

## **LEGISLATIVE COUNCIL BRIEF**

Insurance Ordinance  
(Chapter 41)

### **Insurance (Amendment) Bill 2020**

#### **INTRODUCTION**

A At the meeting of the Executive Council on 17 March 2020, the Council **ADVISED** and the Chief Executive **ORDERED** that the Insurance (Amendment) Bill 2020 (“the Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”) to –

- (a) provide for a new regulatory regime under the Insurance Ordinance (Cap. 41) (“IO”) for the insurance-linked securities (“ILS”) business;
- (b) expand the scope of insurable risks of captive insurers set up in Hong Kong; and
- (c) make minor technical amendments to the IO.

#### **JUSTIFICATIONS**

##### **(a) ILS**

2. ILS are risk management tools that allow insurers/reinsurers to raise capital by offloading insured risks to the capital markets through securitization, and are often described as another form of reinsurance. Unlike conventional reinsurance coverage whereby an insurer transfers a portion of its risk to another reinsurer by way of reinsurance, an ILS enables an insurer/a reinsurer to transfer insurance risk to the capital markets. This improves the capacity of the insurance industry, makes the insurance coverage more affordable and thereby enhances the insurance industry’s sustainable development. For institutional investors, ILS

provide an alternative investment which is not correlated to economic conditions (but to insurance risk), thereby offering institutional investors an option to diversify their portfolios.

3. The operation of ILS typically involves the setting up of a dedicated special purpose vehicle (“SPV”) by an insurer/a reinsurer (referred to as a “cedant”), followed by a transfer of its insurance risk to the SPV through a reinsurance/risk transfer contract. The SPV then issues financial instruments to investors to raise capital to finance the full amount of the risk assumed by it under the reinsurance/risk transfer contract. The investors receive a return in terms of coupons comprising investment yield and the spread for risk premium. At maturity, the investors would redeem the proceeds of the ILS minus any claims payments made by the SPV to the cedant triggered under the reinsurance/risk transfer contract. A common form of ILS is catastrophe bonds.

4. Given a rising trend of catastrophic events caused by climate change and urbanization, global issuance of ILS has grown substantially in recent years but the risk exposure of such ILS is currently mainly confined to the United States and Europe. In 2019, the global issuance of ILS was approximately US\$11 billion<sup>1</sup>, with Bermuda being the leading jurisdiction particularly in respect of catastrophe bonds. There is potential for more ILS transactions in Asia which have hitherto been relatively infrequent. We need to make Hong Kong a more conducive domicile for ILS to capture the potential business opportunities which are expected to arise in Asia in the coming years.

5. Accordingly, the Chief Executive and the Financial Secretary announced in the 2018 Policy Address and the 2019-20 Budget Speech respectively that the Government would make relevant legislative amendments to allow for the formation of SPV specifically for issuing ILS in Hong Kong, with a view to enriching the risk management tools available in the Hong Kong market. The legislative amendments will also facilitate the industry to seize the business opportunities arising from the Guangdong-Hong Kong-Macao Greater Bay Area development<sup>2</sup>.

6. The core feature of ILS business is that it is fully funded, which means the assets held at all times are no less than the prospective liabilities

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<sup>1</sup> Source: The Artemis Catastrophe Bond & Insurance-Linked Securities Deal Directory.

<sup>2</sup> After the meeting of the Leading Group for the Development of the Guangdong-Hong Kong-Macao Greater Bay Area held on 6 November 2019, the Central Government announced a series of policy measures, including supporting Mainland insurers to issue catastrophe bonds in Hong Kong to facilitate the bond market development in Hong Kong.

under the reinsurance/risk transfer contract(s) by which it acquires insurance risk. In other words, the entire insurance risk acquired by the SPV must be fully collateralized by funds raised through the issuance of ILS, the return on which is linked to the underlying insurance risk.

7. Since ILS business involves contracts of transfer of insurance risk, it falls within the regulatory ambit of the IO. However, the purpose and nature of ILS business is essentially the transfer of risks to the capital markets, making it very different from the conventional insurance/reinsurance business currently regulated under the IO. Moreover, applying the existing stringent regulatory requirements under the IO (e.g. capital and solvency requirements, corporate governance requirements) to ILS business makes issuance of ILS in Hong Kong extremely costly and cumbersome, if not impractical. In line with the ILS regulatory regimes in other jurisdictions such as Bermuda and Singapore, we need a simplified regulatory regime under the IO to promote Hong Kong as a domicile for issuance of ILS.

#### *Authorization requirements*

8. We **propose** to add a new class of insurance business, namely special purpose business (“SPB”), under the IO for the purpose of acquiring insurance risk from another insurer/reinsurer under a reinsurance/risk transfer contract and then issuing ILS to investors to collateralize the risk acquired. An insurer authorized to carry on SPB only is referred to as a special purpose insurer (“SPI”) which serves the functions of an SPV as mentioned in paragraph 3 above. SPI will be a new type of authorized insurer under the IO.

9. We also **propose** to require a company to meet the following requirements in order to be authorized as an SPI –

- (a) the company will be fully-funded, meaning that the full liabilities of the company to the cedant must be fully backed by assets including funds raised through debt or other financing arrangements;
- (b) the company appoints an administrator as a controller to manage the SPB, including administration of its assets and any outsourced operations and notifying the Insurance Authority (“IA”) of any non-compliance. The administrator is required to meet the fit and proper requirement;

- (c) the company appoints at least two directors to ensure accountability and responsibility. Directors should also be subject to the fit and proper requirement;
- (d) the company intends to carry on SPB only but not any other class of insurance business;
- (e) the company complies with the relevant financial, solvency, investor's sophistication and other requirements prescribed by rules made by the IA (being subsidiary legislation) under section 129 and the proposed section 129A of the IO; and
- (f) the company pays prescribed fees to the IA for recovering the cost of IA in regulating the SPI. The fees will be prescribed in regulations to be made by the Chief Executive in Council (being subsidiary legislation) under section 128 of the IO.

***Requirements on the sale of ILS***

10. Given the nature of the underlying risk of investing in ILS and the potential for loss of investment upon the occurrence of a predefined trigger event, ILS are not considered to be financial products suitable for ordinary retail investors. Our policy intent is to confine the sale of ILS to qualified institutional investors (e.g. dedicated ILS funds and hedge funds) by private placement.

11. As the financial market is fast evolving, we **propose** to empower the IA to prescribe detailed requirements on the sale of ILS by way of subsidiary legislation to facilitate timely updating of the legal requirements. Specifically, the IA may make rules under the proposed section 129A of the IO to –

- (a) prescribe the types of investors to which ILS may be sold or offered to be sold (hereafter called “qualified investors”);
- (b) prohibit the sale of, or the making of an offer to sell, ILS to any person other than a qualified investor;
- (c) prohibit the sale of, or the making of any offer to sell, ILS to a qualified investor at an amount lower than a prescribed amount; and
- (d) prescribe offences for contravention of the rules in (b) and (c)

above, with penalty levels<sup>3</sup> not exceeding: (i) for an offence of which a person is convicted on indictment, a fine of \$200,000 and imprisonment for two years; and (ii) for an offence of which a person is summarily convicted, a fine at level 6 and imprisonment for six months.

12. There have been calls for prohibiting qualified investors from “repackaging” ILS into other types of financial products for sale to retail investors, and debarring constituent funds of Mandatory Provident Fund Schemes (“MPF funds”) from investing in ILS to better protect the interests of investors. In this regard, we plan to exclude funds targeting at the public (e.g. MPF funds, occupational retirement schemes and retail funds authorized by the Securities and Futures Commission) from being regarded as qualified investors. We also intend to impose a minimum amount of offer to sell ILS and criminal sanctions against the sale of ILS to any person other than a qualified investor. The intended safeguards are not expected to have a material impact on the scope of potential investors because ILS are niche financial products that are not frequently issued<sup>4</sup> and appeal mostly to sophisticated investors with expertise in reinsurance underwriting.

13. The IA will formulate rules on the financial, solvency and investor’s sophistication requirements as well as the fee proposals. In doing so, it will continue to take into account international practices and views to be solicited from further consultation, with a view to striking a reasonable balance between market development and investor protection.

## **(b) Captive Insurer**

14. A captive insurer is an insurance company set up by its parent company with the primary purpose of insuring and reinsuring the risks of the companies in the group to which the captive insurer belongs. Captive insurance provides multinationals with the ability to deploy a more holistic risk management strategy across their international business, and saving

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<sup>3</sup> As the rule-making powers of the IA in paragraph 11(a) to (c) above are of similar nature with those of the Securities and Futures Commission (“SFC”) in relation to the business conduct of intermediaries under section 168 of the Securities and Futures Ordinance (Cap. 571) (“SFO”), the IA has modelled on the maximum penalties for contravention of rules made under section 168 of the SFO in formulating the proposed maximum penalty levels for the contravention of these rules.

<sup>4</sup> According to the Artemis Catastrophe Bond & Insurance-Linked Securities Deal Directory, there have been only some 600 ILS issued over the past 23 years since 1996.

insurance premium spent on an external insurance provider <sup>5</sup>.

15. At present, there are four captive insurers set up in Hong Kong and regulated under the IO. Captive insurers can only underwrite risks in relation to those companies within the captive insurer's "grouping of companies", which includes –

- (a) a company ("first company") which belongs to the captive insurer's "group of companies" <sup>6</sup>;
- (b) a company ("second company") in which either the captive insurer itself or the first company holds or is entitled to exercise the control of, at least 20% but not more than 50% of the voting power at the general meeting of the second company; or
- (c) a company ("third company") which is a subsidiary of a second company at (b) above.

16. The industry considers that the existing scope of insurable risks by captive insurers is too restrictive and not conducive to effective global risk management strategy when multinationals expand further globally. The major problems are –

- (a) at present, the risks which a captive insurer can insure/reinsure are limited to the risks of companies formed and registered in Hong Kong under the Companies Ordinance (Cap. 622) ("CO") and the risks of companies incorporated outside Hong Kong that establishes a place of business in Hong Kong. This means that multinationals cannot use a Hong Kong captive insurer to cover the risks of its overseas companies that are not registered in Hong Kong under the CO and without a place of business in Hong Kong;
- (b) multinationals may hold less than 20% of the voting power of a company when they enter into a new market or diversify their investments. The current regulation, however, does not allow a Hong Kong captive insurer to insure/reinsure risks of that

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<sup>5</sup> In general, captive insurers retain a certain amount of risks within the group of companies (usually high frequency attritional losses) and buy reinsurance for catastrophic exposures from external reinsurers.

<sup>6</sup> Under the Companies Ordinance (Cap. 622), "group of companies" means any two or more bodies corporate one of which is the holding company of the other (or others). This meaning is adopted for the purpose of the IO.

company; and

- (c) some multinationals investing in infrastructural projects may assume the risk management responsibility for other companies (e.g. sub-contractors) participating in a project even though these contractor-companies are not within the same group of companies. The current regulation does not allow a Hong Kong captive insurer to insure/reinsure such risks even though the responsibility for managing the risks (and hence the risk itself) ultimately lies with the group of companies to which the captive insurer belongs.

17. With a sound regulatory regime and availability of a wide range of professionals, Hong Kong is well-positioned to assist multinationals including Mainland enterprises going global to enhance their risk management. To address the problems identified by the industry and assist the industry to capitalize on the business opportunities arising from the Belt and Road Initiative, we **propose** to amend the IO so that the following risks can also be insured/reinsured by a captive insurer set up in Hong Kong –

- (a) the risks of a body corporate within the “relevant company’s corporate group” to which the captive insurer belongs that is incorporated outside Hong Kong and does not have a place of business in Hong Kong;
- (b) in cases where a body corporate belonging to the captive insurer’s “relevant company’s corporate group” controls<sup>7</sup> less than 20% of another body corporate, the proportional share of risks to which the “relevant company’s corporate group” is exposed. In other words, if a body corporate belonging to the captive insurer’s “relevant company’s corporate group” controls 10% of the voting rights at the general meeting of another body corporate, the captive insurer may insure/reinsure up to 10% of the total amount of risks of that body corporate; or
- (c) the risks of an unrelated body corporate (i.e. not within the “relevant company’s corporate group” of the captive insurer), provided that the captive insurer or a body corporate in the

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<sup>7</sup> Including (i) controlling, or being entitled to control, a percentage of the composition of the other body corporate’s board of directors; (ii) controlling, or being entitled to control, a percentage of the voting rights at general meetings of the other body corporate; or (iii) holding a percentage of the issued share capital of the other body corporate.

“relevant company’s corporate group” to which the captive insurer belongs is given a full risk management mandate.

### **(c) Technical amendments to the IO**

18. We **propose** to take the opportunity to amend the IO –
- (a) to allow the IA to delegate to its employees the function of publishing materials relating to its performance to enhance operational efficiency<sup>8</sup>; and
  - (b) to correct editorial errors and incorrect cross-references under the IO.

### **OTHER OPTIONS**

19. We must amend the IO to implement the proposals outlined in paragraphs 8, 9, 11, 17 and 18 above. There is no other option.

### **THE BILL**

20. The main provisions of the Bill are as follows –

#### Amendments relating to SPB

- (a) clause 3 amends section 2(1) of the IO to include defined expressions (e.g. insurance securitization, special purpose business and special purpose insurer) that are necessary for the interpretation of the Bill;
- (b) clause 8 adds new sections 8A, 8B and 8C to the IO to empower the IA to (i) authorize a company to carry on SPB; (ii) specify the form in which an SPI submits information to the IA; and (iii) modify or vary any requirement under sections 17, 20 or 21 of the IO in relation to an SPI;

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<sup>8</sup> Under the existing section 4B(2)(f) of the IO, the IA may publish or otherwise make available materials on any matter relating to the performance by the IA of any of its functions. This function, alongside others set out in Schedule 1D to the IO, is currently non-delegable. Given the technical nature of many of the materials published by the IA (e.g. circulars, Frequently Asked Questions) and their large volume, the IA considers that this function should be delegable to its employees to improve operational efficiency.



- (c) clause 11 amends the definition of “controller” under section 13A(12) of the IO to expand its meaning to include an administrator of an authorized insurer that is an SPI;
- (d) clauses 12 to 13 amend sections 13AE and 13B of the IO to exclude an SPI from the application of those sections;
- (e) clause 15 amends section 26(1)(e) of the IO to add a ground in relation to an SPI on which the IA may exercise the powers under sections 27 to 35 of the IO;
- (f) clause 20 adds a new section 129A to the IO to empower the IA to make rules to (i) prohibit any sale of ILS to any person other than an investor falling within a type prescribed in the rules; (ii) prohibit any sale of ILS at an amount lower than that prescribed in the rules; and (iii) prescribe offences for contravention of the rules;
- (g) clauses 5, 6, 9, 10, 14, 16, 17, 18, 22 and 23 amend the references in certain existing provisions of the IO as a consequence of the authorization of SPIs to carry on SPB under the IO;

Amendments relating to captive insurers

- (h) clause 24 amends the meaning of captive insurer in section 2(7) of the IO to widen the scope of insurable risks of a captive insurer;

Amendment relating to non-delegable functions of the IA

- (i) clause 25 removes a non-delegable function of the IA specified in Schedule 1D to the IO to enable the function to be carried out more effectively; and

Miscellaneous amendments

- (j) clauses 26 to 32 make minor textual amendments to certain existing provisions of the IO.

## LEGISLATIVE TIMETABLE

21. The legislative timetable will be –

Publication in the Gazette	20 March 2020
First Reading and commencement of Second Reading debate	25 March 2020
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

## IMPLICATIONS OF THE PROPOSALS

22. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the current binding effect of the existing provisions of the IO. There are no civil service implications, no environmental, productivity, family or gender implications, and no sustainability implications other than economic implications. The financial and economic implications of the proposal are set out at **Annex B**.

B

## PUBLIC CONSULTATION

23. The IA has consulted its two industry advisory committees<sup>9</sup> and the relevant industry organization and stakeholders<sup>10</sup> in formulating the legislative proposals to facilitate the insurance of ILS in Hong Kong and expand the scope of insurable risks by captive. The Financial Services and the Treasury Bureau and the IA consulted the LegCo Panel on Financial Affairs in June 2019. All stakeholders concerned were generally supportive of the proposals.

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<sup>9</sup> The two industry advisory committees of the IA are the Industry Advisory Committee on Long Term Business and Industry Advisory Committee on General Business.

<sup>10</sup> The relevant industry organization and stakeholders include the Hong Kong Federation of Insurers, major international insurance brokers and captive managers as well as the authorized captive insurers in Hong Kong.

## **PUBLICITY**

24. We will issue a press release upon the gazettal of the Bill, and arrange for a spokesman to answer media enquiries.

## **ENQUIRIES**

25. Enquiries relating to this brief can be directed to Ms Noel Tsang, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2201.

**Financial Services Branch  
Financial Services and the Treasury Bureau  
18 March 2020**

Insurance (Amendment) Bill 2020

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# A BILL

## To

Amend the Insurance Ordinance to provide for the regulation of a new class of insurance business for which the liability of an insurer under a contract of insurance to the person insured is fully funded; to expand the scope of insurable risks of captive insurers; to remove a non-delegable function of the Insurance Authority specified in Schedule 1D to the Ordinance; to make minor textual amendments to the Ordinance; and to provide for related matters.

Enacted by the Legislative Council.

### Part 1

#### Preliminary

##### 1. Short title and commencement

- (1) This Ordinance may be cited as the Insurance (Amendment) Ordinance 2020.
- (2) This Ordinance comes into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

##### 2. Insurance Ordinance amended

The Insurance Ordinance (Cap. 41) is amended as set out in Parts 2 to 5.

### Part 2

#### Amendments Relating to Special Purpose Business

##### 3. Section 2 amended (interpretation)

- (1) Section 2(1), definition of *authorized*, after “section 8”—  
**Add**  
“or 8A”.
- (2) Section 2(1), definition of *general business*, after “term”—  
**Add**  
“business or special purpose”.
- (3) Section 2(1), definition of *prescribed*, after “129”—  
**Add**  
“or 129A”.
- (4) Section 2(1)—

##### **Add in alphabetical order**

“*fully funded* (全期資可抵債)—see subsection (8);

*insurance securitization* (保險證券化), in relation to an insurer, means any debt or other financing arrangement entered into by the insurer with an investor, under which repayment or return to the investor is linked to a contract of insurance effected and carried out by the insurer;

*special purpose business* (特定目的業務) means the insurance business of effecting and carrying out contracts of insurance that are fully funded through insurance securitization;

*special purpose insurer* (特定目的保險人) means a company authorized under section 8A to carry on special purpose business only;”.

(5) After section 2(7)—

**Add**

“(8) For the purposes of the definition of *special purpose business*, a contract of insurance entered into between an insurer and a person as the insured under the contract is fully funded if the value of the assets held under the terms of the contract by, or on behalf of, the insurer for the benefit of the insured is not less than the amount of the insurer’s liabilities (whether actual or potential) under the contract at any time and under all reasonably foreseeable circumstances, taking into account—

- (a) the obligations of the insurer towards the insured under the contract; and
- (b) the expenses the insurer expects to incur.”.

**4. Section 3 amended (classes of insurance business)**

Section 3—

**Repeal subsection (2)**

**Substitute**

“(2) If—

- (a) a contract (including a tontine) referred to in Part 2 or 3 of Schedule 1; or
- (b) a contract belonging to the class of special purpose business,

is not (but for this subsection) a contract of insurance, the contract is, for the purposes of this Ordinance, deemed to be a contract of insurance.”.

**5. Section 5H amended (register of authorized insurers)**

Section 5H(1)(b), after “8(1)(a)”—

**Add**

“or 8A(1)(a)”.

**6. Section 6 amended (restriction on carrying on of insurance business)**

Section 6(1)(a), after “section 8”—

**Add**

“or 8A”.

**7. Section 8 amended (authorization)**

(1) Section 8, heading, after “**Authorization**”—

**Add**

“—**long term business and general business**”.

(2) Section 8(1)—

**Repeal**

“Upon application made by a company under section 7, the Authority”

**Substitute**

“On application made by a company under section 7 for authorization to carry on any class or classes of insurance business specified in Part 2 or 3 of Schedule 1”.

(3) Section 8(1)(a)—

**Repeal**

“may authorize”

**Substitute**

“the Authority may authorize”.

- (4) Section 8(1)(a)—

**Repeal**

“any class”

**Substitute**

“the class”.

- (5) Section 8(1)—

**Repeal paragraph (b)****Substitute**

“(b) the Authority—

- (i) must refuse the application if subsection (2) or (3) applies; and
- (ii) may refuse the application on any other ground.”.

**8. Sections 8A, 8B and 8C added**

After section 8—

**Add****“8A. Authorization—special purpose business**

- (1) On application made by a company under section 7 for authorization to carry on special purpose business—
  - (a) subject to paragraph (b), the Authority may authorize the company in writing to carry on, subject to such conditions as the Authority may impose, special purpose business; or
  - (b) the Authority—
    - (i) must refuse the application if subsection (2) applies; and
    - (ii) may refuse the application on any other ground.

- (2) The Authority must not authorize a company under this section unless the following conditions are satisfied—

- (a) the company has appointed 2 or more directors all of whom appear to the Authority to be fit and proper persons to hold the positions;
- (b) the company has appointed an administrator as a controller who appears to the Authority to be a fit and proper person to hold the position;
- (c) the company complies with the relevant financial, solvency, investor’s sophistication and other requirements prescribed by rules made under section 129 or 129A;
- (d) the company intends to carry on special purpose business only but not any other class of insurance business.

- (3) For the purposes of subsection (2)(a) and (b), if the Authority considers that a person is not a fit and proper person to hold the relevant position, the Authority must notify the company in writing of the fact and the reason for that opinion.

- (4) In this section—

**administrator** (管理人), in relation to a company, means an individual who (alone or jointly with others) is responsible for the administration of the whole business of the company.

**8B. Form of information submitted by special purpose insurers**

The Authority may specify the form in which a special purpose insurer submits information to the Authority under this Ordinance.



**8C. Requirements under section 17, 20 or 21 may be modified or varied for special purpose insurers**

The Authority may modify or vary any requirement under section 17, 20 or 21 in relation to a special purpose insurer for the period and in the ways as the Authority considers appropriate.”.

**9. Section 11 amended (notification of refusal of authorization under section 8(2))**

- (1) Section 11, heading—

**Repeal**

“8(2)”

**Substitute**

“8 or 8A”.

- (2) Section 11(3)—

**Repeal**

“8(1)(b)(ii), the Authority shall”

**Substitute**

“8(1)(b)(ii) or 8A(1)(b)(ii), the Authority must”.

**10. Section 12 amended (conditions for authorization under section 8)**

- (1) Section 12, heading, after “section 8”—

**Add**

“or 8A”.

- (2) Section 12(1), after “section 8(1)(a)—

**Add**

“or 8A(1)(a)”.

**11. Section 13A amended (approval of certain controllers of authorized insurers)**

- (1) Section 13A(12), definition of
- controller*
- , paragraph (a)(i), after “authorized insurer”—

**Add**

“(other than a special purpose insurer)”.

- (2) Section 13A(12), definition of
- controller*
- , paragraph (a)(i)—

**Repeal**

“; or”

**Substitute a semicolon.**

- (3) Section 13A(12), definition of
- controller*
- , paragraph (a)(ii), after “authorized insurer”—

**Add**

“(other than a special purpose insurer)”.

- (4) Section 13A(12), definition of
- controller*
- , paragraph (a)(ii)(B)(II)—

**Repeal**

“but”

**Substitute**

“or”.

- (5) Section 13A(12), definition of
- controller*
- , after paragraph (a)(ii)—

**Add**

“(iii) in relation to an authorized insurer that is a special purpose insurer (whether incorporated in Hong Kong or outside Hong Kong)—an administrator of the authorized insurer; but”.

- (6) Section 13A(12), Chinese text, definition of 控權人, paragraph (b)—

**Repeal the full stop**

**Substitute a semicolon.**

- (7) Section 13A(12)—

**Add in alphabetical order**

“*administrator* (管理人), in relation to a special purpose insurer, means an individual who (alone or jointly with others) is responsible for the administration of the whole business of the special purpose insurer;”.

12. **Section 13AE amended (approval of key persons in control functions of certain authorized insurers)**

Before section 13AE(1)—

**Add**

“(1A) This section does not apply to a special purpose insurer.”.

13. **Section 13B amended (approval of persons proposing to become certain controllers of authorized insurer)**

Before section 13B(1)—

**Add**

“(1A) This section does not apply to a special purpose insurer.”.

14. **Section 14A amended (determination of fit and proper)**

Section 14A(1), after “8,”—

**Add**

“8A,”.

15. **Section 26 amended (grounds on which powers are exercisable)**

Section 26(1)(e), after “(3)(b)”—

**Add**

“or 8A(2)”.

16. **Section 41B amended (power to conduct inspection)**

Section 41B(1)(c), after “section 8”—

**Add**

“or 8A”.

17. **Section 41P amended (disciplinary actions in respect of authorized insurers)**

Section 41P(5), definition of *misconduct*, paragraph (b), after “section 8”—

**Add**

“or 8A”.

18. **Section 53E amended (prescribed person to send report directly to Authority in certain cases relating to authorized insurers)**

Section 53E(3)(a), after “8(1)(a)”—

**Add**

“or 8A(1)(a)”.

19. **Section 129 heading amended (Authority may make rules)**

Section 129, heading, after “rules”—

**Add**

“—general provisions”.

20. **Section 129A added**

After section 129—

**Add**

**“129A. Authority may make rules for special purpose business**

- (1) The Authority may by rules—
  - (a) prohibit any sale of, or the making of any offer to sell, insurance-linked securities to any person other than an investor falling within a type prescribed in the rules; and
  - (b) prohibit any sale of, or the making of any offer to sell, insurance-linked securities at an amount lower than that prescribed in the rules.
- (2) Rules made under this section may prescribe offences for contravention of the rules, punishable by a fine or imprisonment, or both.
- (3) The maximum penalty that may be prescribed under subsection (2) is—
  - (a) for an offence of which a person is convicted on indictment—a fine of \$200,000 and imprisonment for 2 years; and
  - (b) for an offence of which a person is summarily convicted—a fine at level 6 and imprisonment for 6 months.
- (4) In this section—

*insurance-linked securities* (保險相連證券) means securities issued through insurance securitization.”.

**21. Schedule 1 amended (classes of insurance business)**

Schedule 1, Part 1—

**Repeal paragraph 1**

**Substitute**

- “1. The following constitute the classes of insurance business that are relevant for the purposes of this Ordinance—
- (a) classes of long term business that are specified in Part 2 of this Schedule;
  - (b) classes of general business that are specified in Part 3 of this Schedule;
  - (c) the class of special purpose business.”.

**22. Schedule 1D amended (non-delegable functions of Authority)**

Schedule 1D, section 1(m), after “section 8”—

**Add**

“or 8A”.

**23. Schedule 9 amended (specified decisions)**

- (1) Schedule 9, Part 1, item 1, after “or (3)”—

**Add**

“or 8A(2)”.

- (2) Schedule 9, Part 1, item 1, after “8(1)(b)(i)”—

**Add**

“or 8A(1)(b)(i)”.

- (3) Schedule 9, Part 1, item 2, after “8(1)(b)(ii)”—

**Add**

“or 8A(1)(b)(ii)”.

- (4) Schedule 9, Part 1, item 3, after “8(1)(a)”—

**Add**

“, 8A(1)(a)”.

**Part 3****Amendments Relating to Captive Insurers****24. Section 2 amended (interpretation)**

(1) Section 2(7)(a)—

**Repeal subparagraph (ii)****Substitute**

“(ii) is restricted to the insurance and reinsurance of—

- (A) risks of the bodies corporate within the relevant company’s corporate group (within the meaning of paragraph (b)) to which the relevant company belongs;
- (B) the proportional share of risks of another body corporate to which the relevant company, or a first tier member (within the meaning of paragraph (b)(i)) in the relevant company’s corporate group, is exposed directly through—
  - (I) controlling, or being entitled to control, the appointment or removal of a percentage of the directors on the board of directors of the other body corporate;
  - (II) controlling, or being entitled to control, a percentage of the voting rights at general meetings of the other body corporate; or
  - (III) holding a percentage of the issued share capital of the other body corporate,
 that is capped at the highest of those 3 percentages; and
- (C) any other risks—

- (I) of which the relevant company, or a first tier member in the relevant company’s corporate group, has control, oversight or management; or
- (II) to which the relevant company, or a first tier member in the relevant company’s corporate group, is otherwise sufficiently connected, as determined in accordance with the criteria specified for the purposes of this sub-subparagraph in guidelines published under section 133;”.

(2) Section 2(7)—

**Repeal paragraph (b)****Substitute**

- “(b) *relevant company’s corporate group* (同一法人集團) means a corporate grouping made up of a relevant company (within the meaning of paragraph (a)) and one or more of the following members—
- (i) a first tier member being a body corporate—
    - (A) that belongs to the group of companies of the relevant company; or
    - (B) that is a subsidiary of the holding company of the relevant company;
  - (ii) a second tier member being a body corporate in respect of which the relevant company or a first tier member (whether alone or jointly with the relevant company or another first tier member)—
    - (A) controls, or is entitled to control, the appointment or removal of not less than 20% and not more than 50% of the directors on the board of directors of the body corporate;

- (B) controls, or is entitled to control, not less than 20% and not more than 50% of the voting rights at general meetings of the body corporate; or
  - (C) holds not less than 20% and not more than 50% of the issued share capital of the body corporate;
- (iii) a third tier member being a body corporate that is a subsidiary of a second tier member;”.
- 

## **Part 4**

### **Amendment Relating to Non-delegable Functions of Insurance Authority**

25. **Schedule 1D amended (non-delegable functions of Authority)**  
Schedule 1D, section 1—  
**Repeal paragraph (c).**
-

**Part 5****Miscellaneous Amendments**

26. **Section 9 amended (meaning of *controller* (控權人))**
- (1) Section 9(3)(a)—  
**Repeal**  
 “(1)(a)”  
**Substitute**  
 “(1)(a)(i)”.
- (2) Section 9(3)(b)—  
**Repeal**  
 “(1)(b)”  
**Substitute**  
 “(1)(a)(ii)”.
27. **Section 26 amended (grounds on which powers are exercisable)**  
 Section 26(4)(b)—  
**Repeal**  
 “9(1)(c)”  
**Substitute**  
 “9(1)(a)(iii)”.
28. **Section 53A amended (secrecy)**
- (1) Section 53A(1AA)(e)—  
**Repeal**  
 “or who is”

- Substitute**  
 “or who assists”.
- (2) Section 53A(1AAB)(c)—  
**Repeal**  
 “who is”  
**Substitute**  
 “who assists”.
29. **Section 76 amended (Authority may petition for winding up or bankruptcy of licensed insurance intermediary)**  
 Section 76(3), Chinese text—  
**Repeal**  
 “佈”  
**Substitute**  
 “布”.
30. **Section 123 amended (exceptions to sections 64G and 120)**  
 Section 123(5), definition of *actuary*—  
**Repeal**  
 “Companies (Actuaries’ Qualifications) Regulations”  
**Substitute**  
 “(Actuaries’ Qualifications) Regulation”.
31. **Section 128 amended (Chief Executive in Council may make regulations)**  
 Section 128(7), English text, after “subsection (6)”—  
**Add**  
 “is”.

32. **Schedule 6 amended (person who has become controller of authorized insurer in contravention of section 13B(2))**

Schedule 6, Chinese text, paragraph 1—

**Repeal**

“13B(1)條適用”

**Substitute**

“13B(3)條適用”。

**Explanatory Memorandum**

The objects of this Bill are to amend the Insurance Ordinance (Cap. 41) (*Ordinance*) to—

- (a) provide for the regulation of a new class of insurance business for which the liability of an insurer under a contract of insurance to the person insured is fully funded;
- (b) expand the scope of insurable risks of captive insurers;
- (c) remove a non-delegable function of the Insurance Authority (*Authority*) specified in Schedule 1D to the Ordinance;
- (d) make minor textual amendments to the Ordinance; and
- (e) provide for related matters.

2. The Bill is divided into 5 Parts.

**Part 1—Preliminary**

3. Clause 1 sets out the short title and provides for commencement.

**Part 2—Amendments Relating to Special Purpose Business**

4. Clause 3 amends section 2(1) of the Ordinance to include defined expressions (e.g. *insurance securitization*, *special purpose business* and *special purpose insurer*) that are necessary for the interpretation of the Bill. The clause also adds a new section 2(8) to the Ordinance. The new section 2(8) gives the meaning of *fully funded* for the purposes of the definition of *special purpose business*. A contract of insurance is regarded as fully funded if the value of the assets held by the insurer for the benefit of the insured under the terms of the contract is not less than the amount of the insurer’s liabilities under the contract.

5. Clause 4 amends section 3(2) of the Ordinance to include a contract belonging to the class of special purpose business among the contracts deemed to be contracts of insurance for the purposes of the Ordinance.
6. Clause 7 amends section 8 of the Ordinance to provide that that section only applies to long term business and general business.
7. Clause 8 adds—
  - (a) a new section 8A to the Ordinance to empower the Authority to authorize a company to carry on special purpose business if certain conditions are satisfied;
  - (b) a new section 8B to the Ordinance to empower the Authority to specify the form in which a special purpose insurer submits information to the Authority under the Ordinance; and
  - (c) a new section 8C to the Ordinance to empower the Authority to modify or vary any requirement under section 17, 20 or 21 of the Ordinance in relation to a special purpose insurer.
8. Clause 11 amends the definition of *controller* in section 13A(12) of the Ordinance to expand its meaning to include an administrator of an authorized insurer that is a special purpose insurer.
9. Clause 12 amends section 13AE of the Ordinance to exclude a special purpose insurer from the application of that section.
10. Clause 13 amends section 13B of the Ordinance to exclude a special purpose insurer from the application of that section.
11. Clause 15 amends section 26(1)(e) of the Ordinance to add a ground in relation to a special purpose insurer on which the Authority may exercise the powers under sections 27 to 35 of the Ordinance.
12. Clause 20 adds a new section 129A to the Ordinance to empower the Authority to make rules to prohibit any sale of, or the making of any

- offer to sell, insurance-linked securities to any person other than an investor falling within a type prescribed in the rules, and to prohibit any sale of, or the making of any offer to sell, insurance-linked securities at an amount lower than that prescribed in the rules. The meaning of *insurance-linked securities* is defined in the new section 129A. Clause 19 amends the heading of section 129 of the Ordinance in view of the addition of the new section 129A.
13. Clause 21 amends Schedule 1 to the Ordinance to include the class of special purpose business as a class of insurance business for the purposes of the Ordinance.
14. Clauses 5, 6, 9, 10, 14, 16, 17, 18, 22 and 23 amend the references in certain existing provisions of the Ordinance as a consequence of the authorization of special purpose insurers to carry on special purpose business under the Ordinance.

### **Part 3—Amendments Relating to Captive Insurers**

15. Clause 24 amends the meaning of *captive insurer* in section 2(7) of the Ordinance to widen the scope of insurable risks of a captive insurer. The clause also adds a new definition of *relevant company's corporate group* for the purpose of interpreting the amended meaning of *captive insurer*.

### **Part 4—Amendment Relating to Non-delegable Functions of Insurance Authority**

16. Clause 25 remove a non-delegable function of the Authority specified in Schedule 1D to the Ordinance to enable the function to be carried out more effectively.

### **Part 5—Miscellaneous Amendments**

17. Clauses 26 to 32 make certain minor textual amendments to certain existing provisions of the Ordinance.



## **Financial and Economic Implications of the Proposal**

### **Financial Implications**

The Inland Revenue Ordinance (Cap. 112) (“IRO”) has provided 50% tax concessions for profits from the captive insurance business in Hong Kong. The proposed expansion of the scope of insurable risks of captive insurers set up in Hong Kong may attract new captive insurance business to Hong Kong which will be subject to the same half-rate profits tax treatment under the IRO. If new captive insurance businesses can be brought to Hong Kong and make profits, they would generate additional tax revenue despite the prevailing tax incentive for captive insurers under the IRO.

### **Economic Implications**

2. The proposal can create new business opportunities for the insurance sector and generate demand for related professional services including accounting, actuarial and legal services. This would help consolidate Hong Kong’s role as an international risk management hub and enhance our competitiveness as an international financial centre.