GROUP CAPITAL REQUIREMENTS APPLICABLE TO A DESIGNATED INSURANCE HOLDING COMPANY UNDER THE HONG KONG INSURANCE GROUP-WIDE SUPERVISION FRAMEWORK.

The Insurance (Amendment) (No. 2) Ordinance 2020 ("**Amendment Ordinance**"), here, amended the Insurance Ordinance to provide for the regulation and supervision of insurance groups by the Insurance Authority ("**IA**") through exercising direct regulatory powers over their Hong Kong-incorporated holding companies. The group-wide supervision framework in Hong Kong commenced on 29 March 2021. See our client briefing "*Hong Kong Insurance Group-Wide Supervision Framework to Commence on 29 March 2021*" here.

Together with the Amendment Ordinance, the Insurance (Group Capital) Rules (the "**Rules**") applicable to such holding companies also took effect on 29 March 2021. In this briefing we will take a closer look at those Rules

Key issues

- The Rules set out the group capital requirements applicable to a designated insurance holding company, including the minimum amount of capital that the group must maintain and the types, tiering and amounts of capital resources that are eligible to be counted
- The Rules also impose supervisory reporting and public disclosure requirements on such companies
- There are currently no capital requirements for solo insurance companies

BACKGROUND

Prior to the Amendment Ordinance, the powers and functions of the IA were limited to the regulation of companies as "single entities" carrying on insurance business in or from Hong Kong ("**authorized insurers**"). In many cases, authorized insurers are subsidiary companies within a wider group of companies, where decisions relating to risk management and control functions and other significant management and policy decisions are often carried out at the group level. The Amendment Ordinance provides the IA with direct regulatory powers over the holding companies of the authorized insurers it regulates, allowing it to effectively conduct group-wide supervision.

DESIGNATED INSURANCE HOLDING COMPANIES

The government has introduced a framework for the designation of insurance holding companies under which the IA will be able to exercise direct regulatory powers on Hong Kong-incorporated insurance holding companies. The IA may, by notice published in the Gazette, designate a Hong Kong-incorporated insurance holding company of an authorized insurer that belongs to an insurance group as a designated insurance holding company ("**DIHC**"), provided the IA is the appointed group-wide supervisor of the insurance group and that the IA considers it appropriate to do so. The holding company, which may not have any insurance business, does not itself need to be an authorized insurance company to be a DIHC.

INSURANCE (GROUP CAPITAL) RULES

In summary, the Rules set out the group capital requirements applicable to a DIHC. This includes the minimum amount of capital that the group must maintain, the types, tiering and amounts of capital resources of the group that are eligible to be counted and supervisory reporting and public disclosure requirements for a DIHC.

Group capital adequacy requirements

Capital requirements are applicable to a DIHC in relation to its supervised group and consist of two tiers, a group minimum capital requirement (the "**GMCR**") and a group prescribed capital requirement (the "**GPCR**"). The GMCR and GPCR will be the sum of the regulatory minimum capital requirements and prescribed capital requirements, respectively, which apply to each of the regulated entities in the insurance group in the jurisdictions in which they carry on their business.

Eligible group capital resources and tiering

Only eligible group capital resources may be counted towards group capital adequacy requirements. Eligible group capital resources are calculated as the sum of the eligible capital resources of each entity in the insurance group. For regulated entities, eligibility is based on whether such entity can count the capital resource towards meeting its minimum or prescribed capital requirement in the jurisdiction where it carries on its business. For non-regulated entities, eligible group capital resources consist of financial instruments or resources which are either classified as equity or otherwise satisfy the criteria as set out in Schedule 1 and 2 of the Rules (though eligible group capital resources of non-regulated entities are subject to a cap of 10 per cent. of the GMCR). Adjustment mechanisms to the GMCR, the GPCR or eligible group capital resources are further prescribed by the Rules to avoid double-counting.

The Rules further set out the tiering of eligible group capital resources into tier 1 and tier 2 group capital. The Rules require the DIHC to ensure, in relation to its insurance group, that tier 1 group capital must at all times not be lower than the GMCR, and the sum of tier 1 and tier 2 group capital must at all times not be lower than the GPCR. Criteria for tier 1 and tier 2 group capital are set out in Schedule 1 and 2 of the Rules, respectively. The Rules also provide transitional arrangements for any potential grandfathering of financial instruments issued before the commencement date of the Rules.

Supervisory reporting and public disclosure requirements

The Rules further require a DIHC to prepare annual group capital adequacy reports and to report to the IA significant events relating to its insurance group, each in accordance with the requirements prescribed by the Rules. Finally, the Rules also require certain other information to be publicly disclosed by a DIHC on its website within 5 months after its financial year-end.

Structural subordination

- The recognition of structurally subordinated instruments for tier 2 group capital was a topic that attracted attention in the consultation process. Though conceding that this is an evolving area, the IA ultimately allowed for the recognition of structurally subordinated instruments as eligible tier 2 group capital, though such recognition is be subject to prior approval by the IA as guided by the principles established by the International Association of Insurance Supervisors (**IAIS**) and the Rules.
- The Rules define "structural subordination" with specific reference to the IAIS principles and primarily target subordination achieved by issuance structures whereby the proceeds from the issuance of an instrument by an upstream holding entity (including, but not limited to, the ultimate holding company) are downstreamed into an entity in the same insurance group. This means that, in the event of a winding-up of the downstream entity, any claims by holders would be subordinated to the claims of the creditors (including policyholders) of the downstream entity.

Potential Impact on Solo Insurance Companies

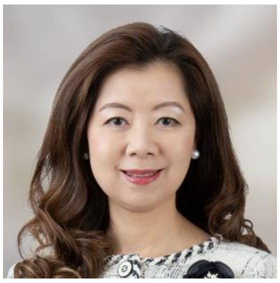
The Rules only apply to DIHCs, which at present comprise a limited number of entities. There are currently no capital requirements for solo insurance companies but, if these were to be introduced in time, we anticipate that the Rules would have a guiding influence on any such broader regulation.

CONTACTS

Financial Services Regulatory / Corporate

Mark Shipman
Partner

T +852 2825 8992
E mark.shipman@cliffordchance.com



Amy Ho
Partner

T +852 2825 8993
E amy.ho@cliffordchance.com

Rocky Mui
Partner

T +852 2826 3481
E rocky.mui@cliffordchance.com

Litigation

Donna Wacker
Partner

T +852 2826 3478
E donna.wacker@cliffordchance.com

William Wong
Consultant

T +852 2826 3588
E william.wong@cliffordchance.com

Global Financial Markets

Mark Chan
Partner

T +852 2826 3424
E mark.chan@cliffordchance.com

Matt Fairclough
Partner

T +44 207006 1717
E matt.fairclough@cliffordchance.com

Malini Budhwani
Professional Support Lawyer

T + 852 2826 2483
E malini.budhwani@cliffordchance.com

Jeffery Hung
Senior Associate

T +44 207006 2700
E jeffery.hung@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 27th Floor, Jardine House, One Connaught Place, Hong Kong

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