

**RESPONSES OF THE BRITISH CHAMBER OF COMMERCE TO THE
CONSULTATION PAPER (“CP”) ON THE PROPOSED ESTABLISHMENT OF AN
INDEPENDENT INSURANCE AUTHORITY (“IA”)**

1. *Do you agree that an independent IA should be established along the principles set out in paragraph 2.6?*

Response:

We agree **but see** our response to Question 2 below.

2. *Do you think that there are other important principles in addition to those set out in paragraph 2.6 that the Administration should adopt in working out the detailed legislative proposals for the establishment of the independent IA? If so, what are they?*

Response:

The principle set out in paragraph 2.6(a) of the CP should also explicitly include “**political**” independence – as paragraph 6.3 of the CP itself recognises, “**political autonomy**” is one of the key international insurance supervisory principles stipulated by the International Association of Insurance Supervisors which should be adopted in relation to the IA as a matter of international insurance supervisory best practice.

Furthermore, additional guiding principles applicable to insurance regulators in comparable jurisdictions (*e.g.* the Financial Services Authority (“FSA”) in the UK) should be closely studied and applied where relevant and appropriate. For instance, the UK Financial Services and Markets Act 2000 (“FSMA”) which established the FSA as a statutory body that is independent of the UK government sets out our **five statutory objectives**¹, which are supported by a set of **principles of good regulation**² that the FSA must have regard to when discharging its regulatory functions.

¹ These being: (1) **market confidence** - maintaining confidence in the financial system; (2) **public awareness** - promoting public understanding of the financial system; (3) **financial stability** - contributing to the protection and enhancement of the UK financial system; (4) **consumer protection** - securing the appropriate degree of protection for consumers; and (5) **the reduction of financial crime** - reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.

² These being: (1) **Efficiency and economy** - the need to use FSA resources in the most efficient and economic way; (2) **Role of management** - the responsibilities of those who manage the affairs of authorised persons for its activities, for ensuring that its business complies with regulatory requirements and for risk management and controls; (3) **Proportionality** - the restrictions that FSA imposes on the UK insurance industry must be proportionate to the benefits that are expected to result from those restrictions; (4) **Innovation** - the desirability of facilitating innovation in connection with regulated activities, involving, for example allowing scope, where appropriate, for different means of compliance so as not to unduly restrict market participants from launching new financial products and services; (5) **International character** - the international character of financial services and markets and the desirability of maintaining the competitive position of the UK, involving co-operating with overseas regulators, both to agree international standards and to monitor global firms and markets

In this regard, in our view, the principles of “*proportionality*”, “*innovation*”, “*international character*” and “*competition*” (see footnote 2 for details) which are applicable to the FSA should also be applied to the IA. The principles of “*proportionality*” and “*competition*” in particular should be the key driving principles in the present consultation exercise and the relevant resulting legislative and regulatory changes. In applying the “*proportionality*” principle, the IA should take into account the costs to firms and consumers - one of the main techniques the FSA uses is a cost benefit analysis of proposed regulatory requirements. This approach is shown, in particular, in the different regulatory requirements the FSA applies to wholesale and retail markets. Competition and innovation considerations play a key role in the FSA’s cost-benefit analysis work. **In our view, the present consultation exercise and the relevant resulting legislative and regulatory changes, and the new IA in its regulatory activities, should adopt the same approach as the FSA as detailed above.**

3. *Do you agree that the independent IA should have an expanded role beyond the existing functions of the IA as set out in paragraph 3.1? If so, do you agree that the independent IA should assume the additional functions as proposed in paragraphs 3.3 and 3.4?*

Response:

We agree.

4. *Do you agree the independent IA should also have a duty to enhance the competitiveness of the insurance industry, which will help to reinforce Hong Kong’s status as an international financial centre?*

Response:

We agree **but see also** our response to Question 2 and footnote 2 above and the principle of “*competition*” detailed therein.

effectively; and (6) *Competition* - the need to minimise the adverse effects on competition that may arise from FSA activities and the desirability of facilitating competition between the firms FSA regulates: *i.e.*, avoiding unnecessary regulatory barriers to entry or business expansion (working with the UK Treasury, the UK Office of Fair Trading and the UK Competition Commission in reviewing the impact of FSA rules and practices on competition).

5. *Do you agree that the independent IA should be vested with additional powers as proposed in paragraph 4.7 to enable it to regulate insurers more effectively?*

Response:

We agree.

6. *Do you consider that the existing self-regulatory arrangements for insurance intermediaries should be changed, and if so, do you support that Option 2 (i.e. direct supervision of insurance intermediaries by the independent IA) should be pursued? If not, why?*

Response:

We support Option 2.

7. *Do you consider that in relation to the sale of insurance products in banks, the HKMA should be vested with powers similar to those for the independent IA to allow HKMA to regulate bank employees selling insurance products given the different client profile and sale environment in banks?*

Response:

No we **do not agree** with this proposal. **This is likely to result in an unclear separation of powers between the IA and the HKMA and could lead to market damaging “turf wars” between the two – see for example the recent damaging, time consuming and costly battles between the Indian insurance regulator (IRDA) and the Indian securities regulator (SEBI) over the right to have the final say in regulating unit linked insurance products (ULIP), which went to court and was only resolved by new Indian insurance and securities legislation. The third sentence of paragraph 5.9 of the CP notes that a weakness of Option 1 is that this option may result in “duplication of regulatory efforts” by the IA and the SROs as well as “regulatory gaps” between them – we consider that the same undesirable consequences could result from this proposal with regards the IA and the HKMA.**

This could also lead to “regulatory arbitrage” where bancassurance is chosen (or not chosen as may be the case) as the distribution channel due to the leniency (or otherwise) of the HKMA as contrasted to the IA³ rather than based solely on commercial considerations.

We believe that the above negative consequences would undermine public confidence in the effectiveness of the IA.

³ A disadvantage noted in the third sentence of paragraph 5.6 of the CP for the current system of two broker SROs.

See also the principles of “*proportionality*” and “*competition*” described in our response to Question 2 and footnote 2 above – **before introducing the HKMA as an additional regulator over sales of insurance products, a full cost-benefit analysis should be undertaken to determine how well the existing suite of legislation and self-regulatory codes of practice and structure is working (including enforcement in practice) in relation to bancassurance and whether the existing structure could be strengthened by giving statutory backing to the self-regulatory codes and structure, more enforcement powers to the IA, and possible wholesale hiring of the existing staff of the three self-regulatory organizations into the new IA rather than introducing a new regulator which the industry and consumers have no previous experience of.**

8. *Do you agree that the recommendations as set out in paragraphs 6.5 to 6.8 should be pursued for the independent IA to operate as an independent entity? Any other views?*

Response:

We agree **subject to** the below comments:

- There should be (like the FSA) a **separate stand-alone “Enforcement” division** (rather than what is indicated in the Annex) to ensure that there is consistency of approach to enforcement across the Long-Term Business, General Business and Market conduct divisions.
- For the same reason, there should also be (like the FSA) a **separate stand-alone “Supervision” division** (rather than what is indicated in the Annex).
- We believe that there should also be (like the FSA) a separate stand-alone “*Risk*” division responsible for sectoral and market-wide risk identification and mitigation, the IA’s overall risk management process and specialist support to the Supervision division, and with the following regulatory objectives:
 - To contribute to a risk based, outcomes focused, proportionate supervisory regime through effective risk identification and mitigation;
 - To focus on fair outcomes for consumers and seek to ensure firms adhere to the IA’s conduct principles;
 - To promote a well regulated market which is efficient, orderly and fair, internationally attractive and sustainable; and
 - To participate fully as a stakeholder in global regulatory reform.

9. *Do you agree with the proposed checks and balances and governance arrangements for the independent IA as set out in this Chapter?*

Response:

We agree **subject to** the below comments:

- To ensure both the appearance of independence and independence in fact, which is a key theme⁴ of the proposals in the CP and which is needed to ensure public confidence in the effectiveness of the IA, the Chief Executive Officer, non-executive Chairman and members of the Governing Body of the IA, **should ideally not be appointed** by the Hong Kong government.
- Having said the above, we recognise that there are international precedents (e.g. in relation to the FSA) for government appointment of the governing body of the insurance regulator and would suggest a **compromise option** whereby **all such government appointments are subject to clear objective criteria** including the requirement for public advertisement of vacancies.

10. *Do you agree that the Government should provide a lump sum to support the independent IA in its initial years of operation and the independent IA should seek to reach full cost recovery in six years?*

Response:

We agree.

11. *Do you agree with the proposed fee structure as set out in paragraphs 8.2 and 8.6?*

Response:

As the stakeholders who will be most immediately affected by the proposed fee structure, we would agree with and support the respective responses of the SROs.

As a further general comment, such fee structure should comply with the principles of “*international character*” and “*competition*” described in our response to Question 2 and footnote 2 above.

⁴ See the strong criticism of the current self-regulatory system due to conflicts of interest both “*perceived and real*” in paragraph 5.6 of the CP.