Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By e-mail < ppf_consultation@fstb.gov.hk > and by post

29 June 2011

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Special Duties Division, Financial Services Branch
Financial Services and the Treasury Bureau
18/F, Tower I, Admiralty Centre
18, Harcourt Road
Hong Kong

Dear Sirs,

Consultation Paper on Proposed Establishment of a Policyholders' Protection Fund

The Hong Kong Institute of Certified Public Accountants ("the Institute") has considered the consultation paper on the above subject, which makes recommendations for the establishment of a Policyholders' Protection Fund ("PPF") to provide a safety net for policyholders against insurer insolvency.

In principle, the Institute supports the proposal for the establishment of a PPF to provide better protection for policyholders' interests and maintain market stability in the event of an insurer's insolvency.

The Institute's comments on the specific aspects of the proposed PPF contained in the consultation paper are set out below.

Initial target fund size of the Non-life Scheme

It is proposed that for the Non-Life Scheme, the initial target fund size should be HK$75 million (paragraph 4.9 of the consultation paper).

We note that in the event of an insurer insolvency, it is recommended that the PPF would meet claims arising from all covered policies up to a compensation limit of HK$1 million per claim. The PPF will also be allowed to pay up to HK$1 million per accident and health ("A&H") policy with guaranteed renewability to facilitate transfer of such policies to another insurer, and if a transfer cannot be arranged, it may pay the affected policyholders an "ex-gratia" payment of up to HK$1 million per policy (paragraphs 3.21 – 3.23 of the consultation paper). Under the proposals, A&H policies without guaranteed renewability will continue until expiry and be treated like non-life policies in the event of an insurer insolvency (paragraph 3.24).

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As the initial target fund size is proposed to be set at HK$75 million for the Non-Life Scheme, this means that the PPF would be able to meet only 75 non-life claims and/or payments in relation to A&H policies with guaranteed renewability, assuming the maximum level of compensation in each case.

While we appreciate that in determining the initial fund size, the government has taken into account a number of relevant factors, and the amount has been worked out on the basis of actuarial modelling, we still have some reservations as to whether the initial target fund size for the Non-Life Scheme, which is to be built up only over 15 years, is adequate, notwithstanding the proposal that the figure will be reviewed regularly (paragraph 4.10).

Asset recovery mechanism

It is recommended, as stated in paragraph 4.13, that when claimants are compensated by the PPF, the protected element of their claims (i.e. the part met by the PPF) should be subrogated to the PPF. It is further recommended, in paragraph 4.14, that the PPF should have equal ranking with the two classes of creditors specified in section 265 of the Companies Ordinance ("CO"), on preferential payments, i.e., the Employee Compensation Assistance Fund and all other direct insurance claims not met by the PPF.

It is noted that there are other existing compensation schemes providing protection against insurer insolvency in Hong Kong, e.g., the Insolvency Fund Scheme administered by the Motor Insurers' Bureau of Hong Kong, which provides insolvency protection in relation to motor vehicle policies and the Employees Compensation Insurer Insolvency Scheme, administered by the Employees Compensation Insurer Insolvency Bureau ("ECIIB"), which provides insolvency protection in relation to employee compensation policies. However, not all of these funds are paid in priority to other creditors under section 265 of the CO in the event of an insurer insolvency, where they have compensated the policyholder. Under the ECIIB's agreement with the government, for example, it is expressly stated (clause 7(f)) that where the ECIIB has "an entitlement against the estate of the [insolvent] Insurer, ECIIB shall only rank as an ordinary, non-preferential creditor against that estate". There is, arguably, some inconsistency, therefore, if the PPF is to be a preferential creditor, under section 265, for the subrogated rights of policyholders that the PPF has compensated.

Governance arrangements

It is stated in paragraph 5.5 that an annual report (including the audited statement of accounts) for both the Life Scheme and the Non-Life Scheme of the PPF should be published and laid before the Legislative Council. In addition, it is recommended that the financial secretary should have the power to appoint the director of audit or an external auditor to perform audit reviews on the PPF.

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In this respect, we recommend that the relevant legislation should state clearly the responsibility for the preparation of the statement of accounts (including what constitutes the statement of accounts of the PPF and the basis of preparation) and the reporting requirements of the auditor (e.g. the type of opinion, reporting timeframe, etc). For example, under section 19 of the Deposit Protection Scheme Ordinance (Cap 581), the auditor is required to state whether, in his opinion, the statement of accounts of the Deposit Protection Scheme Fund gives a true and fair view of the matters to which the statement of accounts relates.

We hope that you find our comments to be helpful. Should you have any questions on this submission, please feel free to contact me at the Institute on 2287 7084.

Yours faithfully,

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