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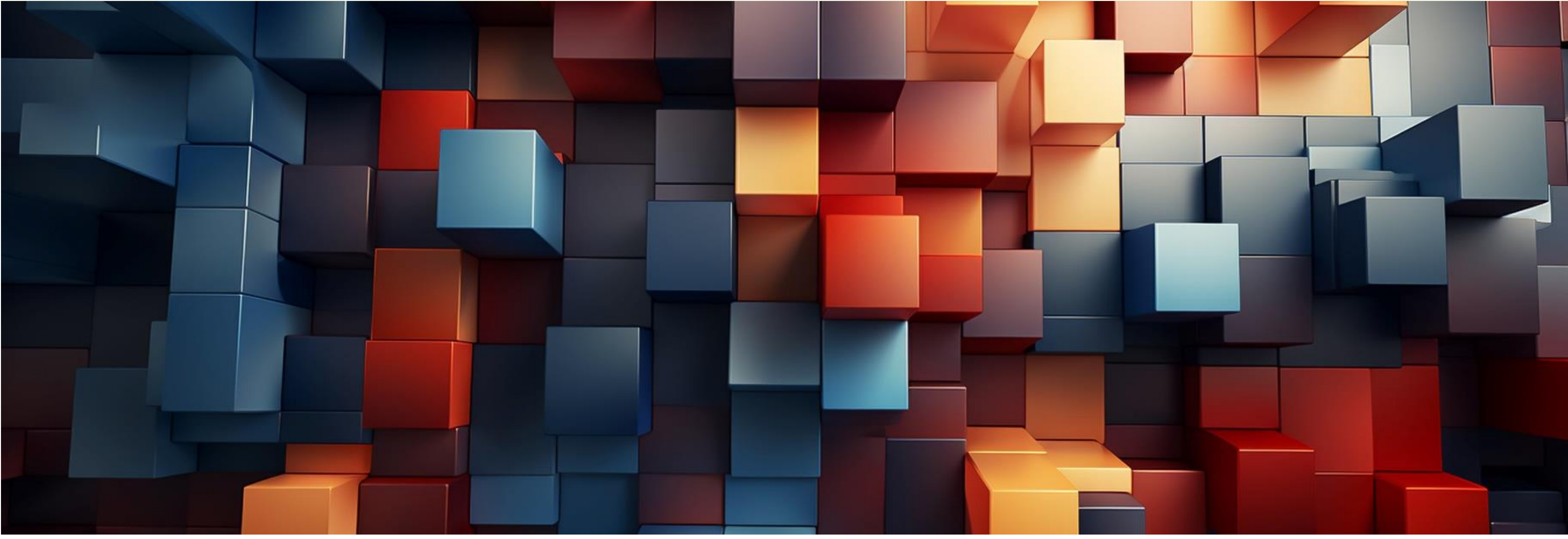
Insurance Authority

Cover Video

CONDUCT IN FOCUS

Managing General Agency Model

Insurance Authority
Spring 2025 • 10th Issue



CONDUCT IN FOCUS

Welcome to the Spring Edition of **Conduct in Focus**! Enjoy the latest complaints statistics, the Insurance Authority (“IA”)’s observations on managing general agents coming back into fashion, and a deeper dive into the thorny issue of conflicts of interest relating to insurance intermediaries. Also, if you want to know what our licensing statistics tell us about turnover rates of insurance intermediaries in the market, or who made it onto our CPD Non-Compliance League Table for the Assessment Year 2023/2024, or take a look at some of our latest enforcement cases, then this edition is for you.

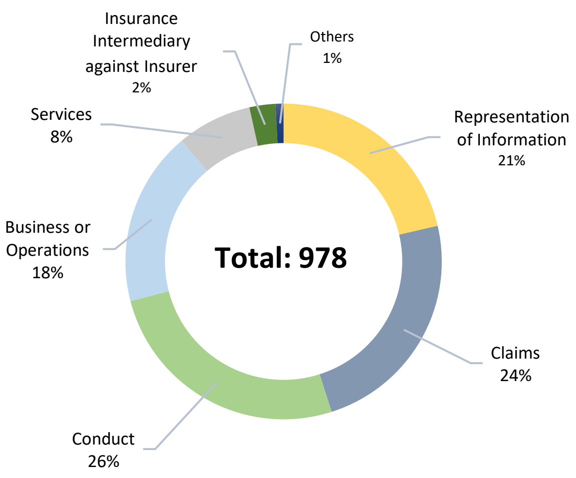
Enjoy!

Complaint Statistics

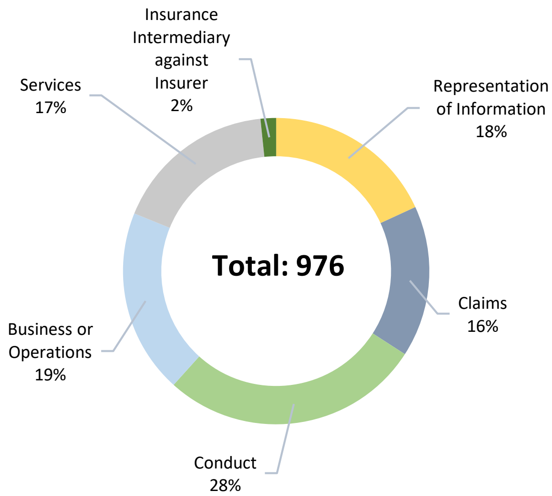
In this edition we present the complaints statistics for the full year 2024.

1 January to 31 December 2024 vs prior year

From 1 January to 31 December 2024



From 1 January to 31 December 2023



The IA received **978 complaints in 2024,** which is on a par with the year before. In terms of category, the most significant number of complaints were received in the category of "Conduct", followed by "Claims" and "Representation of Information". The slightly larger portion of claims complaints is reflected by a rise in travel claims.

Explanation of Complaint Categories

Conduct – refers to complaints arising from the process in which insurance is sold, the handling of client's premiums or monies, cross-border selling, unlicensed selling, allegations of fraud, allegations of forgery of insurance related documents, commission rebates and "twisting" (i.e. insurance agents inducing their clients to replace their existing policies with those issued by another insurer by misrepresentation, fraudulent or unethical means).

Representation of Information – refers to complaints relating to the presentation of an insurance product's features, policy terms and conditions, premium payment terms or returns on investment, dividend or bonus shown on benefit illustrations, etc.

Claims – refers to complaints in relation to insurance claims. The IA cannot adjudicate insurance claims or order payment of compensation. It can, however, handle complaints related to the process by which claims are handled (e.g. delays in processing, lack of controls or weaknesses in governance, areas of inefficiency in the claims handling process).

Business or Operations – refers to complaints related to business or operations of an insurer or insurance intermediary (e.g. cancellation or renewal of policy, adjustment of premium, underwriting decision, or matters related to the management of the insurer, etc.).

Services – refers to complaints regarding insurance related servicing by insurers or intermediaries, such as complaints related to the delivery of premium notice or annual statement, dissatisfaction with services standards etc.

Managing General Agents

A small, but increasingly noticeable part of the Hong Kong insurance market….again!

(English Audio Version)

Managing general agents are not new to the Hong Kong insurance market. They have been around for a very long time. Certain insurers, for example, started off operating here as insurance underwriting agencies before restructuring their legal and regulatory status to become full onshore insurers.

Over the years, however, the number of managing general agents in Hong Kong has waxed and waned in line with the rhythms of the market. During the first few years after the IA acquired the regulatory function of granting licenses to insurance agents in September 2019, there appeared to be little interest in becoming a managing general agent in the market. Applications for agency licences tended only to be from entities looking to conduct business as traditional insurance agencies. In more recent years, however, applications and enquiries indicate a resurgent interest in the managing general agency model, suggesting they are coming back into fashion.

To align with that trend, we offer some observations from the regulatory viewpoint on the managing general agency model to assist those thinking about obtaining an agency licence in order to serve as a managing general agent in Hong Kong. ›

What is a managing general agent?

Like all good regulators, we are tempted to start with a definition, but in doing so we immediately run into a problem. Neither the Insurance Ordinance (Cap. 41), nor the Codes of Conduct, nor the Guidelines issued by the IA make any reference to "managing general agent" let alone define the term.

The nearest thing we find is a reference to a "licensed insurance agency", being a company, partnership or sole proprietor (essentially a business entity) that obtains a licence from the IA to carry on "regulated activities" in specified lines of business as agent for one or more authorized insurer(s). This would indeed be the licence that a managing general agent would have to obtain to operate in Hong Kong. Most licensed insurance agencies, however, are not managing general agents, so this provides no answer as to what a managing general agent actually is. »

The vast majority of licensed insurance agencies focus solely on selling insurance policies (inviting or inducing persons to enter into contracts of insurance) on behalf of the insurers they represent and providing ancillary services related to the policies sold (e.g. arranging the insurance policy once the decision to purchase has been made and servicing enquiries from the policyholder thereafter). This would be recognized in the insurance market as the traditional insurance agency mode of doing business, a model that includes within its range both bancassurance and smaller non-bank agencies that exist to provide a platform for technical representative (agents) to sell insurance just like individual insurance agents would.

A managing general agent goes beyond the traditional agency model, by performing functions on behalf of an insurer that the insurer would otherwise be performing itself in carrying on insurance business. For example, a managing general agent may be delegated to underwrite (and bind) insurance policies on behalf of an insurer, or make decisions on claims payments on the insurer's behalf. Essentially, then, a managing general agent stretches beyond the limits of what a traditional insurance agency would do, by moving up the insurance supply chain to perform certain core insurance functions of an insurer, without itself being an insurer.

Why is the managing general agency model coming back into fashion in Hong Kong?

This is perhaps not a question for a regulator to answer as it is a matter dictated by the market dynamics of supply and demand. Based on the licence applications and queries we have received, however, we would speculate that the answer may lie in both the opportunities and risks presented by the ever increasing societal adoption of technology and, more specifically, the insurance industry's increasing attempt to wrap itself technology's embrace.

- We see examples of tech entrepreneurs seeking to use the nimbleness of an insurance agency platform to offer technology solutions to insurers on policy and claims administration. These solutions would otherwise be low down on an insurer's list of priorities for resource deployment to implement itself, but that problem may be overcome by outsourcing the function to a tech-savvy and talent-equipped managing general agent.
- We see insurers that look at managing general agencies as an opportunity to "dip their toes" into a new niche or specialty line of business (cyber insurance, for example) by accessing the specialist underwriting knowledge and talent offered by an agency, without the insurer itself having to incur massive upfront investment to gain market entry.
- We see consultants offering non-insurance risk consultancy services to clients and setting up a managing general agency platform to tie these services with an insurance offering that would assist in managing the client's risk.

In many ways, each of these examples offer a micro-snapshot of how the insurance market has always adapted - since the history of insurance began - to manage and address the needs of society's evolving risk landscape.

Managing general agencies and regulatory considerations

In the same way that history offers a guide as to why managing general agents may be making a bit of a comeback in Hong Kong – and bring with them evident advantages – one can also draw lessons from history when considering the regulatory risk associated with the managing agency model.

Whenever an insurer grants underwriting authority to a managing general agent (a phenomenon still known in the market as "giving away the pen") a separation occurs between the entity making the decision to accept the risk and underwrite a policy - the managing general agent - and the entity that actually takes on the risk of all the contractual obligations under the policy - the insurer. History tells us that where the entity making the decision on whether or not to accept a risk (in this case the managing general agent), has limited to no "skin in the game" as to how that risk actually performs (as the risk lies with the insurer), this can be a recipe for problems. The problem can become particularly acute where a large part of the agency's revenue model comes from commission paid on each policy underwritten, thereby creating a potentially misaligned incentive that may favour volume of business over quality of business. ›

The de-linkage between the entity that decides to underwrite risks and the entity that ultimately carries that risk can lead to systemic problems if left unchecked and unmonitored. The 2008 financial crisis was an example of this, where the 'originate to distribute' model in the US banking sector saw subprime mortgages being underwritten by banks and then offloaded and transferred several times to other entities (some ultimately in the insurance sector) through securitization. In the insurance sector itself, some of us are old enough to remember the reinsurance spirals created in the market which saw this same phenomenon at play (with managing general agents being at the heart of this).

More recently – in May 2024 - AM Best's report "Rapidly Increasing MGA Premiums Warrant Greater Oversight" indicated that it had looked at 13 insurers with solvency issues in the US property and casualty market during the period from 2000 to 2022 and found that within one year prior to the insolvency issues arising, 98.9% of the total direct premiums written were sourced through affiliated managing general agents with unaffiliated managing general agents also contributing to a number of insurer hardships over the same period[1].

Given this history, a regulator that is having to make licensing decisions and carry on ongoing supervision on entities that use a managing general agency model, would be inclined to focus on the following issues:

- The knowledge and experience of those running the agency in underwriting and managing a portfolio of risk to achieve balance sheet profitability and sustainable solvency;
- How the potential risk of misaligned incentives created by separating the decision to bind a risk (by the agency) from the carrying of that risk (by the insurer), is addressed and mitigated through controls and processes; and
- The adequacy of the level of due diligence and ongoing monitoring of risk and oversight by the insurer that has delegated its authority. »

[1] AM Best – Best's Market Segment Report – "Rapidly Increasing MGA Premiums Warrant Greater Oversight" – May 22 2024.

How these issues are addressed in the broader insurance regulatory framework

Licensing "fit and proper" criteria

As stated, to operate in Hong Kong as a managing general agent of an authorized insurer, the candidate would need to become a licensed insurance agency. To obtain this licence, the applicant would need to demonstrate that it meets the "fit and proper" criteria[2] for being a licensed insurance agency. These criteria are the same for all insurance agencies. How the criteria are applied, however, will depend on the applicant itself and the actual business model it intends to carry out.

Take the experience and skillset element of the "fit and proper" criteria as an example. Being "fit and proper" to sell insurance using a traditional agency model requires a different type of knowledge, as compared with being "fit and proper" to assess and underwrite insurance policies as a managing general agent. ›

Guideline 14 on Outsourcing

There is also a second aspect of the insurance regulatory framework that would likely apply to managing general agents (albeit it would not apply to agencies using the traditional agency model). That is Guideline on Outsourcing ("GL14") issued by the IA. In GL 14, "outsourcing" refers to an arrangement under which the service provider undertakes to perform a service (including a business activity, function or process) which would otherwise be undertaken by the authorized insurer itself. This is exactly what is happening when an insurer delegates underwriting (or claims) authority to a managing general agent to bind insurance policies (or settle claims) on its behalf.

GL 14 would require the authorized insurer, when outsourcing to a managing general agent to:

- carry out a risk assessment;
- perform adequate due diligence;
- ensure that the contract with the managing general agent expresses certain minimum rights and obligations;
- ensure that all relevant laws and statutory requirements on client confidentiality are complied with;
- implement appropriate ongoing monitoring and controls; and
- establish a contingency plan to ensure business continuity if the managing general agent's service is interrupted.

If the outsourcing to the managing general agent is a "material outsourcing" (as defined in GL 14) from the insurer's perspective, then prior notification of the arrangement to the IA would also need to be provided. Even if it is not a "material outsourcing", however, as part of the application for the insurance agency licence, there may be aspects of the outsourcing arrangement that would be relevant to the IA's consideration in the context of assessing the fitness and properness of the candidate. »

[2] As illustrated in the Guideline on "Fit and Proper" Criteria for Licensed Insurance Intermediaries under the Insurance Ordinance (Cap. 41) issued by the IA

Aspects of an agency licence application for a managing general agent on which the IA would focus

Putting this all together, we highlight certain main aspects the IA would focus on when considering an applicant for an insurance agency licence who is seeking to run a managing general agency business model.

Specific knowledge, skill and experience of the proposed responsible officer

Every licensed insurance agency must appoint a responsible officer who must be fit and proper to discharge the functions of that role. Those functions focus on establishing and maintaining proper controls and procedures for securing compliance by the agency with the conduct requirements in section 90 of the Insurance Ordinance regarding the manner in which the agency will carry on regulated activities. In the case of a managing general agent, its regulated activities would extend to the functions it is performing on behalf of the insurer, for example assessing and binding risks through underwriting of insurance policies, or settling claims. A particular focus of the IA's licensing assessment, therefore, would be on the demonstrated track record and experience of the responsible officer candidate in carrying on these functions. If the function is underwriting, we may look at the candidate's experience and track record of underwriting business and implementing underwriting controls and processes in the relevant lines of business for which the licence is being sought. The question to address would be: Does the proposed responsible officer possess knowledge, skill and experience commensurate with the nature and scale of business that the managing general agent will be performing?

Contract with the principal insurer granting the authority

The IA would likely ask to see the contract under which the proposed candidate agency is being delegated authority to act on behalf of the principal insurer(s). This would provide us with context for the arrangement which would form an important part of considering the adequacy of the controls on regulated activities the agency will have in place. The greater level of authority granted, the tighter the accompanying controls we would expect to see, whereas more restricted levels of authority would serve, in themselves, as controls. So the type of matters we would look at (from a control perspective) where the agency is to be delegated underwriting authority, would include the following:

- The underwriting criteria and scope for the agency to set pricing itself – do these give a wide leeway of discretion to the agency or is the discretion within defined, restricted and set parameters;
- Whether there is a premium income limit set and how the premium income levels written by the agency are to be monitored by the principal through reporting obligations;
- Whether the grant of authority is gradual (i.e. is there an initial phase where the authority levels are low, with the authority being increased as trust between the insurer and agency is embedded); and
- The remuneration model - is this solely commission driven or is there a profit element that gives the agency an element of underwriting accountability (as opposed to being just driven by premium income written).

Controls, processes and ongoing monitoring

There are two aspects to this. The IA would want to see that the level of controls and processes the agency has in place on the function delegated to it by the insurer are commensurate with the authority delegated. The greater the authority delegated (both in terms of amount and the degree of judgement it leaves the agency), the more comprehensive the agency's controls would need to be. The other aspect of this would be the controls which the insurer has on the agency, which the insurer would have to establish according to GL14 (in terms of regularity of reporting, audits and reviews and ongoing assessments of the business written through the agency).

Taking account of this, there are two broad tips we would offer applicants to achieve a smooth ride through the licensing process.

Firstly, a high degree of cooperation between the candidate agency and principal insurer in the licensing process will certainly assist. For example, the more satisfied the IA is of the due diligence, controls, processes and ongoing monitoring that the insurer has undertaken and put in place (with documentation from the insurer demonstrating this), the more comfort this would provide in examining the adequacy of the agency's own controls and processes (a key aspect of its fitness and properness).

Secondly, the IA is not averse to looking to best practices from other jurisdictions on controlling and addressing regulatory risk. In this respect, syndicates at Lloyd's of London have a long track record of utilizing delegated authority coverholder models for writing business through third parties, including third party agencies appointed as their agent. An applicant for an agency licence in Hong Kong, seeking to operate a managing general agency model (and its principal insurer) could assist its application by benchmarking its controls, processes and monitoring with the standards for delegated underwriting (for example) required by Lloyd's.

The matters above are not exclusive and it remains the case that an applicant for an agency licence, seeking to run a managing general agent model, would need to meet all requirements for that licence. Further, once licensed, the agency will be subject to the same requirements as all licensed insurance agencies (including the restrictions on the number of principals for which it can accept appointment).

We hope, however, that the above gives some indication of the IA's expectations and offers useful insight to help smooth the way for the welcoming of candidates seeking to become managing general agents in the Hong Kong market.

Focus on …… Conflict of Interests and Insurance Intermediaries

(English Audio Version)

Whenever a professional is engaged to act on behalf of another party, he serves as an agent of that other party, who in turn is his principal. In the eyes of the law, the agent becomes a fiduciary of the principal and must act in the principal's best interests.

A conflict of interest arises where the agent's duty to act in the best interests of his principal, conflicts with any duty the agent may owe to another person, or the agent's own commercial interests. The risk of conflict is therefore inherent to any profession that is based an agency relationship, including both insurance agents and insurance brokers. This makes dealing with conflicts of interest a fact of commercial life for both types of insurance intermediaries. It is something that just comes with the job and a reason why the conduct requirements in section 90(f) and (g) of the Insurance Ordinance require a licensed insurance intermediary to use best endeavours to avoid conflicts arising with the interests of the policyholders for which they act, or to disclose them as a way of managing them.

Conflicts of interest can be injurious if not properly identified and addressed. A conflict can result in insurance intermediaries – whether consciously or subconsciously – acting in their own commercial interests ahead of the policyholders' (whilst deluding themselves that this is not the case). In this way conflicts of interest can result in a 'corruption of the soul'. Where a conflict situation is not properly addressed, the interests of policyholders may be subsumed and prejudiced without the insurance intermediary even appreciating this. Nevertheless, this would likely render the insurance intermediary guilty of misconduct under the insurance regulatory framework and not fit and proper to continue in their role. ›

Identifying, avoiding and (if they can't be avoided) managing conflicts of interest is therefore a necessary part of the professional and ethical skillset of every insurance agent and insurance broker. In the following two articles we explore this skillset further, by providing an overview of where the main conflicts of interest inherent to the role of both an insurance agent and an insurance broker arise and how obligations under the insurance regulatory framework (not only of insurance agents and insurance brokers, but also insurers) seek to address these. »

Insurance Agents and Conflicts of Interest

Section 90(a) of the Insurance Ordinance is the primary conduct obligation for all insurance intermediaries. It imposes a regulatory duty on every insurance intermediary to act fairly and in the best interests of the policyholder. At common law, however, an insurance agent serves as the agent of the principal insurers he represents. An insurance agent is remunerated (mainly in commission) by his principal insurers based on the insurance policies the agent sells on their behalf. Several potential conflicts of interest situations arise from this:-

Selling insurance policies with highest remuneration vs recommending policy which best meets policyholder's needs

An insurance agent's own economic self-interest in selling the insurance policy which generates maximum remuneration for the agent, may conflict with his duty to the policyholder to recommend the most suitable insurance policy based on the client's circumstances.

The Code of Conduct for Licensed Insurance Agents ("Agent's Code") addresses this potential conflict by imposing the following overriding duties on a licensed insurance agent:

- To recommend insurance policies which best meet the client's interests, from the range of insurance products offered by his principal insurer(s) which the agent is authorized to promote; and
- When making a recommendation on an insurance policy, to consider what available insurance policies can reasonably meet the client's circumstances, based on the range of policies offered by his appointing insurer[3].

The imposition of these duties by regulation, effectively forces an agent to override his economic self-interest and recommend the insurance policy most suitable for the policyholder's circumstances (and to face disciplinary action if he fails to do this).

Selling new insurance policies vs servicing existing policies

This potential conflict is particularly acute for long-term insurance policies (policies entered into for multiple years). Currently, for certain long term policies such as participating insurance policies, it is common for the insurer to pay the vast majority of commission to the insurance agent up front in the first year of the policy, in order to reward the agent for building the relationship with the client such that the client buys the policy. This ignores the fact, however, that the relationship is a long term one and needs to be cultivated and maintained by the agent over the duration of the policy period through ongoing servicing obligations (e.g. dealing with changes of policy ownership, requests to add beneficiaries, explaining the performance of the non-guaranteed benefits so the policyholder can assess whether the policy continues to meet their needs, and assisting the policyholder in making claims etc.).

By paying virtually all the commission the agent in the first year of the insurance policy term, the insurer essentially skews an insurance agent's interest in favour of focusing on selling new insurance policies, in conflict with the ongoing duty to service existing policies sold. This risks creating poor servicing levels to the detriment of clients (a common cause of many complaints the IA receives).

The conduct requirements in section 90 of the IO aim to combat this by extending the requirements for the insurance agent to act fairly and in the best interests of the policyholder and with integrity and to exercise care, skill and diligence in respect of all regulated activities, including ongoing post-sales activities.

Insurers also have a crucial role to play here. It is they, after all, who create this conflict through their remuneration structures. Insurers have an express regulatory duty to ensure that their remuneration structures for insurance intermediaries do not create misaligned incentives for their agents, putting them in conflict with the interests of clients. This regulatory duty (which is part of the broader treating customer's fairly principle) applies across all long-term policies within the scope of Guidelines 15 and 16[4] issued by the IA. Whilst the notes to Guideline 15 fleshes this obligation out, by prescribing a spread of commission over a minimum of 5 years (or the premium payment term if shorter) for Class C long term policies, the broader principle also applies to non-Class C long term policies within the scope of Guideline 16. This is one of the reasons why the IA is considering to extend the specific spreading mechanism to participating insurance policies, as a natural and effective way of ameliorating this particular inherent conflict.

[3] Agent's Code General Principle 2, Standards and Practices 2.1(b) and 2.2(b).
[4] Guideline on Underwriting Class C Business (GL 15) and Guideline on Underwriting Long Term Insurance Business (other than Class C Business) (GL 16).

Duty to act in the best interest of the policyholder vs agent's duties to principal insurer

An apparent conflict also arises because insurance agents owe regulatory duties to policyholders to act in their best interests, whilst also owing duties at common law to their principal insurers (for whom they act as agent). This so-called 'obvious' observation was made continuously (by the legal profession, in particular) during the consultations leading up the IA's creation, with the governmental response effectively being that the IA would sort it out in the Agent's Code.

Anyone who has worked in an insurer and actually dealt with insurance agents, will know that in practice the mindset of many insurance agents (naturally) is to view themselves as representatives of policyholders and to represent their interests when dealing with their insurer principals. In discussions between an agent and the insurer, for example, the agent would usually refer to the prospective policyholder as "my customer" or "my client", rather than seeing the insurer as the client (even though the insurer is the real principal). Insurers in turn often label their agents as 'consultants' (denoting their role as being consultants to clients, not the insurer). To this extent, therefore, the regulatory duty imposed on insurance agents to act in the best interest of policyholders, merely codifies an obligation which had already emerged from the nature of an insurance agent's day-to-day practice.

Reconciling this conflict of interest in the Agent's Code was not, therefore, as challenging as it first may have appeared. It simply involved codifying the requirement for a licensed insurance agent to recommend insurance policies which best meet the prospective policyholder's interests, from the range of insurance policies offered by the agent's appointing insurer. In doing so, an insurance agent serves the client's best interests without creating a misalignment with his duties owed to his principal insurer(s).

The Agent's Code further underpins the management of this potential conflict, by requiring licensed insurance agents to provide full transparency to clients about their role as insurance agents. Insurance agents need to expressly inform their clients that an agent's role is to promote, advise on and arrange insurance policies offered only by their principal insurers[5]. The objective here is to leave the client in no doubt about the parameters of the service the insurance agent is providing. The client is going to be offered the insurance policy which best meets their needs, but the insurance agent is only going to be choosing from the insurance policies offered by the principal insurer(s) by which the agent is appointed, not other insurers (as would be the case with an insurance broker). ›

Interests of principal insurer vs the interests of another principal insurer

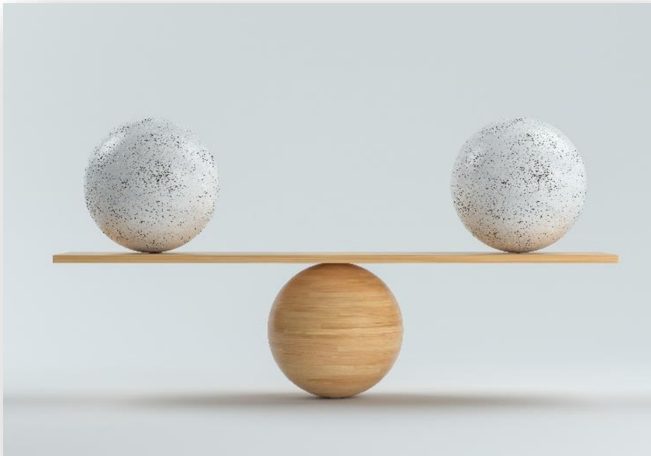
An insurance agent can be appointed by up to four principal insurers (of which no more than two can be long-term insurers). This raises the question of how an insurance agent can reconcile the different interests of his principal insurers, where these conflict.

Again, regulation intervenes through provisions in the Agent's Code to address this:

- An insurance agent must obtain prior consent from an existing principal insurer before accepting an appointment by another principal.[6]

- Where an insurance agent acts for more than one principal insurer, the agent should inform the client which appointing insurer the agent is representing in the transaction.[7]

- Any terms and conditions of the insurance agent's appointment, restricting him only to promote products of a particular insurer (even though the agent is appointed by more than one insurer) should be disclosed to the client.[8] »



[5] Agent's Code, General Principle 7, Standard and Practice 7.1
[6] Agent's Code, General Principle 1, Standard and Practice 1.2(c)
[7] Agent's Code, General Principle 5, Standard and Practice 5.1(b)
[8] Agent's Code, General Principle 7, Standard and Practice 7.2

Insurer's liability for their appointed insurance agents

Given the multiple potential conflicts that come with the territory of being an insurance agent, it is imperative that all insurance agents not only comply with the requirements in the Agent's Code designed to address such matters (as identified above) but also develop an ongoing professional sensitivity to the risk of such conflicts so that they can identify them and deal with them as they arise.

Insurance agents are not on their own in this respect. Their principal insurers also have a crucial role to play. Section 68 of the IO effectively expands an insurer's liability for its appointed insurance agents in their carrying of insurance activity, by attaching such liability to the insurer irrespective of whether or not the agent was acting within the scope of the authority granted to him by the insurer. In recognition of this, the Agent's Code assists insurers by requiring insurance agents to comply with the policies, procedures and other applicable requirements of the appointing insurer in relation to carrying on regulated activities. Insurers – through their intermediary management functions and the key person they appoint to take charge of this – have a regulatory obligation to ensure adequate internal controls and processes are put in place on their insurance agents so that they comply with the requirements in the insurance regulatory framework, including those requirements designed to address conflicts of interest.

Any prejudice to a policyholder caused by an insurance agent failing to avoid or manage a conflict of interest, therefore, will likely attach to the insurer (at common law and section 68 of the IO) and also raise questions as to the adequacy of the insurer's controls and processes on its insurance agents to have prevented this. Insurers would do well, then, to support their agents through proper controls, training and channels through which they can obtain advice on dealing with conflicts of interest, as well as ensuring their remuneration structures do not serve as a cause of such conflicts.

Insurance Brokers and Conflicts of Interest

Like insurance agents, insurance brokers are subject to the conduct requirements in section 90 of the IO, the primary requirement of which is to act with integrity and in the best interests of the policyholders they represent. Unlike insurance agents, at common law insurance brokers serve as agents for their clients to source insurance suitable for the client's particular circumstances (and they have the advantage over insurance agents in being able to deal with any number of insurers for this purpose). The regulatory duties of insurance brokers under the IO are thereby in complete alignment with their common law role as agent of their clients.

Despite this, as is the case with insurance agents (and other professions that are based on agency relationships), there are conflicts of interest that are inherent to the insurance broking profession. The primary potential conflict arises from the main source of remuneration for insurance brokers in Hong Kong – commission.

Insurance broker commission and the requirement for disclosure

Whilst there are different ways of remunerating insurance brokers for the work they do, by far the most common mechanism in the Hong Kong market is payment of commission[9].

The legal basis for commission payments to insurance brokers is as follows. In consideration for sourcing and arranging an insurance policy from an insurer that suits the policyholder's circumstances, the policyholder allows the insurance broker to agree with the insurer an amount that the insurer will pay the insurance broker for introducing the business to the insurer. This amount - payable to the insurance broker by the insurer - is a percentage of the premium paid by the policyholder to the insurer under the insurance policy which the broker arranges, and is termed 'commission'.

Commission structures mean that whilst an insurance broker's duties are owed to his clients to act in their best interest as their agent, the broker is paid by the insurer - a third party to the relationship between the insurance broker and his client. It is this which gives rise to a potential conflict of interest. Consciously or subconsciously, the insurance broker may be tempted to place his client's business with the insurer paying the highest commission, rather than the insurer offering the insurance that best meets the policyholder's circumstances.

In Hong Kong, agency law and regulation align to address this potential conflict in the same way - by requiring the insurance broker to disclose to the client, the fact that the insurer that issues the insurance policy, will pay remuneration to the insurance broker. Having been alerted to this through such disclosure, the policyholder can then readily ask the insurance broker for further and better particulars of the remuneration (for example the amount of commission) to be received and then decide whether to proceed with a transaction. These minimum disclosure requirements are set out in the Code of Conduct for Licensed Insurance Brokers in General Principle 7, Standard and Practice 7.1 and in the Practice Note issued by the IA supplementing this provision. »

[9] The other form of remuneration comes in the form of a fee paid directly to the insurance broker by the policyholder for advice and the representation provided in sourcing and placing an insurance. This is relatively rare – albeit not unknown – form of broker remuneration in the Hong Kong insurance market.

Where disclosure is insufficient to address the conflict

There are, however, certain types of commission mechanisms where even disclosure to the policyholder would be insufficient to manage the conflict and which should thereby be avoided. The insurance regulatory circular of 10 April 2006 – which stands the test of time and is referenced in the abovementioned Practice Note - best summarizes these as follows:

> *"prohibited practices include specifically (but not limited to) an insurer entering into a contract or agreement (exclusive or otherwise) with a view to inducing an insurance broker to place business with it by offering commission level based on volume or requiring an insurance broker to meet certain annual business target."*

Commissions which are in excess of what is normally paid in the insurance market, would also be problematic, not only from the regulatory viewpoint, but also from the perspective of compliance with section 9 of the Prevention of Bribery Ordinance (Cap. 201) ("PBO"), which criminalizes agents making secret profits from their role as agent without the lawful authority of their principal. In *Hobbins v Royal Skandia Life Assurance Limited and Clearwater International Limited [2012] HKCFI 10*, the court of first instance summarized the position for insurance brokers as follows:-

> *"In my view, there is "lawful authority" (consisting of a long line of judicial pronouncements stretching from the 19th century to the present) for the commercial practice that an insurance broker acts as an agent of the insured and not of the insurance company. As a result of that the line of judicial pronouncements, it has long been settled at common law that commission paid to an insurance broker by an insurer does not constitute an illegal secret profit* ***unless it is in excess of what is normally paid within the insurance market."*** [Emphasis added].

Excessive commission levels, therefore, do not bring with them the "lawful authority" that customary levels of commission paid within the insurance market would and would thereby place the insurance broker (and the insurer paying such excessive levels) in difficulties when it comes to compliance with section 9 of the PBO.

This, of course, raises the issue of where the line lies between customary and excessive commission levels. In recent years this issue has threatened to become a live one for commission paid on participating insurance policies, where the levels of commission offered by insurers to certain broker companies in the first year of the policy, have resulted in such commissions being given away by the broker company as excessive referral fees that drive unlicensed business (triggering necessary enforcement action).

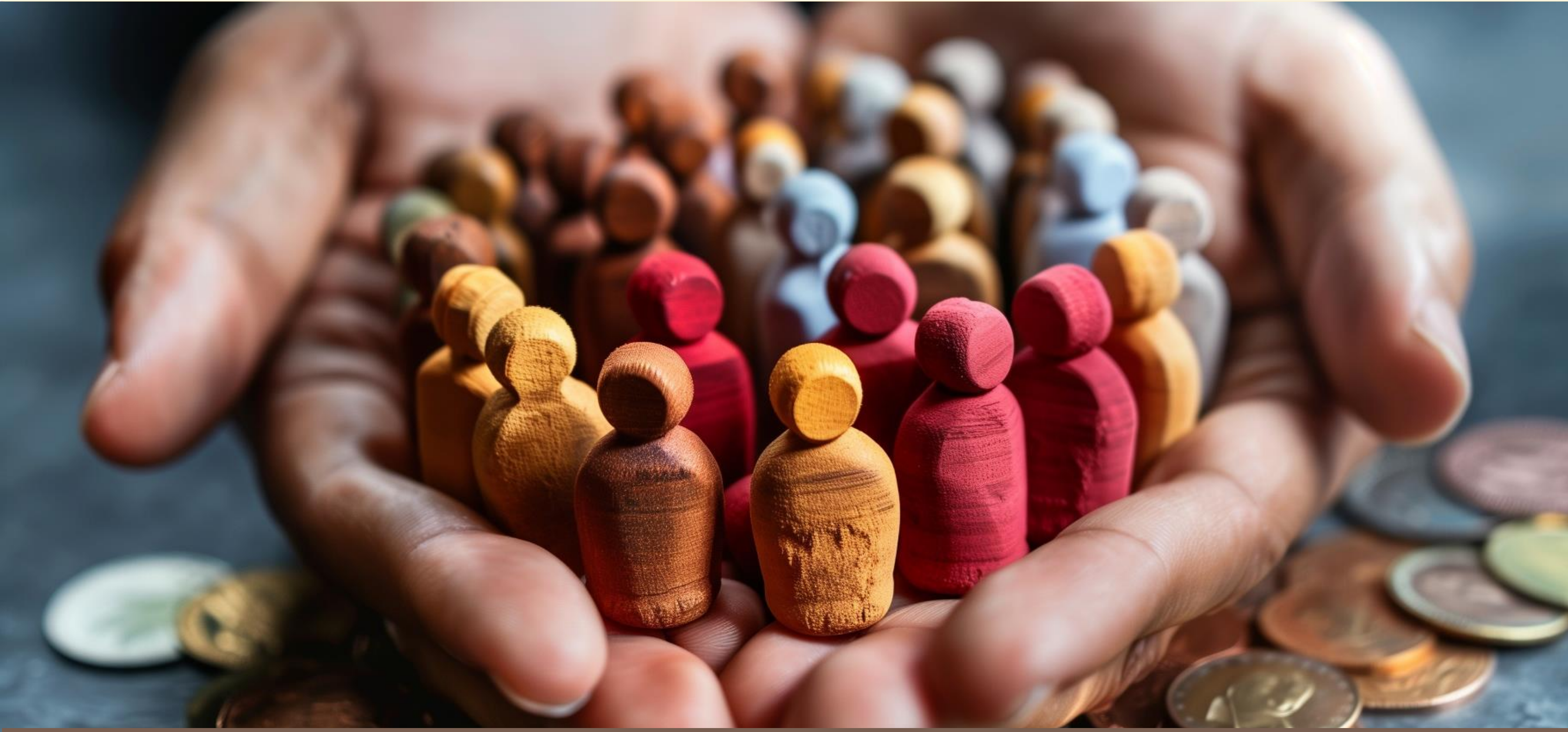
Insurers are mistaken, if they believe that in paying these commissions, they are fire-walled from any regulatory liability arising from the insurance broker's use of such referral fees because the broker is not their agent. The duty of the insurer – under Guideline 16 – is to ensure that their remuneration structures do not create misalignment between the insurance intermediaries' own interests and their duty to act in the policyholder's best interests (part of the wider 'treating customers fairly' principle). This duty of insurers applies to the remuneration they pay to insurance brokers that place business with them, as much as it does to the remuneration they pay their appointed insurance agents.

The IA's circular of 22 May 2024 sought to address these matters. As indicated in the article on insurance agents, however, this issue is still ripe for being further addressed by the proposed introduction of a smoothing mechanism for payment of commission for participating insurance policies, similar to that which applies to ILAS policies. »

Other areas of conflict where an insurance broker should be mindful

In the same way that insurance agents may need to deal with situations where the interests of their different principal insurers' conflict, so an insurance broker needs to be sensitive to addressing situations where the interests between their clients (the broker's principals) may place the broker in a position of conflict. These situations would be rare, but they are ones to which major insurance brokers should be (and based on our inspections, are) alive. Such situations could arise, for example, where an insurance broker has handled placements for two different clients simultaneously and a claim incident happens involving them both, with each client seeking to apportion liability to the other. It might also arise where clients are tendering (and competing), say, for the same construction contract and have engaged to the insurance broker to secure insurance to demonstrate they meet the tender requirements. Addressing such conflicts either through disclosure and consent, handling through separated teams, or ceasing to act, may be solutions an insurance broker in this situation may find itself having to adopt. Major insurance brokers therefore do (and should) have policies and processes in place to address this.

To sum up both these articles, then, the insurance intermediary who buries his head in the sand about potential conflicts is one who will not be long in the insurance market, given the potential conflicts that come with the nature of the profession (based as it is on agency relationships). For professional insurance intermediaries, being sensitive to, recognizing and dealing with potential conflicts of interest is a fact of commercial life and part of the ethical skill-set they must continually cultivate to build both trust and success in their careers.



Ever wondered what the turnover for licensed insurance intermediaries is?

(English Audio Version)

The IA began granting insurance intermediary licences on 23 September 2019. During the period from 23 September 2019 to 31 December 2024, we have granted just over 70,600 new licences to individuals who were new entrants to the insurance market[10].

We thought, with five years of data behind us, it would be an opportune moment to mine the data to find out how many of those 70,600 new entrants were still in the industry.

Of the 70,600 new licences granted, 44,000 licences remain active – a percentage 62%. On the face of it, this does not look too bad!

However, we have to bear in mind that licences are granted for three-year periods. These numbers do not, therefore, present the full story as they are skewed by the inclusion of the 18,700 licences granted in 2024 (which would only have been running for less a year), 13,000 licences granted in 2023 (which would only have been running less than two years) and 9,300 licences granted in 2022 (which would only have been running for less than three years).

What if we were to look at just the licences granted in 2019, 2020 and 2021, for all of which the first full three-year licence period has passed? In respect of these licensees, what if we asked the question: how many of them are still in the industry now? In other words, how many of these decided to renew their licences?

During the period 23 September 2019 to 31 December 2021, the IA granted 29,600 licences to individuals who were new entrants to the market. Of these, only 10,500 – or 35% - are still licensed some 3+ years later, as at 31 December 2024. Of the 19,100 who have dropped out, 15,600 actually dropped out before the end of their initial three-year licence. So let's state those figures again – 29,600 three-year licences granted, with 15,600 (53%) not even making it to the end of the first three-year licence. In other words, as a newly licensed insurance intermediary, the likelihood of you giving up before the end of your first three-year licence is greater than 50%.

[10] In addition to this, we have granted 22,000 licences to individuals who were swapping their existing intermediary licence for a different type of intermediary licence (e.g. moving from being a technical representative (agent) to a technical representative (broker)) and processed the licensing applications for 85,000 deemed licencees (who were already in the market)

Here are some statistics for new entrants:

Year of licences granted#	2019 (Sept – Dec)	2020	2021
No. of licences granted to new entrants	4,600	13,100	11,900
No. of licences remaining active as of 31 Dec 2024	1,400	4,300	4,800
No. of licences revoked	3,200	8,800	7,100
- Revoked within 1st year	300	900	900
- Revoked between 1st – 2nd year	1,000	2,900	3,000
- Revoked between 2nd – 3rd year	900	3,400	2,300
- Revoked after 3 year	1,000	1,600	900

Remark: the figures were rounded to the nearest hundred, and did not include experienced hire who rejoined the industry or swapped their existing licence.

And let's not forget, the licences granted in the aforesaid table were free as the IA only started to collect licensing fees from September 2024!

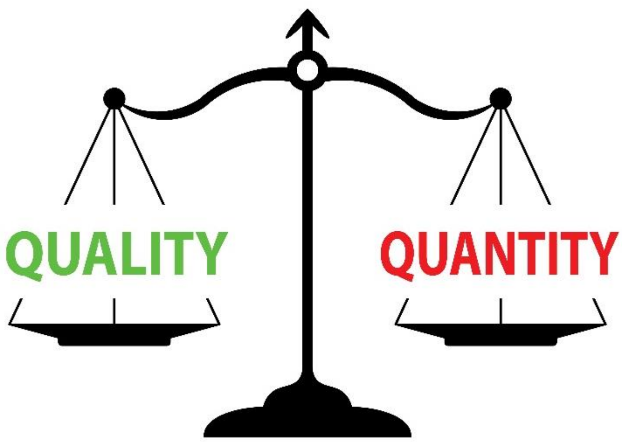
What should one make of these numbers?

Perhaps they are not a surprise to those serving in insurance intermediary management functions of insurers? After all, isn't recruitment focused mainly on quantity – the belief that the more agents the better – which lends itself to high attritional rates in the first 3 years?

From the conduct regulatory viewpoint, however, these numbers show a bright red-flag for the risks associated with orphan policies in the life insurance industry, being a main root cause for a number of the complaints the IA receives. For example, when individual insurance agents leave the industry, the long term policies they arranged still require servicing. That burden passes to the individual insurance agents remaining in the industry to pick up, a burden which becomes more significant, the earlier the outgoing agent leaves the industry which, according the licensing data, is more likely than not going to be in the first three years.

This problem is then compounded further with the remuneration structures offered by insurers on participating policies, which skew commission payments to the first year of the policy, such that the agents who arranged the policies take most of the commission and then leave the industry. This begs the question: what monetary incentive is left for those agents who have to pick up the serving obligations on the policies left behind? Any insurer that answers to the regulator: 'well there are cross-selling opportunities', only demonstrates how little regard it has for conduct risk.

Surely then, this data reinforces the need to look at a smoothing mechanism for payment of commission on participating policies, doesn't it?



CPD Compliance: Assessment Period 2023/2024
A Leap Towards Excellence!

(English Audio Version)

To encourage compliance with continuing professional development ("CPD") hours across the insurance market, after each CPD Assessment Period, the IA will publish the CPD Non-Compliance League, in order to 'name and shame' those market participants with the largest number of appointed licensed individual intermediaries who failed to complete their CPD requirements.

At the risk of repeating ourselves, completing CPD hours to keep one's knowledge up to date is the most basic requirement for any profession. If an insurance intermediary fails to complete their CPD hours, their fitness and properness is put into immediate question.

For Assessment Period 2021/2022, we included 10 principals in the CPD Non-Compliance League Table. For Assessment Period 2022/2023, that number was reduced to 5 principals.

Like a well-oiled machine, the IA's Conduct Supervision Division went into action to prepare the CPD Non-Compliance League Table for the Assessment Period 2023/2024. Here's how the conversation went in the Conduct Supervision Division:

Acting Head: *"Can you give me the CPD Non-Compliance League Table for the Assessment Period 2023/2024 please?"*

Manager: *"Here you are."*

Acting Head: *"Er…..this is a blank spreadsheet."*

Manager: *"Yes, there was 99.9% compliance with CPD hours across the market this year."*

Acting Head: *"What? As in….*

Manager: *"99.9% compliance. As in 0.1% short of 100%. You could actually call it 100% if you like as many of these non-compliant licensees have subsequently given up their licences voluntarily.*

Acting Head: *"So what do we publish in Conduct in Focus?"*

Manager: *"Er…a blank table?"*

Yup! Turns out the CPD Non-Compliance League has been so successful, we have a 99.9% compliance rate this year. That means we have no names to put in our Non-Compliance League Table.

To adopt GenZ slang, our message to the market is this: "**Slay!**" (Translation for non GenZs: You smashed it! Any policyholder who deals with an individual licensee in the Hong Kong insurance market can trust that the individual's insurance knowledge is up to date).

Great job guys! Keep it that way to stop us from publishing the Non-Compliance League Table going forward!

Enforcement Corner

(English Audio Version)

Forgery of Customer's Signature

It is never okay to forge a client's signature on any insurance document under any circumstances. This is illegal and unethical and has serious legal consequences. This, of course, should go without saying. Alas, in light of a spate of cases that the IA has recently taken enforcement action against, this very obvious statement needs to be reiterated.

In December 2024, the IA banned a former technical representative (broker) for 21 months for fabricating a client's signatures on insurance application forms. The case involved the arrangement of a savings insurance policy that was being purchased with a premium financing loan from a bank. Initially, the former technical representative believed the client had signed all the relevant insurance application forms, but he later realized that certain documents critical to the process had not been signed, one being the Financial Needs Analysis. Instead of informing the client and seeking to obtain the outstanding signatures, however, the technical representative signed the documents as if he was the client, thereby fabricating the client's signature.

The matter came to light when the client received the policy documents. At that point, the former technical representative sought to blame his personal assistant (who turned out not to exist!). Eventually, however, the former technical representative admitted what he had done. He sought to explain his actions by suggesting that he had acted out of a sense of urgency, knowing that the client was due to meet with the bank. He felt confident that the client would have signed the documents in any event (so he did not see the harm in what he was doing) and he did not wish to undermine the good relationship established with the client.

Any logic that sees fabricating a client's signature (without the client's knowledge) as a means of maintaining a good relationship with that client, is demonstrative of a moral and ethical compass so twisted and subverted, that it undermines the very foundation of trust and integrity essential for any professional relationship. Such reasoning not only jeopardizes the fitness and properness of the individual concerned, but also risks damaging the overall reputation of the organization he represents and the wider insurance (and in this case banking) industry.

In the IA's enforcement case count, four licensed insurance intermediaries have been banned for forging client signatures for periods ranging from 6 to 21 months. A strict zero-tolerance approach will continue to be maintained until this disgraceful activity is drummed out of the market altogether. »

Care and competence required when arranging general insurance policies for clients

In November 2024, the Insurance Appeals Tribunal affirmed the IA's decision to suspend a technical representative (agent) for 8 months for failing to exercise the requisite level of care, skill and diligence when advising on and arranging an employee's compensation insurance policy ("EC Policy") for a client who was running a butcher's shop.

The technical representative had initially arranged an EC Policy for the client with a particular insurer, when working at a broker company. The following year, the technical representative moved to an insurance agency and, on expiry of the original EC Policy, arranged a new EC Policy for the client and his butcher's shop with his principal insurer (different from the insurer which had underwritten the expiring EC Policy).

Unlike the previous year's EC Policy, the new EC Policy contained an exclusion clause which excluded coverage for bodily harm arising from the use of electronic machinery. A few months later, an employee at the butcher's shop had part his finger severed in an electric meat grinder. When the claim was submitted under the new EC Policy, by reason of the exclusion clause, coverage was denied.

In sourcing an EC Policy with an exclusion clause for electrical equipment in its terms, for a butcher's shop which had electric meat grinders, the technical representative had fallen well below the level of skill and competence expected of an insurance intermediary. He had failed to ascertain the circumstances of the client – in particular the presence of the electric meat grinders at the butcher's shop – and as a result had obtained an EC Policy that failed to address those circumstances of the client. Further, he had failed to bring the client's attention to the exclusion clause or explain its effect to the client at the time of placement (which would likely have uncovered the fact that the EC Policy was unsuitable). ›

The insurance regulatory framework includes prescriptive processes for insurance intermediaries to ascertain a client's circumstances when carrying on regulated activities in relation to life insurance products (i.e. the financial needs analysis). However, even though the same level of prescriptive processes do not exist for general insurance business, General Principle 6 of Codes of Conduct for both Licensed Insurance Agents and Licensed Insurance Brokers, which applies to all types of insurance, requires an insurance intermediary to carry out a suitability assessment to ascertain the client's circumstances and to base a recommendation on an insurance policy on those circumstances. This, in fact, is the core skill-set that every licensed insurance intermediary must have and the reason why members of the public use insurance intermediaries to procure their insurance and seek advice on such matters.

A failure by an insurance intermediary to meet these standards will render the intermediary in breach of the insurance regulatory framework which must be complied with as a baseline. If this results in severe prejudice to policyholders (as it did in this case) proportionate enforcement must be the result in order to send the message that standards of competence will be upheld in this market.

For the latest news on our enforcement work, please check out details of the other disciplinary actions taken by the IA which can be found on "Enforcement News" of the IA's website.

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