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FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE—INSURANCE SECTOR REGULATION AND SUPERVISION

This Technical Note on Insurance Sector Regulation and Supervision for the People's Republic of China–Hong Kong Special Administrative Region FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in June 2021.

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INSURANCE SECTOR REGULATION AND SUPERVISION

Prepared by
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of a Financial Sector Assessment Program (FSAP) mission in the People's Republic of China, Hong Kong Special Administrative Region, led by Ananthakrishnan Prasad. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx.

CONTENTS

Glossary

ASHK	Actuarial Society of Hong Kong
CFR	Council of Financial Regulators
CMG	Crisis Management Group
CWUMPO	Companies (Winding Up and Miscellaneous Provisions) Ordinance
DST	Dynamic Solvency Testing
ERM	Enterprise Risk Management
FIRO	Financial Institutions (Resolution) Ordinance
FSAP	Financial Sector Assessment Program
FSTB	Financial Services and Treasury Bureau of the Government of Hong Kong SAR
FSC	Financial Stability Committee
GIECA	Group Internal Economic Capital Assessment
G-SII	Global Systemically Important Insurer
GWP	Gross Written Premiums
GWS	Group-wide supervision
HKD	Hong Kong dollar
HKFI	Hong Kong Federation of Insurers
HKMA	Hong Kong Monetary Authority
HKSAR	Hong Kong Special Administrative Region
IA	Insurance Authority
IAIG	Internationally Active Insurance Group
IAIS	International Association of Insurance Supervisors
IAT	Insurance Appeals Tribunal
ICB	Insurance Complaints Bureau
ICP	Insurance Core Principle
ICS	Insurance Capital Standard
IFRS	International Financial Reporting Standard
IFS	Insolvency Fund Scheme
ILAS	Investment-linked assurance schemes
IO	Insurance Ordinance
LTA	Long-term adjustment
MA	Matching adjustment
MAV	Market-adjusted valuation
MCR	Minimum Capital Requirement
MCV	Mainland Chinese visitors
ORSA	Own Risk and Solvency Assessment
PCR	Prescribed Capital Requirement
PPS	Policy Holders' Protection Scheme
RBC	Risk-based capital requirements
SFC	Securities and Futures Commission
USD	US dollar

EXECUTIVE SUMMARY[1]

This note provides an update and assessment of developments in insurance supervision since 2014. It is part of the 2020 Financial Sector Assessment Program (FSAP) for the Hong Kong SAR (HKSAR) and draws on discussions there from September 10 to 24, 2019. It has not been updated for the impact of recent global events associated with the COVID-19 pandemic.

The insurance sector is large, especially long-term (life) insurance, highly international and has been growing steadily. The long-term market is amongst the world's largest, particularly by penetration (premiums to GDP). Growth has been supported by the popularity of savings products, including sales of policies to Mainland Chinese visitors (MCVs), although these have declined from their peak. The general insurance sector, though comprising many more companies, is relatively small and spread over many lines. The authorities have identified scope for growth in protection policies as well as opportunities for captive and specialty lines related to China's Belt and Road Initiative. Tax incentives have supported the recent successful introduction of new annuity and health insurance products. Although foreign-owned companies account for a large share of business, the HKSAR is the home of three major domestic groups operating internationally.

While the insurance sector is functioning well, risks have been increasing. The sector has been relatively stable, with only one failure (a specialist motor insurer) over the past ten years, reflecting relatively low risk products (in long-term insurance, mainly participating policies with low guarantees) and effective supervision. However, as in other markets, many long-term insurers are vulnerable to prolonged low interest rates (they moved downwards again in 2019). The incidence of typhoons increased over 2017-18. There is also uncertainty about the longer-term impact of 2019's social unrest, including on future MCV business, while the rapid development of FinTech has the potential to be disruptive. Changing regulation and new accounting standards for insurance pose compliance challenges, especially in general insurance, where there are smaller domestic companies.

Most recommendations of the 2014 FSAP have been implemented or are being addressed. The current FSAP did not include a detailed assessment of observance of the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs). However, recent developments, particularly the establishment of the independent Insurance Authority (IA) in 2015, have addressed the most significant shortcomings. Implementation of full group-wide supervision (GWS) and risk-based capital requirements (RBC), the two key 2014 recommendations, is outstanding. However, plans (including for legislation) were well underway at the time of the assessment and the authorities and industry have been collaborating. Some other recommendations from 2014, including on disclosure requirements, need attention.

The IA's establishment has greatly strengthened insurance regulation. The IA is a dedicated agency, supervising both insurers (since June 2017) and intermediaries (since September 2019), with extended powers, including the resolution authority for relevant insurers, and control over staff

[1] This technical note was prepared by Ian Tower (IMF/MCM). The FSAP mission took place in September 2019.

salaries and use of its resources. More staff with industry experience (including actuaries) have been recruited. Total staff have greatly increased, although mainly in line with extended responsibilities, while turnover continues to be relatively high. Some provisions of previous legislation that could compromise independence from government have been carried over, and the IA remains dependent on government for certain regulations and budgetary approval. However, the risks are mitigated by clear statutory objectives and close collaboration with the government. The IA needs to sustain an appropriate balance between its policyholder protection and market development objectives.

Further development of the IA, particularly in supervision, is needed to maximize its effectiveness. Completing insurance regulation reform will take years. Priority should be given to developing and documenting internal processes for supervision and enforcement (where not complete), with publication of key features. Many processes are subject to independent review, while many individual decisions may be appealed to a tribunal with wide-ranging powers. The IA is developing its separate supervisory processes for long-term and general insurance, reflecting their differences, but should also consider a more integrated approach, covering conduct risks as well, to facilitate risk-based allocation of resources. It should also develop its capacity to identify and respond to risks across the sector, including from outside the HKSAR. A small risk unit could support such work.

Enhancing GWS has a high priority, with implementation due in mid-2020. The IA is now group-wide supervisor for the three major domestic groups, one of which was, at the time of the FSAP work, a Global Systemically Important Insurer (G-SII)[2]. A pragmatic approach has been taken to the new framework, which will include direct regulation of holding companies. The demands of GWS will be met by additional resourcing, although even more may be necessary. Recovery planning (and resolution planning, for the former G-SII and potentially others) should have priority. The IA should refine its view of systemic risk in the light of new IAIS standards and market developments.

The new RBC framework will take until 2022 to implement and should be kept under review as international standards develop. Current capital standards are inadequate. (The IA does, however, require solvency levels well above the minimum and uses stress-tests to assess vulnerabilities). The proposed RBC requirements, as were being tested at the time of the assessment, draw on international practices, while reflecting characteristics of the HKSAR sector. The approach to the valuation discount rate for long-term insurers' liabilities risks incentivizing investment in higher risk assets, while also diverging from the draft new IAIS standards (taking effect in 2024 at the earliest). The IA should keep RBC under review to maintain alignment with international standards. It should avoid generous transitional arrangements and consider enhanced supervision of insurers' investments. RBC will be complemented by IA's recent new requirements on governance and risk management and for key persons in control functions.

Market conduct requirements will also need to be kept under review over a longer timeframe, with the priority being to implement intermediary supervision. The IA has introduced significant

[2] The Financial Stability Board, in consultation with the IAIS and national authorities, decided in November 2019 to suspend G-SII identification pending implementation of a new approach to systemic risk assessment in insurance.

new conduct requirements for insurers and has adopted and strengthened standards previously applied by self-regulatory bodies to insurers and intermediaries. The priority is to ensure visible, effective enforcement of the new framework. In the medium term, the IA should review its approach to intermediary remuneration to ensure adequate disclosure to customers; it should consider supplementing or replacing its reliance on consumer complaints with more forward-looking indicators of conduct risk and an increased role for independent complaints handling; and should develop richer data sources and regulatory reporting to support its conduct risk assessment.

Table 1. Hong Kong SAR: Insurance Regulation: Main Recommendations		
Recommendation	**Responsible Authority**	**Priority**
Implementation of the 2014 FSAP recommendations		
• The authorities should continue to make progress with GWS and RBC (see below under insurance regulation for specific recommendations).	Government and IA	See below
• The IA should develop a plan for addressing other outstanding 2014 FSAP recommendations identified in the Annex to this note.	IA	Medium term (1-3 years)
Establishment of the Insurance Authority		
• The IA should complete the development and documentation of regulatory processes and internal procedures, with an emphasis on finalizing enforcement processes and developing its supervisory framework.	IA	Short term (up to 1 year)
• The IA should review its organization and resources with a view to establishing new functions such as internal audit; strengthening capacities for risk assessment and supervisory response; and reviewing, following its assumption of full responsibilities, whether skills and resources are adequate to (and appropriately allocated for) the demands it faces.	IA	Medium term
Insurance regulation		
• The authorities should proceed with implementation of GWS and RBC as planned, building on progress to date and minimizing delay. The IA should:	Government and IA	Short term
i. implement the RBC requirements without significant transitional arrangements, recognizing that the calibration has been adjusted to meet local market conditions; and keep the calibration under review in the light of experience and the development of IAIS standards;	IA	Short term
ii. consider a strengthening of insurers' investment requirements or enhanced supervision of how investment portfolios develop in practice in case insurers take on significantly increased risk; and develop a policy and plan for a long-term approach to internal models; and	IA	Medium term
iii. implement GWS as planned, after reviewing the approach to non-regulated entities and the disclosure of group Prescribed Capital Requirement (PCR).	IA	Short term

Table 1. Hong Kong SAR: Insurance Regulation: Main Recommendations (concluded)		
• The IA should keep under review the possible need to issue further guidance to insurers on their expectations on Own Risk and Solvency Assessments (ORSAs) and recovery planning.	IA	Medium term
• The authorities should take further measures to improve protection for long-term policyholders in case of insurer insolvency.	Government and IA	Short term
Insurance Supervision and crisis preparedness		
• The IA should further develop current supervisory processes to enhance individual company reviews, risk assessment methodologies and its approach to inspections, while also considering the benefits of developing a new single overall supervisory framework covering all insurers.	IA	Short term
• It should maintain its focus on crisis preparedness, requiring high quality recovery planning by all insurers, while giving priority to recovery and resolution planning for the major domestic groups.	IA	Medium term
• The IA should keep under review its assessment of systemic risk in individual insurers (and potential FIRO designation) at the same time as developing its approach to identification and response to wider cross-sector systemic risks.	IA	Long term (3 to 5 years)
Market conduct and intermediary supervision		
• The IA should prioritize the implementation of intermediary supervision, completing the transition from self-regulation to a full statutory regime.	IA	Short term
• The IA should take a more forward-looking approach to conduct supervision, reducing its reliance on complaints and collecting more conduct-related data.	IA	Medium term
• The authorities should promote a centralized, comprehensive, specialist complaints handling function, including for intermediaries, thereby also limiting the IA's role in complaints work.	Government and IA	Medium term
• HKMA and the IA should further develop cooperation on the supervision of insurance intermediation by banks; in the longer term, the authorities should review HKMA's role with a view to ensuring that the IA's regulation and supervision of insurance intermediaries is applied to banks as to other intermediaries, with continued strong cooperation with HKMA. reflecting its wide-ranging overall responsibilities for banking supervision.	Government, HKMA and IA	Long term (3 to 5 years)

INTRODUCTION[3]

A. Scope and Approach of This Note

1. This technical note provides an update and an assessment of the development of regulation and supervision of the insurance sector since 2014. The note is part of the HKSAR 2020 FSAP and draws on discussions in the Hong Kong SAR of the People's Republic of China, from September 10 to 24, 2019. The FSAP's overall conclusions and recommendations are set out in the Financial Sector Stability Assessment.

2. The note focuses on key issues, with reference to international standards but without presenting a detailed assessment of the Hong Kong SAR's observance. As an update to the full assessment of observance of the ICPs of the International Association of Insurance Supervisors (IAIS) carried out by the IMF in 2013,[4] the note focuses on key developments, including the establishment of the Insurance Authority (IA) as the new insurance regulator with effect from June 2017.[5] Unless stated otherwise, references in this note to the IAIS ICPs are to the version issued in October 2011, as revised in October 2013, November 2015, and November 2017. The institutional arrangements for financial sector regulation and supervision in the Hong Kong SAR are presented in Section B.

3. The note draws on information supplied by the authorities and discussions in the Hong Kong SAR. Meetings were held with the IA, the Financial Services and Treasury Bureau of the Government of the Hong Kong SAR (FSTB), the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Hong Kong Federation of Insurers (HKFI), the Actuarial Society of Hong Kong (ASHK) and with insurance companies and other market participants.

4. The author is grateful to the authorities and private sector participants for their excellent cooperation. The preparation of this Technical Note benefited greatly from their readiness to share insights and information. The author is especially grateful to the staff of the IA for their close cooperation and support for the work of the FSAP.

B. Overview—Institutional and Market Setting

The Insurance Market

5. The HKSAR's insurance sector comprised 162 insurance companies at end-2019. 50 were long-term (life) insurers and 91 general. In addition, there were 21 companies offering both

[3] This technical note was prepared by Ian Tower (IMF external expert).

[4] People's Republic of China, Hong Kong Special Administrative Regime: Insurance Core Principles, Detailed Assessment of Observance of Insurance Core Principles, IMF, July 2014. The findings of that assessment are summarized in the report of the 2014 FSAP (People's Republic of China, Hong Kong Special Administrative Regime: Financial Sector Stability Assessment, IMF Country Report No. 14/130, May 2014).

[5] It was established in December 2015 to take over the functions of the Office of the Commissioner of Insurance.

categories of insurance (i.e., composites[6]), accounting for around 30 percent of long-term business, but less than 20 percent of general insurance. Of the 162 insurers, 17 offer reinsurance only, although other companies can and do write reinsurance alongside direct business, and four are pure captive insurers. Most insurers are corporates and the share of mutual insurers is only 4 percent.

6. **The number of insurers has been broadly stable in recent years, and in long-term insurance the market is relatively concentrated.** As shown in Table 2, the number of licensed companies has not changed significantly since the previous FSAP, with new entrants being in long-term insurance. By contrast, the number of intermediaries has been growing strongly. The long-term market is relatively concentrated, with the largest five companies accounting for around 70 percent of gross premium income (GWP) and the largest 10 for 87 percent, whereas the largest 10 general insurance companies account for 45 percent.

Table 2. Hong Kong SAR: Number of Licensed Insurers and Intermediaries

	2014	2015	2016	2017	2018	2019[a]
Insurers						
Long-term (All)	44	44	47	47	49	50
of which, pure reinsurer	*1*	*1*	*1*	*1*	*1*	*1*
General (All)	95	93	94	93	93	91
of which, pure reinsurer	*11*	*11*	*10*	*10*	*8*	*7*
of which, captive	*3*	*3*	*3*	*3*	*4*	*4*
Composite (All)	19	19	19	19	19	21
of which, pure reinsurer	*7*	*7*	*7*	*7*	*7*	*9*
Total number of companies	**158**	**156**	**160**	**159**	**161**	**162**
Insurance Intermediaries						
Agents[b]	76,027	84,065	92,465	92,261	97,063	104,601
Brokers[b]	10,393	10,130	10,208	10,248	10,348	10,726

Source: The Insurance Authority of the Hong Kong SAR.

Note: [a] as at September 2019 (insurers) and August 2019 (intermediaries). [b] The IA, and formerly the self-regulatory bodies responsible for insurance intermediary supervision, also oversees technical representatives and responsible officers of agents and brokers.

7. **There is a high degree of foreign participation, but bank (and public sector) ownership of insurers is limited.** Foreign companies are established as branches or subsidiaries, although the IA now prefers newly-established long-term insurers to operate as subsidiaries. Parent groups are located mostly in major insurance markets[7] and they include eight of the nine Global Systemically

[6] Newly-established insurers may offer only long-term or general insurance, as defined in Schedule 1 to the Insurance Ordinance (IO). New reinsurers may still operate as composites.

[7] As well as companies from Mainland China, foreign insurers originate from the USA, Canada, Bermuda, the UK (including Isle of Man and Guernsey), Belgium, Germany, France, Italy, Norway, India, South Africa, the Philippines and Singapore.

Important Insurers (G-SIIs) listed (until the end of 2019) by the Financial Stability Board.[8] As shown in Table 3 (latest data are for 2017), foreign insurers accounted for around two-thirds of long-term insurers' total assets, while bank ownership is less significant (and concentrated in a small number of large bank-owned insurers). Public sector ownership is limited to the insurance operations of the government-owned Hong Kong Mortgage Corporation, the main business of which is related to housing market finance.

Table 3. Hong Kong SAR: Ownership Structure as at end-2017

	Long-term		General		Reinsurance		Captives	
	N	Total assets	N	Total assets	N	Total assets	N	Total assets
Domestic								
Banks	7	289.7	7	17.5	1	1.0	0	-
Non-financial entities	0	-	4	6.6	0	-	0	-
Public sector	0	-	1	51.3	0	-	0	-
Others	17	632.6	39	78.4	8	64.1	3	8.0
Foreign								
Banks	1	351.7	1	1.7	0	-	0	-
Non-financial entities	0	-	0	-	0	-	0	-
Public sector	0	-	0	-	0	-	0	-
Others	29	1,576.9	32	28.0	9	34.7	0	-

Source: The Insurance Authority of the Hong Kong SAR

Note: Ownership structure is based on majority (more than 50 percent) of ownership. N = Number of insurance companies. Total assets are expressed in billions of HKD.

8. **In recent years, however, domestically owned groups, all with international operations, have been assuming greater importance.** Restructuring of certain major international insurance groups has left the HKSAR as the base for two significant groups[9], while a third domestic group has been growing significantly. All three groups are mainly active in long-term insurance and have significant operations outside Hong Kong.

9. **The long-term market is amongst the world's largest, particularly by penetration.** The HKSAR ranked 12th by total premiums (USD equivalent) in 2018[10] and second by penetration

[8] See Financial Stability Board: 2016 list of global systemically important insurers (G-SIIs), November 21, 2016. However, subsequent to the FSAP work and preparation of this technical note, the Financial Stability Board, in consultation with the IAIS and national supervisory bodies, decided to suspend G-SII identification from the start of 2020 pending implementation of a new framework (the "Holistic Framework") for the assessment and mitigation of systemic risk in the insurance sector. (This framework recognizes that systemic risk can arise both from sector-wide trends as well as from a concentration of these activities and exposures in individual insurers. See Press Release: FSB welcomes insurance holistic framework, 14 November 2019.)

[9] AIA, created by the restructuring of AIG's Asian operations after the Global Financial Crisis, and Prudential, which inherited the non-European (mainly Asian and US) businesses of the UK Prudential Group in late 2019.

[10] Swiss Re, Sigma Report, Number 3/2019.

(premiums to GDP – 16.81 percent). As Table 4 shows, growth since 2014 has been strong, buoyed by the popularity of savings products, including sales of (mostly USD-denominated) policies to Mainland Chinese visitors (MCVs), which peaked at a 45 percent share of new business in 2016.

10. There was already uncertainty over the future of MCV business at the time of the FSAP assessment. Key drivers of MCV demand have been identified as the need to hedge potential renminbi depreciation and the relative attractiveness of products available to MCVs from the HKSAR insurers (premium rates, product variety and, in the case of health benefits, breadth of protection coverage). However, policies may be sold only when MCVs are physically present in the HKSAR territory. Premium income from MCVs had already declined to 26 percent of new premiums in the first half of 2019 and it fell sharply as visitor numbers slumped in response to social unrest in the HKSAR from June 2019.[11] In the longer term, new MCV business is vulnerable to potential changes in regulation and capital controls in Mainland China.

11. Most long-term business is savings-related. Investment-linked insurance policies, commonly known as investment-linked assurance schemes (ILAS)[12], have been significant in the past. However, following recent regulatory changes to address product design issues as well as selling and remuneration practices, much long-term business now takes the form of participating savings polices, typically whole life, with relatively low guarantees. ILAS accounted for only 10 percent of new business in the first half of 2019. Some insurers specialize in short-term savings in the form of endowments and universal life. Pure life insurance products (term life), including group business, have a negligible market share.

Table 4. Hong Kong SAR: Premium Income (HKD billions)

	2014	2015	2016	2017	2018	2019[a]
Long-term	296	328	406	441	462	265
of which: New business [b]	*112*	*131*	*182*	*158*	*161*	*100*
of which: Mainland Chinese Visitors	*24*	*32*	*73*	*51*	*48*	*26*
General (GWP)	44	46	46	48	53	31
Total	340	374	452	489	515	296

Source: Insurance Authority of Hong Kong SAR.

Notes: [a] First half of 2019. [b] *New business* refers to individual life and annuity products.

12. The general insurance sector is relatively small, spread over many lines and in need of development. Penetration was only 1.35 percent of GDP in 2018, the lowest amongst the Asia-Pacific advanced economies and lower than Mainland China. Motor insurance has a limited share, reflecting low levels of private car usage due to the well-developed public transportation system in

[11] At the time of the FSAP work in HKSAR, there were no indications reported in the discussions that persistency of in-force MCV policies was being affected.

[12] ILAS refers to insurance policies of Class C linked long term (as defined in Part 2 of Schedule 1 to the IO) issued by insurers which are authorized by the IA.

Hong Kong. Accident and health accounted for around one third of GWP in the first half of 2019 and reinsurance (mainly of motor and property risks) for around 25 percent.

13. The authorities have identified opportunities for growth in international business. A large share of general insurance, particularly property insurance as well as reinsurance, is already covering risks outside the HKSAR (see Table 5). The authorities hope to increase the numbers of captives (for example, established by Mainland Chinese state-owned companies) as well as reinsurance and specialty lines related to the Mainland Government's Belt and Road Initiative. They have recently negotiated favorable capital charges for insurers in Mainland China sourcing reinsurance from the HKSAR[13].

Table 5. Hong Kong SAR: General Insurance (Including Reinsurance): Net Technical Reserve Breakdown (HKD millions, end-2018)

	HK Business	Offshore Business	Total	% of total
Accident and Health	5,757.3	1,374.4	7,131.7	9%
Motor vehicle, damage and liability	7,875.3	3,168.0	11,043.3	15%
Aircraft, damage and liability	44.8	0.9	45.7	0%
Ships, damage and liability	2,426.5	330.2	2,756.7	4%
Goods in transit	1,016.6	218.4	1,235.0	2%
Property damage	7,591.6	7,204.9	14,796.6	20%
General liability	23,036.4	2,675.8	25,712.3	34%
Pecuniary Loss	3,587.6	1,305.3	4,892.9	6%
Non-proportional treaty	548.1	1,276.3	1,824.4	2%
Proportional treaty	783.2	5,283.8	6,067.0	8%
Total	52,667.4	22,838.1	75,505.6	100%

Source: The Insurance Authority of the Hong Kong SAR.

14. FinTech initiatives are having an impact and may help to fulfil ambitions to develop demand for protection products. As at mid-2019, there was one virtual insurer operating in the market (see Box 1 on FinTech developments). By increasing access for the currently uninsured and reducing distribution costs, these companies may help remedy a large shortfall identified by the authorities in the penetration of protection policies. The government, regulatory authority and insurance companies have recently collaborated to launch (in April 2019) new deferred annuity and health insurance products which benefit from tax deductibility of premiums up to certain limits.[14] Initial indications are that these products are proven successful.

[13] Part of a wider agreement with the Mainland Chinese authorities on recognition of equivalence of standards (announced May 2017). The HKSAR's role in the Belt and Road Initiative as a risk management hub has been formally recognized by the Mainland Government (see https://www.info.gov.hk/gia/general/201712/14/P2017121400551.htm)

[14] The Qualifying Deferred Annuity Plan (QDAP) offers a limited deferred annuity and may be offered by long-term insurers, while the Voluntary Health Insurance Scheme (VHIS) may be offered by long-term and general insurers.

15. Distribution of insurance products is predominantly through agents and brokers, while online and other direct sales are negligible. Banks dominate in the distribution of long-term business, accounting for 40 percent of new business in 2018. Non-bank agents, typically acting as tied agents with a single or small number of relationships with insurers, and brokers account for almost all the remainder. Banks have a smaller presence in general insurance (only 10 percent in 2018). The significant increase in numbers of agents in recent years seems to reflect the growth of the market as well as relatively high levels of commission payable by insurers.

Risks, Performance and Solvency

16. As in other developed markets, a key risk in long-term business is from low interest rates.

- Insurers are exposed to a large gap between the duration of assets and liabilities. Unlike in some countries, however, the impact of lower rates is mitigated by the relatively low rates of guarantees offered, including in past business.
- Mortality and longevity risks are relatively low, reflecting the predominant use of long-term insurance for savings rather than protection and low levels of annuity business.
- Although much savings business is US dollar (USD)-denominated, in the case of HKD-denominated policies, long-term investments are especially limited, so insurers invest in USD assets, exposing them to foreign exchange risk or counterparty risk, when hedging with currency swaps etc.
- Investment portfolios also include significant amounts of corporate bonds (see Table 6), creating credit spread risk.
- Insurers are exposed to operational risks, including threats to cybersecurity, and business and operational risks from FinTech (see Box 1).

17. In general insurance, there are significant weather-related risks as well as risks from under-reserving due to high competition.

- The incidence of typhoons in Asia has increased, with major storms affecting the HKSAR in consecutive years - 2017 (Hato) and 2018 (Mangkut).
- Certain business lines (especially motor and employee compensation) have been persistently unprofitable, reflecting weak underwriting standards.
- Investments include relatively more cash, with less exposure to corporate bonds than long-term insurers (see Table 6).
- The sector faces business and operational risks in common with long-term insurers.

- Market growth is low, making it hard to achieve scale in a crowded market, underlining the need for product development and increasing the likelihood that some insurers will struggle to remain viable, especially given the challenges of new regulatory and accounting standards.[15]

Table 6. Hong Kong SAR: Asset Breakdown (End-2018, HKD billions)

	Long-term insurers		General insurers			
			All companies		HKSAR incorporated	
	Assets	Share	Assets	Share	Assets	Share
Total assets	2,934.2	100%	262.9	100%	205.9	100%
Intangible assets	8.1	0%	5.2	2%	4.5	2%
Investments						
Government securities	273.0	9%	16.3	6%	6.7	3%
Semi-Government securities	0.4	0%	0.4	0%	0.4	0%
Corporate securities	1,282.2	44%	57.0	22%	52.7	26%
Other securities	397.6	14%	12.7	5%	9.4	5%
Equities	225.6	8%	11.4	4%	9.8	5%
Real estate and RE related	14.4	0%	7.0	3%	6.2	3%
Cash and bank balances	106.7	4%	46.1	18%	37.7	18%
Investments supporting ILAS	274.2	9%				
Total	2,574.2	88%	151.1	57%	122.9	60%
Receivables	73.3	2%	34.7	13%	26.2	13%
Intra-group/related company receivables	37.5	1%	11.3	4%	4.9	2%
Reinsurance recoverables	115.1	4%	43.1	16%	32.4	16%
Other assets	126.0	4%	17.6	7%	15.0	7%

Source: The Insurance Authority of the Hong Kong SAR.

18. Overall, the insurance sector is profitable and meets minimum solvency standards, although these do not yet reflect the risks in the business. Long-term insurers have benefited from the growth in the market, including (until recently) the high level of sales to MCVs. As shown in Table 7, insurers in aggregate comfortably comply with the minimum capital requirement (MCR) set out in the Insurance Ordinance (IO). They also meet the higher Prescribed Capital Requirement (PCR) set by the IA and which is calibrated at 150 percent of the MCR.

19. In practice, the IA requires solvency levels well above the minimum. 200 percent of MCR is a key intervention threshold and the IA also uses stress-tests to assess vulnerabilities (see Findings Section C). At the time of the FSAP, all insurers complied with the MCR, although two general

[15] The HKSAR will be implementing International Financial Reporting Standard 17 (Insurance Contracts) (IFRS) issued by the International Accounting Standards Board in May 2017. IFRS 17 sets out principles for the recognition, measurement, presentation and disclosure of insurance contracts. It takes effect in January 2022 (with restated 2021 accounts).

insurers did not meet the PCR. The IA is in discussion with other insurers whose solvency is below intervention thresholds.

Table 7. Hong Kong SAR: Solvency (End-period, in percent)

	2014	2015	2016	2017	2018
Available capital resources over Minimum Capital Requirement (Insurance Ordinance)					
Long-term	367%	348%	340%	377%	376%
General	656%	627%	632%	693%	724%
Reinsurance	727%	544%	540%	426%	333%
Available capital resources over Prescribed Capital Requirement[a]					
Long-term	245%	232%	227%	251%	251%
General	437%	418%	421%	462%	483%
Reinsurance	485%	363%	360%	284%	222%

Source: Insurance Authority of Hong Kong SAR.

Note: [a] set by IA, 150% of Insurance Ordinance minimum.

Regulatory and Consumer Protection Arrangements

20. Since late 2019, the IA has been sole supervisory authority for insurers and intermediaries. Established in December 2015 following legislative change to amend the Insurance Companies Ordinance, the IA was initially responsible only for insurance company supervision (from June 2017), including their market conduct. Responsibility for intermediaries supervision transferred to IA from self-regulatory organizations in September 2019. Reporting to the Financial Secretary, the Financial Services and Treasury Bureau (FSTB) leads on wider government policy on insurance, on coordination between the different regulatory bodies and on financial stability issues.

21. The IA is an independent administrative authority accountable to the government of the HKSAR.

- The IA comprises (at the time of the FSAP work) a non-executive Chairman, eight other non-executive members (including two with industry expertise) and five executive directors, including

Box 1. Hong Kong SAR: FinTech Developments in the HKSAR Insurance Sector and the Regulatory Response

In common with many jurisdictions, the HKSAR has seen growing interest in FinTech across financial services. In insurance (where it is also known as InsurTech), key features are:

- changes in product design to exploit increased information such as the policyholder's health and fitness;
- a shift towards digital distribution channels and improvements in online services and the establishment of new insurers offering products on an online basis only, i.e., without agents or branches;
- changes in risk management, particularly increased use of data to improve risk analysis and pricing; and
- greater efficiency and lower costs through "digitalization" of processes such as insurers' interfaces with agents, automated underwriting and claims processing etc.

While some FinTech developments have the potential to be damagingly disruptive to insurance markets, they are broadly welcomed in the HKSAR as an opportunity to increase insurance penetration, including to the currently under-served; to enhance consumer choice and the customer experience; to help tackle insurance fraud; and to reduce compliance burdens such as Know Your Customer (KYC).

FinTech developments are also supporting specific HKSAR initiatives such as the Insurance Fraud Prevention Claims Database (using Artificial Intelligence (AI) techniques to identify fraud) and the Motor Insurance DLT-Based Authentication System (using distributed ledger technology (DLT) to verify the authenticity of motor insurance cover notes); and will contribute to the creation of an integrated market for insurance in the Guangdong-Hong Kong-Macau Greater Bay Area, which is at an early stage of development.

The IA is taking a strategic approach to FinTech that seeks to balance facilitating innovation with appropriate policyholder protection. It has established a working group with FinTech expertise from the insurance sector, academic world etc., to help identify and advise on developments. IA's response to date includes:

- establishing the Insurtech Facilitation Team, with four staff, as part of the IA's policy function, to work with industry experts on the regulatory issues raised by FinTech applications in insurance;
- opening (in late 2017) a "regulatory sandbox" for insurers to put on trial digital products that may not satisfy current regulatory requirements: as at mid-2019, eight applications had been tested by six authorized insurers, all of which related to the selling processes for insurance products;
- providing a fast track route to authorization of new insurers with solely digital distribution channels and a limited range of products for HKSAR residents only; as at mid-2019, there was one virtual insurer authorized under the fast track route operating in the market,; other applicants are in discussion with the IA;
- aligning relevant requirements with the needs of digital processes (recognition of digital signatures, simplifying requirements for online sales etc.) as well as issuing new guidance on cybersecurity; and
- building expertise in its specialist and supervisory teams to monitor and respond to developments.

The IA appears so far to have maintained an appropriate balance between facilitation and protection. It has, for example, required virtual insurers to have shareholding and committed financial and risk management support from established insurers; it has limited sales that may be made without customer financial needs analysis to simple products such as non-participating endowments with guaranteed maturity payment.

Established insurers have responded by improving their online services, risk management (especially through data collection) and the overall customer experience. Digitalization is reducing cost. Initial indications are that virtual insurers, although increasing access for the under-served, will not be disruptive (and other potentially far-reaching changes such as peer-to-peer insurance or involvement of "BigTech" are not occurring).

However, risks to business models of established insurers are significant, especially if FinTech results in radical changes to distribution models or increased operational (and cyber) risks. The IA needs to continue to develop its capacity to monitor and respond to risks without deterring innovation.

- the chief executive (minimum requirements are for eight directors, including chairman and chief executive). All are appointed by the Chief Executive of the HKSAR.

- Total staff of the IA are around 300 (full-time equivalent), an increase from 103 at the time of the 2014 FSAP, when insurance supervision was the responsibility of an office within the government. Much of the increase reflects the broader responsibilities of the IA (and staffing for administrative services formerly carried out by the government), but there has also been an increase in staff numbers for supervisory work and more staff have insurance sector backgrounds than previously. The IA sets its own remuneration levels. It will be financed in the longer term entirely by levies and fees.

- Industry Advisory Committees, for long-term and general insurance, have been established under section 4C of the IO to advise on the development of regulatory policy and the IA is required to consult broadly on new regulatory requirements;

- The decisions of the IA may be appealed by an insurer or intermediary to the Insurance Appeals Tribunal (IAT), an independent quasi-judicial body established under Part XII of the IO. The IAT is empowered to make a range of orders in relation to its reviews. In addition, the internal procedures of the IA are subject to review by a Process Review Panel, an independent but non-statutory panel that reviews and advises the IA on the adequacy of internal procedures governing operational decisions such as authorizations.

22. The IA is also the resolution authority for insurers covered by the Financial Institutions (Resolution) Ordinance (Cap. 628) (FIRO). The legislation enacted in 2017 establishes a framework for resolution covering banking, insurance and securities and futures sectors, including arrangements for resolution of cross-sectoral groups. At present, only former G-SIIs are subject to the resolution framework of the FIRO. Nonetheless, the Financial Secretary may designate other insurers as a within scope financial institution of the FIRO. Under the general insolvency legislation (Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (CWUMPO)) together with specific provisions under the IO, the courts oversee the winding up of insurers.

23. The IA has delegated inspection and investigation powers on banks (as insurance intermediaries) to the HKMA under the IO and also co-operates with the securities regulator. As bank supervisor, the HKMA exercises supervision over banks' conduct of business in banking, insurance, securities, Mandatory Provident Fund business, etc. under the Banking Ordinance (Cap. 155). Long-standing arrangements under which it carries out inspections and investigations on banks' selling practices and other conduct issues in insurance have been formalized following the IA's assumption of responsibility for intermediary supervision. Powers of delegation included in the IO have been exercised[16] and arrangements for cooperation set out in a revised IA-HKMA

[16] Under section 4G(1) of the IO, the IA has delegated both inspection powers (under section 64ZZF(6) of the IO) and investigation powers (under section 64ZZH(1) of the IO) to the HKMA in relation to business of regulated activities carried on by authorized institutions as defined in the Banking Ordinance (including banks).

Memorandum of Understanding.[17] The IA retains responsibility for any disciplinary action resulting from investigations conducted by the HKMA under the delegation. The Securities and Futures Commission (SFC) is responsible for authorizing ILAS for public offering in Hong Kong and their offering documents under the Securities and Futures Ordinance (Cap. 571), and there are arrangements for cooperation with the IA.

24. The FSTB has an important role in developing and steering the passage of legislation. The IA has extensive powers to develop its own regulatory standards, including guidelines and codes. However, where these standards require codification in law, usually in the form of subsidiary legislation, the relevant legislation is subject to scrutiny by the Legislative Council. The Chief Executive in Council and the IA are empowered under different provisions of the IO to make subsidiary legislation.

25. The arrangements for cooperation among the authorities are substantially unchanged from 2014. The IA now leads on insurance sector issues in the Council of Financial Regulators (CFR) and the Financial Stability Committee (FSC). The CFR, which is chaired by the Financial Secretary and includes the heads of the IA, HKMA and SFC as well as the Mandatory Provident Fund Schemes Authority, reviews regulatory and supervisory issues with wider market implications. The FSC considers issues with possible cross-market and systemic implications and is chaired by the Secretary for Financial Services and the Treasury and comprises the heads of the IA, SFC and HKMA.

26. There are only limited arrangements for policyholder compensation in case of insurer insolvency. The only source of funds in case of policyholder (or third party claimant) loss on insolvency relate to compulsory insurance: the Insolvency Fund Scheme (IFS) run by the Motor Insurers' Bureau (whose other responsibilities relate to loss involving uninsured or unidentified drivers); and the Employees Compensation Insurer Insolvency Scheme administered by the Employees Compensation Insurer Insolvency Bureau. At the time of the FSAP, the IFS was still making payments in respect of the only insurer insolvency in the last ten years, a specialist motor insurer, the failure of which in 2009 has resulted in liabilities for the fund of around HKD 900 million.

27. A wide-ranging new compensation scheme is, however, planned. Legislation was scheduled for 2020 to establish a Policy Holders' Protection Scheme (PPS) covering most types of direct long term and general policies held by individual policyholders, small and medium enterprises and owners' corporations. It will pay up to HKD 1 million per policy, claim or insured event. There will be separate funds for long-term and general business, supported by levies collected from insurers.

28. There are multiple channels for consumers to pursue complaints against insurers or intermediaries. The IA is open to complaints about licensed insurers and intermediaries and seeks to engage the insurer or intermediary in their resolution. The Hong Kong Federation of Insurers has established the Insurance Complaints Bureau (ICB) to serve as an alternative dispute resolution mechanism to resolve personal insurance disputes with insurers. All insurers writing personal lines

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[17] Memorandum of Understanding between the Monetary Authority and the Insurance Authority, 19 July 2019 (effective 23 September 2019).

must be members of ICB, which provides binding decisions on complaints concerning claims (up to HKD 1 million) and a mediation service on non-claims complaints. Customers of banks can take their complaints to the Financial Dispute Resolution Centre.

FINDINGS AND RECOMMENDATIONS

A. Overview of the Implementation of the 2014 FSAP Recommendations

29. Most recommendations of the 2014 FSAP have been implemented or are being addressed. Developments since 2014, and particularly the establishment of the IA in December 2015, have addressed many shortcomings. Implementation of full GWS and RBC, key 2014 recommendations, is outstanding. However, plans for their implementation, including the necessary legislative changes, are well underway. Some other recommendations from 2014 need attention. A detailed analysis of the 2014 recommendations and how they have been addressed, drawing on input from the IA, is set out in the Annex.

30. The authorities are in particular addressing the issues that in 2014 gave rise to ratings of observance of ICPs of Partly Observed. There were five:

- ICP 2 (Supervisor), where the issues are largely being addressed through the establishment and continuing development of the IA;
- ICP 16 (Enterprise Risk Management for Solvency Purposes), where the IA has issued guidelines on ERM and ORSAs, although these will not be implemented in full until 2020 (and arguably mid-2021, when ORSA submissions are first due);
- ICP 17 (Capital Adequacy), where the development of RBC is well-advanced and is scheduled to lead to new requirements by 2022;
- ICP 19 (Conduct of Business), where an explicit objective for the IA in relation to conduct has been set out in the IO and where various new requirements have been issued to insurers and intermediaries; and
- ICP 23 (Group-wide Supervision), where a GWS framework has been developed and is scheduled for implementation from 2020, assuming that the required legislation is enacted.

31. Many important recommendations relating to other ICPs have also been met. These include the extension of the scope of the fit and proper requirements to cover senior management and key persons in control functions (ICP 5) and strengthening of corporate governance requirements (ICP 7).

32. As noted in the Annex, some detailed recommendations remain outstanding and there is a need to complete the work in progress and to enforce new requirements. Some recommendations are outstanding on ICPs 2 (Supervisor), 4 (Licensing), 6 (Changes in Control and

Portfolio Transfers), 9 (Supervisory Review and Reporting), 11 (Enforcement), 12 (Winding-up and Exit from the Market, 13 (Reinsurance and Other Firms of Risk Transfer), 15 (Investment), 23 (Group-wide Supervision), 24 (Macroprudential Surveillance and Insurance Supervision) and 26 (Cross-border Cooperation and Coordination on Crisis Management). It is also important that the authorities complete implementation of current GWS and RBC initiatives. Where new regulatory standards have been set out as guidelines, it will also be important for the IA to be seen to be enforcing these.

33. It is recommended that:

- the authorities continue to progress with GWS and RBC to complete the implementation of 2014 FSAP recommendations and to address key gaps in the regulatory framework that have become more significant since 2014 as a result of market developments; and
- the IA reviews the commentary in the Annex to this note on outstanding issues in the implementation of past recommendations and develops a plan for addressing them.

B. The Establishment of the Insurance Authority

34. The IA's establishment has greatly strengthened insurance regulation. The new authority enjoys extended powers as well as a high degree of operational independence from the government. Its funding arrangements, a combination of levies on premiums and fees payable by licensees, provide for stability in its financing. In supervising both insurers and insurance intermediaries, it is well-placed to identify and address issues affecting the operation of the market. Its public education and market development objectives complement its regulatory responsibilities and have promoted a strategic approach to carrying out its statutory functions. Its governance arrangements, requiring appointment of insurance industry and professional experts to its board, together with the important role of statutory Industry Advisory Committees, underpin a high degree of engagement with stakeholders. Most significantly, the IA's freedom on staff recruitment and remuneration has enabled it to enrich its staffing mix, while also retaining experienced former civil servant regulators.

35. For all the progress to date, the IA is still a work in progress.

- Responsibilities for intermediary supervision have only recently been assumed and long transitional periods, together with a large portfolio of inherited enforcement cases, mean that it will be some years before the new framework is implemented in full.
- The IA is not yet financially independent from the government, which (notwithstanding the plan for the IA to rely longer-term on levies and fees) has been financing a large share of its start-up costs in order to cushion the impact on the industry and consumers of the long-term arrangements. As well as not yet receiving its planned levy income at the full level, it has not started to charge intermediaries for registration and licensing fees.

- Staffing is not yet stable, and the IA continues to see a high degree of turnover (16 percent in the most recent year) that affects many such new organizations; in addition, demands continue to increase, not least those related to the new GWS framework.

- IA's internal sector-based organization, largely inherited from the previous regulator (with addition of intermediary supervision), may not be best-suited to maximising a coordinated approach, although cooperation between its divisions is increasing.

- Regulatory processes, including supervision, are still developing to fit the needs of an expanded new authority, to reflect new requirements such as GWS and RBC and to match the disciplines required by the new IAT and process review mechanism, of which the IA has no experience as yet.

36. A number of issues and challenges for the IA were covered in the FSAP discussions. They focused on priorities for the next stages of the IA's development, which should include:

- Developing its internal processes in relation to supervision, for example by the creation of a single supervisory framework covering long-term and general insurance or at least a single risk assessment methodology (see also Findings Section D).

- Developing and documenting internal processes, particularly for supervision and enforcement (where not already complete) and publishing the key features in line with the otherwise high degree of transparency of the IA's requirements and processes. There was a particular need at the time of the FSAP to finalize and publish the arrangements for decision-taking on enforcement cases (separating investigation from decision-taking), which will involve panels made up of non-executive and executive board members. There may also be a need to review IA Board committees and the delegation framework generally given the large number of decisions likely to be going to the Board.

- Reviewing the organization of the IA at an appropriate time after full absorption of its new responsibilities for intermediary supervision. Areas to consider include:

    i. the creation of an internal audit function, with appropriate coverage of supervisory work, as already under consideration (and required by ICP 2.1);

    ii. the development of a specialist risk function to support the assessment of risk at a more technical level (including IT risks), reducing the IA's need to hire external expertise; and a dedicated risk function to assess and report to senior management and the Board on the range of risks across the IA's responsibilities; and

    iii. the creation in due course of a resolution function to handle the IA's responsibilities in this area, taking into account its response to the likely development of international standards in this area (see also Findings Section D).

- Increasing its capacity for risk assessment (and the supervisory response). The IA is already expert at assessing financial risks in individual institutions (and market-wide) and is increasingly taking a thematic approach to supervisory work; it could enhance its work still in relation to:

    i. common risks and concerns across the three major domestic groups, reflecting their high impact and the requirements of GWS; and

    ii. the assessment of environmental risks (or common risk issues), including those which could have implications for stability, from within and outside the HKSAR, including risks relating to FinTech, climate change etc. (see also Findings Section D).

- Reviewing staff skills and numbers and the overall adequacy of resources in the light of the implementation of intermediary supervision and GWS (if not RBC, which comes somewhat later). The aim would be to assess needs for new or different skills and expertise and the implications for funding. This would build on existing plans to increase staff resources to meet the demands of GWS, which will be funded in part by fees payable by the affected groups.

37. The FSAP also reviewed the arrangements for accountability to government, which preserve a number of channels for potential influence on regulation and the regulator. The key issues are discussed in more detail in the Annex (under the discussion of ICP 2).

- While the government does not have a role in specific regulatory and supervisory decisions, the Chief Executive of the HKSAR may give directions to the IA "with respect to the exercise by the Authority of any of its functions" (section 4 of the IO) and to determine exemptions from IO provisions (section 53). These powers, which predate the establishment of the IA, have not been used.

- The IA's corporate plan together with its budget are subject to approval by the Financial Secretary (section 5B). This process is just starting.

- The IA is dependent on government for funding regulations (and for direct financing in the continuing transitional period – until and including financial year 2021-22).

- Although the IA is empowered to make rules (i.e. subsidiary legislation) in relation to regulatory requirements under section 129 of the IO, such rules are, as noted, subject to scrutiny by the Legislative Council. The FSTB is responsible only for tabling the relevant subsidiary legislation at the Legislative Council and, while it is consulted by the IA (among other stakeholders) on the substance and timing of regulatory requirements, it has never intervened in IA's decisions on the substance of the rules.

38. The potential risks of intervention are, however, mitigated by clear statutory objectives and close collaboration with the government. The IA has established a close working relationship with the government and objectives are closely aligned, in relation to policyholder protection and financial stability as well as development of the market. The FSTB and the IA are working closely on key regulatory initiatives such as GWS and RBC.

39. The IA also appears free of undue industry influence, notwithstanding the involvement of industry experts in its governance. A minority of IA Board members are appointed for their industry expertise (they are not nominees of industry bodies). As noted, they will be involved in disciplinary decision-taking and all decisions taken by the whole board. The arrangements recognize the value of involving external experts, not least against the background of a transition, for insurance intermediaries, from self-regulation to a full statutory regime. There are requirements on all board members in relation to disclosure of conflicts of interest (section 5 of the IO).

40. The potential for conflict between the IA's regulatory and market development functions was also discussed. While such objectives can be mutually supportive, there is a risk that regulatory requirements are diluted to help promote market development, especially where this would align with wider HKSAR objectives, as in the promotion of more international insurance or in relation to FinTech. No evidence was observed of such dilution in practice (in fact, initiatives such as the licensing framework for virtual insurers and the development of new products with tax incentives, seem to balance the objectives effectively). Nonetheless, the IA needs to be alert to the risks of conflict of objectives and should consider separating responsibilities internally, with close coordination.

41. Finally, in respect to the wide-ranging powers of the IAT, it was noted that the tribunal has power to stay the IA's interventions pending the appeal. Appeals do not themselves involve a stay of the IA's decision, but appellants may apply separately to the IAT for a stay (section 110 of the IO). The effect could be unduly to impede the ability of the IA to make timely interventions in order to protect policyholders' interests (see ICP 2.8). The IA is apprised of this risk and would expect to use its intervention powers to protect policyholders in case of a stay. These powers were extended in the revised IO and the IA can, amongst other measures, impose restrictions on new business or on investments (section 27 and 28 of the IO). It can also, where the conditions in the IO are met, issue directions or appoint an advisor or manager (section 35). It can impose administrative penalties[18] for any "misconduct" (widely defined to cover infringements of IO requirements) (section 41P).

42. In summary, it is recommended that the IA:

- complete the development and documentation of regulatory processes and internal procedures with a particular emphasis on finalizing enforcement processes and developing a new supervisory framework; and
- review its organization and resourcing with a view to the establishment of new functions such as internal audit; strengthening capacities for risk assessment and supervisory response; and

[18] The maximum amount of a financial penalty is the greater of HKD10 million and three times the profit gained (or loss avoided) by the insurer as a result of the misconduct.

reviewing, following the IA's assumption of full responsibilities, whether overall skills and resources are adequate to (and appropriately allocated for) the growing demands of insurance supervision.

C. The Development of Regulation

43. Extensive regulatory changes have been introduced since the 2014 FSAP. Key drivers have been responding to concerns about products (in particular over product design and selling practices in ILAS business – mainly conduct requirements, as discussed in Findings Section E of this note); the need to fill gaps in the regulatory framework, as identified in the 2014 FSAP (a key development has been the strengthening of corporate governance requirements); and the need to revise, update and reissue regulations in response to the enactment of the revised IO in 2015, the IA's taking over of the functions of the then Office of the Commissioner of Insurance to regulate insurance companies in June 2017 and its assumption of responsibility for intermediaries supervision in September 2019. Reform of capital requirements remains the major outstanding issue.

44. Most of the requirements have been issued in the form of guidelines and codes. The IA is empowered under section 129 of the IO to issue rules covering a wide range of issues, but it often prefers to issue guidelines or codes under section 133. These can be applied flexibly to insurers and can readily be amended and updated (although not required to do so, the IA consults on draft guidelines and codes as well as rules). The IA's RBC requirements will, however, be framed as rules.

45. It will be important for the IA to be seen to be enforcing codes and guidelines and to make more use of rule-making powers, if necessary. Although not directly enforceable in the same way as rules, codes and guidelines are admissible (under section 133 (5) of the IO) as evidence in proceedings under the IO before a court, which will take into account non-compliance with a code or guideline. The IA similarly makes clear that non-compliance may affect its view of the continued fitness and properness of directors, controllers etc. and whether an insurer's (or an intermediary's) act or omission is likely to be prejudicial to policyholders' interests.[19] Enforceability has not as yet been challenged. Active and visible enforcement by the IA should support good compliance, but the IA should also be ready to switch to rule-making powers, if compliance is not the outcome in practice.

46. The IA adopts a mainly principles-based approach. The IA sets out many of its requirements (including for market conduct) as principles, enabling insurers to comply in their own way. Again, this affords flexibility and responsiveness to market changes, while reducing compliance burdens. The need for more detailed requirements should nonetheless be kept under review, for example in the case of intermediaries requirements, as the IA's experience develops.

[19] Their status, and related provisions of the IO, is now helpfully explained at the start of new guidelines and codes.

47. The most significant regulatory changes since 2014 have been:

- The upgrading of corporate governance requirements in the IA's guideline on governance (GL10)[20] taking effect in full at the start of 2018. For example (see also the Annex under ICP 10):

    i. Insurers have been required to have an increased minimum number of independent non-executive directors and directors with insurance expertise and experience; and they must establish Audit and Risk Committees of the Board with majority non-executive director membership.

    ii. Responsibilities of the Board are defined to include such matters as setting risk appetite and strategy, providing for appropriate risk management and internal control systems and setting remuneration policy to address potential conflicts of interest.

  There remains a need to establish full requirements to apply at insurance group level.

- Major enhancement of requirements on risk management. Under GL10, insurers are required to have comprehensive risk management policies covering all types of risk, risk management and internal controls systems; and (under section 13AE of the IO) to have control functions for risk management, underwriting, internal audit, actuarial and compliance. Insurers must appoint an individual as a key person for each function, as envisaged by the ICP. Guideline 21 on Enterprise Risk Management (ERM), issued in July 2019 but not effective until the start of 2020, further extends the IA's risk management requirements in the context of solvency. Again, there remains a need to establish full requirements to apply at insurance group level.

- Significant development of the regulation of persons: building on changes to the IO which extended an existing requirement on prior IA approval to cover (as well as controllers) directors, key persons in control functions, and Appointed Actuaries; the IA has issued guidance (Guideline 4) on its expectations in relation to fit and proper requirements. The IO empowers the IA to revoke the appointment of senior management and key persons on fit and proper grounds.

- Strengthening the regulation of insurers' use of reinsurance, building on section 8(3)(c) of the IO requiring that insurers have adequate reinsurance arrangements. The IA's guideline on reinsurance[21] sets out detailed requirements, including the establishment of a reinsurance management framework. No minimum retention levels are set, in line with the principles-based approach, but "fronting" is banned as a condition of authorization (Guideline 1). Guidance on reinsurance arrangements with a company in the same group is set out in the IA's Guideline 12 (the related reinsurer must have a high credit rating).

- Changes to the regulation of anti-money laundering ahead of a Financial Action Task Force (FATF) review in late 2018. As well as legislative changes, IA amended its Guideline 3 on money

[20] The Guideline on Corporate Governance of Authorized Insurers, issued under section 133 of the IO (latest version June 2017).

[21] Guideline on Reinsurance, GL17 (latest version June 2017).

laundering, for example to clarify the circumstances in which an insurer may rely on the customer due diligence of foreign financial institutions.

Risk-based Capital Requirements

48. The IA began working on the modernization of its capital requirements in 2014, after the FSAP, and aims to implement RBC from 2022. After consulting on the general approach, the IA began data collection and testing of its requirements in 2017. A third Quantitative Impact Study (QIS 3) was underway at the time of the FSAP work in the HKSAR. A final consultation on the proposed requirements is scheduled for 2020, legislative changes (the repeal of existing regulations and enactment of new rules) for 2021 and implementation, with any transitional arrangements, from 2022. (The "Pillar 2" requirements – including for an ORSA - will take effect in 2021.[22]) The approach has been highly consultative, which has led to agreement on key aspects. Industry Focus Groups (with HKFI and ASHK representatives) have worked with the IA on the development of the requirements. The IA's policy function has been supported by consultants.

49. Existing requirements are inadequate for the complexity of the Hong Kong market.

- Current solvency rules are derived from the European Union's Solvency I framework, calibrated to local conditions with differences such as the absence of limits on particular types of investment (Europe moved to the risk-based Solvency II in 2016, albeit that significant transitional arrangements were needed and made available to insurers in some countries).
- As noted in the 2014 FSAP report, the requirements do not provide for a consistent, economic approach to valuation of assets and liabilities, although there are elements of conservatism.
- A major limitation of the capital requirements, which are based on a percentage of liabilities and amounts at risk, is asset risk – i.e., required capital is not sensitive to investment portfolios' mix of government versus private risk, bonds versus equities etc. For general business, however, the asset risk is currently addressed under Insurance (General Business) (Valuation) Rules.

50. The IA seeks to mitigate the resulting risks through close supervision and particularly stress-testing. As mentioned, the IA holds insurers to higher than minimum requirements, intervening at 200 percent of the minimum for general insurers and 150 percent for long term insurers to require insurers to take action. It uses stress-testing, in particular (for long-term insurers) the annual Dynamic Solvency Testing exercise (DST). Insurers are required to analyze the impact on solvency over a three-year period of different adverse scenarios. Again, the IA requires insurers with weak results to take appropriate actions in addition to or instead of management actions already proposed. General insurers are subject to ad hoc stress tests, and regular testing of prescribed scenarios will be required of them under the ORSA arrangements. The IA thereby assures itself of the overall financial strength of insurers, but the approach does little to incentivize sound risk

[22] The IA's Guideline (GL21) takes effect at the start of 2020, but only by mid-2021 will ORSA submissions be made to the IA by insurers.

management and does not capture all risks (including operational risk) or reflect the insurer's own assessment of risk. The requirements apply only at the individual insurer level.

51. The timing of the IA's work, although lagging behind other developed insurance markets, has made it possible to learn from others and to reflect developing IAIS standards. Many other jurisdictions have already implemented risk-based capital, including Mainland China. The IA has been able to take account of these and of the IAIS's Insurance Capital Standard (ICS), a first version of which was finalized in late 2019, but which will not be implemented until after a 2020 to 2024 period in which results will only be monitored. In particular, the IA has adopted the ICS market-adjusted approach to valuation of long-term liabilities (MAV). Close alignment to these standards is particularly important for the HKSAR as a highly international market subject to equivalency testing by other jurisdictions.

52. RBC seems likely, in its current form, to meet most of the ICP requirements on solvency and related issues (ICPs 14, 15, 16, 17 and 20). Although a full assessment was not undertaken, the plans include:

- valuation requirements that take a broadly economic approach, with valuation of investments at market prices and valuation of liabilities using discount rates that while not fully risk-free, do eliminate credit risk and require a margin over current estimate (MOCE) as well as recognition of discretionary benefits and the time value of options and guarantees:[23]

- requirements on investments that broadly follow the "prudent person principle" (a continuation of the current approach, with no limits on types of investment);

- comprehensive coverage of risks in the capital requirements, including a requirement to quantify operational risk and a requirement on general insurers in respect of natural catastrophe risks, with two solvency control levels (MCR and PCR); overall calibration is 99.5 percent Value-at-Risk (VaR) over a one-year period; there will be a Pillar 2 framework requiring insurers to prepare ORSAs (many insurers will have access to parent group methodologies, although ORSA may be challenging for some smaller insurers) and the IA will require additional capital, if necessary; and

- reporting and disclosure requirements (Pillar 3 - probably for publication in insurers' annual financial statements), although the detailed requirements are only now being developed. The IA is planning to require key RBC reports to be made with an accompanying auditor's opinion.

53. There has been a particular focus on requirements on the discount rate to be used for valuation of long-term liabilities. While not going as far as to allow insurers simply to use rates derived from their own investment portfolios, with provision for reinvestment risk, the IA is allowing insurers (for the latest testing exercise):

[23] RBC sets its own valuation requirements which will differ from those of IFRS 17 (Insurance contracts) to be implemented at around the same time. The IA will need to consider at some stage whether there are any implications of having different published measures of financial strength from 2022.

- to apply a matching adjustment (MA) to the risk-free rate when valuing all types of liability based on insurers' actual rather than standard portfolios (the calculation is complex, but broadly where the adjustment is higher (and so the liability recognized lower), the matching of its asset and liability duration and cashflows is higher; the approach therefore aims to incentivize sound asset and liability management; and

- to make a further "long-term adjustment" (LTA) of a fixed 100 basis points to the rate used in the MA calculation for segregated portfolios of participating and universal life policy (adjusted by the proportion of equity and property assets in the MA portfolios and subject to a cap based on the share in total liability cashflows of those over 30 years); the aim is to recognize the benefits where insurers with long-term liabilities, as are typical for Hong Kong insurers, invest in long-term assets, even where risk is higher (that risk will be reflected in higher capital charges).

54. The MA has contributed to more companies meeting the new capital requirements in the latest testing. While QIS 3 results were not yet available at the time of the FSAP, it is likely that more insurers will be able to meet the RBC requirements with the MA as now specified (together with other changes) than in previous tests.[24] Some companies will nonetheless struggle to meet the requirements as currently calibrated, and the IA is closely monitoring the compliance plans of companies that face the greatest challenges.

55. The revised MA also has some challenges for the IA. It moves the valuation requirements further from a pure market consistent approach (although other countries have moved similarly). It makes reference to the ICS "Middle Bucket" approach as currently specified, which aims to reflect the illiquidity premium of the assets, but differs from the MAV approach in ICS in being more aligned with insurers' actual portfolios. There is a risk too in the LTA that insurers will respond to the incentive to hold equity and property assets to excess, notwithstanding limits within the requirements and the higher capital required for these assets. It will be important for the IA to monitor these effects closely to avoid unintended consequences. The IA has already committed to reviewing the RBC regime in light of developments in the ICS.

56. Unlike in other countries (and the international standards), there will be no internal model option. There is demand for models, not least as some European groups represented in the HKSAR use them for group Solvency II purposes. The IA's approach recognizes the lack of sufficient technical expertise in Hong Kong and the need to avoid strain on resources of the IA and the industry. (Reliance on catastrophe models is, however, to be allowed in quantifying the natural catastrophe risk for general insurance risk.) The groups subject to the IA's groupwide supervision will be required to develop a Group Internal Economic Capital Assessment (GIECA) in a Pillar 2 context, recognizing modelling techniques without going as far as a full Pillar 1 internal model. As the debate over the design of the MA is driven in part by the insurers' desire to align requirements more closely to their individual asset and liability management, it will be appropriate for the IA to develop a plan for its long-term approach to models in Pillar 1.

[24] QIS3 results will also benefit from higher risk free rate as at year end 2018 compared to 2017, although rates have fallen in 2019.

GWS – Regulatory Elements

57. GWS involves a major overhaul of the IA's approach to groups, requiring changes to regulation and supervision. The much-increased significance of the three major domestic groups (two of which are Internationally Active Insurance Groups (IAIGs), as defined by the IAIS, in the HKSAR) has added urgency to the long-standing need to strengthen GWS. The IA has long focused on groups as well as individual insurers, but has done so with limited tools (analysis of group financial statements, for example, assessing fitness and properness of the holding company as shareholder controller and supervisory discussions with group management). It has not applied regulatory requirements at group level. As with RBC, the timing of the development of the IA's GWS allows it to take account of the IAIS common framework for groups (known as "ComFrame") which in addition to ICS, incudes a tailored supervisory approach to IAIGs.

58. The planned GWS framework, now at an advanced stage of development, includes application of solvency, governance and risk management standards to groups at holding company level. Key elements are:

- Legislative changes, which will implement a direct approach to group supervision through requirements placed on holding companies. They will provide for the designation of insurance holding companies; approval of their shareholder controllers, directors etc.; powers to set group capital requirements; intervention, disciplinary, inspection and investigation powers; and provisions on winding-up of designated insurance holding companies. Draft legislation to amend the IO is expected to be introduced into the HKSAR's Legislative Council in early 2020.

- Group regulatory capital requirements (to be set out in rules and guidelines issued under the IO) will mirror RBC in setting two solvency control levels, but with the group available and required capital both calculated using an aggregation method with adjustments. The IA will be relying, in respect of the significant non-HKSAR elements of these groups, on the local supervisor's capital requirements, with provision for "supervisory adjustments" by the IA to address any limitations of local requirements, limits on capital transferability etc. Capital add-ons may be applied.

- Risk management and governance requirements (to be set out in guidelines) focusing on what is required at holding company/group level, including group control functions.

- Requirements (again issued as guidelines under the IO) for insurance groups to develop ORSAs and a GIECA to analyze the overall risk position, including risks associated with intra-group transactions and exposures, and calculate required capital, calibrated at a 99.5% VaR over one year or equivalent.

- Requirements to develop recovery plans, within the context of their ORSAs.

59. As with RBC, the new framework seems likely to satisfy most current ICP requirements.[25] It is a comprehensive framework that draws on practices in other countries.

- The choice of an aggregation approach to solvency is pragmatic and simple to implement, although the supervisory information content of the results of an aggregation methodology are likely to be limited. While GIECA discussions are likely to be the main supervisory focus (and a major supervisory challenge), it will be helpful to elaborate further on how supervisory adjustments will be made in practice.

- The approach to inclusion of non-regulated companies (using accounting capital but zero capital requirements, regardless of actual risks) should also be reviewed. (Groups will, however, be required to undertake an assessment of the risks posed by non-regulated entities as part of their GIECA and ORSA assessments, and determine if additional capital resources are required.)

- Reporting to the IA needs careful attention; and in relation to disclosure, while there will be group disclosure requirements, they will exclude group PCR numbers, at least initially – this should be reconsidered as the group PCR is the key measure of financial strength.

60. The timetable for GWS is ambitious, but manageable. Implementation will be from mid-2020, assuming legislation is passed, although elements of GWS could and should proceed under existing IA powers, if necessary. Groups are preparing for RBC and IFRS 17 at the same time as GWS, even if they are not due until 2022. However, the two domestic groups with greater international exposure are familiar with the implementation challenges of the IA's GWS framework.

Crisis Management – Regulatory Changes

61. There have also been changes in the arrangements affecting insurer failure, to strengthen the position of long-term policyholders. The amended IO has strengthened the requirements on segregation of assets backing long-term liabilities to policyholders, by requiring separate funds ("section 22 funds") for each class of business, while under section 45(2) the assets in a long term business fund are made available, in case of a winding up of an insurer, only for meeting the liabilities attributable to the business to which the fund relates (see Annex, under ICP 12). However, these arrangements continue to differ from those applying to general insurers, where policyholders with outstanding claims on an insolvent insurer (other than for premium refund) have an explicit preferential status relative to ordinary creditors.[26]

62. Consideration is being given to further strengthening of long-term policyholders' position in the context of work on the planned PPS. It was noted in the FSAP discussions that in other countries, assets backing long-term policyholder liabilities are often subject to requirements on insurers to maintain dedicated asset registers, to hold assets in trust or with a specified custodian

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[25] Likely observance of IAIS ComFrame requirements was not reviewed in detail. The IA is already analyzing the latest draft for potential gaps, which are likely to be matters of detail.

[26] Under section 265(1)(e) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO).

etc., the objective being to ensure access for liquidators immediately in the event of insolvency. Work being led by the IA is considering these and other approaches. The planned introduction of the PPS is an opportunity to make further changes to the IO. The PPS itself will also clearly provide a welcome enhancement of policyholder protection. As noted above, once implemented, it will pay up to HKD 1 million per policy, claim or insured event in case of insurer insolvency.[27] After extended discussions, reflecting the complexity of some of the coverage issues, it should go live in 2021.

63. In addition, the former G-SIIs are now subject to the provisions of FIRO. The IA, as the FIRO resolution authority (and lead resolution authority for insurers in cross-sectoral groups), has powers to prepare relevant insurers for resolution (through resolvability assessments etc.) and to apply "stabilisation options" in case a G-SII ceases to be viable and other "conjunctive conditions" set out in FIRO are met.[28] It may, for example, establish a bridge institution to transfer business from the insurer or apply a bail-in instrument. It can also suspend certain obligations of a G-SII and restrict the commencement of ordinary winding-up petition against the G-SII. Some of these powers are available to the IA in respect of insurers not subject to FIRO under the revised IO.

64. All insurers will soon be required to prepare recovery plans. The IA's Guideline 21 on ERM, taking effect in 2020, will require them to carry out contingency planning and, in the context of their ORSA preparation, to develop a recovery plan for managing severe adverse situations. The plan has to include, amongst much else, an assessment on the timeliness and credibility of recovery options in both going and gone concern situations. ORSAs are deliverable to the IA in mid-2021, although some larger insurers have already prepared and discussed with IA their early versions.

Recommendations

65. It is recommended that the authorities proceed with implementation of GWS and RBC as planned, building on the consensus achieved and minimizing risk of delay, and that the IA:

- implement the RBC requirements without significant transitional arrangements, recognizing that calibration has already been adjusted to meet local market conditions; and keep the calibration under review in the light of experience and the development of ICS in order to maintain alignment with international norms;
- consider strengthening of insurers' investment requirements or enhanced supervision of how investment portfolios develop in practice in case of insurers taking on significantly increased risk; and develop a policy and plan for a long-term approach to internal models; and
- implement the GWS framework as planned, taking into account the observations in this note,

[27] Existing compensation arrangements for motor and employee compensation insurance will continue to apply.

[28] The three conditions are (i) that the institution has ceased, or is likely to cease, to be viable; (ii) that there is no reasonable prospect that private sector action (outside of resolution) would result in it again becoming viable within a reasonable period; and (iii) that the non-viability of the institution poses risks to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions; and resolution will avoid or mitigate those risks.

including on the approach to non-regulated entities and the disclosure of group PCR.

In addition, on other issues, it is recommended that the IA keep under review the possible need to issue further guidance to insurers on their expectations with regard to new requirements, particularly in relation to ORSA and to recovery planning; and continue to work for appropriate enhanced policyholder protection for long-term policyholders.

D. Supervision (Including Recovery and Resolution Planning)

66. The IA's approach to insurer supervision has been inherited from the previous regulator and reflects differences between long-term and general insurance.

- The long-term sector comprises fewer companies, is highly concentrated and includes the three major domestic groups.
- In general insurance, there are more companies, concentration is lower, more insurers are branches (because the reinsurers generally take this form), but there are several smaller domestic companies, albeit accounting for low market share.
- There are also differences in regulation (for example, DST and appointed actuaries being required for long-term insurance only and reinsurers being exempt from various requirements).

These differences have contributed to supervision developing in somewhat distinct directions, although with common ground. The approach to long-term insurers is focused on the major companies, with a binary system of company classification (normal and enhanced supervision) and a significant role for the IA in supervisory colleges. In general insurance, risk assessment is appropriately more granular and thematic initiatives more important. Box 2 sets out details of the approaches.

67. A key issue in the FSAP discussions was the scope to develop more commonality in the supervisory approach to long-term and general insurance. As recommended in Findings Section B, a general framework for the IA should be considered, accepting there will still be differences in the approaches for each sector, reflecting the differences between the sectors themselves. Having a single approach would support the development of the IA's capacity to monitor and manage risks across its responsibilities, equipping its senior management and the Board to allocate resources to the companies, sectors and issues posing the greatest risk to fulfilment of its objectives.

Box 2. Hong Kong SAR: The IA's Approach to Supervision

Long-term insurers

- A risk assessment methodology classifies insurers as High, Medium High or Low, although in practice the supervisory stance divides into two, normal and enhanced supervision. Factors taken into account include market share, complexity of organization/group, compliance with IA Guidelines, initial indications of RBC's impact, complaints history and, for foreign insurers, the impact of the parent company's influence.
- A supervisory plan is developed for each insurer and an inspection plan for the sector, which are reviewed regularly, including at bi-weekly divisional management meetings and all-staff meetings every two months.
- Supervisory work in the course of the year is driven by size and supervisory stance and for larger companies includes meetings with senior management every two months and an inspection (all insurers are subject to inspection once in three years at minimum).
- Inspections are typically scheduled for one to two days but take up to five days including follow-up.
- Work may be required of control functions, particularly internal audit.
- Where relevant, the supervisory college is increasingly used to develop a groupwide view of risk to inform the IA's supervisory work.
- DST must be undertaken annually based on scenarios set out in the ASHK's Actuarial Guidance Note 7 and detailed results reported to the IA. Quarterly and ad hoc stress tests are also required according to risks.
- Thematic work is being undertaken more, including a planned project on the issues in premium financing.

General insurers

- A risk assessment checklist is used to rate insurers High, Medium High, Medium Low or Low, taking into account factors such as solvency, business risk, corporate governance, impact and reliance on parent. High risk companies are subject to at least monthly review, Medium High three months etc.
- In parallel, companies are subject to a company review, which aims to build on the risk assessment with a more forward-looking approach (so more emphasis on business model, potential RBC impact and ORSA results etc.) Reviews are presented by supervisors to all staff meetings and annually for the whole sector.
- Supervisory plans are prepared for each insurer, driven increasingly by the company review.
- After a period during the creation of IA when inspections were rarely undertaken, they were to cover around 60 percent of companies in 2019, not including thematic work. They typically involve four staff and take one to two days, using a standard agenda covering core issues such as claims reserving, reinsurance etc.
- Stress tests are undertaken on a regular and ad hoc basis, for example in response to events such as worsening US-China trade tensions.
- Thematic work is increasingly undertaken, for example an investigation of the issues in loss-making sectors (motor and employee compensation) that looked in detail at company performance.
- As for long-term insurance, customer complaints are a major driver of market conduct supervisory work.

68. Such a common approach could include:

- a single overall supervisory framework (at least for insurers), using international standard risk assessment and risk mitigation tools and terminology, tailored to the needs of the IA;
- a (not too complex) risk assessment methodology that works for both long-term and general insurers, creating a common "risk language" for use across the IA;
- integration of market conduct issues and of RBC and ORSA/Pillar 2 capital assessments, which will greatly add to the IA's capacity not just to monitor financial soundness but to identify and assess risk;

- a common set of supervisory tools, including common expectations on inspections, and processes for initiating and carrying out thematic work, making referrals to enforcement etc.;
- process and documentation standards and, as mentioned in Findings Section B above, a role for a risk function in assessing implementation;
- senior management leadership on overall supervisory style and stance, and creation and monitoring of a supervisory risk appetite for the IA; and
- arrangements for supervisory decision-taking – with the aim of ensuring that judgement-based decisions on, for example, risk assessment grades and supervisory plans, are well-founded in supervisory work and as consistent as possible across different companies.

69. Whether a single framework is adopted or not, there is scope to develop the current approaches in a number of areas:

- the extent and depth of individual company reviews: the FSAP's limited review of documentation suggested that there is scope to carry out fuller regular analyses of (especially larger) companies: the approach taken to company reviews in general insurance and to preparation for group senior management meetings in long-term insurance seem good starting points but need to be extended and adopted generally;
- formalizing the risk assessment methodologies – if separate approaches are to be retained, they could be more fully developed and documented (for example, in long-term insurance, using the approach taken in supervisory colleges, as planned, and in general insurance by integrating the checklist and company review processes, again as planned); and
- reviewing the length and depth of inspections: these are relatively short at present, requiring supervisors to focus on key issues but not making time for really in-depth analysis of business lines, control functions or even particular processes, where necessary: the scope to do more here is closely tied to the need to review resourcing, including the availability of specialist expertise.

70. There is also a need to finalize the supervisory approach to the three major domestic groups, implementing GWS in practice. As discussed in Findings Section D, there will be new demands on supervisors not just to monitor group level reporting and compliance but also to review and respond to group GIECA submissions, recovery and resolution plans etc. As also noted, there are plans to increase staff resources to meet the demands of GWS, though the adequacy of resources needs to be kept under review. GWS needs, of course, to supplement and not duplicate individual company supervision.

71. Cross-border supervision is well-developed, as appropriate for a major international jurisdiction.

- The IA is a member of 16 colleges in total, although a participant in conference calls only in some cases where the risk in HKSAR is low in relation to the group.

- It leads the supervisory colleges for the three major groups (starting from 2016, 2018 and October 2019 respectively) and chairs the Crisis Management Group (CMG) for the G-SII.

- Sample documentation reviewed during the FSAP highlights a well-planned approach with an increasing focus on joint risk assessment and coordination of supervisory actions with host supervisors in addition to exchange of information.

- The IA has also taken the initiative with the global groupwide supervisor of one European insurance group to establish (and co-chair with the groupwide supervisor) a regional college of mainly general insurance supervisors. This also appears to be contributing to effective cross-border supervision.

72. Cross-sector cooperation (with other HKSAR supervisors) is also strong.

- The IA holds regular discussions with the HKMA in relation to insurers which are associated with banks: there are certain cross-sectoral financial groups that include both insurance companies and banks, although some are small and many are parts of larger global operations with a lead regulator in the home country. The IA and HKMA exchange information on companies in the same group. They also cooperate closely on the supervision of banks as insurance intermediaries (see Findings Section E). They are starting to undertake joint thematic work, with the initiative on premium financing, as mentioned.

- The IA also liaises closely with the SFC in respect of their shared role in the approval and regulation of ILAS products and more generally in relation to their observations on market practices and in the case of insurers that are parts of groups with securities companies in relation to the IA's role as lead resolution authority under FIRO. As with the HKMA, more joint supervisory work is planned.

73. The IA also participates in the formal arrangements for cross-sector cooperation. It is an active member and takes cases and analysis of the insurance sector to the CFR and the FSC.

74. The IA is focusing more on crisis preparedness, including recovery and resolution planning, in its supervisory work. It will be examining the insurers' ORSA submissions from mid-2021 and these will include recovery plans, as mentioned. In relation to resolution work, to date the IA has been involved only as a host supervisor of G-SIIs, where international work on resolution planning has focused. It is now groupwide supervisor for the demerged Asian and US operations of one (former) G-SII. As a long-standing member of the CMG for that group, it is well-placed to start work on resolution planning for the reshaped group.

75. The IA should keep under review the systemic importance of all insurers and the corresponding need for wider resolution planning. Only G-SIIs are currently treated as systemic, and within the scope of FIRO (see Findings Section D of this note). However, for some G-SIIs, their Hong Kong operations are relatively limited. By contrast, two of the three major domestic groups are not G-SIIs and so not subject to FIRO and the additional powers it gives to the IA, including for resolution planning.

76. The IA should seek cooperation from the major groups for resolution planning on a voluntary basis. There is a provision in FIRO for the Financial Secretary to designate insurers other than G-SIIs as within scope financial institutions. However, at present, the IA reasonably takes the view that Hong Kong insurers lack critical financial functions, because other insurers could substitute readily in case of a failure, while there is limited interconnectedness with other parts of the financial sector. It will nonetheless be important to keep under review whether, in the Hong Kong context or internationally (given that these groups have extensive foreign operations), any more individual insurers should be brought within the scope of FIRO, for example because of rapid growth, and made subject to full resolution planning, even if this seems uncalled for at present. Working with the two major groups which are not (former) G-SIIs on a voluntary basis, as is being considered already, will help the IA prepare for future developments and ensure equal treatment for the groups subject to GWS.

77. The IA already assesses insurers for systemic significance and will need an increased focus on system-wide risks. It collects relevant data, for its own purposes and for IAIS work. The IAIS's approach to evaluation of systemic risk in insurance is expected to change soon, however, from a focus on insurance companies to an emphasis on products and markets, shared exposures across insurers (including to asset classes) and common threats etc. There will be extensive data collection from member supervisors. The IA will need to develop its approach in response, helping it to enhance the assessment of environmental and financial stability risks, as recommended in this note.

78. In summary, it is recommended that the IA:

- further develop current supervisory processes to enhance individual company reviews, risk assessment methodologies and its approach to inspections, while also considering the benefits of developing a new single overall supervisory framework covering all insurers;
- maintain its focus on crisis preparedness, requiring high quality recovery planning by all insurers, while giving priority to recovery and resolution planning for the major domestic groups; and
- keep under review its assessment of systemic risk in individual insurers (and potential FIRO designation) at the same time as developing its approach to identification and response to wider cross-sector systemic issues.

E. Insurance Conduct of Business and Intermediary Regulation

79. Hong Kong has moved from extensive self-regulation of insurance market conduct and intermediaries to a statutory approach. Agents and brokers had until recently been subject to oversight by self-regulatory organizations, while HKFI had issued guidance for insurers and intermediaries on such matters as financial needs analysis, benefit illustrations and point of sale disclosures. The insurance regulator had a role only in approving requirements such as the code of practice for agents and exercising some indirect oversight of agents via insurer supervision.[29] The insurance intermediation activities of banks were (and remain) subject to the HKMA's comprehensive oversight of banks' activities under the Banking Ordinance. Consistent with their general approach to consumer protection in relation to sale of financial products by banks, the HKMA also issues requirements on selling practices for insurance products that apply only to banks.

80. The key steps in the move to statutory regulation since 2014 have been:

- the amendment of the IO in 2015 to give the IA an explicit market conduct objective, effective from June 2017, for insurers and intermediaries (section 4A 2 (c) and (d) of the IO); the IO also sets out high level conduct requirements applicable to insurers and intermediaries; the IA's intervention and sanctioning powers, including to impose administrative financial penalties, apply to insurers and intermediaries, including persons;

- the development of extensive conduct guidance by both the previous regulator and the IA, elaborating (in line with its principles-based approach) how it expects insurers to treat customers fairly in practice; requirements have been developed for particular products (ILAS, other life insurance products and the new Qualifying Deferred Annuity Policy) and reflect, notably in the case of ILAS, identified shortcomings in market practices; there are no specific product-based requirements applicable to general insurance; at the same time, the IA has been developing its supervisory activities in relation to insurer conduct;

- the transfer to the IA from September 2019 of responsibilities for licensing and regulating all insurance agents and brokers (the previous organizations remain, but no longer have any regulatory responsibilities) and for approving responsible officers of licensed insurance agencies and licensed insurance broker companies; however, existing agents, brokers and responsible officers were not required to apply immediately for new licenses under the IO (they have three years to do so) and some requirements are deferred, including payment of fees to the IA, or subject to transitional arrangements, including agent and broker education and professional qualifications, which have been subject to significant upgrading by the IA, and broker capital requirements; the IA has also assumed responsibilities for dealing with complaints against insurance intermediaries; and

- the issuance by the IA of new codes and guidelines revising, updating and replacing the detailed guidance of the HKFI and self-regulatory organizations in relation to insurer and intermediary conduct.

Box 3 sets out key elements of the regulatory framework effective as at 23 September 2019.

[29] Brokers could in principle seek authorization from the insurance regulatory body, although few, if any, did so.

Box 3. Hong Kong SAR: Key Insurance Conduct and Intermediary Regulatory Requirements

Issued by the IA as regulator of insurance companies only (before 23 September 2019):

- Guidance Note on Underwriting Class C Business (GL15) – covering ILAS requirements
- Guidance Note on Underwriting Long Term Insurance Business (other than Class C Business) (GL16)
- Guideline on Qualifying Deferred Annuity Policy (GL19)

Issued in advance of IA assuming responsibility for intermediary supervision, 23 September 2019:

- Insurance (Maximum Number of Authorized Insurers) Rules
- Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules
- Code of Conduct for Licensed Insurance Agents
- Code of Conduct for Licensed Insurance Brokers
- Guideline on Exercising Power to Impose Pecuniary Penalty in Respect of Regulated Persons under the Insurance Ordinance (GL22)
- Guideline on the "Fit and Proper" Criteria for Licensed Insurance Intermediaries under the Insurance Ordinance (GL23)
- Guideline on the Continuing Professional Development for Licensed Insurance Intermediaries (GL24)
- Guideline on Offering of Gifts (GL25)
- Guideline on Sale of Investment Linked Assurance Scheme ("ILAS") Products (GL26)
- Guideline on Long Term Insurance Policy Replacement (GL27)
- Guideline on Benefit Illustrations for Long Term Insurance Policies (GL28)
- Guideline on Cooling-off Period (GL29)
- Guideline on Financial Needs Analysis (GL30)

81. In respect to insurers, the new requirements on products have had a significant impact, contributing to the decline in ILAS sales in recent years. The IA's Guidelines GL15 and GL16, the original versions of which took effect in full in January 2015 and January 2017 respectively, have set out detailed requirements on product design, provision of adequate and clear information, suitability assessment, advice to the client, appropriate remuneration structure, avoidance of conflict of interests, proper selling process and post-sale controls. Notable features include:

- requirements to undertake financial needs analysis on all but simple products before a decision is made on which product is suitable for the customer (a detailed framework is now set out in IA's GL 30, which is based on previous HKFI work); conducting financial needs analysis is just the start of a detailed process that has to be followed ahead of (and after) a sale. It contains more safeguards in the case of ILAS products, reflecting the higher investment risks for policyholders compared with other products;

- requirements to present benefit illustrations: separate approaches have been developed for ILAS, participating, universal life and non-participating policies, including certain assumed rates of return in the case of ILAS policies that must be used to demonstrate the impact of fees and charges on the amount that the investor may receive. The requirements are supported by detailed work prepared by the ASHK, to which insurers must also have regard (their Actuarial Guidance Notes 5 and 9);

- requirements to prepare and publish fulfilment ratios – data showing the extent to which non-guaranteed dividends/bonuses for participating products actually declared (and crediting interest rates for universal life products) have varied from the illustrated amounts at the point of sale; guidance sets out a uniform methodology to calculate and disclose these ratios, which must be posted in detail on insurers' websites; the objective is better to inform customers and their advisers on the performance of products and providers; it was not clear yet (at the time of the FSAP) how far this innovative approach is having results;

- further relatively prescriptive requirements in relation to ILAS products - for a minimum level of insurance cover (minimum death benefit of at least 105 percent of account value) and on remuneration payable to intermediaries (a ban on indemnity commission and a requirement for commission to be spread over a number of years – the IA sees five years as acceptable) in addition to detailed guidelines on calculating and disclosing the intermediaries' remuneration to customers to highlight potential conflicts of interest. It is these provisions in particular which have accentuated a decline in new sales of ILAS products, although volatile investment markets have also had an impact.

82. In relation to intermediaries, the IA's priority has been readiness for its new responsibilities, while it continues to develop its long-run approach to supervision. It proposes to adopt a risk-based approach, including on-site inspection, both for agencies and for brokers, taking into account the nature and complexity of the potential conduct issues. It will also use industry surveys and self-assessments. In its off-site monitoring, it will review annual returns, auditors' reports, the trend of complaints and self-reported incidences of non-compliance.

83. Given the burden of processing license applications, the IA's supervisory approach will take time to develop. It also faces a significant workload from complaints and disciplinary cases unresolved by the previous regulators, which it has to address with reference to the previous codes, guidance notes etc. at the same time as seeking to enforce the new statutory requirements. The total population of licensees was expected to exceed 110,000 individuals and 3,000 companies.

84. Key issues covered in the FSAP discussions were:

- The importance of the IA being seen to be an effective statutory regulator, while also being open and transparent with the new population of licensees: the IA is well-apprised of this and has an active program of engagement with agents and brokers as well as resources in its Market Conduct Division to deliver an extensive work program (as for other aspects of the IA's work, adequacy of resources needs careful monitoring). As mentioned, it has extensive powers, including financial penalties, although it lacks powers to force insurers or intermediaries to compensate mistreated customers (restitution).

- The scope for the IA to develop its approach to conduct supervision alongside the general development of its supervisory approach, as recommended in Section D above. Conduct risks have been shown to be significant in the HK market, with recent cases relating to ILAS and motor insurance amongst others. The IA is likely to face continuing instances of customer mistreatment, not least because of the prevalence of commission-based distribution. The IA should therefore consider, in the medium term:

i. supplementing or replacing its reliance on consumer complaints with more forward-looking indicators of conduct risk: complaints to the IA have triggered investigations of significant misconduct, leading also to rectification of weaknesses in relevant controls. However, they are backward-looking indicators. The IA is already focusing on governance and controls over conduct risk and could develop its approach further in this area;

ii. developing richer data sources and regulatory reporting: assessing and responding to conduct risks on a forward-looking basis should be supported by conduct-specific data, such as information on the numbers and types of products sold (not just values), the nature of customers etc. Good market intelligence is clearly important too;

iii. in the longer run, a separate risk assessment framework for conduct risks – although in the short term, integration of financial and conduct risk assessment is the priority, as discussed;

iv. addressing market structure issues and barriers to competition (in line with its broad statutory objectives), as appropriate where regulatory action on its own appears insufficient.

- The framework of conduct requirements appears comprehensive and the focus should now be on implementation; as noted, the requirements attaching to ILAS products are more extensive than for others and the IA could consider greater consistency in requirements, for example in remuneration and remuneration disclosure provisions and in the requirements on illustrations (requiring assumed rates or maximum projected rates for all products) both across products and across requirements for insurers and those applying to intermediaries, where applicable; the approach to intermediary remuneration should be reviewed to ensure adequate disclosure to customers in line with ICP 18.5.

- A possible increased role for independent alternative disputes resolution: the IA devotes significant (and unpredictable) amounts of resources to handling individual customer complaints (around 1,100 in 2018); while these have information content for supervisors, its value can be disproportionate to the efforts required to process the complaints, while complainants may be frustrated by the lack of binding settlement. In the longer run, transferring complaints as far as possible to an independent body would help support a more forward-looking supervisory approach. The current landscape on complaints handling is complex (see paragraph 28) and potentially hard for consumers to understand and would benefit from review and development.

- The future of the arrangements for regulation and supervision of banks in their capacity as insurance intermediaries and the role of the HKMA. The IA's intermediary inspection and investigation powers have been formally delegated to the HKMA (the IA may still exercise such powers on banks at its discretion and powers to take action under the IO in relation to investigation findings remain with the IA). Current arrangements work well and help the HKMA deliver its objectives under the Banking Ordinance. Nonetheless there some risk of actual or perceived duplication or inconsistency, since the HKMA issues and enforces its own guidelines as well as undertaking inspections reflecting its supervisory role. In the short term, the HKMA and IA need to develop supervisory cooperation and exchange of information as set out in the recently-revised MoU, including joint inspection and investigation, meetings and staff secondments. In the longer run, IA and HKMA could consider whether, in the light of the movement to full statutory regulation of insurance intermediaries (in the context of what is generally a functional approach to financial supervision), to ensure IA has the fullest overview of the market and to avoid inconsistency, the IA's regulation and supervision of insurance intermediaries should be applied to banks in the same way as to other intermediaries, with continued strong cooperation with HKMA, reflecting its wide-ranging overall responsibilities for banking supervision.

85. In summary, it is recommended that:

- IA should prioritize the implementation of intermediary supervision, completing the transition from self-regulation to a full statutory regime;
- IA should take a more forward-looking approach to conduct supervision, reducing its reliance on complaints and collecting more conduct-related data;
- the IA and other authorities should promote a centralized, comprehensive, specialist alternative dispute resolution function, including for intermediaries, thereby also limiting the IA's role in complaints handling; and
- IA and the HKMA, with the involvement of the FSTB, should in due course review HKMA's role in the supervision of banks as insurance intermediaries with a view to ensuring that the IA's regulation and supervision of insurance intermediaries is applied to banks in the same way as to other intermediaries, with continued strong cooperation with HKMA, reflecting its wide-ranging overall responsibilities for banking supervision.

Annex I. HKSAR's Response to the Recommendations of the 2014 Detailed Assessment

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
1. Objectives, Powers and Responsibilities of the Supervisor	LO	The impending implementation of the proposed Independent Insurance Authority (IIA) regime will enhance the legal capacity and enforcements powers of the IIA, when implemented. The IIA will also exercise direct CoB supervision of insurance intermediaries. To further improve observance of ICP1, the authorities are advised to: a) Consider delegating to the IIA the authority to issue enforceable rules by administrative means, in accordance with specified legal parameters in the ICO; and b) Establish explicit supervisory objectives for group-wide supervision, supported by adequate legal powers to conduct group-wide supervision.	**This recommendation has been substantially implemented.** The Insurance Authority (IA) has been established as a statutory body under the Insurance Ordinance (Cap. 41). It took over the regulatory functions of the Office of the Commissioner of Insurance, a former government department, from 26 June 2017. The IA's principal function is 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. It has additional functions, including - to regulate the conduct of insurance companies and intermediaries; - to assist the Financial Secretary in maintaining the financial stability of Hong Kong; - to promote the public's understanding of insurance products; - to facilitate sustainable market development of the insurance industry; and - to promote the competitiveness of the insurance industry in the global insurance market. Under section 129 of the Insurance Ordinance (IO), the IA may make rules on a wide range of issues, including valuation of assets and liabilities and capital adequacy. The IA's powers in this regard are wider than those of the Insurance Companies Ordinance, reflecting its broader responsibilities. Its rules are

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
			directly enforceable by the IA using the range of intervention tools and sanctions set out in the IO. The delegation from government to the IA is not complete, however. The IA's rules are "subsidiary legislation" in terms of the HKSAR constitution (the Basic Law) and are subject to approval by the Legislative Council, usually on a "negative vetting" process. The government has responsibility for drafting rules, although the IA has a substantial input and is fully involved in the drafting process. The government also legislates Regulations in the few areas (such as setting levies and fees) where regulations are required. The IA in many cases chooses to issue codes or guidelines as provided for in section 133 of the IO, even where rule-making powers are exercisable – to preserve flexibility. The IA has not been given an explicit objective for group-wide supervision. Nonetheless, it already undertakes a form of groupwide supervision, in support of its work to meet the objectives of the IO. It expects to be given new powers, including to apply regulatory requirements to holding companies under legislative amendments to the IO scheduled for introduction into the Legislative Council in the 2019-20 session; and it has developed new tools and processes to provide for more effective groupwide supervision in practice.
2. Supervisor	PO	The proposed IIA will have enhanced operational and financial independence, subject to adequate accountability mechanisms including the Process Review Panel and Insurance Appeals Tribunal. The authorities are advised to: a) provide for the public disclosure of the reasons for the dismissal of the IA in the ICO; and	**This recommendation has not been fully met, although there are mitigating factors (see report Section B).** The provisions of previous legislation have been carried over into the revised IO. In particular: • although members of the board of the IA may be dismissed by the Chief Executive of the Hong Kong SAR

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
		b) eliminate or specify the circumstances under which the legal authority of the CE to give directions to the IA and to exempt/vary the provisions of the ICO for certain insurers may be exercised, without impinging on the Basic Law.	only for cause, as set out in section 4 of Schedule 1B to the IO (for example, because of bankruptcy or physical/mental incapacitation); and the Chief Executive is required, under sections 4(2) and 4(4) of Schedule 1B of the IO, to announce the dismissal to the public, a statement of the reasons for the dismissal is not required; and • the IO continues to provide that the Chief Executive may give directions generally or in a particular case with respect to the exercise of the IA's functions under the IO (section 4); and the Chief Executive in Council may, under section 53 of the IO, direct that certain provisions under the IO shall not apply to an insurer or shall apply with modifications/variations. The risks to the IA's independence from undue political interference are, however, mitigated by the close collaboration with government and the framework of clear statutory objectives as well as other accountability mechanisms such as the independent appeals tribunal (IAT) The powers of the Chief Executive and Chief Executive in Council have not been exercised in practice.

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
3. Information Exchange and Confidentiality Requirements	O	The authorities are advised to empower the IA to obtain information from non-regulated entities of an insurance group and to share such information with relevant authorities subject to appropriate confidentiality safeguards.	**This recommendation will be met on implementation of full group-wide supervision (GWS) – see ICP 23.** Under the proposed new framework, which requires legislation to be implemented in full, the IA will have power to obtain information on non-regulated entities from the designated insurance holding company or from the non-regulated entities direct (as designated within-scope group companies), if necessary. This will supplement existing powers under section 34 of the IO to obtain information and require production of documents from insurers. The IA may share such information with other authorities, in the HKSAR and elsewhere, subject to confidentiality requirements.
4. Licensing	O	The authorities are advised to consider updating the provision in the ICO on the entities exempted from authorization in line with current international best practices.	In the current FSAP discussions, the IA noted that a key provision which could otherwise materially reduce the scope of insurance regulation (exemption of not-for-profit body of persons bound by custom, religion, kinship, nationality or regional or local interest whose) is qualified by a size test (gross premium income not to exceed HK$500,000 in any financial year). However, this test does not apply to cooperative societies and other exempted parties. The IA will be keeping the exemption under review.

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
5. Suitability of Persons	LO	The authorities are advised to extend the scope of the fit and proper requirements under the ICO to cover Senior Management and Key Persons in Control Functions.	**This recommendation has been implemented.** Under the amended IO which took effect in 2017, the IA's prior approval is now required for the appointment of the chief executive (or HK chief executive of an insurer incorporated outside the HKSAR), directors (HK-incorporated insurers), key persons in control functions and appointed actuaries (HK-incorporated insurers). Control functions are risk management, financial control, compliance, internal audit, actuarial functions and intermediary management. The IA may also revoke the approval of appointment if satisfied that the officer is no longer a fit and proper person. The fit and proper requirement for controllers and directors under the IO was extended at the same time to include senior management and key persons in control functions. Under sections 13AC(4) and 13AE(4) of the IO, applicant directors and key persons in control functions are required to be fit and proper before the IA will consider granting approval.

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6. Changes in Control and Portfolio Transfers	O	The authorities are advised to consider: a) Establishing clear definition of "control" and transparent pre- determined control levels under the ICO; and b) Empowering the IA to approve the change of a mutual company to a stock company, or *vice versa*.	**This recommendation has been partly implemented.** The definition of control is clear (section 9 of the IO), but only one control level is set out in the legislation, as in 2014. The IA is contemplating the issuance of a circular to all authorized insurers, requiring them to notify it of a 5% or more change, both increase and decrease, of a shareholding of 15% or more, but this had not been issued at the time of the FSAP. (It would not have the same effect as provisions in law.) Under section13A or 13B of the IO, the IA can approve the change of a mutual company to a stock company or vice versa.
7. Corporate Governance	LO	The authorities are advised to: a) Promulgate minimum corporate governance requirements as enforceable rules (e.g., establishment of Audit Committees and the Board's oversight of risk management), supplemented by supervisory guidance; and b) Expedite the revision of GL10 aimed at reflecting current international best practices, incorporating explicit requirements on: - The role of the Board in setting risk strategy and risk appetite, in line with an insurer's long-term interests and viability; - The Board having adequate powers and resources to be able to discharge its duties fully and effectively; - Individual directors to act in the best interest of the insurer and policyholders; - Remuneration policy of directors, Key Persons in Control Functions and major	**This recommendation has been implemented – and will be further addressed by the new GWS framework.** The new requirements are set out as guidance (see above on ICP1) rather than rules, enabling them to be applied to individual insurers as appropriate and to be readily changed over time. The IA will nonetheless need to ensure that key provisions are implemented fully and consistently and to act in case of non-compliance by reference to IO requirements. The IA's Guideline on the Corporate Governance of Authorized Insurers (GL10) has been revised and has taken effect. It sets out requirements such as for the establishment of an Audit Committee and a Risk Committee under the Board. It defines the responsibilities of the Board to include matters set out in ICP7, including setting risk appetite and strategy which should be in line with the long term interests of the insurer; providing appropriate risk management and internal control systems; and adopting and overseeing remuneration policy and practices which do not induce excessive or inappropriate risk taking.

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
		risk-taking staff; - The Board's policies and procedures to have effective oversight of Senior Management; and c) Extend the requirements and make specific to insurance groups, in particular relating to the checks and balances between different parts and legal entities of groups, group- internal outsourcing and potential conflicts of interests within a group.	The IA's new Guideline on Enterprise Risk Management (ERM) (GL21), published on 5 July 2019, has also contributed to strengthened corporate governance requirements in relation to the role of the Board, Risk Committee, senior management and risk management function in respect to ERM. Where an insurer belongs to a group, the framework already provides that it may adhere to the group policies and procedures, as appropriate. The proposed new GWS framework will include more extensive and specific group-wide requirements on governance and risk management for insurance groups.
8. Risk Management and Internal Controls	LO	The authorities are advised to: a) Widen the scope of the risk management requirements to cover all key risks (i.e. underwriting, market, credit, operational and liquidity risks, at the minimum); b) Establish minimum requirements on risk management systems and key control functions as enforceable rules; c) Require insurers to have compliance and actuarial functions. These requirements could be supplemented by supervisory guidance to facilitate compliance by insurers.	**This recommendation has been implemented.** Under GL10 (see ICP 7 above), insurers are required to have comprehensive risk management policies covering all types of risk, including underwriting risk, credit risk, market risk, operational risk and liquidity risk. Insurers that belong to a group must also monitor the risks associated with intra-group transactions and inter-relationships and interdependence of risks among group members. Under paragraph 7 of GL10, the risk management and internal controls systems of insurers should cover checks and balances; risk management; underwriting; reserves for insurance liabilities; investments; asset management and valuation; claims settlement; reinsurance; audit; accounting matters; actuarial matters; and legal compliance.

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			Insurers are now required by section 13AE of the IO to have control functions for risk management, underwriting, internal audit, actuarial and compliance. Insurers must appoint an individual as a key person for each function, as envisaged by the ICP.
9. Supervisory Review and Reporting	LO	The proposed IIA will have explicit legal authority for on-site inspections and exercise direct CoB supervision of insurers and intermediaries. The authorities are advised to: a) Establish a formal and comprehensive group-wide supervision regime. This should include more granular regulatory reporting (e.g., intra-group transactions and risk concentrations) and empowering the IA to obtain information from material non-regulated entities in order to monitor their impact on regulated insurance entities and the group as a whole; and b) Consider the introduction of a formal risk-based supervision framework, which will be supported by the impending implementation of the proposed RBC framework.	**This recommendation has not yet been implemented, although the measures to be taken to develop GWS will result in partial implementation (see comments under ICPs 1 and 23).** In respect to the recommendation on developing a formal risk-based supervision framework, the IA has been moving in this direction – by developing its approaches to long-term and general insurance supervision which it inherited from the previous regulatory authority. It plans to make significant further changes when risk-based capital (RBC) is implemented from 2022. As noted in the main body of this note, IA should also consider developing a more integrated approach to its supervision framework than is currently envisaged, taking into account the differences between the long-term and general insurance sectors and the differences between insurer and intermediary supervision.
11. Enforcement	LO	The authorities' initiatives in reviewing the current level of penalties and in strengthening the investigation and enforcement powers of the proposed IIA are commendable. In addition, it is recommended that the authorities empower the IA to require an insurer to replace or restrict the power of Board Members, Senior Management, Key Persons in Control Functions, significant owners and external auditors.	**This recommendation has not been implemented as set out in the 2014 report, although the IA has other powers available to achieve the outcome of sound management of the insurer.** There is no explicit power in the revised IO reflecting this recommendation (which itself reflects the language of ICP 11.4).

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			However, the IA does have wide-ranging powers over controllers, directors and persons in key functions (see ICP 5 and 8 above). It also has extensive powers under section 35 of the IO to give directions to insurers and to appoint an advisor or manager. Nonetheless, an explicit power of the sort envisaged in ICP 11.4 (i.e., one directed at requiring the insurer itself to take action) should be considered in a future revision of the IO.
12. Winding-up and Exit from the Market	O	It is recommended that the authorities consider providing greater legal certainty on the priority of claims for long-term policyholders vis-à-vis the unsecured liabilities attributable to the same insurance fund.	**This recommendation has been partly implemented.** • Section 22 of the IO has been amended to require that separate funds be set up for each class of business, while section 23 requires that assets for each fund be applied only for liabilities under that class of business. • Section 45(2)(a) of the IO then provides that the fund should first be used to meet the liabilities of the insurer attributable to its long-term business, including the outstanding claims due to policyholders. The IO now provides stronger protection for long-term insurance policyholders, although the approach taken has been to reinforce existing requirements on segregation of funds rather than to provide for an explicit ranking of creditors, as suggested in the recommendation from 2014. Further strengthening of policyholder protection is, however, being considered in the context of preparations for the new Policy Holders' Protection Scheme (PPS) – see Findings, Section C).

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13. Reinsurance and Other Forms of Risk Transfer	LO	It is recommended that the authorities a) Establish formal regulatory requirements on reinsurance arrangements, including the formulation of reinsurance strategies appropriate to the nature, scale and complexity of their business, sound reinsurance management framework; and prompt documentation and finalization of reinsurance contract; b) Adopt a systematic approach to evaluating the nature of supervision of reinsurers and other counterparties used by insurers; c) Strengthen the requirements on reinsurance with related companies, including – • management of liquidity risk, concentration risk, conflicts of interests, contagion risk etc.; • assessing the acceptability of reinsurance with related companies based not only according to external ratings but in a more comprehensive manner; and according also to other metrics; • introducing risk-based limits on reinsurance exposures to related companies.	**This recommendation has been partly implemented.** The IA issued a Guideline on Reinsurance (GL 17) requiring insurers to establish sound reinsurance management frameworks as part of its overall underwriting and risk management strategy. GL 17 also sets out the criteria that the IA will use to assess the adequacy of reinsurance, for example the reinsurance management framework, type of reinsurance arrangement, maximum retention, spread of risks and security of reinsurers. It also requires the IA's prior approval for any arrangement with insignificant risk transfer. A separate Guideline on Reinsurance with Related Companies (GL 12) provides that in determining the adequacy of an insurer's reinsurance arrangements, the IA will have regard to the security provided by a related reinsurer. The IA will also assess the impact on the ceding insurer's ability to withstand financial vulnerabilities posed by related reinsurers and require additional collateral if appropriate. However, the IA has not adopted a systematic approach to evaluating the nature of supervision of reinsurers and other counterparties used by insurers. It does, however, keep itself informed of changes in home supervisory frameworks through contacts at IAIS meetings held bilaterally and through the management of the HKSAR operations of reinsurers (global reinsurers are well-represented locally). The IA should nonetheless consider establishing a more formal framework for the assessment of home supervision, as envisaged by ICP 13.4.

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14. Valuation	LO	The IA is currently revamping its capital and solvency regime, and a new RBC framework is being developed which will include changes in the valuation of assets and liabilities. It is recommended that the proposed RBC framework will be based on an economic valuation standard that • Is consistent between assets and liabilities such that equal or similar cash flows lead to equal or similar values; • Is responsive to changes in relevant risk factors (including interest rates, spreads, mortalities, etc.); • Provides for an explicit current estimate and a MOCE; and • Is clearly linked to the capital requirement i.e. the capital requirement will be defined as a risk measure applied to the change in the value of assets and liabilities over a given time horizon. It is also recommended that the IA requires insurers to give due regard to the reasonable expectations of participating policyholders, and how the interests of different policyholder generations and other stakeholders are taken into account – both in a going-concern and distress situation. It might be beneficial for the IA and the ASHK to compare the current technical provisions with an economic valuation standard, e.g., a market consistent one, to obtain more insight into the actual level of prudence.	**These recommendations have not yet been implemented, but will be covered by the proposed RBC framework, which includes valuation requirements, now in an advanced stage of development (see Section C of the note).** While a full assessment of the likely observance of ICP 14 of the current RBC proposals was not undertaken, most of the key aspects of the ICP including consistent approaches to assets and liabilities, taking an economic approach responsive to changes in interest rates etc. and provision of MOCE, seem likely to be met. The RBC framework also provides for recognition of policyholders' reasonable expectations.

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15. Investment	O	While a principles-based regime as currently implemented for investments is appropriate for the mature insurance market in HKSAR, some additional quantitative restrictions might nevertheless be useful to consider, particularly with respect to the treatment of more risky or concentrated investments under the proposed RBC framework.	**This recommendation has not yet been addressed but will be covered by the proposed RBC framework now in an advanced stage of development (see Findings Section C of this note).** On current proposals, the approach to insurers' investments will be similar to that of existing requirements, which already embody a prudent person approach without limits on particular types of investment. Under the proposed RBC framework, more risky investments will attract higher capital charges, including corporate bonds with low credit ratings. As noted in Findings Section C of this note, it is recommended that, similar to the 2014 recommendation, the IA consider limits or closer monitoring of higher risk investments.
16. Enterprise Risk Management for Solvency Purposes	PO	It is recommended that the proposed RBC framework includes explicit ERM requirements applicable to all insurers. This would include the requirement to articulate a risk tolerance statement with associated risk tolerance limits, the ability for insurers to measure risks based on a consistent economic assessment, and an explicit requirement for insurers to conduct an ORSA on both a regulatory and economic basis. The requirements should be formulated also for insurance groups and subsidiaries of insurance groups.	**This recommendation has been substantially implemented (or will be following implementation of the RBC and GWS proposed regulatory requirements – see ICPs 17 and 23).** The IA issued guidelines on ERM and ORSA in July 2019, although these will not be implemented in full until 2020 (and arguably mid-2021, when ORSA submissions must first be made). There are currently no requirements at group level, but the GWS framework will include ERM, ORSA and other requirements including for a GIECA.

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		Since the DST that is currently being conducted by long-term insurers contains a number of elements of an ORSA, the authorities may wish to consider extending the DST requirements to bring it more in line with a full ORSA: for example by requiring all insurers and insurance groups to conduct a DST, by requiring multi-year solvency assessment on an economic basis and by linking it more explicitly to an overarching ERM framework. The authorities are also encouraged to consider extending the DST to general insurers and to annually review the set of scenarios being used.	The IA has not extended Dynamic Solvency Testing (DST) to general insurance, but will use the ORSA process (as well as existing regular stress-testing exercises) to assess vulnerabilities in general insurers and respond as appropriate. GL 21 requires insurers in developing their ORSA to use their own scenarios and those prescribed by the IA. For general insurance, the prescribed scenarios will be designed in collaboration with industry groups and issued before the end of 2019 (for long-term insurers, GL 21 requires the use of the DST scenarios in the Actuarial Guidance Note 7 issued by the Actuarial Society of Hong Kong.
17. Capital Adequacy	PO	It is recommended that the authorities: a) Extend the current solvency margin requirements to long- term Class C business. b) Formulate the proposed RBC framework such that the capital requirements: • Are clear in the risks that are quantified explicitly and those that are treated through other means. • Are consistent with the valuation standard being used for both assets and liabilities. • Are based on a consistent underlying methodology for both long-term and general insurance business. • Take into consideration the differences of long-term and general insurance business via specific requirements for the quantification of the capital requirements (be it implemented via standard formulae,	**These recommendations have not yet been implemented but are being covered by the proposed RBC framework now in an advanced stage of development (see Findings Section C of the note).** While a full assessment of the observance of ICP 17 of the current RBC proposals was not undertaken in the current FSAP, most of the key aspects of the ICP including quantification of comprehensive range of risks (operational risk included), solvency control levels (MCR and PCR) and application to groups of insurers, seem likely to be met by the RBC and GWS proposals, when both are implemented. The PCR for both long term and general business will be set (based on current proposals being tested) with the same reference of 99.5% value-at-risk over a one-year period and capital requirements will be applied based on a standardized approach with consistent underlying methodologies applied to risks common for both long term and general insurance. Calibration has been performed based on the Hong Kong industry data. Internal models are not to be accommodated at this stage, but

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		• standard models or internal models) rather than by having different underlying methodologies. • Are responsive to a changing risk landscape to which HKSAR insurers are exposed to. • Take into account group-risks, e.g. from intra-group transactions. • Define intervention levels with clearly associated supervisory actions to be taken. c) Develop a group-wide solvency regime based on a sound and consistent underlying methodological framework (including the valuation standard) and that explicitly addresses risks emanating from group structures, intra-group transactions and from potential limited capital mobility in case of financial stress. It is advisable to consider the implementation of a consistent stress testing framework for all insurers that would indicate the resilience of the capital requirements in response to the insurers' exposure to market wide risks, e.g. via common scenarios that all insurers have to evaluate. The impact of the scenarios on the insurers' balance sheets should be based on a consistent economic valuation standard and take into account potential contagion from groups. Such a stress testing framework would also support the IA in its macro-prudential surveillance.	in recognition of the expertise involved, reliance on a catastrophe model is allowed in quantifying the natural catastrophe risk for general insurance risk. As noted under ICP 16, the IA has not implemented a consistent stress testing framework for all insurers, with common scenarios that all insurers have to evaluate. Separate prescribed scenarios will have to be used by long-term and general insurers in ORSAs. Commonality, where appropriate (on exposures to market risk, for example) should still be considered. In relation to Class C business (ILAS), long term insurers are now required, as an interim measure ahead of RBC implementation, to include an operational incident scenario with a minimum aggregate loss equal to 1% of the Class C funds under management in their DST submissions. On implementation of the RBC framework, the existing capital requirements setting out a margin of solvency for different classes of long-term business (including Class C) will no longer apply and insurers will have to calculate capital requirements based on risks. The proposed new GWS framework includes group-wide capital adequacy requirements which broadly mirror the approach to individual insurers in relation to calibration, Pillar 1/Pillar 2 structure, including a group ORSA and a GIECA requirement and two Pillar 1 solvency control levels. The Pillar 1 requirement will be based on an aggregation approach that allows groups to make use of the local supervisor's capital requirements, while also providing for "supervisory adjustments" by the IA as group-wide supervisor to address any limitations of local requirements, limits on capital transferability etc. Capital add-ons may be applied.

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18. Intermediaries	LO	The mission strongly supports the authorities' initiative to transfer the supervision of intermediaries to the proposed IIA, with a clear legal mandate and adequate legal authority to license, supervise and take proportionate corrective, preventive and enforcement measures.	**This recommendation has been implemented with the transfer of responsibility to the IA effective 23 September 2019.** Specifically, the IA's responsibilities as set out in section 4A of the IO include regulation of the conduct of insurance intermediaries through a licensing regime. Part X of the IO sets out the IA's licensing, regulatory and enforcement powers in relation to insurance intermediaries. Given long transitional periods (for relicensing, compliance with requirements such as fit and proper and capital adequacy for brokers), it will be some years before the new framework for intermediaries regulation and supervision is implemented in full.
19. Conduct of Business	PO	The mission welcomes the authorities' proposal to introduce fundamental CoB principles in the ICO. It is also recommended that the authorities formalize existing industry or supervisory practices in promoting professional conduct by insurers and intermediaries to address current regulatory gaps, (e.g., requirements on fair treatment of customers by insurers and intermediaries, including insurers' marketing, investment, charging and profit distribution strategies for participating policies and ULPs; the need for insurers and intermediaries to handle claims and complaints professionally; and the need for intermediaries to compare and advise customers of different insurance options, such as participating policies vis-à-vis ULPs). The implementation of the proposed IIA regime will bring the CoB regime in line with the IAIS standards.	**This recommendation has been substantially implemented through the issuance of rules, guidelines and codes. Full implementation and enforcement of the requirements will take some years to embed.** In relation to insurers, for whom the IA has had responsibility since June 2017, the IA has taken a product-based approach, but applied the requirements of the ICP. Two guidelines, GL 15 (on Class C – ILAS business) and GL 16 (on business other than Class C) set out extensive guidance. For intermediaries, sections 90, 91 and 92 of the IO, effective from 23 September 2019, set out high level statutory conduct requirements such as acting in the best interests of policyholders. The IA issued a Code of Conduct for Licensed Insurance Brokers and a Code of Conduct for Licensed Insurance Agents setting out detailed requirements.

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20. Public Disclosure	LO	The authorities are advised to empower the IA in establishing disclosure requirements in line with ICP 20 and to supervise insurers' compliance with the disclosure requirements.	**This recommendation is substantially implemented, although the gaps between IA requirements and the ICP remain large.** The IA appears to have adequate powers under the IO to issue requirements on disclosure issues. Section 129 sets out its rule-making powers – disclosure is not explicitly mentioned, but various provisions, including for application to the Financial Secretary to make rules if necessary, for the performance of the authority's functions (section 129(2)), appear to suffice. As part of the planned RBC regime, disclosure requirements will be included as Pillar 3. The IA started to consider the detailed disclosure requirements in late 2019. It will be important to ensure that it considers all the disclosure requirements covered in the ICP, which are wide-ranging (for example, in the detailed information about technical provisions which should be disclosed and in the disclosure of qualitative information). The mode of disclosure should also be considered. Annual financial statements are available from the companies registry but are not required to be made available on websites.
22. Anti-Money Laundering and Combating the Financing of Terrorism	O	While the AML/CFT regime is in line with the Financial Action Task Force (FATF) standards in terms of covering life insurance and other investment-related insurance, the authorities are advised to periodically assess the potential ML/FT risk in the general insurance industry to take account of evolving ML/FT typologies and consider whether to apply the FATF standards to general insurance.	**This recommendation has been implemented**. The Government's latest report (Money Laundering/Terrorist Financing Risk Assessment of Hong Kong), published in April 2018, reflected a threat analysis of insurance and noted that cases of insurance being misused for laundering proceeds of crime or insurance products (including general insurance products) as realizable assets for restraint and confiscation are negligible.

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			The IA's current approach is that FATF standards are not applicable to general insurance products. It will nonetheless keep assessing the risks on an ongoing basis to take into account any evolving ML/TF typologies. The latest FATF/Asia Pacific Group Mutual Evaluation Report on the HKSAR, published in September 2019, raised no adverse findings in relation to insurance and noted that the IA conducts appropriate risk-based supervision. It also commented that the IA needs to monitor the validity of the risk factors used for the intermediaries and enhance its model as necessary to ensure the results adequately reflect the risks.
23. Group-wide Supervision	PO	It is recommended that the authorities formulate and implement a clear and comprehensive regulatory regime for insurance groups under the ICO. Key elements of the regime should cover the scope of the group (including material non-regulated entities) to be subject to group-wide supervision (ICP 9) as well as prudential and market conduct requirements at the group level. Going forward, it is advised that the authorities consider empowering the IA to take necessary remedial and enforcement measures at the level of the holding company, in line with emerging international best practices.	**These recommendations have not yet been implemented, but are being covered by the proposed GWS framework now in an advanced stage of development** (see Findings Section C of the note). While a full assessment of the likely observance of ICP 23 of the current GWS proposals was not undertaken in the current FSAP, most of the key aspects of the ICP seem likely to be met by the RBC and GWS proposals, when both are implemented. The latest proposals contain clear provisions on the scope of the group (including non-regulated entities) to be subject to GWS as well as a full range of prudential requirements at the group level. The framework will include powers for the IA to license and take necessary remedial and enforcement measures against holding companies. The framework is, however, silent on market conduct requirements to be applied at the group level.

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
24. Macroprudential Surveillance and Insurance Supervision	LO	The authorities are advised to formulate macro-prudential surveillance framework appropriate to the nature, scale and complexity of the insurance sector. Enhancements could be made by: a) Requiring insurers to conduct periodic comprehensive industry-wide standardized scenario testing exercises, to provide the IA with an additional tool for assessing the build-up of industry-wide risks/ vulnerabilities; b) Establishing clear and structured internal processes for identifying, assessing, monitoring and reporting on emerging risks in the industry; c) Developing more robust indicators for assessing systemic risk of insurers; d) Reviewing whether the current mainly sector-based approaches of the sectoral supervisors is adequately complemented by consideration of cross-sectoral linkages e.g., *bancassurance*, ULPs and mortgage insurers; and e) Inclusion of risks arising from system-wide market conduct issues, including reputational risks.	**These recommendations have been partly implemented.** The IA carries out periodic comprehensive industry-wide standardized scenario testing exercises – for long-term insurers, the DST reports (due at least annually) analyze the impact on solvency over a three-year projection period under different adverse scenarios. After analyzing the individual insurers' reports, the IA compiles an overall report to identify major market and insurance risks and to follow up the management actions proposed. Quarterly and ad hoc tests are also undertaken. General insurers are subject to ad hoc stress tests, but regular testing of prescribed scenarios will be required of them under the ORSA arrangements (see ICP 16). Cross-sectoral collaboration among financial regulators is also well-established, through the regular meetings of the Council of Financial Regulators and Financial Stability Committee and through regular and ad hoc liaison and communication between regulators. The IA shares the latest market performance of the insurance industry, new or emerging risky insurance products, and the development of interest rates which are sensitive to long term insurers to facilitate discussions on macro-prudential issues. There is close communication with the SFC on ILAS issues and the HKMA on their work on banks as insurance intermediaries. Joint working is now being developed, most significantly a joint initiative of the IA and HKMA to examine the extent of and potential supervisory concerns over an identified growth in premium financing (for example, where a policyholder takes a loan from a bank to finance a short-term endowment, expecting to profit from the interest spread). Bancassurance issues are increasingly well-covered in regulatory cooperation.

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
			Other linkages between banks and insurers are more limited. The IA has used standard indicators such as substitutability to assess systemic importance. It is awaiting developments at the IAIS (completion of the "holistic approach" to assessing systemic risks in insurance) before making changes. The market surveillance work does not explicitly include market conduct issues at present, although the IA has been active in identifying and responding to market-wide conduct issues such as the issues with ILAS. In this and other respects, there is scope to extend the IA's macroprudential surveillance, including identification of risks common to long-term and general insurance such as FinTech, risks from outside the HKSAR, global issues such as climate change etc.
26. Cross-border Cooperation and Coordination on Crisis Management	LO	It is recommended that the authorities: a) Establish clear requirements for insurers to maintain and test contingency plans and procedures for use in a going- and gone-concern situations; and b) Regularly review the existence of practical barriers to efficient and internationally coordinated resolutions and collaborate with the relevant supervisor to resolve these issues.	**This recommendation has been partly implemented.** While there is no standalone requirement relating to insurers' contingency planning, including recovery plans, IA's GL 21 on ERM requires insurers to consider recovery plans and assessments of their recovery options as part of the ORSA that has to be produced regularly. (The requirement for recovery planning in this context arises from the inclusion of current and likely future solvency and liquidity positions.) The ORSA requirement and related requirement for recovery planning will, as noted under ICP 23, be extended to insurance groups under the planned GWS framework.

IAIS ICP (2013 version)	Rating	Recommendations to Improve Observance of ICPs	Comments
			The IA does not carry out resolvability assessments on insurers at present, except that it has been a member of a Crisis management Group (CMG) for one globally systemically important insurer (G-SII) (now one of the three major domestic groups – but see footnote 7 of this note on late 2019 developments with regard to G-SII identification). The IA has been involved in establishing a crisis management plan within the supervisory college, including a resolvability assessment, and in the assessment of the G-SII's systematic risk and liquidity risk management plans and recovery plan and the development and update of the group resolution strategy and plan. This experience has equipped the IA well for the rollout of recovery and resolution planning more systematically and in particular to all three major domestic groups for which it is the group-wide supervisor. Except for what has been inherited on membership of the G-SII CMG, this work had yet to begin at the time of the FSAP work. See Findings, Section D.