KPMG

Hong Kong (SAR) Insurance Alert - INSURANCE (AMENDMENT) BILL 2023

June 2023

Summary

This proposed Bill seeks to amend the Insurance Ordinance (Cap. 41) and other relevant legislation to provide the legal framework to implement a Risk-based Capital (RBC) regime for the Hong Kong insurance industry, noting that some insurers have already adopted the RBC framework.

In addition, the Bill introduces several other important changes including designation, disclosure and reporting, appointed actuary requirements, and the requirement for fund separations.

The Bill was introduced into the Legislative Council on 19 April, 2023. The target effective date is expected to be in 2024.

The Insurance Authority (IA) noted that the Bill will provide the legal basis for Pillar 1 and Pillar 3 requirements, in conjunction with the existing Pillar 2 framework with the Guideline on Enterprise Risk Management (GL21)

Three-Pillar framework proposed in the RBC regime:

Pillar 1
consists of the quantitative requirements, including assessment of capital adequacy and valuation

Pillar 2
sets out the qualitative requirements, including corporate governance, enterprise risk management, and own risk and solvency assessment (ORSA)

Pillar 3
focuses on disclosures and enhancing the transparency of relevant information of insurers that is available to the public

Section 1: Introduction

At present, a rule-based capital adequacy regime applies to companies carrying on insurance business in Hong Kong. This approach assesses an insurer's capital adequacy for long-term and general business on the basis of its solvency margin, which is linked to the amount of premium income and level of insurance liabilities.

The proposed RBC regime recognises the Insurance Core Principles issued by the International Association of Insurance Supervisors (IAIS), and takes a modular approach for an assessment sensitive to the risk profile of the underwritten business. The key changes proposed in this legislation include:

For both long-term and general insurers:

- Change in valuation and capital requirements
- Additional reporting requirements based on the rules set by the IA
- Additional disclosures to the public
- Additional conditions on restoration plan or financial scheme
- Process of designation of non-Hong Kong insurers
- Governance related to shareholder controller
- Change in taxation arrangement under the RBC regime

For general insurers only:

- New requirements and restrictions to appoint a qualified actuary
- Requirement of a periodic actuarial review by an appointed actuary
- New requirements on maintenance of separate accounts and funds
- Minor amendments to the natural catastrophe risk calculation

For long-term insurers:

- Additional requirements on maintenance of separate accounts and funds (including participating business)

Section 2: Key changes under the Bill and implications for insurers

Changes that apply to both long-term and general insurers:

Related to capital requirements:

- **Section 3C** is added, which requires the valuation of assets and liabilities to be based on applicable rules set out by the IA authorised in **Section 129**. If no such rules are applicable:
  - Assets must be determined in accordance with their **market value** and the cost of realising assets
  - Liabilities must be determined in accordance with the **cost of the settlement** and considering the liabilities assessed or estimated to the insurers with same or similar business.
- **Section 13AA** is added to introduce new capital requirements
- **Section 17** is substituted to prescribe requirements for the submission of additional statements, reports or other information based on the rules set by the IA
- **Section 21A** is added to prescribe requirements for public disclosures based on the rules set by the IA
- **Section 35AA** is substituted to require a **restoration plan** or a **financial scheme** when an insurer fails to comply with the capital requirements (Prescribed Capital Requirements and Minimum Capital Requirements)

Related to designation and shareholder controller :

- **Section 3B** is added for designation of non-HK insurers who carry on a majority of their insurance business in or from Hong Kong
- **Section 13B** is amended and **Section 13BA and 13BB** are added for changes in shareholder controller, i.e., split previous controller requirements between majority and minority shareholder controllers with notice / approval / objection rules

***Tax related:**

The Bill also introduces amendments to the Inland Revenue Ordinance to provide for the spreading of tax implications and the tax arrangements arising from the implementation of the RBC regime, with the following impacts:

- Adjustments in the ascertainment of assessable profits from insurance business
- Provide for the spreading of any one-off increase in assessable profits over a period of five years

** Please also refer to the alert for tax implication issued by KPMG in May 2023 (link)*

Section 2: Key changes under the Bill and implications to insurers (cont.)

For general insurers only:

Appointment of actuary and periodic review:

- **Sections 15AAA and 15AAAB** are added to introduce requirements and restrictions on the **appointment of a qualified actuary** for its general insurance business
- **Section 18A** is added to introduce requirements for **periodic actuarial review** by an appointed actuary at least once every 12 months in specified forms, including a requirement to submit the report to the IA.

Fund requirements:

- **Section 25AA to 25AAE** are added to prescribe requirements for the **maintenance of a separate account and a separate fund** for
  (a) general **reinsurance business with offshore risk**
  (b) not general **reinsurance business with offshore risk**
- **Section 25A** is amended to require that the **value of assets** must be maintained at a level above the value of liabilities and capital requirements.

For long-term insurers only:

Fund requirements:

- **Section 21B** is added to require maintaining a separate account and a separate fund for each of the following parts of that business in **class C**, **class G**, **class H** in Part 2 of Schedule 1, and specified business. Also requires maintaining at least one separate account and one separate sub-fund for the part of the specified business that is **participating business**.
- **Section 22** is amended to require the asset value of each fund be maintained at a level **above the value of liabilities and capital requirements**.

New powers for the IA

The Bill also proposed changes to give **additional powers**:

- **Section 10** is substituted to authorise the IA to **prescribe capital requirements**
- **Section 32A** is added to authorise the IA to require insurers or appoint a person to provide reports for the purpose of actuarial investigations or reviews.

Section 3: Key implications for insurers

The proposed amendments are a milestone in the Insurance Authority's efforts to make the insurance sector in Hong Kong resilient and risk-based. The proposed RBC regime is expected to encourage insurance companies to underwrite appropriate risk and manage those risks efficiently. Insurers with a robust risk management framework will be the clear winners as the new regime becomes effective.

Moving to the RBC regime, insurers should consider:

- Planning in advance for the effort required in RBC implementation and explanation of changes to the balance sheet and solvency position, recognizing that there are competing demands from IFRS17 implementation
- Assessing the strategic impact on the customer proposition, product portfolio and changes required in risk management strategy covering investments and reinsurance
- Embedding the new regime in business management practices such as participating fund management and understanding the impact on policyholders and shareholders' dividend distribution
- Defining new risk appetite metrics and level of buffers, recognising that the current ORSA framework already requires insurers to consider RBC requirements
- Setting up RBC production processes efficiently using data and calculations while also using advanced technology for controls, analytics and disclosures
- Managing the transition impact on any one-off tax items and engaging the tax authorities actively in understanding the implications
- Appropriately engaging the Board on the implications of these amendments and their impact on strategic value levers, to facilitate steering the business under the RBC regime

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