INSURANCE COMPANIES (AMENDMENT) BILL 2014

Currently, insurers are regulated by the Insurance Authority ("**IA**") which discharges its functions through the Office of the Commissioner of Insurance ("**OCI**"), a governmental entity staffed predominantly by civil servants. The IA discharges its functions in accordance with the Insurance Companies Ordinance ("**ICO**"), a 1983 piece of legislation based on the 1982 UK Insurance Companies Act. The regulatory regime will undergo a major change through the amendment of the ICO. The Insurance Companies (Amendment) Bill (the "**Amendments**") was published in the Hong Kong Gazette on 25 April 2014 and passed on 10 July 2015. The Bill will need to be gazetted before it becomes law.

Under the Amendments, an insurance authority that is independent from the government ("**IIA**") will be established to replace the OCI. The ICO will be renamed the Insurance Ordinance ("**IO**"). The IIA will be given regulatory, operational and financial independence and be vested with a fuller range of powers to discharge its functions.

It is envisaged the change will be brought about in three stages over two to three years. As the first stage, a provisional insurance authority ("**PIA**") is expected to be established by the end of 2015, which will co-exist with the OCI. The PIA will not have regulatory functions, but will only be vested with administrative powers to conduct preparatory work such as recruitment of senior executives. The second stage will commence in about a year after the establishment of the PIA, during which the IIA will take over the work of the current OCI, such as preparing subsidiary legislation, codes of conduct for insurance intermediaries, and regulatory guidelines. The licensing regime for insurance intermediaries will commence in the third stage.

Some of the main changes are further discussed below.

1. **Independent authority**

The IIA will have an independent governance structure with a majority of non-executive directors. The IIA will appoint two industry advisory committees, one to advise on general business and the other on long term business. A system will be put in place to provide checks and balances for the proper exercise of regulatory powers. For example, the IIA's budget will be subject to approval by the Financial Secretary, and the IIA must consult the industry before introducing new regulatory requirements through subsidiary legislation. An Insurance Appeals Tribunal independent of the IIA will be set up to review decisions made by the IIA pursuant to the IO.

2. **Independent funding**

As opposed to the OCI which relies on government funding, the IIA will be financially independent from the government, relying on revenues generated from licence fees, fees for particular services and a levy on insurance premiums which will be phased in gradually over several years. The government has proposed to set aside HK$500 million for the incorporation of the IIA and for the IIA to meet its expenses in the first five years.

3. **Expanded functions**

The IIA will be responsible for prudential regulation and conduct regulation of insurers. In addition to the existing functions of the OCI, the IIA will have a number of new functions, the most important of which are regulating insurance intermediaries through a licensing regime and conducting thematic industry studies.

4. **Increased supervisory powers**

General powers

With regard to supervisory powers, the OCI does not have explicit powers to enter into premises for inspection and investigation and impose supervisory sanctions. These powers are commonly available to other financial regulators. To align with international practices, the IIA will be vested with new powers such as the following:

(a) Power to enter into premises to conduct inspections and investigations without a warrant;

(b) Power to require production of documents and make enquiries;

(c) Power to apply to the Court of First Instance for court orders to compel compliance with the requirements imposed by the IIA in the course of inspection and investigation;

(d) Power to impose disciplinary sanctions on authorised insurers including reprimands, fines (up to the greater of HK$10,000,000 or three times the amount of the profit gained or loss avoided by the insurer as a result of the misconduct), suspensions or revocation of licence/authorisation; and

(e) Power to prosecute offences summarily.

The maximum amount of fines that can be imposed by the OCI can be very substantial and provides flexibility to the IIA with regard to the level of fines it may impose.

Approval of appointments

Under the existing regime, an authorised insurer cannot appoint a person to be its managing director or chief executive unless the IA indicates no objection to such appointment, or has failed to object within the timeframe. The relevant sections in the ICO will be repealed so that, in addition to the power to grant approval, the IIA will also have the power to revoke the approval of an appointment of a controller if it considers that the person is not, or is no longer, fit and proper. Furthermore, all appointments of directors and key persons who carry out "control functions" of authorised insurers will require approval by the IIA based on fit and proper criteria.

"Control function" is defined in the IO to include risk management, financial control, compliance, internal audit, actuarial and intermediary management functions. Other control functions may be specified through subsidiary legislation. This new approval regime has a much greater scope than the current regime, giving the IIA a potentially extensive role in the organisation and management of insurers. Authorised insurers will as a result be required to exercise greater scrutiny over all their key personnel.

It remains to be seen whether the IIA will reject applications for the approval of key personnel of authorised insurers, for instance on the basis that the applicant does not have the required knowledge of Hong Kong insurance regulation.

5. **Other changes**

Insurers will be required to maintain separate accounts for each class of long term business, and assets representing a long term fund must be applicable only for the purposes of that part of business to which the fund relates. This stands in contrast to the current requirement for separate accounts, which only applies to Classes G and H of long term business (i.e. retirement scheme management).

Whilst the changes made under the ICA align the Hong Kong regulatory regime with regulatory standards in other comparable jurisdictions, it is likely that these changes will increase the burden and cost of regulatory compliance for authorised insurers in Hong Kong.