

**Annual Dinner of the Hong Kong Insurance Law Association
1 June 2016**

Speech by Dr Moses Cheng, Chairman, Insurance Authority

Chairlady Caroline, my friends, Ladies and Gentlemen, good evening!

1. I am most grateful to the chairlady for inviting me to join you all at this Annual Dinner of the Hong Kong Insurance Law Association; and in particular for this opportunity to share with you the latest developments of the Provisional Independent Insurance Authority and some of my observations. Thank you for this opportunity of meeting up with some of my professional colleagues whom I have had the pleasure of working together for many years and making many new acquaintances of the Insurance Industry whom I shall be working closely with in the years to come.

2. In an address to your parent organization, the Association internationale de Droit des Assurances, in Copenhagen last year, Lord Mance, Lord of Appeal in Ordinary, of the Supreme Court of the United Kingdom, emphasized the strong correlation between the law and insurance. He said

“I see the law and insurance as symbiotic. Each should inspire the other.”

He went on to say and I quote ...

“In reality, insurance and the law are inextricably linked at all points. It depends on agreements and wordings for its force and effect, and

agreements and wordings depend on the law for their force and effect.”

3. Most of us sitting in this room tonight would realize the importance of law in the insurance industry. Most, if not all, practising lawyers would have inevitably been involved in insurance work at some stage in their practice.

4. I started my legal practice some 40 years ago as a litigator. In those days litigations would mean either recovery of debts or insurance claims in running down cases. I still remember my first full trial in the district court was a running down case, litigating on the issue of whether the travelling costs incurred by the parents in visiting a young plaintiff injured in a motor accident in the hospital is recoverable against the Insurer of the Defendant.

5. Later on, with the establishment of the P I Scheme of the Law Society of Hong Kong, my law firm was appointed to be one of the panel solicitors. As such, I had the opportunity of dealing with many professional indemnity claims. When development of my Firm brought me into commercial and corporate practice, the opportunities of working with the insurance industry gradually reduced.

6. So, when I was first approached to consider taking up the appointment as the inaugural Chairman of the Independent Insurance Authority, I was quite surprised and felt equally worried. I knew from my experience of setting up the Real Estate Agents Authority and the Financial Reporting Council that it is a daunting task to set up a new organization. And setting up the independent authority for the insurance industry would not be any easier. It was after deep thoughts and prayers that I agreed to take up the invitation to work in this new

venture.

7. On being appointed the chairman of the Authority about 5 months ago, I realized that the operation in these next few years would, besides setting up a new statutory authority, entail a merger and a takeover. The Authority is tasked to take over the Office of the Commissioner of Insurance and then merging it with the three existing Self-Regulatory Organisations for insurance intermediaries. It is definitely a mammoth task. The preparatory work for the transition is onerous. Fortunately, the Government plans to execute the transition in phases; and the Financial Services and Treasury Bureau has been convening a Working Group on Transition to IIA and start sorting out the transitional issues with the relevant parties. With the strong support and guidance from the insurance industry and other stakeholders, I believe the transition would be smooth and effective.

8. At the present moment, the Authority does not yet have an office. It is supported by six seconded staff from the Government. So for the coming months, the Authority's priority is hiring. In accordance with the consultant's recommendations, the Authority should have, by the end of 2016, about 180 officers and staff. Once we got the necessary regulatory staff in place, we shall be ready to take over the operation of the Office of the Commissioner of Insurance. Our target is to do so by the end of this year or early 2017. And then, in about one year later, it is intended that the Authority would have sufficient manpower to take up the regulation of insurance intermediaries. By then, the Authority will be fully up and running.

9. Whilst committing time and resources to building up the Authority, two very

important regulatory tasks demand our attention simultaneously. They are closely related to the Authority's principal functions, i.e., maintaining the stability of the insurance industry in Hong Kong and protecting the interests of policyholders.

10. The first issue involves the adoption of a Risk-based Capital framework, (popularly referred to as the RBC Framework or just RBC). This aims at enhancing prudential regulation of insurers. The Authority will be looking for a lot of inputs from the accounting and actuarial experts to help formulate an appropriate RBC framework for Hong Kong. This issue seems to be worrying a lot of people in the Industry. But permit me to make it clear. The RBC framework does not necessarily increase capital requirements for insurers. As its name implies, RBC seeks to set capital requirements based on the size and degree of risks taken by an insurer. It is a tremendous exercise involving extensive quantitative analysis in the first place and applying the requirements flexibly and realistically to minimize compliance costs and business impact on insurers at the implementation stage.

11. The second task is the establishment of a Policyholders' Protection Scheme. This seeks to enhance the protection of policyholders in the event of insolvency of an insurance company. Put it simply, it is the insurance sector's version of the deposit protection scheme. But it is more complicated because the scheme needs to provide for continuity of insurance contracts instead of straightforward cash compensation as in the case of deposit protection. I understand that the Government is discussing with the industry on legislative details. And I am certain that all of you, legal experts in Insurance laws, will be great resources

that can be tapped upon for ideas and inputs. The Authority will keep in close review the development in this respect.

12. After completing these two important tasks, we should have a more robust and comprehensive framework of prudential regulation and policyholder protection in Hong Kong.

13. Now, let me turn to the vision of the Authority and the insurance industry in Hong Kong. As a new insurance regulator, it is prudent for the Authority to communicate its regulatory philosophy to the industry and the public. On regulatory philosophy, I would venture to suggest that regulation is a balance between “voluntary compliance” and “command and control”.

14. In assessing the success of a regulatory regime, it is not so much about leniency or harshness in its approach. Rather, it is about doing the right things and doing things right, in the eyes of all stakeholders. A lot of it is about establishing credibility. And credibility is founded on accountability, impartiality, transparency, fairness and reasonableness.

15. Experience tells us that command and control are inefficient and acrimonious. Command and control require active policing which could mean inefficient and disproportionate use of resources. Excessive command and control will also result in confrontation that could be costly and time-consuming. All these resources can be put to more constructive and effective use.

16. Voluntary compliance, on the other hand, is basing on agreed objectives between the regulator and those being regulated; and it can be more efficient and

effective. Under the mode of voluntary compliance, the regulator is likely to save enforcement costs whilst regulatees might save compliance costs as well. However, a successful regulatory regime built on voluntary compliance is premised on common regulatory objectives shared by the regulator and regulatees. The process to agree on the shared objectives could be long and time-consuming. Besides, effective enforcement would still be required as back-up to deter free riders who would try to get away with non-compliance. The Authority would very much endorse the regulatory approach of co-operation to promote voluntary compliance.

17. As I have said on many occasions, in regulating any profession or industry, I am always reminded of the story of the little boy holding a bird in his hand. If he grasps it too tightly he would suffocate and kill the bird, too loosely the bird would simply fly away. Ladies & Gentlemen, it is all about achieving the reasonable and proper balance.

18. This sharing would not be complete without a few words on the future development of the insurance industry in Hong Kong. The insurance density¹ and insurance penetration² in Hong Kong are US\$5,647 per capita and 14.2% respectively. Hong Kong has 159 insurers. The premium growth averaged 12.3% in the past 5 years. In the latest figures released yesterday by the Office of the Commissioner of Insurance, mainlanders' purchases of insurance and related investment policies almost doubled from a year earlier to HK\$13.2 Billion. By all standards, Hong Kong's insurance market is vibrant and mature. I reckon that long-term business has a rosier picture than the general business.

¹ Insurance density is the insurance premiums per capita from domestic sources.

² Insurance penetration is the insurance premiums as a percentage of GDP.

But it doesn't mean that there are no new opportunities. Recently, The HK Monetary Authority has urged banks to step up cyber security efforts. I wonder if businesses in general, not only banks, have been well insured against cyber risks. And as the Hong Kong population is aging fast, medical expenses will undoubtedly rise, which means greater demand for health insurance. All these are business opportunities for general insurers to explore.

19. Besides, the extent to which technologies transcend insurance business to the next level is really very fascinating. If you do a Google search on "financial technologies (or "Fintech") in the insurance industry", there are lots of interesting stories including peer-to-peer insurance, and motor insurance which can be offered on a variable rate according to miles driven. It is clear that more and more innovative Fintech ideas would emerge for the insurance industry.

20. However, one might question whether the regulatory framework of Hong Kong is able to catch up with and embrace technological advancement. In answering, it is quite natural to conclude that our regulatory framework needs to be technology-neutral as well as technology-embracing.

21. Ladies & Gentlemen, let me reiterate that the Independent Insurance Authority is firmly committed to building and sustaining a regulatory environment conducive to business development and embracing technology. The Authority has decided to set up a task force to explore the future of the insurance industry and would appeal to all of you to join, volunteer your time and effort to contribute to its work.

22. In conclusion I would like to cite another passage from the Speech of Lord Mance, which I must say is a very important reminder to all of us in the insurance business. He said,

“ The law should of course be a last resort. That is true of all business and personal relations. But, if you are going to avoid legal problems, the right thing is to begin with some law and to have it in mind when you place or underwrite business.”

23. Ladies & Gentlemen, there is no need for me to repeat the important roles played by the law and lawyers in the insurance industry. I would like to thank you once again for your support and this opportunity to share with you the developments of the Authority. I look forward to the continual contributions of your Association and your personal participation and guidance as we work together in building up the new Independent Insurance Authority.

24. Thank you.