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Enhancing
Life Insurance
Regulatory
Regimes in
ASIA

Multilateral agencies and regulatory changes
in life insurance and pension systems

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Ladies and Gentlemen,

It is my great pleasure to have the opportunity to attend this symposium and to be one of the commenters today. To add on to the valuable comments by the two speakers, I would like to share with you some of my regulatory experiences in Hong Kong.

2. I shall start off by introducing the regulatory developments in Hong Kong's life insurance / pension system and the industry prospects beyond Year 2000. I shall follow this with a brief account of how multilateral agencies can play a role in the regulatory development of the insurance industry.

Regulatory Developments

3. The governing legislation for the insurance industry in Hong Kong is the Insurance Companies Ordinance ("ICO"). The ICO came into effect in June 1983 and replaced the various bits and pieces of legislation enacted between 1907 and 1981, which dealt separately with life, fire, marine and motor insurance. It provided the first comprehensive regulatory framework for the prudential supervision of insurance business in Hong Kong.

4. The ICO lays down, among others, the minimum capital and solvency margin requirements for insurers. It also empowers the Insurance Authority to take interventionary action against an insurer to safeguard the interests of policyholders. Under the ICO, a life insurer is required to maintain a separate account in respect of its life and pension businesses. Assets maintained in this account shall only be available for meeting the liabilities in respect of these businesses.

5. Life insurers were previously subject to a fixed solvency margin of HK\$ 2 million. In 1995, a new solvency margin was introduced, which is

calculated on the amounts of an insurer's mathematical reserves¹ and capital at risk². A life insurer is also required to follow the actuarial principles prescribed in a Regulation in determining its life business liabilities.

6. We will be shortly introducing an appointed actuary system for life insurers in Hong Kong. Under the system, the actuary is responsible not only for the valuation of liabilities, but also for the other aspects of the insurer's financial condition (including premium-setting, reinsurance arrangements, reserving and investment policies). A professional standard has been developed by the Actuarial Society of Hong Kong for this purpose. We shall of course accept other standards which are considered comparable to this one.

Occupational Retirement Schemes

7. Hong Kong has a rapidly ageing population. People aged 65 or above currently account for about 10% of the population. This proportion is estimated to rise. In view of this, our Government took, in 1993, the first step to encourage retirement protection by introducing the Occupational Retirement Schemes Ordinance. The Ordinance applies to occupational retirement schemes set up by employers on a voluntary basis. The objective is to ensure that these schemes are properly administered and funded. As at 30 September 1999, there were 19,471 retirement schemes with a total asset of HK\$ 136.5 billion (US\$ 17.5 billion). The schemes covered approximately 926,000 people, accounting for 28% of the total working population in Hong Kong. About half of the schemes are operated by life insurance companies.

Mandatory Provident Fund Schemes

8. In view of the fact that a majority of the working population were still not covered by retirement schemes, our Government has further decided to introduce a mandatory system of retirement protection called the Mandatory Provident Fund Scheme ("Scheme").

9. The Scheme will come into effect in December 2000. It requires all employers in Hong Kong to set up a retirement scheme for its employees. It aims at providing financial protection for members of the workforce when they retire

¹ **mathematical reserves** are the provisions made by an insurer to cover liabilities arising under contracts for life business.

² **capital at risk** is the sum assured net of the amount of the mathematical reserves.

at the age of 65. The schemes are managed privately and will be contributed to jointly by employers and employees.

10. A statutory body, the Mandatory Provident Fund Schemes Authority (“MPFA”) was set up in 1998 for the prudential supervision of the MPF system. The MPFA is now making the necessary preparation for the commencement of the Scheme.

Future Prospect and Challenges

11. The prospect for life insurance and pension businesses in Hong Kong is optimistic. Only 3.8 million people, out of a population of 6.8 million in Hong Kong, have taken out life insurance policies. The rate of penetration, just slightly over 55%, is much lower than those of the developed countries like the United States and Japan. There therefore is ample room for expansion. Life insurance business has grown by about 20% annually in the past 5 years. Coupled with the forthcoming MPF system, this momentum of growth will be sustained.

12. On market structure, we anticipate that convergence of financial services (i.e. banking, insurance, investment and asset management) will become an irreversible trend. Life insurance policies now offer investment opportunities that compete with mutual funds and unit trusts. “Bancassurance” is increasingly popular. The demarcation among the traditionally distinct financial services is blurring. Let me give you an example. The Tokyo Disneyland wanted to buy earthquake insurance this year. It however subsequently issued US\$ 200 million of bonds - on the understanding that if there is earthquake, it will not pay them back. With the convergence of financial services, more financial one-stop shops will be set up to offer a full range of financial services products. Banks, investment houses and insurance companies will merge or form strategic alliances to explore the emerging markets.

13. The 21st century is definitely an age of Information Technology. Computers have become an indispensable part of our daily lives. With the increasing usage of internet, direct sales through electronic means (i.e. e-commerce) will be employed by life insurers to market their products. “Dis-intermediation” will become more and more evident.

14. As a result of increasing awareness of policyholders, the life insurance industry will inevitably have to become more transparent in its operation. The recent Asian Financial Crisis has proved that transparency is

important for maintaining systemic stability. As a regulator, I think we should continue to review our current information disclosure and move towards greater transparency.

Multilateral Agencies

15. As insurance globalisation continues, it poses a challenge for the Government to formulate policies that recognise this market change while maintaining the prudential regulatory standards. Multilateral agencies such as the Organisation for Economic Cooperation and Development (OECD), World Trade Organisation (WTO), the United Nations Conference on Trade and Development (UNCTAD) and International Association of Insurance Supervisors (IAIS) have been contributing to the development in regulation of the life and pension businesses. Some of the achievements of these agencies are as follows:

OECD

16. The mission of OECD is to promote the liberalisation of international trade in goods and services and the progressive freeing of capital movements. Insurance has been covered specifically under the OECD codes. The codes provide that transactions in all types of insurance between residents in a member state and insurers resident in another member state shall be free, subject to the right of the member state to regulate the insurer or its representative. The codes also protect cross-border capital transfers under life insurance contracts and annuities.

WTO

17. The WTO serves as a permanent forum for member governments to address issues affecting their international trade relations. The Uruguay Round in 1994 resulted in the General Agreement on Trade in Services (GATS) which set out the rules and specific commitments on opening markets for service industries, including insurance. Each member state negotiated a schedule of commitments to liberalise its markets and to stipulate how favourably it agreed to treat foreign service providers, including insurers.

UNCTAD

18. The UNCTAD assists developing countries in their trade and development-related issues. It is the only United Nations' agency with a permanent mandate to work on insurance issues. The agency does research, offers technical assistance and conducts training programs for developing member states. It also offers a place for regulatory officials and policy makers from member states to exchange view and share experiences.

IAIS

19. The IAIS has become the most important agency as far as insurance regulation is concerned. Its mission is to enhance cooperation and information sharing among insurance regulators. It is now also the agency for developing international insurance regulatory standards. Hong Kong is committed to following the standards issued by IAIS.

Future Role of Multilateral Agencies

20. Financial convergency, e-commerce and liberalisation of the markets will cause the further development of insurance globalisation. The multilateral agencies should have a role to play in developing, not only international cooperation, but also comprehensive regulatory policies for adoption by member countries to cope with these market trends. Governments must cooperate among themselves to respond positively to any recommended changes. This harmonisation of policies will ensure not only a fair competition, but also settlement of cross-border problems in an effective manner.

21. Thank you.