

Insurance Authority (“IA”) Circular providing interpretation notes (“Circular”) relating to the Guideline on Sale of Investment-Linked Assurance Scheme (“ILAS”) Products

The Insurance Authority (“IA”) issues this Circular with the aim of providing further guidance to authorized insurers and licensed insurance intermediaries in respect of the sale process of ILAS products under the Guideline on Sale of Investment-Linked Assurance Scheme (“ILAS”) Products (GL26) (the “Guideline”).

This Circular is not intended to be a comprehensive guide and does not constitute legal advice. Authorized insurers and licensed insurance intermediaries are advised to seek professional legal advice if they have any questions relating to the application or interpretation of the relevant provisions of the Guideline.

This Circular does not have the force of law and should not be interpreted in a way that would override the provision of any law. The IA reserves the right to review and update this Circular from time to time. Unless otherwise specified, words and expressions in this Circular shall have the same meanings as given to them in the Guideline.

(Q&A 31A, 32A to 32E and 34 were added on 31 August 2021.)

| | | <u>Special Attention in relation to ILAS Products with Open Architecture (“OA ILAS Products”)</u> |
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| Q | 31A | Further to the Professional Investor (“PI”) requirement as set out in Q&A 31, please specify any specific requirement(s) on licensed insurance intermediaries for selling OA ILAS products to PIs. |
| A | 31A | <p>To ensure that new OA ILAS policies (i.e. ILAS with an open architecture which do not carry a list of investment choices set by the authorized insurers) are sold only to PIs,</p> <ul style="list-style-type: none"> (a) licensed insurance intermediaries who sell such policies must possess the necessary knowledge and expertise to determine if a customer is truly a PI; and (b) authorized insurers must put into place adequate controls to ensure that licensed insurance intermediaries who sell such policies possess the necessary knowledge and expertise to determine if a customer is truly a PI. <p>With regards to (b), an authorized insurer must satisfy itself that the relevant licensed insurance intermediaries possess the relevant expertise and will be able to provide the necessary documentary evidence for supervisory review by the IA upon request. Authorized insurers who intend to rely on insurance intermediaries being licensed by the Securities and Futures Commission for this purpose are required to ensure that such insurance intermediaries have adequate internal controls in place for conducting PI assessment competently.</p> |
| Q | 32A | Further to the procurement objectives as set out in Q&A 31 and 32, please elaborate on the following: (i) any specific requirements that should be implemented to ensure an OA ILAS product is only to be recommended to a customer who is a PI for investment and tax/estate planning purpose; and (ii) the proper risk and underwriting control measures that should be put in place by authorized insurers for this purpose. |

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| A | 32A | <p>As part of the FNA process, licensed insurance intermediaries should perform analysis on the customer’s insurance, financial and investment needs and carry out adequate due diligence to establish that:</p> <ul style="list-style-type: none"> a) the customer is a PI who has overseas residency (unless such customer has special reasons for acquiring an OA ILAS product as set out in Q&A 31); b) the customer may be subject to tax obligations (e.g., capital gain tax or estate tax) because of his/her overseas residency; and c) the OA ILAS product which the customer is seeking to procure for his/her investment and tax/estate planning purposes is suitable with regards to the specific investment and tax/estate planning objectives of the customer. <p>Licensed insurance intermediaries are required to verify and ensure that all available information obtained from the customer is not contradictory.</p> <p>Authorized insurers are also required to verify the information (a), (b) and (c) above during their underwriting process and reject applications for such products if any of the applicable requirements are not met. In particular, authorized insurers should have in place effective controls and procedures to verify the customer’s status as a PI with proper documentation in support, and his/her objective(s) of procuring such product (e.g. existence of any tax efficiencies or any efficiencies achieved in estate planning) with proper documentation supporting how the OA ILAS product which is the subject of the application, achieves the customer’s investment and tax/estate planning objectives, with legal and tax advice as appropriate, before policy issuance. Records should be provided for inspection, review and investigation by the IA and other relevant regulatory bodies as soon as practicable upon request.</p> |
| Q | 32B | <p>Further to the investment requirement as mentioned in Q&A 32, please clarify any specific requirement(s) which apply with regards to the investments to be made under new OA ILAS policies with PIs, specifically with a view to ensuring OA ILAS products are not used to enable investing in investments which are subject to less governance or regulation.</p> |
| A | 32B | <p>All investments made under new OA ILAS policies should be restricted to SFC-authorized funds, listed securities, rated bonds, funds authorized or registered with financial regulators in jurisdictions which have entered into mutual recognition of funds arrangements with the Securities and Futures Commission (“SFC”)⁴ or schemes as set out in the list of Recognized Jurisdiction Schemes⁵ as specified by SFC.</p> |
| Q | 32C | <p>Further to the investment requirement as mentioned in Q&A 32 and elaborated on in Q&A 32B, please elaborate further on any specific requirement(s) necessary to ensure account is taken of the risks associated with the investments made under OA ILAS products for PIs, as part of the investment onboarding process.</p> |
| A | 32C | <p>Although OA ILAS products for PIs do not carry a list of investment choices set by the authorized insurers, title to the underlying investments to which an OA ILAS</p> |

⁴ <https://www.sfc.hk/en/Regulatory-functions/Products/List-of-publicly-offered-investment-products/Mutual-recognition-of-funds-arrangements>

⁵ <https://www.sfc.hk/en/Regulatory-functions/Products/List-of-publicly-offered-investment-products/List-of-recognised-jurisdiction-schemes-and-inspection-regimes>

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| | <p>policy is linked is usually vested in the authorized insurer issuing the policy. By making the investment to which the OA ILAS policy is linked, therefore, the authorized insurer cannot and should not seek to disassociate itself from the investment. Rather, an authorized insurer is required to perform due diligence on the investment and have in place appropriate control and monitoring mechanisms for assessment and identification of risks arising from investment activities as part of the investment onboarding process. These due diligence, control and monitoring mechanisms also serve as important investor protection measures, aligning the interests of the authorized insurer with those of the policy holder.</p> <p>Authorized insurers should perform due diligence for investments which the authorized insurers make under both new and existing OA ILAS policies as part of its investment on-boarding process. This due diligence should include compliance with the investment requirements as set out in Q&A 32B.</p> <p>Authorized insurers should also carry out enhanced due diligence for top-up or switching-in investments under the existing OA ILAS policies, if the investments are not in SFC-authorized funds, listed securities, rated bonds, funds authorized or registered with financial regulators in those jurisdictions which have entered into mutual recognition of funds arrangements with the Securities and Futures Commission (“SFC”) or schemes as set out in the list of Recognized Jurisdiction Schemes as specified by SFC. In carrying out this enhanced due diligence, authorized insurers should assess and identify all the risks arising from the investments, particularly for investments/assets which are less transparent or subject to less governance or regulation⁶, before accepting the relevant investments/assets for investment under the OA ILAS policy⁷. For the avoidance of doubt, while existing investments made under existing OA ILAS policies will remain unaffected and can continue to be held pursuant to existing contractual provisions where there is no top-up or switching-in investment, they are subject to the requirements as set out in (iii) and (iv) in the next paragraph.</p> <p>Authorized insurers should establish an investment policy specific to their OA ILAS products setting out in detail, inter alia, the following matters:</p> <ul style="list-style-type: none"> (i) the assessment and due diligence that the authorized insurers must perform on investments to ensure compliance with, including but not limited to the investment requirements as set out in Q&A 32B and 32C; (ii) the limitations on the investments the authorized insurers would accept for investment under OA ILAS products following the authorized insurers’ assessment and due diligence; (iii) the ongoing monitoring on the relevant investment the authorized insurers should perform and the periodic disclosure to customers of material information on such investments the authorized insurers should provide in accordance with the principle of “fair customer treatment”; and (iv) the effective control and monitoring procedures the authorized insurers should establish and perform for compliance with the established investment policy with timely reporting and escalation of compliance status and breaches to |
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⁶ Reference to the requirements under paragraph 7.6 of Guideline on Enterprise Risk Management

⁷ For the avoidance of doubt, please also refer to the requirements as set out in Q&A 30 above, which the suitability requirements apply, in particular, the applicable requirements as set out in Q&A 19(2) relating to processing the switching instructions into a derivative fund. These requirements are applicable to all existing policies of OA ILAS products authorized by SFC.

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| | | <p>senior management including the Investment Committee of the authorized insurers.</p> <p>For the purpose of (ii) above, in relation to existing OA ILAS policies, applications for top-up or switching-in into investments or assets under such existing policies which are considered (as part of the investment onboarding process) to be no less transparent or not subject to less governance or regulation than the relevant limitation on investments set out in the investment policy of the authorized insurer, may generally be considered acceptable.</p> <p>For the purpose of (iii) above, authorized insurers should have adequate procedures in place to discharge their obligations regarding ongoing monitoring of the investments and inform customers as soon as reasonably practicable of information which is necessary to enable the customers to assess the financial and overall position of the investments involved.</p> <p>For supervisory monitoring and inspection purposes, authorized insurers should retain proper documentation and supporting evidence for compliance with the above requirements⁸, and should provide such documentation and evidence for the IA's and other relevant regulatory bodies' inspection as soon as practicable upon request.</p> |
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| | Q 32D | <p>Further to risk awareness requirements as set out in Q&A 31 and 32, please elaborate on any specific enhanced risk disclosure requirement(s) expected to ensure customers' awareness of the risks associated with the investments made under OA ILAS products for PIs before executing customers' investment instructions.</p> |
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| | A 32D | <p>Paragraph 4.2(j) of the Guideline requires licensed insurance intermediaries to disclose and explain the risks associated with ILAS products (including those of the underlying investment choices), such as counterparty risk, credit risk, liquidity risk, foreign exchange risk, market risk, etc., to customers, and take all reasonable measures to satisfy themselves that customers fully understand and accept the relevant features and associated risks.</p> <p>Authorized insurers should explicitly highlight in their marketing literature to customers, among other matters, that (i) all investment choices are not operated or managed by the authorized insurers nor recommended by them; (ii) customers should bear all the risks in relation to the investment they choose including the investment return; (iii) authorized insurers are tasked with executing customers' investment instructions and have the right to reject any assets. For the avoidance of doubt, however, authorized insurers are still obliged to comply with other requirements specific to OA ILAS products as set out in Q&A 30 to 32E.</p> <p>Authorized insurers should have adequate procedures in place to ensure the matters as set out in (i) to (iii) of the last paragraph of Q&A 31, and in (i) to (iii) of the preceding paragraph are clearly explained and disclosed to customers. Such explanation and disclosure may be made through licensed insurance intermediaries. However such explanation or disclosure is provided, proper</p> |

⁸ For the avoidance of doubt, the requirements as set out in (iii) and (iv) of Q&A 32C are applicable to all existing policies of OA ILAS products authorized by SFC.

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| | | <p>documentation in support of the explanation and disclosure should be provided and maintained, before executing customers’ investment instructions (including top-up or switching-in applications).</p> <p>For existing OA ILAS policies where top-up or switching-in investments are not in SFC-authorized funds, listed securities, rated bonds, funds authorized or registered with financial regulators in those jurisdictions which have entered into mutual recognition of funds arrangements with the Securities and Futures Commission (“SFC”) or schemes as set out in the list of Recognized Jurisdiction Schemes as specified by SFC, authorized insurers and licensed insurance intermediaries should, with due regard to the enhanced due diligence on the relevant investments as set out in Q&A 32C, expressly inform the customer in writing of all the risks assessed and identified, and obtain the customer’s acknowledgement that he/she understands the risks associated with the investments. Proper documentation and supporting evidence should be retained for monitoring purpose.</p> |
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| Q | 32E | <p>Further to the governance and control requirements as set out in Q&A 32, please elaborate on the requirement(s) for risk governance and management controls which authorized insurers should put in place to ensure strict compliance with the requirements relevant to OA ILAS products for PIs.</p> |
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| A | 32E | <p>Authorized insurers should maintain clear and documented policies and procedures appropriate for the nature, scale and complexity of the risks associated with the OA ILAS business they conduct and also for strict compliance with all the regulatory requirements. The relevant policies and procedures should detail the governance of the associated risks across the business, including roles and responsibilities, reporting lines and authorities, as well as approaches, methodologies, processes, controls, systems and reviews. Proper procedures should be put in place for authorized insurers to apprise the IA of their OA ILAS products for PI prior to the launch of such products. In this respect an authorized insurer should provide the IA with sufficient details of the product sufficiently in advance of the intended product launch. The relevant policies and procedures should be at least approved by the Risk Committee of the authorized insurer.</p> <p>Any documentation or record relating to OA ILAS products will be subject to the IA’s inspection / review as the IA considers appropriate.</p> |
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| Q | 34 | <p>Further to Q&A 33 above, please clarify any transitional period to enable authorized insurers and licensed insurance intermediaries to align their documentation, controls and processes with the enhanced requirements on OA ILAS products for Professional Investor (PI) as set out in Q&A 31A and 32A to 32E of this Circular (“Enhanced OA ILAS Requirements”).</p> |
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| A | 34 | <p>A transitional period till 30 June 2022 will apply in respect of the Enhanced OA ILAS Requirements on OA ILAS products (“Extended OA ILAS Transitional Period”).</p> <p>During the Extended OA ILAS Transitional Period, authorized insurers and licensed insurance intermediaries should continue to comply with the requirements as set out in the Circular dated 20 September 2019 providing Interpretation Notes relating to the Guideline (“Circular dated 20 September 2019”), whilst they update</p> |

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| | <p>their documentation, controls and processes to align with the Enhanced OA ILAS Requirements in this Circular. This Extended OA ILAS Transitional Period shall apply only to OA ILAS policies (base plan, top-up and switching-in applications) issued prior to the end of the Extended OA ILAS Transitional Period. By the end of the Extended OA ILAS Transitional Period, authorized insurers and licensed insurance intermediaries will be expected to have updated their documentation, controls and processes to align with this Circular.</p> |
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