

1 April 2022

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To: Chief Executives of authorized insurers carrying on long term business and responsible officers of licensed insurance broker companies and licensed insurance agencies carrying on regulated activities in relation to long term business

Dear Sirs,

Circular on the supervisory standards and key requirements on the use of premium financing¹ to take out long term insurance policies

In view of the growing popularity of the use of premium financing to fund premium payment when taking out long term insurance policies in the market, the Insurance Authority (following discussions with the Hong Kong Monetary Authority) issues this circular to clarify the supervisory standards and key requirements in the existing codes of conduct and guidelines, for authorized long term insurers (“**insurers**”) and licensed insurance intermediaries (“**insurance intermediaries**”) when carrying out their insurance operations and regulated activities with respect to the use of premium financing by (potential) policy holders (“**customers**”).

Affordability assessment in respect of premium financing

1. As required under Paragraph 6.11 of GL30, the source of funds of the customer must be duly considered to ensure that the customer can afford the recommended product(s). Insurers and insurance intermediaries should therefore take reasonable steps to ascertain whether the customer² is purchasing the life insurance policy using premium financing³. They should for example, make sufficient enquiries to the customer to find out whether the customer is funding or intends to fund the purchase of the policy using premium financing.
2. If the customer has indicated that premium financing is intended to be used, Paragraph 6.11 of GL30 stipulates that the insurance intermediary must take that into account when assessing the customer’s ability and willingness to pay insurance premiums. This

¹ For the purpose of this circular, “premium financing” is defined as an insurance funding arrangement whereby the customer, borrows funds from the lender (usually a financial institution) to pay for the premiums of the life insurance policy and, in doing so, assigns all or part of his/her rights under the proposed policy to the lender.

² The term “customer” in this circular includes individual and corporate customers. If an insurer or insurance intermediary considers that certain standards or requirements may not be applicable in their circumstances for corporate customers, they should contact the IA for clarification.

³ For the avoidance of doubt, the requirements as contained in this circular apply to every application for a new life insurance policy to be acquired using premium financing. These requirements do not apply to policies which have been issued with premiums already fully paid by the customers using their own funds, but are subsequently assigned by the customers as collateral for loan facility.

assessment (which should be explained to the customer) must at a minimum, ascertain whether the customer has sufficient financial resources to –

- (a) pay at the outset the portion of the premium not financed by the premium financing facility⁴;
- (b) meet all scheduled repayments (including principal and interest repayments) over the entire tenure⁵ of premium financing facility; and
- (c) repay the sum owed under the premium financing facility if demanded by the lender before maturity of the policy.

3. To comply with the above requirement, insurance intermediaries without access to the information regarding the premium financing facility should ask for and obtain such information from the customer. If the customer refuses to disclose such information, the insurance intermediary should perform the affordability assessment as if the customer is not acquiring the proposed policy using premium financing (i.e. the total premium is to be funded entirely by the customer's own funds). The insurance intermediary must also explain to the customer that, without the information, it would not be able to assess the customer's suitability and affordability of acquiring the proposed policy using premium financing pursuant to the Standard and Practice 6.1(b)(iv) of the Code of Conduct for Licensed Insurance Agents and Code of Conduct for Licensed Insurance Brokers (collectively referred to as "**Code of Conduct**"). An acknowledgement of the above should be obtained from the customer. Please refer to Important Facts Statement – Premium Financing ("**IFS-PF**") in **Annex** for more details.
4. For the avoidance of doubt, the alternative arrangement stipulated in Paragraph 3 above is applicable only if the customer refuses to disclose such information and cannot be adopted in lieu of the assessment as stipulated in Paragraph 2. The alternative arrangement is also not applicable to any insurance intermediaries with access to the information regarding the premium financing facility. For example, a bank acting in the dual capacity as the insurance intermediary and as the proposed premium financing facility provider is expected to provide the relevant details to its licensed technical representatives for the purpose of conducting suitability and affordability assessment for the customers.
5. As required under Paragraph 6.10 of GL30, an insurer should have internal controls for identifying the accumulation of multiple policies it has in force for the same customer. It should also check whether any of these in force policies has been assigned or pledged by the customer as collateral for a loan facility, and must take this information into account in the underwriting process. Likewise, insurance intermediaries with access to similar information of the customer, are expected to take the relevant information into account when carrying on regulated activities.

⁴ For the purpose of this circular, the terms "premium financing facility" and "loan facility" are used interchangeably.

⁵ In circumstances where the premium financing facility tenor is not fixed (e.g. an overdraft facility which can be withdrawn and repaid at any time), the insurance intermediary should take a prudent approach in the affordability assessment by assuming that the premium financing facility would last throughout the entire policy term of the proposed policy.

6. A holistic approach should be adopted in assessing customers' affordability for the purpose of GL30. The FNA should explicitly ascertain whether the customer has any outstanding liabilities and whether his/her existing insurance policies are used as collateral for premium financing facilities or otherwise pledged or assigned as collateral for a loan facility. Insurers and insurance intermediaries must take such matters into account.
7. As stipulated under the General Principle 6 of the Code of Conduct, an insurance intermediary's regulated advice (i.e. giving an opinion in relation to a matter specified in the Part 3 of Schedule 1A to the Insurance Ordinance (Cap 41)) should be suitable for the customer taking into account the customer's circumstances. Insurance intermediaries should therefore restrain from giving regulated advice recommending the use of premium financing, unless sufficient information in relation to the customer's circumstances (including details of the proposed premium financing facility) is obtained and an appropriate suitability assessment and affordability assessment has been carried out.

Additional measures for customers with risk of over-leveraging

8. As part of the suitability and affordability assessment, the insurance intermediaries should also assess whether customers using premium financing face a risk of over-leveraging, and if so, take that into account for the purpose of GL30. The risk of over-leveraging exists when loan repayment requested by the lender before maturity of the policy cannot be fully met by the customer's own funds and can only be met using surrender value of the proposed policy⁶. The insurance intermediaries should not recommend a policy that would amount to risk of over-leveraging unless there is sufficient justification⁷. The justification should be clearly explained to the customer and documented as part of the reasons for recommendation of the policy.
9. As required under Paragraph 7.7 (b) of GL16, insurers should endeavor to reduce the risk of sales that do not meet the needs of customers by assessing the suitability and affordability of products for customers during the underwriting process based on available information. Insurers should therefore establish and maintain an effective underwriting process that safeguards customers against over-leveraging by the use of premium financing.
10. Insurers' underwriting process should assess whether customers using premium financing face a risk of over-leveraging and should in addition perform asset / income proof verifications on these customers, to reasonably ascertain if these customers have the level of assets/income disclosed and do not have any undisclosed liabilities

⁶ In other words, the requirements stipulated under the "*Additional measures for customers with risk of over-leveraging*" are not applicable if the customer has own funds available to pay the policy in full without the use of the premium financing facility.

⁷ Insurance intermediaries should consider factors relevant to a particular circumstance in the justification and clearly explain them to the customers, for example, by disclosing the ratio of the loan amount of the premium financing facility to the customer's existing own financial resources to facilitate the understanding of the customers and increase their awareness to the risk of over-leveraging.

attached⁸, which may further impact his/her ability to meet any payments arising from the premium financing facility prior to policy issuance. In any event, if there is any doubt about the customer's affordability, insurers should take a prudent approach (e.g. rejection of applications from these customers) to protect the interest of policyholders.

11. When performing the asset proof verification, insurers should take into account the condition / state of the assets and apply reasonable haircut where appropriate. For example, for assets that are not solely owned by the customer, their value should be adjusted to reflect the customer's portion of ownership; for assets with outstanding liabilities, their value should be adjusted to the net value. Normally, insurers should not accept any owner's occupied properties as asset proof.

Disclosure

12. With reference to Paragraph 6.8 of GL16 and to provide practical guidance to facilitate insurance intermediaries in complying with the requirement to provide customers with accurate and adequate information to make informed decisions as stipulated under General Principle 5 of the Code of Conduct, the IFS-PF in **Annex** has been developed with a view to promoting adequate disclosure related to premium financing across the industry and to ensure full understanding of the relevant risks and features by customers so they can make informed decisions.
13. The IFS-PF should be completed⁹ for every new insurance policy application where the customer intends to use premium financing. Insurance intermediaries are required to fully explain the contents of the IFS-PF to customers, as soon as they are made aware of the customers' interest in the use of premium financing. In any event, the IFS-PF must be duly completed, signed and dated by the customer prior to policy issuance. Insurers and insurance intermediaries are reminded to observe and comply with the requirements appended to the IFS-PF in **Annex**.
14. The IFS-PF is not intended to serve as an exhaustive list of risks and features of acquiring a life insurance policy with the use of premium financing. Insurance intermediaries should take into account the particular circumstances of the customers and fully explain other relevant terms and conditions, risks and features that may be involved with the use of premium financing.

Sales practice, training and other aspects

15. Insurers are reminded to adhere to the principle of "fair treatment of customers" when designing products and underwriting insurance policies. In doing so, insurers are required to take a holistic view of all relevant factors when carrying out the diligent review in the product design stage, as required under Paragraphs 5.1 and 5.2 of GL16.

⁸ For example, an insurer may screen the bank statements submitted by the customer (generally used to verify the bank balance and income level of the customer) for any bank overdraft or an outstanding personal loan, which may not be fully disclosed in the FNA form.

⁹ For the avoidance of doubt, the insurance intermediary is required to explain the content of the IFS-PF for all applications involving premium financing, even if the customer is not willing to disclose any details of loan facility.

Similarly, insurance intermediaries are reminded to apply the same principle in their product due diligence process, where applicable.

16. As required under General Principles 2, 5 and 6 of the Code of Conduct, insurance intermediaries are expected to treat the customers fairly, provide accurate and adequate information to enable customers to make informed decisions, and provide regulated advice that is suitable for the customer taking into account the customer's circumstances. Insurance intermediaries should, as soon as they become aware that the policy to be purchased is being funded by a premium financing facility, take into account the customer's proposed use of premium financing facility in their carrying on of regulated activities. If the policy benefits will be used to repay the loan, the insurance intermediary should remind the customer of the potential shortfall that the benefits receivable under the proposed policy financed by premium financing will be less than the amount indicated in the relevant Benefit Illustration.
17. When advertising, marketing or promoting an insurance product, a licensed insurance agent should only use materials supplied or approved by the appointing insurer or appointing agency (as applicable) as required under Standard and Practice 1.1(c) of the Code of Conduct for Licensed Insurance Agents. Similarly, pursuant to Standard and Practice 1.1(e) of the Code of Conduct for Licensed Insurance Brokers, technical representative (broker) should only use materials supplied or approved by the appointing insurance broker company.
18. Adequate training should be provided by insurers, licensed insurance agencies and licensed insurance broker companies to ensure their licensed individual insurance agents and licensed technical representatives have a good understanding of the nature and the risks associated with premium financing, for the purpose of reducing the risk of sales that do not meet the needs of customers as required under Paragraph 7.7(a) of GL16, and to satisfy General Principle 4 of the Code of Conduct.
19. Regarding the training materials on premium financing, they should be well balanced, without over emphasizing the leveraging benefits of premium financing and, more importantly, provide the insurance intermediaries with a good understanding on the key aspects of premium financing (including key risks, implications and commonly used terms, etc.) and how these aspects may have adverse impacts on the outcome of the insurance policy.
20. Insurers and insurance intermediaries must clearly explain to the customers the impact of their use of premium financing on the customers' rights to cancel the policy within the Cooling-off Period prescribed in GL29. Insurers should update¹⁰ the cooling-off notice accordingly to reflect the change in circumstances.
21. Insurers, licensed insurance agencies and licensed insurance broker companies should have proper controls, procedures and adequate supervision to ensure their staff, licensed

¹⁰ For example, there may be circumstances where the rights to cancel the policy will be assigned to the lender and the cancellation of the policy will require the consent of the lender/assignee. In such cases, it should be properly reflected in the cooling-off notice to ensure clear understanding by the customers pursuant to the requirements under GL29.

individual insurance agents and licensed technical representatives comply with the supervisory standards and key requirements stipulated herein. In particular –

- (a) their on-going monitoring mechanism should cover the compliance controls on premium financing, with a view to identifying whether any inappropriate sales practices have taken place¹¹;
- (b) their mystery shopping programs (if any) should cover regulated activities involving premium financing, in addition to the ordinary sale of insurance products; and
- (c) they should review the declarations made by the customers in the IFS-PF to examine whether the sales practices of the insurance intermediaries align with their internal policies¹².

Compliance with the supervisory standards and key requirements

22. In assessing whether the supervisory standards and key requirements have been satisfied, the IA will adopt a principle-based approach. This approach requires that the underlying objective and substance of each requirement in this circular be achieved, regardless of the exact form of arrangement adopted by insurers or insurance intermediaries to achieve it.
23. Non-compliance with the supervisory standards and requirements would not by itself render an insurer or an insurance intermediary liable to judicial or other proceedings. Non-compliance with the supervisory standards and requirements may, however, reflect on the IA's view of the continued fitness and properness of (i) the directors, chief executives, controllers and key persons in relevant control functions of the insurers to which the standards and requirements apply and (ii) the insurance intermediaries to which the standards and requirements apply and (in the case of licensed insurance agencies and licensed insurance broker companies) their directors, controllers and responsible officers. The IA may also take guidance from the supervisory standards and requirements in considering whether there has been an act or omission likely to be prejudicial to the interest of (potential) policy holders, albeit the IA will always take account of the full context, facts and impact of any matter before it in this respect.
24. The supervisory standards and requirements in this circular shall come into effect on 1 January 2023 (“**effective date**”). For the avoidance of doubt, the supervisory standards and requirements in this circular shall apply to all applications of life insurance policies received by the insurer on or after the effective date.

¹¹ For example, insurers, licensed insurance agencies and licensed insurance broker companies should look into their staff, licensed individual insurance agents and licensed technical representatives with 1) exceptionally high rate of customers refusing to provide details of the premium financing facility, or 2) high amount of insurance applications involving the use of premium financing yet the customers had declared that no solicitation or recommendation on the use of premium financing had taken place.

¹² For example, some insurers, licensed insurance agencies and licensed insurance broker companies have internal rules or guidelines prohibiting their staff, licensed individual insurance agents and licensed technical representatives from soliciting or making recommendations on the use of premium financing.

For enquiries about the contents of this circular, please contact your case officers.

Yours faithfully,

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Long Term Business Division
Insurance Authority

c.c. Hong Kong Monetary Authority
The Hong Kong Federation of Insurers
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