保險業監管局
Insurance Authority

CONDUCT IN FOCUS

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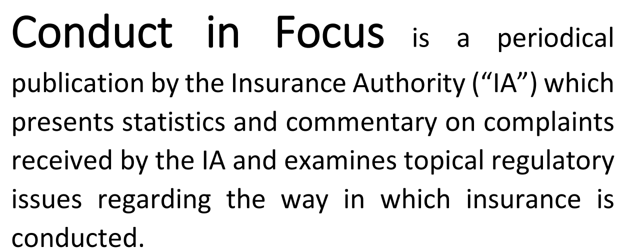

Conduct in Focus is a periodical publication by the Insurance Authority ("IA") which presents statistics and commentary on complaints received by the IA and examines topical regulatory issues regarding the way in which insurance is conducted.

In this edition we present the complaints statistics for the first half of 2022. We look at how the practice of self-reporting material matters to the IA should form an integral part of the corporate governance of every authorized insurer, licensed insurance broker company and licensed insurance agency. In Policyholder Corner, we look at the risks and considerations which policyholders should take into account when looking to purchase insurance with "premium financing".

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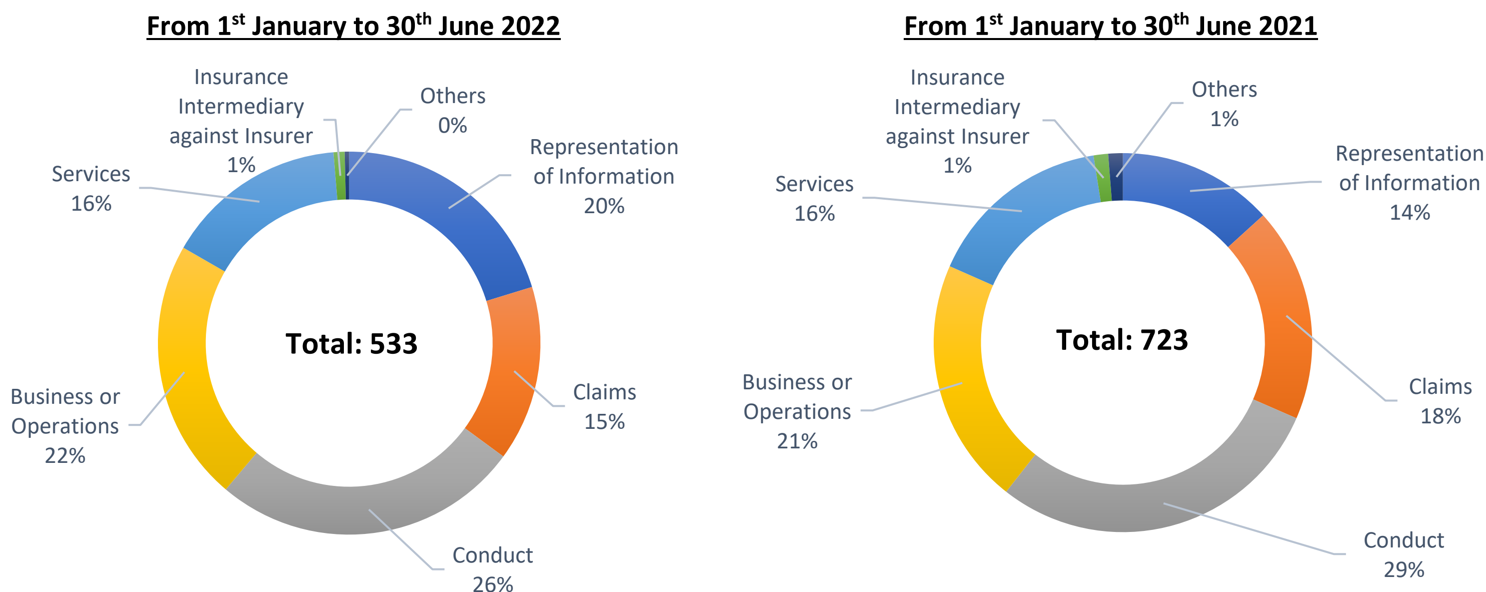
Complaint Statistics



The IA received **533[1] complaints during the period from 1st January to 30th June 2022**, a reduction of 26% as compared to the same period last year. In terms of category, the most significant number of complaints were received in the category of "conduct".

Explanation of Complaint categories

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

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

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

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

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

[1] The IA also received 24 self-reported cases from insurers / intermediary firms during the reporting period (versus 15 in the last year), which are excluded from the above complaints statistics.

Practice

Self-reporting Material Matters:

An integral part of any robust corporate governance framework

Self-reporting of material breaches and incidents to the Insurance Authority ("IA"), should be a core part of the corporate governance and control framework of every authorized insurer, licensed insurance broker company or licensed insurance agency (collectively "regulated entities"). Along with the periodic inspections carried out by the IA and the communications that take place through the day-to-day supervisory process, self-reporting on material matters forms an important part of the regular engagement between the IA and the regulated entities which are subject to its supervision, ensuring that problems are being identified, addressed and rectified in a timely manner and policyholder interests are being upheld.

The Benefits of Self-Reporting

Self-reporting material breaches and incidents to the IA (and other relevant regulatory bodies), brings with it the following potential benefits:

- Self-reporting demonstrates that the detection controls which are part of the regulated entity's governance have operated effectively to detect the problem being self-reported;
- Self-reporting a matter to the IA, serves as an opportunity to relate to the IA the remediation steps which have been taken to fix the problem;
- The discipline of self-reporting promotes early detection and isolation of the problem, by enabling steps to be taken to limit the spread of the problem (through, for example, mechanisms such as audit calls);
- A regulated entity can also, through self-reporting, show how it has identified the root cause of the problem and made improvements to address that root cause.
- By these means, through self-reporting matters to the IA, a regulated entity can give confidence to the IA that its corporate governance and controls are working as they should do.

By contrast, the absence of self-reporting could have a significantly detrimental effect on a regulated entity. For example, a reluctance to self-report a material breach of the insurance regulatory framework (i.e. the Insurance Ordinance, or the rules, regulations, codes and guidelines administrated or issued by the IA) in order to seek to avoid disciplinary action being taken, will result in more severe disciplinary action being taken when the matter is eventually discovered. Indeed, if a regulated entity has covered up a breach, this itself would serve as a breach meriting severe disciplinary action being taken (where none might even have been contemplated had the original matter been self-reported). Further, depending on the circumstances, a repeated failure to self-report incidents may raise systemic questions about the adequacy of entity's entire governance and control system, prompting the IA to have to carry out an immediate inspection or investigation. After all, if the regulated entity has sought to hide one particular breach, it begs the obvious question as to what other breaches it may have hidden or turned a blind eye to.

If, however, a breach is self-reported this would at the very least serve as a mitigating factor capable of reducing the level of disciplinary sanction to be applied (or indeed it may avoid disciplinary sanction altogether). Indeed, self-reporting may serve as a means of demonstrating to the IA that the breach occurred, not because of any weakness in the entity's governance and control system, but in spite of having adequate and reasonable governance and controls in place, which served to detect the problem and resulted in its remediation. A key person in control function who is able to demonstrate this, would certainly have discharged his or her duties!

For these reasons, from the regulatory perspective, regulated entities which have in place robust self-reporting mechanisms and which engage transparently with the IA when problems arise, tend to be viewed as being better run than those which do not. Hence, self-reporting should be taken seriously and considered as an integral part to any robust corporate governance and control system.

What type of incidents should regulated entities self-report to the Insurance Authority?

Licensed Insurance Broker Companies and Licensed Insurance Agencies

The Code of Conduct for Licensed Insurance Brokers and the Code of Conduct for Licensed Insurance Agents ("the Codes") set out in their respective Part IX, requirements for the matters which broker companies and agencies should self-report to the IA. Essentially, these consist of two types of matters.

Firstly, there is a prescribed list of incidents which must be reported to the IA when they occur to the broker company or agency. These are: (i) the filing of a petition to wind-up the entity; (ii) the bankruptcy of any directors, controllers, partners or licensed technical representatives of the entity; (iii) a disciplinary action taken against the entity or its technical representatives by the Hong Kong Monetary Authority, the Securities and Futures Commission or the Mandatory Provident Fund Schemes Authority; or (iv) any criminal conviction (other than a minor offence) of the entity or its directors, controllers, partners or technical representatives by any court in Hong Kong or elsewhere.

Secondly, broker companies and agencies are required to self-report to the IA, "material" breaches of the insurance regulatory framework, or "material" incidents.

A breach or an incident is considered material if:

Licensed insurance broker companies and licensed insurance agencies are therefore required to establish a process for assessing whether a breach or an incident is material in line with the above factors and should self-report such material breaches or incidents to the IA. Indeed, the Codes encourage broker companies or agencies, if they are in any doubt as to whether a breach or incident is material, to err on the side of caution and to report it to the IA. As outlined above, there are significant benefits to doing this in terms of the confidence it may give the IA in the broker company's or agency's corporate governance system in detecting and remediating such issues, or in terms of mitigating either the prospect, or extent of any disciplinary action.

In its enforcement approach against intermediaries, when considering whether to address a breach by way of disciplinary action or by other means (such as a letter of concern), the IA has already been taking into account whether or not the matter was self-reported. Self-reporting is, therefore, generally encouraged.

Authorized insurers

As regards the self-reporting obligations for authorized insurers, the IA's general expectation is as follows:

Firstly, an authorized insurer should have in place systems and procedures to **capture and record any breaches** of requirements under the insurance regulatory framework, by the insurer or its licensed individual insurance agents or licensed insurance agencies. An authorized insurer should make this record available for inspection by the IA when requested (for example, as part of a formal inspection or as part of a periodic supervisory request).

Secondly, an authorized insurer needs to self-report **material breaches and incidents** to the IA when they are discovered. A "material" breach or incident is one which (i) adversely impacts the insurer's ability to carry on business; (ii) indicates systemic deficiency in the insurer's governance, controls and procedures; (iii) potentially causes undue loss or prejudice to policy holders; (iv) causes reputational risk or significant financial consequences to the insurer; or (v) adversely impacts the fitness and properness of its controllers or key persons, or any of its licensed individual insurance agents or licensed insurance agencies.

For these purposes, therefore, an authorized insurer is expected to have in place:

- Processes for identifying breaches of the insurance regulatory framework by the insurer or by any of its appointed licensed insurance agents or agencies;

- A process for assessing whether such breaches (or other incidents) are "material" in line with pre-set materiality criteria;

- A process for capturing non-material breaches in, say a dashboard or spreadsheet format for inspection by the IA upon request; and

- A process for investigating and reporting to the IA on "material" breaches.

When should such matters be self-reported to the IA?

In terms of timing, material breaches or incidents should be reported to the IA as soon as reasonably practicable. In this regard, the following should be borne in mind:

- Generally, material breaches or incidents should be self-reported to the IA as soon as the regulated entity is in a position to inform the IA what the material breach or incident is, how it occurred, the potential adverse impact and the steps being taken to remediate.
- The obligation to self-report is not intended, however, to interrupt or divert resources away from the regulated entity in addressing or remediating the matter.
- If the internal investigation of the matter by the regulated entity is going to take significant time to carry out, the matter should be self-reported to the IA well in advance of its completion, setting out the main facts discovered, steps taken up to the time of the self-report and indicating the way forward. This may be followed by updating reports as the investigation progresses through to completion (addressing any questions the IA has arising from the initial self-reports provided).
- The more severe or widespread the matter (for example, in terms of number of policy holders potentially adversely impacted) the earlier and more immediately it should be self-reported to the IA.
- It would be more beneficial (for example, to the regulated entity) to self-report the matter to the IA before the IA learns of the matter through another source.

Template for self-reports

The IA does not prescribe a template which must be used to make self-reports. However, to ensure consistency and to provide an indication of the level of detail expected in a self-report, the IA encourages regulated entities to use for the purpose of self-reporting, the same template of report used when reporting on complaint matters. We referred to this template in our previous edition of Conduct in Focus (4th edition dated March 2022).

If you require a copy of this template, or if you have any questions about self-reporting generally, please contact us via complaints@ia.org.hk.

Enforcement Update

The disciplinary actions taken by the IA underpin the insurance regulatory framework with the credible threat of fair and proportionate enforcement. Some of our recent disciplinary actions include:

- Prohibiting a former technical representative (broker) from applying for a licence for 5 months, for not paying client monies into client account, paying the monies as premium to an insurer for the wrong policy and then, when trying to rectify the matter, getting his client to say that it was the client (rather than the technical representative) who had made the mistaken payment.

- Reprimanding an agent for distributing by e-mail "self-made" marketing materials that included certain inaccurate and misleading statements, including representations regarding the return that could be obtained by purchasing a particular insurance policy using premium financing and not specifying the risks involved, and using confusing language which might suggest that the product was a banking product rather than an insurance policy. The material was distributed to a limited number of persons.

- Prohibiting a former technical representative (broker) from applying for a licence for the duration that he had been suspended by the Mandatory Provident Fund Schemes Authority (40 months) for making transfers without a scheme member's authorization, misusing the scheme member's personal information, forging the member's signature on certain forms, and impersonating the scheme member in calling a Mandatory Provident Fund trustee to obtain account information.

For the latest news on our enforcement work, please check our website.

Continuing Professional Development ("CPD") related enforcement

In addition, the IA has taken disciplinary action against 91 individual insurance intermediaries for their non-compliance with the CPD requirements during the 2018/19 assessment period[2] and is currently dealing with a voluminous number CPD non-compliance and/ or late reporting cases for the 2019/21 combined assessment period, with a view to taking disciplinary action in line with the IA's new CPD penalty framework (which came into effect last year).

In dealing with these CPD non-compliance cases, we have discovered that some individual insurance intermediaries have resigned or left the industry some time ago, but their appointing principals failed to notify the IA. Principals are reminded of their obligation to notify the IA of the termination of appointment of their licensed insurance individual agents, technical representative (agents) or technical representatives (brokers) (as the case may be) under section 64R of the Insurance Ordinance. Failure to so notify amounts to an offence liable to a fine at level 5[3].

With the new CPD assessment period commencing on 1 August 2022 (and running from 1 August 2022 to 31 July 2023) individual licensees are reminded of their obligation to complete CPD hours. CPD requirements are the hallmark of all professions and it is incumbent on members of the profession to comply with these requirements so as to provide members of the public with confidence that the advice and services they receive will be based on up to date knowledge. Failure to comply will result in disciplinary action.

[2] https://www.ia.org.hk/en/legislative_framework/circulars/reg_matters/files/20220110CircularCPDbreachEngUpload.pdf

[3] A fine at level 5 amounts to HK$50,000 under Schedule 8 of the Criminal Procedure Ordinance (Cap. 221)

Policyholder Corner

In Policyholder Corner, the Insurance Authority ("IA") provides practical guidance to the public on buying insurance or dealing with insurance matters based on lessons learned from the complaints it receives.

The complexities and risks of premium financing

In this edition of Policyholder Corner we look at the risk and complexities involved with premium financing and the considerations a policyholder should take into account before purchasing an insurance policy using premium financing.

What is "premium financing"?

"Premium financing" refers to an arrangement whereby a policyholder borrows funds from a lender (say, a bank) to pay the premiums under a life insurance policy which the policyholder is purchasing. As collateral for the loan, the policyholder assigns all or part of his/her rights under the insurance policy to the lender.

The attraction of premium financing stems from the ability (when borrowing rates are low) to borrow funds at low interest, and to use those funds to pay premium into a life insurance policy, with the objective that the return under the policy (i.e. the increase in value of the policy benefits under the insurance policy) will exceed the cost of the loan (i.e. loan interest and handling fee (if any)), resulting in financial gain for the policyholder.

Essentially, therefore, premium financing involves leveraging to maximize investment returns. As is the case with most leveraging arrangements, however, premium financing comes with potential significant downside (as well as upside) risks which policyholders should be fully aware of before considering entering into such arrangement.

Premium financing – the risks you need to know about

The main considerations and risks associated with premium financing which policyholders need to be aware of and consider are summarized as follows:

1. The risks associated with the lender's rights under a premium financing arrangement

A policyholder should understand that by assigning rights under the insurance policy being purchased to the lender, as collateral for the loan, it is the lender who will be able exercise those rights (whilst the loan remains outstanding) rather than the policyholder. Indeed, if the policyholder wishes to exercise any of the rights assigned, he or she may need the lender's prior consent. The policy rights affected could include:

- The right to receive benefits under the insurance policy (including surrender value, death benefit, etc.) which are payable by the insurer;
- The right to cancel the insurance policy within the cooling off period, surrender the policy, or make withdrawals;
- The right to apply for a policy loan under the insurance policy, or exercise any options under the policy, or to make certain changes or amendments to the policy (e.g. appointment of new beneficiary, further pledge or assign the policy).

Similarly the loan agreement may give the lender certain rights to change or terminate the arrangement. For example, the loan agreement may be subject to review by the lender with the lender having the right to restructure or terminate the loan at any time. The lender may have the right to request the policyholder to provide additional collateral, or to partially or fully repay the outstanding loan under particular circumstances stated in the loan agreement. If the policyholder fails to meet the request, the lender may restructure or terminate the loan agreement or exercise its rights under the insurance policy by, for example, surrendering the policy.

The rights assigned under the insurance policy to the lender as collateral and the rights given to the lender in the loan agreement, are designed to protect the lender if the policyholder is unable to meet any of the scheduled loan or interest payments under the loan agreement. Any late payment under the loan agreement (including interest payment or principal repayment), therefore, may trigger the lender to demand the repayment of the loan immediately or enforce the collateral, by exercising the rights assigned to it under the insurance policy to recover the defaulted payment from the benefits in the policy. The consequences of this for the policyholder could be as follows:

- **Significant financial loss**

  The policyholder may suffer significant financial loss, particularly if the lender surrenders or terminates the policy after only a few years (when the benefits under the policy have not had time to grow or if the early termination triggers an early repayment penalty to be imposed under the loan agreement).

- **Loss of insurance coverage**

  The policyholder may suffer loss of insurance coverage and not be able to obtain the same insurance coverage easily from another insurer, if for example the policyholder's health condition has changed since the insurance policy being surrendered was initially purchased.

- **Liability for the shortfall in recovery by the lender**

  The policyholder will remain liable for any shortfall between the amount of the proceeds of the insurance policy recovered by the lender and the outstanding amount of the loan agreement.

- **Risk of set-off**

  The lender may set-off any obligation under the loan agreement owed by the policyholder to the lender against any obligation owed by the lender to the policyholder (including credit balances in any account the policyholder maintains with the lender).

- **Consequential risks**

  If the insurance policy was used to satisfy a condition of other arrangements made by the policyholder (for example, the policy was required to support arrangements made as part of the policyholder's business), the surrender or termination of the policy could trigger further events of default in these arrangements with adverse consequences to the policyholder.

2. Financial risks

As stated, premium financing relies on a strategy of borrowing at low interest, to buy an insurance policy with benefits that will increase to a value higher than the loan amount plus the loan interest. The assumptions underpinning this strategy, however, are not static and the policyholder considering premium financing should factor in these risks. In particular:

- **Changes in interest rates**

  Your interest rate at start of the loan may be low. But what if you have not borrowed at a fixed interest rate, and interest rates subsequently rise (as we are seeing now)? Or if the lender has a discretion in the loan agreement to increase the interest rate from time to time and exercises this discretion? Could you really continue to afford such increased loan repayments along with all your other financial commitments? And don't forget: with the increased loan repayments, the difference between what you need to repay and the value of the benefits under your insurance policy may significantly reduce.

- **Non-guaranteed benefits under your insurance are exactly that - non-guaranteed**

  In any premium financing arrangement, the policyholder is intending that his cost of borrowing (the interest on the loan taken out) is going to be exceeded by the values of the benefits under the insurance policy being purchased. It is important to realize, however, that the benefits under your insurance policy may be "non-guaranteed" i.e. the growth in the value of the benefit (as shown in the benefit illustration) may not be guaranteed and may depend on a number of factors, for example, the investment performance, claim

experience and operational expenses of the insurance company. If these factors do not turn out as originally expected (for example, if your expected investment return is not achieved), your non-guaranteed benefits may be lower than those illustrated to you at the time of your purchase, and may be substantially lower than the interest due on your loan. In certain circumstances, the benefits may even fall to zero (this is what "non-guaranteed" means).

Whilst the potential upside may make the premium financing arrangement tempting, you also need to consider the potential downside of, for example, the investment return under your insurance policy not performing as anticipated, and the downside, in this respect, could be significant.

- **Exposure to exchange rate fluctuation**

  If the currency under the loan agreement is different from the currency for the premium and benefits under your insurance policy, you could face exchange rate exposure. If the exchange rate has moved against you by the time you pay back the loan using the benefits under your insurance policy, when you convert the amount received under your insurance policy into the loan currency this may not be sufficient to pay back the loan plus outstanding interest.

- **Exposure to credit risk**

  Because you have used the insurance policy as collateral for the loan, and that collateral depends on the insurer being in a position to meet its obligations under the insurance policy, any significant change in the insurer's financial position could impact your premium financing arrangement. For example, if the insurer's credit rating is downgraded, this may trigger a right under the loan agreement for the lender to seek more collateral from you, or indeed to exercise its rights under the collateral (i.e. the rights under the policy which have been assigned to the lender, such as surrendering the policy). As the borrower under a premium financing arrangement you are, therefore, exposed to the insurer's credit risk.

3. Other risks

Other risks you need to be wary of when it comes to premium financing are:

- **Payment timing mismatch**

  If you are relying on extracting value from your insurance policy to meet the loan repayments, you need to be aware of any potential timing mismatch between when benefits under your policy become available and the scheduled dates of your loan repayment. If you are unable to repay a schedule repayment on time because of this mismatch, you may be subject to late penalty interest or default interest.

- **Sufficiency of Death Benefits**

  As the insurance policy likely to have been purchased is a life insurance policy, death benefits will be payable under the insurance in the event of the insured's death. However, you need to consider the potential that the death benefit payable under the insurance policy may be substantially less than the sum of total premium paid, the interest expenses incurred and any early repayment penalty imposed under the loan agreement, resulting in financial loss.

- **Privacy of Information**

  You also need to bear in mind that the lender is likely to have been given access to your policy information and may require the insurer to release information relating to your insurance policy from time to time, such as the surrender vale, cash value and any loans or advances on the insurance policy.

Is premium financing really right for you?

Premium financing, therefore, is not a simple matter and you should not embark upon a premium financing arrangement unless you have considered all the potential risks involved and understand how they may impact your position.

To assist with this, from January 2023 onwards, when arranging any insurance policy being purchased with premium financing, the licensed insurance intermediary or authorized insurer arranging the policy will be required to complete an "Important Fact Statement – Premium Financing" with the prospective policyholder to ensure all the risks are explained and understood. It is important, therefore, that policyholders considering premium financing take the opportunity to discuss the risks with those advising them.

Ultimately, if you do not understand the risks associated with premium financing, it probably isn't for you.

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