

**Elaborations on Statutory Conduct Requirements
for Licensed Insurance Intermediaries
to be Prescribed by the Independent Insurance Authority**

Purpose

This paper seeks Members' comments on the proposed elaborations on certain statutory conduct requirements for licensed insurance intermediaries for consideration by the independent Insurance Authority ("IIA") when drawing up any code / guideline in future.

Background

2. New section 90 added by the Insurance Companies (Amendment) Ordinance 2015 ("Amendment Ordinance") sets out the conduct requirements that licensed insurance intermediaries should comply with when carrying on regulated activities.

3. In formulating the above conduct requirements during the legislative stage, reference was made to the regulatory regime for intermediaries under the Mandatory Provident Fund Schemes Ordinance ("MPFSO"), practices of other jurisdictions and the prevailing international standards, including those adopted by G20, the International Association of Insurance Supervisors and the European Union.

4. New section 95 added by the Amendment Ordinance provides that IIA may publish codes of conduct for giving licensed insurance intermediaries guidance relating to the practices and standards with which licensed insurance intermediaries are ordinarily expected to comply in carrying on regulated activities. New section 133 added by the Amendment Ordinance further provides that IIA may publish codes or guidelines that it considers appropriate for giving guidance in relation to the operation of a provision of this Ordinance. A code or guideline is

not subsidiary legislation and failure to comply with it does not by itself render the person concerned liable to any judicial or other proceedings.

5. We envisage that IIA will consult the industry before finalising any code or guideline. In an attempt to expedite the process, we have developed the attached draft to facilitate an early discussion over certain statutory conduct requirements with members of the Working Group. Without pre-empting the decision of IIA, we hope the document endorsed by the Working Group can be adopted by IIA for formal consultation with the industry at the next stage.

Proposed Clauses

6. When preparing the draft, references have been made to the existing conduct requirements for insurance intermediaries promulgated by the three Self-Regulatory Organisations, the Minimum Requirements for Insurance Brokers specified by the Insurance Authority and the conduct requirements adopted by other local and overseas financial regulators whenever appropriate.

Specific Areas of Concern

7. In view of the voluminous contents to be covered, as explained at previous meetings of the Working Group, we will discuss the conduct requirements in phases. In the first phase, we aim to seek Members' comments on the proposed clauses in three particular aspects i.e. the statutory conduct requirements on "best interests", information disclosure and suitability which had attracted much discussion during the legislative process.

8. It should be noted that the current draft only sets out some high-level wordings. Subject to Members' comments, further elaborations and examples in various areas would be required in later versions.

Advice sought

9. Members are invited to comment on the proposed elaborations on the statutory conduct requirements on “best interests”, information disclosure and suitability as set out in **Annex** of the paper. We will take into account Members’ comments in developing the draft.

Financial Services and the Treasury Bureau
23 June 2016

Best interests of clients**Section 90(a)**

When carrying on a regulated activity, a licensed insurance intermediary must act honestly, fairly, in the best interest of the policy holder concerned or the potential policy holder concerned, and with integrity.

- a. An insurance broker is obliged to act in the best interests of his client under agency law. An insurance agent should exert no undue influence on a policy holder or a potential policy holder because he should bear in mind his role as an advisor, not a persuader or enforcer.
- b. When assessing whether a licensee has complied with the best interest requirements, the Authority will consider whether a reasonable licensee would believe that the client is likely to be in a better position if the client follows the advice given by the licensee. The best interest requirements vary depending on the circumstances in which the advice is provided to the client including, but not limited to, the following:
 - the insurance products the licensee may offer;
 - the type and complexity of the insurance products;
 - capability of the client to understand the licensee's advice;
 - degree of the client's reliance on the licensee's advice;
 - impact of the act or omission of the licensee on the client; and
 - information provided before, during and after the point of sale.
- c. A licensee should ensure adequate provision of appropriate information to the client before, during and after the point of sale.
- d. A licensee should understand the client's circumstances and making reasonable enquiries about the client's circumstances.

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- e. A licensee should understand the insurance products offered.
- f. A licensee should give advice based on objective judgments. A licensee must use judgment objectively where a choice of insurers and insurance products is available to the licensee.
- g. A licensee must not advise client to replace, convert, cancel, surrender or allow to lapse any policy unless the intermediary can demonstrate that such action is in the best interests of the client.
- h. A licensee must make full and frank disclosure of any matters that may affect the client's decision.
- i. A licensee must afford the client reasonable time to consider the licensee's recommendation prior to the client making a decision to accept the recommendation.
- j. Before ceasing to be a licensee, a licensee must ensure that affected clients are promptly notified of the proposed cessation and that any business which remains outstanding is promptly completed.
- k. A licensee must not allow its or his other business interests, if any, to jeopardize its or his integrity, independence or competence.
- l. A licensee must not charge or accept any fee that is disproportionate to the service rendered to the client.

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Illustrative examples on best interests obligation

To beef up the document, an overseas example is set out below for seeking members' suggestions on some local examples that suit the local context.

Overseas Example :

An insurance agent is providing a client with a review of his life insurance policy, which currently sets a death benefit of \$1 million. The agent advises the client that they require additional cover of \$500,000. The agent recommends that the client obtain a new policy with benefit of \$1.5 million and then cancel the existing policy, rather than apply for additional cover within the existing policy. The terms of the life insurance policies and the annual premiums are the same.

The advice entitles the agent to a commission of 80% of the annual premium of the new insured amount of \$1.5 million rather than just the increased amount of \$500,000. The policyholder follows the advice on policy replacement.

The policyholder's existing policy is nearing the four year anniversary. If he had continued to hold his existing policy, including if they increased his level of coverage, they would have been entitled to a 5% increase in the level of cover at no extra cost.

Commentary:

In this situation, section 90(a) has been breached. The agent has given priority to maximising his remuneration over the interests of the client.

Information Disclosure

Section 90(e)

When carrying on a regulated activity, a licensed insurance intermediary must make the disclosure of information to the policy holder or the potential policy holder that is necessary for the policy holder or the potential policy holder to be sufficiently informed of the purpose of making any material decision.

Clear, accurate and relevant information

- a. A licensee must make adequate disclosure of clear, accurate and relevant information to the client that is necessary for the client to be sufficiently informed for the purpose of making any material decision and must not conceal any material facts.
- b. A licensee must provide information to the client timely and ensure the information provided is clear, fair and not misleading.

Information about the intermediary and its or his appointing principal(s)

- c. A licensee must provide appropriate information about the intermediary and its or his appointing principal(s) (e.g. name, licence type, nature of business, services available to clients and contact details). Specific requirements include:
 - A licensee must disclose its or his licence number if so requested and must identify the licence number on its or his business cards if distributed. For a licensed TR(Agent) engaging in Restricted Scope Travel Business, he must also display his name and licence number on the name plate put in front of the service desk or counter if he provides face-to-face insurance service at the service desk or counter.
 - A licensee must disclose the range of insurance products that it or he may offer.

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- Where the appointing principal of a TR(Broker) or its related company is a licensed person under the Securities and Futures Ordinance (Cap. 571), the TR(Broker) must ensure that there is no confusion created to the client as to the services he provides and the principal for which he is acting.
- A licensed individual insurance agent, insurance agency, TR(Agent) and TR(Broker) must properly disclose its or his appointing principal(s).
- A licensee should adequately disclose its or his capacity where the client is referred by another person to the licensee.
- For a licensed insurance broker company, the client agreement must contain minimum contents specified by the Authority.

Information about insurer(s) recommended / represented

- d. A licensee must provide appropriate information about the insurer(s) recommended / represented. Specific requirements include:
- A licensee must disclose the correct name and legal status of the insurer(s) recommended / represented.
 - A licensed insurance broker and a TR(Broker) or a licensed insurance agent and a TR(Agency) representing more than one principals must not use credit ratings or the availability of any protection scheme for policy holders as a basis for recommendation of a particular insurer without disclosure of the same information about other insurers whose products can also be offered by the licensee.
 - A licensed insurance broker and a TR(Broker) must advise the client of the unauthorized status of the insurer if it or he recommends a contract of insurance issued by an insurer, which is not an authorized insurer in Hong Kong.

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Information about insurance products recommended

- e. A licensee must provide appropriate information about the insurance product recommended and ensure the validity of the information provided is reasonable. Specific requirements include:
- A licensee must explain the cover afforded by the insurance product, i.e. major policy terms and conditions including exclusions, and the client's rights and obligations in respect of premium payment term, renewability and premium refund.
 - A licensee must disclose all the relevant fees and charges.
 - A licensee must only use the marketing materials approved or authorized by its or his appointing principal(s).
 - A licensee must not withhold from the client any written documentation relating to the insurance product.
 - A licensee must not make comparisons of insurance products without clarifying the different product features.
 - A licensee must explain the consequences of late or non-payment of premium and possible penalties of early discontinuance or surrender of the policy.
 - A licensee must explain the risks associated with the use of third party service providers, if engaged.

Additional requirements for long term policies

- a. A licensee must explain the difference between surrender value and death benefit and also the difference between guaranteed and non-guaranteed benefits.

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- b. Where projected benefits are illustrated, a licensee must explain the assumptions on which the illustrations are based, including any future bonus or dividend declaration.
- c. For participating (with-profit) business, a licensee must explain that any bonuses or dividends declared in the future may be lower or higher than those currently quoted and that past performance may not be a reliable indicator of future performance.
- d. For linked long term business, a licensee must explain that the unit value and the value of the client's benefits may fluctuate.
- e. If the licensee is authorized by its or his appointing principal or the insurer concerned to prepare certain own illustrations, such illustrations must be based on the assumptions approved by the principal or insurer.

Suitability

Section 90(d)

When carrying on a regulated activity, a licensed insurance intermediary must have regard to the particular circumstances of the policy holder or the potential policy holder that are necessary for ensuring that the regulated activity is appropriate to the policy holder or the potential policy holder.

- a. A licensee must take all reasonable steps (Know-Your-Client procedures):
 - to establish the true and full identity of the client (e.g. proper client identification and certification procedures) and to keep proper records that the client identification procedures are followed satisfactorily;
 - to understand the client's insurance and financial needs and priorities;
 - additional requirements for long term policies:
 - to understand the client's financial situation (e.g. wealth and/or disposable income) and ability to afford the insurance products recommended throughout the policy payment term (e.g. premium to income/liquid assets ratio and retirement age); and
 - to understand the client's investment knowledge, experience, horizon, objectives and risk appetite.
- b. A licensee must explore insurance options and disclose available alternatives to the client.
- c. A licensee must not make a recommendation with respect to any insurance product to the client who may reasonably be expected to rely on the recommendation if the licensee does not have a reasonable basis for making the recommendation. For compliance with the "reasonable basis" requirement, a licensee:

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- must ensure that the recommendation is suitable for the client and based on thorough analysis after taking into account the information obtained from the client and alternative insurance options;
- must explain to the client the basis for the recommendation and the reason why the insurance product recommended is suitable; and
- must not use any rebate of commissions as the basis for the recommendation.

And for a licensed insurance agency or insurance broker company, it must ensure the recommendations of its TR(Agent) or TR(Broker) (as the case may be) are made on a reasonable basis.

- d. A licensee must not unduly influence the decision of the client by offering gifts or rebates.
- e. A licensee must explain the risks involved in premium financing, if recommended.