G.N. 4091

INSURANCE ORDINANCE (Chapter 41) and ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING (FINANCIAL INSTITUTIONS) ORDINANCE (Chapter 615)

Pursuant to section 133(1) of the Insurance Ordinance (Chapter 41), and where applicable, sections 7 and 23(1) of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Chapter 615), the Provisional Insurance Authority publishes the following guidelines, all of which shall take effect from 26 June 2017:—

(1) Authorization Guideline (GL1);

(2) Guideline on Insurance (General Business) (Valuation) Rules (GL2);

(3) Guideline on Anti-Money Laundering and Counter-Terrorist Financing (GL3)

(4) Guideline on Exercising Power to Impose Pecuniary Penalty in respect of Anti-Money Laundering and Counter-Terrorist Financing (GL3A)

(5) Guideline on "Fit and Proper" Criteria under the Insurance Ordinance (Chapter 41) (GL4);

(6) Guideline on Application for Authorization to Carry on Insurance Business in or from Hong Kong (GL5);

(7) Guideline on Reserving for Mortgage Guarantee Business (GL6);

(8) Guideline on the Reserve Provision for Class G of Long Term Business (GL7);

(9) Guideline on the Use of Internet for Insurance Activities (GL8);

(10) Guideline on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses (GL9);

(11) Guideline on the Corporate Governance of Authorized Insurers (GL10);

(12) Guideline on Classification of Class C – Linked Long Term Business (GL11);

(13) Guideline on Reinsurance with Related Companies (GL12);

(14) Guideline on Asset Management by Authorized Insurers (GL13);

(15) Guideline on Outsourcing (GL14);

(16) Guideline on Underwriting Class C Business (GL15);

(17) Guideline on Underwriting Long Term Insurance Business (other than Class C Business) (GL16);

(18) Guideline on Reinsurance (GL17);

(19) Guideline on Exercising Power to Impose Pecuniary Penalty in respect of Authorized Insurers under the Insurance Ordinance (Chapter 41) (GL18); and

(20) Guideline on Minimum Requirements for Insurance Brokers.

12 June 2017

Moses CHENG Mo-chi *Chairperson, Provisional Insurance Authority*

GL1

AUTHORIZATION GUIDELINE

Insurance Authority

Contents

1. Introduction

1.1. Hong Kong adopts a free market economy and provides equal opportunities to participants in all sectors of the market. The insurance industry is no exception. The Insurance Authority ("IA")'s policy is to promote development of the insurance industry in Hong Kong whilst ensuring, through prudential supervision, the best and most up to date industry standards. Any company interested in carrying on insurance business in or from Hong Kong may apply to the IA for authorization to do so under the Insurance Ordinance (Cap. 41) ("the Ordinance").

1.2. This Guideline is issued pursuant to section 133 of the Ordinance. The purpose of this Guideline is to give general guidance to companies applying for authorization to carry on insurance business in or from Hong Kong.

2. Application for authorization to carry on insurance business

2.1. Section 6(1) of the Ordinance provides that:

> "No person shall carry on any class of insurance business in or from Hong Kong except—
>
> (a) a company authorized under section 8 to carry on that class of insurance business;
>
> (b) Lloyd's;
>
> (c) an association of underwriters approved by the Authority."

2.2. Section 7(1) of the Ordinance provides that:

> "Any company may make application in writing to the Authority for authorization to carry on any class of insurance business."

2.3. A "company" for the purposes of the Ordinance is one formed and registered under the Companies Ordinance (Cap. 622), or one formed and registered under the former Companies Ordinance, including a non-Hong Kong company to which Part 16 of the Companies Ordinance (Cap. 622) applies.

2.4. Any applicant falling within the above definition of a "company" may apply for authorization to carry on any class of insurance business in or from Hong Kong.

3. Authorization

3.1. Section 8(1) of the Ordinance provides that:

> "Upon application made by a company under section 7, the Authority—
>
> (a) subject to paragraph (b), may authorize the company in writing to carry on, subject to such conditions as the Authority may impose, any class or classes of insurance business; or
>
> (b) (i) shall refuse the application if subsection (2) or (3) applies; or
>
> (ii) may refuse the application on any other ground whether or not the application has been refused on a ground under subparagraph (i)."

3.2. Section 8(2) provides that:

> "The Authority shall not authorize a company under this section if it appears to the Authority that any person who is a director or controller of the company is not a fit and proper person to hold the position held by him."

In applying the fit and proper person test, the IA will take into account, among other things, the character, qualifications and experience of the directors or controllers of the applicant.

3.3. Section 8(3) further provides that the IA shall not authorize a company unless certain conditions, specified in that subsection, are satisfied. These conditions, which relate to the applicant's financial status, reinsurance arrangements and ability to comply with the Ordinance, are reproduced in the **Annex**.

3.4. Paragraphs 3.5, 3.6 and 3.7 below give general guidance to applicants as to the other grounds determining whether the IA will refuse an application under section 8(1)(b)(ii) of the Ordinance. The requirements set forth in paragraph 3.5 apply to all applicants, whether incorporated locally or outside Hong Kong. A company applying for authorization to carry on long term insurance business in or from Hong Kong must also meet the requirements set forth in paragraph 3.6. An applicant which is a registered non-Hong Kong company must further meet the requirements set forth in paragraph 3.7. However, an applicant incorporated outside Hong Kong may, if it so chooses, incorporate a subsidiary company in Hong Kong for the purpose of application, in which event the additional requirements set forth in paragraph 3.7 will not apply.

3.5. Under section 8(1)(b)(ii) of the Ordinance, **all applicants** must satisfy the IA that:

(a) the applicant would maintain an office as its place of business in Hong Kong with a professional management and staff establishment appropriate to the nature and scale of its operations and a locally-based chief executive who would be a controller of the applicant;

(b) the applicant would at any of its offices in Hong Kong, or at any of its accountant's offices in Hong Kong keep and maintain proper books of account and other records in respect of its Hong Kong operations, so as to enable an audit, actuarial valuation or both to be made, as the case may be;

(c) the applicant's board of directors has sufficient knowledge and relevant experience of insurance business to guide the company and oversee its activities effectively (- sufficiency would normally mean that at least one-third of the applicant's board has such knowledge and experience);

(d) the applicant has, and will continue to have, sufficient financial resources to pre-finance its proposed operations as set out in its three-year business plan (as referred to in the application form);

(e) if applicable, the applicant has, and would continue to have, the financial backing of its parent/controller, who should be a reputable person or reputable persons of good financial standing. In that regard, the parent/controller should satisfy the IA that it

will continue to provide financial support to the applicant and undertake to maintain its solvency at all times (including the required relevant amount as defined in the Ordinance) so as to enable it to meet promptly its obligations and liabilities as they fall due;

(f) with the exception of captive insurer, the applicant has undertaken a detailed market feasibility study in respect of its proposed operations in or from Hong Kong and, based on the result of such feasibility study, is able to demonstrate the viability of its business plan;

(g) the applicant's proposed operations would not have a destabilizing effect on the insurance market in Hong Kong, for instance in terms of both the servicing of the insuring public and the employment of insurance staff;

(h) the international business that the applicant proposes to carry on in or from Hong Kong would not be detrimental to Hong Kong as an insurance centre (for instance, it would not conflict with international agreements or protocol);

(i) with the exception of captive insurer, the applicant demonstrates that there would not be any conflict between the sound management of its insurance operations and the business (including insurance business) interests of its principals or shareholders and, in the case of an applicant which is a member of a group, that it would be managed and operated independently of the group with all transactions between itself and related parties being made at arm's length;

(j) in general, the applicant would not engage in a "fronting" operation (under which the ceding company, i.e. the primary or fronting company, cedes the risk it has underwritten to its reinsurer with the ceding company retaining none or a small part of that risk for its own account);

(k) the purpose of the application is not to bypass the scope and provisions of other regulatory legislation in Hong Kong, e.g. the Banking Ordinance;

(l) with the exception of professional reinsurer, the applicant must be either a general business insurer with an application for general business only, or a long term business insurer with an application for long term business only. A composite insurer wishing to carry on either general or long term business in Hong Kong will need to form a separate company for this purpose; and

(m) in the case of an insurance company already authorized in Hong Kong but wishing to extend into a class or classes of insurance business for which it is not authorized, there is a viable business plan for such expansion and it has the capacity to undertake such a new class or such new classes of business.

3.6. A company applying for authorization to carry on **long term insurance business** must satisfy the IA that:

(a) it has sufficient actuarial expertise, including a qualified staff actuary, to advise it on premium rates and structure, policy terms and benefits, accounting requirements, long term business fund liability valuations, and matching of the terms and nature of the assets and liabilities relating to its long term business. The application shall be accompanied by a report and certificate from a qualified actuary, acceptable to the IA, affirming the appropriateness or otherwise of the business plan according to prudent actuarial principles and stating whether in his opinion prudent and satisfactory arrangements governing actuarial matters have been made; and

(b) where the applicant proposes to carry on any investment-linked type of long term business, there are adequate accounting procedures to enable assets and liabilities to be identified and properly valued and timely reports to be furnished to the policy holders and that the applicant has available sufficient investment management expertise to manage the invested funds.

3.7. An applicant (for either general or long term business authorization) which is a **registered non-Hong Kong company** must satisfy the IA that it:

(a) is a company incorporated in a country where there are comprehensive company law and insurance law;

(b) is an insurer under effective supervision by the authority or authorities of its home country responsible for the proper conduct of insurance business; and

(c) is a well-established insurer with international experience and of undoubted financial standing.

4. Commencement

4.1. This Guideline shall take effect from 26 June 2017.

June 2017

Annex

Section 8(3) of the Insurance Ordinance (Cap. 41)

8. Authorization

(3) The Authority shall not authorize a company under this section unless the following conditions are satisfied—

(a) that, at the date of the application, the value of the assets of the company is not less than—

(i) in the case of a company carrying on or intending to carry on general business only, the aggregate of the amount of its liabilities and the relevant amount within the meaning of section 10;

(ii) in the case of a company carrying on or intending to carry on long term business only, the greater of the following—

(A) the aggregate of the amount of its liabilities and the relevant amount within the meaning of section 10; or

(B) the aggregate of the amount of its liabilities and such amount as may be prescribed by or determined in accordance with rules made under section 129(1)(b); (Amended 29 of 1997 s.3, Amended 12 of 2015 s.18)

(iii) in the case of a company carrying on or intending to carry on both general business and long term business, the aggregate of the amount which, if section 10(1) applied, would be the relevant amount in the case of the company having regard only to its general business and the greater of the following—

(A) the aggregate of—

(I) the amount of its liabilities; and

(II) if any part of the long term business carried on or intended to be carried on is of a nature other than that specified in class G or H in Part 2 of Schedule 1, $2,000,000 or its equivalent; or

(B) the aggregate of the amount of its liabilities and such amount as may be prescribed by or determined in accordance with rules made under section 129(1)(b); and (Replaced 25 of 1994 s. 4, Amended 29 of 1997 s.3, Amended 12 of 2015 s.18)

(b) that in the case of a company having a share capital, the aggregate of the amount paid up thereof and the amount of any subordinated loan stock of the company and the amount paid up in respect of any redeemable preference shares of the company is not less than—

(i) except if subparagraph (ii), (iii) or (iv) applies to the company, $10,000,000 or its equivalent; (Amended 29 of 1997 s.3)

(ii) if the company intends to carry on both general business and long term business, or carries on both general business and long term business outside Hong Kong, $20,000,000 or its equivalent;

(iii) if the company intends to carry on any class of insurance business (not being reinsurance business) relating to liabilities or risks in respect of which persons are required by any Ordinance to be insured, $20,000,000 or its equivalent; (Amended 35 of 1996 s. 4, 29 of 1997 s.3)

(iv) if the company intends to carry on business as a captive insurer, $2,000,000 or its equivalent; and (Added 29 of 1997 s.3)

(c) that as regards each class of risks against which, in the course of carrying on business, the company proposes to insure persons—

(i) adequate arrangements are in force, or will be made, for the reinsurance of risks of that class against which persons are, or are to be, insured by the company in the course of carrying on business; or

(ii) it is justifiable not to make arrangements for that purpose; and

(d) that the company is, and will continue to be, able to meet its obligations including obligations in respect of business other than the class of insurance business in respect of which the application is made; and

(e) in the case of a non-Hong Kong company as defined by section 2(1) of the Companies Ordinance (Cap. 622), that it has complied with Part 16 of that Ordinance; and (Amended 28 of 2012 ss. 912 & 920)

(f) that the company will be able to comply with such of the provisions of this Ordinance as would be applicable to it; and

(g) that in the case of a company which carries on, or proposes to carry on, some other form of business in addition to insurance business, the carrying on of that other form of business in addition to insurance business is not contrary to the interest of existing and potential policy holders; and

(h) that the name of the company is not likely to deceive.

GL2

GUIDELINE
ON
INSURANCE (GENERAL BUSINESS)
(VALUATION) RULES

Insurance Authority

Contents

1. Introduction

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance") and is prepared to assist insurers[1] and their auditors in interpreting and applying the provisions of the Insurance (General Business) (Valuation) Rules ("the Rules") in the valuation of assets and liabilities of insurers. It may be revised or updated as and when considered appropriate.

1.2 While this Guideline seeks to clarify the interpretation of the provisions of the Rules, it is not intended to be a comprehensive guide. Insurers and their auditors are therefore advised to use this Guideline as a general reference to the Rules only, and to seek legal or professional advice if there is any doubt regarding the application of the Rules.

2. Overview of the Insurance (General Business) (Valuation) Rules

2.1 The Rules were made by the Insurance Authority ("IA") and gazetted on 21 April 2017. Its application is stipulated in rule 1. Rule 2 provides for the interpretation of the terms used in the Rules.

2.2 The Rules aim at providing a standard and prudent valuation basis for the assets and liabilities of an insurer and ensuring a prudent spread of its investments for solvency purposes. This is achieved by the following provisions:

(a) different valuation principles for different kinds of assets (rules 3 to 13 of the Rules); and

(b) admissibility limits for different categories of assets (rule 14 of the Rules).

[1] With reference to s.2 of the Insurance (General Business) (Valuation) Rules, "insurer" means (a) a company which is seeking authorization or which is authorized under section 8 of the Ordinance to carry on insurance business; or (b) an association of underwriters which is seeking approval or which is approved under section 6(1)(c) of the Ordinance.

3. Application

Rule 1 - Application

3.1 The Rules apply to the determination of the value of any assets and the amount of any liabilities of an insurer except those attributable to the fund maintained in respect of long term business under section 22 or 22A of the Ordinance. That is,

(a) for a general business insurer, the Rules apply to all assets and liabilities;

(b) for a long term business insurer, the Rules do not apply; and

(c) for a composite business insurer, the Rules apply to all assets and liabilities other than those attributable to the long term business fund.

4. Interpretation

Rule 2 - Interpretation

4.1 This rule provides for the interpretation of the terms used in the Rules. For those terms which are not specifically defined in the Rules, their definitions should follow those as contained in the Ordinance (including Schedule 3 to the Ordinance).

5. Valuation Principles

Rule 3 - Land and buildings

5.1 This rule provides for three different bases of valuation. The value of any land or building, for whatever purposes it is held, is required to be determined by reference to its ***market value*** as assessed in a ***recent valuation*** conducted by an ***independent qualified valuer***. The value of any land or building is admitted up to its net book value plus 75% of the appreciation in value (rule 3(1)(c)). An insurer can opt not to take credit of the appreciation in value (or where there is no recent valuation) and report the net book value

(rule 3(1)(a)). Where the ***market value*** falls below the net book value, the value of the land or building must be stated at the ***market value*** (rule 3(1)(b)).

5.2 The definitions of "recent valuation" and "independent qualified valuer" can be found in rule 2 of the Rules. As regards "market value", it means "market value" as defined in The HKIS Valuation Standards issued by The Hong Kong Institute of Surveyors, which is extracted at **Annex 1**.

5.3 A recent valuation, as defined, is one which was made within 3 years before the date the land or building falls to be valued. Where more than one valuation were made within 3 years, reference should be made to the latest one.

5.4 As defined in the Rules, an independent qualified valuer is a person who, inter alia, holds a professional qualification recognized by the IA. A list of qualifications recognized by the IA in this regard is attached at **Annex 2**. Any insurer who wishes to commission a valuer who holds a qualification other than those shown in Annex 2 must prove to the satisfaction of the IA that the qualification is comparable to those shown. A valuation conducted by a valuer without the relevant qualification and experience will not be recognized, for the purposes of the Rules, as a "recent valuation".

Rule 4 - Listed shares or securities, unit trusts or mutual funds

5.5 The valuation of any ***listed*** shares, ***listed*** securities, unit trusts or mutual funds takes into account the quality (or credit rating) assigned to these assets. For those issued or guaranteed by the Government of the Hong Kong Special Administrative Region or the Exchange Fund or with a high credit rating, its ***middle market quotation/market value*** is admitted in full (rule 4(1)). For those with a lower credit rating or without credit rating, its ***middle market quotation/market value*** is admitted up to 90% or 75%, as appropriate (rule 4(2) and (3)).

5.6 "Listed", as defined in rule 2 of the Rules, means listed on The Stock Exchange of Hong Kong Limited ("SEHK") or on a foreign stock exchange recognized by the IA as being of a standing not lower than that of SEHK. A list setting out those foreign stock exchanges which are recognized by the IA for this purpose is at **Annex 3**.

5.7 It should be noted that any shares or securities listed on a foreign stock exchange not recognized by the IA (i.e. a foreign stock exchange other than those listed in Annex 3) shall be deemed as unlisted for the purposes of the Rules and must be valued in accordance with the principles set out in rules 7 and 8. Any insurer who wishes to value such shares or securities as "listed" shares or securities must prove to the satisfaction of the IA that the foreign stock exchange concerned is of a standing not lower than that of the SEHK.

5.8 "Middle market quotation" and "market value of the holding of a unit, or other beneficial interest, in a unit trust or mutual fund" are also defined in rule 2 of the Rules. As regards "middle market quotation", it should be noted that if a share or security is listed on more than one stock exchange, reference should be made to the middle market quotation in its principal place of listing.

Rule 5 - Shares in investment subsidiaries

5.9 To enhance compliance of the requirement regarding prudent spread of assets (rule 14 of the Rules), this rule requires that any subsidiary of the insurer, whose principal business is investment in land or buildings, listed shares or securities, unlisted shares or securities, unit trusts or mutual funds or any combination thereof, must be valued on a ***proportional consolidation basis***.

5.10 The proportional consolidation basis provided for in this rule is different from the ordinary consolidation basis where the whole value of each item of assets and liabilities of a subsidiary is grouped with the corresponding assets and liabilities of the holding company (irrespective of the latter's proportion of equity interest in the subsidiary), making adjustments for "minority interests" as appropriate. Under the proportional consolidation basis, only that part of the value of an asset or amount of a liability of the subsidiary which is attributable to the shares held by the holding company is grouped with the corresponding asset or liability of the holding company (rule 5(3)). Inter-company balances between the holding company and the subsidiary are also offset by those amounts attributable to the shares held by the holding company, with the remaining amounts shown as "balances due to/owed from minority interests in subsidiary company" (rule 5(5)). Therefore, no adjustment for "minority interests" is necessary.

5.11 It is important to note that this rule also requires the assets and

liabilities of an investment subsidiary, similar to those directly owned/incurred by the insurer, be valued in accordance with the Rules before applying the above principles of proportional consolidation (rule 5(3)).

5.12 This rule requires that the value of assets and liabilities of each subsidiary be separately disclosed (rule 5(4)). It also stipulates the reporting requirements regarding the particulars of the subsidiary (rule 5(6)). Particulars of all the subsidiaries and the insurer's shareholding thereof should be similarly disclosed. An example of the balance sheet which complies with these reporting requirements is at **Annex 4** for illustration purpose. An insurer is however free to adopt any other format most suitable to its own circumstances so far as it can comply with these reporting requirements.

Rule 6 - Shares in other insurers

5.13 This rule adopts a ***"look through" basis*** in dealing with the valuation of shares in subsidiaries which are insurance companies. The value of assets and amount of liabilities of an insurance subsidiary is required to be determined in accordance with any applicable valuation rules made under section 129 of the Ordinance (including the Rules) (rule 6(3)) to arrive at a net tangible asset value for inclusion as an asset of the insurer (rule 6(2)).

5.14 In applying the above basis, it should be noted that:

(a) a relevant amount (as defined in rule 6(8)) must be included as a liability in arriving at the net tangible asset value of the subsidiary (rule 6(4)). Attention is drawn in particular to the definition of "relevant amount" in respect of long term business as used in the Rules, which differs from the same term as specified in section 10(2) of the Ordinance for solvency purposes. The present term refers to the greatest of the relevant amount specified in section 10(2) of the Ordinance and those amounts prescribed in the Insurance (Margin of Solvency) Rules;

(b) if there is a negative net tangible asset value in the subsidiary, the shareholding shall have nil value. The insurer should consider whether any potential net liabilities may arise in relation to its investment in such a subsidiary with negative net tangible asset value

and, as appropriate, include such potential liabilities as its own contingent liabilities (section 8(4)(a) of the Ordinance). If there is a positive net tangible asset value, then, subject to (c) below, consideration will have to be given to what would happen in a liquidation situation. If there are preference shares in existence, these are likely to have a first call on the net tangible assets. There may equally be differential rights if there is more than one class of ordinary shares. In general, it is likely that preference shares held by third parties should be deducted as a liability when valuing the subsidiary, depending upon the specific terms of the preference share issue. It is of course necessary to recognize only the share of the net tangible asset value of the subsidiary to which the insurer's percentage shareholding of that particular class of shares entitles it; and

(c) rule 6(3) clarifies that the assets of the subsidiary are not required to be valued on the basis that the subsidiary were in liquidation and the assets may be valued on a "going concern" basis. The reference to liquidation above is made only for the purpose of determining the extent of the net tangible asset value to which the insurer is entitled by reason of its shareholding in the subsidiary.

5.15 It is recognized that there may be circumstances where it is impracticable for an insurer to value its investment in an insurance subsidiary on the above basis. In such cases, an insurer may apply for the IA's prior approval to value its investment in the insurance subsidiary on an alternative basis, i.e. up to 75% of the attributable share value of the shares (rule 6(6)). Attributable share value is that part of the surplus of the ***net tangible asset value*** of the insurance subsidiary over the relevant amount attributable to the shares held by the insurer as if the subsidiary were in liquidation (paragraph 5.14(b) above also applies here). Rule 6(9) again clarifies that the assets of the subsidiary are not required to be valued on the basis that the subsidiary were in liquidation and the assets may be valued on a "going concern" basis.

5.16 It should be noted that the net tangible asset value referred to in paragraph 5.15 above (and paragraph 5.18 below) must be the value as disclosed in the ***most recent audited accounts*** of the company concerned as audited by an auditor qualified to be appointed under section 15 of the Ordinance (rule 6(7)).

5.17 The definition of "recent audited accounts" can be found in rule 2 of the Rules. It means audited accounts relating to a period ending on a day within 2 years before the date the shares fall to be valued. "Most recent audited accounts" therefore refer to the latest set if there are more than one set of recent audited accounts.

Rule 7 - Other unlisted shares

5.18 This rule provides that the value of any other unlisted share, is admitted up to 75% of its ***ready market price***. If there is no ready market price, then the value of such investment is admitted up to 75% of the ***net tangible asset value*** of the investee company (also see paragraphs 5.16 and 5.17 above) payable in respect of the shares held by the insurer as if the investee company were in liquidation (paragraph 5.14(b) above also applies here). In the absence of ready market price and recent audited accounts, no value of the investment shall be admitted.

5.19 "Ready market price" is defined in rule 2 of the Rules. It makes reference to the prices of the shares concerned quoted on a secondary market or a market acceptable to the IA.

Rule 8 - Unlisted securities

5.20 The value of any unlisted ***security*** is admitted up to 75% of its ***ready market price***. If there is no ready market price, the value is admitted up to 75% of the cost of acquisition.

5.21 "Security" is defined in rule 2 of the Rules. For the avoidance of doubt, it is clarified that "security" does not include bank deposit or certificate of deposit. As such, they shall be valued in accordance with section 8(4)(c) of the Ordinance and are not subject to the admissibility limit as provided in rule 14 of the Rules.

5.22 "Ready market price" is defined in rule 2 of the Rules. It makes reference to the prices of the security quoted on a secondary market or a market acceptable to the IA.

Rule 9 - Premiums receivable

5.23 This rule provides that the value of ***gross premiums receivable*** (less commissions and provisions for bad and doubtful debts) in respect of direct business and reinsurance inward business is admitted up to 25% and 75% respectively of the gross premium income (less commissions) of the corresponding types of business.

5.24 Should the financial year of an insurer relates to a period other than 12 months, "gross premium income" has to be annualized in the manner as set out in the definition of "adjusted gross premium income" in rule 2 of the Rules before applying the above specified percentages.

5.25 "Gross premiums receivable" is defined in rule 2 of the Rules. "Gross premiums receivable" here means, as an asset item, premiums payable to an insurer as at the end of the financial year in respect of contracts written or renewed by an insurer in that financial year or any prior years. This is different from the interpretation of the term "premiums receivable" as specified in section 10(5) of the Ordinance for the purpose of determining the relevant amount (or solvency margin) of an insurer.

Rule 10 - Intangible assets and deferred acquisition costs

5.26 This rule renders inadmissible the value of any intangible asset, including deferred acquisition costs or implied deferred acquisition costs deducted in arriving at unearned premiums.

5.27 Acquisition costs include, apart from commissions paid or payable to agents or brokers, the direct selling or administrative costs associated with the acquisition of insurance business.

Rule 11 - Discounting of claims

5.28 This rule disallows discounting of claims liabilities unless with the prior approval of the IA.

5.29 The IA will consider each application for approval on its own individual merits. As a general guidance, the IA will need to be satisfied, inter alia, of the appropriateness of the valuation bases and assumptions to be adopted in discounting the claims liabilities.

Rule 12 - Additional amount for unexpired risks

5.30 This rule requires that the provision for unexpired risks must be made for each separate class of business authorized and there should be no cross-offsetting, i.e. any premium deficiency in respect of a particular class of business cannot be offset by any premium surplus in respect of another class of business.

Rule 13 - Other assets or liabilities

5.31 The Rules prescribe valuation principles for those assets and liabilities more commonly found in the balance sheet of an insurer. As regards other assets for which no valuation principle has been provided in the Rules, this rule confirms that they should continue to be valued in accordance with section 8(4)(c) of the Ordinance.

6. Admissibility Limit for each Category of Assets

Rule 14 - Asset value to be admitted not exceeding a specified extent for each category of assets

6.1 To ensure a prudent spread of investments by an insurer, this rule stipulates that the aggregate value admitted in respect of each of the following categories of assets (of the insurer and its investment subsidiaries after consolidation under rule 5 of the Rules) must not exceed a prescribed percentage of the insurer's total eligible asset value (rule 14(1)). Total eligible asset value, as defined in rule 2 of the Rules, is the aggregate value of the insurer's assets admitted under the Rules before application of this rule.

		% of total eligible asset value
(a)	Land and buildings	30%
(b)	***Listed shares***, unit trusts and mutual funds	30%
(c)	Aggregate of (a) and (b)	40%
(d)	Listed securities	50%
(e)	Unlisted shares (excluding shares in insurance subsidiaries) and unlisted securities and ***debts*** (excluding insurance debts and loans secured by insurance policies) due from individuals or unlisted companies	10%

6.2 For the avoidance of doubt, it is clarified that the admissibility limit relating to listed shares in item (b) above does not apply to any listed share in insurance subsidiaries which is valued under rule 6 of the Rules. This admissibility limit is intended to apply only to investment in listed shares which is valued under rule 4 of the Rules.

6.3 As regards the admissibility limit relating to debts in item (e) above, it would normally be considered on a gross basis unless an insurer currently has a legally enforceable right to set off the debts and intends either to settle on a net basis, or to realize the debts and settle the liability simultaneously. An insurer currently has a legally enforceable right to set off the debts means that the right of set-off:

(a) must not be contingent on a future event; and

(b) must be legally enforceable in all of the following circumstances:

(i) the normal course of business;
(ii) the event of default; and
(iii) the event of insolvency or bankruptcy of the insurer and all of the counterparties.

6.4 It should be noted that an insurer is not prohibited from holding a greater amount in any particular category of assets than that specified. However, no credit will be given to any excess over the admissible limit in determining whether the insurer complies with the solvency margin requirement under the Ordinance.

6.5 This rule (and this rule only) is not applicable to the valuation of assets for the purposes of the local assets requirement under section 25A or 25B of the Ordinance (rule 14(2)). An insurer is hence at liberty to maintain any amount of assets in any category in Hong Kong to match its Hong Kong liabilities. It should also be noted that in determining the value of an insurer's shares in its investment subsidiary for the purposes of the local assets requirement (and completion of Part 9 of Schedule 3 to the Ordinance), such value should be determined in accordance with rule 4 or 7 of the Rules as appropriate (and not rule 5 which aims at preventing an insurer from bypassing the spread of assets requirement under this rule).

6.6 For financial reporting purposes, adjustments to the relevant category of assets of an insurer in the balance sheet may be necessary resulting from application of this rule. In this regard, it is suggested that an insurer should apportion the adjustment made to a particular category of assets to each of its sub-items on a pro rata basis so as not to distort the relative composition of that category of assets. A working example of the balance sheet to illustrate the treatment is attached at **Annex 5**.

7. Safeguarding Provision

Rule 15 - Asset to be admitted at lower value

7.1 Rule 15 provides that even though the value of an asset can be admitted up to a certain amount under the Rules, a lower value should be given if in the circumstances of the case such lower value is considered more appropriate. It is incumbent upon the insurer to ensure that this provision is properly complied with. An auditor should have regard to this provision when certifying the insurer's compliance with the Rules.

8. Commencement

8.1 This Guideline shall take effect from 26 June 2017.

June 2017

Annex 1

Definition of "Market Value" (Extract from the HKIS Valuation Standards ("Standards") issued by The Hong Kong Institute of Surveyors)

The term, Market Value, is defined by the International Valuation Standards and followed by the Standards as "the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion".

Market value is understood as the value of an asset or liability estimated without regard to costs of sale or purchase (or transaction) and without offset for any associated taxes or potential taxes.

Annex 2

List of professional qualifications in property valuation recognized by the Insurance Authority

For the purpose of rule 2 of the Insurance (General Business) (Valuation) Rules, a person who is a full member of any of the following institutes shall be deemed to have professional qualification in valuing properties recognized by the Insurance Authority.

Australia
The Australian Property Institute

Hong Kong
The Hong Kong Institute of Surveyors

New Zealand
The New Zealand Institute of Valuers

The United Kingdom
The Royal Institution of Chartered Surveyors

Annex 3

List of Foreign Stock Exchanges recognized by the Insurance Authority

For the purpose of rule 2 of the Insurance (General Business) (Valuation) Rules, the foreign stock exchanges recognized by the Insurance Authority as being of a standing not lower than that of The Stock Exchange of Hong Kong Limited, shall be any of the following as specified in Part 3 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571):

1. ASX Limited
2. BSE Limited
3. Borsa Italiana S.p.A.
4. Bursa Malaysia Securities Berhad
5. Deutsche Börse AG
6. Euronext Amsterdam N.V.
7. Euronext Brussels S.A./N.V.
8. Euronext Paris S.A.
9. Korea Exchange, Inc.
10. London Stock Exchange plc
11. Montréal Exchange Inc.
12. Nagoya Stock Exchange, Inc.
13. NASDAQ OMX Copenhagen A/S
14. NASDAQ OMX Helsinki Ltd
15. NASDAQ OMX Stockholm AB
16. National Stock Exchange of India Limited
17. New York Stock Exchange LLC
18. NYSE Amex LLC
19. NZX Limited
20. Osaka Securities Exchange Co., Ltd.
21. Oslo Børs ASA
22. Singapore Exchange Securities Trading Limited
23. SIX Swiss Exchange AG
24. Sociedad Rectora de la Bolsa de Valores de Madrid, S.A. (Sociedad Unipersonal)
25. Société de la Bourse de Luxembourg S.A.
26. The NASDAQ Stock Market LLC
27. The Philippine Stock Exchange, Inc.

28. The Stock Exchange of Thailand
29. Tokyo Stock Exchange, Inc.
30. TSX Inc.
31. Wiener Börse AG

Annex 4

Example on reporting requirements of investment subsidiaries

ABC INSURANCE COMPANY LIMITED
CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER XXXX
(Expressed in Hong Kong Dollars)

	Consolidated	Subsidiary XX Note (1)	Subsidiary YY Note (2)
	$m	$m	$m
Land & buildings	500	300	170
Cash & bank balances	520	10	10
Short term deposits with deposit-taking companies	360	30	30
Receivables relating to insurance business			
- direct business	1,000		
- reinsurance accepted	500		
Treasury bills & other eligible bills	50	20	30
Shares listed on The Stock Exchange of Hong Kong Limited	85	85	
Debt securities	35	35	
Equity shares	100		100
Total Assets	3,150	480	340
Deduct:			
Payables relating to insurance business			
- direct business	330		
- reinsurance ceded	30		
Taxation	110	30	10
Provision for liabilities & charges	50	50	
Other creditors and accruals	30		30
Total Net Assets	2,600	400	300

Please note that the above figures represent 80% share of the assets and liabilities of the subsidiary to which the holding company is entitled.

Representing:	
Share Capital	1,900
Profit & Loss Account (or Retained Profits)	700
Total Shareholders' Fund	2,600

Notes:

	Name of Company	Country of Incorporation	Percentage of ordinary shares held	Principal activities
(1)	XX Investment Ltd.	Hong Kong	100%	Property Investment
(2)	YY Investment Ltd.	Hong Kong	80%	Securities Trading

(3) For the purposes of the Insurance (General Business) (Valuation) Rules, the value of any goodwill arising on consolidatior if any, is not admissible.

Annex 5

Example on admissibility limits of assets

XXX INSURANCE COMPANY LIMITED
CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER XXXX
(Expressed in Hong Kong Dollars)

	NOTE	($'000)	Before asset limits ($'000)
LAND AND BUILDINGS	1	200,000	375,000
INTEREST IN INSURANCE SUBSIDIARIES		100,000	100,000
INVESTMENTS	2	296,667	420,000
INSURANCE DEBTORS		54,700	54,700
OTHER DEBTORS	3	33,333	40,000
DEPOSITS AND CURRENT ACCOUNTS			
- WITH BANKS		7,500	7,500
- WITH DEPOSIT TAKING COMPANIES		2,500	2,500
CASH		100	100
FURNITURE AND EQUIPMENT		200	200
TOTAL ASSETS		695,000	1,000,000
LESS: PROVISION FOR UNEARNED PREMIUMS		(120,000)	(120,000)
CURRENT LIABILITIES		(240,000)	(240,000)
NET ASSETS		335,000	640,000
SHARE CAPITAL		100,000	100,000
RESERVES	4	235,000	540,000
		335,000	640,000

for reference

NOTES (All adjustments made under rule 14 of the Insurance (General Business) (Valuation) Rules ("the Rules") are shown in italics)

1. LAND AND BUILDINGS

	Land and buildings $'000	Investment properties $'000	Total $'000
At cost or valuation:			
- At 1st January	84,000	287,000	371,000
- Additions	1,000	8,000	9,000
- Disposals	-	(5,000)	(5,000)
- Admitted surplus on revaluation	5,000	10,000	15,000
- At 31st December	90,000	300,000	390,000
Amortization and depreciation:			
- At 1st January	10,000	-	10,000
- Charge for the year	5,000	-	5,000
- Written back on disposals	-	-	-
- At 31st December	15,000	-	15,000
Admitted book value (before asset limits):			
- At 31st December	75,000	300,000	375,000
Admitted book value (after asset limits):			
- *Adjustments under rule 14(a) of the Rules*	*(15,000)*	*(60,000)*	*(75,000)*
	60,000	240,000	300,000
- *Adjustments under rule 14(c) of the Rules (Note 5)*	*(20,000)*	*(80,000)*	*(100,000)*
- At 31st December	40,000	160,000	200,000

2. INVESTMENTS

		$'000	$'000
(a)	Listed shares	130,000	
	Unit trusts	120,000	
	Mutual funds	60,000	
		310,000	
	Adjustments under rule 14(b) of the Rules	(*10,000*)	
		300,000	
	Adjustments under rule 14(c) of the Rules (Note 5)	(*100,000*)	200,000
(b)	Listed securities		30,000
(c)	Unlisted shares	20,000	
	Unlisted securities	60,000	
		80,000	
	Adjustments under rule 14(e) of the Rules	(*13,333*)	66,667
			296,667

3. OTHER DEBTORS

	$'000
Amounts due from group companies*	
- Secured	17,000
- Unsecured	8,000
Sundry debtors*	
- Unsecured	15,000
Adjustments under rule 14(e) of the Rules	(*6,667*)
	33,333

* All the debtors are assumed to be unlisted companies and individuals.

4. RESERVES

	$'000
Capital reserves	200,000
General reserves	275,000
Accumulated profits	125,000
* *Adjustments under the Rules other than rule 14*	*(60,000)#*
* *Adjustments under rule 14 of the Rules*	*(305,000)*
	235,000

* These adjustments represent direct debits to reserves which have not first passed through the profit and loss account.

\# This is an arbitrary figure assumed for illustration purpose only.

5. ADJUSTMENTS UNDER RULE 14(c) OF THE RULES

	$'000
Land and building (after adjustments under rule 14(a) of the Rules)	300,000
Listed shares (after adjustments under rule 14(b) of the Rules)	300,000
	600,000
Less : Adjustments under rule 14(c) of the *Rules*	*(200,000)*
	400,000

GL3

Guideline on Anti-Money Laundering and Counter-Terrorist Financing

(For authorized insurers, reinsurers, appointed insurance agents and authorized insurance brokers carrying on or advising on long term business)

Insurance Authority

June 2017

Contents Page

Chapter 1 – OVERVIEW		
Introduction		
	1.1	The Guideline is published under section 7 of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance, Cap. 615 (the AMLO) and section 133 of the Insurance Ordinance, Cap. 41 (the IO), and shall take effect from 26 June 2017.
	1.2	Terms and abbreviations used in this Guideline shall be interpreted by reference to the definitions set out in the Glossary part of this Guideline. Interpretation of other words or phrases should follow those set out in the AMLO and the IO.
	1.3	This Guideline is issued by the Insurance Authority for giving guidance to authorized insurers, reinsurers, appointed insurance agents and authorized insurance brokers carrying on or advising on long term business (hereinafter referred to as "insurance institutions ("IIs")"). In general, the guidance provided in the Guideline in Chapters 1-10 to IIs is not different from the guidance provided by other relevant authorities (RAs) under their respective regulatory regimes. To the extent that the Insurance Authority sees fit to provide supplementary guidance in Chapters 1-10, such will be put in italics for ease of identification.
	1.4	The Guideline is intended for use by financial institutions (FIs) and their officers and staff. The purposes of the Guideline are to: (a) provide a general background on the subjects of money laundering and terrorist financing (ML/TF), including a summary of the main provisions of the applicable anti-money laundering and counter-financing of terrorism (AML/CFT) legislation in Hong Kong; and (b) provide practical guidance to assist FIs and their senior management in designing and implementing their own policies, procedures and controls in the relevant operational areas, taking into consideration their special circumstances so as to meet the relevant AML/CFT statutory and regulatory requirements.
	1.5	The relevance and usefulness of the Guideline will be kept under review and it may be necessary to issue amendments from time to time.
	1.6	Given the significant differences that exist in the organisational and legal structures of different FIs as well as the nature and scope of the business activities conducted by them, there exists no single set of universally applicable implementation measures. It must also be

		emphasized that the contents of the Guideline is neither intended to, nor should be construed as, an exhaustive list of the means of meeting the statutory and regulatory requirements.
	1.7	This Guideline provides guidance in relation to the operation of the provisions of Schedule 2 to the AMLO (Schedule 2). This will assist FIs to meet their legal and regulatory obligations when tailored by FIs to their particular business risk profile. Departures from this Guidance, and the rationale for so doing, should be documented, and FIs will have to stand prepared to justify departures to the RAs.
s.7, AMLO	1.8	A failure by any person to comply with any provision of this Guideline does not by itself render the person liable to any judicial or other proceedings but, in any proceedings under the AMLO before any court, this Guideline is admissible in evidence; and if any provision set out in this Guideline appears to the court to be relevant to any question arising in the proceedings, the provision must be taken into account in determining that question.
	1.8a	*In addition, a failure to comply with any provision of this Guideline by IIs may reflect adversely on the fitness and properness of their directors and controllers[1], and may result in disciplinary action taken against IIs.*
The nature of money laundering and terrorist financing		
s.1, Sch. 1, AMLO	1.9	The term "money laundering" is defined in section 1 of Part 1 of Schedule 1 to the AMLO and means an act intended to have the effect of making any property: (a) that is the proceeds obtained from the commission of an indictable offence under the laws of Hong Kong, or of any conduct which if it had occurred in Hong Kong would constitute an indictable offence under the laws of Hong Kong; or (b) that in whole or in part, directly or indirectly, represents such proceeds, not to appear to be or so represent such proceeds.
	1.10	There are three common stages in the laundering of money, and they frequently involve numerous transactions. An FI should be alert to any such sign for potential criminal activities. These stages are:

[1] *For interpretations of the terms "director" and "controller", please refer to section 2 of the IO.*

		(a) Placement - the physical disposal of cash proceeds derived from illegal activities; (b) Layering - separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the source of the money, subvert the audit trail and provide anonymity; and (c) Integration - creating the impression of apparent legitimacy to criminally derived wealth. In situations where the layering process succeeds, integration schemes effectively return the laundered proceeds back into the general financial system and the proceeds appear to be the result of, or connected to, legitimate business activities.
s.1, Sch. 1, AMLO	1.11	The term "terrorist financing" is defined in section 1 of Part 1 of Schedule 1 to the AMLO and means: (a) the provision or collection, by any means, directly or indirectly, of any property – (i) with the intention that the property be used; or (ii) knowing that the property will be used, in whole or in part, to commit one or more terrorist acts (whether or not the property is actually so used); or (b) the making available of any property or financial (or related) services, by any means, directly or indirectly, to or for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate; or (c) the collection of property or solicitation of financial (or related) services, by any means, directly or indirectly, for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate.
	1.12	Terrorists or terrorist organizations require financial support in order to achieve their aims. There is often a need for them to obscure or disguise links between them and their funding sources. It follows then that terrorist groups must similarly find ways to launder funds, regardless of whether the funds are from a legitimate or illegitimate source, in order to be able to use them without attracting the attention of the authorities.
Vulnerabilities in insurance industry		
	1.12a	*The insurance industry is vulnerable to ML and TF. The inherent characteristics of insurance products may give rise to ML risks unique to the insurance industry. When a life insurance policy matures or is surrendered, funds become available to the policy holder or other*

		beneficiaries (e.g. an assignee, where the policy has been assigned, or a trustee, where the policy has been placed in trust). The beneficiary to the contract may be changed possibly against payment before maturity or surrender, in order that payments can be made by the insurer to a new beneficiary. A policy might be used as collateral to purchase other financial instruments. These investments in themselves may only be one part of a sophisticated web of complex transactions with their origins elsewhere in the financial system.
	1.12b	*Examples of the type of long term insurance contracts that are vulnerable as a vehicle for laundering money or financing terrorism are products such as:* *(a) unit-linked or with profit single premium contracts;* *(b) single premium life insurance policies that store cash value;* *(c) fixed and variable annuities; and* *(d) (second hand) endowment policies.*
	1.12c	*ML and TF using reinsurance could occur either by establishing fictitious (re)insurance companies or reinsurance intermediaries, fronting arrangements and captives or by the misuse of normal reinsurance transactions. Examples include:* • *the deliberate placement via the insurer of the proceeds of crime or terrorist property with reinsurers in order to disguise the source of funds;* • *the establishment of bogus reinsurers, which may be used to launder the proceeds of crime or to facilitate terrorist funding;* • *the establishment of bogus insurers, which may be used to place the proceeds of crime or terrorist property with legitimate reinsurers.*
	1.12d	*Insurance intermediaries[2] are important for distribution, underwriting and claims settlement. They are often the direct link to the policy holder and therefore, intermediaries should play an important role in AML and CFT. The same principles that apply to authorized insurers should generally apply to insurance intermediaries. The person who wants to launder money or finance terrorism may seek an insurance intermediary who is not aware of or does not conform to necessary procedures, or who fails to recognize or report information regarding possible cases of*

[2] *Insurance intermediaries refer to appointed insurance agents or authorized insurance brokers carrying on or advising on long term insurance business in Hong Kong.*

		ML or TF. The intermediaries themselves could have been set up to channel illegitimate funds to insurers.
Legislation concerned with money laundering and terrorist financing		
	1.13	The Financial Action Task Force (the FATF) is an inter-governmental body formed in 1989 that sets the international AML standards. Its mandate was expanded in October 2001 to combat the financing of terrorism. In order to ensure full and effective implementation of its standards at the global level, the FATF monitors compliance by conducting evaluations on jurisdictions and undertakes stringent follow-up after the evaluations, including identifying high-risk and uncooperative jurisdictions which could be subject to enhanced scrutiny by the FATF or counter-measures by the FATF members and the international community at large. Many major economies have joined the FATF which has developed into a global network for international cooperation that facilitates exchanges between member jurisdictions. As a member of the FATF, Hong Kong is obliged to implement the AML requirements as promulgated by the FATF, which include the 40 Recommendations and the Nine Special Recommendations (hereafter referred to collectively as "FATF's Recommendations")[3] and it is important that Hong Kong complies with the international AML standards in order to maintain its status as an international financial centre.
	1.14	The four main pieces of legislation in Hong Kong that are concerned with ML/TF are the AMLO, the Drug Trafficking (Recovery of Proceeds) Ordinance (the DTROP), the Organized and Serious Crimes Ordinance (the OSCO) and the United Nations (Anti-Terrorism Measures) Ordinance (the UNATMO). It is very important that FIs and their officers and staff fully understand their respective responsibilities under the different legislation.
<u>AMLO</u>		
s.23, Sch. 2	1.15	The AMLO imposes requirements relating to customer due diligence (CDD) and record-keeping on FIs and provides RAs with the powers to supervise compliance with these requirements and other requirements under the AMLO. In addition, section 23 of Schedule 2 requires FIs to take all reasonable measures (a) to ensure that proper safeguards exist to prevent a contravention of any requirement under Parts 2 and 3 of Schedule 2; and (b) to mitigate ML/TF risks.

[3] The FATF's Recommendations can be found on the FATF website www.fatf-gafi.org.

s.5, AMLO	1.16	The AMLO makes it a criminal offence if an FI (1) knowingly; or (2) with the intent to defraud any RA, contravenes a specified provision of the AMLO. The "specified provisions" are listed in section 5(11) of the AMLO. If the FI knowingly contravenes a specified provision, it is liable to a maximum term of imprisonment of 2 years and a fine of $1 million. If the FI contravenes a specified provision with the intent to defraud any RA, it is liable to a maximum term of imprisonment of 7 years and a fine of $1 million upon conviction.
s.5, AMLO	1.17	The AMLO also makes it a criminal offence if a person who is an employee of an FI or is employed to work for an FI or is concerned in the management of an FI (1) knowingly; or (2) with the intent to defraud the FI or any RA, causes or permits the FI to contravene a specified provision in the AMLO. If the person who is an employee of an FI or is employed to work for an FI or is concerned in the management of an FI knowingly contravenes a specified provision he is liable to a maximum term of imprisonment of 2 years and a fine of $1 million upon conviction. If that person does so with the intent to defraud the FI or any RA he is liable to a maximum term of imprisonment of 7 years and a fine of $1 million upon conviction.
s.21, AMLO	1.18	RAs may take disciplinary actions against FIs for any contravention of a specified provision in the AMLO. The disciplinary actions that can be taken include publicly reprimanding the FI; ordering the FI to take any action for the purpose of remedying the contravention; and ordering the FI to pay a pecuniary penalty not exceeding the greater of $10 million or 3 times the amount of profit gained, or costs avoided, by the FI as a result of the contravention.
DTROP		
	1.19	The DTROP contains provisions for the investigation of assets that are suspected to be derived from drug trafficking activities, the freezing of assets on arrest and the confiscation of the proceeds from drug trafficking activities upon conviction.
OSCO		
	1.20	The OSCO, among other things: (a) gives officers of the Hong Kong Police and the Customs and Excise Department powers to investigate organized crime and triad activities; (b) gives the Courts jurisdiction to confiscate the proceeds of organized and serious crimes, to issue restraint orders and charging orders in

		relation to the property of a defendant of an offence specified in the OSCO; (c) creates an offence of money laundering in relation to the proceeds of indictable offences; and (d) enables the Courts, under appropriate circumstances, to receive information about an offender and an offence in order to determine whether the imposition of a greater sentence is appropriate where the offence amounts to an organized crime/triad related offence or other serious offences.
UNATMO		
	1.21	The UNATMO is principally directed towards implementing decisions contained in Resolution 1373 dated 28 September 2001 of the United Nations Security Council (UNSC) aimed at preventing the financing of terrorist acts. Besides the mandatory elements of the UNSC Resolution 1373, the UNATMO also implements the more pressing elements of the FATF's special recommendations on terrorist financing.
s.25, DTROP & OSCO	1.22	Under the DTROP and the OSCO, a person commits an offence if he deals with any property knowing or having reasonable grounds to believe it to represent any person's proceeds of drug trafficking or of an indictable offence respectively. The highest penalty for the offence upon conviction is imprisonment for 14 years and a fine of $5 million.
s.6, 7, 8, 13 & 14, UNATMO	1.23	The UNATMO, among other things, criminalizes the provision or collection of property and making any property or financial (or related) services available to terrorists or terrorist associates. The highest penalty for the offence upon conviction is imprisonment for 14 years and a fine. The UNATMO also permits terrorist property to be frozen and subsequently forfeited.
s.25A, DTROP & OSCO, s.12 & 14, UNATMO	1.24	The DTROP, the OSCO and the UNATMO also make it an offence if a person fails to disclose, as soon as it is reasonable for him to do so, his knowledge or suspicion of any property that directly or indirectly, represents a person's proceeds of, was used in connection with, or is intended to be used in connection with, drug trafficking, an indictable offence or is terrorist property respectively. This offence carries a maximum term of imprisonment of 3 months and a fine of $50,000 upon conviction.
s.25A, DTROP & OSCO, s.12	1.25	"Tipping off" is another offence under the DTROP, the OSCO and the UNATMO. A person commits an offence if, knowing or suspecting that a disclosure has been made, he discloses to any other person any matter

& 14, UNATMO		which is likely to prejudice any investigation which might be conducted following that first-mentioned disclosure. The maximum penalty for the offence upon conviction is imprisonment for 3 years and a fine.

Chapter 2 – AML/CFT SYSTEMS AND BUSINESS CONDUCTED OUTSIDE HONG KONG		
AML/CFT systems		
s.23(a) & (b), Sch. 2	2.1	FIs must take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of ML/TF and to prevent a contravention of any requirement under Part 2 or 3 of Schedule 2. To ensure compliance with this requirement, FIs should implement appropriate internal AML/CFT policies, procedures and controls (hereafter collectively referred to as "AML/CFT systems").
Risk factors		
	2.2	While no system will detect and prevent all ML/TF activities, FIs should establish and implement adequate and appropriate AML/CFT systems (including customer acceptance policies and procedures) taking into account factors including products and services offered, types of customers, geographical locations involved.
Product/service risk		
	2.3	An FI should consider the characteristics of the products and services that it offers and the extent to which these are vulnerable to ML/TF abuse. In this connection, an FI should assess the risks of any new products and services (especially those that may lead to misuse of technological developments or facilitate anonymity in ML/TF schemes) before they are introduced and ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks.
Delivery/distribution channel risk		
	2.4	An FI should also consider its delivery/distribution channels and the extent to which these are vulnerable to ML/TF abuse. These may include sales through online, postal or telephone channels where a non-face-to-face account opening approach is used. Business sold through intermediaries may also increase risk as the business relationship between the customer and an FI may become indirect.
Customer risk		
	2.5	When assessing the customer risk, FIs should consider who their customers are, what they do and any other information that may suggest the customer is of higher risk.

	2.6	An FI should be vigilant where the customer is of such a legal form that enables individuals to divest themselves of ownership of property whilst retaining an element of control over it or the business/industrial sector to which a customer has business connections is more vulnerable to corruption. Examples include: (a) companies that can be incorporated without the identity of the ultimate underlying principals being disclosed; (b) certain forms of trusts or foundations where knowledge of the identity of the true underlying principals or controllers cannot be guaranteed; (c) the provision for nominee shareholders; and (d) companies issuing bearer shares.
	2.7	An FI should also consider risks inherent in the nature of the activity of the customer and the possibility that the transaction may itself be a criminal transaction. For example, the arms trade and the financing of the arms trade is a type of activity that poses multiple ML and other risks, such as: (a) corruption risks arising from procurement contracts; (b) risks in relation to politically exposed persons (PEPs); and (c) terrorism and TF risks as shipments may be diverted.
Country risk		
	2.8	An FI should pay particular attention to countries or geographical locations of operation with which its customers and intermediaries are connected where they are subject to high levels of organized crime, increased vulnerabilities to corruption and inadequate systems to prevent and detect ML/TF. When assessing which countries are more vulnerable to corruption, FIs may make reference to publicly available information or relevant reports and databases on corruption risk published by specialised national, international, non-governmental and commercial organisations (an example of which is Transparency International's 'Corruption Perceptions Index', which ranks countries according to their perceived level of corruption).
Effective controls		
	2.9	To ensure proper implementation of such policies and procedures, FIs should have effective controls covering: (a) senior management oversight; (b) appointment of a Compliance Officer (CO) and a Money

		Laundering Reporting Officer (MLRO)[4]; (c) compliance and audit function; and (d) staff screening and training[5].
Senior management oversight		
	2.10	The senior management of any FI is responsible for managing its business effectively; in relation to AML/CFT this includes oversight of the functions described below.
	2.11	Senior management should: (a) be satisfied that the FI's AML/CFT systems are capable of addressing the ML/TF risks identified; (b) appoint a director or senior manager as a CO who has overall responsibility for the establishment and maintenance of the FI's AML/CFT systems; and (c) appoint a senior member of the FI's staff as the MLRO who is the central reference point for suspicious transaction reporting.
	2.12	In order that the CO and MLRO can discharge their responsibilities effectively, senior management should, as far as practicable, ensure that the CO and MLRO are: (a) subject to constraint of size of the FI, independent of all operational and business functions; (b) normally based in Hong Kong; (c) of a sufficient level of seniority and authority within the FI; (d) provided with regular contact with, and when required, direct access to senior management to ensure that senior management is able to satisfy itself that the statutory obligations are being met and that the business is taking sufficiently robust measures to protect itself against the risks of ML/TF; (e) fully conversant in the FI's statutory and regulatory requirements and the ML/TF risks arising from the FI's business; (f) capable of accessing, on a timely basis, all available information (both from internal sources such as CDD records and external sources such as circulars from RAs); and (g) equipped with sufficient resources, including staff and appropriate cover for the absence of the CO and MLRO (i.e. an alternate or deputy CO and MLRO who should, where practicable, have the

[4] The role and functions of an MLRO are detailed at paragraphs 7.19-7.30. For some FIs, the functions of the CO and the MLRO may be performed by the same staff member.

[5] For further guidance on staff training see Chapter 9.

		same status).
Compliance officer and money laundering reporting officer		
	2.13	The principal function of the CO is to act as the focal point within an FI for the oversight of all activities relating to the prevention and detection of ML/TF and providing support and guidance to the senior management to ensure that ML/TF risks are adequately managed. In particular, the CO should assume responsibility for: (a) developing and/or continuously reviewing the FI's AML/CFT systems to ensure they remain up-to-date and meet current statutory and regulatory requirements; and (b) the oversight of all aspects of the FI's AML/CFT systems which include monitoring effectiveness and enhancing the controls and procedures where necessary.
	2.14	In order to effectively discharge these responsibilities, a number of areas should be considered. These include: (a) the means by which the AML/CFT systems are managed and tested; (b) the identification and rectification of deficiencies in the AML/CFT systems; (c) reporting numbers within the systems, both internally and disclosures to the Joint Financial Intelligence Unit (JFIU); (d) the mitigation of ML/TF risks arising from business relationships and transactions with persons from countries which do not or insufficiently apply the FATF Recommendations; (e) the communication of key AML/CFT issues with senior management, including, where appropriate, significant compliance deficiencies; (f) changes made or proposed in respect of new legislation, regulatory requirements or guidance; (g) compliance with any requirement under Part 2 or 3 of Schedule 2 in overseas branches and subsidiary undertakings and any guidance issued by RAs in this respect; and (h) AML/CFT staff training.
	2.15	The MLRO should play an active role in the identification and reporting of suspicious transactions. Principal functions performed are expected to include: (a) reviewing all internal disclosures and exception reports and, in light of all available relevant information, determining whether or not it

		is necessary to make a report to the JFIU; (b) maintaining all records related to such internal reviews; (c) providing guidance on how to avoid "tipping off" if any disclosure is made; and (d) acting as the main point of contact with the JFIU, law enforcement, and any other competent authorities in relation to ML/TF prevention and detection, investigation or compliance.
Compliance and audit function		
	2.16	Where practicable, an FI should establish an independent compliance and audit function which should have a direct line of communication to the senior management of the FI.
	2.17	The compliance and audit function of the FI should regularly review the AML/CFT systems, e.g. sample testing, (in particular, the system for recognizing and reporting suspicious transactions) to ensure effectiveness. The frequency and extent of the review should be commensurate with the risks of ML/TF and the size of the FI's business. Where appropriate, the FI should seek a review from external sources.
Staff screening		
	2.18	FIs must establish, maintain and operate appropriate procedures in order to be satisfied of the integrity of any new employees.
Business conducted outside Hong Kong		
s.22(1), Sch. 2	2.19	A Hong Kong-incorporated FI with overseas branches or subsidiary undertakings should put in place a group AML/CFT policy to ensure that all branches and subsidiary undertakings that carry on the same business as an FI in a place outside Hong Kong have procedures in place to comply with the CDD and record-keeping requirements similar to those imposed under Parts 2 and 3 of Schedule 2 to the extent permitted by the law of that place. The FI should communicate the group policy to its overseas branches and subsidiary undertakings.
s.22(2), Sch. 2	2.20	When a branch or subsidiary undertaking of an FI outside Hong Kong is unable to comply with requirements that are similar to those imposed under Parts 2 and 3 of Schedule 2 because this is not permitted by local laws, the FI must: (a) inform the RA of such failure; and (b) take additional measures to effectively mitigate ML/TF risks faced by the branch or subsidiary undertaking as a result of its inability to comply with the above requirements.

s.25A, OSCO & DTROP	2.21	Suspicion that property in whole, or partly directly or indirectly represents the proceeds of an indictable offence, should normally be reported within the jurisdiction where the suspicion arises and where the records of the related transactions are held. However, in certain cases, e.g. when the account is domiciled in Hong Kong, reporting to the JFIU[6] may be required in such circumstances, but only if section 25A of OSCO/DTROP applies.

[6] Section 25(4) of the OSCO stipulates that an indictable offence includes conduct outside Hong Kong which would constitute an indictable offence if it had occurred in Hong Kong. Therefore, where an FI in Hong Kong has information regarding money laundering, irrespective of the location, it should consider seeking clarification with and making a report to the JFIU.

Chapter 3 – RISK-BASED APPROACH		
Introduction		
	3.1	The risk-based approach to CDD and ongoing monitoring (RBA) is recognized as an effective way to combat ML/TF. The general principle of an RBA is that where customers are assessed to be of higher ML/TF risks, FIs should take enhanced measures to manage and mitigate those risks, and that correspondingly where the risks are lower, simplified measures may be applied. The use of an RBA has the advantage of allowing resources to be allocated in the most efficient way directed in accordance with priorities so that the greatest risks receive the highest attention.
General requirement		
	3.2	FIs should determine the extent of CDD measures and ongoing monitoring, using an RBA depending upon the background of the customer and the product, transaction or service used by that customer, so that preventive or mitigating measures are commensurate to the risks identified. The measures must however comply with the legal requirements of the AMLO. The RBA will enable FIs to subject customers to proportionate controls and oversight by determining: (a) the extent of the due diligence to be performed on the direct customer; the extent of the measures to be undertaken to verify the identity of any beneficial owner and any person purporting to act on behalf of the customer; (b) the level of ongoing monitoring to be applied to the relationship; and (c) measures to mitigate any risks identified. For example, the RBA may require extensive CDD for high risk customers, such as an individual (or corporate entity) whose source of wealth and funds is unclear or who requires the setting up of complex structures. FIs should be able to demonstrate to the RAs that the extent of CDD and ongoing monitoring is appropriate in view of the customer's ML/TF risks.

	3.3	There are no universally accepted methodologies that prescribe the nature and extent of an RBA. However, an effective RBA does involve identifying and categorizing ML/TF risks at the customer level and establishing reasonable measures based on risks identified. An effective RBA will allow FIs to exercise reasonable business judgment with respect to their customers. An RBA should not be designed to prohibit FIs from engaging in transactions with customers or establishing business relationships with potential customers, but rather it should assist FIs to effectively manage potential ML/TF risks.
Customer acceptance/risk assessment		
	3.4	FIs may assess the ML/TF risks of individual customers by assigning a ML/TF risk rating to their customers.
	3.5	While there is no agreed upon set of risk factors and no one single methodology to apply these risk factors in determining the ML/TF risk rating of customers, relevant factors to be considered may include the following: <u>1. Country risk</u> Customers with residence in or connection with high-risk jurisdictions[7] for example: (a) those that have been identified by the FATF as jurisdictions with strategic AML/CFT deficiencies; (b) countries subject to sanctions, embargos or similar measures issued by, for example, the United Nations; (c) countries which are vulnerable to corruption; and (d) those countries that are believed to have strong links to terrorist activities. In assessing country risk associated with a customer, consideration may be given to local legislation (United Nations Sanctions Ordinance (UNSO), UNATMO), data available from the United Nations, the International Monetary Fund, the World Bank, the FATF, etc. and the FI's own experience or the experience of other group entities (where the FI is part of a multi-national group) which may have indicated weaknesses in other jurisdictions.

[7] Guidance on jurisdictions that do not or insufficiently apply the FATF's Recommendations or otherwise pose a higher risk is provided at paragraphs 4.15.

		2. Customer risk The following are examples of customers who might be considered to carry lower ML/TF risks: (a) customers who are employment-based or with a regular source of income from a known legitimate source which supports the activity being undertaken; and (b) the reputation of the customer, e.g. a well-known, reputable private company, with a long history that is well documented by independent sources, including information regarding its ownership and control. However, some customers, by their nature or behaviour might present a higher risk of ML/TF. Factors might include: (a) the public profile of the customer indicating involvement with, or connection to, PEPs; (b) complexity of the relationship, including use of corporate structures, trusts and the use of nominee and bearer shares where there is no legitimate commercial rationale; (c) a request to use numbered accounts or undue levels of secrecy with a transaction; (d) involvement in cash-intensive businesses; (e) nature, scope and location of business activities generating the funds/assets, having regard to sensitive or high-risk activities; and (f) where the origin of wealth (for high risk customers and PEPs) or ownership cannot be easily verified. 3. Product/service risk Factors presenting higher risk might include: (a) services that inherently have provided more anonymity; and (b) ability to pool underlying customers/funds. 4. Delivery/distribution channel risk The distribution channel for products may alter the risk profile of a customer. This may include sales through online, postal or telephone channels where a non-face-to-face account opening approach is used. Business sold through intermediaries may also increase risk as the

		business relationship between the customer and an FI may become indirect.
Ongoing review		
	3.6	The identification of higher risk customers, products and services, including delivery channels, and geographical locations are not static assessments. They will change over time, depending on how circumstances develop, and how threats evolve. In addition, while a risk assessment should always be performed at the inception of a customer relationship, for some customers, a comprehensive risk profile may only become evident once the customer has begun transacting through an account, making monitoring of customer transactions and ongoing reviews a fundamental component of a reasonably designed RBA. An FI may therefore have to adjust its risk assessment of a particular customer from time to time or based upon information received from a competent authority, and review the extent of the CDD and ongoing monitoring to be applied to the customer.
	3.7	FIs should keep its policies and procedures under regular review and assess that its risk mitigation procedures and controls are working effectively.
Documenting risk assessment		
	3.8	An FI should keep records and relevant documents of the risk assessment covered in this Chapter so that it can demonstrate to the RAs, among others: (a) how it assesses the customer's ML/TF risk; and (b) the extent of CDD and ongoing monitoring is appropriate based on that customer's ML/TF risk.

Chapter 4 - CUSTOMER DUE DILIGENCE		
4.1 Introduction to CDD		
	4.1.1	The AMLO defines what CDD measures are (see paragraph 4.1.3) and also prescribes the circumstances in which an FI must carry out CDD (see paragraph 4.1.9). As indicated in the AMLO, FIs may also need to conduct additional measures (referred to as enhanced customer due diligence (EDD) hereafter) or could conduct simplified customer due diligence (SDD) depending on specific circumstances. This chapter sets out the expectations of RAs in this regard and suggests ways that these expectations may be met. Wherever possible, the guideline gives FIs a degree of discretion in how they comply with the AMLO and put in place procedures for this purpose.
	4.1.2	CDD information is a vital tool for recognising whether there are grounds for knowledge or suspicion of ML/TF.
s.2, Sch. 2	4.1.3	The following are CDD measures applicable to an FI: (a) identify the customer and verify the customer's identity using reliable, independent source documents, data or information (see paragraphs 4.2); (b) where there is a beneficial owner in relation to the customer, identify and take reasonable measures to verify the beneficial owner's identity so that the FI is satisfied that it knows who the beneficial owner is, including in the case of a legal person or trust[8], measures to enable the FI to understand the ownership and control structure of the legal person or trust (see paragraphs 4.3); (c) obtain information on the purpose and intended nature of the business relationship (if any) established with the FI unless the purpose and intended nature are obvious (see paragraphs 4.6); and (d) if a person purports to act on behalf of the customer: (i) identify the person and take reasonable measures to verify the person's identity using reliable and independent source documents, data or information; and (ii) verify the person's authority to act on behalf of the customer (see paragraphs 4.4).

[8] For the purpose of this guideline, a trust means an express trust or any similar arrangement for which a legal-binding document (i.e. a trust deed or in any other forms) is in place.

	4.1.4	The term "customer" is not defined in the AMLO. Its meaning should be inferred from its everyday meaning and in the context of the industry practice.
	4.1.4a	*For the insurance industry, the term "customer" refers to policy holder.*
	4.1.5	In determining what constitutes reasonable measures to verify the identity of a beneficial owner and reasonable measures to understand the ownership and control structure of a legal person or trust, the FI should consider and give due regard to the ML/TF risks posed by a particular customer and a particular business relationship. Due consideration should also be given to the measures set out in Chapter 3.
	4.1.6	FIs should adopt a balanced and common sense approach with regard to customers connected with jurisdictions which do not or insufficiently apply the FATF recommendations (see paragraphs 4.15). While extra care may well be justified in such cases, unless a RA has, through a "notice in writing", imposed a general or specific requirement (see paragraph 4.16.1), it is not a requirement that FIs should refuse to do any business with such customers or automatically classify them as high risk and subject them to EDD process. Rather, FIs should weigh all the circumstances of the particular situation and assess whether there is a higher than normal risk of ML/TF.
s.1, Sch. 2	4.1.7	"Business relationship" between a person and an FI is defined in the AMLO as a business, professional or commercial relationship: (a) that has an element of duration; or (b) that the FI, at the time the person first contacts it in the person's capacity as a potential customer of the FI, expects to have an element of duration.
s.1, Sch. 2	4.1.8	The term "occasional transaction" is defined in the AMLO as a transaction between an FI and a customer who does not have a business relationship with the FI.[9]
s.3(1), Sch. 2	4.1.9	CDD requirements should apply: (a) at the outset of a business relationship;

[9] It should be noted that "occasional transactions" do not apply to the insurance and securities sectors.

		(b) before performing any occasional transaction[10]: (i) equal to or exceeding an aggregate value of $120,000, whether carried out in a single operation or several operations that appear to the FI to be linked; or (ii) a wire transfer equal to or exceeding an aggregate value of $8,000, whether carried out in a single operation or several operations that appear to the FI to be linked; (c) when the FI suspects that the customer or the customer's account is involved in ML/TF[11]; or (d) when the FI doubts the veracity or adequacy of any information previously obtained for the purpose of identifying the customer or for the purpose of verifying the customer's identity.
	4.1.10	FIs should be vigilant to the possibility that a series of linked occasional transactions could meet or exceed the CDD thresholds of $8,000 for wire transfers and $120,000 for other types of transactions. Where FIs become aware that these thresholds are met or exceeded, full CDD procedures must be applied.
	4.1.11	The factors linking occasional transactions are inherent in the characteristics of the transactions – for example, where several payments are made to the same recipient from one or more sources over a short period, where a customer regularly transfers funds to one or more destinations. In determining whether the transactions are in fact linked, FIs should consider these factors against the timeframe within which the transactions are conducted.
4.2 Identification and verification of the customer's identity		
s.2(1)(a), Sch. 2	4.2.1	The FI must identify the customer and verify the customer's identity by reference to documents, data or information provided by a reliable and independent source[12]: (a) a governmental body; (b) the RA or any other RA; (c) an authority in a place outside Hong Kong that performs functions similar to those of the RA or any other RA; or (d) any other reliable and independent source that is recognized by the RA.

[10] Occasional transactions may include for example, wire transfers, currency exchanges, purchase of cashier orders or gift cheques.

[11] This criterion applies irrespective of the $120,000 threshold.

[12] See Appendix A which contains a list of documents recognized by the RAs as independent and reliable sources for identity verification purposes.

4.3 Identification and verification of a beneficial owner		
s.1 & s.2(1)(b), Sch. 2	4.3.1	A beneficial owner is normally an individual who ultimately owns or controls the customer or on whose behalf a transaction or activity is being conducted. In respect of a customer who is an individual not acting in an official capacity on behalf of a legal person or trust, the customer himself is normally the beneficial owner. There is no requirement on FIs to make proactive searches for beneficial owners in such a case, but they should make appropriate enquiries where there are indications that the customer is not acting on his own behalf.
	4.3.2	Where an individual is identified as a beneficial owner, the FI should endeavour to obtain the same identification information as at paragraph 4.8.1.
	4.3.3	The verification requirements under the AMLO are, however, different for a customer and a beneficial owner.
	4.3.4	The obligation to verify the identity of a beneficial owner is for the FI to take reasonable measures, based on its assessment of the ML/TF risks, so that it is satisfied that it knows who the beneficial owner is.
s.1 & s.2(2), Sch. 2	4.3.5	FIs should identify all beneficial owners of a customer. In relation to verification of beneficial owners' identities, except where a situation referred to in section 15 of Schedule 2 exists ("high risk"), the AMLO requires FIs to take reasonable measures to verify the identity of any beneficial owners owning or controlling 25% or more of the voting rights or shares, etc. of a corporation, partnership or trust. In high risk situations referred to in section 15 of Schedule 2, the threshold for the requirement is 10%.[13]
	4.3.6	For beneficial owners, FIs should obtain the residential address (and permanent address if different) and may adopt a risk-based approach to determine the need to take reasonable measures to verify the address, taking account of the number of beneficial owners, the nature and distribution of the interests in the entity and the nature and extent of any business, contractual or family relationship.
4.4 Identification and verification of a person purporting to act on behalf of the customer		

[13] In circumstances where an existing customer is reclassified as high-risk under section 15 of Schedule 2, FIs may consider delaying taking reasonable measures to verify the beneficial owner's identity according to the enhanced threshold (i.e. remediate from 25% to 10%) where a risk of tipping-off exists.

s.2(1)(d), Sch. 2	4.4.1	If a person purports to act on behalf of the customer, FIs must: (i) identify the person and take reasonable measures to verify the person's identity on the basis of documents, data or information provided by- (A) a governmental body; (B) the relevant authority or any other relevant authority; (C) an authority in a place outside Hong Kong that performs functions similar to those of the relevant authority or any other relevant authority; or (D) any other reliable and independent source that is recognised by the relevant authority; and (ii) verify the person's authority to act on behalf of the customer.
	4.4.2	The general requirement is to obtain the same identification information as set out in paragraph 4.8.1. In taking reasonable measures to verify the identity of persons purporting to act on behalf of customers (e.g. authorized account signatories and attorneys), the FI should refer to the documents and other means listed in Appendix A wherever possible. As a general rule FIs should identify and verify the identity of those authorized to give instructions for the movement of funds or assets.
s.2(1)(d)(ii), Sch. 2	4.4.3	FIs should obtain written authority[14] to verify that the individual purporting to represent the customer is authorized to do so.
s.2(1)(d), Sch. 2	4.4.4	FIs may on occasion encounter difficulties in identifying and verifying signatories of customers that may have long lists of account signatories, particularly if such customers are based outside Hong Kong. In such cases, FIs may adopt a risk-based approach in determining the appropriate measures to comply with these requirements; for example in respect of verification of account signatories related to a customer, such as an FI or a listed company[15], FIs could adopt a more streamlined approach. The provision of a signatory list[16], recording the names of the account signatories, whose identities and authority to act have been confirmed by a department or person within that customer which is independent to the persons whose identities are being verified (e.g. compliance, audit or human resources), may be sufficient to demonstrate compliance with these requirements.

[14] For corporation, FIs should obtain the board resolution or similar written authority.
[15] Having regard to the advice provided at paragraphs 4.15.
[16] Or equivalent.

		Another option, mainly relevant to overseas customers and which may be considered in conjunction with or separately from reducing the signatories list, is the use of intermediaries in accordance with section 18 of Schedule 2.
4.4a Special requirements for insurance policies		
s.11(1), Sch. 2	*4.4a.1*	*An II must, whenever a beneficiary or a new beneficiary is identified or designated by the policy holder of an insurance policy:* *(a) if the beneficiary is identified by name, record the name of the beneficiary;* *(b) if the beneficiary is designated by description (e.g. by characteristics or by class) or other means (e.g. under a will), obtain sufficient information about the beneficiary to satisfy itself that it will be able to establish the identity of the beneficiary:* *(i) at the time the beneficiary exercises a right vested in the beneficiary under the insurance policy; or* *(ii) at the time of payout or, if there is more than one payout, the time of the first payout to the beneficiary in accordance with the terms of the insurance policy,* *whichever is the earlier.*
s.11(2), Sch. 2	*4.4a.2*	*An II must carry out the measures specified in paragraphs 4.4a.3 and 4.4a.4:* *(a) at the time a beneficiary exercises a right vested in the beneficiary under an insurance policy; or* *(b) at the time of payout or, if there is more than one payout, the time of the first payout to a beneficiary in accordance with the terms of an insurance policy,* *whichever is the earlier.*
s.11(3)(a), Sch. 2	*4.4a.3*	*An II must verify the beneficiary's identity by reference to documents, data or information provided by a reliable and independent source:* *(a) a governmental body;* *(b) the RA or any other RA;* *(c) an authority in a place outside Hong Kong that performs functions similar to those of the RA or any other RA; or* *(d) any other reliable and independent source that is recognized by the RA.*

s.11(3)(b), Sch. 2	*4.4a.4*	*Where the beneficiary is a legal person or trust, an II must:* *(i) identify its beneficial owners; and* *(ii) if there is a high risk of ML or TF having regard to the particular circumstances of the beneficial owners, take reasonable measures to verify the beneficial owners' identities so that the II knows who the beneficial owners are.*
	4.4a.5	*Where an II is unable to comply with paragraphs 4.4a.1 to 4.4a.4 above, it should consider making a suspicious transaction report.*
	4.4a.6	*If payments made under the terms of the policy are to be paid to persons or companies other than the customers or beneficiaries, then the proposed recipients of these monies should also be the subjects of identification and verification.*
4.4b Requirements for reinsurance		
	4.4b.1	*Reinsurers are subject to the CDD and record-keeping requirements set out in Schedule 2. The customers in relation to whom the reinsurers should carry out the CDD measures are the ceding insurers.*
4.5 Characteristics and evidence of identity		
	4.5.1	No form of identification can be fully guaranteed as genuine or representing correct identity and FIs should recognise that some types of documents are more easily forged than others. If suspicions are raised in relation to any document offered, FIs should take whatever practical and proportionate steps are available to establish whether the document offered is genuine, or has been reported as lost or stolen. This may include searching publicly available information, approaching relevant authorities (such as the Immigration Department through its hotline) or requesting corroboratory evidence from the customer. Where suspicion cannot be eliminated, the document should not be accepted and consideration should be given to making a report to the authorities. Where documents are in a foreign language, appropriate steps should be taken by the FI to be reasonably satisfied that the documents in fact provide evidence of the customer's identity (e.g. ensuring that staff assessing such documents are proficient in the language or obtaining

		a translation from a suitably qualified person).
4.6 Purpose and intended nature of business relationship		
s.2(1)(c), Sch. 2	4.6.1	An FI must understand the purpose and intended nature of the business relationship. In some instances, this will be self-evident, but in many cases, the FI may have to obtain information in this regard.
	4.6.2	Unless the purpose and intended nature are obvious, FIs should obtain satisfactory information from all new customers as to the intended purpose and reason for opening the account or establishing the business relationship, and record the information on the account opening documentation. Depending on the FI's risk assessment of the situation, information that might be relevant may include: (a) nature and details of the business/occupation/employment; (b) the anticipated level and nature of the activity that is to be undertaken through the relationship (e.g. what the typical transactions are likely to be); (c) location of customer; (d) the expected source and origin of the funds to be used in the relationship; and (e) initial and ongoing source(s) of wealth or income.
	4.6.3	This requirement also applies in the context of non-residents. While the vast majority of non-residents seek business relationships with FIs in Hong Kong for perfectly legitimate reasons, some non-residents may represent a higher risk for ML/TF. An FI should understand the rationale for a non-resident to seek to establish a business relationship in Hong Kong.
4.7 Timing of identification and verification of identity		
General requirement		
s.3(1), Sch. 2	4.7.1	An FI must complete the CDD process before establishing any business relationship or before carrying out a specified occasional transaction (exceptions are set out at paragraph 4.7.4).
s.3(4), Sch. 2	4.7.2	Where the FI is unable to complete the CDD process in accordance with paragraph 4.7.1, it must not establish a business relationship or carry out any occasional transaction with that customer and should assess whether this failure provides grounds for knowledge or suspicion of ML/TF and a report to the JFIU is appropriate.
Delayed identity verification during the establishment of a business relationship		

	4.7.3	Customer identification information (and information on any beneficial owners) and information about the purpose and intended nature of the business relationship should be obtained before the business relationship is entered into.
s.3(2), (3) & (4)(b), Sch. 2	4.7.4	However, FIs may, exceptionally, verify the identity of the customer and any beneficial owner after establishing the business relationship, provided that: (a) any risk of ML/TF arising from the delayed verification of the customer's or beneficial owner's identity can be effectively managed; (b) it is necessary not to interrupt the normal course of business with the customer; (c) verification is completed as soon as reasonably practicable; and (d) the business relationship will be terminated if verification cannot be completed as soon as reasonably practicable.
	4.7.5	Examples of situations where it may be necessary not to interrupt the normal conduct of business include: (a) securities transactions – in the securities industry, companies and intermediaries may be required to perform transactions very rapidly, according to the market conditions at the time the customer is contacting them, and the performance of the transaction may be required before verification of identity is completed; and (b) life insurance business – in relation to identification and verification of the beneficiary under the policy. This may take place after the business relationship with the policy holder is established, but in all such cases, identification and verification should occur at or before the time of payout or the time when the beneficiary intends to exercise vested rights under the policy.
	4.7.5a	*Having considered the difficulty for IIs to obtain copies of the identification documents of individual customers when the sales process occurs outside the office, IIs may obtain and keep copies of the identification documents after having established the business relationship provided that the ML/TF risks are effectively managed. In all such circumstances, copies of identification documents of individual customers should be obtained and copied for retention in the reasonable timeframe as stated in paragraph 4.7.8 or at or before the time of payout, whichever is the earlier.*

	4.7.6	Where a customer is permitted to utilise the business relationship prior to verification, FIs should adopt appropriate risk management policies and procedures concerning the conditions under which this may occur. These policies and procedures should include: (a) establishing timeframes for the completion of the identity verification measures; (b) regular monitoring of such relationships pending completion of the identity verification, and keeping senior management periodically informed of any pending completion cases; (c) obtaining all other necessary CDD information; (d) ensuring verification of identity is carried out as soon as it is reasonably practicable; (e) advising the customer of the FI's obligation to terminate the relationship at any time on the basis of non-completion of the verification measures; (f) placing appropriate limits on the number of transactions and type of transactions that can be undertaken pending verification; and (g) ensuring that funds are not paid out to any third party. Exceptions[17] may be made to allow payments to third parties subject to the following conditions: (i) there is no suspicion of ML/TF; (ii) the risk of ML/TF is assessed to be low; (iii) the transaction is approved by senior management, who should take account of the nature of the business of the customer before approving the transaction; and (iv) the names of recipients do not match with watch lists such as those for terrorist suspects and PEPs.
	4.7.7	The FI must not use this concession for the circumvention of CDD procedures, in particular, where it: (a) has knowledge or a suspicion of ML/TF; (b) becomes aware of anything which causes it to doubt the identity or intentions of the customer or beneficial owner; or (c) the business relationship is assessed to pose a higher risk.
Failure to complete verification of identity		

[17] It should be noted that the exceptions do not apply to insurance sector.

s.3(4)(b), Sch. 2	4.7.8	Verification of identity should be concluded within a reasonable timeframe[18]. Where verification cannot be completed within such a period, the FI should as soon as reasonably practicable suspend or terminate the business relationship unless there is a reasonable explanation for the delay. Examples of reasonable timeframe are: (a) the FI completing such verification no later than 30 working days after the establishment of business relations; (b) the FI suspending business relations with the customer and refraining from carrying out further transactions (except to return funds to their sources, to the extent that this is possible) if such verification remains uncompleted 30 working days after the establishment of business relations; and (c) the FI terminating business relations with the customer if such verification remains uncompleted 120 working days after the establishment of business relations.
s.25A, DTROP & OSCO, s.12, UNATMO	4.7.9	The FI should assess whether this failure provides grounds for knowledge or suspicion of ML/TF and a report to the JFIU is appropriate.
	4.7.10	Wherever possible, when terminating a relationship where funds or other assets have been received, the FI should return the funds or assets to the source from which they were received. In general, this means that the funds or assets should be returned to the customer/account holder but this may not always be possible.
	4.7.11	FIs must guard against the risk of ML/TF since this is a possible means by which funds can be "transformed", e.g. from cash into a cashier order. Where the customer requests that money or other assets be transferred to third parties, the FI should assess whether this provides grounds for knowledge or suspicion of ML/TF and a report to the JFIU is appropriate.
<u>Keeping customer information up-to-date</u>		
s.5(1)(a), Sch. 2	4.7.12	Once the identity of a customer has been satisfactorily verified, there is no obligation to re-verify identity (unless doubts arise as to the veracity or adequacy of the evidence previously obtained for the purposes of customer identification); however, FIs should take steps from time to time to ensure that the customer information that has

[18] The same principle applies to the verification of address for a direct customer; an example of a reasonable timeframe being 90 working days.

		been obtained for the purposes of complying with the requirements of sections 2 and 3 of Schedule 2 are up-to-date and relevant. To achieve this, an FI should undertake periodic reviews of existing records of customers. An appropriate time to do so is upon certain trigger events. These include: (a) when a significant transaction[19] is to take place; (b) when a material change occurs in the way the customer's account is operated[20]; (c) when the FIs customer documentation standards change substantially; or (d) when the FI is aware that it lacks sufficient information about the customer concerned. In all cases, the factors determining the period of review or what constitutes a trigger event should be clearly defined in the FIs' policies and procedures.
	4.7.12a	*Examples of trigger events after establishment of an insurance contract may include:* *(a) there is change in beneficiaries (for instance, to include non-family members, request for payments to persons other than beneficiaries);* *(b) there is significant increase in the amount of sum insured or premium payment that appears unusual in the light of the income of the policy holder;* *(c) there is use of cash and/or payment of large single premiums;* *(d) there is payment/surrender by a wire transfer from/to foreign parties;* *(e) there is payment by banking instruments which allow anonymity of the transaction;* *(f) there is change of address and/or place of residence of the policy holder and/or beneficial owner;* *(g) there are lump sum top-ups to an existing life insurance contract;*

[19] The word "significant" is not necessarily linked to monetary value. It may include transactions that are unusual or not in line with the FI's knowledge of the customer.

[20] Reference should also be made to section 6 of Schedule 2 "Provisions relating to Pre-Existing Customers".

		(h) there are lump sum contributions to personal pension contracts; *(i) there are requests for prepayment of benefits;* *(j) there is use of the policy as collateral/security (for instance, unusual use of the policy as collateral unless it is clear that it is required for financing of a mortgage by a reputable financial institution);* *(k) there is change of the type of benefit (for instance, change of type of payment from an annuity into a lump sum payment);* *(l) there is early surrender of the policy or change of the duration (where this causes penalties or loss of tax relief);* *(m) there is request for payment of benefits at the maturity date;* *(n) the II is aware that it lacks sufficient information about the customer and/or beneficial owner;* *(o) there is a suspicion of ML and TF; or* *(p) benefits from one insurance policy are used to fund the premium payments of the insurance policy of another unrelated person.*
	4.7.13	All high-risk customers (excluding dormant accounts) should be subject to a minimum of an annual review, and more frequently if deemed necessary by the FI, of their profile to ensure the CDD information retained remains up-to-date and relevant. FIs should however clearly define what constitutes a dormant account in their policies and procedures.
4.8 Natural persons		
Identification		
s.2, Sch. 2	4.8.1	FIs should collect the following identification information in respect of personal customers who need to be identified: (a) full name; (b) date of birth; (c) nationality; and (d) identity document type and number.
Verification (Hong Kong residents)		
s.2(1)(a), Sch. 2	4.8.2	For Hong Kong permanent residents, FIs should verify an individual's name, date of birth and identity card number by reference to their Hong Kong identity card. FIs should retain a copy of the individual's identity card.

	4.8.3	For children born in Hong Kong who are under the age of 12 and not in possession of a valid travel document or Hong Kong identity card, the child's identity should be verified by reference to their Hong Kong birth certificate. Whenever establishing business relationships with a minor, the identity of the minor's parent or guardian representing or accompanying the minor should be recorded and verified in accordance with the above requirements.
	4.8.4	For non-permanent residents, FIs should verify an individual's name, date of birth, nationality and travel document number and type by reference to a valid travel document (e.g. an unexpired international passport). In this respect the FI should retain a copy of the "biodata" page which contains the bearer's photograph and biographical details. Alternatively, FIs may verify the individual's name, date of birth, identity card number by reference to their Hong Kong identity card and the individual's nationality by reference to: (a) a valid travel document; (b) a relevant national (i.e. government or state-issued) identity card bearing the individual's photograph; or (c) any government or state-issued document which certifies nationality. FIs should retain a copy of the above documents.
Verification (non-residents)		
s.2(1)(a), Sch. 2	4.8.5	For non-residents who are physically present in Hong Kong for verification purposes, FIs should verify an individual's name, date of birth, nationality and travel document number and type by reference to a valid travel document (e.g. an unexpired international passport). In this respect the FI should retain a copy of the "biodata" page which contains the bearer's photograph and biographical details.
s.2(1)(a), Sch. 2	4.8.6	For non-residents who are not physically present in Hong Kong for verification purposes, FIs should verify the individual's identity, including name, date of birth, nationality, identity or travel document number and type by reference to: (a) a valid travel document; (b) a relevant national (i.e. government or state-issued) identity card

		bearing the individual's photograph; (c) a valid national driving license bearing the individual's photograph; or (d) any applicable alternatives mentioned in Appendix A.
s.9, Sch. 2	4.8.7	In respect of paragraph 4.8.6 above, where a customer has not been physically present for identification purposes, an FI must also carry out the measures at section 9 of Schedule 2, with reference to the guidance provided at paragraphs 4.12.
Address identification and verification		
	4.8.8	An FI should obtain and verify the residential address (and permanent address if different) of a direct customer with whom it establishes a business relationship as this is useful for verifying an individual's identity and background.
	4.8.9	For avoidance of doubt, it is the trustee of the trust who will enter into a business relationship or carry out a transaction on behalf of the trust and who will be considered to be the customer. The address of the trustee in a direct customer relationship should therefore always be verified.
	4.8.10	Methods for verifying residential addresses may include obtaining[21]: (a) a recent utility bill issued within the last 3 months; (b) recent correspondence from a Government department or agency (i.e. issued within the last 3 months); (c) a statement, issued by an authorized institution, a licensed corporation or an authorized insurer within the last 3 months; (d) a record of a visit to the residential address by the FI; (e) an acknowledgement of receipt duly signed by the customer in response to a letter sent by the FI to the address provided by the customer; (f) a letter from an immediate family member at which the individual resides confirming that the applicant lives at that address in Hong Kong, setting out the relationship between the applicant and the immediate family member, together with evidence that the immediate family member resides at the same address (for persons such as students and housewives who are unable to provide proof of address of their own name); (g) mobile phone or pay TV statement (sent to the address provided

[21] The examples provided are not exhaustive.

		by the customer) issued within the last 3 months; (h) a letter from a Hong Kong nursing or residential home for the elderly or disabled, which an FI is satisfied that it can place reliance on, confirming the residence of the applicant; (i) a letter from a Hong Kong university or college, which an FI is satisfied that it can place reliance on, that confirms residence at a stated address; (j) a Hong Kong tenancy agreement which has been duly stamped by the Inland Revenue Department; (k) a current Hong Kong domestic helper employment contract stamped by an appropriate Consulate (the name of the employer should correspond with the applicant's visa endorsement in their passport); (l) a letter from a Hong Kong employer together with proof of employment, which an FI is satisfied that it can place reliance on and that confirms residence at a stated address in Hong Kong; (m) a lawyer's confirmation of property purchase, or legal document recognising title to property; and (n) for non-Hong Kong residents, a government-issued photographic driving license or national identity card containing the current residential address or bank statements issued by a bank in an equivalent jurisdiction where the FI is satisfied that the address has been verified.
	4.8.11	It is conceivable that FIs may not always be able to adopt any of the suggested methods in the paragraph above. Examples include countries without postal deliveries and virtually no street addresses, where residents rely upon post office boxes or their employers for the delivery of mail. Some customers may simply be unable to produce evidence of address to the standard outlined above. In such circumstances FIs may, on a risk sensitive basis, adopt a common sense approach by adopting alternative methods such as obtaining a letter from a director or manager of a verified known overseas employer that confirms residence at a stated overseas address (or provides detailed directions to locate a place of residence). There may also be circumstances where a customer's address is a temporary accommodation and where normal address verification documents are not available. For example, an expatriate on a short-term contract. FIs should adopt flexible procedures to obtain verification by other means, e.g. copy of contract of employment, or bank's or employer's written confirmation. FIs should exercise a degree of flexibility under special circumstances (e.g. where a

		customer is homeless). For the avoidance of doubt, a post office box address is not sufficient for persons residing in Hong Kong or corporate customers registered and/or operating in Hong Kong.
Other considerations		
	4.8.12	The standard identification requirement is likely to be sufficient for most situations. If, however, the customer, or the product or service, is assessed to present a higher ML/TF risk because of the nature of the customer, his business, his location, or because of the product features, etc., the FI should consider whether it should require additional identity information to be provided, and/or whether to verify additional aspects of identity.
	4.8.13	Appendix A contains a list of documents recognised by the RAs as independent and reliable sources for identity verification purposes.
4.9 Legal persons and trusts		
General		
	4.9.1	For legal persons, the principal requirement is to look behind the customer to identify those who have ultimate control or ultimate beneficial ownership over the business and the customer's assets. FIs would normally pay particular attention to persons who exercise ultimate control over the management of the customer.
s.2(1)(b), Sch. 2	4.9.2	In deciding who the beneficial owner is in relation to a legal person where the customer is not a natural person, the FI's objective is to know who has ownership or control over the legal person which relates to the relationship, or who constitutes the controlling mind and management of any legal entity involved in the funds. Verifying the identity of the beneficial owner(s) should be carried out using reasonable measures based on a risk-based approach, following the guidance in Chapter 3.
	4.9.3	Where the owner is another legal person or trust, the objective is to undertake reasonable measures to look behind that legal person or trust and to verify the identity of beneficial owners. What constitutes control for this purpose will depend on the nature of the institution, and may vest in those who are mandated to manage funds, accounts or investments without requiring further authorisation.
s.2(1)(b), Sch. 2	4.9.4	For a customer other than a natural person, FIs should ensure that they fully understand the customer's legal form, structure and ownership, and should additionally obtain information on the nature of its

		business, and the reasons for seeking the product or service unless the reasons are obvious.
s.5(1)(a) & s.6, Sch. 2	4.9.5	FIs should conduct reviews from time to time to ensure the customer information held is up-to-date and relevant; methods by which a review could be conducted include conducting company searches, seeking copies of resolutions appointing directors, noting the resignation of directors, or by other appropriate means.
	4.9.6	Many entities operate internet websites, which contain information about the entity. FIs should bear in mind that this information, although helpful in providing much of the materials that an FI might need in relation to the customer, its management and business, may not be independently verified.
Corporation		
Identification information		
	4.9.7	The information below should be obtained as a standard requirement; thereafter, on the basis of the ML/TF risk, an FI should decide whether further verification of identity is required and if so the extent of that further verification. The FI should also decide whether additional information in respect of the corporation, its operation and the individuals behind it should be obtained. An FI should obtain and verify the following information in relation to a customer which is a corporation: (a) full name; (b) date and place of incorporation; (c) registration or incorporation number; and (d) registered office address in the place of incorporation. If the business address of the customer is different from the registered office address in (d) above, the FI should obtain information on the business address and verify as far as practicable.

	4.9.8	In the course of verifying the customer's information mentioned in paragraph 4.9.7, an FI should also obtain the following information[22]: (a) a copy of the certificate of incorporation and business registration (where applicable); (b) a copy of the company's memorandum and articles of association which evidence the powers that regulate and bind the company; and (c) details of the ownership and structure control of the company, e.g. an ownership chart. For avoidance of doubt, this requirement does not apply in respect of a company falling within section 4(3) of Schedule 2.
	4.9.9	An FI should[23] record the names of all directors and verify the identity of directors on a risk-based approach.
	4.9.10	FIs should: (a) confirm the company is still registered and has not been dissolved, wound up, suspended or struck off; (b) independently identify and verify the names of the directors and shareholders recorded in the company registry in the place of incorporation; and (c) verify the company's registered office address in the place of incorporation.
	4.9.11	The FI should verify the information in paragraph 4.9.10 from: for a locally incorporated company: (a) a search of file at the Hong Kong Company Registry and obtain a company report[24]; for a company incorporated overseas: (b) a similar company search enquiry of the registry in the place of

[22] Examples given are not exhaustive.

[23] The FI may, of course, be already be required to identify a particular director if the director acts as a beneficial owner or a person purporting to act on behalf of the customer (e.g. account signatories). (see paragraphs 4.3 and 4.4)

[24] Alternatively, the FI may obtain from the customer a certified true copy of a company search report certified by a company registry or professional third party. The company search report should have been issued within the last 6 months. For the avoidance of doubt, it is not sufficient for the report to be self-certified by the customer.

		incorporation and obtain a company report[24]; (c) a certificate of incumbency [25] or equivalent issued by the company's registered agent in the place of incorporation; or (d) a similar or comparable document to a company search report or a certificate of incumbency certified by a professional third party in the relevant jurisdiction verifying that the information at paragraph 4.9.10, contained in the said document, is correct and accurate. For avoidance of doubt, this requirement does not apply in respect of a company falling within section 4(3) of Schedule 2.
	4.9.12	If the FI has obtained a company search report pursuant to paragraph 4.9.11 which contains information such as certificate of incorporation, company's memorandum and articles of association, etc., the FI is not required to obtain the same information again from the customer pursuant to paragraph 4.9.8.
Beneficial owners		
s.1, Sch. 2	4.9.13	The AMLO defines beneficial owner in relation to a corporation as: (i) an individual who – (a) owns or controls, directly or indirectly, including through a trust or bearer share holding, not less than 10% of the issued share capital of the corporation; (b) is, directly or indirectly, entitled to exercise or control the exercise of not less than 10% of the voting rights at general meetings of the corporation; or (c) exercises ultimate control over the management of the corporation; or (ii) if the corporation is acting on behalf of another person, means the other person.
	4.9.14	An FI should identify and record the identity of all beneficial owners, and take reasonable measures to verify the identity of: (a) all shareholders holding 25% (for normal risk circumstances) / 10% (for high risk circumstances) or more of the voting rights or share capital; (b) any individual who exercises ultimate control over the

[25] FIs may accept a certified true copy of a certificate of incumbency certified by a professional third party. The certificate of incumbency should have been issued within the last 6 months. For the avoidance of doubt, it is not sufficient for the certificate to be self-certified by the customer.

		management of the corporation; and (c) any person on whose behalf the customer is acting.
	4.9.15	For companies with multiple layers in their ownership structures, an FI should ensure that it has an understanding of the ownership and control structure of the company. The intermediate layers of the company should be fully identified. The manner in which this information is collected should be determined by the FI, for example by obtaining a director's declaration incorporating or annexing an ownership chart describing the intermediate layers (the information to be included should be determined on a risk sensitive basis but at a minimum should include company name and place of incorporation, and where applicable, the rationale behind the particular structure employed). The objective should always be to follow the chain of ownership to the individuals who are the ultimate beneficial owners of the direct customer of the FI and verify the identity of those individuals.
	4.9.16	FIs need not, as a matter of routine, verify the details of the intermediate companies in the ownership structure of a company. Complex ownership structures (e.g. structures involving multiple layers, different jurisdictions, trusts, etc.) without an obvious commercial purpose pose an increased risk and may require further steps to ensure that the FI is satisfied on reasonable grounds as to the identity of the beneficial owners.
	4.9.17	The need to verify the intermediate corporate layers of the ownership structure of a company will therefore depend upon the FI's overall understanding of the structure, its assessment of the risks and whether the information available is adequate in the circumstances for the FI to consider if it has taken adequate measures to identify the beneficial owners.
	4.9.18	Where the ownership is dispersed, the FI should concentrate on identifying and taking reasonable measures to verify the identity of those who exercise ultimate control over the management of the company.
Partnerships and unincorporated bodies		
	4.9.19	Partnerships and unincorporated bodies, although principally operated by individuals or groups of individuals, are different from individuals, in that there is an underlying business. This business is likely to have a different ML/TF risk profile from that of an

		individual.
s.1, Sch. 2	4.9.20	The AMLO defines beneficial owner, in relation to a partnership as: (i) an individual who (a) is entitled to or controls, directly or indirectly, not less than a 10% share of the capital or profits of the partnership; (b) is, directly or indirectly, entitled to exercise or control the exercise of not less than 10% of the voting rights in the partnership; or (c) exercises ultimate control over the management of the partnership; or (ii) if the partnership is acting on behalf of another person, means the other person.
s.1, Sch. 2	4.9.21	In relation to an unincorporated body other than a partnership, beneficial owner: (i) means an individual who ultimately owns or controls the unincorporated body; or (ii) if the unincorporated body is acting on behalf of another person, means the other person.
	4.9.22	The FI should obtain the following information in relation to the partnership or unincorporated body: (a) the full name; (b) the business address; and (c) the names of all partners and individuals who exercise control over the management of the partnership or unincorporated body, and names of individuals who own or control not less than 10% of its capital or profits, or of its voting rights. In cases where a partnership arrangement exists, a mandate from the partnership authorizing the opening of an account and conferring authority on those who will operate it should be obtained.
	4.9.23	The FI's obligation is to verify the identity of the customer using evidence from a reliable and independent source. Where partnerships or unincorporated bodies are well-known, reputable organisations, with long histories in their industries, and with substantial public information about them, their partners and controllers, confirmation of the customer's membership of a relevant professional or trade association is likely to be sufficient to provide such reliable and

		independent evidence of the identity of the customer. This does not remove the need to take reasonable measures to verify the identity of the beneficial owners[26] of the partnerships or unincorporated bodies.
	4.9.24	Other partnerships and unincorporated bodies have a lower profile, and generally comprise a much smaller number of partners and controllers. In verifying the identity of such customers, FIs should primarily have regard to the number of partners and controllers. Where these are relatively few, the customer should be treated as a collection of individuals; where numbers are larger, the FI should decide whether it should continue to regard the customer as a collection of individuals, or whether it can be satisfied with evidence of membership of a relevant professional or trade association. In either case, FIs should obtain the partnership deed (or other evidence in the case of sole traders or other unincorporated bodies), to satisfy themselves that the entity exists, unless an entry in an appropriate national register may be checked.
	4.9.25	In the case of associations, clubs, societies, charities, religious bodies, institutes, mutual and friendly societies, co-operative and provident societies, an FI should satisfy itself as to the legitimate purpose of the organisation, e.g. by requesting sight of the constitution.
Trusts		
General		
	4.9.26	A trust does not possess a separate legal personality. It cannot form business relationships or carry out occasional transactions itself. It is the trustee who enters into a business relationship or carries out occasional transactions on behalf of the trust and who is considered to be the customer (i.e. the trustee is acting on behalf of a third party – the trust and the individuals concerned with the trust).
s.1, Sch. 2	4.9.27	The AMLO defines the beneficial owner, in relation to a trust as: (i) an individual who is entitled to a vested interest in not less than 10% of the capital of the trust property, whether the interest is in possession or in remainder or reversion and whether it is defeasible or not; (ii) the settlor of the trust; (iii)a protector or enforcer of the trust; or (iv)an individual who has ultimate control over the trust.

[26] Reference should be made to paragraph 4.3.5.

	4.9.28	FIs should collect the following identification information in respect of a trust on whose behalf the trustee (i.e. the customer) is acting: (a) the name of the trust; (b) date of establishment/settlement; (c) the jurisdiction whose laws govern the arrangement, as set out in the trust instrument; (d) the identification number (if any) granted by any applicable official bodies (e.g. tax identification number or registered charity or non-profit organization number); (e) identification information of trustee(s) - in line with guidance for individuals or corporations; (f) identification information of settlor(s) and any protector(s) or enforcers in line with the guidance for individuals/corporations; and (g) identification information of known beneficiaries [27]. Known beneficiaries mean those persons or that class of persons who can, from the terms of the trust instrument, be identified as having a reasonable expectation of benefiting from the trust capital or income.
Verifying the trust		
	4.9.29	An FI must verify the name and date of establishment of a trust and should obtain appropriate evidence to verify the existence, legal form and parties to it, i.e. trustee, settlor, protector, beneficiary, etc. The beneficiaries should be identified as far as possible where defined. If the beneficiaries are yet to be determined, the FI should concentrate on the identification of the settlor and/or the class of persons in whose interest the trust is set up. The most direct method of satisfying this requirement is to review the appropriate parts of the trust deed. Reasonable measures to verify the existence, legal form and parties to a trust, having regard to the ML/TF risk, may include: (a) reviewing a copy of the trust instrument and retaining a redacted copy; (b) by reference to an appropriate register[28] in the relevant country of establishment; (c) a written confirmation from a trustee acting in a professional

[27] With reference to paragraph 4.9.27(i)

[28] In determining whether a register is appropriate, regard should be had to adequate transparency (e.g. a system of central registration where a national registry records details on trusts and other legal arrangements registered in that country). Changes in ownership and control information would need to be kept up-to-date.

		capacity[29]; (d) a written confirmation from a lawyer who has reviewed the relevant instrument; or (e) for trusts that are managed by the trust companies which are subsidiaries (or affiliate companies) of an FI, that FI may rely on a written confirmation from its trust subsidiaries (or trust affiliate companies). For the avoidance of doubt, reasonable measures are still required to be taken to verify[30] the actual identity of the individual parties (i.e. trustee, settlor, protector, beneficiary, etc.).
	4.9.30	Where only a class of beneficiaries is available for identification, the FI should ascertain and name the scope of the class (e.g. children of a named individual).
	4.9.31	Particular care should be taken in relation to trusts created in jurisdictions where there is no money laundering legislation similar to Hong Kong.
Other considerations		
	4.9.32	Appendix A contains a list of documents recognised by the RAs as independent and reliable sources for identity verification purposes.
4.10 Simplified customer due diligence (SDD)		
General		
	4.10.1	The AMLO defines what CDD measures are and also prescribes the circumstances in which an FI must carry out CDD. SDD means that application of full CDD measures is not required. In practice, this means that FIs are not required to identify and verify the beneficial owner[31]. However, other aspects of CDD must be undertaken and it is still necessary to conduct ongoing monitoring of the business relationship. FIs must have reasonable grounds to support the use of SDD and may have to demonstrate these grounds to the relevant RA.
s.3(1)(d) & (e), s.4(1),	4.10.2	Nonetheless, SDD must not be applied when the FI suspects that the customer, the customer's account or the transaction is involved in

[29] "Trustees acting in their professional capacity" in this context means that they act in the course of a profession or business which consists of or includes the provision of services in connection with the administration or management of trusts (or a particular aspect of the administration or management of trusts).

[30] Reference should be made to paragraphs 4.3.5 and 4.9.27.

[31] It includes the individuals who ultimately own or control the customer and the person(s) on whose behalf the customer is acting (e.g. underlying customer(s) of a customer that is an FI).

(3), (5) & (6), Sch. 2		ML/TF, or when the FI doubts the veracity or adequacy of any information previously obtained for the purpose of identifying the customer or verifying the customer's identity, notwithstanding when the customer, the product, and account type falls within paragraphs 4.10.3, 4.10.15 and 4.10.17 below.
s.4(3), Sch. 2	4.10.3	The AMLO defines customers to whom SDD may be applied as follows: (a) an FI as defined in the AMLO; (b) an institution that- (i) is incorporated or established in an equivalent jurisdiction (see paragraphs 4.20); (ii) carries on a business similar to that carried on by an FI; (iii) has measures in place to ensure compliance with requirements similar to those imposed under Schedule 2; and (iv)is supervised for compliance with those requirements by an authority in that jurisdiction that performs functions similar to those of any of the RAs; (c) a corporation listed on any stock exchange ("listed company"); (d) an investment vehicle where the person responsible for carrying out measures that are similar to the CDD measures in relation to all the investors of the investment vehicle is- (i) an FI; (ii) an institution incorporated or established in Hong Kong, or in an equivalent jurisdiction that- i. has measures in place to ensure compliance with requirements similar to those imposed under Schedule 2; and ii. is supervised for compliance with those requirements. (e) the Government or any public body in Hong Kong; or (f) the government of an equivalent jurisdiction or a body in an equivalent jurisdiction that performs functions similar to those of a public body.
s.4(2), Sch. 2	4.10.4	If a customer not falling within section 4(3) of Schedule 2 has in its ownership chain an entity that falls within that section, the FI is not required to identify or verify the beneficial owners of that entity in that chain when establishing a business relationship with or carrying out an occasional transaction for the customer. However, FIs should still identify and take reasonable measures to verify the identity of beneficial owners in the ownership chain that are not connected with that entity.

s.2(1)(a), (c) & (d), Sch. 2	4.10.5	For avoidance of doubt, the FI must still: (a) identify the customer and verify[32] the customer's identity; (b) if a business relationship is to be established and its purpose and intended nature are not obvious, obtain information on the purpose and intended nature of the business relationship with the FI; and (c) if a person purports to act on behalf of the customer, (i) identify the person and take reasonable measures to verify the person's identity; and (ii) verify the person's authority to act on behalf of the customer, in accordance with the relevant requirements stipulated in this Guideline.
<u>Local and foreign financial institution</u>		
s.4(3)(a) & (b), Sch. 2	4.10.6	FIs may apply SDD to a customer that is an FI as defined in the AMLO, or an institution that carries on a business similar to that carried on by an FI and meets the criteria set out in section 4(3)(b) of Schedule 2. If the customer does not meet the criteria, the FI must carry out all the CDD measures set out in section 2 of Schedule 2. FIs may apply SDD to a customer that is an FI as defined in the AMLO that opens an account: (a) in the name of a nominee company for holding fund units on behalf of the second-mentioned FI or its underlying customers; or (b) in the name of an investment vehicle in the capacity of a service provider (such as manager or custodian) to the investment vehicle and the underlying investors have no control over the management of the investment vehicle's assets; provided that the second-mentioned FI: (i) has conducted CDD: (A) in the case where the nominee company holds fund units on behalf of the second-mentioned FI or the second-mentioned FI's underlying customers, on its underlying customers; or (B) in the case where the second-mentioned FI acts in the capacity of a service provider (such as manager or custodian) to the

[32] For FIs and listed companies, please refer to paragraphs 4.10.7 and 4.10.8 respectively.

		investment vehicle, on the investment vehicle pursuant to the provisions of the AMLO; and (ii) is authorized to operate the account as evidenced by contractual document or agreement.
	4.10.7	For ascertaining whether the institution meets the criteria set out in section 4(3)(a) & (b) of Schedule 2, it will generally be sufficient for an FI to verify that the institution is on the list of authorized (and supervised) FIs in the jurisdiction concerned.
Listed company		
s.4(3)(c), Sch. 2	4.10.8	FIs may perform SDD in respect of a corporate customer listed on a stock exchange[33]. This means FIs need not identify the beneficial owners of the listed company. In such cases, it will be generally sufficient for an FI to obtain proof of listed status on a stock exchange. In all other cases, FIs should follow the CDD requirements for a legal person set out in paragraphs 4.9 of this Guideline.
Investment vehicle		
s.4(3)(d), Sch. 2	4.10.9	FIs may apply SDD to a customer that is an investment vehicle if the FI is able to ascertain that the person responsible for carrying out measures that are similar to the CDD measures in relation to all the investors of the investment vehicle falls within any of the categories of institution set out in section 4(3)(d) of Schedule 2.
	4.10.10	An investment vehicle may be in the form of a legal person or trust, and may be a collective investment scheme or other investment entity.
	4.10.11	An investment vehicle whether or not responsible for carrying out CDD measures on the underlying investors under governing law of the jurisdiction in which the investment vehicle is established may, where permitted by law, appoint another institution ("appointed institution"), such as a manager, a trustee, an administrator, a transfer agent, a registrar or a custodian, to perform the CDD. Where the person responsible for carrying out the CDD measures (the investment vehicle[34] or the appointed institution) falls within any of the categories of institution set out in section 4(3)(d) of Schedule 2, an FI may apply SDD to that investment vehicle provided that it is satisfied that the investment vehicle has ensured that there are reliable

[33] Reference should be made to paragraphs 4.15.

[34] If the governing law or enforceable regulatory requirements require the investment vehicle to implement CDD measures, the investment vehicle could be regarded as the responsible party for carrying out the CDD measures for the purpose of section 4(3)(d) of Schedule 2 where the investment vehicle meets the requirements, as permitted by law, by delegating or outsourcing to an appointed institution.

		systems and controls in place to conduct the CDD (including identification and verification of the identity) on the underlying investors in accordance with the requirements similar to those set out in the Schedule 2.
	4.10.12	For the avoidance of doubt, if neither the investment vehicle nor appointed institution fall within any of the categories of institution set out in section 4(3)(d) of Schedule 2, the FI must identify any investor owning or controlling not less than 10% interest of the investment vehicle. The FI may adopt a risk-based approach in determining if it is appropriate to rely on a written representation from the investment vehicle or appointed institution (as the case may be) responsible for carrying out the CDD stating, to its actual knowledge, the identities of such investors or (where applicable) there is no such investor in the investment vehicle. In making the risk-based determination, the FI should take into consideration whether the investment vehicle is being operated for a small, specific group of persons. Where the FI accepts such a representation, this should be documented, retained, and subject to periodic review. Where investors owning or controlling more than 25% interest are identified, the FI must take reasonable measures to verify their identity itself.
Government and public body		
s.4(3)(e) & (f), Sch. 2	4.10.13	FIs may apply SDD to a customer that is the Hong Kong government, any public bodies in Hong Kong, the government of an equivalent jurisdiction or a body in an equivalent jurisdiction that performs functions similar to those of a public body.
s.1, Sch. 2	4.10.14	Public body includes: (a) any executive, legislative, municipal or urban council; (b) any Government department or undertaking; (c) any local or public authority or undertaking; (d) any board, commission, committee or other body, whether paid or unpaid, appointed by the Chief Executive or the Government; and (e) any board, commission, committee or other body that has power to act in a public capacity under or for the purposes of any enactment.
SDD in relation to specific products		

s.4(4) & (5), Sch. 2	4.10.15	FIs may apply SDD in relation to a customer if the FI has reasonable grounds to believe that the transaction conducted by the customer relates to any one of the following products: (a) a provident, pension, retirement or superannuation scheme (however described) that provides retirement benefits to employees, where contributions to the scheme are made by way of deduction from income from employment and the scheme rules do not permit the assignment of a member's interest under the scheme; (b) an insurance policy for the purposes of a provident, pension, retirement or superannuation scheme (however described) that does not contain a surrender clause and cannot be used as a collateral; or (c) a life insurance policy in respect of which: (i) an annual premium of no more than $8,000 or an equivalent amount in any other currency is payable; or (ii) a single premium of no more than $20,000 or an equivalent amount in any other currency is payable.
	4.10.16	For the purpose of item (a) of paragraph 4.10.15, FIs may generally treat the employer as the customer and apply SDD on the employer. Where FIs have a business relationship with the employees, it should identify and verify the identities of the employees in accordance with the requirements set out in paragraphs 4.8.
Solicitor's client accounts		
s.4(6), Sch. 2	4.10.17	If a customer of an FI is a solicitor or a firm of solicitors, the FI is not required to identify the beneficial owners of the client account opened by the customer, provided that the following criteria are satisfied: (a) the client account is kept in the name of the customer; (b) moneys or securities of the customer's clients in the client account are mingled; and (c) the client account is managed by the customer as those clients' agent.
	4.10.18	In addition to performing the normal CDD on the customer, when opening a client account for a solicitor or a firm of solicitors, FIs should establish the proposed use of the account, i.e. whether to hold co-mingled client funds or the funds of a specific client.

	4.10.19	FI should obtain evidence to satisfy that the solicitor is authorized to practise in Hong Kong or in an equivalent jurisdiction. FIs may assume that the solicitor has reliable and proper systems in place to identify each client and allocate the funds to the underlying client and apply SDD unless they become aware of any adverse information (e.g. adverse publicity or reprimand by the Law Society) to the contrary.
	4.10.20	If a client account is opened on behalf of a single client or there are sub-accounts for each individual client where funds are not co-mingled at the FI, the FI should establish the identity of the underlying client(s) in addition to that of the solicitor opening the account.
4.11 High-risk situations		
s.15, Sch. 2	4.11.1	Section 15 of Schedule 2 specifies that an FI must, in any situation that by its nature presents a higher risk of ML/TF, take additional measures to mitigate the risk of ML/TF. Additional measures[35] or EDD should be taken to mitigate the ML/TF risk involved, which for illustration purposes, may include: (a) obtaining additional information on the customer (e.g. connected parties[36], accounts or relationships) and updating more regularly the customer profile including the identification data; (b) obtaining additional information on the intended nature of the business relationship (e.g. anticipated account activity), the source of wealth and source of funds; (c) obtaining the approval of senior management to commence or continue the relationship; and (d) conducting enhanced monitoring of the business relationship, by increasing the number and timing of the controls applied and selecting patterns of transactions that need further examination. For avoidance of doubt, all high-risk customers should be subject to a minimum annual review with reference to paragraph 4.7.13.
4.12 Customer not physically present for identification purposes		
	4.12.1	FIs must apply equally effective customer identification procedures and ongoing monitoring standards for customers not physically present for identification purposes as for those where the customer is

[35] Additional measures should be documented in the FI's policies and procedures.
[36] Consideration might be given to obtaining, and taking reasonable measures to verify, the addresses of directors and account signatories.

		available for interview[37]. Where a customer has not been physically present for identification purposes, FIs will generally not be able to determine that the documentary evidence of identity actually relates to the customer they are dealing with. Consequently, there are increased risks.
s.5(3)(a) & s.9, Sch. 2	4.12.2	The AMLO requires an FI to take additional measures to compensate for any risk associated with customers not physically present for identification purposes. If a customer has not been physically present for identification purposes, the FI must carry out at least one of the following measures to mitigate the risks posed: (a) further verifying the customer's identity on the basis of documents, data or information referred to in section 2(1)(a) of Schedule 2 but not previously used for the purposes of verification of the customer's identity under that section; (b) taking supplementary measures to verify all the information provided by the customer; (c) ensuring that the first payment made into the customer's account is received from an account in the customer's name with an authorized institution or a bank operating in an equivalent jurisdiction that has measures in place to ensure compliance with requirements similar to those imposed under Schedule 2 and is supervised for compliance with those requirements by a banking regulator in that jurisdiction. Consideration should be given on the basis of the ML/TF risk to obtaining copies of documents that have been certified by a suitable certifier.
<u>Suitable certifiers and the certification procedure</u>		
	4.12.3	Use of an independent suitable certifier guards against the risk that documentation provided does not correspond to the customer whose identity is being verified. However, for certification to be effective, the certifier will need to have seen the original documentation.
	4.12.4	Suitable persons to certify verification of identity documents may include: (a) an intermediary specified in section 18(3) of Schedule 2; (b) a member of the judiciary in an equivalent jurisdiction;

[37] For avoidance of doubt, this is not restricted to being physically present in Hong Kong; the face-to-face meeting could take place outside Hong Kong.

		(c) an officer of an embassy, consulate or high commission of the country of issue of documentary verification of identity; and (d) a Justice of the Peace.
	4.12.5	The certifier must sign and date the copy document (printing his/her name clearly in capitals underneath) and clearly indicate his/her position or capacity on it. The certifier must state that it is a true copy of the original (or words to similar effect).
	4.12.6	FIs remain liable for failure to carry out prescribed CDD and therefore must exercise caution when considering accepting certified copy documents, especially where such documents originate from a country perceived to represent a high risk, or from unregulated entities in any jurisdiction. In any circumstances where an FI is unsure of the authenticity of certified documents, or that the documents relate to the customer, FIs should take additional measures to mitigate the ML/TF risk.
4.13 Politically exposed persons (PEPs)		
General		
s.1 & s.10, Sch. 2	4.13.1	Much international attention has been paid in recent years to the risk associated with providing financial and business services to those with a prominent political profile or holding senior public office. However, PEP status itself does not automatically mean that the individuals are corrupt or that they have been incriminated in any corruption.
	4.13.2	However, their office and position may render PEPs vulnerable to corruption. The risks increase when the person concerned is from a foreign country with widely-known problems of bribery, corruption and financial irregularity within their governments and society. This risk is even more acute where such countries do not have adequate AML/CFT standards.
s.15, Sch. 2	4.13.3	While the statutory definition of PEPs in the AMLO (see paragraph 4.13.5 below) only includes individuals entrusted with prominent public function in a place outside the People's Republic of China[38], domestic PEPs may also present, by virtue of the positions they hold, a high risk situation where EDD should be applied. FIs should

[38] Reference should be made to the definition of the People's Republic of China in the Interpretation and General Clauses Ordinance (Cap. 1).

		therefore adopt a risk-based approach to determining whether to apply the measures in paragraph 4.13.11 below in respect of domestic PEPs.
s.1, s.15 & s.5(3)(c), Sch. 2	4.13.4	The statutory definition does not automatically exclude sub-national political figures. Corruption by heads of regional governments, regional government ministers and large city mayors is no less serious as sub-national figures in some jurisdictions may have access to substantial funds. Where FIs identify a customer as a sub-national figure holding a prominent public function, they should apply appropriate EDD. This also applies to domestic sub-national figures assessed by the FI to pose a higher risk. In determining what constitutes a prominent public function, FIs should consider factors such as persons with significant influence in general, significant influence over or control of public procurement or state owned enterprises, etc.
<u>(Foreign) Politically exposed person</u>		
s.1, Sch. 2	4.13.5	A politically exposed person is defined in the AMLO as: (a) an individual who is or has been entrusted with a prominent public function in a place outside the People's Republic of China and (i) includes a head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official; (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i); (b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a) above, or a spouse or a partner of a child of such an individual; or (c) a close associate of an individual falling within paragraph (a) (see paragraph 4.13.6).
s.1, Sch. 2	4.13.6	The AMLO defines a close associate as: (a) an individual who has close business relations with a person falling under paragraph 4.13.5(a) above, including an individual who is a beneficial owner of a legal person or trust of which the person falling under paragraph 4.13.5(a) is also a beneficial owner; or (b) an individual who is the beneficial owner of a legal person or trust that is set up for the benefit of a person falling under paragraph

		4.13.5(a) above.
	4.13.7	FIs that handle the proceeds of corruption, or handle illegally diverted government, supranational or aid funds, face reputational and legal risks, including the possibility of criminal charges for having assisted in laundering the proceeds of crime.
	4.13.8	FIs can reduce risk by conducting EDD at the outset of the business relationship and ongoing monitoring where they know or suspect that the business relationship is with a PEP.
s.19(1), Sch. 2	4.13.9	FIs must establish and maintain effective procedures (for example making reference to publicly available information and/or screening against commercially available databases) for determining whether a customer or a beneficial owner of a customer is a PEP. These procedures should extend to the connected parties of the customer using a risk-based approach.
	4.13.10	FIs may use publicly available information or refer to relevant reports and databases on corruption risk published by specialised national, international, non-governmental and commercial organisations to assess which countries are most vulnerable to corruption (an example of which is Transparency International's 'Corruption Perceptions Index', which ranks countries according to their perceived level of corruption). FIs should be vigilant where either the country to which the customer has business connections or the business/industrial sector is more vulnerable to corruption.
s.5(3)(b) & s.10, Sch. 2	4.13.11	When FIs know that a particular customer or beneficial owner is a PEP, it should, before (i) establishing a business relationship or (ii) continuing an existing business relationship where the customer or the beneficial owner is subsequently found to be a PEP, apply all the following EDD measures: (a) obtaining approval from its senior management; (b) taking reasonable measures to establish the customer's or the beneficial owner's source of wealth and the source of the funds; and (c) applying enhanced monitoring to the relationship in accordance with the assessed risks.

	4.13.12	It is for an FI to decide which measures it deems reasonable, in accordance with its assessment of the risks, to establish the source of funds and source of wealth. In practical terms, this will often amount to obtaining information from the PEP and verifying it against publicly available information sources such as asset and income declarations, which some jurisdictions expect certain senior public officials to file and which often include information about an official's source of wealth and current business interests. FIs should however note that not all declarations are publicly available and that a PEP customer may have legitimate reasons for not providing a copy. FIs should also be aware that some jurisdictions impose restrictions on their PEP's ability to hold foreign bank accounts or to hold other office or paid employment.
Senior management approval		
	4.13.13	While the AMLO is silent on the level of senior management who may approve the establishment or continuation of the relationship, the approval process should take into account the advice of the FI's CO. The more potentially sensitive the PEP, the higher the approval process should be escalated.
Domestic politically exposed persons		
	4.13.14	For the purposes of this Guideline, a domestic PEP is defined as: (a) an individual who is or has been entrusted with a prominent public function in a place within the People's Republic of China and (i) includes a head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official; (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i); (b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a) above, or a spouse or a partner of a child of such an individual; or (c) a close associate of an individual falling within paragraph (a) (see paragraph 4.13.6).
	4.13.15	FIs should take reasonable measures to determine whether an individual is a domestic PEP.

s.5(3)(c) & s.15, Sch. 2	4.13.16	If an individual is known to be a domestic PEP, the FI should perform a risk assessment to determine whether the individual poses a higher risk of ML/TF. Domestic PEPs status in itself does not automatically confer higher risk. In any situation that the FI assesses to present a higher risk of ML/TF, it should apply the EDD and monitoring specified in paragraph 4.11.1.
	4.13.17	FIs should retain a copy of the assessment for RAs, other authorities and auditors and should review the assessment whenever concerns as to the activities of the individual arise.
Periodic reviews		
	4.13.18	For foreign PEPs and domestic PEPs assessed to present a higher risk, they should be subject to a minimum annual review. FIs should review CDD information to ensure that it remains up-to-date and relevant.
4.14 Bearer shares		
	4.14.1	Bearer shares are an equity security that is wholly owned by whoever holds the physical stock certificate. The issuing corporate does not register the owner of the stock or track transfers of ownership. Transferring the ownership of the stock involves only delivering the physical document. Bearer shares therefore lack the regulation and control of common shares because ownership is never recorded. Due to the higher ML/TF risks associated with bearer shares the FATF requires countries that have legal persons able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering.
s.15, Sch. 2	4.14.2	To reduce the opportunity for bearer shares to be used to obscure information on beneficial ownership, FIs must take additional measures in the case of companies with capital in the form of bearer shares, as it is often difficult to identify the beneficial owner(s). FIs should adopt procedures to establish the identities of the holders and beneficial owners of such shares and ensure that they are notified whenever there is a change of holder or beneficial owner.
	4.14.3	Where bearer shares have been deposited with an authorized/registered custodian, FIs should seek independent evidence of this, for example confirmation from the registered agent that an authorized/registered custodian holds the bearer shares, the identity of the authorized/registered custodian and the name and address of the person who has the right to those entitlements carried

		by the share. As part of the FI's ongoing periodic review, it should obtain evidence to confirm the authorized/registered custodian of the bearer shares.
	4.14.4	Where the shares are not deposited with an authorized/registered custodian, the FI should obtain declarations prior to account opening and annually thereafter from each beneficial owner holding 10% or more of the share capital. Given the higher ML/ TF risks associated with bearer shares, FIs may wish to adopt higher levels of risk mitigation than prescribed in the AMLO and obtain such declarations from each beneficial owner holding 5% or more of the share capital. FIs should also require the customer to notify it immediately of any changes in the ownership of the shares.
4.15 Jurisdictions that do not or insufficiently apply the FATF recommendations or otherwise posing higher risk		
	4.15.1	FIs should give particular attention to, and exercise extra care in respect of: (a) business relationships and transactions with persons (including legal persons and other FIs) from or in jurisdictions that do not or insufficiently apply the FATF Recommendations; and (b) transactions and business connected with jurisdictions assessed as higher risk. Based on the FI's assessment of the risk in either case, the special requirements of section 15 of Schedule 2 may apply. In addition to ascertaining and documenting the business rationale for establishing a relationship, an FI should take reasonable measures to establish the source of funds of such customers.
	4.15.2	In determining which jurisdictions do not apply, or insufficiently apply the FATF Recommendations, or may otherwise pose a higher risk, FIs should consider, among other things: (a) circulars issued to FIs by RAs; (b) whether the jurisdiction is subject to sanctions, embargoes or similar measures issued by, for example, the United Nations (UN). In addition, in some circumstances where a jurisdiction is subject to sanctions or measures similar to those issued by bodies such as the UN, but which may not be universally recognized, the sanctions or measures may still be given credence by an FI

		because of the standing of the issuer and the nature of the measures; (c) whether the jurisdiction is identified by credible sources as lacking appropriate AML/CFT laws, regulations and other measures; (d) whether the jurisdiction is identified by credible sources as providing funding or support for terrorist activities and has designated terrorist organisations operating within it; and (e) whether the jurisdiction is identified by credible sources as having significant levels of corruption, or other criminal activity. "Credible sources" refers to information that is produced by well-known bodies that generally are regarded as reputable and that make such information publicly and widely available. In addition to the FATF and FATF-style regional bodies, such sources may include, but are not limited to, supra-national or international bodies such as the International Monetary Fund, and the Egmont Group of Financial Intelligence Units, as well as relevant national government bodies and non-government organisations. The information provided by these credible sources does not have the effect of law or regulation and should not be viewed as an automatic determination that something is of higher risk. An FI should be aware of the potential reputation risk of conducting business in jurisdictions which do not or insufficiently apply the FATF Recommendations or other jurisdictions known to apply inferior standards for the prevention of ML/TF. If an FI incorporated in Hong Kong has operating units in such jurisdictions, care should be taken to ensure that effective controls on prevention of ML/TF are implemented in these units. In particular, the FI should ensure that the policies and procedures adopted in such overseas units are similar to those adopted in Hong Kong. There should also be compliance and internal audit checks by staff from the head office in Hong Kong.
4.16 Notice in writing from an RA		
s.15, Sch. 2	4.16.1	Where the requirement is called for by the FATF (which may include mandatory EDD or the application of countermeasures[39]) or in other

[39] For jurisdictions with serious deficiencies in applying the FATF's Recommendations and where inadequate progress has been made to improve their position, the FATF may recommend the application of counter-measures.

		circumstances independent of the FATF but also considered to be higher risk, RA may, through a notice in writing: (a) impose a general obligation on FIs to undertake EDD measures; or (b) require FIs to undertake specific countermeasures identified or described in the notice. The type of EDD/countermeasures would be proportionate to the nature of the risks and/or deficiencies.
4.17 Reliance on CDD performed by intermediaries		
General		
s.18, Sch. 2	4.17.1	FIs may rely upon an intermediary to perform any part of the CDD measures specified in section 2 of Schedule 2, subject to the criteria set out in section 18 of Schedule 2. However, the ultimate responsibility for ensuring that CDD requirements are met remains with the FI. For avoidance of doubt, reliance on intermediaries does not apply to: (a) outsourcing or agency relationships, i.e. where the agent is acting under a contractual arrangement with the FI to carry out its CDD function. In such a situation the outsource or agent is to be regarded as synonymous with the FI (i.e. the processes and documentation are those of the FI itself); and (b) business relationships, accounts or transactions between FIs for their clients. In practice, this reliance on third parties often occurs through introductions made by another member of the same financial services group, or in some jurisdictions from another FI or third party.
	4.17.1a	*Authorized insurers, reinsurers, appointed insurance agents and authorized insurance brokers all have the responsibility to comply with the requirements relating to CDD as set out in Schedule 2. However, insurance agents and brokers are usually the first line of contacts with the customer, before the customer is known, introduced or referred to an authorized insurer.* *An authorized insurer may carry out a CDD measure through its appointed insurance agents, although such insurer remains liable for a failure to carry out that CDD measure. The insurer should be*

		satisfied that its appointed agents have adequate procedures in place to prevent ML and TF, namely: *(a) the CDD procedures of the agent should be as rigorous as those which the insurer would have conducted itself for the customer; and* *(b) the insurer is satisfied as to the reliability of the systems put in place by the agent to comply with the CDD requirements of Schedule 2.* *If a customer is introduced to an authorized insurer through an insurance broker, the insurer may rely on the broker to carry out any CDD measures pursuant to s. 18(1) of Schedule 2. In this case, paragraphs 4.17.2 to 4.17.7 are to be observed.*
s.18(1) & s.18(4)(b), Sch. 2	4.17.2	The FI must obtain written confirmation from the intermediary that: (a) it agrees to perform the role; and (b) it will provide without delay a copy of any document or record obtained in the course of carrying out the CDD measures on behalf of the FI upon request. The FI must ensure that the intermediary will, if requested by the FI within the period specified in the record-keeping requirements of AMLO, provide to the FI a copy of any document, or a record of any data or information, obtained by the intermediary in the course of carrying out that measure as soon as reasonably practicable after receiving the request.
	4.17.3	FIs should obtain satisfactory evidence to confirm the status and eligibility of the intermediary. Such evidence may comprise corroboration from the intermediary's regulatory authority, or evidence from the intermediary of its status, regulation, policies and procedures.
s.18(4)(a), Sch. 2	4.17.4	An FI that carries out a CDD measure by means of an intermediary must immediately after the intermediary has carried out that measure, obtain from the intermediary the data or information that the intermediary has obtained in the course of carrying out that measure, but nothing in this paragraph requires the FI to obtain at the same time from the intermediary a copy of the document, or a record of the data or information, that is obtained by the intermediary in the course of carrying out that measure.

	4.17.5	Where these documents and records are kept by the intermediary, the FI should obtain an undertaking from the intermediary to keep all underlying CDD information throughout the continuance of the FI's business relationship with the customer and for at least six years beginning on the date on which the business relationship of a customer with the FI ends or until such time as may be specified by the RA. FIs should also obtain an undertaking from the intermediary to supply copies of all underlying CDD information in circumstances where the intermediary is about to cease trading or does not act as an intermediary for the FI anymore.
	4.17.6	FIs should conduct sample tests from time to time to ensure CDD information and documentation is produced by the intermediary upon demand and without undue delay.
	4.17.7	Whenever an FI has doubts as to the reliability of the intermediary, it should take reasonable steps to review the intermediary's ability to perform its CDD duties. If the FI intends to terminate its relationship with the intermediary, it should immediately obtain all CDD information from the intermediary. If the FI has any doubts regarding the CDD measures carried out by the intermediary previously, the FI should perform the required CDD as soon as reasonably practicable.
Domestic intermediaries		
s.18(3)(b), Sch. 2	4.17.8	FIs may rely upon an authorized institution, a licensed corporation, an authorized insurer, an appointed insurance agent or an authorized insurance broker, to perform any part of the CDD measures.
s.18(3)(a), Sch. 2	4.17.9	FIs may also rely upon the following categories of domestic intermediaries: (a) a solicitor practising in Hong Kong; (b) a certified public accountant practising in Hong Kong; (c) a current member of The Hong Kong Institute of Chartered Secretaries practising in Hong Kong; and (d) a trust company registered under Part VIII of the Trustees Ordinance carrying on trust business in Hong Kong, provided that the intermediary is able to satisfy the FI that they have adequate procedures in place to prevent ML/TF.

s. 18(5), Sch. 2		The arrangement for allowing FIs to rely on these intermediaries will expire at midnight on 31 March 2018.
Overseas intermediaries		
18(3)(c), Sch. 2	4.17.10	FIs may only rely upon an overseas intermediary carrying on business or practising in an equivalent jurisdiction where the intermediary: (a) falls into one of the following categories of businesses or professions: (i) an institution that carries on a business similar to that carried on by an FI mentioned in paragraph 4.17.8; (ii) a lawyer or a notary public; (iii) an auditor, a professional accountant, or a tax advisor; (iv) a trust or company service provider; and (v) a trust company carrying on trust business; (b) is required under the law of the jurisdiction concerned to be registered or licensed or is regulated under the law of that jurisdiction; (c) has measures in place to ensure compliance with requirements similar to those imposed under Schedule 2; and (d) is supervised for compliance with those requirements by an authority in that jurisdiction that performs functions similar to those of any of the RAs.
	4.17.11	Compliance with the requirements set out above for both domestic or overseas intermediaries may entail the FI: (a) reviewing the intermediary's AML/CFT policies and procedures; or (b) making enquiries concerning the intermediary's stature and regulatory track record and the extent to which any group's AML/CFT standards are applied and audited.
4.18 Pre-existing customers		
Application of AMLO and guideline to pre-existing customers		
s.6, Sch. 2	4.18.1	FIs must perform the CDD measures prescribed in Schedule 2 and this Guideline in respect of pre-existing customers (with whom the business relationship was established before the AMLO came into effect on 1 April 2012), when: (a) a transaction takes place with regard to the customer, which is, by virtue of the amount or nature of the transaction, unusual or suspicious; or is not consistent with the FI's knowledge of the

		customer or the customer's business or risk profile, or with its knowledge of the source of the customer's funds; (b) a material change occurs in the way in which the customer's account is operated; (c) the FI suspects that the customer or the customer's account is involved in ML/TF; or (d) the FI doubts the veracity or adequacy of any information previously obtained for the purpose of identifying the customer or for the purpose of verifying the customer's identity.
	4.18.2	Trigger events may include the re-activation of a dormant account or a change in the beneficial ownership or control of the account but FIs will need to consider other trigger events specific to their own customers and business.
	4.18.2a	*Examples of trigger events after establishment of an insurance contract are provided in paragraph 4.7.12a.*
s.5, Sch. 2	4.18.3	FIs should note that requirements for ongoing monitoring under section 5 of Schedule 2 also apply to pre-existing customers (see Chapter 5).
4.19 Prohibition on anonymous accounts		
s.16, Sch. 2	4.19.1	FIs must not maintain anonymous accounts or accounts in fictitious names for any new or existing customer. Where numbered accounts exist, FIs must maintain them in such a way that full compliance can be achieved with the AMLO. FIs must properly identify and verify the identity of the customer in accordance with the Guideline. In all cases, whether the relationship involves numbered accounts or not, the customer identification and verification records must be available to the CO, other appropriate staff, RAs, other authorities and auditors upon appropriate authority.
4.20 Jurisdictional equivalence		
General		
s.4(3)(b)(i), s.4(3)(d)(iii), s.4(3)(f), s.9(c)(ii) s.18(3)(c), Sch. 2	4.20.1	Jurisdictional equivalence and the determination of equivalence is an important aspect in the application of CDD measures under the AMLO. For example, section 4 of Schedule 2 restricts the application of SDD to overseas institutions that carry on a business similar to that carried on by an FI and are incorporated or established in an equivalent jurisdiction. Section 18 of Schedule 2 restricts reliance upon intermediaries outside Hong Kong for CDD measures to those practising or carrying on business in an equivalent jurisdiction.

	4.20.2	Equivalent jurisdiction is defined in the AMLO as meaning: (a) a jurisdiction that is a member of the FATF, other than Hong Kong; or (b) a jurisdiction that imposes requirements similar to those imposed under Schedule 2.
Determination of jurisdictional equivalence		
	4.20.3	FIs may therefore be required to evaluate and determine for themselves which jurisdictions other than FATF members apply requirements similar to those imposed under Schedule 2 for jurisdictional equivalence purposes. When doing so an FI should document its assessment of the jurisdiction, which may include consideration of the following factors: (a) membership of a regional group of jurisdictions that admit as members only jurisdictions that have demonstrated a commitment to the fight against ML/TF, and which have an appropriate legal and regulatory regime to back up this commitment. Where a jurisdiction is a member of such a group, this may be taken into account as a supporting factor in the FI's assessment of whether the jurisdiction is likely to be "equivalent"; (b) mutual evaluation reports. Particular attention should be paid to assessments that have been undertaken by the FATF, FATF-style regional bodies, the International Monetary Fund and the World Bank. FIs should bear in mind that mutual evaluation reports are at a "point in time", and should be interpreted as such; (c) lists of jurisdictions published by the FATF with strategic AML/CFT deficiencies through the International Co-operation Review Group processes; (d) advisory circulars issued by RAs from time to time alerting FIs to such jurisdictions with poor AML/CFT controls; (e) lists of jurisdictions, entities and individuals that are involved, or that are alleged to be involved, in activities that cast doubt on their integrity in the AML/CFT area that are published by specialised national, international, non-governmental and commercial organisations. An example of such is Transparency International's 'Corruption Perceptions Index', which ranks countries according to their perceived level of corruption; and (f) guidance provided at paragraphs 4.15 "Jurisdictions that do not or insufficiently apply the FATF's recommendations or otherwise

		posing a higher risk".
	4.20.4	The judgment on equivalence is one to be made by each FI in the light of the particular circumstances and senior management is accountable for this judgment. It is therefore important that the reasons for concluding that a particular jurisdiction is equivalent (other than those jurisdictions that are FATF members) are documented at the time the decision is made, and that the decision is made on up-to-date and relevant information. A record of the assessment performed and factors considered should be retained for regulatory scrutiny and periodically reviewed to ensure it remains up-to-date and valid.

Chapter 5 - ONGOING MONITORING		
General		
s.5(1), Sch. 2	5.1	Effective ongoing monitoring is vital for understanding of customers' activities and an integral part of effective AML/CFT systems. It helps FIs to know their customers and to detect unusual or suspicious activities. An FI must continuously monitor its business relationship with a customer by: (a) reviewing from time to time documents, data and information relating to the customer and obtained pursuant to sections 2 and 3 of Schedule 2 to ensure that they are up-to-date and relevant[40]; (b) monitoring the activities (including cash and non-cash transactions) of the customer to ensure that they are consistent with the nature of business, the risk profile and source of funds. An unusual transaction may be in the form of activity that is inconsistent with the expected pattern for that customer, or with the normal business activities for the type of product or service that is being delivered; and (c) identifying transactions that are complex, large or unusual or patterns of transactions that have no apparent economic or lawful purpose and which may indicate ML/TF.
	5.2	Failure to conduct ongoing monitoring could expose an FI to potential abuse by criminals, and may call into question the adequacy of systems and controls, or the prudence and integrity or fitness and properness of the FI's management.
	5.3	Possible characteristics FIs should consider monitoring include: (a) the nature and type of transactions (e.g. abnormal size or frequency); (b) the nature of a series of transactions (e.g. a number of cash deposits); (c) the amount of any transactions, paying particular attention to particularly substantial transactions; (d) the geographical origin/destination of a payment or receipt; and (e) the customer's normal activity or turnover.
	5.4	FIs should be vigilant for changes on the basis of the business relationship with the customer over time. These may include where:

[40] See paragraphs 4.7.12 and 4.7.13.

		(a) new products or services that pose higher risk are entered into; (b) new corporate or trust structures are created; (c) the stated activity or turnover of a customer changes or increases; or (d) the nature of transactions changes or their volume or size increases etc.
	5.5	Where the basis of the business relationship changes significantly, FIs should carry out further CDD procedures to ensure that the ML/TF risk involved and basis of the relationship are fully understood. Ongoing monitoring procedures must take account of the above changes.
	5.6	FIs should conduct an appropriate review of a business relationship upon the filing of a report to the JFIU and should update the CDD information where appropriate; this will enable FIs to assess appropriate levels of ongoing review and monitoring.
Risk-based approach to monitoring		
	5.7	The extent of monitoring should be linked to the risk profile of the customer which has been determined through the risk assessment required in Chapter 3. To be most effective, resources should be targeted towards business relationships presenting a higher risk of ML/TF.
s.5(3), Sch. 2	5.8	FIs must take additional measures when monitoring business relationships that pose a higher risk. High-risk relationships, for example those involving PEPs, will require more frequent and intensive monitoring. In monitoring high-risk situations, relevant considerations may include: (a) whether adequate procedures or management information systems are in place to provide relevant staff (e.g. CO, MLRO, front line staff, relationship managers and insurance agents) with timely information that might include, as a result of EDD or other additional measures undertaken, any information on any connected accounts or relationships; and (b) how to monitor the sources of funds, wealth and income for higher risk customers and how any changes in circumstances will be recorded.
Methods and procedures		
	5.9	When considering how best to monitor customer transactions and activities, an FI should take into account the following factors:

		(a) the size and complexity of its business; (b) its assessment of the ML/TF risks arising from its business; (c) the nature of its systems and controls; (d) the monitoring procedures that already exist to satisfy other business needs; and (e) the nature of the products and services (which includes the means of delivery or communication). There are various methods by which these objectives can be met including exception reports (e.g. large transactions exception report) and transaction monitoring systems. Exception reports will help FI's stay apprised of operational activities.
s.5(1)(c), Sch. 2	5.10	Where transactions that are complex, large or unusual, or patterns of transactions which have no apparent economic or lawful purpose are noted, FIs should examine the background and purpose, including where appropriate the circumstances, of the transactions. The findings and outcomes of these examinations should be properly documented in writing and be available to assist the RAs, other competent authorities and auditors. Proper records of decisions made, by whom, and the rationale for them will help an FI demonstrate that it is handling unusual or suspicious activities appropriately.
s. 25A(5), DTROP & OSCO, s.12(5), UNATMO	5.11	Such examinations may include asking the customer questions, based on common sense, that a reasonable person would ask in the circumstances. Such enquiries, when conducted properly and in good faith, do not constitute tipping off *(see: <www.jfiu.gov.hk/en/str_ask.html>)*. These enquiries are directly linked to the CDD requirements, and reflect the importance of "knowing your customer" in detecting unusual or suspicious activities. Such enquiries and their results should be properly documented and be available to assist the RAs, other authorities and auditors. Where there is any suspicion, a report must be made to the JFIU.
	5.12	Where cash transactions (including deposits and withdrawals) and transfers to third parties are being proposed by customers, and such requests are not in accordance with the customer's known reasonable practice, FIs must approach such situations with caution and make relevant further enquiries. Where the FI has been unable to satisfy itself that any cash transaction or third party transfer is reasonable, and therefore considers it suspicious, it should make a suspicious transaction report (STR) to the JFIU.

Chapter 6 – FINANCIAL SANCTIONS AND TERRORIST FINANCING		
Financial sanctions & proliferation financing		
	6.1	The obligations under the Hong Kong's financial sanctions regime apply to all persons, and not just FIs.
s.3(1), UNSO	6.2	The United Nations Sanctions Ordinance, Cap. 537 (UNSO) gives the Chief Executive the authority to make regulations to implement sanctions decided by the Security Council of the United Nations and to specify or designate relevant persons and entities.
	6.3	These sanctions normally prohibit making available or dealing with, directly or indirectly, any funds or economic resources for the benefit of or belonging to a designated party.
	6.4	RAs circulate to all FIs designations published in the government Gazette under the UNSO.
	6.5	While FIs will not normally have any obligation under Hong Kong law to have regard to lists issued by other organisations or authorities in other jurisdictions, an FI operating internationally will need to be aware of the scope and focus of relevant financial/trade sanctions regimes in those jurisdictions. Where these sanctions may affect their operations, FIs should consider what implications exist for their procedures, such as the consideration to monitor the parties concerned with a view to ensuring that there are no payments to or from a person on a sanctions list issued by an overseas jurisdiction.
Applicable UNSO Regulation	6.6	The Chief Executive can licence exceptions to the prohibitions on making funds and economic resources available to a designated party under the UNSO. An FI seeking such a licence should write to the Commerce and Economic Development Bureau.
Terrorist financing		
	6.7	Terrorist financing generally refers to the carrying out of transactions involving property that are owned by terrorists, or that have been, or are intended to be, used to assist the commission of terrorist acts. This has not previously been explicitly covered under the money laundering regime where the focus is on the handling of criminal proceeds, i.e. the source of property is what matters. In terrorist financing, the focus is on the destination or use of property, which may have derived from legitimate sources.
UNSCR	6.8	The UN Security Council has passed United Nations Security Council

1373 (2001)		Resolution (UNSCR) 1373 (2001), which calls on all member states to act to prevent and suppress the financing of terrorist acts. Guidance issued by the UN Counter Terrorism Committee in relation to the implementation of UNSCRs regarding terrorism can be found at: www.un.org/sc/ctc/.
UNSCR 1267 (1999); 1390 (2002); 1617 (2005)	6.9	The UN has also published the names of individuals and organisations subject to UN financial sanctions in relation to involvement with Usama bin Laden, Al-Qa'ida, and the Taliban under relevant UNSCRs (e.g. UNSCR 1267 (1999), 1390 (2002) and 1617 (2005)). All UN member states are required under international law to freeze the funds and economic resources of any legal person(s) named in this list and to report any suspected name matches to the relevant authorities.
	6.10	The United Nations (Anti-Terrorism Measures) Ordinance, Cap. 575 (UNATMO) was enacted in 2002 to give effect to the mandatory elements of UNSCR 1373 and the Special Recommendations of the FATF.
s. 6, UNATMO	6.11	The Secretary for Security (S for S) has the power to freeze suspected terrorist property and may direct that a person shall not deal with the frozen property except under the authority of a licence. Contraventions are subject to a maximum penalty of 7 years imprisonment and an unspecified fine.
	6.12	Section 6 of the UNATMO essentially confers the S for S an administrative power to freeze suspected terrorist property for a period of up to two years, during which time the authorities may apply to the court for an order to forfeit the property. This administrative freezing mechanism will enable the S for S to take freezing action upon receiving intelligence of suspected terrorist property in Hong Kong.
s.8 & 14, UNATMO	6.13	It is an offence for any person to make any property or financial services available, by any means, directly or indirectly, to or for the benefit of a terrorist or terrorist associate except under the authority of a licence granted by S for S. It is also an offence for any person to collect property or solicit financial (or related) services, by any means, directly or indirectly, for the benefit of a terrorist or terrorist associate. Contraventions are subject to a maximum sentence of 14 years imprisonment and an unspecified fine.
	6.14	Section 8 of the UNATMO does not affect a freeze per se; it prohibits a person from (i) making available, by any means, directly or indirectly, any property or financial services to or for the benefit of a person he

		knows or has reasonable grounds to suspect is a terrorist or terrorist associate, in the absence of a licence granted by S for S; and (ii) collecting property or soliciting financial (or related) services, by any means, directly or indirectly, for the benefit of a person he knows or has reasonable grounds to suspect is a terrorist or terrorist associate.
s.6(1), UNATMO	6.15	The S for S can licence exceptions to the prohibitions to enable frozen property and economic resources to be unfrozen and to allow payments to be made to or for the benefit of a designated party under the UNATMO. An FI seeking such a licence should write to the Security Bureau.
s.4(1), UNATMO	6.16	Where a person is designated by a Committee of the United Nations Security Council as a terrorist and his details are subsequently published in a notice under section 4 of the UNATMO in the Government gazette, RAs will circulate the designations to all FIs.
s.4, WMD(CPS)O	6.17	It is an offence under section 4 of the Weapons of Mass Destruction (Control of Provision of Services) Ordinance (WMD(CPS)O), Cap. 526, for a person to provide any services where he believes or suspects, on reasonable grounds, that those services may be connected to WMD proliferation. The provision of services is widely defined and includes the lending of money or other provision of financial assistance.
	6.18	FIs may draw reference from a number of sources including relevant designation by overseas authorities, such as the designations made by the US Government under relevant Executive Orders. The RA may draw the FI's attention to such designations from time to time. All FIs will therefore need to ensure that they should have appropriate system to conduct checks against the relevant list for screening purposes and that this list is up-to-date.
Database maintenance and screening (customers and payments)		
	6.19	FIs should take measures to ensure compliance with the relevant regulations and legislation on terrorist financing. The legal obligations of FIs and those of its staff should be well understood and adequate guidance and training should be provided to the latter. FIs are required to establish policies and procedures for combating terrorist financing. The systems and mechanisms for identification of suspicious transactions should cover terrorist financing as well as money laundering.

	6.20	It is particularly vital that an FI should be able to identify and report transactions with terrorist suspects and designated parties. To this end, the FI should ensure that it maintains a database of names and particulars of terrorist suspects and designated parties which consolidates the various lists that have been made known to it. Alternatively, an FI may make arrangements to access to such a database maintained by third party service providers.
	6.21	FIs should ensure that the relevant designations are included in the database. Such database should, in particular, include the lists published in the Gazette and those designated under the US Executive Order 13224. The database should also be subject to timely update whenever there are changes, and should be made easily accessible by staff for the purpose of identifying suspicious transactions.
	6.22	Comprehensive ongoing screening of an FI's complete customer base is a fundamental internal control to prevent terrorist financing and sanction violations, and should be achieved by: (a) screening customers against current terrorist and sanction designations at the establishment of the relationship; and (b) thereafter, as soon as practicable after new terrorist and sanction designations are published by the RAs that these new designations, screening against their entire client base.
	6.23	FIs need to have some means of screening payment instructions to ensure that proposed payments to designated parties are not made. FIs should be particularly alert for suspicious wire transfers.
	6.24	Enhanced checks should be conducted before establishing a business relationship or processing a transaction, where possible, if there are circumstances giving rise to suspicion.
	6.25	In order to demonstrate compliance with the provisions of paragraphs 6.22 to 6.24 above, the screening and any results should be documented, or recorded electronically.
	6.26	If an FI suspects that a transaction is terrorist-related, it should make a report to the JFIU. Even if there is no evidence of a direct terrorist connection, the transaction should still be reported to the JFIU if it looks suspicious for other reasons, as it may emerge subsequently that there is a terrorist link.

Chapter 7 – SUSPICIOUS TRANSACTION REPORTS		
General issues		
s.25A(1), DTROP & OSCO, s.12(1), UNATMO	7.1	Sections 25A of the DTROP and the OSCO make it an offence to fail to disclose where a person knows or suspects that property represents the proceeds of drug trafficking or of an indictable offence respectively. Likewise, section 12 of the UNATMO makes it an offence to fail to disclose knowledge or suspicion of terrorist property. Under the DTROP and the OSCO, failure to report knowledge or suspicion carries a maximum penalty of three months' imprisonment and a fine of $50,000.
s.25A(2), DTROP & OSCO, s.12(2), UNATMO	7.2	Filing a report to the JFIU provides FIs with a statutory defence to the offence of ML/TF in respect of the acts disclosed in the report, provided: (a) the report is made before the FI undertakes the disclosed acts and the acts (transaction(s)) are undertaken with the consent of the JFIU; or (b) the report is made after the FI has performed the disclosed acts (transaction(s)) and the report is made on the FI's own initiative and as soon as it is reasonable for the FI to do so.
s.25A(4), DTROP & OSCO, s.12(4), UNATMO	7.3	Once an employee has reported his suspicion to the appropriate person in accordance with the procedure established by his employer for the making of such disclosures, he has fully satisfied the statutory obligation.
s.25A(5), DTROP & OSCO, s.12(5), UNATMO	7.4	It is an offence ("tipping off") to reveal to any person any information which might prejudice an investigation; if a client is told that a report has been made, this would prejudice the investigation and an offence would be committed.
	7.5	Once knowledge or suspicion has been formed the following general principles should be applied: (a) in the event of suspicion of ML/TF, a disclosure should be made even where no transaction has been conducted by or through the FI[41]; (b) disclosures must be made as soon as is reasonably practical after the

[41] The reporting obligations require a person to report suspicions of ML/TF, irrespective of the amount involved. The reporting obligations of section 25A(1) DTROP and OSCO and section 12(1) UNATMO apply to "any property". These provisions establish a reporting obligation whenever a suspicion arises, without reference to transactions *per se*. Thus, the obligation to report applies whether or not a transaction was actually conducted and also covers attempted transactions.

		suspicion was first identified; and (c) FIs must ensure that they put in place internal controls and systems to prevent any directors, officers and employees committing the offence of tipping off the customer or any other person who is the subject of the disclosure. FIs should also take care that their line of enquiry with customers is such that tipping off cannot be construed to have taken place.
	7.6	CDD and ongoing monitoring provide the basis for recognising unusual and suspicious transactions and events. An effective way of recognising suspicious activity is knowing enough about customers, their circumstances and their normal expected activities to recognise when a transaction or instruction, or a series of transactions or instructions, is unusual.
	7.7	FIs must ensure sufficient guidance is given to staff[42] to enable them to form suspicion or to recognise when ML/TF is taking place, taking account of the nature of the transactions and instructions that staff is likely to encounter, the type of product or service and the means of delivery, i.e. whether face to face or remote. This will also enable staff to identify and assess the information that is relevant for judging whether a transaction or instruction is suspicious in the circumstances.
Knowledge vs. suspicion		
	7.8	FIs have an obligation to report where there is knowledge or suspicion of ML/TF. Generally speaking, knowledge is likely to include: (a) actual knowledge; (b) knowledge of circumstances which would indicate facts to a reasonable person; and (c) knowledge of circumstances which would put a reasonable person on inquiry.
	7.9	Suspicion is more subjective. Suspicion is personal and falls short of proof based on firm evidence.
	7.10	As the types of transactions which may be used for criminal activity are almost unlimited, it is difficult to determine what will constitute a suspicious transaction.

[42] In the context of Chapter 7, staff include appointed insurance agents.

	7.11	The key is knowing enough about the customer's business to recognise that a transaction, or a series of transactions, is unusual and, from an examination of the unusual, whether there is a suspicion of ML/TF. Where a transaction is inconsistent in amount, origin, destination, or type with a customer's known, legitimate business or personal activities, etc., the transaction should be considered as unusual and the FI should be put on alert.
JFIU "SAFE" Approach	7.12	Where the FI conducts enquiries and obtains what it considers to be a satisfactory explanation of the activity or transaction, it may conclude that there are no grounds for suspicion, and therefore take no further action. However, where the FI's enquiries do not provide a satisfactory explanation of the activity or transaction, it may conclude that there are grounds for suspicion, and must make a disclosure (*see: <www.jfiu.gov.hk/en/str_ask.html>)*.
	7.13	For a person to have knowledge or suspicion, he does not need to know the nature of the criminal activity underlying the money laundering, or that the funds themselves definitely arose from the criminal offence.
	7.14	The following is a (non-exhaustive) list of examples of situations that might give rise to suspicion in certain circumstances: (a) transactions or instructions which have no apparent legitimate purpose and/or appear not to have a commercial rationale; (b) transactions, instructions or activity that involve apparently unnecessary complexity or which do not constitute the most logical, convenient or secure way to do business; (c) where the transaction being requested by the customer, without reasonable explanation, is out of the ordinary range of services normally requested, or is outside the experience of the financial services business in relation to the particular customer; (d) where, without reasonable explanation, the size or pattern of transactions is out of line with any pattern that has previously emerged; (e) where the customer refuses to provide the information requested without reasonable explanation or who otherwise refuses to cooperate with the CDD and/or ongoing monitoring process; (f) where a customer who has entered into a business relationship uses the relationship for a single transaction or for only a very short period without a reasonable explanation; (g) the extensive use of trusts or offshore structures in circumstances where the customer's needs are inconsistent with the use of such

		services; (h) transfers to and from high risk jurisdictions[43] without reasonable explanation, which are not consistent with the customer's declared business dealings or interests; and (i) unnecessary routing of funds or other property from/to third parties or through third party accounts. Further examples of what might constitute suspicious transactions are provided in Annexes I and II. These are not intended to be exhaustive and only provide examples of the most basic ways in which money may be laundered. However, identification of any of the types of transactions listed above or in Annexes I and II should prompt further investigations and be a catalyst towards making at least initial enquiries about the source of funds. FIs should also be aware of elements of individual transactions that could indicate property involved in terrorist financing. The FATF has issued guidance for FIs in detecting terrorist financing[44]. FIs should be familiar with the characteristics in that guidance, which are grouped under the headings of (i) accounts; (ii) deposits and withdrawals; (iii) wire transfers; (iv) characteristics of the customer or his/her identity; and (v) transactions linked to locations of concern.
	7.15	The OSCO, DTROP and UNATMO prohibit disclosure by the FI or its staff that a suspicious transaction report (STR) has been made which is likely to prejudice any investigation that might be conducted following that disclosure. A risk exists that customers could be unintentionally tipped off when the FI is seeking to perform its CDD obligations during the establishment or course of the business relationship, or when conducting occasional transactions. The customer's awareness of a possible STR or investigation could prejudice future efforts to investigate the suspected ML/TF operation. Therefore, if FIs form a suspicion that transactions relate to ML/TF, they should take into account the risk of tipping off when performing the CDD process. FIs should ensure that their employees are aware of and sensitive to these issues when conducting CDD.
Timing and manner of reports		

[43] Guidance on determining high risk jurisdictions is provided at paragraphs 4.15.

[44] Available on the FATF website at www.fatf-gafi.org/media/fatf/documents/Guidance%20for%20financial%20institutions%20in%20detecting%20terrorist%20financing.pdf

	7.16	When an FI knows or suspects that property represents the proceeds of crime or terrorist property, a disclosure must be made to the JFIU as soon as it is reasonable to do so[45]. The use of a standard form or the use of the e-channel "STREAMS" [46] by registered users is strongly encouraged. Further details of reporting methods and advice may be found at www.jfiu.gov.hk. In the event that an urgent disclosure is required, particularly when the account is part of an ongoing investigation, it should be indicated in the disclosure. Where exceptional circumstances exist in relation to an urgent disclosure, an initial notification by telephone may be considered.
	7.17	Dependent on when knowledge or suspicion arises, disclosures may be made either before a suspicious transaction or activity occurs (whether the intended transaction ultimately takes place or not), or after a transaction or activity has been completed.
s.25A(1), DTROP & OSCO, s.12(1), UNATMO	7.18	The law requires the disclosure to be made together with any matter on which the knowledge or suspicion is based. The need for prompt disclosures is especially important where a customer has instructed the FI to move funds or other property, close the account, make cash available for collection, or carry out significant changes to the business relationship. In such circumstances, consideration may be given to contact the JFIU urgently.
Internal reporting		
	7.19	An FI should appoint a Money Laundering Reporting Officer (MLRO) as a central reference point for reporting suspicious transactions. The FI should have measures in place to check, on an ongoing basis that it has policies and procedures to ensure compliance with legal and regulatory requirements and of testing such compliance. The type and extent of the measures to be taken in this respect should be appropriate having regard to the risk of ML/TF and the size of the business.
	7.20	The FI should ensure that the MLRO is of sufficient status within the organisation, and has adequate resources, to enable him to perform his functions.
s.25A(4), DTROP &	7.21	It is the responsibility of the MLRO to consider all internal disclosures he receives in the light of full access to all relevant documentation and

[45] The purpose of disclosure is to fulfil the legal obligations set out in paragraph 7.1. Where FIs want to make a crime report, a report should be made directly to the Hong Kong Police.

[46] STREAMS (Suspicion Transaction Report and Management System) is a web-based platform to assist in the receipt, analysis and dissemination of STRs. Use of STREAMS is recommended, especially for FIs who make frequent reports. Further details may be obtained from the JFIU.

OSCO, s12(4), UNATMO		other parties. However, the MLRO should not simply be that of a passive recipient of ad hoc reports of suspicious transactions. Rather, the MLRO should play an active role in the identification and reporting of suspicious transactions. This may also involve regular review of exception reports or large or irregular transaction reports as well as ad hoc reports made by staff. To fulfil these functions all FIs must ensure that the MLRO receives full co-operation from all staff and full access to all relevant documentation so that he is in a position to decide whether attempted or actual ML/TF is suspected or known.
	7.22	Failure by the MLRO to diligently consider all relevant material may lead to vital information being overlooked and the suspicious transaction or activity or suspicious attempted transaction or activity not being disclosed to the JFIU in accordance with the requirements of the legislation. Alternatively, it may also lead to vital information being overlooked which may have made it clear that a disclosure would have been unnecessary.
	7.23	FIs should establish and maintain procedures to ensure that: (a) all staff are made aware of the identity of the MLRO and of the procedures to follow when making an internal disclosure report; and (b) all disclosure reports must reach the MLRO without undue delay.
	7.24	While FIs may wish to set up internal systems that allow staff to consult with supervisors or managers before sending a report to the MLRO, under no circumstances should reports raised by staff be filtered out by supervisors or managers who have no responsibility for the money laundering reporting/compliance function. The legal obligation is to report as soon as it is reasonable to do so, so reporting lines should be as short as possible with the minimum number of people between the staff with the suspicion and the MLRO. This ensures speed, confidentiality and accessibility to the MLRO.
	7.25	All suspicious activity reported to the MLRO must be documented (in urgent cases this may follow an initial discussion by telephone). The report must include the full details of the customer and as full a statement as possible of the information giving rise to the suspicion.
s.25A(5), DTROP & OSCO, s.12(5),	7.26	The MLRO must acknowledge receipt of the report and at the same time provide a reminder of the obligation regarding tipping off. The tipping-off provision includes circumstances where a suspicion has been raised internally, but has not yet been reported to the JFIU.

UNATMO		
	7.27	The reporting of a suspicion in respect of a transaction or event does not remove the need to report further suspicious transactions or events in respect of the same customer. Further suspicious transactions or events, whether of the same nature or different to the previous suspicion, must continue to be reported to the MLRO who should make further reports to the JFIU if appropriate.
	7.28	When evaluating an internal disclosure, the MLRO must take reasonable steps to consider all relevant information, including CDD and ongoing monitoring information available within or to the FI concerning the entities to which the report relates. This may include: (a) making a review of other transaction patterns and volumes through connected accounts; (b) any previous patterns of instructions, the length of the business relationship and reference to CDD and ongoing monitoring information and documentation; and (c) appropriate questioning of the customer per the systematic approach to identifying suspicious transactions recommended by the JFIU[47].
	7.29	As part of the review, other connected accounts or relationships may need to be examined. The need to search for information concerning connected accounts or relationships should strike an appropriate balance between the statutory requirement to make a timely disclosure to the JFIU and any delays that might arise in searching for more relevant information concerning connected accounts or relationships. The evaluation process should be documented, together with any conclusions drawn.
	7.30	If after completing the evaluation, the MLRO decides that there are grounds for knowledge or suspicion, he should disclose the information to the JFIU as soon as it is reasonable to do so after his evaluation is complete together with the information on which that knowledge or suspicion is based. Providing they act in good faith in deciding not to file an STR with the JFIU, it is unlikely that there will be any criminal liability for failing to report if a MLRO concludes that there is no suspicion after taking into account all available information. It is however vital for MLROs to keep proper records of their deliberations and actions taken to demonstrate they have acted in reasonable manner.

[47] For details, please see www.jfiu.gov.hk.

Recording internal reports		
	7.31	FIs must establish and maintain a record of all ML/TF reports made to the MLRO. The record should include details of the date the report was made, the staff members subsequently handling the report, the results of the assessment, whether the report resulted in a disclosure to the JFIU, and information to allow the papers relevant to the report to be located.
Records of reports to the JFIU		
	7.32	FIs must establish and maintain a record of all disclosures made to the JFIU. The record must include details of the date of the disclosure, the person who made the disclosure, and information to allow the papers relevant to the disclosure to be located. This register may be combined with the register of internal reports, if considered appropriate.
Post reporting matters		
	7.33	FIs should note that: (a) filing a report to the JFIU only provides a statutory defence to ML/TF in relation to the acts disclosed in that particular report. It does not absolve an FI from the legal, reputational or regulatory risks associated with the account's continued operation; (b) a "consent" response from the JFIU to a pre-transaction report should not be construed as a "clean bill of health" for the continued operation of the account or an indication that the account does not pose a risk to the FI; (c) FIs should conduct an appropriate review of a business relationship upon the filing of a report to the JFIU, irrespective of any subsequent feedback provided by the JFIU; (d) once an FI has concerns over the operation of a customer's account or a particular business relationship, it should take appropriate action to mitigate the risks. Filing a report with the JFIU and continuing to operate the relationship without any further consideration of the risks and the imposition of appropriate controls to mitigate the risks identified is not acceptable; (e) relationships reported to the JFIU should be subject to an appropriate review by the MLRO and if necessary the issue should be escalated to the FI's senior management to determine how to handle the relationship to mitigate any potential legal or reputational risks posed by the relationship in line with the FI's business objectives, and its capacity to mitigate the risks identified; and (f) FIs are not obliged to continue business relationships with customers if such action would place them at risk. It is recommended that FIs indicate any intention to terminate a

		relationship in the initial disclosure to the JFIU, thereby allowing the JFIU to comment, at an early stage, on such a course of action.
s.25A(1)(c) & (2)(a), DTROP & OSCO, s.1 & 12(2)(a), UNATMO	7.34	The JFIU will acknowledge receipt of a disclosure made by an institution under section 25A of both the DTROP and the OSCO, and section 12 of the UNATMO. If there is no need for imminent action e.g. the issue of a restraint order on an account, consent will usually be given for the institution to operate the account under the provisions of section 25A(2) of both the DTROP and the OSCO. An example of such a letter is given at Appendix B to this guideline. For disclosures submitted via e-channel "STREAM", e-receipt will be issued via the same channel. The JFIU may, on occasion, seek additional information or clarification with an FI of any matter on which the knowledge or suspicion is based.
	7.35	Whilst there are no statutory requirements to provide feedback arising from investigations, the Hong Kong Police and Customs and Excise Department recognise the importance of having effective feedback procedures in place. The JFIU provides feedback both in its quarterly report[48] and upon request, to a disclosing FI in relation to the current status of an investigation.
	7.36	After initial analysis by the JFIU, reports that are to be developed are allocated to financial investigation officers for further investigation. FIs must ensure that they respond to all production orders within the required time limit and provide all of the information or material that falls within the scope of such orders. Where an FI encounters difficulty in complying with the timeframes stipulated, the MLRO should at the earliest opportunity contact the officer-in-charge of the investigation for further guidance.
s.10 & 11, DTROP, s.15 & 16, OSCO, s.6, UNATMO	7.37	During a law-enforcement investigation, an FI may be served with a Restraint Order, designed to freeze particular funds or property pending the outcome of an investigation. An FI must ensure that it is able to freeze the relevant property that is the subject of the order. It should be noted that the Restraint Order may not apply to all funds or property involved within a particular business relationship and FIs should consider what, if any, funds or property may be utilised subject to having obtained the appropriate consent from the JFIU.

[48] The purpose of the quarterly report, which is relevant to all financial sectors, is to raise AML/CFT awareness. It consists of two parts, (i) analysis of STRs and (ii) matters of interest and feedback. The report is available through the JFIU's website at www.jfiu.gov.hk. A password is required, details may be found under the typologies and feedback section of the website or by contacting the JFIU directly.

s.3, DTROP, s.8, OSCO, s13, UNATMO	7.38	Upon the conviction of a defendant, a court may order the confiscation of his criminal proceeds and an FI may be served with a Confiscation Order in the event that it holds funds or other property belonging to that defendant that are deemed by the Courts to represent his benefit from the crime. A court may also order the forfeiture of property where it is satisfied that the property is terrorist property.

Annex I - Indicators of suspicious transactions		
		1. *A request by a customer to enter into an insurance contract(s) where the source of the funds is unclear or not consistent with the customer's apparent standing.* 2. *A sudden request for a significant purchase of a lump sum contract with an existing client whose current contracts are small and of regular payments only.* 3. *A proposal which has no discernible purpose and a reluctance to divulge a "need" for making the investment.* 4. *A proposal to purchase and settle by cash.* 5. *A proposal to purchase by utilizing a cheque drawn from an account other than the personal account of the proposer.* 6. *The prospective client who does not wish to know about investment performance but does enquire on the early cancellation/surrender of the particular contract.* 7. *A customer establishes a large insurance policy and within a short period of time cancels the policy, requests the return of the cash value payable to a third party.* 8. *Early termination of a product, especially in a loss.* 9. *A customer applies for an insurance policy relating to business outside the customer's normal pattern of business.* 10. *A customer requests for a purchase of insurance policy in an amount considered to be beyond his apparent need.* 11. *A customer attempts to use cash to complete a proposed transaction when this type of business transaction would normally be handled by cheques or other payment instruments.* 12. *A customer refuses, or is unwilling, to provide explanation of financial activity, or provides explanation assessed to be untrue.*

		13. *A customer is reluctant to provide normal information when applying for an insurance policy, provides minimal or fictitious information or, provides information that is difficult or expensive for the institution to verify.* 14. *Delay in the provision of information to enable verification to be completed.* 15. *Opening accounts with the customer's address outside the local service area.* 16. *Opening accounts with names similar to other established business entities.* 17. *Attempting to open or operating accounts under a false name.* 18. *Any transaction involving an undisclosed party.* 19. *A transfer of the benefit of a product to an apparently unrelated third party.* 20. *A change of the designated beneficiaries (especially if this can be achieved without knowledge or consent of the insurer and/or the right to payment could be transferred simply by signing an endorsement on the policy).* 21. *Substitution, during the life of an insurance contract, of the ultimate beneficiary with a person without any apparent connection with the policy holder.* 22. *The customer accepts very unfavourable conditions unrelated to his health or age.* 23. *An atypical incidence of pre-payment of insurance premiums.* 24. *Insurance premiums have been paid in one currency and requests for claims to be paid in another currency.* 25. *Activity is incommensurate with that expected from the customer considering the information already known about the customer and the customer's previous financial activity. (For individual customers, consider customer's age, occupation, residential address, general appearance, type and level of previous financial*

		activity. For corporate customers, consider type and level of activity.) *26. Any unusual employment of an intermediary in the course of some usual transaction or financial activity e.g. payment of claims or high commission to an unusual intermediary.* *27. A customer appears to have policies with several institutions.* *28. A customer wants to borrow the maximum cash value of a single premium policy, soon after paying for the policy.* *29. The customer who is based in jurisdictions which do not or insufficiently apply the FATF Recommendations designated by the FATF from time to time or in countries where the production of drugs or drug trafficking may be prevalent.* *30. The customer who is introduced by an overseas agent, affiliator or other company that is based in jurisdictions which do not or insufficiently apply the FATF Recommendations designated by the FATF from time to time or in countries where corruption or the production of drugs or drug trafficking may be prevalent.* *31. A customer who is based in Hong Kong and is seeking a lump sum investment and offers to pay by a wire transaction or foreign currency.* *32. Unexpected changes in employee characteristics, e.g. lavish lifestyle or avoiding taking holidays.* *33. Unexpected change in employee or agent performance, e.g. the sales person selling products has a remarkable or unexpected increase in performance.* *34. Consistently high activity levels of single premium business far in excess of any average company expectation.* *35. The use of an address which is not the client's permanent address, e.g. utilization of the salesman's office or home address for the despatch of customer documentation.* *36. Any unusual or disadvantageous early redemption of an insurance policy.*

Important Note		
		The International Association of Insurance Supervisors (IAIS) has published relevant examples and indicators involving insurance in a document called "Examples of money laundering and suspicious transactions involving insurance". The document can be downloaded from IAIS website at ***http://www.iaisweb.org****. The list will be updated periodically to include additional examples identified. IIs are advised to regularly browse the website for latest information.*

Annex II - Examples of money laundering schemes[49]		
Life Insurance		
		Case 1 *In 1990, a British insurance sales agent was convicted of violating a money laundering statute. The insurance agent was involved in a money laundering scheme in which over US$1.5 million was initially placed with a bank in England. The "layering process" involved the purchase of single premium insurance policies. The insurance agent became a top producer at his insurance company and later won a company award for his sales efforts. This particular case involved the efforts of more than just a sales agent. The insurance agent's supervisor was also charged with violating the money laundering statute. This case has shown how money laundering, coupled with a corrupt employee, can expose an insurance company to negative publicity and possible criminal liability.* ***Case 2*** *A company director from Company W, Mr. H, set up a money laundering scheme involving two companies, each one established under two different legal systems. Both of the entities were to provide financial services and providing financial guarantees for which he would act as director. These companies wired the sum of US$1.1 million to the accounts of Mr. H in Country S. It is likely that the funds originated in some sort of criminal activity and had already been introduced in some way into the financial system. Mr. H also received transfers from Country C. Funds were transferred from one account to another (several types of accounts were involved, including both current and savings accounts). Through one of these transfers, the funds were transferred to Country U from a current account in order to make payments on life insurance policies. The investment in these policies was the main mechanism in the scheme for laundering the funds. The premiums paid for the life insurance policies in Country U amounted to some US$1.2 million and represented the last step in the laundering operation.*

[49] *Majority of the examples of money laundering schemes in this annex are extracted from the IAIS document "Examples of money laundering and suspicious transactions involving insurance". The document can be downloaded at* ***http://www.iaisweb.org/.***

Case 3

Customs officials in Country X initiated an investigation which identified a narcotics trafficking organization utilized the insurance sector to launder proceeds. Investigative efforts by law enforcement agencies in several different countries identified narcotic traffickers were laundering funds through Insurance firm Z located in an off-shore jurisdiction.

Insurance firm Z offers investment products similar to mutual funds. The rate of return is tied to the major world stock market indices so the insurance policies were able to perform as investments. The account holders would over-fund the policy, moving monies into and out of the fund for the cost of the penalty for early withdrawal. The funds would then emerge as a wire transfer or cheque from an insurance company and the funds were apparently clean.

To date, this investigation has identified that over US$29 million was laundered through this scheme, of which over US$9 million has been seized. Additionally, based on joint investigative efforts by Country Y (the source country of the narcotics) and Country Z customs officials, several search warrants and arrest warrants were executed relating to money laundering activities involved individuals associated with Insurance firm Z.

Case 4

An attempt was made to purchase life policies for a number of foreign nationals. The underwriter was requested to provide life coverage with an indemnity value identical to the premium. There were also indications that in the event that the policies were to be cancelled, the return premiums were to be paid into a bank account in a different jurisdiction to the assured.

Case 5

On a smaller scale, local police authorities were investigating the placement of cash by a drug trafficker. The funds were deposited into several bank accounts and then transferred to an account in another jurisdiction. The drug trafficker then entered into a US$75,000 life

		insurance policy. Payment for the policy was made by two separate wire transfers from the overseas accounts. It was purported that the funds used for payment were the proceeds of overseas investments. At the time of the drug trafficker's arrest, the insurer had received instructions for the early surrender of the policy. ***Case 6*** *A customer contracted life insurance of a 10 year duration with a cash payment equivalent to around US$400,000. Following payment, the customer refused to disclose the origin of the funds. The insurer reported the case. It appears that prosecution had been initiated in respect of the individual's fraudulent management activity.* ***Case 7*** *A life insurer learned from the media that a foreigner, with whom it had two life-insurance contracts, was involved in Mafia activities in his/her country. The contracts were of 33 years duration. One provided for a payment of close to the equivalent of US$1 million in case of death. The other was a mixed insurance with value of over half this amount.* ***Case 8*** *A client domiciled in a country party to a treaty on the freedom of cross-border provision of insurance services, contracted with a life-insurer for a foreign life insurance for 5 years with death cover for a down payment equivalent to around US$7 million. The beneficiary was altered twice: 3 months after the establishment of the policy and 2 months before the expiry of the insurance. The insured remained the same. The insurer reported the case. The last beneficiary - an alias - turned out to be a PEP.*
Reinsurance		
		Case 1 *An insurer in country A sought reinsurance with a reputable reinsurance company in country B for its directors and officer cover of an investment firm in country A. The insurer was prepared to pay four times the market rate for this reinsurance cover. This raised the*

		suspicion of the reinsurer which contacted law enforcement agencies. Investigation made clear that the investment firm was bogus and controlled by criminals with a drug background. The insurer had ownership links with the investment firm. The impression is that - although drug money would be laundered by a payment received from the reinsurer - the main purpose was to create the appearance of legitimacy by using the name of a reputable reinsurer. By offering to pay above market rate the insurer probably intended to assure continuation of the reinsurance arrangement.
Intermediaries		
		Case 1 *A person (later arrested for drug trafficking) made a financial investment (life insurance) of US$250,000 by means of an insurance broker. He acted as follows. He contacted an insurance broker and delivered a total amount of US$250,000 in three cash instalments. The insurance broker did not report the delivery of that amount and deposited the three instalments in the bank. These actions raise no suspicion at the bank, since the insurance broker is known to them as being connected to the insurance branch. The insurance broker delivers, afterwards, to the insurance company responsible for making the financial investment, three cheques from a bank account under his name, totalling US$250,000, thus avoiding the raising suspicions with the insurance company.* ***Case 2*** *Clients in several countries used the services of an intermediary to purchase insurance policies. Identification was taken from the client by way of an ID card, but these details were unable to be clarified by the providing institution locally, which was reliant on the intermediary doing the due diligence checks.* *The policy was put in place and the relevant payments were made by the intermediary to the local institution. Then, after a couple of months had elapsed, the institution would receive notification from the client stating that there was now a change in circumstances, and they would have to close the policy suffering the losses, but coming away with a clean cheque from the institution.*

		On other occasions the policy would be left to run for a couple of years before being closed with the request that the payment be made to a third party. This was often paid with the receiving institution, if local, not querying the payment as it had come from another reputable local institution. ***Case 3*** *An insurance company was established by a well-established insurance management operation. One of the clients, a Russian insurance company, had been introduced through the management of the company's London office via an intermediary.* *In this particular deal, the client would receive a "profit commission" if the claims for the period were less than the premiums received. Following an on-site inspection of the company by the insurance regulators, it became apparent that the payment route out for the profit commission did not match the flow of funds into the insurance company's account. Also, the regulators were unable to ascertain the origin and route of the funds as the intermediary involved refused to supply this information. Following further investigation, it was noted that there were several companies involved in the payment of funds and it was difficult to ascertain how these companies were connected with the original insured, the Russian insurance company.* ***Case 4*** *A construction project was being financed in Europe. The financing also provided for a consulting company's fees. To secure the payment of the fees, an investment account was established and a sum equivalent to around US$400,000 deposited with a life-insurer. The consulting company obtained powers of attorney for the account. Immediately following the setting up of the account, the consulting company withdrew the entire fee stipulated by the consulting contract. The insurer reported the transaction as suspicious. It turns out that an employee of the consulting company was involved in several similar cases. The account is frozen.*
Other examples		

		Single premiums *An example involves the purchase of large, single premium insurance policies and their subsequent rapid redemption. A money launderer does this to obtain payment from an insurance company. The person may face a redemption fee or cost, but this is willingly paid in exchange for the value that having funds with an insurance company as the immediate source provider.* *In addition, the request for early encashment of single premium policies, for cash or settlement to an individual third party may arouse suspicion.* ***Return premiums*** *There are several cases where the early cancellation of policies with return of premium has been used to launder money. This has occurred where there have been:* *(a) a number of policies entered into by the same insurer/intermediary for small amounts and then cancelled at the same time;* *(b) return premium being credited to an account different from the original account;* *(c) requests for return premiums in currencies different from the original premium; and* *(d) regular purchase and cancellation of policies.* ***Overpayment of premiums*** *Another simple method by which funds can be laundered is by arranging for excessive numbers or excessively high values of insurance reimbursements by cheque or wire transfer to be made. A money launderer may well own legitimate assets or businesses as well as an illegal enterprise. In this method, the launderer may arrange for insurance of the legitimate assets and 'accidentally', but on a recurring basis, significantly overpay his premiums and request a refund for the excess. Often, the person does so in the belief that his relationship with his representative at the company is such that the representative will be*

		unwilling to confront a customer who is both profitable to the company and important to his own success. *The overpayment of premiums, has been used as a method of money laundering. Insurers should be especially vigilant where:* • *the overpayment is over a certain size (say US$10,000 or equivalent);* • *the request to refund the excess premium was to a third party;* • *the assured is in a jurisdiction associated with money laundering; and* • *where the size or regularity of overpayments is suspicious.* ***High brokerage / third party payments / strange premium routes*** *High brokerage can be used to pay off third parties unrelated to the insurance contract. This often coincides with example of unusual premium routes.* ***Assignment of claims*** *In a similar way, a money launderer may arrange with groups of otherwise legitimate people, perhaps owners of businesses, to assign any legitimate claims on their policies to be paid to the money launderer. The launderer promises to pay these businesses, perhaps in cash, money orders or travellers cheques, a percentage of any claim payments paid to him above and beyond the face value of the claim payments. In this case the money laundering strategy involves no traditional fraud against the insurer. Rather, the launderer has an interest in obtaining funds with a direct source from an insurance company, and is willing to pay others for this privilege. The launderer may even be strict in insisting that the person does not receive any fraudulent claims payments, because the person does not want to invite unwanted attention.*
Important Note		
		Apart from the above examples of money laundering schemes, the FATF has also published annually detailed typologies involving insurance supported by useful case examples in documents called "Money Laundering & Terrorist Financing Typologies". The documents can be

		downloaded at the publications section of FATF website at ***http://www.fatf-gafi.org****. IIs are advised to regularly browse the website for latest information.*

Chapter 8 – RECORD-KEEPING		
General legal and regulatory requirements		
	8.1	Record-keeping is an essential part of the audit trail for the detection, investigation and confiscation of criminal or terrorist property or funds. Record-keeping helps the investigating authorities to establish a financial profile of a suspect, trace the criminal or terrorist property or funds and assists the Court to examine all relevant past transactions to assess whether the property or funds are the proceeds of or relate to criminal or terrorist offences.
	8.2	FIs should maintain customer, transaction and other records that are necessary and sufficient to meet the record-keeping requirements under the AMLO, this guideline and other regulatory requirements, that are appropriate to the scale, nature and complexity of their businesses. This is to ensure that: (a) the audit trail for funds moving through an FI that relate to any customer and, where appropriate, the beneficial owner of the customer, account or transaction is clear and complete; (b) any customer and, where appropriate, the beneficial owner of the customer can be properly identified and verified; (c) all customer and transaction records and information are available on a timely basis to RAs, other authorities and auditors upon appropriate authority; and (d) FIs are able to comply with any relevant requirements specified in other sections of this guideline and other guidelines issued by the RAs, including, among others, records of customer risk assessment (see paragraph 3.8), registers of suspicious transaction reports (see paragraph 7.32) and training records (see paragraph 9.9).
Retention of records relating to customer identity and transactions		
s.20(1)(b)(i), Sch. 2	8.3	FIs should keep: (a) the original or a copy of the documents, and a record of the data and information, obtained in the course of identifying and verifying the identity of the customer and/or beneficial owner of the customer and/or beneficiary and/or persons who purport to act on behalf of the customer and/or other connected parties to the customer; (b) any additional information in respect of a customer and/or beneficial owner of the customer that may be obtained for the purposes of EDD or ongoing monitoring; (c) where applicable, the original or a copy of the documents, and a

s.2(1)(c), Sch. 2 s.20(1)(b)(ii), Sch. 2		record of the data and information, on the purpose and intended nature of the business relationship; (d) the original or a copy of the records and documents relating to the customer's account (e.g. account opening form; insurance application form; risk assessment form) and business correspondence[50] with the customer and any beneficial owner of the customer (which at a minimum should include business correspondence material to CDD measures or significant changes to the operation of the account).
s.20(3), Sch. 2	8.4	All documents and records mentioned in paragraph 8.3 should be kept throughout the business relationship with the customer and for a period of six years after the end of the business relationship.
s.20(1)(a), Sch. 2	8.5	FIs should maintain the original or a copy of the documents, and a record of the data and information, obtained in connection with the transaction, which should be sufficient to permit reconstruction of individual transactions and establish a financial profile of any suspect account or customer. These records may include the following: (a) the identity of the parties to the transaction; (b) the nature and date of the transaction; (c) the type and amount of currency involved; (d) the origin of the funds (if known); (e) the form in which the funds were offered or withdrawn, e.g. cash, cheques, etc.; (f) the destination of the funds; (g) the form of instruction and authority; and (h) the type and identifying number of any account involved in the transaction (where applicable).
s.20(2), Sch. 2	8.6	All documents and records mentioned in paragraph 8.5 should be kept for a period of six years after the completion of a transaction, regardless of whether the business relationship ends during the period.
	8.6a	*Documents and records that IIs may keep include:* *(a) initial proposal documentation such as the customer financial assessment, analysis of needs, details of the payment method, illustration of benefits, and copy of documentation in support*

[50] FIs are not expected to keep each and every correspondence, such as a series of emails with the customer; the expectation is that sufficient correspondence is kept to demonstrate compliance with the AMLO.

		of verification by the IIs; *(b) records associated with the maintenance of the contract post sale, up to and including maturity of the contract; and* *(c) "Discharge documentation" with details of the maturity processing and/or claim settlement.*
s.21, Sch. 2	8.7	If the record consists of a document, either the original of the document should be retained or a copy of the document should be kept on microfilm or in the database of a computer. If the record consists of data or information, such record should be kept either on microfilm or in the database of a computer.
s.20(4), Sch. 2	8.8	An RA may, by notice in writing to an FI, require it to keep the records relating to a specified transaction or customer for a period specified by the RA that is longer than those referred to in paragraphs 8.4 and 8.6, where the records are relevant to an ongoing criminal or other investigation, or to any other purposes as specified in the notice.
Records kept by intermediaries		
s.18(4)(b), Sch. 2	8.9	Where customer identification and verification documents are held by an intermediary on which the FI is relying to carry out CDD measures, the FI concerned remains responsible for compliance with all record-keeping requirements. FIs should ensure that the intermediaries being relied on have systems in place to comply with all the record-keeping requirements under the AMLO and this guideline (including the requirements of paragraphs 8.3 to 8.8), and that documents and records will be provided by the intermediaries as soon as reasonably practicable after the intermediaries receive the request from the FIs.
s.18(4)(a), Sch. 2	8.10	For the avoidance of doubt, FIs that rely on intermediaries for carrying out a CDD measure should immediately obtain the information that the intermediary has obtained in the course of carrying out that measure, for example, name and address.
	8.11	An FI should ensure that an intermediary will pass the documents and records to the FI, upon termination of the services provided by the intermediary.

Part 3, Sch. 2	8.12	Irrespective of where identification and transaction records are held, FIs are required to comply with all legal and regulatory requirements in Hong Kong, especially Part 3 of Schedule 2.
Record-keeping obligations by individual insurance agents		
	8.13a	*Individual insurance agents who are appointed agents of an authorized insurer are usually required to provide all customer and transaction related documentation to the insurer directly, and they do not have the capacity to maintain such documents. Under this arrangement, and from the perspective of meeting the record-keeping requirements set out in Part 3 of Schedule 2, these individual agents are considered to have deposited the required records and documents at the premises of the insurer.* *As the individual insurance agents remain responsible for compliance with all record-keeping requirements, they should ensure that:* *(a) the insurer to which they provide the records and documents has systems in place to comply with all the record-keeping requirements under the AMLO; and* *(b) such records and documents are accessible from the insurer without delay upon request by a RA.* *This guidance applies to individual insurance agents only and does not apply to insurance agencies.*

Chapter 9 – STAFF TRAINING		
	9.1	Staff training is an important element of an effective system to prevent and detect ML/TF activities. The effective implementation of even a well-designed internal control system can be compromised if staff using the system is not adequately trained.
	9.2	Staff[51] should be trained in what they need to do to carry out their particular roles in the FI with respect to AML/CFT. This is particularly important before new staff commence work.
	9.3	FIs should implement a clear and well articulated policy for ensuring that relevant staff receive adequate AML/CFT training.
	9.4	The timing and content of training packages for different groups of staff will need to be adapted by individual FIs for their own needs, with due consideration given to the size and complexity of their business and the type and level of ML/TF risk.
	9.5	FIs should provide appropriate AML/CFT training to their staff. The frequency of training should be sufficient to maintain the AML/CFT knowledge and competence of the staff.
	9.6	Staff should be made aware of: (a) their FI's and their own personal statutory obligations and the possible consequences for failure to report suspicious transactions under the DTROP, the OSCO and the UNATMO; (b) any other statutory and regulatory obligations that concern their FIs and themselves under the DTROP, the OSCO, the UNATMO, the UNSO and the AMLO, and the possible consequences of breaches of these obligations; (c) the FI's policies and procedures relating to AML/CFT, including suspicious transaction identification and reporting; and (d) any new and emerging techniques, methods and trends in ML/TF to the extent that such information is needed by the staff to carry out their particular roles in the FI with respect to AML/CFT.
	9.7	In addition, the following areas of training may be appropriate for certain groups of staff:

[51] In the context of Chapter 9, staff include appointed insurance agents.

		(a) all new staff, irrespective of seniority: (i) an introduction to the background to ML/TF and the importance placed on ML/TF by the FI; and (ii) the need for identifying and reporting of any suspicious transactions to the MLRO, and the offence of "tipping-off"; (b) members of staff who are dealing directly with the public (e.g. front-line personnel, appointed insurance agents who act on behalf of authorized insurers): (i) the importance of their role in the FI's ML/TF strategy, as the first point of contact with potential money launderers; (ii) the FI's policies and procedures in relation to CDD and record-keeping requirements that are relevant to their job responsibilities; and (iii) training in circumstances that may give rise to suspicion, and relevant policies and procedures, including, for example, lines of reporting and when extra vigilance might be required; (c) back-office staff, depending on their roles: (i) appropriate training on customer verification and relevant processing procedures; and (ii) how to recognise unusual activities including abnormal settlements, payments or delivery instructions; (d) managerial staff including internal audit officers and COs: (i) higher level training covering all aspects of the FI's AML/CFT regime; and (ii) specific training in relation to their responsibilities for supervising or managing staff, auditing the system and performing random checks as well as reporting of suspicious transactions to the JFIU; and (e) MLROs: (i) specific training in relation to their responsibilities for assessing suspicious transaction reports submitted to them and reporting of suspicious transactions to the JFIU; and (ii) training to keep abreast of AML/CFT requirements/developments generally.
	9.8	FIs are encouraged to consider using a mix of training techniques and tools in delivering training, depending on the available resources and learning needs of their staff. These techniques and tools may include on-line learning systems, focused classroom training, relevant videos as well as paper- or intranet-based procedures manuals. FIs may consider including available FATF papers and typologies as part of the training materials. All materials should be up-to-date and in line with current requirements and standards.

	9.9	No matter which training approach is adopted, FIs should monitor and maintain records of who have been trained, when the staff received the training and the type of the training provided. Records should be maintained for a minimum of 3 years[52].
	9.10	FIs should monitor the effectiveness of the training. This may be achieved by: (a) testing staff's understanding of the FI's policies and procedures to combat ML/TF, the understanding of their statutory and regulatory obligations, and also their ability to recognise suspicious transactions; and (b) monitoring the compliance of staff with the FI's AML/CFT systems as well as the quality and quantity of internal reports so that further training needs may be identified and appropriate action can be taken.

[52] For insurance institutions, the records should be kept for a minimum of 3 years from the assessment date, i.e. 31 July of each year.

Chapter 10 – WIRE TRANSFERS		
General requirements		
	10.1	This chapter primarily applies to authorized institutions and money service operators. Other FIs should also comply with section 12 of Schedule 2 and the guidelines provided in this Chapter if they act as an ordering institution or beneficiary institution as defined under the AMLO. Where an FI is the originator or recipient/beneficiary of a wire transfer, it is not acting as an ordering institution or beneficiary institution and thus is not required to comply with the requirements under section 12 of Schedule 2 or this Chapter in respect of that transaction.
s.1(4) & s.12(11), Sch. 2	10.2	A wire transfer is a transaction carried out by an institution (the ordering institution) on behalf of a person (the originator) by electronic means with a view to making an amount of money available to that person or another person (the recipient/beneficiary) at another institution (the beneficiary institution), which may be the ordering institution or another institution, whether or not one or more other institutions (intermediary institutions) participate in completion of the transfer of the money.
s.12(2), Sch. 2	10.3	This chapter does not apply to the following wire transfers: (a) a wire transfer between two FIs if each of them acts on its own behalf; (b) a wire transfer between an FI and a foreign institution if each of them acts on its own behalf; (c) a wire transfer if: (i) it arises from a transaction that is carried out using a credit card or debit card (such as withdrawing money from a bank account through an automated teller machine with a debit card, obtaining a cash advance on a credit card, or paying for goods or services with a credit or debit card), except when the card is used to effect a transfer of money; and (ii) the credit card or debit card number is included in the message or payment form accompanying the transfer.
	10.4	For SWIFT users, the above exemption will apply to MT200 series payments, MT400 and MT700 series messages when they are used to settle cheque collection and trade finance obligations between banks. Where the originator is an FI, as will sometimes be the case even for SWIFT MT102 and MT103 messages, supplying the Bank Identifier

		Code[53] (BIC) of the FI constitutes complete originator information for the purposes of the AMLO, although it is also preferable for the account number to be included where available. This also applies to Business Entity Identifiers[54] (BEIs), although in such case the account number should always be included. There may however be requests from beneficiary institution for address information.
	10.5	The FATF issued Special Recommendation VII (SR VII) in October 2001[55], with the objective of enhancing the transparency of all domestic and cross-border wire transfers to make it easier for law enforcement to track funds transferred electronically by terrorists and criminals. The Basel Committee on Banking Supervision guidance paper "Due diligence and transparency regarding cover payment messages related to cross-border wire transfers" (May 2009) also describes supervisory expectations in this area.
Ordering institutions		
s.12(3), Sch. 2	10.6	Ordering institutions must ensure that all wire transfers of amount equal to or exceeding HK$8,000 (or an equivalent amount in any other currency) are accompanied by complete and verified originator information as required under section 12(3) of Schedule 2 which includes: (a) the originator's name; (b) the number of the originator's account maintained with the FI and from which the money for the wire transfer is paid, or a unique reference number[56] (for non-account holders); and (c) the originator's address or, in the absence of an address, the originator's customer identification number or identification document number (e.g. HKID card number for a customer who is a natural person, or business registration number for a customer who is a legal person), or, if the originator is an individual, the originator's date and place of birth. There is also a concession for domestic wire transfers set out below (see paragraph 10.17 below).

[53] BIC ("Business Identifier Code") is also known as SWIFT Code.

[54] When BIC is assigned to a non-financial organization, e.g. a corporate, the code is called a BEI ("Business Entity Identifier").

[55] A revised Interpretative Note to this special recommendation was issued by the FATF on 29 February 2008 and is available on the FATF website.

[56] The unique reference number assigned by the ordering institution should permit the wire transfer to be traced back to the originator.

	10.7	It is acceptable for an ordering institution to include the "correspondence address" of the originator in the wire transfer message provided that the ordering institution is satisfied that the address has been verified.
s.12(4), Sch. 2	10.8	Ordering institutions must ensure that all the originator information accompanying the payment has been verified. The verification requirement is deemed to be met for account holding customers of the FI whose identity has been verified in compliance with the AMLO. No further verification of such account holder's information is normally required, although ordering institutions may exercise their discretion to do so in individual cases.
s.3(c), 12(3)& (4), Sch. 2	10.9	For transactions with non-account holders, the ordering institution must verify the identity of the customer and all originator information to accompany the wire transfer involving an amount equal to or exceeding the equivalent of HK$8,000. For an occasional wire transfer below HK$8,000 (or the equivalent), ordering institutions are in general not required to verify the originator's identity, except when several transactions are carried out which appear to the ordering institution to be linked and are equal to or exceed the equivalent of HK$8,000. Evidence of verification must be retained with the customer information in accordance with the record-keeping requirements of the AMLO (see Chapter 8).
	10.10	Ordering institutions may choose not to include all the required information in the wire transfer message accompanying a wire transfer of less than HK$8,000 or equivalent in foreign currencies. However, the relevant information about the originator should be recorded and retained by the ordering institution and should be made available within three business days on request by the beneficiary institution or the appropriate authorities. In considering whether to apply the threshold of HK$8,000, ordering institutions should take into account the business and operational characteristics of their wire transfer activities. Ordering institutions are encouraged to include, as far as practicable, the relevant originator information in the messages accompanying all wire transfer transactions.
	10.11	For wire transfers conducted by an account holder as the originator, the originator's name and address (or permitted alternative) should generally correspond to the account holder. Any request to override customer information should not be entertained and any suspicion of improper motive by a customer should be reported to the ordering institution's MLRO.

	10.12	In particular, an ordering institution should exercise care if there is suspicion that a customer may be effecting a wire transfer on behalf of a third party. If a wire transfer carries the name of a third party as the ordering person or otherwise does not appear to be consistent with the usual business/activity of the customer, the customer should be asked to provide further explanation of the nature of the wire transfer.
	10.13	The relevant originator information should be recorded and retained in respect of both account holders and non-account holders.
	10.14	Ordering institutions should adopt an RBA to check whether certain wire transfers may be suspicious taking into account such factors as the name of the beneficiary, the destination and amount of the wire transfer etc.
	10.15	Ordering institutions should establish clear policies on the processing of cross-border and domestic wire transfers. The policies should address the following: (a) record-keeping; (b) the verification of originator's identity information[57]; and (c) the information to be included in messages.
	10.16	Ordering institutions should include wire transfers in their ongoing due diligence on the business relationship with the originator and in their scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with their knowledge of the customer, its business and risk profile. Ordering institutions may adopt an RBA in their ongoing due diligence process. The process should be subject to regular audits to ensure its effectiveness.
Domestic wire transfers		
s.12(6), Sch. 2	10.17	Where both the ordering and beneficiary institutions are located within Hong Kong, the originator's information accompanying the wire transfer can simply be the originator's account number or a unique reference number which permits the transaction to be traced back to the originator.
s.12(6), Sch. 2	10.18	However, if requested by the beneficiary institution or the RA, complete originator information (see paragraph 10.6) must be provided by the ordering institution within 3 business days after the request is received.

[57] Where an originator is a non-account holder, institutions should follow the customer identification, verification and record-keeping requirements prescribed for wire transfers in this Chapter.

Beneficiary institutions		
	10.19	In respect of a wire transfer of any value for a beneficiary who is not an account holder, the beneficiary institution should record the identity and address of the recipient. For wire transfers equal to or exceeding HK$8,000, the beneficiary institution should verify the recipient's identity by reference to his identity card or travel document.
Batch file transfers		
s.12(7), Sch. 2	10.20	An ordering institution may bundle a number of transfers into a batch file for transmission to an overseas beneficiary institution. In such cases, the individual transfers within the batch file need only carry the originator's customer account number (or unique reference number if there is no account number), provided that the batch file itself contains complete originator information.
Intermediary institutions		
s.12(8), Sch. 2	10.21	If an FI acts as an intermediary institution in a wire transfer, it must ensure that all originator information which accompanies the wire transfer is retained with the transfer and is passed to the next institution in the payment chain.
s.19(2), Sch. 2	10.22	The requirement to detect the lack of complete originator information applies to intermediaries in the same way as for transfers of funds received directly by the beneficiary institution.
	10.23	It is preferable for an intermediary institution to forward payments through a system which is capable of carrying all the information received with the transfer. However, where an intermediary institution is technically unable to onward transmit originator information with transfers originating outside Hong Kong, it must advise the beneficiary institution of the originator information by another form of communication, whether within a payment or messaging system or otherwise.
Missing, incomplete or meaningless originator information[58]		
s.19(2), Sch. 2	10.24	FIs must establish and maintain effective procedures for identifying and handling incoming wire transfers in compliance with the relevant originator information requirements.
s.12(9)(a) &	10.25	If the domestic or cross border wire transfer is not accompanied by the originator's information, the FI must as soon as reasonably practicable,

[58] This section is only applicable to an FI acting as a beneficiary institution.

s.12(10)(a), Sch.2		obtain the information from the institution from which it receives the transfer instruction. If the information cannot be obtained, the FI should either consider restricting or terminating its business relationship with that institution, or take reasonable measures to mitigate the ML/TF risk involved.
s.12(9)(b) & s.12(10)(b), Sch.2	10.26	If the FI is aware that the accompanying information that purports to be the originator's information is incomplete or meaningless, it must as soon as reasonably practicable take reasonable measures to mitigate the risk of ML/TF involved. FIs may demonstrate compliance by implementing effective risk-based procedures and systems to subject incoming payment traffic to an appropriate level of post-event random sampling to identify wire transfers that contain incomplete or meaningless originator's information. This sampling may be weighted towards transfers: (a) from institutions that are not located in equivalent jurisdictions, particularly those that are known to have failed to adequately implement international messaging standards (i.e. SR VII); (b) from institutions located in high-risk jurisdictions; (c) that are higher value transfers; and (d) from institutions that are identified by such sampling as having previously failed to comply with the relevant information requirement.
s.12(9)(b) & s.12(10)(b), Sch. 2	10.27	If a beneficiary institution becomes aware that a payment message contains meaningless or incomplete information, it must request complete originator information. Beneficiary institutions should set appropriate deadlines for the remediation of deficient transfers.
s.12(9)(b) & s.12(10)(b), Sch. 2	10.28	If the complete and meaningful information cannot be obtained by the beneficiary institution within the deadline set, it must either consider restricting or terminating its business relationship with the institution from which it receives the transfer instruction or take reasonable measures to mitigate the ML/TF risk posed, taking into account such factors as the name of the beneficiary, the origin and amount of the transfer, etc.
	10.29	Other specific measures should also be considered by the beneficiary institutions, for example, checking, at the point of payment delivery, that originator information is complete and meaningful on all transfers that

		are collected in cash by recipients/beneficiaries on a "pay on application and identification" basis.
	10.30	FIs should also consider whether incomplete or meaningless information of which it becomes aware on a funds transfer constitutes grounds for suspicion and a report to the JFIU is appropriate.
	10.31	If an ordering institution in Hong Kong regularly fails to supply the required originator information for a wire transfer involving an amount equal to or exceeding the equivalent of HK$8,000, the beneficiary institution should report the matter to the RA. Where an ordering institution is identified as having regularly failed to comply with these information requirements, the beneficiary institution should consider taking steps, which may initially include issuing warnings and setting deadlines, prior to either refusing to accept further transfers from that institution or deciding whether to restrict or terminate its relationship with that institution either completely or in respect of funds transfers.
	10.32	For incoming wire transfers below HK$8,000 containing incomplete payment information (i.e. below the SRVII threshold where the requirement becomes mandatory), FIs are not precluded from requesting the complete information; however, an RBA is suggested in such circumstances.
s.20(1) Sch. 2	10.33	Records of all electronic payments and messages must be retained in accordance with the AMLO.
Cover payment messages related to cross-border wire transfers		
	10.34	The processing of cross-border wire transfers usually involves several institutions. In addition to the ordering institution and the beneficiary institution, additional institutions (cover intermediary institutions) which provide correspondent banking services to the originating institution or the beneficiary institution are often involved in the settlement of cross-border wire transfers. Cover payment messages are messages used by these institutions for the purpose of arranging funding to settle the interbank payment obligations created by cross-border wire transfers.
	10.35	For wire transfers involving cover payment messages, ordering institutions should ensure that the message they send to cover intermediary institutions contains originator and beneficiary information. The originator and beneficiary information included in the cover payment message should be identical to that contained in the

		corresponding direct cross-border wire transfer message sent to the beneficiary institution. Ordering institutions are encouraged, where possible, to include other identity information about the beneficiary in cover payment messages, where this is necessary to limit the risk of customer assets being incorrectly frozen, blocked or rejected, or of the cover payment being unduly delayed.
	10.36	Cover intermediary institutions should establish clear policies and procedures to ensure, in real time, that the relevant fields for storing originator and beneficiary information in cross-border cover payment messages are not blank. In addition, they should develop and implement policies and procedures to monitor if the originator and beneficiary information in the cross-border cover payment messages is manifestly meaningless or incomplete. The monitoring may be done on a risk sensitive basis, subsequent to the processing of the transactions. Cover intermediary institutions should also implement other measures including screening the originator and beneficiary names against their database of terrorists and terrorist suspects.
	10.37	Beneficiary institutions should identify and verify the beneficiary. They should also have effective risk-based procedures in place to identify and handle wire transfers lacking complete originator information.
	10.38	More detailed guidance for AIs, particularly the responsibilities of cover intermediary institutions is provided in the "Guidance Paper on Cover Payment Messages Related to Cross-border Wire Transfers" issued by the HKMA dated 8 February 2010.

June 2017

APPENDIX A

Examples of reliable and independent sources for customer identification purposes

s.2(1)(a)(iv) & s.2(1)(d)(i)(D), Sch. 2	1	The identity of an individual physically present in Hong Kong should be verified by reference to their Hong Kong identify card or travel document. FIs should always identify and/or verify a Hong Kong resident's identity by reference to their Hong Kong identity card, certificate of identity or document of identity. The identity of a non-resident should be verified by reference to their valid travel document.
	2	For non-resident individuals who are not physically present in Hong Kong, FIs may identify and or verify their identity by reference to the following documents: (a) a valid international passport or other travel document; or (b) a current national (i.e. Government or State-issued) identity card bearing the photograph of the individual; or (c) current valid national (i.e. Government or State-issued) driving license[59] incorporating photographic evidence of the identity of the applicant, issued by a competent national or state authority.
	3	Travel document means a passport or some other document furnished with a photograph of the holder establishing the identity and nationality, domicile or place of permanent residence of the holder. The following documents constitute travel documents for the purpose of identity verification: (a) Permanent Resident Identity Card of Macau Special Administrative Region; (b) Mainland Travel Permit for Taiwan Residents; (c) Seaman's Identity Document (issued under and in accordance with the International Labour Organisation Convention/Seafarers Identity Document Convention 1958); (d) Taiwan Travel Permit for Mainland Residents; (e) Permit for residents of Macau issued by Director of Immigration; (f) Exit-entry Permit for Travelling to and from Hong Kong and Macau for Official Purposes; and (g) Exit-entry Permit for Travelling to and from Hong Kong and Macau.

[59] For avoidance of doubt, international drivers permits and licences are not acceptable for this purpose.

	4	For minors born in Hong Kong who are not in possession of a valid travel document or Hong Kong identity card[60], their identity should be verified by reference to the minor's Hong Kong birth certificate. Whenever establishing relations with a minor, the identity of the minor's parent or guardian representing or accompanying the minor should also be recorded and verified in accordance with the above requirements.
	5	An FI may identify and/or verify a corporate customer by performing a company registry search in the place of incorporation and obtaining a full company search report, which confirms the current reference to a full company particulars search (or overseas equivalent).
	6	For jurisdictions that do not have national ID cards and where customers do not have a travel document or driving licence with a photograph, FIs may, exceptionally and applying a risk-based approach, accept other documents as evidence of identity. Wherever possible such documents should have a photograph of the individual.

[60] All residents of Hong Kong who are aged 11 and above are required to register for an identity card. Hong Kong permanent residents will have a Hong Kong Permanent Identity Card. The identity card of a permanent resident (i.e. a Hong Kong Permanent Identity Card) will have on the front of the card a capital letter "A" underneath the individual's date of birth.

CONFIDENTIAL 機密

Joint Financial Intelligence Unit

G.P.O. Box No. 6555, General Post Office, Hong Kong

Tel : 2866 3366 Fax : 2529 4013 Email : jfiu@police.gov.hk

Date: 2012-XX-XX

Money Laundering Reporting Officer,
XXXXXXX.

Fax No. : XXXX XXXX

Dear Sir/Madam,

Suspicious Transaction Report ("STR")

JFIU No.	**Your Reference**	**Date Received**
XX	XX	XX

I acknowledge receipt of the above mentioned STR made in accordance with the provisions of section 25A(1) of the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap 405) / Organized and Serious Crimes Ordinance (Cap 455) and section 12(1) of the United Nations (Anti-Terrorism Measures) Ordinance (Cap 575).

Based upon the information currently in hand, consent is given in accordance with the provisions of section 25A(2) of the Drug Trafficking (Recovery of Proceeds) Ordinance and Organized / Serious Crimes Ordinance, and section 12(2) of United Nations (Anti-Terrorism Measures) Ordinance.

Should you have any queries, please feel free to contact Senior Inspector Mr. XXXXX on (852) 2860 XXXX.

Yours faithfully,

(XXXXX)
for Head, Joint Financial Intelligence Unit

CONFIDENTIAL 機密

PERSONAL DATA

Joint Financial Intelligence Unit

G.P.O. Box No. 6555, General Post Office, Hong Kong
Tel : 2866 3366 Fax : 2529 4013
Email : jfiu@police.gov.hk

Our Ref. :
Your Ref :

2012-XX-XX

Money Laundering Reporting Officer,
XXXXXX
Fax No. : XXXX XXXX

Dear Sir/Madam,

Drug Trafficking (Recovery of Proceeds) Ordinance/
Organized and Serious Crimes Ordinance

I refer to your disclosure made to JFIU under the following reference:

JFIU No.	Your Reference	Dated
XX	XX	XX

Your disclosure is related to an investigation of 'XXXXX' by officers of XXXXX under reference XXXXX.

In my capacity as an Authorized Officer under the provisions of section 25A(2) of the Organized and Serious Crimes Ordinance, Cap. 455 ("OSCO"), I wish to inform you that you do NOT have my consent to further deal with the funds in the account listed in Annex A since the funds in the account are believed to be crime proceeds.

As you should know, dealing with money known or reasonably believed to represent the proceeds of an indictable offence is an offence under section 25 of OSCO. This information should be treated in strict confidence and disclosure of the contents of this letter to any unauthorized person, including the subject under investigation which is likely to prejudice the police investigation, may be an offence under section 25A(5) OSCO. Neither the accounts holder nor any other person should be notified about this correspondence.

If any person approaches your institution and attempts to make a transaction involving the account, please ask your staff to immediately contact the officer-in-charge of the case, and decline the transaction. Should the account holder or a third party question the bank as to why he cannot access the funds in the accounts he should be directed to the officer-in-charge of the case, without any further information being revealed.

Please contact the officer-in-charge, Inspector XXXXX on XXXX XXXX or the undersigned should you have any other query or seek clarification of the contents of this letter.

Yours faithfully,

(XXXXXXX)
Superintendent of Police
Head, Joint Financial Intelligence Unit

c.c. OC Case

Annex A

S/N	Account holder	Account Number
1.		

GLOSSARY OF KEY TERMS AND ABBREVIATIONS

Terms / abbreviations	Meaning
AMLO	Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615)
AML/CFT	Anti-money laundering and counter financing of terrorism
BO	Banking Ordinance (Cap. 155)
CDD	Customer due diligence
CO	Compliance officer
Connected parties	Connected parties to a customer include the beneficial owner and any natural person having the power to direct the activities of the customer. For the avoidance of doubt the term connected party will include any director, shareholder, beneficial owner, signatory, trustee, settlor/grantor/founder, protector(s), or defined beneficiary of a legal arrangement.
DTROP	Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405)
EDD	Enhanced customer due diligence
FATF	Financial Action Task Force
FI(s)	Financial institution(s)
IAIS	*International Association of Insurance Supervisors*
IO	Insurance Ordinance (Cap. 41)
II(s)	*Insurance institution(s), referring to authorized insurers, reinsurers, appointed insurance agents and authorized insurance brokers carrying on or advising on long term business.*
Individual	Individual means a natural person, other than a deceased natural person.
JFIU	Joint Financial Intelligence Unit

Minor	Minor means a person who has not attained the age of 18 years [Interpretation and General Clauses Ordinance (Cap. 1) - section 3].
MLRO	Money laundering reporting officer
ML/TF	Money laundering and/or terrorist financing
OSCO	Organized and Serious Crimes Ordinance (Cap. 455)
PEP(s)	Politically exposed person(s)
RA(s)	Relevant authority (authorities)
RBA	Risk-based approach to CDD and ongoing monitoring
Schedule 2	Schedule 2 to the AMLO
SDD	Simplified customer due diligence
Senior management	Senior management means directors (or board) and senior managers (or equivalent) of a firm who are responsible, either individually or collectively, for management and supervision of the firm's business. This may include a firm's Chief Executive Officer, Managing Director, or other senior operating management personnel (as the case may be).
SFO	Securities and Futures Ordinance (Cap. 571)
STR(s)	Suspicious transaction report(s); also referred to as reports or disclosures
Trust	For the purposes of the guideline, a trust means an express trust or any similar arrangement for which a legal-binding document (i.e. a trust deed or in any other form) is in place.
UNATMO	United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575)
UNSO	United Nations Sanctions Ordinance (Cap. 537)

GL3A

GUIDELINE ON EXERCISING POWER TO IMPOSE PECUNIARY PENALTY IN RESPECT OF ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING

(For authorized insurers, reinsurers, appointed insurance agents and authorized insurance brokers carrying on or advising on long term business)

Insurance Authority

Contents

1. Introduction

1.1. This Guideline is issued by the Insurance Authority ("IA") pursuant to section 23(1) of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) ("AMLO") and section 133 of the Insurance Ordinance (Cap. 41). Under section 21 of the AMLO, the IA may impose a pecuniary penalty either on its own or together with other disciplinary sanctions on an authorized insurer, appointed insurance agent or authorized insurance broker carrying on or advising on long term business ("insurance institution") if the insurance institution contravenes a specified provision as defined by section 5(11) of the AMLO.

1.2. In exercising the power to impose pecuniary penalty referred to in section 21(2)(c) of the AMLO, the IA shall have regard to this Guideline which indicates the manner in which it proposes to exercise that power.

2. Considerations in exercising the Insurance Authority's power to impose pecuniary penalty

2.1. As a matter of policy, the IA will usually publicize all his decisions to impose pecuniary penalty.

2.2. When considering whether to impose a pecuniary penalty and the amount of the penalty, the IA will consider all of the circumstances of the particular case, including the relevant factors described below.

2.3. A pecuniary penalty imposed by the IA should act as a deterrent to the insurance institution concerned from contravening a specified provision as defined by section 5(11) of the AMLO. It should also act as a general deterrent to other insurance institutions from contravening the same or similar specified provisions.

2.4. Although section 21(2)(c)(ii) of the AMLO states that one alternative maximum level of the pecuniary penalty that can be imposed is three times the amount of the profit gained, or costs avoided, the IA will not automatically link the penalty imposed in any particular case with

the profit gained, or costs avoided.

2.5. A pecuniary penalty should not have the likely effect of putting the insurance institution concerned in financial jeopardy. In considering this factor, the IA will take into account the size and financial resources of the insurance institution.

2.6. The more serious the contravention, the greater the likelihood that the IA will impose a pecuniary penalty and that the size of the penalty will be larger. In determining the seriousness of a contravention, the IA will consider all of the circumstances of the case and take into account but not limited to the factors set out below.

(a) The nature, seriousness and impact of the contravention, including:

(i) whether the contravention is intentional or reckless or negligent – a contravention caused merely by negligence or conduct which only results in a technical breach is generally regarded as less serious;
(ii) the duration and frequency of the contraventions;
(iii) whether the contravention is potentially damaging or detrimental to the integrity and stability of the insurance industry, and/or the reputation of Hong Kong as an international financial centre;
(iv) whether the contravention caused or potentially caused loss to, or imposed costs on, any other person;
(v) whether the contravention was committed by the insurance institution alone or whether as part of a group and the role the insurance institution played in that group;
(vi) whether the contravention reveals serious or systemic weaknesses of the management systems or internal controls in respect of the customer due diligence and record-keeping procedures relating to all or part of that insurance institution's business;
(vii) whether the contravention was indicative of a pattern of contraventions;
(viii) whether there are a number of smaller issues, which individually may not justify a pecuniary penalty, but which do so when taken collectively; and
(ix) the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the contravention.

(b) *The conduct of the insurance institution after the contravention , including:*

(i) whether the insurance institution attempted to conceal its contravention;
(ii) any remedial steps taken since the contravention or the possible contravention was identified, and any action taken by the insurance institution against those involved and any steps taken to ensure that similar contraventions will not occur in future;
(iii) the degree of cooperation with the IA, other relevant authorities and/or law enforcement agencies during the investigation of the contravention; and
(iv) the likelihood that the insurance institution will commit the same type of contravention in the future if no or a lighter penalty is imposed.

(c) *The previous disciplinary record and compliance history of the insurance institution, including:*

(i) the relevant previous disciplinary record of the insurance institution, including its previous similar contraventions particularly that for which it has been disciplined before;
(ii) whether the insurance institution has previously undertaken not to engage in that particular conduct that results in the contravention; and
(iii) any punishment imposed or regulatory action taken or likely to be taken by other relevant authorities on the same incident.

(d) *Other factors, including:*

(i) whether the IA has issued any guideline in relation to the conduct in question – generally the IA will not take disciplinary action against an insurance institution for conduct that is in line with the guideline which was current at the time of the conduct in question;
(ii) what action the IA and/or other relevant authorities have taken in previous similar cases – in general, similar cases should be treated consistently;
(iii) the amount of any benefit gained or costs avoided by the

insurance institution or any of its directors or employees as a result of the contravention; and

(iv) as a mitigating factor, whether the insurance institution has promptly, effectively and completely brought the contravention or possible contravention to the attention of the IA.

3. Commencement

This Guideline shall take effect from 26 June 2017.

June 2017

GL4

GUIDELINE
ON
"FIT AND PROPER" CRITERIA UNDER THE INSURANCE ORDINANCE (CAP. 41)

Insurance Authority

Contents

1. Introduction

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance") taking into account the Insurance Core Principles, Standards, Guidance and Assessment Methodology ("ICP") promulgated by the International Association of Insurance Supervisors. Special reference is made to ICP 5 which stipulates that the supervisor expects board members, senior management, key persons in control functions and significant owners of an insurer to be and remain suitable to fulfil their respective roles.

1.2 It sets out the minimum standard of suitability requirements that are applicable to certain persons of an authorized insurer and the general guiding principles of the Insurance Authority ("IA") in assessing the suitability of such persons in fulfilling their roles in an insurer.

1.3 This Guideline is to provide general guidance to the relevant applicants and is not intended to be exhaustive.

1.4 Words and expressions used in this Guideline shall have the same meanings as given to them in the Ordinance.

2. Approval / Notification Requirements for Appointments of Certain Positions

2.1 Under section 8 of the Ordinance, a company intending to carry on any class of insurance business in or from Hong Kong may apply to the IA for authorization. Section 8(2) of the Ordinance provides that the IA shall not authorize a company if it appears to the IA that any person who is a **director** or **controller** of the company is not a ***fit and proper*** person to hold such position. For the purpose of this section, the meaning of a "controller" is defined in section 9 of the Ordinance.

2.2 After obtaining authorization, an insurer is required to comply with sections 13A, 13AC, 13AE, 13B, 14, 15 and 15B of the Ordinance in respect of any appointments of, or changes in, its controllers, directors, key persons in control functions or appointed actuary (if the insurer carries on long term business). These requirements aim at ensuring that the

persons to be appointed or have been appointed, as controllers, directors, key persons in control functions or appointed actuary of the insurer are fit and proper.

Controllers under Section 13A

2.3 Section 13A stipulates that an authorized insurer must obtain the IA's prior approval for the appointment of a managing director or a chief executive of the insurer. Where the insurer is incorporated outside Hong Kong, it is required to seek the IA's prior approval of any appointment of a managing director in respect of so much of the insurer's insurance business as is carried on within Hong Kong or a chief executive who is responsible for the conduct of the whole of the insurance business carried on by the insurer within Hong Kong. By virtue of section 50B, the authorized representative of Lloyd's is also subject to the prior approval requirement under section 13A.

Directors

2.4 Section 13AC provides that an authorized insurer incorporated in Hong Kong must obtain the IA's prior approval for the appointment of a director. Where an authorized insurer is incorporated outside Hong Kong, it is required to notify the IA of any changes to its directors in accordance with section 14 of the Ordinance.

Key Persons in Control Functions

2.5 Section 13AE provides that an authorized insurer must obtain the IA's prior approval for the appointment of a key person in control functions. If the insurer is incorporated in Hong Kong, a key person in control functions means an individual responsible for the performance of one or more of the control functions for the insurer. Where the insurer is incorporated outside Hong Kong, a key person in control functions means an individual responsible for the performance of one or more of the control functions for the insurer in respect of so much of its insurance business as is carried on within Hong Kong.

2.6 Pursuant to section 13AE(12), a control function is defined as any of the prescribed functions that is likely to enable the individual

responsible for the performance of the function to exercise a significant influence on the business carried on by the authorized insurer. The prescribed functions include risk management function, financial control function, compliance function, internal audit function, actuarial function and intermediary management function. The Financial Secretary may also, by notice published in the Gazette, specify a function to be a control function.

Shareholder Controllers

2.7 Section 13B requires a person who intends to become a controller (as defined under section 13B(1)) of an authorized insurer incorporated in Hong Kong to notify the IA in writing that he proposes to become a controller of that insurer. For the purpose of this Guideline, a controller as defined under section 13B(1) of the Ordinance is referred to herein as shareholder controller.

2.8 Where there are any changes in the controllers (other than a controller to whom section 13B applies), the authorized insurer must notify the IA of the changes in accordance with section 14.

Appointed Actuary

2.9 Section 15(3A) requires that if the authorized insurer is incorporated in Hong Kong and carries on long term business, it must obtain the IA's prior approval for the appointment of an actuary. Where the authorized insurer is incorporated outside Hong Kong, it is required to notify the IA of its appointment of an actuary in accordance with section 15(3) of the Ordinance. For the purpose of this Guideline, an actuary appointed under section 15 of the Ordinance is referred to herein as appointed actuary.

Particulars of Controllers, Directors, Key Persons in Control Functions and Appointed Actuaries

2.10 A person who is proposed to be appointed or has been appointed as a controller, director, key person in control functions or

appointed actuary of an authorized insurer, is required to provide his particulars in the relevant prescribed Form(s) to the IA for consideration. The relevant Forms[1] for seeking approval or notification of any changes of or in the particulars of such persons are set out in Schedules 2, 4, 5 and 6 to the Ordinance.

The IA's Powers of Approval, Revocation of Approval, or Objection in respect of Proposed Appointments or Appointments

2.11 Under sections 13A, 13AC, 13AE and 15 of the Ordinance, the IA must not approve the appointment of a person as a controller, director, key person in control functions or appointed actuary of an authorized insurer respectively unless it is satisfied that the person is a fit and proper person to be so appointed. Pursuant to sections 13AF and 15AA, the IA may impose any conditions that it considers appropriate on the approval when granting and/or after it has granted the approval.

2.12 Under sections 13A, 13AC and 13AE of the Ordinance, the IA has the power to reject an application for approval as a controller (as defined under section 13A(12)), director or key person in control functions of an authorized insurer respectively if it appears to the IA that the person is not fit and proper to hold that position.

2.13 Under sections 13B, 14 and 15B(2A) of the Ordinance, the IA has the power to object respectively to (i) a person proposing to become a shareholder controller or has become a shareholder controller in contravention of section 13B(2); (ii) the appointment of the person as a controller, director (other than a controller or director to whom sections 13A, 13AC or 13B applies); or (iii) appointed actuary (other than an actuary to whom section 15(3A) applies) of an authorized insurer if it appears to the IA that the person is not fit and proper to hold that position.

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[1] The prescribed forms used for different situations are set out below:

- Form A/A1/A2/B in Schedule 2 – Notification of appointments of controller, director, key person in control functions and appointed actuary under sections 7, 14 and 15(3).
- Form A/A1/A2/B in Schedule 4 – Seeking IA's approval for the appointment of controller, director, key person in control functions, appointed actuary and authorized representative under sections 13A, 13AC, 13AE, 15(3A) and 50(B) respectively.
- Form A/B in Schedule 5 – Person proposing to become controller within the meaning of section 13B(1).
- Form A/B in Schedule 6 – Person who has become controller in contravention of section 13B(2).

2.14 In relation to controllers, directors, key persons in control functions and appointed actuaries of an authorized insurer, where it appears to the IA that a person is no longer a fit and proper person to be so appointed, the IA may revoke the approval of the appointment already made as appropriate pursuant to sections 13A(7), 13AC(7), 13AE(7) and 15(3F) of the Ordinance respectively.

2.15 Any person aggrieved by or in respect of whom the decision of the IA is made in refusing to approve, revoking the approval of or objecting to the proposed appointment or appointment already made, as appropriate, may, within 21 days after the notice informing the person of the decision has been served, apply to the Insurance Appeals Tribunal for a review of the decision. If a party to a review is dissatisfied with the Tribunal's determination of the review, the party may appeal to the Court of Appeal against the determination as provided for under section 112 of the Ordinance.

2.16 A table summarizing the prior approval requirements for the appointments of controllers, directors, key persons in control functions and appointed actuaries is set out in the Annex.

3. Factors for Determining "Fit and Proper" Persons

3.1 Pursuant to section 14A of the Ordinance, the IA must have regard to the following matters in determining whether a person is a fit and proper person for the purposes of sections 8, 13A, 13AC, 13AE, 13B, 14 and 15:

(a) the education or other qualifications or experience of the person;

(b) the person's ability to act competently, honestly and fairly;

(c) the reputation, character, reliability and integrity of the person;

(d) the person's financial status or solvency;

(e) whether any disciplinary action has been taken against the person

by:

(i) the Monetary Authority;

(ii) the Securities and Futures Commission;

(iii) the Mandatory Provident Fund Schemes Authority; or

(iv) any other authority or regulatory organization, whether in Hong Kong or elsewhere, which, in the IA's opinion, performs a function similar to those of the IA;

(f) if the person is a company in a group of companies, any information in the possession of the IA, whether provided by the person or not, relating to:

(i) any other company in the group of companies; or

(ii) any substantial shareholder or officer of the person or of any company referred to in subparagraph (i);

(g) the state of affairs of any other business which the person carries on or proposes to carry on; and

(h) any other matter that the IA considers relevant in making the determination.

3.2 Without limiting the generality of the statements referred to in paragraph 3.1 above, the following paragraphs set out the events and matters that are likely to give rise to concerns about the fitness and properness of a person to be appointed or who has been appointed as a controller, director, key person in control functions or appointed actuary of an authorized insurer. However, failure to comply with individual elements will not necessarily result in the IA not being satisfied that a person is fit and proper. The IA will look to the substance of the requirements and materiality of any failure to meet them.

4. Criteria for Individual Persons

4.1 The controllers, directors, key persons in control functions and appointed actuary are holders of important positions in an insurer. They should possess competence and integrity. Competence is demonstrated generally through the level of an individual's professional and/or formal

qualifications and knowledge, skills and pertinent experience within the insurance and financial industries or other related businesses. Competence also includes having the appropriate level of commitment to perform the role. Integrity is demonstrated generally through character, personal behaviour and business conduct.

Competence Requirements - Qualifications and Working Experience

4.2 The requirements on qualifications and experience for controllers, directors, key persons in control functions and appointed actuary may vary depending on the degree of their influence and their respective job duties and roles in the insurer's business. It is generally recognized that an individual considered competent for a particular position within an insurer may not be considered competent for another position with different responsibilities or for a similar position within another insurer.

Controllers under Section 13A

4.3 In general, the IA expects that a controller as defined under section 13A possesses the relevant qualifications and/or experience which would enable him to discharge his functions properly (i.e. whether he is professionally competent). For example, he may be considered as professionally competent:

(a) if he possesses professional qualifications in insurance, accounting, actuarial science or law, and has not less than 5 years' experience in an insurer or similar institution occupying a management position; or

(b) if he does not possess the relevant qualification as set out in (a) above, he has not less than 8 years' experience in an insurer or similar institution occupying a management position.

Directors

4.4 The Board of Directors ("Board") plays an important role in the corporate governance of authorized insurers. In assessing the competence

of individual directors, the IA would give due regard to the respective duties allocated to each individual director to ensure an appropriate diversity of expertise and the effective functioning of the Board as a whole. The IA would give due considerations if a director has sufficient skills, knowledge, experience and soundness of judgment properly to undertake and discharge his roles and responsibilities.

Key Persons in Control Functions

4.5 The IA expects that a key person in control functions possesses the relevant qualification and/or experience which would enable him to discharge his functions properly. To demonstrate competency in his appointment, he should have not less than 5 years' experience in risk management, financial control, compliance, internal audit, actuarial work, intermediary management or relevant discipline.

Appointed Actuary

4.6 The actuary appointed under section 15 of the Ordinance shall possess either any of the following qualifications as prescribed under the Insurance (Actuaries' Qualifications) Regulation or a qualification that is accepted by the IA as being comparable to the following qualifications:

(a) Fellow of the Institute and Faculty of Actuaries of the United Kingdom;

(b) Fellow of the Institute of Actuaries of Australia; or

(c) Fellow of the Society of Actuaries of the United States of America,

as well as appropriate working experience in long term business obtained in the last 5 years. The appointed actuary should also be familiar with the insurance market in Hong Kong, particularly the applicable actuarial standards, legal, judicial and social trends in Hong Kong that may impact upon the valuation of assets and liabilities pertaining to insurance business.

Assessment of Integrity

4.7 In the case of an individual, the following factors are relevant to the assessment of integrity in respect of a controller, director, key person in control functions or appointed actuary, namely, whether the individual concerned:

(a) has been found by a court or other competent authority to have acted fraudulently or dishonestly;

(b) has been disqualified by a court of competent jurisdiction from being a director of a body corporate;

(c) has been convicted of a criminal offence by any court, including a military tribunal or is the subject of unresolved criminal charges, in Hong Kong or elsewhere;

(d) has been refused or restricted from the right to carry on any trade, business or profession by any regulatory authority in Hong Kong or elsewhere;

(e) has been censured, disciplined or publicly criticized by any regulatory authority in Hong Kong or elsewhere;

(f) has been the subject of an investigation conducted by any regulatory authority in Hong Kong or elsewhere;

(g) has, in Hong Kong or elsewhere, been censured, disciplined or publicly criticized by a professional body to which he belongs or belonged, or has been dismissed from any office or employment or refused entry to any profession or occupation;

(h) was a controller, director, key person in control functions or appointed actuary of a body corporate or insurer, in Hong Kong or elsewhere, which has been compulsorily wound up or made any compromise or arrangement with its creditors or ceased trading in circumstances where its creditors did not receive or have not yet received full settlement of their claims, either whilst the individual concerned held any of the above positions or within one year after the individual ceased to hold such position;

(i) has, in connection with the formation or management of a body corporate or insurer, been adjudged by a court in Hong Kong or elsewhere civilly liable for any fraud, misfeasance or other misconduct by the individual concerned towards such a body or insurer or towards any members thereof;

(j) has been adjudicated bankrupt by a court, or is currently subject to bankruptcy proceedings, in Hong Kong or elsewhere;

(k) has failed to satisfy any judgment debt under an order of a court in Hong Kong or elsewhere; or

(l) was or has been, in connection with the management of a body corporate or insurer in Hong Kong or elsewhere, a controller, director, key person in control functions or appointed actuary of the body corporate or insurer, which,

(i) with the consent or connivance of, or because of the neglect or omission by the individual concerned, failed to comply with any legal or regulatory requirements or any guidelines made thereunder;

(ii) was or has been convicted of a criminal offence by any court, or is the subject of unresolved criminal charges, in Hong Kong or elsewhere; or

(iii) was or has been adjudicated by any court civilly liable for any fraud, misfeasance or misconduct, in Hong Kong or elsewhere.

4.8 In respect of the events listed in paragraph 4.7 above, the IA, in considering whether the individual is fit and proper, will have regard to, inter alia, the relevance of the event, the lapse of time since the event, the seriousness of the event, and the degree of his involvement in the event. If necessary, the IA may require further information regarding the event from the individual, the insurer or the relevant party concerned.

4.9 To ensure compliance with this Guideline, an authorized insurer

should set high internal standards of ethics and integrity, promote sound corporate governance and require the aforesaid position holders to have pertinent experience and maintain a sufficient degree of knowledge and decision making ability.

Independence and Conflicts of Interests

4.10 For the prudent and effective management of an insurer, it should have sufficient safeguards in place to prevent undue influence over its controllers, directors, key persons in control functions and appointed actuary with respect to the performance of their duties and responsibilities. In this regard, the IA considers that:

(a) the Chairman of the Board should not be the Chief Executive; and

(b) the appointed actuary should not be the Chairman of the Board or the Chief Executive.

4.11 The IA also considers that if the same person assumes the role of the key person in more than one control functions, there should not be conflicts between these positions.

5. Criteria for Body Corporate

5.1 In the case of a body corporate, the following factors are relevant to the assessment of fitness and properness of the body corporate, namely, whether it:

(a) has financial integrity, e.g. whether the accounts of the body corporate displays a financially sound and stable position;

(b) is subject to receivership, administration, liquidation or other similar proceedings;

(c) has failed to satisfy any judgment debt under an order of a court in Hong Kong or elsewhere;

(d) has been refused or restricted from the right to carry on any trade, business or profession by any regulatory authority in Hong Kong or elsewhere;

(e) has been censured, disciplined or publicly criticized by any regulatory authority in Hong Kong or elsewhere;

(f) has been the subject of an investigation conducted by any regulatory authority in Hong Kong or elsewhere;

(g) was a controller or director of a body corporate or insurer, in Hong Kong or elsewhere, which has been compulsorily wound up or made any compromise or arrangement with its creditors or ceased trading in circumstances where its creditors did not receive or have not yet received full settlement of their claims, either whilst the body corporate concerned was a controller or director or within one year after the body corporate concerned ceased to be such a controller or director;

(h) was or has been, in connection with the management of a body corporate or insurer in Hong Kong or elsewhere, a controller or director of a body corporate or insurer, which

(i) with the consent or connivance of, or because of the neglect or omission by, the body corporate concerned, failed to comply with any legal or regulatory requirements, or any guidelines made thereunder;

(ii) was or has been convicted of a criminal offence by any court, or is the subject of unresolved criminal charges, in Hong Kong or elsewhere; or

(iii) was or has been adjudicated by any court civilly liable for any fraud, misfeasance or misconduct, in Hong Kong or elsewhere; or

(i) has a controller, director or key person in control functions (if applicable) who fails to meet the requirements set out above for individuals (other than those relating to qualifications and experience), or the requirements set out herein for body corporate, as applicable.

5.2 Where a body corporate intends to become or has become a shareholder controller (i.e. a shareholder directly or indirectly controlling the exercise of 15% or more of the voting power at any general meeting of an insurer) of an insurer, the IA will, in addition to the matters referred to in paragraph 5.1 above, take into account whether the body corporate has sufficient financial resources to acquire or support the operations of the insurer, and whether the business plan for the insurer is realistic and viable.

5.3 In respect of any event listed in paragraph 5.1 above, the IA, in considering whether the body corporate is fit and proper, will have regard to, inter alia, the relevance of the event, the lapse of time since the event, the seriousness of the event, the degree of involvement of the body corporate in the event and any information in the possession of the IA (whether provided by the body corporate or not) relating to any other company within the group of companies of the body corporate, as well as any information relating to the substantial shareholder and officer of the body corporate or such other company referred to above. If necessary, the IA may require further information regarding the event from the body corporate, the insurer or the relevant party concerned.

6. Commencement

6.1 This Guideline shall take effect from 26 June 2017.

June 2017

Annex

Summary of Prior Approval Requirements for Appointments of Certain Positions under the Insurance Ordinance (Cap. 41)

	Authorized Insurer Incorporated in Hong Kong	Authorized Insurer Incorporated Outside Hong Kong
Controller under s.13A	✓ **(Form A in Schedule 4)**	✓ (Note: the prior approval requirement applies to controllers of the insurer's Hong Kong operation) **(Form A in Schedule 4)**
Shareholder controller	✓ (Note: appointment of immediate shareholder controller is subject to IA's prior approval under s.13B) **(Form A/B in Schedule 5)** X (Note: changes in controller (other than a controller to whom section 13B applies) are subject to notification requirement under section 14) **(Form A/B in Schedule 2)**	X (Note: the appointment is subject to notification requirement under section 14) **(Form A/B in Schedule 2)**
Director	✓ (under s.13AC) **(Form A/B in Schedule 4)**	X (Note: the appointment is subject to notification requirement under section 14) **(Form A/B in Schedule 2)**
Key Persons in Control Functions under s.13AE	✓ **(Form A1 in Schedule 4)**	✓ (Note: the prior approval requirement applies to those persons appointed for the insurer's Hong Kong operation) **(Form A1 in Schedule 4)**
Appointed Actuary (applicable to insurers carrying on long term insurance business)	✓ (under s.15(3A)) **(Form A2 in Schedule 4)**	X (Note: the appointment is subject to notification requirement under section 15(3)) **(Form A1 in Schedule 2)**

Note:

✓ – The appointment is subject to the Insurance Authority ("IA")'s prior approval.

X – The IA's prior approval for appointment is generally not required, unless otherwise specifically required by the IA.

GL5

GUIDELINE ON APPLICATION FOR AUTHORIZATION TO CARRY ON INSURANCE BUSINESS IN OR FROM HONG KONG

Insurance Authority

Contents

1. Introduction

This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance") to facilitate those who wish to make an application for authorization to carry on insurance business in or from Hong Kong. It attempts to set out the information and documents required for the Insurance Authority ("IA") to process the application. Each application will be considered according to its own individual merits.

2. Requirements for Authorization

2.1. Insurance business is regulated in Hong Kong by the Ordinance and its subsidiary legislation. A list of such subsidiary legislation is at **Annex 1**.

2.2. All applicants are recommended to read carefully this Guideline and the Authorization Guideline at **Annex 2** before they attempt to make an application for authorization. The Authorization Guideline is also available at our website www.ia.org.hk.

2.3. Section 8 of the Ordinance sets out the requirements for authorization including those on minimum amounts of paid-up share capital and solvency margin, fitness and properness of directors and controllers and adequacy of reinsurance arrangements.

2.4. The Authorization Guideline (**Annex 2**) sets out the other criteria for authorization (see paragraph 2.12 below) which the IA will take into account in considering an application.

2.5. Only a company formed and registered in Hong Kong or a company registered as a non-Hong Kong company under Part 16 of the Companies Ordinance (Cap. 622) can apply for authorization.

Capital and Solvency Margin Requirements

2.6. For the purposes of authorization, the amount of paid-up share capital and the amount of solvency margin (i.e. the excess of assets over liabilities) of a company shall not be less than the respective amounts as specified in section 8 of the Ordinance. **Annex 3** sets out the minimum amount required as applicable to different classes of insurance business as well as the bases for determining the solvency margin. It should be emphasized that these are the minimum amounts and an appropriate safety margin on top of these amounts is

required.

2.7. For the purposes of determining compliance with the solvency margin requirement, the value of assets, in the case of a general business insurer, is to be determined in accordance with the Insurance (General Business) (Valuation) Rules while the amount of the long term business liabilities, in the case of a long term business insurer, is subject to the Insurance (Determination of Long Term Liabilities) Rules.

2.8. For classification of insurance business, an applicant may refer to **Annex 4** for Classes of Long Term Business and **Annex 5** for Classes of General Business.

Fitness and Properness of Directors and Controllers

2.9. The IA has to be satisfied that the directors and controllers of the applicant are fit and proper persons to hold such positions in the applicant. Section 9 of the Ordinance gives the meaning of "controller". It includes the following individuals/bodies corporate:

- the Managing Director of the applicant or its holding company
- the Chief Executive of the applicant
- the Chief Executive of the applicant responsible for the whole of the Hong Kong operation (in the case of a non-Hong Kong company)
- the holding company (including intermediate holding companies) of the applicant
- the Chief Executive of the applicant's holding company (only if the holding company is also an insurer)
- any person controlling 15% or more of the voting power of the applicant or its holding companies (including intermediate holding companies)

2.10. In considering whether a person is fit and proper for the position, the IA will take into account all relevant factors as set out in section 14A of the Ordinance, including qualifications, experience, ability to act competently, honestly and fairly, reliability and integrity, as well as financial status. The **Guideline on "Fit and Proper" Criteria under the Insurance Ordinance (Cap.41)** (GL4) containing details in this connection has also been issued by the IA.

Adequacy of Reinsurance Arrangements

2.11. An insurer is required under the Ordinance to have adequate reinsurance arrangements in force for each class of insurance business it carries on. In considering the adequacy of reinsurance arrangements of an insurer, the IA will take into account the following factors:

- the type of treaties;
- the maximum retention of the insurer;
- the security of the reinsurers; and
- the spread of risks among participating reinsurers.

Other Criteria

2.12. In addition to the requirements under section 8 of the Ordinance, the applicant is required to demonstrate to the satisfaction of the IA that it is able to meet the criteria as set out in the Authorization Guideline (**Annex 2**). These criteria include:

- The applicant will maintain an office in Hong Kong, with a locally-based chief executive to oversee its Hong Kong operation;
- Such office will be managed professionally, with adequate staff commensurate to the nature and scale of the Hong Kong operation; and
- The applicant has, and will continue to have, sufficient financial resources to pre-finance its operation.

3. Application Procedure

3.1. Application for authorization to carry on any class of insurance business in or from Hong Kong should be made in the following Forms, as appropriate. These Forms can be downloaded for use from our website.

Form Index	Description
Form IA-6G	Application for Authorization to carry on General Business

Form IA-6L	Application for Authorization to carry on Long Term Business
Form IA-6R	Application for Authorization to carry on Reinsurance Business
Form IA-6C	Application for Authorization to carry on General Business (**by captive insurer only**)

Preliminary Meeting with IA

3.2. We strongly advise all applicants to contact us for a preliminary meeting to discuss briefly their proposals before they complete the Application Form. To facilitate the discussion, we request the applicant to let us have, preferably **one week** before the meeting, any relevant documents currently available. Such documents may include a feasibility study report (if such has been carried out), background of the applicant and its group (if applicable), including a corporate structure chart and the latest financial statements of the applicant and its group (if applicable) and an overview of its business plan. The meeting will enable both the applicant and the IA to understand each other better as well as to enable us to give the applicant our initial views on the viability of its proposed operation.

Draft Application

3.3. The applicant may proceed to prepare the application after it has discussed with us its proposal, if such is considered acceptable to us. We recommend that an application should first be submitted to us ***in draft form***. This means that the applicant should complete the Application Form with the information requested therein and leave it unsigned. We will consider the information in detail and revert to the applicant on outstanding issues or deficiencies if necessary. A draft application will also expedite the process of the applicant's formal application by having any difficult issues resolved before the formal application is submitted.

3.4. Subject to the sufficiency of information, we will normally be able to advise the applicant of the outcome of our initial assessment on its draft application within **two months**.

Formal Application

3.5. As soon as the applicant is advised positively of the outcome of our initial assessment, it may proceed to make a formal application to us. The formal application, in the appropriate Form, should be duly signed and sealed as applicable. Any documents submitted in support of the application should be certified by a principal officer of the applicant as true copies of the originals.

Decision on the Application

3.6. Provided that the formal application has been properly prepared and contains all the relevant information and documents adequate for the IA to make a decision, we will advise the applicant, **within six weeks** of receipt of the formal application, of our decision on the application. If authorization can be given, we will give our approval-in-principle to the applicant and at the same time advise it of the requirements which should be complied with by it before formal authorization will be given. These may include establishing a fully-fledged office and having the necessary capital or fund in place as proposed.

3.7. In the letter giving our approval-in-principle, we will also set out the conditions to which the authorization will be subject. These will normally include:

- To maintain a branch office as its place of business in Hong Kong with a locally-based chief executive and to keep and maintain at such branch office proper books of account and other records in respect of its Hong Kong operation. ***(For insurers incorporated outside Hong Kong)***

- To apply to and become a member of The Insurance Claims Complaints Bureau before writing any personal insurance business in Hong Kong. ***(For insurers other than pure reinsurers or captive insurers)***

- To apply to and become a member of the Motor Insurers' Bureau of Hong Kong before writing any direct motor vehicle liability insurance business in Hong Kong. ***(For insurers writing direct motor vehicle liability insurance)***

- To apply to and become a member of The Employees Compensation Insurer Insolvency Bureau before writing any employees' compensation insurance business in Hong Kong. ***(For insurers writing direct employees' compensation insurance business)***

On-site Inspection

3.8. The applicant may contact us for arranging a visit to its office when it has made all the preparations necessary to commence business as specified in our letter of approval-in-principle. During the visit, we will need to be satisfied that all operational systems and staff are in place to enable the applicant to commence business immediately.

Certificate of Authorization

3.9. If we are satisfied that the applicant has fulfilled all the requirements as set out in our letter of approval-in-principle, we will confirm to it, **within two weeks** of our visit to its office, a formal authorization by issuing a Certificate of Authorization. The Certificate will be sent through ordinary mail unless the applicant wishes to pick it up.

3.10. The handling process of an application for authorization is illustrated in the flow-chart at **Annex 6**.

4. Information and Documents required for the Application

4.1. For the purposes of the application, the applicant is required to complete and submit one of the Forms for Application, as appropriate, as referred to in paragraph 3.1 above. In the Form, the applicant will be asked to provide information and documents that will help us to evaluate whether it is able to meet all the authorization requirements of the Ordinance as well as the criteria set out in the Authorization Guideline mentioned in paragraph 2.12. These will include particulars of the applicant, its directors and controllers, financial standing, staff establishment, accounting policies, internal control and business plan.

4.2. The applicant, with the exception of captive insurer, should have undertaken a detailed market feasibility study in respect of the proposed operations in or from Hong Kong, and a copy of such report is required. Based on the result of such feasibility study report, the applicant should be able to demonstrate the viability of its business plan.

4.3. To enable us to carry out the "fit and proper" test on the applicant's directors and controllers as mentioned in paragraphs 2.9 and 2.10 above, the applicant is required to provide us with their particulars in the prescribed Form A/Form B of Schedule 2 to the Ordinance.

4.4. An organizational chart showing the proposed staff establishment with particulars of the qualifications and experiences of those at managerial level will help our assessment on the competence of the applicant's management team.

4.5. A business plan will demonstrate whether the applicant will have sufficient financial resources to pre-finance its proposed business or withstand any loss sustained in the early periods of its operation. Except for captive insurers, all general business insurers are required to provide us with a three-year business plan consisting of a budgeted revenue account, a budgeted profit and loss account and a budgeted balance sheet in respect of each of the three years. For a long term business insurer, it is required to prepare a business plan with financial projections covering more than three projected years up to a point where the operations can be demonstrated to be self-supporting. Such business plan should be accompanied by a certificate signed by the appointed actuary. In the business plan, two sets of financial projections are required, one on a "best/optimistic estimate" basis and one on a "pessimistic estimate" basis, with the exception of pure reinsurers. A pure reinsurer is required to give only one set of financial projections on a "realistic estimate" basis. As regards a captive insurer, only projections on premium income and claims outstanding for the first three years of operation are required.

4.6. For an insurer, not being a pure reinsurer, who applies for authorization to carry on general insurance business, the business plan should also demonstrate how it will be able to comply with the local asset requirement pursuant to section 25A of the Ordinance.

4.7. For a long term business insurer, it will have to comply with the requirement of the separation of assets and liabilities attributable to its long term business under section 22 of the Ordinance, and ensuring that not less than one-sixth of the required solvency margin is held in the separate fund and in the total long term business funds. Where such requirement cannot be complied with on a global basis, the applicant can avail itself of the provision in section 22A of the Ordinance as complying with the requirement on such long term business as carried on in or from Hong Kong subject to the IA's consideration.

4.8. A long term business insurer will also have to maintain an appointed actuary possessing the prescribed professional qualifications or who is acceptable to the IA, and be prepared to comply with the prescribed professional standards or other standard as accepted by the IA as comparable in carrying out his duties. Information on the arrangements in place to ensure that the appointed actuary has direct access to the board of directors of the applicant, and has access to all relevant information to enable him to carry out his duties is required.

4.9. Copies of the financial statements for the latest three years preceding the application in respect of the applicant and its corporate controllers are also required. In the case of long term business authorization application, a copy of the latest actuarial valuation report prepared in respect of the applicant is also required.

5. Time Scale and Fee Payable

5.1. Depending on the adequacy of the information supplied by an applicant and its promptness to respond to our follow-up enquiries, it is estimated that the whole process from the submission of draft application to the issue of our letter of approval-in-principle can normally be concluded **within four months**. As for the issue of a Certificate of Authorization confirming the formal authorization, this can normally be done **within two weeks** of our on-site inspection mentioned in paragraphs 3.8 and 3.9.

5.2. There is no need to pay any fee on submission of an application. Payment of an annual fee is required only on authorization and on subsequent anniversary date of authorization. The amount of the annual fee payable under section 13(1) of the Ordinance is prescribed by the Insurance (Authorization and Annual Fees) Regulation.

6. Enquiries

6.1. If you have any questions regarding application for authorization, please write to the Insurance Authority.

7. Commencement

7.1. This Guideline shall take effect from 26 June 2017.

June 2017

Annex 1

Current Legislation Relating to Insurance Companies

Principal Ordinance

Insurance Ordinance, Cap. 41 of the Laws of Hong Kong

Subsidiary Legislation

Insurance (Actuaries' Qualifications) Regulation

Insurance (Prescribed Fees) Regulation

Insurance (Authorization and Annual Fees) Regulation

Insurance Companies (Miscellaneous Fees) Regulation
(Note: Amendments to be made in Phase 3 of implementation of the Insurance Companies (Amendment) Ordinance 2015)

Insurance (Determination of Long Term Liabilities) Rules

Insurance (Margin of Solvency) Rules

Insurance (General Business) (Valuation) Rules

Insurance (Actuaries' Standards) Rules

Available at the website of Department of Justice (http://www.elegislation.gov.hk) under the section of "Legislation", or available on payment of a cost at the Publications Sales Unit of the Government Information Services Department at Room 626, 6/F., North Point Government Offices, 333 Java Road, North Point, Hong Kong. (Tel. No.: 2537 1910, Fax No.: 2523 7195, Email: puborder@isd.gov.hk)

Annex 2

GL1

AUTHORIZATION GUIDELINE

Insurance Authority

Contents

1. Introduction

1.1 Hong Kong adopts a free market economy and provides equal opportunities to participants in all sectors of the market. The insurance industry is no exception. The Insurance Authority ("IA")'s policy is to promote development of the insurance industry in Hong Kong whilst ensuring, through prudential supervision, the best and most up to date industry standards. Any company interested in carrying on insurance business in or from Hong Kong may apply to the IA for authorization to do so under the Insurance Ordinance (Cap. 41) ("the Ordinance").

1.2 This Guideline is issued pursuant to section 133 of the Ordinance. The purpose of this Guideline is to give general guidance to companies applying for authorization to carry on insurance business in or from Hong Kong.

2. Application for authorization to carry on insurance business

2.1 Section 6(1) of the Ordinance provides that:

> "No person shall carry on any class of insurance business in or from Hong Kong except—
>
> (a) a company authorized under section 8 to carry on that class of insurance business;
>
> (b) Lloyd's;
>
> (c) an association of underwriters approved by the Authority."

2.2 Section 7(1) of the Ordinance provides that:

> "Any company may make application in writing to the Authority for authorization to carry on any class of insurance business."

2.3 A "company" for the purposes of the Ordinance is one formed and registered under the Companies Ordinance (Cap. 622), or one formed and registered under the former Companies Ordinance, including a non-Hong Kong company to which Part 16 of the Companies Ordinance (Cap. 622) applies.

2.4 Any applicant falling within the above definition of a "company" may apply for authorization to carry on any class of insurance business in or from Hong Kong.

3. Authorization

3.1 Section 8(1) of the Ordinance provides that:

> "Upon application made by a company under section 7, the Authority—
>
> (a) subject to paragraph (b), may authorize the company in writing to carry on, subject to such conditions as the Authority may impose, any class or classes of insurance business; or
>
> (b) (i) shall refuse the application if subsection (2) or (3) applies; or
>
> (ii) may refuse the application on any other ground whether or not the application has been refused on a ground under subparagraph (i)."

3.2 Section 8(2) provides that:

> "The Authority shall not authorize a company under this section if it appears to the Authority that any person who is a director or controller of the company is not a fit and proper person to hold the position held by him."

In applying the fit and proper person test, the IA will take into account, among other things, the character, qualifications and experience of the directors or controllers of the applicant.

3.3 Section 8(3) further provides that the IA shall not authorize a company unless certain conditions, specified in that subsection, are satisfied. These conditions, which relate to the applicant's financial status, reinsurance arrangements and ability to comply with the Ordinance, are reproduced in the **Annex**.

3.4 Paragraphs 3.5, 3.6 and 3.7 below give general guidance to applicants as to the other grounds determining whether the IA will refuse an application under section 8(1)(b)(ii) of the Ordinance. The requirements set forth in paragraph 3.5 apply to all applicants, whether incorporated locally or outside Hong Kong. A company applying for authorization to carry on long term insurance business in or from Hong Kong must also meet the requirements set forth in paragraph 3.6. An applicant which is a registered non-Hong Kong company must further meet the requirements set forth in paragraph 3.7. However, an applicant incorporated outside Hong Kong may, if it so chooses, incorporate a subsidiary company in Hong Kong for the purpose of application, in which event the additional requirements set forth in paragraph 3.7 will not apply.

3.5 Under section 8(1)(b)(ii) of the Ordinance, **all applicants** must satisfy the IA that:

(a) the applicant would maintain an office as its place of business in Hong Kong with a professional management and staff establishment appropriate to the nature and scale of its operations and a locally-based chief executive who would be a controller of the applicant;

(b) the applicant would at any of its offices in Hong Kong, or at any of its accountant's offices in Hong Kong keep and maintain proper books of account and other records in respect of its Hong Kong operations, so as to enable an audit, actuarial valuation or both to be made, as the case may be;

(c) the applicant's board of directors has sufficient knowledge and relevant experience of insurance business to guide the company and oversee its activities effectively (- sufficiency would normally mean that at least one-third of the applicant's board has such knowledge and experience);

(d) the applicant has, and will continue to have, sufficient financial resources to pre-finance its proposed operations as set out in its three-year business plan (as referred to in the application form);

(e) if applicable, the applicant has, and would continue to have, the financial backing of its parent/controller, who should be a reputable person or reputable persons of good financial standing. In that regard, the parent/controller should satisfy the IA that it will continue to provide financial support to the applicant and

undertake to maintain its solvency at all times (including the required relevant amount as defined in the Ordinance) so as to enable it to meet promptly its obligations and liabilities as they fall due;

(f) with the exception of captive insurer, the applicant has undertaken a detailed market feasibility study in respect of its proposed operations in or from Hong Kong and, based on the result of such feasibility study, is able to demonstrate the viability of its business plan;

(g) the applicant's proposed operations would not have a destabilizing effect on the insurance market in Hong Kong, for instance in terms of both the servicing of the insuring public and the employment of insurance staff;

(h) the international business that the applicant proposes to carry on in or from Hong Kong would not be detrimental to Hong Kong as an insurance centre (for instance, it would not conflict with international agreements or protocol);

(i) with the exception of captive insurer, the applicant demonstrates that there would not be any conflict between the sound management of its insurance operations and the business (including insurance business) interests of its principals or shareholders and, in the case of an applicant which is a member of a group, that it would be managed and operated independently of the group with all transactions between itself and related parties being made at arm's length;

(j) in general, the applicant would not engage in a "fronting" operation (under which the ceding company, i.e. the primary or fronting company, cedes the risk it has underwritten to its reinsurer with the ceding company retaining none or a small part of that risk for its own account);

(k) the purpose of the application is not to bypass the scope and provisions of other regulatory legislation in Hong Kong, e.g. the Banking Ordinance;

(l) with the exception of professional reinsurer, the applicant must be either a general business insurer with an application for general business only, or a long term business insurer with an

application for long term business only. A composite insurer wishing to carry on either general or long term business in Hong Kong will need to form a separate company for this purpose; and

(m) in the case of an insurance company already authorized in Hong Kong but wishing to extend into a class or classes of insurance business for which it is not authorized, there is a viable business plan for such expansion and it has the capacity to undertake such a new class or such new classes of business.

3.6 A company applying for authorization to carry on **long term insurance business** must satisfy the IA that:

(a) it has sufficient actuarial expertise, including a qualified staff actuary, to advise it on premium rates and structure, policy terms and benefits, accounting requirements, long term business fund liability valuations, and matching of the terms and nature of the assets and liabilities relating to its long term business. The application shall be accompanied by a report and certificate from a qualified actuary, acceptable to the IA, affirming the appropriateness or otherwise of the business plan according to prudent actuarial principles and stating whether in his opinion prudent and satisfactory arrangements governing actuarial matters have been made; and

(b) where the applicant proposes to carry on any investment-linked type of long term business, there are adequate accounting procedures to enable assets and liabilities to be identified and properly valued and timely reports to be furnished to the policy holders and that the applicant has available sufficient investment management expertise to manage the invested funds.

3.7 An applicant (for either general or long term business authorization) which is a **registered non-Hong Kong company** must satisfy the IA that it:

(a) is a company incorporated in a country where there are comprehensive company law and insurance law;

(b) is an insurer under effective supervision by the authority or authorities of its home country responsible for the proper conduct of insurance business; and

(c) is a well-established insurer with international experience and of undoubted financial standing.

4. Commencement

4.1 This Guideline shall take effect from 26 June 2017.

June 2017

Annex

Section 8(3) of the Insurance Ordinance (Cap. 41)

8. Authorization

(3) The Authority shall not authorize a company under this section unless the following conditions are satisfied—

(a) that, at the date of the application, the value of the assets of the company is not less than—

(i) in the case of a company carrying on or intending to carry on general business only, the aggregate of the amount of its liabilities and the relevant amount within the meaning of section 10;

(ii) in the case of a company carrying on or intending to carry on long term business only, the greater of the following—

(A) the aggregate of the amount of its liabilities and the relevant amount within the meaning of section 10; or

(B) the aggregate of the amount of its liabilities and such amount as may be prescribed by or determined in accordance with rules made under section 129(1)(b); (Amended 29 of 1997 s.3, Amended 12 of 2015 s.18)

(iii) in the case of a company carrying on or intending to carry on both general business and long term business, the aggregate of the amount which, if section 10(1) applied, would be the relevant amount in the case of the company having regard only to its general business and the greater of the following—

(A) the aggregate of—

(I) the amount of its liabilities; and

(II) if any part of the long term business carried on or intended to be carried on is of a nature other than that specified in class G or H in Part 2 of Schedule 1, $2,000,000 or its equivalent; or

(B) the aggregate of the amount of its liabilities and such amount as may be prescribed by or determined in accordance with rules made under section 129(1)(b); and (Replaced 25 of 1994 s. 4, Amended 29 of 1997 s.3, Amended 12 of 2015 s.18)

(b) that in the case of a company having a share capital, the aggregate of the amount paid up thereof and the amount of any subordinated loan stock of the company and the amount paid up in respect of any redeemable preference shares of the company is not less than—

(i) except if subparagraph (ii), (iii) or (iv) applies to the company, $10,000,000 or its equivalent; (Amended 29 of 1997 s.3)

(ii) if the company intends to carry on both general business and long term business, or carries on both general business and long term business outside Hong Kong, $20,000,000 or its equivalent;

(iii) if the company intends to carry on any class of insurance business (not being reinsurance business) relating to liabilities or risks in respect of which persons are required by any Ordinance to be insured, $20,000,000 or its equivalent; (Amended 35 of 1996 s. 4, 29 of 1997 s.3)

(iv) if the company intends to carry on business as a captive insurer, $2,000,000 or its equivalent; and (Added 29 of 1997 s.3)

(c) that as regards each class of risks against which, in the course of carrying on business, the company proposes to insure persons—

(i) adequate arrangements are in force, or will be made, for the reinsurance of risks of that class against which persons are, or are to be, insured by the company in the course of carrying on business; or

(ii) it is justifiable not to make arrangements for that purpose; and

(d) that the company is, and will continue to be, able to meet its obligations including obligations in respect of business other than the class of insurance business in respect of which the application is made; and

(e) in the case of a non-Hong Kong company as defined by section 2(1) of the Companies Ordinance (Cap. 622), that it has complied with Part 16 of that Ordinance; and (Amended 28 of 2012 ss. 912 & 920)

(f) that the company will be able to comply with such of the provisions of this Ordinance as would be applicable to it; and

(g) that in the case of a company which carries on, or proposes to carry on, some other form of business in addition to insurance business, the carrying on of that other form of business in addition to insurance business is not contrary to the interest of existing and potential policy holders; and

(h) that the name of the company is not likely to deceive.

Annex 3

Paid-Up Share Capital and Solvency Margin Requirements [For Global Business]

	Minimum Amount of Paid-up Share Capital (HK$ million)	Minimum Amount of Solvency Margin (HK$ million)	Bases for determining Solvency Margin
General business insurer **with** statutory business	20	20	(I) Assume 'X' represents the greater of the Relevant Premium Income and the Relevant Claims Outstanding. (a) If 'X' ≤ HK$200 million, the Relevant Amount is :- 20% of 'X' (b) If 'X' > HK$200 million, the Relevant Amount is :- 20% x HK$200m + 10% x ('X' - HK$200m)
General business insurer **without** statutory business	10	10	
Long term business insurer	10	2	(II) Aggregation of two components, i.e. a percentage, generally 4%, of mathematical reserves (the first calculation) and a percentage, generally 0.3%, of capital at risk (the second calculation). See Note 4.
Pure reinsurer (General business only)	10	10	As (I) above
Pure reinsurer (Long Term business only)	10	2	As (II) above
Pure reinsurer (Composite business)	20	12	Aggregate of (I) and (II) as above
Captive insurer	2	2	5% of the greater of the net premium income and the net claims outstanding

NB

1. Relevant Premium Income is the greater of Net Premium Income (i.e. Gross Premium Income after deduction of reinsurance premium payment) and 50% of Gross Premium Income.
2. Relevant Claims Outstanding is the aggregate of :
   (a) the greater of (i) 50% of the amount of the claims outstanding before deduction of the amount recoverable from reinsurers; and (ii) the amount of the claims outstanding after deduction of the amount recoverable from reinsurers;
   (b) the additional amount for unexpired risks; and
   (c) the insurance fund for classes accounted for on a fund accounting basis, if any.
3. Statutory business refers to any class of insurance business (not being reinsurance business) relating to liabilities or risks in respect of which persons are required by any Ordinance to be insured, including employees' compensation insurance and third party bodily injury insurance in respect of motor vehicles and local vessels, and building owners' corporation third party risks insurance.
4. The specific percentages to be applied in the first calculation and the second calculation in respect of each class of long term business are prescribed in the Insurance (Margin of Solvency) Rules. The respective amounts so computed for each class of business shall be aggregated to arrive at the required margin of solvency.
5. Pure reinsurer means an insurer whose insurance business is restricted to reinsurance.
6. Composite business insurer refers to an insurer who carries on or intends to carry on both general business and long term business of insurance.
7. Captive insurer refers to a company which carries on general business only (excluding statutory business) and such business is restricted to the insurance and reinsurance of risks of the companies within the same grouping of companies to which the company belongs.
8. Net claims outstanding in the case of captive insurer is the aggregate of (a) the amount of the claims outstanding after deduction of the amount recoverable from reinsurers; (b) the additional amount for unexpired risks; and (c) the insurance fund for classes accounted for on a fund accounting basis, if any.

INSURANCE ORDINANCE (CAP. 41)

PART 2 OF SCHEDULE 1

CLASSES OF LONG TERM BUSINESS

Class	Description	Nature of Business
A	Life and annuity	Effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life, but excluding (in each case) contracts within class C below.
B	Marriage and birth	Effecting and carrying out contracts of insurance to provide a sum on marriage or on the birth of a child, being contracts expressed to be in effect for a period of more than 1 year.
C	Linked long term	Effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).
D	Permanent health	Effecting and carrying out contracts of insurance providing specified benefits against risks of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that – (a) are expressed to be in effect for a period of not less than 5 years, or until the normal retirement age for the persons concerned, or without limit of time, and

Class	Description	Nature of Business
		(b) either are not expressed to be terminable by the insurer, or are expressed to be so terminable only in special circumstances mentioned in the contract.
E	Tontines	Effecting and carrying out tontines.
F	Capital redemption	Effecting and carrying out capital redemption contracts.
G	Retirement scheme management category I	Effecting and carrying out contracts – (a) under which contributions (or premiums) are paid to, and become the property of, one party to the contract in return for the provision by that party of assets to be applied, whether directly or indirectly, towards the provision of benefits under a retirement scheme; and (b) which provide for a guaranteed capital or return.
H	Retirement scheme management category II	Effecting and carrying out contracts - (a) under which contributions (or premiums) are paid to, and become the property of, one party to the contract in return for the provision by that party of assets to be applied, whether directly or indirectly, towards the provision of benefits under a retirement scheme; and (b) which do not provide for a guaranteed capital or return.
I	Retirement scheme management category III	Effecting and carrying out contracts of insurance to provide, whether directly or indirectly, benefits under retirement schemes but excluding - (a) contracts within class G or H above deemed under section 3(2) to be contracts of insurance;

Class	Description	Nature of Business
		(b) contracts within class 1 or 2 below.

Annex 5

INSURANCE ORDINANCE (CAP. 41)

PART 3 OF SCHEDULE 1

CLASSES OF GENERAL BUSINESS

Class	Description	Nature of Business
1	Accident	Effecting and carrying out contracts of insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the persons insured – (a) sustaining injury as the result of an accident or of an accident of a specified class, or (b) dying as the result of an accident or of an accident of a specified class, or (c) becoming incapacitated in consequence of disease or of disease of a specified class, inclusive of contracts relating to industrial injury and occupational disease but exclusive of contracts falling within class 2 below or class D above.
2	Sickness	Effecting and carrying out contracts of insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of the two) against risks of loss to the persons insured attributable to sickness or infirmity, but exclusive of contracts falling within class D above.
3	Land vehicles	Effecting and carrying out contracts of insurance against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.
4	Railway rolling stock	Effecting and carrying out contracts of insurance against loss of or damage to railway rolling stock.

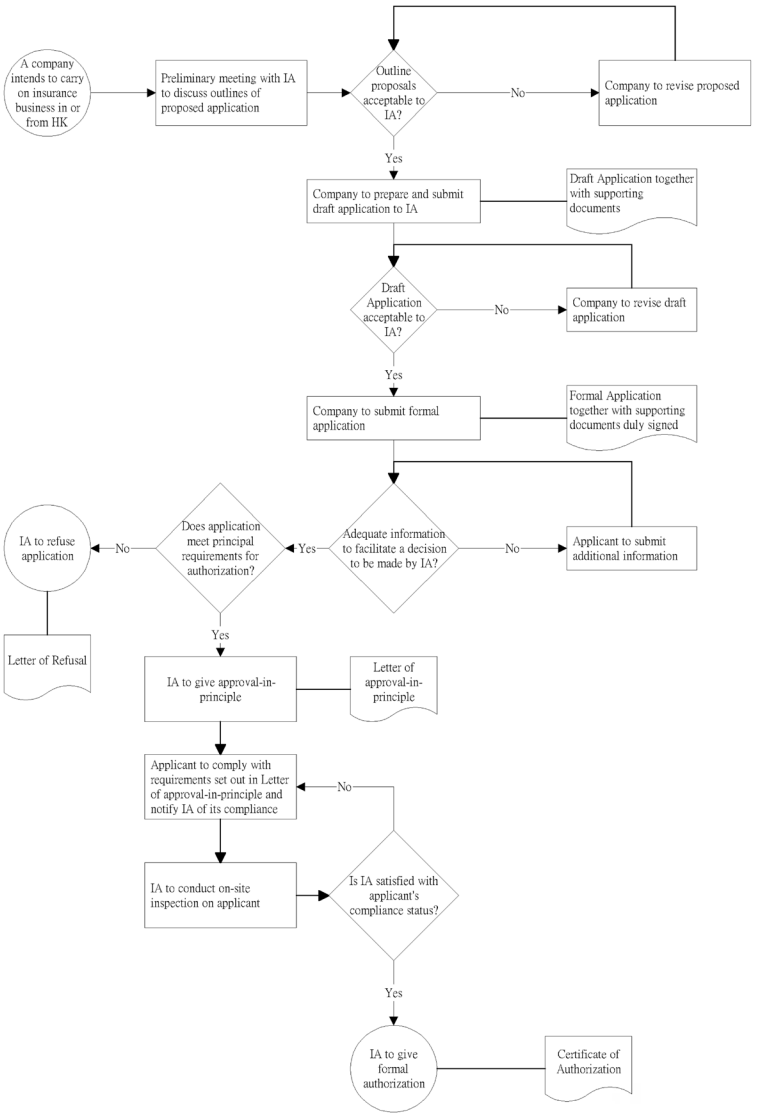
Class	Description	Nature of Business
5	Aircraft	Effecting and carrying out contracts of insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.
6	Ships	Effecting and carrying out contracts of insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.
7	Goods in transit	Effecting and carrying out contracts of insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.
8	Fire and natural forces	Effecting and carrying out contracts of insurance against loss of or damage to property (other than property to which classes 3 to 7 above relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.
9	Damage to property	Effecting and carrying out contracts of insurance against loss of or damage to property (other than property to which classes 3 to 7 above relate) due to hail or frost or to any event (such as theft) other than those mentioned in class 8 above.
10	Motor vehicle liability	Effecting and carrying out contracts of insurance against damage arising out of or in connection with the use of motor vehicles on land, including third-party risks and carrier's liability.
11	Aircraft liability	Effecting and carrying out contracts of insurance against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.
12	Liability for ships	Effecting and carrying out contracts of insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third-party risks and carrier's liability.

Class	Description	Nature of Business
13	General liability	Effecting and carrying out contracts of insurance against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which class 10, 11 or 12 above relates.
14	Credit	Effecting and carrying out contracts of insurance against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) or debtors of theirs to pay their debts when due.
15	Suretyship	Effecting and carrying out – (a) contracts of insurance against risks of loss to the persons insured arising from their having to perform contracts of guarantee entered into by them; (b) contracts for fidelity bonds, performance bonds, administration bonds, bail bonds or customs bonds or similar contracts of guarantee.
16	Miscellaneous financial loss	Effecting and carrying out contracts of insurance against any of the following risks, namely – (a) risks of loss to the persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on; (b) risks of loss to the persons insured attributable to their incurring unforeseen expense; (c) risks neither falling within paragraph (a) or (b) above nor being of a kind such that the carrying on of the business of effecting and carrying out contracts of insurance against them constitutes the carrying on of insurance business of some other class.

Class	Description	Nature of Business
17	Legal expenses	Effecting and carrying out contracts of insurance against risks of loss to the persons insured attributable to their incurring legal expenses (including costs of litigation).

Flow-chart for Processing an Application for Authorization

Annex 6



GL6

GUIDELINE
ON
RESERVING FOR MORTGAGE GUARANTEE BUSINESS

Insurance Authority

Contents

1. Introduction

1.1. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance"). Under the Ordinance, the Insurance Authority ("IA") has the primary responsibility of ensuring that an authorized insurer is able to meet its liabilities or fulfil the reasonable expectations of policy holders. Adequacy of the technical reserves set aside by an authorized insurer for payment of future claims is an important factor affecting the insurer's ability to meet such obligations. As part of its routine monitoring, the IA assesses the adequacy of technical reserves of an authorized insurer when examining its solvency position under the Ordinance.

2. Mortgage Guarantee Business

2.1. Since early 1999, mortgage guarantee insurance has emerged as a new line of business in Hong Kong. Under its present form, mortgage guarantee insurance protects the lending bank against the risk of loss arising from default in payment by a mortgagor in respect of that portion of mortgage loan which exceeds 70% or other pre-determined ratio of the value of the property.

2.2. Mortgage guarantee insurance is generally of a long tail nature which distinguishes it from other classes of general insurance business. The risk it covers is also unique in that defaults by mortgagors are influenced both by events affecting an individual mortgagor's income as well as by general economic downturns. It is a type of insurance which in times of severe economic downturn could give rise to accumulated or catastrophic losses to an insurer.

2.3. In view of its long tail nature and the potential accumulation of risks, the IA expects that an authorized insurer writing mortgage guarantee business shall adhere to the following guidelines in setting aside technical reserves in respect of this line of business.

3. Application of this Guideline

3.1. This Guideline applies to an authorized insurer as well as an authorized reinsurer in respect of its mortgage guarantee business carried on in or from Hong Kong.

4. Adequacy of Technical Reserves

4.1. The IA is not likely to be satisfied that the technical reserves set aside by an authorized insurer in respect of mortgage guarantee business are adequate unless the insurer has established and maintained an Unearned Premium Reserve, a Provision for Claims Outstanding (including claims incurred but not reported ("IBNR")) and a Contingency Reserve in the manner set out in paragraphs 4.2 to 4.6 below respectively.

Unearned Premium Reserve ("UPR")

4.2. Since the risk exposure period of mortgage guarantee business normally straddles more than one year, the total written premiums should be accounted for immediately upon inception of insurance and that portion which does not relate to the current accounting period should be set aside as UPR. An authorized insurer should provide for an UPR in the following manner or in a manner considered to be not less prudent (e.g. apportioning the single premium on a basis reflecting the expected claims incidence) than the following:

(a) Annual Premium Basis

The annual premium shall be recognized on a straight-line basis over the period of insurance with the remaining balance as UPR.

(b) Single Premium Basis

The single premium shall be apportioned equally over the "effective period of risks".

4.3. The "effective period of risks" refers to the period commencing from the loan drawdown date to the date when the loan-to-value ratio reduces to 70% or other pre-determined ratio.

Provision for Claims Outstanding (including IBNR)

4.4. An authorized insurer should set aside an adequate amount of provision to meet outstanding claims, including claims the amounts of which have not been determined and claims arising out of incidents that have not been notified to the insurer (IBNR) and related expenses for settling such claims.

4.5. For the purpose of this Guideline, outstanding claims do not imply total risks, but rather identifiable and probable claims. In computing the amount of the provisions for reported claims and IBNR, an authorized insurer is expected to take into account, among others, the length of the default period, the outstanding principal balance covered by insurance, the current market value of the collateral and the available historical claims data reflecting the frequency and severity of the losses. In particular, an authorized insurer should set up a provision for outstanding claims as soon as a mortgage loan which is delinquent for over 90 days is identified.

Contingency Reserve ("CR")

4.6. An authorized insurer should set aside a provision in the form of a CR in the following manner:

(a) In respect of its mortgage guarantee business which is entered into before 1 January 2011:

(i) An amount equals to 50% of the net earned premium income derived from mortgage guarantee business in each year of account shall be assigned to the CR;

(ii) The amount assigned to the CR in respect of a year of account shall be maintained for a period of 7 years. Withdrawals may be made by the insurer where the claims incurred in any year of account exceeds 35% of the net earned premium income in that year of account for the purpose of meeting those excess liabilities. Any such withdrawals shall only be made on a first-in-first-out basis; and

(iii) At the end of the 7th year, the amount assigned to the CR in respect of a year of account may, to the extent it has not already been depleted by prior withdrawals under (ii) above, be released and available for the general purposes of the insurer.

(b) In respect of its mortgage guarantee business which is entered into on or after 1 January 2011:

(i) Except for direct non-standard mortgage guarantee business as defined in (v) below, an amount equals to 50% of the net earned premium income derived from mortgage guarantee business in each year of account shall be assigned to the CR;

(ii) For direct non-standard mortgage guarantee business as defined in (v) below, an amount equals to 75% of the net earned premium income derived from mortgage guarantee business in each year of account shall be assigned to the CR;

(iii) The amount assigned to the CR in respect of a year of account shall be maintained for a period of 10 years. Withdrawals may be made by the insurer where the claims incurred in any year of account exceeds 35% of the net earned premium income in that year of account for the purpose of meeting those excess liabilities. Any such withdrawals shall only be made on a first-in-first-out basis;

(iv) At the end of the 10^{th} year, the amount assigned to the CR in respect of a year of account may, to the extent it has not already been depleted by prior withdrawals under (iii) above, be released and available for the general purposes of the insurer; and

(v) For the purpose of this Guideline, direct non-standard mortgage guarantee business of an authorized insurer includes any of the following in relation to a loan secured by a property, which is insured by the insurer as its direct mortgage guarantee business:

(aa) the loan-to-value ratio exceeds 85% as at the date of origination of the loan;

(bb) the borrower's debt-to-income ratio exceeds 50% as at the date of origination of the loan; or

(cc) the underlying collateral is not used as the borrower's own and sole residence.

4.7. An authorized insurer should notify the IA within 14 days of any withdrawal made from the CR.

4.8. The maintenance of a CR recognizes the need to provide for the contingency of accumulation of risks in times of severe economic downturn. This practice is generally in line with those applicable to insurers writing mortgage guarantee business in the United States and Australia.

5. Reinsurance Arrangements

5.1. An authorized insurer carrying on mortgage guarantee business, as required by section 8(3)(c) of the Ordinance, shall have adequate reinsurance arrangements in force at all times in respect of such business, having regard to its own circumstances. An authorized insurer will be required to justify its case if no such arrangements are in force.

6. Responsibility of an Authorized Insurer

6.1. This Guideline sets out the *minimum* standard expected of an authorized insurer in setting aside technical reserves in respect of mortgage guarantee business for the purposes of ensuring its ability to meet liabilities or fulfil the reasonable expectations of policy holders. It shall be the sole responsibility of the authorized insurers concerned to have due regard to all relevant factors, including the quality of their business portfolio and risk exposure, in determining whether a higher level of technical reserves should be maintained.

7. Reporting of Contingency Reserve

7.1. For monitoring purposes, an authorized insurer is required to report separately the amount of CR set aside by it, including any amount of withdrawal made from the CR during the year either in the Hong Kong General Business Returns or by way of a note to the Returns which are submitted to the IA annually. In addition, the basis of the calculation of the reserve and whether it has been consistently applied in each accounting period should be disclosed in the Balance Sheet.

7.2. For the clarification of doubt, the CR is not regarded as part of the "liabilities" for the purposes of the local asset requirement under section 25A of the Ordinance.

8. Commencement

8.1. This Guideline shall take effect from 26 June 2017.

June 2017

GL7

GUIDELINE
ON
THE RESERVE PROVISION
FOR CLASS G OF LONG TERM BUSINESS

Insurance Authority

Contents

1. Introduction

1.1. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance"). Under the Ordinance, the Insurance Authority ("IA") has the primary function to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders.

1.2. Policies classified under Class G of long term business ("Class G business") are mainly offered as retirement scheme contracts which provide for a guaranteed capital or return under the Mandatory Provident Fund Schemes or Occupational Retirement Schemes. Given the nature and the risk exposure of the Class G business and its implication on the retirement planning of the insuring public, the IA considers it appropriate that a set of guidelines on reserve provisions for Class G business should be promulgated for compliance by authorized long term insurers.

1.3. The objective of this Guideline is to reinforce and enhance the required standard of provision for Class G business with reference to the regulatory experience gained since the implementation of the first edition of GL7 issued in January 2001 by the Office of the Commissioner of Insurance and the recommendations of the consultancy study commissioned by the Mandatory Provident Fund Schemes Authority ("MPFA") on the subject.

Purpose

1.4. This Guideline aims to provide the basic framework and guiding principles for the provisioning for Class G business. Authorized insurers and hence their appointed actuaries are required to comply with the Guideline with reference to the technical details as drawn up in the relevant professional guidance on the subject issued by the Actuarial Society of Hong Kong ("ASHK").

2. Application of this Guideline

2.1. This Guideline applies to an insurer authorized to carry on Class G of long term business as specified in Part 2 of Schedule 1 to the Ordinance.

3. Regulatory Framework

3.1. An insurer authorized to carry on long term business is required, among other things, to maintain a separate long term business fund for its Class G business carried on in or from Hong Kong. In respect of the Class G business fund, it is required that the value of the assets representing the fund shall be in the aggregate not less than the amount of the liabilities attributable to such business. The insurer shall also determine the liabilities in respect of long term business in accordance with the Insurance (Determination of Long Term Liabilities) Rules ("the Rules"). Pursuant to rule 4(2)(b) of the Rules, the determination of the amount of long term liabilities shall make proper provision for all liabilities on prudent assumptions that shall include appropriate margins for adverse deviation of the relevant factors.

3.2. In view of the above statutory requirements, it is expected that, in so far as Class G business is concerned, an authorized insurer shall maintain a designated fund for each series of Class G insurance policies with broadly identical contract terms within the Class G business fund. In respect of each designated fund, an authorized insurer is required to have sufficient assets to meet the required provision for all liabilities attributable to the insurance policies concerned including the liabilities arising from the proper provision for investment guarantees in accordance with the approach and methodology as specified in this Guideline and interpreted under the professional guidance on the subject issued by the ASHK in consultation with the IA and MPFA.

4. Guiding Principles

4.1. The valuation methodology applied for determining an authorized insurer's provisions shall be based on the following guiding principles:

(a) Objective of the valuation
The objective of the provisioning process is to quantify a total amount of assets sufficient to meet the obligations of the insurer against its policy holders.

(b) Consideration of management action
The insurer can only assume and incorporate into the model an effective response to an evolving risk (through some actions) if it can be demonstrated that:

(i) appropriate decision making authority resides within the insurer;

(ii) relevant controls and monitoring mechanisms are in place that would alert the insurer to an emerging situation in a timely manner;

(iii) adequate documentation exists that describes the insurer's risk and policy management strategies, constraints and objectives; and

(iv) any assumed action is reasonable, practical, lawful and consistent with market conditions, competitive pressures and regulatory requirements (including relevant guidelines).

(c) Relevance of risks

The valuation should attempt to quantify the amount of required assets in light of all relevant risks to which the insurer is exposed. This assessment should consider the insurer's contractual obligations, the reasonable expectations of policy holders, policy issuers, employers and scheme members and the economic conditions that might unfold in the future.

(d) Aggregation of risks

The sufficiency of provisions should be judged in aggregate across all risks for a given product grouping (in respect of Class G insurance policies with broadly identical contract terms), taking into account the diversification and/or concentration effects of pooling risks.

(e) Modelling of risks

Provisions should be established by the modelling of assets and liabilities and the potential interaction between them. All material risks should be reflected in the calculations. Where possible, distinct risks should be separately identified and explicitly modelled. The valuation should incorporate into the provision calculations the potential management response to evolving conditions. However, there should be a precedent for such action, and the insurer should have a written policy for risk management.

(f) Appropriateness of the model

The use of assumptions, methods and models should be appropriate to the valuation of the risks, and any risk management strategies, derivative instruments, structured investments, reinsurance or any other risk transfer or risk-sharing arrangements reflected in the valuation should have a valid business purpose and not merely be constructed to exploit "foreknowledge" of the components of the required provisioning methodology. That is, the models and assumptions should not be artificially constructed to manipulate the level of provisions.

(g) Standard of materiality

The valuation should attempt to quantify all relevant risks and establish appropriate provisions with due consideration to the materiality of such provisions.

(h) Acceptability of approximations

Consistent with the principle of materiality, approximations are acceptable provided they do not misrepresent, materially underestimate or systematically misstate the insurer's liabilities.

(i) Reasonableness of assumptions

The implementation of a model involves decisions about the experience assumptions and the modelling techniques to be used in measuring the risks to which the insurer is exposed. Assumptions should tend towards the conservative end of the spectrum of possibilities, but not be catastrophic. Severally, and in aggregate, assumptions should be plausible, but also reflect a degree of adversity that accounts for the uncertainty in making estimates about the future contingent events to which the assumptions relate.

(j) Consistency

Where practical, the insurer should ensure that all model assumptions and methods are internally consistent. Where such consistency is impractical or indeterminable, the insurer should make suitably conservative assumptions.

(k) Model limitations

A model is only a crude representation of reality. It is not a substitute for sound business practices, sufficient pricing, good judgement,

prudent governance, adequate controls or appropriate management action. The model can produce an estimate of the amount of assets needed to support the insurer's obligations, but it is the actual risk to which the insurer is exposed and the management responses related thereto that will ultimately determine the true provision that is necessary. The insurer should account for known deficiencies of the model by adjusting the input parameters and /or the results.

(l) Evolving practice
In conducting the valuation, the insurer should be guided by evolving practice and the expanding knowledge base in the measurement and management of risk.

Without limiting the generality of the foregoing guiding principles, the reserve provision for Class G of long term business shall consistently be adhered to by an authorized insurer writing the business.

5. Provisions under Designated Fund

5.1. A designated fund shall be mainly comprised of the provision for account balance, the provision for investment guarantee and the provision for the smoothing of investment returns. In other words, the total market value of the assets pertaining to the designated fund shall at least equal to the provision for all liabilities including account balance plus the respective provisions for investment guarantee and the smoothing of investment returns.

5.2. The account balance shall mean the accumulation of contributions paid into the fund, reduced by applicable expenses, fees or charges, and increased (decreased) by actual investment income (loss) or interests credited in accordance with the applicable guaranteed rate or declared rate or rates.

5.3. The respective provisions for investment guarantee and for the smoothing of investment returns shall each be held as separate provision within the designated fund in accordance with the terms of the insurance policy. The respective provisioning methodologies adopted shall pay due regard to the investment strategies/mandate, interest crediting mechanisms and provisioning practices in an integrated fashion. All processes and methodologies involved shall be properly documented and approved by the relevant committee established by the Board of Directors for the purpose.

6. Approaches for Determination of Provisions

Provision for Account Balance

6.1. The provision for account balance within the designated fund should be determined in accordance with the terms of the insurance policy, and the relevant provisions in the Rules.

Provision for Investment Guarantee

6.2. The provision for investment guarantee should be established by modelling to include the cost of the guarantee and have regard to the guidance as set out in paragraphs 6.4 to 6.8 below. The minimum benchmark for the provisioning for investment guarantee maintained in the Class G business fund in aggregate is that the provision should cover most of the adverse situations with a 99% level of confidence. It is expected that an authorized insurer shall use the stochastic approach in determining the provision unless there are circumstances which justify the application of the deterministic or factor approach.

(a) Stochastic approach
The model adopted shall be verifiable (e.g. in terms of data, testing, processes, documentation and reasonableness of results) and the results from stochastic modelling shall be reasonably reproducible.

(b) Deterministic approach
This approach is acceptable only when an adequacy test using a stochastic model has been performed on the chosen adverse deterministic scenarios.

(c) Factor approach
This approach is acceptable only when the factors are determined by a stochastic model which is regularly updated to take into account any significant change in the bases, such as guarantee features, investment environment, fee structures, membership demographics etc.

Provision for Smoothing of Investment Returns

6.3. The methodology should be designed so that the smoothing provision would substantially even out the market fluctuations and be eliminated over longer periods of stable investment returns. Smoothing of the actual provisions arising from the investment guarantees is not permitted, and thus the insurer

cannot simply modify the model results to smooth the reported provision (such as taking a moving average).

Modelling of Liabilities for Provision for Investment Guarantee

6.4. The modelling work ordinarily focuses on quantifying provision for investment guarantee that may be needed in adverse scenarios to honour guaranteed benefit payments and cover associated expenses. In this regard, the liability model needs to be integrated with the investment return model in a reasonable and consistent manner. When constructing the model, it needs to reflect:

(a) all significant product features such as retirement date, fund and other charges, member options and contract guarantees;

(b) the characteristics of the membership demographics as of valuation date, which may include reasonable forecasts of future contributions (from both existing and new members) to the extent that these are covered under existing investment guarantees;

(c) on scheme sponsor behaviour and scheme member behaviour, unless there is clear justification for the contrary, behaviour assumptions should be supported by past experience and reasonable future expectations. For example, it should not assume an unreasonably high level of early voluntary terminations in which the member clearly loses a valuable guarantee by exercising the option; and

(d) the way in which the guarantor expects to exercise any available options in the event of the specific situation projected in each scenario.

Modelling of Investment Returns under the Stochastic Approach

6.5. Investment return models for the provision for investment guarantee may be developed separately for different types of investments. These models include:

(a) Interest rate models;

(b) Fixed income asset return models; and

(c) Equity index return models.

6.6. The testing scenarios shall reflect any significant correlation between the returns of various modelled asset classes. However, investments with similar return and risk characteristics can be grouped together for the purposes of investment return modelling.

6.7. The investment return model shall be determined with due regard to historical data as deemed relevant and reliable for predicting future volatility. The IA may request a calibration to be performed by the actuary to justify the choice of the investment return model where it considers appropriate. In this connection, the actuary shall pay due regard to relevant standard or guidelines issued by the MPFA and the ASHK in respect of the modelling process, the calibration standard and the modelling constraints.

6.8. The investment return model must be tested by the actuary to ensure that it will not produce unacceptable or inconsistent results. In building up the model, the actuary is required to be satisfied with the relationship between the nature and term of the underlying assets and that of the liabilities, having regard to risks of default and anticipated changes in future investment returns.

7. Frequency of Provision Determination

7.1. Provisions for investment guarantees must be revised at least quarterly to reflect current information. Provisions at month-ends within a quarter may be extrapolated from the previous quarter-end values. However, when there are significant fluctuations in the underlying factors that have been modelled by the stochastic analysis, the scenario testing shall be done on a monthly basis.

7.2. For the deterministic or factor approach, a stochastic adequacy test must be performed on the total provision for investment guarantees at least once a year.

8. Reporting

8.1. An insurer authorized to carry on Class G business is required to submit to the IA a report certified by its appointed actuary. The report should document the methodology and assumptions upon which the provisions for Class G business are calculated and demonstrate that this Guideline has been followed.

In case there is any material deviation from this Guideline, it should be clearly described and justified in the report.

8.2. The report shall be submitted to the IA annually within 6 months after the close of the financial year to which the report relates. As and when considered necessary, the IA may require the insurer to submit the information on a more frequent basis or to submit further information as specified by it.

9. Commencement

9.1. This Guideline shall take effect from 26 June 2017.

June 2017

GL8

GUIDELINE
ON
THE USE OF INTERNET
FOR INSURANCE ACTIVITIES

Insurance Authority

Contents

1. Introduction

1.1. The Internet has become the prime driver of contemporary electronic commerce. The increasing use of Internet in the business world has, to a varying degree, broadened and redefined the scope of business transactions and services. The insurance industry is by no means lagging behind in engaging the Internet as an alternative medium for conducting business particularly in marketing of insurance products and servicing of clients.

1.2. Different types of insurance-related websites, which are launched by authorized insurers, insurance intermediaries or other parties, have emerged in the market. Some of the websites cover one authorized insurer or a group of authorized insurers, whereas others are in the form of a supermarket in which a number of authorized insurers participate. The services provided are wide-ranging, such as introduction of authorized insurers and their respective products, brief comparison of a particular type of product offered by different authorized insurers, collection of premiums, handling of claims and provision of information on an insurer's credit rating, etc. It is noticed that there are some other websites which provide affiliated insurance services whilst in the course of conducting the main business which is non-insurance in nature.

1.3. The Insurance Authority ("IA") notes that the Internet is one of the channels for authorized insurers and insurance intermediaries, etc. to solicit business and to provide services to existing and potential policy holders. Hence, in conducting insurance business over the Internet, the parties concerned have to comply with the Insurance Ordinance (Cap. 41) ("the Ordinance") and other regulatory guidelines or industry rules in the same manner as conducting business in the conventional way. Taking into consideration the special features of the Internet which distinguish it from the conventional distribution channels, this Guideline, issued pursuant to section 133 of the Ordinance, is to draw the attention of different service providers to the special points they need to be aware of when engaging in internet insurance activities. It is the aim of this Guideline to better protect the insuring public and to ensure the healthy development of the insurance industry in the new information technology era. The scope of this Guideline covers the internet insurance activities of all service providers to the extent that such activities fall within the jurisdiction of Hong Kong. For the avoidance of doubt, this Guideline only applies to the use of Internet by the service providers in conducting activities or transactions with existing and potential policy holders.

2. Interpretation

2.1. In this Guideline, unless otherwise specified, insurance-related expressions shall have the same meanings as given to them in the Ordinance. Other terminologies shall have their literal meanings. The terms "insurance activities" and "service providers" shall have the meanings appended below:

(a) Insurance Activities

This term refers to all kinds of insurance-related activities conducted wholly or partially over the Internet by a service provider. Examples include but not limited to the following:

(i) displaying information about authorized insurers, insurance intermediaries and their insurance products or services;

(ii) advising existing or potential policy holders on the terms of their insurance policies or their insurance needs, etc.;

(iii) quoting insurance premiums for a particular type of insurance product offered by one or more authorized insurers;

(iv) comparing the respective premiums and terms of the same type of insurance product of different authorized insurers;

(v) soliciting clients' personal information with a view to providing insurance services to them;

(vi) collecting insurance premiums;

(vii) issuing or renewing insurance policies;

(viii) providing channel for policy holders to make enquiries, update personal particulars or report claims, etc.;

(ix) handling complaints or insurance matters; and

(x) making refunds, reimbursements or claims payments to clients.

(b) Service Providers

They are authorized insurers, appointed insurance agents, authorized

insurance brokers, association(s) of underwriters approved by the IA or Lloyd's who provide services related to insurance activities conducted over the Internet.

3. Identity of Service Providers

3.1. A service provider shall explicitly provide information about itself in its own website or, if applicable, in the third party website(s) through which it provides insurance services. In particular, the service provider shall clearly state that it is an authorized insurer, an appointed insurance agent, an authorized insurance broker and the name of the approved body of insurance brokers of which it is a member, if applicable, an association of underwriters approved by the IA or Lloyd's.

3.2. A service provider shall also provide information whereby it can be contacted, including its full name, office address, e-mail address, telephone number and fax number.

4. Authorization Status

4.1. Regardless of the media used in conducting insurance business, no person shall carry on or hold himself out as carrying on any class of insurance business in or from Hong Kong except an insurer authorized under section 8 of the Ordinance, Lloyd's and an association of underwriters approved by the IA. Similarly, a person shall not hold himself out as an insurance agent or an insurance broker unless he is an appointed insurance agent or an authorized insurance broker as defined in section 2 of the Ordinance.

4.2. As the Internet is "borderless" in nature, insurance websites launched by service providers may be accessed by persons residing outside of Hong Kong. Likewise, persons residing in Hong Kong may also gain access to overseas insurance websites. To avoid any unintentional breaches of overseas insurance legislation arising out of cross-border internet transactions, a service provider shall state clearly in its website its authorization, registration or approval status, as the case may be, in Hong Kong and elsewhere, if any. Alternatively, it may set out conspicuously in a disclaimer the territory(ies) in which it does not intend to conduct insurance business.

4.3. As a general principle, insurance activities that are conducted **from outside of Hong Kong** over the Internet do not fall within the ambit of the Ordinance. However, if, through conducting such activities, a person carries on

or holds himself out as carrying on insurance business or insurance intermediary business in or from Hong Kong, he shall be brought under the Ordinance. In determining whether those activities fall within the ambit of the Ordinance, the IA will consider the nature of the insurance activities as a whole and other factors such as:

(a) whether advertisements about the relevant website have been made in the local mass media;

(b) whether promotional or publicity activities have been conducted in the territory;

(c) whether the sales materials as displayed on the Internet are directed at a particular group or groups of people residing in Hong Kong;

(d) whether the contents of the website appear to target at the people residing in Hong Kong e.g. providing a local address for contact, quoting the premiums in Hong Kong Dollars, etc.;

(e) whether the website contains a prominent disclaimer clearly indicating that the insurance products and services are not available to people residing in Hong Kong; and

(f) whether reasonable measures have been implemented to guard against the acceptance of insurance applications from or provision of insurance services to people residing in Hong Kong e.g. ascertaining the potential policy holder's residence by obtaining such information as mailing address or telephone number prior to the provision of any services.

4.4. In respect of sub-paragraph 4.3(e) above, the insurance products and services are deemed not available to people residing in Hong Kong if the disclaimer clearly states that:

(a) the insurance products and services are not available to people residing in Hong Kong;

(b) the insurance products and services are available in the specified countries or places (excluding Hong Kong); or

(c) the insurance products and services are available only in countries or places other than Hong Kong.

5. Security

5.1. A service provider shall take all practicable steps to ensure that:

(a) a comprehensive set of security policies and measures that keep up with the advancement in internet security technologies shall be in place;

(b) mechanisms shall be in place to maintain the integrity of data stored in the system hardware, whilst in transit and as displayed on the website;

(c) appropriate backup procedures for the database and application software shall be implemented;

(d) a client's personal information (including password, if any) shall be protected against loss; or unauthorized access, use, modification or disclosure, etc.;

(e) a client's electronic signature, if any, shall be verified;

(f) the electronic payment system (e.g. credit card payment system) shall be secure; and

(g) a valid insurance contract shall not be cancelled accidentally, maliciously or consequent upon careless computer handling.

5.2. It is advisable for a service provider to display a security statement (i.e. a statement expressing that adequate security measures are in place) on its website to instil confidence in existing and potential policy holders.

6. Privacy of Client Information

6.1. In collecting, processing and storing clients' personal information over the Internet, a service provider shall take all practicable steps to protect the privacy of its clients' personal information against leakage and unauthorized access or use. It is important that a service provider shall comply with the Personal Data (Privacy) Ordinance (Cap. 486) at all times. For that purpose, a service provider is advised to refer to the relevant booklets issued by the Office of the Privacy Commissioner for Personal Data.

7. Form of Communication

7.1. A policy holder who agrees to conduct a transaction by electronic means may subsequently choose to communicate or conduct other transactions with the relevant service provider by non-electronic means. Therefore, unless with the express or implied consent of a policy holder, the service provider shall not inform the policy holder of certain events merely by electronic means. For example, the events which specifically require the response of the policy holders or may affect their interests. In any circumstances, there shall be effective communication between a service provider and its clients.

7.2. If the same notice is to be sent to two or more policy holders via the Internet, the service provider shall ensure that the notice does not contain any personal data for the sake of confidentiality. Besides, where e-mailing is used to deliver the notice, this shall be done in a way that each recipient of the notice is not aware of the identities of other recipients (e.g. by using the "Blind Copy To" option in delivery).

8. Sale of Insurance Products

8.1. A service provider shall take note of the following in the sale of insurance products over the Internet:

(a) Sales Materials or Illustrations

(i) A service provider shall endeavour to ensure that the sales materials or illustrations displayed on the Internet contain accurate and up-to-date information which is written in plain language.

(ii) If a sales transaction can be completed over the Internet, potential policy holders shall be provided with the necessary information such as:

- the name of the authorized insurer;
- the major terms and conditions of the insurance policy offered, including the risks covered, and any significant or unusual restrictions or exclusions;
- the premium of the insurance policy offered;
- the client's duty to disclose information and the consequences of not disclosing material facts;
- the period of the insurance cover; and

- the governing law of the insurance policy.

(iii) To assist a potential policy holder in making an informed decision, he or she shall be given an opportunity to access the full wording of the relevant insurance policy before the sale is completed.

(iv) A service provider whose business relates to long term insurance business shall be additionally required to observe the guidance notes or illustration standards issued by the relevant regulatory authorities and industry bodies from time to time, including:

- Code of Practice for Life Insurance Replacement[Note 1] Cooling-off Period [Note 1]
- Customer Protection Declaration (CPD) Form [Note 1]
- Guidance Note on Gifts [Note 1]
- Guidance Note on Gifts, Promotions and Incentives for Class A and Class C Products [Note 1]
- Initiative on Financial Needs Analysis [Note 1]
- Code on Investment-Linked Assurance Schemes [Note 2]
- HKFI Guidance Note on ILAS Illustration Document [Note 1]
- Standard Illustration for Non Unit-Linked Policies [Note 1]
- Standard Illustration for Participating Policies [Note 1]
- Standard Illustration for Universal Life (Non-Linked) Policies [Note 1]

(b) Underwriting Policy

(i) A service provider, other than an insurance intermediary, shall have a prudent underwriting policy to process insurance applications submitted via the Internet. In particular, it needs to take practicable measures to ascertain the true identity of its clients.

(ii) A service provider whose business relates to long term insurance business shall comply with the Guideline on Anti-Money Laundering and Counter-Terrorist Financing issued by the IA and shall report any suspicious transactions to the relevant authorities.

Note : (1) Issued by the Life Insurance Council, The Hong Kong Federation of Insurers
(2) Issued by the Securities and Futures Commission

(c) ***Issue of Insurance Policy***

(i) Any electronic insurance policies issued shall be dated and preferrably in complete and full version. If an insurance policy is not provided in such version, a statement to this effect must be clearly made. In all cases, a copy of the insurance policy containing the comprehensive terms and conditions, whether in electronic, paper or any other form, shall be sent to the policy holder concerned.

(ii) Any electronic insurance policies or documents shall be received in a readable and retainable form by the policy holder or other party who is entitled to receive the same. In this regard, the software format to be adopted by a service provider shall facilitate effective reading, printing and downloading of the said documents by the recipients. If special software is required for the purpose, the software shall be made available to the recipients.

(iii) Any electronic insurance policies or documents delivered to a policy holder in respect of an insurance transaction shall be maintained by the service provider in electronic, paper or any other form. The service provider shall also be able, within a reasonable period of time, to provide an electronic or paper copy of the insurance policy or document to the policy holder upon his or her request.

(d) ***Complaints Channels***

A service provider shall provide information (e.g. contact particulars) on the appropriate channels for complaints as listed below:

(i) the customer services section of the service provider or, if no such section is established, the name of the person designated to handle complaints on behalf of the service provider;

(ii) the IA;

(iii) The Insurance Claims Complaints Bureau (in cases where the insurance products sold relate to personal insurance policies);

(iv) Insurance Agents Registration Board;

(v) The Hong Kong Confederation of Insurance Brokers; and

(vi) Professional Insurance Brokers Association.

(e) Miscellaneous

A service provider shall comply with the relevant provisions of the Electronic Transactions Ordinance (Cap. 553) in matters concerning, inter alia, digital signatures, presentation or retention of information in its original form and retention of information in electronic records.

9. Use of Third Party Websites

9.1. If a service provider conducts insurance activities through third party website(s), it shall ensure that:

(a) its authorization, registration or approval status in Hong Kong and elsewhere, if any, shall be clearly stated in the website(s) as appropriate;

(b) its insurance products, if applicable, as displayed on the website(s) shall be clearly identifiable from those of other service providers on the same website(s), if any;

(c) the information related to it and its products, if applicable, which is displayed on the website(s) shall be authorized by it;

(d) the relevant information shall be accurate and as up-to-date as possible;

(e) in case monetary transactions are performed and clients' personal data can be accessed via the website(s), adequate security measures shall be in place to protect the interests of the clients and itself; and

(f) subject to the type(s) of services provided, the role of the third party shall be clearly identified (e.g. acting as an insurance agent) and be properly appointed or authorized as appropriate.

9.2. Where enquiry or advisory services relating to contracts of insurance or insurance related matters are available on a third party website, these shall be handled by a service provider.

9.3. In engaging the services of a third party website, a service provider shall draw the attention of the operator of the website concerned to seek the IA's written consent under section 120 of the Ordinance if:

(a) the operator uses the word "insurance" or "assurance" etc. in the domain name, website name or description(s) (which appears in the website) in the manner as specified in section 120 of the Ordinance;

(b) the operator is carrying on business in or from Hong Kong under such domain name, website name or description(s); and

(c) the operator is not a service provider.

10. Information from Other Websites

10.1. If a website contains information or data obtained from another website, care shall be taken not to infringe the copyright of the relevant persons. The prior consent of the copyright owner shall be obtained for any reproduction of the information or data of another website.

11. Review of Guideline

11.1. It is recognized that information technology is constantly evolving. This Guideline is promulgated based on the current use of Internet for insurance activities by the insurance industry. It will be regularly reviewed and revised in the light of developments in this regard.

12. Enquiries

12.1. For enquiries about this Guideline, please contact the IA. With regard to enquiries about the legislation, other than the Ordinance, referred to in this Guideline, please contact the relevant regulatory authorities (e.g. the Office of the Privacy Commissioner for Personal Data) or consult legal advisers.

13. Commencement

13.1. This Guideline shall take effect from 26 June 2017.

June 2017

GL9

GUIDELINE ON ACTUARIAL REVIEW OF INSURANCE LIABILITIES IN RESPECT OF EMPLOYEES' COMPENSATION AND MOTOR INSURANCE BUSINESSES

Insurance Authority

Contents

1. Introduction

1.1. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance"). Under the Ordinance, the Insurance Authority ("IA") has the responsibility of ensuring that an authorized insurer is able to meet its liabilities or fulfil the reasonable expectations of policy holders. Adequacy of the reserves set aside by an authorized insurer for payment of future claims is an important factor affecting the insurer's ability to meet such obligations. The IA attaches great importance to the adequacy of such reserves of an authorized insurer when examining its solvency position under the Ordinance.

1.2. An actuarial review of these reserves will enhance the adequacy and reliability of such reserves, reflect a more accurate picture of the financial position of authorized insurers, and help ensure sustainable market pricing over the longer term. The IA therefore considers it appropriate that authorized insurers which carry on employees' compensation ("EC") and/or motor insurance business should be required to commission an actuarial review of these reserves in respect of such statutory lines of business. The review should be conducted according to the criteria as specified in this Guideline. An actuarial report should be prepared and certified by the actuary. It should be submitted to the IA for review. The IA may contact the actuary direct for further information or clarifications as considered appropriate. The actuarial report and certificate should also be submitted to the Board of Directors of the authorized insurer, or the regional headquarters in the case of a non-Hong Kong incorporated authorized insurer, for information.

2. Application of this Guideline

2.1. This Guideline applies to both direct insurers as well as professional reinsurers which are authorized to carry on EC and/or motor insurance business in or from Hong Kong.

2.2. The definitions of terms referred to in this Guideline shall have the meanings assigned to them under the Ordinance, except otherwise stated.

3. Parameters for the Actuarial Review

3.1. The reserves, which are set aside by an authorized insurer for the purpose of meeting its insurance liabilities, in respect of EC and/or motor insurance business will be subject to actuarial review where such business written

in the relevant financial year separately fall within any one of the following parameters:

(a) the gross premium income at or exceeding HK$20 million; or

(b) the gross reserves for claims outstanding at or exceeding HK$20 million; or

(c) the gross reserves for claims outstanding being below HK$20 million but exceeding the amount of solvency surplus as calculated under the Ordinance (subject to a minimum of gross reserves for claims outstanding of HK$5 million).

3.2. Gross premium income and gross reserves for claims outstanding in this context refer to, in respect of an authorized insurer incorporated in Hong Kong, that of its overall EC or motor insurance business written in or from Hong Kong, and in respect of an authorized insurer incorporated overseas, to that of its Hong Kong EC or motor insurance business.

3.3. The solvency surplus is the amount by which the value of the net assets of the authorized insurer as determined at the end of the relevant financial year in accordance with the Insurance (General Business) (Valuation) Rules ("Rules") or so relaxed by the IA under section 130(1) of the Ordinance exceeded the relevant amount (solvency margin) as determined at the end of the relevant financial year in accordance with section 10 of the Ordinance.

4. Actuarial Review Report

4.1. The actuarial review refers in this Guideline is for EC and/or motor insurance business. The actuary who conducts the actuarial review of reserves for such business as at the end of each financial year shall prepare a formal report on the review.

4.2. For Hong Kong incorporated authorized insurers, the actuarial review shall be conducted in respect of all EC and/or motor insurance business written. For non-Hong Kong incorporated authorized insurers, the actuarial review shall be conducted in respect of the Hong Kong EC and/or motor insurance business.

4.3. It is possible to have the valuation date of the actuarial review to be a date other than the financial year end date, provided that prior notification with reasons is given to the IA and the practice consistently applied.

4.4. The valuation of insurance liabilities of each class of business must comprise:

(a) a best estimate of the premiums liabilities;

(b) a best estimate of the outstanding claims liabilities; and

(c) where considered appropriate by the actuary, risk margins that relate to the inherent uncertainty in each of these best estimate values.

For the above purpose, the following terms are so defined:

"Premiums liabilities" refers to unearned premiums and additional amount for unexpired risks, and includes liabilities for all benefits, claims and expenses, acquisition costs, and maintenance costs to be incurred after the valuation date.

"Outstanding claims liabilities" refers to the obligation whether contractual or otherwise, to make future payments in relation to all claims that have been incurred as at the valuation date, and includes reserves for claims reported, incurred but not reported (IBNR) and incurred but not enough reported (IBNER), as well as direct and indirect[1] claims expenses.

"Best estimate" refers to the mean value in the range of possible values for the future outcome. It is made with assumptions regarding the future experience, and are made using judgement and experience, and are neither deliberately overstated nor understated.

4.5. The premiums liabilities shall be valued on a net of reinsurance basis whilst outstanding claims liabilities shall be valued on both gross basis and net of reinsurance. The actuary shall comment where there is a known material risk that one or more reinsurers will fail to meet their obligations, and the presence of non-reinsurance recoveries such as salvage and subrogation.

4.6. It shall be stated in the report the general principles, details of the methods adopted, and analysis in the valuation of premiums liabilities and outstanding claims liabilities of each class of business, including the following matters:

[1] Indirect claims expenses shall be included where (i) such indirect costs can be reasonably estimated; (ii) an appropriate allocation of these indirect cost estimates to the future settlement of claims can be made; and (iii) the resultant effect of such an allocation has a significant effect on the underwriting results from one accounting period to the next.

(a) assumptions used in the valuation process and the justifications therefor;

(b) definition of terms and expressions used in the report that may be ambiguous or subject to wide interpretation;

(c) data available, a view as to its appropriateness, steps taken by the actuary to validate the data and material adjustment to the data;

(d) grouping of risks;

(e) methods used (if these are different from the preceding report, to justify the change and to quantify the financial implication arising from the change in methods); and

(f) analysis.

4.7. The report shall also address the issues covered in paragraphs 4.8 to 4.18 below.

4.8. The actuary shall ensure that the data used gives an appropriate basis for estimating the insurance liabilities. Reasonable steps shall be taken to verify the consistency, completeness and accuracy of the data collated, with reliance and limitations clearly explained in the report.

4.9. The valuation of the insurance liabilities of the authorized insurer is likely to require sub-division of risks into sub-classes of business with similar characteristics. The actuary shall consider and determine the most appropriate sub-division of risks for the purpose of the valuation, and discuss the credibility and homogeneity of the sub-division of risks so selected. However, the value of insurance liabilities must be reported for each class of business.

4.10. The actuary may make adjustments to the data collated to account for abnormal items, such as large losses. Where such adjustments are made, the nature, amount and rationale for the adjustments shall be disclosed.

4.11. The actuary shall describe any changes in the nature of coverage the authorized insurer provides and the mix of risks underwritten. He or she shall also address the impact of any changes in the business strategy, underwriting policy, and claims policy that may have on the valuation of the insurance liabilities.

4.12. The actuary shall take into consideration economic, technological, medical, legal, judicial and social trends within the broader community that may impact upon the value of insurance liabilities.

4.13. Insurance liabilities must not be discounted in valuation except with the prior approval of the IA as stipulated under rule 11 of the Rules.

4.14. It is not the purpose of this Guideline to be prescriptive in terms of the methods to be adopted for the valuation of insurance liabilities. The actuary is responsible for the selection of an appropriate valuation method, having regard to the availability and reliability of the data and the key drivers of claim cost as revealed by the data analysis or consistent with the nature of the class of business.

4.15. Where the actuary has used a method that is standard and well understood by the general insurance community, a brief reference to the method and an explanation of the elements of the data to which the method has been applied would suffice. Where an unusual or non-standard method has been used, a more detailed description of the method shall be given.

4.16. In view of the inherent uncertainty in insurance business, it may be often appropriate for the actuary to use more than one method in the estimation of insurance liabilities, then select one or blend the results from more than one as considered most appropriate. The key assumptions of each such method shall be clearly stated in the report. Where results of different methods differ significantly, the actuary shall comment on the likely reasons for the differences and explain the basis for the choice of results.

4.17. The actuary shall compare the actual experience of the authorized insurer, for both premiums liabilities and outstanding claims liabilities, with the results of the previous valuation in the report, and highlight and clearly explain where any significant differences between the actual experience and the previous valuation have been observed.

4.18. The actuary shall also compare the results of the current valuation with those of the previous valuation of the authorized insurer in the report, and justify any material changes in the assumptions made, methods used, or conclusions between the current valuation and the previous valuation as well as quantify the financial implication arising from such changes in assumptions, methods or conclusions.

5. Certification of the Actuarial Opinion

5.1. The report prepared shall be certified and signed by the actuary by way of a certificate as prescribed.

5.2. The certificate shall consist of the following:

(a) identifying the qualification and work experience of the actuary;

(b) stating the subjects on which actuarial opinion is to be expressed and describing the scope of the actuary's work;

(c) certifying that the data, assumptions and methodology used are appropriate;

(d) expressing the actuary's opinion with respect to such subjects, including that of the adequacy of the reserves of the authorized insurer and the need for additional risk margins that relate to the inherent uncertainty in each of the best estimate values of the premium liabilities and outstanding claims liabilities as per paragraphs 4.4 and 4.5 above; and

(e) relevant comments if the actuary considers it necessary to state a qualification of his or her opinion, or to explain any aspect which is not already sufficiently explained in the actuarial report.

5.3. A pro-forma actuarial certificate prescribed for the purpose of this Guideline is at **Annex**.

6. The Actuary

6.1. The actuary, either in-house or consulting, shall possess either of the following qualifications or a qualification that is accepted by the IA as being comparable to the following qualifications:

(a) Fellow of the Institute and Faculty of Actuaries of the United Kingdom;

(b) Fellow of the Institute of Actuaries of Australia; or

(c) Fellow of the Casualty Actuarial Society of the United States of America,

as well as appropriate work experience in general business obtained in the last 3 years. The actuary should also be familiar, e.g. by having a physical presence in Hong Kong, with the situation in Hong Kong, particularly the legal, judicial and social trends in Hong Kong that may impact upon the value of insurance liabilities.

6.2. Any authorized insurer wishing to appoint an actuary possessing qualification and work experience other than those listed in paragraph 6.1 above shall seek approval from the IA before making the appointment.

7. Commencement of the Actuarial Review Requirement

7.1. The requirement for actuarial review shall commence with immediate effect.

7.2. For authorized insurers with gross premium income or gross reserves for claims outstanding falling outside the parameters as mentioned in paragraph 3.1 above, they will continue to be subject to the IA's normal monitoring. An actuarial review may nevertheless be required if it is considered appropriate based on the circumstances of individual cases.

8. Submission of the Actuarial Review Report and Certificate

8.1. The actuarial review pursuant to this Guideline is to be conducted on an annual basis.

8.2. The chief executive of the authorized insurer, or the local chief executive in the case of a non-Hong Kong incorporated authorized insurer, shall ensure that the actuarial review report and certificate is submitted to the Board of Directors, or the regional headquarters in the case of a non-Hong Kong incorporated authorized insurer, for information. The actuary shall be given the opportunity to raise matters arising out of the preparation of the report directly with the Board or regional headquarters. This includes matters that have already been raised with the management of the insurer, but have not been dealt with to the satisfaction of the actuary.

8.3. The actuarial review report and certificate prepared are to be submitted to the IA within 4 months after the close of the financial year, together with the annual submission of the audited Hong Kong General Business Returns. An authorized insurer should take into account the valuation result of the actuarial review report in the preparation of the statutory returns as well as in the annual audited accounts as required under the Ordinance. Where an authorized insurer incorporates a value for such insurance liabilities which is below the valuation

result as determined by the actuary, the insurer shall notify the IA in writing with justifications for so doing at the same time when the relevant returns or accounts are submitted to the IA.

9. Commencement

9.1. This Guideline shall take effect from 26 June 2017.

June 2017

Annex

CERTIFICATE OF ACTUARIAL OPINION ON INSURANCE LIABILITIES OF EMPLOYEES' COMPENSATION AND MOTOR INSURANCE BUSINESSES OF

[THE COMPANY]

AS AT

[31 DECEMBER XXXX]

Identification and qualification of the signing actuary

[I, John Citizen, am an actuary employed by XYZ ("the Company") / I, John Citizen, am associated with the Firm of ABC Consulting Actuaries.] I am a Fellow of the [Institute of Actuaries of Australia] with [x] years of experience of insurance liabilities reserving in general insurance business and am familiar with the situation in Hong Kong as it affects the value of insurance liabilities.

Scope

[I have been retained by XYZ to conduct an actuarial review of the reserve / I have reviewed the data, actuarial assumptions and methods used in determining the reserves] in respect of the insurance liabilities of XYZ in accordance to the requirement of "Guideline on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses" ("GL9") issued by the Insurance Authority.

In forming my opinion on the adequacy of the reserves, I have relied upon the data prepared by the Company. Reasonable steps have been taken to check the reasonableness, completeness and internal consistencies of the data, but otherwise the data has not been independently verified.

The reserves are the responsibility of the Company. My responsibility is to express an opinion on those reserves based on my review.

The reserves being reviewed are compared with my estimate of the liabilities in the table below. The details of the review are set out in my report "Actuarial review of

employees' compensation and motor insurance liabilities as at 31 December XXXX" and dated XX April XXXX (the "Actuarial Report").

	Company's reserve	Estimated liability
Gross outstanding claims liabilities		
Motor		XX
Employees' compensation		XX
TOTAL GROSS OUTSTANDING CLAIM		XX
Net outstanding claims liabilities		
Motor	XX	XX
Employees' compensation	XX	XX
TOTAL NET OUTSTANDING CLAIMS	XX	XX
Net premiums liabilities		
Motor	XX	XX
Employees' compensation	XX	XX
TOTAL NET PREMIUMS LIABILITIES	XX	XX

Company's reserves are taken from [Form 1 and 2 of the General Business Return for year XXXX submitted / to be submitted to the Insurance Authority / Company's management accounts as at 31 December XXXX]. My estimates of the insurance liabilities are:

- Valued on both gross and net of reinsurance recoveries outstanding basis
- Net of non-reinsurance recoveries outstanding
- Inclusive of indirect claim handling expenses where (i) such indirect costs can be reasonably estimated; (ii) an appropriate allocation of these indirect cost estimates to the future settlement of claims can be made; and (iii) the resultant effect of such an allocation has a significant effect on the underwriting result from one accounting period to the next.
- Not discounted for time value of money
- Inclusive of an additional risk margin relating to the inherent uncertainty of the best estimate of the insurance liabilities

Additional comments / variability *[Include if applicable, some examples are listed below]*

- [Special feature of the businesses / environment causing uncertainty beyond that the reader would reasonably / normally expect]
- [Uncertainties in projection for immature portfolios. Especially when it impacts on the choice of major benchmark / parameters of the model]
- [Other special risks that the actuary wants to mention – e.g. mass tort, asbestos or other environmental claims]
- [Data issues causing the estimates to be especially volatile]
- [Any known material risk on reinsurance recoveries and/or non-reinsurance recoveries such as salvage and subrogation]
- [Any deliberate non-compliance with the GL9 are listed explicitly]

Opinion

In my opinion, subject to the comments above and qualification below:

- [The data provided was appropriate for this review]
- [The assumptions used are appropriate for this review]
- [The methodologies used are appropriate for this review]
- [The actuarial review and report complies / is intended to comply with the requirement as set out in GL9]
- [Company's net reserves in respect of unearned exposures are greater/less than the best estimate of net premiums liabilities plus risk margins as at 31 December XXXX]
- [Company's net reserves in respect of outstanding claims liabilities are greater/less than the best estimate of net outstanding claims liabilities plus risk margins as at 31 December XXXX]

Qualification *[reasons for qualifying the opinion or if unable to form an opinion]*

- [For example, The data is corrupt that bias estimates were produced and no suitable adjustment was made, or that not all of the businesses required by GL9 were reviewed]
- [Example on the qualification for reserve shortfall: Company's reserves in respect of premiums liabilities and net outstanding claims liabilities are less than the best

estimated liabilities plus risk margins as at 31 December XXXX]

_____

[John Citizen]
[Fellow of the Institute of Actuaries of Australia]

Date: _____

GL10

GUIDELINE
ON
THE CORPORATE GOVERNANCE OF AUTHORIZED INSURERS

Insurance Authority

Contents

1. Introduction

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance") taking into account the Insurance Core Principles, Standards, Guidance and Assessment Methodology ("ICP") promulgated by the International Association of Insurance Supervisors. It sets out the minimum standard of corporate governance that is expected of an authorized insurer and the general guiding principles of the Insurance Authority ("IA") in assessing the effectiveness of the corporate governance of an insurer. Specific references are:

(a) ICP 7 stipulates that the supervisor should require insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.

(b) ICP 8 stipulates that the supervisor should require insurers to have, as part of their overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.

1.2 Corporate governance refers to systems through which an authorized insurer is managed and controlled. It is also a system of "checks and balances". Accordingly, the corporate governance framework of an authorized insurer should:

(a) promote the development, implementation and effective oversight of policies that clearly define and support its objectives;

(b) define the roles and responsibilities of persons accountable for management and oversight;

(c) set out requirements relating to how decisions and actions are taken;

(d) provide for effective means of communicating matters relating to the management and oversight of the insurer;

(e) provide for sound remuneration practices which promote the

alignment of remuneration policies with the long term interests of the insurer to avoid excessive risk taking; and

(f) provide for corrective actions for non-compliance or weak oversight, management and control.

1.3 The IA believes that a high standard of corporate governance established by authorized insurers is important for protecting policyholders' interests. Also, it is an essential step in instilling the confidence of the insuring public and encouraging more stable and long term development of the insurance market of Hong Kong. An insurance industry with a high standard of corporate governance will also help enhance the status of Hong Kong as an international financial centre.

2. Interpretation

2.1 In this Guideline, unless the context otherwise specifies:

(a) "associate" in relation to any person, means:

(i) the wife or husband or minor child (including a step-child) of that person;
(ii) any body corporate of which that person is a director;
(iii) any person who is an employee or partner of that person;
(iv) if that person is a body corporate:
(aa) any director (other than an independent non- executive director) of that body corporate;
(bb) any subsidiary of that body corporate;
(cc) any director (other than an independent non-executive director) or employee of any such subsidiary;

(b) "chief executive" has the meaning assigned to it by section 9(2) of the Ordinance;

(c) "controller" has the meaning assigned to it by section 9 of the Ordinance, but does not include a Manager appointed pursuant to section 35(2)(b) thereof;

(d) "director" includes any person occupying the position of director by whatever name called;

(e) "group of companies" has the meaning assigned to it under section 2 of the Companies Ordinance (Cap. 622);

(f) "key person in control functions" has the meaning assigned to it by section 13AE(12) and (13) of the Ordinance;

(g) "senior management" refers to individuals, headed by the chief executive, responsible for managing the business of an authorized insurer on a day-to-day basis in accordance with strategies, policies and procedures set out by the board of directors; and

(h) "small authorized insurer" refers to an authorized insurer whose annual gross premium income in and total gross insurance liabilities as at the end of the immediate preceding financial year are both less than HK$20 million. In this context, total gross insurance liabilities mean:

(i) General business insurer

Total of the gross figures of unearned premiums, unexpired risks provision, outstanding claims provision (including claims incurred but not reported and the outstanding expenses of settling claims) and other insurance liabilities as per items (q)(i) and (q)(ii) under paragraph 16 of Part 4 of the Schedule 3 to the Ordinance.

(ii) Long term business insurer

Total of the gross figures of long term business funds (excluding the amount required to be maintained under rule 11 of the Insurance Companies (Margin of Solvency) Rules), claims admitted but not paid and other insurance liabilities as per items (q)(i) and (q)(ii) under paragraph 16 of Part 4 of the Schedule 3 to the Ordinance.

(iii) Composite insurer

The aggregate of total gross insurance liabilities from its general business and long term business as defined in (i) and (ii) above respectively.

3. Application

3.1 In general, authorized insurers incorporated in Hong Kong are

required to comply with this Guideline except:

(a) insurers authorized to carry on general insurance business which have ceased accepting new and renewal business and are in the course of running off their liabilities; and

(b) insurers authorized to carry on long term insurance business which have ceased accepting new business and are in the course of running off their liabilities, provided that the annual gross premium income arising from any renewal business of the insurer concerned is less than HK$20 million.

3.2 For an authorized insurer incorporated outside Hong Kong ("overseas insurer"), where 50% or more of the annual gross premium income pertains to its Hong Kong insurance business ("applicable overseas insurer"), it is required to observe this Guideline, unless written consent for exemption has been obtained from the IA. Irrespective of the proportion of its Hong Kong insurance business, the IA expects an overseas insurer authorized in Hong Kong to strictly observe the applicable guidelines on corporate governance promulgated by its home regulatory authority. Where such guideline is of comparable standard to this Guideline, an applicable overseas insurer may apply in writing to the IA for exemption therefrom and furnish the IA with the particulars of the relevant guideline for consideration.

3.3 Captive insurers are encouraged to adopt this Guideline as appropriate.

4. Governance Structure

4.1 There should be clear lines of reporting and division of responsibilities within the organizational structure of an authorized insurer. Special attention should be paid to the governance structure as follows:

4.2 ***Board of Directors***

(a) The board of directors of an authorized insurer ("Board") should comprise a suitable number of directors that enables it to carry out its functions effectively and efficiently. It should review its size from time to time taking into account the activities and business

volume of the insurer. In general, there should be a minimum of five directors (excluding any alternate director(s)). For small authorized insurers, the minimum number of directors should be three.

(b) The Board should have sufficient knowledge and relevant experience of insurance business to guide the authorized insurer and oversee its activities effectively. In this regard, at least one-third[1] of the directors should possess such knowledge and experience. In addition, in view of the wide spectrum of professional knowledge required in administering the business and affairs of an authorized insurer, it is advisable for the Board to have an adequate spread and level of expertise in areas as appropriate to the insurer's business, such as underwriting, claims, actuarial, finance, and investment.

(c) To enable the Board to make sound decisions in the best interests of the authorized insurer, independent and objective opinions are essential. It is necessary for the Board to maintain appropriate checks and balances against the influence of the management and controllers. A sufficient number of independent non-executive directors ("INEDs") on the Board will help achieving this purpose. As a general principle, at least one-third[1] of the Board should be composed of INED(s). For small authorized insurers which have less than five directors, the Board should be composed of at least one INED. Under exceptional circumstances where the number of INEDs has to be lowered temporarily, the insurer should seek approval from the IA for temporary exemption with valid justification. The exemption period will be determined on a case-by-case basis. The INEDs should be individuals with sufficient calibre and breadth of experience to perform the balancing function. They should be independent of the management and free from any business or other relationships with the insurer which could materially affect the exercise of their independent judgement.

(d) The IA is not likely to be satisfied that a director is an INED of an authorized insurer if:

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[1] Illustrative Examples

Total Number of Directors	Minimum Number of Directors Possessing Sufficient Insurance Knowledge & Experience	Minimum Number of INEDs
3*	1	1
4*	2	1
5 - 6	2	2
7 - 9	3	3
10 - 12	4	4

* *Applicable to small authorized insurers only*

(i) he is an employee of that insurer or of a company within the same group of companies as that of the insurer, or has been such an employee within the last three years;

(ii) he is a director, other than an INED, of a company within the same group of companies as that of the insurer;

(iii) he is a controller[2] of that insurer or of a company within the same group of companies as that of the insurer;

(iv) he is an associate of a director or controller of that insurer;

(v) he is a director or controller[2] of a corporation that has significant financial interests with that insurer or any companies within the same group of companies as that of the insurer. For example, he is a major service provider of the insurer; or

(vi) he has significant financial association with that insurer or with a company within the same group of companies as that of the insurer that could affect the impartiality of his independent judgement. For example, he has significant loans due from or to that insurer. For the avoidance of doubt, remuneration for a director generally does not constitute significant financial association.

4.3 ***Senior Management***

(a) Whilst the Board has the ultimate responsibility for setting the business objectives, strategies and policies for the authorized insurer (which is further elaborated in section 5), senior management is accountable for carrying out the day-to-day operations of the insurer and implementing systems and controls in accordance with the corporate culture, business strategies, policies and procedures set out by the insurer. The composition of senior management, which is headed by the chief executive, may vary from one authorized insurer to another. The Board should authorize the appointment of individuals as senior management and to clearly set out their roles and responsibilities supported by formal documentation for the delegation of authority.

[2] For controller of a corporation other than an authorized insurer, it refers to the equivalent office bearer of controller as defined in section 9 of the Ordinance.

(b) Senior management may delegate some of its responsibilities to, for example, key persons in control functions, with clear lines of accountability and reporting established and documented.

(c) Senior management should have appropriate reporting line to the Board and provide relevant and accurate information, on a timely basis, to the Board to facilitate its oversight of the management of the authorized insurer. Adequate systems of control should be put in place for the Board to assess the performance of senior management against the performance objectives set by the Board on a continuous basis.

4.4 ***Chairman and Chief Executive***

(a) The Chairman, as the head of the Board, plays an important role in ensuring the effective governance of an authorized insurer. As for the chief executive, he is, under the immediate authority of the Board, responsible for the conduct of the whole of the insurance business of the insurer concerned. It is essential that there is a balance of power and authority of the Chairman and the chief executive so that neither one has unfettered powers of decision. As such, a person should not play the dual role of Chairman and chief executive.

(b) In case the chief executive of an authorized insurer is temporarily precluded from carrying out his duties as the chief executive because of sickness, absence from Hong Kong or for any other exceptional reasons, the Board should ensure the proper functioning of the business operations of the insurer. Notwithstanding paragraph 4.4(a), the Chairman or a director may be entrusted to take charge of the affairs of the insurer in the interim given that proper control measures are in place.

4.5 ***Appointed Actuary***

To avoid conflicts of interest and to enable an Appointed Actuary to fulfil his obligations independently and effectively, he should not be the Chairman or the chief executive.

4.6 ***Key Persons in Control Functions***

(a) This section is applicable to those authorized insurers having key persons in control functions under their governance structure.

(b) Key person in control functions of an authorized insurer refers to an individual who is solely or jointly responsible for the performance of one or more of the control functions of the insurer. Control functions here include actuarial, financial control, internal audit, compliance, risk management, intermediary management and other function(s) specified by the Financial Secretary[3]. Insurers should satisfy themselves that all key persons in control functions appointed are fit and proper persons.

(c) Control functions are part of an effective system of risk management and internal controls. They provide additional governance checks and balances of the authorized insurer and support the Board in fulfilling its oversight duties. Therefore, the Board should set appropriate authority and independence for each control function to enable them to carry out their functions effectively. Adequate reporting lines to the Board, board committees or senior management should be appropriately set to avoid any conflicts of interest that may arise. Should any conflicts of interest arise and not be resolved, this should be brought to the Board for its attention and resolution.

5. Role and Responsibilities of the Board

5.1 *The Board*

(a) The Board plays a pivotal role in setting the strategic plan and policy of an authorized insurer and in monitoring its management. The main responsibilities of the Board are expected to include:

(i) Setting business objectives and strategies which take into account the long term financial soundness of the insurer, the legitimate interests of its stakeholders, as well as fair treatment of policy holders.

(ii) Ensuring appropriate allocation of responsibilities with the presence of the following:

(aa) a well-defined governance structure which provides for an effective separation between oversight and management functions;

[3] Under section 13AE(14) of the Ordinance.

(bb) a clear allocation of roles and responsibilities, including clear reporting lines of the Board, board committees, senior management and key persons in control functions;
(cc) adequate checks and balances for the avoidance of undue concentration of powers and conflicts of interest;
(dd) an effective oversight of the senior management and key persons in control functions; and
(ee) adequate policies and procedures relating to the engagement, dismissal and succession of the senior management and key persons in control functions.

(iii) Setting risk appetite and strategy which should be in line with the long term interests of the insurer and are embedded in the corporate culture of the entity as well as the group to which the insurer belongs.

(iv) Providing appropriate risk management and internal control systems and ensuring their effective operation.

(v) Adopting and overseeing remuneration policy and practices (details of which are set out in section 9 - Remuneration Matters) which do not induce excessive or inappropriate risk taking; are in line with the risk appetite and long term interests of the insurer; and cover directors, senior management and key persons in control functions.

(vi) Providing a reliable and transparent financial reporting system which include:

(aa) an Audit Committee for oversight function. (details of Audit Committee's function are set out in paragraph 8.4 below); and
(bb) prompt rectification of weaknesses identified in the financial reporting system.

(vii) Establishing adequate policies and procedures for the appointment of external auditor to ensure that:

(aa) the terms of engagement are clear and appropriate;
(bb) its independence by, for example, periodic rotation;
(cc) evaluation of its effectiveness is in place; and
(dd) prompt communication to the Board can be made when it is aware of any internal control weaknesses or deficiencies.

(viii) Promoting transparency on the governance by disclosing timely, appropriate and useful information to the public and within the company. Such disclosure should also take account of the applicable legal requirements.

(b) Where an authorized insurer belongs to a group, it may adhere to the group policies and procedures. The Board of the insurer should ensure the group policies and procedures are appropriate to uphold the sound and prudent operation of the insurer. If the group policy is unable to cover the circumstances of the Hong Kong operation, or does not satisfy the principles set out in this Guideline, the Board should consider establishing a separate policy thereof.

5.2 ***Individual directors***

(a) In general, individual directors owe fiduciary duties and duties of care and skill to the authorized insurer. As such, they should:

(i) act in good faith, honestly and reasonably;

(ii) exercise due care and diligence;

(iii) act in the interests of the insurer and protect the interests of policy holders, and put their interests ahead of his own interests;

(iv) exercise independent judgement and maintain objectivity in the decision making; and

(v) not use his position to gain undue personal advantage or cause any detriment to the insurer.

(b) Individual Board members are expected to discharge their responsibilities properly and make every effort to attend all Board meetings.[4]

(c) Where a director also has directorships in entities other than the subject authorized insurer, the director should ensure that sufficient time and attention should be allocated to the insurer to discharge his responsibilities effectively.

[4] Participation of directors in Board meetings may be facilitated by electronic means (e.g. telephone or video conferencing) and the attendance should be documented.

5.3 ***INEDs***

INEDs mainly provide an independent perspective to and a broader outlook on the decision-making of the authorized insurer, such as assisting the executive directors to set the corporate objectives and strategies, scrutinizing the approach of the management or attending to the affairs of the committees (e.g. the Audit Committee).

5.4 ***Chairman of the Board***

While the Board as a whole is responsible for the stewardship of the authorized insurer, the Chairman of the Board has the leading role to ensure the Board's proper and effective functioning. To promote checks and balances, the Chairman should not be the chief executive or the Appointed Actuary; and preferably not serve as chair of any board committee.

6. Board Matters

6.1 The proper handling of Board matters is a prerequisite for the sound and prudent management of an authorized insurer. The major Board matters include:

6.2 ***Appointment***

(a) Authorized insurers should satisfy themselves that all of the directors, controllers and key persons in control functions are fit and proper persons.

(b) A formal, documented and transparent process, preferably overseen by a Nomination Committee, should be in place for the nomination, selection, appointment, removal as well as succession of directors, controllers and key persons in control functions. Details of a Nomination Committee are set out in paragraph 8.7.

6.3 ***Conflicts of Interest***

Individual Board members should act in the best interests of the authorized insurer and to avoid actual, potential and perceived conflicts of interest. Where there is inevitable circumstance that conflicts of interest may arise, such conflicts should be effectively managed by clear and well defined procedures such as disclosure to

the Board, abstention and prior approval by the Board or shareholders.

6.4 ***Information and Resources***

(a) All directors should be provided and updated on a timely basis with accurate and relevant information (e.g. financial statements, budgets, market statistics and legislation) to enable them to fulfil their responsibilities effectively. They should also have power to access relevant persons within the organization directly for obtaining such information.

(b) The directors should also have recourse to independent professional advice at the expense of the authorized insurer when performing their duties.

(c) A newly appointed director or chief executive should be provided with suitable induction to enable them to discharge their duties properly. Existing directors and the chief executive should also be provided with appropriate training so that they are kept abreast of, amongst other things, the legislative and market developments.

6.5 ***Meetings***

As the Board is collectively responsible for the overall strategic planning and management of the authorized insurer, the directors should meet from time to time to discuss the corporate affairs so as to respond to the market changes by devising suitable strategies. To effectively and efficiently discharge its functions, the Board should convene a minimum of four meetings annually at approximately quarterly intervals. At least two of those meetings should be participated by the directors and not "paper" meetings or meetings by circulation. Full minutes of Board meetings should be kept for record and reference purposes.

6.6 ***Delegations***

(a) The Board should, as appropriate to the authorized insurer's functional activities [5], delegate some of the activities or tasks associated with its own roles and responsibilities to designated committees or groups of persons. Notwithstanding such delegations,

[5] Functional activities include but are not limited to compliance, risk management, underwriting, investment, nomination and remuneration.

the Board retains the ultimate responsibility. Details of functions of certain committees are set out in section 8. Where the Board makes any delegations, it should ensure that the delegation:

(i) is appropriate with regard to tasks and parties and without leading to any undue concentration of powers;

(ii) is made under a clear mandate with well-defined terms and is supported by adequate resources; and

(iii) can be effectively monitored and assessed and withdrawn if the delegated tasks are not properly carried out.

6.7 ***Evaluation***

The Board should review the delegated committees, at least annually, to ascertain members of the committees collectively and individually remain effective in discharging their respective roles and responsibilities. The Board should implement appropriate measures, including training programme for directors, to address any identified inadequacies and improve performance of the Board.

7. Risk Management and Internal Control Systems

7.1 Sound risk management and internal control systems are vital to effective corporate governance as they oversee the proper conduct of an authorized insurer's business and affairs. They help ensure the completeness of accounting records, the accuracy of financial information, the prevention of fraud and the prudent management of risks, etc. The Board should ensure that sound risk management and internal control systems are in place and the relevant procedures are properly followed.

7.2 The risk management and internal control systems of an authorized insurer should include the following aspects:

7.3 ***Checks and Balances***

(a) An authorized insurer should, institute policies and procedures such as requiring the separation of critical functions (for example but are not all inclusive, risk management, underwriting, investments, claims handling, internal audit and compliance with statutory

regulations and rules), cross-checking of documents, dual control of assets and double signatures on certain documents, etc., to ensure checks and balances within the company. Allocation of responsibilities and authority, as well as the reporting line should be clear and well defined.

(b) To promote a culture of sound risk management and compliance, including a robust system of checks and balances, there should be measures to avoid conflicts of interest of particularly key persons in each control function in performing their respective functions.

7.4 ***Risk Management***

(a) An authorized insurer should devise and implement a comprehensive risk management policy which strikes an appropriate balance of returns and risks that the insurer is willing and able to take. The policy should also help to identify, quantify, prevent and control the various types of risk that the insurer faces. Examples of such risks are underwriting risk, credit risk, market risk, operational risk and liquidity risk. As a basic principle, adequate measures should be taken to guard against the concentration of risks in a particular aspect or country. Where an authorized insurer belongs to a group, attention should be paid to the risks associated with the intra-group transactions, as well as the inter-relationship and interdependence of risks among group members.

(b) An authorized insurer may designate responsible person(s) to take charge the operations of risk management function. The risk management function should have direct reporting line to the Board and/or Risk Committee to ensure its independent assessment and prompt reporting of risks of the insurer. Also, the role of the designated responsible persons for risk management should be distinct from other executive functions to avoid conflicts of interest and ineffectiveness in carrying out its risk management functions. [6]

7.5 ***Underwriting***

An authorized insurer should adopt a prudent underwriting policy and should not underwrite any risks that are beyond its financial capacity or insurance expertise. Where necessary, independent professional valuation or advice should be sought for an assessment

[6] As a best practice, the chief risk officer should not report to the chief financial officer, or vice versa.

of the risks in the underwriting process. The premiums should also be set at a level that corresponds with the level of risks underwritten.

7.6 ***Reserves for Insurance Liabilities***

(a) An authorized insurer should employ suitable methodology and assumptions to compute and make provision for its insurance liabilities. Such methodology and assumptions should take into account the business volume, claims experience, industry practice, types of insurance product and the trend of court awards, if applicable. As such, it is essential for the insurer to build up a database that consists of the historical claims data; and an actuarial system that determines the liabilities of insurance business and ensures a prudent and satisfactory relationship between the nature and term of the assets and the nature and term of its liabilities, if applicable.

(b) For an authorized insurer that carries on employees' compensation and/or motor insurance businesses, it is also required to observe the Guideline on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses ("GL9") and arrange for the reserves of those classes of business to be subject to actuarial review as appropriate.

(c) Any reserving assumptions made should be periodically reviewed to ensure that due recognition has been given to changes in the composition of the business portfolio, market and legislative developments, etc.

7.7 ***Investments***

(a) An authorized insurer should have a written investment policy appropriate for its capital, surplus, types of business and liquidity needs. The Board has the core responsibility for formulating and assuring implementation of the investment policy. In formulating the investment policy, the Board should also consider investment risks and measures to mitigate such risks e.g. diversification of investments. The insurer is required to observe the Guideline on Asset Management by Authorized Insurers ("GL13"). Besides, it should establish and implement investment procedures to ensure that:

(i) the relevant staff and any investment professionals engaged are competent, and that they fully understand the corporate

investment objectives and adhere to the investment policy;

(ii) periodic evaluations are conducted to assess effectiveness of the investment policy and strategies;

(iii) timely actions are taken to identify any significant investment losses and make provision for them;

(iv) the cash inflows from invested assets is regularly reviewed so that it is adequate to meet the cash outflows due for settling liabilities under different economic conditions; and

(v) any engagements of investment tools such as derivatives should be closely monitored.

(b) Where an authorized insurer, in the course of carrying on its business, also manages funds on behalf of its customers, it should take practicable steps to ensure that the customers' funds are prudently managed and the relevant investment particulars are accurately recorded. A separate set of books and accounts for customers should be maintained for the purpose.

7.8 ***Asset Management and Valuation***

An authorized insurer must take every practicable step to safeguard its assets and ensure that the value of its assets is not less than the aggregate of the amount of its liabilities and the applicable level of solvency under the Ordinance. Besides, the insurer should maintain a buffer above the statutory solvency margin at all times for prudent risk and capital management.

7.9 ***Claims Settlement***

An authorized insurer should set out policies and procedures for the settlement of claims. Any claims reported are promptly recorded and the relevant reserves are provided for accordingly. The amounts of estimated and actual claims should be compared from time to time to ensure that adequate provisions are made for outstanding claims. The Board and senior management should also be notified of large or fraudulent claims and take timely actions as appropriate.

7.10 ***Reinsurance***

An authorized insurer should make adequate reinsurance arrangements for the risks underwritten. Through such arrangements, the exposures of the insurer's business portfolio to huge losses owing to individual large risks and accumulations of losses could be reduced. The insurer should clearly understand its underwritten risks in order to look for suitable reinsurance products and determine the appropriate retention amounts, reinsurance limits, scopes of coverage and the participating reinsurers, etc. It should also assess the security of the participating reinsurers and periodically review the collectability of the amounts due from them.

7.11 ***Audit***

(a) An authorized insurer should have ongoing audit function (both internal and external) of a nature and scope appropriate to the nature and scale of its business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer's policies, practices and controls remain sufficient and appropriate for its business.

(b) An authorized insurer may designate responsible person(s) to take charge the operations of internal audit function.

(c) The internal auditor should:

(i) have unfettered access to the authorized insurer's entire business lines and support departments;

(ii) be independent from the day-to-day operation and have status within the insurer to ensure that the Board and senior management are responsive to his recommendations and take timely actions thereon;

(iii) have sufficient resources and suitable staff of appropriate qualification and training; and

(iv) have direct reporting line and prepare internal audit report to the Audit Committee.

(d) Where the authorized insurer is part of a group of companies, it is acceptable for its internal audit function to be performed by the group's internal auditor.

(e) Small authorized insurers are exempted from establishing the internal audit function.

(f) The external auditor should have an effective channel of communication with the internal auditor, the Board and the Audit Committee.

(g) The Board should give due consideration to the opinions and findings of both the internal and external auditors and should take timely actions on the recommendation(s). The Board should also monitor the progress in redressing any problems raised by the auditor(s). In case the Board's views are different from the auditor(s)' opinion, this should be documented.

7.12 ***Accounting Matters***

An authorized insurer should clearly set out its policies and procedures on accounting matters, including the reconciliation of accounts, the preparation of control lists and the provision of other relevant information to facilitate the management's decision-making process.

7.13 ***Declaration of Dividends***

An authorized insurer should establish policy on the declaration of dividends, if applicable, to shareholders and participating policy holders. Such dividend policy should comply with the relevant statutory requirements, fulfil the reasonable expectations of shareholders and participating policy holders, conform with the terms of any relevant insurance policies and be fair and equitable.

7.14 ***Actuarial Matters***

(a) An authorized insurer that carries on long term business must appoint an actuary pursuant to section 15(1)(b) of the Ordinance and comply with any regulations, rules or guidelines issued by the IA in connection with the appointed actuary system.

(b) An authorized insurer that carries on employees' compensation and/or motor insurance businesses, if applicable, is required to observe GL9 and engage an actuary to review the reserves in respect of those classes of business.

7.15 ***Suspicious Transactions***

An authorized insurer should have formal procedures to identify potential suspicious transactions. In this regard, an authorized insurer that carries on long term business is required to pay particular attention to the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (GL3), for preventing and identifying any suspicious money laundering activities. There should also be established lines of communication for reporting any suspicious transactions or activities to the Board, the senior management and/or the law enforcement authorities.

7.16 ***Proper Books and Records***

(a) Pursuant to section 16 of the Ordinance, an authorized insurer is required to keep proper books of accounts which sufficiently exhibit and explain all transactions entered into by the insurer in the course of any business carried on by it. These books and records must be kept for not less than seven years from the end of the financial year to which the last entry made or matter recorded therein relates. Also, the IA may require an authorized insurer to provide it, within a specified period, any books of accounts that are required to be kept by section 16 of the Ordinance.

(b) Authorized insurers are also required to comply with any regulations, rules or guidelines issued by the IA in connection with record keeping and should have a proper documentation system in place.

(c) Books and records include contracts, agreements, vouchers or recorded business details in the form of written as well as digital/electronic data like sound track, visual image, email and message, tape, disc, etc. For the sake of clarity, records here include those forms and statements required under any applicable Guidelines. Proper books and records should be either in a legible form or in a non-legible form capable of being reproduced in a legible form. Those digital/electronic data embodied in any devices should also be capable of being reproduced.

7.17 ***Cyber Security***

(a) With the increased incidents of cyber attack and its increasing sophistication, strong cyber resilience is important for an authorized insurer to protect the personal information of its policy holders, and

digital/electronic data of its business to ensure continuity of the business operations. An authorized insurer should have policies and procedures, which are commensurate with the scale and complexity of its business, to identify, prevent, detect and mitigate cyber security threats.

(b) An authorized insurer should identify cyber security threats arising from network, email and relevant devices. It would be more optimal to prevent and detect such threats rather than to deal with the consequences of the cyber security threats. Mitigation measures should be in place to prepare for possible cyber security threats. There should be periodic testing on the mitigation measures to ensure their capability to deal with the cyber security threats timely and effectively.

(c) An authorized insurer should regularly review and assess the cyber security policies and procedures, as well as monitor their implementation. It should also communicate the relevant policies and procedures to its staff and as appropriate to other users of the cyber security system concerned.

7.18 ***Business Continuity Planning***

(a) An authorized insurer should maintain business continuity policy and business continuity plans ("BCP")[7] for both going-concern and gone-concern situations. The policy and plan should include identification of viable measures and actions the insurer can take to continue and restore its position or business activities under different stressed conditions or in advance as precautionary measures.

(b) The business continuity policy covers the governance structure, identification of plausible disruptions and the impacts to the authorized insurer and approach to continue and restore the business activities. BCP covers more detailed actions and procedures, including contingency plan, identification of critical business activities, roles and responsibilities of different parties, succession plan of critical staff, communication plan, recovery target timeline and technology recovery and support.

(c) The business continuity policy and BCP should be commensurate with the nature, scale and complexity of the business and the risk

[7] Notwithstanding here refers to business continuity policy and BCP, these can be combined in a single document.

position of the authorized insurer, and should be properly documented. They should be regularly updated and tested to ensure their effectiveness.

(d) If an authorized insurer in any circumstances needs to activate the BCP, it has to inform the IA promptly, and provide information of the disruptions, actions taken, potential impacts and the recovery target timeline. Progress reports should be provided thereafter until the position or business activities are restored to or resumed normal.

7.19 ***Compliance with Laws , Regulations and Rules***

(a) The Board is responsible to ensure compliance with all the relevant laws, regulations, rules, guidance notes, guidelines and codes issued by the relevant regulators; and standards and codes issued by the industry bodies.

(b) An authorized insurer is encouraged to designate responsible person(s) to take charge of the operations of the compliance function. The responsible person(s) should report the compliance status and remedial actions for any non-compliance to the Board at regular intervals.

7.20 The Board should review the internal control system from time to time to ensure that it is adequate for the nature and scale of the relevant authorized insurer's business.

7.21 The Board shall, upon the IA's request, submit detailed information on the internal control system of the authorized insurer to the IA and strengthen such system if required by the IA.

8. Committees[8]

8.1 Where committees are established, they should have clearly defined mandates, appropriate authority, and appropriate independence and objectivity to carry out their functions. If the functions of any committees are combined, the Board should ensure such a combination does not compromise the integrity or effectiveness of the functions combined. In all cases, the Board remains ultimately responsible for matters delegated to any committees.

[8] Committees refer to Board level committees. However, authorized insurers may establish other Board level or management level committees for different functions.

8.2 The Board should at the minimum establish an Audit Committee and a Risk Committee.[9] It may consider establishing other specialized committees to assist it in performing its functions. The functions of other specialized committees are set out in paragraphs 8.6 to 8.11. The types of committees to be set up should be commensurate with the size of the authorized insurer, its business activities and practical needs. The relevant committees should comprise an appropriate number of directors possessing the necessary knowledge and expertise. To avoid undue concentration of powers, rotation of membership may be considered.

8.3 An authorized insurer may rely on group committees for certain functions, provided that these group committees take account of the matters in respect of the insurer and the principles set out in this Guideline appropriately. Otherwise, the Board should establish its own committees for carrying out the functions effectively. The reliance of Group Audit Committee and Group Risk Committee are set out in paragraphs 8.4(c) and 8.5(b) respectively.

8.4 ***Audit Committee***

(a) The precise duties of the Audit Committee may vary from one authorized insurer to another. Its principal function is however to assist the Board in fulfilling the latter's responsibilities by providing an independent review of the effectiveness of the financial reporting process and internal control system of the insurer. The Audit Committee should also make recommendations [10] on the appointment, re-appointment and removal of external auditors.

(b) To enable the Audit Committee to perform its functions independent of the management, the Audit Committee should comprise a minimum of three directors, including at least one INED, and preferably INEDs in majority. The Audit Committee should be chaired by an INED. In view of the nature of work of the Audit Committee, the majority of its members need to have financial, accounting or auditing knowledge.

(c) Where an authorized insurer is part of a group of companies which has established a Group Audit Committee to perform the same

[9] Audit Committee and Risk Committee are two separate committees.
[10] The Audit Committee may take account of, amongst others, integrity, independence, objectivity, competency and performance of the external auditor when making recommendations.

function, it may not be necessary for the insurer concerned to separately establish its own Audit Committee.

(d) Small authorized insurers are exempted from establishing an Audit Committee.

8.5 ***Risk Committee***

(a) The Risk Committee oversees the establishment and operation of the risk management system independently. The majority of its members is preferably to be INEDs. Its duties include advising the Board on the authorized insurer's risk appetite, reviewing the adequacy and effectiveness of the risk management policies for material risks (such as pricing, capital management, market, liquidity, operation and compliance) on a regular basis and ensuring sufficient resources are in place for risk management. The Risk Committee should have access of information provided by the senior management of the insurers and key person(s) in the risk management function. Its members should collectively possess adequate knowledge and experience in risk management for discharging their responsibilities effectively.

(b) Where an authorized insurer is part of a group of companies which has established a Group Risk Committee to oversee the risk of the insurer as well, the insurer may rely on the Group Risk Committee for the oversight of the risk management system. However, where the IA considers the Group Risk Committee does not take into account the risk profile of the insurer, the insurer should establish its own Risk Committee.

(c) Small authorized insurers are exempted from establishing a Risk Committee.

8.6 ***Investment Committee***

The Investment Committee sets out the investment policy and strategies and oversees the investment portfolio of the authorized insurer. It should monitor the investment results of the insurer, regularly review and revise its investment strategies in the light of changes of the market environment. It should also give due consideration to matching the assets of the insurer with its liabilities as appropriate. It is required to observe GL13.

8.7 ***Nomination Committee***

The Nomination Committee nominates suitable candidates for appointment of the directors and senior management of the authorized insurer. In making a nomination, it should ensure, amongst other things, that the qualifications and experience of the nominee meet the relevant requirements. Where the Nomination Committee is established, the Nomination Committee should comprise at least one INED.

8.8 ***Remuneration Committee***

(a) The Remuneration Committee reviews and recommends the remuneration of directors, senior management, key persons in control functions and material risk-taking employees. It should ensure that the remuneration package recommended for each person should be commensurate with, amongst others, his personal performance, the authorized insurer's business results, business strategies, corporate culture, risk appetite and the prevailing market condition.

(b) Where the Remuneration Committee is established, the Remuneration Committee should comprise directors including INEDs, and be chaired by an INED. The members should be competent and able to exercise independent judgement on remuneration policy and practices. The Committee should work closely with other relevant committees such as the Risk Committee to assess the impact of the remuneration policy on the authorized insurer's risk-taking behavior. Details of the remuneration matters are set out in section 9.

8.9 ***Underwriting Committee***

The Underwriting Committee formulates the underwriting policy of the authorized insurer. It sets out the criteria for assessing various types of insurance risks and determines the pricing policy of different risks. It should regularly review the underwriting and pricing policies of the insurer with due regard to relevant factors such as its business portfolio and the market development.

8.10 ***Claims Settlement Committee***

The Claims Settlement Committee devises the claims settling policy of the authorized insurer. It oversees the claims position of the insurer and ensures that adequate claims reserves are made. It should pay particular attention to significant claims cases or events which will give rise to a series of claims. The Committee should determine the circumstances under which claims disputes should be brought to its attention and decide how to deal with such claims disputes. It should also oversee the implementation of the measures for combating fraudulent claims cases.

8.11 ***Reinsurance Committee***

The Reinsurance Committee ensures that adequate reinsurance arrangements are made for the authorized insurer's business. It peruses the proposed reinsurance arrangements prior to their execution, reviews the arrangements from time to time and, subject to the consent of the participating reinsurers, makes appropriate adjustments to those arrangements in the light of market development. It also assesses the effectiveness of the reinsurance programme for future reference.

9. Remuneration Matters[11]

9.1 Sound remuneration practices are vital to sound corporate governance of an authorized insurer. The insurer should establish a prudent and effective remuneration policy which should not induce inappropriate or excessive risk taking. Also, the policy should be in line with the insurer's objectives, business strategies and long-term interests.

9.2 ***Remuneration Policy***

(a) A written remuneration policy covering all directors and employees should be established and maintained. The policy should have specific regard to the following personnel:

(i) Directors, including INEDs;

(ii) Senior management;

[11] Section 9 does not cover agents, whose remuneration are commission based and who do not have employment contract entered with the authorized insurers.

(iii) Key persons in control functions – who are responsible to perform one or more of the control functions including actuarial, financial control, internal audit, compliance, risk management and intermediary management; and

(iv) Material risk-taking employees[12] – whose duties or activities involve the assumption of material risk or the taking on of material exposures on behalf of the authorized insurer. They could be either individual employees or groups of employees whose activities in the aggregate may expose the insurer to material amounts of risks.

(b) To ensure remuneration policy supports the risk management framework and does not bring any adverse impact to the risk profile of the authorized insurer, in addition to directors and senior management, key persons in risk management function should be involved in the remuneration policy setting and monitoring process. Their involvement can be in the form of joint meetings, being members of the Remuneration Committee, acting as observers in the meeting on remuneration matters or maintaining a close dialogue with the Remuneration Committee.

(c) The remuneration policy should motivate directors and employees to pursue the long-term growth and success of the authorized insurer and demonstrate a clear relationship between performance and remuneration. Remuneration for INEDs should be set at a level that does not compromise their independence and is commensurate with their time and efforts contributed.

(d) Where the authorized insurer is part of a group of companies, it can make reference to the remuneration policy of the group[13].

9.3 ***Board Oversight***

(a) The Board should review and approve the remuneration policy and practices. The Board may establish a Remuneration Committee as described in paragraph 8.8, whilst the Board retains the ultimate responsibilities of the oversight.

(b) The Board should ensure that in structuring, implementing and

[12] For example, they may include staff authorized to make decision on underwriting activities or investment activities.
[13] Please also refer to paragraphs 5.1(b) and 8.3.

reviewing the authorized insurer's remuneration policy, the decision-making process will identify and manage conflicts of interest and is properly documented. No director should be placed in a position of actual or perceived conflicts of interest in respect of remuneration decisions.

(c) The Board should monitor and review the implementation of the policy regularly to ensure its adequacy and effectiveness.

9.4 ***Remuneration Structure***[14]

(a) Good remuneration structure should have the following elements:

Fixed and Variable Components

(b) There should be an appropriate proportion of fixed and variable components, where the variable components could be allocated among cash and other forms of remuneration, such as shares. A variable component linked to performance that is disproportionately high relative to the fixed component may make it difficult for an authorized insurer to reduce or eliminate variable remuneration in a poor financial year.

(c) Consideration should be given to variable remuneration as follows:

(i) based on individual and/or group performance;

(ii) subject to prudent limits that are consistent with an authorized insurer's capital management strategy and its ability to maintain a sound capital base taking account of its targets or regulatory capital requirements. For example, an insurer may cap the total variable remuneration to a percentage of the net profits; and

(iii) major part of any variable remuneration should be deferred for an appropriate period. The deferral period[15] usually varies on the level of seniority[16], responsibility of the individual, and the nature and time horizon of the risks undertaken by the

[14] For the purpose of paragraph 9.4, variable remuneration is not applicable to INEDs.
[15] As a point of reference, Implementation Standards (No. 7) for the Financial Stability Board Principles for Sound Compensation Practices suggest a minimum deferral period of three years.
[16] As a point of reference, Implementation Standards (No. 6) for the Financial Stability Board Principles for Sound Compensation Practices suggest the proportion of variable remuneration subject to deferral be set at 40%-60% for senior executives and other employees whose actions have a material impact on the risk exposure of the company; and over 60% for most senior management and most highly paid employees.

individual. The objective is to allow an authorized insurer to observe the risks and performance over a longer period of time and to make adjustment before payment, if necessary. Under exceptional circumstances and subject to Board's approval and proper documentation, an authorized insurer may exercise discretion to pay remuneration within the deferral period.

(d) Where variable remuneration comprises share-based elements (such as shares and share options), the following safeguards should be implemented to align the long-term incentives of an authorized insurer:

(i) Vesting restrictions – include vesting conditions and vesting schedules where shares should be vested over a period of at least three years after their award;

(ii) Holding restrictions – share options should be exercisable for a minimum period of at least three years after their award; and

(iii) Retention restrictions – an appropriate proportion of the shares should be retained after vesting or exercise. Retention portion and period set should take account of factors including seniority level, nature and time horizon of risks undertaken, and the relevant vesting period or holding period of shares.

(e) Guaranteed bonuses should generally not be offered, as they are not consistent with sound risk management and performance-based principle.

(f) There should be malus provisions for the unvested portion of the deferred remunerations and preferably clawback provisions for the vested portion of the deferred remunerations, if the financial performance of the authorized insurer or the circumstances under which the performance is measured has been proved not genuine in case of, for example, misstatement of data, fraud, malfeasance or violation of policies, etc.

9.5 ***Criteria for Performance Measurement***

(a) In measuring the performance of an individual, judgement may be exercised by the authorized insurer on top of predetermined performance criteria. The performance criteria applicable to the variable remuneration should promote a complete assessment of

risk-adjusted performance, and should have the following characteristics:

(i) clearly defined, pre-determined and objectively measurable;

(ii) include both financial and non-financial factors[17] as appropriate;

(iii) based on performance of both individual, business unit, the overall results of the insurer and its group, as appropriate;

(iv) set in multi-year framework[18] (e.g. three to five years) to allow adjustments for material current and future risks and/or performance, as appropriate. This approach can align the remuneration with long term performance and prevent short term gains by taking greater risks; and

(v) not adopt growth or volume as an isolated criterion.

9.6 ***Key Persons in Control Functions***

(a) In order to mitigate the potential conflicts of interest that may compromise the integrity and objectivity of the key persons in control functions, their remuneration should be:

(i) based on the effective achievement of the objectives appropriate to such control functions;

(ii) not solely linked to the performance of any business units which are subject to their control or oversight; and

(iii) be adequate to attract and retain staff with the requisite skills, knowledge and expertise to discharge those control functions effectively.

(b) Where the control function is outsourced, the remuneration payable to the service provider should be consistent with the authorized insurer's remuneration policy and objectives. In this connection, reference should be made to the Guideline on Outsourcing (GL14).

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[17] Examples of financial factors include net profits, underwriting results, business growth, etc. Commonly used non-financial factors include compliance with regulations, rules and internal rules, effectiveness of risk management, customer satisfaction, etc.

[18] For example, a moving average of financial results is a measure that takes multi-year performance of the authorized insurer into account.

9.7 ***Severance Payments (also known as 'golden parachutes')***

Where an authorized insurer provides discretionary payouts on termination of employment, such payment should be in line with the financial condition and performance over certain time horizon. Discretionary severance payments should not be paid in case of failure or threatened failure of the insurer, particularly to an individual whose actions have contributed to the failure or potential failure of the insurer.

10. Servicing of Customers

10.1 Insurance products have become more sophisticated and are now commonly used as one of the tools for financial planning by the policy holders. Fair treatment of customers is an important concept and should form an integral part of an authorized insurer's business culture, business strategies as well as internal controls.

10.2 Authorized insurers should exercise due care and diligence in servicing the customers before an insurance contract is entered into and through to the point at which all obligations under that contract have been satisfied, with due regard to the groups of customers and the types of products provided.

10.3 The Board has the ultimate responsibility for fair treatment of customers. The authorized insurer should clearly set out proper policies and procedures regarding servicing of customers, including in particular disclosure of policy benefits, risks and responsibilities, pricing of insurance policies, handling of customers' complaints and settling of insurance claims, etc. Such policies and procedures should be made available to the IA upon request.

10.4 Implementation of the policies and procedures dealing with fair treatment of customers should be monitored and evaluated. Deficiencies identified should be properly remedied.

10.5 ***Provision of Information***

(b) To better serve customers, authorized insurers should enhance transparency of their products and improve customers' awareness of their rights and obligations under their insurance policies.

(c) Adequate and clear information should be made available to customers before, during and after the point of sale. Information relating to any changes during the term of the insurance contracts (e.g. early cancellation of a policy) should also be clearly communicated to the customers.

(d) Product features, policy terms and conditions should be clearly presented to enable policy holders to understand the coverage, limitations and exclusions. Technical terms in a policy should be elaborated clearly.

10.6 ***Complaints Handling***

Authorized insurers should establish clear complaints handling policy and procedures, including but not limited to accessibility, record keeping, time frame and monitoring, to ensure all complaints are properly handled. Appropriate reporting mechanism to the Board and senior management should be in place, particularly for those relating to operational issues. Where a dispute arises, the insurer should ensure resolving dispute in a fair manner and document the dispute resolution process properly. The policy and procedures should be communicated to customers.

11. Implementation

11.1 This Guideline, except those requirements specified in paragraph 11.2 below, shall take effect from 26 June 2017.

11.2 For the requirements on the minimum number of INEDs (paragraph 4.2(c)), the establishment of a Risk Committee (paragraphs 8.2 and 8.5) and the requirements on remuneration matters (section 9), this Guideline shall take effect from 1 January 2018.

June 2017

GL11

GUIDELINE
ON
CLASSIFICATION OF CLASS C – LINKED LONG TERM BUSINESS

Insurance Authority

Contents

1. Introduction

1.1. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance").

1.2. Both Class A - Life and Annuity and Class C - Linked Long Term are classes of long term business for contracts of insurance on human life or contracts to pay annuities on human life. A life or annuity contract is required to be classified under Class C if the features of the policies so designed should fall within the definition of Class C of long term business under Part 2 of Schedule 1 to the Ordinance.

2. Background

2.1. Insurers authorized under the Ordinance to write Class C business are required, in addition to compliance with the provisions of the Ordinance, to seek authorization for the marketing of the products from the Securities and Futures Commission ("SFC") pursuant to the Securities and Futures Ordinance (Cap. 571). They are required to conduct their business in accordance with the disclosure requirements as prescribed in the Code on Investment-Linked Assurance Schemes issued by the SFC.

2.2. There has been confusion in the market as to the classification of business between Class A and Class C. It has been reported that certain Class C products were mistakenly classified under Class A and vice versa. As the regulatory regimes for Class A and Class C business are quite different from each other in terms of the requirements for solvency and product approval, the Insurance Authority ("IA") considers that there is a need to provide guidance to the insurance industry on the classification of Class A and Class C business.

3. Definition of Class A and Class C of long term business under the ICO

Class	Description	Nature of Business
A	Life and Annuity	Effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life, but excluding (in each case) contracts within Class C below.

C	Linked Long Term	Effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property or any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).

Authorized insurers shall have due regard to the above definitions in determining whether a product should be classified under Class A or Class C of long term business. Some predominant features of Class C (linked business) are identified below to assist the insurers in distinguishing whether a policy should be classified as Class C business.

4. Distinguishing features of Class C linked long term

4.1. The policy must either be a life or annuity contract and possesses one or more of the following features:

(a) The benefits of the policy are calculated in whole or in part by reference to the value of, or the income from, specified assets or group of assets or by reference to movements in a share price or other index, whether or not subject to deductions in respect of expenses or charges;

(b) The policy holder is given the options to choose the underlying investment assets from a range of investment fund options;

(c) The policy is designed in such a way that the policy holder is contractually bound to bear partly or wholly the risk of the investments to which the benefits are linked.

4.2. The aforesaid features shall in no way represent a comprehensive list of the features of Class C – linked products as, after all, the great strength of the insurance industry lies, among others, on their innovativeness in devising policies tailored to suit the needs of prospective policy holders.

4.3. For the avoidance of doubt, it is not the intention of the IA to include conventional or traditional participating policies as Class C policies. As such,

whole life and endowment participating policies under which policy holders are entitled to bonus/dividend regularly declared by authorized insurers on the basis of their surplus position shall remain as Class A business.

4.4. If there shall be any inconsistencies between this Guideline and the Ordinance, the legal provisions shall prevail.

5. Commencement

5.1. This Guideline shall take effect from 26 June 2017.

June 2017

GL12

GUIDELINE
ON
REINSURANCE WITH RELATED COMPANIES

Insurance Authority

Contents

1. Introduction

1.1. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance").

1.2. Under section 8(3)(c) of the Ordinance, an authorized insurer shall arrange adequate reinsurance protection unless there are justifications not to do so. An insurer should arrange reinsurance protection appropriate to its overall risk profile, having regard to, amongst other things, the security of reinsurers, the need to avoid concentration of reinsurers, and the need to obtain collateral securities, if appropriate.

1.3. In the normal course of business, an insurer is expected to exercise prudent control on its reinsurance arrangements. However, such control may be compromised when the reinsurer is a related company, thus posing a higher risk to the regulatory control of the Insurance Authority ("IA"). For the protection of policy holders, the IA has to ensure that an authorized insurer is able to withstand financial vulnerabilities and hence a higher security is expected of the related reinsurer to commensurate with the higher risk posed. This Guideline aims to promulgate how reinsurance arrangements with related companies will be considered adequate by the IA in terms of financial security; and how the IA intends to address the supervisory concern if such reinsurance arrangements are not considered adequate. However, this Guideline shall not affect the operation of the provisions of the Ordinance.

2. Application of this Guideline

2.1. This Guideline applies to:

(a) an authorized insurer incorporated in Hong Kong;

(b) an authorized insurer incorporated outside Hong Kong if

(i) 75% or more of its annual gross premium income for general business pertains to Hong Kong insurance business; or

(ii) 75% or more of its annual gross premium income for long term

business pertains to Hong Kong long term insurance business; and

(c) an authorized insurer which is required under section 25A of the Ordinance to maintain assets in Hong Kong in respect of its liabilities pertaining to its Hong Kong insurance business, irrespective of whether it is incorporated in or outside Hong Kong.

3. Interpretation

3.1. In this Guideline, unless the context otherwise specifies:

(a) "insurer" means a ceding company or retroceding company.

(b) "reinsurance" includes reinsurance and retrocession, whether on treaty basis or facultative basis.

(c) "reinsurer" means a company accepting reinsurance cessions or retrocessions.

(d) "reinsurance payable" includes Premium Deposits Withheld and Claims Reserves Withheld by the insurer, and other amounts due to the reinsurer.

(e) "reinsurance recoverable" includes the reinsurer's share of Unearned Premium Reserve, the reinsurer's share of mathematical reserve for long term business and the reinsurer's share of Claims and Claims Reserves, together with other amounts due from the reinsurer in respect of reinsurance contracts.

(f) "net reinsurance recoverable" is the amount of reinsurance recoverable less reinsurance payable.

(g) "related reinsurer" means one within the same grouping of companies, as defined in section 2(7)(b) and (c) of the Ordinance, to which the insurer belongs.

4. Adequacy of Reinsurance Arrangements

4.1. In determining the adequacy of reinsurance arrangements made by an authorized insurer, the IA would have regard to the security provided by a related reinsurer. The IA would be satisfied that the security provided is adequate if the related reinsurer satisfies the following criteria:

(a) the particular reinsurer is an authorized insurer in Hong Kong; or

(b) the particular reinsurer or any one of its holding companies[Note] has an Insurer Financial Strength Rating of AA- or above by Standard & Poor's, Aa3 or above by Moody's or A+ or above by A. M. Best or equivalent rating; or

(c) the particular reinsurer or any one of its holding companies is otherwise considered by the IA as having a status comparable to the above.

4.2. If neither a particular reinsurer nor any one of its holding companies meet the criteria set out in paragraph 4.1 above, the IA would not consider the security offered by the particular reinsurer as acceptable and hence would have supervisory concern on such reinsurance arrangement. In assessing the impact on the ceding insurer's ability to withstand financial vulnerabilities posed by such reinsurer(s):

(a) for an authorized insurer referred to in paragraph 2.1(a) and (b) above, the IA would restrict the net reinsurance recoverable due from the particular related reinsurer or the aggregate net reinsurance recoverable due from all such related reinsurers to 10% of the ceding insurer's Net Assets Amount; and

(b) for an authorized insurer referred to in paragraph 2.1(c) above, notwithstanding whether that insurer is also subject to the impact assessment made under (a), the IA would restrict the net reinsurance recoverable due from the particular related reinsurer or the aggregate net reinsurance recoverable due from all such related reinsurers

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Note The holding companies concerned include the holding company, intermediate holding company and ultimate holding company of the reinsurer.

arising from the ceding insurer's Hong Kong insurance business to 10% of its Hong Kong Net Assets Amount.

If the ceding insurer would wish to have a higher amount of net reinsurance recoverable to be included in the impact assessment, it may cause to be produced collateral securities acceptable to the IA for the additional amount so included.

4.3. For the purpose of this Guideline, "Net Assets Amount" means the surplus amount of the authorized insurer's assets over its liabilities as reported in its own (unconsolidated) financial statements submitted pursuant to section 17 of the Ordinance for the period concerned. For the avoidance of doubt, the assets and liabilities of the insurer so reported shall be determined in accordance with section 8(4) of the Ordinance.

4.4. On the other hand, the "Hong Kong Net Assets Amount" means the amount of assets maintained in Hong Kong pursuant to section 25A of the Ordinance by the ceding insurer less 80% of its liabilities net after reinsurance arising from Hong Kong insurance business (i.e. the amount specified under section 25A(3)(a)(i) of the Ordinance).

4.5. In general, the IA will consider the following collateral securities to be acceptable:

(a) clean, irrevocable, unconditional and permanently renewable (evergreen) letter of credit drawn on a bank in Hong Kong which holds a valid banking licence granted under section 16 of the Banking Ordinance (Cap. 155) and made payable to the IA; or

(b) other securities or arrangements as may be accepted by the IA.

The IA has the absolute discretion to determine whether a particular collateral security produced by an authorized insurer is acceptable for the purpose of this paragraph.

4.6. For monitoring purposes, an authorized insurer is required to inform the IA:

(a) whether there has been any reinsurance arrangement made with related reinsurers as defined in paragraph 3.1 above; and if so

(b) the names of the related reinsurers; and

(c) the respective breakdown of reinsurance payable and reinsurance recoverable (paragraph 3.1 above) at its financial year end for each related reinsurer. Where the amount of the related reinsurer's share of Unearned Premium Reserve cannot be precisely computed, the authorized insurer shall make an estimate thereof and inform the IA of the amount of the estimate with the underlying bases and assumptions.

Such information shall be submitted as and when required by the IA.

5. Commencement

This Guideline shall apply to any reinsurance arrangements, including renewal of reinsurance arrangements, of an authorized insurer with effect from 26 June 2017.

June 2017

GL13

GUIDELINE
ON
ASSET MANAGEMENT
BY AUTHORIZED INSURERS

Insurance Authority

Contents

1. Preamble

1.1. The nature of the insurance business implies the formation of technical provisions, and investment in and the holding of assets to cover these technical provisions and a solvency margin. In order to ensure that an authorized insurer can meet its contractual liabilities to policyholders, such assets must be managed in a sound and prudent manner taking account of the profile of the liabilities held by the insurer and, indeed, the complete risk-return profile. The complete risk-return profile should result from an integrated view on product and underwriting policy, reinsurance policy, investment policy and solvency level policy. The liabilities profile of an authorized insurer with respect to term, and the predictability of the size and timing of claims payments, may differ significantly according to the nature of the insurance business conducted. It thus follows that the need, for example, to maintain a high degree of liquidity within the asset portfolio will similarly differ between authorized insurers. Differences in the accounting and taxation treatment of the various types of insurance business may also influence investment decisions.

1.2. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41). Its objective is to describe the essential elements of a sound asset management system and reporting framework across the full range of investment activities. The Guideline thus provides a good checklist in assessing how authorized insurers should control the risks associated with their investment activities. Given the wide variation in the nature of insurers, it is acknowledged that the extent of the application of the practices described in the Guideline by any given authorized insurer may differ according to the size and structure of the insurer and the type of business it conducts. However, the basic principles of the Board of Directors ("Board")' responsibility, the need for an investment policy, segregation of duties and control will be applicable to all authorized insurers.

1.3. The Guideline shall apply to an authorized insurer incorporated in Hong Kong and the Hong Kong branch of an authorized insurer incorporated outside Hong Kong whose investment in financial assets (see paragraph 2.2 below) exceeds HK$100 million. An authorized insurer which has ceased insurance underwriting in Hong Kong and is running off its Hong Kong insurance business is exempted.

2. Introduction

Asset Liability Management

2.1. A key driver of the asset strategy adopted by an authorized insurer will be its liabilities profile, and the need to ensure that it holds sufficient assets of appropriate nature, term and liquidity to enable it to meet those liabilities as they become due. Detailed analysis and management of this asset/liability relationship will therefore be a pre-requisite to the development and review of investment policies and procedures which seek to ensure that the insurer adequately manages the investment-related risks to its solvency. The analysis will involve, *inter alia,* the testing of the resilience of the asset portfolio to a range of market scenarios and investment conditions, and the impact on the insurer's solvency position. An authorized long term business insurer will inevitably also take into account the relevant input from its appointed actuary.

The Investment Process

2.2. Depending upon the nature of their liabilities authorized insurers will typically hold, in varying proportions, four main types of financial assets either directly, via other investment vehicles (such as UCITS [Undertakings for Collective Investments in Transferable Securities]), or through third party investment managers:

(a) Bonds and other fixed income instruments;

(b) Equities and equity type investments;

(c) Debts, deposits and other rights;

(d) Property.

2.3. The holding of a given asset portfolio carries a range of investment-related risks to technical provisions and solvency which authorized insurers need to monitor, measure, report and control. The main risks are market risk (adverse movements in, for example, stocks, bonds and exchange rates), credit risk (counterparty failure), liquidity risk (inability to unwind a position at or near market price), operational risk (system/internal control failure), and legal risk.

2.4. The actual composition of an asset portfolio at any given moment should be the product of a well-structured investment process itself, which for the purposes of this Guideline is regarded as a circular movement characterised by the following steps:

(a) Formulation and development of a strategic and tactical investment policy;

(b) Implementation of the investment policy, in a suitably equipped investment organisation, and on the basis of a clear and precise investment mandate(s);

(c) Control, measurement and analysis of the investment results which have been achieved and the risks taken;

(d) Feedback to the appropriate level of authority on points (a), (b) and

2.5. Authorized insurers should develop and operate overall asset management strategies, which take account of the need to ensure the existence of:

(a) The definition of a strategic investment policy by the Board, based on an assessment of the risks incurred by the insurer and its risk appetite;

(b) On-going Board and senior management oversight of, and clear management accountability for, investment activities;

(c) Comprehensive, accurate and flexible systems which allow the identification, measurement and assessment of investment risks, and the aggregation of those risks at various levels, for example for any separate portfolios held, for the insurer and, as appropriate, at group level, at any given time. Such systems will vary from insurer to insurer, but should be:

(i) sufficiently robust to reflect the scale of the risks and the investment activity undertaken;

(ii) capable of accurately capturing and measuring all significant risks in a timely manner;

(iii) understood by all relevant personnel at all levels of the insurer;

(d) Key control structures, such as the segregation of duties, approvals, verifications, reconciliations;

(e) Adequate procedures for the measurement and assessment of

investment performance;

(f) Adequate and timely communication of information on investment activities between all levels within the insurer;

(g) Internal procedures to review the appropriateness of the investment policies and procedures in place;

(h) Rigorous and effective audit procedures and monitoring activities to identify and report weaknesses in investment controls and compliance;

(i) Procedures to identify and control the dependence on and vulnerability of the insurer to key personnel and systems.

2.6. The following sections further develop the above principles, recognising that less formalised structures and procedures than those described herein may be applicable depending on the size and nature of the business of an individual authorized insurer.

3. Definition of the Investment Policy and Procedures

Board of Directors

3.1. The Board should be responsible for the formulation and approval of the strategic investment policy, taking account of the analysis of the asset/liability relationship, the authorized insurer's overall risk tolerance, its long-term risk-return requirements, its liquidity requirements and its solvency position. For a long term business insurer, the Board should also consider the relevant input of its appointed actuary. Alternatively, the Board can delegate formulation of the strategic investment policy, including consideration of the factors listed, to an appropriately constituted committee such as the Investment Committee as mentioned in the Guideline on the Corporate Governance of Authorized Insurers (GL10) issued by the Insurance Authority ("IA"), whilst retaining the power of ratification.

3.2. The investment policy, which should be communicated to all staff involved in investment activities, should in principle address the following main elements:

(a) The determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories;

(b) The establishment of limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency;

(c) The formulation of an overall policy on the selection of individual securities and other investment titles;

(d) The adoption of passive or more active investment management[1] in relation to each level of decision making;

(e) In the case of active management, definition of the scope for investment flexibility, usually through the setting of quantitative asset exposure limits;

(f) The extent to which the holding of some types of assets is ruled out or restricted where, for example, the disposal of the asset could be difficult due to the illiquidity of the market or where independent (i.e. external) verification of pricing is not available;

(g) An overall policy on the use of financial derivatives as part of the general portfolio management process or of structured products that have the economic effect of derivatives;

(h) The framework of accountability for all asset transactions.

3.3. The Board should also be responsible for establishing policies on related issues of a more operational nature, including:

(a) The choice between internal or external investment management, and, for the latter, the criteria for selection of the manager(s). Also, in case of external management, a choice usually needs to be made between having a segregated (discretionary) portfolio managed, or participating in a collective or pooled fund, or other indirect investment vehicles;

[1] Passive management refers to the situation where investment transactions are undertaken in order to maintain a predefined strategic mix between asset categories, or within an asset category, possibly in accordance with market indices. Active management on the other hand refers to the situation where transactions are undertaken in order to deliberately deviate from the predefined strategic mix to achieve a risk-return profile different from that implied by the strategic portfolio composition. This may take place at various levels, e.g. by changing the portfolio mix between equities and fixed income investment, altering the geographical allocation, or, in an equity portfolio, over- and underweighting of shares against an index, and, in a fixed income portfolio, increasing or decreasing the duration of the portfolio.

(b) The selection and use of brokers;

(c) The nature of custodial arrangements;

(d) The methodology and frequency of the performance measurement and analysis.

3.4. The Board should authorize senior management to implement the overall investment policy. The Board must, however, always retain ultimate responsibility for the authorized insurer's investment policy and procedures, regardless of the extent to which associated activities and functions are delegated or, indeed, outsourced.

3.5. As part of the development of the asset management strategy the Board must also ensure that adequate reporting and internal control systems of the authorized insurer are in place, and designed to monitor that assets are being managed in accordance with the investment policy and mandate(s), and legal and regulatory requirements. The Board must ensure that:

(a) They receive regular information, including feedback from the insurer's risk management function, on asset exposures, and the associated risks, in a form which is understood by them and which permits them to make an informed judgment as to the level of risk on a mark-to-market basis;

(b) The systems provide accurate and timely information on asset risk exposure and are capable of responding to ad hoc requests;

(c) The internal controls include an adequate segregation of the functions responsible for measuring, monitoring and controlling investment activities from those conducting day to day asset transactions;

(d) Remuneration policies are structured to avoid potential incentives for unauthorized risk taking.

3.6. Where external asset managers are used, the Board must ensure that senior management is in a position to monitor the performance of the external managers against Board approved policies and procedures. External managers should be engaged under a contract that, inter alia, sets out the policies, procedures and quantitative limits of the investment mandate. The authorized insurer must retain appropriate expertise and ensure that, under the terms of the contract, it regularly

receives sufficient information to evaluate the compliance of the external asset manager with the investment mandate.

3.7. The Board should collectively have sufficient expertise to understand the important issues related to investment policy and should ensure that all individuals conducting and monitoring investment activities have sufficient levels of knowledge and experience.

3.8. At least annually, the Board should review the adequacy of its overall investment policy in the light of the authorized insurer's activities, and its overall risk tolerance, long-term risk-return requirements and solvency position and the local asset requirement for a general business insurer.

Senior Management

3.9. The responsibility for the preparation of a written investment mandate(s) setting out the operational policies and procedures for implementing the overall investment policy established by the Board will frequently be delegated to senior management. The precise content of the mandate will be different for each authorized insurer but the level of detail should be consistent with the nature of any regulatory constraint and complexity and volume of investment activity, and should specify as appropriate:

(a) The investment objective, and the relevant limits for asset allocation, and the currency allocation and policy; any relevant investment benchmarks should also be specified;

(b) An exhaustive list of permissible investments and, as appropriate, derivative instruments, including details of any restrictions as to markets (e.g. only securities listed at specified stock exchanges), minimum rating requirements or minimum market capitalisation, minimum sizes of issues to be invested in, diversification limits and related quantitative or qualitative limits;

(c) Details of who is authorized to undertake asset transactions;

(d) Any other restrictions with which portfolio managers have to comply, for example maximum risk limits within the overall investment policy (or in terms of limits on the duration of the portfolio in the case of a fixed-income portfolio), authorized counterparties;

(e) The agreed form and frequency of reporting and accountability.

3.10. Supporting internal management procedures should be documented and include:

(a) Procedures for seeking approval for the usage of new types of investment instruments: the desirability of retaining the flexibility to utilise new investment instruments should be balanced with the need to identify the risks inherent in them and ensure that they will be subject to adequate controls before approval is given for their acquisition. The principles for measuring such risk, and the methods of accounting for the new investments (with the methods of accounting concerned being subject to generally accepted accounting practice and accepted by the auditor) should be clarified in detail prior to approval being given for their acquisition;

(b) Procedures for the selection and approval of new counterparties and brokers;

(c) Procedures covering front office, back office, measurement of compliance with quantitative limits, control and reporting;

(d) Details of the action which will be taken by senior management in cases of non-compliance;

(e) Valuation procedures for risk management purposes;

(f) Identification of who should be responsible for the valuation. Valuations should be carried out by individuals independent of those responsible for trade execution or, if this is not possible, valuations should be independently checked or audited on a timely basis.

Accounting and taxation rules should be taken into consideration in developing the above operational policies and procedures.

3.11. Senior management should ensure that all individuals conducting, monitoring and controlling investment activities are suitably qualified and have appropriate levels of knowledge and experience.

3.12. At least annually, senior management should review the adequacy of its written operational procedures and allocated resources in the light of the

authorized insurer's activities and market conditions.

4. Monitoring and Control

Risk Management Function

4.1. Authorized insurers should be capable of identifying, monitoring, measuring, reporting and controlling the risks connected with investment activities. This process should be performed by a risk management function with responsibility for:

(a) Monitoring compliance with the approved investment policy;

(b) Formally noting and promptly reporting breaches;

(c) Reviewing asset risk management activity and results over the past period;

(d) Reviewing the asset/liability and liquidity position.

4.2. The risk management function should also assess the appropriateness of the asset allocation limits. To do this, regular resilience testing should be undertaken for a wide range of market scenarios and changing investment and operating conditions. Once an authorized insurer has identified those situations to which it is most at risk, it should ensure that it feeds back appropriate amendments to the policies and procedures defined in its investment mandate in order to manage those risk situations effectively.

4.3. The risk management function should regularly report to appropriate levels of senior management and, as appropriate, to the Board. The reports should provide aggregate information as well as sufficient detail to enable management to assess the sensitivity of the authorized insurer to changes in market conditions and other risk factors. The frequency of reporting should provide these individuals with adequate information to judge the changing nature of the insurer's asset profile, the risks that stem from it and the consequences for the insurer's solvency.

Internal Controls

4.4. Adequate systems of internal control must be present to ensure that investment activities are properly supervised and that transactions have been entered into only in accordance with the authorized insurer's approved policies and

procedures. Internal control procedures should be documented. The extent and nature of internal controls adopted by each authorized insurer will be different, but procedures to be considered should include:

(a) Reconciliations between front office and back office and accounting systems;

(b) Procedures to ensure that any restrictions on the power of all parties to enter into any particular asset transaction are observed. This will require close and regular communication with those responsible for compliance, legal and documentation issues in the insurer;

(c) Procedures to ensure all parties to the asset transaction agree with the terms of the deal. Procedures for promptly sending, receiving and matching confirmations should be independent of the front office function;

(d) Procedures to ensure that formal documentation is completed promptly;

(e) Procedures to ensure reconciliation of positions reported by brokers;

(f) Procedures to ensure that positions are properly settled and reported, and that late payments or late receipts are identified;

(g) Procedures to ensure asset transactions are carried out in conformity with prevailing market terms and conditions;

(h) Procedures to ensure that all authority and dealing limits are not exceeded and all breaches can be immediately identified;

(i) Procedures to ensure the independent checking of rates or prices: the systems should not solely rely on dealers for rate/price information.

4.5. The functions responsible for measuring, monitoring, settling and controlling asset transactions should be distinct from the front office functions. These functions should be adequately resourced.

4.6. Regular and timely reports of investment activity should be produced which describe the authorized insurer's exposure in clearly understandable terms and include quantitative and qualitative information. The reports should, in principle, be produced on a daily basis for senior management purposes; less frequent reporting may be acceptable depending on the nature and extent of asset transactions. Upward reporting by senior management is recommended on at least a monthly basis. Reports should at least include the following areas:

(a) Details of, and commentary on, investment activity in the period and the relevant period end position;

(b) Details of positions by asset type;

(c) An analysis of credit exposures by counterparty;

(d) Details of any regulatory or internal limits breached in the period and the actions taken thereto;

(e) Planned future activity;

(f) Details of the relative position of assets and liabilities.

Audit

4.7. Authorized insurers should have an audit that includes full coverage of their investment activities and ensures timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it must be independent. Concerns with regards to investment activity must be reported to senior management and the Board.

4.8. Audit coverage should be provided by competent professionals who are knowledgeable of the risks inherent in all assets held.

4.9. Auditors should be expected to evaluate the independence and overall effectiveness of the authorized insurer's asset management functions. In this regard, they should thoroughly evaluate the effectiveness of the internal controls relevant to measuring, reporting and limiting risks. Auditors should evaluate compliance with risk limits and the reliability and timeliness of information reported to senior management and the Board.

4.10. Auditors should also periodically review the authorized insurer's asset portfolio and written investment policies and procedures to ensure compliance with the insurer's regulatory obligations.

5. Supervision

5.1. In monitoring the asset management of authorized insurers, IA will seek to ensure that the insurers have the ability to identify, monitor, measure, report and control the associated risks. In order to achieve this objective, the insurers should have in place an overall investment policy and procedures approved by the Board, including procedures that ascertain that the Board receives appropriate quantitative

and qualitative information on the investment activities and asset positions. IA may also wish to satisfy itself that the insurers have in place effective procedures for monitoring and managing their asset/liability position to ensure that their investment activities and asset positions are appropriate to their liabilities profiles.

5.2. In order to assess how authorized insurers control the risks associated with their investment activities, IA may periodically request the following information:

(a) A description of the Board's overall approach and policy on products and underwriting, reinsurance, investment and solvency;

(b) Asset/liability management procedures;

(c) Specific details of the investment policy, and monitoring and control procedures including:

(i) the asset classes approved by the Board for use by the insurer and details of portfolio composition;

(ii) procedures for the approval of counterparties;

(iii) procedures for seeking approval to use new investment instruments and for ensuring that asset risk controls, once established, keep pace with the emergence of new investment instruments;

(iv) procedures covering front and back office functions, measurement of compliance with any limits, oversight, control and reporting;

(v) the limits to credit, market, and other risks;

(vi) procedures for monitoring liquidity risk;

(vii) the professional qualifications of those entrusted with investment activities;

(viii) the valuation methodologies;

(ix) compliance reports;

(x) the procedures for selecting and monitoring any external asset managers used;

(xi) the risk position of the asset portfolio, using, for example,

value at risk calculations or other methodologies.

5.3. This information should be accessible to IA through on-site inspections and discussions with authorized insurers. It may make use of internal management information on asset portfolios. Information should be timely and comprehensive (i.e. it should include all assets held and cover the entire reporting entity). In cases where the insurers outsource all or part of their asset management, they should still be responsible for ensuring the availability of information for supervisory purposes.

6. Commencement

6.1. This Guideline shall take effect from 26 June 2017.

June 2017

GL14

GUIDELINE
ON
OUTSOURCING

Insurance Authority

Contents

1. Introduction

1.1. It has become increasingly popular for financial services institutions to outsource their business activities to other parties as a means of reducing costs and achieving strategic aims. These activities may include customer-related services and back-office activities.

1.2. While outsourcing may bring cost and other benefits, such arrangement may increase an insurer's dependence on other parties and increase its risk profile. An authorized insurer is therefore expected to adopt a sound and responsive management framework in formulating and monitoring its outsourcing arrangements.

1.3. This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance"). It sets out the essential issues that the Insurance Authority ("IA") expects an authorized insurer to take into account in formulating and monitoring its outsourcing arrangements for protecting the interests of its existing and potential policy holders. It also sets out the supervisory approach of the IA in monitoring the outsourcing arrangements of an authorized insurer.

1.4. Whilst this Guideline seeks to help authorized insurers to identify and mitigate the risks associated with outsourcing without hindering the efficiency and effectiveness of their operation, it however should not be regarded as a substitute for consultation of professional and legal advice. The IA will not accept any responsibility for any liability which may arise from application of this Guideline.

2. Application of this Guideline

2.1. Subject to paragraph 2.2 below, this Guideline should apply to all outsourcing arrangements of an authorized insurer which is incorporated or based in Hong Kong. For an authorized insurer which is neither incorporated nor based in Hong Kong, it should apply to outsourcing arrangements relating to that insurer's operation in Hong Kong.

2.2. Section 5 of this Guideline sets out the essential issues that the

IA expects an authorized insurer to take into account in formulating and monitoring its outsourcing arrangements. The IA recognizes that outsourcing arrangements may exhibit varying degree of materiality and expects an authorized insurer to manage its outsourcing risks in a manner that is commensurate with the degree of materiality of the arrangements. For material outsourcing, the IA expects the insurer to take into account and address all the relevant essential issues. However, irrespective of the degree of materiality of an outsourcing arrangement, it will not diminish the insurer's ultimate accountability of the outsourced service and obligations to comply with relevant laws, regulations and rules.

3. Interpretation

3.1. In this Guideline, unless the context otherwise specifies:

(a) "based in Hong Kong", in relation to an authorized insurer, means that the insurer is incorporated outside Hong Kong with 75% or more of its annual gross premium income for general business pertaining to Hong Kong insurance business; or 75% or more of its annual gross revenue premium income for long term business pertaining to Hong Kong long term insurance business.

(b) "outsourcing" refers to an arrangement under which the service provider undertakes to perform a service (including a business activity, function or process) which would otherwise be undertaken by the authorized insurer itself. For the purposes of this Guideline, **Annex 1** sets out some examples of outsourcing and some arrangements which would generally not be regarded as outsourcing.

(c) "material outsourcing" means an outsourcing arrangement, which if disrupted or falls short of acceptable standards, would have the potential to significantly impact on an authorized insurer's financial position, business operation, reputation or its ability to meet obligations or provide adequate services to policy holders or

to conform with legal and regulatory requirements.

(d) "overseas outsourcing" means an outsourcing arrangement relating to an authorized insurer's operation in Hong Kong and the service of which is performed outside Hong Kong, irrespective of the place of incorporation of the service provider.

(e) "service provider" includes a service provider located in or outside Hong Kong, and the service provider can be an independent third party, a party related to the authorized insurer (e.g. a subsidiary or fellow subsidiary of the insurer) or a unit of the insurer (e.g. head office or overseas branch).

4. Legal and Regulatory Obligations

4.1. Whilst an authorized insurer has the flexibility to carry out its operation in the way best suited to accomplishing its corporate objectives, its Board of Directors and management retain ultimate accountability for all the outsourced services. The insurer's liability shall not be restricted or limited by way of outsourcing.

4.2. Outsourcing does not diminish the obligations of an authorized insurer to comply with relevant laws, regulations and rules. The insurer is obliged to comply with, including but not limited to, the Ordinance, and observe the guidelines promulgated by the IA. Specifically, an authorized insurer must ensure that proper books of account and records are maintained and made available for inspection by the IA in Hong Kong when required, and adequate and up-to-date data can be timely retrieved from the insurer or the service provider. It should not enter into any outsourcing arrangement that would impede the IA's ability to exercise its statutory responsibilities.

5. Essential Issues

Outsourcing Policy

5.1. Prior to the outsourcing of services, an authorized insurer should develop an outsourcing policy, approved by the Board of Directors, which includes, among other things, the following:

(a) the objectives of outsourcing and criteria for approving an outsourcing arrangement;

(b) the framework for evaluating the materiality of outsourcing arrangements;

(c) the framework for a comprehensive assessment of risks involved in outsourcing;

(d) the framework for monitoring and controlling outsourcing arrangements;

(e) the identities of the parties involved and their roles and responsibilities in approving, assessing and monitoring the outsourcing arrangements, and how those responsibilities may be delegated and details of any authority limits; and

(f) the review mechanism to ensure the outsourcing policy and the monitoring and control procedures are capable to accommodate changing circumstances of the insurer and cater for market, legal and regulatory developments.

5.2. The insurer should have appropriate documentation of its outsourcing policy and ensure that procedures are in place such that all relevant staff of the insurer are fully aware of, and comply with, the outsourcing policy.

5.3. For an authorized insurer incorporated outside Hong Kong, the approval required in paragraph 5.1 above may be delegated to a management committee responsible for the oversight and supervision of

the insurer's operation in Hong Kong.

Materiality Assessment

5.4. An authorized insurer should develop a framework for assessing the materiality of an outsourcing arrangement. The assessment of what is material may involve qualitative judgment and depends on the circumstances of the insurer concerned. Factors that should be considered include, but are not limited to:

(a) impact on the financial position (e.g. solvency and liquidity), business operation (e.g. provision of adequate services to customers) and reputation of the insurer if the outsourced service is disrupted or falls short of acceptable standards;

(b) impact on the ability of the insurer to maintain adequate internal controls and comply with legal and regulatory requirements if the outsourced service is disrupted or falls short of acceptable standards;

(c) cost of outsourcing as a proportion to the total operating costs of the insurer; and

(d) degree of difficulty and time required to find alternative service provider or to bring the outsourced service in-house, if necessary.

5.5. An authorized insurer should regularly conduct reviews on the materiality of its outsourcing arrangements. An outsourcing arrangement which was previously immaterial may become material due to, for instance, changes in the volume and the nature of the service outsourced to the service provider. If such an outsourcing arrangement is reassessed to be material, the insurer should notify the IA forthwith and take practical steps to address all the essential issues set out in this Guideline in a timely manner. For the avoidance of doubt, an authorized insurer should notify the IA of the information as mentioned in paragraph 6.1 of this Guideline when it is planning to enter into a new material outsourcing arrangement

or significantly vary an existing material outsourcing arrangement.

Risk Assessment

5.6. Before entering into a new outsourcing arrangement or renewing or varying an existing outsourcing arrangement, an authorized insurer should conduct a comprehensive assessment on the risks associated with the proposed arrangement or change. The assessment should take into account all relevant risks including impact on financial, operational, legal and reputation aspects and potential losses to the customers in the event of a failure by the service provider to perform the outsourced service. The insurer should exercise due diligence and care to ensure that all risks identified have been addressed before implementing the proposed arrangement or change.

5.7. After the insurer implements a new outsourcing arrangement or renews or varies an existing outsourcing arrangement, it should re-perform such assessment regularly.

Service Provider

5.8. An authorized insurer should exercise due diligence and care and consider factors such as aggregate exposure to that particular service provider, possible conflict of interest that may arise, and price of the outsourcing vis-à-vis the benefit gained in assessing and selecting a service provider. Besides, when assessing a service provider, it should, among other things, take into account the following factors of the service provider:

(a) reputation, experience and quality of service;

(b) financial soundness, in particular, the ability to continue to provide the expected level of service;

(c) managerial skills, technical and operational expertise and competence, in particular, the ability to deal with disruptions in business continuity;

(d) any licence, registration, permission or authorization required by law to perform the outsourced service;

(e) extent of reliance on sub-contractors and effectiveness in monitoring the work of sub-contractors;

(f) compatibility with the insurer's corporate culture and future development strategies; and

(g) familiarity with the insurance industry and capacity to keep pace with innovation in the market.

5.9. An authorized insurer should periodically review (at least annually) the ability (including financial strength and technical competence) of the selected service provider to ascertain whether it can continue to provide the expected level of service.

Outsourcing Agreement

5.10. An outsourcing arrangement should be undertaken in the form of a legally binding written agreement. In negotiating the contract with the service provider, an authorized insurer should consider, among other things, the following matters:

(a) scope of the outsourced service;

(b) location where the outsourced service will be performed;

(c) effective period of the outsourcing arrangement;

(d) contractual obligations and liabilities of the insurer and the service provider;

(e) performance standards to be attained in respect of the outsourced service. This is particularly appropriate when the insurer has committed a service standard or performance pledge to its customers;

(f) reporting or notification requirements that the insurer may wish to impose on the service provider;

(g) the way in which the insurer and the service provider should monitor the performance under the agreement (e.g. evaluation of performance through service delivery reports, periodic self-certification, independent reviews by the insurer's or service provider's auditors);

(h) information and asset ownership rights, information technology security and protection of confidential information;

(i) rules and restrictions on sub-contracting, e.g. requiring insurer's prior consent on sub-contracting of the outsourced service. The insurer should retain the ability to maintain similar control over its outsourcing risks when a service provider uses a sub-contractor;

(j) remedial action and escalation process for dealing with inadequate performance;

(k) contingency planning of the service provider to provide business continuity for the outsourced service;

(l) management and approval process for changes to the outsourcing arrangement;

(m) conditions under which the insurer or service provider can terminate the outsourcing agreement;

(n) termination agreement, including intellectual property and information rights and clarification of the process to ensure the smooth transfer of outsourced service either to another service provider or back to the insurer;

(o) guarantee or indemnity from the service provider, e.g. an indemnity to the effect that any sub-contracting by the service provider of the outsourced service will be the responsibility of the service provider including liability for any failure on the part of the sub-contractor;

(p) requirement for the service provider to hold relevant insurance;

(q) mechanism to resolve disputes that might arise under the outsourcing arrangement;

(r) the service provider's agreement to allow access by the auditors and actuaries of the insurer and the IA to any books, records and information which facilitates them to discharge their statutory duties and obligations; and

(s) governing law of the outsourcing agreement. The agreement should preferably be governed by Hong Kong law.

5.11. Where the service provider is the head office or another branch of an authorized insurer, a memorandum of understanding which has been properly endorsed by its Board of Directors may be acceptable.

Information Confidentiality

5.12. An authorized insurer should ensure that the outsourcing arrangements comply with relevant laws and statutory requirements on customer confidentiality (e.g. the Personal Data (Privacy) Ordinance, Cap. 486 ("PDPO")). The insurer should ensure that it and the service provider

have proper safeguards in place to protect the integrity and confidentiality of the insurer's information and customer data.

5.13. An authorized insurer should take into account any legal or contractual obligation to notify customers of the outsourcing arrangement and circumstances under which their data may be disclosed or lost. In the event of the termination of the outsourcing agreement, the insurer should ensure that all customer data are either retrieved from the service provider or destroyed.

5.14. An authorized insurer should notify the IA forthwith of any unauthorized access or breach of confidentiality by the service provider or its sub-contractor that affects the insurer or its customers.

Monitoring and Control

5.15. An authorized insurer should ensure that it has sufficient and appropriate resources to monitor and control the outsourcing arrangements at all times. For effective monitoring and control of the outsourcing arrangements, an authorized insurer should, among other things:

(a) ensure the responsibility for monitoring the service provider and the outsourced service to be assigned to staff with appropriate expertise;

(b) maintain a central list of the outsourcing arrangements that includes the name of each service provider, service outsourced, location where the outsourced service is performed, commencement date and expiry or renewal date of the outsourcing agreement, and contact details of the key persons of the service provider. The central list should also record similar information relating to any sub-contracting arrangement of the outsourced service;

(c) exercise due diligence and care to monitor each outsourcing arrangement to ensure the service is being delivered in the manner

expected, and to ensure the provisions included in the outsourcing agreement are properly effected; and

(d) conduct reviews or audits periodically (at least annually) to ensure that the outsourcing policy and the monitoring and control procedures are being effectively complied with.

5.16. Once an authorized insurer implements an outsourcing arrangement, it should regularly review the effectiveness and adequacy of its controls in monitoring the performance of the service provider and managing the risks associated with the outsourced service. The insurer should have reporting procedures that can promptly escalate problems relating to the outsourced service to the attention of the management of the insurer and the service provider. It should take appropriate rectification actions forthwith if deficiencies are identified. The insurer is expected to notify the IA forthwith of any significant problem that has the potential to materially affect its financial position, business operation or compliance with legal and regulatory requirements.

Contingency Planning

5.17. An authorized insurer outsourcing service to a service provider should put in place a contingency plan to ensure that its business would not be disrupted as a result of undesired contingencies (e.g. systems failure) of the service provider. The following issues should be considered and properly addressed in formulating such contingency plan:

(a) back-up facilities or availability of alternative service provider or possibility of bringing the outsourced service back in-house;

(b) procedures to be followed and the persons responsible for respective activities if business continuity problem arises; and

(c) procedures for regular reviews and testing of the contingency plan.

5.18. An authorized insurer should also ensure that the service

provider has its own contingency plan in respect of daily operational and systems problems. The insurer should have adequate understanding of the service provider's contingency plan and consider the implications for its own contingency planning in the event that the outsourced service is interrupted due to undesired contingencies of the service provider.

Overseas Outsourcing

5.19. In addition to the essential issues mentioned above, an authorized insurer should pay particular attention to the following issues in relation to overseas outsourcing:

(a) Country risk – The country risks associated with overseas outsourcing should be taken into account. Such risks cover the social, economic and political conditions and the legal and regulatory systems of an overseas jurisdiction which may adversely affect the ability of the service provider to carry out the provisions of the outsourcing agreement and the ability of the insurer to effectively monitor the outsourced service and the service provider.

(b) Information confidentiality – There may be circumstances under which the insurer's information and customer data are subject to the right of access by an overseas authority (e.g. police and tax authority). The insurer should take into account the extent and possibility of such access right and, as considered appropriate, seek legal advice to clarify the position. In case an overseas authority seeks access to the insurer's customer data, the insurer should forthwith notify the IA.

(c) Notification to customers – Having regard to the additional risks posed by overseas outsourcing, the insurer should consider the need to inform their customers of the jurisdiction in which the service is to be performed and any right of access available to overseas authorities.

(d) Examination by the IA – The insurer should ensure that, although its service is outsourced to be performed outside Hong Kong, such arrangement would not, in any case, impede the ability of the IA to access in Hong Kong the books and records and other information of the insurer as necessary for the IA to carry out its statutory responsibilities.

(e) Transfer of personal data – The insurer should pay particular attention to relevant provisions of PDPO if it needs to transfer personal data outside Hong Kong under an overseas outsourcing arrangement.

(f) Governing law of agreement – The governing law of the outsourcing agreement should preferably be governed by Hong Kong law.

Sub-contracting

5.20. Additional risk will be posed on the risk profile of an authorized insurer if the service provider of the outsourcing arrangement is allowed to further contract the service out to other parties. The insurer should put in place adequate procedures to control and monitor such sub-contracting arrangements and ensure that the service provider will take into account the essential issues set out in this Guideline as if it was the insurer concerned when further contracting out the service.

5.21. An authorized insurer should incorporate in the outsourcing agreement rules and restrictions on sub-contracting, e.g. requiring insurer's prior consent for sub-contracting and making the service provider liable for the capability of the sub-contractor. The insurer should ensure that its service provider would not engage in sub-contracting arrangement which may impede its ability to carry out the provisions of the outsourcing agreement with the insurer, in particular, the requirements on information confidentiality, contingency planning and information access right by regulator.

6. Supervisory Approach

Prior Notification of Material Outsourcing

6.1. An authorized insurer should notify the IA when it is planning to enter into a new material outsourcing arrangement or significantly vary an existing one. Unless otherwise justifiable by the insurer, the notification should be made at least three months before the day on which the new outsourcing arrangement is proposed to be entered into or the existing arrangement is proposed to be varied significantly. The insurer should satisfy the IA that it has taken into account and properly addressed all the essential issues set out in Section 5 of this Guideline in the planning stage. The IA, if considered appropriate, may discuss with the insurer on any area of concern on the outsourcing arrangement and require it to take necessary actions to address the concerns. The three-month prior notification period may be extended by the IA if the insurer is not able to address the area of concerns to the satisfaction of the IA within the period. In the event that the three-month prior notification period has expired without the IA having communicated with the insurer on the proposed outsourcing arrangement or significant changes, the insurer may take it that the proposal is acceptable to the IA and proceed to enter into the proposed arrangement or changes.

6.2. The prior notification to the IA should be accompanied with a detailed description of the proposed outsourcing arrangement to be entered into or the significant change proposed to be made. The IA may request any additional information where the IA considers it necessary in order to assess the potential impact on the insurer's risk profile. For overseas material outsourcing, the IA may also communicate with the home or host regulator of the insurer and the service provider to seek clarification or confirmation on relevant issues as considered necessary.

6.3. After entering into a new material outsourcing arrangement or significantly varying an existing one, the insurer should within 30 days submit to the IA information relating to the arrangement. The information to be submitted includes:

(a) the service outsourced;

(b) the name of the service provider;

(c) the location where the outsourced service is performed;

(d) the commencement date and expiry or renewal date of the outsourcing agreement; and

(e) a copy of the outsourcing agreement.

The insurer should notify the IA forthwith whenever there is any subsequent change to the information submitted and any renewal or termination of the outsourcing arrangement.

Regular Monitoring

6.4. As outsourcing arrangements have the potential of increasing an authorized insurer's business/operational risk, such arrangements are subject to on-site inspection and off-site review by the IA. An authorized insurer should submit to the IA any supplementary information as required by the IA from time to time to enable it to monitor the insurer's outsourcing arrangements. The IA reserves the right, in extreme case, to require an authorized insurer to take steps to make alternative arrangement for any outsourced service.

7. COMMENCEMENT

7.1. This Guideline shall take effect from 26 June 2017.

June 2017

Annex 1

Examples of Outsourcing

The following are some examples of services that when performed by a service provider may be regarded as outsourcing for the purposes of this Guideline:

- Application processing (e.g. insurance proposals, policy loans)
- Policy administration (e.g. premium collection, invoicing, policy renewals, customer services)
- Claims processing (e.g. claims assessment, claims recoveries)
- Documents processing (e.g. cheques, bill payments)
- Investment management (e.g. portfolio management, cash management)
- Manpower management (e.g. manpower planning, staff recruitment, salaries and benefits administration, training and development)
- Marketing and research (e.g. product development, telemarketing, media relations)
- Information system management (e.g. information system, intranet and website development and maintenance, information technology security, desktop support)
- Risk management and internal control (e.g. compliance, internal audit)
- Professional services related to the business activities of the authorized insurer (e.g. accounting, actuarial)

The following are some examples which would generally not be regarded as outsourcing for the purposes of this Guideline:

- Sale of insurance policies by agents or brokers, and ancillary services relating to those sales
- Ceding insurance business
- Independent advisory and consultancy services

- Loss adjusting service
- Independent audit review
- Medical examination by assigned medical and health clinics and centres
- Market information services (e.g. Standard & Poor's, Moody's)
- Purchase of goods and commodities
- Repair and maintenance of fixed assets
- Maintenance and support of licensed software
- Specialized recruitment and procurement of specialized training
- Employment of contract or temporary personnel
- Common network infrastructure (e.g. VISA, Mastercard)
- Banking services
- Printing services
- Transportation services
- Mail and courier services
- Cleaning services
- Utilities and telephone

Annex 2

Prior Notification of Material Outsourcing Arrangement

Checklist of Information to be Submitted to the Insurance Authority for Entering into an Outsourcing Arrangement	**"✓" if submitted**
A. Basic Particulars A description of the service proposed to be outsourced, name of service provider, location where the outsourced service will be performed, the commencement, expiry and renewal (if any) dates of the proposed arrangement.	
B. Outsourcing Policy A copy of the outsourcing policy of the authorized insurer (or, if the outsourcing policy has been submitted to the Insurance Authority, the date of submission).	
C. Materiality Assessment A summary of the materiality assessment conducted in respect of the proposed outsourcing arrangement, including the factors under consideration and the assessed impact.	
D. Risk Assessment A summary of the key risks identified in the proposed outsourcing arrangement and the risk mitigation strategies put in place to address these risks.	
E. Service Provider A brief account on the background of the service provider and its ability to perform the outsourced service, supplemented with a copy of the latest annual accounts/ report of the service provider, if available.	
F. Outsourcing Agreement A copy of the proposed outsourcing agreement.	

G. Information Confidentiality A summary of the key measures to protect the integrity and confidentiality of the insurer's information and customer data under the proposed outsourcing arrangement.	
H. Monitoring and Control A summary of the key procedures for monitoring and control of the proposed outsourcing arrangement.	
I. Contingency Planning A contingency plan to address the possibility that the outsourced service is disrupted or falls short of acceptable standards.	
J. Sub-contracting A summary of key measures to control and monitor sub-contracting of the outsourced service; or a statement confirming that the service provider is not allowed to sub-contract the outsourced service under the proposed outsourcing arrangement.	

Annex 3

Prior Notification of Material Outsourcing Arrangement

Checklist of Information to be Submitted to the Insurance Authority for Significant Change to an Outsourcing Arrangement	**"✓" if submitted**
A. Basic Particulars A description of the existing outsourcing arrangement (e.g. the outsourced service, location where the outsourced service is performed, the commencement, expiry and renewal (if any) dates and the proposed change).	
B. Materiality Assessment A summary of the materiality assessment conducted in respect of the outsourcing arrangement if the change is incorporated ("revised outsourcing arrangement").	
C. Risk Assessment A summary of the key risks identified in the revised outsourcing arrangement and the risk mitigation strategies put in place to address these risks.	
D. Service Provider A brief account on the background of the service provider and its ability to perform the outsourced service under the revised outsourcing arrangement, supplemented with a copy of the latest annual accounts/ report of the service provider, if available.	
E. Outsourcing Agreement A draft of the change or revised outsourcing agreement.	
F. Information Confidentiality A summary of the key measures to protect the integrity and confidentiality of the authorized insurer's information and customer data under the revised outsourcing arrangement.	
G. Monitoring and Control A summary of the key procedures for monitoring and control of the revised outsourcing arrangement.	

H. Contingency Planning A contingency plan to address the possibility that the outsourced service is disrupted or falls short of acceptable standards.	
I. Sub-contracting A summary of key measures to control and monitor sub-contracting of the outsourced service; or a statement confirming that the service provider is not allowed to sub-contract the outsourced service under the revised outsourcing arrangement.	

GL15

GUIDELINE ON
UNDERWRITING CLASS C BUSINESS

Insurance Authority

Contents

1. Introduction

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance") taking into account the Insurance Core Principles, Standards, Guidance and Assessment Methodology ("ICP") promulgated by the International Association of Insurance Supervisors ("IAIS"). Specific references are:

(a) Section 4A of the Ordinance stipulates that the Insurance Authority ("IA")'s function is to protect existing and potential policyholders. Section 4A(2)(c) states that the IA shall promote and encourage the adoption of proper standards of conduct, and sound and prudent business practices by authorized insurers.

(b) ICP 19 stipulates that the conduct of the business of insurance should ensure that customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. ICP 19.0.1 further stipulates that the conduct of insurance business should help to strengthen public trust and consumer confidence in the insurance sector.

1.2 This Guideline applies to all authorized insurers underwriting Class C business, or more commonly known as Investment-linked Assurance Schemes ("ILAS") business.

2. Relevant Regulatory Documents

2.1 Where appropriate, this Guideline should be read in conjunction with other relevant codes/circulars/guidelines issued by the IA or other regulatory bodies, including the following[1]:

(a) Updated Requirements Relating to the Sale of Investment-linked Assurance Schemes to Enhance Customer Protection issued by the

[1] The list is not exhaustive and may be subject to changes from time to time. Authorized insurers have the responsibility to ensure compliance with all the relevant requirements with due regard to their own circumstances.

Hong Kong Federation of Insurers ("HKFI")

(b) Enhanced Regulatory Requirements on Selling of Investment-Linked Assurance Scheme Products issued by the Hong Kong Monetary Authority (HKMA)

(c) Guidance on Internal Product Approval Process issued by the Securities and Futures Commission ("SFC")

(d) Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products issued by the SFC

3. Purpose

3.1 ILAS is a hybrid product with both insurance and investment elements. Clients have to bear the associated investment risks but at the same time benefit from some form of insurance protection.

3.2 As ILAS are long term insurance contracts, they normally entail a more complex charging structure and the investments involved do not have the same level of liquidity as other forms of investments. Clients should be fully apprised of the nature of such products, as well as the associated rights and obligations, before they enter into such contracts.

3.3 Both the IAIS and the global insurance industry have placed increasing emphasis on fair treatment of customers. ICP 19.2.4 stipulates that fair treatment of customers encompasses:

(a) developing and marketing products in a way that pays due regard to the interests of customers;

(b) providing customers with clear information before, during and after the point of sale;

(c) reducing the risk of sales which are not appropriate to customers' needs;

(d) ensuring that any advice given is of a high quality; and

(e) managing the reasonable expectations of customers.

3.4 This Guideline aims to set out the proper standards of conduct and business practices for authorized insurers underwriting Class C business. In assessing whether the requirements have been duly followed by authorized insurers, the IA will consider the substance and nature of the matters involved. The name or form of the arrangements adopted by individual authorized insurers would be irrelevant.

4. Duties of the Board, the Controller and the Appointed Actuary

4.1 It is the duty of the Controller, as specified under section 13A(12) of the Ordinance, to ensure that requirements set out in this Guideline and the relevant ICPs are observed throughout the life cycle of all ILAS policies. It is also the duty of the Board to maintain general oversight over the implementation of measures in compliance with this Guideline.

4.2 Any attempt to circumvent the requirements prescribed in this Guideline would be regarded as acting in bad faith. In the case of Controllers, this may affect the "fit and proper" assessment under sections 8(2) and 13A(4) of the Ordinance. In the case of Appointed Actuaries, this may constitute non-compliance with professional standards under section 15C of the Ordinance, and may render the incumbent not acceptable to the IA under section 15(1)(b) of the Ordinance.

5. Product Design

5.1 ICP 19.2.4 stipulates that insurers should develop and market products with due regard to the interests of customers. During the product design stage, an authorized insurer should carry out a diligent review to ensure that the product meets the "fair treatment of customers" principle, particularly in the areas set out below.

5.2 Insurance Value

(a) ILAS products should bring insurance value to clients.

(b) Authorized insurers have agreed that effective from 1 January 2015,

all ILAS products would provide a minimum death benefit of 105% of the account value. This notwithstanding, authorized insurers are encouraged to provide additional insurance benefits beyond this minimum level.

5.3 Fees and Charges

(a) Fees and charges to be paid by the customers should be fair, commensurate with the insurance protection offered by the ILAS product concerned, and reflect the services/added value of the authorized insurer.

(b) It would be questionable whether an ILAS product, which only carries minimal insurance content but has high upfront charges or multiple charges, could meet the "fair treatment of customers" principle.

5.4 Sustainability of the product

ILAS products should be sustainable. High level of fees that could deplete a client's investment notwithstanding a modest growth scenario can hardly be considered as sustainable.

5.5 In considering whether the design of an ILAS product meets the requirements of this Guideline and the "fair treatment of customers" principle, the IA will look at all relevant factors in their totality, including the product features, insurance elements, added value/services to clients, all fees/charges, surrender penalties, remuneration structure etc.

6. Provision of Adequate and Clear Information

6.1 ICP 19.2.4 stipulates that insurers should provide customers with clear information before, during and after the point of sale.

6.2 ICP 19.3.4 stipulates that the product development and marketing process should include the use of adequate information on customer needs.

6.3 Authorized insurers should include information on the key product features

and risks in all the product documents, including the product brochure, Key Facts Statement and Important Facts Statement / Applicant's Declaration ("IFS/AD").

6.4 Product information should be bilingual[2], clear and succinct, with the use of plain language and legible font size, and should be easily understandable by average clients.

6.5 ICP 19.2.4 further stipulates that insurers should manage the reasonable expectations of customers. Accordingly, projections in relation to the growth scenarios should not be overly optimistic. Clients should at least be apprised of the no-growth scenario (0%), alongside other growth scenarios, in the standard illustration statement.

7. Suitability Assessment

7.1 ILAS products should only be sold to clients with both investment and insurance needs.

7.2 Authorized insurers should endeavour to reduce the risk of sales that do not meet the needs of customers.

7.3 ICP 19.6.2 specifies that insurers should seek the information from their customers that is appropriate for assessing their insurance needs, before giving advice or concluding a contract. This information may vary, but should at least include information on the client's:

(a) financial knowledge and experience;

(b) needs, priorities and circumstances;

(c) ability to afford the product; and

(d) risk profile.

7.4 Clients' needs must first be properly assessed through the use of Financial Needs Analysis ("FNA") form. ILAS must not be marketed to clients

[2] For the avoidance of doubt, the English and Chinese versions of the product documents can be separated, but BOTH must be available to the clients.

before their needs are properly analyzed.

7.5 Clients that have indicated their insurance needs should then be presented with different insurance options that are available to meet their specific needs and financial circumstances. Examples include:

(a) clients wanting both insurance protection and "saving up for the future" should be presented with the option of procuring an endowment policy; and

(b) clients wanting both insurance protection and benefitting from growth in the investment market should be presented with the options of procuring a participation policy or an ILAS policy, and the advantages and risks of both products should be explained in detail. Only in cases where the clients wish to make the investment decision and are willing to bear the investment risk should ILAS be recommended.

7.6 Suitability assessment includes assessing the investment horizon of the potential policyholder, with due regard to the financial circumstances, planned retirement age etc.

(a) Premium payment term – The clients' age at the time of policy inception as well as his/her target retirement age are relevant to the suitability of the premium payment term. For instance, a policy maturing in 40 years with prolonged redemption penalties would unlikely be appropriate for a 60-year-old client.

(b) Regular premium – It is also necessary to ascertain the client's ability to pay continuously throughout the policy payment term. For instance, it would not be appropriate to sell a regular premium product to retirees or clients that do not have a stable income.

7.7 The suitability assessment should be carried out whenever there are changes to the circumstances of the client, including the scenario where an existing policyholder requests a top-up.

7.8 Authorized insurers have the duty to verify all available information,

particularly the "Statement of Purpose" section in the IFS/AD, the FNA and Risk Profile Questionnaire ("RPQ"), and assess whether a particular ILAS product is suitable for the client.

8. Advice to Clients

8.1 After a client has considered the insurance options, and is beginning to consider an ILAS policy, he/she should also be properly apprised of all the product features, particularly the fees and charges, surrender penalties (if any) as well as the product and investment risks.

8.2 After a client has decided to procure an ILAS policy, he/she should be fully apprised of the key products features again, as well as his/her rights and obligations, such as the right to ask for details of the intermediaries' remuneration, the need to complete the post-sale call, the 21-day cooling-off period etc. The IFS/AD must be duly signed by the client.

8.3 Authorized insurers have the duty to put in place a proper mechanism to ensure full understanding of the above by the client, as evidenced in the IFS/AD.

9. Appropriate Remuneration Structure

9.1 ILAS products are susceptible to mis-selling and aggressive selling. In addition, they can be used as vehicles for fraudulent acts and money laundering activities.

9.2 Authorized insurers have the duty to ensure that the remuneration structure for their intermediaries do not create misaligned incentives for the intermediaries to engage in the aforesaid activities. For instance, an overly high commission in the initial years of the policy term, coupled with a short clawback period, may create such misaligned incentives.

9.3 Accordingly, indemnity commission, or any standing arrangement that offers advance payment of commission, is strictly prohibited. Authorized insurers should only pay commission on an earned basis. Commission

payable should also spread over an appropriate duration to encourage good after-sale service and duly reward long term relationship between intermediaries and policyholders.

9.4 Cases of mis-selling, aggressive selling, fraud and money-laundering often surface after the expiry of the clawback period. Authorized insurers should therefore put in place an appropriate clawback period to address this particular risk. In addition, to deter such activities, a clawback mechanism must also be put in place to fully recover all commission paid in proven fraud / money laundering / mis-selling cases.

10. Avoidance of Conflict of Interests

10.1 ICP 19.7 requires insurers and intermediaries to ensure that, where customers receive advice before concluding an insurance contract, any potential conflicts of interest are properly managed. ICP 19.7.5 further stipulates that conflicts of interest may be managed in different ways as relevant to the circumstances, for example, through appropriate disclosure and informed consent from customers.

10.2 In regard to intermediaries' remuneration, authorized insurers should follow the formulation stipulated by the IA in calculating the remuneration for each product and distribution channel. The presentation format and wordings should follow IA's template.

11. Clients' Investments and Assets

11.1 Authorized insurers are required to strictly follow the investment instructions of policyholders in the allocation of premiums received. Any deviation must be based on sound actuarial principles and subject to the agreement of the IA.

11.2 Authorized insurers are also reminded to strictly follow the requirements under sections 22, 22A and 23 of the Ordinance regarding segregation and application of assets.

12. Post-sale Control

12.1 ICP 19.2 stipulates that insurers and intermediaries should establish and implement policies and procedures on fair treatment of customers. Authorized insurers should have proper control systems in place to achieve fair treatment of customers and monitor that such policies and procedures are adhered to.

12.2 The proper sales process flow is set out in the flowchart at the **Annex**. It involves completion of the FNA, confirmation of needs, comparison of different insurance options, completion of the RPQ, explanation of the key product features and completion of the IFS/AD.

12.3 To reaffirm clients' understanding of the ILAS policy that they have procured, and that they are fully aware of their rights and obligations under the ILAS policy, authorized insurers are required to make audio-recorded post-sale confirmation calls to all ILAS clients within 5 working days of the date of policy issue. The content of the call should follow the HKFI's template.

(a) The insurers should appoint a separate quality assurance team to make the post-sale calls.

(b) The insurers should use their best endeavours to make the post-sale calls, attempting different times of the day and different days of the week.

(c) The insurers are encouraged to adopt additional measures such as on-site recording at the service centre or immediate "dial-in" to or from the call centre for clients who are visitors or who may be difficult to reach.

(d) In the event of unsuccessful calls, a confirmation letter should be sent to the clients, alongside an email/SMS alert that draws the attention of the clients to the importance of the confirmation letter.

12.4 Authorized insurers are required to put in place an effective mechanism to identify possible cases of intermediaries abetting clients to evade the control measures, such as high frequency of clients opting out or deviating from the RPQ process, or having high rate of unsuccessful post-sale calls.

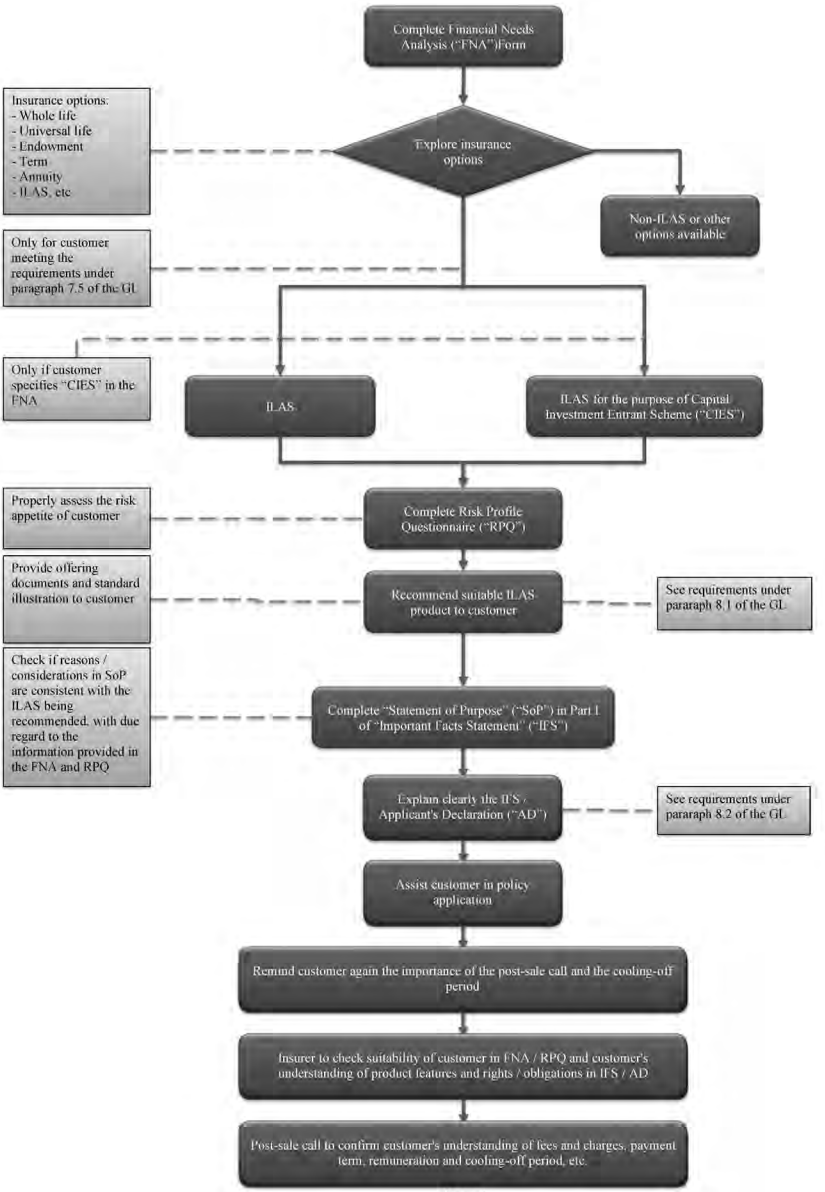
12.5 Authorized insurers should have in place proper documentation systems for quality control and future monitoring. Apart from the policy documents and the IFS/AD, records of the post-sale calls, confirmation letters and the email/SMS alerts, as well as control reports in respect of measures in paragraph 12.4, should also be kept properly.

12.6 Authorized insurers should, during the underwriting process, reject applications for ILAS policies if any of the requirements above are not met.

13. Commencement

13.1 This Guideline shall take effect from 26 June 2017.

June 2017


Complete Financial Needs Analysis ("FNA")Form
Insurance options:
- Whole life
- Universal life
- Endowment
- Term
- Annuity
- ILAS, etc
Explore insurance options
Non-ILAS or other options available
Only for customer meeting the requirements under paragraph 7.5 of the GL
Only if customer specifies "CIES" in the FNA
ILAS
ILAS for the purpose of Capital Investment Entrant Scheme ("CIES")
Properly assess the risk appetite of customer
Complete Risk Profile Questionnaire ("RPQ")
Provide offering documents and standard illustration to customer
Recommend suitable ILAS product to customer
See requirements under pararaph 8.1 of the GL
Check if reasons / considerations in SoP are consistent with the ILAS being recommended, with due regard to the information provided in the FNA and RPQ
Complete "Statement of Purpose" ("SoP") in Part I of "Important Facts Statement" ("IFS")
Explain clearly the IFS / Applicant's Declaration ("AD")
See requirements under pararaph 8.2 of the GL
Assist customer in policy application
Remind customer again the importance of the post-sale call and the cooling-off period
Insurer to check suitability of customer in FNA / RPQ and customer's understanding of product features and rights / obligations in IFS / AD
Post-sale call to confirm customer's understanding of fees and charges, payment term, remuneration and cooling-off period, etc.

Annex-i

GL16

GUIDELINE ON UNDERWRITING LONG TERM INSURANCE BUSINESS (OTHER THAN CLASS C BUSINESS)

Insurance Authority

Contents

1. Introduction

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance") taking into account the Insurance Core Principles, Standards, Guidance and Assessment Methodology ("ICP") promulgated by the International Association of Insurance Supervisors ("IAIS"). Specific references are:

(a) Section 4A of the Ordinance stipulates that the Insurance Authority ("IA")'s function is to protect existing and potential policyholders. Section 4A(2)(c) states that the IA shall promote and encourage the adoption of proper standards of conduct, and sound and prudent business practices by authorized insurers.

(b) ICP 19 stipulates that the conduct of the business of insurance should ensure that customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. ICP 19.0.1 further stipulates that the conduct of insurance business should help to strengthen public trust and consumer confidence in the insurance sector.

1.2 This Guideline applies to all authorized insurers underwriting long term business (other than Class C business).

2. Relevant Regulatory Documents

2.1 Where appropriate, this Guideline should be read in conjunction with other relevant codes/circulars/guidelines issued by the IA or other regulatory bodies, including the following[1]:

(a) Standard Illustration for Participating Policies issued by the Hong Kong Federation of Insurers ("HKFI")

(b) Standard Illustration for Universal Life (Non-linked) Policies issued by HKFI

(c) AGN 5 Principles of Life Insurance Policy Illustrations issued by the Actuarial Society of Hong Kong ("ASHK")

[1] The list is not exhaustive and may be subject to changes from time to time. Authorized insurers have the responsibility to ensure compliance with all the relevant requirements with due regard to their own circumstances.

(d) AGN on Best Estimate Assumptions issued by the ASHK

(e) Selling of Non-linked Long Term Insurance ("NLTI") Products issued by Hong Kong Monetary Authority

3. Purpose

3.1 Both IAIS and the global insurance industry have placed increasing emphasis on fair treatment of customers. ICP 19.2.4 stipulates that fair treatment of customers encompasses:

(a) developing and marketing products in a way that pays due regard to the interests of customers;

(b) providing customers with clear information before, during and after the point of sale;

(c) reducing the risk of sales which are not appropriate to customers' needs;

(d) ensuring that any advice given is of a high quality; and

(e) managing the reasonable expectations of customers.

3.2 This Guideline sets out the requirements for authorized insurers underwriting long term insurance business (other than Class C business). In assessing whether the requirements have been duly followed by authorized insurers, the IA will consider the substance and nature of the matters involved. The name or form of the arrangements adopted by individual authorized insurers would be irrelevant.

4. Duties of the Board, the Controller and the Appointed Actuary

4.1 It is the duty of the Controller, as specified under section 13A(12) of the Ordinance, to ensure that requirements set out in this Guideline and the relevant ICPs are observed throughout the life cycle of all long term (except Class C) insurance policies. It is also the duty of the Board to maintain general oversight over the implementation of measures in compliance with this Guideline and is ultimately responsible for ensuring fair treatment of customers.

4.2 It is a reasonable expectation for policyholders to expect to receive at least a fair proportion, if not all, of the non-guaranteed part of the illustrated

benefits. It is the duty of the Controller, the Appointed Actuary and the Board to ensure that such policyholders' reasonable expectation is met.

4.3 It is a continuing duty of the Appointed Actuary to advise the Board of his or her interpretation of policyholders' reasonable expectations. For instance, in the context of the provision of standard illustration, it is the duty of the Appointed Actuary to adopt reasonable assumptions, as well as to provide regular and up-to-date assessment of such assumptions to the Board for making suitable amendments. When a significant change of the underlying assumptions is likely to take place, the Appointed Actuary should take all reasonable steps to ensure that the Board appreciates the implications for the reasonable expectations of the policyholders.

4.4 Any attempt to circumvent the requirements prescribed in this Guideline would be regarded as acting in bad faith. In the case of Controllers, this may affect the "fit and proper" assessment under sections 8(2) and 13A(4) of the Ordinance. In the case of Appointed Actuaries, this may constitute non-compliance with professional standards under section 15C of the Ordinance, and may render the incumbent not acceptable to the IA under section 15(1)(b) of the Ordinance.

5. Product Design

5.1 ICP 19.2.4 stipulates that insurers should develop and market products with due regard to the interests of customers. During the product design stage, the insurer should carry out a diligent review to ensure that the product meets the "fair treatment of customers" principle, including:

(a) sustainability of the product;

(b) needs and affordability of the target customers;

(c) risks of the product; and

(d) distribution channels for the product.

5.2 When performing the diligent review mentioned above during the product design stage, authorized insurers are required to take a holistic view of all the relevant factors. For example, a product with complex features may not be suitable for distribution through the online channel, where advice to customer cannot be given during the sale process.

5.3 Authorized insurers are required to monitor the products after launch to ensure that they continue to meet the needs of the target customers, assess the performance of the various distribution channels with respect to sound commercial practices, and take the necessary remedial actions where appropriate.

5.4 In considering whether the design of a product meets the requirements of this Guideline and the "fair treatment of customers" principle, authorized insurers are required to look at all relevant factors in their totality, including the product features, insurance elements, added value/services to customers, fees/charges, surrender penalties (where applicable), remuneration structure etc.

5.5 Fees and charges (including charging basis, level of charges, applicable period etc.), where applicable, to be paid by the customers should be fair, commensurate with the insurance protection offered by the product concerned, and reflect the services/added value of the authorized insurer.

5.6 During product design, the determination of pricing assumptions should be based on the best estimate assumptions. For the guidance and considerations in setting best estimate assumptions, the Appointed Actuary should follow AGN on Best Estimate Assumptions issued by the ASHK.

6. Provision of Adequate and Clear Information

6.1 ICP 19.2.4 stipulates that insurers should provide customers with clear information before, during and after the point of sale.

6.2 ICP 19.3.4 stipulates that the product development and marketing process should include the use of adequate information on customer needs.

6.3 ICP 19.2.4 further stipulates that insurers should manage the reasonable expectations of customers.

6.4 ICP 19.5.1 stipulates that an insurer should take reasonable steps to ensure that a customer is given appropriate information about a policy in good

time and in a comprehensible form so that the customer can make an informed decision about the arrangements proposed.

6.5 Product information (e.g. product brochure, standard illustration) should be bilingual[2], clear and succinct, with the use of plain language and legible font size, and should be easily understandable by average customers. To facilitate understanding by customers, authorized insurers should avoid using technical or industry terminology.

6.6 Key product risks should be included in the product brochure and marketing materials and authorized insurers should communicate the relevant product risks to their potential customers. The risks are different for different products and it is the insurer's duty to identify the key product risks in the interest of customers, including the areas (where applicable) below:

(a) Key exclusion – The insurers should disclose key exclusion of the policy in the product brochure and marketing materials alongside description of policy coverage.

(b) Premium adjustment – If the insurer has the right to adjust the policy premium, it should disclose the factors leading to such adjustment and also the frequency and timing of adjustment. For insurance products with premium adjustment features within premium payment term, they cannot be labeled as "level premium".

(c) Premium term – The insurers should disclose the minimum premium term of the policy and the consequence of non-payment of premium within the premium term, including loss of coverage, surrender penalty, and financial loss incurred by the policyholder.

(d) Termination conditions – If the insurer has the right to terminate the policy before the maturity date, it should disclose the conditions of making such a decision.

(e) Market value adjustment – If the insurer has the right to apply market value adjustment on premium paid within cooling-off

[2] For the avoidance of doubt, the English and Chinese versions of the product documents can be separated, but BOTH must be available to the customers. Authorized insurers should ensure consistency between English and Chinese versions of all the product documents (including product brochure, standard illustration, policy contract, etc.).

period, the insurer should disclose the factors for the determination of such adjustment.

(f) Inflation risk – The insurers should alert customers, where appropriate, the adverse impact of inflation (i.e. where the actual rate of inflation is higher than expected, and the policyholder might receive less in real terms even if the insurer meets all of its contractual obligations).

6.7 For products with policy loan facility, authorized insurers should provide policyholders with information about the terms of the loan (including interest rate to be charged) before the loan is drawn down. For products with automatic policy loan facility, policyholders should be immediately notified that a loan has been first drawn down in accordance with the policy provisions and the interest rate being charged. Whenever there are changes to the policy loan interest rate, policyholder should be notified within a reasonable period before the new interest rate is effective. For ongoing disclosure, regular account statements to be sent to policyholders should contain information about the interest rate being charged, opening and ending loan balance as well as the interest amount charged in the period, with the relevant information highlighted to draw policyholders' attention.

6.8 For policies to be used as collateral assignment (e.g. for premium financing), authorized insurers should ensure that the policyholder fully understands the relevant risks and limitations (e.g. interest rate risk, rights that the assignee may exercise on the policy on behalf of the policyholder, risk of release of information to the assignee, etc.).

6.9 Authorized insurers have the sole responsibility of ensuring accuracy of the proposal vis-a-vis the policy provisions, with warning statements and other tools (e.g. FAQs) where appropriate to increase customers' awareness.

7. Suitability Assessment

7.1 ICP 19.6.2 specifies that insurers should seek the information from their customers that is appropriate for assessing their insurance needs, before giving advice or concluding a contract. This information may vary, but should at least include information on the customer's:

(a) knowledge and experience;

(b) needs, priorities and circumstances; and

(c) ability to afford the product.

7.2 Customers' needs should be properly assessed through the use of Financial Needs Analysis ("FNA") form where appropriate. Insurance policies should not be marketed to customers before their needs are properly analyzed.

7.3 Customers that have indicated their insurance needs should be presented with different insurance options that are available to meet their specific needs and financial circumstances.

7.4 For insurance products with long term contribution commitment or investment elements, suitability assessment should include assessing the premium payment horizon of the potential policyholder, with due regard to the financial circumstances, planned retirement age etc.

7.5 The suitability assessment should be carried out whenever there are relevant changes to the circumstances of the customer.

7.6 Authorized insurers have the duty to verify all available information and assess whether a particular product is suitable for their needs during the underwriting process.

7.7 Authorized insurers should endeavour to reduce the risk of sales that do not meet the needs of customers by:

(a) strengthening training to intermediaries;

(b) assessing the affordability and suitability of products for policyholders during the underwriting process based on available information; and

(c) providing tools for intermediaries to facilitate the recommendation of suitable products to customers.

8. Advice to Customers

8.1 ICP 19.1.1 stipulates that insurers and intermediaries should discharge their duties in a way that can reasonably be expected from a prudent person in a like position and under similar circumstances. Authorized insurers have the duty to put in place appropriate measures to ensure that their employees and agents are adequately trained to act with due skill, care and diligence.

8.2 ICP 19.6.1 further stipulates that where advice is given to a customer, such advice goes beyond the provision of product information and relates specifically to the provision of a recommendation on the appropriateness of a product to the disclosed needs of the customer.

8.3 After a customer has considered the insurance options, and is beginning to consider an insurance policy, he/she should also be properly apprised of all the product features, including the fees and charges (where applicable), surrender penalties (if any) as well as the product risks, key exclusions, 21-day cooling-off period etc.

8.4 The proper sales process flow is set out in the flowchart at the **Annex**. It involves completion of the FNA (if applicable), confirmation of needs, comparison of different insurance options (where FNA has been performed), and explanation of the key product features/exclusions.

9. Appropriate Remuneration Structure

9.1 Authorized insurers have the duty to ensure that the remuneration structure for their intermediaries do not create misaligned incentives for the intermediaries to engage in mis-selling, aggressive selling, fraudulent acts or money laundering activities. The insurers are therefore required to put in place an appropriate remuneration structure to address such risks.

9.2 Indemnity commission, or any standing arrangement that offers advance payment of commission, is strictly prohibited. Authorized insurers should only pay commission on an earned basis.

9.3 Cases of mis-selling, aggressive selling, fraud and money-laundering often surface after the expiry of the clawback period. To deter such activities, authorized insurers should put in place a clawback mechanism to fully recover all commission paid in proven fraud / money laundering / mis-selling cases.

10. Ongoing Monitoring

10.1 ICP 19.7 requires insurers and intermediaries to ensure that, where customers receive advice before concluding an insurance contract, any potential conflicts of interest are properly managed.

10.2 ICP 19.7.5 further stipulates that conflicts of interest may be managed in different ways as relevant to the circumstances, for example, through appropriate disclosure and informed consent from customers.

10.3 Authorized insurers should put in place a proper mechanism to monitor on an ongoing basis any such potential conflict of interests.

10.4 ICP 19.8 stipulates that insurers are required to:

(a) service a policy appropriately through to the point at which all obligations under the policy have been satisfied;

(b) disclose to the policyholder information on any contractual changes during the life of the contract; and

(c) disclose to the policyholder further relevant information depending on the type of insurance product.

10.5 On-going communication with policyholders should be maintained at least annually as an integral part of expectation management (e.g. projections for non-guaranteed benefits in anniversary statements).

10.6 Authorized insurers should also put in place a proper mechanism to monitor the products (e.g. complaints, design flaw etc.) after launch.

11. Post-sale Control

11.1 ICP 19.2 stipulates that insurers and intermediaries should establish and implement policies and procedures on fair treatment of customers. Authorized insurers should have proper control systems in place to achieve fair treatment of customers and monitor that such policies and procedures are adhered to.

11.2 For the protection of vulnerable customers[3], authorized insurers are required to make audio-recorded post-sale confirmation calls to all vulnerable customers procuring life insurance products (except term insurance) or products involving investment risks to ensure customers' understanding on the products and their associated risks. The post-sale confirmation calls are required to be conducted within 5 working days of the date of policy issue to reaffirm customers' understanding of the policy that they have procured, and that they are fully aware of their rights and obligations under the policy.

(a) The insurers should appoint a separate quality assurance team to make the post-sale calls.

(b) The insurers should use their best endeavours to make the post-sale calls, attempting different times of the day and different days of the week.

(c) The insurers are encouraged to adopt additional measures such as on-site recording at the service centre or immediate "dial-in" to or from the call centre for customers who are visitors or who may be difficult to reach.

(d) In the event of unsuccessful calls, a confirmation letter should be sent to the customers, alongside an email/SMS alert that draws the attention of the customers to the importance of the confirmation letter.

11.3 Authorized insurers should collect sufficient information of the policyholder for the purpose of identification of vulnerable customers.

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[3] A vulnerable customer is a person (i) over 65 years of age, (ii) whose education level is "primary level" or below, or (iii) who has no regular source of income.

11.4 Authorized insurers are required to put in place an effective mechanism to identify possible cases of intermediaries abetting customers to evade the control measures, such as having high rate of unsuccessful post-sale calls.

11.5 Authorized insurers should have in place proper documentation systems for quality control and future monitoring. Apart from the policy documents, records of the post-sale calls, confirmation letters and the email/SMS alerts, as well as control reports in respect of above measures, should also be kept properly.

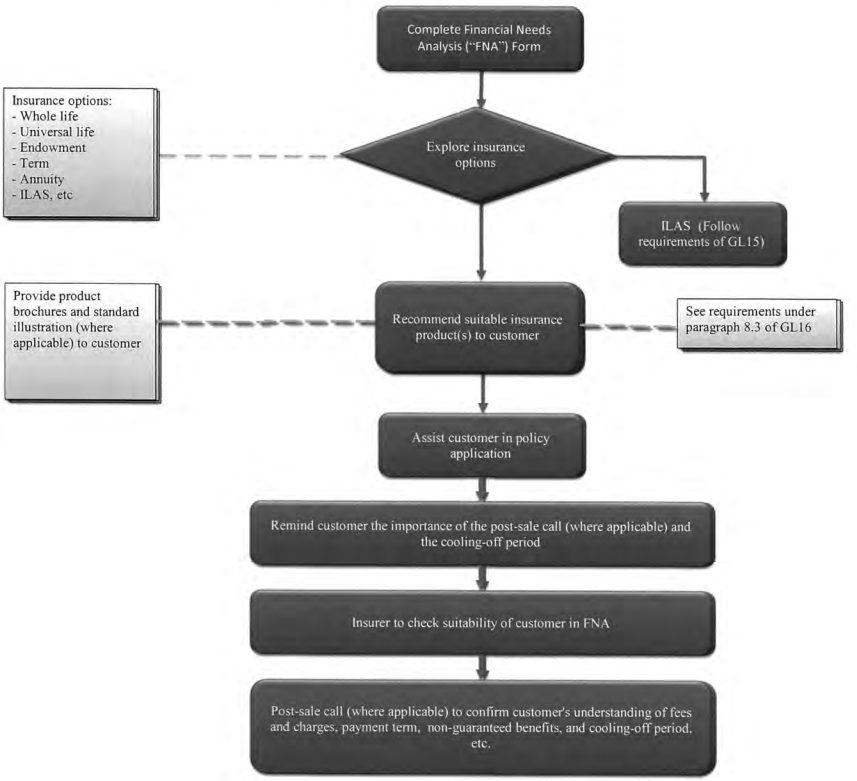
12. Commencement

12.1 This Guideline shall take effect from 26 June 2017.

June 2017

Annex

Selling Process of Non-linked Insurance Products



Appendix 1

Requirements Applicable to Participating Policies

1. Introduction

1.1 For the purpose of this Guideline, a participating (or with-profit) policy is a policy that pays non-guaranteed dividends or bonuses (including cash bonus and reversionary bonus) to the policyholder. Dividends/bonuses are generated from profits of the authorized insurer that sold the policy and are typically paid out on an annual basis over the life of the policy. Some policies also include final or terminal payments that are paid out to the policyholders upon maturity or termination of contract.

2. Governance of Participating Policy Business

2.1 To ensure appropriate governance of participating policies, an authorized insurer should have a corporate policy covering allocation of surplus/profits between shareholders and the participating pool, as well as declaration of policyholder dividends/bonuses and other discretionary benefits. This should be clearly documented, approved by the Board and made available to the Insurance Authority ("IA") on request.

2.2 As a minimum, the policy should cover:

(a) The overall philosophy in setting non-guaranteed policyholder benefits, including sharing surplus or experience, smoothing and guarantees.

(b) The approach to sharing surplus or experience, including the items to be shared and any quantifications for these.

(c) The charges for guarantees and/or capital if appropriate, including justifications and reasonableness etc.

(d) The investment strategy, including ongoing management of the asset mix.

(e) Maintenance of fairness between different products and generations.

(f) Smoothing of payouts should be explained and justified, including whether it is expected to be on average cost-neutral to the shareholder.

(g) How the assets are held and managed, including the segregation mechanism in case of pooling of funds for investment purpose.

(h) The principles and practices in determining the projected non-guaranteed benefits of standard illustration at point of sales and annual inforce illustration.

(i) Measures to manage potential conflict between its duty to policyholders and its duty to shareholders, particularly in relation to the declaration of dividends/bonuses for policyholders. The authorized insurer should provide information about the above measures either in the product brochure or in a separate leaflet to be provided to customers at the point of sale; or on its website (should also provide the relevant link to the website address in the product brochure). These may include:

(i) The profit sharing ratio between shareholders and participating fund;

(ii) Establishment of Dividend/Profit Sharing/With Profits Committee to provide independent advice on the management of participating business; or

(iii) Written declaration by the Chairman of the Board, an Independent Non-Executive Director and Appointed Actuary.

2.3 When designing products with non-guaranteed benefits, it is the Appointed Actuary's duty to ensure that there is a fair chance in achieving the non-guaranteed returns. It is thus essential for the Appointed Actuary to define the philosophy and assumptions for the determination of non-guaranteed benefits, as well as to advise the Board.

2.4 The Appointed Actuary should submit a report to the Board recommending policyholder dividends/bonuses and other non-guaranteed benefits annually and more frequently, if such is required. The authorized insurer's dividends/bonuses declaration mechanism will be subject to IA's regulatory review. The IA may require the authorized insurer to appoint an independent party to assess whether the policy has been applied completely, consistently and fairly. The report should also cover:

(a) Any changes to the policy since the last report, including an explanation of why this is consistent with policyholders' reasonable expectation.

(b) Explanation where decisions are contractual and related to policy documents or other customer communications, and where decisions are at the discretion of the authorized insurer, taking into account the issue of equity between shareholders and policyholders.

(c) Consistency in the dividends/bonuses declaration mechanism needs to be maintained for the product design stage and throughout the policy life.

2.5 The Appointed Actuary's report should be made available to the IA upon request.

2.6 The Board, on the advice of the Appointed Actuary, is ultimately responsible for interpretation of the policyholders' reasonable expectation, and deciding the dividends/bonuses declaration, taking into account the principle of fair treatment of customers, and the issue of equity between shareholders and policyholders.

3. Provision of Standard Illustration

3.1 The objective of a standard illustration is to provide a potential customer with the projected performance of a life insurance policy showing the total benefits with a breakdown for guaranteed and non-guaranteed benefits, which may reasonably be payable at each policy year should certain conditions be met. Hence, it is important for an authorized insurer to identify clearly what assumptions are made in producing the projected non-guaranteed benefits.

3.2 It is important for the potential customer to understand the projected benefits of the life insurance policy where he or she intends to purchase. The potential customer must sign the standard illustration to confirm his/her understanding (including understanding of the worst and extreme scenario where dividends/bonuses may be zero).

3.3 In the provision of standard illustrations, the authorized insurer must follow the guiding principles as laid out by the Actuarial Society of Hong Kong ("ASHK") in AGN 5 Principles of Life Insurance Policy Illustrations, namely:

(a) the standard illustration must not be misleading;

(b) where premiums and benefits are illustrated, the conditions upon which these are payable must be clearly set out;

(c) the use of such standard illustration in different distribution channels; and

(d) the standard illustration must be consistent with the regulatory requirements.

3.4 Additional high and low return scenarios must be provided in the standard illustration to show the variability of the ultimate results. A wider range of scenarios is expected for investment strategy with higher volatility.

3.5 The Appointed Actuary should have regard to Appendix A of AGN on Best Estimate Assumptions issued by the ASHK, which provides guidance and considerations for setting the standard illustration assumptions.

3.6 In the standard illustration, guaranteed and non-guaranteed dividends/bonuses should be separately presented with an explicit message that non-guaranteed dividends/bonuses may be zero.

3.7 The illustration should show the annual dividend (or reversionary bonus) and terminal dividend (or terminal bonus) separately. The policyholders need to understand the different implications on annual and terminal dividends/bonus if there are changes in, say, the assumptions (e.g. the terminal dividends/bonuses may be more volatile than annual dividends/bonuses).

4. Disclosure of Non-Guaranteed Benefits

4.1 In addition to the provision of standard illustration, an authorized insurer should adopt the following process in disclosing non-guaranteed benefits:

(a) Disclosure at the point of sale:

(i) Customers should be apprised of factors that will significantly affect the determination of policyholders' dividends/bonuses, including but not limited to the following factors:

(aa) Claims factors – The claims factors represent the experience of mortality and morbidity of the business.

(bb) Interest income factors – This may include not only interest earnings, but also outlook of interest rates, and the effects of capital gains and losses.

(cc) Market risk factors – Authorized insurers should disclose the types of market risk that would significantly affect the determination of dividends.

(dd) Expense factors – This may include direct expenses

which are specifically related to the group of policies, such as commission, underwriting and issue expenses and other maintenance expenses, such as premium collection expense. This may also include indirect expenses such as general overhead costs, which will be allocated to such group of policies.

(ee) Persistency factors – This includes policy lapse and partial surrender experience; and the corresponding impact on investments.

(ii) Non-guaranteed rate (e.g. dividend/bonus) philosophy should include investment policies and objectives and investment strategy, which will very likely result in the variation of investment returns against the long term expectation. In most circumstances, it is the key driver leading to volatility of non-guaranteed benefits.

(iii) The authorized insurer should highlight the investment strategy (e.g. target asset mix / geographical allocation / currency mix, use of derivative instruments and securities lending etc.) of the underlying investment in its product brochure. The asset classes (e.g. equities, bonds, deposits) and security concentration (e.g. US Treasury, corporate bonds, high yield bonds) should also be mentioned in the investment strategy. The additional information can help customers understand the risk and volatility of returns of the underlying assets and the non-guaranteed returns.

(iv) The authorized insurer should provide information on its philosophy in deciding dividends/bonuses in the product brochure (with updated information published on its website as well).

(v) The authorized insurer should disclose on its company website the non-guaranteed dividends/bonuses fulfillment ratios for each product series which has new policies recently issued. Customers should be informed the website address that shows these fulfillment ratios. It

is required to disclose at least the product type and fulfillment ratios for each product series. The fulfillment ratio is calculated as the average ratio of non-guaranteed dividends/bonuses actually declared against the illustrated amounts at the point of sale. Non-guaranteed benefits may vary from product type to product type. The authorized insurer should therefore disclose:

(aa) For dividend type traditional participating products – fulfillment ratios of the accumulated dividends (including accumulation interest and terminal/maturity dividend, if applicable).

(bb) For reversionary bonus type traditional participating products – fulfillment ratios of accumulated reversionary bonus and terminal bonus.

(vi) Customers must be alerted to the fact that dividend history is not an indicator of future performance of the participating products.

(b) Disclosure during policy life (process to ensure timely and accurate communication especially when changes to customer benefits are anticipated):

(i) Ongoing communication must be provided to policyholders at least on an annual basis on both actual non-guaranteed benefits declared for the year and a refreshed up-to-date inforce standard illustration reflecting the latest conditions and outlook. Such communication will help manage policyholders' reasonable expectation at least once a year and minimize the gap between the original standard illustration and the actual performance.

(ii) Monitor the non-guaranteed benefits regularly (at least annually) and check the sustainability of the non-guaranteed benefits based on the actual experience and investment outlook.

(iii) If there is any change to dividends/bonuses (or their philosophy), the authorized insurer should inform relevant policyholders of the change of dividend/bonus by writing separately or include the information in the annual statements with explicit reasons for the change.

(c) In illustrating premium offset option, the authorized insurer should follow the requirements below:

(i) Projection of the premium offset option based on different scenarios, especially the adverse situation (where the premiums are not offset due to a reduced dividend level), is required to be provided to the customer.

(ii) The illustration should not use the term "vanish" or "vanishing premium" or similar terminologies that suggest that the policy has been fully paid up, to describe a plan for using non-guaranteed elements to pay a portion of future premiums. The customer should be reminded that he/she has the obligation to pay premiums for the entire term. Otherwise, the benefit will be affected.

(iii) Clear disclosure should be made to ensure that the customers fully understand the risk involved, in particular under the scenario where the level of dividend is persistently low. In cases where future dividends are to be used to pay premiums for medical riders, the authorized insurer is required to alert customers the additional risk brought about by possible future medical cost inflation and/or reduced dividends. The authorized insurers should provide policyholders with regular update through annual statements.

(iv) If the product offers a range of premium payment terms, the authorized insurer should mention the shorter premium term options only as an alternative. Customers should be warned that the sustainability of premium offset depends on future dividend declaration, which is

not guaranteed. Policyholders may be obliged to resume future premiums, even if the premium offset option has been activated, in case declaration of policyholder dividends is lower than the illustrated scale. While policyholder dividends play an important part in determining the future premium offset point, customers should be reminded there are a number of other factors that should be taken into consideration. These factors include dividend withdrawals, change in dividend options and addition of optional benefits to the policy.

(d) For the withdrawal illustration option, disclosure should be made to ensure that the customers fully understand the risk involved. For example, illustrated withdrawal amounts, which depend on non-guaranteed dividends, might not be sustainable. If withdrawal or partial surrender is used, a warning message that withdrawal or partial surrender will affect future benefits should be in place.

Appendix 2

Requirements Applicable to Universal Life Policies

1. Introduction

1.1 For the purpose of this Guideline, a universal life policy is a type of life insurance with a savings element that may provide a cash value buildup. The cash value is credited with declared interest (i.e. at the declared crediting interest rate), and debited by cost of insurance charges, as well as any other policy charges and fees. The declared interest rate will vary from time to time and will be subject to a minimum if the product offers a guaranteed interest rate. It provides flexibility to policyholders in respect of premium payment and withdrawal from policy accounts (with applicable fees and charges). The death benefit, savings element and premiums can be reviewed and altered as policyholders' circumstances change.

2. Governance of Universal Life Policy Business

2.1 To ensure appropriate governance of universal life policies, authorized insurers should have internal policies covering the mechanism to determine the crediting interest rate, cost of insurance charge, other policy fees and charges, as well as other discretionary benefits. This should be clearly documented, approved by the Board and made available to the Insurance Authority upon request.

2.2 Authorized insurers should follow paragraphs 2.2 to 2.6 of the Appendix 1 for the purpose of this section.

3. Provision of Standard Illustration

3.1 Authorized insurers should follow paragraphs 3.1 to 3.3 of Appendix 1 for the purpose of this section.

3.2 Projections of policy benefits should be provided on at least two bases: (a) guaranteed or conservative basis; and (b) current assumed basis.

3.3 If a policy provides a minimum guaranteed interest rate and maximum policy charges, one of the projections has to be prepared based on such

guaranteed interest rate and maximum policy charges. The projection could be labeled as guaranteed basis. Otherwise, projected crediting interest rate at 0% p.a. (if minimum guaranteed interest rate is not available) or current charges (if maximum charges are not available) should be used, and this projection can only be labeled as conservative basis. The other projection has to be prepared based on a set of best estimate assumptions whereby current best estimate crediting interest rate and current charges are to be used for this purpose. Policyholders should be alerted with an explicit message that the crediting interest rate may be zero (or the minimum guaranteed interest rate where applicable).

3.4 It is optional for authorized insurers to provide additional high and low return scenarios in the standard illustration to show the variability of projected benefits provided that the projections are not misleading. The optional standard illustration is only applicable for products having substantial variable investment exposure.

3.5 The Appointed Actuary should have regard to Appendix A of AGN on Best Estimate Assumptions issued by the Actuarial Society of Hong Kong, which provides guidance and considerations on setting the standard illustration assumptions.

3.6 In the standard illustration, all fees and charges (current and maximum scales, if applicable) should be shown clearly, with an explicit message that the current fees and charges could be subject to change (if applicable).

4. Disclosure of Non-Guaranteed Benefits

4.1 Authorized insurers should follow paragraphs 4.1(a) and 4.1(b) of Appendix 1 for disclosure of non-guaranteed benefits where applicable for universal life policies, with the exception of paragraph 4.1(a)(v). For example, terminology may be modified from "dividend/bonus" to "crediting interest rate".

4.2 The authorized insurer should disclose on its company website the historical crediting interest rates for each product series which has new policies recently issued. Customers should be informed the website address that shows these historical crediting interest rates. It is required to disclose at least the historical crediting interest rates for each product series.

4.3 In addition, key risks applicable to universal life policies (including fees and charges, lapsation risk due to zero account value etc.), and different types of crediting interest rates for different cohort of universal life product (if applicable), etc. should be disclosed.

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ON
REINSURANCE

Insurance Authority

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1. Introduction

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("the Ordinance") with reference to the requirements set out in the Insurance Core Principles, Standards, Guidance and Assessment Methodology ("ICP") promulgated by the International Association of Insurance Supervisors. It sets out prudent practices pertinent to reinsurance management and the general guiding principles of the Insurance Authority ("IA") in assessing the adequacy of the reinsurance arrangements of an insurer. Specific references are:

(a) Section 8(3)(c) of the Ordinance requires an insurer to have adequate reinsurance arrangements in respect of its insurance business unless it is justified otherwise.

(b) ICP 13 stipulates that the supervisor should set standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programmes.

1.2 It is incumbent upon an insurer to adopt a prudent approach in arranging reinsurance cover for its insurance business. Inadequacy in the arrangement of reinsurance may jeopardize the financial position of an insurer and affect its ability to meet the obligations to policy holders. The IA may from time to time provide guidance to insurers on prudent reinsurance practices through the issue of guidelines and circular letters. An authorized insurer is obliged to follow any applicable guidance so provided. For the avoidance of doubt, the insurer should also follow the "Guideline on Reinsurance with Related Companies" ("GL12") in respect of any reinsurance effected with related reinsurers.

2. Interpretation

2.1 In this Guideline, unless the context otherwise specifies:

(a) "authorized insurer" means an insurer authorized under the Ordinance.

(b) "governing body" of an insurer refers to the Board of Directors ("Board") of that insurer or a reinsurance committee or any senior officer properly delegated by the Board.

(c) "Hong Kong insurance business" and "Hong Kong long term insurance business" have the same meaning as in paragraph 1(1) of Schedule 3 to the Ordinance.

(d) "professional reinsurer" means an insurer whose authorizations under the Ordinance are restricted to reinsurance business only.

(e) "reinsurance" includes reinsurance and retrocession, whether on treaty basis or facultative basis.

(f) "reinsurance recoverable" includes the reinsurer's share of unearned premium reserve, the reinsurer's share of mathematical reserve for long term business and the reinsurer's share of claims and claims reserves, together with other amounts due from the reinsurer in respect of reinsurance contracts.

(g) "reinsurer" means a company accepting reinsurance cessions or retrocessions.

(h) "related reinsurer" means one within the same grouping of companies, as defined in section 2(7)(b) and (c) of the Ordinance, to which the insurer belongs.

3. Scope of Application

3.1 This Guideline applies to the reinsurance arranged by:

(a) an authorized insurer incorporated in Hong Kong; or

(b) an authorized insurer incorporated outside Hong Kong pertaining to its Hong Kong insurance business or Hong Kong long term insurance business[1].

[1] The definitions of the "Hong Kong insurance business" or "Hong Kong long term insurance business" are set out in the respective interpretations in paragraph 2.1.

4. Reinsurance Management Framework

4.1 Reinsurance management framework relates to the rules and practices put in place to manage the selection, implementation, monitoring, control, review and documentation of reinsurance arrangements. A sound reinsurance management framework should include a documented reinsurance management strategy and proper systems and controls for implementation of the strategy.

Reinsurance Management Strategy

4.2 An authorized insurer should formulate a written reinsurance management strategy that is appropriate to the company's overall risk profile and financial condition. For an authorized insurer incorporated in Hong Kong, the reinsurance management strategy should be approved by its Board or the reinsurance committee designated by the Board. For an authorized insurer incorporated outside Hong Kong, the reinsurance management strategy should be approved by the governing body. In case that a non-Hong Kong incorporated insurer chooses to have its strategy approved by any senior officer delegated by the Board, the strategy should still be reviewed at least annually by the Board or the designated reinsurance committee. The reinsurance management strategy should form part of the insurer's overall underwriting and risk management strategies. The Board or the designated reinsurance committee should review the reinsurance management strategy at least annually and when there are material changes to the insurer's circumstances, its underwriting and risk management strategies or the credentials of its major reinsurers.

4.3 The insurer should define and document in the reinsurance management strategy all aspects for reinsurance management, including but not limited to:

(a) setting out the objectives of and key factors in formulating the strategy for reinsurance management;

(b) identifying the parties involved and their roles and responsibilities in relation to the reinsurance management framework (e.g. for approving, monitoring and reviewing the reinsurance management strategy and managing reinsurance arrangements); specifying how those responsibilities may be delegated and details of any authority

limit;

(c) describing the process for setting, monitoring and reviewing its risk tolerance level, including the key factors considered (e.g. business strategy, financial strength and cost of reinsurance);

(d) describing the process for determining the most appropriate types of reinsurance arrangements and the risk retention levels to manage the insurer's risk exposure with regard to its risk tolerance level (e.g. assessment on the adequacy of the limit covering maximum exposure vis-à-vis an accumulation of several claims and the need for clash cover for employees' compensation / motor insurance business; or assessment on the need to acquire catastrophe cover to provide specific reinsurance cover against accumulation of employees' compensation claims arising from outbreak of infectious disease (i.e. buy-back arrangement) etc.);

(e) without prejudice to paragraph 4.7, describing the process for selecting and ongoing monitoring of reinsurers, including the criteria for evaluating the creditworthiness and diversification of reinsurers and assessing the need for reinsurance deposits and collateral;

(f) describing the process for identification and monitoring of credit risk exposure to reinsurance counterparties;

(g) describing the process for identification and monitoring of liquidity risks to cover any timing mismatch between payment of claims and receipt of reinsurance recoverables;

(h) describing the process for identification and monitoring of aggregation of risks (e.g. relating to a particular industry or geographical region) for relevant insurance business (e.g. property and casualty);

(i) describing the process and control for managing reinsurance arrangements (e.g. reinsurance placement, reinsurance recovery collection and audit examination);

(j) describing the involvement of reinsurance brokers, if any, in the

procurement of reinsurance and the selection criteria of the brokers;

(k) describing the process for ensuring accurate and proper documentation of reinsurance arrangements; and

(l) describing the criteria and process for the use of facultative reinsurance, which should be secured before the insurer accepts a risk that exceeds its capacity and/or risk appetite.

Systems and Controls

4.4 The governing body of an authorized insurer is responsible for establishing appropriate systems and controls to ensure that the reinsurance management strategy is being delivered and complied with by the insurer's management. The systems and controls should be subject to regular audit examination.

4.5 The governing body's monitoring of compliance with the reinsurance management strategy should include approval of the reinsurance program. Deviations from the strategy should be approved by the governing body. The performance of the reinsurance program should be subject to regular reviews to ensure that it functions as intended and continues to meet its strategic objectives.

4.6 Underwriting control system should be put in place to ensure that all underwriting is carried out in accordance with the company policy and that the planned reinsurance cover is in place. The system should be able to identify and report on a timely basis where underwriters infringe authorized limits, breach company guidelines or otherwise assume risks exceeding the ability of the company's capital base and reinsurance covers.

4.7 There should be proper due diligence measures for selecting participating reinsurers during reinsurance placement and on an ongoing basis. The selection process should take into account factors such as the reputation, financial soundness, expertise and counterparty risks of reinsurers. The insurer should have its own methodologies of assessment for counterparty risks of reinsurers and due diligence on the reinsurers. Such assessment should not solely rely on the ratings of external credit rating agencies. The insurer should maintain a list of reinsurers that have been approved for reinsurance placements

and set the procedures for dealing with situations where there is a need to assess reinsurers outside the approved list. It should set prudent limits or guidelines reflecting security of the approved reinsurer, in relation to its maximum aggregate exposure to any one reinsurer or to a group of reinsurers. It should also put in place procedures for monitoring this aggregate exposure to ensure that these limits or guidelines are not breached; including procedures to ensure that excess concentrations are brought back within limits or guidelines, or otherwise managed, going forward. The insurer should also consider requesting for collateral from reinsurers as a means for security.

4.8 Appropriate procedures should be put in place to ensure the timely finalization of reinsurance contracts. Reinsurance contract documentation should be written in clear contract language and preferably a reinsurance agreement (or pending the finalization of the terms of a reinsurance agreement, i.e. a reinsurance cover slip or other similar documentation) be finalized prior to the inception of coverage.

4.9 The insurer should have in place processes to ensure that all reporting due to and from reinsurers is timely and complete and that settlements are made as required by the contract. There should be proper credit control procedures to ensure prompt collection of reinsurance recoverables from the reinsurance counterparties. The insurer should also have appropriate measures to manage its liquidity risk including funding requirements in reasonably adverse circumstances.

4.10 The reporting system of the insurer should be able to ensure timely and effective communication of information for identifying potential discrepancies to the reinsurance management strategy. Specifically, the insurance information system should be reliable and capable of producing updated and essential information to facilitate the management of reinsurance arrangements.

5. Adequacy of Reinsurance Arrangements

5.1 Under the Ordinance, the IA is charged with the principal function of regulating and supervising the insurance industry for the promotion of the general stability of the insurance industry and for the protection of the interests of existing and potential policy holders. For the purpose of ensuring the financial

soundness of an authorized insurer, the IA must be satisfied, among other things, that adequate arrangements are in force, or will be made, for reinsurance of risks of each and all classes of the insurance business underwritten by the insurer.

5.2 In considering the adequacy of an authorized insurer's reinsurance arrangements, the IA will generally take into account, among other things, the following factors:

(a) reinsurance management framework of the insurer;

(b) type of reinsurance arrangements;

(c) maximum retention of the insurer;

(d) spread of risks among reinsurers; and

(e) security of reinsurers.

5.3 Authorized insurers should also consider conducting stress testing under different stressed scenarios regularly (e.g. systemic or market risk environment) for material reinsurance arrangements to ensure the reinsurance cover is adequate in adverse situations.

Reinsurance Management Framework of an Authorized Insurer

5.4 The Board or the designated reinsurance committee of an authorized insurer should establish a reinsurance management framework to steer the company in effecting a reinsurance program that adequately addresses its risk profile and financial condition. In assessing the adequacy of the reinsurance arrangements of an authorized insurer, the IA will consider whether the insurer has put in place a sound reinsurance management framework with regard to the components set out in section 4 above.

Type of Reinsurance Arrangements

5.5 An authorized insurer should clearly understand the nature and scope of its underwritten risks and pay due regard to its risk tolerance level in order to look for suitable type of reinsurance protection.

5.6 In entering into a reinsurance contract, the insurer should ensure that the terms and conditions of the contract are compatible with the size and profile of the risks of the underlying business. It should also have clear understanding on the content of the contract, particularly the class of business covered, the type of loss to which the contract applies and the way in which the amount recoverable from reinsurers is calculated.

Maximum Retention of an Authorized Insurer

5.7 An authorized insurer should exercise due diligence in setting the maximum retention levels. The retention strategy should take into account not only single risk claims but also multi-risk events (e.g. the occurrence of catastrophic or disastrous events). The insurer should also be mindful of possible gaps in the reinsurance program which may cause undue exposure. The insurer should set its own retention levels having regard to its risk profile, risk tolerance, business strategy, capital levels and other factors relevant to its risk assessment.

Spread of Risks among Reinsurers

5.8 An authorized insurer should have control in place to ensure that reinsurance is properly spread among reinsurers to minimize the risks of over-concentration on a small number of reinsurers. It should also set prudent limits in relation to its maximum aggregate exposure to any one reinsurer or to a group of reinsurers having regard to the nature, size and security of the relevant reinsurers.

Security of Reinsurers

5.9 In determining the adequacy of the reinsurance arrangements made by an authorized insurer, the IA will have regard to the security of the reinsurer or other security provided by the reinsurer. The IA will be satisfied that such security is adequate if the reinsurer satisfies the following criteria:

(a) It is an authorized insurer or Lloyd's; or

(b) It has strong financial strength and is under the supervision of a robust insurance supervisory authority. In this respect, the insurer should demonstrate to the satisfaction of the IA that they have

evaluated the financial strength of the reinsurer by going through the due diligence process as mentioned in paragraph 4.7.

5.10 Where the security is provided by a related reinsurer, the related reinsurer should additionally satisfy the criteria as set out in paragraph 4.1 of the GL12.

6. Alternative Risk Transfer

6.1 Apart from traditional reinsurance, an authorized insurer may migrate its insurance risks by using alternative risk transfer ("ART") arrangements. The IA expects that an authorized insurer should put in place a robust framework in managing and monitoring the ART arrangements, which is comparable to the reinsurance management framework set out in section 4 above. The insurer should ensure that its ART management framework is adequate and proportionate to the nature of the underlying risks and to the complexity of the ART arrangements.

6.2 Risk transfer to the capital market might entail the creation of an Special Purpose Entity (also known as Special Purpose Vehicle etc.) ("SPE") which is specifically constituted to carry out the transfer of risk. A key element of any SPE structure is the transfer of insurance risk to a "fully funded", "bankruptcy-remote" vehicle whereby the claims of any investors are subordinated to the cedant and whereby the investors have no recourse to the cedant in the event of an economic loss to the vehicle. In such case, the insurer should ensure that the SPE has sound investment and strategies on its underlying risks. The insurer should also put in place adequate systems and controls on the SPE, in addition to those required for a traditional reinsurer, to ensure that:

(a) investment restrictions are not breached;

(b) interest payments, dividends, expenses and taxes are properly accounted for;

(c) movements above established thresholds in assets and collateral accounts are properly reported;

(d) assets are legally existent and technically identifiable; and

(e) liabilities can be determined on a timely and accurate basis and obligations satisfied in accordance with the underlying contracts.

6.3 In considering if an SPE structure meets the "fully-funded" criterion, the IA will take into account the following:

(a) ownership structure of the SPE;

(b) investment and liquidity strategy of the SPE;

(c) the SPE's strategy in relation to credit, market, underwriting and operational risks;

(d) the ranking and priority of payments (e.g. waterfall);

(e) the extent to which the cash flows in the SPE structure have been stress tested;

(f) the arrangements for holding the SPE's assets (e.g. trust accounts) and the legal ownership of the assets;

(g) the extent to which the SPE's assets are diversified; and

(h) use of derivatives, especially for purposes other than risk reduction and efficient portfolio management.

6.4 To ensure that an SPE structure meets the "bankruptcy remote" criterion, the insurer should obtain an appropriate legal opinion as to the bankruptcy remoteness. There should also be a full disclosure of the bankruptcy remoteness of the SPE in any prospectus, offering circular or private placement memorandum.

6.5 Except for a professional reinsurer, an authorized insurer should seek the written approval from the IA before effecting an insurance risk transfer to the capital market through an SPE. The IA may give approval subject to any condition as it considers appropriate.

6.6 The insurer should provide to the IA in relation to the proposed SPE arrangement for approval:

(a) an outline of the proposed SPE structure which should include,

among others, the "fully-funded" features as mentioned in paragraph 6.3;

(b) a copy of the legal opinion on the bankruptcy remoteness as mentioned in paragraph 6.4;

(c) whether there is any event or circumstance whereby the insurer will remain exposed to primary insurance losses without having recourse to the SPE;

(d) extent to which key parties have been fully disclosed (e.g. sponsor, insured, reinsured, investors, advisors, counterparties, etc.) and are known to the IA;

(e) extent to which potential conflicts of interest between all parties to the SPE have been adequately disclosed and addressed (such as situations where sponsors also take a managing role);

(f) degree of basis risk that is assumed by the sponsor and to what extent this could have immediate ramifications for the sponsor's financial position in case of a loss;

(g) details of the SPE's management arrangements and key personnel;

(h) third party assessments of the SPE structure (e.g. by external agencies);

(i) expertise of the legal advisors involved;

(j) robustness of any financial or actuarial projections, if applicable (e.g. if triggers are indemnity based);

(k) disclosure of outsourcing agreements; and

(l) credit risk associated with key service providers, including financial guarantors used to protect the position of investors.

6.7 For ongoing monitoring of those SPE arrangements which have been approved by the IA, the insurer should report to the IA, at least annually, the level of capital and the ability of the SPE to continue responding adequately should covered events occur. This should cover the SPE's courses of action in the event of fluctuations in the value of invested assets vis-à-vis mismatch between collateral account and exposure.

6.8 For those SPE arrangements which have been approved by the IA, in the case when there is a dismantling arrangement on the SPE, the insurer should report to the IA about the arrangement, which should include:

(a) the process related to the generation, mitigation and management of any residual risk emerging from the dismantling of the SPE;

(b) the process on the share buy-back and disposal of the investment portfolio, if any; and

(c) any residual risks that will revert to the sponsor/insurer on termination of the arrangement.

7. Arrangement with Insignificant Risk Transfer

7.1 Except for a professional reinsurer, an authorized insurer should seek the written approval from the IA before entering into a new arrangement with insignificant risk transfer or varying an approved arrangement with insignificant risk transfer to a material extent. The IA may grant approval subject to any condition as it considers appropriate.

7.2 While such arrangement may be used to strengthen the insurer's solvency position (e.g. where there is a genuine transfer of risks), there are circumstances where it can distort or disguise the true financial position of the insurer that may ultimately pose risks to policy holders.

7.3 In applying approval from the IA for a new arrangement with insignificant risk transfer, the insurer should make full and frank disclosure of all material information to the IA, including specified particulars of the arrangement. In applying approval from the IA for a proposed material change to an approved arrangement with insignificant risk transfer, the insurer should make full and frank disclosure of all material information including the purpose and details of the proposed change and specified particulars of the arrangement as if the change had been effected ("varied arrangement"). The specified particulars are:

(a) the purpose of the arrangement;

(b) main features of the arrangement, including such details as necessary to facilitate proper understanding of the nature of the cover;

(c) a description of the risks covered;

(d) details on retention level and cover limit;

(e) effective period of the contract;

(f) the name of the proposed reinsurer and the credit assessment of the proposed reinsurer carried out by the insurer;

(g) draft contract wording and any other documentation or information

relevant to the arrangement (including a written description of any verbal understandings, side agreements or undertakings that are material to the operations of the arrangement);

(h) the extent of insurance risks transferred;

(i) details of the proposed accounting treatment and whether the proposed arrangement can be booked following reinsurance accounting requirements, confirmed by the appointed auditor, and the manner in which the arrangement will be disclosed (e.g. in the reinsurance summary in the Directors' Report); and

(j) confirmation by the insurer's appointed actuary on the extent of insurance risks transferred in the proposed arrangement, and details of the effect of the proposed arrangement on the financial and solvency position of the insurer over the period of the arrangement (before and after the arrangement, under base and stressed scenarios).

The IA has the right to ask for further information where it considers it necessary in order to assess the potential impact of the new or varied arrangement with insignificant risk transfer.

7.4 The IA, in assessing the application for approval, will take into account all relevant factors, including but not limited to:

(a) whether the new or varied arrangement has a legitimate purpose and effect;

(b) the extent of insurance risks transferred between the insurer and the reinsurer;

(c) whether the new or varied arrangement is likely to disguise, or is designed to disguise the profitability, solvency or capital position of the insurer;

(d) whether the insurer is able to demonstrate to the IA's satisfaction on the credentials of the reinsurer and the adequacy of the security provided by it under the new or varied arrangement;

(e) whether the new or varied arrangement is likely to adversely affect the interests of policy holders; or

(f) whether the new or varied arrangement provides any substantial cash

transaction.

7.5 In considering whether an arrangement involves a significant transfer of insurance risks, the insurer should take into account, amongst other things, the following factors:

(a) the nature of risk (e.g. mortality risk, morbidity risk, underwriting risk and timing risk) to be transferred;

(b) whether the transfer is considered significant in the context of the commercial substance of the contract and with reference to the range of practical outcomes that could reasonably be expected to occur; and

(c) whether assessment on the transfer of insurance risks has been made prospectively at the time the contract is entered into.

7.6 Any arrangement with insignificant risk transfer that has been approved by the IA should be accounted for as a reinsurance arrangement in the revenue and profit and loss accounts. Otherwise, it should be treated as a financing arrangement and is to be excluded from the revenue and profit and loss accounts / other comprehensive income statement.

8. Reinsurance Reporting

8.1 The Directors' Report as required under Part 2 of Schedule 3 to the Ordinance should contain a summary of the material reinsurance arrangements effected by an authorized insurer. If the insurer has any reinsurance arrangement that has been approved by the IA and effected during the accounting period, it should also include information relating to such arrangement in the summary.

8.2 In addition, an authorized insurer should submit to the IA any supplementary information as required by the IA from time to time to enable it to monitor the insurer's reinsurance and ART arrangements effectively.

8.3 In case an authorized insurer identifies that a problem is likely to arise out of its reinsurance or ART arrangements that may materially and adversely affect its solvency position or its capacity to meet any regulatory obligations, it should notify the IA forthwith and take appropriate actions to address the problem promptly.

9. Commencement

9.1 This Guideline should apply to the reinsurance, ART arrangement and arrangement with insignificant risk transfer, including any renewals, of an authorized insurer with effect from 26 June 2017.

9.2 Where an authorized insurer has any existing ART arrangement or arrangement with insignificant risk transfer, it should immediately notify the IA of such arrangement.

June 2017

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GUIDELINE ON EXERCISING POWER TO IMPOSE PECUNIARY PENALTY IN RESPECT OF AUTHORIZED INSURERS UNDER THE INSURANCE ORDINANCE (CAP. 41)

Insurance Authority

Contents

1. Introduction

1.1 This Guideline is made pursuant to section 41R of the Insurance Ordinance (Cap. 41) ("the Ordinance"). Under section 41P of the Ordinance, the Insurance Authority ("the IA") may exercise disciplinary powers in respect of an authorized insurer if the insurer is or was guilty of misconduct, or when a person is or was, in the opinion of the IA, not fit and proper to hold the position of a director or controller of the insurer.

1.2 Pursuant to section 41P of the Ordinance, the IA may exercise, amongst other powers, the power to order under section 41P(2)(e) for payment of pecuniary penalty by an authorized insurer.

1.3 Under section 41R, in exercising the power to impose pecuniary penalty under section 41P of the Ordinance, the IA shall have regard to this Guideline which indicates the way in which it proposes to exercise that power.

2. Scope of Application

2.1 This Guideline applies to the following:

(a) an insurer authorized under the Ordinance;
(b) Lloyd's;
(c) a member of Lloyd's who carries on insurance business in Hong Kong; and
(d) the members of Lloyd's taken together who carry on insurance business in Hong Kong.

2.2 In this Guideline, unless the context otherwise specifies, a reference to an authorized insurer is a reference to those under sub-paragraphs 2.1(a) to (d) and a reference to a controller includes a reference to the authorized representative appointed by Lloyd's under section 50B of the Ordinance.

3. Considerations in Exercising IA's Power to Impose Pecuniary Penalty

3.1 The principal purposes of imposing a pecuniary penalty are:

(a) to promote and encourage the adoption of proper standards of conduct and sound and prudent business practices by authorized insurers so as to protect policy holders, potential policy holders and the public interest by deterring authorized insurers which have engaged in misconduct from engaging in further misconduct, and to help deter other authorized insurers from engaging in similar misconduct;

(b) to deter authorized insurers from engaging a person who is not fit and proper to hold the position of director or controller of authorized insurers;

(c) to sanction authorized insurers which engaged a person who was not fit and proper to hold the position of director or controller of the authorized insurers; and

(d) to ensure that an authorized insurer guilty of misconduct should not benefit from the misconduct.

3.2 The IA regards a pecuniary penalty as a more severe sanction than a reprimand. The IA will not impose a pecuniary penalty if the circumstances of a particular case only warrant a reprimand and the deterrence may be effectively achieved by issuing a reprimand.

3.3 A pecuniary penalty should be effective, proportionate and fair. The more serious the conduct, the greater the likelihood that the IA will impose a pecuniary penalty and that the amount of the penalty will be higher. When considering whether to impose a pecuniary penalty and the amount of the penalty, the IA will consider all the circumstances of the particular case, including relevant factors listed below. These factors are not exhaustive and not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.

(a) The nature, seriousness and impact of the conduct, including:

(i) nature of the conduct (e.g. whether it was intentional, reckless,

fraudulent, negligent or technical breach);

(ii) impact of the conduct on the interests of policy holders, potential policy holders or the public interest;

(iii) costs imposed on and loss or risk of loss caused to policy holders and/or potential policy holders;

(iv) duration and frequency of the conduct;

(v) the amount of profits gained or loss avoided;

(vi) whether the conduct is potentially damaging or detrimental to the integrity and stability of the insurance industry, and/or the reputation of Hong Kong as an international financial centre;

(vii) whether there are a number of smaller issues, which individually may not justify a disciplinary action, but which do so when taken collectively;

(viii) whether the conduct is or was part of a more serious misconduct;

(ix) whether the conduct was engaged in by the authorized insurer alone or as a group and in the latter case, the insurer's role in that group;

(x) the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the conduct;

(xi) the level of senior management involved and the extent of their involvement;

(xii) whether there is a breach of fiduciary duty; and

(xiii) revealing of serious / systemic weaknesses of management systems or internal control failures.

(b) *The behaviour of the authorized insurer since the conduct was identified, including:*

(i) manner of reporting the conduct by the authorized insurer (e.g. whether the insurer takes a proactive approach and has timely and comprehensively reported the conduct to the IA or another relevant regulatory authority);

(ii) whether the authorized insurer attempted to conceal the conduct;

(iii) the degree of co-operation with the IA and other authorities;

(iv) remedial steps taken since the identification of the conduct; and

(v) the likelihood that the authorized insurer will engage in the same type of conduct in the future.

(c) *The previous disciplinary record and compliance history of the*

authorized insurer, including:

(i) previous disciplinary record and compliance history of the authorized insurer; and

(ii) whether the authorized insurer has previously undertaken not to engage in a particular conduct.

(d) Other relevant factors

(i) guidelines issued by the IA – generally, the IA will not take disciplinary action against an authorized insurer for conduct that it considers to be in line with any guideline that was current at the time of the conduct in question;

(ii) the IA's action or decision in previous similar cases;

(iii) financial jeopardy – generally, a pecuniary penalty should not have the likely effect of putting the authorized insurer concerned in financial jeopardy so that the interests of policy holders, potential policy holders or the public interest may be adversely affected;

(iv) actions taken by other domestic or overseas regulatory authorities in respect of the conduct in question; and

(v) result or likely result of any civil action taken or likely to be taken against the authorized insurer in respect of the conduct in question.

4. Commencement

4.1 This Guideline shall take effect from 26 June 2017.

June 2017

GUIDELINE ON
MINIMUM REQUIREMENTS
FOR INSURANCE BROKERS

Insurance Authority

Contents

Exhibits

1. Introduction

This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("Ordinance") to specify the minimum requirements that an insurance broker should comply with for the purpose of section 69(2) and section 70(2) of the Ordinance.

Under the Ordinance, an insurance broker means a person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policy holder or potential policy holder or advising on matters related to insurance.

In the above context, a contract of insurance is a contract which contains an element of insurance. Henceforth, any person acting as the agent of the policy holder or potential policy holder in advising on or arranging any contract which contains an element of insurance, irrespective of the extent of such insurance element, is deemed to carry on insurance broking business and is required either to obtain authorization from the Insurance Authority ("IA") under section 69 of the Ordinance or become a member of a body of insurance brokers approved by the IA under section 70 of the Ordinance.

The IA, before authorizing an insurance broker under section 69, is required to satisfy itself that the applicant insurance broker complies at least with the specified minimum requirements. Similarly, the IA, before approving a body of insurance brokers under section 70, is required to satisfy itself that the applicant body has adequate provisions in its regulation for members of the body to comply with the specified minimum requirements. The minimum requirements specified by the IA are for:

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

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

Pursuant to the above, this Guideline is drawn up to give guidance to insurance brokers or bodies of insurance brokers for compliance with the Ordinance and, in particular, the minimum requirements as specified by the IA. Failure to comply with this Guideline may result in a person or

body of insurance brokers not being authorized or approved or having his/its authorization/approval withdrawn, as the case may be.

This Guideline is kept under regular review in the light of market developments to ensure that the interests of policy holders and potential policy holders are adequately protected.

Insurance brokers should also be aware that other legislation may affect their business activities, in particular the Securities and Futures Ordinance (Cap. 571) ("SFO"). In certain cases, an insurance product will constitute a collective investment scheme under the SFO, it must therefore be authorized by the Securities and Futures Commission before it can be offered to the public in Hong Kong.

Words and expressions used in this Guideline shall have the same meaning as are ascribed to them in the Ordinance.

For the purpose of this Guideline:

(a) Chief Executive ("C.E.") in relation to

(i) an insurance broker means a person who, alone or jointly with others, is responsible for the conduct of the insurance broking business of such insurance broker, not being a person who:

(1) is also responsible for the conduct of other business; and

(2) has a subordinate responsible for the whole of the insurance broking business; or

(ii) an insurance broker formed outside Hong Kong means a person who, alone or jointly with others, is responsible for the conduct of the whole of the insurance broking business of such insurance broker carried on within Hong Kong, not being a person who:

(1) is also responsible for the conduct of insurance broking business carried on by the insurance broker elsewhere; and

(2) has a subordinate responsible for the whole of the insurance broking business carried on by the insurance broker within Hong Kong.

(b) "Line of Insurance Business" means:

(i) General Business;
(ii) Long Term (excluding Linked Long Term) Business; and/or
(iii) Long Term (including Linked Long Term) Business

as defined in the Ordinance.

(c) "Policy Replacement" means a transaction involving the purchase of long term insurance if within 12 months before or after a new long term insurance policy[1] is effected:

(i) an existing long term insurance policy[1] or a substantial part[2] of the sum insured of its basic life coverage:

(1) has lapsed/will lapse;
(2) was/will be surrendered; or
(3) was/will be converted to reduced paid-up or extended-term insurance under the non-forfeiture provision of the policy;

OR

(ii) a substantial part[2] of the guaranteed cash value of the existing long term insurance policy was reduced/will be reduced including where a policy loan was/will be taken out against a substantial part[2] of the guaranteed cash value.

This list is not conclusive and may be expanded from time to time to include other forms of replacement. For the avoidance of doubt, internal replacement i.e. both the existing and new long term insurance policies are issued by the same insurer, is considered as "Policy Replacement" and covered by this Guideline. However, converting term life insurance to whole life insurance (or some forms of permanent life insurance) under policy provisions of the existing long term insurance policy is not construed as a replacement.

(d) "Technical Representative" in relation to an insurance broker means a person who provides advice to a policy holder or potential policy holder on insurance matters for an insurance broker, or negotiates or arranges contracts of insurance in or from Hong Kong on behalf of an insurance broker for a policy holder or potential policy holder.

(e) "Twisting" means the making of inaccurate or misleading statements or comparisons to induce a policy holder to replace existing long term

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[1] *Long term insurance policy includes all types of traditional life, annuity and other non-traditional life policies.*

[2] *"a substantial part" means "50% or above"*

insurance policy with other long term insurance policy to the policy holder's disadvantage.

2. Authorization/Approval of Insurance Brokers/Bodies of Insurance Brokers

(A) ***Insurance Brokers authorized under section 69***

A person, whether a sole proprietorship, partnership or limited company, can apply to the IA to become an authorized insurance broker. An insurance broker, at the time of his application for authorization and any subsequent renewal of authorization, is required to satisfy the IA that he has complied and has continued to comply with all relevant statutory provisions and,
amongst others, the minimum requirements as specified by the IA and contained herein.

(a) *Nomination of Chief Executive*

An insurance broker is required to nominate a C.E. The C.E. shall be a fit and proper person and shall meet the minimum requirements of qualifications and experience as specified by the IA.

Without limiting the generality of the definition of C.E.:

(i) in respect of a sole proprietorship, the sole proprietor shall be deemed to be the C.E. and shall assume full responsibilities over the conduct of the brokerage business of that proprietorship;

(ii) in respect of a partnership, the C.E. shall be one of the partners under whom the business of the partnership is supervised or conducted and shall assume full responsibilities over the conduct of brokerage business of that partnership;

(iii) in respect of a limited company, the C.E. shall either be a full time director or full time employee under whom the business of the company in Hong Kong is supervised or conducted.

(B) ***Bodies of Insurance Brokers approved under section 70***

A body of insurance brokers can apply under section 70 for approval to become an approved body of insurance brokers. A body of insurance brokers, at the time of its application for approval or any subsequent renewal of approval, is required to satisfy the IA that it has complied and has continued to comply with all relevant statutory provisions and, amongst others, that it has maintained an appropriate set of rules and regulations for its members to comply with the minimum requirements as specified by the IA and contained herein.

An appropriate set of rules and regulations shall, amongst other things, include the eligibility of membership, membership rules, code of conduct for members and disciplinary procedures.

3. Minimum Requirements for Compliance by Insurance Brokers and Constituent Members of Bodies of Insurance Brokers

(A) ***Qualifications and Experience***

An insurance broker or the C.E. nominated by him is required to (1) have attained the age of 21; (2) be a Hong Kong Permanent Resident or a Hong Kong Resident whose employment visa conditions, if any, do not restrict him from being engaged in insurance broking business; (3) have the minimum education standard of Form 5 or equivalent; and (4) have:

EITHER (i) an acceptable insurance qualification, a minimum of two years' experience in the insurance industry occupying a management position and, if he intends to be engaged in the long term (including linked long term) insurance broking business, passed the Investment-linked Long Term Insurance paper (Paper (d) as referred to in (ii) below) of the Insurance Intermediaries Qualifying Examination recognized by the IA ("the Qualifying Examination"), unless exempted under (ii)(2) below. An acceptable insurance qualification may be a/an:

(1) Associate or Fellow of The Chartered Insurance Institute (ACII/FCII);

(2) Senior Associate or Fellow of the Australian and New Zealand Institute of Insurance and Finance (ANZIIF (Snr Assoc) / ANZIIF (Fellow));
(3) Fellow of the Life Management Institute (FLMI);
(4) Chartered Life Underwriter (CLU);
(5) Chartered Property Casualty Underwriter (CPCU);
(6) Hong Kong Diploma in Insurance Studies of The Insurance Institute of Hong Kong/The Chartered Insurance Institute[3];
(7) Fellow of the Institute and Faculty of Actuaries of the United Kingdom (FIA/FFA)[4];
(8) Fellow of the Institute of Actuaries of Australia (FIAA); or
(9) Fellow of the Society of Actuaries of the United States of America (FSA);

or other qualifications considered acceptable to the IA;

OR (ii) in the event he has no acceptable insurance qualification as mentioned in (i) above, a minimum of five years' experience in the insurance industry of which 2 years is at management position and passed the relevant papers of the Qualifying Examination unless exempted. The Qualifying Examination consists of the following papers:

Paper (a)	compulsory paper – Principles and Practice of Insurance;
Paper (b)	qualifying paper – General Insurance;
Paper (c)	qualifying paper – Long Term Insurance; and
Paper (d)	qualifying paper – Investment-linked Long Term Insurance[5].

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[3] *The Chartered Insurance Institute has become the awarding body of Hong Kong Diploma in Insurance Studies after the merger between The Insurance Institute of Hong Kong and The Chartered Insurance Institute Hong Kong Limited completed on 27 November 2015.*

[4] *Fellow of the Institute of Actuaries of England (FIA) and Fellow of the Faculty of Actuaries in Scotland (FFA) granted by The Institute of Actuaries of England and the Faculty of Actuaries in Scotland respectively before their merger to form the Institute and Faculty of Actuaries of the United Kingdom continue to be acceptable insurance qualifications.*

[5] *On 1 March 2010, the enhanced version of the Investment-linked Long Term Insurance Examination ("IL Paper") was introduced superseding the previous version. Subject to the requirements set out at Annexure E, an insurance broker, his C.E. or Technical Representative who wishes to engage or continue to engage in Long Term (including Linked Long Term) Business on or after 1 March 2010 is required to pass the enhanced version*

(1) An individual shall be exempted from Papers (a), (b) and (c) as appropriate of the Qualifying Examination if he was engaged in the insurance intermediary business in Hong Kong immediately before 1 January 2000 and is in possession of one of the following:

(a) proven relevant experience in insurance business in Hong Kong for a cumulative period of at least five years within the six-year period immediately before 1 January 2000; or

(b) the Certificate of Proficiency in General Insurance Studies issued by the Hong Kong Federation of Insurers.

(2) An individual shall be exempted from Paper (d) of the Qualifying Examination if he

(a) is in possession of any of the following recognized professional qualifications in insurance, investment or actuarial science:

(1) Chartered Life Underwriter (CLU) with an elective paper "HS 328 Investments" in the CLU qualifying examination successfully passed;
(2) Chartered Financial Consultant (ChFC);
(3) Certified Financial Planner (CFP);
(4) Fellow of the Institute and Faculty of Actuaries of the United Kingdom (FIA/FFA)[6];
(5) Fellow of the Institute of Actuaries of Australia (FIAA);
(6) Fellow of the Society of Actuaries of the United States of America (FSA);
(7) person passed the Foundation Programme Examination of the Hong Kong Securities and Investment Institute (FPE);
(8) person passed the Diploma Programme Examination of the Hong Kong Securities and Investment Institute (DPE);

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of IL Paper.

[6] *See footnote 4.*

(9) HKSI Practising Certificate of the Hong Kong Securities and Investment Institute;
(10) HKSI Specialist Certificate of the Hong Kong Securities and Investment Institute; or
(11) HKSI Professional Diploma in Financial Markets of the Hong Kong Securities and Investment Institute;

or other qualifications acceptable to the IA.

(a) In respect of (i) above, the following applies:

(1) An insurance broker or his C.E. who has met, inter alia, the experience requirement and any one of the qualification requirements specified in (i)(1) to (6) above is eligible to carry on or conduct both general and long term (excluding linked long term) insurance broking business.

(2) An insurance broker or his C.E. who has met, inter alia, the experience requirement and any one of the qualification requirements specified in (i)(7) to (9) above is eligible to carry on or conduct both general and long term (including linked long term) insurance broking business.

(3) Subject to the requirements as set out at Annexure E, an insurance broker or his C.E. who has ceased to be engaged in insurance-related work in the insurance industry in Hong Kong for two consecutive years shall, inter alia, pass Paper (d) of the Qualifying Examination again before he can be authorized or registered as an insurance broker or the C.E. of an insurance broker to carry on or conduct long term (including linked long term) insurance broking business again, unless he has met the requirements specified in (i) and has been exempted under (ii)(2)(a) above as appropriate.

(4) Subject to the requirements as set out at Annexure E, an individual, who has passed Paper (d) of the Qualifying Examination, but if for two consecutive years during which he has not been engaged in insurance-related work in the insurance industry in Hong Kong, shall inter alia, re-sit and pass Paper (d) of the Qualifying

Examination again before he can be authorized or registered as an insurance broker or the C.E. of an insurance broker to carry on or conduct long term (including linked long term) insurance broking business, unless he has met the requirements specified in (i) and has been exempted under (ii)(2)(a) above as appropriate.

(b) In respect of (ii) above, the following applies:

(1) An insurance broker or his C.E., who has met, inter alia, the experience and Qualifying Examination requirements, is only eligible to be engaged in the Line of Insurance Business in respect of which he has passed the Qualifying Examination, unless exempted under (ii) above as appropriate. In addition to passing the compulsory paper on Principles and Practice of Insurance, he is required to pass the General Insurance paper and Long Term Insurance paper for his engaging in General Business and Long Term (excluding Linked Long Term) Business respectively. He is required to pass, in addition to the compulsory paper, both Long Term Insurance and Investment-linked Long Term Insurance papers for his engaging in Long Term (including Linked Long Term) Business.

(2) An insurance broker or his C.E. who has met, inter alia, the experience requirement and has been exempted under (ii)(1)(a) above is only eligible to be engaged in the Line of Insurance Business (General Business and Long Term (excluding Linked Long Term) Business only) in which he has been engaged or substantially engaged for five years within the six-year period immediately before 1 January 2000.

(3) An insurance broker or his C.E. who has met, inter alia, the experience requirement and has been exempted under (ii)(1)(b) above is eligible to carry on or conduct general insurance broking business only.

(4) Subject to the requirements as set out at Annexure E, an insurance broker or his C.E. who has ceased to be engaged in insurance-related work in the insurance industry in Hong Kong for two consecutive years shall, inter alia, pass the relevant papers of the Qualifying

Examination again before he can be authorized or registered as an insurance broker or the C.E. of an insurance broker again, unless he has met the requirements specified in (i) and has been exempted under (ii)(2)(a) above as appropriate.

(5) Subject to the requirements as set out at Annexure E, an individual, who has passed the Qualifying Examination, but if for two consecutive years during which he has not been engaged in insurance-related work in the insurance industry in Hong Kong, shall inter alia, re-sit and pass the relevant papers of the Qualifying Examination again before he can be authorized or registered as an insurance broker or the C.E. of an insurance broker, unless he has met the requirements specified in (i) and has been exempted under (ii)(2)(a) above as appropriate.

An insurance broker or his C.E. shall comply with the requirements of the Continuing Professional Development Programme in such manner and form as specified by the IA.

An insurance broker which is not an individual is only eligible to be engaged in the Line of Insurance Business which its C.E. is eligible to be engaged in.

(B) Capital and Net Assets

An unincorporated insurance broker shall maintain in his insurance brokerage business a minimum net assets value of HK$100,000 at all times.

An incorporated insurance broker shall maintain a minimum net assets value and a minimum paid up share capital of HK$100,000 at all times.

The minimum net assets value is to be determined by excluding all intangible assets and in accordance with accounting principles generally accepted in Hong Kong.

(C) Professional Indemnity Insurance

An insurance broker is required to maintain a professional indemnity insurance policy with a minimum limit of indemnity for any one claim and in any one insurance period of 12 months. The minimum limit of indemnity shall be:

(i) a sum equal to:

- two times the aggregate insurance brokerage income relating to 12 months immediately preceding the date of commencement of the professional indemnity insurance cover (applicable to insurance broker who has been in business for more than one year);

- two times the projected insurance brokerage income for 12 months for the period of the professional indemnity insurance cover (applicable to insurance broker who has been in business for less than one year); or

(ii) a sum of HK$3,000,000,

whichever sum shall be greater, up to a maximum of HK$75,000,000. Cover in excess of this prescribed amount may, of course, be arranged to meet the requirements of individual broker. If as a result of a claim(s), the indemnity available shall fall below the amount determined in (i) above, the broker shall effect a reinstatement of cover up to not less than such minimum determined amount. Where the limit of indemnity has been determined in accordance with (ii) above, the policy shall include provision for one automatic reinstatement to a limit of indemnity of not less than HK$3,000,000.

Insurance brokerage income, in this context, means brokerage income derived from advising on or arranging any contract which contains an element of insurance, irrespective of the extent of such insurance element.

(D) Keeping of Separate Client Accounts

An insurance broker is required to keep client monies in a client account separate from his own monies. He is not allowed to use client monies for any purpose other than for the purposes of the client. The "client account" shall be designated as such and held by the insurance broker for his client:

(i) A "client account" means a current or deposit account maintained with a financial institution duly authorized under the Banking Ordinance (Cap. 155) in the name of the insurance broker in the title of which the word "client" appears.

(ii) An insurance broker shall keep at least one client account and may keep as many such accounts as he thinks fit.

(iii) An insurance broker who receives or holds monies on behalf of his client in relation to insurance broking business shall, without delay, deposit such monies into the client account.

There shall also be evidence that the provisions of section 71 of the Ordinance have been notified to and acknowledged by the financial institution with which the "client account" is maintained.

Without limiting the generality of the above requirements, the following are to give brief guidance on the circumstances under which monies shall be deposited into or withdrawn from a client account.

(a) *Deposit into client account*

These shall be paid into a client account:

(i) monies received from client for the purpose of purchasing contracts of insurance;

(ii) monies received on behalf of client from insurers, reinsurers, insurance intermediaries and any other third parties relating to the settlement of insurance claims;

(iii) monies received for the purposes of the client which are incidental to the ordinary transactions of insurance broking business; and

(iv) monies required to be deposited for settlement of bank charges incurred on a client account.

(b) *Withdrawal from client account*

Withdrawals from a client account shall be restricted to:

(i) premium monies required to be paid on behalf of client to insurers, reinsurers or other insurance intermediaries for the purchase of contracts of insurance;

(ii) claim monies received on behalf of client and required to be paid to the claimant or the person entitled to receive them;

(iii) payments made for the purposes of the client which are incidental to the ordinary transactions of insurance broking business;

(iv) monies drawn on client's written authority;

(v) interests received from deposits placed with client account;

(vi) monies required to be withdrawn for settlement of bank charges incurred on a client account; and

(vii) monies which may by mistake or accident have been paid into the account in contravention of paragraph (D)(a).

For the avoidance of doubt, monies incidental to ordinary insurance broking business, as referred to in para. (D)(a)(iii) and para. (D)(b)(iii) above, are:

(i) premiums, renewal premiums, additional premiums and return premiums of all kinds;

(ii) claims and other monies due under contracts of insurance;

(iii) refunds to clients;

(iv) policy loans and associated interests;

(v) fees, charges, levies relating to contracts of insurance; and

(vi) discounts, commissions and brokerage.

(E) ***<u>Keeping Proper Books and Accounts</u>***

(a) (i) An unincorporated insurance broker shall cause to be kept such accounting and other records as will sufficiently explain the transactions, and reflect the financial position of the insurance broking business carried on by him, and will enable financial statements of such insurance broking business to be prepared from time to time which give a true and fair view of the financial position and results of the insurance broker;

(ii) An incorporated insurance broker shall cause to be kept such accounting and other records as will sufficiently explain the transactions, and reflect the financial position of the insurance broker, and will enable financial statements to be prepared from time to time which give a true and fair view of the financial position, and results of the insurance broker; and

(iii) An insurance broker, whether incorporated or unincorporated, shall cause those records to be kept in such a manner as will enable them to be conveniently and properly audited.

(b) The records referred to in (a) above shall be kept:

(i) in writing or in such a manner as to enable them to be readily accessible and readily converted into written form; and

(ii) in sufficient detail to show separately particulars of:

(1) all transactions by the broker with, or for the account of:
- insurers and reinsurers;
- clients of the insurance broker; and
- the insurance broker himself;

(2) all income received from brokerage, commissions, interest and other sources, and all expenses, commissions and interest paid by the insurance broker; and

(3) all the assets and liabilities (including contingent liabilities) of the insurance broker.

(c) An insurance broker shall retain for a period of not less than 7 years the records referred to in (a) above.

4. Fundamental Principles relating to the Test on Fitness and Propriety of an Insurance Broker

An insurance broker, apart from compliance with the above minimum requirements, is required to satisfy the IA that he is and will continue to be fit and proper to be authorized as an insurance broker. For this purpose, an insurance broker is deemed to be not fit and proper if:

(i) in the case of a sole proprietorship or partnership, the proprietor or any of the partners (including the C.E.) is not a fit and proper person to hold such position;

(ii) in the case of a limited company, any of its C.E., directors or controllers (within the same meaning as defined in section 9 of the Ordinance) is not fit and proper to hold the position held by him;

(iii) the C.E. or any of his/its Technical Representatives is not confirmed and registered pursuant to these guidelines.

In this connection, the fundamental principles relating to the test on fitness and propriety of an insurance broker include the following:

(A) Utmost Good Faith

(a) An insurance broker shall be of good character and reputation.

(b) He shall, at all times, conduct his business with utmost good faith and integrity.

(c) He shall be independent and impartial in providing advice to his clients.

(d) He shall not give any misleading information or make any false statements.

(e) He shall not describe himself as an insurer or agent of an insurer.

(f) He shall use his best endeavour to avoid conflict of interest and shall not allow his other business interests, if any, to jeopardize his integrity, independence or competence.

(g) He shall not be engaged in twisting.

(B) ***<u>Due Care and Diligence</u>***

(a) An insurance broker shall exercise due care and diligence in understanding and satisfying the insurance needs and requirements of his client.

(b) He shall take all reasonable steps to ensure that his C.E., Technical Representatives and employees, who are dealing with the policy holder or potential policy holder, are competent as well as fit and proper persons. He shall also ensure that his C.E. or Technical Representatives are eligible to be engaged in the Line of Insurance Business which he (the insurance broker) is eligible to be engaged in. He shall not employ any insurance broker whose authorization has been withdrawn by the IA, or any person whose membership as appointed insurance agent or insurance broker is currently suspended or deregistered by the Insurance Agents Registration Board or by any approved body of insurance brokers.

(c) He shall not appoint any C.E. or Technical Representative who is not a fit and proper person.

(d) He shall terminate the appointment of his C.E. or Technical Representative who has been determined by the IA or an approved body of insurance brokers not to be fit and proper.

(e) He shall explain the principle of utmost good faith to his client and make it clear that all answers and statements given in completing the proposal form, claim form, or any other material document are the client's own responsibility.

(f) He shall advise his client that incorrect answers or information given in completing the proposal form, claim form or any other material document may result in the contract of insurance being invalidated or void or claims being repudiated.

(g) He shall explain the terms of the insurance contracts to his client and shall advise his client of any exclusion clauses provided in the contract.

(h) He shall comply with all guidelines, codes of practice or similar guidance materials to which he is subject.

(i) He shall comply with the performance requirements as stipulated in the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") and applicable guidelines issued by the Mandatory Provident Fund Schemes Authority under the MPFSO where he is engaged in conducting sales and marketing activities and/or giving advice in relation to registered schemes or their constituent funds as defined under the MPFSO.

(C) Priority of Client's Interests

(a) An insurance broker shall place the interests of his client above all other considerations in providing advice to, or arranging contracts of insurance for his client.

(b) He shall not prejudice his client's selection of insurers by unreasonably limiting the choices of insurers.

(c) He shall not be unreasonably dependent on any particular insurer in transacting insurance broking business.

(D) Information from Client

An insurance broker shall not disclose any information acquired from his client except:

(a) in the normal course of negotiating, maintaining or renewing a contract of insurance for that client to the extent that the information disclosed is required for such purposes;

(b) to other professional or commercial organizations in connection with the contract of insurance for that client including but not limited to loss adjusters and surveyors, security consultants and installation companies, property and engineering surveyors consultants and vendors, consulting engineers and architects;

(c) with the written consent of that client; or

(d) with court order or to comply with obligations imposed upon him by law.

(E) Information for Client

(a) An insurance broker shall make adequate and accurate disclosure of relevant material information in dealing with his client.

(b) If he, at the request of his client or as a result of the absence of suitable products available locally, refers or arranges a contract of insurance with an insurer authorized in other jurisdiction but not authorized in Hong Kong, he shall advise his client of the unauthorized status of the insurer and obtain a written acknowledgement of the fact from the client. Where the client is a corporate entity, he may, in lieu of obtaining a written acknowledgement of the fact, include a notice to the corporate client in the cover note or placement confirmation. The notice and acknowledgement shall follow the Specimen Notice to client and Acknowledgement from client at Annexure A and Annexure B respectively. The notice to corporate client shall follow the Specimen Notice at Annexure C.

(c) He shall disclose his association, if any, he may have with any insurer to whom he is recommending his client and which may result in a potential conflict of interests. Without limiting the generality of the statement, an insurance broker must disclose his association with the insurer arising from common shareholder/director/controller.

(d) If he is the director/C.E./Technical Representative/employee of more than one insurance broker, he shall disclose the capacity in which he is acting in dealing with his clients.

(e) He shall disclose his registration number assigned by the IA or an approved body of insurance brokers (as the case may be) if so requested. He shall also identify his registration number on his business cards if they are distributed.

(f) He shall ensure that the Customer Protection Declaration (Annexure D) has been completed before the client agrees or makes a decision in relation to the purchase of a new long term

insurance policy. In the course of completing the Customer Protection Declaration, he shall follow the Explanatory Notes attached to the Customer Protection Declaration. If any long term insurance policy replacement is recommended, he shall explain the important consequences and ensure that the client fully understands the important consequences. In the event that he explains there is no disadvantage attached to the replacement, he shall give the reason for this conclusion in writing in the Customer Protection Declaration as fully as possible. He shall then forward the completed Customer Protection Declaration to the insurer issuing the new long term insurance policy.

(g) He shall deliver any new long term insurance policy together with a copy of the Customer Protection Declaration (if applicable) issued by the insurer through him to his client without delay.

(F) Capabilities

(a) An insurance broker shall be capable to perform his functions efficiently. In this regard, whether he, inter alia, has ever been declared bankrupt or been a controller, a director, an officer or a senior manager of a corporation that has become insolvent shall be taken into account.

(b) He shall be mentally sound.

(c) He has not been convicted of any criminal offence which may affect his fitness, suitability or propriety to act as an insurance broker or found guilty of misconduct by a professional body to which he belongs or has belonged.

(d) He shall comply with all statutory obligations.

In this connection, the provisions under section 4(A)-(F) may, as appropriate, apply to the sole proprietor in case of an insurance broker being a sole proprietorship, any of the partners in case of an insurance broker being a partnership, any of its directors or controllers (within the same meaning as defined in section 9 of the Ordinance) in case of an insurance broker being a limited company, as if he were an insurance broker.

In considering whether the appointment of C.E. and Technical Representative can be confirmed by the IA or an approved body of insurance

brokers, as the case may be, and registered in the sub-register under the Register of Insurance Brokers kept by the IA or an approved body of insurance brokers, the following shall, inter alia, be taken into account:

(1) whether the prospective C.E. or Technical Representative is fit and proper to act as an insurance broker if he were to apply to be authorized as such. In this connection, the provisions under section 4(A)-(F) may, as appropriate, apply to the prospective C.E. or Technical Representative as if he were an insurance broker;

(2) whether the prospective C.E. has met the requirements specified in section 3(A);

(3) whether the prospective Technical Representative:

(i) has attained the age of 18;

(ii) is one of the following persons:

(a) a Hong Kong Permanent Resident; or

(b) a Hong Kong Resident whose employment visa conditions, if any, do not restrict him from being engaged in insurance broking business; or

(c) a person who is permitted to work in Hong Kong and whose employment visa conditions, if any, do not restrict him from being engaged in insurance broking business; and

(iii) has the minimum education standard of Form 5 or equivalent unless he was engaged in the insurance intermediary business in Hong Kong immediately before 1 January 2000 and has not since ceased to be engaged in insurance-related work in the insurance industry in Hong Kong for two consecutive years;

(4) subject to the requirements as set out at Annexure E, whether the prospective Technical Representative has passed the relevant papers of the Qualifying Examination as if he were an insurance broker unless he is in possession of an acceptable insurance qualification specified under section 3(A)(i)(1) to (9) or other qualifications considered acceptable to the IA and

he has been exempted under section 3(A)(ii)(1) or (2) as appropriate; and

(5) whether the C.E. or Technical Representative has complied with the requirements of the Continuing Professional Development Programme in such manner and form as specified by the IA.

In respect of the examination or exemption requirements mentioned in (4) above, the restrictions in section 3(A)(a) and (b) shall be applicable to a Technical Representative as if he were an insurance broker or C.E. subject always that no Technical Representative shall be engaged in a Line of Insurance Business other than that the insurance broker appointing him is eligible to be engaged in.

Appointment and registration of C.E. and Technical Representatives shall be effected in the following manner:

(1) An insurance broker shall obtain the confirmation of the IA or relevant approved body of insurance brokers before confirming the appointment of any person as his C.E. or Technical Representative.

(2) An insurance broker shall be responsible for submitting the application for confirmation of appointment and registration of his C.E. or Technical Representative in such manner and form as may be specified by the IA or relevant approved body of insurance brokers from time to time.

(3) An insurance broker and the prospective C.E. or Technical Representative shall provide to the IA or relevant approved body of insurance brokers such additional information relevant to the application as the IA or relevant approved body of insurance brokers may require. The IA or relevant approved body of insurance brokers shall not be required to consider an application unless it is made in the specified manner and form and is duly completed with the information requested being provided in full. If the insurance broker becomes aware of any change in the material circumstances of the prospective C.E. or Technical Representative who is the subject of a pending application, he shall notify the IA or relevant approved body of insurance brokers forthwith of such change.

(4) A prospective C.E. or Technical Representative who is the subject of an application shall satisfy the IA or relevant approved body of insurance brokers that he is fit and proper to act as such and has complied with the specified qualifications and experience requirements. Unless the IA or relevant approved body of insurance brokers is so satisfied, it shall not confirm the appointment of that person as a C.E. or Technical Representative by the insurance broker and register that person as the C.E. or Technical Representative of the insurance broker.

(5) The registration of a C.E. or Technical Representative shall continue only for such period as the IA or relevant approved body of insurance brokers may specify. The insurance broker may apply for re-registration of a C.E. or Technical Representative prior to the expiration of the current registration of the C.E. or Technical Representative concerned.

(6) As a condition for re-registration, a C.E. or Technical Representative shall comply with the requirements of the Continuing Professional Development Programme in such manner and form as specified by the IA. Failure to comply with the requirement may lead to refusal of re-registration or de-registration of the C.E. or Technical Representative concerned.

(7) The registration of a C.E. or Technical Representative shall be cancelled upon his cessation to be the C.E. or Technical Representative of the insurance broker. The insurance broker shall notify the IA or relevant approved body of insurance brokers within seven days of such cessation and provide such details as the IA or relevant approved body of insurance brokers may require. Upon such notification by the insurance broker, the IA or relevant approved body of insurance brokers shall immediately remove the name of the C.E. or Technical Representative concerned from that part of the sub-register relating to that insurance broker.

(8) The approved bodies of insurance brokers shall give the IA details of the registration and cancellation of registration of C.E. or Technical Representative within seven days of such registration or cancellation of registration (as the case may be) and shall make the sub-register available to the IA for inspection.

5. Submission of Annual Financial Statements and Auditor's Report

(A) ***Authorized Insurance Brokers***

Under section 73(1) of the Ordinance:

(i) An unincorporated insurance broker is required to submit to the IA audited financial statements in respect of the insurance broking business carried on by the insurance broker which show a true and fair view of the financial position of the broking business carried on by him as at the end of the financial year and of the profit or loss for the period then ended;

(ii) An incorporated insurance broker is required to submit to the IA audited financial statements which show a true and fair view of the financial position of the insurance broker as at the end of the financial year and of its profit or loss for the period then ended;

(iii) An insurance broker, whether incorporated or unincorporated, is required to submit a report from the auditor stating whether in the auditor's opinion, the insurance broker satisfied the minimum requirements for capital and net assets, professional indemnity insurance, keeping of separate client accounts and keeping of proper books and accounts as at the end of the financial year and 2 such other dates in the financial year as the auditor may elect, provided that the intervening period between those 2 dates shall not be shorter than 3 months.

For the purposes of reporting on the 2 such other dates as referred to above, the IA considers that it is sufficient for the auditor to perform such procedures as laid down in the guidelines to be issued by the Hong Kong Institute of Certified Public Accountants in consultation with the IA in this respect.

The auditor's report and audited financial statements shall be submitted to the IA within 6 months after the close of the period to which the statements relate.

(B) ***Approved Body of Insurance Brokers***

A body of insurance brokers authorized under section 70 of the Ordinance shall include in its membership rules and regulations a requirement that each of its members shall submit to it annually, within six months following the end of the financial year of the member:

(i) for members who are unincorporated, audited financial statements in respect of the insurance broking business carried on by the member which show a true and fair view of the financial position of the broking business carried on by the member as at the end of the financial year and of its profit or loss for the period then ended;

(ii) for members who are incorporated, audited financial statements which show a true and fair view of the financial position of the member as at the end of the financial year and of its profit or loss for the period then ended;

(iii) an auditor's report expressing whether, in his opinion, the member satisfies the minimum requirements for capital and net assets, professional indemnity insurance, keeping of separate client accounts and keeping of proper books and accounts as at the end of the financial year and 2 such other dates in the financial year as the auditor may elect, provided that the intervening period between those 2 dates shall not be shorter than 3 months.

For the purposes of reporting on the 2 such other dates as referred to above, the IA considers that it is sufficient for the auditor to perform such procedures as laid down in the guidelines to be issued by the Hong Kong Institute of Certified Public Accountants in consultation with the IA in this respect.

A body of insurance brokers authorized under section 70 of the Ordinance shall in accordance with section 73(2) of the Ordinance, give the IA a report by its auditor stating:

(i) whether the body of insurance brokers has received from each of its members the financial statements and auditor's report in accordance with its membership rules and regulations;

(ii) that he has reviewed all reports by auditors of members in respect of the financial statements and the minimum

requirements and none contained any adverse statement or qualification except those listed by him in his report.

The above report, together with its audited financial statements, shall be submitted to the IA within 6 months after the close of the period to which the audited financial statements relate.

6. Commencement

This Guideline shall take effect from 26 June 2017.

June 2017

Annexure A

NOTICE TO CLIENT

Your insurance contract *may be/*has been arranged or effected wholly or partly with an insurer authorized in other jurisdiction but not authorized by the Insurance Authority under the Insurance Ordinance (Cap. 41) ("Ordinance") to conduct insurance business in Hong Kong ("insurer not authorized in Hong Kong"). Such insurers are not subject to the provisions of the Ordinance, which establishes a system of prudential supervision of authorized insurers in Hong Kong.

It is a matter for your consideration whether you should obtain further information from the insurance broker involved on matters such as:

(a) name and address of the insurer not authorized in Hong Kong;

(b) country of incorporation of the insurer not authorized in Hong Kong and whether that country has a compatible system for supervision of insurers;

(c) financial standing of the insurer not authorized in Hong Kong;

(d) which country's laws will determine disputes under the contract.

* Delete if not applicable

Annexure B

ACKNOWLEDGEMENT

I, _____ (full name) of _____
_____
(address) have read the above notice and I acknowledge that the insurance contract *may be/*has been/arranged or effected wholly or partly with an insurer authorized in other jurisdiction but not authorized by the Insurance Authority under the Insurance Ordinance (Cap. 41) to conduct insurance business in or from Hong Kong.

Dated

_____
(Signature of client)

* Delete if not applicable

Annexure C

NOTICE TO CORPORATE CLIENT

The underwriting security of this insurance contract includes participation by an insurer authorized in other jurisdiction but not authorized by the Insurance Authority under the Insurance Ordinance (Cap. 41) ("Ordinance") to conduct insurance business in Hong Kong ("insurer not authorized in Hong Kong"). You are reminded that such insurers are not subject to the provisions of the Ordinance, which establishes a system of prudential supervision of authorized insurers in Hong Kong.

It is a matter for your consideration whether you should obtain additional information from the insurance brokers on matters such as:

(a) name and address of the insurer not authorized in Hong Kong;

(b) country of incorporation of the insurer not authorized in Hong Kong;

(c) financial standing of the insurer not authorized in Hong Kong;

(d) which country's laws will determine disputes under the contract.

Annexure D

CUSTOMER PROTECTION DECLARATION FORM

IMPORTANT DOCUMENT! PLEASE STUDY CAREFULLY BEFORE SIGNING!

This is an **IMPORTANT PART** of the Code of Practice for Life Insurance Replacement issued by The Hong Kong Federation of Insurers ("Code") and the Guideline on Minimum Requirements for Insurance Brokers issued by the Insurance Authority under the Insurance Ordinance ("Minimum Requirements") but does not form part of the application/proposal. Please refer to the Explanatory Notes before completing this Form.

Name of the Insurer of the New Life Insurance Policy：
_____

Application/Proposal Number：
_____

Name of Applicant/Proposer：_____

HKID Card/Passport No. of Applicant/Proposer：
_____

SECTION A

1. a) **Have you replaced*** in the past 12 months any or a substantial part of your existing life insurance policy(ies) with the above application/proposal?

□ Yes (Please go to Section B) □ No (Please answer question b below)

b) **Do you intend to replace** in the next 12 months any or a substantial part of your existing life insurance policy(ies) with the above application/proposal?

□ Yes (Please go to Section B) □ No (Please read carefully and sign the Declaration in this Section only)

Declaration by the Applicant/Proposer：

I realize if I answer "No" to both questions above but indeed,

i) the above-mentioned application/proposal has replaced any or a substantial part of my existing life insurance policy(ies) in the past 12 months; or

ii) my current intention is to replace any or a substantial part of my existing life insurance policy(ies) within the next 12 months by the above-mentioned application/proposal,

I may jeopardize my future right of redress if I find later that I have been disadvantaged because of such replacement.

I hereby authorize the Insurer of the new life insurance policy to give the Insurance Agents Registration Board, The Hong Kong Confederation of Insurance Brokers, Professional Insurance Brokers Association, the Insurance Authority, The Hong Kong Federation of Insurers, the insurer(s) of the life insurance policy(ies) that is/are being or has/have been replaced (if applicable) or other parties, as required for proper administration/ implementation/execution of the Code and the Minimum Requirements, a copy of this Form and any related records or information.

_____ _____

Signature of the Applicant/Proposer Date (D / M / Y)

* Notes: Please refer to clause C of the Explanatory Notes for the definition of "Replacement".

SECTION B

Attention: A policy holder would usually suffer losses if he/she chooses to replace his/her existing life insurance policy(ies), especially within the first few years of the policy term. The intent of this Form is to ensure that the Agent/Broker has already explained to you in detail any real and potential disadvantages in replacing your existing life insurance policy(ies). You are advised to study the pamphlet titled "Life Insurance Policy Replacement – What you need to know" issued by the Insurance Authority and provided by the Agent/Broker before you complete this Form.

The Agent/Broker shall explain to you the full implications of replacing your existing life insurance policy(ies) with the new life insurance policy.

The Agent/Broker **MUST HELP YOU** complete all items below and tick where appropriate.

Please write down the life insurance policy(ies) replaced/to be replaced and complete items 2 to 6 :

Name of insurer(s) : _____

Policy Number(s) : _____

You are strongly advised :

a) To consult the insurer(s) of your existing life insurance policy(ies) for further information **(please note that this Form will be copied to the insurer(s) of your existing life insurance policy(ies) you indicate above)**;

b) **NOT** to cancel your existing life insurance policy(ies) until the new life insurance policy is issued; and

c) To use **additional blank paper(s)** if the space provided in this Form for answer is not enough, but remember to sign and ask the Agent/Broker to sign on the additional paper(s).

2. **Financial implications** of the replacement :

a) You could be paying the policy set-up cost **TWICE** – the set-up cost is usually two years premiums or 10% of single premium of the basic life insurance policy replaced/to be replaced (This is for reference only; the Agent/Broker should advise you of the estimated loss for this replacement).	Estimated Loss HK$: _____ If no loss or if estimated loss is less than two years premiums or 10% of single premium of the basic life insurance policy replaced/to be replaced, please give reason and justification : _____ _____
b) You may have to pay **HIGHER** premiums under the new life insurance policy because you are older.	Will the annualized premiums be **HIGHER** under the new life insurance policy for the same sum insured? □ Yes □ No If no, please give reason : _____ _____
c) The projection of future values of the new life insurance policy may be higher than the existing life insurance policy(ies), but the projected values in most cases depend on the performance of the insurers and may **NOT** be guaranteed.	Guaranteed Cash Values on the policy anniversary dates immediately after age 65 (if one of the policies or all policies mature(s) before age 65, please fill in the Guaranteed Cash Values on the policy anniversary dates of each policy in the earliest maturity year) : On the policy anniversary date of the calendar year of _____, Guaranteed Cash Value(s) of the existing life insurance policy(ies) : _____ On the policy anniversary date of the year indicated above, the Guaranteed Cash Value of the new life insurance policy : _____

3. **Insurability implications** of the replacement：	
Some coverage may be denied or a higher premium may be charged due to changes in： a) health conditions; b) occupation; c) lifestyle/habit, e.g. smoking/drinking; or d) recreational activities, e.g. hazardous sports, etc.	Has the Agent/Broker explained to you the implication(s) of changes in each of the conditions listed on the left-hand side in this replacement? a) □ Yes □ No b) □ Yes □ No c) □ Yes □ No d) □ Yes □ No
4. **Claims eligibility implications** of the replacement：	
a) The benefits under a life insurance policy may not be payable if the life insured commits suicide within a certain period of the policy's issue date. Your new life insurance policy may restart the period in the "suicide clause".	a) Period in the "Suicide Clause" expires on： Existing life insurance policy(ies)： _____ (D / M / Y) New life insurance policy： _____ Number of months from the new policy's issue date
b) The benefits under a life insurance policy may not be payable if information on the application was incomplete. The benefits under your existing life insurance policy(ies) will be payable, in the absence of fraud, if this incomplete information is not discovered within the "contestability period" (usually two years). Your new life insurance policy may restart the "contestability period".	b) "Contestability period" expires on： Existing life insurance policy(ies)： _____ (D / M / Y) New life insurance policy： _____ Number of months from the new policy's issue date
c) Where replacement including twisting of life insurance policy has occurred and you opt for reinstatement of your policy by the Non-selling office, the benefits under your existing life insurance policy(ies), once surrendered or lapsed, will **NOT** be payable for any claims arising thereafter; and the benefits under the new life insurance policy will be payable subject to the terms and conditions of the new life insurance policy.	c) Has the Agent/Broker explained to you the implications of this replacement for claims payment, if any, as indicated on the left-hand side? □ Yes □ No
5. **Other considerations**：	
a) List riders/supplementary benefits you have under the existing life insurance policy(ies) but will not have under the new life insurance policy.	_____ _____
b) List reasons why the new life insurance policy is more suitable for your needs and objectives.	_____ _____
c) Have you been advised by the Agent/Broker of any alternatives to replacing the existing life insurance policy(ies)?	□ Yes □ No

6. **Declaration by the Applicant/Proposer** :	7. **Declaration by the Agent/ Broker** :
I declare that I have read and discussed the relevant item(s) of this Form with the Agent/Broker. I understand and accept the financial and other implications of changing my existing insurance arrangement as explained by the Agent/Broker. I also declare that I have received a copy of the pamphlet titled, "Life Insurance Policy Replacement – What you need to know", issued by the Insurance Authority. **I realize if I have not fully understood this Form, in signing this Declaration I may jeopardize my future rights of redress if I find later that I have been disadvantaged because of this replacement.** I hereby authorize the Insurer of the new life insurance policy to give the Insurance Agents Registration Board, The Hong Kong Confederation of Insurance Brokers, Professional Insurance Brokers Association, the Insurance Authority, The Hong Kong Federation of Insurers, the insurer(s) of the life insurance policy(ies) that is/are being or has/have been replaced or other parties, as required for proper administration/implementation/ execution of the Code and the Minimum Requirements, a copy of this Form and any related records or information. _____ Signature of the Applicant/Proposer _____ Date (D / M / Y) **(Warning** : **a. You must read all items carefully and check that the Agent/Broker has completed with you all the information on this Form before you sign your name here.** **b. Please do not sign a blank Form or leave any space blank.)**	I declare that I have explained fully the above listed items and the related implications of the decision of the Applicant/Proposer in regard to replacing the existing life insurance policy(ies), and have not made any inaccurate or misleading statements or comparisons nor withheld any information which may affect the decision of the Applicant/ Proposer. _____ Signature of the Agent/Broker _____ Agent/Broker's name in full _____ Insurance Agent/Broker Reg. No. _____ Date (D / M / Y)

Explanatory Notes to Customer Protection Declaration Form

(A) The agent/broker must help the applicant/proposer complete a Customer Protection Declaration Form ("Form") for each new individual life insurance policy applied for/proposed by an applicant/proposer. The agent/broker must inform the applicant/proposer that according to the Code of Practice for Life Insurance Replacement ("Code") the insurer of the new life insurance policy (i) will send to the applicant/proposer a copy of the Form together with the policy when it is issued and (ii) will send a further copy to the insurer(s) of the life insurance policy(ies) which has been replaced/to be replaced. For the purpose of the Form, any reference to insurance agent/broker shall include its responsible officer/chief executive(s) and technical representatives.

To enable the insurer of the new life insurance policy to process the insurance application of the applicant/proposer, the applicant/proposer should work with the agent/broker to complete the Form which will be used for regulatory purposes as stated in the Code and the Guideline on Minimum Requirements for Insurance Brokers issued by the Insurance Authority under the Insurance Ordinance and a copy of the Form may be transferred to the parties as stipulated in the "Declaration by the Applicant/Proposer" of the Form. Requests for access to and/or correction of the information (if appropriate) in the Form can be made to the same contact point as for the data in the insurance application.

(B) For identification purpose, the agent/broker must help the applicant/proposer fill in the full name of the Insurer issuing the new life insurance policy (the Insurer may pre-print its name on the Form), the relevant application/proposal number, the name of applicant/proposer of the new life insurance policy and the Hong Kong Identity Card/Passport number of applicant/proposer.

(C) Any transaction involving the purchase of life insurance is construed as a Replacement if (i) any existing life insurance policy(ies) or a substantial part of the sum insured of its/their basic life coverage has been/have been/will be terminated or (ii) a substantial part of the guaranteed cash value of the existing life insurance policy(ies) was reduced/will be reduced including where a policy loan was/will be taken out against a substantial part of the guaranteed cash value. Existing life insurance policy(ies) include(s) all types of traditional life, annuity and other non-traditional policies of the applicant/proposer, which has/have been terminated within 12 months before or will be terminated within 12 months after the new life insurance policy's issue date. Termination includes lapse, surrender, converted to reduced paid-up or extended-term insurance under the non-forfeiture provision of the existing life insurance policy(ies). "A substantial part" means "50% or above". However, converting term life insurance to whole life insurance (or some forms of permanent life insurance) under policy provisions of the existing life insurance policy(ies) is not construed as a Replacement.

(D) If the applicant/proposer answers "No" to both items 1(a) and 1(b) of Section A, he/she shall read carefully and simply sign the Declaration in Section A only and ignore the rest.

(E) How to complete the Form

(1) If the applicant/proposer answers "No" to both items (a) and (b), the agent/broker must explain the Declaration before he/she asks the applicant/proposer to sign in Section A. There is no need to fill in Section B.

If the applicant/proposer answers "Yes" to either item (a) or (b), the agent/broker must help the applicant/proposer complete items 2 to 5 and must explain and discuss with the applicant/proposer the full implications of replacing any or a substantial part of his/her existing life insurance policy(ies) with the new life insurance policy in relation to financial implications, insurability implications and claims eligibility implications of the replacement and other considerations. The applicant/proposer may consult the insurer(s) of his/her existing life insurance policy(ies) for further information. There is no need to sign in Section A.

(2a) The agent/broker must help the applicant/proposer fill in the estimated loss for the replacement by referencing that the set-up cost is usually two years premiums or 10% of single premium of the basic life insurance policy replaced/to be replaced. No reason is required if the estimated loss stated is equal to or higher than this reference. The agent/broker may use other reference for the estimated loss provided he/she could reasonably justify the estimation, and must give reason and the justification if there is no loss or if estimated loss is less than two years premiums or 10% of single premium.

(2b) The agent/broker must help the applicant/proposer compare the annualized premiums of the existing life insurance policy(ies) and the new life insurance policy by using the same sum insured, and give reason if the annualized premiums will not be higher under the new life insurance policy for the same sum insured.

(2c) The agent/broker must help the applicant/proposer fill in the guaranteed cash values of the existing life insurance policy(ies) and the new life insurance policy using the values on the policy anniversary dates immediately after the applicant/proposer reaches age 65, or if one of the policies or all policies mature(s) before age 65, fill in the guaranteed cash values on the policy anniversary dates of each policy in the earliest maturity year. The agent/broker has to obtain the value(s) of the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided for "Guaranteed Cash Value(s) of the existing life insurance policy(ies)" that he/she does not want to disclose such information.

(3) The agent/broker must explain the implications of the changes of health conditions, occupation, lifestyle/habit and recreational activities in this replacement to the applicant/proposer before the latter ticks the boxes.

(4a) The agent/broker must help the applicant/proposer fill in the expiry dates of the period in the "suicide clause" for both the existing life insurance policy(ies) and the new life insurance policy. The expiry date of the latter will be the number of months from its issue date. The agent/broker has to obtain the expiry date(s) of the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided for "Existing life insurance policy(ies)" that he/she does not want to disclose such information.

(4b) The agent/broker must help the applicant/proposer fill in the expiry dates of the "contestability period" for both the existing life insurance policy(ies) and the new life insurance policy. The expiry date of the latter will be the number of months from its issue date. The agent/broker has to obtain the expiry date(s) of the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided for "Existing life insurance policy(ies)" that he/she does not want to disclose such information.

(4c) The agent/broker must explain to the applicant/proposer that to the scenario where twisting of life policy has occurred and the policy holder opted for reinstatement of his policy by the Non-selling office, the insurer(s) of the existing life insurance policy(ies) will **NOT** be responsible for any payment of claims that occurred during the period that the existing life insurance policy(ies) is/are surrendered or lapsed as a result of policy replacement. The insurer of the new life insurance policy will be responsible for the claim subject to the terms and conditions of the new life insurance policy.

(5a) The agent/broker must help the applicant/proposer list out the riders/supplementary benefits under the existing life insurance policy(ies) that will not have under the new life insurance policy for the applicant/proposer. Detailed benefits under each rider/supplementary benefit are not required to be listed. The agent/broker has to obtain the riders/supplementary benefits under the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided that he/she does not want to disclose such information.

(5b) The agent/broker must help the applicant/proposer list out the reasons why the new life insurance policy is more suitable for the applicant/proposer unless the applicant/proposer declares in writing in the space provided that he/she does not mind whether the new life insurance policy is more suitable or not.

(5c) The agent/broker must help the applicant/proposer answer this question.

(6) The agent/broker must explain the "Declaration by the Applicant/Proposer" to the applicant/ proposer before the latter signs it.

(7) The agent/broker shall sign the "Declaration by the Agent/Broker", declaring that he/she has explained fully the related implications of the decision of the applicant/proposer in regard to replacing the existing life insurance policy(ies) and has not made any inaccurate or misleading statements or comparisons nor withheld any information which may affect the decision of the applicant/proposer.

(Notes: Additional papers may be used wherever the spaces provided in the Form are insufficient. However, both agent/broker and applicant/proposer must sign on all the papers that are used.)

~ End ~

Annexure E

Requirements applicable to Insurance Brokers, their Chief Executives and Technical Representatives wishing to engage or continue to engage in Long Term (including Linked Long Term) Business on or after 1 March 2010

1. Requirements

Commencing 1 March 2010, the previous Paper (d) qualifying paper – Investment-linked Long Term Insurance Examination Paper (referred to "IL Paper" as below) was superseded by the enhanced IL Paper. The two-year transitional period available for "Serving Practitioners" (i.e. insurance brokers, their chief executives and technical representatives who were registered as engaging in long term (including linked long term) business immediately before 1 March 2010) expired on 29 February 2012.

From 1 March 2012 onwards, all insurance brokers, their chief executives and technical representatives who wish to engage in or continue to engage in long term (including linked long term) business are required, among others, to pass the enhanced IL Paper, unless they fall within any one of the following three categories of persons:

(a) A person who is exempted from the enhanced IL Paper pursuant to Section 2 of this Annexure;

(b) A "Serving Practitioner" who met the additional Continuing Professional Development (CPD) requirement within the two-year transitional period, i.e. completed 20 extra CPD hours dedicated towards the additional modules of the enhanced IL Paper ("IL CPD hours") between 1 March 2010 and 29 February 2012, and has not since ceased to be engaged in insurance-related work in the insurance industry in Hong Kong for two consecutive years; or

(c) A person who has passed the previous IL Paper:

  (i) completed 20 extra IL CPD hours within the transitional period (i.e. 1 March 2010 to 29 February 2012);

  (ii) applied for (and subsequently succeeded in) registration for engaging in long term (including linked long term) business within the transitional period (i.e. 1 March 2010 to 29 February 2012) (the date of application should be within the transitional period although the date of registration could be sometime after the transitional period); and

  (iii) has not since the abovementioned date of registration ceased to be engaged in insurance-related work in the insurance industry in Hong Kong for two consecutive years.

2. Exemption

Exemption from the enhanced IL Paper could be granted to holders of any of the following recognized professional qualifications in insurance, investment or actuarial science:

- Chartered Life Underwriter (CLU) who has passed the elective paper: "HS 328 Investments" of the CLU qualifying examination;
- Chartered Financial Consultant (ChFC);
- Certified Financial Planner (CFP);
- Fellow of the Institute and Faculty of Actuaries of the United Kingdom (FIA/FFA)[7];
- Fellow of the Institute of Actuaries of Australia (FIAA);
- Fellow of the Society of Actuaries of the United States of America (FSA);
- person who has passed the Foundation Programme Examination of the Hong Kong Securities and Investment Institute (FPE);
- person who has passed the Diploma Programme Examination of the Hong Kong Securities and Investment Institute (DPE);
- HKSI Practising Certificate of the Hong Kong Securities and Investment Institute;
- HKSI Specialist Certificate of the Hong Kong Securities and Investment Institute; or
- HKSI Professional Diploma in Financial Markets of the Hong Kong Securities and Investment Institute.

[7] *See footnote 4.*