International Symposium

Enhancing Life Insurance Regulatory Regimes in ASIA

In Search of World's Best Practice for Life Insurance Regulatory Systems

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Ladies and Gentlemen,

**In Search of World's Best Practice
for Life Insurance Regulatory Systems**

It is a great pleasure for me to share with you the regulatory practices established under the Hong Kong Life Insurance Regulatory System.

2. Policy holders buy insurance to secure the protection they need. It is therefore important that there is adequate regulation to ensure that they or their beneficiaries can receive the insurance benefits from the insurance carrier if the contingent event insured against occurs.

3. In Hong Kong, the Insurance Authority is the body responsible to supervise the insurance industry. We do not regulate policy provisions nor premium rates to be charged by the insurers. We believe in market forces that can perform their functions of encouraging competition, disciplining poor performance and optimizing resource allocation to the greatest extent possible. Where possible, we encourage self-regulation by the industry body, the Hong Kong Federation of Insurers ("HKFI"), which has been formed by the insurers since 1988.

4. In the subsequent paragraphs, I shall go through the measures taken to protect policy holders' interests and measures taken by us to reduce the risk of insurer insolvency.

Measures to protect policy holders' interests

(Introduce Screen 1 on Customer Protection)

Open competition

5. Hong Kong is characterized by a large number of international insurers from different countries which compete with each other to offer a large variety of products. Policy holders can compare and choose the most suitable product for themselves.

Qualification of agents

6. HKFI has established the Insurance Agents Registration Board as a central body to handle the registration of agents to ensure that they comply with certain minimum requirements such as fitness and properness. IARB is also responsible to handle complaints about agents' malpractice pursuant to the Code of Practice for the Administration of Insurance Agents.

7. Effective from 1 January 2000, a quality assurance scheme consisting of a qualifying examination and a continuing professional development programme will be introduced to establish a common professional standard for all insurance agents.

Procedure to guard against mis-selling by agents

8. Agents selling insurance are required to explain to every prospective policy holder the likely policy benefits receivable from a policy in accordance with an illustration standard issued by the HKFI. Where replacement of policy is involved, the agent is required to explain to the policy holder any potential disadvantage of replacement and must obtain his signed acknowledgement. After signing up for purchase, policy holders have a right to cancel the policy and obtain a full refund of premium if they change their mind within a cooling-off period of 21 days.

Complaint on claims mishandling

9. HKFI has established the Insurance Claims Complaints Board which is an independent body to provide a speedy and inexpensive avenue for resolving claims disputes below HK$ 600,000 arising from personal insurance policies. The decision of the Board is binding on insurers but not policy holders.

Code of Conduct for Insurer

10. Recently in May 1999, the HKFI issued a Code of Conduct for Insurers which, inter alia, requires its member insurers to establish and follow good practice in relation to different aspects of their operations. This marked another milestone development in the self-regulatory system.

Measures to reduce risk of insurer insolvency

(Introduce Screen 2 on Insurance Operation)

Insurance as a risk management business

11. In Hong Kong, the insurance market is still dominated by traditional insurance products whereby policy holders will receive a fixed sum of money at policy maturity and/or scheduled sums of coupon payments on some accelerated dates prior to maturity.

12. Insurance is a risk management business, which, for life insurance, has to be planned over a long time horizon. By selling a policy, an insurer creates a liability which may range from cash value of the policy (upon termination by the policy holder) to the full sum assured (upon death of insured). An insurer will have to plan carefully to ensure that the liabilities created will be met as they become due. There are a range of risks which an insurer must be able to deal with effectively. On the liability side, there is the risk of underestimation of reserve, or delay in building up reserve which may cause strain in catching up in later years. On the asset side, there is the risk of earning insufficient investment return to fulfil product obligation as well as the risk of loss of capital due to asset default or market value fluctuation. There is the risk of mismatching of assets and liabilities which may cause cash flow problem and render the company insolvent. There is also the operational risk of mis-management on underwriting, claim control or expense overrun that fails to bring in the expected profit to sustain business continuity or growth. For insurers to stay in business, it is the primary responsibility of the insurer's board of directors and its management team to see to it that the above risks can be properly addressed and minimised as far as possible.

13. As a benchmark standard, the Hong Kong Insurance Companies Ordinance prescribes a minimum margin of solvency by which the total asset must exceed the total liability to serve as buffer for unexpected or residual risks. The required margin of solvency for traditional business is the aggregate of 4% of the mathematical reserves and 0.3% of the capital at risk, subject to a minimum of HK$2 million. For the mathematical reserves, the Ordinance prescribes a minimum reserve basis of reserve modification method with a deferrable acquisition expense equal to 150% of valuation net premium and valuation interest below 6%.

Authorization

(Introduce Screen 3 : Hong Kong Life Insurance Regulatory System)

14. An insurer obtaining authorization must satisfy a number of authorization criteria, among which the major ones are:

(a) Its directors and controllers must be “fit and proper” persons with the requisite professional insurance expertise and know-how.

(b) It meets the prescribed paid-up capital requirement. In view of the business strain of initial years, the Insurance Authority would require capital commitment up-front to finance the operation for the next 3 or more years.

(c) It appoints a qualified actuary to advise on its business and to certify its solvency position.

(d) It has adequate reinsurance arrangement to reduce impact of adverse claim experience.

<u>On-going monitoring</u>

15. On an annual basis, insurers have to submit audited financial statements together with an actuary’s report and certificate. For those companies giving rise to causes for concern, the regulator may call for interim reports to keep track of developments between reporting dates. A better alternative is to put the responsibility on the appointed actuary to require him to take all reasonable steps to be satisfied at all times that, if he were to carry out a full actuarial valuation, the financial position of the insurer would be satisfactory. To implement the change, the Insurance Authority is proposing to introduce shortly an appointed actuary system which has been practised effectively in the UK, Canada and of course Australia.

<u>Other regulatory tools</u>

16. The Insurance Authority is empowered to intervene in the operation of the insurer if the circumstances warrant it. The objective is to minimize the losses to policy holders. The Insurance Authority may also arrange for suitable buyers to take over the business of the company. We may also request for ad hoc actuarial investigation to be carried out.

17. In normal circumstances, we schedule to visit our insurers on a regular basis, to make acquaintance with management, to understand their business, and to check whether systems of controls are in place to ensure that the company’s affairs are properly and prudently managed.

18. We are also improving the transparency of the insurance market by releasing on a quarterly basis statistics on the performance of the life insurance industry.

19. We will be interested to learn the regulatory experience of other countries in order to improve ourselves.

20. This ends my presentation. Thank you.