Comprehensive report on common issues requiring improvements and sharing of good practices

Section A: (i) Insurance Ordinance (Cap. 41) ("Ordinance")
(ii) Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules (Cap. 41L) ("Rules")
(iii) Code of Conduct for Licensed Insurance Brokers ("Code of Conduct")
(iv) Guidelines relating to selling of long term insurance policies

A1) Keeping of separate client account

Relevant Regulations:

1. Section 71 of the Ordinance requires a licensed insurance broker company to hold client monies separate from the company's monies and only to use client monies relating to a client for the purposes of that client. Rule 6 of the Rules specifies the types of client monies that may be paid into a client account, and the circumstances under which a licensed insurance broker company may make withdrawals from its client account. These "client account" requirements serve as a vital policy holder protection measure, aimed at safeguarding and protecting policy holder funds held by licensed insurance broker companies.

Observations:

2. Examples of contraventions relating to the client account requirement observed by the Insurance Authority ("IA") in its inspection work, include:

   - premium being deposited into the broker company's house account instead of the client account (because the client was mistakenly provided with the house account number);
   - commission income being deposited into broker company's client account (because the insurer was mistakenly provided with the client account number to make the payment);
   - one client's money being used to pay for another client (because the broker company paid the insurer using the funds in the client account in respect of premium paid by another client, prior to receiving payment from the client concerned).

3. Whilst most of these contraventions are unintentional and inadvertent, in isolated cases more serious breaches were observed, for example, withdrawals from client account being made for personal use of the director/controller of the licensed insurance broker company. The IA has zero-tolerance for these types of serious contraventions and the matters have been referred to our enforcement team for follow-up.

Good Practices:

4. It is vital that licensed insurance broker companies establish and maintain proper internal controls and procedures to ensure compliance with the client account

requirements. Examples of good practices for controls we have observed include, providing accounting staff with sufficient training so that they are mindful of the separate client account requirements, and ensuring monies are withdrawn from the broker company's house account (instead of client account) in cases where the broker company settles premium for a client before it receives payment from that client.

5. Broker companies are also reminded of the requirement (per Rule 6 of the Rules) to give written notice to the authorized institution with which the client account is maintained, stating that the client account is maintained by the company pursuant to section 71 of the Ordinance, and to keep a proper record of such written notice.

A2) Referral business

Relevant Regulations:

6. Under section 64G of the Ordinance, no person may carry on regulated activities, or hold out that the person is carrying on regulated activities, unless such person is a licensed insurance intermediary or exempt.

7. Controls and Procedures 1(a)(i) in Section IX of Part C of the Code of Conduct requires a licensed insurance broker company to ensure that persons who are recruited, employed by, associated with, or act for the broker company in relation to the carrying on of regulated activities have the integrity and competence to discharge their duties and responsibilities. It follows that a licensed insurance broker company should ensure that any persons who are associated with or act for it in relation to the carrying on of regulated activities do not contravene section 64G of the Ordinance (for example if a broker company has arrangements in place to accept business from unlicensed referrers it must put controls and procedures in place to ensure the unlicensed referrers are not carrying on regulated activities, when making such referrals).

Observations:

8. Referrals are a common source of business for licensed insurance broker companies. Sometimes these referrals are "one-off" word-of-mouth recommendations from existing clients satisfied with the broker company's service. Other referrals, however, come in the form of more structured arrangements, for example with a non-insurance business that would like to be able to refer its clients to the broker company as a "value-add" to its non-insurance business; or other types of structured arrangements involving multiple referrals being made from the same referrer.

9. Whatever the arrangement may be, it is imperative that the referrers (assuming they are not licensed themselves) do not stray into carrying on (or holding out that they carry on) regulated activities, but rather the regulated activities (both in substance and form) are carried on only by the licensed insurance broker company (through its appointed technical representatives (broker) ("**TRs**")). Where the referral mechanism is in the form of a regular arrangement (with the referrer making multiple referrals), the broker company has a responsibility for putting in place adequate controls and governance on the arrangement to ensure the referrer is not

carrying on unlicensed regulated activities. The broker company must not turn a blind eye to this (and risk aiding and abetting (or even enabling) what would be an offence).

10. The other aspect of referrals where licensed insurance broker companies must pay particular attention to, is where fees are paid by the broker company to the referrer for a referral ("referral fees"). Whilst payment of referral fees is not prohibited, the broker company must ensure it does not contravene the Prevention of Bribery Ordinance (Cap. 201) ("**PBO**") by paying a referral fee (i.e. an advantage) to someone who is in an agency relationship with the person being referred (i.e. the person referred is the referrer's principal), as an inducement for the referrer to make the referral without the explicit consent of the person referred being obtained. A similar concern with the PBO may arise where the referrer to whom the licensed insurance broker company is paying a referral fee is a licensed insurance agent who is referring a potential policy holder to the broker company rather than referring the business with the agent's insurer principal (and where the insurer principal has not given its explicit consent to the insurance agent accepting a referral fee for this). These are matters which may attract the attention of law enforcement unless due care and attention is paid to ensure no contraventions are taking place.

Good Practices:

11. Where a licensed insurance broker company has an arrangement with a referrer which is not merely a one-off referral (i.e. the intention is that the referrer makes repeated referrals to the broker company) then the broker company should consider implementing the following practices:

    (i) entering into a written referral agreement with the referrer setting out the governing terms of the referral arrangement and the respective party's rights and obligations under the agreement and explicitly prohibiting the referrer from carrying on (or holding out that it carries on) regulated activities;

    (ii) putting in place controls to ensure that in substance the referrer is not carrying on regulated activities as part of the referral process. These can include controls such as (a) providing referrers with "Do's and Don'ts" so they know what they can or cannot do; (b) making spot-check enquiries of clients (or indeed doing client surveys or obtaining feedback) as to what the referrer informed the client when making the referral; (c) sending periodic reminders to referrers about not carrying on regulated activities; and (d) having a system of "red flags" in place which identify where unlicensed regulated advice may have been given by the referrer and then following up with the client to make enquiries. In the case of (d) such "red flag" would be, for example where the client mentions insurance advice they obtained from the referrer; and

    (iii) licensed insurance broker companies are also reminded to provide referred clients with the disclosure statements in clear format as required by Standard and Practice 5.5 of Part C of the Code of Conduct.

12. For the IA, the most obvious "red flag" indicating that unlicensed regulated activities may be carried on by referrers (and the broker company has inadequate

controls in place to prevent this, or is turning a blind eye to this), is where the referral fees being paid by the broker company to the referrer are so high that it incentivizes the referrer to carry on regulated activities and means that the broker company has insufficient resources itself to carry on adequate regulated activities (given the amount business generated by the referrals). One can see indications of this in the broker company financial statements where the expenses paid to referrers are almost the same (or 95%+) of the amount of commission income received by the broker company, and the level of commission income versus the number of TRs is such that it simply would not be physically possible for the broker company to have given adequate regulated advice on all the policies arranged. This is indicative of a business model where it is the unlicensed referrers sourcing the business and carrying on regulated activities, with the broker company doing little more than a tick-box compliance exercise on the sales process. Such a business model will not be tolerated by the IA and is certainly not a sustainable one for a licensed insurance broker company.

A3) Ensuring that trust structures for insurance policies are used for legitimate purposes (long term policies)

Relevant Regulations:

13. Paragraph 6.7 of the Guideline on Financial Needs Analysis ("**GL30**") states that if a long-term insurance policy is to be held on trust, the financial needs analysis ("**FNA**") should be based on the circumstances of the potential policy owner and/or the insured rather than the trustee. The Interpretation Notes to GL30 (Question 6) further clarifies that information privy to the client (e.g. for the purpose of identifying the objectives of the client through the FNA) should be collected from the relevant individual, who has knowledge of the subject matter privy to him or her, rather than collected via the trustee.

Observations:

14. During the COVID-19 epidemic, the IA has observed a rising trend of clients residing in other jurisdictions using trust structures to enter into and hold insurance policies. Under this kind of arrangement, the overseas client sets up a trust in Hong Kong and the relevant trust service company (being the trustee) is named as the policy holder to purchase the insurance policy with the relevant client (the settlor of the trust) being the life assured under the policy and principal beneficiary. The client is often not present in Hong Kong during the entire sales/onboarding process, and in particular, the FNA process is conducted by TRs of the licensed insurance broker company with an authorized representative of the trustee company, in the trustee company's capacity of policy holder.

15. The IA has also observed that it is not uncommon for insurers to insist on either standalone questionnaires or declaration forms, to be signed by the relevant TR to confirm / declare that (i) the TR has reviewed the entry proof of the applicant and insured or (ii) the TR has witnessed the signature of the application by the trustee and settlor. The intention, of course, is for the confirmations/declarations only to be made if what is being confirmed or declared is true.

Good Practices:

16. The IA appreciates that purchasing an insurance policy through a trust can have legitimate aims such as estate planning and tax efficiency. We would observe however that using trusts only for the purpose of disguising and circumventing potential contraventions of insurance regulations and laws in the jurisdiction where the settlor-client resides (which may prohibit cross-border sales activities) would not be considered a legitimate purpose. Where trusts are being used in this manner, it would raise issues with the fitness and properness of the TR involved in the arrangement, the licensed insurance broker company itself and its Responsible Officer ("RO") and directors.

17. An obvious "red flag" for where trusts may be being used solely for the illegitimate purpose of masking potential contraventions of insurance regulations and laws in other jurisdictions (by making it appear that the entire sales process takes place with the trust in Hong Kong), is where shortly after the policy is arranged, the trust is unwound with the trustee assigning ownership of the insurance policies back to the settlor (i.e. the client) as policy holder. This is indicative that the trust was not being used for purposes such as estate planning/tax efficiently at all.

18. Licensed insurance broker companies should note that pursuant to Question 6 in Interpretation Notes to GL30, they should conduct the FNA with the client directly, rather than via the trustee. Further, the IA would remind broker companies that certain requirements in other rules and guidelines issued by the IA are also relevant to the settlors rather than the trustees (though they are the policy holders). For example, for the purpose of the IA's Guideline on Long Term Insurance Policy Replacement ("**GL27**") it is the client (the settlor) whose situation should be considered in respect of potential policy replacements (not the trustee). Similarly for the Guideline on Cooling-off Period ("**GL29**"), the policy should be delivered to the client i.e. the settlor of the trust (as it is this client who in substance ultimately considers whether the purchase is right for his or her circumstances).

19. Licensed insurance broker companies should also consider carefully the position before signing the confirmations or declarations required by insurers mentioned in paragraph 15 above. They should only sign if the confirmation/declaration accurately represents what actually happened. Licensed insurance broker companies should seek their own legal advice when necessary.

20. As best practice, therefore, where trusts are being used to purchase insurance policies licensed insurance broker companies should ensure the following:

    (a) the purchasing of the insurance policy through the trust serves the legitimate circumstances of the client i.e. the settlor of the trust (such as estate planning, tax efficiency etc.) and that these circumstances are properly documented in the broker company's records;
    (b) the FNA is conducted with the client directly (i.e. the settlor of the trust) rather than with or through the trustee;
    (c) legal advice is obtained in relation to the jurisdiction where the settlor resides, to ensure that the broker company is not contravening the insurance regulations or laws in that jurisdiction; and

(d) confirmations or declarations signed by the TRs are only signed if the matters being confirmed or declared are true.

The broker company may be asked to produce records related to these matters when inspected, or when requested, by the IA.

21. We would mention the IA has received (and approved) certain applications to its Sandbox from broker companies in relation to onboarding mechanisms for clients residing in certain other jurisdictions using video-conferencing (where the broker company has demonstrated that it has performed its legal and other due diligence and all applicable regulations and laws are being complied with). If you wish to consider making a similar Sandbox application please contact the IA.

A4) Financial needs analysis (long term policies)

Generating illustration documents before conducting FNA

22. Standard and Practice 6.1(a) (*Suitability Assessment*) of Part C of the Code of Conduct, states that before giving regulated advice, a licensed insurance broker should carry out an appropriate suitability assessment in relation to the client's circumstances. In relation to long-term insurance policies, the FNA forms a crucial part of this suitability assessment. The core purpose of the FNA is to ascertain the financial needs of the client so that, based on this information, the TR can determine what type of insurance policy would be suitable for the client and then provide his/her recommendation to the client.

23. When recommending an insurance policy to a client, the licensed insurance broker company would often prepare an illustration document to illustrate to the client the insurance policy being recommended. The FNA should precede the preparation of such illustration documents (as the information from the FNA would be used to determine the suitable insurance policy to be recommended, so only after that determination has been made can the illustration document be prepared). The IA has observed, however, situations where illustration documents are generated prior to the FNA being conducted, indicating that the broker company is determining which insurance policy to recommend before the circumstances of the client are known. These would not be the actions of a competent and professional insurance broker company.

Good Practices - Licensed insurance broker companies should therefore put in place policies and procedures to ensure that (a) the recommendations on insurance policies given by their TRs are not being determined prior to the FNA being conducted; (b) the FNA is being properly conducted to understand client's needs and circumstances; and (c) the recommendations being made are based on the needs and circumstances of the client as identified in the FNA.

Assessment of affordability of customers who have concurrent applications

24. Paragraph 6.10 of GL30 states that when carrying out an FNA with a client, a licensed insurance intermediary should base the FNA on an aggregate of all the in-force policies of the client, rather than just the policy which is the subject of the

application. Similarly, when assessing the client's ability and willingness to pay insurance premiums, a licensed insurance intermediary should take into account any insurance premiums payable under insurance policies which are the subject of concurrent applications being made by the client, as well as applications already made but not yet accepted. The IA, in its inspections, has observed several cases where the total premium payable under all insurance policies being concurrently applied for by the client exceeds what the client can afford to pay (albeit there would be no affordability issue identified if each application is considered in isolation – which would be wrong).

25. Taking the time to understand a client's insurance needs and to make recommendations on which insurance policies best address and are suitable for the client based on such needs and circumstances, is part of an insurance broker's core skill-set and expertise. This includes ensuring that the client can afford to pay for such insurance policies being recommended (based on the information collected in the FNA). In assessing affordability and making a recommendation, a licensed insurance broker company should seek to clearly demonstrate to the client (based on the broker company's assessment) that the client can afford the premium payable, taking account of the totality of premium payable under all insurance policies that are the subject of concurrent applications by the client.

Good Practices - Licensed insurance broker companies should therefore review the design of their FNA forms (or other document as they see fit) and provide relevant guidance in their internal manuals, to ensure the affordability assessment is sufficiently comprehensive.

Deviation between level of insurance protection/saving amount offered by the recommended policy and that needed/indicated by the customers

26. According to paragraph 6.17 of GL30, a deviation between level of insurance protection/saving amount offered by the recommended insurance policy and that needed/indicated by the client is considered a mismatch unless the deviation has a justified, sound and reasonable basis. In its inspection work, the IA has come across situations where the level of insurance protection provided by the recommended policy is much less than the indicated insurance needs of the client; or the projected surrender value (including non-guaranteed amount) could not exceed the client's savings target until many years after the desired savings horizon.

Good Practices - Licensed insurance broker companies are reminded that in case of a deviation between the level of insurance protection/saving amount offered by the recommended insurance policy and that needed/indicated by the client, the TR should clearly explain the deviation to the client, and properly document why the level of protection/saving is suitable in view of client's circumstances, in spite of the deviation. To facilitate their TRs in handling similar cases, a good practice for a licensed insurance broker company would be to set and document internal deviation thresholds which (if exceeded) would trigger the necessity for the TR to explain the deviation to the client.

A5) Non-disclosure of material facts by clients in application documents

Relevant Regulations:

27. Pursuant to Standard and Practice 5.3 (*disclosure in relation to a policy holder's obligations*) of Part C of the Code of Conduct, a licensed insurance broker should explain to the client the principle of utmost good faith and remind the client that non-disclosure of material facts or provision of incorrect information to an insurer may result in the insurance policy being invalidated or avoided or claims being repudiated by the insurer.

Observations:

28. In application forms for certain types of insurance coverage, clients are requested to declare whether they (and, if relevant, the proposed life insured) have any existing in-force insurance policy with other insurer(s) or whether they are currently applying for another insurance policy with a different insurer (and, if so, to provide the relevant coverage amount). In its inspection work, the IA has observed occasions where clients simply leave this section of the application form blank and do not disclose their concurrent applications nor their other in-force policies. This observation aligns with our above finding regarding concurrent applications for or other in-force insurance policies not being taken into account as part of the affordability assessment in the FNA (see paragraphs 24 to 25 above). In other cases, the IA has observed differences in the information about clients provided in application forms as compared with the FNA form, despite the fact that both forms being handled by the same TR on the same day. Usually these discrepancies concern the client's financial status (e.g. monthly income and expense, liquid assets held) but may also extend to the number of dependents and even marital status.

Good Practices:

29. The duty of utmost good faith remains fundamental to insurance contracts and non-disclosure of material information (in breach of this duty) may result in the contract being avoided. To ensure all material information is disclosed (so as not to expose clients to the potential risk of avoidance), licensed insurance broker companies should ensure all relevant information requested in application forms (including on the total insurance coverage held/applied for by a client) is completed. Further, to assist their clients, licensed insurance broker companies should have processes in place to:

    (a) remind the client to disclose all in-force and concurrent applications as requested by insurers when they assist clients to complete application forms;

    (b) maintain a database of their clients' in-force policies and concurrent applications which are known to the broker company (i.e. applications previously handled by the broker company), and make reference to the database when handling any new applications for the client; and

    (c) draw to the client's attention any inaccurate or inconsistent information observed by the broker company in concurrent applications being made by the

client, where the information in the concurrent applications is observed to be different (and ensure that it is corrected or an explanation for the difference is obtained).

A6) Delivery of long term insurance policy

Relevant Regulations:

30. In case an insurance policy contains a cooling-off period provision and is delivered to a licensed insurance broker company by the insurer, Standard and Practice 3.6(ii) (*Cooling-off Period*) of Part C of the Code of Conduct requires the licensed insurance broker to deliver the policy to the client as soon as reasonably practicable and keep a record of the date of such delivery, so that the client has sufficient time to review the insurance policy and reflect on his decision to purchase before expiry of the cooling-off period. In relation to long term insurance policies falling within the scope of GL29, paragraph 5.5(b) of GL29 requires that the insurance policy be delivered to the policy holder (or the nominated representative of the policy holder) within 9 calendar days of the date of issue of the policy ("**9 calendar day period**").

Observations:

31. Depending on the arrangement between the insurer and the licensed insurance broker company, the insurance policy may be delivered to the client by the insurer directly or via the licensed insurance broker company. The IA in its inspection work has come across situations where the licensed insurance broker company asserts that insurance policies are to be delivered by insurers directly to clients, but is unable to provide any records to demonstrate the existence of such arrangements. The IA has also observed occasions where a broker company is responsible for delivering the policy to the client, but the broker company has not retained a record of the delivery having been made. Further, in some cases where a signed receipt is retained as a record of delivery, the date of the client's signature is beyond the 9 calendar day period (thereby the record does not serve as a record that delivery was made within the requisite 9 calendar day period).

Good Practices:

32. Licensed insurance broker companies should keep adequate records to demonstrate that policies have been delivered to clients within the 9 calendar day period. For delivery by courier, the record should at minimum include the date of delivery, name of recipient and delivery address. For delivery by insurer, the arrangement should be documented and licensed insurance broker companies should put in place a mechanism to monitor the timeline of delivery and take necessary follow-up actions in case delay is observed.

A7) Ensuring TRs comply with Continuing Professional Development ("CPD") requirements

Relevant Regulations:

33. Individual licensed insurance intermediaries have to complete a certain number of

CPD hours every annual Assessment Period (i.e. 1 August to 31 July) and report their attainment to the IA (either directly or through their principal) by 30 September. These requirements, set out in the IA's Guideline on Continuing Professional Development for Licensed Insurance Intermediaries ("**GL24**"), ensure expertise and knowledge is kept up to date and is a crucial demonstration of professionalism across the insurance industry.

34. As GL24 makes clear, licensed insurance broker companies (as principals) are responsible for ensuring their appointed TRs comply with the CPD requirements. Broker companies must therefore establish controls and processes and provide sufficient support to their TRs to achieve this.

Observations:

35. During the 2021/22 CPD Assessment Period (1 August 2021 to 31 July 2022), 88.3% of TRs representing broker companies complied with the CPD requirements, leaving 11.7% either failing to complete their CPD hours or reporting on their CPD attainment to the IA. Astonishingly, 6% of responsible officers ("**RO**") of broker companies (who are supposed to be setting an example) failed to comply with the CPD requirements. Broker companies with particularly high non-compliance rates can expect to be considered as potential targets of enforcement action.

Good practices:

36. It is essential that CPD compliance rates across the insurance broking sector improve. Broker companies (and their RO) must ensure they have controls and support in place to ensure compliance by their TRs. The following good practices are suggested (albeit we appreciate the level of controls should always be proportionate to the number of TRs and size of the broker company's operation):

    (a) **Arranging CPD Courses** - If possible, the broker companies should arrange CPD courses throughout the year for their TRs to attend. This may be done by the broker company itself or in cooperation with industry bodies and/or insurers. As the IA has removed the cap on the number of CPD hours that may be completed by e-learning, broker companies can encourage / arrange their TRs to complete their CPD activities by e-learning which can be done any time and anywhere.

    (b) **Monitoring throughout the CPD Assessment Period -** The broker company should monitor CPD attainment by its TRs throughout the Assessment Period (so that TRs complete CPD evenly throughout the period rather than leaving it to the last minute). Benchmarks for TRs (e.g. 5 CPD hours every three months) can be set and CPD courses arranged in line with this benchmark throughout the year. Notifications should be sent to TRs who fall behind schedule.

    (c) **Setting an internal Advanced Date for completing CPD hours -** Principals with the best CPD attainment records have the practice of internally setting a requirement for their TRs to complete their CPD hours either by 31 May or 30 June (one or two months in advance of the ultimate deadline of 31 July).

(d) **Internal Disciplinary Action** – A broker company should reinforce the necessity of CPD attainment and reporting with robust internal disciplinary action in the event of non-compliance (e.g. termination).

(e) **Onboarding and exiting TRs -** Broker companies should ensure that newly recruited TRs fully understand their obligations to complete their CPD hours and that the obligation continues for as long as the TR is licensed. Even if the TR leaves the broker company (and does not move onto another principal) he or she is still responsible for fulfilling their CPD hours for as long as their licence continues. The same message must be given to TRs when they leave the broker company as part of the exit process. If new TRs onboarded are already licensed, the broker company should check the CPD attainment of the TR during the year up to that point (and consider the TR's previous CPD attainment record in assessing fitness and properness).

(f) **Processes for ensuring TRs report their CPD attainment -** TRs can report their CPD compliance to the IA either via their appointing broker company or directly to the IA (through the IA's e-portal). Either way, as a good principal, a broker company should have in place processes to ensure their TRs report the required declaration within the reporting deadline.

(g) **Responsible Officers -** ROs must set a good example and the right "tone from the top" by completing their own CPD hours and reporting on time. The "P" in CPD stands for "professional" and the "R" in RO stands for responsible. If an RO fails to comply with the CPD requirements, he or she is neither professional nor responsible.

Section B: Guideline on Anti-Money Laundering and Counter-Terrorist Financing ("GL3") (version: September 2019) – applicable to licensed insurance broker companies carrying on regulated activities in respect of long term business

B1) Customer risk assessment

Relevant Regulations:

37. Paragraph 2.14 of GL3 requires a licensed insurance broker company to adopt a risk-based approach in its customer risk assessment ("**CRA**") framework. Such CRA framework should include customer risk factors; country risk factors; and product, service, transaction or delivery/distribution channel risk factors.

38. If the CRA identifies that a customer may present a high money laundering and terrorist financing ("**ML/TF**") risk, a licensed insurance broker company should apply enhanced due diligence ("**EDD**") in relation to its business with the customer (paragraph 4.11.1 of GL3).

Observations:

39. Common shortfalls in the CRA framework observed in our inspections are as follows:

    (a) Certain risk factors are not taken into account, or are not sufficiently considered in a broker company's CRA. For example, only the "type of insurance products" may be considered under "product risk", but not other material factors such as size of the premium.

    (b) The score under each risk factor is not reasonably assigned. For example, unit-linked insurance products and universal life products with higher inherent ML/TF risk are assigned equal or even lower scores than traditional life or protection products. Other examples observed are where no clients are categorized as high risk even if a client receives the highest possible score under each risk factor.

    (c) A CRA is sometimes not conducted prior to the establishment of a business relationship. In extreme cases, the CRA is conducted weeks after the relevant insurance policies have been issued.

    (d) After identifying a customer who may present a high ML/TF risk, the due diligence measures applied to the customer is more or less similar to that for a low/medium risk customer. For example, no approval from senior management is sought, no additional enquiries of the customer are made, no extra identification documents / wealth proof etc. are obtained, and no enhanced ongoing monitoring is carried out.

Good Practices:

40. Broker companies should ensure that their Anti-Money Laundering and Counter-Terrorist Financing ("**AML/CTF**") policies and procedures are sufficiently detailed to give TRs clear guidance on how to perform a CRA properly.

41. Under the risk-based approach, the AML/CTF measures applied to a customer should be commensurate with the risk presented by that customer. As such, the EDD measures a broker company applies to a high risk customer should be proportionate, appropriate, discriminating and sufficiently different from that applied to a low or medium risk customer.

42. A broker company should regularly review its CRA framework, including the reasonableness of the factors considered in the CRA, taking account of the results of its institutional risk assessment (see below, paragraphs 43 to 46).

B2) Institutional risk assessment ("IRA")

Relevant Regulations:

43. Paragraph 2.2 of GL3 requires a licensed insurance broker company to conduct an IRA to identify, assess and understand its ML/TF risks in relation to:

    (a) its customers;
    (b) the countries or jurisdictions its customers are from or in;
    (c) the countries or jurisdictions the licensed insurance broker company has operations in; and
    (d) the products, services, transactions and delivery/distribution channels of the licensed insurance broker company.

44. Paragraph 2.9 of GL3 requires a licensed insurance broker company to conduct an IRA every two years and upon trigger events which are material to its business and risk exposure, in order to keep the IRA up-to-date.

Observations:

45. Some licensed insurance broker companies do not conduct an IRA at all, while others do not consider all factors listed in paragraph 43 above.

Good Practices:

46. An IRA forms the basis of the risk-based approach for a licensed insurance broker company's AML/CFT systems by enabling it to understand how and to what extent it is vulnerable to ML/TF risk. When conducting an IRA, a broker company should consider a comprehensive range of quantitative and qualitative ML/TF risk factors. Such risk factors may include: target market and customer segments; number and proportion of customers identified as high risk; countries or jurisdictions to which there is exposure; nature, scale, diversity and complexity of the broker company's business, volume and size of its transactions; delivery/distribution channels involving non face-to-face means to establish

business relationships; compliance, regulatory and audit findings, etc.

B3) Customer due diligence ("CDD") on corporate customers

Relevant Regulations:

47. For a customer who is a legal person, GL 3 requires that a licensed insurance broker company should carry out CDD measures to:

- Identify and verify customer's identity (paragraphs 4.3.6-7)
- Identify and verify the beneficial owner of the customer (paragraph 4.4.1)
- Identify the connected party of the customer (paragraphs 4.3.18-19)
- Identify and verify the person purporting to act ("**PPTA**") on behalf of the customer (paragraph 4.5)

Observations:

48. Licensed insurance broker companies usually carry out CDD measures to identify and verify the identity of a corporate customer. However, on occasion not all identification information (GL3 paragraph 4.3.6) are obtained or the identification documents referenced are insufficient (GL3 paragraph 4.3.7). Some broker companies were observed as not having carried out any CDD measures as regards the beneficial owner, connected party or PPTA of a corporate customer.

Good Practices:

49. In relation to corporate customers, licensed insurance broker companies should carry out CDD measures not only on the corporate customer itself, but also on the beneficial owner, connected party and PPTA of the corporate customer in accordance with GL3. As per paragraphs 8.3 and 8.4 of GL3, proper records of relevant identification documents should be kept throughout the continuance of the business relationship with the corporate customer and for a period of at least five years after the end of the business relationship with the corporate customer.

B4) Screening of Politically Exposed Persons, Terrorists and Sanction Designations

Relevant Regulations:

50. Paragraphs 4.11.9 and 4.11.15 of GL3 require licensed insurance broker companies to establish and maintain effective procedures/reasonable measures for determining whether a customer or a beneficial owner of a customer is a Politically Exposed Person ("**PEP**" includes a foreign PEP, a domestic PEP and an international organization PEP).

51. Paragraphs 6.16 and 6.17 of GL3 require licensed insurance broker companies to implement effective screening mechanisms to screen their customers, as well as beneficial owners, connected parties and PPTAs of the customers, so as to avoid establishing business relationships with any terrorist suspects and persons/entities subject to sanctions.

Observations:

52. The IA notices that a few licensed insurance broker companies have not implemented proper screening mechanisms, for instance failing to perform screening prior to the establishment of a business relationship with a client, failing to keep proper records of the screening result, or with no documentation or justification being put forward to disregard possible positive screening results.

Good Practices:

53. Licensed insurance broker companies should put in place an effective screening mechanism to identify whether any client is a PEP, terrorist suspect or person/entity subject to sanctions before establishing a relationship with the clients. Name screening of customers should be conducted no later than submission of the relevant insurance application to insurer, so that in case of a positive name screening result, licensed insurance broker companies may take appropriate follow up action before they continue their business relationship with the customer concerned.

54. In addition to screening of a corporate customer, screening should also be performed for the customer's beneficial owner, connected parties and PPTA.

Section C: Guidelines on Conduct Requirements for Registered Intermediaries issued by the Mandatory Provident Fund Schemes Authority ("MPFA") – (relating to licensed insurance broker companies which are carrying on regulated activities in relation to long term business and which are registered with the MPFA as registered intermediaries)

C1) Periodic Review of compliance with Part 4A of the Mandatory Provident Fund Schemes Ordinance (Cap. 485)

Relevant Regulations:

55. Paragraph III.60(v) of the Guidelines on Conduct Requirements for Registered Intermediaries ("**MPF Conduct Requirements**") issued by the MPFA requires a principal intermediary ("PI") to regularly review and assess the effectiveness and efficiency of the PI's controls and procedures.

Observations:

56. The IA is aware that although a number of licensed insurance broker companies, who are MPF PIs, declare in their annual return submitted to the MPFA that they have conducted a review of their controls and procedures in the reporting year, they are unable to provide documentation of the review when requested by the IA.

Good Practices:

57. Licensed insurance broker companies are reminded to conduct a regular review of their controls and procedures to ensure that these are appropriate taking into account the nature, scale and complexity of their MPF business. Proper documentation of the review, such as review date, scope and result of the review, name of reviewer and approver, any follow-up action etc. should be made available for the IA's inspection upon request.

C2) Keeping record of orders and provision of copies of forms to clients

Relevant Regulations:

58. Pursuant to paragraph III.16 of the MPF Conduct Requirements, PIs should record the particulars of any order instructions relating to material decisions received from a client (including the date and time of receipt and details of the order).

59. In addition, PIs should ensure that a copy of any form completed and signed by the client is provided to the client as soon as reasonably practicable, as required under paragraph III.3 of the MPF Conduct Requirements.

Observations:

60. The IA observes that several PIs do not put in place any mechanism to keep a record of the required particulars of order instructions or any record to demonstrate the provision of copies of signed forms to clients. Some PIs require their subsidiary

intermediaries to record particulars of order instructions in a form devised by the PIs (which also serve other purposes such as disclosure of remuneration, record of regulated advice provided to the client, enquiry about investment in guaranteed fund etc.), but in practice the relevant field (especially the time of receipt) is sometimes left blank on the form.

Good Practices:

61. PIs should establish proper procedures and controls to record the required particulars of order instructions received from clients, and to record that copies of signed forms are provided to clients as soon as practicable (for example by retaining a receipt signed by the client concerned).