

# Hong Kong passed bills to help grow the insurance sector

DENTONS

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On 17 July 2020, the Hong Kong Legislative Council passed the Insurance (Amendment) Bill 2020<sup>1</sup> and the Insurance (Amendment) (No. 2) Bill 2020<sup>2</sup>. The two bills seek to amend the Insurance Ordinance (Cap. 41) in order to create new business opportunities for the insurance sector. Key changes introduced by the two bills are (a) to provide for a new regulatory regime for the insurance-linked securities business, (b) to expand the scope of insurable risks of captive insurers set up in Hong Kong, and (c) to enhance the regulatory framework for the regulation and supervision of insurance groups where a holding company of the group is incorporated in Hong Kong.

## Insurance (Amendment) Bill 2020

### New regulatory regime for insurance-linked securities (ILS) business

ILS are introduced as a new class of insurance business known as special purpose business (SPB). Typically, an insurer will establish a special purpose vehicle (SPV) and then transfer the risk to the SPV. A special purpose insurer (SPI), which is an insurer authorised to carry on the business of the SPB, will raise funds by issuing securities in the capital markets through the SPV to cover the risk. This allows the SPI to transfer the full risk to qualified institutional investors.<sup>3</sup>

To be an SPI, certain regulatory requirements have to be satisfied, such as having two or more directors and an administrator as controller who satisfy the fit and proper criteria. However, the usual capital requirements applicable to authorised insurers carrying on general insurance business do not apply to SPIs. As ILS contain features of derivative products, it is expected that the Securities and Futures Commission will also play a role in their regulation.

In a press release issued by the Insurance Authority (IA) on 20 March 2020, Dr Moses Cheng, Chairman of the IA, said: “The Central Government has announced support for Mainland insurers to issue catastrophe bonds<sup>4</sup> in Hong Kong...the proposed legislative amendments will pave the way for Hong Kong to become the preferred domicile for ILS, in particular catastrophe bonds. This will facilitate insurers to better capture business opportunities and, more importantly, extend the capacity of the insurance industry; thus enhancing its sustainable development.”

### Widening the scope of insurable risks of captive insurers

The scope of the insurable risks of captive insurers before the passing of the first bill was found to be too narrow – captive insurers could only insure risks of companies formed and registered in Hong Kong. This poses particular problems for multinational companies in planning their global risk management strategies.

The first bill expands the scope of insurable risks so that captive insurers in Hong Kong can underwrite risks for overseas group companies. Further, the risk of companies unrelated to the captive insurer may also be insured when the full risk management mandate is provided.

Through the combination of favourable regulatory requirements for captive insurers in Hong Kong and the potential for captive insurance in China arising from the Belt and Road Initiative, it is expected that Hong Kong will act as the springboard for China to open up its financial market to foreigners.

## Insurance (Amendment) (No. 2) Bill 2020

### Widening the supervisory power of IA to align with international standards

The objective of the second bill is to “consolidate a clear and firm legal basis for the IA to exercise direct regulatory powers over the holding companies of multinational insurance groups. Building on Hong Kong’s extensive experience in the supervision of insurance groups, the legislative framework would clearly set out the basis upon which the IA would perform effective and efficient group-wide supervision and ensure that the insurance regulatory system in Hong Kong will continue to be conducive to the maintenance of strong, well-capitalised, well-managed insurance groups.”<sup>5</sup>

The supervisory powers of the IA are expanded and are no longer limited to authorised insurers in Hong Kong, but also where the holding company of the authorised insurer is incorporated in Hong Kong. This enables Hong Kong’s insurance regulatory regime to meet the international standard adopted by the International Association of Insurance Supervisors.

Other than existing insurance holding companies incorporated in Hong Kong, the IA is also empowered to designate an insurance holding company (a DIHC) if it considers this to be appropriate. The IA will take into account the number of jurisdictions outside Hong Kong in which the group carries out insurance business, the size of its business and other relevant criteria promoted by the international standard-setting bodies. Once designated, the DIHC, together with its subsidiaries and group companies, will be subject to group-wide supervision. The DIHC will be responsible for ensuring capital adequacy in compliance with the group capital requirement to protect policyholders.

To ensure fitness and properness of the whole supervised group, the second bill provides the IA with a wide range of powers, including intervention, inspection and investigative powers.

The changes brought about by the two bills are welcomed by the insurance industry in Hong Kong. Going forward, the Hong Kong government and the IA will proceed with the next stage of preparatory work, including formulation of implementation details and drafting of subsidiary legislation. The target is to commence the group-wide supervisory regime by the end of 2020 or early 2021.

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1. <https://www.gld.gov.hk/> ↩
  2. <https://www.gld.gov.hk/> ↩
  3. The IA will formulate rules on the sale of ILS with severe penalties for any violation to ensure that ordinary individual investors are excluded. ↩
  4. ISL covering natural disasters. ↩
  5. Press Release of the IA, 20 March 2020. ↩

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