

Insurance Intermediaries Quality Assurance Scheme

Principles and Practice of Insurance Examination

Study Notes

2017 Edition

Study Notes for Principles and Practice of Insurance Examination Update

Renaming of The Insurance Claims Complaints Bureau

The Insurance Claims Complaints Bureau ('ICCB') has been renamed The Insurance Complaints Bureau ('ICB') with effect from 16 January 2018.

This Update serves to set out the textual updates to the Study Notes for the Principles and Practice of Insurance Examination (2017 Edition) to reflect the aforesaid change.

1. **Sections 6.1.4, 6.1.4a and 6.1.4b** are replaced by the text below:

6.1.4 Insurance Complaints Bureau ('ICB')

The Insurance Complaints Bureau ('ICB') was inaugurated on 16 January 2018 to supersede The Insurance Claims Complaints Bureau ('ICCB') in providing an alternative dispute resolution mechanism to help resolve insurance-related disputes of a monetary nature arising from personal insurance contracts. Apart from maintaining the ICCB's service of adjudicating claim-related disputes, the ICB has launched a new mediation service to handle non-claim related insurance disputes of a monetary nature starting from 16 July 2018. It is worth noting that the ICB has no jurisdiction over insurance intermediaries' misconduct.

The ICB continues to have a compulsory membership of all authorised insurers carrying on personal insurance business in Hong Kong. The independence and impartiality of the ICB are partly reflected by the composition of its Board of Directors, of whom four – including the Chairman – come from outside the insurance industry and three from the insurance industry.

6.1.4a Composition and Powers of The Insurance Claims Complaints Panel

- (a) Claim-related complaints that are filed with the ICB are actually adjudicated by the *Insurance Claims Complaints Panel* (the 'Complaints Panel'), which is led by an independent Chairman appointed by the ICB with the prior consent of the Secretary for Financial Services and the Treasury.
- (b) Of the other four members on the Complaints Panel, two come from the insurance industry and two from outside.

- (c) No fee is charged to the complainant, whether he wins his case or not.
- (d) The Complaints Panel can make an award against an insurer up to **HK\$1,000,000**, who has no right of appeal against an award. If the complainant is unsatisfied with the decision of the Complaints Panel, he may, however, seek legal redress.
- (e) Further points on the powers of the Complaints Panel: The Articles of Association of the ICB stipulates that the Complaints Panel, in making its ruling, *'shall have regard to and act in conformity with the terms of the relevant policy, general principles of good insurance practice, any applicable rule of law or judicial authority; and any codes and guidelines issued from time to time by the Hong Kong Federation of Insurers (HKFI) or the ICB. In respect of the terms of the policy contract, these shall prevail unless they would, in the view of the Complaints Panel, produce a result that is unfair and unreasonable to the complainant'*. The gist of these provisions is that, the Complaints Panel, in making a ruling, is empowered by the ICB Members to look beyond the strict interpretation of policy terms.

As far as good insurance practice is concerned, the Complaints Panel relies heavily on the expected standards set out in *The Code of Conduct for Insurers*, with particular reference to 'Part III: Claims'. The first requirement of the section states, *'Insurers should seek to handle all claims efficiently, speedily and fairly'*. As such, as to whether an insurer has acted fairly in the settlement of claims or not is subjected to the scrutiny of the Complaints Panel.

6.1.4b Terms of Reference of ICB's Services

Any complaint that the ICB sets out to handle should satisfy the following conditions:

For both claim and non-claim related complaints:

- (a) the complaint is of a monetary nature;
- (b) the claim amount/monetary value of the complaint does not exceed HK\$1,000,000;
- (c) the insurer concerned is an ICB member;

- (d) the policy concerned is a personal insurance policy;
- (e) the complaint is filed by a policyholder/policy beneficiary/insured person/rightful claimant (e.g. an assignee);
- (f) the insurer concerned has made its final decision on the claim/dispute;
- (g) the complaint is filed with the ICB within 6 months from the day of notification by the insurer of its final decision;
- (h) the complaint does not arise from commercial, industrial or third party insurance;
- (i) the complaint is not subject to legal proceedings or arbitration.

For non-claim related complaints:

- (j) the complaint is not about quality of service or an underwriting decision of an insurer; and
- (k) the complaint is not related to investment performance, level of a fee, premium, charge or interest rate unless the dispute concerns an alleged non-disclosure, misrepresentation, incorrect application, negligence, breach of any legal obligation or duty or maladministration on the part of an insurer.

6.1.4c Non-claim Related Mediation Service

Where the parties concerned in dispute have failed to reach an amicable resolution despite the ICB's encouragement to do so, they may select a mediator from a list of qualified mediators with relevant experience and qualification that the ICB maintains for mediation service. With a jurisdiction limit of **HK\$1,000,000**, the mediation service is free to complainants.

2. Update to the Glossary: the entry of “**Insurance Claims Complaints Bureau** (保險索償投訴局)” is replaced by the text below:

Insurance Complaints Bureau (保險投訴局) With a membership of all authorised insurers carrying on personal insurance business in Hong Kong, its primary function is to help resolve both claim-related and non-claim related disputes of a monetary nature arising from personal insurance contracts, in the capacity of an adjudicator and mediator respectively. **6.1.4**

3. For ease of reference, textual updates to the rest of the Study Notes are set out below:

Existing Wording	Updated Wording	Sections
Insurance Claims Complaints Bureau ('ICCB')	Insurance Complaints Bureau ('ICB')	Table of Contents: 6.1.4 5.5.3(a)
participate in the <i>Insurance Claims Complaints Bureau</i> ('ICCB')...	become a member of the <i>Insurance Complaints Bureau</i> ('ICB')...	6.1.2e(b)
Insurance Claims Complaints Bureau	Insurance Complaints Bureau	6.1.3b
Insurance Claims Complaints Bureau ('ICCB') 保險索償投訴局 (「投訴局」) 6.1.4	Insurance Complaints Bureau ('ICB') 保險投訴局 (「投訴局」) 6.1.4	Index (page (4))

Insurance Authority

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PREFACE

These Study Notes have been prepared to correspond with the various Chapters in the Syllabus for the Principles and Practice of Insurance Examination. The Examination will be based upon these Notes. A few representative examination questions are included at the end of each Chapter to provide you with further guidance.

*It should be noted, however, that these Study Notes will not make you a fully qualified underwriter or other insurance specialist. It is intended to give a preliminary introduction to the subject of Principles and Practice of Insurance, as a **Quality Assurance** exercise for Insurance Intermediaries.*

We hope that the Study Notes can serve as reliable reference materials for candidates preparing for the Examination. While care has been taken in the preparation of the Study Notes, errors or omissions may still be inevitable. You may therefore wish to make reference to the relevant legislation or seek professional advice if necessary. As further editions will be published from time to time to update and improve the contents of these Study Notes, we would appreciate your feedback, which will be taken into consideration when we prepare the next edition of the Study Notes.

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GLOSSARY

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NOTE

For your study purposes, it is important to be aware of the relative 'weight' of the various Chapters in relation to the Examination. All Chapters should be studied carefully, but the following table indicates areas of particular importance:

Chapter	Relative Weight
1	12%
2	16%
3	30%
4	9%
5	5%
6	21%
7	7%
Total	100%

1 RISK AND INSURANCE

1.1 CONCEPT OF RISK

1.1.1 Meaning of Risk

There have been many attempts to define 'risk'. Probably, to most of us, 'risk' contains a suggestion of *loss* or *danger*. We may therefore define it as '**uncertainty concerning a potential loss**', a situation in which we are not sure whether there will be loss of a certain kind, or how much will be lost. It is this uncertainty and the *undesirable* element found with risk that underlie the wish and need for insurance.

The potential loss that risk presents may be:

- (a) *financial*: i.e. measurable in monetary terms (e.g. loss of a camera by theft);
- (b) *physical*: death or personal injury (often having financial consequences for the individual or his family); or
- (c) *emotional*: feelings of grief and sorrow.

Only the first two types of risks are likely to be (commercially) **insurable risks**. Also, from a wider perspective, not every risk will be seen in the **negative** form we have just outlined (see **1.1.2a** below).

Note: Without trying to complicate matters, we should also be aware that insurance practitioners may use the word 'risk' with other meanings, including:

- 1 the property or person at risk that they are insuring or considering insuring; and
- 2 the *peril* (i.e. cause of loss) insured (so, some policies may insure on an '**all risks**' basis, meaning that any loss due to any cause is covered, except where the cause is excluded from cover).

1.1.2 Classification of Risk

To simplify a complex subject, we may classify risk under two broad headings (each having two categories) according to:

- (a) its potential *financial results*; and
- (b) its *cause and effect*.

1.1.2a Financial Results

Risks may be considered as being either *Pure* or *Speculative*:

- (i) *Pure Risks* offer the potential of **loss** only (no gain), or, at best, no change. Such risks include fire, accident and other undesirable happenings.
- (ii) *Speculative Risks* offer the potential of **gain or loss**. Such risks include gambling, business ventures and entrepreneurial activities.

The majority of the risks which are insured by commercial insurers are pure risks, and speculative risks are not normally insurable. The reason for this is that speculative risks are engaged in voluntarily for gain, and, if they were insured, the insured would have little incentive to strive to achieve that gain.

1.1.2b Cause and Effect

Risks may also be considered as being either *Particular* or *Fundamental*:

- (i) *Particular Risks*: They have relatively limited consequences, and affect an individual or a fairly small number of people. The consequences may be serious, even fatal, for those involved, but are comparatively localised. Such risks include motor accidents, personal injuries and the like.
- (ii) *Fundamental Risks*: Their causes are outside the control of any one individual or even a group of individual, and their outcome affects large numbers of people. Such risks include famine, war, terrorist attack, widespread flood and other disasters which are problems for society or mankind rather than just the 'particular' individuals involved.

The majority of the risks which are insured by commercial insurers are particular risks. Fundamental risks are not normally insurable because it is considered financially infeasible for insurers to handle them commercially.

1.1.3 Risk Management

'Risk management' is a term which is used with different meanings:

- (a) in the world of banking and other financial services outside insurance, it is probably used with reference to investment and other *speculative* risks (see **1.1.2a** above);

- (b) insurance companies will probably use the term only in relation to *pure* risks, but they may well restrict it even further to *insured* risks only. Thus, when insurers talk about '**risk management**', they could well be referring to ways and means of reducing or improving the *insured loss potential* of the 'risks' they are insuring, or being invited to insure;
- (c) as a separate field of knowledge and research, risk management may be said to be that branch of management which seeks to:
- (i) *identify*;
 - (ii) *quantify*; and
 - (iii) *deal with* risks (whether **pure** or **speculative**) that threaten an organisation. Tools or measures of risk handling include:
 - *risk avoidance*: elimination of the chance of loss of a certain kind by not exposing oneself to the peril (e.g. abandoning a nuclear power project so as to eliminate the risk of nuclear accidents);
 - *loss prevention*: the lowering of the frequency of identified possible losses (e.g. activities promoting industrial safety);
 - *loss reduction*: the lowering of the severity of identified possible losses (e.g. automatic sprinkler system);
 - *risk transfer*: making another party bear the consequences of one's exposure to loss (e.g. purchase of insurance and contractual terms shifting responsibility for possible losses);
 - *risk financing*: no matter how effective the loss control measures an organisation takes, there will remain some risk of the organisation being adversely affected by future loss occurrences. A risk financing programme is to minimise the impact of such losses on the organisation. It uses tools like: insurance, risk transfer other than insurance, self-insurance, etc. (Whilst insurance is closely connected with risk management, it is only one of the tools of risk management.)

To illustrate (i) - (iii) above, suppose a supermarket finds that it is losing goods from its shelves. It *identifies* its possible causes by observation, which could be theft by customers, theft by staff, etc. It *quantifies* the loss from frequent stocktaking compared with cash receipts (making allowance for staff errors). It may *deal with* the risk, for example, by installing closed circuit TV, or (if market conditions allow) by raising prices generally to offset such losses, or by setting up a self-insurance fund for them.

1.2 FUNCTIONS AND BENEFITS OF INSURANCE

Insurance has many functions and benefits, some of which we may describe as **primary** and others as **ancillary** or secondary, as follows:

- (a) **Primary functions/benefits:** Insurance is essentially a *risk transfer mechanism*, removing, for a **premium**, the potential financial loss from the individual and placing it upon the insurer.

The primary benefit is seen in the *financial compensation* made available to insured victims of the various insured events. On the commercial side, this enables businesses to survive major fires, liabilities, etc. From a personal point of view, the money is of great help in times of tragedy (life insurance) or other times of need.

- (b) **Ancillary functions/benefits:** Insurance contributes to society directly or indirectly in many different ways. These will include:

(i) *employment:* the insurance industry is a significant factor in the local workforce;

(ii) *financial services:* since the relative decline in manufacturing in Hong Kong, financial services have assumed a much greater role in the local economy, insurance being a major element in the financial services sector;

(iii) *loss prevention and loss reduction* (collectively referred to as ‘*loss control*’): the practice of insurance includes various surveys and inspections related to **risk management** (see 1.1.3(b) above). These are followed by requirements (conditions for acceptance of risk) and/or recommendations to improve the ‘risk’. As a consequence, we may say that there are fewer fires, accidents and other unwanted happenings;

(iv) *savings/investments:* life insurance, particularly, offers a convenient and effective way of providing for the future. With the introduction of the Mandatory Provident Fund Schemes in 2000, the value of insurance products in providing for the welfare of people in old age or family tragedy is very evident;

(v) *economic growth/development:* it will be obvious that few people would venture their capital on costly projects without the protection of insurance (in most cases, bank financing will just not be available without insurance cover). Thus, developments of every kind, from erection of bridges to building construction and a host of other projects, are encouraged and made possible partly because insurance is available.

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Representative Examination Questions

*The examination will consist of 75 multiple-choice questions. The majority of the questions will be very straightforward, involving a simple choice from four alternatives. These we may call **Type 'A' Questions**. A selection of the questions (probably between 10% and 15%) will be slightly more complex, but again involving a choice between four alternatives. These we may call **Type 'B' Questions**. Examples of each are shown below.*

Type 'A' Questions

- 1 Risk may be described as the uncertainty concerning a potential loss. That potential loss may be:
- (a) physical;
 - (b) financial;
 - (c) emotional;
 - (d) all of the above.

[Answer may be found in **1.1.1**]

- 2 A risk which offers the prospect of loss only, with no chance of gain, may be described as a:
- (a) pure risk;
 - (b) particular risk;
 - (c) speculative risk;
 - (d) fundamental risk.

[Answer may be found in **1.1.2a**]

Type 'B' Questions

- 3 Which of the following statements concerning risk are **true**?
- (i) All risks are commercially insurable.
 - (ii) Not all risks are commercially insurable.
 - (iii) The only remedy for any kind of risk is insurance.
 - (iv) Insurers may mean a number of things when talking about 'risk'.
-
- (a) (i) and (iii) only;
 - (b) (ii) and (iv) only;
 - (c) (i) and (iv) only;
 - (d) (i), (iii) and (iv) only.

[Answer may be found in **1.1-1.1.1**]

4 Which of the following may be considered as being among the secondary or subsidiary benefits of insurance to Hong Kong?

- (i) means of savings
 - (ii) source of employment
 - (iii) encouragement of economic development
 - (iv) reduction in number of accidents/losses
-
- (a) (i) and (ii) only;
 - (b) (i), (ii) and (iii) only;
 - (c) (iii) and (iv) only;
 - (d) (i), (ii), (iii) and (iv).

[Answer may be found in **1.2(b)**]

***Note:** The answers to the above questions are for you to discover. This should be easy, from a quick reference to the relevant part of the Notes. If still required, however, you can find the answers at the end of the Study Notes.*

2 LEGAL PRINCIPLES

This and the next Chapter will concern principles of law, but the Notes will not provide a comprehensive survey of some very complex issues. The purpose of the Notes, as with the overall study, is to give an insight into the important aspects of an insurance intermediary's professional activities.

2.1 THE LAW OF CONTRACT

This is an area of law which affects every one of us, whether in our personal or business lives. As we shall see, contract is an essential element in civilised societies, therefore it is important to have some appreciation of this important subject.

2.1.1 Definition

The simplest definition for 'contract' is probably: a *legally enforceable agreement*. There are a large variety of agreements, but not all are intended to have legal consequences. A *social arrangement* between two persons, such as a lunch appointment for example, is an agreement, but where either of them unilaterally cancels the appointment, there is no suggestion that the disappointed party should be able to take legal action against the other party, because the agreement is not legally recognised as valid.

Contracts comprise promises or undertakings, usually given in exchange for a promise or undertaking from the other side. In legal terminology, contracts are something intangible. Therefore, an insurance policy in itself is not a contract; instead it is the most commonly used evidence of an insurance contract. An insured who has been affected by a fire will not expect the insurer to deny his insurance claim on the grounds that the insurance contract no longer exists after the insurance policy has been destroyed in the fire.

Contracts may concern relatively *trivial* (such as buying a newspaper or taking a tram ride) or very *important* matters (such as a major building project or employment). In any event, the contracting parties expect promises to be honoured, and can demand compensation or enforced performance if they are not honoured.

2.1.2 Types of Contracts

For our purposes, we may consider that there are two major types of contract, as follows:

- (a) **Simple contracts:** Although these are described as ‘simple’, this does not mean that they only deal with uncomplicated matters and are easy to understand. Rather, it means that they are simple or easy to form. A simple contract is one created verbally, or by writing not under seal. It can also be inferred from conduct. In short, the validity of simple contracts does not depend on special formalities.

[An example of a contract inferred from *conduct* is where someone picks up a newspaper from a street vendor and where their body language clearly indicates a purchase. Technically, a contract is formed between the seller and buyer, with the acts of handing over and accepting the money for the newspaper: no words or writing are needed.]

In fact, the great majority of insurance contracts are ‘simple’ contracts. Technically, insurance contracts, to be valid, do not have to be evidenced in writing; but in practice, they almost always are. Nevertheless, as we shall see later, insurance contracts of a certain type are legally required to be evidenced by insurance policies.

- (b) **Contracts by deeds:** A deed is a written instrument signed, sealed and delivered. (Delivery is no longer required to be physical delivery; an intention to be unconditionally bound by the deed suffices.) It must be used with certain transactions such as a transfer of land. Besides, suretyship is always issued in the form of a deed; otherwise, when a claim arises, the obligee may possibly face a defence put up by the surety that he has not the right to sue because he has provided no consideration (see 2.1.3 (c) below for the doctrine of consideration).

2.1.3 Elements or Essentials of a Contract

For the purposes of this section, we shall be talking only of *simple* contracts (see 2.1.2(a) above), since these constitute the great majority of contracts that are met in insurance transactions.

To be a valid contract, an agreement must meet certain criteria called ‘elements of contract’ in the course of its formation. Should any of these elements be absent, the proposed contract either does not exist or is defective in another sense. There are three types of **defective contracts**, as follows:

1 *Void (or invalid) contracts:* This means that the proposed contract does not exist in law; it is entirely without legal effect. In the context of insurance, the implication is that generally all premiums which have already been paid under a void contract (or invalid agreement) are returnable; so are claims paid.

2 *Voidable contracts*: A voidable contract is one that is apparently of legal effect and that remains to be legally effective unless and until an aggrieved party to the contract treats it as void as from contract conclusion within a reasonable time after acquiring knowledge of the availability of such a right of election. In insurance, it could arise, for instance, with a breach of some types of policy provision, or the discovery that important information was omitted or wrongly given at the proposal stage (see 3.2 below);

3 *Unenforceable contracts*: This means what it says, an unenforceable contract cannot be enforced (or sued on) in a court of law. However, this is not because it is void, but because some required action has not been taken (e.g. stamp duty not paid on a lease of land, *marine* insurance policy not issued, etc.). This defect can be remedied by carrying out the required action, so that the contract becomes enforceable (e.g. by issuing a marine policy even after a loss has realised).

Turning to the **elements of contract** themselves, legal textbooks are not always agreed just exactly how many elements should be found with any one valid contract, but we shall consider **six** criteria here, as follows (remembering that we need not go into great detail):

- (a) *Offer*: if no offer is made, obviously there can be no agreement between the two or more parties. In insurance, the *offeror* may be the intending insured (perhaps by completing and submitting to the insurer a proposal form (or application form)), or the insurer (perhaps as a *counter-offer* or in connection with a policy *renewal*); all depends on intention as evidenced by facts. Therefore, although it is widely accepted that an act of completing an insurance proposal form is normally an act of offer, it is technically incorrect to say that it is a settled law that completing an insurance proposal form is an act of offer to the insurer.
- (b) *Acceptance*: the proposed contract cannot come into being unless the offer is accepted by the other party (the *offeree*). All terms of the offer must be accepted before a contract is concluded. If that other party intends to vary the terms of the proposed contract (requiring increased premium or policy restrictions, for example), this, upon its communication, constitutes a *counter-offer*, which will have the effect of nullifying the original offer. A counter-offer is subject to acceptance by the original *offeror* (who becomes the *offeree* with the counter offer).
- (c) *Consideration*: this is the price (monetary or otherwise) a contracting party pays for the promise the other party ('promisor') makes to him. In the case of a simple contract, consideration must be given by *both* parties; otherwise it is void. On the other hand, a promise contained in a deed, even if it has been given not for consideration, is enforceable at common law by the promisee. In other words, a unilateral promise not made by a deed is invalid. In insurance, the consideration is:

- (i) the *promise* by the insured to pay premium; and
- (ii) the *promise* by the insurer to pay or compensate as per policy terms.

Note: 1 Where an insured event occurs before the premium promised is paid, the insured will still be entitled to insurance payment in accordance with the terms of the contract and the insurer will have a separate claim against him for the unpaid premium. However, some policies require actual payment of premium as consideration, which requirement will have the effect of overriding the said legal rule.

2 The insurer's consideration is the *promise* to pay, etc., rather than the actual payment. In many cases, no claim arises under the policy, but when the insured period ends the insurer is treated as having provided consideration, and therefore there will not be a question of the contract being void for lack of consideration leading to an entitlement to return premiums.

- (d) *Capacity to contract:* it means the legal ability to enter into a contract. With individuals, if they are *mentally disordered*, or are *minors*, the contracts they make are *generally* voidable at their option. With companies, they must not act in a way that exceeds their legal powers.
- (e) *Legality:* the subject of the agreement must be legal. A contract to kill or to commit any other crimes, for example, is not valid. Likewise, insurance on smuggled goods would also not be legally recognised. However, exceptions do exist. For instance, the courts may enforce an insurance claim in favour of an insured under an insurance contract that is illegal because the insurer was not authorised to transact the kind of insurance business in question.
- (f) *Intention to create legal relation:* to make a valid contract, each party to it must clearly have the intention that it is to have legal consequences. This seldom gives rise to any problem with insurance contracts because, unlike social or domestic agreements, commercial agreements are presumed to have been made with an intention to create legal relation.

2.2 THE LAW OF AGENCY

Before we commence this section, it is very important to realise that the law of agency is much wider than its application to *insurance agents* (important as that is). Therefore, in the following paragraphs, do not think only of **insurance** agents. The comments apply to every kind of **agent** (a shipping agent, an estate agent, etc.), an explanation of which immediately follows.

- (a) An *agent* in this context is a person who represents a *principal*. In insurance, the position is made a little complex because insurance intermediaries may be described as **Insurance Agents** (usually representing the insurer) or as **Insurance Brokers** (usually representing the insured/proposer), as the case may be. Within the law of agency, they are both **agents**.

- (b) The law of agency is deceptively simple in theory, but sometimes quite complex in practice. Essentially, this whole area of law is governed by the legal principle that *'he who acts through another is himself performing the act'*. In other words, the principal is bound (for good or ill) by the authorised actions, and sometimes even the unauthorised actions (see 2.2.2 and 2.2.3 below), of his agent. Thus, when a child (agent) buys something on credit from a grocery store at his mother's (principal) bidding, a contract of sale is created between the store and the mother so that she becomes liable to pay the price.
- (c) The principal who becomes bound by the acts of his agent is exposed to *vicarious liability*, liability incurred as a result of an act or omission of another.

2.2.1 Definition

Agency is the *relationship* which exists between a *Principal* and his *Agent*. Because it is a relationship, it may arise as a matter of fact rather than as a precise agency appointment. In legal terms, an agency relationship may be *deemed* to arise in certain given circumstances.

The *law of agency* are those rules of law which govern an agency relationship. The law of contract also has to be considered as the agent often arranges an agreement with the *third party*, or performs it, on behalf of his principal. There are two contracts to consider:

- (a) one between the **agent** and the **principal**; and
- (b) another quite different one between the **principal** and the **third party**.

Note: an agency can exist without an agency contract. For example: a child (gratuitous agent) goes to buy a pack of sugar on behalf of his mother (principal), with authority to bind the mother in so doing, which is not granted under a contract of agency between them (remember that a domestic arrangement generally does not constitute a contract).

2.2.2 How Agency Arises

When we say that an agency relationship exists between two parties, we are, in essence, saying that the agent owes certain duties to the principal and vice versa, and that the agent has some sort of authority to bind the principal in respect of some contract or transaction to be made on the principal's behalf with another person (third party).

There are a number of ways in which an agency relationship may arise. These we consider below:

- (a) *By agreement*: whether contractual or not; express, or implied from the conduct or situation of the parties.

- (b) *By ratification*: Ratification is the giving of *retrospective authority* for a given act. That is to say, authority was not possessed at the time of the act, but the principal subsequently confirms the act, effectively **backdating** approval. It can be done in writing, verbally, or by conduct.

For example, an insurance agent who is only authorised to canvass household insurance business for an insurer has an opportunity to secure an attractive fire insurance risk and purports to grant the required fire insurance cover to the client. The proposed insurance contract is technically void for it has been made without authority from the insurer. However, the insurer may subsequently accept the insurance and confirm cover so that the contract becomes valid retrospectively.

2.2.3 Authority of Agents

The issue of authority is related to, but distinct from, the issue of agency relationship. Where a certain act done by A purportedly on behalf of B will be binding on B, A is said to have B's authority to do it; but that does not necessarily mean that there is an agency relationship, or a full agency relationship, between them, which will, for instance, entitle A to reimbursement by B of expenses incurred on behalf of B. The various types of authority that an agent may have are considered below:

- (a) *Actual authority*: The authority of an agent may be actual where it results from a manifestation of consent that he should represent or act for the principal, expressly or impliedly *made to the agent himself* by the principal. An actual authority can be an express actual authority or an implied actual authority. An *express actual authority* is an actual authority that is deliberately given, verbally or in writing. By contrast, an *implied actual authority* arises in a larger variety of circumstances; put simply, it may arise out of the conduct of the principal, from the course of dealing between the principal and the agent, or the like.
- (b) *Apparent authority*: The authority of an agent may be apparent instead of actual, where it results from a manifestation of consent, *made to third parties* by the principal. The notion of apparent authority is essentially confined to the relationship between the principal and a third party, under which the principal may be bound by an unauthorised act of the agent of creating a contract or entering into a transaction on behalf of the principal.

Suppose an underwriting agent has been expressly forbidden by his principal from accepting cargo risks destined for West Africa. In contravention of this prohibition, the agent has on several occasions verbally granted temporary cover to a client for such risks purportedly on behalf of the principal, each time followed by issuance of policies for them by the principal to the client. Because of such past dealings, future similar acceptance by the agent may be binding on the insurer on the basis of apparent authority to the agent.

- (c) *Authority of necessity*: In urgent circumstances where the property or interests of one person (who may possibly be an existing principal) are in imminent jeopardy and where no opportunity of communicating with that person exists, so that it becomes necessary for another person (who may possibly be an existing agent) to act on behalf of the former, the latter is said to have an *authority of necessity* so to act and becomes an *agent of necessity* by so acting even though he has not acquired an express authority to do that. The implications are that: by exercising such an authority, the agent creates contracts binding and conferring rights on the principal, and becomes entitled to reimbursement and indemnity against his principal in respect of his acts. Besides, he will have a defence to any action brought against him by the principal in respect of the allegedly unauthorised acts.

For example, when a person is very ill in hospital, a neighbour and friend volunteers and gives help, by assisting with domestic arrangements at his home. This includes payment of the renewal premium for his household insurance. As a result, he will probably be unable to refuse repaying the neighbour for the premium, as the neighbour will almost certainly be considered an *agent of necessity*. Secondly, he will probably be unable to declare the insurance void and demand a return of premium from the insurer. Thirdly, it is unlikely that the insurer will be able to deny claims under the policy on the grounds that the policy was renewed without his authority.

- (d) *Agency by estoppel*: Where a person, by words or conduct, represents or allows it to be represented that another person is his agent, he will not be permitted to deny the authority of the agent with respect to anyone (third party) dealing with the agent on the faith of such representation. Despite the binding effect of the acts of the agent done in such circumstances, this doctrine, *agency by estoppel*, does not generally create an agency relationship unless, say for example, the unauthorised act of the agent is subsequently ratified. In other words, the operation of this doctrine only concerns the relationship between principal and third party.

Note The doctrine of apparent authority is distinct from the doctrine of estoppel. The first doctrine applies where an agent is allowed to appear to have a greater authority than that actually conferred on him, and the second doctrine applies where the supposed agent is not authorised at all but is allowed to appear as if he was.

2.2.4 Duties Owed by Agent to Principal

These may be summarised as follows:

- (a) *Obedience*: The agent has to follow all lawful instructions of his principal, strictly or as best as is reasonably possible.
- (b) *Personal performance*: The agent is not allowed to *delegate* his authority and responsibilities to others (subagents) unless he has authority to do so.

- (c) *Due care and skill*: The law does not demand perfection, and an agent is normally only required to display all reasonably expected skills and diligence in performing his duties. Whilst his principal may be bound by his lack of care, the principal may in turn reclaim from the agent in respect of a loss caused by the lack of care.
- (d) *Loyalty and good faith*: The agent's obligations of loyalty and good faith are governed by several strict rules of law, the no conflict rule being one of them.
- (e) *Accountability*: The agent has to account for all moneys or other things he receives on behalf of his principal. He also has to keep adequate records relating to the agency activities.

2.2.5 Duties Owed by Principal to Agent

These may be summarised as follows:

- (a) *Remuneration*: The agent is entitled to receive commission or other remuneration (such as bonus) as agreed. This the principal has to pay within a reasonable time or any specified time limit, as the case may be.
- (b) *Expenses, etc.*: The principal, subject to any express terms in the agency agreement, has to reimburse the agent for costs and expenses properly and reasonably incurred by the agent on behalf of the principal; e.g. legal defence expenses paid by a claims settling agent.
- (c) *Breach of duty*: The agent may take action against the principal for the latter's breach of obligations to him.

2.2.6 Termination of Agency

There are a number of ways in which an agency agreement can be brought to an end. These include:

- (a) *Mutual Agreement*: Generally speaking, all agreements may be terminated by mutual agreement, on terms agreed between the parties.
- (b) *Revocation*: Subject to any contract terms as to notice and/or compensation, either the principal or the agent may **revoke** (i.e. cancel) the agreement during its currency.

- (c) *Breach*: If either the principal or the agent commits a fundamental breach of contract, the other party may treat the contract as ended (with a possible right of compensation). For example, an exclusive agent, upon discovering that the principal, in breach of a contract condition, has appointed a second agent before the expiry of the agency agreement, may terminate performance immediately and sue the principal for any loss of the profit expected from performing the agreement during the remainder period.
- (d) *Death*: Because an agency relationship is a personal one, the death of either the principal or the agent will end the agreement. Should either party be a corporate body (company), its liquidation will have the same effect.
- (e) *Insanity*: If either the principal or the agent becomes insane so that he no longer can perform the agreement, the agreement will automatically come to an end.
- (f) *Illegality*: If it happens that the agency relationship or the performance of the agreement is no longer permitted by law, this will automatically end the agreement. Suppose a British company (buying agent) has a contract with a company (principal) incorporated and domiciled in another country whereby the buying agent will purchase in the United Kingdom stuffs like wheat, steel, sulphur and other chemicals on behalf of the principal. On the outbreak of a war between the two countries, this agreement will, in the English law, automatically end for illegality.
- (g) *Time*: If the agreement is for a determined period, it will terminate at the end of such period.

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Representative Examination Questions

Type 'A' Questions

- 1 A contract may be defined as:
- (a) a legally enforceable agreement;
 - (b) a promise between two or more people;
 - (c) an agreement that is expressed in writing;
 - (d) any agreement between two or more parties.

[Answer may be found in **2.1.1**]

- 2 Ratification by a principal of the actions of his agent effectively means that:
- (a) the agency agreement is terminated;
 - (b) the agent will not be entitled to any commission;
 - (c) the principal 'back-dates' approval of the actions;
 - (d) the principal refuses to accept responsibility for those actions.

[Answer may be found in **2.2.2(b)**]

Type 'B' Questions

- 3 Which **two** of the following statements regarding **simple contracts** are **true**?
- (i) they must never be in writing
 - (ii) they are not issued under seal
 - (iii) they must always be in writing
 - (iv) they may be verbal or in writing
-
- (a) (i) and (ii);
 - (b) (i) and (iii);
 - (c) (ii) and (iii);
 - (d) (ii) and (iv).

[Answer may be found in **2.1.2(a)**]

4 Which of the following are regarded as essential elements in any valid simple contract?

- (i) offer
- (ii) acceptance
- (iii) consideration
- (iv) capacity of the parties to contract

- (a) (i) and (ii) only;
- (b) (i) and (iii) only;
- (c) (ii) and (iii) only;
- (d) (i), (ii), (iii) and (iv).

[Answer may be found in **2.1.3**]

[If still required, the answers may be found at the end of the Study Notes.]

3 PRINCIPLES OF INSURANCE

3.1 INSURABLE INTEREST

The word ‘interest’ can have a number of meanings. In the present context, it means a *financial relationship* to something or someone. There are a number of features to be considered with ‘insurable interest’, as below.

3.1.1 Definition

Insurable interest is a person’s *legally recognised relationship* to the subject matter of insurance that gives them the right to effect insurance on it. Since the relationship must be a **legal** one, a thief in possession of stolen goods does not have the right to insure them.

3.1.2 Importance of Insurable Interest

An insurance agreement is void without insurable interest. The rules relating to return of premiums under such an agreement vary as between the different classes of insurance. These rules are the general rules on illegality of contract and the relevant provisions of the Insurance Ordinance and of the Marine Insurance Ordinance.

3.1.3 Its Essential Criteria

For insurable interest to exist, the following criteria must be satisfied:

- (a) there must be some *person (i.e. life, limbs, etc.), property, liability or legal right* (e.g. the right to repayment by a debtor) capable of being insured;
- (b) that person, etc. must be the *subject matter* of the insurance (that is to say, claim payment is made contingent on a mishap to such person, etc.);
- (c) the proposer must have the *legally recognised relationship* to the subject matter of insurance, mentioned in **3.1.1** above, so that financial loss may result to him if the insured event happens. (However, insurable interest is sometimes legally presumed without the need to show financial relationship. For example, any person is regarded as having an insurable interest in the life of their spouse.)

Note: A financial relationship alone is not sufficient to give rise to insurable interest. For instance, a creditor is legally recognised to have insurable interest in the life of his debtor, but is not allowed to insure the debtor’s property despite his financial relationship to it, unless the property has been mortgaged to him.

3.1.4 How It Arises

Insurable interest arises in a variety of circumstances, which may be considered under the following headings:

- (a) Insurance of the **Person**: everyone has an insurable interest in his own life, limbs, etc. One also has an insurable interest in the life of one's *spouse*. Further, one may insure the life of one's *child* or *ward* (in guardianship) who is under 18 years of age, and a policy so effected will not become invalid upon the life insured turning 18.
- (b) Insurance of **Property** (physical things): the most obvious example arises in *absolute ownership*. Executors, administrators, trustees and mortgagees, who have less than absolute ownership, may respectively insure the estate, the trust property and the mortgaged property. Bailees (i.e. persons taking possession of goods with the consent of the owners or their agents, but without their intention to transfer ownership) may insure the goods bailed.
- (c) Insurance of **Liability**: everyone facing potential legal liability for their own acts or omissions may effect insurance to cover this risk (sometimes insurance is *compulsory*), such liability being termed '*direct liability*' or '*primary liability*'. Insurance against *vicarious liability* (see 2.2(c) above) is also possible, where, for example, employers insure against their liability to members of the public arising from negligence, etc. of their employees.
- (d) Insurance of Legal **Rights**: anyone legally in a position of potential loss due to infringement of rights or loss of future income has the right to insure against such a risk. Examples include landlords insuring against *loss of rent* following a fire.

Note: Anyone (agent) who has authority from another (principal) to effect insurance on the principal's behalf will have the same insurable interest to the same extent as the principal. For instance, a property management company may have obtained authority from the individual owners of a building under its management to purchase fire insurance on the building. There is no question of a fire insurance effected under such authority being void for lack of insurable interest, even if it is the property management company (rather than the property owners) which is designated in the policy as the insured.

3.1.5 When Is It Needed?

- (a) With life insurance, insurable interest is **only** needed at **policy inception**. Suppose a woman had effected a whole life policy on the life of her husband, who died some years later. When the woman presented a claim to the insurer, the latter discovered that at the time of the man's death, they were no longer in the relationship of husband and wife. That means the woman had no insurable interest in the life of the deceased at the time of the death. Nevertheless, this lack of insurable interest will not disqualify her for the death benefit.

- (b) However, with marine insurance, insurable interest is **only** needed **at the time of loss**.
- (c) The above marine insurance rule is *probably* applicable to other types of indemnity contracts as well.

3.1.6 Assignment

‘Assignment’ is a legal term that generally means a *transfer of property*.

In insurance, there are broadly **two types of assignment**: *assignment of the insurance contract (or insurance policy)* and *assignment of the right to insurance money (or insurance proceeds)*. They are different from each other in the following manner:

- (a) **Effect of an assignment of the insurance contract**: With an effective assignment of a policy (or contract) from the assignor (original policyholder) to the assignee (new policyholder), the interest of the assignor in the contract passes wholly to the assignee to the effect that when an insured event occurs afterwards, the insurer is obliged to pay the assignee for *his* loss, not that suffered by the assignor, if any. In the case of life insurance, assignment will never substitute a new life insured.
- (b) **Effect of an assignment of the right to insurance money** (sometimes simply referred to as an assignment of policy proceeds): Assignment of policy proceeds will have an effect on both losses that have arisen and those that may arise. An assigned policy remains to cover losses suffered by the assignor, not those by the assignee, although it is now the assignee (instead of the assignor) who has the right to sue the insurer to recover under the policy.
- (c) **Necessity for insurable interest**: With assignment of the insurance contract, both the assignor and the assignee need to have insurable interest in the subject matter of insurance at the time of assignment; otherwise the purported assignment will not be valid. (Taking assignment of motor policy as an illustration, the requirement of insurable interest will be satisfied by having the motor policy assigned to the purchaser contemporaneously with the transfer of property in the insured car.) However, with assignment of the right to insurance money, no insurable interest is needed on the part of the assignee, so that it may actually take effect as a gift to the assignee.
- (d) **Necessity for insurer’s consent**: An assignment of the right to insurance money requires no consent from the insurer, irrespective of the nature of the insurance contract concerned. But the position is not that simple with assignment of the insurance contract. Different types of insurance are subject to different legal rules as to whether a purported assignment of the insurance contract will have to be agreed to, by the insurer. The matter is further complicated by the fact that very often non-marine policies include provisions that override these legal rules. Fortunately, it is sufficient for you simply to know that, in practice, unlike all other types of policies, life policies and marine cargo policies are assignable without the insurers’ consent.

- (e) **Assignment of benefits as opposed to obligations:** Assignment does not have the effect of transferring the assignor's obligations under the insurance contract to the assignee. Such a transfer requires the insurer's consent.

Note: 1 It is sometimes misunderstood that any policy provision that claim payments have to be made to a designated person other than the insured is an assignment of the right to insurance money. In fact, the courts may construe such a provision as a mere instruction to pay, which will at most give the designated payee an expectation to be paid, rather than the right to sue the insurer, which right remains in the hands of the insured.

2 Statutory assignment, the best known form of assignment, is subject to the requirements of Section 9 of the Law Amendment and Reform (Consolidation) Ordinance.

3.2 **UTMOST GOOD FAITH**

3.2.1 **Ordinary Good Faith**

At common law, most types of contracts are subject to the principle of good faith, meaning that the parties have to behave with honesty and such information as they supply must be substantially true. However, it is not their responsibility to ensure that the other party obtains all vital information which may affect his decision to enter into the contract, or may affect the terms on which he would enter into the contract. For example, if only after you have boarded a double-decker and paid the fare do you find that no seats on it are vacant, you will have no grounds for complaint. In technical terms, you are not entitled, in such circumstances, to avoid your contract with the bus company for its failure to voluntarily disclose to you the fact that all the seats have been taken on the bus.

3.2.2 **Utmost Good Faith**

Insurance is subject to a more stringent common law principle of good faith, often called the principle of utmost good faith. It means that each party is under a duty to reveal all vital information (called **material facts**) to the other party, *whether or not* that other party asks for it. For example, a proposer of fire insurance is obliged to reveal the relevant loss record to the insurer, even where there is not a question on this on the application form.

Note: 1 Insurers sometimes *extend* the common law duty of utmost good faith by requiring the proposer to declare (or *warrant*) that all information supplied, whether relating to 'material' matters or not, is totally (not simply substantially) true. For example, where a proposer for medical insurance enters '30' as his current age on the proposal form when he is aged 31, this is a technical breach of the above kind of warranty, if any, although this inaccuracy is unlikely to be material in the eyes of the common law principle of utmost good faith as applied to medical insurance.

2 On the other hand, a policy provision may state that an innocent or negligent (as opposed to 'fraudulent') breach of the duty will be waived (excused).

3.2.3 Material Fact

- (a) **Statutory Definition:** 'Every circumstance which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will accept the risk'.

From this definition, it can be seen that there are three categories of material facts, by reference to the kinds of decisions likely to be affected by their disclosure. The first one only concerns the decision to accept or to reject a proposed risk (e.g. the fact that a proposed life insured has an inoperable malignant brain tumour.) The second only concerns the setting of premium (e.g. the fact that the insured person of a proposed personal accident insurance is a salesperson). And the third concerns both (e.g. where a proposed life insured is a diabetic).

You should also note that the law looks at an alleged 'material fact' in the eyes of a prudent insurer - not a particular insurer, a particular insured or a reasonable insured.

- (b) **Facts that need not be disclosed:** In the absence of enquiry, certain facts need not be disclosed; they include:
- (i) matters of common knowledge (e.g. the explosive character of hydrogen);
 - (ii) facts already *known*, or deemed to be known, to the insurer (e.g. the problem of piracy in Somalia);
 - (iii) facts which diminish the risk.
[Example: A proposer for commercial fire insurance did not mention the fact that his premises were protected by an automatic sprinkler system, which fact, if disclosed, would have influenced the determination of the premium. This omission does not breach utmost good faith, as the fact (although very relevant) actually indicates a lower risk.]

3.2.4 When to Disclose Material Facts

It may be said that utmost good faith involves a duty of disclosure by the proposer/insured. Technically, the insurer is under the same duty, but here we will concentrate on the proposer's duty. This duty has some features that we should note:

- (a) *Duration* (at common law): Those material facts which do not come to the proposer's (or his agent's) knowledge until the insurance contract has been concluded do not have to be disclosed. Suppose a proposal for a one-year medical insurance commencing on 15 January 2011 was accepted on 2 January, and the insured had a routine medical examination on 10 January, which revealed to him on 16 January the contraction of malaria. An important question to ask is: 'Is the insured legally obliged to disclose such finding to his insurer?' Applying the legal rule just said, the insured is not obliged to do so, assuming that the terms of insurance are silent on this point. Of course, the policy will normally contain an exclusion for pre-existing diseases, in which case the insurer may rely on this exclusion rather than a breach of utmost good faith in trying to deny a claim in respect of malaria.
- (b) *Duration* (under policy terms): Some non-life policies require the disclosure of material changes in risk happening during the currency of the contract, such as a change in occupation in the case of a personal accident insurance. At common law, such a change, which could at most represent an increase in risk, need not be notified until renewal.
- (c) *Renewal*: when the policy is being renewed, the duty of utmost good faith revives. (Note: the duty of utmost good faith does not revive when a life policy is approaching its anniversary date.)
- (d) *Contract alterations*: If these are requested during the currency of the policy, the duty of utmost good faith applies in respect of these changes. Where, for example, the insured of a fire policy is requesting an extension to cover theft, he is immediately obliged to disclose all material facts relating to the theft risk, e.g. the physical protections of the insured premises and his record of theft losses, if any.

3.2.5 Types of Breach of Utmost Good Faith

A breach of utmost good faith can be in the form of either a **misrepresentation** (i.e. the giving of false information) or a **non-disclosure** (i.e. failure to give material information). Alternatively, it can be classified into a **fraudulent** breach and a **non-fraudulent** breach (i.e. a breach committed either innocently or negligently, rather than fraudulently). Both classifications combined produce a four-fold categorisation as follows:

- (a) *Fraudulent Misrepresentation*: an act of fraudulently giving false material facts to the other party;

- (b) *Non-fraudulent Misrepresentation*: an act of giving false material facts to the other party done either innocently or negligently;
- (c) *Fraudulent Non-disclosure*: a fraudulent omission to give material facts to the other party; or
- (d) *Non-fraudulent Non-disclosure*: an omission to give material facts to the other party done either innocently or negligently.

3.2.6 Remedies for Breach of Utmost Good Faith

If the duty of utmost good faith is breached (any one of the four types mentioned above), the aggrieved party (normally the insurer) may have available certain remedies against the guilty party:

- (a) To *avoid* within a reasonable time the whole contract as from policy inception, with the effect that premiums (and claims) previously paid without knowledge of the breach are generally returnable, unless it was a fraudulent breach on the part of the insured or his agent;
- (b) In addition to (a) above, it is in principle possible to *sue in tort* (see *Glossary*) for damages in the case of fraudulent or negligent misrepresentation;
- (c) To *wave* the breach, alternatively, in which case the contract becomes valid retrospectively.

Note: An insurer aggrieved by a breach of utmost good faith has not the option to refuse payment of a particular claim, to treat the policy as valid for the remainder of the insurance period, and to retain part of or the whole of the premium paid. This is because rescinding only part of a contract is not an available remedy.

3.3 PROXIMATE CAUSE

3.3.1 Meaning and Importance of the Principle

The proximate cause of a loss is its effective or dominant cause.

Why is it important to find out which of the causes involved in an accident is the proximate cause? A loss might be the combined effect of a number of causes. For the purposes of insurance claim, one dominant cause must be singled out in each case, because not every cause of loss will be covered.

3.3.2 Types of Peril

In search of the proximate cause of a loss, we often have to analyse how the causes involved have interacted with one another throughout the whole process leading to the loss. The conclusion of such an analysis depends very much on the identification of the perils (i.e. the causes of the loss) and of their nature. All perils are classified into the following **three** kinds for the purposes of such an analysis:

- (a) *Insured peril*: It is not common that a policy will cover all possible perils. Those which are covered are known as the ‘insured perils’ of that policy, e.g. ‘fire’ under a fire policy, and ‘stranding’ under a marine policy.
- (b) *Excepted (or excluded) peril*: This is a peril that would be covered but for its removal from cover by an exclusion, e.g. fire damage caused by war is irrecoverable under a fire policy because war is an excepted peril of the policy.
- (c) *Uninsured peril*: This is a peril that is neither insured nor excluded. A loss caused by an uninsured peril is irrecoverable unless it is an insured peril that has led to the happening of the uninsured peril. For example, raining and theft are among the uninsured perils of the standard fire policy.

3.3.3 Application of the Principle

The principle of proximate cause applies to all classes of insurance. Its practical applications may be very complex and sometimes controversial. For our purposes, we should note the following somewhat simplified rules:

- (a) There must always be an *insured peril* involved; otherwise the loss is definitely irrecoverable.
- (b) If a *single cause* is present, the rules are straightforward: if the cause is an **insured peril**, the loss is covered; if it is an **uninsured** or **excepted peril**, it is not.
- (c) With more than one peril involved, the position is complex, and different rules of proximate cause are applicable, depending on whether the perils have happened as a chain of events or concurrently, and on some other considerations. Specific cases should perhaps be a matter of consultation with the insurer and/or lawyers, but the general rules are:
 - (i) **uninsured perils** arising directly from **insured perils**: the loss is covered, e.g. water damage (uninsured peril) proximately caused by an accidental fire (insured peril) in the case of a fire policy;
 - (ii) **insured perils** arising directly from **uninsured perils**: the loss from the insured peril is covered, e.g. fire (insured peril) damage proximately caused by a careless act of the insured himself or of a third party (uninsured peril) in the case of a fire policy.
 - (iii) the occurrence of an **excluded peril** is generally fatal to an insurance claim, subject to complicated exceptions.
- (d) Other Features of the Principle
 - (i) Neither the first nor the last cause necessarily constitutes the proximate cause.

- (ii) More than one proximate cause may exist. For example, the dishonesty of an employee and the neglect on the part of his supervisor of a key to a company safe may both constitute proximate causes of a theft loss from the safe.
- (iv) The proximate cause need not happen on the insured premises. Suppose a flat insured under a household policy is damaged by water as a result of a fire happening upstairs. The damage is recoverable under the policy, although the insured flat has never been on fire.
- (iv) Where the proximate cause of a loss is found not to be an insured peril, it does not necessarily mean that the loss is irrecoverable under the policy.

[Illustration: There are four containers of cargo being carried on board a vessel and insured respectively under four marine cargo policies. The first policy solely covers the peril of collision, the second fire only, the third explosion only, and the fourth entry of water only. During the insured voyage, because of the master's negligence, this vessel collides with another. The collision causes a fire, which then triggers an explosion. As a result, the vessel springs several leaks and all the cargo is damaged by seawater entering through the leaks. These facts show that the cargo damage was proximately caused by negligence. Bearing in mind that negligence is merely an uninsured rather than insured peril of each of the four cargo policies, an immediate, important question that has to be grappled with is: 'Is the cargo damage irrecoverable under those policies?' In search of an answer to this question, we must look at the links between the individual events of the incident. Negligence, the identified proximate cause, naturally causes a collision, which then naturally causes a fire. The fire naturally leads to an explosion, which then naturally causes an entry of water. At last, the water damages the cargo. Before us is a chain of events, happening one after another without being interrupted by other events. With respect to each policy, the water damage is regarded as a result of its sole insured peril, notwithstanding that this peril can be traced backward to an uninsured peril. Therefore, the only conclusion that we can reach is that each of the policies is liable for the water damage to the cargo it has insured. (Of course, if the proximate cause is found to be an excepted peril, the opposite conclusion will have to be made.)]

3.3.4 Policy Modification of the Principle

It is very common for insurers to adopt policy wording that has the effect of modifying the application of proximate cause rules. Two examples of such practice are given below:

- (a) ***'Directly or indirectly'***: There are a whole number of ways that an insurer can frame his policy wording for the purposes of specifying what he wants to cover or not to cover. For instance, it may use such wording as 'loss caused by ...', 'loss directly caused by ...' and 'loss proximately caused by ...'. Well do they mean different things to you? Will any of them have the effect of modifying the rules of proximate cause? The answer is that they have been held to mean the same thing. That is to say, whether the term 'directly' or 'proximately' is adopted or left out, the legal rules to be applied are exactly the same and the same scope of cover is given or excluded, as the case may be. But what if the term 'indirectly' is used? A policy exclusion that says that loss *'directly or indirectly'* arising from a particular peril (excepted peril) is excluded has been construed by the courts to mean that a loss will not be recoverable even where the operation of that excepted peril has only been a *remotely* (as opposed to 'proximately') contributory factor. Read the following decided court case for illustrations:

An army officer was insured under a personal accident policy, which excluded claims 'directly or indirectly caused by war'. During wartime, the insured was on duty supervising the guarding of a railway station. Walking along the track in the darkness, he was struck by a train and killed. It was held that although the war was merely an 'indirect' cause of the death, the policy wording meant that the insurer was not liable.

- (b) ***'Loss proximately caused by delay, even though the delay be caused by a risk insured against'*** (an exclusion wording quoted from a marine cargo insurance clause most commonly used): Suppose an insured shipment of calendar for the year 2011, expected to arrive on 1 December 2010, does not arrive until 15 February 2011 because of a collision (insured peril) involving the carrying vessel during the insured voyage. By relying on the exclusion, the insurer can deny a 'loss of market' claim from the insured even though the loss is due to an insured peril.

Note: Remember that the principle of proximate cause is sometimes very complicated. There have been many interesting, sometimes surprising court cases which have decided its application. In particular, not too rarely are inconsistent or opposing judicial decisions seen in factually similar cases which are made on the basis of the same rule(s) of proximate cause, perhaps because the judgments of the judges vary from one case to another on how the facts of a case relate to one another. Therefore, please do not assume that knowledge of the above brief notes will make you an expert in this area.

3.4 INDEMNITY

3.4.1 Definition

Indemnity means *an exact financial compensation* for an insured loss, no more no less.

3.4.2 Implications

Indemnity cannot apply to all types of insurance. Some types of insurance deal with ‘losses’ that cannot be measured precisely in *financial* terms. Specifically, we refer to **Life Insurance** and **Personal Accident Insurance**. Both are dealing with death of or injury to human beings, and there is no way that the loss of a finger, say for instance, can be measured precisely in money terms. Thus, *indemnity* cannot normally apply to these classes of business. (Note: medical expenses insurance, which is often included in personal accident and travel insurance policies, is indemnity insurance unless otherwise specified in the policies.)

Other insurances are subject to the principle of indemnity.

Note: It is sometimes said that life and personal accident insurances involve *benefit policies* rather than policies of *indemnity*. Since indemnity cannot normally apply, the policy can only provide a **benefit** in the amount specified in the policy for death or for the type of injury concerned.

3.4.3 Link with Insurable Interest

We studied insurable interest in **3.1**. That represents the financial ‘interest’ in the subject matter, which is exactly what should be payable in a total loss situation, if the policyholder is to be completely compensated. However, life and personal accident insurances may generally be regarded as involving an *unlimited insurable interest*, and therefore indemnity cannot apply to them.

3.4.4 How Indemnity is Provided

It is common for property insurance policies to specify that the insurer may settle a loss by any one of four methods named and described below. However, both marine and non-property policies are silent on this issue so that the insurer is obliged to settle a valid claim by payment of cash.

- (a) *Cash payment* (to the insured): This is the most convenient method, at least to the insurer.
- (b) *Repair*: Payment to a repairer is the norm, for example, with motor partial loss claims.
- (c) *Replacement*: With new items, or articles that suffer little or no depreciation, giving the insured a replacement item may be a very suitable method, especially if the insurer can obtain a discount from a supplier.

- (d) *Reinstatement*: This is a word that has a number of meanings in insurance. As a method of providing an indemnity, it means the restoration of the insured property to the condition it was in immediately before its destruction or damage.

Note: You are absolutely correct if you understand that the term ‘reinstatement’ overlaps in meaning with ‘repair’ and with ‘replacement’.

3.4.5 Salvage

When measuring the exact amount of loss (which indemnity is), it has to be borne in mind with certain property damage that there will sometimes be something left of the damaged *subject matter of insurance* (fire-damaged stock, the wreck of a vehicle, etc.). These remains are termed ‘**salvage**’. If the remains have any financial value, this value has to be taken into account when providing an indemnity. For example:

- (a) The value of the salvage is *deducted* from the amount otherwise payable to the insured (who then keeps the salvage); or
- (b) The insurer pays in full and *disposes* of the salvage for its own account.

Note: The term ‘salvage’ in maritime law has a very different meaning, where it usually refers to acts or activities undertaken to save a vessel or other maritime property from perils of the sea, pirates or enemies, for which a sum of money called ‘salvage award’ (or just ‘salvage’) is payable by the property owners to the salvor provided that the operation has been successful. The term is sometimes also used to describe property which has been salvaged.

3.4.6 Abandonment

This is a term mostly found in marine insurance, where it refers to the act of *surrendering* the subject matter insured to the insurers in return for a total loss payment in certain circumstances. This is quite standard in marine practice, but in other classes of property insurance, policies usually specifically exclude abandonment.

The important thing to be remembered with abandonment is that the subject matter insured (or what is left of it) is *completely* handed over to the insurer, who may therefore benefit from its residual value. (This will be important with **Subrogation**; see 3.6 below).

3.4.7 Policy Provisions Preventing Indemnity

While policies in some classes of business promise to *indemnify* the insured, this has to be done subject to the express terms of the policy, if any. Some of these terms mean that something less than indemnity is payable. For example:

- (a) *Average*: Most non-marine property insurances are expressly *subject to average*. This means that the insurer expects the insured property to be insured for its full value. If it is not, in the event of a loss the amount payable will be reduced in proportion to the *under-insurance*. For example, if the actual value of the affected property at the time of a loss was \$4 million and it was only insured for \$1 million, we may say that the property was at the time of the loss only *25% insured*. Therefore, by the application of **average**, only 25% of the loss is payable.

In view of this penalty for under-insurance, it is very important for insurance intermediaries to do their best to ensure that their clients will arrange full value insurance.

Note: In marine insurance, ‘**average**’ has a totally different meaning. Here it means *partial loss*, a loss other than total loss. Average in marine insurance is complex and beyond the needs of this present study.

- (b) *Policy excess/deductible*: An excess or deductible is a policy provision whereby the insured is not covered for losses up to the specified amount, which is always deducted from each claim.

Suppose a motor policy is comprehensive, with a \$4,000 excess for damage to the insured vehicle. If an accident occurs and the repair bill for the car amounts to \$14,000, the insurer is only liable for \$10,000. On the other hand, with a minor accident and repairs costing \$3,000, the insurer would have no liability at all.

- (c) *Policy franchise*: Seldom seen today (except for time franchise – see example below), it is similar to an excess in that it eliminates small claims. On the other hand, it is different from an excess in that if the loss exceeds or reaches the franchise – depending on the wording used - the loss is payable *in full*. Like an excess, a franchise can be expressed as a percentage, an amount of loss, or a time period.

Suppose a ship which is insured for \$5,000,000 subject to a 5% franchise sustains insured damage. If repairs cost only \$100,000 (2%), nothing is payable by the insurer. But if repairs cost \$1,000,000 (20%), the loss is payable in full.

Example of time franchise: A particular hospitalisation policy contains a 2-day franchise provision; in other words, there is a waiting period of two days. If the insured person stays in hospital for one day, no expenses are reimbursable. But if he has to stay for 5 days, the policy pays the medical expenses incurred during the whole of that 5-day period.

- (d) *Policy limits*: As the *sum insured* is the insurer's maximum liability, any loss exceeding that limit will not be fully indemnified. Other types of limits may also exist within the policy terms; examples include:

- (i) *Single Article Limit*: It is a limit commonly found in a household contents policy. Where such a policy covers property described in broad terms like ‘contents’ for a stated amount, there is no way the insurer can tell whether the insured contents will not, at the time of loss, be found to include an article which is so valuable that its value already accounts for, say, 90% of the sum insured for the whole of the contents. This is a situation the insurer will not want to see, partly because of the theft risk it represents. In fact, the insured could have declared the value of this item of contents to the insurer, requiring that it be separately subject to a sum insured representing its value. The benefit of this approach is that the insurer will be liable for an insured loss of this item of property up to its own sum insured. On the other hand, in the event that an insured has not made such an article the subject of a separate sum insured, the insurer will have to restrict the amount payable for a loss of this item to a limit specified in the policy, called the ‘single article limit’.
- (ii) *Section Limit*: A policy may contain two or more sections, which take effect in relation to different subject matter of insurance (as in the case of a travel insurance policy, which normally covers property damage, legal liability and others), different insured perils, etc. Each of these sections is usually made subject to its own limit of liability, which operates similarly to a sum insured.

3.4.8 Policy Provisions Providing More Than Indemnity

Indemnity is very logical and technically easy to defend. However, in practice, most policyholders are ignorant of this and are confused and offended when insurers ‘reduce’ their claims, by deducting depreciation, wear and tear, etc. As a marketing or public relations exercise, insurers sometimes offer or agree to grant property insurances which may be said to give a *commercial* rather than a *strict* indemnity. Some examples are as follows:

- (a) *Reinstatement insurances* (or insurances on a reinstatement basis): This is one of the several uses of the term ‘reinstatement’ (see 3.4.4(d) above) and is often found with fire and commercial ‘all risks’ insurances. The meaning is that where reinstatement takes place after a loss, no deductions are made from claim payments in respect of wear and tear, depreciation, etc.
- (b) *‘New for Old’ cover*: Again, this means that no deductions are made in respect of wear and tear, depreciation, etc. This term is more generally used with household and marine hull policies.

- (c) *Agreed value policies* (or valued policies): Such policies may be used for articles of high value, where depreciation is unlikely to be a factor (e.g. works of art, jewellery, etc.) or where property valuation contains a rather subjective element. The sum insured is fixed on the basis of an expert's valuation, and agreed between the insured and the insurer as representing the value at risk of the property *throughout* the currency of the policy. In non-marine insurance, a valued policy undertakes to pay this sum in the event of a total loss, without regard to the actual value at the time of loss, whereas in the event of a partial loss, the actual amount of loss would instead be payable without regard to the agreed value.
- (d) *Marine policies*: Almost without exception, marine hull and marine cargo policies are written on a valued basis, and the agreed value will be taken as the actual value at the time of loss for the purposes of both partial and total loss claims.

3.4.9 The Practical Problems with Indemnity

Indemnity, as mentioned above, is extremely logical. What makes more sense than to say that a person should only recover what he has lost? He should not *profit* from a loss! However, most people feel that they should receive the amount they have insured for, with a total loss. Moreover, the fact or amount of *depreciation* is an area where you, or the claims handler, may definitely expect problems with the claimant. When claims are being made, a lot of claimants will say that their property has not depreciated at all, or only marginally!

3.5 CONTRIBUTION

3.5.1 Equitable Doctrine of Contribution

This is a claims-related doctrine of equity which applies as between insurers in the event of a double insurance, a situation where two or more policies have been effected by or on behalf of the insured on the same interest or any part thereof, and the aggregate of the sums insured exceeds the indemnity legally allowed.

[Example: Suppose a husband and wife each insure their home and contents, each thinking that the other will forget to do it. If a fire occurs and \$200,000 damage is sustained, they will not receive \$400,000 compensation. The respective insurers will share the \$200,000 loss.]

Apart from any policy provisions, any one insurer is bound to pay to the insured the full amount for which he would be liable had other policies not existed. After making an indemnity in this manner, the insurer is entitled to call upon other insurers similarly (but not necessarily equally) liable to the same insured to share (or to contribute to) the cost of the payment.

3.5.2 Rateable Proportions

Where contribution applies, the ultimate proportion of the insured's loss that any one particular insurer is responsible for is called the 'rateable proportion' of that insurer. It is not difficult to understand that the sum of all the insurers' rateable proportions equals one, that is to say, 100% of the insured's loss.

A few methods are available for calculating rateable proportions. But as an insurance intermediary, it is not essential that you should know them well, bearing in mind that how much your clients will ultimately get paid for a loss will not depend on the basis of contribution to be employed.

3.5.3 How Arising

The criteria (or essentials) that need to be satisfied before contribution applies are:

- (a) the respective policies must each be providing an *indemnity* (rather than benefit) to the loss in question (this is the reason why it is said that contribution is a corollary (i.e. a natural consequence of an established principle) of indemnity);
- (b) they must each cover the *interest* (which term does not mean property, liability, etc.) affected (see counter-example below);
- (c) they must each cover the *peril* (cause of loss) that has given rise to the loss;
- (d) they must each cover the *subject matter of insurance* (property, liability, etc.) that has been affected; and
- (e) each policy must be *liable to* the loss (i.e. not be subject to a policy exclusion or limitation preventing contribution).

[*Counter-example of criterion (b)*: A merchant has some stock-in-trade kept in a public warehouse, and insured under a fire policy. Separately and at the same time, the warehouse operator buys fire insurance on the same property. When a fire occurs damaging the stock-in-trade, both the merchant and the warehouse operator claim under their own policies for the same damage. Immediately two basic questions come to mind. First, is the warehouse operator, not being an owner of the damaged property, entitled to claim under his own fire policy? Second, if both policyholders are entitled to claim, will there be contribution between the insurers? The answer to the first question is: the warehouse operator, being a bailee of the stock-in-trade, has insurable interest in it at the time of loss, and is thus entitled to claim under his own policy. Turning to the merchant, you probably will not conclude or argue that he cannot expect to be indemnified. Now we have to wrestle with the second question. The answer to this question hinges on that to the question of whether the two policies cover the same interest (criterion (b)). For whose benefit has the merchant bought his fire insurance? And what about the warehouse operator? In fact, each of them has bought insurance for their own benefit. In other words, the first mentioned policy

covers the merchant's 'interest as owner', and the second one covers the warehouse operator's 'interest as bailee'. Is it apparent to you now that the two policies cover different interests, so that contribution will not apply as between them?

At this point, we have completely resolved the issue of contribution arising in the case. But there remains an issue of the cogency of indemnifying for the same loss with twice its amount. Now it is time for another principle of insurance – subrogation (see **3.6** below) – to play its part. The insurer of the merchant, upon indemnification, is entitled to claim, for his own benefit albeit in the name of the merchant, against the warehouse operator (bailee) for the indemnity provided by the other insurer.]

3.5.4 How Applicable

Contribution will only apply if **indemnity** applies. Thus, if a person dies whilst insured by two or more separate *life insurance* policies, each has to pay in full, because the insurances are not subject to indemnity.

3.5.5 How Amended by Policy Conditions

The position between insurers as governed by the equitable doctrine of contribution is of little or no concern to the insured, unless that has been modified by one of the following policy provisions:

- (a) *Rateable Proportion Clause* (or Contribution Condition), restricting the insurer's liability to its *rateable share* of the loss. The effect is that, where there is double insurance and each of the relevant policies contains such a clause, the insured could no longer claim all of his loss from one insurer alone.

[Example: Using the example in **3.5.1** again, the standard fire policy contains a clause restricting its contribution to its 'rateable share' in the event of double insurance. In the given circumstances, if Insurer A is approached first and his rateable share is, say, \$50,000 (25%), he cannot be made to pay the full loss. He is liable only for \$50,000 and the insured must himself go to Insurer B for B's rateable share (\$150,000 or 75%).]

- (b) *Non-contribution Clause*, to the effect that it is the other policies that will have to pay the loss.

[Example: Household policies on contents may exclude items '*more specifically insured*'. If a camera is separately insured under an 'All Risks' policy, that policy may be regarded as more specific than the household policy, so that the latter policy, if it contains such a clause, will not be liable for a, say, theft loss of the camera from the insured premises.]

(c) *Partial Contribution Condition*

[Example: The so-called 'Marine Clause' in the standard fire policy provides that in the event of potential contribution between a marine policy and the fire policy, the fire policy will not share the loss, except for that part of the loss which is above the marine compensation. (This may happen where, for example, some cargo, while being left in a container depot awaiting the carrying vessel, catches fire. The usual marine policy will cover the damage so caused. It is also possible that there is in place a fire policy whose cover has been extended to cover a fire occurring in such circumstances.)]

3.6 SUBROGATION

3.6.1 Definition

Subrogation is the exercise, for one's own benefit, of rights or remedies possessed by another against third parties. As a corollary (i.e. a natural consequence of an established principle) of indemnity, subrogation allows proceeds of claim against third party be passed to insurers, to the extent of their insurance payments. At common law, an insurer's subrogation action must be conducted in the name of the insured.

Suppose, for example, that a car, covered by a comprehensive motor policy, is damaged by the negligence of a building contractor. The motor insurer has to pay for the insured damage to the car. *As against the negligent contractor*, the insured's right of recovery will not be affected by the insurance claim payment. However, the motor insurer may, after indemnifying the insured, take over such right from the insured and sue the contractor for the damage in the name of the insured.

From this, it will easily be seen how subrogation seeks to protect the parent principle of **indemnity**, by ensuring that the insured does not get paid twice for the same loss.

3.6.2 How Arising

Subrogation rights arise in several manners as follows:

- (a) In *tort*: This usually arises where a third party negligently causes a loss indemnifiable by a policy. For example, a fire insurer, after paying a fire loss, discovers that the fire was caused by a negligent act of a neighbour of the insured. It sues the neighbour in the name of the insured for damages recognised by the law of tort.
- (b) In *contract*: This arises where the insured (perhaps a landlord) has a contractual right (perhaps under a tenancy agreement) against another person (perhaps a tenant) for an insured loss. After indemnifying the insured for the loss, the insurer may exercise such right against that other person in the name of the insured.

- (c) Under *statute*: If a person is injured at work, his employer, if any, will have to pay an *employee compensation* benefit to him in accordance with the provisions of the Employees' Compensation ('EC') Ordinance. The Ordinance will then grant subrogation rights to the indemnifying employer against another person who is liable to the employee for the injury. In turn, the employer has to pass these rights to the EC insurer who has paid the employee compensation benefit for or on behalf of the employer.
- (d) In *salvage*: This we have already considered (see **3.4.5** above). The insurer may be said to have subrogation rights in what is left of the subject matter of insurance (salvage), arising under the circumstances already discussed.

3.6.3 How Applicable

As with contribution, **subrogation** can only apply if **indemnity** applies. Thus, if the life insured of a life policy is killed by the negligence of a motorist, the paying life insurer will not acquire subrogation rights, as this payment is not an indemnity.

3.6.4 Other Considerations

There are other features to note:

- (a) In the common law, subrogation rights are only acquired *after* an indemnity has been provided. Non-marine policies usually remove such restriction by stipulating that the insurer is entitled to such rights *even before indemnification*.
- (b) Some considerations arise in respect of proceeds of subrogation:
 - (i) The insurer cannot recover more under subrogation than he has paid as an indemnity. By way of example, suppose there is an insured loss of an antique. The insurer pays, and sometime later when the antique is found, its value is much higher. The insurer can only keep an amount equal to what he has paid and any balance belongs to the insured.
 - (ii) The above saying is not true in the event of subrogation arising after *abandonment* of the property to the insurer (see **3.4.6** above). There, **all rights** in the property belong to the insurer, of course including the right to 'make a profit'!
 - (iii) Sharing of Subrogation Proceeds

Where the insurer has only provided a less-than indemnity on the basis of certain policy limitations, the insured may possibly be entitled to part of – sometimes even the whole of - the subrogation proceeds, depending on what limitations have been applied in the

process of claims adjustments. The following are illustrations of several manners in which the sharing of subrogation proceeds between the insured and the insurer can be done:

- (1) *Excess*: Suppose the insured is responsible for a loss (excess) of \$10,000 before his liability insurer pays \$40,000, and \$20,000 is subsequently recovered from a negligent third party. The whole of \$20,000 will belong to the insurer. However, if the subrogation recovery is \$45,000 instead, the insured will be entitled to \$5,000 and the insurer \$40,000.
- (2) *Limit of Liability*: Suppose an insured contractor has incurred liability to a road user in the amount of \$1.5 million, of which the insured has to pay \$0.5 million out of his own pocket because his policy is subject to a limit of liability of \$1 million. Any recovery from a joint tortfeasor will belong to the insured, except where it amounts to more than \$0.5 million in which case that part over and above the \$0.5 million threshold will belong to the insurer up to the amount of insurance payment.
- (3) *Average*: Suppose a fire insurer has paid 80% of a loss where there is a 20% underinsurance. The insured is entitled to 20% of subrogation proceeds as if he was a co-insurer for 20% of the risk.

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Representative Examination Questions

Type 'A' Questions

- 1 Insurable interest may be described as:
- (a) possession of certain goods;
 - (b) the amount always payable for insurance claims;
 - (c) a legally recognised relationship to the subject matter;
 - (d) the interest payments due if the insurance premium is paid late.

[Answer may be found in **3.1.1**]

- 2 For marine insurance, insurable interest is required:
- (a) certainly at the time of loss;
 - (b) only when the policy is first arranged;
 - (c) only at the time the first premium is paid;
 - (d) only if this is specifically mentioned in the policy.

[Answer may be found in **3.1.5**]

Type 'B' Questions

- 3 Which of the following are the types of breach of utmost good faith?
- (i) Fraudulent non-disclosure
 - (ii) Non-fraudulent non-disclosure
 - (iii) Non-fraudulent misrepresentation
 - (iv) Fraudulent misrepresentation
-
- (a) (i) and (ii) only;
 - (b) (i) and (iii) only;
 - (c) (ii), (iii) and (iv) only;
 - (d) (i), (ii), (iii) and (iv).

[Answer may be found in **3.2.5**]

4 Which **three** of the following insurance policy provisions could mean that something **more** than indemnity is payable with claims?

- (i) 'New for Old' cover
- (ii) Agreed value policies
- (iii) Reinstatement insurances
- (iv) The condition of average

- (a) (i), (ii) and (iii);
- (b) (i), (ii) and (iv);
- (c) (i), (iii) and (iv);
- (d) (ii), (iii) and (iv).

[Answer may be found in **3.4.8**]

[If still required, the answers may be found at the end of the Study Notes.]

4 CORE FUNCTIONS OF AN INSURANCE COMPANY

Whilst an insurance intermediary is unlikely to have close contact with the internal organisation of insurance companies, it is good to understand something of their infrastructure and to be aware of the various departments and personnel behind the marketing process. These, in outline, are considered below. Please remember, however, that there is no single system for insurance companies to follow, and therefore the suggested structure must be seen as representative only.

4.1 PRODUCT DEVELOPMENT

Someone once said, 'Insurance is not something that is *bought*, it is something that has to be *sold*'. We shall recall this when discussing marketing and promotion (4.3 below), but to the extent that it is true the whole exercise depends upon having **something** to sell. That something may be described as an insurance *product*.

Some insurances, of course, are *compulsory* (e.g. **third party motor** and **employees' compensation**), but even with these classes the precise policy wording is not decreed by statute. Therefore there is scope for flexibility in presentation (whilst the requirements of Ordinances must be respected). With other classes of insurance business, Hong Kong is an open and very *competitive* business environment. Insurers must therefore be efficient and dynamic in preparing the products they 'sell'. As an abbreviated summary, the Product Development department/section of an insurer will be much occupied with:

- (a) **Individual product development:** this is a never-ending process. With competitors eager to learn and copy, it has been said that the unchallenged 'lifespan' of a totally new product is very short, perhaps a matter of only a few weeks or months. After that time, the product has been copied, adapted and frequently undersold.
- (b) **Product portfolio development:** increasingly, producing a 'package' of cover, especially for larger clients, has become sensible, even vital, in order to retain a competitive edge.
- (c) **Product research:** we may think of this in three areas:
 - (i) **our own products:** nothing is perfect beyond improvement.
 - (ii) **competitors' products:** we do not, and cannot, live in a vacuum. It is essential to know what is happening in our market and 'what we are up against'. Besides, they will have no hesitation in 'borrowing' from us!
 - (iii) **market trend:** the needs of the general public.

4.2 CUSTOMER SERVICING

Sometimes described as **Client Servicing**, this section has a number of functions, and with a particular insurer some of these may be carried out by other departments (such as Accounts, Claims etc.). The general scope of its responsibilities is indicated by its name. It is to provide a service to existing and potential customers/clients, and the duties probably include:

- (a) **Correspondence:** enquiries of every imaginable kind are likely to be received, asking for guidance and information. Sometimes, the enquiries will be totally unrelated to the company's business; therefore a degree of perception and tact will be required. It is quite sure that the response a company gives to enquiries is very important.
- (b) **Public relations:** the more formal aspects of this could be within the province of the marketing people, but the way clients are dealt with profoundly influences a company's standing in the eyes of the public.
- (c) **Documentation:** requests for duplicate policies, amendments to existing policies, copies of motor insurance certificates, etc. will probably receive at least their initial attention in this department.
- (d) **Complaints:** an area that must be seen to be handled fairly and promptly. This may require considerable liaison with other colleagues/departments. It must also be remembered that complaints may reach high levels of company management and receive media and even the insurance regulator's attention.

4.3 MARKETING AND PROMOTION

Remembering the quotation in **4.1**, this is a very important area for the insurer. The particular areas of responsibility include:

- (a) **Public Relations:** as explained, this may overlap to some extent with Customer Services, but the image of the company and its perceived standing in the eyes of the public is of great significance. This wide-ranging activity will include:
 - (i) the co-ordination of all *external communications*;
 - (ii) the co-ordination of *media enquiries and interviews*;
 - (iii) *press conferences*, to announce or explain things, as necessary;
 - (iv) preparing *press releases* and *copy* for trade and other journals.
- (b) **Promotions:** organising and co-ordinating their preparation and conduct.

- (c) **Advertising:** closely interconnected with the above, this enormously important area includes:
- (i) selection of external agencies (if used);
 - (ii) the extent to which TV or other media are to be involved;
 - (iii) co-ordination of advertising campaigns;
 - (iv) expenditure analysis and control.
- Note:** Advertising is an area which could involve **massive** expenditure. Great care must therefore be taken in its management and control. As one famous businessman said 'Half the money I spend on advertising is wasted. Unfortunately, I do not know *which* half!'
- (d) **Sponsorship:** insurers are frequently asked to sponsor industry or educational projects. Also, this is of course an important aspect of advertising, involving much time and probably a considerable budget.
- (e) **Market research:** obviously, continuous monitoring of one's present and potential market is a vital element for a marketing department. This will seek to establish existing and perceived needs and demands in respect of insurance products.

4.4 INSURANCE SALES

Very closely connected with **marketing**, there may be considerable overlap of activity, if separate sections exist. The name, however, indicates the functions, which specifically will include:

- (a) **Product liaison:** it is vital that the closest co-operation exists between Product Development, Marketing and Sales, for obvious reasons. Poor communication between colleagues in this area could have disastrous results.
- (b) **Sales enhancement programmes:** again requiring co-operation with other colleagues, e.g. Training and Marketing.
- (c) **Monitoring:** it is important to keep abreast of results and trends. Again, much teamwork with colleagues is required.

4.5 UNDERWRITING

This may be defined as the *selection* of risks to be insured and the determination of the *terms* under which the insurance is given. With non-life insurances, it also involves a continuing process of monitoring results and individual risks, to see whether *renewals* should be offered, and on what terms. Special features to note are:

- (a) **Life insurance:** for individual life policies, underwriting is a *once only* exercise, since the policy cannot be cancelled by the insurer and changes are only possible with the insured's consent. Because of its crucial importance, life insurance underwriting is often centralised.
- (b) **General insurance:** here the range of different cover is very wide and mistakes in underwriting are not permanent, in the sense that policies will come up for renewal and their terms be reviewed, and can even be cancelled if necessary. Therefore much less centralised underwriting is still affordable.
- (c) **Guidelines:** whilst underwriting is at a 'one to one' level, there is obviously a need for the preparation of underwriting manuals, rating guides and similar guidelines for staff. These involve considerable research and development, again with much attention to trends and results.
- (d) **Target risks:** curiously, this term could mean highly *desirable* types of business (in Life Insurance) or highly *undesirable* types of business (in General Insurance). In the former, of course, this is business the insurance intermediaries should be encouraged to seek diligently. In the latter, the term could mean large, hazardous risks, e.g. petrochemical plants.

Each insurer will have its own ideas about what constitutes desirable or undesirable risks. Typically, however, in life insurance, healthy young professionals are likely to be desirable contacts. In theft insurance, jewellery stores in Central Hong Kong may not be favoured.

- (e) **Stop-lists:** sometimes given other names, a 'stop-list' indicates those types of business that should not be encouraged, or should be rejected if offered. Some examples may readily come to mind, with different types of insurance, although not every insurer will have the same opinions on this subject. Nevertheless, compiling such lists involves considerable underwriting expertise, especially bearing in mind the sensitivity over *discrimination* of every kind (see 7.3 below).

4.6 POLICY ADMINISTRATION

This is another departmental description that may involve overlap with other sections or departments mentioned above or below. The general areas of concern here may be:

- (a) **General or Life insurance?** : this is a most important question, since the policy document with each has a very different significance. With general insurance, technically there need not be a policy (although there almost invariably is) and it is seldom necessary to produce the original policy document when making a claim. With life insurance, however, the contract is non-cancellable by the insurer, and the policy documents are required to be produced at the time of a claim.
- (b) **Life insurance policies:** as mentioned above, these must be produced when a claim is made. A mistake in a life policy is potentially much more serious than with General Business, especially since the policy may be *assigned* to another person and/or used as *collateral* with a loan and any assignees are expected to be relying on the veracity of the policy.
- (c) **New business procedures:** especially with Life business (as noted) the process of verification and checking, both for factual accuracy and errors in document preparation, is very important. With any class of business, it is important that the policy should be prepared and issued as efficiently and as impressively as possible, for reasons that are obvious.
- (d) **Other procedures:** this topic embraces such matters as error handling, policy correction, endorsement preparation and renewal procedures. With life insurance, once more, the great importance of the *actual payment* of the first premium must be considered. In other classes, the contract may commence without the receipt of a premium (often a non-marine policy requires that the insured 'has paid or agreed to pay the premium'). With life insurance, the usual practice is that the existence of the contract depends upon the first premium being *received*.

4.7 CLAIMS

Once more, there are significant differences between Life and General Business claims. Specifically, the implications include:

- (a) **Life insurance claims:** obviously, there will only be one death claim. It is quite essential for the claims handler to check each claim with the utmost care, as all sorts of considerations are involved, such as:
 - (i) possible *disputes* or complications, for instance, problems may arise when the primary beneficiary cannot be traced, or more than one person lodges a claim as alleged assignees;
 - (ii) possible outstanding *policy loans*;
 - (iii) possible *assignment*, so that the claimant is not the original policyholder;
 - (iv) *uncertainties* over actual death or the identity of the deceased;

(v) *dividend/bonus* considerations with *participating/with-profit* policies.

For similar reasons to those pertaining to underwriting (see 4.5 above), life insurance claims handling is frequently centralised.

(b) **General insurance claims:** the range of different types of claims is much wider than with life insurance. Also, it is quite possible that the amounts involved are **enormous**. Therefore, equal care should be taken in verification, although most claims being relatively small, the work is much more likely to be decentralised, sometimes with fairly junior staff having some degree of authority in claim settlement.

[Example: Claims may be relatively trivial, such as the loss of a camera, or exceedingly complex, such as a major explosion at a large power station.]

(c) **Common features:** there are two areas that must be the subject of attention in all insurance claims. These are:

(i) **Liability:** is the insurer liable under the policy? When dealing with liability insurance, it must also be ascertained whether the insured is liable at law to the third party claimant.

(ii) **Quantum:** how much is payable with the claim? With life insurances, it is usually pre-determined, but with other classes of business, this could involve complex and sometimes bitter discussion.

(d) **Significance:** it has been said that an insurer stands or falls on the way it deals with its claims. There is truth in the remark and the insurance intermediary will want to know and feel confidence in the support he looks for in this area.

4.8 REINSURANCE

This is not an area where the insurance intermediary is likely to have a close association, but he should be aware that reinsurance is very important to the insurer. The aftermath of the September 11 terrorist attack is a testimony to this saying.

(a) **Definition:** insurance used to transfer all or part of the risk assumed by an insurer under one or more insurance contracts to another insurer, who may be referred to as a reinsurer in relation to such a transaction.

(b) **Reasons:** The major reason for buying reinsurance is security. It is very likely that an individual insurance claim is payable from the assets of the insurer, but it may be very inconvenient (and even costly) to produce large amounts of cash at short notice, since assets will mostly be in investments. A reinsurance contract may be so arranged as to entitle the reinsured to an immediate claim payment by the reinsurer in the event of a valid direct claim (i.e. a claim from the original insured) exceeding a pre-determined figure, even before the reinsured has actually paid the direct claim.

Another important reason for reinsurance is to increase an insurer's 'underwriting capacity', which means the ability to accept proposed business with in mind all risk management considerations. Having reinsurance means that some risks may be accepted which might otherwise have to be declined in part or total.

- (c) **Methods:** This does not concern insurance intermediaries, unless they handle reinsurance matters on behalf of insurers or reinsurers.
- (d) **Effects for the Insured:** Reinsurance has no direct effect for the policyholder. He is not entitled to know, and probably has no need to know, that his insurance is being reinsured. That is a matter entirely between the insurer and the reinsurer(s). The insurer is always directly liable to the policyholder for the full amount payable under the contract irrespective of the financial condition of its reinsurers. Reinsurance, however, does give an added security that the insurer will be *able* to pay!

4.9 ACTUARIAL SUPPORT

An actuary may be thought of as a highly skilled mathematician. His particular expertise is not only in the collation and presentation of numerical information, but also in projecting and predicting future trends, based on available data and assumptions. It will immediately be understood, therefore, that such an expert has a very important role to play in insurance. Some specific observations:

- (a) **Life insurance:** more than any other class of business, life insurance depends upon mathematical calculations (although they are very important to all classes). It is essential for the life insurer to know mathematical facts about *mortality* (death statistics) and projected *interest* earnings, for example.

Note: 1 The Insurance Ordinance requires all insurers who carry on long term business to appoint a qualified actuary, acceptable to the Insurance Authority.

2 This Ordinance also requires long term insurers to carry out a *valuation* of all assets and liabilities at least once a year. This is perhaps the most important function of the actuary.

- (b) **General insurance:** Their expertise, especially with *long-tail business* (insurance where claims arise and develop over a long period of time until, say, 5 years or even more after policy expiry, e.g. liability classes), is extremely valuable. This is particularly true when having to calculate *outstanding claims reserves* required. The Insurance Authority requires motor and employees' compensation insurers to annually conduct actuarial review of their reserves relating to such statutory classes of business.

Note: A corresponding term, '*short-tail business*', refers to business where claims are mostly settled within a relatively short space of time after arising, e.g. motor (own-damage) and fire insurance.

- (c) **Generally:** the application of an actuary's skills is very obvious in such areas as *premium rating*, the calculation of *reserves* and the *valuation* of liabilities.

4.10 ACCOUNTING AND INVESTMENT

The Accountant is another official with a vital role to play in the running of any business enterprise, and particularly that of an insurer. The functions of this department are fairly obvious, but for completeness we note:

- (a) **Record keeping:** financial records must be accurate and reliable.
- (b) **Collections:** ensuring that money receivable by the insurer is in fact paid clearly affects the very existence of the company. A satisfactory system for collecting, monitoring and reminding the company debtors is thus of high priority.
- (c) **Payments:** ensuring that bills and debts are paid promptly and efficiently (and correctly) entails much routine but important work.
- (d) **Investment:** if there is not a separate investment department, the care and placement of company assets may be the responsibility of the Accountant. It goes without saying that this is extremely important, from the perspectives of *security*, relative *return (or yield)* and *liquidity* (having sufficient cash-flow to meet known and anticipated monetary demands).

4.11 TRAINING AND DEVELOPMENT

Sometimes unappreciated by line managers, ever conscious of targets and deadlines, the Training and Development department within a company is very important. Some observations to note:

- (a) **Staff and Agents:** Training is essential for both in-house personnel and field staff. The educational and training needs of both must not be overlooked.
- (b) **Relevance:** Training is not an *optional extra*, nor is it *independent*. It is part of the overall team that constitutes the insurer, and its activities must not be self-fulfilling, but relevant and effective to the continuance and enhancement of the company.
- (c) **Training:** This may be seen as preparation for the actual job in hand, or the job in prospect. As such, it will involve courses, seminars and self-preparation arranged or encouraged by staff training personnel.

- (d) **Education:** This may be seen as involving the quest for wider learning and professional or related qualifications. Preparations, etc. for this may be encouraged rather than provided, but having qualified staff (and insurance agents) is of great importance.
- (e) **In-house or external:** Whether instruction is provided by its own staff, or arranged on behalf of staff with outside providers, this will be an important concern of company trainers.
- (f) **Resources and records:** Facilities for training (library and other aids) as well as up to date records of individual training progress will clearly assist the efficient running of this section.

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Representative Examination Questions

Type 'A' Questions

- 1 Product development for an insurer is:
- (a) a never-ending process;
 - (b) not necessary for a large insurer;
 - (c) not necessary with compulsory classes of business;
 - (d) no longer necessary once policy wording has been decided.

[Answer may be found in **4.1**]

- 2 Underwriting, in the context of an insurance company's operations, means:
- (a) sales activities;
 - (b) being responsible for any unsold shares;
 - (c) the assessment of risks for insurance purposes;
 - (d) the actual signing of policy and other contract documents.

[Answer may be found in **4.5**]

Type 'B' Questions

- 3 Which of the following may have significance with life insurance claims?
- (i) Outstanding policy loans
 - (ii) Complications with beneficiaries
 - (iii) Possible assignment of the policy to a third party
 - (iv) Uncertainty over the death or identity of the deceased
-
- (a) (i) and (ii) only;
 - (b) (ii) and (iii) only;
 - (c) (i), (iii) and (iv) only;
 - (d) (i), (ii), (iii) and (iv).

[Answer may be found in **4.7(a)**]

4 Which **two** of the following are **not** likely to be the responsibility of the Accounts department in an insurance company?

- (i) Payment of outstanding bills
- (ii) Collection of unpaid premiums
- (iii) Determining whether a risk is insurable
- (iv) Arranging the launch of a new policy product

- (a) (i) and (ii);
- (b) (i) and (iii);
- (c) (ii) and (iii);
- (d) (iii) and (iv).

[Answer may be found in **4.10**]

[If still required, the answers may be found at the end of the Study Notes.]

5 STRUCTURE OF HONG KONG INSURANCE INDUSTRY

5.1 TYPES OF INSURANCE BUSINESS

Insurance is classified in different cross-cutting ways for different purposes. Without trying to give an exhaustive review, we may consider the topic under three headings:

- (a) *Statutory*: for the purposes of the insurance regulator's authorisation and supervision.
- (b) *Practical*: for the purposes of internal company organisation.
- (c) *Academic*: for the purposes of professional study and training.

5.1.1 Statutory Classification of Insurance

This is found in Schedule 1 of the Insurance Ordinance, which specifies the various classes of business, using essentially the format used in the U.K. and the European Community. The Ordinance divides insurance into *Long Term Business* and *General Business*, with a number of sub-divisions, as follows:

- (a) **Long Term Business** (predominantly Life Insurance): this is divided into nine categories, with a designated letter per class, i.e.

A	<i>Life and annuity</i>	-	life insurance and annuity (see Glossary), excluding class C below
B	<i>Marriage and birth</i>	-	insurance contracts providing benefits payable on marriage or on the birth of a child
C	<i>Linked long term</i>	-	unit-linked life insurance and unit-linked annuity (see Glossary for 'Unit-linked Business')
D	<i>Permanent health</i>	-	essentially long term policies providing benefits for incapacity from accident or for ill-health (the policy is not normally cancellable by the insurer)
E	<i>Tontines</i>	-	A tontine is an unusual contract on a group of persons, the accumulated contributions payable to the last survivor(s) at the end of a defined period.

F	<i>Capital redemption</i>	-	a contract to provide a capital sum at the end of a term in order to replace one's capital because, e.g. debentures will become repayable; not related to human life
G	<i>Retirement scheme management category I</i>	-	group retirement scheme contracts providing for a guaranteed capital or return
H	<i>Retirement scheme management category II</i>	-	group retirement scheme contracts not providing for a guaranteed capital or return
I	<i>Retirement scheme management category III</i>	-	group contracts providing insurance benefits under retirement schemes, but excluding classes G and H above

Note: It will be appreciated that not all the above will have equal significance in the day to day business of the Hong Kong insurance market. For instance, only a handful of companies are currently authorised to write class B, E or F business.

(b) **General Business:** this is divided into 17 categories, with a designated number per class, i.e.

1	<i>Accident</i>	-	this is more usually referred to by insurance practitioners as Personal Accident (and Sickness) , providing benefits or indemnity in the event of accident or sickness
2	<i>Sickness</i>	-	policies providing benefits or indemnity for loss due to sickness or infirmity, but excluding class D above
3	<i>Land vehicles</i>	-	property insurance on vehicles used on land, including motor vehicles but excluding railway vehicles)
4	<i>Railway rolling stock</i>	-	property insurance on such vehicles
5	<i>Aircraft</i>	-	property insurance on aircraft
6	<i>Ships</i>	-	property insurance on ships
7	<i>Goods in transit</i>	-	property insurance on goods in transit, including marine cargo

8	<i>Fire and natural forces</i>	-	property insurance covering fire and some other perils (e.g. storm and explosion)
9	<i>Damage to property</i>	-	property insurance exclusive of classes 3-8 above
10	<i>Motor vehicle liability</i>	-	third party Motor insurance (including compulsory motor insurance)
11	<i>Aircraft liability</i>	-	covering liabilities for property damage or personal injury/death arising out of the use of aircraft
12	<i>Liability for ships</i>	-	covering marine liabilities for property damage or personal injury/death
13	<i>General liability</i>	-	liability insurance exclusive of classes 10-12 above; employees' compensation insurance is included here
14	<i>Credit</i>	-	covering loss to creditors from debtors' failure to pay debts
15	<i>Suretyship</i>	-	contracts of guarantee, including fidelity guarantee, performance bonds (see Glossary for the meanings of these two terms)
16	<i>Miscellaneous financial loss</i>	-	any other classes of business (business interruption, loss of use, etc.)
17	<i>Legal expenses</i>	-	insurance to pay legal costs, with the insured as defendant or as claimant)

Note: Few, if any, local insurers are likely to use the above classification in their internal organisation, but authorisation to transact business will be granted in respect of the classes indicated.

5.1.2 Practical Classification of Insurance

For internal management and operational purposes, each insurer is free to classify his business as he sees fit. The following are typical examples of classifications used by insurers in Hong Kong:

(a) Departmental (Class of Business)

There is no single pattern under this form of classification, but there are two main approaches:

- (i) **U.K. (European) Style:** where traditionally the major classes were *Life, Marine, Fire* and *Accident* ('Accident' effectively meant anything else, such as personal accident, liability, motor, etc.).

- (ii) **U.S. Style:** where there is a very clear distinction between *Life* (including annuity, medical expense and disability) and *Non-Life* business, the latter frequently being sub-divided into *Fire, Marine, Bonding* and *Casualty* (i.e. automobile, liability, theft, workers' compensation, etc.).

(b) **Source of Business**

Under this system, for control and management purposes, business is sub-divided according to how it was obtained, i.e.

- (i) from **insurance agents**;
- (ii) from **insurance brokers**;
- (iii) **direct** from the public, no insurance intermediary being involved.

(c) **Type of Client**

Under this system, for control and management purposes, business is sub-divided according to whether it covers:

- (i) **individuals** - Personal Insurance; or
- (ii) **firms and organisations** - Business or Commercial Insurance.

5.1.3 Academic Classification of Insurance

For academic and professional examination purposes (especially with the U.K. and Commonwealth countries), insurance is frequently sub-divided on a *Subject Matter of Insurance* or *Functional* basis, as follows:

- (a) Insurance of *the person* (which is not equivalent to 'personal insurance'), i.e. human beings being the subject matter of insurance (life, health and personal accident insurances, etc.);
- (b) Insurance of *property*, i.e. covering tangible objects against loss or damage (fire, motor damage, marine cargo, etc.);
- (c) Insurance of *liability*, i.e. covering legal liability for death, injury or property damage to others (employees' compensation, public liability, etc.);
- (d) Insurance of *pecuniary interests*: It relates to any financial interest to be insured not covered by (a) - (c) above, including business interruption, credit and rent insurances.

Note: It must not be thought that the academic classification is only of use in studying for examinations. Thinking about insurance according to the function it performs (person, property, liability etc.) is a useful check-list when trying to help a client decide what insurances he should have.

5.1.4 Reinsurance

Reinsurers insure the insurers. This is absolutely normal, indeed essential to the well-being of the insurance industry (see **6.1.1e** below). Reinsurance is usually a normal activity of insurers. It can be:

- (a) **Outwards reinsurance:** where the insurer insures again with other insurers/reinsurers; or
- (b) **Inwards reinsurance:** where the insurer acts as a reinsurer, covering risks already insured by other insurers/reinsurers.

(Those insurers who confine their business to reinsurance are sometimes called '**Professional Reinsurers**'.)

5.2 SIZE OF INDUSTRY

As insurance is a dynamic element in the financial services industry of Hong Kong, statistics are always likely to be somewhat out of date. Nevertheless, we may usefully consider this topic under four headings (source of figures: the Insurance Authority, unless otherwise stated):

- (a) number of authorised *insurers* (including those which are professional reinsurers);
- (b) number of registered or authorised *insurance intermediaries*;
- (c) number of persons *employed* in the industry;
- (d) premium volume.

5.2.1 Authorised Insurers

As at 31 December 2012, there were totals as follows:

- (a) **'Pure' Long Term Business** (see **5.1.1** (a) above): 'pure' in this context means 'only' or 'exclusively' (specialising) in this class. A total of 44 pure long term insurers were authorised, comprising 15 Hong Kong incorporated companies and 29 others (including 1 from the Mainland of China).
- (b) **'Pure' General Business** (see **5.1.1** (b) above): 92 pure general insurers were authorised, comprising 58 Hong Kong incorporated companies and 34 others (including 1 from the Mainland of China).

- (c) **‘Composite’**: the term implies carrying on both Long Term and General Business. 19 insurers were so authorised, comprising 10 Hong Kong incorporated companies and 9 others (none from the Mainland of China).

5.2.2 Registered or Authorised Insurance Intermediaries

As at 31 December 2012, adding the total number of appointed insurance agents and their Responsible Officers and Technical Representatives in Hong Kong to that of authorised insurance brokers and their Chief Executives and Technical Representatives gave a grand total of 77,259.

Note: An *‘insurance intermediary’* is defined in the Insurance Ordinance as either an *‘insurance agent’* or an *‘insurance broker’* (see 6.2 below). Whether the intermediary being referred to is a firm or an individual, the same set of terms are used.

5.2.3 Persons Employed

The biennial Manpower Survey Report on the Insurance Industry in Hong Kong (commissioned by the Vocational Training Council) was most recently conducted in 2011. This survey concluded that the industry on 3 January 2011 had a workforce of 52,485 people. 69% of this workforce were mainly connected with Life Insurance (77% of these being insurance agents or technical representatives of insurance agents) and 31% mainly with General Insurance.

5.2.4 Premium Volume

When discussing premiums, many technical considerations arise which are beyond the scope of the present study. We shall therefore confine ourselves to the broad picture. In 2011 (source of data: the Insurance Authority):

- (a) the gross premiums for *General Insurance Business* (comprising Direct Business and Reinsurance Inward Business) amounted to a total of HK\$34,834.7 million, representing 1.84% of Hong Kong’s Gross Domestic Product;
- (b) the premiums for Long Term Business were as follows: HK\$186,696.5 million of Individual Life In-Force Business office premium, HK\$1,847.9 million of Group Life In-Force Business office premium, HK\$8,119.1 million of contributions for Retirement Scheme In-Force Business transacted by insurers, HK\$2,251.6 million of Annuity and Other In-Force Business office premium. The total premium (HK\$198,915.1 million) represents 10.49% of Hong Kong’s Gross Domestic Product.

5.3 INSURANCE COMPANIES

Some statistical information about insurance companies in Hong Kong has already been considered (see 5.2.1 above). Some other features should be noted as well, as follows (source of figures: the Insurance Authority, unless otherwise stated):

(a) International Basis

As is well-known, Hong Kong is a major international centre for financial services. Of the 155 authorised insurers as at 31 December 2012, 83 were Hong Kong incorporated and 72 incorporated in 21 jurisdictions outside Hong Kong (including 2 incorporated in the Mainland of China).

(b) Market Analysis

Below are statistics on the market shares of the top insurers by major classes of business in the year 2011:

- (i) **General Business:** by gross premium, the aggregate percentage market share of the top ten insurers in relation to General Business (comprising Direct Business and Reinsurance Inward Business) is 42% and in relation to each of the major classes is 73% for Accident and Health, 60% for Motor Vehicle, 56% for Property Damage, and 51% for General Liability (comprising Statutory Business and Other Business). No one insurer had a market share of more than 17% in any one of these classes.
- (ii) **Long Term Business:** here the analysis reveals a different picture, with the top ten insurers accounting for 75% of the 2011 market, the top five accounting for 55% and the top one 16%, all by premium (annual plus single) of Total In-Force Business.

With 111 insurers authorised to write General Business and 63 authorised to write Long Term Business, we may reasonably conclude that General Business is more evenly distributed among authorised insurers than Long Term Business.

(c) Market Co-operation

More will be said on this topic later (see for example 5.5 below), but it is appropriate to mention at this stage that Hong Kong insurers have a central body representing their interests, *The Hong Kong Federation of Insurers* ('HKFI'). Since its formation in August 1988, the HKFI has been recognised by the insurance regulator as the **representative body of insurers** in Hong Kong. According to the HKFI, as at the end of 2012, it had 86 general insurance members and 43 life insurance members. Without doubt, it is a major factor in the structure of the Hong Kong Insurance Industry.

5.4 INSURANCE INTERMEDIARIES

As noted above (5.2.2), insurance intermediaries comprise *insurance agents* and *insurance brokers*. More detailed comments on their respective roles and legal requirements appear elsewhere in these Notes (see especially 6.2 below), but considering them under the topic of the structure of the Hong Kong Insurance Industry, we should note the following:

- (a) **Registration/Authorisation:** Insurance intermediaries in Hong Kong are required by the Insurance Ordinance to be formally registered or authorised, as the case may be (see 6.2.1 below).
- (b) **Qualifications:** Before a person can be registered or authorised to act as an insurance intermediary, he must satisfy certain criteria. These are considered in detail later (see Chapter 6).
- (c) **Role:** It is true that insurance may be arranged *direct* with the insurer, i.e. without using an insurance intermediary, but this is not the norm, especially in Long Term Business. It would be relatively rare, for instance, to find life insurances being arranged in Hong Kong without an insurance intermediary being involved. Also, with complex commercial risks, it is quite normal for an insurance broker to be engaged, in view of the wide experience and independent expertise which they are generally seen to possess. It is therefore quite clear that insurance intermediaries have, and are very likely to continue to have, an important role in the structure of the Hong Kong insurance industry.
- (d) **Market Co-operation:** More will be said on this topic in 5.5 below, but it would probably be fair to say that the roles of *insurance agents* and *insurance brokers* are quite distinct. All, however, through their market representations and individually, have a common interest in quality service and the integrity of the market.

5.5 MARKET ASSOCIATIONS/INSURANCE TRADE ORGANISATIONS

Some of the major market associations/insurance trade organisations in the Hong Kong insurance market are:

5.5.1 The Hong Kong Federation of Insurers ('HKFI')

- (a) This organisation has already been mentioned (see 5.3(c) above), but the importance of the HKFI on the local insurance scene cannot be overstated. An important objective of the HKFI is to promote and advance the common interests of **insurers** and **reinsurers** transacting business in Hong Kong. As a major influence in the **self-regulatory** process, the HKFI has numerous areas of activity.

- (b) According to its Mission Statement, the HKFI exists to promote insurance to the people of Hong Kong and build **consumer confidence** in the industry by encouraging the highest standards of **ethics** and **professionalism** amongst its members.
- (c) The HKFI established the *Insurance Agents Registration Board* ('IARB') in January 1993 to perform the dual role of **registering** insurance agents and their Responsible Officers and Technical Representatives, and of **handling complaints** against insurance agents or their Responsible Officers or Technical Representatives, pursuant to the Code of Practice for the Administration of Insurance Agents (see **6.2.2** below).

5.5.2 Approved Bodies of Insurance Brokers

The Insurance Authority has the power to approve a body of insurance brokers under Section 70 of the Insurance Ordinance, so that its members are deemed to be authorised insurance brokers, without the need to seek authorisation from the Insurance Authority direct. There are two such approved bodies in Hong Kong:

- (a) *the Hong Kong Confederation of Insurance Brokers*; and
- (b) *the Professional Insurance Brokers Association*.

5.5.3 Industry Organisations to Assist Claimants or Victims

Three such organisations should be noted:

- (a) *The Insurance Claims Complaints Bureau* ('ICCB'): this is considered in more detail in **6.1.4** below.
- (b) *The Motor Insurers' Bureau of Hong Kong* ('MIB'): funded by a surcharge on motor insurance premiums, the MIB seeks to provide compensation in respect of the death of or injury to innocent victims of motor vehicle road accidents, where the required compulsory insurance for such situations does not exist or is not effective, or the insurer concerned is in liquidation.
- (c) *The Employees Compensation Insurer Insolvency Bureau* ('ECIIB'): composed of all insurers carrying on the business of employees' compensation insurance in Hong Kong, the ECIIB runs the Employees Compensation Insurer Insolvency Scheme to assume responsibilities for liabilities under employees' compensation policies of its member insurers that have become insolvent. The Scheme is funded by a surcharge on employees' compensation insurance premiums.

5.5.4 Employees' Compensation Insurance Residual Scheme Bureau

There have been cases in which employers appeared to have difficulty obtaining EC insurance in respect of employees engaged in certain high risk occupations. To tackle this problem, an '**Employees' Compensation Insurance Residual Scheme**' ('ECIRS') was set up to act as a market of last resort for these employers. By a market agreement, all employees' compensation insurers have to become members of the ECIRS, taking on risks on a collective basis. The running of this scheme is overseen by a market body called the 'Employees' Compensation Insurance Residual Scheme Bureau', which was formed for the purposes of enabling employers who have found themselves being unable to obtain employees' compensation insurance to obtain such insurance.

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Representative Examination Questions

Type 'A' Questions

- 1 The Insurance Ordinance in Hong Kong divides insurance business into two broad categories. One is General Business and the other is:
- (a) Specific Business;
 - (b) Accident Insurance;
 - (c) Long Tail Business;
 - (d) Long Term Business.

[Answer may be found in **5.1.1**]

- 2 The difference between 'inwards reinsurance' and 'outwards reinsurance' for a given insurance company is that:
- (a) inwards reinsurance is with Hong Kong reinsurers;
 - (b) outwards reinsurance is with non-Hong Kong reinsurers;
 - (c) inwards reinsurance is where the company acts as reinsurer;
 - (d) outwards reinsurance is where the company acts as reinsurer.

[Answer may be found in **5.1.4**]

Type 'B' Questions

- 3 Which **two** of the following are classes of Long Term Business?
- (i) Aircraft liability
 - (ii) Life and Annuity
 - (iii) Permanent Health
 - (iv) Damage to property
-
- (a) (i) and (ii);
 - (b) (ii) and (iii);
 - (c) (ii) and (iv);
 - (d) (iii) and (iv).

[Answer may be found in **5.1.1(a)**]

4 Which of the following statements are **true** in the Hong Kong situation, based upon available data?

- (i) Relatively few insurers dominate General Business
- (ii) Relatively few insurers dominate Long Term Business
- (iii) General Business is shared more evenly among insurers
- (iv) Long Term Business is shared more evenly among insurers

- (a) (i) and (ii) only;
- (b) (i) and (iii) only;
- (c) (ii) and (iii) only;
- (d) (iii) and (iv) only.

[Answer may be found in **5.3**]

[If still required, the answers may be found at the end of the Study Notes.]

6 REGULATORY FRAMEWORK OF INSURANCE INDUSTRY

All civilised societies recognise that a financial service as important as insurance must be subjected to some form of supervision or control. This is a sensitive area, since on the one hand it is not good for society to ‘strangle’ any kind of worthwhile business activity with excessive controls. On the other hand, left totally unsupervised, the huge amounts of money involved with insurance have over the centuries proved irresistible to fraudsters and irresponsible people, to the great harm and detriment of the societies affected.

A measure of balance is therefore to be sought. That balance, to some extent, is achieved by a judicious mixture of *statutory regulation* and *self-regulation*, where representatives of the industry itself exercise discipline and oversight. Below, we shall examine both these aspects of the Hong Kong insurance industry regulatory framework.

6.1 REGULATION OF INSURANCE COMPANIES IN HONG KONG

The Insurance Companies (Amendment) Ordinance 2015 (‘the Amendment Ordinance 2015’) enacted by the Legislative Council of Hong Kong on 10 July 2015 provides for, among other things, the establishment of a new and independent statutory body officially known as the “Insurance Authority” (‘IA’), as the new insurance regulator independent of the Government, to take over the statutory functions of the Office of the Commissioner of Insurance (‘OCI’) in regulating the insurance industry in Hong Kong.

The policy objectives of setting up the IA are to modernise the insurance industry regulatory infrastructure to facilitate the stable development of the industry, provide better protection for policy holders and potential policy holders, align Hong Kong with the international practice that insurance regulators should be financially and operationally independent of the government and industry, and set up a direct regulatory regime for insurance intermediaries to replace the existing self-regulatory system administered by three self-regulatory organisations (‘SROs’).

6.1.1 Insurance Ordinance

This very important piece of legislation provides the framework for the prudential supervision of the insurance industry of Hong Kong. In fact, it covers not only the supervision and regulation of insurers, but also that of insurance intermediaries. The Insurance Ordinance (Cap. 41), formerly entitled the Insurance Companies Ordinance (‘ICO’), came into effect in June 1983. The principal functions of the then Insurance Authority under the ICO were to ensure that the interests of policy holders and potential policy holders are protected, and to promote the general stability of the insurance industry.

With the relevant provisions of the Amendment Ordinance 2015 coming into operation on 26 June 2017, the ICO was renamed the Insurance Ordinance

(Cap. 41). The IA took over the statutory functions of the OCI to regulate the insurance industry in Hong Kong and the OCI was disbanded on the same day. The principal functions of the new regulator remain unchanged but it is also tasked to (i) regulate the conduct of insurance intermediaries through a licensing regime; (ii) promote the understanding by policy holders and potential policy holders of insurance products and the insurance industry; (iii) formulate effective regulatory strategies and facilitate the sustainable market development of the insurance industry, and promote the competitiveness of the insurance industry in the global insurance market; (iv) conduct studies into matters affecting the insurance industry; and (v) assist the Financial Secretary of the Government in maintaining the financial stability of Hong Kong by taking appropriate measures in relation to the insurance industry.

The IA took over the statutory functions of the OCI on 26 June 2017 to regulate insurance companies; it will eventually take over the regulation of insurance intermediaries from the three SROs through a statutory licensing regime in the next stage (see section 6.2 for the regulation of insurance intermediaries in Hong Kong). Some of the major provisions of the Insurance Ordinance concerning the regulation of insurance companies are outlined below.

6.1.1a Authorisation of Insurers

Any ‘person’ (which may, as a legal term, mean a corporation), before they carry on insurance business in or from Hong Kong, must first of all obtain authorisation to do so from the IA. The Insurance Ordinance prescribes certain minimum requirements for authorisation, relating to such matters as:

- (a) *paid-up capital*;
- (b) *solvency margin*;
- (c) *directors and controllers*;
- (d) *adequate reinsurance arrangement*.

In addition, the IA has issued *Guidelines* which seek to ensure that the applicant insurer is financially sound and otherwise suitable, not only at the time of authorisation but continuing to be so in the future.

6.1.1b Capital Requirement

Minimum paid-up capital required:

- (a) **HK\$10 million**: if carrying on only General or only Long Term business, but not any statutory (or compulsory) insurance business;
- (b) **HK\$20 million**: if carrying on any *statutory* (or compulsory) insurance business, either alone or together with any other insurance business;

- (c) **HK\$20 million:** if carrying on *both* General *and* Long Term business;
- (d) **HK\$2 million** (instead of the above figures): if the insurer is a *Captive Insurer* (see Glossary).

Note: The above figures are merely **minimum** requirements. Insurers in Hong Kong almost invariably have paid-up capital well in excess of these requirements.

6.1.1c Solvency Margin Requirement

‘Solvency’ may be thought of as the point at which *assets* are just sufficient to meet *liabilities*. A *margin of solvency* is therefore the degree or amount by which assets *exceed* liabilities. Insurance companies must have a **solvency margin** of not less than the ‘**relevant amount**’ – the minimum amount of solvency margin required of a particular insurer - as a safeguard against the risk that the insurer may not be able to meet its liabilities. The **relevant amount** is prescribed as follows:

- (a) **General Business:** calculated on two different bases,
 - (i) ‘*Premium Income*’ (the higher the volume of premium income, the larger the relevant amount) and
 - (ii) ‘*Claims Outstanding*’ (the higher the amount of claims outstanding (see Glossary), the larger the relevant amount),

whichever produces the higher figure; and subject to a Minimum Amount of HK\$10 million (or HK\$20 million if carrying on statutory insurance business).

- (b) **Long Term Business:**

Calculated in accordance with the detailed requirements of the Insurance Companies (Margin of Solvency) Regulation, subject to a total of not less than **HK\$2 million**.

- (c) **Composite Business:**

In respect of the Long Term Business, the calculation of the relevant amount follows (b) above. In respect of the General Business, it will be calculated in the usual manner for General Business (see (a) above).

(d) **Captive Insurer:**

Either the ‘premium income’ basis or the ‘claims outstanding’ basis, whichever produces the higher figure; subject to a **minimum of HK\$2 million.**

6.1.1d Fit and Proper Requirement for Controllers, Directors, Key Persons in Control Functions and Appointed Actuaries

Controllers, directors and key persons in control functions of an authorised insurer must be **fit and proper** to assume such a position. In addition, prior approval of the IA is required for an authorised insurer’s appointment of such persons. The appointment of an appointed actuary by a long term insurer is also subject to prior approval of the IA as well as the fit and proper criteria.

In determining whether a person is a fit and proper person for this purpose, the IA will give due regard to the following matters in addition to any other matter that the IA considers relevant:

- (a) education, qualification or experience of the person;
- (b) the person’s ability to act competently, honestly and fairly;
- (c) reputation, character, reliability and integrity of the person;
- (d) the person’s financial status or solvency;
- (e) disciplinary action taken by any other authority or regulatory organisation against the person;
- (f) if the person is a company in a group of companies, any information in the possession of the IA relating to any other company in the group of companies, or to any substantial shareholder or officer of the person or of any other company in the group of companies; and
- (g) the state of affairs of any other business which the person carries on or proposes to carry on.

Related but distinct from the concept of ‘fitness and properness’ is that of corporate governance, which term refers to the rules and practices put in place within a corporation for the management and control of its business and affairs. The IA has issued the **Guideline on the Corporate Governance of Authorised Insurers** (the ‘Guideline on Corporate Governance’), which sets out the minimum standard of corporate governance that is expected of authorised insurers. A high

standard of corporate governance established by authorised insurers is considered to be an essential step in instilling the confidence of the insuring public and encouraging more stable and long term development of the insurance market. The Guideline on Corporate Governance covers all levels of management, and all functions (risk management, underwriting, claims, client servicing, audit, etc.), of an authorised insurer.

6.1.1e Adequate Reinsurance

Reinsurance is an extremely important, in many cases **crucial**, element in the financial security of an insurer. Its importance is much influenced by various factors, including the financial strength of the insurer, and the type and volume of business. The Insurance Ordinance requires authorised insurers to have adequate reinsurance arrangements in force. It is a vital consideration in the overall financial supervision of an insurer, both with regard to the *quantity* and the *quality* (probable ‘**collectability**’) of the reinsurance effected.

The IA has issued and implemented a guideline on the subject, the ‘**Guideline on Reinsurance with Related Companies**’. This Guideline applies only where an authorised insurer reinsures with a ‘related reinsurer’ (meaning one within the same grouping of companies, as defined in Section 2(7)(b) and (c) of the Insurance Ordinance). The reason why this Guideline is important is that the prudent control that any one insurer should exercise on its reinsurance arrangements may possibly be compromised when the reinsurer is related to it. This situation, if allowed to be loosely supervised, will put the interests of the insuring public at risk.

The Guideline aims to promulgate how reinsurance arrangements with related companies will be considered adequate by the IA in terms of financial security, and how the IA intends to address the supervisory concern if such reinsurance arrangements are not considered adequate.

6.1.1f Other Major Provisions of the Insurance Ordinance

Certain other features of the Insurance Ordinance which should be noted include:

- (a) **Maintenance of Assets in Hong Kong:** An insurer carrying on General Business must maintain assets in Hong Kong in respect of its liabilities arising from its Hong Kong General Business. The amount required is to be calculated in accordance with one of two prescribed methods, one of which requires an amount *not less than* the **aggregate** of:

- (i) **80%** of its **net liabilities** (i.e. after deducting those covered by reinsurance); and
- (ii) the **relevant amount**.

Claims from Hong Kong general insurance policyholders have preference under Hong Kong insolvency law. Such protection is enhanced by the above requirement of the Insurance Ordinance to have funds available in Hong Kong.

Note: This requirement does **not** apply to *Captive Insurers* and *Professional (Specialist) Reinsurers*.

- (aa) **Maintenance of separate accounts for different classes of long term business:** An insurer must maintain an account for each class of its long term business and assets representing a fund maintained by the insurer in respect of its long term business must be applicable only for the purposes of that part of business to which the fund relates.
- (b) **Valuation Bases for Assets and Liabilities:** Assets and liabilities must be valued for both General and Long Term Business. The way each is calculated is obviously of the greatest importance to the perceived financial position of the insurer concerned.
 - (i) **General Business:** Specific regulation governs the valuation of assets and liabilities. However, it does not apply to a *Captive Insurer*.
 - (ii) **Long Term Business:** Again, specific regulation governs the valuation of liabilities, especially concerning such matters as projected *interest earnings* and *expected yield* from investments.
- (c) **Reporting Requirements:** The following reporting requirements apply:
 - (i) **Every insurer:** Has to submit annually to the IA its *financial statements* prepared in accordance with the requirements of the Insurance Ordinance.
 - (ii) **General Business:** These insurers, in addition to the requirement mentioned in (i) above, have to submit annually to the IA an audited *General Business Return* and audited *Statement of Assets and Liabilities* relating to its Hong Kong business. However, *Captive Insurers* and *Professional (Specialist) Reinsurers* are not required to submit audited *Statements of Assets and Liabilities* to the IA.

The '*Guideline on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses*' issued by the IA requires that insurers (including reinsurers) which carry on employees' compensation business and/or motor insurance business should annually commission an actuarial review of their reserves set aside for future claims payments in respect of such statutory line(s) of business. The review should be conducted according to specified criteria. An actuarial report should be prepared and certified by the actuary, and submitted to the IA for review within a prescribed period. It should be noted that this Guideline applies to professional reinsurers as well as to direct insurers.

- (iii) **Long Term Business:** In addition to meeting the requirement mentioned in (i) above periodically – normally every 12 months - Long Term insurers have to commission an actuarial investigation into its financial condition in respect of its long term business. An abstract of the *actuarial investigation* report together with a certificate made by the appointed actuary have to be submitted to the IA within a prescribed period.

Note: 1 With the enactment of the Electronic Transactions Ordinance, insurers may submit these documents by electronic means.

2 Some people might find it difficult to distinguish between reserves and solvency margin. In simple terms, the solvency margin of an insurer represents the surplus of its assets over its liabilities. On the other hand, claims reserves represent projected or estimated future insurance liabilities. If an insurer's claims reserves have been set up on the basis of a less than prudent projection or estimation, other things being equal, its net asset value must be an overstated figure.

- (d) **Transparency:** As an enhancement to market transparency, with effect from June 2000, the Insurance Ordinance allows the IA to disclose financial and statistical information of individual insurers and Lloyd's when it is considered in the interests of policyholders or the public to do so.

Note: The Insurance Ordinance, however, specifically prohibits the IA from disclosing any information relating to the affairs of individual insurers, except under specified court proceedings.

- (e) **New regulatory powers under the Amendment Ordinance 2015:** For more effective regulation of insurers and better protection of policy holders' interests, the IA is also vested with express powers to conduct inspection, initiate investigation, and impose disciplinary sanctions on authorised insurers. The range of disciplinary sanctions which the IA could impose include revocation/suspension of an insurer's authorisation, prohibition from application for authorisation to carry on a class of insurance business, public/private reprimand and pecuniary penalty.

6.1.1g Powers of Intervention

It is often said that for effective supervision, insurance regulators must not only have 'eyes', but must also have 'teeth'. The statutory provisions therefore outline various actions the regulators may take for protecting the interests of policyholders and potential policyholders. These actions include:

- (a) **Limitation of premium income:** if, for example, it is deemed that an insurer is growing too fast or may otherwise be facing potential difficulties with the inevitable liabilities that new business might produce.
- (b) **Restrictions on investments:** on the type and/or location of investments.
- (c) **Restrictions on new business:** on the capacity to effect or vary any contracts of insurance or contracts of insurance of a specified description.
- (d) **Custody of assets by an approved Trustee:** for additional security.
- (e) **Special actuarial investigation:** probably when there is cause for concern on a particular insurer's ability to meet liabilities.
- (f) **Assumption of control by a Manager appointed by the IA:** in serious cases.
- (g) **Winding up (liquidating) the insurer:** in extreme cases; by presenting a petition to the courts.

6.1.2 Code of Conduct for Insurers

This Code was implemented by the Hong Kong Federation of Insurers ('HKFI') in May 1999. It applies to insurance effected in Hong Kong by **individual** (not company) policyholders resident in Hong Kong, insured in their *private capacity* only.

6.1.2a Objectives

These set out the expected standards of **good insurance practice** relating to such matters as

- (a) underwriting and claims;
- (b) product understanding;
- (c) customers' rights and obligations under insurance contracts;
- (d) customers' rights and interests generally;
- (e) the industry's public image as a good corporate citizen.

Sections of the Code relevant to the activities of insurance agents are covered below.

6.1.2b Advising and Selling Practices

This Part of the Code makes specific comment on:

- (a) **Sales Materials:** these should be up to date, accurate, in understandable language and not misleading to the public.
- (b) **Proposal/Application Forms:** these are documents of prime importance to the formation of the contract, being the vehicle through which the intending insured supplies information to the insurer. As such, the forms should:
 - (i) be in understandable language, with clear guidance as necessary;
 - (ii) carefully explain the significance of *utmost good faith* requirements;
 - (iii) make matters of *material significance* the subject of clear questions;
 - (iv) explain carefully the importance of any associated questionnaires.
- (c) **Policies:** these provide visible evidence of the insurance contract terms. As such, they should be clear and as understandable as possible to the consumer. Also, any utmost good faith implications regarding material facts to be disclosed at *renewal* should be carefully explained.
- (d) **Administration:** this covers such matters as *confidentiality*, *service standards*, *customer enquiries* and the fact that customers should not be the loser from *inaccuracy* on the part of the insurer's employees.

- (e) **Medical Evidence:** confirmation that the *Personal Data (Privacy) Ordinance* requirements will be observed in this sensitive area.

6.1.2c Claims

Since claims, or their possibility, are at the heart of insurance, clear statements are necessary to establish good practice in this area. These include:

- (a) **General Handling:** should be fair, efficient and speedily.
- (b) **Denial of Claims:** This should **not** happen
 - (i) unreasonably, especially with *non-disclosure* of material facts and particularly where no proposal form was obtained;
 - (ii) with *innocent misrepresentation* of material facts (other than with **marine** or **aviation** insurance);
 - (iii) with a *breach of warranty* committed **without fraud**, where it has **not caused the loss**.
- (c) **Claim Forms:** to be issued promptly without charge, and in understandable language.
- (d) **Other Issues:** specific mention is made of other matters such as:
 - (i) claimants to be kept *reasonably informed* of claim progress;
 - (ii) *reasonable explanation* to be given, if a claim cannot be admitted;
 - (iii) payment made **promptly** with *valid claims*;
 - (iv) third parties acting for the insurer (*adjusters* etc.) should always act reasonably and should be professionally qualified.

6.1.2d Management of Insurance Agents

Generally, insurers are to ensure that insurance agents comply with the law and all relevant HKFI Codes. Specifically, insurers should give attention to the following:

- (a) **Registration:** all insurance agents must be registered under the provisions of the Insurance Ordinance and governed by the *Code of Practice for the Administration of Insurance Agents* (see **6.2.2** below).

- (b) **Complaints:** proper procedures should be in place to deal with complaints against insurance agents.
- (c) **Adequate Support:** insurers should ensure that insurance agents have adequate support to perform their duties efficiently.
- (d) **Miscellaneous:** insurers must not seek to limit their liability for the actions of their insurance agents and should ensure as far as possible that the insurance agents act fairly and honestly.

6.1.2e Inquiries, Complaints and Disputes

Insurers should handle inquiries in a fair and timely manner, have in place documented internal complaint-handling procedures for resolving complaints by policyholders, and:

- (a) comply with the *Code of Practice for the Administration of Insurance Agents* (see **6.2.2** below), which provides an external mechanism for dealing with complaints against insurance agents; and
- (b) participate in the *Insurance Claims Complaints Bureau* ('ICCB') (see **6.1.4** below), which adjudicates insurance claims disputes between insurers and individual policyholders.

6.1.3 Guidelines on Complaint Handling

The HKFI has issued the 'Guidelines on Complaint Handling' to supplement the requirements stipulated in the Code of Conduct for Insurers on the handling of inquiries, complaints and disputes. The Guidelines apply to complaints about an insurer's provision of, or failure to provide, a service or product. They are summarised as follows:

6.1.3a Recommended Internal Complaint Handling Procedures

- (a) **General Principles:** The Guidelines lay down general principles for complaint handling procedures as: comprehensive cover, transparency and accessibility to customers, ease of use, fairness, impartiality, consistent approach to provision of redress, flexibility, simplicity, promptness, efficiency, measurability of performance standards, and provision of feedback to all the relevant regulatory or public bodies.
- (b) **Policies and Procedures:** Insurers should have in place appropriate and effective internal procedures for handling customer complaints, subjected to management controls. The procedures should be in writing, and should at least cover:

- receipt of complaints;
 - response to complaints;
 - investigation of complaints; and
 - provision of redress.
- (c) **Accessibility:** Insurers should ensure that customers know where and how to complain, and that complaints are courteously received. They should:
- publish their internal complaint handling procedures;
 - provide access to them in each of their offices;
 - supply them freely to customers upon request;
 - supply them freely and automatically to complainants;
 - inform new customers of the availability of the procedures.
- (d) **Communications:** Complainants should be allowed to complain by any reasonable means, including verbal means. Communications with complainants should be made in clear and plain language, and in a language that the complainants desire or use.
- (e) **Confidentiality:** Information relating to complaints including the complainants' identity should be treated as confidential, and access to it restricted.
- (f) **Independence and Authority in Handling Complaints**
- Complaints should not be investigated by an employee who was directly involved in the matter complained about;
 - Those responsible for responding to complaints must have the authority to settle them or have ready access to those who have it;
 - Serious matters should be brought to the attention of senior management.
- (g) **Redress:** Where a complaint is upheld, appropriate redress (e.g. apology, fair compensation, including compensation for loss of interest) should be offered.
- (h) **Resources and Staff Training**
- Adequate resources should be provided to ensure the efficiency and effectiveness of the complaint management system;

- Insurers should ensure that all relevant employees and registered persons are aware of the procedures and comply with them. Staff having contact with customers should be trained in complaints handling.

(i) **Monitoring and Audit**

- Effective procedures should be set up to monitor complaints and to make regular reports for senior management's review.
- To measure the attainment of the procedures, regular audits should be conducted by competent and independent staff. Based on the results of the audits, improvements to the procedures, where necessary, should be made by competent staff.

(j) **Management Review:** Insurers should carry out periodic reviews of the ability of their complaint management systems to meet customers' expectations.

(k) **Time Limit for Dealing with Complaints:** Upon receipt of a complaint, the insurer should send a written acknowledgement advising the complainants of:

- the name or job title and contact details of the complaint handler;
- expected date of final response to the complaint; and
- the internal complaint handling procedures.

(l) **Final Response**

- Insurers are encouraged to give the complainant, no later than 30 days after receiving the complaint,
 - (a) a final response, or
 - (b) the reasons for not being able to make the final response yet together with the expected date of a final response.
- Insurers should consider including in the final response:
 - (a) the outcome of the investigation,
 - (b) whether there has been fault on the part of the insurer,
 - (c) what redress, if any, will be made, and
 - (d) when the redress will be made.

6.1.3b External Dispute Resolution

Insurers should inform the complainants of the existence of the following bodies/regulator to which the complaints could be referred if they are not satisfied with the insurers' response:

- Insurance Agents Registration Board;
- The Insurance Claims Complaints Bureau; and
- Insurance Authority.

6.1.3c Record Keeping

Insurers should record details of complaints properly, and provide them to the relevant self-regulatory bodies/regulator upon request.

6.1.4 Insurance Claims Complaints Bureau ('ICCB')

The ICCB has a membership of all authorised insurers underwriting personal insurance in Hong Kong. Its primary objective is to handle insurance claims complaints from individual policyholders, arising out of personal contracts with its members.

6.1.4a Composition and Powers

- (a) The *Insurance Claims Complaints Panel* (the 'Panel') is appointed by the ICCB to handle complaints. It consists of a Chairman and four members and is **independent** in the sense that the incumbent Chairman is independent of the industry and is appointed with the prior consent of the Secretary for Financial Services and the Treasury.
- (b) Of the four members on the Panel, two are nominated by the HKFI, and two from outside the insurance industry (one representing the legal/accounting profession and the other representing consumer interests).
- (c) No fee is charged to the complainant, whether he wins his case or not.
- (d) The Panel can make an award against an insurer up to **HK\$800,000**, who has no right of appeal against an award. If the complainant is unsatisfied with an award, he may, however, seek legal redress.

- (e) Further points on the powers of the Panel: The Articles of Association of the ICCB stipulates that the Panel, in making its ruling, *'shall have regard to and act in conformity with the terms of the relevant policy, general principles of good insurance practice, any applicable rule of law or judicial authority; and any codes and guidelines issued from time to time by the Hong Kong Federation of Insurers (HKFI) or the Bureau. In respect of the terms of the policy contract, these shall prevail unless they would, in the view of the Complaints Panel, produce a result that is unfair and unreasonable to the complainant'*. The gist of these provisions is that, the Panel, in making a ruling, is given the power by the ICCB Members to look beyond the strict interpretation of policy terms.

As far as good insurance practice is concerned, the Panel relies heavily on the expected standards set out in *The Code of Conduct for Insurers*, with particular reference to 'Part III: Claims'. The first requirement of the section states, *'Insurers should seek to handle all claims efficiently, speedily and fairly'*. As such, as to whether an insurer has acted fairly in the settlement of claims or not is subjected to the scrutiny of the Panel.

6.1.4b Terms of Reference

To summarise, the ICCB can only deal with a particular case if:

- (a) the complaint is **claim-related**;
- (b) the claim amount does not exceed **HK\$800,000**;
- (c) the insurer concerned is an **ICCB member**;
- (d) the policy concerned is a personal insurance policy;
- (e) the complaint is filed by a policyholder/beneficiary/rightful claimant (e.g. an assignee);
- (f) the insurer concerned has made its final decision on the claim;
- (g) the complaint is filed within 6 months from the date of notification of the insurer's final decision on the claim;
- (h) the dispute in question does not arise from **commercial, industrial or third party** insurance; and
- (i) the claim is not subject to **legal proceedings or arbitration**.

6.2 REGULATION OF INSURANCE INTERMEDIARIES IN HONG KONG

The self-regulatory system for insurance intermediaries, i.e. insurance agents and brokers, has been in operation since 30 June 1995. It is supported by legislation which is contained in Part X of the Insurance Ordinance (Cap. 41) (formerly known as the Insurance Companies Ordinance). Under the current self-regulatory regime, insurance intermediaries are required to be registered with and be regulated by one of the three self-regulatory organisations ('SROs'), namely the Insurance Agents Registration Board (IARB), the Hong Kong Confederation of Insurance Brokers (CIB) and the Professional Insurance Brokers Association (PIBA).

As mentioned in section 6.1.1, the Insurance Authority took over the functions of the OCI on 26 June 2017 to regulate insurance companies; it will eventually take over the regulation of insurance intermediaries from the three SROs through a statutory licensing regime in the next stage. In the meantime, the existing self-regulatory system for insurance intermediaries will continue.

Some details of the requirements of the current regulatory system are set out below.

6.2.1 Roles and Responsibilities of Insurance Agents and Brokers

- (a) **'Insurance agent'**: The Insurance Ordinance prohibits any person from acting as an **'insurance agent'** unless he has become an **'appointed insurance agent'** in accordance with the relevant provisions of the Insurance Ordinance. (Remember that in law a corporation is a 'person'.)

But what is an 'insurance agent'? In the Insurance Ordinance, *'a person who holds himself out to advise on or arrange contracts of insurance in or from Hong Kong as an agent or subagent [i.e. an agent of an agent] of one or more insurers'* is termed an 'insurance agent'.

How to become an 'appointed insurance agent'? To become an 'appointed insurance agent', one must get registered with and appointed by an insurer.

- (b) **'Insurance broker'**: The Insurance Ordinance prohibits any person from acting as an 'insurance broker' unless he has become an 'authorised insurance broker' in accordance with the relevant provisions of the Insurance Ordinance.

But what is an 'insurance broker' within the meaning of the Insurance Ordinance? *'A person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policyholder or potential policyholder or advising on matters related to insurance'* is termed an 'insurance broker' in the Insurance Ordinance.

How to become an ‘authorised insurance broker’? To become an ‘authorised insurance broker’, one either has to obtain authorisation from the Insurance Authority or to become a member of a body of insurance brokers that has been approved by the Insurance Authority for such purpose.

- (c) **No wearing of two hats:** The Insurance Ordinance prohibits any person from being *an appointed insurance agent and an authorised insurance broker at the same time*, whether in relation to the same or different clients.
- (d) **Further Insurance Ordinance prohibitions:**
 - (i) A proprietor of, or partner in, an insurance agent shall not be a proprietor or employee of, or partner in, another insurance agent or an insurance broker.
 - (ii) An employee of an insurance agent who provides insurance advice to a policy holder or potential policy holder shall not be a proprietor or employee of, or partner in, another insurance agent or an insurance broker.
 - (iii) A proprietor or employee of, or partner in, an insurance agent may be a director of another insurance agent or of an insurance broker only if he does not provide insurance advice to a policy holder or potential policy holder for the company.
 - (iv) Where a director of an insurance agent does provide insurance advice to a policy holder or potential policy holder, he may be a director of another insurance agent or of an insurance broker only if he does not provide insurance advice to a policy holder or potential policy holder for the other company.
 - (v) A proprietor of, or partner in, an insurance broker shall not be a proprietor or employee of, or partner in, an insurance agent.
 - (vi) An employee of an insurance broker who provides insurance advice to a policy holder or potential policy holder shall not be a proprietor or employee of, or partner in, an insurance agent.
 - (vii) A proprietor or employee of, or partner in, an insurance broker may be a director of an insurance agent only if he does not provide insurance advice to a policy holder or potential policy holder for the insurance agent.
 - (viii) Where a director of an insurance broker does provide insurance advice to a policy holder or potential policy holder, he may be a director of an insurance agent only if he does not provide insurance advice to a policy holder or potential policy holder for the insurance agent.

Note: Breach of the relevant provisions of the Insurance Ordinance is a serious **criminal offence**. For example, claiming to be an insurance broker without having obtained an authorisation, could result in a fine as much as **HK\$1 million** and **2 years'** imprisonment on conviction upon indictment (or up to **HK\$100,000** and **6 months'** imprisonment on summary conviction).

6.2.1a Appointed Insurance Agent's Relationship with Insurer

The Insurance Ordinance says that an 'appointed insurance agent' (note: it does not say 'insurance agent') is the agent of the insurer when dealing with a third party for (1) the issue of a contract of insurance and (2) insurance business relating to the contract. What this provision is largely saying is that whenever someone who is an appointed insurance agent of an insurer is dealing with a client in respect of (1) or (2) above, he is treated as having authority to bind the insurer; in other words, the insurer will be vicariously liable to the client for the agent's acts or omissions in the course of such dealings.

You will recall the common law rule you have learnt in Chapter 2 that the principal is vicariously liable for the agent's conduct. But if you think that the said Insurance Ordinance provision is just repeating this common law rule, you are missing the essence of the Insurance Ordinance with respect to regulation of insurance agents.

Before the said provision was enacted, a dispute between an insured and an insurer as to for whom an insurance intermediary has acted would have to be adjudicated on the basis of the relevant common law rules. In the common law, the nub of this issue is best represented by this question: 'For whom at the material time was the insurance intermediary acting in respect of the act which is alleged to have given rise to a contract or transaction between the insured and the insurer?' The courts would resolve this question on the particular facts of the case and might possibly hold that the insurance intermediary was an agent of the insured for the act in question, even if he was at and about the material time in the business of insurance agency rather than insurance broking. In other words, this is a question of *fact*, rather than a question of law.

Now that the said provision has come into effect, when a similar dispute arises, the insurer will be held vicariously liable for the acts of the insurance intermediary provided that he was at the material time its 'appointed insurance agent' and that the acts in question fall within the scope of (1) or (2) (see the first paragraph of **6.2.1a**).

6.2.2 The Code of Practice for the Administration of Insurance Agents (the Code)

The Code is in seven Parts (A - G) and was issued by the HKFI with the approval of the Insurance Authority ('IA') in accordance with the provisions of the Insurance Ordinance. It is therefore of considerable legal and professional importance. The following summary of the Code should be noted carefully.

6.2.2a PART A: Interpretation

Two matters to note are:

- (a) Various definitions for the purposes of the Code, and these Notes, i.e.

"HKFI" = The Hong Kong Federation of Insurers

"IARB" = the Insurance Agents Registration Board established by the HKFI to administer the Code pursuant to Article 48 of its Amended Articles of Association

"Individual Agent" = an Insurance Agent who is an individual, natural person and who is not registered as an Insurance Agency

"Insurance Agency" = an Insurance Agent operating as an insurance agency business in the form of a sole proprietor, a partnership or a corporation

"Insurance Agent" = a person who holds himself out to advise on or arrange contracts of insurance in or from Hong Kong as an agent or subagent of one or more insurers and for the purposes of the Code includes: (i) an Individual Agent; and (ii) an Insurance Agency; but does not include a Responsible Officer or a Technical Representative of an insurance agent

"Line of Insurance Business" = (a) General Business (as defined in the *Insurance Ordinance*);
(b) Long Term (excluding Linked Long Term) Business (as defined in the *Insurance Ordinance*);
(c) Long Term (including Linked Long Term) Business (as defined in the *Insurance Ordinance*); and/or

	(d) Restricted Scope Travel Business
<i>"MPF Code"</i>	= the Code of Conduct for MPF Intermediaries issued by the Mandatory Provident Fund Schemes Authority ("MPFA"), as amended from time to time
<i>"MPF Intermediary"</i>	= has the meaning assigned to it by the MPF Code
<i>"Principal"</i>	= an insurer to whom Part X of the Insurance Ordinance applies. However, unless otherwise stated, persons collectively represented as a syndicate of Lloyd's should be treated as one Principal for the purposes of any insurance business relating to the syndicate
<i>"Registered Person"</i>	= a person who has been registered under clause 15 or 30 of the <i>Code</i> as either: <ul style="list-style-type: none"> (a) an Individual Agent; (b) an Insurance Agency; (c) a Responsible Officer of an Insurance Agency; or (d) a Technical Representative of an Individual Agent or Insurance Agency
<i>"Responsible Officer" in relation to an Insurance Agent which is an Insurance Agency</i>	= a person who, alone or jointly with others, is responsible for the conduct of the insurance agency business of such Insurance Agent, not being a person who: <ul style="list-style-type: none"> (i) is also responsible for the conduct of other business; and (ii) has a subordinate responsible for the whole of the insurance agency business
<i>"Responsible Officer" in relation to an Insurance Agent which is an Insurance Agency formed outside Hong Kong</i>	= a person who, alone or jointly with others, is responsible for the conduct of the whole of the insurance agency business of such Insurance Agent carried on within Hong Kong, not being a person who:- <ul style="list-style-type: none"> (i) is also responsible for the conduct of the insurance agency business

carried on by the Insurance Agent elsewhere; and

- (ii) has a subordinate responsible for the whole of the insurance agency business carried on by the Insurance Agent within Hong Kong

"Restricted Scope Travel Business " = effecting and carrying out contracts of travel insurance tied to a tour, travel package, trip or other travel services which the same travel agent arranges for his clients, excluding any annual travel insurance policies or any travel insurance policies for tours, travel packages, trips or other travel services which the travel agent does not arrange for his clients

"Technical Representative" in relation to an Insurance Agent = a person (not being an insurance subagent, who is classified as an Insurance Agent for the purposes of the *Code*) who provides advice to a policy holder or potential policy holder on insurance matters for such Insurance Agent, or arranges contracts of insurance in or from Hong Kong on behalf of that Insurance Agent

- (b) All words and expressions not defined in the *Code* carry the meanings ascribed to them by the *Insurance Ordinance*. In the event of a conflict between the *Code* and the *Insurance Ordinance*, the *Insurance Ordinance* will prevail and the *Code* will be invalid to the extent of any such inconsistency.

6.2.2b PART B: General Principles

- (a) **Functions of the IARB:** subject to any general or specific directions given to it by the HKFI as to the execution of its functions under the *Code*, the IARB may do anything it considers necessary or desirable for the purposes of implementing and administering the provisions of the *Code*. Specifically, the IARB may:
 - (i) investigate any matters in respect of any application for registration or renewal of registration of a proposed Registered Person or Registered Person, or any complaints against any Registered Person;
 - (ii) refer any matters or complaints received by it to any Principal or Registered Person as appropriate for investigation;

- (iii) receive investigation reports from any Principal or Registered Person relating to any matters or complaints;
 - (iv) require any Principal or Registered Person to take disciplinary or other action in respect of a Registered Person;
 - (v) register Insurance Agents, Responsible Officers and Technical Representatives as Registered Persons or revoke such registration; and
 - (vi) report to the IA where it appears to the IARB that any Registered Person, Principal or insurer has breached Part X of the *Insurance Ordinance* or the Code, or that any Registered Person is not or has ceased to be a fit and proper person to be registered as such.
- (b) **Guidance Notes:** the HKFI/IARB may issue Guidance Notes from time to time as to how it intends to exercise its powers and fulfil its responsibilities under the *Code*.
- (c) **Interpretation of the Code:** the *Interpretation and General Clauses Ordinance* shall apply to the construction and interpretation of the English language text and Chinese language text of the Code, and the HKFI has the power to determine the meaning of both versions and to resolve inconsistencies, if any, between them. Its determination will be conclusive and binding.

6.2.2c PART C: Rules

- (a) **Confirmation of Appointment** of an Insurance Agent by his Principal or of a Responsible Officer or Technical Representative by his appointing Insurance Agent must not take place until the IARB's confirmation is obtained.
- (b) **Registration of Insurance Agents, Responsible Officers and Technical Representatives**
- (i) The IARB, on behalf of the relevant Principal, may, upon application in the prescribed manner and payment of the prescribed fee, register an insurance agent as the insurance agent of that Principal. It may, upon application in the prescribed manner by an insurance agent and payment of the prescribed fee, also register a person as a Responsible Officer or Technical Representative of an insurance agent.
 - (ii) Each registration will be for a specified period, **not exceeding three years**. A Principal may apply for re-registration of an Insurance Agent, and an Insurance Agent may apply for re-registration of his Responsible

Officer/Technical Representative, not earlier than **3 months** before the current registration expires. (**Note:** the appointees are required to fulfil the ‘fit and proper’ criteria (see **6.2.2e** below), including the requirement of the Continuing Professional Development Programme.)

- (iii) The Registered Person has to disclose the registration number that the IARB assigned to him if so requested, and identify the number on his business cards, if distributed. He also has to display his name and registration number on the name plate put in front of the service desk or counter if he is registered as engaging in the Restricted Scope Travel Business and provides face-to-face insurance service at service desk or counter.
- (c) **Cancellation of Registration:** the appointing Principal or appointing Insurance Agent, as the case may be, has to notify the IARB within **7 days** of an appointee ceasing to be an appointed Insurance Agent of the Principal, or a Responsible Officer or Technical Representative of the Insurance Agent and provide such details as the IARB may require. When such notification is received, the relevant registration of the appointee is deemed cancelled and the IARB has to remove the Insurance Agent from the relevant part of the register of Insurance Agents or remove the Responsible Officer or Technical Representative from the relevant part of the sub-register of Responsible Officers and Technical Representatives, as the case may be.
- (d) **Representation of Principals by Insurance Agents** is subject to the following:
- (i) A person must not act as or be registered as an Insurance Agent for more than four Principals of whom no more than two may be insurers who conduct Long Term Business;
 - (ii) for the purposes of (i) above, a **composite** insurer constitutes **two** Principals, one general and one long term, unless the Insurance Agent’s activities are restricted to either (i) General Business or Restricted Scope Travel Business or (ii) Long Term Business;
 - (iii) for the purposes of (i) above, a **group** of companies (see Glossary) constitutes one Principal if their activities are limited to either (i) General Business or Restricted Scope Travel Business or (ii) Long Term Business; or two Principals if their activities include both (i) General Business or Restricted Scope Travel Business and (ii) Long Term Business unless the Insurance Agent’s activities are restricted

to either (i) General Business or Restricted Scope Travel Business or (ii) Long Term Business;

- (iv) for the purposes of (i) above, a group of Lloyd's syndicates constitutes:
 - (1) one Principal if the activities of the syndicates are limited to either (i) General or Restricted Scope Travel Business or (ii) Long Term Business;
 - (2) one Principal if the activities of the syndicates include both (i) General or Restricted Scope Travel Business and (ii) Long Term Business, but the insurance agent's activities are restricted to just one of those activities;
 - (3) two Principals if the activities of the syndicates include both (i) General or Restricted Scope Travel Business and (ii) Long Term Business, and the insurance agent's activities are not restricted to either (i) General or Restricted Scope Travel Business or (ii) Long Term Business.
- (v) the Insurance Agent has to obtain the consent of his Principal(s) **prior** to accepting an appointment to act as an Insurance Agent for another Principal.
- (vi) Subject to (i)-(iii) above, if a person is registered as an agent of another Insurance Agent, he is deemed to act for and has to register to represent all the Principal(s) of the appointing Insurance Agent. In addition, he is deemed to engage in and has to register for all appointed Line(s) of Insurance Business of the appointing Insurance Agent.
- (e) **Representation of Insurance Agents by Responsible Officers and Technical Representatives:** A person must not act as a Responsible Officer or Technical Representative for more than one Insurance Agent.
- (f) **Obligations of Principals** in respect of Insurance Agents: The Principal has to ensure that the Insurance Agent:
 - (i) does not, at any one time, act for more than the maximum number of Principals allowed;
 - (ii) is eligible to engage in a Line of Insurance Business in respect of which the Principal is authorised to conduct and in which he has appointed the Insurance Agent to engage;

- (iii) meets the ‘fit and proper’ criteria set out in the Code;
 - (iv) has his appointment confirmed by and is registered with the IARB;
 - (v) is appointed as an Insurance Agent of the Principal **in writing** by an **agency agreement** that requires the Insurance Agent to comply with Part F (Minimum Requirements of Model Agency Agreement) of the Code (see **6.2.2f** below);
 - (vi) discloses his registration number upon request, and identifies the number on his business cards, if distributed;
 - (vii) displays his name and registration number on the name plate put in front of the service desk or counter if he is registered as engaging in Restricted Scope Travel Business and provides face-to-face insurance service at the service desk or counter;
 - (viii) complies with the Code;
 - (ix) has registered as an MPF intermediary with the MPFA where the Insurance Agent also engages in selling or advising on MPF schemes or their constituent or underlying funds; and
 - (x) has been licensed as a travel agent under the *Travel Agents Ordinance* where the Insurance Agent is registered to engage in Restricted Scope Travel Business.
- (g) **Obligations of Insurance Agents** in respect of their Responsible Officers and Technical Representatives: An Insurance Agent has to ensure that any person acting as its Responsible Officer or Technical Representative:
- (i) does not, at any one time, act for more than one Insurance Agent;
 - (ii) meets the ‘fit and proper’ criteria for Registered Persons set out in the Code;
 - (iii) is eligible to engage in a Line of Insurance Business in which the Insurance Agent is eligible to engage;
 - (iv) has his appointment confirmed by and is registered with the IARB;
 - (v) discloses his registration number upon request, and identifies the number on his business cards, if distributed;
 - (vi) displays his name and registration number on the name plate put in front of the service desk or counter if he is registered as engaging in Restricted Scope Travel Business and

provides face-to-face insurance service at the service desk or counter; and

- (vii) complies with the Code.
- (h) **Obligations of Responsible Officers:** a Responsible Officer of an Insurance Agent has to ensure that all Technical Representatives of that Insurance Agent comply with the Code.
- (i) **Training of insurance agents** has to be sufficiently provided by the Principal so that a **reasonable person** receiving such training would:
 - (i) be familiar with the requirements of the Insurance Ordinance and the Code; and
 - (ii) be able to competently undertake the duties of an Insurance Agent in accordance with the requirements of the Insurance Ordinance and the Code.
- (j) **Training of Responsible Officers and Technical Representatives** has to be sufficiently provided by the Insurance Agent so that a **reasonable person** receiving such training would:
 - (i) be familiar with the requirements of the Insurance Ordinance and the Code; and
 - (ii) be able to competently undertake the duties of a Responsible Officer or Technical Representative, in accordance with the requirements of the Code.

6.2.2d PART D: Procedures

- (a) The **IARB** has to maintain a register of Insurance Agents, and a sub-register of Insurance Agents' Responsible Officers and Technical Representatives, whose appointments it has confirmed. The register and sub-register have to be kept in a manner and form determined by the IA and be available for public inspection at any time at the website of the HKFI or during normal working hours at the HKFI's registered office.
- (b) **Applications** for confirmation of appointment and registration of Registered Persons are in substance subject to the following:
 - (i) an application for registration as an Insurance Agent has to be submitted by the relevant Principal, and an application for registration as a Responsible Officer or Technical Representative has to be submitted by the appointing Insurance Agent;
 - (ii) they have to be in a manner and form prescribed by the IARB;

- (iii) the appointing Principal or the appointing Insurance Agent, and the applicant, have to provide to the IARB such additional, relevant information as the IARB may require;
- (iv) the IARB is not required to consider an application unless it is made in the prescribed manner and form, it is complete and the information requested has been provided in full;
- (v) if the appointing Principal or the appointing insurance agent becomes aware of any changes in the circumstances of an applicant who is the subject of a pending application which may potentially affect the IARB's consideration of the application, they have to notify the IARB forthwith of such changes;
- (vi) the applicant has to satisfy the IARB that he is **fit and proper** to be or continue to be registered as a Registered Person and, unless the IARB is so satisfied, it must not confirm the appointment of the applicant as a Registered Person.

(c) **Procedures for Determining Fitness and Properness of Registered Persons and Complaints against Registered Persons.**

If the IARB becomes aware of any matter or complaint which may involve a breach of the Code or render a Registered Person not fit and proper to remain appointed and registered as a Registered Person:

- (i) the IARB may investigate the matter or complaint or refer it to any Principal or Registered Person for investigation;
- (ii) if the matter or complaint is referred to a Principal or Registered Person for investigation, the Principal or the Registered Person has to diligently and expeditiously investigate the matter or the circumstances of the complaint, and, if so requested by the IARB, report the progress and findings of the investigation within 14 days of the date of referral or such further period as may be specified by the IARB. The IARB may request the Principal and/or the Registered Person to conduct further inquiries;
- (iii) if the IARB considers that it will likely take disciplinary or other action if the matter or complaint is proven, it has to provide (i) the respondent to whom the matter or complaint relates and (ii) any Principal or appointing Insurance Agent who will likely be adversely affected by such action, with an opportunity to make representations in such a manner and

form as it considers appropriate and within 14 days or such further period as it may specify, and the IARB has to consider such representations;

- (iv) when all representations concerning the matter or complaint have been considered by the IARB and it is of the view that either there has been a breach of the Code or the matter at issue renders the respondent not fit and proper to be or continue to be registered as a Registered Person, it may take disciplinary or other action in the manner set out in (v) below and/or require the Principal or any Registered Person (including the respondent's appointing Insurance Agent) to take disciplinary or other action in the manner set out in (v) below;
- (v) disciplinary or other action may include:
 - (1) issuing a **reprimand** to the relevant respondent ;
 - (2) **suspending or terminating** the appointment of the relevant respondent;
 - (3) taking or refraining from taking such **other action** (including refunding premiums paid by persons affected by the conduct of the relevant respondent) as the IARB thinks fit;

Any respondent whose appointment has been terminated in these circumstances will have their registration cancelled and will be barred from appointment and registration as an Insurance Agent, a Responsible Officer or Technical Representative for a period specified by the IARB;

- (vi) when taking disciplinary or other action and/or when requiring any Principal or Registered Person (including the respondent's appointing Insurance Agent) to take disciplinary or other action, the IARB has to serve upon:
 - (1) any party who is the subject of disciplinary or other action; and
 - (2) any Principal or Registered Person (including the respondent's appointing Insurance Agent) required to take or otherwise likely to be adversely affected by disciplinary or other action;

a notification of the disciplinary or other action and a statement of the grounds thereof;

- (vii) if a relevant Principal and/or Registered Person (including the respondent's appointing Insurance Agent) fails to comply with a requirement to take disciplinary or other action, the IARB may report such failure to the IA and impose a further requirement by way of disciplinary or other action on the Principal or Registered Person (including the respondent's appointing Insurance Agent) who has failed to comply; and
 - (viii) Registered Persons and Principals have to comply with any directions issued by the IARB in connection with the conduct of investigations or proceedings carried out in accordance with the abovementioned procedures. The IARB may, in its discretion, vary the procedures in any particular case where it considers it appropriate to do so.
- (d) The *Code* provides for an **Appeals Tribunal**, which is to determine appeals against the IARB's decisions, in respect of which the following apply:
- (i) its decisions shall be **final**;
 - (ii) its members shall be persons (not being members of the IARB) **nominated** by the HKFI and **confirmed** by the IA;
 - (iii) an appeal lies in the following circumstances;
 - (1) Where the IARB refuses to confirm an application for registration under the *Code*, the applicant will be entitled to appeal to the Appeals Tribunal; and
 - (2) Where the IARB determines to impose disciplinary or other action under the *Code*, the party who is the subject of the disciplinary or other action will be entitled to appeal to the Appeals Tribunal;
 - (iv) any decision of the IARB which is subject to a right of appeal will take effect 14 days after the party with a right of appeal has been notified of the decision;
 - (v) any party with a right of appeal in respect of a decision of the IARB may apply to it for a stay of the decision pending the outcome of their appeal, which application may be granted at its discretion. If an application for a stay is made prior to the decision taking effect, the decision will not take effect until it has determined the stay application. If an application for a stay is made after the decision has taken effect, the decision will continue in effect pending determination of the application and the IARB, in deciding whether to grant a stay, will consider whether a stay is reasonable and practicable in the circumstances;

- (vi) the Appeals Tribunal may determine its own procedures, but otherwise an appeal has to be conducted and determined in accordance with the Appeals Tribunal Proceedings Rules;
 - (vii) the Appeals Tribunal may confirm, vary or reverse the IARB's decision being appealed or substitute such other decision, consistent with the powers of the IARB, as it thinks fit.
- (e) **Reports to the IA** may be made by the IARB on any matters concerning a complaint or an investigation under the *Code*, and such disclosures if made in good faith will not incur any liability for the IARB or its members towards any person concerned.

6.2.2e PART E: 'Fit and Proper' Criteria for Registered Persons

- (a) In considering whether a person is fit and proper to be or continue to be registered as a Registered Person, the IARB may take into account:
- (i) whether that person has ever been declared bankrupt;
 - (ii) whether that person has ever been a controller, a director, a company secretary or a senior manager of a corporation that has become insolvent in Hong Kong or elsewhere;
 - (iii) whether the person has acquired educational or other qualifications commensurate with his proposed responsibilities or responsibilities as a Registered Person;
 - (iv) whether the person has ever been convicted of any criminal offence in Hong Kong or elsewhere which may affect his fitness, suitability or properness to be registered as a Registered Person;
 - (v) whether the person has ever been found guilty of misconduct in a profession, trade or industry to which he belongs or has belonged;
 - (vi) whether the person has ever been subject to any order of the court or other competent authority in Hong Kong or elsewhere for fraud, dishonesty or misfeasance
 - (vii) whether the person has failed to conduct insurance agency business in a manner complying with Part F: Minimum Requirements of Model Agency Agreement, and Part G: Conduct of Registered Persons (see **6.2.2f** and **6.2.2g** below), of the Code, and/or the rules of the HKFI;

- (viii) whether the person is or has ever been found not to have complied with or to be in breach of this Code and/or the rules of the HKFI;
 - (ix) whether the person possesses the qualifications specified in clauses 61 to 70 (Minimum Qualifications for Persons to be registered as Registered Persons) of the Code (see (d) below);
 - (x) whether the person has been registered as an MPF intermediary with the MPFA where the person is engaged in selling or advising on Mandatory Provident Fund schemes or their constituent or underlying funds;
 - (xi) if the person is or has been an MPF intermediary, whether the person is found not to have complied with or is in breach of the MPF Code;
 - (xii) in case where the person is a company, partnership or sole proprietorship, whether the person has taken adequate measures to ensure that each of its directors and employees, as appropriate:
 - (1) has registered as an MPF intermediary with the MPFA; and
 - (2) complies with the requirements as specified in the MPF Code

where the director or employee is engaged in selling or advising on Mandatory Provident Fund schemes or their constituent or underlying funds; and
 - (xiii) such other matters as the IARB considers relevant in the circumstances.
- (b) The IARB may consider a person not fit and proper to be or continue to be registered as a Registered Person if:
- (i) his appointment as a Registered Person was terminated by a Principal or appointing insurance agent pursuant to a requirement imposed by the IARB or the IA; or
 - (ii) in the opinion of the IARB, by his words or actions, he has manifested a material lack of understanding of the duties and ethical responsibilities of a Registered Person.
- (c) The IARB may consider a person not fit and proper to be or continue to be registered as an insurance agent if:

- (i) its appointed Responsible Officers or any of its Technical Representatives would not be considered fit and proper to act as an insurance agent if he applied as an individual; or
- (ii) any of its controllers or directors would not be considered fit and proper to act as an insurance agent if he applied as an individual. For the purposes of this sub-clause, the requirements specified in clauses 61(b) to (d) (see (d)(i)(2)-(4) below) and 70 (see (d)(iii) below) of the Code are not applicable to any controller or director not being an insurance agent, a Responsible Officer or Technical Representative.

(d) **Minimum Qualifications**

- (i) Minimum qualifications for a fit and proper Registered Person are that:

- (1) he has attained the age of **18**;
- (2) he is a Hong Kong Permanent Resident or Hong Kong Resident whose employment visa conditions, if any, do not restrict him from acting as an Insurance Agent, a Responsible Officer or a Technical Representative;
- (3) he has completed education to a level of Form 5 or equivalent unless he has been exempted under the criteria specified in the Code;
- (4) he has successfully passed the relevant papers of the Insurance Intermediaries Qualifying Examination ('IIQE') recognised by the IA, unless he has been exempted under the criteria specified in the Code;

(Note: an Insurance Agency is only eligible to engage in the Line(s) of Insurance Business in which its Responsible Officer is eligible to engage.)

and

- (5) he complies with such rules and policies as may be prescribed by the IA or the HKFI as applicable to him from time to time.
- (ii) A person's non-engagement in insurance-related work in the insurance industry in Hong Kong for two consecutive years after passing any of the papers will nullify the recognition of his qualification in respect of such paper(s).
- (iii) All Registered Persons have to comply with the requirements of the Continuing Professional Development Programme in such manner and form as specified by the IA.

6.2.2f PART F: Minimum Requirements of Model Agency Agreement

To appoint an Insurance Agent, a Principal has to do so under a **written agency agreement** that meets the minimum requirements of a *model agency agreement* adopted by the HKFI. The model agency agreements, for selling long-term insurance and general insurance respectively, are published on the HKFI's website. The minimum requirements of these model agency agreements will be inclusion of the Conduct of Registered Persons.

6.2.2g PART G: Conduct of Registered Persons

(a) Conduct of Registered Persons for General Insurance Business and Restricted Scope Travel Business

- (i) Business is to be conducted at all times in **good faith** and with **integrity**.
- (ii) The Registered Person has to co-operate with the IARB and the Principal or Insurance Agent concerned to establish the facts if there is a complaint concerning his conduct. The complainant has to be informed that he should in the first instance refer the complaint to the relevant Principal or Insurance Agent. If the complainant is still dissatisfied, he may refer the matter to the IARB.
- (iii) The Registered Person should:
 - (1) ensure that he is registered with the IARB in respect of the Line of Insurance Business to be engaged in prior to conducting such business;
 - (2) before discussing insurance policies with any person, identify himself as a Registered Person acting on behalf of the Principal(s) or Insurance Agent he represents;
 - (3) disclose his registration number upon request, and identify the number on his business cards, if distributed;
 - (4) display his name and registration number on the name plate put in front of the service desk or counter if he is registered as engaging in Restricted Scope Travel Business and provides face-to-face insurance service at the service desk or counter;
 - (5) give advice **only** where he is **competent** to do so or seek advice from his Principal(s) or appointing

Insurance Agent when necessary;

- (6) explain the **policy cover** recommended to ensure that the potential policy holder understands what he is buying;
 - (7) explain the specific **differences** to which he is referring when making comparisons with other types of policies;
 - (8) treat all information supplied by a potential policy holder as **confidential** and disclose it **only** to the Principal(s) or appointing Insurance Agent concerned, and otherwise comply at all times with the Personal Data (Privacy) Ordinance when dealing with personal data provided by a potential or current policy holder;
 - (9) **not** make **inaccurate** or **misleading** statements about any Principals or appointing Insurance Agent, or their policies, or any other intermediaries;
 - (10) **not** make any charge additional to the premium without disclosing to the policy holder, before the policy becomes binding, the amount and purpose of such charge; and
 - (11) **not** pay any part of any commission or discount allowed to him to any partner, director or employee of any insured as an inducement to place the business with the Principal or appointing insurance agent, or assist any other Registered Person to make such a payment, unless prior **written agreement** and approval of the payment by the insured is received.
- (iv) When assisting with the completion of a **proposal** or **application**, the Registered Person has to:
- (1) **refrain from** influencing the potential policy holder, and make it clear that the answers or statements given are the latter's own responsibility; and
 - (2) **explain** to the potential policy holder the consequences of fraud, non-disclosure and inaccuracies, drawing his attention to the relevant statements on the form.

(b) **Conduct of Registered Persons for Long Term Business**

Many of the requirements for Registered Persons of Long Term Business are identical with those indicated above. We shall not repeat these, but make appropriate reference. Take special note, however, of differences. Also please note that the sub-divisions given below may not always correspond with those in the actual Model Agreement (which should be referred to for full understanding).

- (i) as with (a)(i) above;
- (ii) as with (a)(ii) above;
- (iii)
 - (1) as with (a)(iii)(1) above;
 - (2) as with (a)(iii)(2) above;
 - (3) as with (a)(iii)(3) above;
 - (4) as with (a)(iii)(5) above;
 - (5) as with (a)(iii)(6) above;
 - (6) as with (a)(iii)(8) above;
 - (7) as with (a)(iii)(9) above;
 - (8) as with (a)(iii)(10) above;

The following are requirements exclusive to Long Term Business Registered Persons:

- (9) make every reasonable effort to ensure that the proposed policy is suitable to the **needs and resources** of the potential policy holder as disclosed to the Registered Person;
- (10) explain the specific differences to which he is referring when making comparisons with other types of policies or forms of investment;
- (11) **not** make inaccurate or misleading statements or comparisons to induce an insured to **replace** existing long term insurance with other long term insurance to the insured's **disadvantage**;
- (12) **not** pay or offer to pay any **rebate** of premium, commission or other incentive not specified in the

policy as an **inducement** to any potential long term insurance policyholder unless specifically authorised by a Principal; and

- (13) comply with the requirements as specified in the MPF Code where he engages in selling or advising on MPF schemes or their constituent or underlying funds.
- (iv) as with (a)(iv)(1) and (2) above;
 - (v) When selling policies related to long term business, the Registered Person has to:
 - (1) explain the **long term** nature of the policy and the consequences of early discontinuance and/or surrender;
 - (2) explain the specific difference between **guaranteed** and **projected** benefits in the case of an investment-linked or participating policy;
 - (3) where projected benefits are **illustrated**, explain the assumptions on which illustrations are based, including any future bonus or dividend declaration, and that projected benefits are **not** guaranteed;
 - (4) explain that any future dividends or bonuses with participating (or with-profit) policies may be higher or lower than those currently quoted, and that past performance may not be a guide to future performance;
 - (5) explain with linked long term business that the unit value and the value of the policyholder's benefits may fluctuate;
 - (6) unless specifically authorised by a Principal or appointing Insurance Agent, use only sales proposals and illustrative figures supplied by the Principal or appointing Insurance Agent and has to use the whole relevant illustration in respect of the policy being discussed without adding to it or selecting only its most favourable aspects;
 - (7) when authorised to prepare illustrations himself, use only the assumptions authorised by the Principal or appointing Insurance Agent.

Part G of the Code also prohibits the Registered Person from acting as an authorised insurance broker or as the Chief Executive or Technical Representative of an authorised insurance broker.

6.2.2h Guidance Notes

As said, the HKFI/IARB may issue Guidance Notes from time to time as to how it intends to exercise its powers and fulfil its responsibilities under the Code of Practice for the Administration of Insurance Agents. Below are summaries of the prevailing Guidance Notes that have been issued under the Code. The full text of the Guidance Notes can be found on the website of the HKFI.

(a) **Guidelines on Misconduct ('IARB – GN4')**

(i) **Background**

This *Guidance Note* is intended to help both insurers and insurance agents comply with the Code and in particular Part F of the *Code*. The phrase 'in good faith and with integrity' used in this Part cannot have a fully defined meaning; however, it is clear that it is in the best interests of customers, insurance agents and Principals to set out, from time to time, certain guidelines which if followed, will provide comfort to all concerned that all possible steps are being taken to conduct business in good faith and with integrity. Failure to comply may constitute a breach of the *Code* by either a Principal/an insurance agent under Part C or an insurance agent under Part F.

(ii) **On no account will insurance agents ask customers to sign blank or incomplete forms and any alterations to forms must be initialled by the customers**

In order to protect the insuring public against potential losses arising from misrepresentation or forgery, insurance agents should not request their prospective customers and/or clients to sign blank forms or sign any documents relating to the policy before they have been duly completed and any alteration should be initialled by the customer.

(iii) **An insurance agent selling a life assurance policy shall ensure that the prescribed *Customer Protection Declaration ('CPD')* form is completed**

It is an insurance agent's duty to present each policy with complete honesty and objectivity. In the case where the client is already a policyholder, this means that full and fair disclosure of all facts regarding both the new cover and the existing insurance is necessary. Policyholders should be made fully aware of the estimated cost of replacing an existing policy. In selling a life insurance policy, insurance agents have to duly complete the Customer Protection

Declaration ('CPD') form as prescribed by the HKFI from time to time and bring its contents to the attention of the customer.

(iv) **Principals must establish control procedures to monitor insurance agents' compliance with the *Code***

Principals will take all necessary steps to satisfy themselves that insurance agents are complying with the *Code* and with any Guidance Notes issued (as required by Part C).

(b) **Guidelines on Handling of Premiums ('IARB – GN5')**

(i) **Background**

This *Guidance Note* is intended to help both insurers and insurance agents comply with the *Code* and in particular Part F of the *Code* which stipulates that an insurance agent shall at all times conduct business in good faith and with integrity. Failure to comply may constitute a breach of the *Code* by either a Principal/an insurance agent under Part C or an insurance agent under Part F.

(ii) **Handling of Premiums**

Customers will want to pay their premiums in a variety of ways, including cash, credit card, cheque and bank transfer. It is up to the Principal to decide which methods are acceptable, but the following methods are recommended:

Cheque in favour of the Principal; or

Credit card/direct deposit/bank transfer from the customer's account to the Principal.

Any other method of payment or credit facilities extended to an insurance agent should be subject to clear rules set out by the Principal designed to avoid the mixing of customers' money with insurance agents' personal funds.

(c) **Guidelines on the Effective Date of Registration of Insurance Agents, Responsible Officers and Technical Representatives ('IARB – GN6')**

(i) **Background**

This *Guidance Note* is intended to help both insurers and insurance agents comply with the *Code* and in particular Part C of the *Code*, which stipulates that the appointment of insurance agents, Responsible Officers and Technical Representatives shall be confirmed in accordance with the *Code*.

(ii) **Provisions of the Guidance Note**

No prospective or current insurance agents, their Responsible Officers or Technical Representatives shall hold themselves out as engaging in the insurance agency business relating to a Principal before the IARB confirms their relevant registrations in writing by way of a Notice of Confirmation of Registration.

A prospective or current **insurance agent** must take note that it may be an offence under Section 77 of the Insurance Ordinance to hold himself out as an insurance agent of a Principal before he is registered by the IARB. Therefore, no person shall act or hold himself out as an insurance agent for and on behalf of any prospective appointing Principal before the date specified by the IARB in the Notice of Confirmation of Registration. Any breach may render that person liable to criminal prosecution for an offence under Section 77 of the Insurance Ordinance.

A prospective or current **Responsible Officer or Technical Representative** of an insurance agent should also take note that it may be a breach of the Code for him to hold himself out as the Responsible Officer or Technical Representative of such insurance agent before he is registered by the IARB. Therefore, no person shall be a Responsible Officer or Technical Representative of any prospective appointing insurance agent before the date specified by the IARB in the Notice of Confirmation of Registration. Any breach may affect the fitness and properness of the Responsible Officer, Technical Representative or insurance agent concerned.

(d) **Guidance Note on Compliance with the Requirements of the Continuing Professional Development (CPD) Programme ('IARB – GN7')**

(i) **Background**

Part E of the Code stipulates that a Registered Person ('RP') should comply with the CPD requirements in such manner and form as specified by the Insurance Authority ('IA'). This *Guidance Note* aims to assist RPs to comply with the annual CPD requirements. Those RPs who are registered as engaging in Restricted Scope Travel Business only should instead refer to the **Guidance Note on Compliance with the Requirements of the Continuing Professional Development (CPD) Programme for Registered Persons Who are Registered as Engaging in Restricted Scope Travel Business (RSTB) Only**.

For the purposes of this *Guidance Note*, any reference to 'RP(s)' should include insurance agent(s), responsible officer(s) and technical representative(s).

(ii) **CPD Requirements**

The IA has specified that except for travel insurance agents, their responsible officers ('RO's) and technical representatives, all RPs are required to earn 10 CPD hours every year. Subject to compliance with other fitness and propriety criteria, the IARB should deem an RP having complied with the CPD requirements as qualified for maintaining his registration status for another 12 months if he completes all 10 CPD hours for the assessment year within that assessment year.

(iii) **CPD Assessment**

The Guidance Note details how RPs' compliance with the CPD requirements is assessed. It is important for RPs to get familiar with the relevant provisions.

(iv) **Maintaining CPD records and Monitoring CPD Compliance**

The Guidance Note lays down responsibilities of RPs, insurance agents who have appointed TRs and all insurers to maintain CPD records. It also lays down responsibilities of insurance agents who have appointed TRs and all insurers to monitor CPD compliance.

(v) **Consequence of Non-Compliance**

In circumstances where an RP fails to meet the CPD requirements, his registration should be revoked for 3 months as a starting point by the IARB. Such RP should be required to complete all outstanding CPD hours at the time of re-registration.

In circumstances where an RP makes a false declaration in reporting his CPD hours, his registration should be revoked for 12 months as a starting point by the IARB. Such RP should be required to complete all outstanding CPD hours at the time of re-registration.

In circumstances where an RP fails to respond to a request of the IARB to produce proof of compliance with the CPD requirements, his registration should be revoked for a specified period of time as determined by the IARB. The future application for registration of such RP will not be processed unless he can produce proof of compliance.

(e) **Guidance Note on Restricted Scope Travel Business ('IARB – GN9')**

(i) **Background**

This *Guidance Note* aims to:

- (1) provide waiver for a person who has not completed education to a level of Form 5 or equivalent but wishes to be registered with the IARB in order to be engaged in Restricted Scope Travel Business only (the 'Applicant'); and
- (2) facilitate the identification of the registration status of insurance agents, Responsible Officers and Technical Representatives engaging in Restricted Scope Travel Business.

(ii) **Waiver of Requirement for Form 5 or Equivalent Education**

This *Guidance Note* waives the requirement for Form 5 or equivalent education as stipulated under clause 61(c) of the *Code* in favour of an Applicant who complies with prescribed criteria under the *Guidance Note*. Nevertheless, such a waiver is no longer available to new applicants as the time limits imposed by the *Guidance Note* have expired. Apart from the requirements specified in Clause 61(c), the

Applicant should meet the Minimum Qualifications for Persons Acting as Insurance Agents specified in the Code.

Unless and until the Applicant has been successfully registered with the IARB, he should not be engaged in Restricted Scope Travel Business.

Should the Applicant wish to be engaged in any other lines of business other than Restricted Scope Travel Business, he should fulfil all the requirements specified in the *Code*, including Clause 61(c).

(iii) **Identification of the Registration Status of Insurance Agents, Responsible Officers and Technical Representatives Engaging in Restricted Scope Travel Business**

The IARB may consider a person not fit and proper to act or continue acting as an insurance agent, a Responsible Officer or a Technical Representative engaging in Restricted Scope Travel Business, who provides face-to-face insurance service at service desks or counters, if he does not show his name and registration number, whether printed or in handwriting, on receipts for premium on travel insurance directly arranged by him for his clients.

(f) **Guidance Note on Compliance with the Requirements of the Continuing Professional Development (CPD) Programme for Registered Persons Who are Registered as Engaging in Restricted Scope Travel Business (RSTB) Only ('IARB – GN10')**

(i) **Background**

Part E of the Code stipulates that a Registered Person ('RP') should comply with the CPD requirements in such manner and form as specified by the IA. This *Guidance Note* aims to assist RPs who are registered as engaging in RSTB only to comply with the annual CPD requirements. Those RPs who engage in other line(s) of business should refer to the **Guidance Note on Compliance with the Requirements of the Continuing Professional Development (CPD) Programme.**

For the purposes of this *Guidance Note*, any reference to 'RP(s)' should include insurance agent(s), responsible officer(s) and technical representative(s).

(ii) **CPD Requirements**

The IA has specified that: *‘From 1 August 2008 onwards, travel insurance agents, their responsible officers and technical representatives are required to earn 3 CPD hours every year.’*

Subject to compliance with other fitness and properness criteria, the IARB should deem an RP who is registered as engaging in RSTB only having complied with the CPD requirements under Part E of the Code as qualified for maintaining his registration status for another 12 months if he completes all 3 CPD hours for the assessment year within that assessment year.

(iii) **CPD Assessment**

The Guidance Note details how RPs’ compliance with the CPD requirements is assessed. It is important for RPs to get familiar with the relevant provisions.

(iv) **Maintaining CPD records and Monitoring CPD Compliance**

The *Guidance Note* lays down responsibilities of responsible officers (‘RO’s), technical representatives (‘TR’s), insurance agents who have appointed TRs and all insurers to maintain CPD records. It also lays down responsibilities of insurance agents who have appointed TRs and all insurers to monitor CPD compliance.

(v) **Consequence of Non-Compliance**

In circumstances where an RP fails to meet the CPD requirements, his registration should be revoked for 3 months as a starting point by the IARB. Such RP should be required to complete all outstanding CPD hours at the time of re-registration.

In circumstances where an RP makes a false declaration in reporting his CPD hours, his registration should be revoked for 12 months as a starting point by the IARB. Such RP should be required to complete all outstanding CPD hours at the time of re-registration.

In circumstances where an RP fails to respond to a request of the IARB to produce proof of compliance with the CPD programme, his registration should be revoked for a specified period of time as determined by the IARB. The future application for registration of such RP will not be processed unless he can produce proof of compliance.

(g) **Guidance Note Applicable to Registered Persons Wishing to Engage/Continue to Engage in Investment-linked Long Term (ILLT) Insurance Business on or after 1 March 2010 ('IARB – GN11')**

(i) **Background**

This *Guidance Note* aims to assist Registered Persons ('RPs') to comply with the requirements to engage in ILLT insurance business from 1 March 2010, on which date the enhanced Paper V - ILLT Insurance Examination Paper (enhanced IL Paper) under the Insurance Intermediaries Qualifying Examination ('IIQE') came into effect.

For the purposes of this *Guidance Note*, any reference to 'RP(s)' should include insurance agent(s), responsible officer(s) ('RO'(s)) and technical representative(s) ('TR'(s)).

(ii) **Contents**

This *Guidance Note* sets out the requirement to pass the enhanced IL Paper in order to be registered as engaging in ILLT insurance business on or after 1 March 2010 and the conditions for exemption from such requirement. It details the transitional arrangements for RPs who were registered as engaging in this line of business immediately before that date (referred to in the *Guidance Note* as 'Serving Practitioners'). Serving Practitioners may choose to pass the enhanced IL paper or comply with the additional CPD requirement of 20 extra hours, dedicated towards the additional modules of the enhanced IL Paper, during the 2-year transitional period commencing 1 March 2010. The transitional period expired on 29 February 2012.

6.2.3 Minimum Requirements Specified for Insurance Brokers

These **Minimum Requirements** are as specified under Part X of the Insurance Ordinance which brought into the regulatory regime a framework for the supervision of the **self-regulation** by the insurance industry of insurance *agents and brokers*.

It is worth repeating at this stage the statutory definition of an insurance broker:

'a person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policyholder or potential policyholder or advising on matters related to insurance.'

Persons falling within this definition must have either:

- (a) obtained authorisation from the **Insurance Authority** ('IA'); or
- (b) become a member of a **body of insurance brokers** approved by the IA.

6.2.3a Minimum Requirements Specified by the IA

These requirements are for (see also **6.2.3d**):

- (a) *qualifications and experience;*
- (b) *capital and net assets;*
- (c) *professional indemnity insurance;*
- (d) *keeping of separate client accounts;*
- (e) *keeping proper books and accounts;*

and that the applicant **insurance broker** is *fit and proper* to be an insurance broker and that, in the case of the **applicant body** of insurance brokers, the applicant body has adequate rules and regulations to ensure that its members are *fit and proper* to be insurance brokers.

Note: 1 The IA has published *guidelines* to assist compliance with the requirements of the Insurance Ordinance and, in particular, the **minimum requirements** as specified by the IA. Failure to comply with these guidelines may result in a person or body of insurance brokers not being authorised/approved or having their authorisation/approval withdrawn, as the case may be.

2 In certain cases, an insurance product will constitute a collective investment scheme under the *Securities and Futures Ordinance*, and therefore has to be authorised by the **Securities and Futures Commission** ('SFC') before it can be offered to the public in Hong Kong.

6.2.3b Authorisation of Insurance Brokers

- (a) The applicant can be a *sole proprietor* (individual person), a *partnership* or a *limited company*.
- (b) At the time of application for authorisation and any subsequent renewal of authorisation, the IA has to be satisfied that the applicant has complied and has continued to comply with all relevant statutory provisions and, among others, the said minimum requirements.

- (c) The applicant has to satisfy the IA that he is and will continue to be **fit and proper** to be authorised as an insurance broker. The applicant has to appoint a *Chief Executive* ('CE'). The CE has to be **fit and proper** and has to meet the **minimum requirements** of qualifications and experience as specified by the IA.

6.2.3c Approval of Bodies of Insurance Brokers

- (a) The applicant has to satisfy the IA that it has complied and has continued to comply with all relevant statutory provisions;
- (b) That it has maintained appropriate rules and regulations for its members to comply with the said **minimum requirements**; and
- (c) The rules and regulations have to include eligibility of membership, membership rules, code of conduct for members and disciplinary procedures.

6.2.3d Specifics of the Minimum Requirements

(a) Qualifications and Experience

An insurance broker or the CE nominated by him is required to have a minimum education standard of Form 5 or equivalent and be aged 21 or above. Besides being Hong Kong Permanent Residents or Hong Kong Residents whose employment visa conditions, if any, do not prohibit engagement in insurance broking business, they also have to have:

- (i) any of the acceptable insurance qualifications specified in the **Minimum Requirements** and a minimum of two years' experience in the insurance industry occupying a management position. In addition, if any of them intends to engage in the long term (including linked long term) insurance broking business, they have to have passed the Investment-linked Long Term Insurance Paper of the IIQE, unless exempted under the criteria specified in the **Minimum Requirements**.
- (ii) if they have none of those acceptable insurance qualifications, a minimum of five years' experience in the insurance industry of which at least 2 years is at management position and passed the relevant papers of the IIQE unless exempted under the criteria specified in the **Minimum Requirements**.

As regards a Technical Representative of an insurance broker, besides being a Hong Kong Permanent Resident or a Hong Kong Resident/a person who is permitted to work in Hong Kong and whose employment visa conditions, if any, do not prohibit engagement in insurance broking business, he must:

- (i) have attained the age of 18;
- (ii) have the minimum education standard of Form 5 or equivalent unless exempted under the criteria specified in the **Minimum Requirements**; and
- (iii) have passed the relevant papers of the IIQE as if he was an insurance broker unless he has an acceptable insurance qualification specified in the **Minimum Requirements** or has been exempted under the criteria specified in the **Minimum Requirements**.

A person who met the relevant requirements of qualifications by passing the relevant papers of the IIQE and became an authorised insurance broker or a registered Chief Executive or Technical Representative of an insurance broker, but who later ceased to engage in insurance-related work in the insurance industry in Hong Kong for two consecutive years, must pass the relevant papers again before being authorised/registered again, unless exempted under the criteria specified in the **Minimum Requirements**.

An insurance broker, his CE or Technical Representatives have to comply with the requirements of the Continuing Professional Development Programme in such manner and form as specified by the IA.

(b) **Capital and Net Assets**

The requirements are:

- (i) **Unincorporated insurance broker** has to maintain in his insurance broking business a minimum net assets value of **HK\$100,000** at all times.
- (ii) **Incorporated insurance broker** has to at all times maintain a minimum net assets value of **HK\$100,000** and a minimum paid-up share capital of **HK\$100,000**.
- (iii) **Determining minimum net assets** is by excluding all *intangible assets* (e.g. goodwill) and using accounting principles generally accepted in Hong Kong.

(c) **Professional Indemnity Insurance** has to be maintained, each of whose *limits of indemnity* per **claim** and per insurance **year** has to be at least the **greater** of:

(i) **two times** the aggregate insurance brokerage income relating to the 12 month period immediately before the date of commencement of the professional indemnity insurance (but the projected insurance brokerage income for the 12 month insurance period if in business for less than one year); and

(ii) **HK\$3 million;**

but no more than **HK\$75 million** is required.

In the event that the limit of indemnity available is reduced as a result of a claim to an amount below that determined in (i) above, the insurance broker is required to have the cover reinstated to a level not below the minimum determined limit. On the other hand, where the limit of indemnity has been determined in accordance with (ii) above, the policy has to provide for one automatic reinstatement to a limit of indemnity of not less than HK\$3 million.

(d) **Keeping of Separate Client Account** in accordance with the following:

(i) The *client account* has to be so designated and held for the client.

(ii) Client monies must only be used for the purposes of the client.

(iii) The ‘client account’ means a *current or deposit* account maintained in the name of the insurance broker with a financial institution duly authorised under the Banking Ordinance, the title of which contains the word ‘client’.

(iv) The insurance broker has to keep at least one client account.

(v) Monies received or held on behalf of clients have to be *deposited into the client account without delay*.

(e) **Keeping Proper Books and Accounts** in accordance with the following:

- (i) The insurance broker has to keep accounting and other records which:
 - (1) sufficiently explain transactions;
 - (2) sufficiently reflect the financial position of the business;
 - (3) enable 'true and fair view' financial statements to be prepared;
 - (4) can be conveniently and properly audited.
 - (ii) The records have to be in writing or in a form that can readily be accessed and turned into writing, and in sufficient detail to separately show particulars of:
 - (1) all transactions by the broker with, or for the account of, insurers/reinsurers, his clients and the insurance broker himself;
 - (2) all income received from brokerage, commissions, interest and other sources, and all expenses, commissions and interest paid by the broker; and
 - (3) all his assets and liabilities.
 - (iii) The records have to be retained for a period of not less than **7 years.**
- (f) **'Fit and Proper' Test:** an insurance broker is deemed to be not fit and proper if in the case of a sole proprietorship or partnership, the proprietor or any of the partners (including the CE), or in the case of a limited company, any of its CE, directors or controllers, is not fit and proper to hold such position, or if the CE or any of his technical representatives is not confirmed and registered pursuant to the relevant guidelines. The fundamental principles relating to the 'fit and proper' test of an insurance broker include the following:
- (i) **Utmost Good Faith**
 - (1) An insurance broker has to be of good character and reputation.
 - (2) He has to, at all times, conduct his business with utmost good faith and integrity.

- (3) He has to be independent and impartial in providing advice to his clients.
- (4) He should not give any misleading information or make any false statements.
- (5) He should not describe himself as an insurer or agent of an insurer.
- (6) He has to use his best endeavour to avoid conflict of interest and should not allow his other business interests, if any, to jeopardize his integrity, independence or competence.
- (7) He should not engage in twisting.

(ii) Due Care and Diligence

- (1) An insurance broker has to exercise due care and diligence in understanding and satisfying the insurance needs and requirements of his clients.
- (2) He has to take all reasonable steps to ensure that his C.E., Technical Representatives and employees, who are dealing with the policy holder or potential policy holder, are competent as well as fit and proper persons. He also has to ensure that his C.E. or Technical Representatives are eligible to engage in the Line of Insurance Business which he (the insurance broker) is eligible to engage in. He should not employ any insurance broker whose authorisation has been withdrawn by the IA, or any person whose status as appointed insurance agent or as authorised insurance broker is being suspended by the Insurance Agents Registration Board or an approved body of insurance brokers or who has been deregistered by any of them.
- (3) He should not appoint any C.E. or Technical Representative who is not a fit and proper person.
- (4) He has to terminate the appointment of his C.E. or Technical Representative who has been determined by the IA or an approved body of insurance brokers not to be fit and proper.
- (5) He has to explain the principle of utmost good faith to his clients and make it clear that all answers and statements given in completing the proposal form, claim form, or any other material document are the clients' own responsibility.

- (6) He has to advise his clients that incorrect answers or information given in completing proposal forms, claim forms or any other material documents may result in the contracts of insurance being invalidated or void or claims being repudiated.
- (7) He has to explain the terms of the insurance contracts to his clients and advise them of any exclusion clauses that are incorporated into the contracts.
- (8) He has to comply with all guidelines, codes of practice and similar guidance materials that apply to him.
- (9) He has to comply with such requirements as specified in the Code of Conduct for MPF Intermediaries ('MPF Code') issued by the Mandatory Provident Fund Schemes Authority ('MPFA') where he engages in selling or advising on Mandatory Provident Fund schemes or their constituent or underlying funds.
- (10) He has to take adequate measures to ensure that each of his directors and employees has registered as an MPF intermediary with the MPFA and complies with such requirements as specified in the MPF Code, where the director or employee engages in selling or advising on Mandatory Provident Fund schemes or their constituent or underlying funds.

(iii) **Priority of Client's Interests**

- (1) An insurance broker has to place the interests of his clients above all other considerations in providing advice to them or in arranging contracts of insurance for them.
- (2) He should not prejudice his clients' selection of insurers by unreasonably limiting the choices of insurers.
- (3) He should not be unreasonably dependent on any particular insurer in transacting insurance broking business.

(iv) **Information from Client:** An insurance broker should not disclose any information acquired from any one client except:-

- (1) in the normal course of negotiating, maintaining or renewing a contract of insurance for that client to the extent that such disclosure is required for such purposes;
- (2) to other professional or commercial organisations in connection with the contract of insurance for that client, including but not limited to loss adjusters and surveyors, security consultants and installation companies, property and engineering surveyors consultants and vendors, consulting engineers and architects;
- (3) with the written consent of that client; or
- (4) with court order or with a view to complying with obligations imposed upon him by law.

(v) **Information for Client**

- (1) An insurance broker has to make adequate and accurate disclosure of relevant material information in dealing with his clients.
- (2) If he, at the request of a client or as a result of unavailability of suitable products locally, refers or arranges a contract of insurance with an insurer authorised elsewhere than in Hong Kong, he has to advise the client of such status of the insurer and obtain a written acknowledgement of the fact from the client. Where the client is a corporate entity, he may, in lieu of obtaining a written acknowledgement of the fact, include a notice to the corporate client in the cover note or placement confirmation. The notice and acknowledgement have to follow prescribed specimens.
- (3) He has to disclose his association, if any, with the insurer he is recommending to a client that may result in a potential conflict of interests. It could be an association arising from common shareholder/director/controller.
- (4) If he is the employee/director/C.E./Technical Representative of more than one insurance broker, he has to disclose the capacity in which he is acting in dealing with his clients.

- (5) He has to disclose his registration number assigned by the IA or an approved body of insurance brokers (as the case may be) if so requested, and identify such number on his business cards if they are distributed.
- (6) In the event that a new long term insurance policy is purchased, he has to comply with those requirements that concern a Customer Protection Declaration, and to deliver the new policy together with a copy of the Customer Protection Declaration to his client without delay.

(vi) **Capabilities**

- (1) An insurance broker has to be capable of performing his functions efficiently. In this regard, whether he, inter alia, has ever been declared bankrupt or been a controller, a director, an officer or a senior manager of a corporation that has become insolvent will be taken into account.
- (2) He has to be mentally sound.
- (3) He has not been convicted of any criminal offence which may affect his fitness, suitability or propriety to act as an insurance broker or found guilty of misconduct by a professional body to which he belongs or has belonged.
- (4) He has to comply with all statutory obligations.

The above principles relating to the 'fit and proper' test of an insurance broker may, as appropriate, apply to the sole proprietor in case of an insurance broker being a sole proprietorship, any of the partners in case of an insurance broker being a partnership, any of its directors or controllers (within the same meaning as defined in Section 9 of the Insurance Ordinance) in case of an insurance broker being a limited company, as if he were an insurance broker.

In considering whether the appointment of C.E. and Technical Representative can be confirmed and registered by the IA or an approved body of insurance brokers, as the case may be, the following should, inter alia, be taken into account:

- (1) whether the prospective C.E. or Technical Representative is fit and proper to act as an insurance broker if he were to apply to be authorised as such. In

this connection, the above principles may, as appropriate, apply to the prospective C.E. or Technical Representative as if he were an insurance broker;

- (2) whether the prospective C.E. has met the relevant requirements for qualifications and experience (see **6.2.3d(a)** above);
- (3) whether the prospective Technical Representative has met the relevant requirements concerning age, residence status, right to work, employment visa conditions, education standard and examination achievements (see **6.2.3d(a)** above);
- (4) whether the C.E. or Technical Representative has complied with the requirements of the Continuing Professional Development Programme as specified by the IA.

6.2.3e Annual Financial Statements and Auditor's Report

- (a) Under Section 73(1) of the Insurance Ordinance, an insurance broker authorised by the IA has to submit to the IA annual audited financial statements in respect of the insurance broking business carried on by him which show a true and fair view of the financial position of the business as at the end of the financial year and of the profit or loss for the period then ended.
- (b) In addition, all insurance brokers authorised by the IA have to submit to the IA an *auditor's report* confirming that in the auditor's opinion the *minimum requirements* imposed upon the insurance broker mentioned in **6.2.3d(b)** through (e) above have been met.
- (c) The auditor's report and audited financial statements mentioned in (a) and (b) above have to be submitted to the IA *within 6 months* after the close of the relevant financial period.
- (d) According to the Minimum Requirements, an approved body of insurance brokers has to include in its membership rules and regulations a requirement that each member has to submit to it, *within 6 months* following the end of each financial year of the member, audited financial statements and an auditor's report (similar to the requirements in (a) and (b) above).
- (e) Besides, an approved body of insurance brokers has to, within 6 months after the close of the relevant financial period, give the IA an auditor's report stating:-

- (i) whether it has received the financial statements and auditor's reports from each of its members in accordance with its membership rules and regulations;
- (ii) that he has reviewed all reports by auditors of members in respect of the financial statements and the minimum requirements, and none contained any adverse statement or qualification except those listed by him in his report.

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Representative Examination Questions

Type 'A' Questions

- 1 In the general rules for the authorisation of insurers under the Insurance Ordinance, the requirement concerning **reinsurance** is that it must be:
- (a) adequate;
 - (b) sufficient to meet all liabilities;
 - (c) at least equal to the solvency margin;
 - (d) all be placed with Hong Kong reinsurers.

[Answer may be found in **6.1.1a**]

- 2 Under the Code of Practice for the Administration of Insurance Agents, which of the following boards may refer complaints against insurance agents to the relevant principals for investigation?
- (a) the Insurance Claims Complaints Board;
 - (b) the Insurance Agents Registration Board;
 - (c) the board of directors of the company which is an appointed insurance agent;
 - (d) none of the above.

[Answer may be found in **6.2.2d(c)(i)**]

Type 'B' Questions

- 3 Under the Code of Practice for the Administration of Insurance Agents, which of the following are permitted disciplinary actions against an insurance agent?
- (i) Issue a reprimand
 - (ii) Suspend the agent's appointment
 - (iii) Terminate the agent's appointment
 - (iv) Other action deemed fit by the IARB
- (a) (i), and (ii) only;
 - (b) (i), (ii) and (iii) only;
 - (c) (iii) and (iv) only;
 - (d) (i), (ii), (iii) and (iv).

[Answer may be found in **6.2.2d(c)(v)**]

- 4 Which of the following should be included in the Conduct of Insurance Agents for General Insurance Business and Restricted Scope Travel Business?
- (i) Give advice only when competent to do so
 - (ii) Identify himself before business discussions
 - (iii) Explain policy differences when making comparisons
 - (iv) Explain policy cover and ensure the client understands what he is buying
-
- (a) (i) and (ii) only;
 - (b) (i), (ii) and (iii) only;
 - (c) (iii) and (iv) only;
 - (d) (i), (ii), (iii) and (iv).

[Answer may be found in **6.2.2**]

[If still required, the answers may be found at the end of the Study Notes.]

7 ETHICAL AND OTHER RELATED ISSUES

7.1 INSURANCE INTERMEDIARIES' DUTIES TO POLICYHOLDERS

At the outset, it must be remembered that insurance intermediaries may be either **insurance agents** or **insurance brokers**. Depending on the category involved, the duties towards policyholders may be different. Of course, there are areas which are common ground. These will include:

- (a) absence of *fraud*: this is a common obligation on all;
- (b) *fair and reasonable* behaviour: if not specifically covered by (a) above, then this standard must at least be expected when considering ethical issues;
- (c) take *no unfair advantage of clients*: especially of physical, mental or educational deficiencies (again, this must be a matter of basic ethics);
- (d) exert *no undue influence*: the role of the insurance intermediary is that of an adviser, not a persuader or enforcer;
- (e) all actions must be *legal*: the honourable insurance intermediary will not only keep to the *letter* of the law, he will observe the *spirit* of the law and good insurance practice;
- (f) where the duties are governed or required by *legislation*, it is important to know that a breach could involve **criminal** proceedings, with severe penalties.

All the above are virtually self-evident, but they are still important things to remember in the context of this Chapter. Specifically, there are other matters that should be borne in mind, according to whether the insurance intermediary is an insurance agent or an insurance broker. We shall look at them in reverse order.

7.1.1 If the Insurance Intermediary is an Insurance Broker

- (a) **Relationship**: the cardinal point to remember is that the insurance broker is normally **agent of the policyholder**. All the legal obligations and duties within agency law therefore apply to the insurance broker in relation to the insured.
- (b) **Minimum Requirements**: In addition to the requirements of agency law, the minimum requirements discussed in **6.2.3** above have relevance here. Without too much by way of repetition, some of the relevant points are recalled below:
 - (i) special responsibilities regarding *client's monies* (see **6.2.3d**(d) above);
 - (ii) duty always to act in *utmost good faith* (**6.2.3d**(f)(i) above);
 - (iii) other duties under '*Fit and Proper*' Tests (also **6.2.3d**(f) above).

- (c) **Insurance Broker's general responsibilities:** the insurance broker is seen to be an *expert* in insurance. He must also be *independent* of any one insurer. His client is the policyholder, who may expect *impartial advice*, with his interests **paramount**.
- (d) **Professional liability:** if, as a deemed expert, the insurance broker fails to take reasonable care in his client's interests, he could well be guilty of *professional negligence*. This would give the policyholder the right to sue the insurance broker, who is required to be covered by a **Professional Indemnity Insurance** (see **6.2.3d(c)**).

7.1.2 If the Insurance Intermediary is an Insurance Agent

- (a) **Relationship:** the relationship with the policyholder is quite different for the insurance agent. His principal is normally the *Insurer*, not the *Insured*. As such, his primary responsibilities are to the insurer, although of course he is not exempt from the legal and ethical obligations discussed in **7.1** above.
- (b) **Minimum Requirements:** as discussed, all insurance agents must be appointed *in writing* and subject therefore to an **Agency Agreement** (see **6.2.2f**). Such an agreement must include certain minimum requirements. These will include a wide range of obligations towards both his Principal and the policyholder (or prospective policyholder). These may be reviewed in **6.2.2f**.

Note: Please **do** revise the passage suggested. We do not repeat the requirements here, but they are important and consist of knowledge that will be expected in your examination.

- (c) **Professional liability:** Tortious liability on the part of an insurance intermediary may to some extent depend upon the degree of knowledge/expertise expected of him, which in turn depends upon the nature of the skills he has professed for undertaking on behalf of the claimant the activity which has allegedly led to a loss to the claimant. As the typical insurance broker will hold himself out as being an insurance expert for the client, his duty of care to the client can be said to be onerous. By contrast, if an insurance agent has not professed to his clients special skills for undertaking an activity for them, he should be at a much lower risk of being held liable to them for incompetent performance of such activity. With in mind this contrast and the statutory imposition of vicarious liability on an insurer for his appointed insurance agents' conduct in prescribed circumstances, it is understandable that unlike an insurance broker an insurance agent is not statutorily required to buy and maintain professional indemnity insurance.

7.2 PROTECTION OF PERSONAL DATA

One of the consequences of the ‘computer revolution’ has been the fear that the speed, efficiency and capabilities of information technology will severely affect personal privacy. This has been a worldwide concern and many jurisdictions, including Hong Kong, have passed laws to safeguard the individual in this respect. The particular statute for Hong Kong is the *Personal Data (Privacy) Ordinance* (the ‘Ordinance’).

7.2.1 Features of the Ordinance

- (a) **Scope:** by international standards, this Ordinance is thorough, relating to personal data without distinguishing between automatic and manual personal data, and binding all persons and the Government as well. A body has been established under the Ordinance to oversee its application, namely *the Office of the Privacy Commissioner for Personal Data* (‘OPCPD’).
- (b) **Definitions:** the following terms are defined in the Ordinance:
 - (i) ‘*data*’ - any representation of information (including an expression of opinion) in any document and includes a personal identifier;
 - (ii) ‘*personal data*’ - any data (including expressions of opinions)
 - (1) relating directly or indirectly to a living individual (data subject);
 - (2) from which it is practicable for the identity of the individual to be directly or indirectly ascertained; and
 - (3) in a form in which access to or processing of the data is practicable.
- (c) **Data Protection Principles:** any person who controls the collection, holding, processing or use of personal data (data user) has to follow the fair information practices stipulated in the six data protection principles laid down in the Ordinance, as follows:
 - (i) **Principle 1 - purpose and manner of collection of personal data:** it outlines the *lawful and fair* collection of personal data, also the information that the *data user* should give to the *data subject* when collecting personal data.

Example:

When insurance practitioners collect customers’ personal data, they should provide the customers with a Personal Information Collection Statement (PICS) stating clearly the purpose of collecting the data, the classes of persons to whom the data may

be transferred, the consequences of failing to supply the data, and the right of access to and correction of the data. The PICS should be attached to documents such as insurance application forms.

- (ii) **Principle 2 - accuracy and duration of retention of personal data:** the personal data should be *accurate, up-to-date* and kept *no longer* than necessary.

In particular, if a data user engages a data processor, whether within or outside Hong Kong, to process personal data on the data user's behalf, the data user should adopt contractual or other means to prevent any personal data that has been transferred to the data processor from being kept longer than is necessary for processing of the data. The term 'data processor' means "a person who (a) processes personal data on behalf of another person, and (b) does not process the data for any of the person's own purposes". For the Privacy Commissioner for Personal Data's ('PCPD') recommended means of compliance with the requirements, please see **7.2.1(d)** below.

Example:

If letters sent to a customer are always returned, it could be because of an inaccurate mailing address. Insurance practitioners should stop using that mailing address and update it.

- (iii) **Principle 3 - use of personal data:** unless the *data subject* gives consent, the personal data should only be used for the purposes for which they were collected, or a *directly related* purpose.

Example:

Under general circumstances, insurance practitioners are not allowed to disclose their customers' personal data to other companies for promotion of their products, unless prior prescribed consent has been obtained from the customer.

- (iv) **Principle 4 - security of personal data:** appropriate *security measures* should be applied to personal data (including data in a form in which access to or processing of it is not practicable) to ensure that personal data are protected against unauthorised or accidental access, processing, erasure, loss or use.

In particular, if a data user engages a data processor, whether within or outside Hong Kong, to process personal data on the data user's behalf, the data user should adopt contractual or other means to prevent unauthorised or accidental access to, processing, erasure, loss or use of, the data that has been transferred to the data processor for processing. For the definition of 'data processor', please see (ii) above. Please see **7.2.1(d)** below for the

PCPD's recommended means of compliance with the requirements.

Example:

When using window envelopes to mail documents containing customers' personal data, insurance practitioners should ensure that the customers' sensitive data (e.g. identity card number) does not show through the envelope window. If the letter is intended for the recipient only, insurance practitioners should consider marking "Private and Confidential" on the envelope and seal it.

- (v) **Principle 5 - information to be generally available:** data users should take all practical steps to ensure openness and transparency about their policies and practices in relation to personal data, the kinds of personal data they hold and the *main purposes* for which personal data is used.

Example:

Formulate and maintain a Privacy Policy Statement, stating the kinds of personal data held, purpose for using the personal data and its personal data policies and practices, which can be displayed on the website of the insurance practitioners' company.

- (vi) **Principle 6 - access to personal data:** data subjects have the rights of access to, and of correction of, their personal data.

Example:

A customer has the right to ask an insurer to supply a copy of the personal data contained in his insurance policy.

- (d) **How to Comply with Requirements of Data Protection Principles 2 and 4 where Processing of Personal Data is Outsourced to a Data Processor:** the PCPD recommends to data users the following means of compliance with the requirements:

- (i) **Through contractual means**

The primary means by which a data user may protect personal data entrusted to its data processor is through a contract. In practice, data users often enter into contracts with their data processors for the purpose of defining the respective rights and obligations of the parties to the service contract. To fulfil their obligations under data protection principles 2 and 4 where processing of personal data is outsourced to a data processor, data users may incorporate additional contractual clauses in the service contract or enter into a separate contract with the data processor.

The types of obligations to be imposed on data processors by contract are numerous, including the following:

- (1) Security measures required to be taken by the data processor to protect the personal data entrusted to it and obligating the data processor to protect the personal data by complying with the data protection principles;
- (2) Timely return, destruction, or deletion of the personal data when it is no longer required for the purpose for which it is entrusted by the data user to the data processor;
- (3) prohibition against any use or disclosure of the personal data by the data processor for a purpose other than that for which the personal data is entrusted to it by the data user;
- (4) the data user's right to audit and inspect how the data processor handles and stores personal data; and
- (5) consequences of breach of the contract.

(ii) **Through other means**

Sometimes, a data user may not be able to enter into a contract with its data processor to protect the personal data entrusted to it. The Ordinance provides flexibility by allowing the use of 'other means' of compliance. The term 'other means' is not defined in the Ordinance. Generally, data users may engage non-contractual oversight and auditing mechanisms to monitor their data processors' compliance with the data protection requirements.

(iii) **Further good practice recommendations**

Further good practice recommendations are made by the PCPD to data users who engage data processors to process personal data on their behalf:

- (1) Data users should be transparent about their personal data handling practices and, when collecting personal data, make it plain to the data subjects, in clear and understandable language, that their personal data may be processed by data processors.
- (2) If the data processors are not situated in Hong Kong, the data users should make sure that their contracts are enforceable both in Hong Kong and in the countries in which the data processors are situated. The meaning of any technical and legal terms to be used in the contracts such as

‘personal data’, which may vary from one jurisdiction to another, should be clearly defined to suit compliance with the Hong Kong requirements.

- (3) Both data users and data processors should keep proper records of all the personal data that have been transferred for processing.
- (4) Before entrusting any personal data to data processors for system testing, data users have to consider whether use of anonymous or dummy data by data processors can equally serve the purpose.

(e) **Direct Marketing:** a new Part VIA of the Ordinance comprising provisions relating to use of personal data in direct marketing and provision of personal data for use in direct marketing has been introduced, with effect from 1 April 2013.

(i) **Interpretation of Part VIA:** in this Part,

Direct Marketing is defined to include the offering, or advertising of the availability, of goods, facilities or services through direct marketing means;

Direct Marketing Means means—

- (1) sending information or goods, addressed to specific persons by name, by mail, fax, electronic mail or other means of communication; or
- (2) making telephone calls to specific persons;

Marketing Subject, in relation to direct marketing, is defined to include any goods, facility or service offered, or the availability of which is advertised.

(ii) **Data user to take specified actions before using personal data in direct marketing**

A data user who intends to use the personal data of a data subject in direct marketing, or to provide it to others for use in direct marketing should inform the data subject of certain prescribed information (see below) and provide the data subject with a response channel through which the data subject may indicate whether he objects to the intended use or provision.

A data user who intends to use the data subject’s personal data in direct marketing for his own purposes is permitted to provide the data subject with the prescribed information either **orally or in**

writing. However, the provision of personal data (whether for gain or not) to another data user will be subject to the requirement that the data user should provide to the data subject **in writing** the prescribed information.

The prescribed information includes the kinds of personal data to be used or provided, the classes of marketing subjects in relation to which the data is to be used in direct marketing, and (where appropriate) the classes of persons to which the data is to be provided for direct marketing purposes. If the personal data is to be provided for gain, the data user must inform the data subject the data is to be so provided.

Presentation of the prescribed information by data users should be done in a manner that is easily readable and understandable.

(iii) **Grandfathering arrangement for pre-existing personal data**

The abovementioned requirements for a data user to notify the data subject of his intention to use the latter's personal data in direct marketing will not apply to personal data that the data user has, before the entry into force of the new provisions concerned, used in direct marketing in compliance with those requirements under the Ordinance that existed before. This grandfathering arrangement applies to use of any personal data of the data subject in relation to the same class of marketing subjects if any of the data subject's personal data has been so used before the commencement of the new provisions.

(iv) **Data user must not use personal data, or provide it to others for use, in direct marketing without data subject's consent or indication of no objection**

A data user can only use a data subject's personal data, or provide it to others for use, in direct marketing if he has provided the prescribed information and response channel to the data subject and received a reply from the data subject indicating that the data subject consents or does not object to the data user doing so.

Where a data user intends to use a data subject's personal data in direct marketing for his own purposes and provides the data subject with the prescribed information either **orally or in writing**, the data subject's reply to the data user indicating his consent or no objection may reciprocally be given either orally or in writing. If the reply is given orally, the data user must, before using the personal data in direct marketing, confirm **in writing** to the data subject within 14 days from the date of receipt of the reply, the permitted kind of personal data and the permitted class of marketing subjects.

Where a data user provides a data subject's personal data (whether for gain or not) to others for use in direct marketing, he must, before proceeding to provide the data, receive a reply **in writing** from the data subject indicating that the data subject consents or does not object to the data user doing so.

(v) **Data user must notify data subject when using personal data in direct marketing for the first time**

As before, a data user must notify a data subject of his opt-out right when using personal data in direct marketing for the first time. The maximum penalty for a contravention is a fine of \$500,000 and imprisonment for 3 years.

(vi) **Data subject may require data user to cease to use personal data or provide it to others for use in direct marketing**

A data user must comply with a data subject's request at any time to cease to use the data subject's personal data in direct marketing.

A data user must comply with a data subject's request at any time to cease to provide the data subject's personal data to others for use in direct marketing, and to notify any person to whom the data subject's personal data has been so provided to cease to use the data in direct marketing.

(vii) **Penalty**

Contraventions of the requirements under the new regulatory regime are offences. For those contraventions that involve provision of personal data for gain, the maximum penalty is a fine of \$1,000,000 and imprisonment for 5 years. For other contraventions, the maximum penalty is a fine of \$500,000 and imprisonment for 3 years.

(f) **Offence of Disclosure of Personal Data Obtained Without Data User's Consent**

(i) **Offences and penalty:** A person commits an offence if the person discloses any personal data of a data subject which was obtained from a data user without the data user's consent, with an intent (a) to obtain gain in money or other property, whether for the benefit of the person or another person, or (b) to cause loss in money or other property to the data subject.

A person also commits an offence if he discloses any personal data of a data subject which was obtained from a data user without the data user's consent, and the disclosure causes psychological harm to the data subject.

The maximum penalty for either offence is a fine of \$1,000,000 and imprisonment for 5 years.

(ii) **Defence:** The Ordinance provides the following defence to any person charged with any of the offences:

- (1) he reasonably believed that the disclosure was necessary for the purpose of preventing or detecting crime;
- (2) the disclosure was required or authorised by or under any enactment, by any rule of law or by an order of a court;
- (3) he reasonably believed that the data user had consented to the disclosure; or
- (4) he disclosed the personal data for the purposes of a prescribed news activity or a directly related activity; and had reasonable grounds to believe that the publishing or broadcasting of the personal data was in the interest of the public.

(g) **Contravention of the Ordinance:**

Data subjects may complain to the PCPD about a suspected breach of the Ordinance and sue the wrongful data users for compensation for damage (inclusive of injured feeling) they have suffered as a result of a contravention of the Ordinance.

Complications are involved where an alleged breach occurred as a result of a data user's outsourcing of processing of a data subject's personal data to a data processor. The data processor is not directly liable to the data subject for infringing his personal data privacy. The aggrieved data subject may seek recourse from the data user, who is liable as principal for the wrongful act of its authorised data processor.

Where a complaint is brought by a data subject against a data user for its data processor's wrongful act or practice which has infringed his personal data privacy, the contract made between the data user and the data processor incorporating specific provisions on data protection can be admitted as evidence of the data user's compliance with data protection principles 2 and 4. The data user may also bring an action against the data processor by relying on any contractual terms that govern the data processor's obligations in data protection.

Apart from breaches of the Ordinance that may give rise to civil redress by data subjects, there are a variety of offences under the Ordinance, including the offence of non-compliance with an enforcement notice that has been served by the PCPD.

- (h) **Exemptions:** The right to privacy is **not absolute**. Clearly, criminals have no right to expect total secrecy, and the normal conduct of business and social life in a community demand that some information can be generally or specifically available to those with a legitimate right to know. Exemptions from the Ordinance include:
- (i) a broad exemption for personal data held for *domestic* or *recreational* purposes;
 - (ii) exemptions on access by data subject for certain *employment-related* personal data held by their employers;
 - (iii) exemptions from the subject access and use limitation requirements where their application is likely to prejudice certain competing public or social interests, i.e. security, defence and international relations; prevention or detection of crime; apprehension, prosecution or detention of offenders; assessment or collection of any tax or duty; health; legal professional privilege; news activities; statistics and research; and human embryos, etc.
- (i) **User-friendly Materials for Use by Data Users and Insurance Practitioners:** apart from the Ordinance, insurance practitioners are advised to read the guidance notes and information leaflets issued by the relevant regulatory bodies for practical guidance on collection and use of personal data, including the following:
- (i) ‘How Insurance Practitioners Can Protect Their Customers’ Personal Data’ jointly issued by the OPCPD and the Hong Kong Federation of Insurers;
 - (ii) ‘Guidance on the Proper Handling of Customers’ Personal Data for the Insurance Industry’ issued by the OPCPD; and
 - (iii) ‘New Guidance on Direct Marketing’ issued by the OPCPD.

7.2.2 Insurance Applications

The above relate to society generally, of which insurance is of course a part. In order to assist the insurance industry in complying with the relevant requirements of the Ordinance when handling the collection, storage, use and security of customers’ personal data, and when handling customers’ data access requests, the PCPD has published a guidance note titled ‘Guidance on the Proper Handling of Customers’ Personal Data for the Insurance Industry’ (‘the Guidance Note’). Insurance practitioners should find the Guidance Note useful as it covers real work situations which they commonly encounter and which involve various key data protection compliance issues.

The following are some of the practical tips that the Guidance Note offers to insurance practitioners:

- (a) **Collection of customers' medical data:** insurers often collect customers' medical data on an application for life or health insurance or in processing a claim under such insurance.
 - (i) No collection of excessive data: collection of excessive data is contrary to data protection principle 1. For example, in an insurance claim for medical expenses incurred in relation to an operation to remove a claimant's tonsils, it may not be necessary to collect medical data about a surgery performed on his knee ten years ago, unless the insurer can show the relevancy of the data to the claim.
 - (ii) Lawful and fair means of collection: as required by data protection principle 1, personal data should only be collected by means which are fair and not prohibited under any law. In general, obtaining information by deception or misrepresentation would not be considered fair means of collection of data.
- (b) **Collection of Hong Kong identity card ('HKIC') number and copy:** collection of an HKIC number (and other personal identifiers such as a passport number) and an HKIC copy is regulated by data protection principle 1 and the Code of Practice on the Identity Card Number and other Personal Identifiers ('PI Code') issued by the PCPD.
 - (i) HKIC number: a data user should not collect HKIC number (or other personal identifiers) of an individual unless authorised by law or permitted in the situations set out in paragraph 2.3 of the PI Code. For example, an insurer may require the HKIC number of a customer or beneficiary to ensure that an insurance claim is paid to the right person.
 - (ii) HKIC copy: insurance institutions should comply with paragraph 3.2 of the PI Code in collecting an HKIC copy. For example, an insurance institution may collect a copy of the identity card of an individual who is a life insurance customer, as proof of compliance with section 3 of Schedule 2 to Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance.
- (c) **Engagement of private investigators in insurance claims:** insurers may appoint private investigators to investigate suspicious claims. While private investigators are regulated by the Ordinance, insurers who appoint private investigators should pay attention to the issue of vicarious liability for the acts of their appointed private investigators.

- (i) Lawful and fair means of collection: generally speaking, obtaining information covertly would not be considered fair means of collection of data. However, each case turns on its own facts and there may be special circumstances which justify particular means of collection. For example, collecting information about a claimant's activities by physical surveillance may be justified if there is reasonable suspicion of a fraudulent insurance claim of personal injury and there are no realistic alternatives to using such means of collection in seeking evidence of the suspected fraud.
 - (ii) Data is adequate but not excessive: in the course of investigating a suspected false claim of personal injury, for instance, data in relation to the claimant's private life which is unrelated to the claim should not be collected.
- (d) **Collection and use of personal data in direct marketing:** the following examples highlight some of the areas to which insurance practitioners should pay attention:
- (i) Lawful and fair means of collection: when an insurance practitioner changes job to work for another insurance institution, he should not make copies of the insurance policies or other information of his former customers from the records of his former principal/employer.
 - (ii) No change in purpose of use of data: In example (i) above, using a former customer's personal data for marketing products or services of the new principal/employer would unlikely be within the original purpose for which the data was collected by the former principal/employer.
- (e) **Access to, storage and handling of customers' personal data by staff and agents:** in compliance with the requirement of data protection principle 4, insurance institutions should implement security safeguards and precautions in relation to the security of customers' personal data held by them or by their staff or agents, which should include the following:
- (i) Secure transmission of documents containing personal data: When transmitting documents containing personal data of customers, insurance institutions and insurance practitioners should ensure that the data is protected against unauthorised or accidental access by unrelated parties. For example, in the case of transmission by mail or via another person, sealed envelopes should be used, no sensitive data (e.g. HKIC number) is visible through the envelope window, and mail only intended for the eyes of the addressee should be marked 'private and confidential'.

- (ii) Insurance agents or representatives working at home or outside workplace: insurance agents and representatives often meet customers in public places, taking with them policies and other documents that contain the customers' personal data. During the process, they should ensure that the personal data is not seen, and conversations concerning sensitive customer information are not overheard by unrelated parties. On the other hand, insurance institutions should provide clear policies and guidelines to the relevant staff for handling customers' data outside the workplace.

For more examples, please refer to the Guidance Note.

7.3 ISSUES REGARDING EQUAL OPPORTUNITY

7.3.1 Legislation Addressing Discrimination

An **Equal Opportunities Commission** ('EOC') exists to implement four Ordinances, whose objectives are to eliminate discrimination on grounds of:

- (a) *sex, marital status or pregnancy* (the *Sex Discrimination Ordinance*, 1995);
- (b) *disability* (the *Disability Discrimination Ordinance*, 1995);
- (c) *family status* (the *Family Status Discrimination Ordinance*, 1997); and
- (d) *race* (the *Race Discrimination Ordinance*, 2008).

7.3.2 'Fair' Discrimination in Insurance

The insurance industry, like every other area of our society, must respect the law regarding anti-discrimination. That said, in the practice of insurance business, insurers will in certain circumstances differentiate between proposers in ways that are legitimate, insofar as that is permitted by the Ordinances mentioned above. An identical provision is contained in each of the first three Ordinances (not including the Race Discrimination Ordinance) to the effect that the treatment of a person in relation to insurance is not outlawed where the treatment (a) was effected by reference to actuarial or other data from a reliable source, and (b) was reasonable having regard to the data and any other relevant factors. The following are instances of 'discrimination' in insurance that are generally considered to be legitimate:

- (a) **Life insurance:** The premium charged for a life insurance is very much affected by the life expectancy of the life insured at the time the insurance is arranged. It is a biological fact that women, on average, live *longer* than men. From this, insurers may:
 - (i) charge a *lower* premium rate for *life insurances* on women than for men of the same age, health condition, etc., because on average the policy benefit will not be paid so soon and/or more premium payments are expected in the case of women; and

- (ii) offer higher *annuity benefit payments* to men than to women of the same age, health condition, etc., because on average fewer payments will be made to men.
- (b) **Personal accident insurance:** A person with a disability, such as impaired eyesight or other serious medical condition, clearly represents a very different risk from a person with a normal healthy body. This difference could mean that insurers *decline* (refuse to insure) such persons, or impose various *underwriting measures* (higher premium, additional policy limitations, etc.).

7.3.3 Unfair Discrimination in Insurance

The conducts of discrimination that are common throughout our society (appointing only either sex, unfairly denying promotion to either sex, refusing to employ the physically handicapped, sexual harassment and so on) may happen in insurance situations as well. Below are two examples of unfair discrimination with insurance:

- (a) **Motor insurance:** charging higher premiums or imposing stricter terms on women because of the widely held male prejudice to the effect that women drivers are worse than men. (There have been statistics of accidents and driving convictions in certain countries which seem to suggest that the opposite is true!)
- (b) **Fire insurance:** refusing to grant household insurance to a woman on the grounds that she is divorced or a single parent.

7.4 PREVENTION OF MONEY LAUNDERING AND TERRORIST FINANCING

7.4.1 What is Money Laundering

The term ‘money laundering’ means an act intended to have the effect of making any property:

- (a) that is the proceeds obtained from the commission of an indictable offence under the laws of Hong Kong, or of any conduct which if it had occurred in Hong Kong would constitute an indictable offence under the laws of Hong Kong; or
 - (b) that in whole or in part, directly or indirectly, represents such proceeds,
- not to appear to be or so represent such proceeds.

7.4.2 What is Terrorist Financing

The term ‘terrorist financing’ means:

- (a) the provision or collection, by any means, directly or indirectly, of any property –
 - (i) with the intention that the property be used; or
 - (ii) knowing that the property will be used, in whole or in part, to commit one or more terrorist acts (whether or not the property is actually so used); or
- (b) the making available of any property or financial (or related) services, by any means, directly or indirectly, to or for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate; or
- (c) the collection of property or solicitation of financial (or related) services, by any means, directly or indirectly, for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate.

7.4.3 Vulnerabilities in Insurance Industry

The insurance industry is vulnerable to money laundering (‘ML’) and terrorist financing (‘TF’). The inherent characteristics of insurance products may give rise to ML risks unique to the insurance industry. When a life insurance policy matures or is surrendered, funds become available to the policy holder or other beneficiaries (e.g. an assignee, where the policy has been assigned; or a trustee, where the policy has been placed in trust). The beneficiary to the contract may be changed possibly against payment before maturity or surrender, in order that payments can be made by the insurer to a new beneficiary. A policy might be used as collateral to purchase other financial instruments. These investments in themselves may only be one part of a sophisticated web of complex transactions with their origins elsewhere in the financial system.

Examples of those long term insurance contracts that are vulnerable as a vehicle for laundering money or financing terrorism include:

- (a) unit-linked or with profit single premium contracts;
- (b) single premium life insurance policies that store cash value;
- (c) fixed and variable annuities; and

- (d) (second hand) endowment policies.

Long term insurance intermediaries are important for distribution, underwriting and claims settlement. They are often the direct link to the policy holder and therefore, intermediaries should play an important role in anti-money laundering ('AML') and counter-financing of terrorism ('CFT'). The same principles that apply to insurers should generally apply to insurance intermediaries. The person who wants to launder money or finance terrorism may seek an insurance intermediary who is not aware of or does not conform to necessary procedures, or who fails to recognise or report information regarding possible cases of ML or TF. The intermediaries themselves could have been set up to channel illegitimate funds to insurers.

7.4.4 Stages of Money Laundering

There are three common stages in the laundering of money, and they frequently involve numerous transactions. A financial institution ('FI') should be alert to any such sign for potential criminal activities. These stages are:

- (a) **Placement:** the physical disposal of cash proceeds derived from illegal activities;
- (b) **Layering:** separating illicit proceeds from their sources by creating complex layers of financial transactions designed to disguise the sources, subvert the audit trail and provide anonymity; and
- (c) **Integration:** creating for criminally derived wealth an impression of apparent legitimacy. In situations where the layering process succeeds, integration schemes effectively return the laundered proceeds back into the general financial system and the proceeds appear to be the result of, or connected to, legitimate business activities.

7.4.5 Legislation on Money Laundering and Terrorist Financing

An inter-governmental body named 'Financial Action Task Force' ('FATF') has been formed to set international AML standards, and to combat terrorist financing. As a member of the FATF, Hong Kong is obliged to implement the AML requirements as promulgated by the FATF, and it is important that Hong Kong complies with the international AML standards in order to maintain its status as an international financial centre.

The four main pieces of legislation in Hong Kong that are concerned with ML/TF are the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ('AMLO'), the Drug Trafficking (Recovery of Proceeds) Ordinance ('DTROP'), the Organized and Serious Crimes Ordinance ('OSCO') and the United Nations (Anti-Terrorism Measures) Ordinance ('UNATMO'). It is very important that FIs and their officers and staff fully understand their respective responsibilities under the different legislation.

7.4.5a Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ('AMLO')

The AMLO imposes requirements relating to customer due diligence ('CDD') and record-keeping on FIs and provides relevant authorities ('RA's) with powers to supervise compliance with these requirements and other requirements under the AMLO. In addition, section 23 of Schedule 2 requires FIs to take all reasonable measures (a) to ensure that proper safeguards exist to prevent a contravention of any requirement under Parts 2 and 3 of Schedule 2; and (b) to mitigate ML/TF risks.

The AMLO makes it a criminal offence if an FI knowingly contravenes a specified provision, subject to a maximum penalty of imprisonment for 2 years and a fine of \$1 million. Another offence is for an FI to contravene a specified provision with intent to defraud any RA, with imprisonment for 7 years and a fine of \$1 million upon conviction as the maximum penalty.

The AMLO also makes it a criminal offence if a person who is an employee of an FI or is employed to work for an FI or is concerned in the management of an FI knowingly causes or permits the FI to contravene a specified provision in the AMLO, subject to a maximum penalty of imprisonment of 2 years and a fine of \$1 million upon conviction. Another offence is for such a person to, with intent to defraud the FI or any RA, cause or permit the FI to contravene a specified provision in the AMLO, with imprisonment for 7 years and a fine of \$1 million upon conviction as the maximum penalty.

RAs may take disciplinary actions against FIs for any contravention of a specified provision in the AMLO. The disciplinary actions that can be taken include publicly reprimanding the FI; ordering the FI to take any action for the purposes of remedying the contravention; and ordering the FI to pay a pecuniary penalty not exceeding the greater of \$10 million or 3 times the amount of profit gained, or costs avoided, by the FI as a result of the contravention.

7.4.5b Drug Trafficking (Recovery of Proceeds) Ordinance ('DTROP')

The DTROP contains provisions for investigation of assets that are suspected to be derived from drug trafficking activities, freezing of assets on arrest and confiscation of proceeds from drug trafficking activities upon conviction.

Under the DTROP, a person commits an offence if he deals with any property knowing or having reasonable grounds to believe it to represent any person's proceeds of drug trafficking. The highest penalty for the offence upon conviction is imprisonment for 14 years and a fine

of \$5 million. Filing a report to the Joint Financial Intelligence Unit ('JFIU') in a prescribed manner provides a statutory defence to such an offence in respect of the acts disclosed in the report.

The DTROP also makes it an offence if a person fails to disclose, as soon as it is reasonable for him to do so, his knowledge or suspicion of any property that directly or indirectly, represents a person's proceeds of, was used in connection with, or is intended to be used in connection with, drug trafficking. Such an offence carries a maximum term of imprisonment of 3 months and a fine of \$50,000 upon conviction. Once an employee has reported his suspicion to the appropriate person in accordance with the procedure established by his employer for the making of such disclosures, he has fully satisfied the statutory obligation.

'Tipping off' is another offence under the DTROP. A person commits this offence if, knowing or suspecting that a disclosure has been made, he discloses to any other person any matter which is likely to prejudice any investigation which might be conducted following that first-mentioned disclosure. The maximum penalty for the offence upon conviction is imprisonment for 3 years and a fine.

7.4.5c Organized and Serious Crimes Ordinance ('OSCO')

The OSCO creates an offence of ML in relation to proceeds of indictable offences. The highest penalty for the offence upon conviction is imprisonment for 14 years and a fine of \$5 million. Filing a report to the JFIU in a prescribed manner provides a statutory defence to such an offence in respect of the acts disclosed in the report.

The OSCO also makes it an offence if a person fails to disclose, as soon as it is reasonable for him to do so, his knowledge or suspicion of any property that directly or indirectly, represents a person's proceeds of, was used in connection with, or is intended to be used in connection with an indictable offence. Such an offence carries a maximum term of imprisonment of 3 months and a fine of \$50,000 upon conviction. Once an employee has reported his suspicion to the appropriate person in accordance with the procedure established by his employer for the making of such disclosures, he has fully satisfied the statutory obligation.

'Tipping off' is another offence under the OSCO. A person commits this offence if, knowing or suspecting that a disclosure has been made, he discloses to any other person any matter which is likely to prejudice any investigation which might be conducted following that first-mentioned disclosure. The maximum penalty for the offence upon conviction is imprisonment for 3 years and a fine.

7.4.5d United Nations (Anti-Terrorism Measures) Ordinance ('UNATMO')

The UNATMO is principally directed towards implementing decisions contained in Resolution 1373 dated 28 September 2001 of the United Nations Security Council ('UNSC') aimed at preventing the financing of terrorist acts. Besides the mandatory elements of the UNSC Resolution 1373, the UNATMO also implements the more pressing elements of the FATF's special recommendations on TF.

The UNATMO criminalises any act of providing or collecting property and of making property or financial (or related) services available to terrorists or terrorist associates. The highest penalty for either of these offences upon conviction is imprisonment for 14 years and a fine. Filing a report to the JFIU in a prescribed manner provides a statutory defence to any of such offences in respect of the acts disclosed in the report.

The UNATMO also make it an offence if a person fails to disclose, as soon as it is reasonable for him to do so, his knowledge or suspicion that any property is terrorist property. This offence carries a maximum term of imprisonment of 3 months and a fine of \$50,000 upon conviction. Once an employee has reported his suspicion to the appropriate person in accordance with the procedure established by his employer for the making of such disclosures, he has fully satisfied the statutory obligation.

'Tipping off' is another offence under the UNATMO. A person commits this offence if, knowing or suspecting that a disclosure has been made, he discloses to any other person any matter which is likely to prejudice any investigation which might be conducted following that first-mentioned disclosure. The maximum penalty for the offence upon conviction is imprisonment for 3 years and a fine.

7.4.6 Guideline on Anti-Money Laundering and Counter-Terrorist Financing

7.4.6a Introduction

The Insurance Authority has issued a Guideline on Anti-Money Laundering and Counter-Terrorist Financing ('Guideline') to give guidance on the subjects to authorised insurers, reinsurers, appointed insurance agents and authorised insurance brokers carrying on or advising on long term business ('II's), with effect from 1 April 2012. The Guideline was published under section 7 of the AMLO and section 133 of the Insurance Ordinance.

Intended for use by FIs and their officers and staff, the Guideline provides guidance which is no different from that provided by other RAs under their respective regulatory regimes.

The purposes of the Guideline are to:

- (a) provide a general background on the subjects of money laundering and terrorist financing ('ML/TF'), including a summary of the main provisions of the applicable anti-money laundering and counter-financing of terrorism ('AML/CFT') legislation in Hong Kong; and
- (b) provide practical guidance to assist FIs and their senior management in designing and implementing their own policies, procedures and controls in the relevant operational areas, taking into consideration their special circumstances so as to meet the relevant AML/CFT statutory and regulatory requirements.

It must be emphasised that the contents of the Guideline are neither intended to, nor should be construed as, an exhaustive list of the means of meeting the statutory and regulatory requirements.

The Guideline provides guidance in relation to the operation of the provisions of Schedule 2 to the AMLO ('Schedule 2'). This will assist FIs to meet their legal and regulatory obligations when tailored by FIs to their particular business risk profile. Departures from this Guidance, and the rationale for so doing, should be documented, and FIs will have to stand prepared to justify departures to the RAs.

A failure by any person to comply with any provision of the Guideline does not by itself render the person liable to any judicial or other proceedings but, in any proceedings under the AMLO before any court, this Guideline is admissible in evidence; and if any provision set out in this Guideline appears to the court to be relevant to any question arising in the proceedings, the provision must be taken into account in determining that question.

In addition, a failure to comply with any provision of this Guideline by IIs may reflect adversely on the fitness and properness of their directors and controllers, and may result in a disciplinary action being taken against the non-complying IIs.

7.4.6b AML/CFT Systems

According to the Guideline, FIs must take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of ML/TF and to prevent a contravention of any requirement under Part 2 or 3 of Schedule 2. To ensure compliance with this requirement, FIs should implement appropriate internal AML/CFT policies, procedures and controls ('AML/CFT systems').

The Guideline specifies various factors that FIs should take into consideration when setting up an AML/CFT system. The controls to be put in place should cover: senior management oversight; appointment of a Compliance Officer and a Money Laundering Reporting Officer; compliance and audit function; and staff screening and training.

7.4.6c Group AML/CFT Policy for Business Conducted Outside Hong Kong

The Guideline sets out guidance for circumstances where an FI conducts business outside Hong Kong. A Hong Kong-incorporated FI with overseas branches or subsidiary undertakings should put in place a group AML/CFT policy to ensure that all branches and subsidiary undertakings that carry on the same business as an FI in a place outside Hong Kong have procedures in place to comply with the CDD and record-keeping requirements similar to those imposed under Parts 2 and 3 of Schedule 2 to the extent permitted by the law of that place. The FI should communicate the group policy to its overseas branches and subsidiary undertakings.

When a branch or subsidiary undertaking of an FI outside Hong Kong is unable to comply with requirements that are similar to those imposed under Parts 2 and 3 of Schedule 2 because this is not permitted by local laws, the FI must:

- (a) inform the RA of such failure; and
- (b) take additional measures to effectively mitigate ML/TF risks faced by the branch or subsidiary undertaking as a result of its inability to comply with the above requirements.

Suspicion that any property in whole or in part directly or indirectly represents any person's proceeds of an indictable offence, should normally be reported within the jurisdiction where the suspicion arises and where the records of the related transactions are held. However, in certain cases, e.g. when the account is domiciled in Hong Kong, reporting to the JFIU may be required in such circumstances, but only if section 25A of OSCO/DTROP applies.

7.4.6d Risk-based Approach ('RBA')

The Guideline requires FIs to, in determining the extent of CDD measures and ongoing monitoring required, take a risk-based approach. The general principle of an RBA is that where customers are assessed to be of higher ML/TF risks, FIs should take enhanced measures to manage and mitigate those risks, and that correspondingly where the risks are lower, simplified measures may be applied. The use of an RBA has the

advantage of allowing resources to be allocated in the most efficient way directed in accordance with priorities so that the greatest risks receive the highest attention.

7.4.6e Customer Due Diligence ('CDD')

The AMLO defines what CDD measures are and prescribes the circumstances in which an FI should carry out CDD. As indicated in the AMLO, FIs may also need to conduct additional measures or could conduct simplified CDD depending on specific circumstances. The Guideline sets out the expectations of RAs in this regard and suggests ways that these expectations may be met. Wherever possible, the Guideline gives FIs a degree of discretion in how they comply with the AMLO and put in place procedures for this purpose.

7.4.6f Ongoing Monitoring

The Guideline stresses that effective ongoing monitoring in an FI is vital for understanding of customers' activities and is an integral part of an effective AML/CFT system. Effective ongoing monitoring helps FIs know their customers and detect unusual or suspicious activities. The Guideline gives guidance on how to achieve effective ongoing monitoring.

7.4.6g Financial Sanctions

The United Nations Sanctions Ordinance ('UNSO') gives the Chief Executive the authority to make regulations to implement sanctions decided by the Security Council of the United Nations ('UNSC') and to specify or designate relevant persons and entities. These sanctions normally prohibit making available or dealing with, directly or indirectly, any funds or economic resources for the benefit of or belonging to a designated party. RAs circulate to all FIs designations published in the government Gazette under the UNSO.

While FIs will not normally have any obligation under Hong Kong law to have regard to lists issued by other organisations or authorities in other jurisdictions, an FI operating internationally will need to be aware of the scope and focus of the relevant financial/trade sanctions regimes in those jurisdictions. Where these sanctions may affect their operations, FIs should consider what implications exist for their procedures, such as the consideration to monitor the parties concerned with a view to ensuring that there are no payments to or from a person on a sanctions list issued by an overseas jurisdiction.

The Chief Executive can, in response to an application from an FI, license exceptions to the prohibitions on making funds and economic resources available to a designated party under the UNSO.

7.4.6h Terrorist Financing and Proliferation Financing

The Guideline summarises the laws concerning CTF. To fulfill Hong Kong's obligations under the relevant international laws, the UNATMO was enacted, which gives the Secretary for Security ('S for S') powers to freeze suspected terrorist property and to direct that a person shall not deal with the frozen property except under the authority of a licence. Contraventions are subject to a maximum penalty of 7 years' imprisonment and an unspecified fine.

It is an offence under the UNATMO for any person to make any property or financial services available, by any means, directly or indirectly, to or for the benefit of a terrorist or terrorist associate except under the authority of a licence granted by S for S. It is also an offence for any person to collect property or solicit financial (or related) services, by any means, directly or indirectly, for the benefit of a terrorist or terrorist associate. Contraventions are subject to a maximum sentence of 14 years' imprisonment and an unspecified fine. The S for S can, in response to an application from an FI, license exceptions to the prohibitions to enable frozen property and economic resources to be unfrozen and to allow payments to be made to or for the benefit of a designated party under the UNATMO.

Where a person is designated by a Committee of the UNSC as a terrorist and his details are subsequently published in a notice under section 4 of the UNATMO in the Government gazette, RAs will circulate the designations to all FIs.

It is an offence under section 4 of the Weapons of Mass Destruction (Control of Provision of Services) Ordinance ('WMD(CPS)O'), for a person to provide any services where he believes or suspects, on reasonable grounds, that those services may be connected to WMD proliferation.

FIs may draw reference from a number of sources including relevant designation by overseas authorities. The RA may draw FIs' attention to such designations from time to time. FIs should therefore ensure that they have an appropriate system to conduct checks against the relevant list for screening purposes and that this list is up-to-date.

7.4.6i Database Maintenance and Screening (Customers and Payments)

The Guideline reminds FIs to take measures to ensure compliance with the relevant regulations and legislation on TF. The legal obligations of FIs and those of its staff should be well understood, and adequate guidance and training should be provided to the latter. FIs are required to establish policies and procedures for combating TF. The systems and mechanisms for identification of suspicious transactions should cover TF as well as ML.

It is particularly vital that an FI should be able to identify and report transactions with terrorist suspects and designated parties. To this end, the FI should ensure that it maintains a database of names and particulars of terrorist suspects and designated parties which consolidates the various lists that have been made known to it. Alternatively, an FI may make arrangements to have access to such a database maintained by third party service providers.

FIs should ensure that the relevant designations are included in the database. Such database should, in particular, include the lists published in the Gazette and those designated under the US Executive Order 13224. The database should also be subject to timely update whenever there are changes, and should be made easily accessible by staff for the purposes of identifying suspicious transactions.

Comprehensive ongoing screening of an FI's complete customer base is a fundamental internal control to prevent TF and sanction violations, and should be achieved in specified manners.

FIs should have some means of screening payment instructions to ensure that proposed payments to designated parties are not made, and be particularly alert to suspicious wire transfers.

Enhanced checks should be conducted before establishing a business relationship or processing a transaction, where possible, if there are circumstances giving rise to suspicion.

In order to demonstrate compliance with the above requirements for screening of customer bases, screening of payment instructions, and enhanced checks, the screening and any results should be documented, or recorded electronically.

If an FI suspects that a transaction is terrorist-related, it should make a report to the JFIU. Even if there is no evidence of a direct terrorist connection, the transaction should still be reported to the JFIU if it looks suspicious for other reasons, as it may emerge subsequently that there is a terrorist link.

7.4.6j Suspicious Transaction Reports

Once knowledge or suspicion of ML/TF or terrorist property has been formed, FIs should apply the following general principles laid down in the Guideline:

- (a) in the event of suspicion of ML/TF, a disclosure should be made even where no transaction has been conducted by or through the FI;
- (b) disclosures must be made as soon as is reasonably practical after the suspicion was first identified; and

- (c) FIs should ensure that they put in place internal controls and systems to prevent any directors, officers and employees committing the offence of tipping off customers or any other person who is the subject of the disclosure. FIs should also take care that their line of enquiry with customers is such that tipping off cannot be construed to have taken place.

The Guideline suggests an effective way of recognising unusual and suspicious activities, i.e. by knowing enough about customers, their circumstances and their normal expected activities to recognise when a transaction or instruction, or a series of transactions or instructions, is unusual.

FIs are required to ensure sufficient guidance is given to their staff (including appointed insurance agents in this context) to enable them to form suspicion or to recognise when ML/TF is taking place, and to identify and assess the information that is relevant for judging whether a transaction or instruction is suspicious in the circumstances.

Where an FI has formed a suspicion that particular transactions relate to ML/TF, it should take into account the risk of tipping off when performing the CDD process. It should ensure that their employees are aware of and sensitive to this issue when conducting CDD.

Furthermore, the Guideline gives guidance on timing and manner of suspicious transaction reports, internal reporting system, recording of internal reports and reports to the JFIU, and post reporting matters. A list of indicators of suspicious transactions and examples of ML schemes are appended to the Guideline for reference purposes.

7.4.6k Record-keeping

The Guideline stresses the importance of record-keeping to compliance with general legal and regulatory requirements. It gives guidance on retention of records relating to customer identity and transactions, and control of intermediaries' record-keeping.

In relation to record-keeping obligations by individual insurance agents, the Guideline points out that individual insurance agents who are appointed agents of an insurer are usually required to provide all customer and transaction related documentation to the insurer directly, and they do not have the capacity to maintain such documents. Under this arrangement, and from the perspective of meeting the record-keeping requirements set out in Part 3 of Schedule 2, these individual agents are considered to have deposited the required records and documents at the premises of the insurer. As the individual insurance agents remain responsible for compliance with all record-keeping requirements, they should ensure that:

- (a) the insurer to which they provide the records and documents has systems in place to comply with all the record-keeping requirements under the AMLO; and
- (b) such records and documents are accessible from the insurer without delay upon request by an RA.

7.4.6l Staff Training

According to the Guideline, the staff (including appointed insurance agents in this context) of any FI should be trained in what they need to do to carry out their particular roles in the FI with respect to AML/CFT. This is particularly important before new staff commence work. FIs should implement a clear and well-articulated policy for ensuring that relevant staff receive adequate AML/CFT training. The timing and content of training packages for different groups of staff will need to be adapted by individual FIs for their own needs, with due consideration given to the size and complexity of their business and the type and level of ML/TF risk. Training should be provided so frequently as is sufficient to maintain the AML/CFT knowledge and competence of the staff.

Apart from what staff should be made to know, the Guideline also provides guidance on the training techniques and tools that may be used. In addition, adequate records of training should be kept and the effectiveness of the training monitored.

7.4.6m Wire Transfers

The Guideline provides guidance on wire transfers, which primarily applies to authorised institutions and money service operators. Other FIs should also comply with section 12 of Schedule 2 and the guidance on wire transfers if they act as an ordering institution or beneficiary institution as defined under the AMLO.

7.5 PREVENTION OF CORRUPTION

Corruption is an individual's act of abusing his authority for personal gain at the expense of other people.

Administered by the Independent Commission Against Corruption ('ICAC'), the Prevention of Bribery Ordinance helps the business sector maintain an environment that is conducive to efficiency and fair competition. It protects principals against agents' abuses of authority for personal gain. Under Section 9(1) of the Ordinance, an agent (normally an employee), when conducting his principal's business or affairs, should not seek or accept an advantage without the permission of his principal. The offeror of advantage commits an offence under Section 9(2) of the Ordinance. Section 9(3) of the Ordinance provides that any agent who, with intent to deceive his principal, uses any receipt, account or other document which is false or erroneous commits an offence. Each of the offenders is subject to a maximum penalty of imprisonment for 7 years and a fine of \$500,000.

The ICAC offers free and confidential corruption prevention services to organisations. For example, Best Practice Packages covering a wide range of topics have been developed to provide both public corporations and private sector companies with user-friendly guidelines on plugging corruption loopholes. The ICAC also provides free, confidential corruption prevention advice to individual organisations.

To make insurance intermediaries better understand the importance of anti-corruption and ethics management, the ICAC offers a large variety of anti-corruption training courses and activities to the insurance industry. It has issued a booklet named the 'Practical Guide on Professional Ethics for Life Insurance Intermediaries' in collaboration with the Insurance Authority, the self-regulatory bodies of the insurance industry and various professional associations of insurance. The objectives are to enhance the vigilance of the life insurance industry against potential corruption and fraud, and to strengthen insurance companies' ability to manage the ethical conduct of their staff, so that the risks of violations of laws and regulations are reduced, contributing to long-term success.

Insurance intermediaries are encouraged to get familiar with the substance of the Ordinance, the best practices suggested by the ICAC (including the module on Verification of Insurance Claims), and the Practical Guide on Professional Ethics for Life Insurance Intermediaries, with a view to preventing corrupt conduct both within and outside their organisations. Other services of the ICAC should also be used as much as is necessary. In dealing with clients or other third parties, insurance intermediaries should guard against violating the Ordinance. Corruption cases should be reported to the ICAC in person, by phone or by letter.

7.6 PREVENTION OF INSURANCE FRAUD

Fraud is of course 'dishonesty' or 'cheating'. Since insurance is a process involving a high element of trust, there is ample scope for the dishonest person to take advantage.

Insurance fraud may take any of a large number of forms. Usually, we tend to associate the term with dishonest claims, from relatively 'small' matters, such as having a cheap watch stolen and saying that it was an expensive one, to elaborate swindles involving arson or faked death certificates. There have even been examples of large life insurance being arranged and then having the person concerned murdered for the insurance money.

Fraud, however, may arise at other than the claims level. Obtaining insurance by the deliberate falsification of material information, or knowingly hiding bad features, is equally fraud. Of course, this is a form of breach of utmost good faith (see 3.2 above), but often it is difficult to prove such things later.

Although fraud may be committed by anyone involved with insurance (policyholder, insurance intermediary or even the insurer), we shall concentrate on the customary understanding of the proposer or insured seeking an illegal advantage against the insurer. The comments below refer specifically to the role of the insurance intermediary in this subject area.

7.6.1 Beware of Becoming Partners in Crimes

Undoubtedly all of us know that we must refrain from carrying out criminal activities, or we may face criminal prosecution and even civil action. For instance, an insurance intermediary who misappropriates premiums that have been collected on behalf of his principal is liable to prosecution for theft, and to civil action by the principal to recover the stolen money and for damages such as loss of interests. It is also common knowledge that, apart from the actual perpetrator(s), a **secondary party** to the crime (see the next paragraph for its definition) is also punishable by law. However, a general knowledge cannot be assumed that the secondary party and the **principal perpetrator** (or just **'principal'**) can be equally responsible for the same crime. This **7.6.1** introduces the criminal law of secondary parties so as to enhance the ability of insurance intermediaries to identify potential criminal activities and to prompt them to take extra care in distancing themselves from such activities. It will be seen that the discussions here are not restricted to the offence of fraud and offences involving fraud, in view of the fact that the law of secondary participation is generally applicable to all offences.

Depending on the nature of participation, a participant in crime can either be in the capacity of a principal or a secondary party (alternatively known as **'secondary participant'** and **'accessory'**). Where there are more than one principal and they should be jointly responsible, they are also known as joint principals. A secondary party to an offence is one who aids, abets, counsels or procures the commission of that offence. Without going into details about these four legal terms, it is sufficient for the purposes of these Study Notes to mention that secondary participation almost invariably consists simply in assisting or encouraging the commission of the crime.

It surprises almost anyone who is new to this area of the law to know that it is generally immaterial whether a defendant is alleged to have participated in the crime as principal or as secondary party, as he is equally responsible either way. Not too many people, it is also believed, realise that participation by inactivity can be as culpable as participation by acting. Where the defendant has the right to control another person's actions and he deliberately refrains from exercising the right, such inactivity may constitute a positive encouragement to that other person to carry out an illegal act, and therefore an aiding, etc. Let us say, an insurance agent Mr Wong (who is an appointed insurance agent of Insurer A alone) solicits insurance business from a prospective client for Insurer B, with his up-line manager Miss Chiu (who is also an appointed insurance agent of Insurer A) standing by and watching. If Miss Chiu knows that Mr Wong is not an appointed insurance agent of Insurer B, then her failure to stop Mr Wong very likely constitutes aiding and abetting the commission of the offence under s 77(1) of the Insurance Ordinance.

The final aspect of the law of secondary participation to be discussed here is the mens rea (or guilty mind) of the defendant at the time of aiding, etc. that must be proved as one of the elements of the crime. Neither an intention to gain from the commission of the crime nor from the conduct of aiding, etc. is

required. What is required is an intention to aid, etc., which conduct he knew to be capable of assisting or encouraging the commission of the crime. Such an intention, it should be noted, is not the same thing as an intention that the crime be committed. Let us say, an insurance intermediary issues to a client, at the request of the latter, an inflated premium receipt for a private car insurance policy, which receipt he realises might be presented to the latter's employer for the purposes of over-claiming living costs allowance. By so doing, the insurance intermediary can still be held to be an aider and abettor, even if he is indifferent whether the client cheats his employer by use of the bogus receipt as planned.

7.6.2 The Insurance Intermediary and Examples of Insurance Fraud

As stated, fraud takes many forms. We do not talk about deliberate collusion and dishonesty on the part of insurance intermediaries. The illegality and unethical nature of that is self-evident. Below are examples where the insurance intermediary may be approached or tempted to assist in insurance fraud:

- (a) **Arranging the insurance:** it often happens that the insurance intermediary possesses or is supplied with information which could have an adverse effect upon an application or proposal for insurance. This information could even mean that the risk is uninsurable. Under no circumstances should that information be omitted or misrepresented. Doing this with the intention of misleading the insurer is **fraud**.

Remember, by law and ethics, an insurance intermediary is *bound* to exercise the duty of utmost good faith in such matters, whatever the practical consequences for the proposed insurance.

- (b) **Fraudulent claims:** it is not the responsibility of the insurance intermediary to become a 'detective' or a 'law-enforcement officer', but there is a common duty not to assist fraud and to report evidence or suspicions of it. Concerning claims, this may mean suspicious circumstances, doubtful medical or other documentary evidence or even verbal communications which clearly indicate that all is not correct with a particular claim.

Note: A word of caution must be given. Fraud is a most serious matter and to allege it is something that must not be done lightly. It is the insurer's primary duty to investigate claims, and certainly only he can allege fraud. The insurance intermediary's role is to assist the insurer, and indeed the law, in resisting attempted fraud and in revealing fraud, but this is a matter of the greatest sensitivity, as will be readily appreciated.

7.6.3 Practical Steps in Preventing Fraud

As with all matters involving illegal activities, perhaps the most important advice in preventing fraud is firstly to be **aware** that it *can happen*. Of course, we must not become paranoid about this, but the possibility that it can arise is always a good beginning in fraud prevention. Additionally:

- (a) **Vigilance:** suspicious actions, like sudden increases in sums insured with no or inadequate explanation, apparently inordinate amounts of insurance, and so on, should put the insurance intermediary on guard.
- (b) **Diligence:** sometimes fraud can arise when records are inadequately kept or unnecessary delays occur. Keeping up to date with actions and record keeping is not only good business, it is an excellent fraud prevention exercise.
- (c) **Communication:** whether representing the insured or the insurer, the insurance intermediary should always keep in close touch with the insurer, especially where there may be suspicious circumstances.
- (d) **Integrity:** by law, contract and all recognised ethical behaviour, insurance agents and brokers have to maintain the highest moral standards. Remembering this at all times will almost automatically supply all necessary guidance in this area. Insurance agent, insurance broker or insurer, we are all the enemy of fraud.

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Representative Examination Questions

Type 'A' Questions

- 1 The Personal Data (Privacy) Ordinance for Hong Kong applies to:
- (a) the public sector only;
 - (b) the private sector only;
 - (c) both the public sector and the private sector;
 - (d) neither the public sector nor the private sector.

[Answer may be found in **7.2.1(a)**]

- 2 Legislation has been enacted in Hong Kong regarding equal opportunity. Which of the following are areas where discrimination may arise have been made the subject of an appropriate Ordinance?
- (a) sex;
 - (b) pregnancy;
 - (c) physical disability;
 - (d) all of the above.

[Answer may be found in **7.3.1**]

Type 'B' Questions

- 3 Which of the following are among the recognised principles of Data Protection?
- (i) Access to personal data
 - (ii) Security of personal data
 - (iii) Purpose and manner of collection
 - (iv) Information to be generally available to the data subject
- (a) (i) and (ii) only;
 - (b) (i) and (iii) only;
 - (c) (ii) and (iv) only;
 - (d) (i), (ii), (iii) and (iv).

[Answer may be found in **7.2.1(c)**]

- 4 Which of the following are among the types of insurance commonly used in money laundering activities?
- (i) Fire insurance
 - (ii) Purchased annuities
 - (iii) Motor insurance
 - (iv) Unit-linked single premium contracts
-
- (a) (i) and (ii) only;
 - (b) (ii) and (iii) only;
 - (c) (ii) and (iv) only;
 - (d) (i), (iii) and (iv) only.

[Answer may be found in **7.4.3**]

[If still needed, the answers may be found at the end of the Study Notes.]

GLOSSARY

Abandonment (委付) A practice effectively restricted to marine insurance, whereby the assured surrenders all rights in the subject matter insured to the insurer, in return for a total loss settlement. **3.4.6**

Academic Classification of Insurance (保險的學術類別) A method of classifying insurance business, often used for examination and educational purposes (insurance of the person, insurance of property, insurance of pecuniary interest and insurance of liability). **5.1.3**

Acceptance (law of contract) ((合約法)承約) One of the elements of a contract, where one party agrees to accept an offer. **2.1.3(b)**

Accounting and Investment (會計及投資) Those functions of insurers which concern the receipt and payment of monies and the effective and productive use of accumulated funds. **4.10**

Actuarial Support (精算支援) The contribution of actuaries in insurance, in such matters as premium rating, loss reserving and valuation of liabilities. **4.9**

Adequate Reinsurance (足夠的再保險) One of the requirements under the Insurance Ordinance for an insurer wishing to be authorised, or to remain to be authorised, in Hong Kong. **6.1.1e**

Administrator (遺產管理人) Put simply, he is a person appointed to manage the property of another. **3.1.4(b)**

Agency (代理關係) Principal and agent relationship. **2.2.1**

Agency by Estoppel (不容反悔的代理權) An application of the doctrine of estoppel to an agency situation is where a person, by words or conduct, represents or allows it to be represented that another person is his agent, in which case he will not be permitted to deny the authority of the agent with respect to anyone (third party) dealing with the agent on the faith of such representation. **2.2.3(d)**

Agent (代理人) A person acting on behalf of a principal. **2.2(a)**

Agreed Value Policy (約定價值保單) Property insurance where it is agreed at policy inception that the item(s) concerned have, throughout the currency of the contract, the value stated in the policy. Mostly used with items that tend not to depreciate, e.g. jewellery and antiques, and in marine insurance. **3.4.8(c)**

'All Risks' (「全險」) A form of property insurance cover where all causes of loss are insured unless specifically excluded. **1.1.1 Note 2**

Ancillary Functions of Insurance (保險的輔助功能) Indirect benefits, consequences and results of insurance (as opposed to its direct intentions and objectives). **1.2(b)**

Annual Financial Statements and Auditor's Report (年度財務報表和核數師報告) A requirement upon all insurance brokers, under Section 69 of the Insurance Ordinance, is that they have to submit an annual audited financial statement representing a true and fair picture of the business profit or loss for the period then ended. **6.2.3e**

Annuity (年金) A contract whereby an insurer promises to make a series of periodic payments ('annuity benefit payments') to a designated person ('payee') throughout the lifetime of a person ('annuitant') or for an agreed period, in return for a single payment or a series of payments made in advance by the annuity purchaser. Very often, the payee, the annuitant and the annuity purchaser are the same person. **5.1.1(a)**

Apparent Authority (表面權限) The authority of an agent may be apparent instead of actual, where it results from a manifestation of consent, *made to third parties* by the principal. This doctrine is distinct from the doctrine of estoppel in that it applies where an agent is allowed to appear to have a greater authority than that actually conferred on him, whereas the doctrine of estoppel applies where the supposed agent is not authorised at all but is allowed to appear as if he was. **2.2.3(b)**

Appeals Tribunal (上訴裁判處) A body of members nominated by The Hong Kong Federation of Insurers and confirmed by the Insurance Authority, to hear appeals by applicants in respect of applications for registration under the Code of Practice for the Administration of Insurance Agents or by any party who is the subject of any disciplinary or other action imposed by the IARB under the Code. The Tribunal's decision is final. **6.2.2d(d)**

Approved Bodies of Insurance Brokers (認可保險經紀團體) Associations of insurance brokers approved by the Insurance Authority under Section 70 of the Insurance Ordinance (at present consisting of the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association Limited). **5.5.2**

Assignment of Policy (Insurance Contract) (保單 (保險合約) 的轉讓) The transfer of rights under a contract of insurance, whereby another person becomes the policyowner in respect of the same subject matter of insurance. **3.1.6**

Assignment of the Right to Insurance Money (收取保險金的權利的轉讓) The transfer of the right to insurance money to a third party, who then acquires the right to sue the insurer under the contract. **3.1.6**

Average (in marine insurance) (海損) : partial (i.e. non-total) loss. **3.4.7(a) Note**

Average (in non-marine insurance) (比例分攤) : a policy provision which imposes a penalty for under-insurance when a claim arises. **3.4.7(a)**

Bailee (受託保管人) A bailee of goods is a person taking possession of the goods with their owner's consent, where there is no intention to transfer ownership. **3.5.3**

Breach (違反) Failure to fulfil an obligation, perhaps in connection with contractual terms, or related to agency relationship. **2.1.3, 2.2.5(c)**

Capacity 1 **Capacity to Contract** (訂約的行為能力) : The legal ability to enter into a contract, without which, the proposed contract will be defective. **2.1.3(d)**

2 **Underwriting Capacity** (承保能力) : The practical, financial ability of an insurer to accept proposed business, with or without the assistance of reinsurance. **4.8(b)**

Captive Insurer (專屬自保保險人) It primarily underwrites its founder's own risks. The founder, or parent company, may be one company, several companies, or an entire industry. (Note: a captive insurer, more strictly defined in the Insurance Ordinance, is subjected to less stringent statutory supervision than an ordinary insurer.) **6.1.1b(d)**

Cash Payment (現金支付) A method of providing an indemnity, or paying the policy benefit. **3.4.4(a)**

Claims (索償／保險金要求) The request by the insured for indemnity or policy benefit under his insurance. Alternatively, claims made by a third party against the insured of a liability policy. The term ‘claims’ is also used to refer to an insured’s act of asking for payments of benefits under his policy. **4.7**

Claims (Denial of) (拒絕賠付) A section within the Code of Conduct for Insurers relates to guidelines to be followed when rejecting insurance claims. Broadly, these guidelines call for a fair and reasonable approach and good communication with the claimant as to the reasons for the denial, etc. **6.1.2c(b)**

Claims Outstanding (未決申索) Put simply, they are claims which, as at a particular date, remain unpaid. The term is defined in much greater detail in the Insurance Ordinance. **6.1.1c(a)(ii)**

Classification of Risk (風險的分類) Categorising risks for a particular purpose. **1.1.2**

Client Account (客戶賬戶) Part of the Minimum Requirements Specified for Insurance Brokers is that they should maintain at least one client account, so that clients’ money is kept separate from the insurance broker’s money and used only for the purposes of the client. **6.2.3a(d)**

Client Servicing (顧客服務) (see **Customer Servicing (客戶服務)**) **4.2**

Code of Conduct for Insurers (《承保商專業守則》) Implemented by The Hong Kong Federation of Insurers in May 1999, this code lays down recommended practices for insurers. The code only applies to insurance for personal policyholders resident in Hong Kong, effected in their private capacity only. **6.1.2**

Code of Practice for the Administration of Insurance Agents (《保險代理管理守則》) Issued by The Hong Kong Federation of Insurers with the approval of the Insurance Authority in accordance with the provisions of the Insurance Ordinance, this has 7 parts (A to G) covering a wide range of expectations and requirements in the subject of administration of insurance agents. **6.2.2**

Collectability (收回應收賬款的能力) Whether or not arranged reinsurance is likely to prove effective (i.e. whether the reinsurers can or will pay their shares of loss). It in fact is not a technical term. **6.1.1e**

Complaints and Disputes (投訴及糾紛) This important topic is given guidelines and recommended practices in the Code of Conduct for Insurers, and includes such matters as the existence of appropriate structures for receiving and dealing with complaints, both internally and externally. **6.1.2e**

Composite (Insurer) (綜合業務 (保險人)) Originally designating an insurer which transacted more than one type of business, the term now is likely to mean an insurer which transacts both types of insurance business as per the Insurance Ordinance (i.e. Long Term Business and General Business). **5.2.1(c)**

Contract (合約) A legally enforceable agreement. **2.1.1**

Counter-Offer (反要約) An offer made by the original offeree to the original offeror, proposing a contract on different terms from those originally offered by the latter (thus legally destroying the original offer). **2.1.3(b)**

Customer Servicing (客戶服務) Also known as **Client Servicing** (顧客服務), this involves all aspects of communication with existing policyholders and potential policyholders, including public relations, complaints handling and correspondence. **4.2**

Deeds (契據) A deed is a written instrument signed, sealed and delivered. **2.1.2(b)**

Deemed (當作) Treated as. **2.2.1**

Defective Contracts (有缺陷的合約) Contracts which, for one reason or another, are void, voidable or unenforceable, as the case may be. **2.1.3**

Duties owed by Agent to Principal (代理人對委託人的責任) Responsibilities deemed to apply, or individually specified, such as obedience to legitimate orders, the exercise of due care and skill, etc. **2.2.4**

Duties owed by Principal to Agent (委託人對代理人的責任) Corresponding responsibilities deemed to apply, or individually mentioned, such as payment of agreed remuneration, etc. **2.2.5**

Electronic Transactions Ordinance (《電子商務條例》) Legislation which from April 2000 (amongst other things) allows electronic information submission when supplying details required by the Insurance Authority. **6.1.1f(c) Note 1**

Emotional (Risk) (情緒上的 (風險)) An uncertainty that leads to grief and sorrow if realised. **1.1.1(c)**

Employees' Compensation Insurance (僱員補償保險) Compulsory insurance in Hong Kong which relates to the statutory liability of an employer to pay specified compensation in respect of an employee's death or injury arising out of and in the course of his employment. **5.1.1(b)**

Endorsement (批單) A document that an insurer issues to add policy provisions to an existing policy. **4.6(d)**

Equal Opportunity (平等機會) A concept that has received particular legislative attention in Hong Kong, with Ordinances passed with a view to eliminating discrimination on various grounds, such as sex, marital status, disability, race, etc. **7.3.1**

Equity (衡平法) That body of rules formulated by the courts to supplement the rules and procedure of the common law. **3.5.1**

Excepted (Excluded) Peril (除外危險) A cause of loss excluded by the terms of the insurance (e.g. suicide under a personal accident insurance), or by statutory provisions. **3.3.2(b)**

Excess (免賠額) A policy provision requiring the insured to bear the first amount, up to the prescribed amount, with each and every claim; in other words, the insurance is only liable 'in excess' of the prescribed amount. **3.4.7(b)**

Executor (遺囑執行人) Person named in a will whom the testator wishes to administer the estate. **3.1.4(b)**

Fair Discrimination in Insurance (保險中的「公平」歧視) Justified differential practices adopted by insurers to meet the realities of situations, e.g. charging men more premium in life insurance than women of the same age, health condition, etc. Thus, this is no breach of the relevant anti-discrimination legislation. **7.3.2**

Fidelity Guarantee (忠誠保證) An insurance guarantee to a person against the dishonesty of another person (perhaps, an employee of the first person). **5.1.1(b)**

Financial Risk (財務上的風險) An uncertainty producing a loss measurable in monetary terms if realised. **1.1.1(a)**

Fit and proper (適當的人選) A common phrase in regulatory instruments, indicating that the individual occupying or wishing to occupy a certain position is suitable and acceptable from a regulatory point of view. **6.1.1d, 6.2.2e, 6.2.3a**

Fitness and Properness of Registered Persons (登記人士的適當人選準則) A range of requirements and limitations concerning the criteria for this subject are contained in Part E of the Code of Practice for the Administration of Insurance Agents. **6.2.2e**

Franchise (起賠額) A rare policy provision whereby the insured is not covered for any loss not exceeding or attaining the specified franchise, but is covered in full if the loss exceeds or attains the franchise, depending on the wording used. It could be related to a time, rather than an amount, so that (for example) no hospitalisation compensation or benefit is payable for less than three days' stay, but compensation for the full period is payable for longer stay. **3.4.7(c)**

Fraud (Insurance) ((保險) 詐騙) Fraud against the insurer is possible in a number of ways. These could involve the insurance intermediary, concerning the arrangement of the insurance or in connection with a claim. **7.6**

Fraudulent Misrepresentation (欺詐性失實陳述) A breach of utmost good faith, arising from the fraudulent provision of false or inaccurate material facts. **3.2.5(a)**

Fraudulent Non-Disclosure (欺詐性不披露) A breach of utmost good faith, arising from a fraudulent omission to provide a material fact. **3.2.5(c)**

Fundamental Risk (基本風險) That type of risk whose causes are outside the control of any one individual or even a group of individual, and whose outcome affects large numbers of people. **1.1.2b(ii)**

General Business (一般業務) One of the two major divisions of insurance classified under the Insurance Ordinance. It consists of a very wide range of different types of insurance, with seventeen classes in the Insurance Ordinance. **5.1.1(b)**

General Insurance (一般保險) Another term for General Business, denoting insurance other than long term insurance. **5.1.1(b)**

Group of Companies (保險公司集團) For the purposes of clause 22(b) of the Code of Practice for the Administration of Insurance Agents, the term means that the relationship between the companies is that of 'subsidiary' and 'holding company' or they are the subsidiaries of another company, with 'subsidiary' and 'holding company' having the meanings attributed to them by Sections 2(4)-(7) of the Companies Ordinance. **6.2.2c(d)(iii)**

Guidelines on Handling of Premiums (《代理人應如何處理客戶保費指引》) The Insurance Agents Registration Board has published this set of guidelines, recommending the method of payment of premiums. **6.2.2h(b)**

Guidelines on Misconduct (《違規行為指引》) Another set of guidelines issued by the Insurance Agents Registration Board, recommending procedures and appropriate actions to avoid potential losses arising from misrepresentation and forgery, etc. **6.2.2h(a)**

Guidelines on the Effective Date of Registration of Insurance Agents, Responsible Officers and Technical Representatives (《保險代理、負責人及業務代表的登記生效日期指引》) These include reference to the fact that holding oneself out to be an insurance agent, Responsible Officer or Technical Representative, before being registered by the Insurance Agents Registration Board is an offence against the Insurance Ordinance or a breach of the Code of Practice for the Administration of Insurance Agents. **6.2.2h(c)**

Hong Kong Confederation of Insurance Brokers (香港保險顧問聯會) One of the two approved bodies of insurance brokers in Hong Kong, whose members are deemed to be authorised insurance brokers. **5.5.2(a)**

Hong Kong Federation of Insurers ('HKFI') (香港保險業聯會(「保聯」)) The central market body, representing majority of the authorised insurers in Hong Kong. A major objective of the HKFI is to promote and advance the interests of insurers and reinsurers transacting business in Hong Kong, and its mission statement further states that the HKFI exists to promote insurance to the people of Hong Kong and build consumer confidence in the insurance industry. **5.5.1**

Indemnity (彌償) An exact financial compensation, restoring the insured to the same financial situation he occupied immediately prior to the loss. A standard understanding of all insurances except life and personal accident (but its application or non-application may be modified by contractual terms). **3.4.1**

Indemnity (How Provided) (如何提供) 彌償) Exact compensation to the insured may be provided by a cash payment, by repair or replacement, or by reinstatement. The non-marine practice is that this will be at the insurer's option. **3.4.4**

Insurable Interest (可保權益) The legal right to insure. The relationship with the subject matter of insurance that gives the right to effect insurance. **3.1.1**

Insurable Risk (可保風險) A threat of loss that meets the necessary criteria for feasible insurance cover. **1.1.1**

Insurance Agent (保險代理人) An agent in an insurance contract, usually representing the insurer and remunerated by commission on the premium paid. **2.2**

Insurance Agents Registration Board ('IARB') (保險代理登記委員會) The body set up by The Hong Kong Federation of Insurers to register insurance agents and to handle complaints against insurance agents pursuant to the Code of Practice for the Administration of Insurance Agents. **6.2.2a(a), 6.2.2b**

Insurance Broker (保險經紀) An insurance intermediary who arranges insurance on behalf of the intended or actual insured. Remunerated by commission (or brokerage) paid by the insurer. **2.2(a)**

Insurance Claims Complaints Bureau (保險索償投訴局) Has a membership of all authorised insurers underwriting personal insurance in Hong Kong. Its primary function is to handle complaints from personal policyholders, in respect of claims affecting personal insurances. **6.1.4**

Insurance Claims Complaints Panel (保險索償投訴委員會) Consisting of an independent Chairman and four members, only two of which are nominated by The Hong Kong Federation of Insurers, the Panel may hear and adjudicate on claim-related complaints from personal policyholders. No fee is involved for the policyholder, win or lose. **6.1.4a**

Insurance Intermediaries (保險中介人) In Hong Kong these consist of insurance agents (usually representing the insurer) and insurance brokers (usually representing the insured). Separate regulatory rules and provisions apply to each group. **2.2(a)**

Insurance Intermediaries' Duties to Policyholders (保險中介人對保單持有人的責任) With this topic, there are common areas for both insurance agents and insurance brokers. In addition there will be separate requirements upon each, the former especially involving the requirements of the agency agreement. **7.1**

Insurance of Legal Rights (合法權利保險) Also called pecuniary insurance, this covers the infringement of rights or the loss of future income, e.g. fidelity guarantee and business interruption insurance. **3.1.4(d)**

Insurance of Liability (責任保險) Insurances where the subject matter is the legal liability of the insured for death, injury or property damage to third parties, e.g. public liability insurance and motor car (third party) insurance. **5.1.3(c)**

Insurance of Pecuniary Interests (經濟權益保險) The insurance of financial interests, not conveniently falling within the traditional categories of property insurance, liability insurance or insurance of the person. Includes fidelity guarantee and business interruption insurance. **5.1.3(d)**

Insurance of Property (財產保險) Insurances where the subject matter is physical property, e.g. motor car (own damage) and fire insurance. **5.1.3(b)**

Insurance of the Person (人身保險) Insurances where the subject matter is the life, limb or health of the person insured e.g. life insurance and personal accident insurance. **5.1.3(a)**

Insurance Ordinance (保險業條例) This is the legislation for regulating the Hong Kong insurance industry. It is formerly known as the Insurance Companies Ordinance (Cap. 41). With the relevant provisions of the Insurance Companies (Amendment) Ordinance 2015 coming into operation on 26 June 2017, the Insurance Companies Ordinance (Cap. 41) was renamed the Insurance Ordinance (Cap. 41). **6.1.1**

Insurance Sales (保險的銷售) The activity of an insurer in connection with marketing, product liaison and general monitoring of the results of product development. **4.4**

Insured Peril (受保危險) A cause of loss insured by the policy. An insured peril must always be involved before a valid claim can arise. **3.3.2(a)**

Insurer (保險人) That party to an insurance contract who carries the risk. Insurers usually are corporations, though individual insurers are also found in the London market. **1.1.2a**

Intention to Create Legal Relation (訂立法律關係的意向) An important element in simple contracts, whereby the parties must have intended the agreement to have legal consequences in the event of breach. **2.1.3(f)**

Invalid (Contract) (無效的 (合約)) An agreement that has no legal effect. **2.1.3**

Inwards Reinsurance (分入再保險) Reinsurance of part or all of another insurer's risks, resulting in reinsurance premium coming 'in'. **5.1.4(b)**

Joint Tortfeasors (共同侵權人) Joint wrongdoers in cases of common action, agency or vicarious liability. **3.6.4(b)(iii)(2)**

Legality (contract) ((合約) 合法性) An essential requirement with contracts, that the proposed agreement is not contrary to any aspect of law; otherwise, the contract is generally unenforceable. **2.1.3(e)**

Life Insurance (人壽保險) The major type of Long Term Business and forming the leading class of insurance, by premium volume, in Hong Kong. **5.1.1(a)**

Long-tail Business (長期責任業務) Classes of insurance where claims under a policy may arise and develop over a long period of time, perhaps a number of years after the expiry of the period of insurance, e.g. most liability insurances. **4.9(b)**

Long Term Business (長期業務) One of the two major divisions of insurance, as per the Insurance Ordinance. The dominant categories within this division concern life insurance contracts. It is 'long-term' because policies are normally not annual contracts, but last for a number of (sometimes many) years. **5.1.1(a)**

Loss Prevention (損失防範) The lowering of the frequency of identified losses. **1.1.3(c)(iii)**

Loss Reduction (損失降低) The lowering of the severity of identified losses. **1.1.3(c)(iii)**

Management of Insurance Agents (保險代理人管理) Forming Part IV of the Code of Conduct for Insurers, this section provides guidance on various relevant issues, including registration, complaints, adequate support, etc. **6.1.2d**

Marine Clause (海上條款) A clause in a fire policy to the effect that any marine insurance covering the same loss should pay for the loss and the fire policy will pay towards any remaining uncompensated loss after the marine policy has responded. **3.5.5(c)**

Market Co-operation (市場合作) Whilst competition is strong among insurers, there is considerable inter-company co-operation, especially seen in the central representative body for insurers, The Hong Kong Federation of Insurers. **5.3(c)**

Marketing and Promotion (市場行銷及促銷) Conscious contact with the public to maintain public relations and promote the company's interests. **4.3**

Material Fact (重要事實) A fact that would influence the judgement of a prudent underwriter as to the acceptance of a risk or the premium on which it is to be accepted. **3.2.3**

Minimum Requirements Specified for Insurance Brokers (保險經紀的最低限度規定) Minimum Requirements are specified under Part X of the Insurance Ordinance for compliance by persons applying to become authorised insurance brokers and by existing authorised insurance brokers. In addition to the requirements that insurance brokers be fit and proper and the approved bodies of insurance brokers must have rules and regulations to ensure that its members are fit and proper, the Insurance Authority has stipulated five requirements, including qualifications and experience, capital, net assets, etc. **6.2.3**

Model Agency Agreement (標準代理合約) A principal must appoint an insurance agent under a written agency agreement, which must at least meet the minimum requirements of The Hong Kong Federation of Insurers' model agency agreement, as outlined in Part F of the Code of Practice for the Administration of Insurance Agents. **6.2.2f**

Money Laundering (洗錢) A matter of international concern, where illegally obtained money is 'processed' through various methods in order to 'cleanse' it. One method adopted was by the use of insurance contracts, and in addition to legislation covering the issue, the Insurance Authority has given specific guidelines to help combat this illegal practice. **7.4.1**

More Specifically Insured (更具體地受保) A provision which is effectively a non-contribution clause, so that any insured item (e.g. under a household contents insurance) which has a more specific insurance (e.g. an 'all risks' policy covering that item alone) is excluded from the less specific insurance. **3.5.5(b)**

Motor Insurers' Bureau of Hong Kong ('MIB') (香港汽車保險局) An industry organisation of which all authorised motor insurers in Hong Kong must be members. Funded by a levy on motor insurance premiums, it exists to implement the intentions of compulsory motor insurance, by compensating eligible victims for death or injury claims required to be covered by compulsory motor insurance, but where for some reason the insurance does not exist or is defective. **5.5.3(b)**

'New for Old' Cover (「以新代舊」的保險保障) Claims settlements are not subject to deduction for wear and tear, depreciation, etc. An expression found mostly with personal lines property insurance, with some items (e.g. clothing) not subject to this provision. **3.4.8(b)**

Non-Contribution Clause (免分擔條款) A provision in an indemnity policy to avoid contributing to a claim settlement in the event of a double insurance. **3.5.4(b)**

Non-fraudulent Misrepresentation (非欺詐性失實陳述) A breach of utmost good faith, arising when one party innocently or negligently gives to another party an inaccurate or untrue representation of a material fact. **3.2.5(b)**

Non-fraudulent Non-Disclosure (非欺詐性不披露) A breach of utmost good faith, arising when one party innocently or negligently fails to give to another party material facts. **3.2.5(d)**

Obligee (權利人) There are three parties to a suretyship: the surety, the principal and the obligee. It is the obligee in whose favour the suretyship is issued. That is to say, when there is failure on the part of the principal to fulfil an obligation to the obligee, the surety will pay the obligee. **2.1.2(b)**

Offer (contract) ((合約)要約) An essential element in a simple contract, constituting the proposed terms of the intended contract. **2.1.3(a)**

Offeree (受要約人) The person to whom a contract offer is made. **2.1.3(b)**

Offeror (要約人) The person making a contract offer. **2.1.3(a)**

Ordinary Good Faith (一般誠信) The common law duty not to lie or deliberately mislead the other party in a contract. However, this duty does not require the disclosure of all facts known, but only in response to specific questions. **3.2.1**

Outwards Reinsurance (分出再保險) Reinsurance of insurer's own business with a reinsurer, thus resulting in reinsurance premium having to be paid 'out'. **5.1.4(a)**

Paid-up Capital (實繳股本／繳足款股本) Shares for which no amount remains 'on call' (i.e. all the money due for them has actually been paid to the company). **6.1.1a&b, 6.2.3d(b)**

Participating Policy (分紅保單) Every year a life insurer will determine the amount of its divisible surplus, if any. Dividends will be paid out of the divisible surplus to holders of its participating policies. **4.7(a)(v)**

Particular Risk (特定風險) A risk where the consequences are potentially of *limited* application, i.e. affecting *relatively* few people or a relatively small area (although the consequences for those concerned may be fatal or very serious). **1.1.2b(i)**

Performance Bond (履約保證) A guarantee that a construction contract will be carried out. **5.1.1(b)**

Peril (危險) The cause of a loss. This is important in connection with the application of proximate cause. **1.1.1Note 2, 3.3.2**

Personal Data Protection (保護個人資料) A subject of international importance, with the advances in computer technology. The specific legislation dealing with the issue in Hong Kong, which includes any applications in insurance, is the Personal Data (Privacy) Ordinance. **7.2**

Physical (Risk) (身體上的 (風險)) An uncertainty resulting in death or injury if realised. **1.1.1(b)**

Policy (保單) A written/printed instrument most often issued to an insured as an evidence of the insurance contract. **2.1.1**

Policy Condition (保單條件) Policies often contain a collection of provisions which provide a framework for the policy explaining some of the relationships, rights and duties of the insured and the insurer. Such provisions are termed ‘Policy Conditions’. **3.5.5**

Policy Limits (保單限額) Policy provisions which determine the maximum amount of insurance recovery, e.g. sum insured. **3.4.7(d)**

Powers of Intervention (干預權) The statutory ‘teeth’ given to the regulatory authorities to take action in appropriate circumstances. The options available range from various restrictions and limitations to liquidation of the insurer concerned. **6.1.1g**

Practical Classification of Insurance (保險的業務分類) The categorisation of insurance business best suited to the internal organisation of the insurer (perhaps, for example, using the source of business as the category: direct, broker produced and agent produced). **5.1.2**

Premium (保費) The consideration payable by the insured for an insurance. **4.6(d)**

Primary Functions of Insurance (保險的主要功能) The direct objectives and intentions of insurance, e.g. transferring risk and compensating losses. **1.2(a)**

Principal (委託人) The person for whom an agent acts. **2.2(a)**

Product Development (產品的開發) The invention and introduction of new forms of cover, either as an individual product or as a portfolio development (package of cover). **4.1**

Product Research (產品的研究) Monitoring and developing existing and new products to keep in line with trends and market competition. **4.1(c)**

Professional Indemnity Insurance (專業彌償保險) A liability insurance covering professional people (doctors, lawyers, insurance brokers, etc.) for legal liability in respect of injury, loss or damage caused through their negligence. **6.2.3d(c)**

Professional Insurance Brokers Association (香港專業保險經紀協會) One of the two approved bodies of insurance brokers in Hong Kong, whose members are deemed to be authorised insurance brokers. **5.5.2(b)**

Professional Negligence (專業疏忽) A failure of the expected degree of professional competence, resulting in death, injury or loss to a third party. Resulting claims may be covered by various forms of professional indemnity insurance. **7.1.1(d)**

Professional Reinsurer (專業再保險人) An insurer that only transacts reinsurance business. **5.1.4**

Proposal Form (or **Application Form**) (投保書) A standard form on which a proposer of insurance is required to supply the insurer with material information. **2.1.3(a)**

Proposer (投保人) A prospective insured who completes a proposal form when seeking insurance; may also be known as an applicant. **2.2(a)**

Proximate Cause (近因) The dominant or effective reason for a loss, which must be ascertained to determine whether that loss constitutes a valid claim under an insurance contract or not. **3.3**

'Pure' General Business (「純」一般業務) When an authorised insurer in Hong Kong is described as doing **'Pure' General Business**, that means it transacts only general (not long term) business. **5.2.1(b)**

'Pure' Long Term Business (「純」長期業務) When an authorised insurer in Hong Kong is described as doing **'Pure' Long Term Business**, that means it transacts only long term (not general) business. **5.2.1(a)**

Pure Risk (純風險) An uncertainty that can only result in either a loss or no change. **1.1.2a(i)**

Quantum (數額) The amount of loss, or the amount recoverable from the insurer. **4.7(c)(ii)**

Rateable Share (比率份額) The proportion of a loss to be paid by the respective insurers in a contribution situation, i.e. where more than one insurer is involved with providing indemnity to the same insured. **3.5.5(a)**

Ratification (追認) A retrospective act of adopting a contract or a transaction by someone who was not bound by it originally because it was entered into on his behalf but without his authority. **2.2.2(b)**

Register of Insurance Agents (保險代理登記冊) A register to be maintained by the Insurance Agents Registration Board, as prescribed by the Insurance Authority and available for public inspection at The Hong Kong Federation of Insurers' office or website. **6.2.2d(a)**

Registered Person (登記人士) A person who has been registered under the Code of Practice for the Administration of Insurance Agents as either an Individual Agent; an Insurance Agency, a Responsible Officer of an Insurance Agency; or a Technical Representative of an Individual Agent or Insurance Agency. **6.2.2a(a)**

Regulation of Insurance Intermediaries (保險中介人的規管) Under the current self-regulatory regime, insurance intermediaries are required to be registered with and be regulated by one of the three self-regulatory organisations ('SROs'), namely the Insurance Agents Registration Board (IARB), the Hong Kong Confederation of Insurance Brokers (CIB) and the Professional Insurance Brokers Association (PIBA). The new Insurance Authority established under the Insurance Companies (Amendment) Ordinance 2015 will eventually take over the regulation of insurance intermediaries from the SROs through a statutory licensing regime in the next stage. **6.2**

Reinstatement (Property insurance) (恢復原狀 (財產保險)) As a method of providing an indemnity, it means the restoration of the insured property to the condition it was in immediately before its destruction or damage. **3.4.4(d)**

Reinstatement Insurance (重置保險) Property insurance where the settlement basis for claims is effectively 'new for old' (i.e. no deduction for depreciation, etc.) if the damage is reinstated (or made good). **3.4.8(a)**

Reinsurance (再保險) An insurance used to transfer all or part of the risk assumed by an insurer under one or more insurance contracts to another insurer. **4.8**

Renewal (續保) The continuation of an insurance contract for a further period (legally constituting a new contract). **4.5(b)**

Replacement (更換) A method of providing an indemnity, by the insurer providing a substitute item for the one lost/damaged. **3.4.4(c)**

Reporting Requirements (呈報規定) Under the Insurance Ordinance, every insurer has to submit annually to the Insurance Authority its financial statements in prescribed form. There are additional separate requirements for insurers transacting general and long term business respectively. **6.1.1f(c)**

Reserve (儲備金) An amount subtracted from a firm's retained earnings for a general or specific purpose. (A firm's 'retained earnings' represent its cumulative net income since it was established, less the total dividends (or drawings, in the case of unincorporated businesses) that have been paid to owners over its entire life.) **4.9(b)**

Responsible Officer (負責人) More fully defined in the Code of Practice for the Administration of Insurance Agents, such a person is responsible for the conduct of an insurance agency business. **6.2.2a(a)**

Revocation (撤銷協議) The cancellation of an agency agreement by either party (which must be subject to legal and specific contractual terms). **2.2.6(b)**

Risk (風險) Uncertainty concerning a potential loss. **1.1**

Risk Avoidance (風險避免) Elimination of the chance of loss of a certain kind by not exposing oneself to the peril. **1.1.3(c)(iii)**

Risk Financing (風險融資) No matter how effective the loss control measures an organisation takes, there will remain some risk of the organisation being adversely affected by future loss occurrences. A risk financing programme is to minimise the impact of such losses on the organisation. It uses tools like: risk assumption, risk transfer other than insurance, self-insurance, insurance, etc. **1.1.3(c)(iii)**

Risk Management (as used by insurers) (風險管理 (保險人所運用的)) Ways and means of improving the insured loss potential of risks that are insured. **1.1.3**

Risk Management (not as used by insurers) (風險管理 (不屬於保險人所運用的)) In banking and other financial service areas, the reference is to the control of speculative risks. As a separate field of knowledge and discipline, it refers to the identification, quantification and methods of dealing with all types of risk, pure and speculative. **1.1.3**

Risk Transfer (風險轉移) Finding another party to promise in advance to bear the consequences of one's exposure to risk. **1.1.3(c)**

Salvage (in maritime law and marine insurance): This term is used to mean (a) (救助賞金) a reward payable to a person (salvor) who has successfully rescued ships or other maritime property from perils of the sea, pirates or enemies by the property owners, or (b) (救助) such a rescue. **3.4.5 Note**

Salvage (in non-marine insurance) (損餘): what is left of the subject matter of insurance, following damage, e.g. the wreck of a car, which may still have some scrap value. **3.4.5**

Section Limit (部分限額) A policy provision limiting the amount payable under a particular section of the policy. **3.4.7(d)(ii)**

Short-tail Business (短期責任業務) Classes of insurance where claims arise and are notified in a relatively short time-scale, e.g. fire insurance and motor (own damage) insurance. **4.9(b) Note**

Simple Contract (簡單合約) It is a contract created verbally, or by writing not under seal. It can also be inferred from conduct. **2.1.2(a)**

Single Article Limit (單一物件限額) A property policy provision stipulating that the policy liability in respect of any one article should not exceed a specified sum called the 'single article limit', unless separately subject to its own sum insured. **3.4.7(d)(i)**

Solvency Margin (償付準備金) The extent to which assets exceed liability. Insurers in Hong Kong must have a solvency margin which does not fall below the 'relevant amount' (minimum required sum) at all times. **6.1.1a(b)**

Speculative Risk (投機風險) A risk which offers the possibilities of gain and loss. **1.1.2a(ii)**

Statutory Classification of Insurance (法定的分類) The categorisation of insurance classes in accordance with statute (the Insurance Ordinance), which broadly divides insurance into Long Term Business and General Business. **5.1.1**

Stop-Lists (拒絕名單) Risks identified by the insurer as being of a type or class not to be offered insurance cover (e.g. comprehensive motor insurance to young drivers of high-powered motor cars). **4.5(e)**

Subject Matter of Insurance (保險標的) Where the **Subject Matter of Insurance** is lost, damaged, injured, or the like, the insurance policy will pay the insured according to the extent to which his interest in it will have been affected. It can be property, the person, potential liability or legal right. **5.1.3**

Subrogation (代位) The common law principle allowing an insurer to acquire and exercise for his own benefit any recovery rights the insured may possess against third parties in respect of the loss for which the insurer has indemnified the insured. **3.6**

Subrogation - How Arising (代位 (如何產生)) Subrogation may arise in tort, under contract, under statute or in salvage. **3.6.2**

Subrogation - Rights Limited (代位 (權利的限制)) The insurer may not retain under subrogation more than he paid as an indemnity. **3.6.4(b)(i)**

Sum Insured (保額) The limit of the insurer's liability under the policy. **3.4.7(d)**

Suretyship (擔保) A suretyship contract is one whereby the surety is obliged to pay the obligee in the event of the principal's failure to fulfil an obligation to the obligee. It is the principal who pays the contract price. **2.1.2(b), 5.1.1(b)**

Target Risks (目標風險)

- 1 General insurance: the term may be used to refer to large, hazardous risks. **4.5(d)**
- 2 Life insurance: risks that are especially attractive to the insurer (e.g. healthy school teachers) and therefore actively sought by insurance agents. **4.5(d)**

Technical Representative (Insurance Agent's) ((保險代理人的) 業務代表)
More fully defined in the Code of Practice for the Administration of Insurance Agents, such a person (not being an insurance subagent) provides advice to actual or potential policyholders on insurance matters for an insurance agent, or arranges contracts of insurance in or from Hong Kong on behalf of that insurance agent. **6.2.2a(a)**

Technical Representative (Insurance Broker's) ((保險經紀的) 業務代表)
More fully defined in the Minimum Requirements Specified for Insurance Brokers, such a person provides advice to actual or potential policyholders on insurance matters for an insurance broker, or negotiates or arranges contracts of insurance in or from Hong Kong on behalf of an insurance broker for actual or potential policyholders. **5.2.2**

Termination of Agency (終止代理關係) An agency relationship may be brought to an end on various grounds, including mutual consent. **2.2.6**

Third Party (第三者) A person, not being the insured or the insurer, who might be involved in a claim as a claimant against the insured or a potential source of subrogation. **2.2.1**

Tontine (聯合養老保險) An unusual type of Long Term Business, where the policy benefit is payable to the last survivor of a specified insured group of persons. **5.1.1(a)**

Tort (侵權) The law of tort is notoriously difficult to define. In simple words, it is a kind of civil wrong (especially negligence) giving rise to a possible claim against the wrongdoer. It is the most important source of subrogation rights of insurers. **3.2.6(b), 3.6.2(a)**

Training and Development (培訓及發展) An important area of company activity, both with inside and field staff. Especially important with insurance agents, whom the insurer is under a duty to train. **4.11**

Transparency (透明度) An important word in regulatory matters, indicating that information should be freely available and the public should be able to understand procedures and implications. Specifically, for example, from June 2000 the Insurance Authority is allowed to disclose financial and statistical information of individual insurers and Lloyd's if they deem it to be in the interests of policyholders or the public. **6.1.1f(d)**

Trustee (受託人) A person who is holding property on trust for another. **3.1.4(b)**

Underwriting (核保) The process of determining the insurability of a risk and the terms to be applied. **4.5**

Unenforceable Contract (不能強制執行的合約) A contract which cannot be enforced (or sued on) in a court of law. **2.1.3**

Unfair Discrimination in Insurance (保險中的不公平歧視) This relates to the application of different terms which are not justified by the technical merits of the risk, e.g. charging higher premiums for women drivers in motor insurance. **7.3.3**

Uninsured Peril (不保危險) A cause of loss which is not specifically excluded from policy cover, but it is not specifically included either, e.g. raining under a standard fire policy. Damage from an uninsured peril may be recoverable, if proximately caused by an insured peril, e.g. water damage caused in fighting a fire. **3.3.2(c)**

Unit-linked Business (or Linked Business) (單位相連業務 (或相連業務))
The policyowner's contributions (after deductions for expenses and premiums) are used to buy 'units' in an investment fund, so that the value of the product is linked to the value of the units. **5.1.1(a)**

Utmost Good Faith (最高誠信) The common law duty upon both parties in an insurance contract to reveal all material information to the other party, whether or not such information has been specifically requested. **3.2**

Valued Policy (定值保單) A valued policy – a policy effected on a valued basis – is commonly issued in marine insurance. A sum called 'agreed value' is specified in the policy, which will be taken as the value of the subject matter insured throughout the currency of the policy. **3.4.8(c)**

Vicarious Liability (轉承責任) A person's liability at law for the acts and omissions of another, e.g. the principal, in respect of his agent's actions. **2.2(c)**

Void Contract (無效的合約) An agreement devoid of any legal effect. **2.1.3**

Voidable Contract (可使無效的合約) Although it has full legal effect, a voidable contract may be declared void as from inception, at the option of the aggrieved party. A temporary situation demanding selection by that party within a reasonable time, failing which the contract will become valid. **2.1.3**

Waive (a breach) (不追究 (違反)) Effectively an 'act of forgiveness', where a breach of policy condition or other contractual requirement is disregarded – actively or passively - by the aggrieved party, so that the contract remains unaffected by the breach. **3.2.2 Note 2, 3.2.6(c)**

Warrant (保證) To make a formal declaration as to the truth and accuracy of information supplied. **3.2.2 Note 1**

Warranty (保證) An absolute undertaking by the insured to do, or to refrain from doing, some specified thing(s), or an absolute affirmation as to the truth and completeness of information supplied. **3.2.2 Note 1, 6.1.2c(b)(iii)**

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Representative Examination Questions

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5	(d)	(c)	(b)	(c)
6	(a)	(b)	(d)	(d)
7	(c)	(d)	(d)	(c)

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