

5 July 2024

By Email

To: Chief Executives of all Authorized Insurers carrying on long term business

Dear Chief Executives,

Reference Checking Scheme for Insurance Intermediaries launched by The Hong Kong Federation of Insurers

We refer to reference checking scheme for insurance intermediaries (“the Scheme”) launched by The Hong Kong Federation of Insurers (“HKFI”) by its circular dated 5 July 2024 to be used by its members which are authorized insurers carrying on long-term business (“Long Term Insurers”) from 1 September 2024 onwards. The Insurance Authority (“IA”) hereby endorses and supports the Scheme.

Addressing the “rolling bad apples” phenomenon

“One bad apple spoils the whole barrel” so the old adage goes. In the context of the Scheme, the phenomenon of “rolling bad apples” refers to those few individual insurance intermediaries who, in seeking to evade the consequences of their poor conduct, resign from one principal and seek appointment with a new principal without their problematic behavior being disclosed. These isolated “bad apples” must not be allowed to spoil the reputation of the insurance market, by continuing to roll from one principal to another without accountability for their actions.

In introducing an efficient, practical and robust reference checking mechanism, the Scheme serves as a concerted effort to address this phenomenon. Pursuant to the Scheme, if a Long Term Insurer (“Recruiting Insurer”) seeks to appoint a prospective agent and is aware that the candidate has previously been appointed as an insurance agent by (or is currently appointed by) any other Long Term Insurers (“Responding Insurer(s)”) in the past 7 years, the Recruiting Insurer will need to carry out reference checking on the candidate with the relevant Responding Insurers before making a decision on whether or not to proceed with the appointment. The Scheme enables the Recruiting Insurer to take up references using a standard template and the Responding Insurer to provide its response within a specified pre-agreed timeframe (so as not to disrupt the recruiting process).

The Recruiting Insurer retains full discretion on whether or not to proceed with the appointment, even in the event of adverse information being disclosed through the reference checking mechanism. In such circumstances, however, the Recruiting Insurer will need to document its assessment if it decides to proceed with the appointment, and the assessment must be reviewed by the Recruiting Insurer’s key person in control function for intermediary management (“KPIM”)

and made available to the IA upon request (whether during a regulatory inspection or as part of the IA's ongoing supervision).

At its outset, the Scheme will only cover individual insurance agents carrying on long term business, this being the largest segment of licensed insurance intermediaries in the Hong Kong insurance market. However, consideration is already being given to how and when to extend the scope of the Scheme to other types of insurance intermediaries once sufficient experience of the practical operation of the Scheme has been built up. The IA will continue to work closely with the HKFI and other insurance intermediary bodies in this regard.

The IA's Supervisory Approach

The IA's endorsement and support to the Scheme, which serves to protect the interests of policy holders from the risk of poor conduct, is reflected in how the IA will take into account participation in and compliance with the standards in the Scheme, in its supervision and regulation of Long Term Insurers going forward. The basis for this and the manner in which this is to be done, is set out below:

- (a) Section 13AE of the Insurance Ordinance ("IO") sets out the key persons in control functions which an authorized insurer needs approval from the IA to appoint. One of these is the KPIM (being the individual responsible for the "intermediary management control function" of the insurer). The intermediary management control function is the function responsible for administering and monitoring licensed insurance agents who carry on regulated activities on behalf of the insurer and for establishing and maintaining internal control measures, inter alia, for ensuring that the arrangements by the licensed insurance agents for the insurance business they refer to the insurer comply with the IO and the requirements imposed by the IA in any code or guideline published under section 95 or 133 of the IO.
- (b) As part of the intermediary management control function for a Long Term Insurer, the IA expects the Long Term Insurer (and its KPIM) to establish internal controls for the onboarding of newly appointed individual insurance agents (i.e. prospective agents). The IA expects these internal controls to include adequate due diligence and vetting procedures to enable the Long Term Insurer to assess the prospective agent's fitness and properness to carry on regulated activities on its behalf.
- (c) The responsibility for establishing and administering these internal control measures lies with the board of directors and controllers (e.g. Chief Executive) of the Long Term Insurer (as part of their overall responsibility for the corporate governance of the insurer) and with the KPIM of the Long Term Insurer. Inadequacies in these internal control process may call into question the fitness and properness of the directors, controllers and KPIM of the Long Term Insurer and raise issues with the insurer's ability to control and limit its conduct risk. This will, in turn, attract follow-up action by the IA as we would need to consider whether it is necessary to exercise our powers under the IO (e.g. intervention, inspection, investigation or disciplinary action) in relation to the insurer.

- (d) In general, the IA will consider a Long Term Insurer's participation in and compliance with the Scheme as one of the minimum internal controls that it should implement and maintain as part of its on-boarding processes, in order to assess the fitness and properness of prospective agents, before making an appointment decision.
- (e) If a Long Term Insurer does not participate in the Scheme or repeatedly fails to discharge its obligations as required under the Scheme, the IA may consider this indicative of systemic weakness in the insurer's internal control measures. The insurer can expect close follow-up scrutiny from the IA as a consequence, with focus being placed on the adequacy of its recruiting and on-boarding controls and the fitness and properness of the management responsible for those controls. As a further consequence, increased scrutiny may be placed (and time expended) on licensing applications (new and renewal) made to be insurance agents of the Long Term Insurer, given the question marks over non-participation in the Scheme (or non-compliance with the Scheme obligations) would raise on the insurer's processes for assessing the fitness and properness of individuals it proposes to appoint as its insurance agents.
- (f) The Scheme depends on the mutual reliance of its participants to live up to their obligations as both Recruiting Insurer and Responding Insurer. If a member repeatedly does not meet its obligations, a report may be made to the IA (conductsupervision@ia.org.hk) for consideration and action.

The Scheme is the practical result of much in-depth consultation and discussion, led by the HKFI, between Long Term Insurers, intermediary representatives and the IA and our thanks go to the industry for the determination shown in bringing this to fruition. It serves as a visible manifestation of the collective responsibility of insurers, insurance intermediaries and the IA to uphold and reinforce professional standards of conduct and underpin Hong Kong's insurance market with trust and confidence.

Yours faithfully,

Peter Gregoire
Head of Conduct Supervision
General Counsel
Insurance Authority

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