

## Hong Kong's new insurance regulator set to herald greater enforcement

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The establishment of Hong Kong's new independent insurance regulator may lead to greater enforcement activity, just as the capital markets regulator became more active following the enactment of the Securities and Futures Ordinance in 2004. Any change was likely to be gradual but compliance teams should get on the front foot, officials said.



David Wu, Deloitte China insurance sector leader in Hong Kong, said the Insurance Ordinance (IO) would empower the Insurance Authority (IA) to appoint inspectors to conduct inspections to ascertain whether an insurer is complying with the IO and associated regulatory requirements. At any reasonable time, an inspector may enter the premises of an insurer and obtain copies of business records.

"Where the IA has reasonable cause to believe there has been a breach of the IO or a person has carried on insurance business in a manner that is not in the interests of the policyholders or the public, the IA may appoint an investigator to conduct an investigation," Wu said.

The territory's insurance regulator will have powers to conduct inspections, initiate investigations and impose disciplinary sanctions on authorised insurers.

"There is no doubt that the introduction of the IA will lead to increased regulation and enforcement activities across the insurance industry in Hong Kong. The IA will be empowered to adopt a watchdog role similar to the Securities and Futures Commission [SFC] and the Hong Kong Monetary Authority [HKMA]," Wu said.

Padraig Walsh, partner with Bird & Bird in Hong Kong, said IA would take its time. "The authority will want to make the first one [case] count to make sure they are sending the right message to the market and also to build morale in its own enforcement team."

### **New era for insurance regulation**

The comments followed the inception of Hong Kong's first independent Insurance Authority, which took over regulation of authorised local insurance companies on June 26, 2017 from its predecessor, the Office of the Commissioner of Insurance

(OCI).

The IA is also expected to take over the supervision of insurance intermediaries from the three local self-regulatory organisations, the Insurance Agents Registration Board (IARB), the Hong Kong Confederation of Insurance Brokers (HKCIB) and the Professional Insurance Brokers Association (PIBA).

The Insurance Companies (Amendment) Ordinance 2015 (Commencement) Notice 2017 was gazetted on April 21 this year. The notice said that, on June 26, the various provisions of the Insurance Companies (Amendment) Ordinance 2015 would come into effect. The government appointed John Leung Chi-yan as the chief executive of the IA until June 25, 2018.

### **Compliance implications**

As the IA takes over responsibility for insurance prudential and conduct regulation, and significantly expands its enforcement powers, the level of regulatory interaction and scrutiny faced by insurers will increase accordingly.

"Enforcement of the anti-money laundering regime is just one example," said Mariano Selvaggi, consultant at Bovill and its insurance lead in London.

Selvaggi said the enhancements were welcome as they addressed recognised gaps in the regulatory regime where Hong Kong fell short of internally accepted standards.

"The IA's strengthened approach to supervision and enforcement is likely to evolve gradually. In the near term, regulatory focus will be on firms' risk management and governance arrangements, particularly in connection to the new responsibilities of individuals performing key [or] control functions," he said.

In the medium term, enforcing capital requirements and solvency assessments emanating from a new risk-based prudential framework for insurers would guide additional supervisory activity, Selvaggi said.

"Judging from similar experiences in other jurisdictions, the introduction of new conduct requirements for insurers and insurance intermediaries will drive significant enforcement action, so firms should think now about the likely impacts of the new regime on their business," he said.

It is anticipated that, with "SFC-type powers", the Insurance Authority will take a more inquisitive approach since it is assuming functions from the self-regulatory organisations which, at present, regulate the various arms of the insurance industry, said Denis Brock, partner at O'Melveny & Myers in Hong Kong.

Brock said insurance entity compliance officers would need to gain a thorough understanding of the powers of the IA, and the

limits to those powers. They would need to establish internal procedures to deal with IA investigations. Compliance officers would also need to understand the duties, responsibilities and liabilities, as regulated persons.

The amendments bringing brokers under the umbrella of the IA and the provisions relating to the supervision of agents have been long expected within the industry and have been agreed in consultation with the relevant industry and other interested bodies, said Michael Turnbull, senior consultant with DLA Piper in Hong Kong.

"The industry has had time to prepare for these changes and has been assisted greatly by the long lead-in time from the enactment of the legislation in 2015 to the appointment of the Provisional Board in 2016 and now toward the commencement of the effective date of the legislation later this month," he said.

### **Comparisons to SFC**

Differences between the capital market and insurance sectors remain. The SFC regulates around 1,800 licensed corporations; in contrast, there are around 160 authorised insurers in Hong Kong.

"The thing about Hong Kong's securities market is that it covers a broad spectrum of activities and has a significantly larger number of people that need to be regulated than with the insurance sector. The local insurance market is not insignificant, but at least in Hong Kong, it is much smaller by comparison with the securities sector," Walsh said.

Compliance officers must be prepared nonetheless and appreciate such differences.

"The new watchdog has teeth and it will be keen to demonstrate its existence. Compliance officers should have in place a clear process for dealing with an investigation [or] inspection and a pre-designated response team to deal with such investigations and inspections," said Tow Lu Lim, partner with Mayer Brown JSM in Hong Kong.

He said it was incumbent on in-house compliance and legal staff to train their colleagues so that they are prepared in the event the IA conducts an on-site inspection or investigation, and know whom to contact.

"In our view, there is an increased risk of investigations once the new IA becomes operative, although it is will not happen immediately. That said, we believe it is unlikely to be as aggressive as the SFC, as the SFC has a greater scope of coverage," Tow said.

For example, the SFC oversees licensed corporations and individuals, publicly-listed companies, market conduct and price-sensitive information matters. As a result, the different context may call for different approaches to enforcement.

"It is too early to give a considered view on enforcement by the new IA. What I can say is that the changes to the Insurance

Companies Ordinance give the new IA a broader range of regulatory powers and sanctions," said Scott Carnachan, a consultant with law firm Deacons in Hong Kong.

It was reasonable that, over time, the IA would use those regulatory powers and sanctions in appropriate circumstances, he said.

Bovill's Selvaggi, too, said it was early days in the transitional process and therefore unclear how the Authority would deploy its enhanced supervisory and enforcement powers in practice. However, based on UK and international regulatory experience, he said, in the future, firms should prepare more thoroughly for interactions with the regulator and proactively manage supervisory inspections or visits.

"Compliance officers should review their internal policies and procedures with regards to regulatory interactions, and enhance training material to ensure staff and senior management are well equipped to assist the IA without jeopardising the firm's interest in the process. This is particularly important in the context of new 'control functions' recently introduced and the enhanced responsibility and accountability placed on the individuals performing them," Selvaggi said.

Taking the UK's Senior Insurance Managers Regime as a relevant example, he said it would be expected that Hong Kong compliance officers carry out in-depth reviews of insurer's internal controls as well as policies and procedures in areas such as the fitness and propriety of senior managers and individuals in control functions; the application process for the IA's approval of senior individuals and control functions; and the remuneration of executive and non-executive directors. Other matters of concern included board composition and sub-committee structure, as well as board practices such as attendance, minutes and management information, coupled with identification and management of conflicts of interest. Similarly, code of conduct issues; whistleblowing; and ongoing training and development were perennial issues where vigilance was required, Selvaggi said.

Some, however, remained more optimistic about the effect the IA would have on the insurance business.

"The SFC has a wide remit with a proper enforcement structure in place and legislation to back them up," said Greg Crichton, a consultant at law firm Oldham, Li & Nie in Hong Kong.

"The IA also has the statutory power, but as many of the senior officers of the IA came from the OCI and have also in a number of cases spent time in the industry working for insurers they are likely to be a lot more attuned to commercial realities and therefore unlikely to take immediate steps to enforce a position, except where it is clear there is urgency to protect policyholder interests," he said.

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