



PEOPLE'S REPUBLIC OF CHINA— HONG KONG SPECIAL ADMINISTRATIVE REGION

FINANCIAL SECTOR ASSESSMENT PROGRAM

July 2014

INSURANCE CORE PRINCIPLES—DETAILED ASSESSMENT OF OBSERVANCE

This Insurance Core Principles Detailed Assessment Report was prepared in the context of the Financial Sector Assessment Program for the People's Republic of China—Hong Kong Special Administrative Region.

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PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

June 2014

DETAILED ASSESSMENT OF OBSERVANCE

INSURANCE CORE PRINCIPLES

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) missions in People's Republic of China—Hong Kong Special Administrative Region (HKSAR) during August and November 2013, led by Carlos Medeiros, and overseen by the Monetary and Capital Markets Department.

CONTENTS

GLOSSARY	3
EXECUTIVE SUMMARY	6
ASSESSMENT OF INSURANCE CORE PRINCIPLES	8
A. Introduction and Scope	8
B. Information and Methodology Used for Assessment	8
C. Overview—Institutional and Macro Prudential Setting	9
D. Preconditions for Effective Insurance Supervision	18
AUTHORITIES' RESPONSE TO THE ASSESSMENT	37
DETAILED ASSESSMENT	38
TABLES	
1. Insurance Penetration and Density as at end-2012	11
2. Insurance Market Structure	11
3. Ownership Structure as at end-2012	12
4. Composition of Assets as at end-2012	15
5. Gross Written Premium by Major Lines of Business—Long-term Business	16
6. New Policies Issued to Mainland Visitors	16
7. Gross Written Premium by Major Lines of Business in 2012—General Business	17
8. Solvency Position of Domestic Insurers	18
9. Summary of Compliance with the Insurance Core Principles	21
10. Summary of Observance Level	30
11. Recommendations to Improve Observance of the Insurance Core Principles	31
12: Detailed Assessment of Observance of the Insurance Core Principles	38
APPENDIX	
I. Status of Implementation of 2003 FSAP Recommendations	105

Glossary

AGN3	Additional Guidance for Appointed Actuaries
AMLO	The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance
ASHK	Actuarial Society of Hong Kong
Board	Board of director
CDD	Customer due diligence
C&ED	Customs and Excise Department
CoCI	Code of Conduct for Insurer
CEO	Chief Executive (Officer) of insurers
CE	Chief Executive in Council
CEPA	Closer Economic Partnership Arrangement
CFR	Council of Financial Regulators
CO	Companies Ordinance
CoB	Conduct of business
CoP	Code of Practice for the Administration of Insurance Agents
CR	Contingency reserve
Court	Court of First Instance (Court)
Determination Regulation	The Insurance Companies (Determination of Long-term Liabilities) Regulation (Cap. 41E)
DST	Dynamic Solvency Testing
ERM	Enterprise risk management
FATF	Financial Action Task Force
FSC	Financial Stability Committee
FSAP	Financial Sector Assessment Program
FSTB	Financial Services and the Treasury Bureau
FTE	Full-time-equivalent
GN2	Guidance Note on Insurance Companies (General Business) (Valuation) Regulation
GN3	Guidelines on Anti-Money Laundering and Counter-Terrorist Financing
GN4	Guidance Note on "Fit and Proper" Criteria
GN5	Guidance Note on Application for Authorization to Carry on Insurance Business in or from Hong Kong

GN6	Guidance Note on Reserving for Mortgage Guarantee Business
GN7	Guidance Note on the Reserve Provision for Class G of Long-term Business
GN10	Guidance Note on the Corporate Governance of Authorized Insurers
GN12	Guidance Note on Reinsurance with Related Companies (GN12)
GN13	Guidance Note on Asset Management by Authorized Insurers
GN14	Guidance Note on Outsourcing
GWP	Gross written premiums
HKFI	Hong Kong Federation of Insurers
HKCIB	Hong Kong Confederation of Insurance Brokers
HKICPA	Hong Kong Institute of Certified Public Accountants
HKMA	Hong Kong Monetary Authority
HKMC	Hong Kong Mortgage Corporation
HKSAR	Hong Kong Special Administrative Region
Police	Hong Kong Police Force
IA	Insurance Authority
IIA	Independent Insurance Authority
IAC	Insurance Advisory Committee
IAIS	International Association of Insurance Supervisors
IARB	Insurance Agents Registration Board
ICCB	Insurance Claims Complaints Bureau
ICO	Insurance Companies Ordinance
ICP	Insurance Core Principle
IIQE	Insurance Intermediaries Qualifying Examinations
JFIU	Joint Financial Intelligence Unit
MD	Managing Director
Minister	Minister of Finance
ML/FT	Money laundering and financing of terrorism
MOCE	Margin over current estimate
MoS Regulation	Insurance Companies (Margin of Solvency) Regulation (Cap 41F)
MoU	Memorandum of Understanding
MPF	Mandatory Provident Fund
MPFA	Mandatory Provident Fund Schemes Authority
MRIB	Minimum Requirements for Insurance Brokers
OCI	Office of the Commissioner of Insurance
ORSA	Own Risk and Solvency Assessment
PCR	Prescribed capital requirement
PDPO	Personal Data (Privacy) Ordinance (Cap. 486)

PIBA	Professional Insurance Brokers Association
PPF	Policyholder protection funds
PS1	Professional Standard 1
RBC	Risk-based capital
SFC	Securities and Futures Commission
SFGS	SME Financing Guarantee Scheme
SRO	Self-regulatory organization
TO	Theft Ordinance (Cap 210)
TP	Technical provisions
ULP	Unit-linked policies
Valuation Regulation	The Insurance Companies (General Business) (Valuation) Regulation (Cap. 41G)

EXECUTIVE SUMMARY

The insurance sector in HKSAR is mature and diversified. The insurance penetration and density in HKSAR is amongst the top-10 in the world. Foreign-owned insurers are dominant in the HKSAR insurance sector, and account for about 72 percent of total assets as at end-2012. The long-term insurance industry is highly concentrated, while the market share of general insurance industry is more evenly distributed. All except one of the top-10 insurance groups are all foreign-owned, with much larger consolidated operations compared to their operations in HKSAR.

While there had been some consolidation in the number of insurers, the industry as a whole has seen strong growth in the last three years. Growth in the long-term industry is underpinned by increasing affluence and an aging population. For the general insurance industry, expansion in the dominant accident and health insurance has been sustained by increased awareness of the need to plan for future healthcare needs. Long-term insurers are vulnerable to a protracted period of low interest rates and volatile financial markets, while general insurers are confronting keen competition in the market.

The Insurance Authority (IA) is responsible for regulating and supervising the insurance industry of the HKSAR. It is supported by the Office of the Commissioner of Insurance (OCI), a government department in the HKSAR. A self-regulatory system is used to supervise the conduct of business (CoB) of intermediaries. Currently, three self-regulatory organizations (SROs) supervise insurance intermediaries in accordance with non-statutory codes approved by the IA. In practice, the IA supervises the SRO's oversight of intermediaries, and conducts spot checks and independent inspections of insurance intermediaries for quality assurance on the effectiveness of the SROs.

The authorities have proposed establishing an Independent IA (IIA), scheduled to be implemented in 2015. The proposed IIA will have enhanced legal capacity, as well as financial and operational independence as well as a transparent system of accountability, in line with international best practice. It will have explicit legal authority for inspections, investigation, and prosecution, as well as broader sanction powers. In addition, direct licensing and supervision of intermediaries by the proposed IIA will replace the current self-regulatory regime.

The proposed IIA could be further strengthened in a number of areas by: (i) granting delegated authority to issue enforceable rules via administrative means; (ii) requiring public disclosure of the reasons for removing the head of the agency; and (iii) granting clear authority to establish and supervise public disclosures by insurers. The authorities are also advised to consider eliminating or specifying the circumstances under which the legal authority of the Chief Executive in Council (CE) to give directions to the IA and to exempt/vary the provisions of the Insurance Companies Ordinance (ICO) for certain insurers, without impinging on the Basic Law.

The regulatory regime for the insurance sector in HKSAR, supported by the IA's robust supervisory practices, has a high level of observance of the Insurance Core Principles (ICPs). The IA is highly regarded by the industry. Staff of the IA have a good understanding of the industry and markets, facilitated by open communication and close dialogue with directors and management of insurers. Established internal procedures and checklists promote the consistency

and effectiveness of supervision. The strong and robust supervisory practices compensate for many of the legal regulatory gaps noted by the assessors.

The ICO needs to be updated to better reflect current international best practices. The key areas are: (i) extending the fit and proper regime to cover Senior Management and Key Persons in Control Function; (ii) establishing clear definition of control and pre-determined control levels; (iii) updating risk management requirements; (iv) authority to remove or disqualify persons on fit and proper grounds; and (v) requiring insurers to implement contingency plans. In addition, the list of entities exempted from authorization should be reviewed, and there are merits for clarifying the priority of claims of long-term policyholders. A number of guidance notes could also be updated and to more clearly differentiate minimum requirements from supervisory guidance.

Given the presence of insurance groups in HKSAR, it is timely that the IA formulates and implements a clear and comprehensive regulatory regime for insurance groups. Key elements of the regime should cover the scope of the group to be subjected to group-wide supervision, as well as prudential and market conduct requirements at the group level. Going forward, it is advised that the authorities: (i) ensure adequate supervisory resources to effectively supervise insurance groups; and (ii) consider legal authority to take measures at the level of the holding company, in line with emerging international best practices.

The IA's plan to move towards a risk-based capital (RBC) regime is welcomed and a structured process for macro-prudential surveillance is recommended. The RBC regime should establish a clear and consistent valuation standard (including explicit best estimates of technical provisions and risk margins) and risk sensitive capital requirements. As a stop-gap measure, the IA is advised to establish solvency margin requirements for all classes of long-term business, and to provide supervisory guidance on insurers' obligations to meet policyholders' reasonable expectation. Pending the introduction of explicit enterprise risk management requirements, the current dynamic solvency tests could be enhanced in the interim. The proposed IIA's new mandate on thematic research and studies will contribute to more comprehensive and systematic macro-prudential analysis, which could be supported by a framework for assessing the systemic risk of insurers. The proposed enhancements in the prudential regime need adequate technical support of experienced supervisors and technical specialists.

To enhance the protection of policyholders, the mission strongly supports the authorities' initiative to transfer the supervision of intermediaries to the proposed IIA, and to strengthen CoB requirements in the ICO. While the IA has been exercising effective oversight of the SROs, it involves significant duplication of efforts. In addition, industry codes and standards issued by the SROs are not legally binding and the SROs are not full-fledged supervisors. These constraints dilute the effectiveness of the SRO regime. Direct supervision would also minimize the potential conflict of interests arising from self-regulation, and is more in line with international best practices. In addition to the proposal to introduce fundamental CoB principles in the ICO, the authorities should formalize existing practices in promoting professional conduct by insurers and intermediaries to fill current regulatory gaps.

ASSESSMENT OF INSURANCE CORE PRINCIPLES

A. Introduction and Scope

1. **This assessment provides an update on the regulatory and supervisory developments in the insurance sector of HKSAR since 2003.** The assessment was conducted by Su Hoong Chang and Philipp Keller (both external experts engaged by the IMF) from August 29 to September 17, 2013. HKSAR undertook an initial FSAP in 2003, which included a formal assessment of its observance with the ICPs issued by the International Association of Insurance Supervisors (IAIS) in 1999. The status of implementation of the 2003 recommendations is summarized in the Appendix.
2. **The current assessment is benchmarked against the ICPs issued by the IAIS in October 2011, as revised in October 2012.** The ICPs apply to all insurers, whether private or government-controlled. Specific principles apply to the supervision of intermediaries. The scope of the assessment covers the supervision of insurers exercised by the IA as well as the oversight of intermediaries' CoB by SROs. The institutional arrangements for financial sector regulation and supervision are outlined in Section C.

B. Information and Methodology Used for Assessment

3. **The level of observance for each ICP reflects the assessments of its standards.** Each ICP is rated in terms of the level of observance as follows:
 - **Observed:** where all the standards are observed except for those that are considered not applicable. For a standard to be considered observed, the supervisor must have the legal authority to perform its tasks and exercises this authority to a satisfactory level.
 - **Largely observed:** where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
 - **Partly observed:** where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
 - **Not observed:** where no substantive progress toward observance has been achieved.
4. **The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment in September 2013.** Ongoing regulatory initiatives are noted by way of additional comments. The authorities have provided a full and well-written self-assessment, supported by anonymized examples on actual supervisory practices, which enhanced the robustness of the assessment. Technical discussions with, and briefings by, officials from the IA have also enriched this report; as did discussions with industry participants.
5. **The assessors are grateful to the authorities for the full cooperation and thoughtful logistical arrangements,** particularly the helpful co-ordination of various meetings with industry participants. The assessors also benefitted from the valuable inputs and insightful views from meetings with insurers, as well as representatives of industry and professional organizations,

including the Insurance Agents Registration Board (IARB), Professional Insurance Brokers Association (PIBA), and The Hong Kong Confederation of Insurance Brokers (HKCIB).

C. Overview—Institutional and Macro Prudential Setting

Institutional Framework and Arrangements

6. The Financial Secretary oversees the financial sector of HKSAR, with policy support by the Financial Services and the Treasury Bureau (FSTB), headed by the Secretary for Financial Services and the Treasury. The IA, the Hong Kong Monetary Authority (HKMA), and the Securities and Futures Commission (SFC) are the respective supervisors of the insurance, banking and securities sectors.

7. The IA is responsible for regulating and supervising the insurance industry of the HKSAR. It is supported by the OCI, a government department in the HKSAR. It is empowered under the ICO with the principal function to regulate and supervise the insurance industry, in order to promote the general stability of the insurance industry, and protect existing and potential policyholders.

8. A self-regulatory system is adopted for the supervision of intermediaries. Currently, three SROs supervise insurance intermediaries in accordance with non-statutory codes approved by the IA. The SROs are also responsible for handling all complaints against their members, conducting investigations, and taking disciplinary actions on substantiated cases. The IARB set up by the Hong Kong Federation of Insurers (HKFI) is responsible for the oversight of insurance agents, while the HKCIB and PIBA are responsible for the oversight of insurance brokers. In practice, the IA supervises the SRO's oversight of intermediaries, and conducts spot checks and independent inspections of insurance as well as the examination and Continuing Professional Development Program for intermediaries.

9. The authorities have consulted on the establishment of an IIA, which is scheduled to be implemented in 2015. One of the key recommendations arising from the 2003 FSAP was the strengthening of the legal capacity and independence of the IA. The FSTB conducted public consultations in July 2010, followed by more detailed proposals in June 2011 and key legislative proposals in October 2012. The key proposals for the IIA include:

- The establishment of the IIA as a body corporate;¹
- Setting and explicit legal mandates for the IIA to undertake additional functions: (i) CoB regulation of insurance intermediaries; (ii) public education programs to raise financial literacy; (iii) thematic research and studies; and (iv) assisting the Secretary for Financial Services and the Treasury in maintaining financial stability;

¹ The Government will appoint a Governing Board, comprising members who represent the IIA's key stakeholders (except the government) but free from any conflict of interests with IIA's licensees.

- Enhancing the legal capacity of the IIA in: (i) inspection, investigation, prosecution, and sanctions; (ii) licensing and regulation of insurance intermediaries; and (iii) regulating the insurance intermediation activities of bank employees (*bancassurance*); and
- Establishing an independent Insurance Appeals Tribunal to provide checks-and-balance. Members of the Tribunal will be appointed by the chief executive. The Tribunal's mandate will be to review supervisory decisions, including all disciplinary decisions of the IIA.

10. Supervisory coordination among the regulatory agencies in HKSAR is facilitated by the Council of Financial Regulators (CFR) and the Financial Stability Committee (FSC). The CFR was established in 2000 to minimize gaps or duplication in the regulation and supervision of financial institutions. It is chaired by the Financial Secretary, and includes heads of SFC, HKMA, and the IA, and serves as a platform to review regulatory and supervisory issues with cross-market implications. The FSC was set up in 2000 to monitor the functioning of the financial markets in HKSAR, including the banking, debt, equity, insurance and related markets, and to deliberate on issues with possible cross-market and systemic implications. It is chaired by the Secretary for Financial Services and the Treasury and comprises heads of SFC, HKMA, and the IA.

Market Structure and Industry Performance

Industry Structure and Recent Trends

11. The insurance sector is an important pillar of the financial system in HKSAR. In 2012, financial services overall accounted for 15.9 percent of GDP of HKSAR (based on the value-added approach), with the insurance sector alone accounting for 2.9 percent. Assets held by insurers totaled about HK\$1,519 billion as at end-2012, accounting for about 9 percent of the total assets of the financial sector. As at end-2012, there were about 65,000 employees working in the insurance industry, including agents having principal-agent relationship with insurers, but excluding bank employees who sell insurance products.

12. The insurance penetration and density² in HKSAR is amongst the top-10 in the world (Table 1). In terms of total business, HKSAR was ranked fourth for insurance penetration and seventh for insurance density according to Swiss Re's research. In particular, long-term insurance in HKSAR recorded significantly higher penetration and density compared to the average rates in advanced markets. On the other hand, penetration and density rates of general business are below advanced markets. (See section on operating performance for the analysis of the different business models.)

13. The number of insurers has been consolidating since 2007 (Table 2). As at end-2012, there were 155 authorized insurers, with the highest number of exits seen in general insurers. The number of professional reinsurers has remained stable, of which 12 write only general reinsurance business, one writes only long-term reinsurance business, and six are composite reinsurers. Although there was only one captive insurer, the FSTB has been considering strategies to promote HKSAR as a sustainable captive insurance center.

² Insurance penetration is premiums as a percentage of GDP while insurance density is premium per capita.

Table 1. Hong Kong SAR: Insurance Penetration and Density as at end-2012

	Penetration (In percent of GDP)	Density (US\$ per capita)
Long Term		
HKSAR	11.0	4,016
Advanced markets ^{1/}	5.0	2,133
General		
HKSAR	1.9	703
Advanced markets	3.6	1,544

Source: Swiss Re Sigma No 3/2013: World Insurance in 2012 and the IA (HKSAR data).
1/ Based on Swiss Re definition as listed in Figure 15 of the Swiss Re Sigma No 3/2013: World Insurance in 2012.

Table 2. Hong Kong SAR: Insurance Market Structure

	2007	2012	<i>Inc/Dec</i>
Long term	46	43	<i>(3)</i>
General	95	79	<i>(16)</i>
Reinsurers	21	19	<i>(2)</i>
Composite	14	13	<i>(1)</i>
Captives	2	1	<i>(1)</i>
Total	178	155	<i>(23)</i>
Tied individual agents	28,892	37,608	8,716
Agencies (including banks)*	2,150	2,419	269
Brokers**	508	604	96

Source: The Insurance Authority.

* For agencies, there were 24,398 responsible officers and technical representatives in 2007; and 27,830 responsible officers and technical representatives in 2012.

** The figures represent insurance broker firms. Their chief executives and technical representatives were 6,552 in 2007 and 8,798 in 2012.

14. Foreign-owned insurers dominate the HKSAR insurance sector (Table 3). Foreign-owned insurers accounted for about 72 percent of the total assets in the insurance sector, i.e., 79 percent of total assets held by long-term insurers, 12 percent held by general insurers, and

47 percent held by reinsurers. There is no restriction regarding foreign entrants to the insurance market and ownership of insurers in HKSAR. Foreign branches account for almost half the number of authorized insurers, although the number of foreign branches has fallen from 89 in 2007 to 72 in 2012.

15. The long-term insurance industry is highly concentrated while the market share of general insurance industry is more evenly distributed. The top-3 long-term insurers, all foreign-owned, accounted for 46 percent of total assets of long-term insurers as at end-2012. In contrast, the top-3 general insurers made up only 16 percent of the total premiums written. No insurer enjoys a monopolistic position in any particular lines of business in either general or long-term business.

Table 3. Hong Kong SAR: Ownership Structure as at end-2012^{1/}

	Long term		General		Reinsurance		Total
	#	Assets (HK\$ millions)	#	Assets (HK\$ millions)	#	Assets (HK\$ millions)	Assets (HK\$ millions)
Domestic							
Banks	5	169,582	10	23,254	1	661	193,497
Non-financial entities			4	4,586			4,586
Public sector			1	52,728			52,728
Others	14	110,556	40	51,436	7	20,009	182,001
Foreign							
Banks	2	236,400	1	1,058			237,458
Others	30	812,980	28	17,111	11	18,648	848,739
Total	51	1,329,518	84	150,173	19	39,318	1,519,009
							15 4

1/ Based on majority (more than 50 percent) of ownership.

16. All except one of the top-10 insurance groups are all foreign-owned, with much larger consolidated operations compared to their operations in HKSAR. The domestic operations of the top-10 groups represented only 1.5 percent of their global assets while contributing to 7.5 percent of the premiums written in 2012. A number of insurers are part of financial conglomerates headed by parent banks where HKMA is the lead supervisor. Transfers of assets from the parent banks to insurers or increases in insurers' investments in parent/related banks have been immaterial over the last three years (0.05 percent of long-term insurance assets and 3.9 percent of general insurance assets in 2012).

17. The Hong Kong Mortgage Corporation (HKMC) is wholly owned by the HKSAR Government through the Exchange Fund and regulated by the IA. In 1999, the HKMC pioneered the provision of mortgage insurance in HKSAR to fill a gap in the industry. The HKMC offers insurance coverage to most mortgage banks in HKSAR. In response to escalating property prices in recent years, the HKMC has revised the maximum loan amount it will insure. The latest change in February 2013 lowered the loan-to-value ratio (maximum of 90 percent), which varies with the property value (up to HK\$6 million). As at end-July 2013, the total loan drawdown

recorded by the HKMC was HK\$240 billion and the reported delinquency ratio of its loan portfolio (0.003 percent as at June 2013) was lower than the general mortgage market delinquency. The HKMC has launched the following new products since 2011:

- SME Financing Guarantee Scheme (SFGS) in January 2011—to assist local small- and medium-size enterprises (SMEs) obtain sustainable bank financing by offering loan guarantees of between 50–70 percent and at the same time help authorized institutions³ mitigate default risks. As of May 31, 2012, at the request of the government, the HKMC rolled out the special concessionary 80 percent loan guarantee product (with application period until end-February 2014) under SFGS to help HKSAR enterprises raise capital in the face of persistently weak export markets and a challenging external environment;
- Reverse Mortgage Insurance⁴ in July 2011 whereby the HKMC provides insurance to mortgage banks to cover any shortfall between the proceeds from property disposal (on the death of the elderly or other maturity events) and the outstanding loan balance on the reverse mortgage. The estate of the elderly is not liable for any shortfall incurred but can recoup the surplus if the proceeds exceed the loan balance; and
- Microfinance scheme was launched in June 2012.

18. The three core missions of the HKMC are enhancing the stability of the banking sector by offering a reliable source of liquidity; promoting wider home ownership in HKSAR; and facilitating the growth and development of the debt security and mortgage-backed security markets in HKSAR.

19. Insurers in HKSAR typically adopt a multi-channel distribution strategy. As at end-2012, there were 37,608 tied individual insurance agents, 2,419 agencies (including 38 banks) with 27,830 responsible officers and technical representatives as well as 604 brokers with 8,798 chief executives and technical representatives. The proportion of general insurance business distributed by the various channels has been stable over the past three years—about 41 percent of the gross premiums of general insurers were produced by brokers; 21 percent by agents; 12 percent via *bancassurance*; 13 percent from direct sales; and the remaining from other channels. For long-term business, a survey conducted in 2012 indicated that approximately 15 percent of in-force unit-linked policies (ULPs) were sold through banks, 42 percent by agents, and 43 percent via brokers.⁵

20. The insurance sector enjoys certain concessions under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) although the impact has not been

³ In HKSAR, deposit-taking business may be carried out by banks, restricted license banks and deposit-taking companies – referred to as authorized institutions.

⁴ Reverse mortgage insurance enables the elderly people to utilize their self-occupied and residential properties as collateral to borrow loans in return for a stream of monthly payouts while staying at their original residences for the rest of their life. Under certain conditions, the elderly may also apply for a lump sum payout.

⁵ For long term insurance business, the IA did not collect information on distribution channel in the past. With effect from the second quarter of 2013, insurers are required to submit information on premiums for new business with breakdown by distribution channels.

material so far. The CEPA, which came into effect on January 1, 2004, is an arrangement whereby a form of free trade area is established between the Mainland and HKSAR. It covers three broad areas, namely trade in goods, trade in services, and trade and investment facilitation, and accords the following concessions to the insurance market participants in HKSAR:

- Groups formed by HKSAR insurers through re-grouping and strategic mergers may access the Mainland insurance market subject to meeting certain conditions⁶;
- Capital participation by a HKSAR insurer in a Mainland insurer allowed, subject to a maximum limit of 24.9 percent;
- HKSAR residents with Chinese citizenship are permitted, after obtaining the Mainland's professional qualifications in actuarial science, to practice in the Mainland without prior approval;
- HKSAR residents may, after obtaining the Mainland's insurance qualifications and being employed or appointed by a Mainland insurer, engage in the relevant insurance business;
- Establishment of an examination center in HKSAR for the Mainland qualifying examinations for insurance intermediaries;
- HKSAR insurance agency companies are allowed to set up wholly-owned companies in the Mainland to provide insurance agency services for the Mainland insurers; and
- Qualified HKSAR insurance brokers⁷ may set up wholly-owned insurance agency companies in Guangdong Province (including Shenzhen) on a pilot basis.

Assets and Liabilities

21. Long-term insurers held 64 percent of their assets in government, corporate and other securities as at end-2012 and investments portfolios accounted for 91 percent of total assets (Table 4). Investments supporting ULPs constituted 14 percent of total assets, while their exposures to equities were relatively low at six percent. The IA does not currently collect information on the market-consistent value and amortized costs of long-term insurers' holdings of securities, which are subject to the Dynamic Solvency Testing (DST) annually to monitor their sensitivity to interest rates movement (ICP 14). There were insignificant amounts of receivable, including intra-group receivables.

22. The asset profile of general insurers is very liquid with cash and bank balances constituting 27 percent of total assets as at end-2012 (Table 4). Government, corporate and

⁶ Total assets held by the group of over US\$ 5 billion; more than 30 years of establishment experience attributable to one of the HKSAR insurer in the group; and a representative office established in the Mainland for over two years by one of the HKSAR insurer in the group.

⁷ The applicant have been operating insurance brokerage businesses in HKSAR for over 10 years, with average annual revenue for the past three years of not less than HK\$500,000 and total assets of not less than HK\$500,000; no serious misconduct and record of disciplinary action; and have set up a representative office in the Mainland for over one year.

other securities accounted for another 25 percent, with the highest significant allocation to corporate securities, 30 percent of which was held by one general insurer. Most of the corporate securities were rated A- or above. The bulk of the "Other assets" was the mortgage loan portfolio of HKMC. Unlike long-term insurers, general insurers' securities investments are valued on a market consistent basis. Foreign branches conducting general insurance business in or from HKSAR are required to hold a minimum level of qualified assets in HKSAR.

23. Reinsurers also recorded a relatively high level of securities that accounted for 45 percent of total assets (Table 4). In addition, receivables and reinsurance receivables added up to another 25 percent of assets. The relatively high level of reinsurance receivables was due to provisions for huge catastrophic losses arising from the Japan earthquake and the flood in Thailand in 2011.

Table 4. Hong Kong SAR: Composition of Assets as at end-2012

(In millions of HK\$)

	Long term		General		Reinsurance	
		<i>percent of total</i>		<i>percent of total</i>		<i>percent of total</i>
Government	116,523	9	5,046	3	6,509	17
Semi-Government	0	0	1,897	1	1,281	3
Corporate	496,540	37	23,180	15	8,690	22
Other securities	243,232	18	6,800	5	1,255	3
<i>Total Securities</i>	856,295	64	36,923	25	17,735	45
Equities	78,159	6	7,176	5	698	2
Real estates	2,005	0	2,539	2	77	0
Cash & bank balances	75,097	6	40,710	27	9,145	23
ULP investments	192,469	14	0	0	0	0
<i>Total investments</i>	1,204,025	91	87,347	58	27,655	70
Receivables	22,388	2	8,422	6	5,432	14
Intra-group receivables	7,791	1	7,354	5	215	1
Reinsurance recoverables	45,463	3	12,495	8	4,273	11
Other assets	49,851	4	34,554	23	1,742	4
Total Assets	1,329,518	100	150,173	100	39,318	100

Source: The Insurance Authority.

24. Both long-term and general insurers have immaterial off-balance sheet activities.

For long-term insurers, these are mainly currency forward or exchange rate contracts, guarantees provided to trust subsidiaries conducting mandatory provident fund (MPF) business, capital commitments, and operating lease commitments. The notional amount outstanding of over-the-counter off-balance sheet derivatives (e.g., currency swaps) accounted for less than 1 percent of the total assets of long-term insurers. The off-balance sheet activities of general insurers are mainly capital commitment, operating lease commitment and letters of credit in favor of the IA. The exposure amounts are considered to be immaterial (0.6 percent of assets as at end-2012).

Operating performance

25. The long-term insurance industry in HKSAR has recorded double-digit growth rates in the last three years (Table 5). This has been underpinned by increasing affluence and an aging population. Traditional policies accounted for two-thirds of the market share in 2012. The growth of ULPs slowed to 5.0 percent in 2012 although wealth management products are viewed as the potential growth segment. The IA has been monitoring the sale of policies to visitors from the Mainland (Table 6), who are attracted by the broad range of well-regulated insurance products in HKSAR and the prospects of higher rates of returns. Premiums of policies issued to Mainland policyholders accounted for almost 13 percent of new business premiums in 2012, more than doubling the market share recorded in 2008. The sale of endowment and protection products denominated in Renminbi has also been rising rapidly and the policyholders are mainly residents in HKSAR.

**Table 5. Hong Kong SAR: Gross Written Premium by Major Lines of Business—
Long-term Business**

(In millions of HK\$)

	2010	2011	2012	<i>percent of total</i>
Traditional	105,652	126,451	145,782	68.8
Annuities	1,293	1,505	2,951	1.4
ULP	54,587	60,246	63,259	29.8
Total	161,532	188,202	211,992	100.0
<i>Inc/Dec (previous year)- In percent</i>		16.5	12.6	

Source: The Insurance Authority.

Table 6. Hong Kong SAR: New Policies Issued to Mainland Visitors

	Mainland Policyholders			Percent of Mkt premium		Market Total		
	No of policies	Percent	Premiums (millions of HK\$)	Percent		No of policies	Premiums (millions of HK\$)	Percent
2008	27,375		3,263	-9.0	5.4	1,036,261	60,417	
2009	32,823	19.9	2,969	47.6	6.4	990,127	46,310	-23.3
2010	45,393	38.3	4,382	44.9	7.5	1,025,045	58,780	26.9
2011	65,476	44.2	6,349	56.2	9.0	1,086,905	70,256	19.5
2012	83,393	27.4	9,918		12.8	1,095,201	77,565	10.4

Source: The Insurance Authority.

26. Gross written premium (GWP) of the general insurance industry rose by 6 percent in 2012 after a surge of almost 15 percent in 2011. Accident and health insurance is the dominant class of business, accounting for 27 percent of domestic GWP and 70 percent of foreign GWP (HK\$3,5 billion) (Table 7). The sustained growth in accident and health business is mainly due to increase in premium rates and enhanced market demand, primarily due to increased awareness of the community to plan for future healthcare needs. Liability business, comprising the mandatory employees' compensation insurance, also grew over the past five years, mainly due to the increase in construction projects and the general increase in the wage levels. The overall retention ratio for all classes of general insurance has been consistently above 70 percent for the past three years, with a lower retention for domestic property risks of 41 percent.

Table 7. Hong Kong SAR: Gross Written Premium by Major Lines of Business in 2012—General Business (in millions of HK\$)

Domestic Risks	GWP	Net Premiums	Retention <i>(In percent)</i>	percent of total <i>(GWP)</i>
Motor	4,104	3,435	83.7	9.8
Property	7,401	3,031	41.0	17.7
Liabilities	9,164	6,598	72.0	22.0
Accident & health	10,079	8,365	83.0	24.2
Others	6,024	3,666	60.9	14.4
Sub-total	36,771	25,095	68.2	88.1
Foreign Risks	4,948	4,398	88.9	11.9
Total	41,720	29,493	70.7	100.0

Source: The Insurance Authority.

Solvency position

27. On average, the insurance sector reported solvency positions above the minimum and prescribed requirements. The ICO sets minimum solvency margin requirements for various classes of business (the relevant amounts). In practice, the IA requires insurers to maintain 150 percent of the relevant amounts, which is deemed to be the prescribed capital requirement (PCR). As at end-2012, long-term insurers recorded available capital resources over the PCR of more than 190 percent while the general insurers and reinsurers reported higher ratios of 560 percent and 639 percent, respectively (Table 8). The existing solvency regime is rules-based, largely modeled on the European Union's current Solvency I framework.

Table 8. Hong Kong SAR: Solvency Position of Domestic Insurers^{1/}

	2010	2011	2012	<i>End-period in percentages</i>
Available capital resources over Minimum Capital Requirements (100% of relevant amount)				
Long-term insurers	235	274	289	
General insurers	717	714	841	
Reinsurers	515	336	958	
Available capital resources over PCR (150% of relevant amount)				
Long-term insurers	157	183	193	
General insurers	478	476	560	
Reinsurers	343	224	639	

Source: The Insurance Authority.

1/ Insurers incorporated in HKSAR and Bermuda carrying insurance in and from HKSAR.

Key Risks and Vulnerabilities

28. Long-term insurers are vulnerable to low interest rates and potential pandemic risks. Substantial drops in prevailing interest rates have had a negative impact on the valuation of long-term liabilities. A prolonged low interest climate has a particular negative impact on savings insurance products (especially guaranteed products with long duration) since investment income is the main profit source for these type of products. The IA has been monitoring insurers' exposures to pandemic risks through stress testing.

29. Overcapacity is the main risk for general insurers, compounded by keen competition in the market. This has kept premium rates low, which may lead to some insurers compromising their underwriting discipline. The more vulnerable lines of business are employees' compensation and motor insurance, where aggressive insurers may try to gain market share through rate cutting. To uphold underwriting discipline, the IA has maintained close vigilance⁸ and requires actuarial certification on the adequacy of technical provisions for these two classes of business. General insurers' exposures to pandemic and natural catastrophe risks have been limited by reinsurance protection and the predominantly domestic risk portfolios (Table 7).

D. Preconditions for Effective Insurance Supervision

Sound and Sustainable Macroeconomic and Financial Sector Policies

30. As a free market economy, HKSAR provides equal opportunities to participants in all sectors of the market. HKSAR has been ranked first in terms of economic freedom for 19 consecutive years (1995–2013) by the Heritage Foundation.⁹ The Government's policy is to promote development of the insurance industry in HKSAR whilst ensuring, through prudential

⁸ The IA has stepped up supervision of insurers' underwriting discipline and the internal controls system in verifying declarations and information provided by applicants and claimants.

⁹ Source of information: Heritage Foundation (<http://www.heritage.org/index/ranking>)

supervision, the best and most up to date industry standards.¹⁰

A Well-developed Public Infrastructure

31. HKSAR has a well-developed system of business and financial sector laws, and an efficient judiciary system. These include financial sector, corporate, insolvency, contract, consumer protection and private property laws. There is a mature mechanism for the fair resolution of disputes by an efficient and independent Judiciary. HKSAR was ranked fifth place (out of 142) in terms of the efficiency of the legal framework in settling disputes and fifteenth place for judicial independence.¹¹ There are well-defined regulatory regimes and adequate supervision of the financial sector and the regulated entities. The payment as well as clearing and settlements systems in HKSAR are adequately regulated and supervised.

32. Accounting standards adopted in HKSAR are in line with international standards, and auditors are subject to a self-regulatory regime. The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorized by law to register and grant practicing certificates to certified public accountants in HKSAR.¹² It has more than 33,000 members and is responsible for promulgating financial reporting, auditing and assurance and ethical standards in alignment with the International Accounting Standards Board and the International Auditing and Assurance Standards Board. The Financial Reporting Council conducts independent investigations into possible auditing and reporting irregularities in relation to listed entities and report irregularities identified to the HKICPA for follow-up.

33. Long-term insurers are required to have Appointed Actuaries that meet the IA's prescribed criteria. The Actuarial Society of Hong Kong (ASHK) has some 1,000 members, 75 percent of which serves in the insurance industry. ASHK is a member of the International Actuarial Association and regulates actuarial practices by issuing professional conduct codes, professional standards and actuarial guidance notes. ASHK members must fulfill continuous professional development requirements.

34. A wide range of economic, financial and social statistics is readily available to insurance businesses and the IA. The Census and Statistics Departments publishes a wide range of economic and business statistics, including regular (monthly, quarterly, and annual) surveys on various topics, including selected indicators on the insurance sector. The IA also publishes selected key indicators of the insurance industry and insurers on its website.

Effective Market Discipline in Financial Markets

35. General corporate governance standards in HKSAR are set out in the Companies Ordinance (CO). The corporate governance regime prescribes certain requirements in respect of roles and accountabilities of the board of directors, including requirements on independent

¹⁰ Guidance Note on Application for Authorization to Carry on Insurance Business in or from Hong Kong

¹¹ Source: The Global Competitiveness Report 2011-2012, World Economic Forum.

¹² Members of the HKICPA are entitled to use the description certified public accountant and the designation CPA.

directors, and senior management. The Hong Kong Stock Exchange imposes higher governance and disclosure requirements on listed entities. Financial and market analyses are widely available from media, rating agencies, brokers etc. The public disclosure regime for insurers is largely based on the accounting standards adopted in HKSAR (ICP20).

Mechanisms for Consumer Protection

36. The consumer protection regime is supported by a predominantly self-regulatory regime for market conduct requirements, dispute resolution mechanisms, and policyholder protection funds (PPF). The IA and the relevant SROs supervises the professional conduct of insurers and intermediaries. The Financial Dispute Resolution Centre Limited¹³ currently covers the banking and securities sectors. For the insurance industry, the HKFI has established the Insurance Claims Complaints Bureau (ICCB) that serves as an alternative dispute resolution mechanism to resolve personal insurance claims disputes between policyholders and insurers. All insurers writing personal lines of business are members of ICCB. The jurisdiction limit for the ICCB has been progressively increased from HK\$250,000 in 1990 to HK\$800,000 in 2006. The ICCB's decisions are binding on insurers but complainants can pursue legal action if unsatisfied by its ruling.

37. There are two insolvency funds for mandatory insurances to protect policyholders or claimants against insolvency of insurers:

- The Motor Insurers' Bureau¹⁴ operates an Insolvency Fund, which is available to meeting claims for bodily injuries or death arising from motor accidents. This Fund protects, without limit, any final claim which is not paid in full by a member insurer due to its insolvency. The Fund has been gradually built up by a 2.5 percent levy on all motor policy premiums when it was established in 1985. The levy rate has since been revised several times and has been adjusted to 2 percent from July 1, 2012.
- The Employees Compensation Insurer Insolvency Scheme administered by the Employees Compensation Insurer Insolvency Bureau covers employees' compensation claims. It is funded by a levy of 2 percent on member insurers.

38. The HKSAR Government plans to introduce in 2015 a Bill to establish two PPF, one for long-term business and one for general business (except for the mandatory insurances mentioned). The authorities have consulted on the key proposals of the PPF in January 2012, and the Government aims to introduce the bill into the legislature in 2015. The key proposals include:

- All authorized direct life and non-life insurers, except reinsurers, captive insurers and wholesale retirement schemes, will be required to participate in the PPF. Both Schemes will cover direct insurance policies written in HKSAR.

¹³ It is a non-profit making organization that administers a Financial Dispute Resolution Scheme whereby independent and impartial mediators and arbitrators provide mediation and arbitration services to financial institutions and their customers (individuals and sole proprietors).

¹⁴ A limited liability company established by the insurance industry.

- The PPF will cover individual policyholders, small and medium enterprises, as well as building owners' corporations.
- The compensation will be 100 percent for the first HK\$100,000 of any claim, plus 80 percent of the balance, up to a total compensation limit of HK\$1 million.
- The PPF will facilitate the transfer of life policies and accident and health policies with guaranteed renewability.
- The PPF will be funded by a levy on insurers set at 0.07 percent of premium.

Efficient Financial Markets

39. As a major international financial sector, financial markets in HKSAR are generally deep and liquid, although there is scope for further development of the bond markets.

There are no barriers of access to the market by foreign businesses, and no restrictions on capital flows into and out of HKSAR. There are also no exchange controls. In addition, HKSAR was the world's sixth largest foreign exchange market in terms of turnover in 2010,¹⁵ largely benefiting from its favorable time zone location. Hong Kong Exchange was the sixth largest exchange in the world and the second largest in Asia in terms of market capitalization (US\$2,873 billion) as at end-May 2013.¹⁶ Some long-term insurers have indicated that the limited supply of longer-term government and corporate securities constrains their asset-liability management, with implications for their product design and development.

Insurance Core Principle	Level	Overall Comments
1. Objectives, Powers and Responsibilities of the Supervisor	LO	<p>The authorities responsible for insurance regulation and supervision and the objectives of insurance supervision are clearly defined in the ICO. The IA has taken action to recommend amendments to the ICO when conflicts between legislation and supervisory objectives were identified. While the IA is authorized to issue guidance on its supervisory expectation, it is not empowered to issue enforceable rules by administrative means.</p> <p>The ICO does not explicitly address the objectives and authority for the supervision of insurance groups. Under the current institutional arrangement, close coordination between the IA and the relevant SROs exercising CoB supervision of intermediaries is critical to achieving the overall objectives of insurance supervision. The responsibility for supervising insurance intermediaries is to be transferred to the proposed IIA.</p>

¹⁵ According to 2010 Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity conducted by the Bank for International Settlements (<http://www.bis.org/publ/rpfx10t.pdf>)

¹⁶ Source of information: World Federation of Exchanges (http://www.world-exchanges.org/files/WFE%20Key%20Market%20Indicators_May%202013.pdf)

Insurance Core Principle	Level	Overall Comments
2. Supervisor	PO	The Commissioner/IA is appointed by the CE and the OCI is currently an agency of the government. The ICO does not explicitly provide for criteria for the appointment of the IA and there is no legal provision on the disclosure of the reasons for the dismissal of the IA. In addition, the CE may give direction to the IA on the performance of the functions under ICO and has authority to exempt/vary the provisions of the ICO for certain insurers. Although such reserve powers have not been exercised by the CE, these powers could potentially be exercised in a manner that could compromise the operational autonomy of the IA. While substantially funded by the government, the IA has adequate financial and supervisory resources and the discretion to allocate resources in accordance with supervisory priorities. There is adequate legal protection of confidential information and a robust code of conduct applies to the IA staff. The IA and staff members have appropriate legal protection.
3. Information Exchange and Confidentiality Requirements	O	The IA is empowered to exchange information of regulated entities with regulatory authorities based on the statutory gateways provided under the ICO. The information exchange is typically done via a framework of cooperation agreements. To this end, the IA has entered into cooperation agreements with local and relevant overseas regulators and is also one of the signatories to the IAIS Multilateral Memorandum of Understanding (MoU). In exchanging regulatory information, the IA and its staff are required to observe the confidentiality requirements under the ICO. While the IA does not have explicit legal authority to obtain and share information with respect to non-regulated entities within an insurance group, such information may be accessed indirectly through the regulated entity if necessary.
4. Licensing	O	The ICO clearly defines the insurance activities that require authorization and sets out the authorization requirements. The IA has issued guidance notes explaining clearly the authorization criteria as well as the required information, process and timing in considering an application. The licensing process involves significant interaction with the applicants and the IA exercises appropriate due diligence. The IA also visits an applicant that has received in-principle approval before issuing a Certificate of Authorization.
5. Suitability of Persons	LO	The ICO establishes fit and proper requirements on controllers and directors. The IA has issued guidance on its supervisory assessment of the fitness and propriety of controllers and directors. However, the fit and proper requirements do not apply to Senior Management (other than the Managing Director (MD) or CEO) and Key Persons in Control Functions. The IA is empowered to

Insurance Core Principle	Level	Overall Comments
		issue a notice of objection on the proposed appointments (or the continued appointment) of controllers or directors although there has not been a need to issue such an objection in recent years.
6. Changes in Control and Portfolio Transfers	O	While there is no explicit definition of control under the ICO, the IA approves shareholder controllers of locally-incorporated insurers and monitors changes in their particulars including increase/decrease in their shareholdings. Portfolio transfers are subject to court sanction (long-term insurance) or approval from the IA (general insurance).
7. Corporate Governance	LO	The IA has issued the guidance note on corporate governance in 2002, which is largely in line with ICP7. GN10 was being reviewed at the time of this assessment to better reflect current international best practices. The IA monitors and assesses insurers' corporate governance as part of its on-going supervision, including evaluating the effectiveness of corporate governance in practice. There are no explicit requirements on the corporate governance of groups.
8. Risk Management and Internal Controls	LO	<p>GN10 provides high-level guidance on risk management systems and internal audit function. GN13 covers risk management functions relating to insurers' investments operations and asset liability management. GN14 establishes requirements on risk management relating to outsourcing. GN10 does not have explicit provision on the establishment of an effective risk management function covering all material risks. Although the ICO adopts the Appointed Actuary system, there is no explicit requirement on insurers to establish an effective actuarial function. There is also no explicit provision on insurers having a compliance function.</p> <p>A majority of large insurers have investment, reinsurance and risk management committees. While there is no requirement to have a dedicated Chief Risk Officer (CRO), nevertheless a majority of the large insurers have such a function. The majority of CROs report to the CEO or to the Risk Committee of the Board of Directors. Equally, a majority of large insurers have a head of compliance.</p>
9. Supervisory Review and Reporting	LO	The ICO empowers the IA to require insurers to provide comprehensive supervisory information, including on off-balance sheet guarantees, material outsourcing activities, and corporate governance framework/practices. Notwithstanding the lack of explicit legal authority, the IA has been conducting inspections of insurers regularly. To promote consistency and effectiveness of supervisory assessments, the IA has established an internal operations manual that sets out procedures and relevant checklists to guide supervisory staff in assessing insurers' financial condition and risk profiles.

Insurance Core Principle	Level	Overall Comments
		<p>The supervisory approach of the IA involves close communication and dialogue with management and the Board of insurers, to facilitate understanding of their strategies and operations. The IA takes account of the evolving risks profiles of insurers as part of its on-going supervision, notwithstanding that a formal risk-based supervision has not been implemented. The CoB supervision of insurance intermediaries will be transferred to the proposed IIA.</p> <p>The ICO has not established an explicit group-supervision framework, but it requires that an insurer that is a holding company must submit its consolidated financial statement. The IA has no explicit power to obtain information from non-regulated entities within an insurance group, in order to supervise insurance groups in a holistic manner.</p>
10. Preventive and Corrective Measures	O	Carrying insurance business in HKSAR without an authorization from the IA is an offence under the ICO. The IA would investigate any suspicious unauthorized activities and refer the matter to the police for further investigations, where appropriate. The ICO confers powers on the IA to take a broad range of proportionate corrective and preventive measures under specified grounds. The IA's policy is to make timely intervention and communicate its actions to the insurer in a transparent manner.
11. Enforcement	LO	The IA is empowered to take supervisory interventions in a progressive approach that is commensurate with the severity of the offence. It monitors insurers' compliance with the enforcement actions imposed and may take further actions, as appropriate. There are established internal guides as well as arrangements to ensure consistent and fair application of enforcement actions and sanctions. The proposed IIA will have enhanced enforcement powers to initiate and conduct investigations, prosecute offences summarily, and enhanced sanctions powers.
12. Winding-up and Exit from the Market	O	The procedures governing the winding-up of insurers are provided in the ICO and CO. An insurer shall not be wound up voluntarily unless ordered by the Court. The Court may make an order on the petition of 10 or more policyholders or the IA on specified grounds. Claimants of general insurance are given preferential priority of distribution of assets in liquidation under the CO. Long-term insurers are required to ensure proper segregation of applicable insurance funds, and the assets belonging to respective funds can only be applied to liabilities attributable to that part of that business to which the fund relates. The insurance fund concept is intended to protect long-term policyholders' entitlement to assets

Insurance Core Principle	Level	Overall Comments
		<p>belonging to each fund. While it is highly likely the court would rule in favor of policyholders vis-à-vis unsecured creditors, it is preferable that an explicit priority ranking of long-term policyholders vis-à-vis unsecured creditors be established under the relevant laws.</p>
<p>13. Reinsurance and Other Forms of Risk Transfer</p>	<p>LO</p>	<p>One of the authorization conditions under the ICO is the adequacy of reinsurance arrangement. The IA supervises insurers' governance of their reinsurance arrangements and encourages the establishment of Reinsurance Committee. It also examines reinsurance treaties provided by insurers annually, and assesses the adequacy of the reinsurance programs. Insurers are required to obtain prior approval of the IA for financial reinsurance. The proposed guidance note on reinsurance will bring the reinsurance regime in line with ICP 13.</p> <p>GN 12 exempts insurers who meet certain requirements from limits on reinsurance beyond which collateral are required. This could potentially lead to an excessive concentration or liquidity risk to related companies. To mitigate this risk, the IA adopts a restrictive supervisory practice that discourages the excessive use of intra-group reinsurance.</p>
<p>14. Valuation</p>	<p>LO</p>	<p>The valuation of assets and liabilities is based on an amortized cost approach for long-term insurance, while for general insurance the valuation of assets is based on a fair value approach and liabilities are not discounted. Decision usefulness is enhanced by the DST for long-term business.</p> <p>For general insurance, insurance liability cash flows are not discounted (this is not mandated by ICP 14), and the valuation of assets is based on market values with haircuts. For long-term business, technical provisions are based on current assumptions and discounted with the expected asset return, with haircuts to take into account credit risk and bonds are valued at amortized cost. For Class G business (investment guarantees), technical provisions must be adequate to cover most of the adverse situations with a 99 percent level of confidence.</p> <p>While due regard has to be given to the reasonable expectations of participating policyholders, there is no guidance on what this means in practice and how the interest of different policyholder generations and other stakeholders are taken into account—both in a going—concern and distress situation.</p> <p>The requirements for estimating technical provisions take into account the specifics of the different underlying risks. However there is no clear overarching</p>

Insurance Core Principle	Level	Overall Comments
		<p>methodology used for the valuation. This makes it difficult to assess the overall sufficiency of technical provisions of insurers. Except for employees' compensation and motor business, there is no requirement to have an explicit margin over current estimate (MOCE). Rather, the MOCE is implicit, via no discounting for general insurance business and using prudent assumptions for long-term business.</p> <p>The valuation used for long-term business is generally perceived by industry to be prudent, in particular due to the fact that no allowance can be made for the voluntary discontinuance of contracts if the amount of the liability so determined would be reduced. However, the discount rate which is linked to the expected asset yield might not necessarily be prudent, in particular in an environment with falling interest rates. On the other hand, the reinvestment yield component of the discount rate reflects the current spot rate which mitigates the effect to a certain extent. These inconsistent levels of implicit prudence make it challenging to assess the overall margin for risk. While the valuation standard might introduce the potential for unintended investment incentives: to go into risky assets to increase the discount rate or to remain invested in risky and non-performing assets in time of financial market stresses, there is no evidence that insurers have done so. The existing DST includes testing the impact on solvency under prescribed scenarios of drop in values of equities, but it needs to be strengthened to take into consideration the above.</p>
15. Investment	O	<p>The IA has issued guidance setting out its supervisory expectation on insurers' investment management including formulating sound investment strategy, well documented investment policies and limits, asset-liability management, investment risk management and policy on the use of financial derivatives. Insurers are required to submit their investment policy and information on their investment portfolio to the IA for review. The guidance is qualitative and principles-based.</p> <p>HKSAR is one of the leading international financial centers and insurers have a broad choice of investment instruments for assets-liability management. However, insurers have indicated that the market for long dated bonds is not very deep, making the management of liabilities with long duration challenging.</p>
16. Enterprise Risk Management for Solvency Purposes	PO	<p>The ICO has only set out capital adequacy requirements. It has not provided for enterprise risk management (ERM) or Own Risk and Solvency Assessment (ORSA) requirements, which are integral parts of a risk-based regime. Risk management is addressed separately</p>

Insurance Core Principle	Level	Overall Comments
		<p>through the DSTs. Under the DST, insurers writing long-term business are required to capture certain elements of an ORSA. However, for general insurers and for insurance groups, there are no ORSA requirements. In addition, there are currently no explicit requirements on insurers to:</p> <ul style="list-style-type: none"> a) implement an ERM framework for solvency purposes. Currently, the asset-liability management guidance note focuses on investment risks while GN10 defines risk management practices as high level principles; b) adopt a risk management policy that details how all relevant and material risks are managed on a regulatory and economic basis; and c) establish and maintain a risk tolerance statement and risk tolerance limits which take into account all relevant and material categories of risk.
17. Capital Adequacy	PO	<p>The ICO sets out the existing capital adequacy framework, which is in essence a rules-based solvency regime with a set of standardized methods for calculating the required amount of capital. The law does not permit the use of tailored approaches (i.e. partial or full internal models).</p> <p>The capital requirement is not based on a clear, transparent underlying methodology. Some risks are reflected in the required amount of capital, some are reflected in haircuts applied to assets and others in prudent margins in liabilities, while others are treated via qualitative requirements; differing on the lines of business.</p> <p>There is no capital adequacy test on a group-wide basis and the current capital requirement is purely legal entity based. It is also not able to reflect potential group risks to which subsidiaries are exposed to, e.g. via intra-group transactions.</p>
18. Intermediaries	LO	<p>HKSAR currently adopts a self-regulatory regime for insurance intermediaries, with three SROs responsible for the licensing and CoB regulation of insurance agents and brokers. The IA has been supervising the SROs' oversight, including conducting its own spot checks, inspections and mystery shopping to ensure that the SROs discharge their duties effectively and equitably. While the IA's proactive engagement has provided a safety net and critical quality assurance on the SRO regime, it involves significant duplication of efforts. In addition, industry codes and standards issued by the SROs are not legally binding and the SROs are not full-fledged supervisors, in the absence of a statutory mandate. These constraints dilute the effectiveness of the SRO regime. The move</p>

Insurance Core Principle	Level	Overall Comments
		towards direct supervision by the proposed IIA would also minimize the potential conflict of interests arising from a self-regulatory regime, and is more in line with international best practices.
19. Conduct of Business	PO	The ICO does not provide for any explicit requirements on CoB of insurers, other than fit and proper criteria of controllers and directors. Nonetheless, some aspects of the CoB standards are covered under the corporate governance guidelines issued by the IA and the Code of Conduct for Insurers (CoCIs) issued by HKFI. While the Code of Practice for the Administration of Insurance Agents (CoP) and the MRIB establish industry standards for insurance intermediaries on disclosures, proper advice, professional claims and complaints handling etc., these standards are not legally binding. Furthermore, the CoCIs would not apply to insurers who are not members of the HKFI although its members account for more than 90 percent of the premiums in the insurance market in HKSAR. Personal data collected by insurers and intermediaries are subject to confidentiality safeguards under the PDPO (Personal Data (Privacy) Ordinance (Cap. 486)).
20. Public Disclosure	LO	The current public disclosure regime is largely based on the accounting standards adopted in HKSAR, which is not fully aligned with the disclosure standards under ICP 20. All annual audited accounts of insurers are accessible to the public. While insurers submit more granular information to the IA, with some selected information published by the IA on individual and industry aggregate level. The proposed RBC framework will incorporate disclosure requirements in line with IAIS standards. In addition, the IA will keep in view the second phase development of HKFRS4 on Insurance Contracts regarding disclosure requirements on insurance risks exposures.
21. Countering Fraud in Insurance	O	Fraud is an offence punishable by law. As part of its ongoing supervision, the IA assesses insurers' risk management frameworks to determine their adequacy and effectiveness for managing fraud risk exposures. Domestically, the IA collaborates closely with the insurance industry, law enforcement agencies and other relevant financial regulators. Recognizing the potential for cross-jurisdictional frauds, the IA also works with regional supervisors and is in discussion with supervisors in China and Macau the signing of a MoU specifically on fraud prevention.
22. Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)	O	The AML/CFT statutory obligations of insurance institutions are enshrined in the AMLO and the guidelines issued by the IA. Currently, the AML/CFT regime covers insurers, reinsurers, and insurance intermediaries engaged in long-term insurance business

Insurance Core Principle	Level	Overall Comments
		<p>specifically. The IA is a designated AML/CFT competent authority and is empowered to conduct AML/CFT inspections.</p> <p>The IA has good understanding of the money laundering and financing of terrorism (ML/FT) risks in the insurance sector through AML/CFT surveys, on-site inspections, insurance business statistics, market intelligence, liaison with industry bodies, and suspicious transaction reports data from Joint Financial Intelligence Unit (JFIU) etc. This supports its risks-based approach to supervising insurance institutions' compliance with their AML/CFT obligations. The IA supports the industry's AML/CFT compliance through industry seminars, briefing sessions, training course, website portal and publications, and responding to telephone and written enquiries etc. The IA has sufficient resources to carry out its AML/CFT mandate and monitors the effectiveness of the regulatory regime and its supervisory approach in this area. The IA cooperates and exchanges information with local and overseas supervisory authorities, facilitated by a network of bilateral MoUs and the IAIS Multilateral MoU, subject to confidentiality safeguards. Regular dialogue and meetings with the industry is maintained to promote effective implementation of AML/CFT measures.</p>
23. Group-wide Supervision	PO	<p>The ICO does not have an explicit definition for insurance group nor the scope of an insurance group for the purpose of group-wide supervision. Nonetheless, the IA has identified one insurance group that is based in HKSAR.</p> <p>The IA exercises indirect supervision of an insurance group based in HKSAR through the approval conditions of its holding company as shareholder controller. It actively monitors developments in this group and communicate regularly with other host supervisors of this group either through the supervisory college or on an informal basis. The IA has obtained information from non-regulated entities through the regulated insurer or its holding company, when necessary.</p>
24. Macroprudential Surveillance and Insurance Supervision	LO	<p>The IA identifies, monitors and analyzes various market and financial developments, as well as other environmental factors, which have implications for insurers and the insurance market in HKSAR. It discusses emerging issues or concerns with the industry or individual insurers to facilitate timely preventive actions.</p> <p>As a member of the CFR and the FSC, the IA benefits from the discussions on macro-economic developments, market vulnerabilities and financial stability issues at the meetings of the CFR/FSC. There is no formal process to</p>

Insurance Core Principle	Level	Overall Comments
		assess the potential systemic importance of insurers.
25. Supervisory Cooperation and Coordination	O	<p>The IA places much emphasis on supervisory cooperation both domestically and with foreign supervisors. Domestically, the IA liaises closely with all relevant agencies involved in the financial sector of HKSAR, bilaterally as well as at the CFR and FSC level. It has formalised some of the arrangements through bilateral and joint MoUs.</p> <p>Despite the lack of an explicit group supervision framework, the IA has formally assumed the role of the group-wide supervisor of a large insurance group based in HKSAR with significant cross-border operations. It has organized regular supervisory college meetings and takes the lead in coordinating supervisory work for the group. The IA also contributes actively to relevant supervisory colleges as a host supervisor and participated in more than 50 supervisory colleges since 2010. In exchanging information with other regulators on group issues, the IA is required to preserve confidentiality requirements under the ICO.</p>
26. Cross-border Cooperation and Coordination on Crisis Management	LO	<p>The IA has maintained positive relationship with foreign supervisors, which contributes to effective, coordinated cross-border crisis resolution in the event of need. It has demonstrated its openness and commitment in working collaboratively with relevant foreign home and host supervisors during the global financial crisis in 2008. In addition, the IA has been reviewing and discussing the common tools for managing a cross-border financial crisis with the relevant supervisory colleges. However, there is currently no explicit requirement for insurers to maintain recovery or resolution plans.</p>

Table 10. Hong Kong SAR: Summary of Observance Level

Observed (O)	9
Largely observed (LO)	12
Partly observed (PO)	5
Not observed (NO)	0
Total	26

Table 11. Hong Kong SAR: Recommendations to Improve Observance of the Insurance Core Principles	
Insurance Core Principle	Recommendations
1. Objectives, Powers and Responsibilities of the Supervisor	<p>The impending implementation of the proposed 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:</p> <ul style="list-style-type: none"> 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.
2. Supervisor	<p>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:</p> <ul style="list-style-type: none"> a) provide for the public disclosure of the reasons for the dismissal of the IA in the ICO; and 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.
3. Information Exchange and Confidentiality Requirements	<p>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.</p>
4. Licensing	<p>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.</p>
5. Suitability of Persons	<p>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.</p>
6. Changes in Control and Portfolio Transfers	<p>The authorities are advised to consider:</p> <ul style="list-style-type: none"> 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 <i>vice versa</i>.
7. Corporate Governance	<p>The authorities are advised to:</p> <ul style="list-style-type: none"> 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 GN10 aimed at reflecting current international best practices, incorporating explicit requirements on: <ul style="list-style-type: none"> - The role of the Board in setting risk strategy and risk appetite, in line with an insurer's long-term interests and

Insurance Core Principle	Recommendations
	<p>viability;</p> <ul style="list-style-type: none"> - 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 risk-taking staff; - The Board's policies and procedures to have effective oversight of Senior Management; and <p>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.</p>
8. Risk Management and Internal Controls	<p>The authorities are advised to:</p> <ul style="list-style-type: none"> 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. <p>These requirements could be supplemented by supervisory guidance to facilitate compliance by insurers.</p>
9. Supervisory Review and Reporting	<p>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:</p> <ul style="list-style-type: none"> 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.
11. Enforcement	<p>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.</p>
12. Winding-up and Exit from the Market	<p>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.</p>

Insurance Core Principle	Recommendations
13. Reinsurance and Other Forms of Risk Transfer	<p>It is recommended that the authorities</p> <ol style="list-style-type: none"> 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 – <ul style="list-style-type: none"> • 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.
14. Valuation	<p>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</p> <ul style="list-style-type: none"> • 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. <p>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.</p> <p>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.</p>
15. Investment	<p>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.</p>

Insurance Core Principle	Recommendations
16. Enterprise Risk Management for Solvency Purposes	<p>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.</p> <p>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.</p> <p>The authorities are also encouraged to consider extending the DST to general insurers and to annually review the set of scenarios being used.</p>
17. Capital Adequacy	<p>It is recommended that the authorities:</p> <ol style="list-style-type: none"> a) Extend the current solvency margin requirements to long-term Class C business. b) Formulate the proposed RBC framework such that the capital requirements: <ul style="list-style-type: none"> • 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, 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.

Insurance Core Principle	Recommendations
	<p>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.</p>
18. Intermediaries	<p>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.</p>
19. Conduct of Business	<p>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.</p>
20. Public Disclosure	<p>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.</p>
22. Anti-Money Laundering and Combating the Financing of Terrorism	<p>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.</p>
23. Group-wide Supervision	<p>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.</p>

Insurance Core Principle	Recommendations
24. Macroprudential Surveillance and Insurance Supervision	<p>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:</p> <ul style="list-style-type: none"> 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., <i>bancassurance</i>, ULPs and mortgage insurers; and e) Inclusion of risks arising from system-wide market conduct issues, including reputational risks.
26. Cross-border Cooperation and Coordination on Crisis Management	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> 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.

AUTHORITIES' RESPONSE TO THE ASSESSMENT

The IA greatly appreciates the opportunity to be assessed by the IMF against the new set of IAIS ICPs. The entire FSAP process has provided an opportunity for the IA to thoroughly review the insurance regulatory framework of Hong Kong and pave ways for further improvement. The implementation plan of IMF's recommendations is elaborated as below:

- the HKSAR Government is strongly committed to establishing an IIA which is a statutory body independent of the government. A Bill to amend the ICO would be introduced into the Legislative Council in the second quarter of 2014 for establishing the IIA in 2015;
- through this exercise, the HKSAR Government would also update other aspects of the regulatory regime so as to observe international best practices, e.g., empowering the IIA to give prior approval and revoke insurers' appointment of controllers, directors and key persons in control functions;
- upon the establishment of the IIA, the existing self-regulatory regime for insurance intermediaries will be replaced by a statutory direct licensing regime. The IIA would exercise direct supervision of insurance intermediaries through the statutory licensing regime. The fundamental principles in respect of conduct requirements will be set out in the legislation, with details to be promulgated in subsidiary legislation as well as codes and guidelines to be issued by the IIA. The IIA will be given statutory powers to impose disciplinary sanctions on insurance companies and insurance intermediaries;
- the IA fully agrees with the need to strengthen the existing regulatory regime for insurance groups with operations in Hong Kong. For insurance groups based in Hong Kong, although the ICO does not have explicit provisions on groups, the IA has assumed the role of group-wide supervisor, responsible for leading supervisory colleges and coordinating all periodic meetings with other supervisors to discuss and monitor issues related to the groups. The IA will continue to play this role and will fully collaborate with other supervisors for effective cross-border cooperation and coordination. The IA will also consider how to amend the ICO to provide for group supervision; and
- the IA is developing an RBC framework for Hong Kong. The new RBC framework will be applicable to insurers, both on a solo and group basis, and will encompass the requirements under the relevant ICPs, particularly in the aspects of valuation of assets and liabilities, technical provisions, capital requirements, and other requirements for solvency purposes.

DETAILED ASSESSMENT

Table 12. Hong Kong SAR: Detailed Assessment of Observance of the Insurance Core Principles

ICP 1	<p>Objectives, Powers and Responsibilities of the Supervisor</p> <p>The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.</p>
Description	<p>The ICO clearly provides that the IA is responsible for supervising the insurance industry. A self-regulatory system is adopted for the supervision of intermediaries; undertaken by three SROs in accordance with the non-statutory codes approved by the IA. Please refer to Section C of this report on the institutional arrangements for insurance regulation and supervision.</p> <p>The principal function of the IA is to regulate and supervise the insurance industry to promote the general stability of the insurance industry and protect existing and potential policyholders. To this end, the IA shall:</p> <ol style="list-style-type: none"> Supervise insurers and insurance intermediaries' compliance with the ICO; Consider and propose reforms of the law relating to insurance business; Promote and encourage proper standards of conduct and sound and prudent business practices of the insurers; Promote proper standards of conduct of insurance intermediaries as well as review and revise the regulatory regime for intermediaries; Promote and develop self-regulation by market and professional bodies of the insurance industry; and Cooperate with other financial services regulators, both local and overseas, to the extent permitted by the ICO. (<i>s4A of ICO</i>) <p>The IA's current mandate for CoB supervision largely reflects the self-regulatory regime adopted historically, which would be revised when the proposed IIA assumes direct supervision of intermediaries.</p> <p>The IA exercises its supervision within the legal authorities conferred under the ICO and may take a range of preventive, corrective and enforcement powers under specified statutory grounds. Clear legal authority for inspections, investigations and prosecution as well as enhanced sanctions powers will be introduced under the proposed IIA regime (refer to ICP 9 to ICP 11).</p> <p>If the IA identifies conflicts between the ICO and supervisory objectives, changes to the ICO will be initiated. A clear illustration is the OCI's current status as a government department, which is not in line with international best practices in conferring adequate legal and operational flexibility to insurance supervisors. The proposed IIA initiative is at an advanced stage, and the draft legislation is expected to be submitted to the legislature in Q2 2014. Similar changes are underway in relation to the establishment of two PPFs and the introduction of an RBC regime.</p> <p>The CE has the authority to issue regulation on specified topics and generally pursuant to the specified provisions under the ICO. The IA may issue regulation, with the approval of the Financial Secretary, to: a) amend specified Schedules under the ICO; b) prescribe</p>

	<p>standards to be complied with an appointed actuary; and c) provide for the better carrying into effect of the ICO. The IA may publish guidance notes to explain how powers conferred by the ICO would be exercised or issue circular letters to insurers. (<i>s59 and s4A(3) of ICO</i>)</p> <p>While the guidance notes and circulars do not have the force of law, insurers are expected to voluntarily comply with the IA's supervisory expectations. The IA also explained that supervisory interventions may be taken on fit and proper grounds if insurers fail to comply with the guidelines. In this regard, current international best practice is for supervisors to be empowered to issue directly legally enforceable rules/standards via administrative means without going through the parliamentary process, in accordance with the parameters specified in the primary legislation. This allows the supervisor to respond in a timely manner to emerging developments and risks while retaining the IA's capacity to articulate supervisory expectation on issues that are difficult to be hardwired in law via guidance. Going forward, it is preferable that the IA be explicitly empowered to issue directly legally enforceable rules.</p>
Assessment	Largely observed.
Comments	<p>The authorities responsible for insurance regulation and supervision and the objectives of insurance supervision are clearly defined in the ICO. The IA has taken action to recommend amendments to the ICO when conflicts between legislation and supervisory objectives were identified. While the IA is authorized to issue guidance on its supervisory expectation, it is not empowered to issue enforceable rules by administrative means.</p> <p>The ICO does not explicitly address the objectives and authority for the supervision of insurance groups. Under the current institutional arrangement, close coordination between the IA and the relevant SROs exercising CoB supervision of intermediaries is critical to achieving the overall objectives of insurance supervision. The responsibility for supervising insurance intermediaries is to be transferred to the proposed IIA.</p> <p>The impending implementation of the proposed 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:</p> <ol style="list-style-type: none"> 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.
ICP 2	<p>Supervisor</p> <p>The supervisor, in the exercise of its functions and powers:</p> <ul style="list-style-type: none"> • is operationally independent, accountable and transparent; • protects confidential information; • has appropriate legal protection; • has adequate resources; and • meets high professional standards.
Description	<p>Governance, accountability and independence</p> <p>The Commissioner of Insurance assumes the position of the IA, the statutory authority under the ICO. The IA has a simple structure with clear delineation of supervisory</p>

	<p>responsibilities. There are four supervisory Divisions; namely Long-term Business, General Business, Enforcement and Policy & Legislation. Each Division is headed by a directorate officer¹⁷. Two other Divisions are responsible for day-to-day administration of the IA and the setting up of the proposed IIA. There is clear delegation of authority for decision making within the IA, for operational decisions as well as significant issues or in case of emergency. As a small agency with an open communication culture, issues/potential issues are always brought to the attention of the IA so that urgent supervisory decisions can be made at the earliest possible opportunity.</p> <p>The CE appoints the Commissioner of Insurance. There is no explicit provision in the ICO on public disclosure of the reasons for the dismissal of the Commissioner. Nonetheless, changes in the appointment of the Commissioner will be publicly announced by the HKSAR Government. The CE may give directions generally or in a particular case with respect to the exercise of any of the Commissioner's functions under the ICO, and the Commissioner shall comply with the direction. The CE may by order direct that, certain provisions of the ICO shall not apply to an insurer or shall apply to the insurer with modifications or variations as specified. The IA informed that the CE has not exercised these powers. (<i>s4 and s53 of ICO</i>)</p> <p>The ICO also provides for the establishment of an Insurance Advisory Committee (IAC) to advise the CE on the administration of the ICO; or on insurance issues either referred by the CE or in the interests of the insurance industry in HKSAR. The Financial Secretary or his representative shall be the chairman of the IAC, which comprises members appointed by the CE¹⁸. The IAC meets two or three time a year and the IA sets the agenda for the meetings. It is a discussion forum with no authority to make policy decisions. (<i>s54 of ICO</i>)</p> <p>Insurers and intermediaries may appeal to the Financial Secretary against specific decisions of the IA, under the circumstances and in accordance with the procedures specified in the ICO. (<i>s11(2) & (4), s13A(8), s13B(7), s14(6), s38D(1)(b)&(2), s38E(8), s50B(5)&(6), s66(8)&(9) and s75(2) of ICO.</i>)</p> <p>The Judiciary of the HKSAR is independent of the legislature and the HKSAR Government. The courts make their own judgments regardless of the parties involved, be they private citizens, corporate bodies or the Government. The Judiciary does not interfere into the IA's supervisory work. In case there are lawsuits or judicial reviews against the IA, the Judiciary will only judge on the merits of the cases in question.</p> <p>The IA is subject to the scrutiny of the Audit Commission of the HKSAR Government. In addition, for general business, statutory deposits with the IA made by insurers are subject to audit by the Audit Commission. (<i>s35B of ICO</i>)</p> <p>Going forward, the proposal for the IIA include:</p> <ol style="list-style-type: none"> a) The composition, appointment and dismissal of the chairman, chief executive officer (CEO) and other members of the governing board of the IIA would be clearly provided in the legislation; b) An Insurance Appeals Tribunal to confirm, vary or set aside a decision by the IIA. A
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¹⁷ Senior management rank under the civil service scheme in HKSAR.

¹⁸ The IAC members comprise representatives from diverse background including insurance industry participants, consumers, Legislative Council members, lawyer, academia, actuary etc.

- list of specified regulatory decisions made in relation to insurers and intermediaries will be subject to the Tribunal's review;
- c) A Process Review Panel to review the proposed IIA's observance with established supervisory processes; and
 - d) A staff handbook to formalize the decision making authority including policies and procedures to deal with significant issues and in case of emergencies.

Funding and supervisory resources

The IA currently recovers some 37 percent of its annual operating costs from fixed annual license fees paid by insurers. The fees have remained unchanged since 1996. The IA can and have requested for additional resources from the Government if needed, and has the discretion to allocate the resources in accordance with supervisory priorities.

The IA regularly takes stock of the skills and experiences of staff members, and projects requirements over the short to medium term. The hiring policies are in accordance with that of the HKSAR Government. As at end-2012, the IA has 103 full-time-equivalent (FTE) supervisors, of which 48 FTEs had more than 10 years of supervisory experience. The staff turnover rates have been low. A broad range of training and professional development programs are provided to keep staff updated of industry and professional practices.

When outsourcing some of the supervisory work to external parties, the IA follows the procurement policy and process as well as salary scale of the HKSAR Government. Specifications, including the experience, capability, expertise, method of approach of the selected consultants are assessed by the IA prior to the consideration by the Central Consultants Selection Board. The external experts are subject to the same legal requirements that are applicable to IA staff and are required to sign confidentiality undertakings upon award of the contract.

The proposed IIA will be self-financed with industry levies as well as user fees and charges. The IIA proposals include changes in supervisory fees structure to ensure stable sources of revenue on a cost-recovery basis and implemented in phased approach. The long-term target is to have about 70 percent of IIA's expenditure met by a levy of 0.1 percent on insurance premiums and the remaining 30 percent by the various license and user fees. It is proposed that the Government provides a lump sum of HK\$500 million on the IIA's inception to help meet part of its expenses in the initial years. The proposed IIA will also have more flexibility on its remuneration structure.

Transparency and Review of Requirements and Procedures

The regulatory requirements and supervisory procedures of the IA are clearly set out in the ICO and regulations as well as guidance notes and circulars issued by the IA. All legislation, guidance notes and circulars are available on the IA's website. Similarly, information about the insurance industry, the IA's role, structure and responsibilities, its annual reports, circulars, newsletters, press releases, quarterly & annual statistics on the insurance sector, etc. are published on the IA's website.

The IA constantly reviews the ICO and updates the guidance notes promulgated to the industry. The insurance industry participants are consulted in the development of new/revised requirements, guidance notes and circulars. All major regulatory reforms are subject to public consultation.

	<p>Confidentiality, supervisory integrity and legal protection</p> <p>Any public officer, employees of the IA, Advisor or Manager as well as persons assisting Advisor or Manager are required to preserve confidential of information obtained in the course of their duties. The legal gateways for disclosure of information are outlined under ICP 3. A breach of the secrecy provision of the ICO is an offence, liable to penalties including imprisonment. (<i>s53A of ICO</i>)</p> <p>The IA has issued internal circulars to all staff on avoidance of conflict of interests, acceptance of advantages, declaration of private investments, and outside work. All IA staff members are to make a conscious effort to avoid or declare any conflicts of interest situation. They are expected to be honest, impartial and objective in carrying out their duties. They should not solicit or accept, directly or indirectly, any advantage or gift which might reasonably be seen to compromise their integrity or judgment. They should not place themselves under any financial or other obligation to outside individuals or organizations that might seek to influence them in the performance of their official duties. They should ensure that the views they express will not compromise their capacity to fulfill their official duties professionally, effectively and impartially. The IA and staff members are also bound by the Prevention of Bribery Ordinance.</p> <p>No liability shall be incurred by the Government or any public officer, Advisor or Manager in performing their functions, or exercising the power conferred by the ICO in good faith. (<i>s55A of ICO</i>)</p>
<p>Assessment</p>	<p>Partly observed.</p>
<p>Comments</p>	<p>The Commissioner/IA is appointed by the CE and the OCI is currently an agency of the government. The ICO does not explicitly provide for criteria for the appointment of the IA and there is no legal provision on the disclosure of the reasons for the dismissal of the IA. In addition, the CE may give direction to the IA on the performance of the functions under ICO and has authority to exempt/vary the provisions of the ICO for certain insurers. Although such powers have not been exercised by the CE, these reserve powers could potentially be exercised in a manner that could compromise the operational autonomy of the IA. While substantially funded by the government, the IA has adequate financial and supervisory resources and the discretion to allocate resources in accordance with supervisory priorities. There is adequate legal protection of confidential information and a robust code of conduct applies to the IA staff. The IA and staff members have appropriate legal protection.</p> <p>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:</p> <ol style="list-style-type: none"> a) provide for the public disclosure of the reasons for the dismissal of the IA in the ICO; and 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.
<p>ICP 3</p>	<p>Information Exchange and Confidentiality Requirements</p> <p>The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose and use requirements.</p>

Description	<p>Exchanges with Domestic Authorities</p> <p>The statutory basis for disclosure of information are:</p> <p>a) Production of document/information for: the prosecution for any offence; the determination by the Court of First Instance (Court) of an application for transfer of long-term business; or a winding up order by the Court</p> <p>b) disclosure of information:</p> <ul style="list-style-type: none"> - in the form of a summary; - for the purpose criminal proceedings/investigation or civil proceedings under the ICO; - by the IA: for the purposes of disciplinary proceedings relating to a prescribed person; with the consent of the person concerned; if the information has been made available to the public; - disclosure of accounts, statements and information relating to the business of an insurer that, in the opinion of the IA, is desirable in the interests of existing or potential policy holders or in the public interest - by the IA to: a prescribed person¹⁹; to an auditor or actuary of an insurer or insurance broker(s); the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Review Tribunal - communication by a prescribed person with the consent of the IA; or the reporting of certain cases by a prescribed person to the IA e.g., matters that have adverse effect on the financial condition or solvency of an insurer (<i>s53D and s53E of ICO</i>); - to the Financial Secretary, a person holding an authorized statutory office²⁰ or persons authorized by the Financial Secretary in the interests of (or without compromising the interests of) existing or potential policyholders or the public interest. (<i>s53A of ICO</i>) <p>The person(s) who receive information under b) shall not disclose the information to any other person without the consent of the IA. The IA, and a person employed or authorized by or assisting the IA, shall not disclose any information relating to the affairs of any individual policyholder. (<i>s53A of ICO</i>)</p> <p>To formalize the sharing and exchange of information among local financial regulators, the IA has entered into cooperation agreements with each of them (ICP 25), and assistance will be provided upon request, subject to the provisions of the agreements (including the permissible uses and confidentiality protection).</p> <p>Exchanges with Foreign Authorities</p> <p>The IA may disclose information to a foreign authority where:</p> <p>a) that authority exercises functions that corresponding to the functions of the IA or an authorized statutory office; and</p> <p>b) in the opinion of the IA that authority is subject to adequate secrecy provisions; and it is desirable or expedient that the information should be disclosed in the interests of existing or potential policy holders or the public interest; or such disclosure will enable or assist the recipient to exercise his functions and it is not contrary to the interests of</p>
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¹⁹ Defined as an (former) auditor, (former) actuary; or (former) accountant of an (former) insurer; and (former) auditor of an (former) insurance broker.

²⁰ This means the HKMA, SFC, the Mandatory Provident Fund Schemes Authority and the Financial Reporting Council.

	<p>existing or potential policy holders or the public interest.</p> <p>The IA shall not provide any information relating to the affairs of any individual policy holder of an insurer. (<i>s53B of ICO</i>)</p> <p>The IA has entered into cooperation agreements with all relevant overseas regulators in jurisdictions where HKSAR insurers have operations, and it is one of the signatories of the IAIS Multilateral MoU.</p> <p>Subject to confidentiality safeguards and the provisions of the cooperation agreements, a foreign authority may disclose the information it obtained from the IA to other supervisors/bodies. Generally, the foreign authority is required to notify the IA of the request and seek its consent prior to making a disclosure. Any information obtained by a foreign authority under the co-operation agreement needs to be kept confidential and not to be disclosed to third parties without prior commitment from such third parties to keep the information confidential.</p> <p>An insurer shall permit foreign insurance supervisor(s) to examine its books, accounts and transactions in HKSAR, subject to the approval of the IA. The IA shall not give an approval unless it is desirable or expedient that the examination is in the interests of existing or potential policy holders or in the public interest. (<i>s53B of ICO</i>)</p> <p>Insurance groups</p> <p>The ICO does not provide explicit powers to the IA to obtain information from non-regulated entities within an insurance group and to share such information to relevant supervisors. In practice, the IA may obtain such information, if deemed necessary. The IA takes into account all potential impacts that its decisions may have on the insurance group entities as well as the stability of both the local and global financial system. The IA will engage in close dialogues with other relevant supervisors of the insurance group, both local and overseas, before and after the imposition of supervisory interventions on the insurance entity/group in HKSAR.</p> <p>Supervisory practices</p> <p>The IA exchange information with other relevant supervisory and regulatory authorities via a framework of cooperation agreements. The information to be obtained by the IA under the framework of cooperation will be used solely for the purposes set forth in the request and for supervisory purposes. Moreover, all information requested by the IA must be reasonably relevant to securing compliance with the law, regulation or requirement specified in the request.</p> <p>All requests for information made under the cooperation agreement will be assessed by the IA on a case-by-case basis. In considering whether to accept or decline a request, the IA takes into account:</p> <ol style="list-style-type: none"> a) matters specified by the laws and regulations in the jurisdiction of the foreign authority who made such a request; b) whether the request involves an assertion of jurisdiction not recognized by the IA; and c) whether the request would be contrary to the essential interests of the IA to give the assistance sought. <p>The IA facilitates an appropriate and timely response to the request for information if it is reasonably relevant to securing compliance with the law, regulation or requirement, given</p>
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	<p>that the following is specified in the request:</p> <ol style="list-style-type: none"> a) the information/assistance required; b) the purpose for which the information/assistance is sought; c) a description of any particular conduct/suspected conduct which has given rise to the request, and its connection with the authority seeking the information/assistance; d) the link between any suspected breach of law, regulation/requirement and the regulatory functions of the authority seeking information/assistance; e) the relevance of the requested information/assistance to any suspected breach of law, regulation/requirement of the authority seeking information/assistance; and f) any information related to the urgency of the request. <p>The IA only requires strict reciprocity in regard to the confidentiality guarantees before it exchanges information with other supervisors. Reciprocity in terms of level, format and/or detailed characteristics of the information exchanged is not a prerequisite.</p> <p>The IA checks that the recipient of information is subject to adequate confidentiality safeguards. A foreign authority requesting for information is required to have adequate secrecy provisions in its jurisdiction before the IA can make any disclosure. The IA will remind the foreign authority to keep the information exchanged in strict confidence. The confidentiality requirement also applies to the disclosure of information to law enforcement agencies and local financial regulators. (<i>s53B and s53A of ICO</i>)</p> <p>IA's disclosure of information received from a foreign authority will be subject to the provisions of the cooperation agreement. Any information obtained by the IA under the co-operation agreement will be kept confidential and will not be disclosed to third parties. The IA will generally notify the foreign authority and seek its consent prior to making a disclosure.</p> <p>Should there be a mandatory disclosure requirement or a legally enforceable demand for information under applicable laws, regulations and requirements, the IA will notify the foreign authority, from whom the information is obtained, of its obligation to disclose and will seek consent from the foreign authority prior to making the disclosure.</p>
Assessment	Observed.
Comments	<p>The IA is empowered to exchange information of regulated entities with regulatory authorities based on the statutory gateways provided under the ICO. The information exchange is typically done via a framework of cooperation agreements. To this end, the IA has entered into cooperation agreements with local and relevant overseas regulators and is also one of the signatories to the IAIS Multilateral MoU. In exchanging regulatory information, the IA and its staff are required to observe the confidentiality requirements under the ICO. While the IA does not have explicit legal authority to obtain and share information with respect to non-regulated entities within an insurance group, such information may be accessed indirectly through the regulated entity if necessary.</p> <p>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.</p>

ICP 4	<p>Licensing</p> <p>A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.</p>
Description	<p>It is an offence to carry on insurance business in or from HKSAR without an authorization from the IA. A person shall be deemed to carry on insurance business in or from HKSAR if the person: a) opens or maintains an office or agency in HKSAR for the purpose of carrying on insurance business; or b) holds himself out as carrying on insurance business in or from HKSAR. The same requirement applies whether the person is a legal entity, branch or subsidiary of a foreign insurer. (<i>s6 and s2 (3) of ICO</i>)</p> <p>The following persons are exempted from the ICO:</p> <ul style="list-style-type: none"> a) A not-for-profit body of persons bound by custom, religion, kinship, nationality or regional or local interest whose gross premium income does not exceed HK\$500,000 in any financial year; b) A person carrying on reinsurance business without a physical presence or represented by an agent in HKSAR; c) Registered trade unions carrying on insurance business for its members of provident benefits or strike benefits; d) A registered co-operative society; e) The Hong Kong Export Credit Insurance Corporation; f) Authorized banks that conduct classes G or H long-term business, miscellaneous financial loss or legal expenses, certain group business (accident and health, credit and surety, and retirement schemes); g) The Credit Union League of Hong Kong; and h) A recognized clearing house or authorized automated trading services in guaranteeing the settlement of securities or futures transactions. (<i>s51 of ICO</i>) <p>The IA has confirmed that no persons are conducting insurance business and exempted under a), c) and d) above. Under international best practices, insurance laws typically establish quantitative thresholds for exemptions from licensing and the supervisors would monitor compliance with the exemption conditions.</p> <p>The ICO provides for the following classes of insurance business:</p> <ul style="list-style-type: none"> a) Long-term business: life and annuity (Class A); marriage and birth (B); linked long term or ULP²¹ (C); permanent health (D); tontines²² (E); capital redemption²³ (F); group retirement scheme contracts providing for a guaranteed capital or return (G); group retirement scheme contracts not providing for a guaranteed capital or return (H); and group retirement schemes excluding classes G and H (I); b) General business, which comprises 17 categories; and c) Group business, with 11 categories. (<i>Schedule 1, Part 2 and Part 3 of ICO</i>);

²¹ ULP are policies where the benefits vary wholly or partly with the market values of the underlying investments attributable to the policies.

²² Under a tontine, a group of persons contribute to a pool of funds and receives regular dividends. The accumulated contributions are payable to the last survivor(s) at the end of a defined period. This is a historical provision and no tontine has been authorized.

²³ A contract to provide a capital sum at the end of a term in order to replace one's capital because, e.g. Debentures will become repayable; not related to human life.

	<p>The IA is empowered to authorize insurers (i.e. direct insurer, reinsurer or captive insurer) to carry on insurance business in or from HKSAR, based on the criteria established under the ICO. It has issued a Guidance Note on Application for Authorization to Carry on Insurance Business in or from Hong Kong (GN5) to set out its supervisory expectations. (<i>s8 of ICO</i>)</p> <p>The criteria for authorization under the ICO include:</p> <ol style="list-style-type: none"> a) Fitness and propriety of any director or controller of the applicant (ICP 5); b) Meeting applicable minimum financial requirements (<i>s8(3) and s10 of ICO</i>); c) Adequate reinsurance arrangements; d) Demonstration that the applicant is, and will continue to be, able to meet its obligations; e) Ability to comply with the provisions of the ICO; and f) The carrying on of any proposed non-insurance business, where applicable, is not contrary to the interest of existing and potential policyholders. <p>With the exception of professional reinsurer, new composite insurers are not permitted although existing composite insurers have been grandfathered. The authorization criteria for captive insurers are lower, e.g., minimum assets of HK\$ 2 million compared to HK\$ 10 million for general insurers. (<i>GN 5 and s2 (7) and s10(1A) of ICO</i>)</p> <p>A foreign company applying to establish a branch in HKSAR must satisfy the IA that it is: incorporated in a country with comprehensive company law and insurance law; an insurer under effective supervision in its home country; and a well-established insurer with international experience and of undoubted financial standing. If a local insurer applies for license in a foreign jurisdiction, the IA will disclose relevant information to the home supervisor upon request. (<i>GN5 and s53B of ICO</i>)</p> <p>There is no explicit prohibition for an insurer to conduct cross border insurance activities without a physical presence in HKSAR. In practice, such insurers would use brokers in HKSAR to place business overseas²⁴. In this regard, the IA requires insurance brokers to demonstrate that the suitable policies are not available locally and advise their clients of the unauthorized status of the insurer and obtain a written acknowledgement of the fact from the client. (<i>Minimum Requirements for Insurance Brokers, MRIB</i>)</p> <p>The IA maintains a register of authorized insurers, which is open for public inspection for a fee. The register contains, <i>inter alia</i>, the class or classes of insurance business authorized and any registration conditions imposed. (<i>s5 of ICO</i>)</p> <p>Appeal against the IA's decision to refuse authorization can be made to the Financial Secretary, whose decision shall be final. The IA may impose conditions on authorization as well as to revoke such conditions. (<i>s11 and s12 of ICO</i>).</p> <p>Long-term insurers are required to separate assets and liabilities attributable to:</p> <ol style="list-style-type: none"> a) long-term business classes other than retirement scheme business (including Class A – life and annuity, Class C – linked long-term, Class D – permanent health etc.); b) retirement scheme business under which contributions provide for a guaranteed
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²⁴ Under the ICO, having an agency in HKSAR shall be deemed as carrying on insurance business in or from HKSAR.

	<p>capital or return; and</p> <p>c) retirement scheme business under which contributions do not provide for a guaranteed capital or return.</p> <p>The ICO permits insurers to group long-term business classes other than retirement scheme business into one fund. However, in practice, the IA requires insurers to further separate those assets and liabilities by classes of business, particularly between the traditional policies and ULPs. Legislative amendments are being pursued to explicitly set out this requirement in the ICP. (<i>s22 of ICO</i>).</p> <p>Assets attributable to a fund shall only be applicable for the purposes of that part of business to which the fund relates and any mortgage or charge shall be void if it contravenes this requirement. Insurers shall also maintain books of account and other records necessary for identifying the assets belonging to each fund and the liabilities attributable to the corresponding funds.</p> <p>Supervisory practices</p> <p>The IA has two designated teams responsible for licensing, one for general business and the other for long-term business. In line with the IA's supervisory expectation under GN5, an applicant for authorization must:</p> <p>a) be an incorporated company ;</p> <p>b) complete the appropriate application forms and provides required information, including: a market feasibility report demonstrating the viability of the proposed business operation; business plan of at least three years accompanied by financial forecasts for each year²⁵; background of the applicant and its group (if applicable); an organizational chart showing the proposed staff establishment with particulars of the qualifications and experiences of the management team; and financial statements for the latest three years preceding the application in respect of the applicant and its corporate controllers;</p> <p>c) demonstrate to the satisfaction of the IA that it is able to meet the authorization criteria, including: maintaining an office in HKSAR, with a locally-based CEO; such office will be managed professionally, with adequate staff commensurate to the nature and scale of the operations in HKSAR; and sufficient financial resources to pre-finance its operation and on-going basis;</p> <p>d) has, and would continue to have, the financial backing of its parent/controller</p> <p>e) demonstrate that there would not be any conflict between the sound management of the insurance operations and the business (including insurance business) interests of their principals or shareholders and, in case the applicant is a member of a group, it would be managed and operated independently of the group with all transactions with related parties effected at arm's length;</p> <p>f) not engage in a "fronting" operation²⁶ (except captive insurer); and</p> <p>g) a proposed long-term insurer must: separate assets and liabilities attributable to its long-term business as required under the ICO (see above); ensure that not less than</p>
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²⁵ In the business plan, two sets of financial projections are required, one on a "best/optimistic estimate" basis and one on a "pessimistic estimate" basis, with the exception of pure reinsurers. A pure reinsurer is required to give financial projections on a "realistic estimate" basis. For captive insurers, only projections on premium income and claims outstanding for the first three years of operation are required.

²⁶ A fronting arrangement is one where a primary/fronting company cedes the risk it has underwritten to its reinsurer with the ceding company retaining none or a small part of that risk for its own account.

	<p>one-sixth of the required solvency margin is held in the long-term business funds; and have an appointed actuary.</p> <p>The IA strongly advises all applicants to arrange for a preliminary meeting to discuss their proposals before submitting their applications. It also recommend that an application should first be submitted in draft form (i.e. unsigned), which would expedite the process by resolving difficult issues before the formal application is submitted. Subject to the sufficiency of information, the IA would advise an applicant of the outcome of its initial assessment on the draft application within two months. Upon being advised of a positive outcome, an applicant may proceed to make a formal application. The IA advises the applicant, within six weeks of receipt of the formal application, of its decision on the application. The assessors review a sample of the licensing files and noted extensive discussions and due diligence checks. (GN5)</p> <p>The applicant shall arrange for the IA to visit its office when it has made all the preparations necessary to commence business as specified in the letter of approval-in-principle. During the visit, the IA ascertains that operational systems and staff are in place to enable the applicant to commence business. A Certificate of Authorization will be issued within two-weeks of the visit. (GN5)</p> <p>The IA would refuse authorization if the applicant does not meet the authorization requirements. It is also empowered to impose authorization conditions. Typical authorization conditions include:</p> <ul style="list-style-type: none"> a) Maintaining an office in HKSAR with a locally-based CEO and to maintain proper books of account and other records in respect of its operations in HKSAR (for foreign branches); b) Membership in the ICCB before writing any personal insurance business (for direct insurers except captive insurers); c) Membership in the Motor Insurers' Bureau of Hong Kong before writing any direct motor vehicle liability insurance business (where applicable); and d) Membership in the Employees Compensation Insurer Insolvency Bureau before writing any employees' compensation insurance business (where applicable). (GN5) <p>The IA will notify the applicant of the conditional/restricted authorization or refusal. Reasons for the decision will be given.</p> <p>The Certificate of Authorization issued by the IA specifies the date of authorization, the class/classes of insurance business authorized, restrictions or conditions imposed (if any) on the class/classes of insurance business authorized.</p>
<p>Assessment</p>	<p>Observed.</p>
<p>Comments</p>	<p>The ICO clearly defines the insurance activities that require authorization and sets out the authorization requirements. The IA has issued guidance notes explaining clearly the authorization criteria as well as the required information, process and timing in considering an application. The licensing process involves significant interaction with the applicants and the IA exercises appropriate due diligence. The IA also visits an applicant that has received in-principle approval before issuing a Certificate of Authorization.</p> <p>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.</p>

ICP 5	<p>Suitability of Persons</p> <p>The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.</p>
Description	<p>The ICO imposes a "fit and proper" requirement on any person who is a director or controller of an insurer. The IA has issued a Guidance Note on "Fit and Proper" Criteria (GN4) to outline the factors that are taken into consideration in administering this requirement. (<i>s8(2) and s9 of ICO</i>)</p> <p>Controllers and Directors</p> <p>With respect to an applicant for authorization, a controller is defined to include:</p> <ul style="list-style-type: none"> a) the MD of the applicant or its holding company b) the CEO²⁷ of the applicant c) the CEO of the applicant responsible for the whole of the Hong Kong operation (in the case of a company incorporated outside Hong Kong) d) the holding company (including intermediate holding companies) of the applicant e) the CEO of the applicant's holding company (only if the holding company is also an insurer) f) Any person controlling 15 percent or more of the voting power of the applicant or its holding companies (including intermediate holding companies). <p>An applicant's board of directors must have sufficient knowledge and relevant experience²⁸ of insurance business to guide the insurer and oversee its activities effectively. (<i>s9 of ICO and GN5</i>)</p> <p>A locally incorporated insurer must obtain the IA's prior approval for the appointment of a MD or a CEO. A person intending to acquire control of 15 percent or more of the shareholdings of a locally incorporated insurer must seek the IA's approval before the acquisition. (<i>s13A and s13B of ICO</i>)</p> <p>The IA may issue a notice of objection on the ground that the person proposed to be appointed as a controller is not a fit and proper person, after serving preliminary notice of the IA's intention. However, the IA is not obliged to disclose the grounds for the notice of objection. The insurer and the person involved may make representations to the IA before the notice of objection is issued. An appeal against the IA's decision may be made to the Financial Secretary, whose decision shall be final. The IA has not issued any notice of objection in the last three years. (<i>s13A and s13B of ICO</i>).</p> <p>An insurer must notify the IA on any change in its directors or controllers in the prescribed form. The IA may, on the ground of a person not being fit and proper to be appointed to the position in question, serve a notice of objection on the insurer and the person concerned, after giving them a preliminary notice. (<i>s14 of ICO</i>)</p>

²⁷ Means an employee who, alone or jointly with others, is responsible under the immediate authority of the directors for the conduct of the whole of the insurance business of the applicant or its parent.

²⁸ Sufficiency would normally mean that at least one-third of the applicant's board has such knowledge and experience.

	<p>A person who is proposed to be appointed or has been appointed as a director or controller of an insurer, is required to submit his particulars in the relevant form to the IA for consideration as to his fitness and properness. <i>(Second, Fourth, Fifth and Sixth Schedules to the ICO)</i></p> <p>Although the ICO does not define “fit and proper”, the IA expects high standards of competence and honesty. In this regard, the IA takes into account all relevant factors, including: financial status; character, reputation, integrity and reliability; qualifications or experience with regard to the nature of the functions to be performed; and ability to perform such functions efficiently, honestly and fairly. The IA assesses whether a person intending to become a shareholder controller has sufficient financial resources to acquire or support the operations of the insurer, and a realistic and viable business plan. The IA has provided guidance on the events and matters that are likely to give rise to concerns about the fitness and properness of a director or controller of an insurer. <i>(GN4)</i></p> <p>Senior Management and Key persons in Control Functions ²⁹</p> <p>The fit and proper requirements under the ICO do not cover Key Persons in Control Functions and Senior Management other than the MD or CEO.</p> <p>Long-term insurers are required to have an Appointed Actuary that meet the IA's prescribed criteria. They must notify the IA if an Appointed Actuary is removed or replaced or ceases to be an Appointed Actuary. An Appointed Actuary shall notify the IA: a) if he resigns; b) where he decides not to seek reappointment; or c) if an insurer has not fully addressed his advice, within a reasonable time, on concerns that may lead to a qualification or adverse amplification/explanation in the actuarial certificate. <i>(s15 and s15B of ICO)</i></p> <p>Supervisory practices</p> <p>As part of the approval process, the IA typically interviews the proposed MD or CEO candidates. The IA maintains on-going monitoring of the fitness and properness of directors and controllers of insurers. This is done through regulatory returns on changes in/proposed appointment of directors, controllers or authorized representatives. The information to be reported includes disciplinary actions or investigations by other regulators in HKSAR or elsewhere. Should there be additional information, e.g., through market intelligence, that may affect the suitability of certain directors or controllers, the IA would follow up with the insurer concerned.</p> <p>If the IA considers that the directors or controllers no longer meet the suitability requirements, the IA may exercise appropriate enforcement powers under the ICO. The IA may also exercise its residual power by requiring the insurer concerned to take whatever action that the IA considers appropriate. <i>(s26(1)(e) and s35(1) of ICO)</i></p> <p>In assessing the suitability of the directors or controllers, the IA can obtain relevant information from relevant foreign authorities through its network of cooperation agreements (ICP3). The IA has sought information from the relevant home supervisor on</p>
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²⁹ Control functions are defined in ICP 8.0.6 to include risk management, compliance, actuarial matters and internal audit.

	controllers.
Assessment	Largely observed.
Comments	<p>The ICO establishes fit and proper requirements on controllers and directors. The IA has issued guidance on its supervisory assessment of the fitness and propriety of controllers and directors. However, the fit and proper requirements do not apply to Senior Management (other than the MD or CEO) and Key Persons in Control Functions. The IA is empowered to issue notice of objection on the proposed appointments (or the continued appointment) of controllers or directors although there has not been a need to issue such an objection in recent years.</p> <p>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.</p>
ICP 6	<p>Changes in Control and Portfolio Transfers</p> <p>Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.</p>
Description	<p>Changes in control</p> <p>The ICO does not define control (or any predetermined control levels), although fit and proper requirements are imposed on “controllers”. Changes in controllers must be notified to the IA. (Please refer to ICP 5).</p> <p>The ICO is silent on whether the approval of the IA is required for any significant increase above the predetermined control levels in an insurer by person(s) and there is no explicit requirement for notification from insurers in the case of a significant decrease below the predetermined control levels. Insurers must report changes in controllers, including any increase/decrease in their holdings, to the IA.</p> <p>The IA requires insurers to report details of beneficial ownership annually or when deemed necessary. The IA assesses the fitness and propriety of controllers based on criteria that are similar to the authorization process. If the IA is not satisfied that a proposed controller is a fit and proper person, the IA will object to the acquisition. (Please refer to ICP 5)</p> <p>The definition of controllers includes a person who is able to exercise the controlling interests through a nominee or associate, which allows the IA to identify beneficial ownership. It is not a common practice for insurers in HKSAR to have shareholder controllers holding their interests via nominees.</p> <p>Demutualization and conversion of companies</p> <p>In HKSAR, many mutual insurance companies have been “demutualized” a decade ago. Apart from P&I clubs, there are currently no mutual insurers. The change from a mutual insurer to a stock insurer, or <i>vice versa</i>, is mostly carried out via a portfolio transfer or a change in shareholding controller.</p> <p>Portfolio Transfer</p> <p>The transfer of the whole or part of the long-term business must be sanctioned by the</p>

	<p>Court of First Instance, on the petition by the transferor or the transferee. The petition shall be accompanied by an independent actuary's report and the Court must be satisfied that:</p> <ul style="list-style-type: none"> a) a notice has been published in the Gazette and newspapers; b) a statement, setting out the terms of the scheme and a summary of the independent actuary's report sufficient to indicate the actuary's opinion on the impact of the transfer on the policyholders of the insurers concerned, has been sent to each policyholder and to every member of those insurers; c) a copy of the petition, the independent actuary's report and the statement has been served on the IA; and d) copies of the petition and the independent actuary's report have been open to inspection at the offices of the insurers concerned for at least 21 days. <p>The IA and any person who alleges that he would be adversely affected by the proposed transfer shall be entitled to be heard. (<i>s24 of ICO</i>)</p> <p>For general business, the transferor may apply to the IA for approval of a portfolio transfer. In approving the transfer, the IA must be satisfied that:</p> <ul style="list-style-type: none"> a) the necessary documentation has been submitted e.g., the proposed instrument of transfer; a report setting out the particulars of the transfer and legal proceedings; the notice published in the Gazette or newspapers; and any other relevant information the IA may require; b) The following requirements are met: the transferor has published a notice in the Gazette and newspapers; the transferor has sent the notice to every affected policy holder and any person who has interest in a policy included in the transfer; the report setting out particulars of the transfer are available to any interested persons; and the transferee's financial resources and other circumstances justify his approval. <p>(<i>s25D of ICO</i>)</p>
Assessment	Observed.
Comments	<p>While there is no explicit definition of control under the ICO, the IA approves shareholder controllers of locally-incorporated insurers and monitors changes in their particulars including increase/decrease in their shareholdings. Portfolio transfers are subject to court sanction (long-term insurance) or approval from the IA (general insurance).</p> <p>The authorities are advised to consider:</p> <ul style="list-style-type: none"> 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 <i>vice versa</i>.
ICP 7	<p>Corporate Governance</p> <p>The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.</p>
Description	<p>The ICO does not contain corporate governance requirements although insurers would be bound by the general requirements under the CO. The IA has issued the Guidance Note on the Corporate Governance of Authorized Insurers (GN10). This Guidance is applicable to all active locally incorporated insurers except captive insurers and insurers incorporated</p>

	<p>outside HKASAR (overseas insurers) with 75 percent or more of annual gross premiums derived from HKSAR (unless exempted by the IA)³⁰.</p> <p>The board of directors (Board) of an insurer has to play a pivotal role in the strategic planning and policy and in monitoring its management. The main responsibilities of the Board include:</p> <ol style="list-style-type: none"> a) Formulating strategic objectives, the means of attaining them and the procedures for monitoring and evaluating the progress towards those objectives; b) Establishing clear nomination and appointment procedures, structure, functions, re-elections and balance between executive and independent non-executive directors; c) Selecting, monitoring and, when necessary, replacing key executives and overseeing succession planning; d) Reviewing the remuneration of the directors and the key executive(s); e) Ensuring the integrity and effectiveness of the internal control system; f) Establishing and monitoring independent risk management functions; g) Setting clear policies regarding conflicts of interest; fair treatment of clients and information sharing with stakeholders; j) Devising clear policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses and other inordinate trade practices of a non-arm's length nature. <i>(p9 of GN10)</i> <p>The Board is held accountable for distinguishing clearly between the responsibilities, accountabilities, decision-making, interaction and cooperation of the Board, Chairman, CEO and the management. A person should preferably not play the dual role of Chairman and CEO. Where these two posts are combined in one person, appropriate controls have to be put in place to ensure that the management is sufficiently accountable to the Board. Equally, Appointed Actuaries and CEO should not be dual roles and if a person holds both positions simultaneously, sufficient safeguards must be built in the internal control system. Currently, no Appointed Actuary holds such a dual role. <i>(p9(c), p8(b) &(c) of GN10)</i></p> <p>GN10 outlines the considerations on the size and composition of the Board; knowledge and relevant experience <i>(p8(a)(i))</i>, fitness and propriety of directors <i>(p11(a))</i> and minimum number of independent non-executive directors <i>(p8(a)(i))</i>. In order for the Board to effectively discharge its accountabilities, insurers are advised to provide accurate, relevant and timely information to the Board <i>(p11(b)(i))</i> and appropriate training of directors <i>(p11(b)(ii))</i>. Insurers must establish an audit committee and, where appropriate, other specialized committees, such as nomination committee, to assist the Board in performing its functions <i>(p12)</i>. The Board may also seek independent professional advice or services at the expense of the insurer <i>(p11(b)(i))</i>.</p> <p>Directors are expected to act bona fide for the benefit of the insurer and exercise due care and diligence in carrying out their functions <i>(p9)</i>. The Board shall maintain appropriate checks and balances against the influence of the management and controllers <i>(p8(a)(iii))</i>. Independent non-executive directors shall be individuals with sufficient calibre and</p>
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³⁰ Irrespective of the proportion of its HKSAR insurance business, the IA expects an overseas insurer to strictly observe the applicable guidelines on corporate governance promulgated by its home supervisor.

	<p>breadth of experience to perform the balancing function. They shall be independent of the management and free from any business or other relationships with the authorized insurer which could materially affect the exercise of their independent judgement (p8(a)(iii)). Common directorship on the Board within the same group of the insurer is not recommended. (p8(a)(iv))</p> <p>Insurers need to ensure that they have sound internal control systems that ensure proper checks and balance, adequate risk management measures, prudent underwriting policies, appropriate reserving methods and assumptions, sound and documented investment policies, safeguarding of assets, adequate reinsurance arrangements, fair treatment of customers and formal procedures to identify suspicious transactions. (p13&p14 of GN10)</p> <p>The Board (or the Remuneration Committee) reviews and recommends the remuneration of senior management and other key personnel. It has to ensure that the remuneration package recommended for each person shall be commensurate with his qualifications and experience, performance, the insurer's business results, business strategies and the prevailing market conditions. Furthermore, the Board should ensure that the remuneration policy is structured to avoid potential incentives of unauthorized risk-taking by an insurer's investment function (ICP15). (p11(d) of GN10)</p> <p>To ensure that there is a reliable financial reporting process, insurers have to establish an audit committee to provide an independent review of the effectiveness of the process and internal control system (p12). External auditors should have effective communication channels with the internal auditor of an insurer (p14(i)(iv)). The Board should give due consideration to the opinions and findings of both the internal and external auditors, take timely actions, and monitor the progress of the redress. (p14(i)(vi) of GN10)</p> <p>The Board should convene regular meetings to discuss the corporate affairs with directors and communicate with the IA when requested. The IA would meet an insurer's CEO and director(s) as appropriate, including discussion on corporate governance issues. (p11(c) of GN10)</p> <p>Supervisory practice</p> <p>Insurers submit their annual self-assessment questionnaires/checklists on compliance with GN10 for review by the IA. The IA may meet with the CEO and the director(s) of insurers to discuss their operations, internal controls and future strategies (P11(c)). The IA can also request the Board to submit detailed information on the internal control of an insurer and to strengthen the system when required by the IA. (p16 of GN10)</p> <p>If a prescribed person (auditor, former auditors, actuary, former actuary, accountant, and former accountant) becomes aware of any matter which in his opinion adversely affects the financial condition of the insurer to a material extent, he has the obligation to notify the IA (s53. of ICO) In doing so, they have legal immunity under the ICO.</p> <p>There are no explicit corporate governance requirements in place regarding insurance groups.</p>
Assessment	Largely observed.
Comments	The IA has issued the guidance note on corporate governance in 2002, which is largely in line with ICP7. GN10 was being reviewed at the time of this assessment to better reflect

	<p>current international best practices. The IA monitors and assesses insurers' corporate governance as part of its on-going supervision, including evaluating the effectiveness of corporate governance in practice. There are no explicit requirements on the corporate governance of groups.</p> <p>The authorities are advised to:</p> <ol style="list-style-type: none"> 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 GN10 aimed at reflecting current international best practices, incorporating explicit requirements on: <ul style="list-style-type: none"> - 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 risk-taking staff; - The Board's policies and procedures to have effective oversight of Senior Management; and - 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.
<p>ICP 8</p>	<p>Risk Management and Internal Controls</p> <p>The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters, and internal audit.</p>
<p>Description</p>	<p>Systems for Risk Management and Internal Controls</p> <p>Insurers should have sound internal control systems that include a comprehensive risk management policy to identify, quantify, prevent and control the various risks (interest rate risk, stock market fluctuation risk, currency fluctuation risk, asset concentration risk, morbidity risk and price assumption risk) that arise from their operations. As a basic principle, adequate measures should be taken to guard against the concentration of risks. The Board should regularly review the internal control system to ensure its adequacy for the nature, scale and complexity of an insurer. <i>(p14 & p15 of GN10)</i></p> <p>Risk Management Function</p> <p>Insurers are required to devise and implement a comprehensive risk management policy. The risk management policy shall help to identify, quantify, prevent and control various risks that an insurer is encountering or may face and limit concentration to risks. <i>(p14(b) of GN10)</i>. In addition, a number of requirements on the risk management function are formulated in GN13 on Asset Liability Management. The Board must ensure that they receive feedback from the risk management function on asset exposures and the associated risks.</p> <p>The risk management function has the responsibility for:</p> <ol style="list-style-type: none"> a) Monitoring compliance with the approved investment policy; b) Formally noting and promptly reporting breaches;

- c) Reviewing asset risk management activity and results over the past period;
- d) Reviewing the asset/liability and liquidity position; and
- e) Assessing the appropriateness of asset allocation limits and undertaking regular resilience testing.

The risk management function should regularly report to appropriate levels of senior management and, as appropriate, to the Board, in such a way that it allows these individuals to judge the changing nature of the insurer's asset profile, the risks stemming from it and consequences for the insurer's solvency.

Compliance Function

An insurer is encouraged to appoint a compliance officer to oversee the compliance by it and its staff with the relevant laws, regulations, guidance notes and industry standards and codes of practice. The compliance officer shall also report to the Board at regular intervals. (*p19 of GN10*)

Actuarial Function

Insurers writing long-term business need to have an Appointed Actuary possessing prescribed qualifications or who is acceptable to the IA. Prescribed qualifications are full membership to the UK, Scottish, Australian or US actuarial associations. If an Appointed Actuary is removed or replaced by the insurer or ceases to satisfy the prescribed qualification, the insurer has to notify the IA immediately.

Insurers writing employees' compensation (EC) and motor insurance business have to commission an actuarial review of the reserves that is certified by an actuary. The actuarial report and certificate should also be submitted to the Board of the insurer, or the regional headquarters in the case of a non-Hong Kong incorporated insurer, for information.

For long-term insurers, their Appointed Actuaries have to prepare an DST on the insurer's financial condition for the Board (please refer to ICP 16). The ASHK has published a number of Guidance Notes that relate to regulatory requirements, which have been formulated and put in force in consultation with the IA. In particular, ASHK has defined a Professional Standard 1 (PS1), which details the duties and responsibilities of Appointed Actuaries.

The IA puts heavy reliance on the actuaries: on the appointed actuary for long-term business, the actuarial review for EC and motor business and for the DST. Even though the ASHK members have a very high standing and professionalism, the IA might consider closer collaboration with the ASHK to better support the local insurance industry.

Internal Audit Function

Insurers should have ongoing audit functions, both internal and external, of a nature and scope appropriate to the nature and scale of their businesses. Small insurers are exempt from establishing an internal audit function, but there is no threshold for an insurer to be considered small.

The internal audit function should ensure compliance with all applicable policies and procedures and review whether the insurer's policies, practices and controls remain sufficient and appropriate for its business. It should be: able to have unfettered access to the authorized insurer's entire business lines and support departments, independent from the day-to-day operation and have status within the authorized insurer; have sufficient resources and experienced staff; employ a methodology for identifying major risks of the

	<p>insurer; and prepare internal audit reports to the Audit Committee. <i>(P14(i) of GN10)</i></p> <p>The Board is responsible for giving due consideration to the opinions and findings of both the internal and external auditors and monitor the progress in redressing of any problems raised by the auditors. Cases of differing views of the Board and the auditors, have to be recorded.</p> <p>If the insurer is part of a group of companies, it is acceptable for its internal audit function to be performed by the group's internal auditor.</p> <p>Outsourcing</p> <p>The IA has recently issued a Guidance Note on Outsourcing (GN14). Insurers must adopt sound and responsive management frameworks in formulating and monitoring its outsourcing arrangements. GN14 also sets out the supervisory approach in monitoring outsourcing arrangements.</p> <p>Insurer should manage outsourcing risks in a manner that is commensurate with the degree of materiality of the arrangements. For material outsourcing, the IA expects insurers to take into account and address all the relevant essential issues. Material outsourcing arrangements are defined as those, which if disrupted or falls short of acceptable standards, would have the potential to significantly impact on an insurer's financial position, business operation, reputation or its ability to meet obligations or provide adequate services to policyholders or to conform with legal and regulatory requirements. Irrespective of the degree of materiality of an outsourcing arrangement, the Board and management retain ultimate accountability for all outsourced services <i>(p6 & p8 of GN14)</i>. Insurers have to notify the IA when planning to enter into a new or significantly change an existing material outsourcing arrangement at least three months prior to the arrangement becoming in force. <i>(p31)</i></p> <p>An insurer should develop an outsourcing policy approved by the Board outlining the assessment of the risks involved <i>(p10)</i>. It should ensure that it has adequate resources to monitor and control the outsourcing arrangements at all times so that the policy and procedures are complied with <i>(p24)</i>. It should also develop a contingency plan so that the activities will not be interrupted due to undesired contingencies of the service provider. <i>(P26 GN14)</i></p>
<p>Assessment</p>	<p>Largely observed.</p>
<p>Comments</p>	<p>GN10 provides high-level guidance on risk management systems and internal audit function. GN13 covers risk management functions relating to insurers' investments operations and asset liability management. GN14 establishes requirements on risk management relating to outsourcing. GN10 does not have explicit provision on the establishment of an effective risk management function covering all material risks. Although the ICO adopts the Appointed Actuary system, there is no explicit requirement on insurers to establish an effective actuarial function. There is also no explicit provision on insurers having a compliance function.</p> <p>A majority of large insurers have investment, reinsurance and risk management committees. While there is no requirement to have a dedicated Chief Risk Officer (CRO), nevertheless a majority of the large insurers have such a function. The majority of CROs report to the CEO or to the Risk Committee of the Board of Directors. Equally, a majority of large insurers have a head of compliance.</p>

	<p>The authorities are advised to:</p> <ul style="list-style-type: none"> 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. <p>These requirements could be supplemented by supervisory guidance to facilitate compliance by insurers.</p>
<p>ICP 9</p>	<p>Supervisory Review and Reporting</p> <p>The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.</p>
<p>Description</p>	<p>Supervisory Approach and Process</p> <p>The IA has not adopted a formal risk-based supervision approach. Nonetheless, based on the nature, scale and complexity of insurers, supervisory plans are made annually to set priorities regarding the monitoring and assessment of insurers, determine the scope and frequency of off-site reviews and on-site inspections. Should there be substantial developments in the financial market or international standards, the supervisory plans and processes will be suitably revised.</p> <p>The IA's supervisory approach places much emphasis on communication with insurers. In addition to the insurers' submission of its business and financial information, off-site reviews and on-site inspections, the IA supervisors meet regularly with insurers' management or Boards, and leverage on the work of external auditors and Appointed Actuaries, where appropriate. The IA is currently revamping its capital and solvency regime, and an RBC framework is being developed. Pending the introduction of the RBC framework, examination of the evolving nature, scale and complexity of risks both posed by the insurer and to which the insurer may be exposed has always been the IA's supervisory focus.</p> <p>The IA has an operation manual that sets out internal procedures and relevant checklists for guiding its staff in assessing insurer's financial positions and risk profiles. Where there are causes for concern (e.g., concentration of business or investment, need for more reinsurance coverage), the IA will meet the insurer's management or Board to express its concern. If the insurer is unable to rectify the situation satisfactorily, the IA will consider taking corrective and preventive measures (ICP 10) or enforcement actions (ICP11).</p> <p>Regulatory reporting</p> <p>The IA is empowered to require insurers to furnish the prescribed regulatory returns as well as modify the reporting requirements, as appropriate. Insurers are also required to submit accounts, balance sheet, abstract, certificate or statement and any report of the auditor within 6 months of the end of financial year. Any modification to the reporting requirements of an insurer must be published in the Gazette. (<i>s17, Third Schedule and s20 of ICO</i>)</p> <p>Long-term insurers are required to have an actuarial investigation into their financial</p>

	<p>condition at least annually. An abstract of the actuary's report on the investigation should be submitted to the IA. The IA may also require an insurer to conduct an actuarial investigation on its financial condition and report to the IA. (<i>s18, s20 and s32 of ICO</i>)</p> <p>The ICO requires that one of the copies of any document submitted to the IA (except the auditor's report) should be signed by at least two directors of the insurer and the CEO or, two directors and the secretary. The IA may inform an insurer on correcting any inaccuracies and deficiencies in the documents submitted. Any discrepancies identified which may have a material effect on the financial statements should be brought to the insurer's attention for rectification, or if necessary, for an explanation. (<i>s20 of ICO</i>)</p> <p>Insurers are required to report supplementary information as part of the annual returns, which includes, <i>inter alia</i>, hedging activities and off-balance sheet guarantees/loans as well as compliance with GN10 e.g., directors and independent non-executive directors, board meetings held during the year, audit committee and internal audit function etc. If there are material changes that could affect the insurer's conditions, insurers are also required to report promptly to the IA.</p> <p>The Directors' Report submitted to the IA should contain particulars of any other matters, including events after the date of the balance sheet, so far as they are material for the appreciation of the state of the insurer's affairs.</p> <p>As from January 2013, insurers should notify the IA when it is planning to enter into a new or significantly vary an existing material outsourcing arrangement and such notice should be made at least three months prior to the effective date. (<i>P31 of GN14</i>)</p> <p>The IA periodically reviews the adequacy of the reporting requirements and sets additional requirements, as appropriate. Examples include stepped-up (daily/weekly) solvency reports for individual insurers between 2008 and 2012, additional statistical reporting requirements for insurers underwriting unit-linked business since July 2013, and for those underwriting motor business since 2010.</p> <p>The IA also analyses statistical returns to see if there are concerns about certain lines of business on an industry-wide basis. An example is the persistent underwriting losses caused by low premium levels vis-à-vis high claims amount for some motor insurers who specialized in specific types of commercial vehicles. Whilst not interfering into the pricing and policy terms of individual insurers, the IA raised the matter with the industry, focusing on the underwriting discipline, reserving requirements and claims handling procedure.</p> <p>On-site inspections</p> <p>Although the ICO does not provide explicit legal authority for on-site inspection of insurers, the IA regularly conducts inspections on insurers to check compliance with the laws, regulations and other regulatory requirements. Through its on-site inspections, the IA obtains first-hand information on the latest developments of insurers' operations, thereby facilitating supervisory effectiveness and direct communication with the industry. Insurers are normally inspected at least once every three years, but the frequency may increase, depending on the conditions of individual insurers.</p> <p>The IA has developed a checklist for on-site inspections. The objectives and scope of the inspection are tailored for each visit. Typically, inspections include a review of the books and records of an insurer as well as evaluating its underwriting, claims handling, asset</p>
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	<p>management, reinsurance arrangement, supervision of intermediaries, internal controls. The inspectors also assess the implication of changes in senior staff, quality of the actuary's work etc. In addition, IA staff will verify compliance with the requirements on maintenance of assets in HKSAR, corporate governance guidance, prevention of money laundering, as well as selling of insurance policies to Mainland visitors.</p> <p>On completion of on-site inspections, the IA supervisory staff discusses the findings and with the management or the Board of the insurer concerned followed by a formal management letter. Insurers are required to draw up an action plan to address the weaknesses identified. If the weaknesses involve other financial sectors, the IA discusses the concerns with the relevant regulators. The IA monitors continuously insurers' progress in implementing the recommendations.</p> <p>Based on the Assessors review of a sample of sanitized inspection files, the supervisors prepared well in advance of the on-site visits, including a tailored questionnaire covering pertinent issues noted during the pre-inspection preparation, for discussion or verification during the on-site. There were extensive discussions with the relevant management personnel and the team also met the Boards of the insurers concerned.</p> <p>Group-wide supervision</p> <p>An insurer which is a holding company is required to submit consolidated financial statements. The IA will be developing a formal group-wide supervision framework. (<i>Part 3 of the Third Schedule to the ICO</i>).</p> <p>CoB Supervision</p> <p>The IA supervises the SROs' oversight of the self-regulatory codes, handling of complaints and disciplinary actions taken based on the returns submitted by the SROs and statistics on complaints. The IA conducts spot checks on the SROs' handling of complaints regularly to ascertain whether established procedures were observed and that complainants are treated equitably. It maintains a close dialogue with the SROs to discuss market issues with a view to enhancing supervision of insurance intermediaries.</p> <p>The IA reviews long-term insurers' agency management systems and controls as part of its on-site inspections. It has required insurers concerned to rectify any shortcomings noted. Insurance brokers are required to have their financial statements audited and their externals auditors must confirm their compliance with the IA's requirements on capital and net assets, professional indemnity insurance, segregation of clients' monies and maintenance of proper books and accounts.</p>
Assessment	Largely observed.
Comments	<p>The ICO empowers the IA to require insurers to provide comprehensive supervisory information, including on off-balance sheet guarantees, material outsourcing activities, and corporate governance framework/practices. Notwithstanding the lack of explicit legal authority, the IA has been conducting inspections of insurers regularly. To promote consistency and effectiveness of supervisory assessments, the IA has established an internal operations manual that sets out procedures and relevant checklists to guide supervisory staff in assessing insurers' financial condition and risk profiles.</p> <p>The supervisory approach of the IA involves close communication and dialogue with management and the Board of insurers, to facilitate understanding of their strategies and</p>

	<p>operations. The IA takes account of the evolving risks profiles of insurers as part of its on-going supervision, notwithstanding that a formal risk-based supervision has not been implemented. The CoB supervision of insurance intermediaries will be transferred to the proposed IIA.</p> <p>The ICO has not established an explicit group-supervision framework, but it requires that an insurer that is a holding company must submit its consolidated financial statement. The IA has no explicit power to obtain information from non-regulated entities within an insurance group, in order to supervise insurance groups in a holistic manner.</p> <p>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:</p> <ol style="list-style-type: none"> 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.
ICP 10	<p>Preventive and Corrective Measures</p> <p>The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.</p>
Description	<p>No person shall carry on any class of insurance business in or from HKSAR except: a) a insurer authorized by the IA; Lloyd's; and an association of underwriters approved by the IA. Contravenes of this prohibition is an offence that is liable to a fine and imprisonment. (s6 of ICO)</p> <p>The IA would conduct investigation into any entity suspected of carrying out unauthorized insurance business in or from HKSAR. Upon detecting unauthorized activities, the IA will report the matter to the police for further investigation and make a public announcement to alert the public.</p> <p>When there are causes for concern, the IA would discuss with the management or the Board of the insurer concerned, and require the insurer to draw up an action plan to address the issue. If the issue involves other financial sectors, the IA would discuss with the relevant regulators, and require remedial actions by the insurer. The IA closely monitors the progress of the insurers in implementing the agreed measures. Where an insurer fails to address the IA's concerns satisfactorily, the IA may impose preventive or corrective measures based on the grounds spelt out in the ICO, commensurate with the severity of the insurer's problems.</p> <p>The grounds for the IA to exercise the above powers include:</p> <ol style="list-style-type: none"> a) desirable for protecting (potential) policyholders against the risk that an insurer may be unable to meet its liabilities or to fulfill the reasonable expectations of (potential) policyholders; b) an insurer (or its parent) has failed to satisfy an obligation under the ICO; c) an insurer has furnished misleading or inaccurate information to the IA; d) inadequate reinsurance arrangements; e) an insurer no longer meet authorization criteria; and

	<p>f) failure to meet solvency requirements, as outlined under ICP 17 (<i>s35AA</i>). (<i>s26 of ICO</i>).</p> <p>The IA is empowered to take the following preventive and corrective measures:</p> <ul style="list-style-type: none"> a) Restrictions on new business, subject to prior notice served on the insurer concerned (except where the ground relates to the fitness of directors and controllers) (<i>s27 and s36 of ICO</i>); b) Requirements on investments, e.g., realize/not to make specified investments (<i>s28 of ICO</i>); c) Maintenance of asset in Hong Kong equal to the whole or specified proportion of the insurer's domestic liabilities (<i>s29 of ICO</i>); d) Custody of assets by a person approved by the IA as trustee for the insurer. Such assets shall not be released without the prior approval of the IA. Mortgage or security on assets held by the custodian as trustee shall be void against the liquidator or creditors of the insurer (<i>s30 of ICO</i>); e) Limitation on premium income (<i>s31 of ICO</i>); f) Actuarial investigations on long-term business (<i>s32 of ICO</i>); g) Acceleration of the provision of information required (<i>s33 of ICO</i>); h) Power to obtain additional information or production of documents (<i>s34 of ICO</i>); and i) Residual powers to require an insurer to take such action in respect of its affairs, business or property as the IA considers appropriate, e.g., appointment of an Advisor or Manager of the insurer (<i>s35 of ICO</i>). <p>Before exercising any of the above powers on the ground that any director or controller of the insurer is not fit and proper, the IA shall serve on that person a written notice stating the ground for the exercise of the power(s) and an opportunity for the person to make representations to the IA. Failure to comply with the IA's requirements imposed under these powers is an offence under the ICP. (<i>s37 and s41 of ICO</i>)</p>
Assessment	Observed
Comments	<p>Carrying insurance business in HKSAR without an authorization from the IA is an offence under the ICO. The IA would investigate any suspicious unauthorized activities and refer the matter to the police for further investigations, where appropriate. The ICO confers powers on the IA to take a broad range of proportionate corrective and preventive measures under specified grounds. The IA's policy is to make timely intervention and communicate its actions to the insurer in a transparent manner.</p>
ICP 11	<p>Enforcement</p> <p>The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.</p>
Description	<p>The IA is empowered to take the following enforcement powers:</p> <ul style="list-style-type: none"> (a) Require the insurer to submit a rehabilitation plan to restore its solvency position (<i>s35AA of ICO</i>); (b) Require an insurer, insurance agent, insurance broker or approved body of insurance brokers to produce books or papers as specified (<i>s74 of ICO</i>); (c) withdrawal of authorization or approval of an insurance broker (<i>s75 of ICO</i>); and (d) petition the winding up of an insurance intermediary (<i>s76 of ICO</i>). <p>The IA's power to withdraw authorization of insurers only applies when an insurer ceases to or has not commenced insurance business. Nonetheless, the IA is empowered to stop an authorized insurer from effecting new insurance business in or from HKSAR, which will</p>

	<p>effectively stop an insurer from carrying on insurance business and require the insurer to orderly run off its insurance liabilities before withdrawing its authorization. In addition, the IA can appoint a manager to take over the control and affairs of the insurer and allow it to have an orderly run-off or in winding up. The authorities will consider amending the ICO to make withdrawal of authorization an additional tool for enforcement, while ensuring that there will be an orderly run-off before invoking the power of de-authorization. (s40, s27, s35(2)(b) of ICO)</p> <p>IA closely monitors the progress of compliance and the effectiveness of the remedial measures taken by the insurers and may take further actions, as appropriate.</p> <p>The IA's prior approval is required for the appointment of controllers and directors and insurers must notify IA of changes in its directors/controllers. The IA may object the appointment of a director or controller on fit and proper grounds. Failure to meet the fit and proper criteria by directors/controllers' failure is also a ground for supervisory intervention by the IA. The IA has no explicit legal authority to take action against Key Persons in Control Function. (s13A, s13B, s14 and s26 of ICO)</p> <p>An insurer is required to notify the IA on changes in appointed auditors. Concurrently, auditors are also required to give written notice to the IA. The IA would enquire whether there are matters which may call for the IA's attention. (s15A of ICO)</p> <p>Where the IA considers there are risks that the insurer may be unable to meet its liabilities or to fulfill the reasonable expectations of policyholders, the IA may give directions that, during the period for which the direction is in force:</p> <ol style="list-style-type: none"> a) the insurer concerned should seek advice on the management of its affairs, business and property from an Advisor appointed by the IA; or b) the affairs, business and property of the insurer concerned should be managed by a Manager appointed by the IA. (s26 and s35 of ICO) <p>The ICO imposes various penalties (fines and imprisonment) for breaches of its provisions. The penalties are proportionate to the severity of breaches. For example, a person carrying on of unauthorized insurance business is liable on conviction upon indictment to a fine of HK\$2 million and imprisonment for 2 years (individuals). On summary conviction, the person will be liable to a fine of \$200,000 and to imprisonment for 6 months (individuals). In either case, there will be a fine of HK\$2,000 for each day on which the offence continues. Failure to submit required documents to the Companies Registry is an offence liable to a fine of HK\$200,000. The levels of penalties are currently being reviewed. (s6(3), s17/s18 and s21 of ICO)</p> <p>An insurer who fails to submit the required documents/information within a specified time period commits an offence and is liable to a fine. Any person, who furnishes information that is false in a material particular knowingly or recklessly is liable to a fine and/or imprisonment. A person who causes or permits to be included in any notice/statement/certificate or any document submitted under any provision of the ICO, knowingly or recklessly, is also liable to a fine and/or imprisonment. (s20, s41(1)(b) and s56(2) of ICO)</p> <p>The judicial process for which the sanctions are applied will not affect the IA's exercising its corrective measures and enforcement.</p>
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	<p>All notices of the imposition of supervisory interventions and the rescission or variations of such measures are filed properly in a central file. IA staff members are required to refer to the precedents in the central file for ensuring consistency in applying interventions. Proposed intervention actions are subject to the approval of the IA and/or the directorate officer heading the division. These procedures help to promote consistency of the courses of action taken against insurers.</p> <p>The proposed IIA will be vested with additional powers, subject to statutory safeguard, to:</p> <ul style="list-style-type: none"> a) initiate investigations/enter into premises of regulated entities to conduct investigations; b) make inquiries and have access to records and documents; c) make an application to the Court of First Instance for court orders to compel compliance with requirements in relation to inspections or investigations; d) apply to a Magistrate for a warrant to search for, seize or remove records or documents on reasonable grounds; e) prosecute offences summarily; f) impose disciplinary sanctions in proven cases of misconduct or breaches of fit and proper requirements : private or public reprimand; pecuniary penalties, suspension or revocation of authorization (similar sanctions apply to insurance intermediaries) ; g) suspend a licensed insurance intermediary or an RO from carrying on a regulated activity before it has made a final determination on the disciplinary sanction in serious and complicated cases, as a stopgap measure. <p>In addition, non-compliance with IIA's requirements related to inspection and investigation, or knowingly or recklessly providing false or misleading information in relation to inspection and investigation, will be an offence.</p>
Assessment	Largely observed.
Comments	<p>The IA is empowered to take supervisory interventions in a progressive approach that is commensurate with the severity of the offence. It monitors insurers' compliance with the enforcement actions imposed and may take further actions, as appropriate. There are established internal guides as well as arrangements to ensure consistent and fair application of enforcement actions and sanctions. The proposed IIA will have enhanced enforcement powers to initiate and conduct investigations, prosecute offences summarily, and enhanced sanctions powers.</p> <p>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.</p>
ICP 12	<p>Winding-up and Exit from the Market</p> <p>The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimizing disruption to provision of benefits to policyholders.</p>
Description	The procedures governing the winding-up of insurers are provided in the ICO and CO. An insurer shall not be wound up voluntarily unless ordered by the Court of First Instance

(Court). The Court may make an order on the petition of 10 or more policyholders or the IA on specified grounds. *(s43 and s44 of ICO)*.

The ICO specifies the following grounds for IA's petition for compulsory winding-up of an insurer :

- a) Inability to meet the solvency margin requirement. An insurer shall be deemed to be unable to pay its debts if the value of its assets does not exceed its liabilities by the relevant amount (please refer to ICP 17) *(section 42(1))*;
- b) Inability to pay debts when they fall due *(section 44(1)(a))*;
- c) Failure to satisfy statutory obligations *(section 44(1)(b))*;
- d) Failure to keep/produce proper books of account *(section 44(1)(c))*; and
- e) Expedient in the public interest and the Court thinks it just and equitable for the insurer to be wound-up *(section 44(3))*.

The Court shall not make an order unless notice of the application has been served on the IA, who shall be entitled to be heard on the application and to call, examine and cross-examine any witness and, if he so thinks fit, support or oppose the making of the order. *(s45 of ICO)*

In a winding up, the assets of an insurance fund in respect of long-term business shall be available only for meeting the liabilities attributable to that part of that business to which the fund relates. The other assets of the insurer shall be available only for meeting the liabilities of the insurer attributable to its other business. The excess assets of a long-term insurance fund may be used to the liabilities of another insurance fund in deficit. If there are two or more such other funds, the excess assets may be used to satisfy the respective liabilities of those other funds (in deficit) pro rata. Any excess assets remaining may be used to meet the liabilities of the insurers' other business. *(s45 of ICO)*

The liquidator of a long-term insurer shall carry on business of the insurer with a view to its being transferred as a going concern to another insurer and may agree to the variation of any contracts of insurance in existence when the winding-up order is made but shall not effect any new contracts of insurance. The liquidator may apply to the Court to appoint a special manager, if deemed necessary in the interests of the creditors of its long-term business. The Court may, on the application of the liquidator, a special manager or the IA, appoint an independent actuary to investigate the long-term business of an insurer and to report on the desirability continuing that business and on any reduction in the contracts that may be necessary for its successful continuation. *(s46 of ICO)*

If an insurer has been proven to be unable to pay its debts, the Court may, if it thinks fit, reduce the amount of the contracts of the insurer on such terms and subject to such conditions as the Court thinks just, in place of making a winding-up order. This provision aims to expedite the payment on or transfer of the relevant contracts, which may retain at least some level of coverage for policyholders, as opposed to the total loss of benefits or the receipt of a limited surrender value. *(s48 of ICO)*

General business claimants are given preferential creditors status, ahead of unsecured creditors, under the CO in the distribution of the assets of a general insurer in liquidation. *(s265(1)(e) of CO)*

In addition, the following insolvency funds have been established in respect of motor insurance and employees' compensation insurance:

	<p>a) The Insolvency Fund operated by the Motor Insurers' Bureau of Hong Kong is available for meeting claims for bodily injuries or death arising from motor accidents due to insolvency of an insurer.</p> <p>b) The Employees Compensation Insurer Insolvency Scheme operated by the Employees Compensation Insurer Insolvency Bureau is available for meeting employees' compensation claims due to insolvency of an insurer.</p>
Assessment	Observed.
Comments	<p>The procedures governing the winding-up of insurers are provided in the ICO and CO. An insurer shall not be wound up voluntarily unless ordered by the Court. The Court may make an order on the petition of 10 or more policyholders or the IA on specified grounds. Claimants of general insurance are given preferential priority of distribution of assets in liquidation under the CO. Long-term insurers are required to ensure proper segregation of applicable insurance funds, and the assets belonging to respective funds can only be applied to liabilities attributable to that part of that business to which the fund relates. The insurance fund concept is intended to protect long-term policyholders' entitlement to assets belonging to each fund. While it is highly likely the court would rule in favor of policyholders vis-à-vis unsecured creditors, it is preferable that an explicit priority ranking of long-term policyholders vis-à-vis unsecured creditors be established under the relevant laws.</p> <p>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.</p>
ICP 13	<p>Reinsurance and Other Forms of Risk Transfer</p> <p>The supervisor sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programmes. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.</p>
Description	<p>Adequate reinsurance arrangements are a condition for authorization and the IA is empowered to require insurers to take necessary corrective measures to ensure adequate reinsurance protection. (s8, s26 and s35 of ICO)</p> <p>Insurers are expected to understand their underwritten risks in order to look for suitable reinsurance products and determine the appropriate retention amounts, reinsurance limits, scopes of coverage and the participating reinsurers. They are also expected to assess the financial stability of the participating reinsurers and periodically review the collectibility of the amounts due from them. (p12 of GN10)</p> <p>Depending on the nature, scale and complexity of their operations, some insurers are expected to establish a Reinsurance Committee to ensure that adequate reinsurance arrangements are made. The Committee should peruse the proposed reinsurance arrangements prior to their execution, reviews the arrangements from time to time and, adjust the arrangements in the light of market development. It also has to assess the effectiveness of the reinsurance programme. (p14 and p12 of GN10)</p> <p>The IA has also issued a Guidance Note on Reinsurance with Related Companies (GN12). It states that the IA considers the security provided by a related reinsurer as acceptable if the reinsurer:</p> <ul style="list-style-type: none"> • is an authorized insurers in HKSAR; or

- has a minimum insurer financial strength rating (AA- S&P, A+ A.M. Best, Aa3 Moody's); or
- it or any of its holding companies is considered to have equivalent status as above.

The IA has to be informed by insurers obtaining reinsurance with related companies. The information to be submitted includes the names of the related reinsurers and the breakdown of reinsurance payable and recoverable at its financial year end for each related reinsurer. (p10 of GN12)

The IA takes into account insurance risk transfer through capital markets or special purpose vehicles in its assessment of the adequacy of reinsurance arrangements of insurers. So far, insurers in the HKSAR are not using such mechanisms or vehicles.

The use of alternative risk-transfer mechanism by general insurers is very limited. For long-term insurers, the more common alternative risk-transfer mechanism is financial reinsurance. Insurers are required to seek the IA's consent before entering into new financial reinsurance arrangement or varying an approved arrangement to a material extent. Insurers must provide the IA with details about the purpose and main features of such arrangement, risks covered, draft contract wordings, accounting treatment and the effects on its financial position. They must also demonstrate that there will be real transfer of insurance risks.

The IA takes into account the nature of supervision of reinsurers and other counterparties, in assessing the adequacy of insurers' reinsurance arrangements.

The IA assesses the liquidity position of insurers during its on-going supervision, including the receivable from reinsurers (e.g., aging analysis). The insurance industry adopts clauses for acceleration of payment by reinsurers in case of large claims, which mitigates insurers' liquidity risk. For intra-group reinsurance where collateral from reinsurers are required, the securities must be acceptable to the IA, e.g., letter of credit which is clean, irrevocable, unconditional and permanently renewable and issued by an authorized institution in HKSAR (p9 of GN12). However, GN12 applies only for reinsurance with related parties.

Supervisory practices

At the end of each year, insurers have to submit to the IA an annual summary on their reinsurance arrangements for the coming year, covering the projected business and the related risk exposure/retention. A copy of the related reinsurance contracts/documents are to be submitted to the IA for examination and verification. During on-site inspections, the IA inspects minutes of the discussions of the Reinsurance Committee (if established) to gain insight into insurers' reinsurance policy and strategy.

The IA assesses the adequacy of reinsurance arrangements by considering the reinsurance management framework of the insurer; the type of reinsurance arrangements; the maximum retention of the insurer; the spread of risks among reinsurers; and the security of reinsurers. The IA requires insurers to strengthen or rectify their reinsurance programs, where necessary. It has also established internal guidelines on the benchmarks for financial reinsurance.

The IA adopts a restrictive supervisory practice that discourages the excessive use of intra-group reinsurance. It has required insurers to exchange intra-group reinsurance with external reinsurance.

	The IA will develop a new Guidance Note on Reinsurance requiring an insurer to put in place a sound reinsurance management framework and criteria for the adequacy of reinsurance arranged by insurers.
Assessment	Largely observed.
Comments	<p>One of the authorization conditions under the ICO is the adequacy of reinsurance arrangement. The IA supervises insurers' governance of their reinsurance arrangements and encourages the establishment of Reinsurance Committee. It also examines reinsurance treaties provided by insurers annually, and assesses the adequacy of the reinsurance programs. Insurers are required to obtain prior approval of the IA for financial reinsurance. The proposed guidance note on reinsurance will bring the reinsurance regime in line with ICP 13.</p> <p>GN 12 exempts insurers who meet certain requirements from limits on reinsurance beyond which collateral are required. This could potentially lead to an excessive concentration or liquidity risk to related companies. To mitigate this risk, the IA adopts a restrictive supervisory practice that discourages the excessive use of intra-group reinsurance.</p> <p>It is recommended that the authorities</p> <ol style="list-style-type: none"> 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 – <ul style="list-style-type: none"> • 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.
ICP 14	<p>Valuation</p> <p>The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.</p>
Description	<p>The valuation of the assets and liabilities of insurers is subject to the requirements under the ICO and relevant guidance issued by the IA. In addition, insurers are required to comply with the accounting and actuarial standards set by the HKICPA and the ASHK.</p> <p>There are different valuation standards for long-term insurance business and general insurance business. The valuation requirements for general insurers are detailed in the Insurance Companies (General Business) (Valuation) Regulation (Valuation Regulation), those for long-term business in the Insurance Companies (Determination of Long-term Liabilities) Regulation (Determination Regulation). For example, market values are used as a basis for valuation of assets of general insurers while asset values of long-term business are based on generally accepted accounting principles.</p>

	<p>Relevant Guidance Notes by the IA are:</p> <ul style="list-style-type: none"> • GN2: Guidance Note on Insurance Companies (General Business) (Valuation) Regulation • GN6: Guidance Note on Reserving for Mortgage Guarantee Business • GN7: Guidance Note on the Reserve Provision for Class G of Long-term Business • GN 9 Guidance Note on the Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses <p>Relevant Guidance Notes by the ASHK are:</p> <ul style="list-style-type: none"> • PS1: Statutory duties of an actuary in relation to long-term insurers • AGN 3 Additional Guidance for Appointed Actuaries • AGN 4: Outstanding Claims in General Insurance Note on Professional Practice • AGN 5: Principles of Life Insurance Policy Illustrations • AGN 6: Continuing Professional Development • AGN 7: Dynamic Solvency Testing <p>and the</p> <ul style="list-style-type: none"> • Notice for Appointed Actuaries: Chapter 41E – Reinvestment Yield for Reserving <p>Relevant Standards by the HKICPA are:</p> <ul style="list-style-type: none"> • HKFRS 4: Hong Kong Financial Reporting Standard: Insurance Contracts • HKAS 39: Hong Kong Accounting Standard 39: Financial Instruments: Recognition and Measurement <p>The IA may relax the regulations on the valuation of assets and liabilities of an insurer, if it is not be contrary to the interests of (potential) policyholders and without adverse impact on his supervisory functions. Where the IA relaxes such regulations, it has to be published in a notice in the Gazette stating that the regulation has been relaxed for the insurer concerned. (<i>s60 of ICO</i>)</p> <p>The IA can require a revaluation of liabilities if the IA is of the opinion that liabilities are significantly higher than that as calculated at a day later than the end of its last financial year. (<i>s25B of ICO</i>)</p> <p>Long-term insurance business</p> <p>The key regulatory requirements on valuation include:</p> <ol style="list-style-type: none"> a) The submission of an annual actuarial investigation report on financial condition, including the valuation of liabilities, in prescribed format to the IA. (<i>s18 of ICO</i>) b) The Determination Regulation codifies sound actuarial principles in determining long-term liabilities, by adopting prudent provisions and assumptions particularly on rates of interest and amortization of deferrable acquisition expenses. c) Guidance Note on the Reserve Provision for Class G of Long-term Business (<i>GN7</i>) provides guidance on the reserving methodologies and assumptions with respect to guaranteed capital and return on retirement business. d) PS1 and Additional Guidance for Appointed Actuaries (<i>AGN 3</i>) issued by ASHK provide additional guidance on the determination of liabilities under the Determination Regulation. PS1 sets out the steps to be taken by actuaries in ensuring the accuracy and completeness of data, as well as the documentation and reporting requirements, including the statutory duty of actuaries to report to the IA and the Board of insurers on their actuarial investigation findings.
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	<p><u>Assets</u></p> <p>Bonds held for maturity are valued at amortized cost and other invested assets are valued according to fair market value.</p> <p><u>Liabilities</u></p> <p>Subject to the Determination Regulation, the liabilities of an insurer in respect of long-term business are determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurers. <i>(s4(1) of Determination Regulation)</i></p> <p>The determination of long-term liabilities has to</p> <ol style="list-style-type: none"> a) be made on actuarial principles which have due regard to the reasonable expectations of policyholders; b) be based on prudent assumptions that shall include appropriate margins for adverse deviation of the relevant factors; c) take account of all prospective liabilities as determined by the policy conditions for each existing contract, taking credit for premiums payable after the valuation date; and d) take into account, inter alia: all guaranteed benefits, including guaranteed surrender values; vested, declared or allotted bonuses to which policyholders are already either collectively or individually contractually entitled; all options available to the policyholder; and expenses, including commissions. <p><i>(s4(2) and (3) and of Determination Regulation)</i></p> <p>Technical provisions (TP) should include prudent provisions:</p> <ol style="list-style-type: none"> a) additional amount on an aggregated basis for general risks which are not individualized, where necessary; b) against the effects of changes in exchange rates on the adequacy of the assets where the liabilities of an insurer in any particular currency are not matched by assets expressed in or capable of being realized without any exchange risk into that currency; c) to cover any increase in liabilities caused: by policyholders exercising options under their contracts³¹; and by the operation of any guarantee included in a contract. Where a contract includes an option whereby the policyholder could secure guaranteed cash payment within 12 months following the valuation date, the provision for that option shall not be less than the payments that would have to be made if the option were exercised; and d) against the effects of possible future changes in the value of the assets on the ability of the insurer to meet its obligations arising under contracts for long-term business; and the adequacy of the assets to meet the liabilities, <p><i>(s5, s6, s10 and s16 of Determination Regulation)</i></p> <p>The discount rate TP should be no greater than the rates determined from a prudent assessment of the yields on existing assets attributed to the long-term business and, to the extent appropriate, the expected yields on sums to be invested in the future. The ASHK issues circulars setting out the parameters and examples for the determination of reinvestment yield for reserving in actuarial valuation reports for a specified duration. The</p>
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³¹ AGN3 specifies that prudent allowance should be made in the valuation of the proportion of policyholders likely to exercise the options.

	<p>Determination Regulations prescribes a methodology for deriving the discount rate, and requires assets to be valued in accordance with the ICO. (<i>s8 of Determination Regulation and s8(4) of ICO</i>).The discount rate is in essence based on the expected yield of the assets held, multiplied by 97.5 percent and reduced by the part of the yield representing default risk.</p> <p>The ASHK issued Notices for Appointed Actuaries: Chapter 41E – Reinvestment Yield for Reserving on 19 December 2008 and 9 December 2011. The Notices were published to address the extreme low yield rates of government bonds during the financial crisis and which has to be used to determine the reinvestment yield more than three years after the valuation date in the estimation of the expected yield. Until then, the common practice was the use of the adjusted yield at the valuation date. The Notices propose the use of the mean of the yield on the valuation date and of the average of yields of long-term fixed government bonds denominated in the currency of the liabilities over the 3-year period ending on the valuation date.</p> <p>For long-term business, where the liabilities of an insurer in any particular currency are not matched by assets expressed in or capable of being realized without any exchange risk into that currency, a prudent provision has to be included in the liabilities of the insurer against the effects of changes in exchange rates on the adequacy of the assets. (<i>s6 of Determination Regulation</i>)</p> <p>Prudence is also included in the valuation in that no allowance can be made for the voluntary discontinuance of any contract if the amount of the liability so determined would thereby be reduced. (<i>s13 of Determination Regulation</i>)</p> <p>The IA has issued a Guidance Note on the Reserve Provision for Class G of Long-term Business (GN7). Class G business are mainly offered as retirement scheme contracts which provide for a guaranteed capital or return under the MPF Schemes or Occupational Retirement Schemes. Provisions should be such that the total amounts of assets are sufficient to meet the obligations of the insurer against its policyholders. The provisioning methodologies adopted have to pay due regard to the investment strategies/mandate, interest crediting mechanisms and provisioning practices of various segregated funds in an integrated fashion. The provision for investment guarantees should be established by modeling to include the cost of the guarantees.</p> <p>Management actions can be incorporated in the valuation model if the decision making authority resides with the insurer, relevant controls and monitoring mechanisms are in place to alert the insurer; and the assumed actions are reasonable, practical, lawful, consistent with the market, competitive pressure and with regulatory requirements. (<i>p8 of GN7</i>)</p> <p>The minimum benchmark for the provisioning for investment guarantees maintained in the Class G business fund in aggregate is that the provision should cover most of the adverse situations with a 99 percent level of confidence. To determine the provisions, it is expected that the insurer uses a stochastic approach. It is also expected that the liability model and the investment return model are integrated in a reasonable and consistent manner. The model needs to reflect all significant products features, demographic characteristics, the scheme sponsor and member behavior and the way the guarantor expects to exercise any available options for each scenario. Provisions for investment guarantees must be revised at least quarterly to reflect current information. (<i>p8(e), p11 p13 and p20 of GN7</i>)</p>
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Long-term insurers are required to test their solvency position under different adverse scenarios by conducting the DST. This includes the impact of the increase/decrease in interest rates on their securities portfolios held to match their long-term liabilities. (*please also refer to ICP 16*)

The IA analyses the submitted DST report and compiles an Overall Report. The Overall Report allows the IA to compare the assumptions used by the long-term insurers, in particular on the estimated expected investment yields. Outliers are then identified by the IA and further information requested, if necessary. The management actions proposed by the insurers are analyzed and actions formulated for the supervisors of the insurers. Supervisors then follow up to see if management actions are actually being implemented, where warranted.

General insurance business

The key regulatory requirements on valuation include:

- a) The Valuation Regulation prescribes prudent valuation methods for certain classes of general business assets, intangible assets, prohibition on discounting of claims, segregation of unexpired risks for different accounting classes, and admissibility limits for different categories of assets (ICP15);
- b) Guidance Note on Insurance Companies (General Business) (Valuation) Regulation (GN 2).
- c) Guidance Note on Reserving for Mortgage Guarantee Business (GN6) specifies technical provision in respect of mortgage guarantee business;
- d) Guidance Note on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses (GN9) provides the reserving methods and assumptions for motor and employee compensation businesses; and
- e) Maintenance of assets in HKSAR of not less than the aggregate of 80 percent of net liabilities and the solvency margin applicable to an insurer's HKSAR general business. (*s25A of ICO*); and
- f) Where the IA opines that a general insurer's TP is inadequate, it may direct the insurer to re-determine its liabilities and specify the manner of redetermination. (*s25B of ICO*)

Assets

The asset valuation is on a market value basis with prudent haircuts. Simplified, the values are:

- Land and Buildings: the net book value plus up to 75 percent of the surplus of its open market value.
- Listed shares, securities, unit trusts or mutual funds: market values, with haircuts depending on the current credit rating of the security, ranging from 0 to 25 percent.
- Shares in investment subsidiaries: the value of the assets of the investment subsidiaries valued in accordance with the Valuation Regulation.
- Shares in other insurers: the liquidation value of the subsidiary, where assets are valued according to the Valuation Regulation.
- Other unlisted shares: if there is a ready market price, 75 percent of that, otherwise the liquidation value of the net tangible assets, if there are recent, audited accounts, otherwise the asset is not admitted.
- Intangible assets and deferred acquisition costs: no value is given.

Assets have to be maintained in HKSAR of not less than the aggregate of 80 percent of net liabilities and the solvency margin applicable to an insurer's HKSAR general business.

	<p>This requirement does not apply to a professional reinsurer and a captive insurer. The IA can exempt insurers if there are special or unusual circumstances that make the maintenance of assets in HKSAR impractical, and provided that the IA is satisfied with the financial status of the insurer. <i>(s25A of ICO)</i></p> <p><u>Liabilities</u> Except with prior approval of the IA, liability cash flows are not discounted.</p> <p>Specific guidance is given for employee compensation and motor insurance (GN9), and for mortgage insurance. <i>(GN6)</i></p> <p>The valuation of technical provisions for employee compensation and motor insurance includes a risk margin, where considered appropriate by the actuary. Discounting of general insurance liability cash flows is not allowed, except with the prior approval of the IA. The risk margins for employee compensation and motor insurance can be determined on a discounted basis. <i>(s11 of Valuation Regulation and p11(c) and p20 of GN9)</i></p> <p>GN6 sets out the expectations of the IA on the determination of reserves. An actuarial report has to be prepared and certified by the actuary. The report then has to be submitted to the IA for review, as well as to the Board. The IA expects that insurer establish and maintain an Unearned Premium Reserve, a Provision for Claims Outstanding including IBNR and Contingency Reserve. For each year of account, mortgage insurers are:</p> <ul style="list-style-type: none"> a) To set aside 50 percent of net earned premium income as CR; b) To maintain the CR for 7 years; and c) Allowed to withdraw from the CR where the claims incurred in any year of account exceeds 35 percent of the net earned premium income in that year of account. <p>As from 1 January 2011, the CR ratio has been increased to 75 percent for direct non-standard mortgage guarantee business - mortgages where the loan-to-value ratio exceeds 85 percent as at the date of origination of the loan; the borrower's debt-to-income ratio exceeds 50 percent as at the date of origination of the loan; or the underlying collateral is not used as the borrower's own and sole residence - and has to be maintained for 10 years.</p>
Assessment	Largely observed.
Comments	<p>The valuation of assets and liabilities is based on an amortized cost approach for long-term insurance while for general insurance the valuation of assets is based on a fair value approach and liabilities are not discounted.</p> <p>Decision usefulness is enhanced by the DST for long-term business.</p> <p>For general insurance, insurance liability cash flows are not discounted (this is not mandated by ICP 14), and the valuation of assets is based on market values with haircuts. For long-term business, technical provisions are based on current assumptions and discounted with the expected asset return, with haircuts to take into account credit risk and bonds are valued at amortized cost. For Class G business (investment guarantees), technical provisions must be adequate to cover most of the adverse situations with a 99 percent level of confidence.</p> <p>While due regard has to be given to the reasonable expectations of participating policyholders, there is no guidance on what this means in practice and how the interest of</p>

	<p>different policyholder generations and other stakeholders are taken into account – both in a going-concern and distress situation.</p> <p>The requirements for estimating technical provisions take into account the specifics of the different underlying risks. However there no clear overarching methodology used for the valuation. This makes it difficult to assess the overall sufficiency of technical provisions of insurers. Except for employees’ compensation and motor business, there is no requirement to have an explicit MOCE. Rather, the MOCE is implicit, via no discounting for general insurance business and the requirement for using prudent assumptions for long-term business.</p> <p>The valuation used for long-term business is generally perceived by industry to be prudent, in particular due to the fact that no allowance can be made for the voluntary discontinuance of contracts if the amount of the liability so determined would be reduced. However, the discount rate which is linked to the expected asset yield might not necessarily be prudent, in particular in an environment with falling interest rates. On the other hand, the reinvestment yield component of the discount rate reflects the current spot rate which mitigates the effect to a certain extent. These inconsistent levels of implicit prudence make it challenging to assess the overall margin for risk. While the valuation standard might introduce the potential for unintended investment incentives: to go into risky assets to increase the discount rate or remain invested in risky and non-performing assets in time of financial market stresses, there is no evidence that insurers have done so. The existing DST includes testing the impact on solvency under prescribed scenarios of drop in values of equities, but it needs to be strengthened to take into consideration the above.</p> <p>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</p> <ul style="list-style-type: none"> • 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. <p>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.</p> <p>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.</p>
<p>ICP 15</p>	<p>Investment</p> <p>The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.</p>

<p>Description</p>	<p>The IA has issued a Guidance Note on Asset Management by Authorized Insurers (GN13).</p> <p>For insurers writing general business, the Valuation Regulations requires that the aggregate value admitted in respect of each of the following categories of assets of a general insurer does not exceed a prescribed percentage of total eligible asset value (i.e. the aggregate value of admitted assets).</p> <table border="0" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th style="text-align: right;"><u>Percentage of total eligible asset</u></th> </tr> </thead> <tbody> <tr> <td>a) Land and buildings</td> <td style="text-align: right;">30%</td> </tr> <tr> <td>b) Listed shares, unit trusts and mutual funds</td> <td style="text-align: right;">30%</td> </tr> <tr> <td>c) Aggregate of (a) and (b)</td> <td style="text-align: right;">40%</td> </tr> <tr> <td>d) Listed securities</td> <td style="text-align: right;">50%</td> </tr> <tr> <td>e) Unlisted shares</td> <td style="text-align: right;">10%</td> </tr> </tbody> </table> <p>where unlisted shares exclude shares in insurance subsidiaries, unlisted companies and securities and debts other than insurance debts and loans secured by insurance policies due from individuals.</p> <p>General insurers are not prohibited from holding a greater amount in any particular category of assets than that specified. However, no credit will be given to any excess over the admissible limit in determining whether the insurer complies with the solvency margin requirement under the ICO. <i>(p6.1& p6.4 of the Valuation Regulation)</i></p> <p>For long-term insurers, no such limits exist. However, the DST has helped insurers to have effective asset liability management where investments closely match liabilities. This has led insurers to be heavily weighted in bonds.</p> <p>The Board of insurers should be responsible for the formulation and approval of the strategic investment policy, taking account of the analysis of the asset/liability relationship, overall risk tolerance, long-term risk-return requirements, liquidity requirements and solvency position. For a long-term insurer, the Board should also consider the relevant input of its Appointed Actuary. Alternatively, the Board can delegate formulation of the strategic investment policy to an appropriately constituted Investment Committee. The Board should review the adequacy of the investment at least annually. <i>(p11&p18 of GN13)</i></p> <p>Insurers should communicate their investment policies to all staff involved in investment activities, which should address: strategic asset allocation; limits by geographical area, markets, sectors, counterparties and currency; policy on the selection of individual securities; investment management in philosophy; types of prohibited or restricted investments (e.g., illiquid assets or where independent verification of pricing is not available); policy on the use of financial derivatives; and the framework of accountability for all asset transactions. <i>(p12 of GN13)</i></p> <p>Insurers are expected to invest in a manner that is appropriate to the nature of its liabilities. In addition, the Appointed Actuary is obliged to opine (in the annual actuarial investigation report) on the relationship between the nature and term of the assets and liabilities of a long-term insurer. <i>(p11 of GN13, s18, p5(1)(c) of the Third Schedule to the ICO)</i></p> <p>If the investment function intends to use new types of investment instruments, the IA expects insurer to adopt an approval process. Prior to approval being given, insurers have</p>		<u>Percentage of total eligible asset</u>	a) Land and buildings	30%	b) Listed shares, unit trusts and mutual funds	30%	c) Aggregate of (a) and (b)	40%	d) Listed securities	50%	e) Unlisted shares	10%
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	<p>to identify the risks inherent in these instruments, and document the principles for measuring such risks and the method of accounting for the new instruments. <i>(p20 of GN 13)</i></p> <p>Insurers should have an overall policy on the use of financial derivatives including structured products that have the economic effect of derivatives. Adequate control systems must be in place for monitoring adherence to the investment policy and mandate(s), as well as legal and regulatory requirements. <i>(p12&p15 of GN13)</i></p> <p>The risk management function for investment needs to report regularly to senior management and the Board, where appropriate, on all information relating to the sensitivity assessments on changes in market conditions and other risk factors. <i>(p13, p23 & p24 of GN13)</i></p>
Assessment	Observed
Comments	<p>The IA has issued guidance setting out its supervisory expectation on insurers' investment management including formulating sound investment strategy, well documented investment policies and limits, asset-liability management, investment risk management and policy on the use of financial derivatives. Insurers are required to submit their investment policy and information on their investment portfolio to the IA for review. The guidance is qualitative and principles-based.</p> <p>HKSAR is one of the leading international financial centres and insurers have a broad choice of investment instruments for assets-liability management. However, insurers have indicated that the market for long dated bonds is not very deep, making the management of liabilities with long duration challenging.</p> <p>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.</p>
ICP 16	<p>Enterprise Risk Management for Solvency Purposes</p> <p>The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.</p>
Description	<p>Since 2005, long-term insurers are required to perform the DST, in accordance with the Actuarial Guidance Note on Dynamic Solvency Testing (AGN 7) issued by the ASHK. The Appointed Actuary is required to determine the projected solvency position of an insurer in the next three financial years or a longer period under the base scenario, six prescribed simple scenarios, and three compound scenarios.</p> <p>The base scenario is defined by the assumptions used by the insurer to predict its financial position over the forecast period. Usually, the base scenario is consistent with the insurer's business plan.</p> <p>In each of the six prescribed simple scenarios, AGN7 prescribes testing based on changes in a number of parameters covering:</p> <ul style="list-style-type: none"> • A deterioration of mortality and morbidity experience • A change in lapse rates resulting in a deterioration of results

	<ul style="list-style-type: none"> • A decrease in interest rates and an equity and real estate value drop • An increase in interest rates and an equity and real estate value drop • A high growth rate of new business with a corresponding increase in general expenses • A low growth rate, without corresponding decrease in general expenses. <p>The actuary has to consider at least three company specific compound scenarios so that in total at least nine adverse scenarios and the base scenario are tested independently and reported annually.</p> <p>The DST is considered to show a satisfactory financial position for the insurer if:</p> <ul style="list-style-type: none"> • Under the base scenario, it meets the minimum regulatory capital requirement; and • Throughout the forecast period and under all tested prescribed and compound scenarios, the assets exceed liabilities throughout the forecast period. <p>The quantification of the financial position can take into account assumed management actions, subject to the effectiveness of the insurer's management information systems, the historical record of promptness and willingness to take difficult decisions, and the external environment assumed in the scenario. In addition, the financial position should take into account assumed regulatory actions and rating agency actions. (AGN7)</p> <p>In addition to the annual DST review, stress tests are also carried out quarterly. Ad-hoc stress tests are conducted when there are adverse market conditions for both long-term and general insurers (please refer also to ICP17). On asset-liability management, insurers have to test the resilience of the asset portfolio in a range of market scenarios and investment conditions, and assess the impact on their solvency position. (p5&p33 of GN13)</p> <p>GN10 on Corporate Governance contains elements of ERM requirements. Amongst these are to:</p> <ul style="list-style-type: none"> • devise and implement a comprehensive risk management policy; • adopt a prudent underwriting policy; • employ suitable methodologies and assumptions to compute and make provisions for its insurance liabilities; • have a written investment policy appropriate for its capital, surplus, type of business and liquidity needs; • make adequate reinsurance arrangements and periodically review the collectibility of the reinsurance recoverables; and • have ongoing internal and external audit functions of a nature and scope appropriate to the nature and scale of its business. <p>There are no explicit requirements for insurers to establish and maintain a risk tolerance statement covering all material risks and defined risk tolerance limits; to make use of risk tolerance levels in business strategies; and embed defined risk tolerance limits in day-to-day operations via its risk management policies and procedures.</p> <p>There are no explicit requirements for an insurer to perform its ORSA regularly, including the:</p> <ul style="list-style-type: none"> • assessment of the adequacy of its risk management and current, and likely future, solvency position; under the responsibility of the Board and Senior Management; and
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	<p>the quality and adequacy of its capital resources to meet regulatory capital requirements and any additional capital needs;</p> <ul style="list-style-type: none"> • analysis of its ability to continue in business, and the risk management and financial resources required to do so over a longer time horizon; and • continuity analysis to address a combination of quantitative and qualitative elements in the medium and longer-term business strategy of the insurer and include projections of its future financial position and analysis of its ability to meet future regulatory capital requirements. <p>The ORSA has to encompass all reasonably foreseeable and material risks, including at a minimum underwriting, credit, market, operational and liquidity risks and additional risks arising due to membership of a group; as well as for the insurer to</p> <ul style="list-style-type: none"> • determine the overall financial resources it needs; • manage its business given its own risk tolerance and business plans, and to demonstrate that supervisory requirements are met; • base its risk management actions on consideration of its economic capital, regulatory capital requirements and financial resources, including its ORSA. <p>There are no requirements or guidance for insurance groups and subsidiaries of insurance groups that:</p> <ul style="list-style-type: none"> • the measurement of risks are to be based on a consistent economic assessment of the total balance sheet; • the management of risk has to take into account risks arising from all parts of an insurance group including non-insurance entities (regulated or unregulated) and partly-owned entities; • the direct and indirect interrelationships between its members, e.g., via capital and risk transfer instruments are taken into account; • constrains in capital mobility are take into account in the ERM framework; • a risk management policy is in place which outlines the way in which it manages all the risks that are relevant and material at insurance group level; • the insurance legal entity's risk management policy includes all the risks it faces as a result of its membership of a group; and • an insurance legal entity's risk tolerance statement should define risk limits taking into account group risks. <p>Under the proposed RBC framework, the capital requirement for each insurer will take into account the various risks that an insurer faces and insurers will be required to develop an ERM framework and ORSA system.</p> <p>Supervisory practice</p> <p>The latest review of the DST reports has shown that some long-term insurers are sensitive to changes in the interest rate and/or equity prices. Proposed management actions include capital injection, financial reinsurance arrangement, reduction in new business, reduction in expenses, dividend cut, and re-pricing of certain products. The solvency positions of these insurers have then been under close monitoring, including the submission of daily/weekly solvency reports.</p> <p>The most recent stress test carried out by general insurers in July 2013 revealed that all insurers were able to withstand a drop of 15 percent in property value. The stress test carried out in June 2013 revealed that some insurers could not pass the test under extreme adverse scenario (40 percent drop in listed equities value plus 15 percent drop in bonds value). Out of these insurers, a majority were already under liquidation or run-off. Further analysis into the remaining insurers revealed that their listed equities and bonds</p>
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	<p>were of very good quality, and the marginal shortfall would not pose real or immediate risk.</p> <p>Although the IA has yet to adopt a RBC framework, it pays attention to the risks to which an insurer may be exposed to, taking into account the business nature of the insurer, the macroeconomic and overall financial climate, as well as the political environment.</p>
Assessment	Partly observed.
Comments	<p>The ICO has only set out capital adequacy requirements. It has not provided for ERM or ORSA requirements, which are integral parts of a risk-based regime. Risk management is addressed separately through the DSTs. Under the DST, insurers writing long-term business are required to capture certain elements of an ORSA. However, for general insurers and for insurance groups, there are no ORSA requirements. In addition, there are currently no explicit requirements on insurers to:</p> <ol style="list-style-type: none"> implement an ERM framework for solvency purposes. Currently, the asset-liability management guidance note focuses on investment risks while GN10 defines risk management practices as high level principles; adopt a risk management policy that details how all relevant and material risks are managed on a regulatory and economic basis; and establish and maintain a risk tolerance statement and risk tolerance limits which take into account all relevant and material categories of risk. <p>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.</p> <p>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.</p> <p>The authorities are also encouraged to consider extending the DST to general insurers and to annually review the set of scenarios being used.</p>
ICP 17	<p>Capital Adequacy</p> <p>The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.</p>
Description	<p>Regulatory capital requirements (including the bases on which they are determined) for authorized insurers are prescribed by law.</p> <p>The existing capital adequacy framework is a rules-based solvency regime with a set of standardized methods for calculating the required amount of capital, largely modeled on Solvency I.</p>

The solvency margin requirement is supplemented by stress testing. For general insurers, the IA conducted ten stress tests since 2010 to assess potential vulnerabilities to financial market stresses. Stress tests have been applied on the five major asset types (land and buildings, fixed interest securities, variable interest securities (excluding listed shares), listed shares and unit trusts/mutual funds). Long-term business insurers have to conduct an annual DST. In addition, the IA conducts ad-hoc stress tests when there are adverse market conditions as well as frequent stress tests using balance sheet data, focusing on financial market risks.

Available Capital Resources

Available capital resources are arrived at through a top-down approach. Paid-up capital, subordinated loan stock and redeemable preference shares are included in the definition of the prescribed amount under the ICO. Intangible asset are not admitted as assets of a general insurer for the purpose of computing capital resources and there are admissibility limits on various assets and limit on assets mix for general insurers. (*s8(3)(b) of ICO and s10 of Valuation Regulation*).

General insurers are required to maintain assets in the HKSAR (*s25A of ICO*). The ICO lists the assets that qualify and must meet requirements on availability (capital fully paid up and in Hong Kong), and free from encumbrance. (*Schedule 8 of ICO*)

The Margin of Solvency

The determination of the solvency margin is detailed in the Insurance Companies (Margin of Solvency) Regulation (Cap 41F) (MoS Regulation).

The margin of solvency is based on factors that are applied to volume measures and is derived from the Solvency I approach, but adapted to the specific HKSAR situation. The factors and volume measures differ for different lines and classes of businesses.

Insurance risks are taken into account explicitly by the solvency margin. Credit risk is taken into account implicitly via haircuts of asset values for general insurers. Concentration risk for asset classes is taken into account by explicit investment limits for general insurers. Currency risk is not taken into account in the solvency margin but via a prudent margin in the liabilities and via asset liability management requirements. Reinsurance ceded can be taken into account, within given limits.

The Margin of Solvency for Long-term Insurance

The MoS Regulation prescribes the methods for determining the required margin of solvency. The solvency margin required is dependent on the class of insurance business written and linked to the amounts of mathematical reserves and the capital at risk as well as on the amount of business ceded to reinsurer.

The base equation to arrive at the margin of solvency is a linear equation of mathematical reserves and capital at risk, each multiplied with a factor. The factors are in general four percent for the mathematical reserves and 0.3 percent for capital at risk. Both factors as well as the amounts with which the factors are multiplied are modified to take into account reinsurance cessions, investment risk, expense risk and the class of business and type of insurance company. The total margin of solvency for a long-term business insurer is the sum of the margins of solvencies of each lines of business it writes.

For certain long term Class C businesses, no margin of solvency is required. This is the case when the insurer bears no investment risk, if the total expired and unexpired term is less than or equal to five years; and the allocation to cover management expenses has no fixed upper limit.

Long-term insurers are required to maintain insurance funds for business classes G and H, which must be segregated from the insurance funds maintained for the other classes of business. For class G or H insurance funds, the value of the fund assets must not be less than the liabilities attributable to the fund. For the other insurance funds, the fund assets should exceed liabilities (i.e. the fund margin) by at least HK\$ 2 million or the required solvency margin (*s22 and s59 of ICO*)

The assets of an insurance fund are applied only for the purposes of that part of the business to which the fund relates. This restriction does not apply to excess assets in the fund. An insurer may also exchange assets of an insurance fund with other assets of the insurer, provided the exchange is done at fair market value. No dividends can be declared by an insurance fund that does not meet the fund margin requirement. (*s23 of ICO*)

The appointed actuary is required in AGN3 to advise his company as to actions required to maintain the margins of solvency as the existing business becomes more mature.

A currency mismatch has to be provisioned prudently but does not require an insurer to hold additional capital. (*ASHK Supplement to AGN3*)

The Margin of Solvency for General Insurance

The solvency margin (i.e. the relevant amount) is calculated on a sliding scale based on the premiums income and claims outstanding (with minimum amounts prescribed), whichever is greater. Different amounts apply if statutorily required insurance is written. (*s10 of ICO*)

Supervisory intervention

The ICO requires all insurers to maintain a 100 percent solvency ratio at all times, which conceptually is equivalent to minimum capital requirement as a minimum bound below which an insurer would no longer be regarded viable as a going concern. To allow sufficient safeguard, the IA requires all insurers to maintain 150 percent solvency ratio, below which the IA may intervene on capital adequacy grounds. Under the IA's early warning system, it will closely monitor the solvency position of insurers with solvency ratio below 200 percent. The early warning system enables the IA to take appropriate interventions at an early stage. (*s8 of ICO*)

If an insurer has a deficit of assets over liabilities, the IA may require the insurer: a) to submit a plan for the restoration of a sound financial position or modify a submitted plan to the satisfaction of the IA and to implement the plan accepted by the IA. If an insurer's solvency margin falls below the required amount, the IA may require the insurer to submit a short term financial scheme or modify the scheme to the satisfaction of the IA and implement the scheme accepted by the IA. In determining the value of the assets and liabilities of an insurer for these purposes, the IA may take into account any unpaid share capital, future profits and hidden reserves of the insurer. (*s35AA of ICO*).

The IA's ability to adjust capital through the interventionary powers is mainly conferred

	<p>through under the ICO. It has residual power to require an insurer to take such action in respect of its affairs, business or property (ICP 10) which enables the IA to adjust capital requirements for insurers based on specified grounds. Such powers are only invoked in limited circumstances. The IA shares solvency appraisal and adjustments in regulatory capital requirement with the insurer concerned. (<i>s35 and s26 of ICO</i>)</p> <p>Group Solvency Requirements</p> <p>The current capital adequacy regime is on legal entity basis. For general insurers, the value of an insurance subsidiary is admitted after deducting its applicable solvency margin. The IA also requires insurers to supply updated information on their groups on an annual basis.</p> <p>However, the IA is participating in a number of supervisory colleges of subsidiaries operating in the HKSAR and obtains information on the economic and solvency position of the group and adapts its supervisory intensity also based on this information. (ICP 25)</p> <p>Supervisory practices</p> <p>The IA is aware of the shortcomings of the current solvency system and is developing a RBC framework in line with ICP 17. To obtain more information on the exposures to risk of insurers, the IA is conducting regular and ad hoc stress tests, using balance sheet data to test vulnerabilities to the financial market. In addition, long-term insurers have to undertake at least annually the DST, which is scenario based and projects the solvency margins over several years under different scenarios.</p> <p>To monitor insurers' liquidity risks, the IA analyses the liquidity risk assessment reported in the audited accounts of insurers which shows the amount of assets at different maturity periods and the amount of expected future cash outflows from insurance liabilities.</p>
Assessment	Partly observed.
Comments	<p>The ICO sets out the existing capital adequacy framework, which is in essence a rules-based solvency regime with a set of standardized methods for calculating the required amount of capital. The law does not permit the use of tailored approaches (i.e., partial or full internal models).</p> <p>The capital requirement is not based on a clear, transparent underlying methodology. Some risks are reflected in the required amount of capital, some are reflected in haircuts applied to assets and others in prudent margins in liabilities, while others are treated via qualitative requirements; differing on the lines of business.</p> <p>There is no capital adequacy test on a group-wide basis and the current capital requirement is purely legal entity based. It is also not able to reflect potential group risks to which subsidiaries are exposed to, e.g. via intra-group transactions.</p> <p>It is recommended that the authorities:</p> <ol style="list-style-type: none"> a) Extend the current solvency margin requirements to long-term Class C business. b) Formulate the proposed RBC framework such that the capital requirements: <ul style="list-style-type: none"> • 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

	<p>liabilities</p> <ul style="list-style-type: none"> • 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, 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. <p>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.</p> <p>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.</p>
<p>ICP 18</p>	<p>Intermediaries</p> <p>The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.</p>
<p>Description</p>	<p>Supervisory arrangements</p> <p>At the time of assessment, HKSAR adopts a self-regulatory system for insurance intermediaries:</p> <ul style="list-style-type: none"> a) Insurance agents, their responsible officers and technical representatives³² need to be registered with and monitored by the IARB, in accordance with CoP; and b) Insurance brokers³³ need to be either authorized by the IA or become members of one of the two approved broker bodies, namely HKCIB and PIBA. Their chief executives and technical representatives must be registered with the IA or the relevant broker body. At the time of assessment, there was no broker authorized by the IA. <p>As at end-2012, there were 37,608 tied individual insurance agents, 2,419 insurance agencies with 27,830 responsible officers and technical representatives; as well as 604 insurance brokers with 8,798 chief executives and technical representatives.</p>

³² An insurance agent means a person who advises on or arranges contracts of insurance as an agent or subagent of one or more insurers. A responsible officer generally means a person who is responsible for the conduct of the business of an insurance agency, and ensures that all its technical representatives comply with the CoP.

³³ An insurance broker means a person who carries on the business of negotiating or arranging contracts of insurance as the agent of the (potential) policyholder or advising on matters related to insurance.

	<p>The CoP sets out, <i>inter alia</i>, the registration requirements for agents including fit and proper criteria and minimum qualifications. The HKFI is required to amend the CoP as the IA directs but it may not, without the prior approval of the IA, amend or withdraw the CoP. An insurer is required to comply with a CoP issued by HKFI. The IA has the power to require an insurer and agent to supply information to verify compliance with the CoP. (s67 of ICO)</p> <p>To be approved by the IA for authorizing insurance brokers, a SRO must have adequate provision in its member regulations to comply with the minimum requirements specified by the IA for brokers. In addition, the SRO should be managed or supervised by fit and proper persons; and has appropriate disciplinary procedures to deal with misconduct of its members. The SRO is required to maintain a register of its members containing the information required by the IA. Registration of brokers is reviewed annually by the HKCIB/PIBA to ensure that their members continue to comply with registration requirements. An approved SRO must furnish an annual auditor's report on its members' compliance with these requirements to the IA. (s70 and s73 of ICO)</p> <p>Authorization requirements</p> <p>A person shall not hold himself out as an insurance agent or broker unless he has been properly registered or authorized. In addition, a person shall not act both as an insurance agent and broker at the same time whether in relation to the same or different clients. There are also a number of legal provisions that prohibit potential conflict of interests arising from the involvement of directors, proprietors, partners and employees of insurance agents in an insurance broker and <i>vice versa</i>. (s65 of ICO)</p> <p>It is an offence for an unregistered insurance intermediary to conduct insurance intermediation activities. Where there is a <i>prima facie</i> case of illegal activities, the matter will be referred to the police and the Department of Justice for further investigation and prosecution.</p> <p>The criteria for authorizing an insurance broker by the IA include: qualifications and experience; capital and net assets; professional indemnity insurance; segregation of client accounts; proper books and accounts; and fitness and propriety of the broker. The IA has elaborated its supervisory expectations on these in the MRIB issued pursuant to the ICO. (s69 of ICO)</p> <p>An insurer shall not: a) effect an insurance contract through an insurance intermediary; or b) accept any insurance business referred to it by an insurance intermediary unless the intermediary is its appointed agent or an authorized broker. Non-compliance renders the insurance contract void at the option of the policyholder. (s65 of ICO)</p> <p>Banks selling insurance products are required to be registered as insurance agencies with the IARB and comply with the CoP. Banks shall not act as insurance agencies for more than four insurers, of whom no more than two shall be long-term insurers. Some insurers are subsidiaries of banking groups, which sell insurance products through related banks. Some insurers form partnership with banks outside their groups. Banks may sell insurance products within the group exclusively or third party products. Bank employees who are involved in the sale of insurance products must be registered as Technical Representatives of the bank (in its capacity as an insurance agency) after passing the relevant examinations and comply with the CoP.</p>
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	<p>An insurance agent is the agent of the insurer. An insurer is prohibited from excluding or limiting its liability for the actions of its appointed agent. Where, in an insurance transaction, a particular insurer is not able to be identified, all the insurers who have appointed the agent are jointly and severally liable for the actions of the agent. The liability of an insurer arises whether the appointed agent purports to act as a principal or as an agent for an undisclosed or disclosed principal. (<i>s68 of ICO</i>)</p> <p>An insurer is required to keep a register of appointed insurance agents and record the prescribed details of the agents appointed. (<i>s66 of ICO</i>)</p> <p>Professional Knowledge and competence</p> <p>To be eligible for registration, insurance intermediaries are required to pass the relevant papers of the Insurance Intermediaries Qualifying Examinations (IIQE), consisting of the following papers: Principles and Practice of Insurance; General Insurance; Long-term Insurance; Investment-linked Long-term Insurance and Travel Insurance. Exemption is granted to certain recognized professional qualifications in insurance or actuarial science³⁴. The IIQE is conducted by the Vocational Training Council, an independent statutory body. The average passing rate for the IIQE is around 55 percent.</p> <p>Insurance intermediaries are required to fulfill 10 hours on continuing professional development per year, through training courses accredited by the Hong Kong Council for Accreditation of Academic and Vocational Qualifications. Insurers are required to provide sufficient training to their agents to ensure that they are familiar with the prescribed requirements and to perform their role competently. Brokers shall take all reasonable steps to ensure that their chief executives, technical representatives and employees, who are dealing with (potential) policyholders, are competent as well as fit and proper persons. (<i>Part IV (B) of MRIB</i>)</p> <p>Integrity and conflict of interests</p> <p>Checks for criminal convictions and bankruptcy filing are conducted prior to registration. Where an insurance intermediary is found to have committed an offence or have filed for bankruptcy after registration, the relevant SRO will consider whether he remains fit and proper to be registered.</p> <p>Insurance agents are required to conduct business in good faith and with integrity. Detailed conduct requirements for general and long-term insurance business are set out in the CoP and the Guidelines on Misconduct, which expressly states that the agent must act in the best interests of customers, and must present each policy with complete honesty and objectivity. HKCIB and PIBA have issued guidelines requiring their members to conduct business with utmost good faith and integrity at all times, and to place the interests of clients before all other considerations.</p> <p>Corporate governance</p> <p>Currently, most agents are tied individual agents. Insurance agencies must appoint a Responsible Officer to oversee their agency business and to ensure their technical representatives' compliance with CoB requirements. The Guidelines on Misconduct stipulates that insurers must establish control procedures to monitor insurance agents'</p>
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³⁴ E.g., Associate or Fellow of the Chartered Insurance Institute, Senior Associate or Fellow of the Australian and New Zealand Institute of Insurance and Finance, Fellow of the Society of Actuaries of the United States of America and Certified Financial Planner.

<p>compliance with CoB requirements.</p> <p>All insurance brokers are corporates, which are subject to the general governance requirements under the CO. In addition, the MRIB and the respective Membership Regulations of HKCIB and PIBA require brokers to appoint a chief executive to oversee the conduct of broking business and to ensure compliance with applicable rules and regulations by their technical representatives.</p> <p>Disclosure of information to clients</p> <p>An agent is required to identify himself as acting on behalf of his appointing insurer to prospective policyholders prior to discussing insurance policies, and identify his registration number on his business cards. Brokers shall make adequate and accurate disclosure of relevant material information in dealing with their clients, including whether they have any association with the insurer whose insurance products are recommended, and whether such association may result in a conflict of interest. They shall not give any misleading information or make any false statements. In particular, they shall not describe themselves as agents of insurers. (<i>Part IV (A) and (E) of the MRIB</i>)</p> <p>HKCIB and PIBA have adopted a uniform disclosure standard which requires brokers to disclose to their clients that they are remunerated for their services by the commissions paid by insurers, and to provide the remuneration details upon clients' request.</p> <p>Segregation of Clients' Monies</p> <p>Under IARB's guidelines, use of cheques payable to insurer or credit card/direct deposit/bank transfer from clients' account to the insurer are recommended for premiums payment. It is expressly stated that any other method of payment should be subject to clear rules set out by an insurer to avoid the mixing of clients' money with the agents' personal funds.</p> <p>Brokers are required to keep clients' monies in a bank account separate from their own monies. Client monies are not to be used for any purpose other than for the purposes of the client. A broker is entitled to retain the interest that is earned on client monies unless the broker and the client agree otherwise. A lien or claim on client monies made by or through the broker is void unless the monies in the client account are for fees owing to the broker. A charge or mortgage on client monies made by a broker is void. Brokers must also appoint qualified auditors to audit the financial statements to be submitted to the IA or the SROs. To ensure compliance, brokers are required to submit annual auditors' reports certifying their continued compliance with this requirement. On-site inspections by the IA, HKCIB and PIBA also check compliance. (<i>s71 to s73 of ICO</i>)</p> <p>Supervisory practices</p> <p>The IARB, HKCIB and PIBA maintain an adequate system in handling complaints against registered persons. They have established disciplinary procedures for dealing with non-compliance and misconduct cases. For substantiated case, disciplinary actions (including warning, reprimand, fine, membership suspension or expulsion and prohibition from registration) will be taken. SROs are required to submit their monthly complaints and disciplinary reports to the IA. The IA monitors the work of the SROs, including how they ensure that registered persons continuously comply with the codes, rules and regulations issued by them (ICP 9).</p> <p>In addition, the IA conducts Mystery Shopping Programs on the sale of insurance</p>
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	<p>products by insurance intermediaries. Where deficiencies are identified, the IA will follow up with the SROs and other relevant parties to address the concerns. In 2012, the IA referred 240 complaints to the three SROs, about a quarter of the 1,007 complaints that were received by the SROs. On aggregate, the three SROs took disciplinary actions against 151 intermediaries, including 11 technical representatives working in banks.</p> <p>The IA requires insurers to establish internal control procedures to ensure their agents' compliance with the CoP. Insurers are expected to report promptly any breaches of the CoP by their agents to the IARB, which is also required by the CoP to report to the IA such breaches. If an agent is found to have breached the prescribed requirements after IARB's deliberation, the IARB will consider taking disciplinary action including the issuing a reprimand, and suspension or termination of registration. (<i>s67 of ICO</i>)</p> <p>Brokers are required to submit to the IA or HKCIB/PIBA their annual audited financial statements and auditor's report certifying their continued compliance with the MRIB. The IA, HKCIB and PIBA conduct regular on-site inspections on brokers. Brokers must rectify breaches identified or noted by IA/ HKCIB/PIBA in a timely manner and disciplinary actions may be taken, where appropriate. HKCIB and PIBA are required to inform the IA of breaches and disciplinary actions taken.</p> <p>The IA is empowered to give notice to an agent to demonstrate that either he has not breached the code of practice as alleged; or the breach was not sufficient to warrant deregistration. Failure to satisfy the IA would result in deregistration and the affected person has the right to appeal to the Financial Secretary. Deregistration takes immediate effect despite an appeal. (<i>s66 of ICO</i>)</p> <p>The HKMA is responsible for supervising banks' role as insurance agencies under the Banking Ordinance (Cap. 155). Pertinent supervisory findings are shared with the IA under the bilateral MoU and through regular liaison and meetings. The IA had referred relevant cases for the IARB's further investigations and action. In addition to the abovementioned 11 cases where the IARB took disciplinary actions, the HKMA also suspended the registration of one relevant individual (i.e. technical representative of a bank) in 2013. Separately, banks have also taken disciplinary actions on their bank staff in 3 cases in 2012.</p> <p>Proposed IIA</p> <p>Upon the establishment of the proposed IIA, the self-regulatory regime for insurance intermediaries will be replaced by a direct supervision regime, under which the IIA will be responsible for the licensing and CoB supervision of insurance intermediaries.</p> <p>Under the proposed IIA regime, licensed insurance intermediaries will continue to comply with the qualification, integrity and competence requirements which are no less stringent than the current requirements. Clear and detailed eligibility criteria and conduct requirements relating to professional knowledge and experience, integrity and competence as well corporate governance³⁵ will be prescribed by the IIA. The IIA will</p>
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³⁵ The Responsible Officers of insurance intermediaries will be legally responsible for the operations of the insurance agency or broking business, and they are required to oversee the internal controls to ensure compliance by the insurance intermediaries. Detailed requirements for the internal controls and procedures will be issued by the IIA.

	<p>assess the competence of insurance intermediaries through onsite inspections. It will also be vested with regulatory powers to investigate misconduct or non-compliance cases, to impose disciplinary sanctions and to prosecute offences summarily.</p>
Assessment	Largely observed.
Comments	<p>HKSAR currently adopts a self-regulatory regime for insurance intermediaries, with three SROs responsible for the licensing and CoB regulation of insurance agents and brokers. The IA has been supervising the SROs' oversight, including conducting its own spot checks, inspections and mystery shopping to ensure that the SROs discharge their duties effectively and equitably. While the IA's proactive engagement has provided a safety net and critical quality assurance on the SRO regime, it involves significant duplication of efforts. In addition, industry codes and standards issued by the SROs are not legally binding and the SROs are not full-fledged supervisors, in the absence of a statutory mandate. These constraints dilute the effectiveness of the SRO regime. The move towards direct supervision by the proposed IIA would also minimize the potential conflict of interests arising from a self-regulatory regime, and is more in line with international best practices.</p> <p>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.</p>
ICP 19	<p>Conduct of Business</p> <p>The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.</p>
Description	<p>Under the CoP, insurance agents are expected to conduct business in good faith and with integrity. The MRIB requires brokers to exercise due care and diligence in understanding and satisfying the insurance needs and requirements of clients.</p> <p>The Board of an insurer is expected to set out clearly a policy on fair treatment of clients and monitor its implementation. To enhance transparency of insurance products and to better service clients, the Board shall fulfil the objectives of improving clients' awareness of their rights and obligations under their insurance policies and enhancing their knowledge on insurance products. (p9(i), p20 and p21 of GN 10)</p> <p>While there is no explicit requirement for intermediaries to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture, certain practices stipulated in the CoP or the MRIB contributes to this objective. For example, an agent must complete Customer Protection Declaration Form for switching of policies to ensure the client is fully aware of potential disadvantages of replacing an existing policy; and brokers should disclose conflict of interests.</p> <p>There is no explicit requirement for insurers to take into account the interests of different types of customers when developing and marketing insurance products.</p> <p>It is an offence under the ICO for any person who induces or attempts to induce another person to enter into an insurance contract through: false, misleading or deceptive statement, promise or representation; dishonestly conceal material facts; or reckless</p>

	<p>making false, misleading or deceptive statement, promise or representation. This is supplemented by CoCIs issued by HKFI. Insurers should ensure that information contained in their sales materials and illustrations is current, correct, expressed in plain language and not misleading. They must also provide their agents with sufficient support facilities and materials to enable proper advice to clients. Life insurers are not allowed to offer any gift other than a discount of fees or charges for the sale and promotion of life products with a significant investment or savings component. Under the CoP and MRIB, insurance intermediaries are prohibited from making inaccurate or misleading statements about insurance policies. <i>(s56 of ICO and P8 and P36 of the Code of Conduct)</i></p> <p>Insurers and insurance intermediaries are required to comply with the following disclosures at the point-of-sale:</p> <ol style="list-style-type: none"> a) Questions in the proposal form should be in plain language; b) A summary illustration of the benefits of the insurance; c) Relevant Key Facts Statement showing main policy terms; d) Insurance intermediaries to clearly identify their capacity as to whether they are acting as an agent or broker prior to discussing insurance policies and disclose their registration numbers. For ULPs, insurance intermediaries must disclose their commissions upon the clients' request; e) Important Fact Statement signed by the client to confirm understanding of the key features of the policy e.g., fees, early withdrawal penalties etc. <p>To ensure the advice provided by an insurance intermediary is suitable to the client's needs, the intermediary must conduct a detailed suitability assessment. There are specific requirements under relevant guidelines issued by SROs to ensure the appropriateness of advice given by insurance intermediaries for life insurance. Intermediaries must complete a Financial Needs Analysis and Risk Profile Questionnaire (for ULPs only). Post-sale audio-recorded confirmation calls are required to be conducted by a separate team of quality assurance staff of the insurer. A cooling-off period of 21 days must be provided and the intermediary must inform the client of this right. The Guidelines on Misconduct states that agents must not request clients to sign blank or incomplete forms and any alteration should be initialled by the clients.</p> <p>To avoid recommendation of an inappropriate life policy to a client, safeguards are in place to require the client to make a Suitability Declaration in his own handwriting where the policy recommended is not suitable to the client (e.g. mismatching of risk profile) or the client is unwilling to provide sufficient information for the suitability assessment.</p> <p>In HKSAR, it is an industry practice for long-term insurers to: service policies through to the point at which all obligations under the policy have been satisfied; disclose to the policyholder information on any contractual changes during the long-term of the contract; and disclose to the policyholder further relevant information depending on the type of insurance product.</p> <p>The IA recommends that insurers set up a Claims Settlement Committee to devise and oversee the claims settling policy. One of the functions of this Committee is to determine the circumstances under which claims disputes shall be brought to its attention and decide how to deal with such claims disputes. Claims should be promptly recorded, adequate provisions made, and that senior management shall be notified of large claims and take timely actions as appropriate. The CoCIs requires insurers to handle all claims efficiently, speedily and fairly. The ICCB was established by the industry to determine disputes between insurers and individual policyholders relating to rejected or partially-</p>
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<p>rejected claims. (p12(f) of GN10 and Part III of the CoCIs)</p> <p>Brokers also have to exercise due care and diligence in handling of claims. Specifically they are required to explain the principle of utmost good faith to their clients and make it clear that all answers and statements given in completing the claim form and relevant documents are the clients' own responsibility and that incorrect answers or information given therein may result in the claims being repudiated. (MIRB)</p> <p>The Board of an insurer shall establish clear complaints procedures and inform policyholders of these procedures upon request. Insurers should establish procedures for dealing with complaints against their agents. (p23 of GN 10 and p35 & Part VII of the CoCIs)</p> <p>All the three SROs have established transparent policies and procedures in handling complaints against the insurance intermediaries registered with them. One of IARB's functions is to investigate complaints against agents and take appropriate disciplinary action. Disciplinary decisions of the IARB can be appealed to the Appeals Tribunal of the HKFI. Both HKCIB and PIBA handle complaints against their members. A designated committee will be responsible for the review, investigation and deliberation of a complaint. If a <i>prima facie</i> case is established, the case will be referred to the Disciplinary Committee for hearing and deciding on the disciplinary actions to be imposed. An appeal mechanism is also in place. The IA also handles complaints against insurers from policyholders or claimants.</p> <p>Personal data collected by insurers and intermediaries are subject to the PDPO. HKFI has issued a guideline for Insurers providing guidance in complying with the PDPO. In addition, to facilitate compliance by insurers and intermediaries, Guidance on the Proper Handling of Customers' Personal Data for the Insurance Industry has been issued by the Privacy Commissioner for Personal Data. This guidance stipulates specific requirements for the handling, collection, storage, retention and use of clients' and policyholders' personal data.</p> <p>The IA considers consumer empowerment and public education an essential tool in enhancing consumer protection and fair treatment of customers in the insurance sector. Examples of consumer education and empowerment efforts include:</p> <ol style="list-style-type: none"> The IA works with the Consumer Council on consumer education campaigns e.g. alerting consumers on features of insurance products that consumers often overlook; As the Executive Member of the Investor Education Centre, the IA helps develop consumer education campaigns on ULPs Education campaigns through the electronic media (TV and radio ads) and the print media (feature articles). Education pamphlets for distribution to the public. <p>Proposed IIA</p> <p>The proposed IIA regime will introduce the following CoB Principles in the legislation requiring insurance intermediaries to:</p> <ol style="list-style-type: none"> act honestly, fairly, in the best interests of the policyholder and with integrity; exercise a level of care, skill and diligence that may reasonably be expected of a prudent person who is carrying on the regulated activity; advise only on matters for which the licensed insurance intermediary is competent to advise;

	<p>d) have regard to the particular circumstances of a (potential) policyholder as is necessary for ensuring that the regulated activity is appropriate;</p> <p>e) make such disclosure of information to the policyholder as is necessary for the policyholder to be sufficiently informed for the purpose of making any material decision;</p> <p>f) use best endeavors to avoid a conflict between the interests and, in the case of such a conflict, disclose the conflict to the (potential) policyholder;</p> <p>g) ensure that policyholder's assets are promptly and properly accounted for.</p> <p>Relevant code of conduct covering the above statutory requirement will be issued by the IIA.</p> <p>The proposed IIA will also require insurers and insurance intermediaries to appoint Responsible Officers to secure observance of their internal controls and procedures in compliance with the statutory conduct requirements.</p> <p>The proposed IIA will be vested with investigation power to handle complaints against insurance intermediaries. A set of clear complaints handling and disciplinary procedures will be set out in the guidelines.</p>
<p>Assessment</p>	<p>Partly observed.</p>
<p>Comments</p>	<p>The ICO does not provide for any explicit requirements on CoB of insurers, other than fit and proper criteria of controllers and directors. Nonetheless, some aspects of the CoB standards are covered under the corporate governance guidelines issued by the IA and the CoCIs issued by HKFI. While the CoP and the MRIB establish industry standards for insurance intermediaries on disclosures, proper advice, professional claims and complaints handling etc., these standards are not legally binding. Furthermore, the CoCIs would not apply to insurers who are not members of the HKFI although its members account for more than 90 percent of the premiums in the insurance market in HKSAR. Personal data collected by insurers and intermediaries are subject to confidentiality safeguards under the PDPO.</p> <p>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.</p>
<p>ICP 20</p>	<p>The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed</p>
<p>Description</p>	<p>Insurers are required to submit to the IA their accounts, financial statements and other information, a copy of which must be lodged with the Companies Registry. Disclosures in</p>

	<p>the annual accounts of insurers are in accordance with the CO and the ICO, which include information in relation to an insurer's business profile or activities, financial position, technical performance, risks exposures, as well as major accounting policies and assumptions and sources of estimation uncertainty. The public may access insurers' annual accounts on the Companies Registry for a small fee. (s17, s21 of ICO)</p> <p>Insurers are required to disclose the following in their financial statements:</p> <ol style="list-style-type: none"> a) Insurance liabilities: long-term business funds and claims admitted but not paid (long-term business); and unearned premiums; unexpired risks; claims outstanding (general business) b) Capital adequacy - qualitative information on the objectives, policies and processes for managing capital; and quantitative information on the available capital resources, local regulatory capital and excess capital resources³⁶. (p134-136 of HKAS1 (Presentation of Financial Statements)) c) Exposure to risks arising from financial instruments - qualitative and quantitative information including specified minimum disclosures about credit risk, liquidity risk and market risk. These include sensitivity analysis for each type of market risk, as well as the objectives, policies and processes to manage these risks. (HKFRS7 (Financial Instruments : Disclosure)) d) (Enterprise) risk management - risk management objectives, policies and processes to manage risks arising from insurance contracts and financial instruments. Asset-liability management is disclosed on an aggregate level as part of the qualitative disclosure of risk management. (HKFRS4 (Insurance Contracts) and HKFRS7 (Financial Instruments : Disclosure)) e) Financial performance – the income statement and/or revenue account and/or statement of comprehensive income; claims information including claims development; and investment returns by component. Breakdown into long-term business and general business is disclosed in the financial information under the ICO and /or the annual or quarterly returns.(HKAS1 (Presentation of Financial Statements), HKFRS4 (Insurance Contracts) and HKFRS7 (Financial Instruments : Disclosure) and the Third Schedule to the ICO) f) Insurance risk exposures and their management - information that enables users of financial statements to evaluate the nature and extent of risks arising from insurance contracts, insurance risk (both before and after risk mitigation by reinsurance), sensitivity to insurance risk, concentrations of insurance risk etc. (p38 and p39 of HKFRS4 (Insurance Contracts)) g) Company profile - nature of operations and principal activities of an insurer and its subsidiaries, as well as the location of operations and incorporation, a general description of key products is usually included as part of the risk management disclosure in assessing the insurance risks of major contracts.(HKAS1 (Presentation of Financial Statements and HKFRS4 (Insurance Contracts)) h) Corporate governance framework and management controls - information on principal business activities, list of directors or controllers, summary of the material reinsurance arrangements etc. (Directors' Report stipulated in the Third Schedule to the ICO.) <p>The gaps in the current disclosure regime include:</p>
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³⁶ The proposed RBC framework will require disclosures of appropriately detailed quantitative and qualitative information about capital adequacy.

	<p>a) TP - appropriately detailed qualitative information about the determination of TP such as information about the future cash flow assumptions, the rationale for the choice of discount rates, risk adjustment methodology (where used) or a description of the method used to determine TP;</p> <p>b) Investments - values, assumptions and methods used for general purpose financial reporting and solvency purposes, as well as an explanation of differences (where applicable);</p> <p>c) Asset-liability management - the methodology used and the key assumptions employed in measuring assets and liabilities for asset-liability management purposes and any capital and/or provisions held as a consequence of a mismatch between assets and liabilities;</p> <p>d) Financial performance - quantitative source of earnings analysis and pricing adequacy.</p> <p>e) Corporate governance framework and management controls – more comprehensive disclosures are required compared to the current practice.</p> <p>Currently, the IA does not have explicit authority to establish disclosure requirements and to supervise insurers' public disclosures. Listed insurers are subject to listing requirements including publication of quarterly and annual financial statements. However, non-listed insurers are not obliged to publish their financial statements on their websites. The IA is developing a RBC regime for insurers, which will include public disclosure requirements.</p>
<p>Assessment</p>	<p>Largely observed.</p>
<p>Comments</p>	<p>The current public disclosure regime is largely based on the accounting standards adopted in HKSAR, which is not fully aligned with the disclosure standards under ICP 20. All annual audited accounts of insurers are accessible to the public. While insurers submit more granular information to the IA, with some selected information published by the IA on individual and industry aggregate level. The proposed RBC framework will incorporate disclosure requirements in line with IAIS standards. In addition, the IA will keep in view the second phase development of HKFRS4 on Insurance Contracts regarding disclosure requirements on insurance risks exposures.</p> <p>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.</p>
<p>ICP 21</p>	<p>Countering Fraud in Insurance</p> <p>The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.</p>
<p>Description</p>	<p>Fraud is an offence under the Theft Ordinance (Cap 210) (TO) liable on conviction upon indictment to imprisonment for a maximum of 14 years. The TO also cover deception-related offences.</p> <p>The IA has a thorough and comprehensive understanding of the types of fraud risk to which insurers and intermediaries are exposed. For general insurance, the major fraud risks are related to fraudulent representation by policyholders in employees' compensation business, as well as fraudulent claims in medical, employees' compensation</p>

	<p>and motor lines of business. The former risk could be mitigated by insurers through effective underwriting practices³⁷ and internal controls, whereas the latter could be addressed by proper claims management system. Insurers are expected to adopt these measures as part of their corporate governance framework. Insurers need to be vigilant and cooperate with the Police, loss adjusters and lawyers on suspicious cases. <i>(GN10)</i></p> <p>For life insurance, the major fraud risk lies with intermediaries e.g., fraudulent documentation. Insurers should put in place effective procedures and controls to deter and detect fraud, both for new business and ongoing monitoring. Adequate customer identification procedures (e.g. checking travel documents for inbound policyholders) and verification of the relevant customer information must be performed and properly recorded.</p> <p>To prevent misappropriation of clients' monies by insurance intermediaries, insurance agents have to observe the guidelines on premiums issued by the HKFI while insurance brokers have to comply with the segregation of clients' monies requirements under the ICO and MRIB. Brokers should have adequate internal controls in place for fraud prevention, especially when conducting investment-linked business.</p> <p>Supervisory practices</p> <p>The IA identifies possible fraud cases through: on-site inspection, examination of financial statements to identify irregularities, and complaints from the public which arouse the attention of the IA on irregularities. The supervisors also assess the adequacy of the internal control systems of insurers, especially in claims and underwriting management and verification of customer information.</p> <p>Apart from tackling fraud on a case-by-case basis, the IA also assists insurers to put in place preventive measures. For instance, employers of high risk industry (e.g. scaffolding industry where the employees may vary everyday) must declare the place of work and estimated number of employees on the previous work day and submit a declaration of the actual number of employees, the waggeroll concerned and the names of the employees at the end of the work day.</p> <p>The IA has encouraged the insurance industry to collaborate in tackling fraud through sharing of data etc. A Task Force on the Prevention of Insurance Fraud & Claims Database has been formed to deal with fraud-related matters in the insurance sector.</p> <p>The IA maintains close liaison with the Hong Kong Police (Police) and the Independent Commission Against Corruption on the investigation of suspected fraud. It has worked with the Commercial Crime Bureau of the Police in setting up a dedicated reporting system for the insurance industry to deal with suspected fraud cases.</p> <p>The IA works closely with other financial regulators on the investigation of suspected fraud cases. For example, in one case, the IA suspected that certain bank deposits of an insurer were fictitious. The IA, together with the HKMA, investigated into the matter and subsequently took actions the insurer to protect policyholders. The case was also reported to Police resulting in criminal charges brought against the directors and controllers of the</p>
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³⁷ For example, for employees' compensation business, insurers should check the employers' MPF or other payroll records and audited financial statements at the underwriting stage.

	<p>insurer.</p> <p>As some fraud cases involve cross-jurisdiction activities, the IA also works with other supervisors (e.g. the Guangdong Bureau of the China Insurance Regulatory Commission) in handling such cases. In addition, the IA is discussing with supervisors in China and Macau the signing of a MoU specifically on fraud prevention.</p>
Assessment	Observed.
Comments	<p>Fraud is an offence punishable by law. As part of its ongoing supervision, the IA assesses insurers' risk management frameworks to determine their adequacy and effectiveness for managing fraud risk exposures. Domestically, the IA collaborates closely with the insurance industry, law enforcement agencies and other relevant financial regulators. Recognizing the potential for cross-jurisdictional frauds, the IA also works with regional supervisors and is in discussion with supervisors in China and Macau the signing of a MoU specifically on fraud prevention.</p>
ICP 22	<p>Anti-Money Laundering and Combating the Financing of Terrorism</p> <p>The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, and the supervisor takes effective measures to combat money laundering financing of terrorism.</p>
Description	<p>AML/CFT regime</p> <p>The IA is a designated AML/CFT competent authority. Currently, the AML/CFT regime in HKSAR covers insurers, reinsurers, and insurance intermediaries engaged in long-term insurance business specifically.</p> <p>The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (AMLO) came into effect on 1 April 2012. The AMLO provides for, <i>inter alia</i>, the requirements relating to customer due diligence (CDD) and record-keeping for specified financial institutions, and provide for the powers of the relevant authorities including the IA to supervise compliance with requirements under the AMLO.</p> <p>The IA is empowered to conduct on-site inspections to supervise compliance by insurance institutions with the AMLO. It has issued the Guidelines on Anti-Money Laundering and Counter-Terrorist Financing (GN3). The Guidelines set out the IA's expectation of the risk-based approach to CDD and on-going monitoring by insurance institutions. In particular, the IA provided guidance on the risk factors to be considered in determining ML/FT risks ratings of their customers, documentation of risk assessments, (non-exhaustive) examples of suspicious transactions/circumstances, indicators of suspicious transactions and examples of money laundering schemes. Insurance institutions should implement clear and well-articulated policies to ensure that relevant staff receives adequate AML/CFT training. (<i>s9 of AMLO and p3.1, p3.5, p7.14, Annex 1 and Annex II & p9 of GN3</i>)</p> <p>The IA is also empowered to impose supervisory sanctions for breaches of the AMLO, including public reprimand, order for remedial actions and pecuniary penalties. It has published the Guideline on Exercising Power to Impose Pecuniary Penalty, which took effect from 1 July 2012. In addition, the IA may also invoke interventionary actions as outlined under ICP 10 and 11, where appropriate. (<i>s21 and s23(1) of AMLO</i>)</p> <p>Supervisory cooperation and coordination</p> <p>Close liaison has been established between IA and the JFIU of the Police. Statistics on</p>

suspicious transaction report filed by the insurance industry are provided by JFIU to the IA on a monthly basis. In its AML/CFT supervision, the IA can draw on the expertise from the Police (especially the JFIU) on investigation work, particularly in relation to complex cases and that of the Department of Justice for legal and prosecution matters. In addition, the IA has been jointly organizing seminars with FSTB and JFIU to enhance awareness of the insurance industry on AML/CFT matters.

The IA has entered into bilateral MoUs with HKMA, SFC and MPF Schemes Authority to facilitate exchange of information and mutual assistance; including AML/CFT matters. The IA has also signed cooperation agreements with relevant foreign counterparts. (Please refer to ICP 3). Meetings are held, from time to time, with HKMA and SFC and the Customs and Excise Department (C&ED) for sharing information and insights on regulatory issues on AML/CFT. To facilitate efficient exchange of information, a designated contact person at the IA (at senior management level) is appointed as the contact for AML/CFT matters (local or overseas).

A working Group on AML/CFT regulatory regime for Financial Sectors have been established, chaired by a senior FSTB representative, and comprising supervisors from the HKMA, SFC, IA and C&ED. Representatives from other relevance agencies e.g., the Police, may be invited to attend on a need basis. The key objectives of the Working Group include monitoring the operation of the AML/CFT regulatory regime for the financial sectors and facilitating the sharing of information and coordination. A separate AML Regulatory Enforcement Co-ordination Group has also been established comprising members from the HKMA, C&ED, IA and SFC, to discuss issues of common interest relating to enforcement of the AMLO. A proposed specific MoU on AML/CFT supervisory and enforcement matters to be signed amongst the IA, HKMA, SFC and C&ED is in the pipeline.

In July 2013, a territory-wide ML/FT risk assessment exercise overseen by the FSTB and a Task Force comprising financial regulators, law enforcement agencies and other relevant government departments was launched. The IA is part of the Task Force to provide necessary input to the risk assessment exercise, which facilitate enhanced understanding of the ML/FT vulnerabilities and risks in the insurance industry. This exercise was still on-going at the time of assessment.

Supervisory practices

The IA takes into account the ML/FT risks at each stage of the supervisory process. At the licensing stage, the authorization application forms for long-term insurers and reinsurers require applicants to describe the policies, procedures and controls in relation to AML/CFT, and submit the policies, guidelines or manuals on AML/CFT for review.

The IA analyses information collated from industry surveys³⁸ as well as the business statistics for long-term insurance to evaluate the level of ML/FT risks for each insurer and the insurance industry as a whole. Resources on AML/CFT supervision are prioritized on a risk-based basis, as part of its supervisory plan. The supervisory plan is updated annually

³⁸ For example, in late 2011, the IA conducted a survey of insurers, agencies and insurance brokers engaged in long term businesses to obtain the industry's views on the main ML/FT vulnerabilities and risks to the insurance sector.

	<p>and as required to timely reflect the changes in ML/FT risks. Information collected during on-site inspections is also used to update the ML/FT risks assessments.</p> <p>The AMLO and the Guideline will be regularly reviewed and revised to ensure that these are in line with international requirements, and that the information provided by the IA to the insurance sector is adequate. The IA will also review the effectiveness of its risk-based approach to supervising insurance institutions' statutory obligations to combat ML/FT.</p> <p>The IA has sufficient financial, human and technical resources to combat ML/FT. There is a dedicated team for supervising compliance with the AMLO and GN3. For on-site inspection, IA staff would meet the CEOs, Senior Management and compliance officers of insurance institutions to understand their ML/FT risks exposures and the relevant controls in place to mitigate the risks. The IA assesses the effectiveness of the AML/CFT measures adopted including sample checks on insurance policies for compliance with the CDD and record-keeping requirements. Off-site supervisory reviews are conducted for institutions posing lower risks, focusing on policies and procedures for compliance. For any non-compliance identified, the IA would take appropriate corrective actions.</p> <p>The IA circulates the lists of suspected terrorists or sanctioned persons/entities, gazetted under the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575) and the United Nations (Sanctions) Ordinance (Cap. 537) or published by other international sources regularly, to keep insurance industry abreast of the latest developments. The circulars also cover various topics such as countries that do not or insufficiently apply the standards established by the FATF. Insurance institutions are encouraged to be alert to suspicious transactions and report any suspicious cases promptly to the JFIU.</p> <p>The IA devotes much effort to the training of industry practitioners through seminars and industry briefings. Around 1,800 CEOs, industry practitioners, training managers and compliance officers of insurance institutions participated in these seminars and briefing sessions. Information on current ML/FT techniques, methods and trends, sanitized examples of actual ML/FT cases were shared by JFIU. Industry practitioners shared their experiences on AML/CFT compliance. Areas for focus and attention were communicated during the seminar by the IA. The IA often leverages on these opportunities to have direct dialogue with industry practitioners to further understand their practical difficulties and clarify their queries concerning compliance, thus enhancing effectiveness of implementation.</p> <p>Regular dialogue between the IA and various industry bodies is maintained. For any proposed changes in the AML/CFT regulatory requirements, public consultation would be carried out. The IA has regular liaison meetings with industry bodies, including HKFI, CIB and PIBA, to discuss matters of mutual concern, including AML/CFT matters.</p> <p>The IA has also liaised with the Vocational Training Council to launch AML-specific training session for the insurance industry since 2012. Staff efforts have been deployed for quality assurance to ensure sufficient coverage and accuracy of AML training materials and effectiveness of training. The IA also responds to queries from insurance institutions regarding compliance matters on the AMLO and GN3.</p>
Assessment	Observed.
Comments	The AML/CFT statutory obligations of insurance institutions are enshrined in the AMLO and the guidelines issued by the IA. Currently, the AML/CFT regime covers insurers,

	<p>reinsurers, and insurance intermediaries engaged in long-term insurance business specifically. The IA is a designated AML/CFT competent authority and is empowered to conduct AML/CFT inspections.</p> <p>The IA has good understanding of the ML/FT risks in the insurance sector through AML/CFT surveys, on-site inspections, insurance business statistics, market intelligence, liaison with industry bodies, and suspicious transaction reports data from JFIU etc. This supports its risks-based approach to supervising insurance institutions' compliance with their AML/CFT obligations. The IA supports the industry's AML/CFT compliance through industry seminars, briefing sessions, training course, website portal and publications, and responding to telephone and written enquiries etc. The IA has sufficient resources to carry out its AML/CFT mandate and monitors the effectiveness of the regulatory regime and its supervisory approach in this area. The IA cooperates and exchanges information with local and overseas supervisory authorities, facilitated by a network of bilateral MoUs and the IAIS Multilateral MoU, subject to confidentiality safeguards. Regular dialogue and meetings with the industry is maintained to promote effective implementation of AML/CFT measures.</p> <p>While the AML/CFT regime is in line with the 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.</p>
<p>ICP 23</p>	<p>Group-wide Supervision The supervisor supervises insurers on a legal entity and group-wide basis.</p>
<p>Description</p>	<p>The ICO does not have an explicit definition for insurance group nor the scope of an insurance group for the purpose of group-wide supervision. Nonetheless, the IA has identified one insurance group that is based in HKSAR. The IA serves as the group-wide supervisor and has established a supervisory college for this group (ICP25)</p> <p>The IA requires insurers to submit updates relating to their organization/group structures as part of the supplementary information to the annual regulatory returns and would examine the structures to identify possible supervisory risks. Supplementary information submitted by insurers include intra-group guarantees and loans. However, there is no explicit provision in the ICO on insurance group structure and the IA is not empowered to require insurance group structures to be sufficiently transparent and that group-wide supervision will not be hindered.</p> <p>While the legal framework does not provide for a formal group supervision framework, the IA has exercised indirect supervision in practice. This is done through the approval of the holding company of the insurance group as shareholder controller (ICP 5), subject to fit and proper requirements and other regulatory requirements as the conditions for approval e.g. notification requirements of significant intra-group transactions which are not transacted at arms' length. The IA also holds monthly meetings with the holding company to monitor pertinent developments and requires the group to submit regular solvency assessment reports. In addition, the IA communicates regularly with relevant regulators regarding the group's operation in other jurisdictions.</p> <p>Despite not having explicit legal authority to obtain information from non-regulated entities within the group, the IA has obtained the information through the regulated</p>

	<p>insurer and/or the holding company.</p> <p>The COB supervision of the IA and the three SROs is focused at the legal entity level. There are no explicit market conduct requirements covering group issues, both for insurers and intermediaries.</p> <p>The HKMA is the lead supervisor for insurers that are part domestic banking groups. The IA has frequent bilateral meetings with the HKMA to discuss issues of mutual concerns on these financial conglomerates and share selected key information and financial indicators with the HKMA.</p>
Assessment	Partly observed.
Comments	<p>The ICO does not have an explicit definition for insurance group nor the scope of an insurance group for the purpose of group-wide supervision. Nonetheless, the IA has identified one insurance group that is based in HKSAR.</p> <p>The IA exercises indirect supervision of an insurance group based in HKSAR through the approval conditions of its holding company as shareholder controller. It actively monitors developments in this group and communicate regularly with other host supervisors of this group either through the supervisory college or on an informal basis. The IA has obtained information from non-regulated entities through the regulated insurer or its holding company, when necessary.</p> <p>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.</p>
ICP 24	<p>Macroprudential Surveillance and Insurance Supervision</p> <p>The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilize information from, and insights gained by, other national authorities.</p>
Description	<p>The IA regularly performs analysis, both qualitative and quantitative, on market performances and trends, and assesses the likely risks and challenges to the insurance industry as a whole, and also to individual insurers. The analysis is based on regulatory information and quarterly statistics submitted by insurers. Where there are specific issues of concern, the IA would carry out thematic reviews and collect additional information. It meets HKMA and SFC regularly to discuss issues related to the financial sector, macro-economic vulnerabilities, financial market risks, as well as issues of common concern. Financial data and intelligence gathered from these meetings are also used for analysis.</p> <p>Arising from these analyses and assessments, the IA would discuss with the industry or individual insurers on issues that may have adverse impact or potential impact on the stability of the industry or on individual insurers, which facilitates taking preventive actions at an early stage.</p>

	<p>The IA is a member of the CFR and the FSC (see Section 3 of this report). These two bodies meet frequently to discuss macro-economic developments, market vulnerabilities and financial stability issues.</p> <p>The IA is not the home regulator for any of globally systematically important insurers. Nonetheless, it maintains close cooperation with the relevant home supervisors and participated in the supervisory colleges of four globally systematically important insurers of them. The IA has not identified any domestically systematically important insurers.</p>
Assessment	Largely observed.
Comments	<p>The IA identifies, monitors and analyzes various market and financial developments, as well as other environmental factors, which have implications for insurers and the insurance market in HKSAR. It discusses emerging issues or concerns with the industry or individual insurers to facilitate timely preventive actions. As a member of the CFR and the FSC, the IA benefits from the discussions on macro-economic developments, market vulnerabilities and financial stability issues at the meetings of the CFR/FSC. There is no formal process to assess the potential systemic importance of insurers.</p> <p>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:</p> <ol style="list-style-type: none"> 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; Establishing clear and structured internal processes for identifying, assessing, monitoring and reporting on emerging risks in the industry; Developing more robust indicators for assessing systemic risk of insurers; Reviewing whether the current mainly sector-based approaches of the sectoral supervisors is adequately complemented by consideration of cross-sectoral linkages e.g. <i>bankassurance</i>, ULPs and mortgage insurers; and Inclusion of risks arising from system-wide market conduct issues, including reputational risks.
ICP 25	<p>Supervisory Cooperation and Coordination</p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.</p>
Description	<p>The IA has entered into cooperation agreements with relevant supervisors and regulatory authorities (ICP 3). The cooperation agreements between the IA and other supervisors include provisions that facilitate appropriate and timely exchange of information subject to confidentiality safeguards.</p> <p>Domestic arrangements</p> <p>The IA has executed the following bilateral MoUs with relevant domestic agencies:</p> <ol style="list-style-type: none"> HKMA – to strengthen cooperation in respect of supervision of entities or financial groups, including the role of banks as insurance agents or brokers and insurance subsidiaries of banks; SFC – covering insurance related products that are collective investment schemes and investment advisers that hold dual license as insurance brokers and securities brokers; FRC – setting out the notification and consultation processes with respect to the FRC’s investigations of auditing or reporting irregularities;

	<p>d) China Insurance Regulatory Commission - Cooperative Agreement on Insurance Supervision.</p> <p>e) Monetary Authority of Macau - MoU of Mutual Assistance and Exchange of Information</p> <p>The IA/HKMA/SFC has also executed a joint MoU with the MPF covering certain administrative and operational arrangements among the four regulators regarding the exercise of their respective functions under the MPF Schemes Ordinance.</p> <p>There have active exchange of information and extensive cooperation and coordination between the IA and the relevant regulators pursuant to the above MoUs.</p> <p>Cooperation with foreign supervisors</p> <p>The IA places much emphasis on supervisory cooperation, and has actively participated in supervisory colleges. It has formally assumed the role of a group-wide supervisor for an insurance group that is based in HKSAR since its initial public offering in Oct 2010 (and informally from Sept 2008 to Oct 2010) and has organized supervisory college meetings. Since 2010, the IA has participated in more than 50 supervisory colleges as the host supervisor.</p> <p>As the group-wide supervisor, the IA coordinates periodic meetings, and the senior management of the group is invited to attend the supervisory college meetings. Coordination of work, particularly in areas such as risk assessment and stress testing are also led by the IA. The IA ensures that cooperation agreements are in place amongst the college members. It also acts as the central point of contact for all matters relating to the structure and modus operandi of the college, and coordinates regular meetings/ teleconferences to discuss and monitor issues related to the group. To increase efficiency, the IA and other college members jointly plan supervisory activities and undertake to work in collaboration with each other. Relevant documents would be shared amongst supervisors before and after discussions to reduce duplication of efforts and enhance the quality and effectiveness of supervision.</p> <p>Based on the IA's experience, typically, the home supervisor would be identified to take up the role of the group-wide supervisor. Other factors such as the jurisdictions in which the group has the largest premium income/balance sheet total may also be considered. The group-wide supervisor once identified will be responsible for coordinating the information exchange and supervisory activities among involved supervisors/college members. The IA will establish a supervisory college for any insurance group that is based in HKSAR with cross-border operations.</p>
Assessment	Observed.
Comments	<p>The IA places much emphasis on supervisory cooperation both domestically and with foreign supervisors. Domestically, the IA liaises closely with all relevant agencies involved in the financial sector of HKSAR, bilaterally as well as at the CFR and FSC level. It has formalised some of the arrangements through bilateral and joint MoUs.</p> <p>Despite the lack of an explicit group supervision framework, the IA has formally assumed the role of the group-wide supervisor of a large insurance group based in HKSAR with significant cross-border operations. It has organized regular supervisory college meetings and takes the lead in coordinating supervisory work for the group. The IA also contributes actively to relevant supervisory colleges as a host supervisor and participated in more than 50 supervisory colleges since 2010. In exchanging information with other regulators</p>

	on group issues, the IA is required to preserve confidentiality requirements under the ICO.
ICP 26	<p>Cross-border Cooperation and Coordination on Crisis Management</p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.</p>
Description	<p>The IA has been employing cross-border frameworks of cooperation in the supervision of insurers with cross-border operations. These include: entering into MoUs with regulators in overseas jurisdictions; and participating in the supervisory colleges for major insurance groups (ICP 25).</p> <p>The IA has been reviewing and discussing the common tools for managing a cross-border financial crisis with the relevant supervisory colleges. Building on the MoU and/or college-specific confidentiality arrangements, the IA works collaboratively with other college members on whether additional protocols are required for crisis management purpose. To facilitate better coordination during times of crisis, the IA is also exploring the need to share information with appropriate non-supervisory authorities involved in crisis management (e.g. central banks), provided that there are confidentiality arrangements in place. The IA will, in accordance with the ICO and the relevant MoUs with members of the supervisory colleges, inform the group-wide supervisor of any causes for concern that has come to its notice or as soon as it becomes aware of an evolving crisis. (<i>s53B of ICO</i>)</p> <p>As mentioned, the IA has established a supervisory college for a large insurance group based in HKSAR, with operations spanning 16 jurisdictions (ICP 25). To keep all college members and supervisors informed of the crisis management preparations, the IA maintains up-to-date contact points and responsibilities of all representatives of college members.</p> <p>The IA is empowered to require insurers to provide information at specified times/ intervals. In times of crisis, the IA can require insurers to provide urgent information at short notice, to facilitate assessment of the situation or take crisis management measures. (<i>s34 of ICO</i>)</p> <p>The supervisory regime does not explicitly require insurers to maintain contingency plans and procedures based on their specific risks for use in a going-and gone-concern situation. The IA considers that this is implicit in insurers' corporate governance framework or it could direct an insurer to do so pursuant to its residual enforcement power. (<i>GN 10 and s35 of ICO</i>)</p> <p>During times of crisis, the IA as the home/group-wide supervisor would promptly gather information necessary for managing the crisis, analyze and assess the systemic impact, identify areas of vulnerabilities, share the analysis with college members and coordinate supervisory activities. A relevant example occurred during the global financial crisis in 2008. When problems related to AIG surfaced, there was substantial anxiety amongst policyholders of AIA (AIG's wholly-owned subsidiary then) in HKSAR and other jurisdictions in Asia, as evidenced from the sudden increase in policy surrenders and enquiries from policyholders. To prevent a potential policy run, the IA took swift actions to impose interventionary measures on AIA, including daily monitoring of its financial and cash-flow position and ring-fencing of its assets etc. Before and after such actions, the IA maintained close liaison with the other 13 supervisors in Asia through direct telephone calls and group teleconferences. In essence, the IA had assumed the role of the de facto lead supervisor for AIA. Such liaison continued on a regular basis until the IA formally</p>

	<p>assumed the role of lead regulator for AIA and established a supervisory college in this regard. The IA's approach and procedures had proven to be effective in managing the crisis.</p> <p>The IA will, subject to the provisions under the ICO and MoUs with college members/college-specific confidentiality agreements, cooperate with college members to find internationally coordinated, timely and effective solutions that take into account the impact of the crisis on the financial systems and real economies of all relevant jurisdictions, drawing on information, arrangement and crisis management plans developed ex-ante. The IA will strive to find a coordinated supervisory solution, and if this is not possible, national resolution measures will be discussed with other relevant supervisors.</p> <p>In order to sustain market stability, the IA would make appropriate public announcements on a timely basis. The IA would notify college members/appropriate authorities of other affected jurisdictions about its plans for public communication, share with them the details of the announcements prior to public release, and coordinate similar actions in other jurisdictions.</p>
<p>Assessment</p>	<p>Largely observed.</p>
<p>Comments</p>	<p>The IA has maintained positive relationship with foreign supervisors, which contributes to effective, coordinated cross-border crisis resolution in the event of need. It has demonstrated its openness and commitment in working collaboratively with relevant foreign home and host supervisors during the global financial crisis in 2008. In addition, the IA has been reviewing and discussing the common tools for managing a cross-border financial crisis with the relevant supervisory colleges. However, there is currently no explicit requirement for insurers to maintain recovery or resolution plans.</p> <p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> 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.

Appendix I. Status of Implementation of 2003 FSAP Recommendations

Recommendation	Status
Define more precisely the status, resources, staffing and accountability of the IA, with independent funding arrangement for insurance supervision. Consider introducing an equitable assessment system so the industry funds the costs of insurance supervision	<p>It is proposed to establish an IIA. The IIA would be self-financed with income streams from license fees and service charges on insurers and intermediaries, and a market levy based on the premiums of all insurance policies.</p> <p>The authorities are currently finalizing the legislative amendments, with a view to establishing the IIA in 2015.</p>
Ensure early implementation of the Guidance Note on Corporate Governance, accompanied with proper training and dissemination of the spirit underlying its provisions.	The Guidance Note on Corporate Governance was issued and became effective on 1 September 2003 and insurers comply with this GN.
Regulations should be reviewed to ensure that long-term assets matching long-term liabilities are clearly identified, and can be secured if necessary.	<p>Under section 22/22A of the ICO, long-term insurers are required to maintain separate funds for long-term businesses in respect of Classes G, H and all other classes.</p> <p>Amendments will be made to section 22 of the ICO to require every insurer to maintain separate insurance funds for each class of long-term business.</p>
The framework within which the appointed actuaries system operate should be strengthened; IA should enhance its requirements on appointed actuaries; eventually all actuaries should be required to be members in good standing of the ASHK.	<p>An appointed Actuary (AA) is required to meet prescribed qualifications under the Insurance Companies (Actuaries' Qualifications) Regulations or other qualifications acceptable to the IA under section 15(1)(b) of ICO. They are also required to observe PS1 under Insurance Companies (Actuaries' Standards) Regulation.</p> <p>Amendments will be made to the ICO requiring prior approval of AAs for all insurers incorporated in HKSAR (and prior notification for insurers incorporated outside HKSAR but the IIA will be empowered to object the appointment) under the proposed IIA regime.</p> <p>ASHK is now considering to a change of its status into a statutory body.</p>
Set up capital requirements for Class G and H business.	The Guidance Note on the Reserve Provision for Class G of Long-term Business (GN7) imposes reserving and solvency requirement on Class G business with 99 percent confidence level (based on stochastic modeling). It provides a prudent reserving requirement with adequate buffer embedded in the reserves.

Recommendation	Status
	Class H businesses have been converted to a trust arrangement in 2011. The authorities will review the remaining ORSO business as part of the RBC framework reform.
Insurance companies should be required to disclose the extent to which, and the purpose for which derivatives are used.	All insurers are required to report to the IA annually the extent of their exposure to derivatives and the objectives of holding such derivatives. Insurers use derivatives mostly for hedging purposes.
The IA or other competent body should have the power and responsibility to supervise market conduct in the insurance market, and carry out active oversight of the insurance sector SROs	The IA has put in place a number of measures on market conduct and policyholder protection, e.g. prohibition of offering gifts for life products, new measures on the sale of ULPs. The IA has been maintaining active oversight of the self-regulatory bodies. The self-regulatory system will be abolished upon the establishment of the IIA.
The financial reporting requirements should be considered for harmonization so that all life insurance companies file statutory reports on the same accounting and reporting basis. Companies should be required to file their audited annual financial reports in period less than six months after the end of the year.	<p>All insurers report their financial statements under the Hong Kong Financial Reporting Standards issued by the HKICPA</p> <p>All insurers are required to file the annual Hong Kong business return within four months after the financial year end.</p> <p>Amendment will be made to the ICO to accelerate the submission of audited annual financial reports to four months.</p>