

For the meeting  
on 6 November 2003

**The Legislative Council Panel  
on Financial Affairs**

**Review of the Institutional Set-up of the Insurance Authority**

**PURPOSE**

This paper briefs Members on the Review of the Institutional Set-up of the Insurance Authority (IA).

**BACKGROUND**

2. Pursuant to section 4 of the Insurance Companies Ordinance, the Chief Executive shall appoint a public officer to be the IA<sup>1</sup>. The principal function of the IA 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 policyholders. The Commissioner of Insurance is appointed for this role. To exercise the statutory functions, he is assisted by the staff of the Office of the Commissioner of Insurance (OCI). Unlike all other financial services regulators in Hong Kong, however, the IA, while independent in law, remains institutionally within the Government and is staffed by civil servants.

3. This institutional arrangement is not in line with the international regulatory trend that regulators be seen to be clearly independent of the government. Thus, for example, the insurance regulators in the United Kingdom, Australia and Singapore are all independent of their governments. By the same token, the IA's current institutional set-up also deviates from Core Principle 3 of the International Association of Insurance Supervisors<sup>2</sup> on the organisation of an insurance supervisor. The anomaly

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<sup>1</sup> The IA is a person but the term has in practice been institutionalised. The Commissioner of Insurance, who is the head of the OCI (a government department) has been appointed by the Chief Executive as the IA.

<sup>2</sup> The IAIS Core Principles provide an internationally accepted framework for the regulation and supervision of the insurance sector. Core Principle 3 covers the following essential elements relating to a supervisory authority: its legal basis, independence and accountability, powers, financial resources, human resources, etc. The relevant principle also provides that the authority should have adequate financial resources to exercise its duties and is operationally independent and accountable.

was highlighted by the International Monetary Fund (IMF) in its Financial Sector Assessment Programme report published earlier this year, which commented that the insurance supervisory function in Hong Kong could not be considered truly independent for as long as the OCI is part of the Government. The IMF also expressed the view that the IA's institutional and governance framework needs to be more clearly defined, and to be made more transparent and accountable.

4. Separately, as a result of a study conducted by the then Financial Services Bureau in 2002, the Government had in fact also come to the conclusion that, in the longer term, the IA should become an independent regulator. The insurance market has achieved significant growth in recent years<sup>3</sup>. Whilst the IA is at present effective in carrying out its regulatory duties, it would be more consistent with our overall regulatory framework and institutionally more sound, if the IA were to be established on an independent footing. An independent IA would also be in a better position to respond to market changes, which may occur quickly and unpredictably. For example, an independent regulator, not being subject to normal governmental resource allocation and personnel constraints, would enjoy greater flexibility in quickly acquiring and deploying adequate manpower and expertise in response to new priorities or regulatory challenges.

5. In the light of the considerations set out in paragraphs 2 to 4 above, the Government is studying proposals for turning the IA into an independent regulator. The proposal was announced in the 2003-04 Budget Speech. Compared with the current institutional set-up (namely IA being within the government structure), the proposal would bring Hong Kong's insurance regulatory framework in line with that of the other financial services sectors, as well as the international practice. Moreover, as explained in paragraph 4 above, an independent regulator would have greater flexibility (say in budgetary matters and manpower deployment). It would be able to explore other means of services provision that are more cost-effective, be more able to respond to market development quickly. The independence exercise will also give us an opportunity to review any room for enhancement in the governance and accountability of the IA. In a nutshell, the proposal would help modernize Hong Kong's regulatory framework, which is in turn conducive to the further development of the fast-growing insurance market and the maintenance of the confidence of market participants. It would also help Hong Kong to safeguard its position as a regional insurance centre. In this regard, it is noted that many other

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<sup>3</sup> The insurance market in Hong Kong achieved double-digit growth in recent years. Total premium income in 2002 surged by 15% to a new record of HK\$66 billion, equivalent to about 5% of the GDP.

places in the region are also striving to promote their insurance markets and reforming their insurance regulatory regimes.

## **Stakeholders' Consultation**

6. As part of the study, the Government had conducted a stakeholder consultation from late May to the end of July this year. Those consulted include the Hong Kong Federation of Insurers (HKFI), members of the statutory Insurance Advisory Committee, self-regulatory bodies for insurance intermediaries, other financial services regulators and the Consumer Council. In addition, a press release was issued on 29 May 2003 inviting the public to express views. Meetings have been arranged by OCI with representatives of insurers and intermediaries to discuss the proposal. Altogether five forums were held to allow market participants to better understand the proposal and to express their views.

7. By the end of the consultation, a total of 20 written submissions had been received. The results are summarized in paragraphs 8 to 9 below.

8. Market participants were generally cautious about the powers and governance of the future IA as well as its funding and any cost implications for the insurance industry. In some cases, while they indicated general support or neutrality on the proposals, they at the same time flagged a number of concerns, most of which fall into the following areas:

- possible increase in operating cost and license fees for insurers and insurance intermediaries
- possible increase in powers of the future IA
- possible change to the existing self-regulatory system for insurance intermediaries
- possible lack of independence<sup>4</sup>
- possible dilution of expertise of the IA if it were to be merged with another existing financial services regulator(s)
- flexibility and efficiency of the future IA

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<sup>4</sup> Some respondents consider that the independent IA should be seen to be independent of the Government and to exercise its power accordingly and that the independent IA should be apolitical and not be influenced by political parties when fulfilling its role in prudential supervision and regulation. They are therefore concerned about the "possible lack of independence" of the IA from political and government influence.

- accountability and governance of the future IA

9. Respondents who are not market participants generally supported the proposal. They did not raise specific concerns relating to the proposal.

### **Way Forward**

10. The study on turning the IA into an independent regulator is on-going. We will give detailed examination to the governance and funding of the future IA, as well as the staffing arrangements, if the independence proposal is to be taken forward. We will consult all relevant parties, including both the insurance industry and staff of the OCI, before taking a firm view on how to move forward.

11. We would like to point out that the independence proposal should be considered on its own merits. We have no intention to effect any other framework changes to insurance regulation in the context of the independence exercise. We will ensure that there are adequate checks and balances in law regarding the powers of the future IA, and it remains our intention that there should be no expansion in the IA's regulatory powers as a result of its becoming independent.

12. Views of Members on the proposal are welcome.

**Financial Services and the Treasury Bureau**  
**October 2003**