

## Hong Kong: The enactment of the Insurance (Amendment) Ordinance 2023 on 6 July 2023

### In brief

On 6 July 2023, the Insurance (Amendment) Ordinance 2023 ("**Amendment Ordinance**") was enacted by the Legislative Council which provides the legal basis for the implementation of the risk-based capital ("**RBC**") regime for the insurance industry in Hong Kong.

The RBC regime is targeted for implementation in 2024. Prior to its implementation, it is expected that the Insurance Authority of Hong Kong ("**IA**") will further consult the insurance industry on the detailed rules and technical requirements of the RBC regime. Based on the conclusions of the consultation, it is expected that new subsidiary legislation(s) will be promulgated to set out the detailed rules and technical requirements of the RBC regime.

Upon implementation of the RBC regime, it is proposed that insurers should be allowed to comply with the requirements relating to capital and disclosure under the RBC regime on a progressive basis. Such transitional provisions for compliance with the requirements will be prescribed by the IA by way of subsidiary legislation. We will monitor updates on the promulgation of the subsidiary legislation(s).

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### In more detail

#### The Amendment Ordinance

The Amendment Ordinance amends the Insurance Ordinance (Cap. 41) ("**IO**") and other relevant legislations including the Inland Revenue Ordinance (Cap. 112) and the Companies Ordinance (Cap. 622).

The main provisions of the Amendment Ordinance are the amendments to the IO made for implementing the RBC regime, which include providing the legal basis for implementing the Pillar 1 and Pillar 3 requirements under the RBC regime, removing or updating certain obsolete provisions, and empowering the IA to prescribe the detailed requirements by way of subsidiary legislation.

Other than the amendments relating to the RBC regime, there are also other key amendments to the IO relating to maintenance and separation of funds and accounts, approval of shareholder controllers, designation of non-Hong Kong insurers, appointment of actuary and submission of actuarial reports for general insurers and regulatory intervention powers of the IA.

This client alert will focus on the amendments to the IO relating to the RBC regime. For completeness, we will also touch on the other key amendments to the IO unrelated to the RBC regime. Amendments to the other relevant legislations, outside of the IO, will not be covered in this client alert but if you would like to obtain the relevant information, please liaise with your usual contact at Baker McKenzie or the lawyers listed in this client alert.

#### The RBC regime

##### Basis of the RBC regime

The RBC regime is modelled on the Insurance Core Principles on capital adequacy issued by the International Association of Insurance Supervisors ("**IAIS**") in 2011, which prescribe principles for a risk-based framework to fully reflect the risk profile of individual insurers as the international insurance regulatory standards for capital adequacy requirements.

Prior to the implementation of the Amendment Ordinance, insurers in Hong Kong are subject to a rule-based capital adequacy regime under the IO, which assesses an insurer's capital adequacy based on whether the value of the assets of the insurer exceeds the value of its liabilities by the required margin of solvency. Under the RBC regime, an insurer's capital adequacy is assessed with reference to the risk profile of the underwritten business of the insurer.

### The three-pillar framework

Following the international standards for capital adequacy requirements prescribed by the IAIS, the RBC regime comprises three pillars (i.e., Pillar 1, Pillar 2 and Pillar 3), and each of the three pillars cover different aspects of the RBC regime.

The Amendment Ordinance provides the legal basis for Pillar 1 and Pillar 3, while Pillar 2 has been implemented with the issuance of the Guideline on Enterprise Risk Management ("**GL21**") by the IA, which took effect on 1 January 2020. The key conceptual features of the three pillars are summarized in the table below.

	Pillar 1	Pillar 2	Pillar 3
Focus	Quantitative assessment	Corporate governance and risk management	Disclosure
Key conceptual features	1. <b>Total balance sheet approach</b> for assessing capital adequacy	1. <b>Enterprise risk management ("ERM") framework</b> for identifying, assessing, measuring, monitoring, controlling and mitigating risks for solvency purposes	1. <b>Disclosure of insurers' information to the public</b>
	2. <b>Prescribed capital requirement ("PCR") and minimum capital requirement ("MCR")</b> as two solvency control levels	2. <b>Own risk and solvency assessment ("ORSA")</b> for assessing the adequacy of the ERM framework and the current and future solvency position of the insurers	2. <b>Submission of information by the insurers to the IA</b>
	3. <b>Methodology for determining PCR and MCR</b>	3. <b>Principle of proportionality</b> apply based on the insurers' business nature, scale and complexity	
	4. <b>Tiering approach</b> for categorising capital resources	4. <b>Capital add-ons<sup>1</sup></b> (i.e., additional capital requirement) imposed by the IA on insurers where there is weakness or inadequacy in the ERM framework or ORSA process	

### Pillar 1 and Pillar 3

For the purpose of this client alert, we will focus on the requirements under Pillar 1 and Pillar 3 and we will set out brief details of each of the key conceptual features of Pillar 1 and Pillar 3 in the table below, based solely on the conclusions of the previous consultations conducted prior to the enactment of the Amendment Ordinance<sup>2</sup>. It is expected that the detailed requirements for Pillar 1 and Pillar 3 will be subject to further industry consultation to be conducted by the IA shortly after the enactment of the Amendment Ordinance. Based on the conclusions of the consultation, it is expected that new subsidiary legislation(s) will be promulgated to set out the detailed rules and technical requirements of each of the key conceptual features of Pillar 1 and Pillar 3.

For Pillar 2, the detailed requirements are set out in GL21, except that the details on the capital add-ons under Pillar 2 will be prescribed by the IA when the components of PCR, MCR and capital resources under Pillar 1 are established. If you would like to obtain information on the existing requirements under GL21, please liaise with your usual contact at Baker McKenzie or the lawyers listed in this client alert.

<sup>1</sup> Details on the capital add-ons under Pillar 2 will be prescribed by the IA when the components of PCR, MCR and capital resources under Pillar 1 are established.

<sup>2</sup> Initial public consultations on the proposed RBC framework for the Hong Kong insurance industry were conducted by the IA from September to December in 2014 and the consultation conclusions were published in September 2015. Further consultations were subsequently conducted until 2021.

Pillar 1 – Quantitative assessment			
Key conceptual features	Brief details	Relevant sections under the Amendment Ordinance	Remarks
1. <b>Total balance sheet approach</b> for assessing capital adequacy	<p>The required capital and capital resources of an insurer are determined on the basis of a consistent valuation of its assets and liabilities, with due regard to the risks inherent in the assets and liabilities. In doing so, all quantifiable risks associated with the insurer's assets and liabilities are explicitly factored into determining the required capital and capital resources.</p> <p>Valuation on consistent bases means that differences in the values of assets and liabilities can be explained in terms of the differences in the nature of the cash flows (including their timing, amount and inherent uncertainty), rather than differences in methodology and assumption.</p>	Not specified	Detailed requirements will be prescribed by the IA by way of subsidiary legislation.
2. <b>PCR and MCR</b> as two solvency control levels	<p>In lieu of the existing rule-based capital requirements, an insurer's capital resources are required to meet two solvency control levels, i.e., PCR and MCR.</p> <p>When the insurer's capital resources are lower than either one or both of these solvency control levels and the insurer has not taken appropriate remedial measures, the IA will take appropriate intervention and follow-up action.</p>	Not specified	Detailed requirements on the asset levels and valuation method for PCR and MCR will be prescribed by the IA by way of subsidiary legislation.
3. <b>Methodology for determining PCR and MCR</b>	<p>PCR will be expressed in probabilistic terms, based on a value-at-risk measure at a confidence level of 99.5% over a one-year period.</p> <p>Value-at-risk measures the worst expected loss under normal conditions over a specific time interval at a given confidence level.</p> <p>This would mean that an insurer's PCR would be the amount of capital resources required to be at a 99.5% confidence level (i.e., under a 1-in-200-year event) of having non-negative net assets at the end of a one-year time horizon.</p> <p>The minimum categories of risk to be captured include underwriting risk, credit risk, market risk and operational risk. In the initial stage, a standardized approach will be adopted by all insurers to produce their PCR target at the value-at-risk level. Flexibility is retained for using internal models by individual insurers, subject to the IA's approval.</p> <p>For the determination of MCR, there are no proposed details yet.</p>	Not specified	Detailed requirements on the asset levels and valuation method for PCR and MCR will be prescribed by the IA by way of subsidiary legislation.
4. <b>Tiering approach</b> for categorising capital resources	<p>Under the tiering approach, capital resources will be categorised into different classes of tiers based on quality by reference to, for example, its ability to absorb losses on going-concern basis and wind-up basis. For each category, certain limits or restrictions will be applied.</p>	Not specified	Detailed requirements will be prescribed by the IA by way of subsidiary legislation.

Pillar 3 – Disclosure			
Key conceptual features	Brief details	Relevant sections under the Amendment Ordinance	Remarks
1. <b>Disclosure of insurers' information to the public</b>	<p>In addition to the statutory reporting requirements to the IA, insurers are required to disclose to the public information about their (i) risk assessments; (ii) capital resources and (iii) capital requirements in their published accounts.</p> <p>Failure to do so is an offence under the IO and liable on conviction to a fine of HK\$200,000; and in the case of a continuing offence, to a further fine of HK\$1,000 for each day during which the offence continues.</p>	Section 37 (adding a new section 21A to the IO)	Detailed requirements on the information that the insurer must disclose to the public, and how and when the information must be disclosed will be prescribed by the IA by way of subsidiary legislation.
2. <b>Submission of information by the insurers to the IA</b>	<p>An insurer is required to report to the IA any information relevant to the compliance with the capital requirements for the insurer (including requirements as to how and when such a report must be made).</p> <p>Failure to do so is an offence under the IO and liable on conviction on indictment to a fine of HK\$200,000; and in the case of a continuing offence, to a further fine of HK\$5,000 for each day during which the offence continues.</p>	Section 11 of the Amendment Ordinance (adding a new section 13AA to the IO)	Detailed requirements will be prescribed by the IA by way of subsidiary legislation.
	<p>The IA may serve a written notice on an insurer requiring the insurer to submit to the IA (i) a plan for restoring the insurer to a sound financial position, if the IA is of the opinion that the amount of capital of the insurer is less than the PCR for the insurer or is at risk of becoming less than the PCR for the insurer; or (ii) a short term financial scheme, if the IA is of the opinion that the amount of capital of the insurer is less than the MCR for the insurer or is at risk of becoming less than the MCR for the insurer.</p>	Section 55 (amending section 35AA of the IO)	Nil

## Other key amendments

Other than the above provisions relating to the RBC regime, the Amendment Ordinance has also introduced other key amendments to the IO which insurers should take note of and these are summarized in the table below.

Other key amendments	Requirements applicable to long term insurers	Requirements applicable to general insurers	Relevant sections under the Amendment Ordinance
1. <b>Maintenance and separation of funds and accounts</b>	<ul style="list-style-type: none"> <li><b>Separate funds for Class C, Class G, Class H and specified business:</b> under the IO prior to the enactment of the Amendment Ordinance, long term insurers are required to maintain separate funds and accounts for each class of long term insurance business.</li> </ul>	Not applicable	Section 38 (adding a new section 21B to the IO)

Other key amendments	Requirements applicable to long term insurers	Requirements applicable to general insurers	Relevant sections under the Amendment Ordinance
	<p>Following the enactment of the Amendment Ordinance, separation of funds and accounts are only required for Class C (linked long term), Class G (retirement scheme management category I), Class H (retirement scheme management category II) and the remaining classes of long term business (i.e., Class A, Class B, Class D, Class E, Class F and Class I) which are referred to as "specified business" under the Amendment Ordinance.</p> <ul style="list-style-type: none"> <li>• <b>Separate sub-funds and accounts for participating business:</b> at least one separate account and one separate sub-fund for the part of the specified business that is participating (i.e., with profits) business must be maintained by long term insurers.</li> <li>• <b>Separate funds for onshore and offshore reinsurance business:</b> certain insurers that are not Hong Kong incorporated (other than designated insurers and subject to certain exemptions and elections under the IO) must, in respect of their insurance business carried on in or from Hong Kong, maintain a separate account and fund in relation to their reinsurance business with offshore risk.</li> </ul>	<p>Not applicable</p>	<p>Section 38 (adding a new section 21B to the IO)</p> <p>Section 38 (adding a new section 21B to the IO) <i>in respect of long term reinsurance business</i></p> <p>Section 44 (adding a new section 25AA to the IO) <i>in respect of general reinsurance business</i></p>
<p>1. <b>Approval of shareholder controllers</b></p>	<p>In respect of a Hong Kong incorporated insurer and a designated insurer (that is not a special purpose insurer), a person will require the IA's prior approval to become:</p> <p>(i) a majority shareholder controller (i.e., with entitlement to exercise or control the exercise of 50% or more of the voting power at a general meeting of the insurer), regardless of whether the person is a minority shareholder controller of the insurer before becoming such a majority shareholder controller; and</p> <p>(ii) a minority shareholder controller (i.e., with entitlement to exercise or control the exercise of 15% or more but less than 50% of the voting power at a general meeting of the insurer), unless immediately before becoming a minority shareholder, the person was a majority shareholder controller of the insurer.</p> <p>The forms and manner of submission in relation to the above set out in Schedules 2, 4, 5 and 6 to the IO will be repealed. The new forms and manner of submission are yet to be prescribed.</p>		<p>Section 18 (amending section 13B of the IO)</p>
<p>2. <b>Designation of non-Hong Kong insurers</b></p>	<p>Non-Hong Kong insurers (i.e., insurers that are not incorporated in Hong Kong) that carry on the majority of their insurance business in or from Hong Kong may be designated by the IA as "designated insurers" under the IO and made subject to the same regulatory regime that applies to Hong Kong incorporated insurers including valuation, capital and funds requirements, and requirements on approval of directors, controllers and other key persons of the insurers.</p>		<p>Section 4 (adding a new section 3B to the IO)</p>
<p>3. <b>Notification of changes in particulars</b></p>	<p>Prior to the enactment of the Amendment Ordinance, it is unclear under the IO on what types of changes in particulars referred to in an application for authorization or changes in particulars in relation to directors, controllers and other key persons should be notified to the IA. The Amendment Ordinance provides that "particulars falling within a type of particulars set out in a form specified by the IA" will have to be notified to the IA and the IA can amend those particulars from time to time.</p>		<p>Section 21 of the Amendment Ordinance (amending section 14 of the IO)</p>

Other key amendments	Requirements applicable to long term insurers	Requirements applicable to general insurers	Relevant sections under the Amendment Ordinance
<p>4. <b>Appointment of actuary and submission of actuarial reports for general insurers</b></p>	<p>Not applicable</p>	<p>Prior to the enactment of the Amendment Ordinance, under the IO, only long term insurers are required to appoint qualified actuaries approved by the IA for carrying out valuation and submit actuarial reports on a regular basis to the IA. Under the Amendment Ordinance, this requirement has been extended to general insurers.</p>	<p>Section 24 (adding new sections 15AAA and 15AAAB to the IO) Section 35 (adding a new section 18A to the IO)</p>
<p>5. <b>Regulatory intervention powers of the IA</b></p>	<p>Certain powers of the IA may now also be exercised if the IA is of the opinion that doing so is "desirable for mitigating or controlling the risks posed to or by the business of the insurer".</p> <p>Such powers include the power to require submission of reports (<i>see Section 52 of the Amendment Ordinance, adding a new section 32A to the IO</i>), the power to order actuarial investigations (<i>see Section 51 of the Amendment Ordinance, amending section 32 of the IO</i>), the power to accelerate submission of information (<i>see Section 53 of the Amendment Ordinance, amending section 33 of the IO</i>), and the power to obtain information and require production of documents (<i>see Section 34 of the IO</i>).</p> <p>The IA may require an insurer to provide the IA with a report on any matter that relates to the insurer or the IA may appoint a person with requisite skills to provide the IA with such report.</p>	<p>The IA may require general insurers to submit actuarial investigation reports.</p>	<p>Section 48 (amending section 26 of the IO)</p> <p>Section 52 (adding a new section 32A to the IO)</p> <p>Section 51 (amending section 32 of the IO)</p>

If you have any questions on any information set out in this client alert, please liaise with your usual contact at Baker McKenzie or the lawyers listed in this client alert.

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