Entry and exit solutions as deal activity rebounds in Hong Kong's insurance market

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Introduction and Context

The Special Administrative Region of Hong Kong remains the most attractive gateway for insurers expanding both into and out of Mainland China. It plays host to many of the largest insurance companies from Europe, America, Mainland China, Japan and Australia.

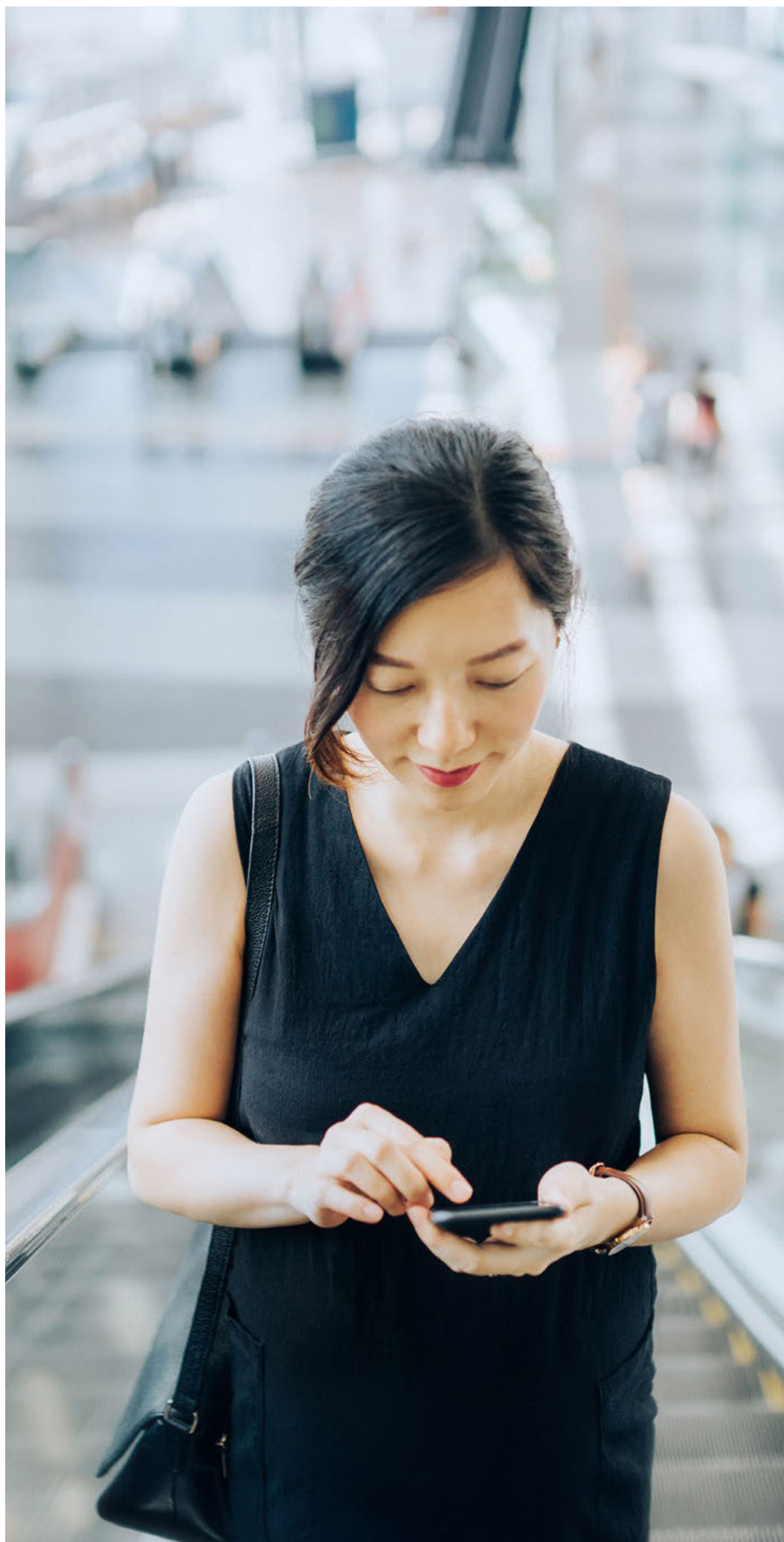
Hong Kong's Insurance Authority (HKIA) became an independent government agency in 2017.

This modernisation not only put the HKIA on a path to becoming a world class, fully IAIS-compliant regulator, but also resulted in its commitment to promote and support the growth of Hong Kong as a leading international insurance and reinsurance market. The future looks bright as Hong Kong gears up to be a key part of the Greater Bay Area, with policy incentives promised for insurance companies. These include proposals to allow Hong Kong insurers to establish service centres in the Mainland cities of the GBA as a means to enhance financial connectivity.

If successful, this would help Hong Kong insurers to facilitate cross-boundary after-sales services in the Mainland GBA, such as premium payment processing and claims handling. At the same time, Hong Kong is seeking to become Asia's premier risk management and reinsurance hub and has recently established new regulations to attract both captives and ILS to Hong Kong. This is in part directed at attracting business from China's Belt and Road Initiative. The HKIA is also doing its utmost to make Hong Kong a destination of choice for both global and regional insurance head offices.

Exit Solutions

So why would anyone want to leave the party? Over the past 20 years, Hong Kong has seen a degree of consolidation, with locally authorised insurers dropping from 202 to 163 since 2002. Yet the market here is still crowded and insurers are facing up to the business pressures of competition, COVID-19, low interest rates, the increasing compliance burden from the likes of IFRS 17 (coming in 2023) and a fully IAIS-compliant RBC framework (expected in 2024), as well as the increased capital strain that this may bring. There are also some insurance groups here with more than one company holding a Hong Kong insurance licence. These would ideally like to rationalise to a single licenced entity in order to reduce compliance costs. There are also global pressures on some life and GI companies to strategically refocus on core business and rationalise their portfolios. Partial disposals and portfolio transfers are therefore on the cards. In fact, some large exits are pending for both life and GI insurers, either in their entirety or in relation to significant portfolios.



Entry/expansion opportunities

While some players are looking to exit, many are looking to acquire and grow. In fact, we are aware of a long list of insurers looking for the right opportunity to enter Hong Kong's insurance market. The list of acquisition-hungry parties includes insurers/reinsurers looking to either establish a presence in Hong Kong or expand their existing business, as well as international run-off specialists looking to capitalise on the returns available from an efficiently managed run-off. We are also seeing acquisition interest from investment funds, as well as from Chinese conglomerates who have international referral business waiting for the right home. Hong Kong can also be attractive to Chinese insurance groups, as the territory has no currency convertibility or remittance restrictions, such as those present on the Mainland.

How to conduct an orderly deal/entry/exit in Hong Kong

Broadly speaking, if an insurer wants to exit the Hong Kong market, it has the following options:

1. Outright sale of the company itself
2. Portfolio transfer under the relevant statutory instrument
3. Run-off
4. Accelerated run-off

Those entering the market can seek to be on the acquisition side of points 1 and 2 above or may consider a greenfield market entry.

Whichever route is taken, early and regular contact with the HKIA is a key ingredient for success.

Greenfield market entry

A new insurance licence application in Hong Kong needs to be supported by a viable and well thought out business proposal, supported by comprehensive analyses, including feasibility study; business plan; details of systems, controls and governance; evidence that key personnel will meet the fit and proper requirements; as well as detailed financial information. Typically, applicants work closely with their HKIA case officer to get their draft application forms to the necessary standard, prior to formal submission of the final application to the HKIA, and subsequent approval by the relevant HKIA Executive Director, the CEO and ultimately the HKIA Board. This can be a lengthy process, depending on the quality of submission and project management by the applicant, as well as how long it takes to discharge any concerns which the regulator may raise. We have often seen situations where clients come to us with unrealistic expectations in terms of how long it may take to obtain a new licence. This is often as a result of being misinformed by parties not 100% familiar with the local process – be prepared for a year-long process and sometimes longer.

As Hong Kong seeks to become Asia's premier risk management and reinsurance hub it has established new regulations to attract both captives and ILS to Hong Kong. This is directed at attracting business from multiple geographies, including both the Mainland and Belt and Road territories. The HKIA offers a number of regulatory concessions for captives, including reduced capital, solvency and asset localisation requirements, as well as a favourable tax regime.

Outright purchase/sale of a licenced insurance company

For those who do not already possess a licence to write business in Hong Kong, buying an entire insurance company enables the acquisition of a portfolio, together with the opportunity for the acquirer to execute its own growth strategy. We have also seen entire smaller GI entities being acquired as a route to enter the Hong Kong market on the basis that an existing licence offers a quicker, cheaper and potentially more certain route to market entry than a new licence application. It goes without saying that a Hong Kong branch of an overseas company may not be sold on a stand-alone basis in Hong Kong (as the entire company, of which the branch is a part, would need to be bought/sold to effect such a transaction).

The process of gaining regulatory approval for a "change in controllership" of a company comes with a regulatory approval process not dissimilar to a new licence application and can take over a year for both life and GI companies. However, where an entire group is being acquired globally, and the Hong Kong company forms just part of this group, the HKIA may be able to place some reliance on the group regulator and, as a result, the Hong Kong approval process can be somewhat simplified.

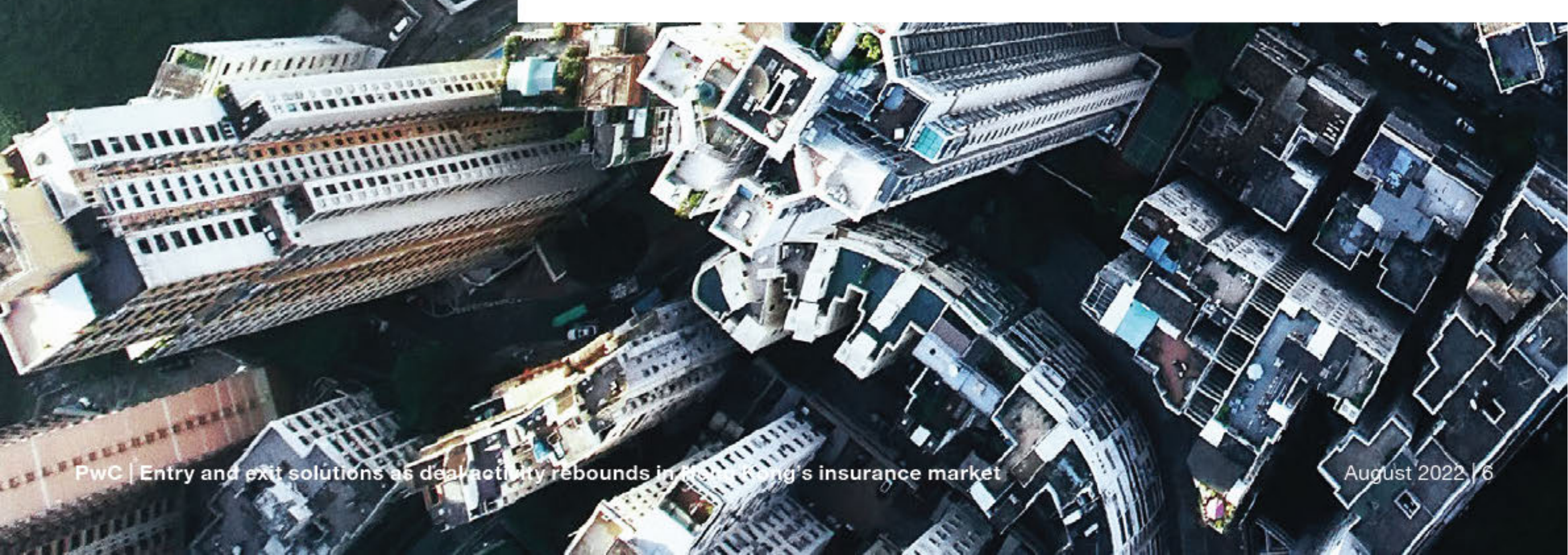
Portfolio transfer under the relevant statutory instrument

Where an acquirer already has an insurance licence in Hong Kong, there may be benefits in acquiring a book of business via portfolio transfer rather than the outright purchase of the licenced insurance company (as discussed above). It is generally a lot quicker and easier to acquire a GI book via a portfolio transfer than is the case for a life insurer.

For GI portfolios, the transfer process takes several months and requires detailed planning. On the plus side the necessary procedure is well documented, does not require court assent, and is relatively straightforward. Issues of interest include the cut-across date of new business from the transferor to the transferee, for which there are two broad options: either the date when the transferor gives notice of the transfer, or the date on which the notice period expires.

To facilitate approval of a GI portfolio transfer it is important to ensure the prerequisites set out in section 25D are strictly complied with. This includes producing a report setting out the particulars of the transfer and publishing a notice in the Gazette and relevant English and Chinese language newspapers giving notice of the transfer application to the IA, as well as notices to the affected policyholders to afford them the opportunity to inspect the report. Thorough and careful planning in advance will make the process straightforward."

Tow Liu Lim – Partner, Mayer Brown Hong Kong

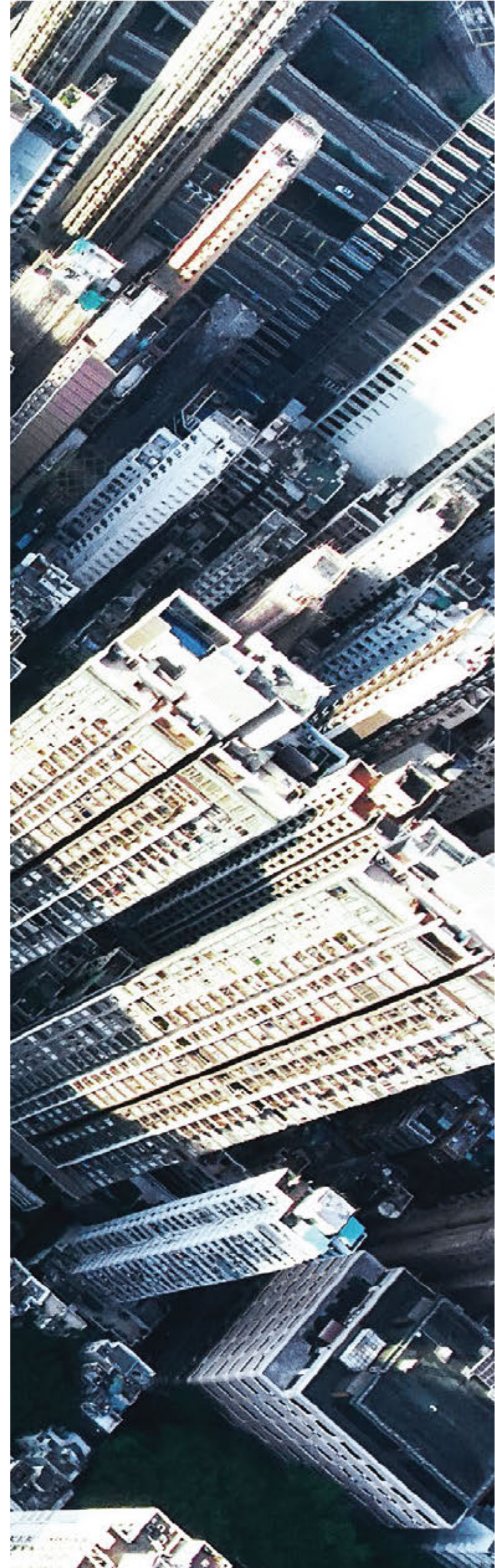


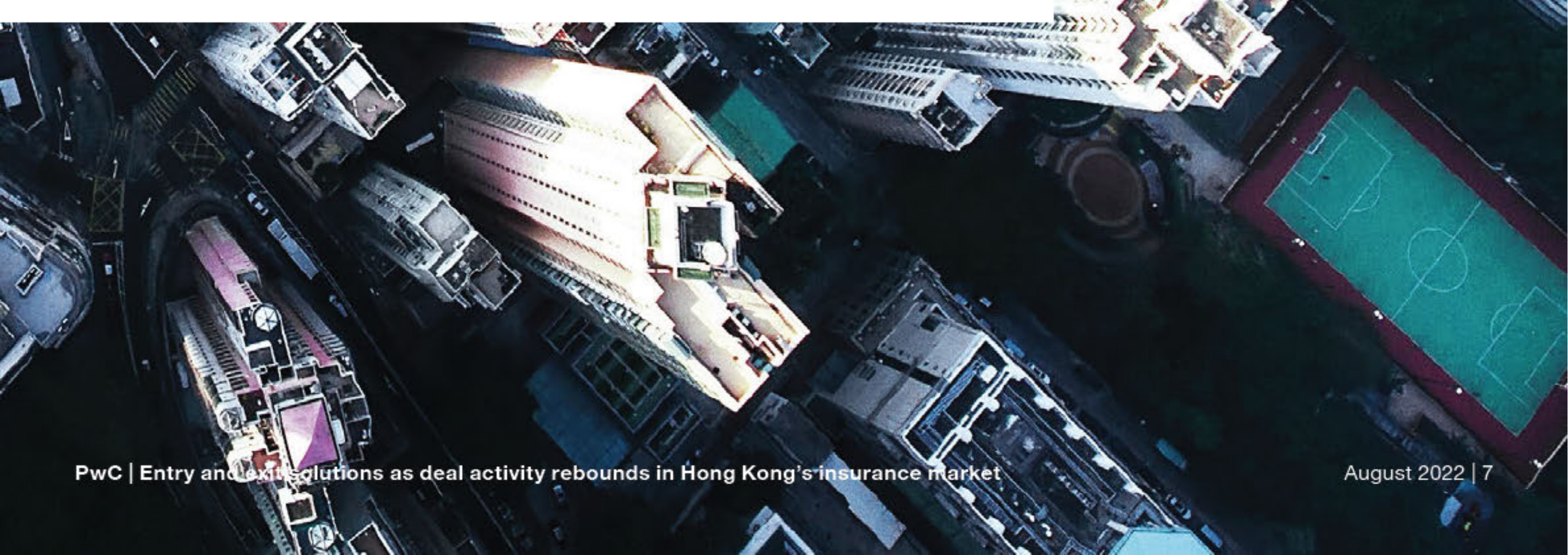
For life portfolios, the portfolio transfer process requires court sanction, is far more complicated, and may take anything from a period of twelve months to several years. There are particular separation challenges for Hong Kong branches of overseas companies, including issues around the equitable allocation of par (with profits) funds. Where the Hong Kong insurer is a branch of an overseas company, court sanction may be required in the home jurisdiction. This process needs to be planned and run in parallel with the Hong Kong process, or risk a situation where the home regulator may rule out the proposed transaction altogether. There have been several examples in Hong Kong of locally domiciled life companies or branches of overseas groups attempting to exit their portfolio via a transaction to transfer it to a third party insurer. Some of these have failed, due to the challenges of resolving such transfers within typical deal time frames. As the court-sanctioned process for life business can take so long, the preferred approach is often to acquire a life insurance company as a whole, and then to rationalise the book at a later stage.

Like any other major transaction, key legal and regulatory execution risks needs to be meticulously planned for, managed and mitigated as much as possible – these include:

- Communication strategy with transferor and transferee policyholders;
- Anticipating and mitigating policyholders' concerns (including those of non-transferring policyholders);
- Dealing with frequently asked questions and objections;
- Anticipating and preparing for all relevant stakeholders (other than the policyholders) – i.e. the Insurance Authority, employees, shareholders, creditors".

Heng Loong Cheong – Partner, DLA Piper Hong Kong





Run-off

Sometimes there is no willing buyer for a company (or its portfolio) due either to a lack of critical mass in the business to justify a transaction or a lack of attractiveness in terms of the business portfolio being offered. Branches of overseas companies, in addition, sometimes face restrictions on the sale or transfer of their business from the regulator in their home jurisdiction. As a result, companies or branches of overseas groups based in Hong Kong may be faced with the need to cease underwriting ahead of running off their business. At the same time, consideration may be given as to whether it is feasible to sell the "renewal rights" to desirable portfolios.

In such situations, the name of the game is to drive an efficient and orderly run-off, preferably in an accelerated timeframe, while limiting expenses. At the same time, the minimum key people required by the Regulator need to be maintained, to meet the local reporting and other regulatory requirements without incident.

For these purposes, a local Chief Representative/CEO is always required. This may not in practice be a full-time job. The Regulator will, however, apply the same "fit and proper" requirements to these roles. This is why retired CEOs of active insurers (with an appropriate track record) often gravitate towards these positions. At PwC we have experience of fielding a partner as Chief Representative of an insurer in its final phases of closure.

Where there is a sizable portfolio to run-off, technology can play a role in the development and execution of the run-off plan.

Modern technologies, such as modular architecture and intelligent automation, are seeing wide applications in new business generation in insurance, but are scarcely applied in run-off scenarios. With these technologies gaining maturity and availability, at lower cost, the opportunity to apply modern toolkits to run-off blocks is now significantly greater. Applying the right technology would not only help insurers lower ongoing operating expenses, but also assist policyholders to receive higher quality of services and offer regulators greater peace of mind."

Greg Crichton – Joint Founder, Pace Solutions Limited (developers of proprietary technology to assist insurers in run-off)

Reinsurance can also play a role in de-risking a run-off, or even in monetizing the residual portfolio. Where this is contemplated, the local rules in GL 17 Guideline on Reinsurance need to be observed. This includes seeking written permission from the HKIA for reinsurance arrangements that involve significant risk transfer. Applications for such permission need to include full and frank disclosure of all material information in relation to the reinsurance, the purpose and main features of the arrangement, a credit assessment of the proposed reinsurer, and draft contract wording.

Once the final in-force policy has been discharged, the process to de-licence can begin, and typically takes several months to complete.

Before executing a run-off, it is important for the run-off candidate to present a run-off plan to the HKIA. The run-off plan may help to align expectations on matters such as the appropriate key people to remain locally employed in Hong Kong, as well as the plan for the repatriation of capital as the run-off progresses.

Accelerated run-off

When a portfolio is too small or insufficiently attractive to justify a transaction, there are other options available in Hong Kong to accelerate a run-off.

One way of doing this is via individual policy endorsement, which involves a series of individual agreements with policyholders to transfer their policies to another insurer. There is also the option to commute/early settle claims on a policy-by-policy basis (in the case of GI business), or to make a cash payment for a negotiated early surrender of each policy (for life cover). We have, however, sometimes seen insurers struggle with the execution of such approaches, for example where there are difficulties tracing policyholders on older programs. An insurer would be well advised to clear any large-scale programs of this nature in advance with the HKIA. The Hong Kong branches of overseas companies need to consider any restrictions on such measures imposed by the Regulator in their home jurisdiction.

Solvent schemes of arrangement are also an option in Hong Kong to achieve finality, but to date we have only seen insurance schemes applied in the case of insolvency. This is perhaps due to the fact that a scheme remains an expensive process more appropriate to situations with critical mass, in terms of the size of the book of business, to make them worthwhile.

In conclusion

Opportunities abound in the Hong Kong insurance market – we are seeing increasing deal appetite from both buyers and sellers. With Covid now BAU, deal activity is picking up pace against a backdrop of a suite of established entry, exit and expansion mechanisms overseen by a progressive regulator. Selecting the appropriate deal/entry/exit mechanism, as well as attending to the details of disentanglement, appropriately navigating the Laws and Regulations in Hong Kong and (most importantly) communicating effectively with the HKIA, will be essential to the timely success of each transaction.

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