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Insurance Authority

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By Email

To : Chief Executives of All Authorized Insurers carrying on long term business, Responsible Officers of All Licensed Insurance Agencies and Responsible Officers of All Licensed Insurance Broker Companies carrying on regulated activities in respect of long term business

Dear Chief Executives and Responsible Officers,

Action against (and correction of) non-compliant business models that incentivize unlicensed selling of long term insurance policies to Mainland China Visitors

As an international finance centre, Hong Kong serves clients from across the globe who look to the financial services sector here for quality financial products and reliable services and advice. Hong Kong's life insurance industry (on which this circular focuses) plays an important part in this, offering a market where individuals from other jurisdictions, particularly Mainland China, can come to source a full range of diverse insurance policies to meet their insurance needs.

The Insurance Ordinance (Cap. 41) ("IO") seeks to reinforce trust and confidence in the Hong Kong insurance market by only permitting persons who are licensed by the Insurance Authority ("IA") as licensed insurance intermediaries to carry on regulated activities (i.e. to sell insurance, give advice on insurance matters and arrange insurance policies[1]). To obtain a licence, a person must be fit and proper (in terms of character, educational level and insurance qualifications). Once licensed, the person must adhere to the conduct requirements in the IO and related rules, codes of conduct and guidelines, when carrying on regulated activities to serve each client's insurance needs and best interests.

The licensing requirement is underpinned by section 64G of the IO. This makes it a criminal offence for a person to carry on regulated activities without the requisite licence (unless an exemption applies). Such is the importance of this requirement that, in the event it is breached, it comes with punishment of a fine and possible imprisonment for up to two years.

Non-compliant broker referral models

As our circulars of 30 November 2022 and 5 January 2023 warned, the IA has no tolerance for contraventions of the licensing requirement which serves as a vital policy holder protection. Equally, the IA has no tolerance for licensed insurance intermediaries who renege on their responsibilities as licensees by not performing regulated activities themselves, but who instead

[1] see Schedule 1A of the IO for the full description of "regulated activities"

rely on or have arrangements with unlicensed persons to do the regulated activities for them. This seriously prejudices the interests of policy holders and exposes the insurance buying public to the risk of mis-selling.

Despite these unequivocal warnings, our inspections, intelligence received and mystery shopping have continued to reveal business models adopted by certain licensed insurance broker companies that appear obviously to rely on unlicensed persons to perform regulated activities (with the broker company and its technical representatives failing to perform the substantive regulated activities themselves). These business models are characterized by the following features:

- Engagement of referrers without the requisite licence to carry on regulated activities on behalf of the broker company, to source clients usually from Mainland China to buy long-term insurance policies with savings and investment elements;

- Payment of inordinately high referral fees to referrers as reward for inducing clients to buy long-term insurance policies from Hong Kong authorized insurers via the broker company, with the referral fees being directly tied to successful sales (e.g. 90%+ of the commission received by the broker company for the insurance policy sold);

- The use by referrers of prohibited rebates to clients to induce them to buy long-term insurance policies;

- Inadequacies in the broker company's operation to fulfill its own duties to carry on regulated activities with clients. Technical representatives of the broker company do not have sufficient time or resources (with most of the commission being paid to the referrers) to perform anything other than a "cosmetic" form-filling exercise with the clients (at times with the referrers present) to make it seem like the broker company (rather than the referrers) has performed all the selling in Hong Kong. Essentially, this business model turns technical representatives into nothing more than rubber-stamps (or *"signing TRs"*) who spend limited time with clients and provide no post-sales ongoing servicing; and

- Clients being required by the broker company to sign statements asserting that all regulated activities were carried out by the broker company in Hong Kong (when this was not the case) and also being actively prompted by the technical representatives to state this to the insurer in any post-sales call received (thereby circumventing the insurer's controls).

The IA and the Independent Commission Against Corruption have conducted a joint operation against these non-compliant business models. The investigation is ongoing. The IA is also following up with other broker companies suspected of using this type of business model and also with the authorized insurers that have had long-term insurance policies sold using this business model (to ascertain the adequacy of their controls to prevent unlicensed selling).

The persistence of these non-compliant business models despite the previous warnings given, means that the following messages need to be reinforced to licensed insurance broker companies and authorized insurers that focus on offering long-term insurance policies with savings and investment elements, to Mainland China Visitors ("MCV").

I. Referral business must not breach requirements under the IO or other applicable laws

Whilst there is no prohibition on licensed insurance broker companies accepting introductions of clients (i.e. referrals) from persons who are not licensed, it is imperative that in sourcing, dealing with and referring clients to broker companies, there is no breach of the licensing requirement and the broker company (and its technical representatives) provides clients with proper advice and services in accordance with the IO, the rules, the codes, the guidelines and circulars issued by the IA (collectively "Insurance Regulatory Framework").

A licensed insurance broker company that seeks to rely on referrers (without the requisite licence) to refer prospective clients to the broker company, must ensure that any referral model adopted is consistent with the following three self-evident principles:

> ***Principle 1*** **–** Unlicensed referrers must **not** give any regulated advice to clients and must not carry on any regulated activities or sales activities.
>
> ***Principle 2*** **–** The broker company (and its technical representatives) must give all regulated advice to the client and carry on all regulated activities needed to arrange insurance policies for the client to the minimum standards required in the Insurance Regulatory Framework.
>
> ***Principle 3*** **–** If any payments are to be offered to referrers by the broker company for introducing clients, such payments should be calibrated to be consistent with (i) the referrers not carrying on regulated activities (and not being incentivized to do so); and (ii) the broker company being properly resourced to provide regulated advice and perform regulated activities for the clients being introduced.

To ensure its referral business model operates in line with the above three principles, a broker company must design, implement and practically and substantively carry out its referral model in line with these three principles. It must also reinforce this with adequate controls, processes and risk management.

The IA has given general guidance on this in its circular of 30 November 2022 and the Explanatory Notes it has issued on the subject of regulated activities[2]. We also provide further guidance on the three principles in the Annex to this circular. However, we emphasize that the adequacy of any controls and processes implemented will always be judged on a "substance over form" approach. The IA will be short on tolerance for any broker company that just seeks to put in place cosmetic controls and processes, whilst in substance relying on, turning a blind eye to, or encouraging unlicensed referrers to carry on regulated activities to source clients (while the broker company

[2] Explanatory Note on "Regulated Activity" under the Insurance Ordinance (Cap. 41) dated 12 October 2021; Explanatory Note on Licensing Requirements for Banking Sector under Regulatory Regime for Insurance Intermediaries dated 22 October 2019; and Explanatory Note on Licensing Requirements for Employees of Authorized Insurers under Regulatory Regime for Insurance Intermediaries dated 30 November 2018.

fails to perform the regulated activities itself). Broker companies that do this can, at the very least, expect to have their licence revoked and may also find themselves the target of criminal investigation and proceedings.

II. Responsibilities of the Intermediary Management Control Function of Insurers in respect of Licensed Insurance Broker Companies that rely on referral business

Authorized insurers are also reminded that their intermediary management control function is not only there to monitor their appointed licensed insurance agents. Such function must also ensure the arrangements by the licensed insurance intermediaries (including licensed insurance broker companies) for insurance business referred to the insurer, comply with the requirements of the Insurance Regulatory Framework. This includes compliance with the licensing requirement in section 64G of the IO.

In the training sessions we have carried out for Key Persons in the Intermediary Management Control Function and Directors of authorized insurers (provided through The Hong Kong Federation of Insurers), we have already provided guidance on the type of controls and processes an intermediary management function of an insurer may consider implementing in respect of the licensed insurance broker companies which place insurance policies with the insurer. These training sessions emphasized the need for enhanced due diligence and enhanced controls on licensed insurance broker companies that rely on referrals to offer long term insurance products to MCV clients. We supplement this further in the Annex in the context of the three principles and will continue to assess the effectiveness of controls and processes of insurers using a "substance over form" approach in our conduct inspections of insurers.

III. Rebates

Authorized insurers and licensed insurance intermediaries are also reminded of the prohibition on rebates of premium and commission on long term insurance products within the scope of the IA's GL 25 - Guideline on Offering of Gifts [3], with the exception of rebates recorded in the insurance policy, the policy schedule, the quotation, offer letter or promotional material (the terms of which are incorporated by reference into the insurance policy).

Where unchecked and undocumented rebates are used purely as an inducement in the sales process, it risks diverting the client's attention away from considering whether the insurance policy being purchased is suitable for the client's circumstances. These types of undocumented rebates thereby serve as a tool for mis-selling and can risk poor policy holder outcomes. Unchecked rebating can also result in discrimination between clients, with rebates only being provided to some but not others without any basis for such differentiation. This is the reason for the prohibition on unchecked rebates on long term insurance policies within the scope of GL25.

The fact that the non-compliant business model identified in this circular has been enabling unchecked rebates to be offered through referrers (as part of their unlicensed sales practices),

[3] For the scope of the prohibition on rebates on medical insurance business, see GL 31 – Guideline on Medical Insurance Business

demonstrates the correlation between prohibited rebates, unlicensed selling and potential erosion of standards of insurance advice (which is detrimental to confidence and trust in the Hong Kong insurance market).

If a licensed insurance broker company is aware of, turning a blind eye to, or doing nothing to prevent its referrers from offering such rebates to clients (from the referral fees the broker company pays to the referrer), then this amounts to a breach of GL25 and disciplinary action can be expected.

As GL25 states, if rebates are to be offered on long term insurance policies falling within the scope of GL25, they must be offered by authorized insurers as a formal part of the insurance policy documentation, so the rebate is part of the overall terms and conditions of the insurance policy being considered and therefore offered in a transparent, non-discriminatory manner (see further comments in section IV below).

IV. Commission and the 'treating customers fairly' principle

Authorized insurers are also reminded of their duties, as stated in the IA's GL 15 – Guideline on Underwriting Class C Business and GL 16 – Guideline on Underwriting Long Term Business (other than Class C Business), to ensure that the remuneration structures on long-term insurance products do not create misaligned incentives for intermediaries to engage in mis-selling and aggressive selling. Given that the remuneration being offered to the licensed insurance broker companies running the non-compliant business model cited in this circular, has resulted in inordinately high referral fees (incentivizing unlicensed selling) and indirect undocumented rebates being offered to clients, insurers should consider whether, based on the "treating customers fairly" principle, their commission structures are aligned with the cited principles in GL15 and GL16 and the objective of positive policy holder outcomes and satisfaction. The IA will be giving increasing focus to this in its inspections and supervision of insurers going forward (in respect of remuneration structures for **all licensed insurance intermediaries**) and ensuring insurers are held accountable to the regulatory standards (including through disciplinary action). Further comment on this issue is also included in the Annex.

V. Responsibilities of senior management and controllers

Finally, we remind all licensed insurance broker companies and authorized insurers that the responsibility lies with your senior management to implement controls and processes to ensure compliance with the Insurance Regulatory Framework. Under section 124 of the IO, controllers[4], directors, responsible officers and key persons in control functions may themselves be **personally guilty of a criminal offence**, if an offence is committed under the IO by the companies for which they work. Aside from this, disciplinary action may be taken by the IA resulting in, among other penalties, public reprimands which name and shame the individual controllers or members of

[4] In the context of broker companies, a "controller" is, per section 64F of the IO: "…a person who – (i) owns or controls, directly or indirectly, including through a trust or bearer share holding, not less than 15% of the issued share capital of the company; (ii) is, directly or indirectly, entitled to exercise or control the exercise of not less than 15% of the voting rights at general meetings of the company; or (iii) exercises ultimate control over the management of the company".

senior management of the company for their failures to discharge their responsibilities. It is therefore imperative that persons holding these positions take seriously their responsibilities to implement adequate controls and processes to prevent non-compliances with the Insurance Regulatory Framework and, in particular, to ensure the prevention of the non-compliant business models and other matters highlighted in this circular.

The Hong Kong insurance market has a collective duty to ensure that any client who comes to buy insurance here is provided with quality, suitable, impartial and objective advice based on the client's insurance needs and best interests. Clients must be put in a position to make informed decisions on the insurance protections they are considering. Licensed insurance intermediaries and authorized insurers must work together to ensure this so that the insurance market in Hong Kong is underpinned with trust, confidence and a deserved reputation for treating policy holders fairly.

Yours faithfully,

Peter Gregoire
Head of Market Conduct Division
General Counsel
Insurance Authority

Encl.

c.c. The Hong Kong Federation of Insurers
Professional Insurance Brokers Association
The Hong Kong Confederation of Insurance Brokers