit to be set at 100% for the first HKD100,000 plus 80% of the balance of the claim, up to a total of HKD1 million. Moreover, the limit will be applied on a per-policy basis for life insurance policies and a per-claim basis for non-life insurance policies.

Based on this approach, individual policyholders who have decided to take out insurance policy with a significant amount of coverage will subsequently be imposed a larger amount of levy but with only a limited amount of protection under the PPF.

It should be emphasized that the same principle of protection should be applicable to all policyholders and individual policyholders or insurers should not be required to pay for protection that is not applicable to them. It is therefore proposed that a maximum amount of levy should be developed and it is believed that the limit on the levy should be based on the limit of coverage under the PPF.

3.3 Determination of Levy

While it is agreed that the establishment of the PPF will not only benefit the policyholders but the whole insurance industry, it is also important that an equal opportunity and a level play field should be assured for all insurance companies.

It is noted that under the Deposit Protection Scheme, the contributions payable by the members are determined by the amount of protected deposits held with the members and the supervisory ratings assigned to them by the Hong Kong Monetary Authority. Based on the same principle, the similar approach should be adopted for determining the levy for PPF and the calculation should also take into account the rating of the insurance companies.

For those companies with a better rating, they should be allowed to pay a lower level of levy as they have made every effort to ensure their own financial security. Furthermore, by determining the levy based on the rating of the insurance companies, it will minimize the cross subsidization between stronger and weaker insurers. It is also worth noting that this approach will encourage the insurers to strengthen their balance sheet and at the same time improve the overall stability of the insurance industry.

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As per the Consultation Paper, the compensation from the PPF will be applicable on a per-policy basis for life insurance and on a per-claim basis for non life insurance. However, it is a common practice that medical insurance coverage could be purchased as riders in addition to a life insurance policy.

Should a medical insurance rider be bundled with a life insurance policy and the insurer become insolvent, the former will follow the per-claim basis but the latter will be covered by the per-policy basis.

Therefore, it will merit a more elaborated definition on the treatment of insurance riders under the PPF for both coverage and compensation.

3.5 Treatment of Paid-up Policy

It is inevitable that insurance companies which have been operating in Hong Kong for a considerable period of time will have a significant number of paid-up insurance policies under their portfolio. It is observed that the current proposal will cover these paid-up policies but the levy will be determined base on the applicable premiums and no levy will be paid for these policies.

It is advisable that a clear methodology should be developed to determine the levy on the paid-up policies so as to ensure the PPF will be adequate to cover all eligible policies in the event that an insurer becomes insolvent.

3.6 Protection to joint name policy

The coverage of the PPF has now been proposed to be applicable to individual and SME policyholders but in the market there are insurance policies jointly purchased by a company and an individual.

Should a non-SME company own an insurance policy jointly with an individual, the definition of eligible policyholders may not be extensive enough to cover this kind of arrangement for ownership. Accordingly, it may be required to develop a systematic approach to handle the joint ownership of an insurance policy such that the coverage of the individual policyholders could be broadened.

3.7 Targeted Fund Size

Based on the actuarial consultancy study, the initial target fund size has been proposed to be HKD1.2 billion for the Life Scheme and HKD75 million for the Non-Life Scheme. It is hard to ignore the fact the proposed targeted fund size of Non-Life Scheme is comparatively smaller than that of the Life Scheme.

Although the progress funding approach is recommended under the Consultation Paper, the risk that the Non-Life Scheme may not be able to support the coverage will not be regarded as small due to the likelihood that multiple claims could occur under one single event, especially under compulsory insurance. It is therefore advised that the Government should assess the feasibility to increase the targeted fund size of Non-Life Scheme in order to enhance the sustainability of the fund.

4. Other Comment

It is foreseeable that individual policyholders will take the initiative to purchase several insurance policies in the future so as to maximize their protection under the PPF rather than taking out only one insurance policy with a large amount of coverage. Even though it is believed that this is inevitable, it is essential to accentuate that the general public will need to be educated that while splitting insurance policy may maximize their coverage under the PPF, there could also be additional fees and expenses.



HSBC Insurance

By email and post

24th June 2011

Private & Confidential

Special Duties Division, Financial Services Branch
Financial Services and Treasury Bureau
18/F, Tower 1
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir

We refer to the Consultation Paper for Proposed Establishment of a Policyholders' Protection Fund issued by the Financial Services and Treasury Bureau in March 2011.

We would like to take this opportunity to share our views and comments on this government initiative and attached please find our submission.

If you have any queries, please do not hesitate to contact us.

Yours faithfully

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Robert Lang
Managing Director, Insurance Businesses Hong Kong

Encl

**Response to Proposed Establishment of a
Policyholder's Protection Fund**

By

HSBC Insurance

June 2011

1. Executive Summary

The Financial Services and the Treasury Bureau (FSTB) has recently issued a consultation paper (the Consultation Paper) on the establishment of a policyholder's protection fund (PPF) and commenced a three-month consultation on 25 March 2011.

HSBC Insurance is in general supportive of the establishment of the PPF and appreciates the efforts made by the Government for developing the proposed structure of the PPF. HSBC Insurance believes that the proposed PPF will benefit both the policyholders as well as the insurance industry. On the other hand, the key comments and concerns from HSBC Insurance on the proposed PPF are shown below:

- A clear definition of Small and Medium Enterprises (SMEs) should be developed and it is recommended that for SMEs only group life, group medical, property damage protection for company furnishing and equipments, and public liability insurance policies should be covered under the Non-Life Scheme of the PPF;
- HSBC Insurance believes that there should be a maximum amount of levy being imposed on each insurance policy;
- It is proposed that the determination of levy should also take into account the rating of the insurers so as to minimize the cross subsidization;
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HSBC Insurance understands while it is inevitable that individuals will purchase a number of insurance policies to maximize the coverage from the PPF, education should be provided to the general public so as to ensure the sustainability of the PPF.

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The Financial Services and the Treasury Bureau (FSTB) has recently issued a consultation paper (the Consultation Paper) on the establishment of a policyholder's protection fund (PPF) and commenced a three-month consultation on 25 March 2011. The proposed PPF will provide the following coverage:

- (a) The PPF will comprise two separate and independent schemes, namely the Life Scheme and the Non-Life Scheme, to cover life and non-life insurance policies respectively;
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- (c) Subject to public views, the PPF may also cover small and medium enterprises.

As per the coverage of the proposed PPF, there will be a limit on the compensation to be paid by the PPF. In the Consultation Paper, it has proposed that the limit will be set at 100% for the first HKD100,000 plus 80% of the balance of the claim, up to a total of HKD1 million. Moreover, the limit will be applied on a per-policy basis for life insurance policies and a per-claim basis for non-life insurance policies.

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CONSULTATION PAPER ON PROPOSED ESTABLISHMENT OF A POLICYHOLDERS' PROTECTION FUND

From: Peter Tisman []
Date: Jun 29, 2011 16:38
To: "ppf_consultation@fstb.gov.hk" <ppf_consultation@fstb.gov.hk>
Cc: "Mary Lam" <[redacted]>, "Angel Yu" <[redacted]>
Attachments:  Policyholders' Protection Fund - submission_290611.pdf
(479.5 KB)

Dear Sirs,

Please find attached a submission from the Hong Kong Institute of Certified Public Accountants in response to the above consultation paper. The original version of the submission will be sent to you by post.

If you have any questions on the submission please feel free to call me on the number below.

Yours faithfully,

Peter Tisman
Director, Specialist Practices
Hong Kong Institute of CPAs
Tel: [redacted]
Fax: [redacted]

CPA: *The Success Ingredient*

This email together with the file(s) transmitted with it is intended solely for addressee(s) only and may contain confidential and/or privileged information. If you received this email in error, please contact the sender and delete it together with its attachment(s) from your computer(s). You should note that the views and opinions expressed in this email are those of the author and do not necessarily represent those of the Hong Kong Institute of Certified Public Accountants. The recipient should check this email and all attachments for the presence of virus. The Institute will not accept liability for any damage caused by any virus transmitted with this email.



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By e-mail < ppf_consultation@fstb.gov.hk > and by post

29 June 2011

Our Ref.: C/RIFEC, M77995

Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I, Admiralty Centre
18, Harcourt Road
Hong Kong

Dear Sirs,

**Consultation Paper on Proposed Establishment of a
Policyholders' Protection Fund**

The Hong Kong Institute of Certified Public Accountants ("the Institute") has considered the consultation paper on the above subject, which makes recommendations for the establishment of a Policyholders' Protection Fund ("PPF") to provide a safety net for policyholders against insurer insolvency.

In principle, the Institute supports the proposal for the establishment of a PPF to provide better protection for policyholders' interests and maintain market stability in the event of an insurer's insolvency.

The Institute's comments on the specific aspects of the proposed PPF contained in the consultation paper are set out below.

Initial target fund size of the Non-life Scheme

It is proposed that for the Non-Life Scheme, the initial target fund size should be HK\$75 million (paragraph 4.9 of the consultation paper).

We note that in the event of an insurer insolvency, it is recommended that the PPF would meet claims arising from all covered policies up to a compensation limit of HK\$1 million per claim. The PPF will also be allowed to pay up to HK\$1 million per accident and health ("A&H") policy with guaranteed renewability to facilitate transfer of such policies to another insurer, and if a transfer cannot be arranged, it may pay the affected policyholders an "ex-gratia" payment of up to HK\$1 million per policy (paragraphs 3.21 – 3.23 of the consultation paper). Under the proposals, A&H policies without guaranteed renewability will continue until expiry and be treated like non-life policies in the event of an insurer insolvency (paragraph 3.24).



As the initial target fund size is proposed to be set at HK\$75 million for the Non-Life Scheme, this means that the PPF would be able to meet only 75 non-life claims and/or payments in relation to A&H policies with guaranteed renewability, assuming the maximum level of compensation in each case.

While we appreciate that in determining the initial fund size, the government has taken into account a number of relevant factors, and the amount has been worked out on the basis of actuarial modelling, we still have some reservations as to whether the initial target fund size for the Non-Life Scheme, which is to be built up only over 15 years, is adequate, notwithstanding the proposal that the figure will be reviewed regularly (paragraph 4.10).

Asset recovery mechanism

It is recommended, as stated in paragraph 4.13, that when claimants are compensated by the PPF, the protected element of their claims (i.e. the part met by the PPF) should be subrogated to the PPF. It is further recommended, in paragraph 4.14, that the PPF should have equal ranking with the two classes of creditors specified in section 265 of the Companies Ordinance ("CO"), on preferential payments, i.e., the Employee Compensation Assistance Fund and all other direct insurance claims not met by the PPF.

It is noted that there are other existing compensation schemes providing protection against insurer insolvency in Hong Kong, e.g., the Insolvency Fund Scheme administered by the Motor Insurers' Bureau of Hong Kong, which provides insolvency protection in relation to motor vehicle policies and the Employees Compensation Insurer Insolvency Scheme, administered by the Employees Compensation Insurer Insolvency Bureau ("ECIIB"), which provides insolvency protection in relation to employee compensation policies. However, not all of these funds are paid in priority to other creditors under section 265 of the CO in the event of an insurer insolvency, where they have compensated the policyholder. Under the ECIIB's agreement with the government, for example, it is expressly stated (clause 7(f)) that where the ECIIB has "an entitlement against the estate of the [insolvent] Insurer, ECIIB shall only rank as an ordinary, non-preferential creditor against that estate". There is, arguably, some inconsistency, therefore, if the PPF is to be a preferential creditor, under section 265, for the subrogated rights of policyholders that the PPF has compensated.

Governance arrangements

It is stated in paragraph 5.5 that an annual report (including the audited statement of accounts) for both the Life Scheme and the Non-Life Scheme of the PPF should be published and laid before the Legislative Council. In addition, it is recommended that the financial secretary should have the power to appoint the director of audit or an external auditor to perform audit reviews on the PPF.



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

In this respect, we recommend that the relevant legislation should state clearly the responsibility for the preparation of the statement of accounts (including what constitutes the statement of accounts of the PPF and the basis of preparation) and the reporting requirements of the auditor (e.g. the type of opinion, reporting timeframe, etc). For example, under section 19 of the Deposit Protection Scheme Ordinance (Cap 581), the auditor is required to state whether, in his opinion, the statement of accounts of the Deposit Protection Scheme Fund gives a true and fair view of the matters to which the statement of accounts relates.

We hope that you find our comments to be helpful. Should you have any questions on this submission, please feel free to contact me at the Institute on .

Yours faithfully,

A handwritten signature in black ink that reads 'Peter Tisman'. The signature is written in a cursive, flowing style.

Peter Tisman
Director, Specialist Practices
Hong Kong Institute of Certified Public Accountants

PMT/ML/ay

Hong Kong Institute of
Certified Public Accountants
香港會計師公會



Lv114/11

By Fax 25270292 and by mail

30 June 2011

Ms Jennifer Chan
Principal Assistant Secretary (Special Duties)
Financial Services Branch
Financial Services & the Treasury Bureau
18th Fl., Admiralty Centre Tower 11
18 Harcourt Road
Hong Kong

Dear Ms Chan

PROPOSED ESTABLISHMENT OF A POLICYHOLDER PROTECTION FUND

Thank you for your letter dated 23 March 2011 addressed to our Chairman.

After consultation with our member companies, we are pleased to attach our consolidated comments for your consideration. While we are very supportive to the introduction of the Policyholder Protection Fund and support most of the recommendations in this paper we do have some recommendations for change.

1. Clarity will be needed as to who is included and who is excluded as there are many special classes to consider as set out in the attachment (e.g. off-shore trusts, on-shore trusts, joint names, inward reinsurance etc).
2. We believe that SMEs should be excluded as is the case for most jurisdictions overseas, which only cover natural persons. We have set out a number of reasons on page 2 of our reply. Almost all members felt strongly about this point. We do understand the concern around Building Owners' Corporation insurance, but feel that this class needs special consideration in view of the potential for large claims from injured parties and the compulsory nature of the insurance, making it closer to MIB and ECIIB in nature.
3. Clarity as to what is to be covered by PPF and what is to be covered by MIB and ECIIB is important and we recommend that these three plans all have the same creditor status in the event of an insurer insolvency.
4. In 3.18, 3.19 and 3.21 the Consultation Paper recommends total payments of up to HK\$1 million to facilitate transfer of a block or policy to another insurer. This amount may exceed the total possible benefits on the policy and so in our view should be capped. A simple cap may be total premiums already paid by the insured. The alternative is an independent actuarial assessment.



註冊有限公司 Incorporated with limited liability

HKFIPage 2

Ref: Lv114/11

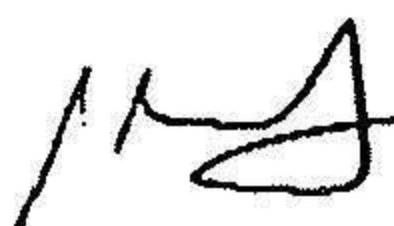
30 June 2011

Ms Jennifer Chan
Principal Assistant Secretary (Special Duties)
Financial Services Branch
Financial Services & the Treasury Bureau

5. We do not believe for general insurance the policyholders should have the right to continue their policies with the insolvent insurer. In our understanding, no other PPFs in any jurisdictions are made compulsory to continue providing cover for any un-expired policies. In practice, the liquidator has the discretion to exercise such decision to allow un-expired policies to run off until natural expiry as he sees fit. Therefore, we disagree with Section 3.20 and 3.21 of the Consultation Paper.
6. We strongly recommend that the PPF levy only be applied to those policies receiving the benefits of the PPF. Thus policies covered by ECIIB and MIB, commercial insurance and other excluded policies would not be subject to the levy.
7. The investment of the PPF should be conservative but, in our view, should not seek to minimize investment returns through excessive restrictions. As such investment-grade corporate bonds and other investments with a similar risk profile should be allowed.

Please do not hesitate to contact the undersigned or our Chief Executive, Mr Peter C H Tam at
if you require any clarification.

Yours sincerely



Michael Huddart
Chairman of the Task Force on
Policyholders' Protection Fund

Encl.

c.c. Commissioner of Insurance
The Hon K P Chan
Governing Committee Members

MH/iw/sw

CH	Comments from HKFI on the Proposed Establishment of a Policyholders' Protection Fund (PPF)
3	OBJECTIVES, COVERAGE AND LEVEL OF COMPENSATION
	Coverage The setup of two schemes separately for Life & Non-life sectors is found appropriate to avoid administrative confusion.
	We appreciate the Paper has acknowledged the availability of some compensation systems overseas. As you are aware, certain Hong Kong branches of offshore insurers are already covered by those systems of other jurisdictions. As such, the proposed PPF should also give consideration to branches if they have already been covered under an offshore compensation system. Need clarification from Government whether to include trust (local versus offshore) and the possible transfer from policyholder to a trust. As it is quite common for policies with beneficiary individuals being assigned to trust companies (in which case the corporate trustee will become the new policy owner after assignment), we suggest it should be stated more clearly that the assignment situation falls within the scope of the abovementioned exception.
	Clarification is required as to whether a policy owned by a corporation, trust or other entity would be covered. It should be considered that policyholders may have the contractual right under a policy to change ownership. We would like to understand the basis for differentiating on the type of entity owning the policy. Please further clarify whether non-Hong Kong residents buying a policy in Hong Kong would be covered or not? If only Hong Kong residents would be covered, the assessment should only be based on premiums related to Hong Kong policies.
	We recommend that Motor Insurance Own Damage and Motor Third Party Damage be placed under the auspices of MIB to make it easier for the customer to know where to go for claims relating to motor policies and claims. However, the formula specified in Section 3.14 of the Consultation Paper should apply in these cases. We believe that there is general agreement to this. There is also the issue of domestic helper policy with medical insurance and other covers, for example, Personal Accident, Repatriation Cost, etc., attaching to EC insurance. Will these be covered under the PPF or will they also be placed within ECIIB?
	We suggest that SME should not be covered due to the following reasons: - Complications, exposure and run-off liability could be very high e.g. HIH collapse case.

CH	Comments from HKFI on the Proposed Establishment of a Policyholders' Protection Fund (PPF)
3	OBJECTIVES, COVERAGE AND LEVEL OF COMPENSATION (CONTINUED)
	- Most claims are on per claim basis. For multiple claims, the claim amount may even be higher than the policy limit, e.g. building third party liability. The aggregate of the claims could be open-ended. Another example for multiple claims under a Product Liability policy with a limit of indemnity of HK\$100m, and hence the cumulative claims amount could go up as high as the policy limit in a disastrous loss situation. This was not clearly stated in the consultation paper. Clarification from the Government is required. - Suggest that at the least, professional indemnity insurance be excluded, e.g. doctors, lawyers and accountants. - SME policyholders, as businesses, nearly always place their insurance protection through insurance intermediaries. It is the responsibility of these registered professionals that they only place their clients' accounts with insurance companies who are able to meet their future financial obligations. Also we want to ensure registered intermediaries focus on this important selection process and not place business with the cheapest insurer, knowing that there is a high level of recovery if they collapse. - The definition of SME is currently based on number of person employed. It may not necessarily reflect the financial strength or sophistication of the entities. - The number of employed is not a mandatory information required for every class of business. Collecting and verifying such information (which is a determining factor for the eligibility of the PPF) will bring additional administration works to various parties concerned. It may not meet the objectives of striking a reasonable balance between enhancing protection for policyholders and minimizing the additional burden to the insurance industry.
	If SMEs are to be included there needs to be a clear definition in the PPF, and whether it includes the sole proprietorship and partnership. It is noted that the definition of SME for the purpose of granting credit line differs between banks. It should also be noted that it is very difficult for general insurers to extract information on SME's from their systems in order to pay the levy. The information obtained by underwriters does not always provide the number of employees in a company to be insured or the turnover of the company. The definition of the SMEs therefore needs to be clear and simple in order for general insurers to remit payment to the PPF.
	We propose that the focus of the PPF is on natural persons, as is the practice with the majority of compensation funds internationally, and we agree with the suggestion that corporate insurance buyers should be excluded from the PPF.

CH	Comments from HKFI on the Proposed Establishment of a Policyholders' Protection Fund (PPF)
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3	OBJECTIVES, COVERAGE AND LEVEL OF COMPENSATION (CONTINUED)
	Clarification is required from the government on the following: - Should Joint Insured Name between individual and corporations. (P.13, 3.3) e.g. ABC Co as owner and Chan Tai Man as occupier for a home package policy, covering the respective interests of MTRC & individual owners be included? To make it clean cut, it is opined that we should only compensate policy arranged under individual name. - Point 3.5 - inclusion of OC policyholders also induce the confusion of joint name issue - property manager and incorporated owners. Will the HKD1m protection be adequate against the minimum statutory requirement of HKD10m on third party bodily injuries? Will this trigger dissatisfaction from consumers instead of a sense of security to incorporated owners?
	Reinsurance inward business should be exempted to avoid double counting of GWP and office policies should also be exempted same as in other places such as Mainland China: (中国保险保障基金 :保险公司的下列业务不属于保险保障基金的救济范围: (一) 保险公司在境外直接承保的业务和从境外分入的业务; (二) 保险公司的政策性保险业务; (三) 中国保监会认定不属于保险保障基金救济范围的其他保险业务。 第二十一條: http://www.circ.gov.cn/tabid/106/InfoID/27713/ftid/3871/Default.aspx
	This proposal does not state our previous communication with IA on exclusion of marine hull, marine cargo business (aviation, transport, credit, marine insurance) which is mobile and can be easily taken away from HK market to places overseas in Singapore, UK, Japan whereby exemptions are granted under their protection funds.
	Clarification is also required on the following: "wholesale retirement scheme" on page 13, clause 3.6; and - EC and Motor are excluded in the PPF because of current ECIB and MIB. Own Damage of motor which presently is not catered for is assumed to be tackled under MIB. But how about the medical sections or free cover of domestic helper/Repatriation sold under EC packages; can these be claimed under PPF or tackled under ECIB?
	Paragraph's 3.9 and 3.12 are slightly inconsistent as 3.9 only covers in-force policies so would exclude policies already terminated but where there is an outstanding claim to be paid, while 3.12 includes all claims. We assume that 3.12 is the intention, but please clarify.

CH	Comments from HKFI on the Proposed Establishment of a Policyholders' Protection Fund (PPF)
3	OBJECTIVES, COVERAGE AND LEVEL OF COMPENSATION (CONTINUED)
	<u>Compensation Limit</u>
	We understand that there should be limit on the compensation to be paid by the PPF, which is proposed to be set at 100% for the first HKD100,000 plus 80% of the balance, up to a total of HK\$1m on a <i>per-policy basis</i> for life insurance policies. We are concerned that an applicant of insurance policies may split the application for one large sum assured into different policies, each having a smaller sum assured. Therefore, we believe that the maximum limit should be measured on a per-life basis for each life insurance company.
	With over 90% of relevant claims or policies calculated to be captured into the proposed cover, the protection limit of HK\$1 million should be appropriate. Note that it is higher than both the Deposit Protection Scheme and Investor Compensation Scheme Limits. MIB and ECIIB have higher limits but this reflects that their main purpose is to cover injured parties.
	An individual policy may have a sum assured substantially greater than the maximum covered amount of HKD1,000,000. We believe that any assessment should be based on the premium associated with the first HKD1,000,000 sum assured of a policy. For example, if a policy has a sum assured of HKD10,000,000, the insurer should not be assessed on the premiums received for the full HKD10,000,000 but rather on the premiums received to cover the amount protected by the fund. It is suggested to set a maximum levy per policy to avoid large policies subsidizing smaller policies.
	<u>Arrangements in the Event of Insurer Insolvency</u> The consultation paper does not give full details on how the transfer of policies would operate. Please elaborate on the mechanism of the transfer of policies from an insolvent insurer to another insurer. - Which party will have say on the choice of the solvent insurer to whom insurance policies will be transferred, the policyholder or the liquidator? - Are all authorised insurers eligible to take up insurance policies from an insolvent insurer? - Under what circumstances will payment from the PPF be allowed to facilitate the transfer? - Will such payment from the PPF be subject to any conditions, if so, what are the conditions? - Would the transferee (i.e. the solvent insurer) be bound by the terms and conditions of the policies issued by the insolvent insurer? - Will there be any minimum credit rating requirements to be the transferee?

CH	Comments from HKFI on the Proposed Establishment of a Policyholders' Protection Fund (PPF)
3	OBJECTIVES, COVERAGE AND LEVEL OF COMPENSATION (CONTINUED)
	We do not understand why such a high amount (\$1M) is set in the policy transfer process. This number may exceed the maximum possible benefits of the policy. We recommend that the transfer amount be limited to the amount that would be the greater of the cash value or reserve on the policy (as determined by an independent actuary) and then applying the PPF formula to this amount. Another possible alternative would be to use the greater of cash value and total premiums paid and then apply the PPF formula to this amount.
	We would like further clarification on why the PPF will be required to provide 'continuity of coverage until expiry of all policies'. (Paragraph 3.20) This proposal could open a significant in liability (particularly if insolvency was caused by significant under pricing of risk) as the unexpired portion of some policies may last over one year, e.g. professional indemnity. As a practice, if an insurer would be close to liquidation, all policies would be cancelled and policyholders would need to arrange for new cover. Anglo-Starlite was an unusual arrangement. We are of opinion that refunding unearned premium is the responsibility of the liquidator, subject to the liquidation law. This avoids the PPF is acting as the Insurer for the un-expired portion of any policy issued by the liquidated company. It is better for policyholders to be encouraged to affect a new policy with another reputable insurer.
	There is no basis for determination of 'ex-gratia' payment in Section 3.19. This may need to be more clearly defined as to the criteria and mechanism for application. We would suggest that the total of the cash / account value plus declared dividends / bonuses plus the 'ex-gratia' payment be limited to a return of total premiums paid.
	For A&H with guaranteed renewability policies - the process is not clear (P.17-18, 3.22-24). " <i>....we recommend to allow the PPF to make a payment to facilitate the transfer, up to the proposed limit of HKD1 million per policy</i> ". This number may exceed the maximum possible benefits of the policy. We recommend that the transfer amount be limited to the amount that would be the greater of the cash value or reserve on the policy (as determined by an independent actuary) and then applying the PPF formula to this amount. Another possible alternative would be to use the greater of cash value and total premiums paid and then apply the PPF formula to this amount.
	In Example 7 of page 36 should the terms and conditions of the policy be determined by the Court after transfer? We believe the transfer and acceptance should be a commercial decision.
	Please clarify that other monthly automatic renewal policies to cover accident and home insurance would not be subject to the terms of 3.22-3.24.

CH	Comments from HKFI on the Proposed Establishment of a Policyholders' Protection Fund (PPF)
4	FUNDING MECHANISM
	<u>Funding Model/Collection of Levy</u>
	We agree with the recommendation that a progressive funding model is a more pragmatic approach for the PPF, as compared with the pre-funding and post-funding models.
	We agree with this level of funding and suggest we do not add as a levy to the individual policy premium but rather pay as an annual adjustment to the PPF. We would then factor this small amount into our rating mechanism. If the levy goes up drastically in future, there is possibility that the insurer will add the levy into the premium rather than absorbing the costs.
	"Applicable Premium" in Section 4.11 is not defined. Funding should directly relate to the protection being provided and hence should only apply to premiums from policyholders who will receive the benefit of protection of the PPF. This will exclude: ➤ Commercial insurance (including / excluding SME depending on the what decision is made re this group). ➤ Inward bound reinsurance. ➤ Business covered by the MIB to avoid double counting. ➤ Business covered by ECIB to avoid double counting.
	The application of "stepped-up" levy is not detailed in the Executive Summary. The triggers the mechanism and criteria for determination of duration for such "stepped-up" levy should be provided in more details for industry consultation. Stepped-up levy could be enormous and this can put insurance companies into serious trouble. We strongly recommend that a cap be set as a percentage of premiums. Will the levy be in form of same as the proposed arrangement but different percentage? Will the government consider the 'refund' of the 'stepped up' levy to insurers upon subrogation to the PPF upon recovery from the assets of the insolvent insurer?
	<u>Initial target fund size</u> Paragraph 4.10 states that the initial target fund is to be built up in 15 years, and the basis of premiums for calculating the levy for life insurers (i.e. the office premiums) are defined to be the sum of premiums of new businesses and renewal premiums of existing businesses for a financial year. Given the levy will be collected on an going basis, we assume the levy is calculated and collected en bloc rather than every time when a policy is issued. Besides, the definition of office premiums has not catered for premiums of existing businesses which have been received prior to the establishment of PPF.

CH	Comments from HKFI on the Proposed Establishment of a Policyholders' Protection Fund (PPF)
4	FUNDING MECHANISM (CONTINUED)
	The scheme does not indicate the frequency to review and the criteria to consider the adequacy of the fund size. We recommend a review be required every 3 to 5 years, particularly the calculation of the levy is impacted by the cost of financing in an insolvency situation and this cost will reduce as the fund increases in size.
	The initial levy rate of 0.07% of applicable premiums is acceptable.
	<u>Asset Recovery Mechanism</u> We support the MIB / ECIIB position that it is preferable for the PPF, MIB and ECIIB to have the same creditor status. This is to avoid MIB and ECIIB being put at a disadvantage and subsequently needing to increase levies for MIB and/or ECIIB subject to actuarial study.
	<u>Financing Arrangement to Bridge Liquidity Gap</u> The fact that the PPF will be set up with legislative backing should enable any gap in financing to be available on competitive terms, but this would be further enhanced if the Government agreed that it will guarantee any financing.
5	GOVERNANCE ARRANGEMENTS AND RELATED MATTERS
	<u>Legal and Organizational Structure / Functions and Powers of PPF / Governance Arrangements</u> We agree with the structure, proposed functions and powers, and Governance arrangements proposed in Sections 5.1-5.5 of the Consultation Paper.
	<u>Guidance on Investment</u> We consider the investment strategy proposed too conservative, and one that will lead to an unnecessarily slow build up of the PPF. In view of the fact that the PPF will now be funded by the industry our view is important in this aspect. We recommend that the mandate be left as investing in a prudent manner but open it up to include investment grade corporate bonds and other investments consistent with maintaining a low risk profile.
	<u>Daily Operations / Confidentiality / Appeal Mechanism</u> The recommendations in Sections 5.7-5.9 of the Consultation Paper all seem appropriate.

中西區區議會



CENTRAL & WESTERN DISTRICT COUNCIL

檔 號：C&WDO 103/49 (Pt.20)
電 話：
傳真號碼：
電子郵址：

香港中環統一碼頭道 38 號
海港政府大樓 11 樓

傳真文件(共 4 頁)

財經事務及庫務局
首席助理秘書長(財經事務)
陳秀芳女士
(傳真號碼：2527 0292)

陳女士：

**第 11 項：關注「建議設立保單持有人保障基金」諮詢文件
(中西區文康會文件第 27/2011 號)**

中西區區議會文化康樂及社會事務委員會(文康會)曾於二零一一年六月二日召開的第八次會議上，就題述的議題進行討論。

席間，有委員表示保單持有人保障基金的人壽計劃最高賠償限額為 100 萬元不合時宜，因為市民一般購買人壽計劃的投保額甚少低於 100 萬。假如賠償最高限額只為 100 萬元，對於人壽計劃的投保人並沒有足夠保障，未能發揮保障基金的保障效用。另外，亦有委員擔心保障基金的徵費最終也由保單持有人承擔，他們認為政府首要工作應加強對業界的監管，而非把責任轉移至消費者身上。經討論後，委員會同意把是次會議的會議紀錄節錄擬稿交予 貴局作為參考。先此致謝。

中西區區議會
文化康樂及社會事務委員會主席
鄭麗琼

附會議紀錄(草擬摘錄)

副本分送：

財經事務及庫務局 助理秘書長(財經事務) 林詩農先生
(傳真號碼：2527 0292)

二零一一年七月七日

中西區區議會
二零一零至一一年度
文化康樂及社會事務委員會
第八次會議紀錄(草擬摘錄)

日期：二零一一年六月二日 (星期四)

時間：下午二時三十分

地點：香港中環統一碼頭道 38 號

海港政府大樓 14 樓

區議會會議室

第 11 項：關注「建議設立保單持有人保障基金」諮詢文件
(中西區文康會文件第 27/2011 號)

(下午 4 時 54 分至 5 時 18 分)

2. 財經事務及庫務局陳秀芳女士向委員補充有關建議設立保單持有人保障基金(簡稱「保障基金」)的目的及背景資料。她表示局方正就保障基金進行公眾諮詢，在本年 3 月 25 日至 6 月 24 日期間，歡迎業界人士及公眾向局方提供意見。局方計劃在今年內收集意見，希望在本年內公布最終方案。
3. 黃堅成議員認為保障基金的人壽計劃最高賠償限額為 100 萬元不合時宜，市民一般購買人壽計劃的投保額已甚少低於 100 萬元。假如賠償最高限額只為 100 萬元，對於人壽計劃的投保人沒有足夠保障，因為他們保單的帳戶價值及積累的紅利可能已高於 100 萬元，再加上投保人死後所提出的申索額，總數肯定為最高賠償限額的數倍，投保人屆時甚至連本金亦未能全數收回，令保障基金名存實亡，未能提供適當的保障。
4. 保險業監理處(簡稱「保監處」)許美瑩女士補充有關保障基金的保障範圍內容及管治安排等相關事宜。她回應黃堅成議員時稱賠償水平方面，申索額的首 10 萬元將會全數賠償，而餘額則會賠償百份之八十，上限為 100 萬元。人壽計劃將會以每一份保單為單位，而非人壽計劃則以每一宗申索為單位。上述賠償金額是由精算師綜合由保險公司所提交的數據，包括保單、投保人提出的申索以及不同類型保險的詳情，再以 5 萬個模擬個案進行精算測試所得。結果顯示，根據 2009 年市場實際情況，100 萬元的賠償上限已經可以應付約百份之九十的人壽保單中百份之九十至一百的申索及約百份之九十六非人壽保單全數的申索。

5. 許美瑩女士續稱香港過去從未發生人壽保險公司倒閉的事件。其他國家若遇上人壽保險公司倒閉的情況，通常都能將保單成功轉移至另一家保險公司。因此保障基金建議當出現人壽保險公司倒閉時，盡量促成保單轉移到另一間保險公司。保障基金亦會同樣地盡量促成一些有保證續保條款的意外及健康保單的轉移。假如保單未能成功轉移而被終止，保障基金除會賠償現金值及紅利外，也會視乎保單持有人的情況而考慮發放特惠金，以賠償投保人因保單提早終止而蒙受的損失金額。非人壽保單因為年期較短，清盤人大多會讓保單生效直到合約期滿為止。根據精算師計算結果，保障基金目標用約 15 年時間達到初期預定基金金額：人壽計劃的基金金額為 12 億元，非人壽計劃的基金金額為 7 千 5 百萬元。由於現時已有其他賠償計劃保障汽車及僱員的補償保險，非人壽計劃並未涵蓋以上兩項保險，因此非人壽計劃基金金額較少。人壽計劃及非人壽計劃的徵費率建議均為 0.07%。收費方式主要參考其他國家及存款保障基金的做法，由保障基金向保險公司收取徵費。由於現有的保險公司共有 167 間，業界競爭相當大，因此她相信保險公司應不會將徵費轉嫁予投保人。當發生保險公司倒閉事件時，保障基金會先賠償予投保人，並且接收投保人的申索權益(即獲保障基金賠償的部份)，以便從倒閉的保險公司的資產中追討該部份的款項。在流動資金不足時，保障基金可向其他商業機構借款，由政府作擔保，或直接向政府借款。無論採用哪一種方案，都必須經由立法會考慮通過。

6. 委員就是份文件發表的意見及提問如下：

- (i) 楊浩然議員指出現時香港汽車保險局及保險公司(僱員補償)無力償債管理局所管理的賠償基金皆源自消費者，因此他擔心保障基金的徵費最終亦是由保單持有人承擔，他認為政府現時首要工作應加強對業界的監管，以避免雷曼事件再度發生，而非把責任轉移至消費者身上。
- (ii) 黃堅成議員指出現時大部份的非人壽計劃均由保險代理人或保險經紀代表保險公司銷售。雖然保單最後亦會交由保險公司負責，但政府在過程中可會有特別的監控。

7. 許美瑩女士表示政府當局曾於 2003 年 12 月至 2004 年 4 月期間就上述保障基金計劃進行公眾諮詢，但因保險業界及公眾的意見紛紜而擱置。雷曼事件發生後，各界紛紛要求再度考慮推行上述保障基金計劃，以加強對保單持有人的保障，而公眾亦支持。她指出保監處已加強了對業界的監管，並一直積極推行公眾教育，例如印製不同小冊子來教導公眾如何分辨不同保單的保障內容及其在投保過程中應有的權益等，這些工作仍會一直持續進行。她表示市民經常經由中介人(包括保險代理人或保險經紀)購買各種保險計劃，這些中介人除受《保險公司條例》(第 41 章)監管外，也應依從中介人管理守則，必須誠信地向投保人解釋清楚保單內容。一般而言，保險公司也會

與中介人簽定協議書，即在銷售過程中必須向投保人清楚解釋保單內容及投保人須注意的事項。銷售人壽保單時，保險中介人須遞交已填妥及簽署的客戶保障聲明書。若銷售的是特定的保險產品，保險公司隨後須致電相關客戶跟進和確認，過程會被錄音，以證明投保人清楚明白有關計劃內容及條款。她指出保監處也會在例行巡查中，抽查保險公司是否已進行有關內部監控的步驟。

8. 經討論後，委員會同意把會議節錄擬稿在諮詢期完結前提交予財經事務及庫務局參考。