Insurance Intermediaries
Quality Assurance Scheme

Investment-linked Long Term Insurance Examination

Study Notes

2015 Edition

PREFACE

These Study Notes have been prepared to correspond with the various Chapters in the Syllabus for the Investment-linked Long Term Insurance Examination. The Examination will be based upon these Notes. A few representative examination questions are included at the end of each Chapter to provide you with further guidance.

It should be noted, however, that these Study Notes will not make you a licensed person for any of the regulated activities under the ***"Securities and Futures Ordinance",*** *or otherwise an insurance specialist. It is intended to give a preliminary introduction to the subject of Investment-linked Long Term Insurance, as a* ***Quality Assurance*** *exercise for Insurance Intermediaries.*

We hope that the Study Notes can serve as reliable reference materials for candidates preparing for the Examination. While every care has been taken in the preparation of the Study Notes, errors or omissions may still be inevitable. You may therefore wish to make reference to the relevant legislation or seek professional advice if necessary. As further editions will be published from time to time to update and improve the contents of these Study Notes, we would appreciate your feedback, which will be taken into consideration when we prepare the next edition of the Study Notes.

First Edition:	*August 2001*
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NOTE

If you are taking this subject in the Insurance Intermediaries Qualifying Examination, you will also be required, unless exempted, to take the subjects "Principles and Practice of Insurance" and "Long Term Insurance". Whilst the examination regulations do not require you to take those two subjects first, it obviously makes sense to do so. Those subjects lay a foundation for further studies and many of the terms and concepts found in those subjects will be assumed knowledge with this subject.

For your study purposes, it is important to be aware of the relative "weight" of the various chapters in relation to the examination. All chapters should be studied carefully, but the following table indicates areas of particular importance:

Chapter	Relative Weight
1	**2.5%**
2	**20%**
3	**35%**
4	**32.5%**
5	**10%**
Total	**100%**

Calculators brought into the examination centre are subject to inspection. Non-programmable electronic calculators may be used in examination, provided that the calculators are battery-powered, silent in operation and with neither print-out nor graphic/word display functions.

Chapter 1
INTRODUCTION TO INVESTMENT-LINKED LONG TERM INSURANCE POLICIES

1.1 DEFINITION

As specified in Part 2 of Schedule 1 to the ***"Insurance Companies Ordinance" (Cap 41)***, investment-linked long term insurance policies fall within Class C of Long Term Business – Linked Long Term. Linked Long Term Business is defined as the business of effecting and carrying out 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).

In order to minimise the confusion with the classification of business between Class A (Life and Annuity) and Class C (Linked Long Term), the Insurance Authority, after consultation with the Life Insurance Council and the Securities and Futures Commission (SFC), has issued a ***"Guidance Note on Classification of Class C – Linked Long Term Business"*** (GN11) which highlights some of the predominant features of Class C Linked Long Term policy. In GN11, it is stated that Class C policy must either be a life or annuity contract and possess 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 policyholder is given the options to choose the underlying investment assets from a range of investment fund options;

(c) Market Value Adjustment or adjustment of similar nature is applied under the terms of policy for the calculation of surrender/withdrawal value with the exception of where the market value adjustment is applied to single premium non-linked policies for refund of premium during the Cooling-off Period (please refer to section **4.13.4** for details); and

(d) The policy is designed in such a way that the policyholder is contractually bound to bear partly or wholly the risk of the investments to which the benefits are linked.

In other parts of the world, investment-linked insurance policies are also known by the following terms:

(a) ***Unit-linked life/annuities***: This is a common term used in the UK. The term "unit-linked" illustrates that the values of the policies are linked to the price of the units.

(b) **Variable life/annuities:** This is the common term used to describe investment-linked business in the US. The term "variable" illustrates that the returns vary with the value of the underlying investment. There are two different types of variable life insurance.

- ***Fixed premium variable life*** is based on whole life. When talking about this product, life insurance practitioners generally drop the "fixed premium" qualifier and refer to the product simply as **variable life**. It provides a fixed premium payment schedule.

- ***Flexible premium variable life*** is based on universal life (a flexible premium derivative of whole life). This product may also be called "**variable universal life**" or "universal variable life." When talking about this product, life insurance practitioners generally retain the "universal" qualifier. It combines the premium and death benefit flexibility of universal life insurance and adopts its feature of unbundling of the pricing factors with the investment characteristics of variable life policies. Variable universal life has increasingly become more popular than variable life, owing to its flexibility.

In Hong Kong, investment-linked annuities are not commonly found. The most popular type of investment-linked insurance product is ***flexible premium variable life insurance*** (also called "variable universal life" or "universal variable life")**.**

1.2 CONCEPT

As mentioned in the previous section, investment-linked insurance policies are insurance policies with its policy value directly linked to the performance of its underlying investment. This may be achieved by formally linking the policy value to units in a special unitised fund run by the life insurer, or linked with the units in a unit trust (or mutual fund). The value of the units is directly related to the value of the underlying assets of the fund. This value may fluctuate according to the performance of the investments concerned.

Investment-linked insurance policies may come in a variety of forms, but there is a common factor. Part of the premiums will be used to purchase units in a fund at the price applicable at the time of purchase. The value of the policy will then fluctuate according to the value of the units allocated to it.

How the investment-linked insurance policies work somewhat differs from the traditional life insurance and annuities. With traditional life insurance and annuity policies, net premiums (i.e. premiums net of the insurer's costs of doing business) once paid will become part of the company's general investments whose earnings help to accumulate cash value, from which policy benefits are paid. The death benefit and cash value of these policies are usually fixed and guaranteed. Under these types of policies, the insurance company assumes the investment risk. Where the amount of investment proceeds is more than what is required to fund the insurance contract's guarantees, the difference is added to the company's earnings. Part of such earnings is distributed to the policyholders of participating policies in the form of dividends, and the rest may wholly or partly be transferred to the shareholders' funds. On the contrary, in the case of a deficit (perhaps because of poor investment results), the insurance company bears the loss.

However, for the investment-linked insurance policies, net premiums are invested in investment funds accounts that are separated from the company's general assets ("separate accounts") and are therefore entirely separated from the insurer's general account liabilities. The policy value, death benefit or annuity payment amounts will vary depending on the performance of these investment fund accounts. With these types of policies, all the investment risk is borne by the policyholder who however does not directly own any of the underlying assets recorded in the accounts. This allows investment gains to be passed through to the policyholders, but it also means that investment losses are borne by the policyholders.

A variety of assets may be used for linking purpose including equities (ordinary shares), fixed income securities (money market instruments and bonds) and a whole range of cash and other security/asset funds.

As these policies are considered collective investment schemes under the definition provided for in the ***"Securities and Futures Ordinance" (Cap 571)*** authorisation has to be sought from the SFC if they are sold to the general investing public.

Finally, it should be noted that only insurance companies authorised under the ***"Insurance Companies Ordinance" (Cap 41)*** to carry on Class C business in or from Hong Kong can underwrite investment-linked long term insurance policies.

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Representative Examination Questions

*The examination will consist of **80** multiple-choice questions. The majority of the questions will be very straightforward, involving a simple choice from four alternatives. These we may call **Type "A" Questions.** A selection of the questions (probably between 10% and 15%) will be slightly more complex, but again involving a choice between four alternatives. These we may call **Type "B" Questions.** Examples of each are shown below.*

Type "A" Question

1. All investment-linked long term insurance policies have to obtain authorisation from which of the following organisations if they are sold to the general investing public:

   (a) the Hong Kong Federation of Insurers (HKFI);
   (b) the Securities and Futures Commission (SFC);
   (c) the Professional Insurance Brokers Association (PIBA);
   (d) the Insurance Authority (IA).

[Answer may be found in **1.2**]

Type "B" Question

2. An investment-linked long term insurance policy usually serves which of the following objectives:

   (i) protection
   (ii) investment
   (iii) fixed interest income
   (iv) guaranteed final return

   (a) (i) and (ii) only;
   (b) (ii) and (iii) only;
   (c) (iii) and (iv) only;
   (d) all of the above.

[Answer may be found in **1.2**]

***Note**: The answers to the above questions are for you to discover. This should be easy, from a quick reference to the relevant part of the Notes. If still required, however, you can find the answers at the end of the Study Notes.*

Chapter 2
INVESTMENTS

Since the value of an investment-linked long term insurance policy depends on the performance of its underlying investment portfolio, in order to fully understand its nature, it is necessary to have a basic knowledge of investment.

Our discussion on the investment topics is covered in two chapters. In Chapter 2, we review the basic concepts of investment with special emphasis on investment objective, risk and return, risk management, factors affecting investment considerations and finally investment advising. In Chapter 3, we give a detailed description of the major types of investment assets including money market instruments, debt securities, equities (shares), financial derivatives, real estate, low liquidity investments, investment funds and insurance products.

2.1 RISK OF INVESTMENT

What motivates a person to invest, rather than spending their money immediately? The most common answer is accumulation of wealth and provision for the future. To increase wealth, a person needs to do something to the savings to make them grow. What a person does with the savings to make them increase over time is investment. Thus, investment is the commitment of money for a period of time in order to derive larger future payments. The definition of investment is ***to sacrifice present value for future value*.**

When we talk about investment, most people focus on how much money they can make without any detailed analysis or are even ignorant of the risks involved in the investment. It is imperative for investment advisors to fully understand the concept of risk and help investors define their risk appetite before embarking on investment or giving investment advice. Therefore, we start with a detailed look at risk.

2.1.1 Meaning of Risk

Risk is the possibility of loss or injury. In investment terms, it is the uncertainty associated with the end-of-period value of the investment. Investors are however, more concerned with the downside risk, which represents the possible loss or reduction of the original sum invested – ***financial risk***. In the investment industry, the existence of financial risk means that it is possible for investors to lose money, and that there is no absolute guarantee of capital growth.

Financial risk is often perceived to have increased in recent years. The equity market crash in 1987, the Sterling Pound's exit from the Euro Exchange Rate Mechanism in 1992, the bursting of the bond market bubble in 1994, the Asian markets meltdown in 1997-1998, the 9/11 terrorists attack in 2001, the epidemic of SARS and more recently the Global Financial Crisis of 2007–2008, have all left their marks in the minds of investors. This perceived increase in financial risk, together with a growing awareness among investors of the various techniques and products for managing it, has led to a sharp increase in demand for risk management services.

2.1.2 Types of Risks

Investors are sometimes mistaken by the concept that they can avoid risks by just placing their asset in a bank account. This act however, is still subject to two risks:

- default risk in that the bank they invest in may go out of business; and
- inflation risk in that higher prices of goods in the future will reduce the purchasing power of the saved funds.

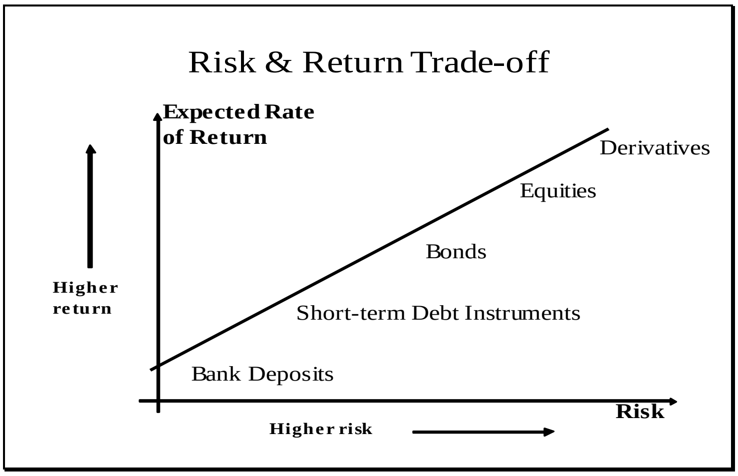
There is an endless list of risk factors in investment to the average investors. The following list covers the more common and important risks:

- ***Market risk –*** basic demand and supply in the market will affect the price of investment instruments. An investor will suffer a loss if he/she has to sell an asset when the price drops below his/her original purchase price.
- ***Company risk –*** negative developments such as the loss of market share or the failure of a new product launch will have an adverse effect on a company's financial status and thus its share price.
- ***Economic risk*** – the possible impact of an overall economic slowdown.
- ***Inflation risk*** – the loss of purchasing power as return on investment does not match the inflation rate.
- ***Default (credit) risk*** – the potential inability of a debt issuer to pay interest and/or repay principal.
- ***Interest rate (price) risk*** – the price fluctuation of certain fixed income investments prior to maturity due to current market interest rate changes.
- ***Liquidity risk*** – the inability to liquidate (sell) an investment or the need to pay a substantial cost to liquidate.
- ***Reinvestment-rate risk*** – the inability to reinvest interim cash flows or a mature investment at the same or higher rate of return.
- ***Exchange (currency) risk*** – a foreign financial investment upon maturity may have to be converted into home currency at a less favourable rate due to foreign exchange rate fluctuation.
- ***Sovereign or Political risk*** – political instability may cause governments to take actions that are detrimental to the financial interest of financial investment instruments in that country.
- ***Operational risk*** – the risk faced by financial institution arising from the operations of the business deal processing, deficiency of information system, ineffective internal management and control system, human errors, etc.

2.1.3 Risk-return Trade-off

Inevitably, investment involves risk. Any investment involves a trade-off between risk and expected return. As a general rule, the higher the return an investor seeks, the higher the risk he/she must be prepared to accept. The higher return is to compensate for the higher risk of the investment. As such, investors should be aware of the risks and returns of different asset classes in making investment decisions.

The following graph provides a perspective on the relationship between the risks and returns of several investment assets. Please note that the graph is not drawn to proportion but it does give a relative position of the level of risk and expected return of those assets.



2.1.4 Risk Reduction Techniques

There are a few proven techniques for reducing risk in investment. They are diversification, dollar cost averaging, and time.

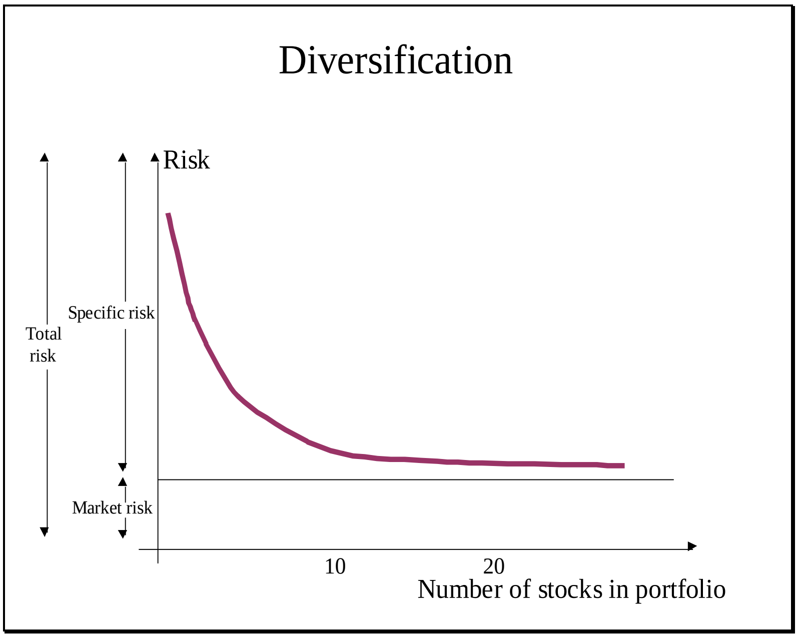
(a) Diversification

Diversification means owning different issues of the same asset class or different asset classes within a portfolio of investment, or investing in different markets, regions or countries. Diversification is a normal practice of investment managers to reduce the risk without substantial reduction in returns. It has been demonstrated that putting assets with low correlation in their return together in a portfolio could reduce substantially the overall risk of the portfolio without giving up return.

Why does diversification reduce risk? This is because normally markets do not all move in tandem and some financial instruments react differently to market movements. That is, one instrument may drop in value but the other may increase in value at any point in time responding to the same market/economic movement. For example, a downturn in the economy will normally lead to a fall in the equity market (economic risk) and at the same time give a boost to the bond market (lower interest rate, higher bond price). Another example is that an increase in oil price is detrimental to energy dependent firms like airlines and manufacturing companies but beneficial to energy producing firms like oil companies. Therefore, if your portfolio holds both types of stock, for example Cathay Pacific and CNOOC, the adverse effect of rising oil price on Cathay Pacific may be reduced by the positive impact on CNOOC.

A "balanced portfolio" – return from investing in a variety of investment assets tends to be less volatile than that from investing in a single asset, because the investor is in effect spreading the risks. Insofar as investment is concerned, one should always avoid putting all eggs in one basket. This is also the underlying concept of investment funds.

The following diagram shows how the total risk of a portfolio decreases when more assets are added into the portfolio.



(b) Dollar Cost Averaging

It is an investor's dream to be able to enter the market at its bottom but nobody knows when a market reaches its bottom. To the contrary, we often see people got caught at the top of the market. Investors want to buy low and sell high but turn out to buy high and sell low.

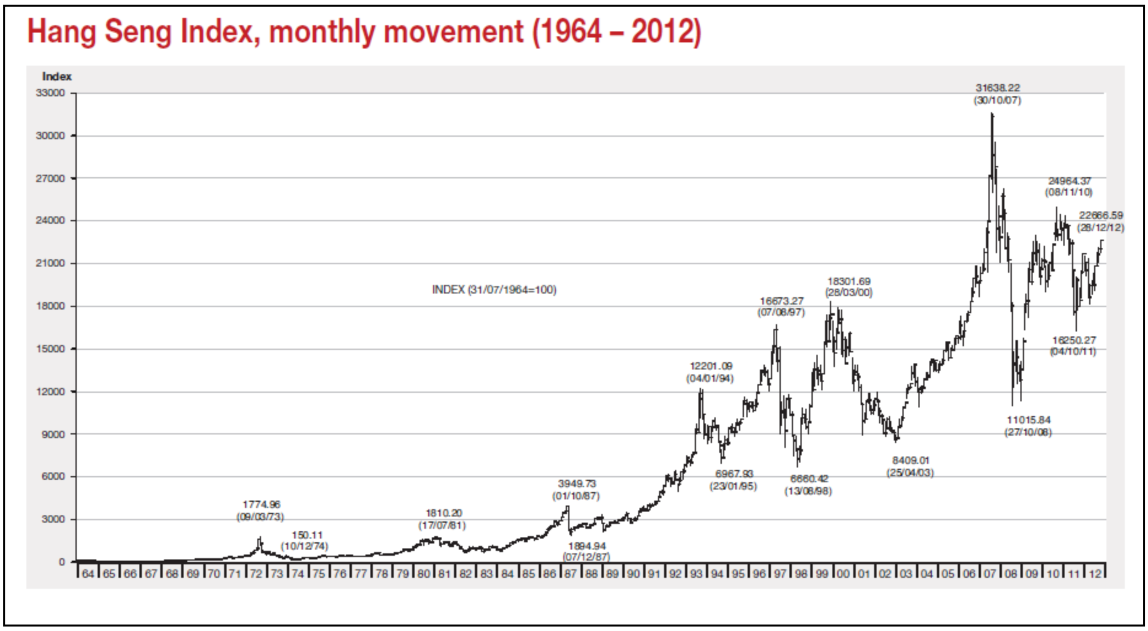
Dollar cost averaging is a technique to prevent investors from putting all their money in the market at the inappropriate time. This involves investing a fixed sum of money at fixed intervals of time. Let us look at the following example. Suppose an investor wanted to invest HKD150,000 in stock A but he/she was not sure whether it was the suitable time to enter the market. He/she therefore decided to split his/her capital into 5 equal sums of HKD30,000 and buy stock A worth of HKD30,000 in the middle of each month. The following table illustrates his/her transaction records.

Date	**Market Price**	**No. of share Bought**
15-Jan	HKD50	600
15-Feb	HKD60	500
15-Mar	HKD40	750
15-Apr	HKD25	1,200
15-May	HKD50	600
Total no. of shares bought		3,650
Average cost per share		HKD41.10

We can see from the table that although at the end of the period the stock price of A was virtually unchanged at HKD50, the same level when the investor started his/her investment, the investor has built up his/her portfolio at the average price of HKD41.10. The reason is that with a fixed sum of investment, the investor bought more shares when the stock price was lower and bought less shares when it was higher, a lower average cost was thus achieved.

(c) Time as a Risk Moderator

Time not only works for investors through the power of compounding (please refer to **Appendix A**) but also helps to dampen the risk of investments. At the Hang Seng Index chart below, we see that the stock market basically follows an upward trend with interim fluctuation. Suppose an investor was unfortunate enough to enter the market at the peak in 1997. If he/she was able to keep his/her position till year 2007, he/she would have a chance to get out with a good profit. However, if he/she was a short term investor and had to close his/her position in 1998, the story would be very different.



Hang Seng Index, monthly movement (1964 – 2012)

Source: HKEx Fact Book

It must be pointed out that although most stock markets tend to come back and surpass their previous high if investors can stay long enough in the market, the waiting period could be indefinite. For instance, the Japanese Nikkei 225 index – closing at 18,665 on 10 March 2015 - is still way below its record high of 38,957 seen in December 1989. This is yet another example illustrating the importance of “diversification”.

2.1.5 Risk Management Process

Having laid down the risk management principles of an average investor, we are going to discuss the risk management process from the perspective of a financial intermediary. The risk management process typically involves four steps: Identification of Risk; Measurement of Risk; Management of Risk; and Monitor of Risk.

(a) Identifying Risk

The business must be fully understood before the risks inherent therein can be identified. For example, a securities broker whose business relies heavily on a few clients is subject to a higher credit risk than a broker which has diverse client mix. If the nature of the business is not properly understood, the risks identified may be over or under estimated or even incorrectly classified.

In identifying the risk, the management of the business should be aware of the different types of risk discussed in Section **2.1.2** related to its activities such as credit, market, economic or political risks and their possible impacts, etc.

(b) Measuring Risk

The most common method to quantify risk is the concept of volatility of the rate of return of an asset. Volatility is defined as the standard deviation of the rate of return. Historical volatility is a measure of the dispersion of returns around the average of historical returns. It can also be used in a forward-looking manner to calculate the dispersion around the expected return.

(i) **Expected Return**

We may employ scenario analysis to assist us to find out the expected return of a financial asset, e.g. a fund. Firstly we forecast the expected returns of the fund in different scenarios like bull market, stable market and bear market. Secondly we assign probabilities of occurrence to each scenario. Then the expected return is calculated by:

$$r = \Sigma p_i r_i$$

Where

r = expected return

p_i = probability of occurring r_i

r_i = return of an expected scenario

(ii) **Volatility**

After finding out the expected return, we can use the formula of standard deviation to calculate the volatility. The higher the volatility, the higher is the risk of the investment.

Volatility = standard deviation = $\sqrt{\Sigma p_i (r_i - r)^2}$

Example:

Find out the expected return and volatility of Fund A and Fund B given the following return scenarios:

Probabilities	Return of Fund A	Return of Fund B
0.2	20%	20%
0.7	25%	40%
0.1	5%	-10%

Expected return of Fund A:
(0.2 x 20%) + (0.7 x 25%) + (0.1 x 5%) = 22%

Expected return of Fund B:
(0.2 x 20%) + (0.7 x 40%) + [0.1 x (-10%)] = 31%

The volatilities of both funds are:

Probabilities	Return of Fund A	$p_i (r_i - r)^2$	Return of Fund B	$p_i (r_i - r)^2$
0.2	20%	0.8	20%	24.2
0.7	25%	6.3	40%	56.7
0.1	5%	28.9	-10%	168.1
		36		249

The volatility of Fund A = $\sqrt{\Sigma p_i (r_i - r)^2}$
$= \sqrt{36} = 6$

The volatility of Fund B = $\sqrt{249} = 15.8$

(iii) **Sharpe Ratio**

From the above example, Fund B has a higher return carrying at the same time a higher risk as compared to Fund A. An investor would however be more interested in the question as to which fund gives a higher return for the same level of risk. To answer this question, we need to rely on Sharpe ratio which is the return of an asset over risk free rate per unit of risk undertaken:

Sharpe ratio = (Expected return – Risk free rate) / volatility

Assuming the risk free rate is 5% in the above example:

Sharpe ratio of Fund A = (22 – 5) / 6 = 2.83

Sharpe ratio of Fund B = (31 – 5) / 15.8 = 1.65

Despite the higher absolute return of Fund B, Fund A in fact can give a higher return for the same level of risk.

(iv) **Other Measurements of Risk**

Other major market risk measurement methodologies include:

1. Value at Risk (VaR): It is widely adopted as an industry benchmark for risk measurement for banks and financial institutions. It is a measure of the change in value of an investment as a result of changes in market conditions at a specified confidence levels. An example of a VaR statement is "The 1-day 99% VaR for the position is HKD1 million". It means that there is 99% chance that the maximum daily loss likely to occur is HKD1million.
2. Stress test: VaR only indicates the maximum loss within certain level of confidence. There is still chance of a loss much larger than the VaR figure. Stress test can supplement this shortcoming of VaR by assessing how an investment performs when specific large moves in the market parameters occur.
3. Option sensitivity measures: it measures the option price changes as against changes in other parameters such as time, interest rate, volatility, etc.
4. Duration: it is used to measure the percentage change in bond prices with respect to change in interest rate.

(c) Managing Risk

In order to manage the risk identified and measured in the previous steps, effective risk management policies and procedures must be established.

Risk management is a top-down process and therefore the endorsement of top management is one of the key success elements of risk management policy. The policy must be set out clearly and properly documented. The risk management responsibilities have to be clearly defined and communicated to the staff concerned. Sufficient training has to be provided. The senior management has the responsibility to implement the policy properly and oversee the day to day operations. Effective segregation of duties must be ensured so that risk management functions are independent of any of the business units.

An effective organisational structure is also a prerequisite of successful risk management. A direct reporting line to the senior management is necessary so that anything unusual can be reported and responded to quickly. Adequate resources, competent and experienced personnel must be available for the implementation of the risk management policy.

(d) Monitoring Risk

Finally, an internal system should be in place to regularly monitor the risk management process. It can be done either by internal or external auditors in order to assess the effectiveness of the system. Appropriate revision or enhancement can be made if necessary. Similar to the risk management policy, the monitoring system must be clearly set out and properly documented.

2.1.6 Financial Risk Management in Hong Kong

(a) Risk Management Systems and Processes

The regulatory bodies in Hong Kong play a key role to ensure that high standard of risk management system and processes are implemented in financial institutions of Hong Kong. There are different regulatory frameworks in place to govern the risk management of different types of financial institutions such as authorised institution, brokerage house, investment fund company.

Hong Kong Monetary Authority (HKMA)
The authorised institution is governed by the HKMA. The HKMA has issued various guidelines as contained in the HKMA's Supervisory Policy Manual to the industry which are either minimum standards or best practices in risk management.

The regulatory approach undertaken by the HKMA is called risk-based supervisory approach which is based on the recommendation of the Basel Committee on Banking Supervision. It seeks to determine whether authorised institutions have appropriate systems of risk management and internal control. The objective is to provide an effective process to monitor and assess the safety and soundness of authorised institution on an on-going basis.

The HKMA implemented the **CAMEL rating system** since 1995 which is an international recognised framework for assessing **Capital adequacy**, **Asset quality**, **Management**, **Earnings** and **Liquidity**. The overall rating is expressed through the use of a numerical scale of 1 to 5 in ascending order of supervisory concern. The risk-based supervision provides the supervisory process with the necessary framework to factor the risk profile of an authorised institution into the CAMEL system.

All in all, the HKMA has identified four basic elements contributing to a sound risk management environment:

- active Board and senior management oversight;
- organisational policies, procedures and limits that have been developed and implemented to manage business activities effectively;
- adequate risk measurement, monitoring and management information systems that are in place to support all business activities; and
- established internal controls and the performance of comprehensive audits to detect any deficiencies in the internal control environment in a timely fashion.

Securities and Futures Commission (SFC)
The SFC is the statutory body responsible for regulation of the securities and futures industry and facilitating and encouraging the development of these markets. The SFC also adopted risk-based regulation to the securities and futures industry. It means identifying and then focusing its attention and resources on the areas where it perceives to be of highest risk. The ultimate aim is to encourage intermediaries and market participants to develop a compliance culture.

The SFC has a range of regulatory tools such as regulatory programmes, policy projects and compensation schemes. These tools are either diagnostic, monitoring, preventative or remedial in nature:

- Diagnostic tools to identify and assess risks: For instance, the Intermediaries Supervision Department, which requires registrants to submit monthly financial resources returns, uses a set of assessment indicators to assess the financial risk exposure of registrants. The Licensing Department uses diagnostic tools in order to identify applicants for licences who could pose an unacceptable risk to investors.
- Monitoring tools to monitor and track identified risks: For instance, the Enforcement Division carries out market surveillance to gather evidence in relation to market crime. The Intermediaries Supervision Department uses both desktop and field reviews to identify instances of intermediaries' misconduct.
- Preventative tools to prevent or limit risks: For instance, the Investor Education and Communications Department provides education programmes that help investors become more aware of their rights and about how to protect their investments.
- Remedial tools to respond to risks that have arisen: For instance, where intermediary misconduct has been proven, disciplinary sanctions may be imposed. Finally, the investor compensation scheme is another example of a remedial tool used as a response when an intermediary fails and causes loss to investors.

(b) Risk Management Techniques

We are going to look into some practical risk management techniques that are encountered in the day-to-day risk management operation.

(i) **Marking to Market**

It is the process to revalue the collateral value of a client to reflect the current market value. For example, a futures broker should mark its clients’ open position regularly to ensure that margin calls would be made if the clients’ margins fall short of the maintenance margin. Frequent marking to market should be performed especially when there is a dramatic move in the market.

(ii) **Limit Setting**

Market risk exposure of a financial intermediary can be limited by setting trading limits. For example, position limit is the maximum open position a client of a securities broker may take. More detailed limits such as intraday and overnight limits can also be set. Stop-loss limit is also a common technique to limit the loss by liquidating a position when a pre-defined loss level has been suffered.

(iii) **Hedging**

The impact of future adverse price movement can be minimised by hedging with the use of derivative. For instance, if a fund manager expects a short-term downward correction in the market, he/she may sell short stock index futures in order to hedge against any potential decline in the portfolio value. When the stock market drops, the gain from the short stock index futures contracts will "offset" the loss in value of the portfolio.

(c) Past Experience

We have discussed some incidents of financial downturn in section **2.1.1**. They illustrate the utmost importance of risk management. Some other recent examples further confirm this.

(i) Barings

The collapse of Barings Bank in 1995 overnight was a classic example of operational risk. A trader in Barings had undertaken unauthorised dealing activities in futures. He was however able to conceal them because he was responsible not only in trading, but also in settlement of the transactions. By the time it was discovered, the bank had already lost billions of dollars.

The incident highlights the importance of segregation of duties in the risk management processes and procedures. The business unit (the dealing department) must be separated from the risk management unit (the settlement department) such that any irregularities in dealing can be identified much earlier.

(ii) Asian Financial Crisis in 1997-1998

Due to the impressive economic record of the East Asian countries, the region has attracted large inflows of capital from foreign investors in the 1990s. Unfortunately, the funds were not invested efficiently but lent to family members or political affiliated parties by the banks. The funds ended up with poor returns and defaults from borrowers were surging. When the foreign investors started withdrawing funds by selling off assets in the region, speculative attack on the regional currencies were launched.

This is not only a case of wrong assessment of credit risk by the banks in evaluating the chance of default by the borrowers, but also the ignorance of the importance of risk management. Moreover, the extreme interest rate and exchange rate movement caused by the crisis has posed severe market risk to financial institutions. Some local securities houses collapsed in the event, seemingly due to underestimation of the market risk at the time.

(iii) Global Financial Crisis of 2007–2008

The global credit market was hard hit in 2008 following the peaking off of real estate market in the US by the end of 2006. New purchasers were warded off by the unsustainable level of property price. At the same time, default rate of property mortgage increased. Market began to lose confidence in those firms which had been active in lending to the property purchasers. Following the collapse of Bear Stearns in March 2008, market confidence continued to deteriorate and the bankruptcy of Lehman Brothers in September 2008 finally triggered the global credit crunch. It illustrates again the importance of risk management. Any wrong assessment of default risk and market risk may lead to collapse of seemingly unassailable financial institutions.

(d) Looking Ahead

The Hong Kong banking system has remained largely intact under the global credit crunch in 2008. This is possibly attributed to the growing awareness of risk management in the industry.

However, the collapse of Lehman Brothers has led to the Minibond crisis in Hong Kong. This further demonstrates that a financial institution should not only focus in managing financial risks. Other risks such as legal risk, reputation risk and systemic risk are equally important. Both the HKMA and the SFC has taken initiatives related to the offering and selling of investment products. To this end, the Life Insurance Council of the Hong Kong Federation of Insurers has also issued a set of guidelines relating to the selling of investment-linked long term insurance policies for better consumer protection (see section **4.13.1** for details).

2.2 INVESTMENT CONSIDERATIONS

After we have gained a basic understanding of risk in investment, it is time for us to move on to other factors that have to be taken into consideration before making investment decision.

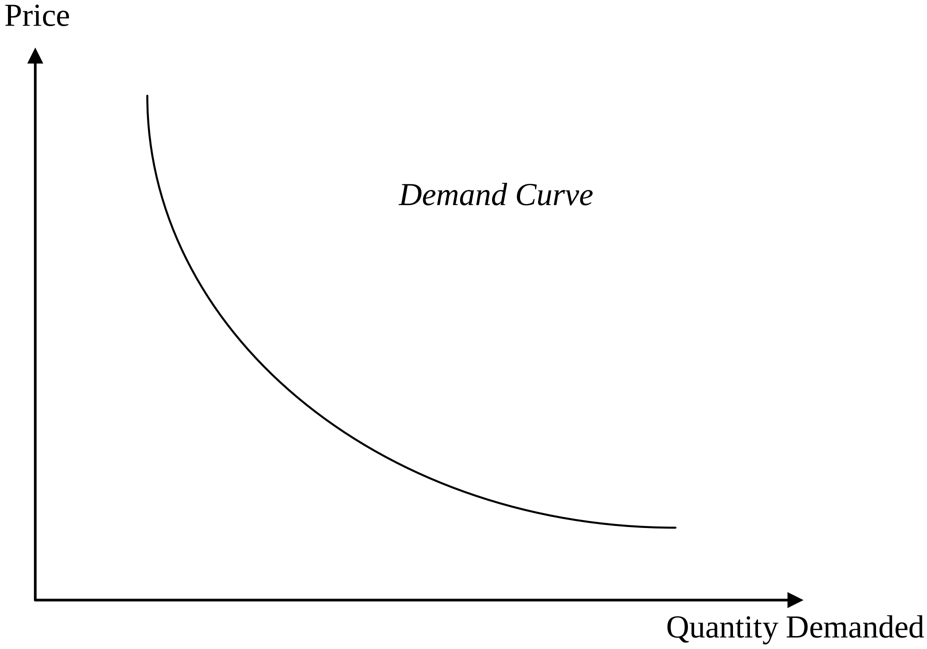
2.2.1 Basic Economics

Economics is the study of how individuals make choices under the constraint of limited resources and of the results of those choices for society. For example, the market for oranges consists of buyers and sellers. Buyers (individuals) determine the quantities to purchase at different prices and the sellers determine the quantities to produce at different prices. The interaction among buyers and sellers determines the market price and quantity of oranges traded in the market (society).

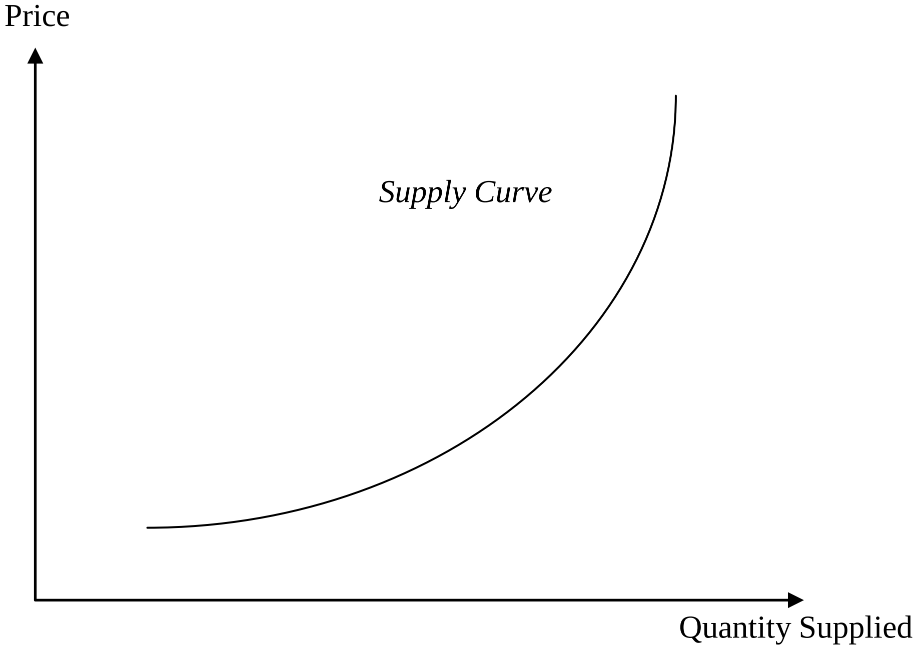
(a) Demand and Supply

Demand curve is a graph showing the quantity of a good that buyers are willing to buy on the x-axis at each price on the y-axis. The quantity demand is normally downward sloping with respect to price. This inverse relationship is attributed to the substitution effect and the income effect.

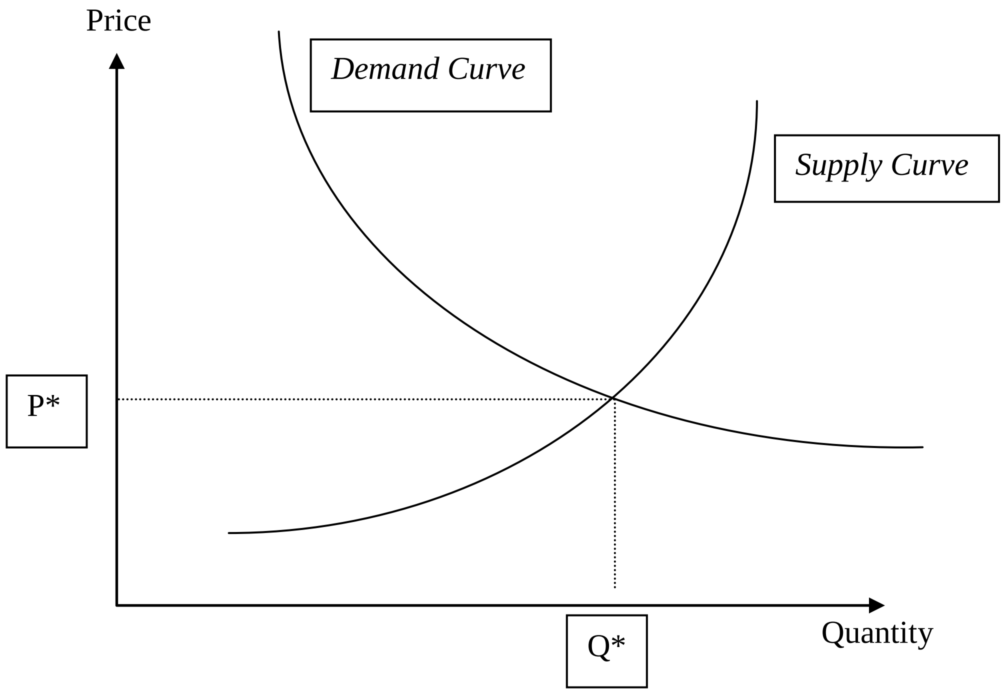
When oranges are getting more expensive, buyers may switch to apples or other fruits that substitute for orange and consume fewer oranges. This is the substitution effect. Moreover, the price increase reduces purchasing power and buyers cannot afford to buy as many oranges as before: the income effect. The quantity demanded can be illustrated in the following demand curve.



Supply curve is a graph showing the quantity of a good that sellers are willing to sell on the x-axis at each price on the y-axis. The supply curve is normally upward sloping. The assumption is that sellers would be more than happy to sell or produce additional oranges, so long as the price received is higher than the additional costs of supplying or producing them. This can be illustrated in the following supply curve.



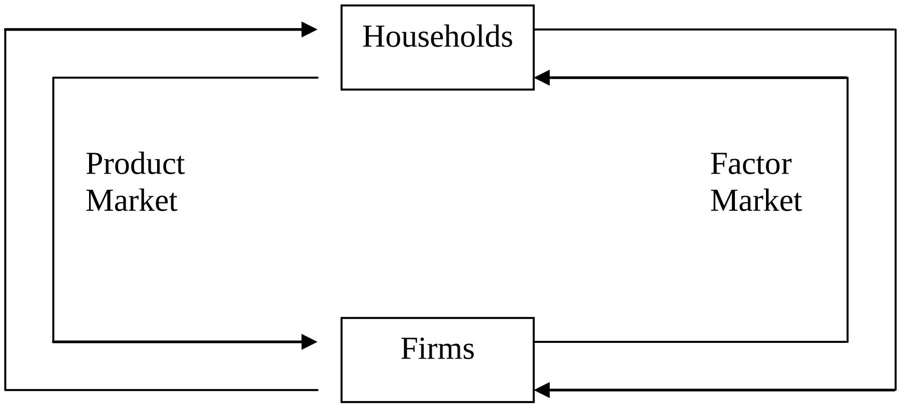
The demand curve intercepts the supply curve at the equilibrium price and equilibrium quantity where buyers are happy to purchase and sellers are happy to supply the equilibrium quantities at the equilibrium price. The equilibrium price (P*) and the equilibrium quantity (Q*) are shown in the following graph.



However there are factors other than price that would affect the equilibrium such as incomes, tastes, population, expectations, and the prices of substitutes and complements. These factors may shift the demand curve leftward or rightward. For example, when the general income of a society increases, the quantity demand of oranges at each price level will increase. The demand curve will be shifted to the right and the equilibrium price and quantity will therefore increase.

(b) Economic Sectors

An economy in its simplest form consists of only two sectors: the household sector and the business sector. The household sector buys goods and services supplied by the business sector. It also supplies labour (factor services) to the business sector in return of wages. These two sectors can be illustrated in the following diagram:-



However, the above model excludes the government sector and foreign sector. The government sector receives taxes from the household and business sectors; and spends money to fulfil its economic, political and social objectives. The foreign sector trades (export and import) goods and services with the domestic economy.

More importantly the simple economy assumes that there are no savings in the economy thus ignoring the finance sector. It includes the financial intermediaries and institutions through which funds are transferred from people who have an excess to those who have a shortage. The different sectors mentioned above can either be a lender-saver or borrower-spender.

(c) Money and Banking

The finance sector is to facilitate the transfer of funds or money. Money has three principal uses: medium of exchange; a means of holding wealth; and a unit to measure value.

Money as defined by the Hong Kong Monetary Authority is classified as:

- M1: The sum of legal tender notes and coins held by the public plus customers' demand deposits placed with banks.
- M2: M1 plus customers' savings and time deposits with banks plus negotiable certificates of deposit (NCDs) issued by banks held outside the banking sector.
- M3: M2 plus customers' deposits with restricted licence banks and deposit-taking companies plus NCDs issued by these institutions held outside the banking sector.

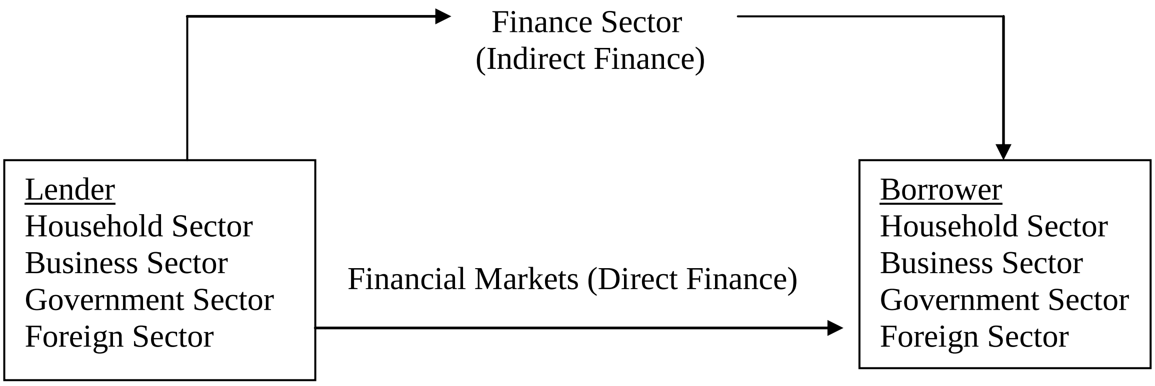
The banking system plays the most important role in the finance sector by extending credit to borrowers and using funds raised from depositors. The main reasons why we need the banks to facilitate the money market are as follows:-

- Specialisation: banks specialise in evaluating the quality of borrowers whereas individual savers do not have the expertise to determine the credit standing of potential borrowers.
- Investment: banks help saver accumulate wealth and direct their savings toward higher return and more productive investments.
- Payment: banks facilitate payments of account holders with the use of current accounts, remittances and credit cards.

2.2.2 Global Economy

(a) Flow of Funds

The excess of funds of different economic sectors can flow towards those who are in need either directly or indirectly. Direct finance refers to the borrowers obtaining funds directly from lenders. In this situation, the amount of lending, return and risk profile of lender and borrower match each other. Indirect finance occurs when the funds flow through the finance intermediaries from the lender to the borrower. It happens when the risk and return of borrower and lender do not match. The intermediaries are therefore compensated for assuming the risk by adding a fee (brokerage or commission) on top of the interest charged. It can be shown in the following figure:



(b) International Capital and Investment Flows

A financial market does not exist on its own. There are always investment opportunities across the borders which furnish international capital and investment flows. The globalisation of financial market allows countries with higher productive investment opportunities and lower domestic savings to fill the gap by attracting capital inflows from countries with higher savings and lesser investment opportunities. Moreover, an investor can easily diversify his investment portfolio by holding financial assets in different countries. It results in more efficient use of financial resources.

However, it is worth noting that international capital flow is a double edged sword which may cause global financial market instability. The economic crisis in one country may easily spread to other markets. For example the global financial markets were put under severe stress due to the credit crunch in the United States in 2008. The problems of the US banks' balance sheets have brought cross border lending to emerging markets to a halt by the US banks. Furthermore, overseas investors holding assets in the US also experienced asset degrading which would end up reducing consumption in the domestic economy.

(c) Global Market

Due to the integration of the global financial market, Hong Kong is one of the participants which are greatly influenced by their trading and investment partners. In examining factors affecting the Hong Kong economy, it is important to consider its relationship and interaction with the US and the Mainland of China.

<u>Chinese Economy</u>

The Mainland of China plays a key role in Hong Kong's economy and financial markets. By virtue of its close proximity to the Mainland, Hong Kong is perfectly situated for trade with it. For many years, Hong Kong has served as the gateway for foreign investment in the Mainland by providing financial, management and technical expertise.

The entry to the World Trade Organization in 2001 has set the stage for even greater economic expansion in the Mainland which has since further opened up to global trade and capital flows. The Closer Economic Partnership Arrangement (CEPA) was rolled out in 2004, which provided Hong Kong with additional and exclusive benefits for access to the Mainland economy.

Impact of the US Economy on Hong Kong

The US is one of the major trading and investment partners of Hong Kong. In 2014, exports of goods to the US made up 9.30% of Hong Kong's total exports, seconded only to the Mainland of China. As regards direct investment, US investors accounted for 3.31% of direct investments in Hong Kong by market value at the end of 2013. (Source of data: Census and Statistics Department)

Moreover, the Hong Kong dollar is linked to the USD operating under the currency board system. As a result, the interest rate in Hong Kong tends to move in tandem with the US interest rate. For the above reason, the US economy has a direct impact on that of Hong Kong.

Regional Influences

In considering the global financial market's impact on the Hong Kong economy, one should not lose sight of the regional influences. Hong Kong is one of the leading economies in Asia and international fund managers interested in Asian markets would likely allocate a substantial part of their investments in Hong Kong. As a result, any instability of the regional economies and their currencies would lead to capital outflow from the region and inevitably from Hong Kong. An obvious example was the Asian Financial Crisis in 1997 which was triggered by the devaluation of the Thai Baht, with the Hong Kong dollar being attacked by speculators in the ensuing chain of events.

2.2.3 Economic Factors Affecting the Financial Markets

The performance of financial markets is subject to the domestic and global economy. As the well-being of an economy is reflected from different economic factors and indicators, it is important to have a good understanding of them in order to gauge the financial market.

(a) Gross Domestic Product (GDP)

The ultimate measurement of an economy's performance is its gross domestic product. It is the market value of the final goods and services produced in a country during a given period. There are three methods to calculate GDP, namely, the production method, the income method and the expenditure method.

The expenditure method is by far the most popular one. It assumes that all the final goods and services that are produced in a country in a given year will be consumed by household, business, government and foreign sectors. These four sectors consume the final goods and services in four different types of expenditures: consumption by households, investment spending by firms, government purchases and net exports.

(b) Economic Cycles

Over time, an economy's output may increase more rapidly in some years than in others. As measured by the real GDP, a country's economic performance will tend to fluctuate by way of a cycle throughout history. This is known as the economic cycle which has four phases generally:

1. Expansion: The real GDP increases rapidly during period of expansion where profits and wages start increasing and unemployment rate falls. This also leads to higher prices.

2. Peak: The economy expands until the peak occurs. The real GDP is at a maximum and inflation is a threat to the economy.

3. Recession: It is the contraction phase of the economy after the peak. Output and employment fall. It would become a depression if the recession prolongs such as the Great Depression in the 1930s.

4. Trough: Employment and profits are at the minimum at the trough stage of the economic cycle and after which comes a new economic cycle again.

(c) Government fiscal and monetary policies

A government by deploying different policies can stabilise the economy to a certain extent. The right policy mix may bring an economy out of recession or prevent it from overheating. Fiscal policy refers to decisions on the government's budget as to how much the government spends and how much tax it collects. The logic behind fiscal policy is straightforward: the government increases purchase of goods and services, which are components of GDP, would directly boast the GDP. Furthermore, increasing spending by the government sector may increase the income of the household sector which will fuel further consumption by the private sector.

Monetary policy is the action by the government to influence the money supply in the economy so as to affect the market interest rate. During a recession, the central bank should lower the interest rate by increasing money supply, which would in turn stimulate investment and thus GDP. On the other hand, in order to prevent the economy from overheating, the central bank should raise the interest rate thus reducing investment and GDP. Monetary policy can be done through open market operation, control of reserve requirement or discount rate and intervention of foreign exchange market.

(d) Interest rate

Interest rate is in essence the price of holding money which is determined by the demand and supply of money. The higher the market interest rate, the greater the cost of holding money as people would prefer the alternatives to money such as deposits and bonds. For countries which have control over their monetary policy, the money supply is controlled by the central banks. However, Hong Kong is operating under a linked exchange rate system. It is the local interest rate rather than the exchange rate which is adjusted to cater for inflows and outflows of funds. As a result, Hong Kong has effectively surrendered its control over money supply in return for a stable exchange rate against the US dollar.

(e) Exchange rate

The exchange rate between two currencies is the amount of one currency that can be traded for the other. Under a flexible exchange rate system, the exchange rate is not officially fixed but changes in accordance to the market force of demand and supply for the currency. Most developed countries nowadays adopt flexible exchange rate system. Some currencies are however fixed against another currency under a fixed exchange rate system. The linked exchange rate system of the Hong Kong dollar is a good example.

(f) Inflation

Inflation is a measure of the annual percentage rate of change in the general price level. Higher inflation will bring about lower purchasing power of money.

The price level is distinguished from inflation in that the former is the overall level of prices at a particular point in time as measured by a price index like the consumer price index.

Furthermore, the increase in price of one particular goods does not necessarily lead to inflation. The monetarist economists argue that if the money supply is constant, the price increase in one good will leave lesser amount of money to consume some other goods and thus lower the price in other goods. In short, the price increase in one goods is offset by the decrease in others in such situation. It will only result in the relative price change without affecting the general price level.

Deflation occurs when there is negative inflation. This normally happens during the recession phase of the economic cycle. It is different from disinflation which refers to a decrease in the inflation rate.

(g) Unemployment rate

Unemployment rate is expressed as a percentage of the number of unemployed divided by the labour force. One must therefore first ascertain the size of the labour force which is defined as the total number of employed and unemployed people. According to the definition of the Hong Kong Census and Statistics Department, the employed are those aged 15 and over who have been at work for pay or profit during the 7 days before enumeration or who have had formal job attachment. The unemployed population consists of those persons aged 15 and over who fulfil the conditions of: having not had a job and having not performed any work for pay or profit during the 7 days before enumeration; having been available for work during the 7 days before enumeration; and having sought work during the 30 days before enumeration.

(h) Globalisation and Technology

The global financial markets are integrating with the assistance of technology advancement such as computer network. Most international financial markets are accessible around the world so that any investment markets or assets are not restricted to the domestic investors but open to all global investors. Transmission of funds can also be done instantly which further facilitates settlement of financial transactions. These developments may increase the transaction volume of the financial markets.

The internet has also greatly improved the transparency of financial markets. Besides the traditional financial news provider such as Reuters and Bloomberg, there are a lot of up-to-date news and information on global markets which can be accessed via the internet.

As discussed above, the international mobility of funds has its advantages and disadvantages. While this will help economic growth, some of the capital flows are bound to be speculative and volatile. As a result, a domestic economy may be vulnerable to the attack of hot money.

2.2.4 Investment Objective and Risk Tolerance

The first step of investment should be the formulation of an investment objective. When being asked about their investment objective, most investors would say they want to make money. And when being asked about how much they would want to make? The typical answer is the more the better. However, such answers are not good enough.

An investment objective must be specific and realistic, taking into consideration the investor's personal needs, risk tolerance and investment constraints. A person's investment return objective may be stated in terms of an absolute or relative percentage. For example, the investment objective is to achieve an average annual rate of return of 15%, or 1% above the inflation rate, for the next 10 years. Also, it may be stated in terms of a general goal, such as capital appreciation, capital preservation or current income.

In setting an investment objective, risk tolerance is the most important consideration. As we have seen in the risk reward trade-off discussion, huge risk accompanies high return. An understanding of the level of risk tolerance is needed before a realistic investment goal can be set.

Risk tolerance is the largest amount of loss that an investor is willing to take for a given increase in the expected return. Each investor is said to have a risk tolerance factor, i.e. the extent to which he/she is prepared to risk a loss on his/her investment in return for chances of an enhanced return. An investor who prefers an investment with less risk to one with more risk, assuming that the two investments offer the same expected return is known as a risk-averse investor. One standard way of classifying investors, in relation to their risk tolerance is:

(a) ***Conservative***: such an investor is more concerned with capital protection than with high rates of return. He/she may also be described as risk averse, i.e. not a gambler ready to play for high stakes.

(b) ***Aggressive***: such an investor is much more ready to accept risk and to improve chances of enhanced returns. This necessarily involves variations of return and in the short-term at least could involve losses.

(c) ***Balanced***: the happy medium, where a degree of risk is acceptable, but where protection of capital remains important.

In general, different stages of life also influence risk appetite. As age increases, the investor's investment strategy will usually adjust to fit new goals and circumstances. On the other hand, the ability of a person to take risk also affects the level of risk tolerance. Generally, higher net worth investors have higher risk tolerance than lower net worth investors.

Many tests have been developed to help investors to evaluate their risk tolerance. Investors should take such a test to get a better understanding of their tolerance levels before investing.

2.2.5 Other Investment Constraints

Apart from investment objectives and risk tolerance that set limits on risk and determine the return objective of investment, some other factors also influence investors and need to be considered before making their investments. These factors are:

1. Liquidity requirement;
2. Time horizon; and
3. Tax considerations.

(a) Liquidity Requirement

Liquidity refers to the ability of an investor to sell the asset quickly without having to make a substantial price concession.

An example of an illiquid investment asset would be an antique item. An investor who owns a piece of Tang dynasty porcelain may have to settle for a relatively low price if the item has to be sold within an hour. If the sale could be postponed long enough for a public auction to be set up, undoubtedly a much higher price could be obtained.

Alternatively, an investor who has to sell HKD1,000,000 worth of HSBC common stock within an hour will probably be able to receive a price close to the price that other sellers of HSBC stock recently received.

Investment plan must take into account of the liquidity needs of an investor. A young investor with a long-term investment goal probably has very low liquidity need while a retiree living on pension would need regular cash flows. The latter should have part of his/her portfolio in liquid securities such as money market instruments.

(b) Investment Time Horizon

This is the time period within which the investor intends to make the investment. This is dependent upon the investor's investment objectives, age and current financial condition. Most investment instruments can generally be classified under the following time frames:

- Short term — up to 1 year
- Medium term — from 1 to 5 years
- Long term — over 5 years

As have been discussed previously, time is an offsetting element for risk. One of the proven risk control strategies is for the investor to ignore short-term fluctuations in value (not being overly enthusiastic or overly concerned) and focus on the long term. History shows that the longer an investor stays invested, in general, the less likely that he/she will experience a negative return.

Investors with short investment time horizons should avoid risky investments because assets may have to be liquidated at an unsuitable time. Investors with long investment time horizon normally have greater risk tolerance because any shortfalls or losses can be recovered from returns in subsequent years.

It should be noted that using investment-linked insurance policies, is usually of a long-term nature, compared to the direct purchase of stocks and bonds.

(c) Tax Considerations

Personal taxes are based on an individual's or family's taxable income. In Hong Kong, returns on investment are not normally subject to personal taxation (capital gains or investment income tax). Since February 2006, estate duty has also been abolished in Hong Kong. However, for investors who are subject to foreign tax jurisdiction, it is worthwhile to consult tax advisors for tax planning.

2.2.6 Investment Advising

(a) Retail Investment Advising

Investment advising refers to the process of providing investment advices to the clients. There is a fine distinction between investment advising and financial planning. The latter is a process in which a financial planner evaluates a client's financial needs such as insurance, retirement, investment, etc. in order to meet the client's overall financial objectives. Investment advising however focuses on the investment objectives and needs of the clients and provides investment advices on investment products, investment strategies and so on.

The development of the retail investment advising market in Hong Kong in the last decade has been fast. The retail banks and independent financial advisors have taken a leading role in promoting the service of investment advising. At the same time, the improvement in living standards and demand for high quality personal financial services are also strong driving forces.

(b) Investment Advisors

The work of an investment advisor is very demanding. Owing to significant differences in the nature, features and risks of investment products and the personal circumstances of clients, an investment advisor should take in account different factors in order to provide appropriate and suitable investment advices:-

(1) Knowing the client: the investment advisor must seek information about the client's financial situation, investment experience and investment objectives. It includes the client's investment knowledge, investment horizon and risk tolerance, etc. Preferably, the information collected should be fully documented and updated on a continuous basis to see if there is any change of circumstances of the client.

(2) Understanding the investment products: the investment advisor should have a thorough understanding of the investment products including the structure of the products, the level of risk, fees and charges, the relative performance, liquidity, etc.

(3) Providing reasonable advice: the investment advisor must ensure that the risk return profile of the investment product matches the personal circumstances of the client to whom it is recommended.

The investment advisor should also provide all relevant information to the clients to assist them to make an informed decision. The reasons of recommendation should be properly documented for future reference.

Given the complex nature of work, an investment advisor needs to have all-round knowledge not only in financial market but also in economics, laws, asset management and risk management. But the above is only technical knowledge. An investment advisor is also expected to have excellent communication skills to take care of the psychological well-being of the clients. For example, he/she must be able to raise personal matters with the clients in a non-offensive manner and to convey bad news in poor market environment.

Most important of all, an investment advisor must build up trust and confidence from the clients by acting ethically. Different regulatory bodies or professional association may have issued their only code of ethics. Some basic ethical principles include integrity, honesty, due diligence, avoidance of conflict of interests, confidentiality competence, etc.

2.2.7 Summary

As explained above, an advisor who is advising on a client's investment portfolio must be concerned with the client's investment needs and objectives and understand the client's level of risk tolerance, constraints and other unique circumstances in order to advise and recommend on the appropriate investment portfolio.

In the selling of investment-linked policies, an insurance intermediary should clearly communicate to the client features and benefits of the insurance policy. The understanding of the various types of investments as well as their related risk and return structures will thus facilitate the communication of relevant and correct information to prospective clients as well as assist in the early identification of the type of products that a prospective client may require.

Most insurance companies/brokers have devised their own set of questionnaire to assist their agents/technical representatives in the collection of relevant client information for the above noted purpose. Such information includes nationality (tax purposes), number of dependents, cash flow, investment objective and preference, current asset portfolio and insurance coverage. Please refer to section **4.13.1** for a more detailed discussion on this topic.

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Representative Examination Questions

Type "A" Questions

1. Which of the following is the correct sequence of risk management process?

   I. Management of risk
   II. Identification of risk
   III. Monitor of risk
   IV. Measurement of risk

   (a) II, IV, I, III.
   (b) I, II, III, IV.
   (c) II, III, I, IV.
   (d) II, III, IV, I.

[Answer may be found in **2.1.5**]

2. An investment fund has the following return scenarios. What is the expected return of this investment fund?

Probabilities	Return
0.6	25%
0.4	5%

   (a) 15%.
   (b) 17%.
   (c) 20%.
   (d) 25%.

[Answer may be found in **2.1.5**]

3. Why does the economy of the US have a direct impact on that of Hong Kong?

   (a) The US is one of the major trading and investment partners of Hong Kong;
   (b) The interest rate in Hong Kong is the same as that of the US due to the linked exchange rate system;
   (c) The US stock market is a global financial market;
   (d) None of the above.

[Answer may be found in **2.2.2**]

Type "B" Questions

4. Which of the following statements about diversification in investment is/are true?

   (i) It eliminates the risks of investing in stocks in a portfolio.
   (ii) It helps spread the investment risk by investing in different categories of investment in a portfolio.
   (iii) It involves purchasing different types of stocks and investing in stocks of different countries.
   (iv) It reduces overall risk of a portfolio to an investor without sacrificing the return substantially.

   (a) (ii) only;
   (b) (iii) and (iv) only;
   (c) (ii), (iii), and (iv) only;
   (d) (i), (ii), and (iii) only.

[Answer may be found in **2.1.4**]

5. Which of the following are the principal uses of money?

   (i) Medium of exchange
   (ii) A means of holding wealth
   (iii) A unit to measure value

   (a) (i) and (ii) only;
   (b) (ii) and (iii) only;
   (c) (i) and (iii) only;
   (d) all of the above.

[Answer may be found in **2.2.1**]

6. Which of the following economic factors have impact on financial markets?

   (i) Monetary policy
   (ii) Gross domestic product
   (iii) Risk free rate
   (iv) Unemployment rate

   (a) (i) and (ii) only;
   (b) (i), (ii) and (iv) only;
   (c) (ii) (iii) and (iv) only;
   (d) all of the above.

[Answer may be found in **2.2.3**]

[*If still required, the answers may be found at the end of the Study Notes.*]

Chapter 3
INVESTMENT ASSETS

Investment assets are usually grouped into different asset classes according to their common characteristics. Each type of investment asset has its own particular potentials and drawbacks. The following is a list of the most common asset classes that we will discuss in some detail in the following sections:

1. Money Market Instruments
2. Debt Securities
3. Equities
4. Financial Derivatives
5. Real Estate
6. Low-liquidity Investments
7. Investment Funds
8. Life Insurance and Annuity

3.1 MONEY MARKET INSTRUMENTS

Money Market Instruments include highly liquid debt securities with maturities of less than one year. There are two categories of money market instruments, namely, bank deposits and negotiable short-term debt instruments.

3.1.1 Bank Deposits

This means simply placing the money with a “bank” for term or demand deposits. In Hong Kong, only financial institutions authorised by the Hong Kong Monetary Authority are allowed to accept deposits from the public and use the proceeds to make consumer or commercial loans. These institutions are classified as licensed banks, restricted licensed banks, and deposit taking companies. Hong Kong has a strong and solid banking system which makes banks in Hong Kong a very safe place to put our money. The rate of return, derived from interest payments, for bank demand deposit is normally the lowest when compared to other investment assets, reflecting the relatively low risk and high liquidity nature of this class of asset.

It should be noted that term or fixed deposits usually carry higher rates of return than demand deposit as a trade-off for lower liquidity. Early uplift of term or fixed deposit is subject to heavy penalty.

3.1.2 Negotiable Short-term Debt Instruments

These are short-term (typically maturing in less than 1 year), highly liquid, low-risk debt instruments issued by governments, banks and large non-financial corporations. They play an important role in the short-term investment and borrowing activities of most financial institutions.

Although most investors would hold such instrument to maturity, most of these instruments are negotiable which means that an investor may sell it to another investor in the secondary market if he/she needs the funds before maturity. Investors with substantial funds may invest in such money market instruments directly, but most do so indirectly via money market accounts at various financial institutions.

Most short-term debt instruments are sold on a discount basis, meaning that investor pays a price lower than the face value of the instrument and gets repaid at the face value. For example, a 182-day (26-week) Hong Kong Exchange Fund Bill (EFB) with a face value of HKD500,000 selling at a yield of 3.75% p.a. will cost an investor HKD490,822.30 (being HKD500,000/(1 + 3.75% x 182/365)). So the investor who pays HKD490,822.30 for purchase of the EFB will receive back HKD500,000 after 182 days and earns a rate of return of 3.75% p.a.

Major short-term debt instruments include:

- Government Bills;
- Short-term Certificates of Deposit; and
- Commercial Papers.

(a) Government Bills

These are short-term debts issued by the government to finance their expenses. Examples are US Treasury bills (US T-bills) and Hong Kong Exchange Fund bills (EFB). Investing in such bills is literally the same as lending to the government. As the risk of default by the government is extremely low or even regarded as default-risk free, such instruments command the lowest yield among similar instruments. Minimum denomination of US T-bills is USD10,000 and that of EFB is HKD500,000. They are issued and traded on a discount basis with maturities of 4, 13, 26 and 52-week.

(b) Short-term Certificates of Deposit (CDs)

These are negotiable short-term time deposit certificates issued by commercial banks evidencing a deposit of a fixed maturity of less than 1 year. Most CDs are issued in amounts of HKD500,000 or HKD1,000,000.

The yields on CDs are usually higher than government bills of similar maturity. This is because commercial banks are considered to have a higher possibility of default than the government. The less liquid secondary market and the tax implication are also negative for the investors.

(c) Commercial Papers (CPs)

These are unsecured promissory notes issued by top-rated financial and non-financial companies with maturities of under one year. CP is a low-cost alternative to bank borrowing. The rates of return on commercial papers typically exceed other comparable term money market instruments rates, reflecting its higher liquidity risk and default risk.

However, these are still relatively low in comparison with the interest rates of other corporate fixed income securities, such as corporate bonds.

In the US, the dollar amount of commercial paper outstanding exceeds the amount of any other type of money market instruments except for Treasury Bills, with the majority being issued by financial companies such as bank holding companies as well as companies involved in sales and personal finance, insurance, and leasing.

3.1.3 Advantages and Disadvantages of Money Market Instruments

This class of investment instruments is more suitable for short-term safe haven purpose pending longer-term move and have the following **advantages**:

- low risk;
- provide a reserve for emergencies;
- accumulate funds for specific future purposes;
- principal will not change, sometimes insured; and
- high liquidity.

On the other hand, such instruments do have some **disadvantages** such as:

- low return (inflation risk);
- fluctuating yield (reinvestment-rate risk);
- default risk (for non-government issues); and
- large denomination.

3.2 DEBT SECURITIES

3.2.1 Investing in Debt Securities

Debt or fixed income securities are a group of investment instruments that offer a fixed periodic return with maturities of over one year. This is typically a security document or certificate showing that the investor has lent money to the issuer, which is usually a company or a government, in return for fixed interest income and repayment of principal at maturity. Debt securities can be regarded as companies or government borrowing from the market and the returns are based on the credit worthiness of the respective borrower.

Debt securities generally stress current income although there is also opportunity for appreciation in value. If there is an active secondary market, they can be bought and sold at any time before maturity. However, if the secondary market is very inactive, the investor's money is tied up for the full life span of the security.

Debt securities fall into two general categories:

1. Debt obligations such as bonds; and
2. Preferred Shares (see section **3.2.14** for details).

The debt securities market can be categorised in different ways. Firstly, it can be divided into the primary and secondary market. On the primary market, new issues of debt securities are offered to the public for the first time. For example, the Exchange Fund Notes (EFN) issued by the Hong Kong Monetary Authority can be subscribed by investors through tendering on the primary market. Primary issues for corporate bonds are usually organised by financial intermediaries such as lead manager and underwriters.

Trading of the already issued debt securities are transacted on the secondary market which is predominately an over-the-counter (OTC) market. OTC market is an informal network of market participants such as brokers and dealers who negotiate sales of securities with each other. It is not a standardised market as opposed to an exchange market in that the trade specifications such as contract size, settlement date, etc. are subject to the parties' negotiation. However, since 2000, EFN have also been listed on the Stock Exchange of Hong Kong.

Bonds are debt instruments issued by corporations or government organisations and are usually long-term in nature (above 1 year up to 30 years or more).

These are characterised by a promise by the issuer to pay the bondholder (investor) two types of cash flows. The first type of cash flow involves the payment of a fixed dollar amount periodically, until a specified date. The second involves the payment of a lump sum on this stated date. The periodic payments are known as ***coupon payments***, and the lump sum payment is known as the bond's ***principal***.

There are different types of institutions/organisations issuing debt securities in the market.

(a) Supra-nationals Bonds

These are issued by multilateral organisations such as the International Bank for Reconstruction and Development (commonly known as the World Bank), the Asian Development Bank and the International Monetary Fund. Bonds issued by such organisations carry very high quality with minimal default risk.

(b) Government Bonds

These are financial instruments used by the government to borrow money from the public. They are the safest type of investments, carrying almost no default or credit risk because interest payment and repayment of principal are guaranteed by the government. Because of its credit quality, government bond yields are usually the lowest among fixed income securities of similar maturity periods. In the US, they are called Treasuries (US Treasury Notes and Treasury Bonds), and the debt securities issued by the Government of the Hong Kong Special Administrative Region are known as Exchange Fund Notes.

(c) Government Agency Securities

These are used by corporations owned or sponsored by government such as the Hong Kong Mortgage Corporation, MTRC, and the Airport Authority to raise capital in the bond market.

(d) Municipal Bonds

States or local governments of many large countries also issue bonds to finance their budget. Repayment of debts relies either on the taxing ability of the local government or revenue from some public projects. Municipal bonds carry a higher risk than the government bonds.

(e) Corporate Bonds

Corporate bonds are medium or long-term debt obligations of private or public corporations. Such bonds may be secured by certain assets or unsecured. Bonds issued by corporations fall into many categories. Corporate issuers range from large well known multi-nationals to smaller companies. The nature and risk of corporate bonds could be very different.

3.2.2 Par Value

The par value, also known as face value, maturity value or redemption value, is the amount the issuer agrees to repay the bondholder at maturity. Bonds can have different par values.

3.2.3 Convertibility

For certain type of bonds, the investor may have a right to choose whether to receive the par value or something else, typically the common stock of the issuer or of some other company. This type of bonds is called ***convertible bonds***. These are corporate bonds issued with a right granted to the investors, enabling them to convert the bonds into a specified number of ordinary shares at a pre-determined price and specified date, on or before the date the bond matures. The conversion right is intended to make the issue more attractive to the investors, especially if the bond is unsecured. Convertible bonds generally pay a fixed rate of interest, which is less than the interest on a non-convertible bond because of the value of the convertible feature.

3.2.4 Coupon Rate

This is the interest rate the issuer promises to pay the investor. Coupon payments are calculated by

Par value x coupon rate x fraction of a year

e.g. a bond with a coupon rate of 8% p.a., a par value of HKD10,000 and paying interest semi-annually will pay the bondholder HKD400 coupon payment every 6 months. The coupon payment is calculated by

HKD10,000 x 0.08 x ½ = HKD400

Coupon rate can either be fixed for the whole life of the bond or floating, i.e. the coupon rate is reset periodically based on certain reference rate. Most bonds are fixed-coupon bonds with the coupon rate fixed at the issuance and the bondholders will receive coupon payments determined by this rate no matter how the interest rates change after the bond is issued.

3.2.5 Term to Maturity

Most bonds have a fixed maturity when the issuer will repay the money to the bondholder. Some investors view bonds with a maturity between 1 and 5 years as short-term, 5 and 12 years as intermediate or medium-term and over 12 years as long-term. Bonds issued in Hong Kong rarely have original maturity longer than 10 years while in the US, the maturity for long-term bonds is typically 30 years.

3.2.6 Pricing of Bond

(a) Time Value of Money

Fundamental to the pricing of debt securities is the concept of time value of money. It is the relationship between the value of dollars today and that of dollars in the future.

Future value is the amount that an investment will yield after earning interest. For example an investor deposits HKD100 in a bank today and the deposit interest rate is 5% compounded annually. After a year, the future value of the deposit will be:

$$\begin{aligned} \text{Future Value (FV)} &= \text{Principal (P)} \times [1 + \text{interest rate (r)}]^{(t)} \\ &= \text{HKD100} \times (1 + 5\%)^{1} \\ &= \text{HKD105} \end{aligned}$$

Present value is the amount today of a future cash flow. Let us find out how much an investor needs to deposit in a bank now to yield HKD100 at the end of one year if the interest rate is 5% per year. The present value can be found by discounting the future value at the market interest rate (r):

$$\begin{aligned} \text{Present Value (PV)} &= \text{Future Value} / (1 + r)^{t} \\ &= \text{HKD100} / (1 + 5\%)^{1} \\ &= \text{HKD95.24} \end{aligned}$$

The above example shows that HKD100 a year later is worth only HKD95.24 today. This is why people say a dollar today is more than a dollar tomorrow.

(b) Interest Rates

Interest rates in the context of debt securities are the costs of borrowing of the issuers. This is reflected in the coupon interest rate as specified in each issue of debt securities. Most of the debt securities have fixed coupon rate which means that the cost of the issuer is constant despite of changes in market interest rates. As opposed to fixed interest rates are floating interest rates which are more common to mortgage lending which is linked to a pre-determined benchmark such at prime rate or Hong Kong Interbank Offer Rate.

However, coupon rate does not necessarily equal to the actual return of a bondholder. It is more common for an experienced bond investor to purchase the bond in the secondary market after it was issued. It follows that the investor may not hold the bond for its entire life span and may not entitle to all coupon payments. The return of the investor is measured by the required rate of return or yield which is the effective interest rate taking into account of the holding period of the bond by the investor.

For the purpose of bond pricing, all interest rates are based on compound interest which assumes that all interest income earned is reinvested at the same interest rate.

(c) Calculation of Bond Price

The value of a bond is the sum of present values of all future cash flows generated from the bond discounted at the yield. The expected future cash flows include the coupon payments and the final principal repayment.

For example, a bond has a par value of HKD100 with 2 years to maturity. The coupon rate is 2% paid annually. An investor requires a rate of return of 5% pa. It means that the investor will receive HKD2 coupon payment one year from now; and HKD2 coupon payment and HKD100 repayment of principal two years from now. The maximum price the investor would be willing to pay for the bond would be the total of present value of these cash flows discounted at the yield of 5%.

$$P = 2 / (1.05) + 2 / (1.05)^2 + 100 / (1.05)^2$$
$$= HKD94.42$$

3.2.7 Price and Yield Relationship

When a fixed-coupon bond is issued, the coupon rate is normally set according to the prevailing market condition and the creditworthiness of the issuer at the time of the issuance. Once a bond is issued, it may change hands in the secondary market at the market price. Over time, the prices paid by each subsequent investor, the number of coupons to be received and the time till maturity are different from each investor. The net rate of return of the investors taking into account of the market price, par value, coupon interest rate and time to maturity is called **yield**. As time passes, the overall level of interest rates and the creditworthiness of the issuer may change reflecting the macroeconomic condition and the performance of the issuer. New buyer of the bond may require a yield that is comparable to similar instruments in the market (market yield) which is different from the coupon rate of the bond.

A bond with a coupon rate that is higher than the market yield looks attractive to the new buyer if it is sold at a price equal to the par value of the bond. However, the holder of the bond would surely not be willing to sell the bond at its par value. To make a transaction possible, the bond should be sold at a price higher than the par value. We say the bond sells at a **premium**. For example, a HKD10,000 par value 5-year bond issued by ABC Corporation bears a coupon rate of 10%, an investor willing to lend 5-year money to the company for a yield of 8% would be willing to pay a price higher than HKD10,000 for the bond.

Conversely, if the market yield is higher than the fixed coupon rate, the bond will only be sold at a price lower than the par value. We say the bond sells at a **discount**. In the previous example, an investor who demands a 12% yield for buying ABC Corporation’s bond would not pay HKD10,000 to buy it. In order to sell the bond, the seller has to offer it at a price lower than HKD10,000.

Only when the coupon rate equals to the yield required by the market, the bond will be sold at the same price as the par value. We say the bond sells ***at par***.

Market Yield = Coupon Rate	==>	**Bond sells at Par**
Market Yield > Coupon Rate	==>	**Bond sells at Discount**
Market Yield < Coupon Rate	==>	**Bond sells at Premium**

From the above discussion, we can further conclude that there is an inverse relationship between market yield and the price of a bond. When interest rate (market yield) goes up, bond price will come down and vice versa. This relationship is referred to as the **Law of Fixed Income** by some market players.

The following table shows the prices of a 20-year bond under different market yield levels. The relationship is also plotted in a graph.

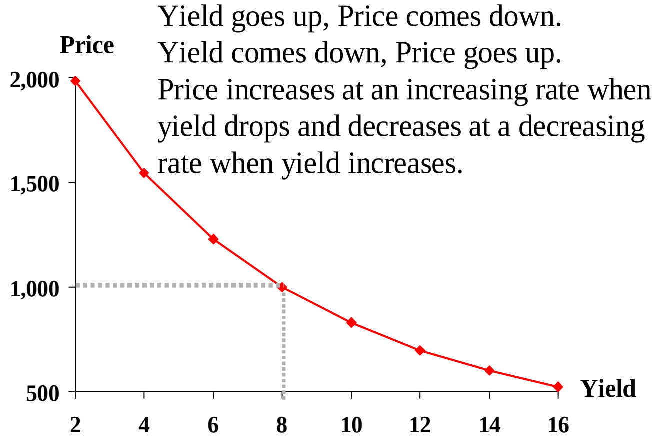
Price-yield Relationship

¥ We have here a 20-year, 8% coupon bond ($1,000 par value), what is the price of the bond under different yield levels?

Yield	Yield Change	Price	Price Change	% Price Change
2	-6	$1,985.09	437.97	28.31%
4	-4	1,547.12	315.93	25.66%
6	-2	1,231.19	231.19	23.12%
8	0	1,000.00	0	0
10	2	828.36	-171.64	-17.16%
12	4	699.05	-129.31	-15.61%
14	6	600.07	-98.98	-14.16%
16	8	522.98	-77.09	-12.85%

Price-yield Relationship

Yield goes up, Price comes down.
Yield comes down, Price goes up.
Price increases at an increasing rate when yield drops and decreases at a decreasing rate when yield increases.



Apart from the inverse relationship between market yield and bond price, we can also observe some interesting relationship from them.

1. The magnitude of change in the bond price for a 2% increase in market yield (from 8% to 10%) is not the same as that for a 2% decrease in yield rate (from 8% to 6%). A decrease in market yield will raise the bond's price by an amount that is greater than the corresponding fall in the bond's price for an equal sized increase in the market yield.

2. This is a convex curve, meaning that when market yield drops, the bond price will increase at an increasing rate and when market yield increases, the bond price will decrease at a decreasing rate.

3.2.8 Yield Curve

As explained above, an interest rate is the cost charged to a borrower for the utilisation of funds for a certain period of time or the return of the lender for postponing current consumption to a later date. Generally, an interest rate is composed of three elements:

(a) the real risk free rate: the return from investing financial securities with no default risk;

(b) inflation expectation: the compensation for expected loss in purchasing power due to inflation;

(c) risk premium: the compensation to the lender for bearing the default risk of the bond issuer.

Investors would generally have different risk premiums and inflation expectations for debt securities with different maturities. Therefore there are usually different interest rates for different maturities and such relationship can be depicted by a yield curve which is a graphic representation of the relationship between the level of interest rate and the corresponding maturity.

Yield curve can be of different shapes:

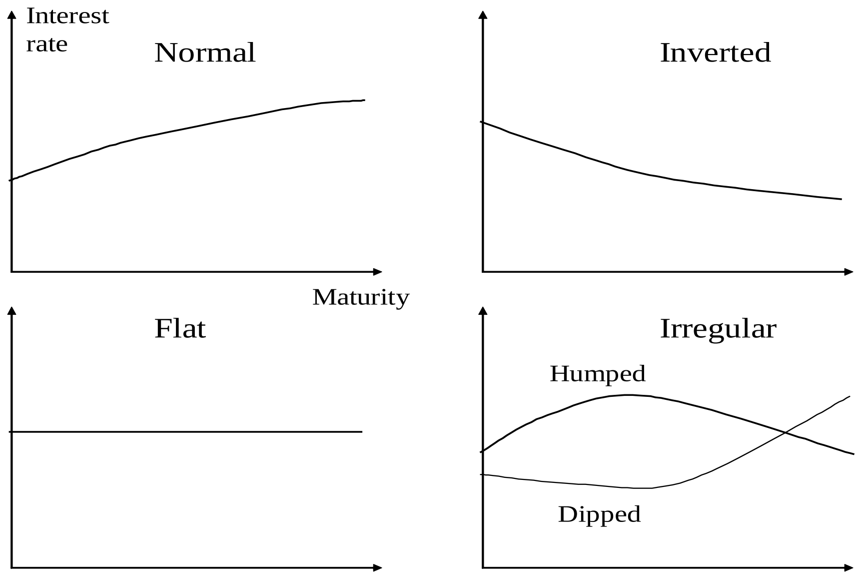
(a) A normal or positive yield curve: it is the most common yield curve. The longer the maturity, the higher the interest rate.

(b) Inverted or negative yield curve: the longer the maturity, the lower the interest rate. It reflects that the market expects lower interest rate in the future.

(c) Flat yield curve: interest rates for all maturities are at similar level which is a reflection of stable interest rate expectation.

(d) Irregular yield curve: any yield curve of any shape other than the above.

The shapes of the different yield curve are shown in the following graphs.



3.2.9 Marketability

This refers to how easily the investor can sell the bonds without having to make a substantial price concession, in other words, the liquidity. Because most bonds are bought and sold in dealer markets, bonds that are actively traded will tend to have lower bid and offer spreads than those that are inactive. Accordingly, bonds that are actively traded should have a relatively lower yield to maturity and a higher intrinsic value than bonds that are inactive.

3.2.10 Bond Ratings

These are alphabetical designations attesting to the investment quality of bonds issued by corporations (rating agencies) which specialise in providing ratings of the creditworthiness of corporations and bond issuers. Such ratings are often interpreted as an indication of the likelihood of default by the issuer. This is a prerequisite for many US debt issuers and may directly affect the issuing price. Debt issuers will have to submit their financial data to the rating agencies in order to get a rating. The two most widely accepted rating agencies are Standard and Poor’s Corporation (S&P) and Moody’s Investors Service, Inc. (Moody’s).

A broader set of categories is often employed, with bonds classified as being of either investment grade or speculative grade. In general, investment grade bonds are bonds that have been assigned to one of the top four ratings (AAA through BBB by S&P; Aaa through Baa by Moody’s). In contrast, speculative grade bonds are bonds that have been assigned to one of the lower ratings (BB, Ba or below). Sometimes these low-rated securities are called high yield bonds or junk bonds.

Bond Ratings

Moody's	S&P	Description
Investment Grade		
Aaa	AAA	Maximum safety
Aa	AA	High-grade, high-credit quality
A	A	Upper-medium grade
Baa	BBB	Lower-medium grade
Speculative Grade		
Ba	BB	Low grade, speculative
B	B	Highly speculative
Caa	CCC	Substantial risk, in poor standard
Ca	CC	May be in default, very speculative
C	C	Extremely speculative
	CI	Income Bonds that pay no interest
	D	Default

3.2.11 International Markets

Bonds may be classified according to the market where the bond was issued. There are different legal and regulatory issues guiding the issuance of such bonds which may have different implications for the issuers and investors.

Domestic bonds are bonds issued in the domestic currency by corporations domiciled in the same country. **Foreign bonds** are bonds issued in the currency of the country by foreign corporations. There are many interesting names to denote such issues. **Yankee bonds** are USD bonds issued in the US market by foreign corporations. **Samurai bonds** are Japanese Yen bonds issued in Japan by corporations domiciled outside Japan. Formal application and approval from regulatory bodies are needed for the issuance of these bonds.

Eurobonds are bonds issued in the currency of one country but sold in other national markets. For example, a bond issued by a US corporation that is denominated in USD (or any currency other than Euro) and sold in Europe would be referred as a Eurobond. The major advantage of investing in the Eurobond market is that it is neither regulated nor taxed.

3.2.12 Advantages of Bond Investment

This is more suitable for longer-term investment and carries advantages such as:

- low to moderate risk;
- liquidity, ready market available;
- higher return than money market instruments;
- capital preservation;
- regular and determinable income; and
- hedging through derivative products available.

3.2.13 Disadvantages of Bond Investment

- high denominations – some bonds may have high denominations that are not affordable for average investors;
- price risk – fluctuation in interest rates;
- inflation risk – fixed interest rate;
- liquidity – some bonds may not have a ready secondary market;
- no participation in company profits;
- no right of voting;
- possibility of default by issuer; and
- sophisticated trading techniques may be involved.

3.2.14 Preferred Shares (Preference Shares)

Preferred shares, representing an ownership interest in a corporation, give the investor a right to a fixed dividend provided enough profit has been made to cover it. Unlike investors who own a corporation's common shares, preferred shareholders have no voting right but are entitled to be paid the dividends due to them first, before ordinary shareholders can be paid their dividends.

Preferred shareholders also have priority claims on company assets in case of company liquidation. One point to note is that preferred shares are not very common in Hong Kong.

The benefits of investing in preferred shares are similar to those of bonds. Preferred share dividends are usually paid at a fixed rate. However, they differ from bonds in that although the income is fixed, they are not interests and may not be paid if a company does not make profits. They also differ from ordinary shares in that dividend will not be more than the fixed rate even if exceptionally high profits are made. As preferred shareholders are not entitled to the full earning potential of the company, the price of the share will typically have only limited opportunity for capital appreciation.

3.3 EQUITIES

3.3.1 Investing in Equities

(a) What is Equity

Ordinary share, or common stock, represents equity, or an ownership interest in a corporation. This is perhaps the widest known type of financial instruments. It is a residual claim, meaning that creditors and preferred shareholders must be paid as scheduled before ordinary shareholders can receive any payment. It allows investors the opportunity to participate (share) in the long-term growth of a public company. In the liquidation of a corporation, ordinary shareholders are in principle only entitled to any value remaining after all other claimants have been satisfied.

Transactions made in listed securities in Hong Kong are cleared through the Central Clearing And Settlement System (CCASS), which is a computerised book entry clearing and settlement system. Transactions are electronically recorded on brokers' (or investors') stock account balances in CCASS, without the need for the physical movement of share certificates.

On purchasing stock, an investor can request to receive the physical scrip to give evidence of his/her ownership. This can be registered in his/her own name with the share registrar. If the certificates are lost, getting replacement certificates is both a time consuming and costly process. Alternatively, the investor can entrust the shares to his/her bank or broker for safe custody; and the latter will usually deposit the shares in CCASS. Note however that with this method of safekeeping, CCASS only recognises the bank or broker as the direct holder of the securities.

The investor can also open an investor account in CCASS for custody of his/her stocks, though trading of shares still requires to be made through a bank or a broker. In this way, the investor will have direct control over his/her share holdings.

(b) Why Raise Equity

A company can raise funds either by debt financing or equity financing. As opposed to debt financing for which cost of borrowing is fixed as represented by the coupon rate, equity financing is more flexible as its costs depend on the amount of dividend paid out which is a matter of discretion of the board of directors. It is therefore generally believed that equity finance is cheaper than debt financing.

In the event of liquidation, debt investors have priority over equity investors to get paid. Therefore, equity finance has also the advantage to spreads the risk of investment amongst investors.

In the case of obtaining equity financing by listing on an exchange, a company can secure longer term access to capital. After raising funds from the primary market for the first time, it can always go back to the market for future fund raising. It is in particular important during economic hard times when debt finance is costly due to credit crunch. For example, during the Global Financial Crisis of 2007–2008, a few blue chips companies in Hong Kong have raised funds by private placement or rights issues. However, it is important to note that whether a listed company can raise further funds from the market is subject to the willingness of the shareholders to take up the rights.

3.3.2 Methods of Raising Equity

There are different ways to raise funds in the equity market:-

(a) Initial Public Offering (IPO)

When a privately owned company is to be listed on the stock market, it will issue stocks to the public which is called an IPO.

A private company will seek advice from investment bankers as to the feasibility of going public. In Hong Kong this role is played by a ***sponsor*** which is an SFC registered intermediary. The sponsor conducts due diligence to see if a company is qualified for listing. It will then facilitate the company to list on the Stock Exchange of Hong Kong (SEHK) by lodging the application and preparing all supporting documents.

After the listing application is approved by the SEHK, the new issuer has to provide the public with a prospectus which is a detailed description of the company and the listing matters of the shares to be issued. It will include business plans, the latest financial statements, the prospects of the company and the proposed use of the funds to be raised.

Then the new issuer may appoint a ***lead manager,*** who is an investment bank primarily responsible for organising the marketing of the new issues of shares. Normally, the lead manager will form a syndicate with other underwriters to assist with the distribution of the new shares. In order to raise interest among the investing public of the shares underwritten, the lead manager will organise road shows to publicise the offering. For example, potential investors such as funds managers and securities analysts will be invited to luncheons where they can meet the management of the company.

An ***underwriter*** is usually an investment bank or a brokerage company which undertakes the risk of the new issue. Under a typical underwriting arrangement, in the event that the IPO is under subscribed, the underwriters have to take up the shares unsold.

The listing requirements are governed by the Listing Rules of the SEHK. Since there are two trading platforms on the SEHK, namely the Main Board and the Growth Enterprise Market (GEM), there are two sets of Listing Rules applicable.

Investors should refer to the Listing Rules for the full and complete requirements of listings. Generally, to qualify for listing on the Main Board, an applicant must satisfy one of the following tests: (1) the profit test; (2) the market capitalisation / revenue / cash flow test; and (3) the market capitalisation / revenue test. For example, under the profit test, a new applicant must have a trading record of not less than three financial years under substantially the same management. There must be ownership continuity and control for the most recent audited financial year. Profit attributable to shareholders must, in respect of the most recent year, be not less than HKD20 million and, in respect of the two preceding years, be in aggregate not less than HKD30 million.

There are also other general requirements such as the expected market capitalisation. At the time of listing it must not be less than HKD200 million and the expected market capitalisation of its securities held by the public at the time of listing must not be less than HKD50 million.

GEM was established in November 1999 to provide capital formation opportunities for growth companies of all industries and sizes. Therefore, generally the listing requirements of the GEM are less stringent than that of the Main Board. For example, unlike the Main Board there is no profit requirement. However, the new applicant must have a positive cash flow from adjusted operating profits (before changes in working capital and taxes paid) of not less than HKD20 million in aggregate for the two financial years preceding the issue of the listing documents. The market capitalisation requirement is only at least HKD100 million.

For avoidance of doubt, the above are not meant to be exhaustive and one should refer to the respective Listing Rules for the full and complete requirements of listing.

(b) Private Placements

It takes place when the shares are issued to a specific class of investors. Normally, only professional investors such as mutual funds or high net worth clients are eligible to subscribe shares through private placement. This is contrasted with IPO where shares are offered to the general public.

(c) Equity Warrants

An existing listed company may raise funds by issuing warrants which grant the holder the right to purchase shares of the company at a pre-determined price before a deadline.

(d) Rights Issues

Rights issue is also a popular method to raise funds for existing listed companies. It refers to a listed company raising funds by inviting existing shareholders to subscribe for new shares in proportion of their existing shareholding. As the name suggest, rights issue represents a right of the shareholders who are not obliged to subscribe the new shares offered. A shareholder has three options: (1) subscribing the shares offered; (2) selling the rights to others who would like to subscribe for the shares; (3) doing nothing. In the last two cases, the shareholders will have their shareholding diluted.

For example, an investor has 1,000 shares in Company A which has just announced a “1 for 4” rights issue. For every 4 existing shares, the investor may subscribe one additional share. So the investor has the right to subscribe to an additional 250 shares (1,000 / 4). Generally, the offer price of a rights issue or subscription price is at a discount to the existing market price. For example, the market price of Company A is HKD1 and the subscription price may be HKD0.75.

Following the above example, the value of your shareholding before rights issue is HKD1,000 (1,000 shares x market price at HKD1). The cost of rights issue is HKD187.5 (250 shares x offer price at HKD0.75). After the rights issue, you will hold 1,250 shares (1,000 + 250) and the value of your investment should be HKD1,187.5 (HKD1,000 + HKD187.5). Therefore the theoretical value per share after right issue, or ex-rights price is HKD0.95 (HKD1,187.50 / 1,250 shares). In other words, the theoretical value of the rights is HKD0.2 (ex-rights price at HKD0.95 – subscription price of HKD0.75).

3.3.3 Why Invest in Equity

The greatest advantage of the corporate form of organisation is the limited liability of its shareholders. In Hong Kong, ordinary shares are generally fully paid and non-accessible, meaning that ordinary shareholders may lose their initial investment but not more. That is, if the corporation fails to meet its obligations, the shareholders cannot be forced to give the corporation the funds that are needed to pay off the obligations. However, as a result of such a failure, it is possible that the value of a corporation's shares will be negligible; i.e. the investor will suffer a total loss of his original investment.

As with other types of investments, the total return is important. Shareholders have two ways of gaining: by selling the shares at a higher price than that at which they were purchased, and from dividends paid by the company. However, shareholders may suffer capital loss due to a fall in share price. Also, second line or smaller stocks may be illiquid; i.e. difficult to sell.

A successful company will probably pay an increasing dividend on its shares each year. The price of its shares is also likely to rise, so the return will include both dividend income and capital gains. If a company is unsuccessful, the value of its shares is likely to decline. Share prices on stock markets can change rapidly. In general, equities are considered riskier than money market instruments and bonds.

Earnings, not dividends, are the source of a corporation's value. Some of the commonly used terms in the analysis of stock value are outlined as follows:

1. **Price Earnings Ratio (or PE Ratio):** A corporation's current stock price divided by its past 12-month earnings per share.
2. **Return on Equity:** The earnings of a corporation divided by its book value.
3. **Dividend Yield:** The current annualised dividend paid on a share, expressed as a percentage of the current market price of the corporation's common stock.
4. **Payment Ratio (or Pay-out Ratio):** The percentage of a corporation's earnings paid to shareholders in the form of cash dividends.
5. **Retention Ratio:** The percentage of a corporation's earnings that are not paid to shareholders but instead are retained for future expansion.

3.3.4 Bonus Issue

A listed company may offer shares to the existing shareholders for free as a result of capitalisation of profits. It is similar to rights issues except that the new shares are free of charge.

Using the above example, instead of rights issues it is now a "1 for 4" bonus issue announced. Similarly, the value of the investment before bonus issue is HKD1,000 and the total number of shares held thereafter is 1,250. However, this time the value of the investment after the bonus issue is same as that of before, i.e. HKD1,000, because the bonus issue is free of charge. Therefore the theoretical price of the share after bonus issue is HKD0.8 (HKD1,000 / 1,250).

3.3.5 Dividend

Payments made in cash to shareholders out of the earnings of a company are termed dividends. In Hong Kong, these are typically declared semi-annually by the board of directors and are paid to the current shareholders of record at a date specified by the board known as the dividend date.

Corporate management may use dividend changes as a signalling device, raising or lowering dividends on the basis of its assessment of the corporation's future earnings. Share prices will change according to the investors' perceptions of each company's performance and prospects.

Compiling a list of shareholders to receive the dividend is not as simple as it seems, because for many corporations the list changes almost constantly as shares are bought and sold. Those shareholders who are to receive the dividend are identified by the use of an ex-dividend date.

Because of the time required to record the transfer of ownership of common stock, the Stock Exchange of Hong Kong specifies an ex-dividend date that is two business days prior to the date of record. Investors purchasing shares before the ex-dividend date are entitled to receive the dividend in question; those purchasing on or after the ex-dividend date are not entitled to the dividend. The same principle applies to rights and bonus issues.

3.3.6 Stock Exchange of Hong Kong (SEHK)

(a) Basic Structure and Functions

The SEHK was set up in 1980 with a view to consolidating the then four stock exchanges and was in full operation after 1986. All along only companies with proven track records could go listed on the SEHK. It was until 1999 the GEM was established to facilitate equity financing by emerging companies and the original exchange is referred as the Main Board. The Hong Kong Clearing and Exchanges Limited (HKEx) wholly owns the SEHK and GEM and is itself a listed company in Hong Kong. It is aimed to provide an efficient and transparent regulatory framework to facilitate the raising of capital and trading of securities in Hong Kong.

Different types of securities apart from equity are now listed on the SEHK:-

- derivative warrants with underlying assets of ordinary shares, market indices, foreign currencies or a basket of shares;
- equity linked instruments (investors are in essence writing an option on the underlying stock);
- exchange traded funds which represent a portfolio of securities designed to track the performance of an index;
- debt securities such as the Exchange Fund Notes issued by the HKMA;
- the Pilot Programme whereby a number of securities listed on the National Association of Securities Dealers and Automatic Quotations (NASDAQ) and the American Stock Exchange (AMEX) were also listed on the SEHK.

(b) Major Features

The Hong Kong stock market plays a leading role in the world equity market. According to the statistics of World Federation of Exchanges, as at the end of January 2015, the Hong Kong stock market was the 5th largest market in the world by "domestic market capitalisation" in USD. It was the 3rd largest market in Asia, only behind the Tokyo Stock Exchange (1^{st}) and the Shanghai Stock Exchange (2^{nd}). However, it was ranked number one by total turnover of securitised derivatives for January 2015 in USD terms.

At the end of February 2015, there were a total of 1,766 companies listed on the Main Board and the GEM combined. Their total market capitalisation was HKD26,239.1 billion. (Source of data: Hong Kong Exchanges and Clearing Limited)

(c) Primary and Secondary Markets

Similar to the debt market, the equity market can also be divided into primary and secondary market.

The primary market is one when a company goes listed and new shares are issued for the first time. New capital from the public will be raised by the company. It is an exercise between the company and the investors. The procedures to raise funds on the primary market have been discussed in Section **3.3.2**.

On the other hand, the secondary market refers to the transaction between buyers and sellers of the shares of the already listed company. No funds are raised by the company irrespective of the price and trading volume of the company's shares in the secondary market.

The secondary market of equities in Hong Kong is transacted at the third generation of the Automatic Order Matching and Execution System (AMS/3) which connects investors, Stock Exchange Participants, and other market participants and the central market through ecommerce facilities. All orders of securities transactions on the SEHK must be placed on the AMS/3 for matching and execution. The AMS/3 has made placing order electronically through internet or by mobile phone possible whereby investors can place order via either Online Trading Service Channel, Proprietary Network Service Channel or Brokers' Proprietary Channel.

3.3.7 International Markets

Due to the mobilisation of investment, the performances of other major international equity markets have a significant impact on the Hong Kong stock market due to globalisation.

(a) US Market

There are many stock exchange markets in the US. The most familiar ones are the American Stock Exchange, the NASDAQ and the New York Stock Exchange. Due to the close ties between the US and Hong Kong in terms of the linked exchange rate and the export and import markets, the economy of the US as reflected in the US stock market may have a significant impact on that of Hong Kong. Since the US and Hong Kong are in different time zones, the Hong Kong market opens after the US market was closed. As such the volatility in the US market will be largely reflected in the Hong Kong market upon opening.

In March 2002, the Pre-opening Session (from 9:30am to 10:00am) was introduced by the SEHK whereby all Exchange Participants may place orders into the AMS/3 before the market opens at 10:00am. It has the benefit of preventing significant price fluctuations when the market formally opens.

(b) European Markets

The economic and political union of 28 member states primarily in Europe brought about by the European Union (EU) and also the use of a single currency of Euro has strengthened the economic power of the European markets. In accordance to the statistics of the International Monetary Fund, the EU's GDP for the year 2014 based on purchasing-power-parity (PPP) share of world total was 16.939%.

The most prominent stock markets in Europe are the London Stock Exchange in the UK, the Frankfurt Stock Exchange in Germany and the pan-European stock exchange of Euronext which is based in Paris, France.

(c) Asian Markets

According to the statistics of World Federation of Exchanges, as at the end of January 2015, the Tokyo Stock Exchange was the largest market in Asia by "domestic market capitalisation" (in USD). Consisting of 225 stocks traded on the Tokyo Stock Exchange, the Nikkei Stock Average (or the Nikkei Index) tracks the Japanese stock market.

Other key players in Asian stock markets are Hong Kong, Singapore, Seoul, Kuala Lumpur and Taiwan.

(d) China Market

The Mainland of China has two stock exchange markets, one in Shenzhen and the other in Shanghai, which are regulated by the China Securities Regulatory Commission (CSRC). The first ever legislation governing the Mainland securities market is the Securities Law which came into effect in 1999.

The Shanghai Stock Exchange was established in November 1990 followed by the Shenzhen Stock Exchange in December 1990. Both markets trade A and B shares. A shares are accessible by Mainlanders alone (until the launch of the programmes introduced below), whose transactions are settled in the local currency. B shares are now open to both domestic citizens and foreign investors, whose transactions are settled in US dollars (in the Shanghai Stock Exchange) and in HK dollars (in the Shenzhen Stock Exchange).

The Mainland stock market has gradually been opened to foreign investors. In 2003 the Qualified Foreign Institutional Investor programme (QFII) was launched to allow approved foreign investors to trade A shares. Given the increasing number of H shares listed in Hong Kong, the impact of the Mainland market on Hong Kong is getting more and more significant.

In April 2014, the SFC and the CSRC made a Joint Announcement regarding their in-principle approval for the development of a Pilot Programme called the Shanghai-Hong Kong Stock Connect, for the establishment of mutual stock market access between the Mainland and Hong Kong. Commencing on 17 November 2014, the Shanghai-Hong Kong Stock Connect has created for the first time a feasible, controllable and expandable channel for mutual market access between the Mainland and Hong Kong by a broad range of investors, paving the way for further opening up of the Mainland's capital account and RMB internationalisation. The Programme imposes different restrictions for Northbound trading and Southbound trading. For instance, unlike Northbound trading, which allows all Hong Kong and overseas investors to participate in the Programme, Southbound trading was, when the Programme started, only open to Mainland institutional investors and to eligible Mainland individual investors. The restrictions were relaxed when the CSRC announced on 27 March 2015 that with effect from the date of announcement fund managers are allowed to launch new publicly offered securities investment funds that invest in the Hong Kong stock market through the Shanghai-Hong Kong Stock Connect, without being Qualified Domestic Institutional Investors (QDII).

Furthermore the CSRC and SFC signed a memorandum of regulatory cooperation on 22 May 2015 in respect of a Mainland-Hong Kong Mutual Recognition of Funds (MRF) initiative. Starting from 1 July 2015, through the MRF, eligible Mainland and Hong Kong funds are allowed to follow streamlined procedures to obtain authorisation or approval for offering to retail investors in each other's market.

3.3.8 Market Indexes

Market index is widely adopted in different stock exchange markets as reference of the price level of a particular stock market. By comparing the market index of the same market over a period, one can find out the performance of the stock market during that period. Therefore market index is commonly used by investors as a barometer of share price movement. It can also be used as a benchmark to evaluate whether an investment fund outperforms or underperforms the market.

(a) Hang Seng Index (HSI)

The HSI was launched on 24 November 1969 and has become the most widely quoted indicator of the performance of the Hong Kong stock market. It is calculated and managed by the Hang Seng Indexes Company Limited.

As of March 2015, the HSI includes 50 constituents stocks, which were selected on the following conditions:

- must be among those companies that constitute the top 90% of the total market value of all primary listed shares on the SEHK (market value is expressed as an average of the past 12 months);

- must be among those companies that constitute the top 90% of the total turnover of all primary listed shares on the SEHK (turnover is aggregated and individually assessed for eight quarterly sub-periods over the past 24 months); and
- should normally have a listing history of at least 24 months on the SEHK or meet other specified requirements for large-cap securities.

Since its launch, the HSI was calculated based on the full market capitalisation weighted methodology using the following formula:

$$\text{Current Index} = \frac{\text{Today's Current Aggregate Market Capitalisation of Constituent Stocks}}{\text{Yesterday's Closing Aggregate Market Capitalisation of Constituent Stocks}} \text{ X } \text{Yesterday's Closing Index}$$

Currently, the HSI is calculated using a freefloat-adjusted market capitalisation weighted methodology with a 15% cap on individual stock weightings. Freefloat-adjusted Factor is adopted to exclude for index calculation the long-term strategic holdings not ready for trading in the market. It ensures the liquidity needed for investment. The 15% capping is to avoid single stock domination in the HSI.

(b) Hang Seng Composite Index Series

The Hang Seng Composite Index, under the Hang Seng Composite Index Series ("HSCI Series"), includes the top 200 listed companies in the Hong Kong stock market. The HSCI Series are further divided into Geographical Indexes and Industry Indexes, and aims to provide a comprehensive benchmark of the performance of stocks listed on the SEHK. There are other sub-indexes under the HSCI Series such as the Hang Seng Hong Kong Composite Index, the Hang Seng Mainland Composite Index, etc.

(c) International Indexes

The following international indexes are widely used to track the performance of the world markets:

Dow Jones Industrial Average

The Dow Jones Industrial Average (DJIA) has been tracking the performance of the US stock market since it was founded in 1896. Including 30 constituent companies - large publicly owned companies based in the United States, DJIA is calculated by taking the average of the sum of the prices of all the 30 stocks, subject to prescribed adjustments to take into account structural changes of the constituent stocks such as stock splits over the years.

Standard & Poor's 500 Index

Despite the long history and popularity of the DJIA, it is generally considered that the Standard & Poor's 500 Index (S&P 500) is more reflective of the stock performance of the US stock market. It is more broadly based consisting of 500 large-cap stocks. Similar to the HSI, S&P 500 is also a market capitalisation weighted index.

Nasdaq-100 Index

The most common index which tracks the performance of stock market on the Nasdaq Stock Market (commonly known as the Nasdaq) is the Nasdaq-100 Index which constitutes the 100 largest stocks traded on the Nasdaq.

FTSE 100 Index

FTSE Group operates the well-known FTSE 100 Index which tracks the performance of the London stock market. It is again a market capitalisation weighted index.

Nikkei 225 Stock Average

The most popular Japanese market index for the stocks traded on the Tokyo Stock Exchange is the Nikkei 225 Stock Average.

Morgan Stanley Capital International (MSCI) Indexes

MSCI Indices are more commonly used by mutual funds companies as benchmarks for the performance of the funds managed.

3.3.9 Fundamental Investment Analysis

Funds managers' investment decisions are based on their analysis of the value of the subject securities. There are two schools of thoughts in investment analyses: fundamental and technical analysis (see section **3.3.10** for details). Fundamental analysis is the study of the economic and political factors to determine the intrinsic value of the securities. For example, valuation of a stock involves the study of the company's financial statements, operations, future prospects, etc.

(a) Top-down and Bottom-up Analysis

In making a fundamental analysis on a stock, an analyst may take the top-down approach or the bottom-up approach.

The top-down approach starts with a study of the macroeconomic factors from a global and domestic perceptive such as GDP, interest rates, inflation rate, etc. The analysts then move down to identify which industries would perform favourably under the macroeconomic environment. The industry analysis includes consideration of the market competition, entry barrier, market turnover, technology development, etc. Only then the analysts would narrow down to the companies in the industry.

The bottom-up analysts would however take an opposite approach. They focus on the financial performance of specific companies first before moving on to the industries and finally the economy.

(b) Industry Analysis and Competitive Analysis

Industry analysis is important in fundamental analysis because it is common sense that a company in a prospering industry would more likely perform well. The ultimate question to be asked is which part in the life cycle the industry is which can be described by four stages:

(i) Start-up stage: the sales and earnings will grow at an extremely rapid rate as a new product has just emerged. There is no market leader and there is a risk that a company may be driven out of the market when the industry moves on to the next stage.

(ii) Consolidation stage: industry leaders begin to emerge when the product becomes more established. Those remaining in the industry are more stable. The industry will grow faster than the rest of the economy.

(iii) Maturity stage: further growth of the industry simply follows that of the economy. The product becomes standardised and the competition is based on price, thus narrowing the profit margin.

(iv) Decline: the industry grows slower than the overall economy due to obsolescence of the products and competition from new products.

Other relevant issues in industry analysis include the competition structure (monopoly, oligopoly or monopolistic competition), the impact of economics variables on the industry (interest rates and exchange rates), and government policy (whether favourable or unfavourable to the industry), etc.

(c) Ratio Analysis of a Specific Company

Ratio analysis is used to ascertain a company's financial performance as compared to previous years and to an industry standard. The raw data of ratio analysis is sourced from the previous financial statement of a company such as balance sheet and profit & loss statement. In other words, ratio analysis only reflects the historical performance instead of providing a forward looking view.

The following are some commonly used ratios:

(i) Liquidity ratios:

It measures a company's ability to repay its short term debt:

$$\text{Current Ratio} = \frac{\text{Current Asset}}{\text{Current Liability}}$$

$$\text{Quick Ratio} = \frac{\text{Current Asset} - \text{Current Inventory}}{\text{Current Liability}}$$

(ii) Profitability ratios:

It highlights a company's profitability and management's performance:

$$\text{Return on Equity} = \frac{\text{Profit after Tax}}{\text{Shareholder's Capital}}$$

$$\text{Earnings per Share} = \frac{\text{Profit after Tax}}{\text{Number of Issued Shares}}$$

$$\text{Price Earnings ratio} = \frac{\text{Market Price per Share}}{\text{Earnings per Share}}$$

(iii) Solvency ratios:

It determines a company's ability to fulfil its long term debt obligation:

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

$$\text{Gearing Ratio} = \frac{\text{Total Debt}}{\text{Shareholder's Capital}}$$

(d) Valuation of Equity Securities

While the ratio analysis discussed above focuses on historical performance of a company, an investor is more concerned about the future price of the shares of the company. There are different valuation methods a fundamental analyst can use to find out the intrinsic value of a company. We will look into three of the most common valuation methods.

(i) Dividend Discount Model (DDM)

The DDM works on the same principle as the pricing of bonds which is based on the present value of all future cash flow. In the case of stock, the future cash flow is the future dividends payment and there is no repayment of principal because there is no maturity date for equity investment. The DDM states that the share price is equal to the present value of all expected future dividends discounted at the required rate of return on the share:

$$P = \frac{D1}{(1+r)^1} + \frac{D2}{(1+r)^2} + \frac{D3}{(1+r)^3} \dots \frac{Dn}{(1+r)^n}$$

Where: P = Share price
D = Expected annual dividend per share
r = Required rate of return on the share

There are different variations of DDM. The constant growth DDM assumes that the dividends increase at a stable growth rate. The DDM formula can be simplified to:

$$P = \frac{D}{r - g}$$

Where:	P	=	Share price
	D	=	Annual dividend per share expected for the following year
	r	=	Required rate of return on the share
	g	=	Dividend growth rate

Under the zero growth DDM, the same amount of dividends is expected to be paid forever. Then the DDM formula can be further simplified as:

$$P = \frac{D}{r}$$

(ii) Price Earnings Model (P/E model)

The P/E model is to compare the PE Ratio of companies in the same industry to ascertain the relative value of an individual company.

A company with a high PE Ratio in comparison with other companies in the same industry reflects that the market expects it to have higher earnings growth. On the other hand, it may also be an indication that the company is overvalued.

Though P/E model is simple to use, it has its own pitfalls. It is a ratio based on historical accounting data. Current earnings can however differ significantly from future earnings. PE Ratio would also be distorted by inflation rate. As a result, it is not possible to say if a PE Ratio is high or low without referring to the general trend of the company and the industry in question.

(iii) Capital Asset Pricing Model (CAPM)

CAPM is a highly complex model. In short, it relates the expected return of a security to its risk as measured by beta. Beta is the measure of the change of return on a security for a 1% change in the return on the whole market. The higher the beta, the more sensitive is the return of the security to the market; and therefore the riskier the investment. The CAPM laid down the theoretical explanation of the well-known risk-return trade-off of investment.

3.3.10 Technical Analysis

(a) Historical Data

Technical analysis is a study of historical market data to predict future securities prices. It ignores the financial aspect of the underlying securities such as the company's financial statements or the economic environment in which the company is operating. It is widely used by day traders. They will plot the historical market prices onto a chart and rely on the past pattern to predict future trends and reversal points.

(b) Charts and Trend Lines

There are different types of charts used by market players. The most common one is the **bar chart** which draws a vertical line to connect the highest price and the lowest price recorded during a fixed period. Then a short horizontal line to the left is used to indicate the opening level and another one to the right for the closing price.

The **point and figure chart** is usually used for day trading. Circles and crosses are plotted on a graph paper to represent price moments: a cross indicates the price is up and a circle represents the price is down.

Another popular charting technique is the Japanese **candlestick chart** which was invented by Japanese rice trader in the 17th century. It is similar to a bar chart save that it has a fat body to represent the range between the opening and closing price. If the market opening price is higher than the closing, the body is blackened. When the opening is lower than the closing, the body will be white.

Based on these charts, technical analysts try to draw trend lines and pattern so as to find out support and resistance levels of the market price.

(c) Technical Indicators

Besides chart, technical analysts also rely on certain technical indicators to read market trends such as moving average and relative strength indicator.

Moving average is the calculation of the average closing prices for a specific period such as 10-day, 20-day or 250-day moving averages. A simple trading strategy is to buy the securities whenever the price goes above the moving average and to sell whenever it drops there below. Another popular strategy is called **cross-over trade** which relies on the cross over between a shorter and a longer moving average. For example, if the 10-day moving average crosses above the 20-day moving average, it is a buying signal and a downward crossover is a selling signal.

The **relative strength indicator** (RSI) plots the price relationship between the closing prices of up days and down days within a specific period, the most common is 14-day RSI. RSI has a value between 0 to 100%. Analysts normally use the 30 and 70 levels as the thresholds. If the RSI drops below 30, the market is said to be oversold while RSI above 70 indicates an overbought signal.

(d) Common Technical Analysis Methods

There are also some common theories of technical analysis which assist investors to make investment decision.

Wave theory assumes that a market cycle consists of two phases, the Bull or up phase and the Bear or down phase. Financial market prices unfold according to a basic pattern of five waves up and three waves down to form a complete cycle.

The Fibonacci sequence and the golden ratio are also common theories to predict market reversal points and target levels.

3.3.11 Advantages of Equities

- dividend income;
- capital appreciation;
- part ownership of the company;
- limited liability;
- liquidity;
- higher return than bonds; and
- a good hedge against inflation.

3.3.12 Disadvantages of Equities

- subject to fluctuations in company earnings;
- high short-term price volatility;
- market risk;
- company risk; and
- economic risk.

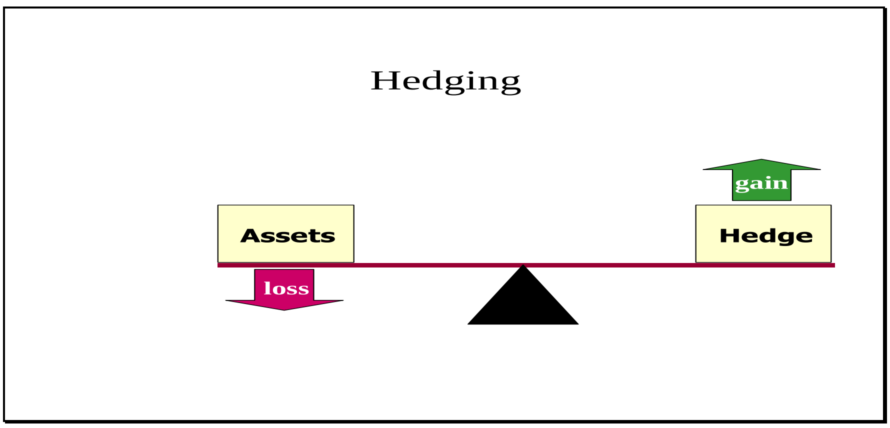
3.4 FINANCIAL DERIVATIVES

A financial derivative is a financial instrument whose value depends on or is ***derived*** from an underlying financial asset such as stock, bond, interest rate, foreign currency or stock market index. There are many types of financial derivatives such as option and forward contract. Being more speculative in nature and complex in structure than other types of investment, financial derivatives are only suitable for sophisticated or professional investors.

3.4.1 Uses of Financial Derivatives

Financial derivatives can be used for different purposes: risk management, speculation or arbitrage:

(a) **Risk management**: Derivatives are being used for hedging extensively. The purpose of hedging is to eliminate the impact of change in market price on the value of an asset or investment portfolio. For instance, a fund manager holding a portfolio of stocks is expecting a short-term downward correction in the market. In order to protect the portfolio value, the manager may sell short stock index futures contracts so that when the stock market drops, the gain from the short stock index futures contracts will "offset" the loss in value of the portfolio. If the stock market continues to go up, the futures hedge will incur a loss that would be offset by the appreciation of the portfolio. Thus hedging with futures contracts will eliminate the downside risk but at the same time forfeit the upside potential.



(b) **Speculation**: Speculators buy and sell derivatives for the sole purpose of making a profit by closing out their positions at a price that is better than the initial price. For instance, a trader who believes the Hang Seng Index (HSI) will go down may sell short HSI futures contracts. Should the HSI go down as expected, he/she can buy back his/her futures contracts at a lower level and make a profit. On the other hand, if his/her view is proved wrong and the HSI goes up, a loss will result. Speculators are often blamed for creating excessive volatility in the market. This may be an unfair accusation in view of their contribution to the liquidity of the market.

(c) **Arbitrage**: An arbitrage is a simultaneous purchase and sale of same or similar assets in different markets in order to capture a risk-free profit caused by mis-pricing. As the value of a financial derivative is derived from an underlying asset, there exists a relationship between the price of the underlying asset and that of the derivative. However, as the two markets are driven by different demand and supply, such relationship breaks down occasionally. This provides an opportunity for arbitrageur to make a profit by buying the under-priced (e.g. the stocks) and selling the over-priced (e.g. the index) simultaneously. For instance, if the HSI futures contract trades at a premium of, say 300 points above the current HSI, investment managers may enter the market to sell short HSI futures contracts and buy back the underlying stocks in the cash market. On the settlement date of the HSI futures contracts, the two markets will converge and a risk-free profit is generated.

There are a wide variety of financial derivative products and their structure can be highly complex. Here we will focus only on the more basic types of derivatives. There are two major types of financial derivatives:

1. Forward and Futures Contracts; and
2. Options and Warrants.

3.4.2 Forward and Futures Contracts

A **forward contract** is an agreement between two parties (buyer and seller) to set a price today for assets/goods that will be delivered on a specified future date. The assets or goods being traded include stocks, bonds, interest rates, foreign currencies, commodities, stock indexes etc.

A **futures contract** is typically a standardised forward contract that is traded in an organised market called futures exchange. Futures contracts are traded on a large number of underlying assets such as agricultural and metallurgical products, interest earning assets, foreign currencies and stock indexes. Futures contracts are settled either through offsetting deals, physical delivery or cash settlement.

A **stock index futures contract** is based on a particular stock market index, e.g. Dow Jones Industrial Average (DJIA), Standard and Poor's (S&P) 500, Hang Seng Index (HSI), which is constructed to measure the overall price movement of a stock market.

The trading of stock index futures involves standardised contracts to buy or sell a hypothetical portfolio of all stocks included in the index at some specified future date at a price agreed at the time of the deal.

For futures contract of deliverable underlying goods, the buyer agrees to take delivery and to make payment at expiry date, and the seller agrees to make delivery at the same time. But for stock index futures contract, the settlement is made in cash without the actual delivery of the securities covered by the index. The profit or loss derived from trading stock index futures is determined by the difference between the price of the original contract and the final settlement price. For example, an investor bought one HSI futures contract at 16,500 and the final settlement price of the contract is 17,000, then the investor will make (17,000 – 16,500) x HKD50 (each index point of the HSI futures contract is worth HKD50) = HKD25,000.

In Hong Kong, HSI futures contracts are traded at the Hong Kong Futures Exchange Limited. There are two types of HSI futures, the standard HSI futures and the Mini-HSI futures contracts. The value of a standard HSI futures contract equals HKD50 times the index points whereas the multiplier for the Mini-HSI futures contract is HKD10. That is to say, if the contracts are traded at 17,000 index points, their values will be HKD850,000 (HKD50 x 17,000) and HKD170,000 (HKD10 x 17,000) respectively.

Buyers and sellers of contracts are exposed to the overall movement of the stock market, as measured by the market index. Whereas an investor in the underlying stocks needs to pay in full for the purchases within two business days of trading, the buyer or seller of a futures contract pays only a margin which is a certain percentage of the contract value. The margin requirements are different in different markets and for different types of investment products and may be subject to the prevalent market condition (at the time of writing, the initial margin requirement for one HSI futures contract is HKD90,500, equals to about 10% of the contract value). Thus, the investor gains exposure to the index by using only a fraction of the capital that would otherwise be needed to gain the same exposure to the underlying stocks. It must be pointed out that the leverage effect of futures contract may backfire. Should the stock market move 10% against the investor, all the capital invested in the futures contract will be wiped out.

3.4.3 Options and Warrants

An **option** contract gives the holder the **right**, but not the obligation, to buy or sell a specified amount of an underlying asset at an agreed price within or at a specified time.

In order to get this right, the **buyer** (also referred to as **holder**) pays the ***seller*** (also referred to as **writer**) an agreed fee, which is known as the **premium.**

Underlying assets: Stock, index, bond, FX, commodity ?

To exercise an option means the holder puts this right into effect and the two parties enter into the specified transaction in the option contract. If the holder chooses to exercise the option, the writer has the obligation to complete the specified deal.

Options on different **underlying assets** are being traded. Such underlying assets include stocks (stock options or warrants), stock indexes, bonds (callable and putable bonds), foreign exchanges (currency options), interest rates, commodities etc.

A **call option** gives the holder the right, but not the obligation, to buy the underlying asset while a **put option** gives the holder the right, but not the obligation, to sell the underlying asset.

The pre-agreed price for a holder of a call option to buy the underlying asset or a holder of a put option to sell the underlying asset is called the **strike or exercise price**. The strike price is fixed when the option contract is being negotiated.

There is a time limit for an option contract. The date (last day) the right has to be exercised is called the **expiration date**, **expiry date or maturity date**. There are two types of option styles, namely, European and American options. A **European option** can only be exercised on the expiration date while an **American option** may be exercised on or before the expiration date.

Deal date: 23 May 0x
Buyer: ABC
Seller: XYZ
American style
HSBC Call
Quantity: 400 shares
Strike: $140
Expiration Date:
23 Aug 0x
Premium: $2,800

By paying $2,800 premium to XYZ, ABC has the right to buy from XYZ 400 shares of HSBC stock at a price of $140 per share on or before 23 Aug 0x

Options can be traded over-the-counter or through organised exchanges. Option trading is facilitated by standardised contracts traded on organised exchanges. These exchanges employ the services of a clearing corporation, which maintains records of all trades and acts as a buyer from all option writers and a writer to all option buyers.

Option writers are required to deposit margin to ensure performance of their obligations. The amount and form of the margin will depend on the particular option contract involved.

A **warrant** works in the same way as a stock option. In Hong Kong, most warrants are call warrants although there are a few put warrants. There are two types of warrants, namely equity warrants and derivative warrants. Equity warrants are issued by the company issuing the underlying stock, whereas derivative warrants are issued by a third party, typically an investment house or a financial institution.

A special feature of options and warrants is that the payoff of such contracts is asymmetrical. Suppose an investor is bullish on Cheung Kong Holdings (CKH) and chooses to buy a call option on 1,000 shares of CKH at a strike price of HKD85 for a premium of HKD6,000 and hold the option contract to maturity. At the expiry date of the option, if CKH's share price stays below HKD85, the option will not be worth exercising and the investor loses what he/she has paid, the premium of HKD6,000. No matter how low CKH share price goes, the maximum loss is HKD6,000. However, if CKH share price goes up to say, HKD100, the investor will make (HKD100 – HKD85) x 1,000 = HKD15,000 from exercising the option, After deducting the HKD6,000 premium paid, the net profit is HKD9,000. In this case, the higher the CKH share price at the expiration of the option, the larger will be the profit.

Therefore, the maximum loss of an option buyer is limited to the premium paid but the gain, in theory, is unlimited. However, the payoff for the option writer is exactly the reverse where the gain is limited (to the premium received) but the loss could be unlimited.

3.4.4 Advantages of Derivatives

- provide effective hedge for unwanted risks;
- efficient means for speculative purpose;
- loss limited to premium paid only (for buyer of options);
- highly leveraged;
- potential high return;
- liquidity (for exchange traded derivatives); and
- low transaction cost.

3.4.5 Disadvantages of Derivatives

- extremely high risk;
- unlimited loss (for writer of options and trader of futures);
- substantial front end premium outlay (for buyer of options);
- total loss in value (premium paid) after maturity date; and
- no right of ownership or dividend income to underlying securities.

These financial instruments are not for everyone as they can be complex and have unique risk features. Prior to trading in derivatives, the investors should make certain that they fully understand the nature of, and the risks associated with, these products.

3.5 REAL ESTATE

Real estate investment used to be one of the best types of investment in Hong Kong until the property market bubble burst in 1997. Property prices increased multi-fold during the 1991-1997 property market boom but fell over 50% within a short period of time afterward.

Real estate investment can be carried out in different forms. The most common type is ***rental property*** where investors acquire apartments, houses, shops or office premises with down payments and use rental incomes to pay off the mortgage and other expenses. Simultaneously, rental property provides both a cash flow and an opportunity to capital appreciation of property market value.

Another form of real estate investment involves the purchase of apartments, houses, shops, office premises or even raw land with an intention to sell them later for a profit. Such investment could be financed by mortgage as well.

3.5.1 Advantages of Real Estate Investment

- capital appreciation;
- inflation hedge;
- leverage through bank mortgages available; and
- pride of ownership.

3.5.2 Disadvantages of Real Estate Investment

However, as a means of investment, it has the following disadvantages:

- high volatility/risk;
- high transactions costs;
- illiquid market;
- management problems;
- high denomination; and
- low rental yield.

3.6 LOW LIQUIDITY INVESTMENTS

We will finish this part by a brief discussion on another class of investment assets that is viewed more as hobbies than investment even though some of these assets did experience substantial returns in the past. They include **antiques, art, coins and stamps, diamonds** and other **collectible items**.

Apart from possible financial return from such investments, investor may also gain satisfaction and enjoyment from the ownership of such items. However, the market for such investments is always illiquid and transaction costs could be very high. Many of these assets are sold at auctions and prices may thus vary substantially. Also, special knowledge and expertise are required.

3.7 INVESTMENT FUNDS

In the following sections, terms such as investment funds, mutual funds, or unit trusts are regarded as collective investment schemes under the ***Securities and Futures Ordinance*** (Cap. 571).

Since investment-linked long term insurance policies are mostly offered with their value directly linked to the performance of investment fund(s), the insurance intermediary selling these products should possess thorough knowledge on the features, benefits, and operations of investment funds.

Investment funds are a form of collective investment schemes through which a number of investors having similar investment objectives combine their money into a large central pool. The investment company then channels the funds from this pool into a diversified portfolio of financial instruments such as stocks and bonds. In return, the investors are entitled to any earnings that the company may generate.

There are a wide variety of funds created to suit different needs of investors. Investment funds can be classified according to the asset class they invest in such as stock funds, bond funds, money market funds, venture capital funds etc. They can also be termed as aggressive growth funds, growth funds, income funds, balanced funds etc. according to their investment objectives. Some funds are set up for investment in specific industry (e.g. technology funds), or geographic areas such as global funds, American funds, European funds, Far East funds, China funds, Hong Kong funds etc.

The market for investment funds is huge. According to the Investment Company Institute, worldwide mutual funds' total net assets amounted to over USD31.38 trillion at the end of the fourth quarter of 2014. In Hong Kong, the number of SFC authorised mutual funds and units trusts as at 31 March 2015 was 2,045 (source of data: the SFC).

Investment funds are highly regulated in Hong Kong. Under section 103 of the **"Securities and Futures Ordinance"** (Cap 571), it would be an offence to issue advertisements, invitations or documents relating to certain investments, including collective investment schemes, to the public unless the issue is authorised by the SFC under section 105(1), or exempted. Section 104 of the Ordinance provides power to the SFC to grant authorisation for such collective investment schemes which include investment funds. In addition, pursuant to the Ordinance, the SFC also published the "**Code on Unit Trusts and Mutual Funds**" in April 2003, which established guidelines for the authorisation of collective investment schemes in the nature of mutual fund corporations or unit trusts, and whose latest edition became effective on 25 June 2010. Some of the relevant issues will be discussed in the following sections.

3.7.1 Mutual Fund and Unit Trust

Investment funds differ in many ways and thus classification is difficult. Different names are often used depending on the jurisdiction. Investment funds are commonly known as mutual fund or unit trust.

(a) Mutual Fund

This is the simplest and most common situation. An investment company is set up with the objective of investing in shares of other companies and has only one type of investors, i.e. the stockholders for whom it makes the investment. These stockholders own the investment company directly and thus own indirectly the financial assets that the company itself owns.

A mutual fund company has a board of directors that is elected by its stockholders. In turn, the board will commonly hire professional money manager, the management company, to manage the company's assets. These management companies may be authorised financial institutions, registered companies, or insurance companies. Often the management company is the business entity that started and promoted the mutual fund. A management company may have contracts to manage a number of mutual funds, each of which is a separate organisation with its own board of directors.

(b) Unit Trust

Trust is an old concept under English Common Law. This concept is recognised in common law countries such as the UK, Australia, Canada and Singapore. It is also adopted in Hong Kong. However, in other jurisdictions such as the US, Taiwan, Japan, France or Luxembourg, it is not recognised; instead mutual funds are adopted.

A unit trust is an investment vehicle set up under a trust. To form a unit trust, the investment company purchases a specific set of securities and deposits them with a trustee. The investors who share similar investment objectives then pool their money together for the investment into such types of assets.

A number of units known as redeemable trust certificates are sold to the public. These certificates provide their owners with proportional interests in the securities that were previously deposited with the trustee. All income received by the trustee on these securities is subsequently paid out to the certificate holders, as are any repayments of principal.

An investor who purchases units of a unit trust is not required to hold them for the entire life of the trust. Instead the units usually can be sold back to the trust, at a price calculated on the basis of bid prices for the underlying assets in the portfolio, i.e. the market value of the securities in the portfolio. This is otherwise known as the Net Asset Value (NAV) per unit.

The NAV is derived using the following formula:

$$\text{NAV} = \frac{\text{Total Assets} - \text{Total Liabilities}}{\text{Number of Units Outstanding}}$$

Having determined the per unit price, the trustee may sell one or some of the securities to raise the required cash for the repurchase.

3.7.2 Open-end and Closed-end Funds

Investment funds sell shares to investors and use the proceeds to purchase assets and securities according to the investment objective of the funds. However, funds differ in the way they operate after the funds have been launched and can be classified as open-end or closed-end.

(a) Open-end Funds

An open-end fund has a variable capitalisation. It stands ready to purchase existing shares at a price based on or near the NAV of the underlying investments. On the other hand, it may continuously offer new shares to investors, again at a price based on the NAV. The open-ended nature means that the fund gets bigger and more shares are created as more people invest in it. The fund shrinks and shares are cancelled as people withdraw their investment. The price of the shares is based on the value of the investments the fund has invested in.

(b) Closed-end Funds

A closed-end fund is an investment company whose line of business is investing in other financial assets or companies. It issues a set number of shares initially to capitalise the fund, i.e. the fund size is fixed. After the initial launch, new shares are rarely issued or repurchased and the number of shares does not change regardless of the number of investors.

An investor who wants to buy or sell shares in the closed-end fund has to do it through the secondary market. These funds are commonly traded on organised exchanges such as the New York Stock Exchange, the American Stock Exchange or the Hong Kong Stock Exchange.

Although the price of the shares of a closed-end fund reflects the value of the investments in the fund, it does not equal to the NAV of the fund as in the case of open-end funds. If there are more people willing to sell their shares than people willing to buy, the share price tends to fall and may be lower than the NAV, in which case a discount exists. If there are more buyers than sellers, the share price tends to rise and may be higher than the NAV, in which case a premium exists. The premium or discount may vary dramatically depending upon market sentiments and market conditions.

Closed-end funds are generally established to invest in markets where the assets are less liquid, e.g. the stock markets of emerging economies or property. This is due to the closed-ended nature of the fund which protects the underlying assets from having to be sold (at unreasonable price) to meet the redemption requirement of the investors during extreme market condition.

3.7.3 Charges and Fees of Investment Funds

There are, at a minimum, usually two types of fees incurred in investment in funds. The first type is a sales fee or load of a fund for the operation and distribution costs of the fund and the second type is the annual management fee paid to the fund management company for their services.

(a) No Load

With direct marketing, the fund house sells the units/shares directly to the investors without the use of a sales organisation. This type of investment fund is known as a no load fund and imposes no initial sales fee. The units/shares are sold to the investors at a price equal to their NAV. However, some fund houses may charge a redemption fee or exit penalty if the units/shares are sold back to them within a certain time limit. Other fund houses may charge an on-going distribution fee on an annual basis.

(b) Sales Fee/Load

When investment funds are sold through the use of a sales force, the fund house has to pay a commission based on the units/shares sold. This is known as a load charge and the common load types are described as follows:

- Front-end load;
- Back-end load; and
- Level load.

(i) Front-end Load

A front-end fee is charged to the investors when the shares/ units are purchased from the fund house. The fee is paid up-front and just once, as a percentage of the initial purchase price. This type of funds is commonly known as class A unit/share and is an attractive choice for long-term investors.

(ii) Back-end Load

Back-end load will only be paid by the investors when the units/shares are sold back to, rather than when they are purchased from, the fund house. That is, when the investors sell their units/shares back to the fund house, a deferred contingent sales charge or redemption charge may be applicable. The deferred contingent sales charge is typically calculated as a percentage of the NAV and applies for the first few years that the investors own the units/shares. The fee decreases over time in steps until it disappears. The redemption charge may be a fixed percentage of the NAV, or based on the time period for which the investors have held their units/shares. In addition, a ***distribution fee*** of up to 1% is usually applicable annually. This type of funds is commonly known as class B unit/share and is more attractive for investors who intend to hold the units/shares for a medium term of at least 5 years. Some class B units/shares may be set up so that they convert to class A units/shares after a number of years and the annual distribution fee will be avoided thereafter.

(iii) Level Load

A level load fund requires the investors to pay a small front-end charge when the units/shares are purchased from the fund house, and possibly a small back-end charge if they are sold back to the fund house in less than a year. However, a distribution fee is again applicable to cover the selling expenses. This type of funds is commonly known as class C unit/share and is more attractive for the short-term investors. However, it should be noted that level load is not too common in Hong Kong.

(c) Management Fees

In addition to sales charges, the management company will charge annual management fees for the investment and advisory services provided by the professional fund manager. The management fee is set at a certain percentage, usually ranges from 0.5% to 1% per annum, of the average market value of the fund.

Under the ***"Code on Unit Trusts and Mutual Funds"***, the level/basis of calculation of all costs and charges payable from the scheme's property must be clearly stated, with percentages expressed on a per annum basis. The aggregate level of fees for investment management advisory functions should also be disclosed.

If a performance fee (i.e. a fee based on the actual investment gains achieved) is levied, the fee can only be payable:

(1) no more than annually; and
(2) if the NAV per unit/share exceeds the NAV per unit/share on which the performance fee was last calculated and paid (i.e. on a high-on-high basis).

(d) Other Fees

Other fees which may be charged by the investment company include (but not limited to):

(1) administration fee which covers record keeping and services to investors;
(2) guarantee fee (mainly for guaranteed funds);
(3) trustee fee; and
(4) custodian fee.

3.7.4 Benefits of Investment Funds

The benefits of investment funds have been well summed up by one of the many quotations: "they offer people with limited time, or limited investment skills or modest means, access to investment returns available only to more sophisticated investors who are able to buy their own professional advice. They generally entail less risk than direct holdings of securities, and offer economies of scale."

Some of the major benefits are summarised as follows.

(a) Diversification

Investment funds provide an assortment of investment options. They offer growth, income, or a mixture of both, and the opportunity to invest in international markets, as well as in the local market. Investment managers typically establish a portfolio of as many as 50 to 200 or more different securities.

In effect, they are putting the investors' money in many baskets instead of just one. Traditionally, only large institutions and "high net worth" individual investors can attain the diversification on their own. This is now made available to mass investors through investment funds.

(b) Professional management

With investment funds, investors have access to professional, expert and full time investment managers who base their buying and selling decisions on extensive and on-going economic research. After analysing macro-economic conditions, stock market conditions, interest rates, inflation and the financial performances of individual companies, they select investments that best match the fund's objectives. Again, only large institutions and high net worth individual investors used to enjoy the service of such professional investment managers but investment funds have made this type of financial expertise accessible by the mass market.

(c) Growth potential

Investment funds create possibility of higher long-term returns than conventional savings. As a matter of fact, one reason for the phenomenal growth of investment funds is their performance record in relation to what individual investors might expect by investing on their own. Of course, performance varies from fund to fund, but on average and over the long run, the growth of equity funds has paralleled the growth in the US economy. In addition, bond and money market funds have also reflected the long-term movements in their respective markets.

(d) Convenience

Investors can purchase most types of investment funds through a professional licensed representative of an investment company. The intermediary can help analyse the investor's financial needs and objectives and recommends the appropriate funds. Nowadays, most of the commercial banks in Hong Kong sell their own investment funds while some also sell the funds of investment companies.

Investors, depending on the availability of secondary market and subject to the terms of the funds, also have access to their money. They can redeem all or part of their investment on any business day and receive the current value of the investment, which of course may be more or less than the original cost. Payment for redeemed investment will generally be made within a few business days.

(e) Access to global markets

Some markets may not allow access by foreign investors. However, international investment companies may be able to establish a local company and thus invest into the market. This provides additional opportunity to investors who may otherwise not be able to take advantage of the investment opportunity.

(f) Flexibility

Investment funds offer various features that allow investors to stay in control of their investment. Investors can choose the type of investment that most fits their own investment objectives and risk tolerance.

(g) Liquidity

Most of the investment funds are readily marketable at a price equal to the net asset value (NAV). Investors can therefore realise their investment easily without having to make a substantial price concession.

(h) Affordability

For those investors with moderate financial resources who wish to invest in the stock market, they could only purchase stocks in odd lots, which result in high brokerage commission. Moreover, they would have to sacrifice the benefits of diversification. Economies of scale in investment funds make such investment possible to the mass market.

Furthermore, investment funds are available in small units that make them affordable even to the mass market. Investors can get an investment programme started for HKD10,000 (or lower). Subsequent and regular monthly investments can be made for as little as HKD1,000.

(i) Cost efficiency

Investors sometimes have the feeling that investing in investment funds are expensive given that they are charged an upfront (front-end load) commission of up to 5%. However, with this amount of money they are hiring the professional service of some world class experts in their particular field to make the investment decision for them. Furthermore, the investment companies often employ "state-of-the-art" computer equipment that is usually unaffordable for individual investors.

Moreover, dealing and administrative costs would be greatly reduced by pooling the investors' funds together to take advantage of buying in bulk.

(j) Administration

Investors do not have to perform any administrative work associated with managing their own portfolios, such as handling payments connected with share trading, registering shares, arranging for custodian, collecting dividends and applying for rights issues.

(k) Protection

The assets of the investment funds are typically protected by the trustees, or custodians, who have the responsibility to act in the interests of investors, owning the investments on their behalf. It is also the trustee's role to ensure the investment is made according to its investment objectives while the custodian will be responsible for the safekeeping of the assets.

Investment fund business is highly regulated. In Hong Kong, investment funds must be authorised by the SFC before being marketed to the public. Although SFC authorisation is not a guarantee of an investment product, it has made specific requirements necessary before authorisation will be granted.

(l) Up-to-date investment position

Most investment funds publish the bid and offer price, and their NAV if applicable, daily on newspapers. With the advance in technology, some of them even make their information available through the internet.

(m) Automatic reinvestment of gains

Most investment funds allow investors to automatically reinvest their dividends and capital gains to purchase additional fund units/shares at no extra cost. Over time, the power of compounding may significantly increase the value of investors' assets.

(n) Switch privilege (into other funds)

Within a fund family, investors can generally switch all, or any portions, of their investments into other funds with different objectives as their financial situations, and thus investment strategies, change.

3.7.5 Disadvantages of Investment Funds

(a) Management fees

The professional investment managers running the investment fund on behalf of the investors will inevitably take a fee directly from the investment fund. This is a cost investors could avoid if they manage their own investment.

(b) Lack of choice

Although investors can choose the type of fund they intend to invest in, they have no control over the choice of individual share, or bond which goes into the fund.

(c) Lack of owner's rights

If investors hold a company's shares direct, they will have the right to attend the company's annual general meeting and vote on important matters. Investors in an investment fund have none of the rights connected with the individual investment in the fund.

3.7.6 Roles of the Various Parties of an Investment Fund

Pursuant to the ***"Securities and Futures Ordinance"***, the SFC published the "**Code on Unit Trusts and Mutual Funds**" in April 2003, which outlines the authorisation criteria and on-going obligations in respect of authorised investment funds that are offered to the public in Hong Kong, and whose latest edition became effective on 25 June 2010. Some of the major sections have been extracted as follows (**Note**: these have only been reproduced in a simplified version, for full details please refer to the Code):

(a) Role of Management Company

"Authorised" investment funds must appoint a management company acceptable to the SFC. A management company must be properly licensed or registered under Part V of the **"Securities and Futures Ordinance"** to carry on its regulated activities if it is incorporated in and/or operates from Hong Kong. It is responsible for investment management within the scope of the constituent documents. For this, a management company must:

(1) be engaged primarily in the business of fund management;
(2) have sufficient financial resources to enable it to conduct its business effectively and meet its liabilities; in particular, it must have a minimum issued and paid-up capital and capital reserves of HKD1 million or its equivalent in foreign currency;
(3) not lend to a material extent;
(4) maintain at all times a positive net asset position; and
(5) have its investment management operations based in a jurisdiction with an inspection regime acceptable to the SFC.

The general obligations of the management company are that it must:

(1) manage the fund in accordance with the constitutive documents in the exclusive interest of the holders and to fulfil the duties imposed on it by the general law;
(2) maintain the books and records of the fund and prepare the fund's accounts and reports. At least two reports must be published each financial year; and
(3) ensure that the constitutive documents are made available for inspection by the public.

(b) Role of Trustee/Custodian

Every "authorised" investment fund established as a unit trust or mutual fund must respectively appoint a trustee or custodian acceptable to the SFC. Trustees are expected to fulfil the duties imposed on them by the general law of trusts. In the case of a mutual fund corporation, the responsibilities of a custodian should be reflected in a constitutive document such as a Custodian Agreement.

As outlined under the Code, an acceptable trustee/custodian should either:

(1) on an on-going basis, be subject to regulatory supervision; or
(2) appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC and should file such report with the SFC.

A trustee/custodian must be:

(1) a bank licensed under Section 16 of the **"Banking Ordinance"**; or
(2) a trust company which is a subsidiary of such a bank; or
(3) a trust company registered under Part VIII of the **"Trustee Ordinance"**; or
(4) a banking institution or trust company incorporated outside Hong Kong which is acceptable to the Commission. Additionally, a

trustee/custodian must be independently audited and have minimum issued and paid-up capital and non-distributable capital reserves of HKD10 million or its equivalent in foreign currency.

A. General obligations of Trustee/Custodian

The trustee/custodian must:

(1) take under its control all the property of the fund in trust for the holders in accordance with the provisions of the constitutive documents;

(2) register all assets in the name of the trustee/custodian; where borrowing is undertaken for the account of the fund, such assets may be registered in the lender's name;

(3) be liable for the acts of its agents in relation to assets forming part of the property of the fund;

(4) take reasonable care to ensure that the sale and repurchase of units/shares are carried out in accordance with the constitutive documents;

(5) take reasonable care to ensure that the sale and repurchase prices are calculated in accordance with the constitutive documents;

(6) carry out the instructions of the management company unless they are in conflict with the provisions of the constitutive documents or the Code;

(7) take reasonable care to ensure that the investment and borrowing limitations set out in the constitutive documents are complied with;

(8) issue a report to the holders on whether the management company has managed the fund in accordance with the provisions of the constitutive documents; if not, the steps which the trustee/custodian has taken; and

(9) take reasonable care to ensure that unit/share certificates are not issued until subscription moneys have been paid.

B. Independence of Trustee/Custodian and Management Company

The trustee/custodian and the management company must be persons who are independent of each other. Where the trustee/custodian and the management company have the same ultimate holding company, they are deemed to be independent of each other if:

(a) (1) they are both subsidiaries of a substantial financial institution;

(2) neither the trustee/custodian nor the management company is a subsidiary of the other;

(3) no person is a director of both the trustee/custodian and the management company; and

(4) both the trustee/custodian and the management company sign an undertaking that they will act independently of each other; or

(b) the fund is established in a jurisdiction where the trustee/custodian and the management company are required by law to act independently of one another.

(c) Role of Auditor

The management company or the directors of a mutual fund corporation must, at the outset and upon any vacancy, appoint an auditor for the scheme.

The auditor must be independent of the management company, the trustee/ custodian and, in the case of a mutual fund corporation, the directors.

The management company must cause the fund's annual report to be audited by the auditor.

(d) Role of Registrar

The fund, or in the case of a unit trust the trustee, or the person so appointed by the trustee must maintain a register of holder. The Commission must be advised on request of the address where the register is kept.

3.8 LIFE INSURANCE AND ANNUITY

The US Life Office Management Association Inc. (LOMA) defines a life insurance policy as follows:

"A policy under which the insurance company promises to pay a benefit upon the death of the person who is insured."

3.8.1 Life Insurance

(a) Major Types of Life Insurance

Some of the major types of life insurance are summarised as follows:

(i) **Term insurance**: this provides cover for a specified period or term only, and may also be described as temporary insurance. The policy benefit is only payable if the insured person dies during the specified period, and the policy is valid at the time of death.

(ii) **Endowment insurance**: this provides for the payment of the face amount at the end of a specified term or upon earlier death. Should the insured survive the term, the policy is said to mature.

(iii) **Whole life insurance**: this involves a policy that is designed to last the whole of one's life. The fundamental feature is that the face amount is paid on death, whenever that occurs, and not before.

(iv) **Universal life insurance:** this is basically a life insurance contract with the following special features:

(1) It is subject to a flexible premium;
(2) It has an adjustable benefit;
(3) The expenses and other charges are disclosed to a purchaser;
(4) It accumulates a cash value; and
(5) It separates and discloses to the policyholder (unbundles) the pure cost of protection, the investment earnings, and the company expenses.

(b) Advantages of Life Insurance (as an investment vehicle)

- protection against uncertainty;
- suitable for long-term investment (except term insurance);
- protection against loss of income arising out of premature death;
- low risk; and
- accumulation of funds for specific purposes (except term insurance).

(c) Disadvantages of Life Insurance (as an investment vehicle)

- current cash flow reduced;
- low yield;
- need to have insurable interest at the inception of life insurance policy;
- illiquid (at least in the short term);
- lack of flexibility;
- no ownership of any underlying assets; and
- acceptance of purchase dependent upon underwriting decision of the insurer.

3.8.2 Annuity

An annuity is a series of periodic payments to an annuitant for life or other agreed term or conditions, in return for a single payment (premium) or series of payments. For example, an annuitant pays HKD1,500,000 now to buy an annuity that will pay the annuitant a monthly fixed payment of HKD10,000 for twenty years.

(a) Features of Annuities

Some features to be noted with annuities are:

(i) **Immediate annuity**: this is usually purchased with a single payment, the benefits or instalments begin one annuity period (one month or six months) immediately thereafter.

(ii) **Deferred annuity**: the instalment payments begin at some specified time or specified age of the annuitant.

(iii) **Variations**: a number of possible variations exist. One provides for instalments to be paid for a fixed number of years only (whether death occurs in the meantime or not – an annuity certain). Another provides for instalments to be paid for at least a specified number of years, whether death occurs or not, and for life if longer than that number of years – known as a guaranteed annuity (or life income with period certain).

(b) Advantages of Annuities (as an investment vehicle)

- stable cash flow;
- suitable for retiree;
- suitable for long-term investment;
- protection against lack of income arising out of excessive longevity;
- accumulation of fund for specific future purposes;
- regular and guaranteed income;
- low risk; and
- hedge against adverse financial developments.

(c) Disadvantages of Annuities (as an investment vehicle)

- decreasing purchasing power with fixed payments if inflation exists;
- retiree may outlive the annuity;
- low return;
- illiquid in the short term;
- no ownership of any underlying assets; and
- lack of flexibility.

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Representative Examination Questions

Type "A" Questions

1. Which of the following is not a benefit for investing in investment funds?

   (a) affordability;
   (b) bank guarantee;
   (c) convenience;
   (d) diversification.

[Answer may be found in **3.7.4**]

2. Which one of the following investment options has all the advantages of capital appreciation, dividend income, liquidity and inflation hedge?

   (a) cash;
   (b) bonds;
   (c) options;
   (d) shares.

[Answer may be found in **3.3.11**]

3. Looking at the charges only, which type of investment funds is more suitable for an investment-linked insurance policy?

   (a) Class A stock because the investors are typically looking for a long term investment;
   (b) Class B stock because there is no load charge;
   (c) Class C stock because there is both load charge and an annual distribution fee;
   (d) None of the above.

[Answer may be found in **3.7.3**]

4. One of the advantages of investing in derivatives is:

   (a) the low level of volatility;
   (b) the guaranteed return;
   (c) the potential high return;
   (d) the dividend income.

[Answer may be found in **3.4.4**]

Type "B" Questions

5. A time deposit placed in a major bank is a good form of investment because of:

   (i) its high degree of liquidity
   (ii) its low level of risk
   (iii) its traditional high return
   (iv) its low cost of investment

   (a) (i) and (ii) only;
   (b) (i) and (iv) only;
   (c) (ii) and (iii) only;
   (d) (ii) and (iv) only.

[Answer may be found in **3.1.3**]

6. Some of the advantages of investing in bonds are:

   (i) liquidity
   (ii) higher return than money market instruments
   (iii) risk free
   (iv) regular and determinable income

   (a) (i) and (ii) only;
   (b) (i), (ii) and (iv) only;
   (c) (ii) (iii) and (iv) only;
   (d) all of the above.

[Answer may be found in **3.2.13**]

7. Some of the disadvantages of investing in investment funds are:

   (i) management fees charged
   (ii) lack of choice
   (iii) lack of owner's rights
   (iv) liquidity problems

   (a) (i) and (ii) only;
   (b) (iii) and (iv) only;
   (c) (i), (ii) and (iii) only;
   (d) (ii), (iii) and (iv) only.

[Answer may be found in **3.7.5**]

[*If still required, the answers may be found at the end of the Study Notes.*]

Chapter 4
INVESTMENT-LINKED LONG TERM INSURANCE POLICIES

4.1 HISTORICAL DEVELOPMENT

Life insurance started some 400 years ago. It was created to satisfy the need for financial security. Over the years, existing insurance products were enhanced and new insurance products were developed to satisfy the market's evolving requirements.

Term life and ordinary whole life are the two traditional types of life insurance and have occupied the majority of the world individual life insurance market. Different features have been added to these two traditional types of life insurance to cater to customers' requirements over the years, with universal life, variable life and variable universal life (US-name) / unit-linked (UK-name) / investment-linked (Asia-name) being the most significant derivatives over the past decades.

Universal life is a type of permanent life insurance that is characterised by flexible premiums (both size and frequency), adjustable death benefits, and transparency of the administrative expenses and cost of insurance; but it gives the policyowner no freedom to invest in his preferred investment portfolio. Variable life is a type of permanent life that shifts investment risk to the policyowner, who is given the choice to select from a wide range of investment options; the interests that his account or accounts earn increase the cash value(s) of the account(s). Variable universal life combines the premium and death benefit flexibility of universal life with the investment flexibility and risk of variable life.

We will briefly discuss the historical development of investment-linked policies through the review of the two bigger insurance markets: the US and the UK.

In the UK, unit-linked policies were first introduced in l957. In 1958, the government required that unit trusts could only be sold by intermediaries or by advertisements in the newspapers and for very modest commissions. This led to a problem for unit trust managers that it was almost impossible for them to produce a regular stream of sales of units. Therefore, they developed an idea to set up a regular savings plan under the form of a life insurance policy whereby the premiums would effectively be invested in a unit trust.

This type of unit-linked policies was a life insurance and not a direct holding in the unit trust. It was regulated in the same way as other forms of life insurance products, thus it was possible to sell it directly to the public by salesmen and for higher commissions. Therefore, many unit trust companies began to write unit-linked policies or make arrangements with existing life companies to offer policies linked to their own units. A number of life insurance companies also started to develop their own unit-linked products along similar lines. At the same time, single premium unit-linked life business also began in the UK. That was considered as a better way of lump sum investment than unit trusts. Another point to note was that originally in the UK, unit trusts were not allowed to invest in property because of its illiquidity. However, there was no such limitation on single premium life insurance. If the UK people wanted to invest a lump sum in property "units", single premium unit-linked life insurance was the only option.

The unit-linked insurance market in the UK is fast growing since then and now occupies a large portion of the individual life insurance market. The main factors which have led to the popularity of this product are:

- favourable economic trends leading to good performance of unit-linked products;
- consumers finding the product attractive;
- the sales environment of aggressive marketing;
- limited regulation on sales methods;
- tax relief on premiums; and
- advance in information technology (without which it would be impossible to administer the unit-linked business).

Another major reason for the growth in the UK for unit-linked life insurance versus unit trusts was that the latter could not offer managed funds (or more recently described as balanced funds). Unit trusts were usually single entity or specialist sector investments e.g. growth, technology, geographic funds, etc. On the other hand, the internal funds of unit-linked life assurance companies could offer a managed fund investing in varying proportions of fixed interest securities, equities, properties and cash deposits without the need at the outset to fix the exact proportions.

Of the 7.2m investment and savings policies in force in the UK in 2013, around a third were linked policies (source of data: Association of British Insurers). The UK major banks have all set up their own life insurance subsidiaries and they have also concentrated on selling unit-linked products.

In the US, both universal life and variable life were first introduced in the mid-1970s. Both products gained modest success when they were first introduced. When variable life was introduced in the US, after being marketed successfully in the UK, Canada, and the Netherlands, it was considered as a product that could help offset the adverse effects of inflation on life insurance policy death benefits. Variable universal life was introduced to the US market in 1986.

The US life insurance market enjoyed a period of steady growth in premiums during the period 1995 to 2005. Then the Global Financial Crisis of 2007–2008 caused significant drops in life insurance sales in 2008 and 2009, probably owing to a decline in consumers' purchasing power and to withdrawal of supply of premium finance to institutional buyers. Individual life insurance sales have begun to recover gradually since 2010. In 2014, the US market shares by product in terms of new premiums were as follows: universal life and indexed universal life combined (38%), whole life (33%), term life (21%) and variable universal life (8%). (Source of data: LIMRA)

Hong Kong has been slower than the overseas markets in the development of investment-linked long term insurance products. They were first introduced in the late 1980’s. They gained popularity over the years because of the increasing demand of Hong Kong customers for higher returns on the insurance policies and the increasing familiarity of Hong Kong customers to investment funds especially with the introduction of the Mandatory Provident Fund Scheme in 2000.

Investment-linked long term insurance policies are one of the major life insurance products in Hong Kong. According to the statistics published by the Office of the Commissioner of Insurance on investment-linked individual life in-force business, its office premiums amounted to HKD69,895.8 million as at the end of 2013, constituting 29.0% of total office premiums of individual life in-force business, with the number of policies decreasing by 2.7% over the previous year. In respect of investment-linked individual life new business, the amount of office premiums for 2013 was HKD19,115.7 million, accounting for 21.5% of individual life new business.

4.2 CHARACTERISTICS OF INVESTMENT-LINKED LONG TERM INSURANCE POLICIES

The premium rate for a life insurance policy/annuity is based on three main factors:

- cost of insurance;
- expenses to cover distribution and operation costs and to provide for contingency and profits of the insurance company; and
- interest/investment earnings.

The main characteristics of investment-linked policies are follows:

1. all fees and charges are made known to the policyholder;

2. premium payments net of relevant charges such as cost of insurance and expenses are invested in the policyholder's chosen investment funds accounts that are separated from the company's general assets or investments (please refer to sections **4.6.2** and **4.6.8** for the different methods of premium application);

3. the value of the policy will fluctuate with the value of the underlying investment funds. The policy benefit such as the death benefit amount or annuity payment amount or cash value thus varies with investment performance while the downside is protected by a minimum guaranteed death benefit;

4. generally offers a variety of investment funds each with a different investment strategy – such as money market, stock, bond funds etc.;

5. the policyholder takes on all the investment benefits as well as losses relating to the performance of his/her chosen investment fund; and

6. generally does not work well for too small premium amounts because deduction of expenses (some of which are in terms of fixed amounts) and cost of insurance will leave behind a very small amount available for investment.

4.3 TYPES OF CHARGES OF INVESTMENT-LINKED LONG TERM INSURANCE POLICIES

As mentioned above, one of the fundamental differences of investment-linked policies and traditional term or whole life policies is that all charges are separated and made known to the policyholder. To better understand this product, we will start with an overview and description of the charges as follows:

4.3.1 Charges

Insurance companies charge certain fees for the provision of insurance policies to cover the marketing, distribution, administration, and insurance expenses. These will also contribute to the profit margins of the insurance companies. These charges apply to all insurance policies. The only difference is that for investment-linked policies, they are separately specified.

(a) Cost of Insurance/Mortality Charges

The cost of insurance is to cover the mortality, annuity payment and other benefits and is mainly based on the gender, age, smoking habit, sum assured, class of risk of life assured and death benefit option. Cost of insurance for life insurance policies is also known as mortality charges. The sharing of risk of death among a large group of people is the basis of life insurance. Mortality tables that reflect the average life expectancy of each age group are often used to give companies an estimate of how much will be required to pay for death claims per year.

Insurance companies in Hong Kong usually use various mortality tables, e.g. “Hong Kong Assured Lives Mortality Table 2001” published by the Actuarial Society of Hong Kong and some creditable overseas mortality tables as a reference. Cost of insurance for annuities is based on Annuity Mortality Tables instead of Life Insurance Mortality tables.

(b) Policy Fee/Initial Charges

This is also described as “premium charges” and “contribution charges” by some insurance companies. This covers the distribution, marketing and policy issue expenses of setting up a policy. The charges may be small when you look at the life of the policy. However, on the short term, it can be a sizable amount that equates the premium payments for the first twelve months of the policy.

There are three common methods to impose initial charges, depending on the terms of the investment-linked policy.

The most common method used is to charge them as a percentage of the premium payments. For example, it can be 100% of the first year regular premium payment and a specified percentage of the contributions in subsequent years, generally on a sliding scale.

The second one is the concept of “initial contribution period”. While most insurance companies have set the “initial contribution period” as the first 18 months, this can actually be extended to the first few years, or even throughout the whole term, of the policy. Alternatively, particular schemes offer the policyholder choices of initial contribution period. Units purchased during the initial contribution period will be allocated into an “initial units account” notionally created for the policy. One or more types of initial charge, usually expressed as percentages of the account value of the “initial units account”, are deducted from the initial units account during specified periods, which may be longer than the initial contribution period.

The third one is the concept of “initial investment allocation ratio”. For example, if the “initial investment allocation ratio” is set at 95%, then only 95% of the contributions will be invested (subject to other charges) and an initial charge of 5% is imposed.

The name of “initial charges” seems to suggest that they are only imposed at the beginning of the policy. However, they are in essence the type of charges to recover the initial cost of setting up the policy. Furthermore， whenever a policyholder increases the amount of regular premium or tops-up a single premium after policy inception, the same set of "initial charges" will be levied on the increased amount of contributions.

(c) Administration/Maintenance Fee

This is normally a fixed charge per year and/or a percentage of the premium applied to cover the insurance company's administrative expenses.

4.3.2 Charges related to Investment-linked Policy

(a) Bid-offer Spread

Premium payments net of insurance charges are allocated for purchase of investment fund, in accordance with the policyholder's investment strategy. The purchase of investment fund involves a charge reflected in the price difference between the purchase and sale of the investment units to the insurance company called the bid-offer spread.

The spread is the difference between the price at which the policyholder can buy units (the offer price) from the insurance company and that at which the policyholder can sell units (the bid price) to the insurance company.

The bid price is typically set at the Net Asset Value (NAV), which represents the value at which the underlying assets can be realised. Hence, when the NAV is HKD12, the bid price will normally be HKD12 and if the offer price is HKD12.60, then we would say the spread is 5% (expressed as a percentage of the bid price).

This is a charge imposed by the insurance company and is normally used to fund the marketing cost of the policy and the trading cost of the funds. It is normally directly proportional to the size of the policy.

(b) Fund Management Fee

This is charged by the investment fund manager for their services rendered to manage the fund. It is usually expressed as a specified percentage of the fund's market value and is used to support the insurance company's investment management team and may range from 0.5% to 1% per annum. The level of this charge depends on competition, the type of assets under management, the level of management activity involved and the profit requirements of the insurance companies. For example, an index fund would normally attract a lower management charge compared to an equity fund. Pricing of the units would have taken this into account.

(c) Fund Switching Charge

This relates to the fee charged for the policyholder to amend his/her investment option and allocation from time to time, i.e. to switch his/her investments between different funds offered by the insurance company. Normally, insurance companies may allow several switches per year free of charge. However, it should be noted that some insurance companies do not impose any charges for switching.

(d) **Surrender Charge**

This is charged when the policyholder surrenders his/her policy through the sale of the investment fund units. The fee is normally deducted from the value of the units sold at surrender. It represents the upfront expenses that have already been incurred by the insurance company such as policy fee, initial charges etc., but not yet recovered. As such, the surrender fee of an investment-linked policy is normally charged on a sliding scale. The first-year surrender charge may be as high as 100% of a policyholder's contributions to cover the insurance company's upfront expenses.

(e) **Top-up Fee**

This is charged when the policyholder chooses to top-up his/her investment, i.e. to pay in further single premiums to purchase additional units. Some insurance companies apply a flat fee or percentage charge on the top-up amount. Please refer to section **4.6.3** for an example of top-up application.

(f) **Fees and Charges of Underlying Funds**

Some investment fund choices available under investment-linked policies are "feeder' or "mirror" funds in the sense that contributions made into these fund choices are invested entirely into an underlying fund which in turn invests in direct investments such as shares, bonds etc. (please refer to section **3.7** for details on investment funds). This design is aimed at taking advantage of the investment management expertise of the manager of the underlying fund and economies of scale where monies from a wide range of investors are pooled together at the underlying fund level and invested.

Although the feeder/mirror fund structure has its advantages, policyholders who invest via the investment-linked policy will have to indirectly bear all fees and charges of the underlying fund, including investment management fee, custodian or trustee fee, administration fee and perhaps also subscription and redemption charge when units/shares in the underlying fund are subscribed or redeemed by the insurance company on behalf of policyholders (please refer to section **3.7.3** for details of fees and charges of investment funds). These fees are in addition to whatever charges imposed at the policy level. However, depending on the relationship and bargaining power of the insurance company vis-à-vis the investment manager of the underlying fund, some of the fees and charges at the underlying fund level may be reduced or waived.

4.4 TYPES OF INVESTMENT-LINKED LONG TERM INSURANCE POLICIES

Investment-linked long term insurance policies can be divided into two groups:

(a) Investment-linked annuities – this is a type of annuities whose annuity payment is variable according to the performance of the investment funds. Annuities are not common in Hong Kong due to the lack of demand.

(b) Investment-linked life insurance – the more common linkages are with whole life and endowment. It should be noted that the most popular type of investment-linked long term insurance policy sold in Hong Kong is known as "flexible premium variable life insurance" or "variable universal life" or "universal variable life" in the US. The policy, in addition to the investment linkage, also offers premium and sum assured flexibility. Therefore, besides the characteristics of investment-linked long term insurance policies we mentioned in section **4.2**, these policies may also include (but not mandatory) some of the following features:

(i) It usually offers flexibility in premium payments, although single premium payment options are also offered. It allows the policyholder to increase or decrease the amount of regular premiums, add top-ups to the policy at any time, or even skip premium payments for a period of time (take premium holiday), provided that the policy value is sufficient to cover the mortality charges and fees.

(ii) It offers flexibility in the sum assured. The policyholder can adjust the sum assured of the policy. Increase in sum assured is usually subject to evidence of insurability.

(iii) It offers three options of death benefit. The policyholder can choose between a level death benefit option, an increasing death benefit option, or a 105 Plan (please refer to section **4.6.6** for details).

(iv) It allows withdrawal from the policy provided that the remaining balance is sufficient to cover mortality charges and fees and no debit interest is incurred.

It is however important to note that the above mentioned special features, and in particular the flexibility, are offered at a cost. The policyholder is to pay continually a higher level of charges throughout the term of the policy, even when he/she ceases paying into it, especially when he/she tops up the payment.

In the following sections, we will focus our discussion on this type of investment-linked policy.

4.5 PREMIUM STRUCTURES OF INVESTMENT-LINKED POLICIES

We can generally classify investment-linked policies into two categories which are differentiated by its premium structure: single premium plan and regular premium plan. It should be noted that in 2008, as reported by the Office of the Commissioner of Insurance, 74.4% (in value) of the office premiums of new investment-linked business were in the form of single premium payments, the remaining 25.6% being regular premium payments. In 2013, the percentages were 64.4% and 35.6% respectively.

4.5.1 Single Premium Plan

Investment-linked policies that are financed by single premiums are for individuals who have a large capital sum at their disposal. In addition to the value of protection, they will be looking for a long-term and profitable investment alternative that will also provide them with the freedom to implement their own investment strategy.

4.5.2 Regular Premium Plan

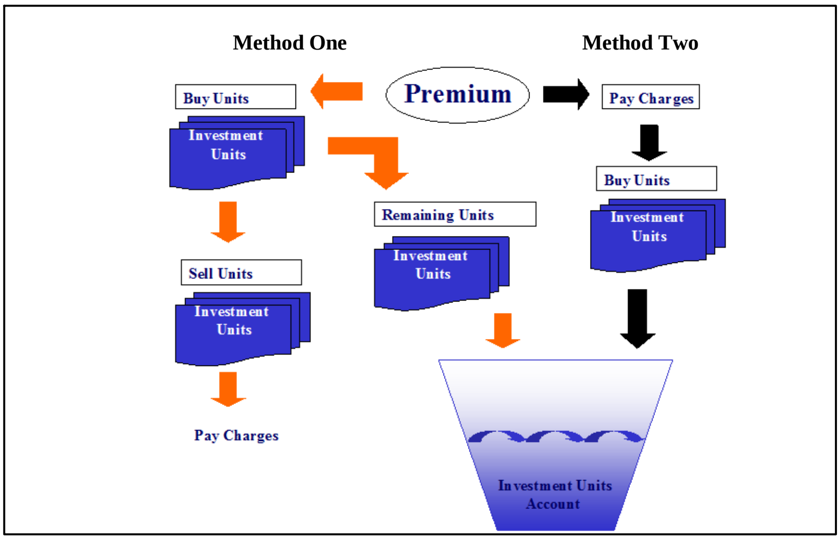
Investment-linked policies financed by regular premiums are for individuals who want to build up savings on a regular basis. Also, in addition to the value of protection, they will enjoy a flexible investment strategy as well as the ability to spread the risk of investment with small amounts of capital investment through unit participation in various investment funds.

4.6 BASIC CALCULATIONS OF SINGLE PREMIUM AND REGULAR PREMIUM INVESTMENT-LINKED POLICIES AND THEIR DEATH BENEFITS

4.6.1 Basic Calculations of Single Premium Policies

Initially, a single premium is paid to the insurance company. Insurance charges are deducted from the premium either initially when the premium is paid or at regular intervals (monthly, annually etc.) throughout the life of the policy. The remainder is used to purchase units of the selected investment funds.

There are generally two ways used by an insurance company to deduct insurance charges from the premium. One method is to convert the entire premium into investment units and then convert the appropriate number of units back into cash to cover the relevant charges. The other method is to deduct the relevant insurance charges upfront with the remaining to be converted into investment units for the policyholder's investment account.



The following example is used to demonstrate the calculation of premium application, top-up, withdrawal or partial surrender benefit, the two types of death benefit options, applicable in the case of a single premium policy. An example on the calculation of return on gross premium is also illustrated. For simplicity of illustration, we will assume that only life cover is purchased, no other rider benefits are attached to the policy and the investment has been put into one single fund.

Assuming:

Single premium = HKD50,000
Current NAV per unit of investment fund = HKD12
Bid-offer spread = 5%

4.6.2 Premium Application Method One

One of the practices is to apply all of the HK50,000 premium into the purchase of investment fund units. Bid price as mentioned earlier is usually set at the net asset value (NAV). Given the bid-offer spread of 5%, with the bid price at HKD12, the offer price can be calculated as HKD12 x (1 + 0.05), or HKD12.60. That is, the insurance company will sell the units for this investment fund at HKD12.60 each.

The number of units that can be purchased will be 50,000/12.60, i.e., 3,968.25 units or, in other words, the fund will allocate 3,968.25 units to this policy.

Assuming:

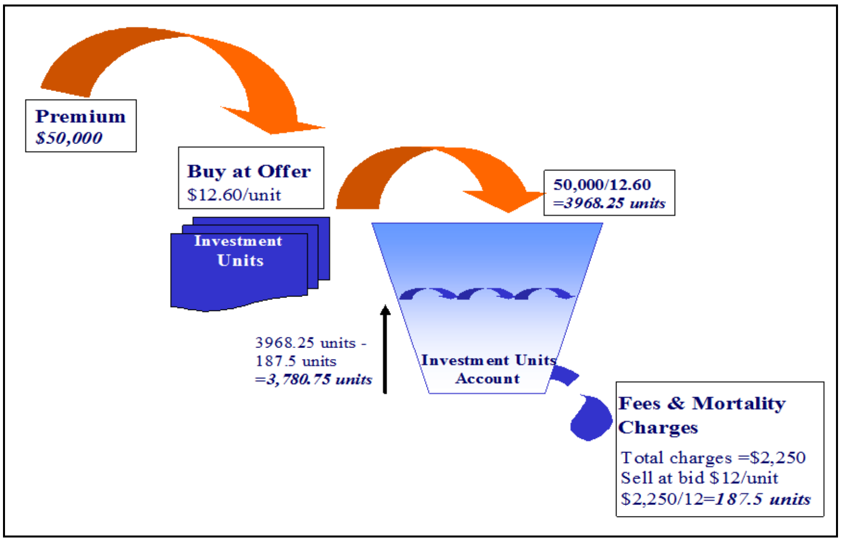
Policy fee = HKD1,000
Administration and mortality charges for the entire duration of the policy = **2.5% of premium

** It is an assumed rate because we will not get into the mortality rate of the specific policyholder. Charges and fees will be collected through the cancellation of units. We will assume that all charges and fees are deducted at inception and that other selling expenses are charged into the bid-offer spread. Then, the number of units which is required to be cancelled (cashed) would be:

Policy fee = HKD1,000
Administrative and mortality charge = HKD50,000 x 2.5% = HKD1,250
Total charges = HKD1,000 + HKD 1,250 = HKD2,250

Since the units will be cancelled at the bid price, i.e. HKD12

Number of units to be cancelled = 2,250/12 = 187.5
Hence, the number of units left = 3,968.25 - 187.5 = 3,780.75



4.6.3 Top-up Application

If the policyholder wants to top-up HKD20,000 two years after the inception of the policy.

Assuming:

Top-up fee = HKD200
Administrative charge = 1.5% of top-up premiums applied

Assuming that the unit price does not fluctuate but grows at a flat rate of 8% per annum for two years from the initial bid price of HKD12.

Bid price in year one = HKD12 x 1.08 = HKD12.96
Bid price in year two = HKD12.96 x 1.08 = HKD14.00

Or = HKD12 x 1.08^2
= HKD12 x 1.1664 = HKD14.00

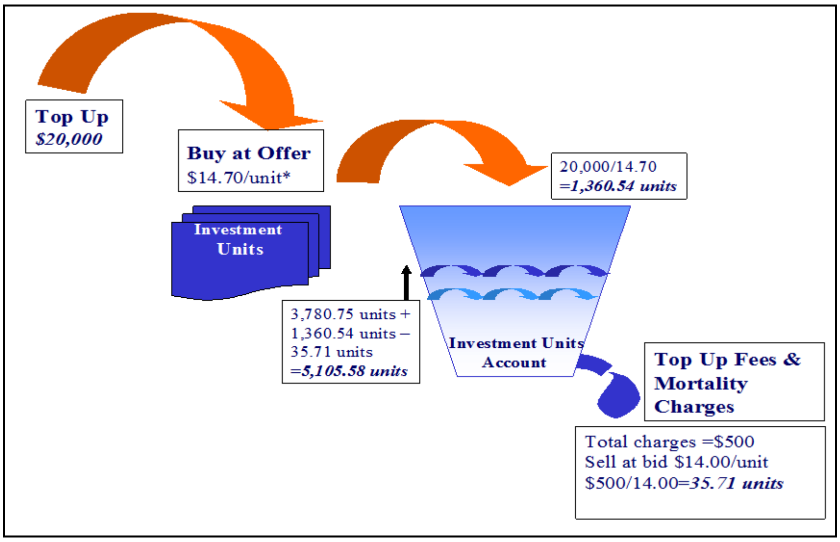
Offer price in year one = HKD12.60 x 1.08 = HKD13.61
Offer price in year two = HKD13.61 x 1.08 = HKD14.70

Number of additional units that can be purchased
= 20,000/14.70 = 1,360.54

Administrative charge = HKD20,000 x 1.5% = HKD300
Total charges for top-up = HKD200 + HKD300 = HKD500
Number of units to be cancelled = 500/14.00 = 35.71

Additional number of units purchased = (1,360.54 - 35.71) units
= 1,324.83 units

Total holding (in number of units) = (3,780.75 + 1,324.83) units
= 5,105.58 units

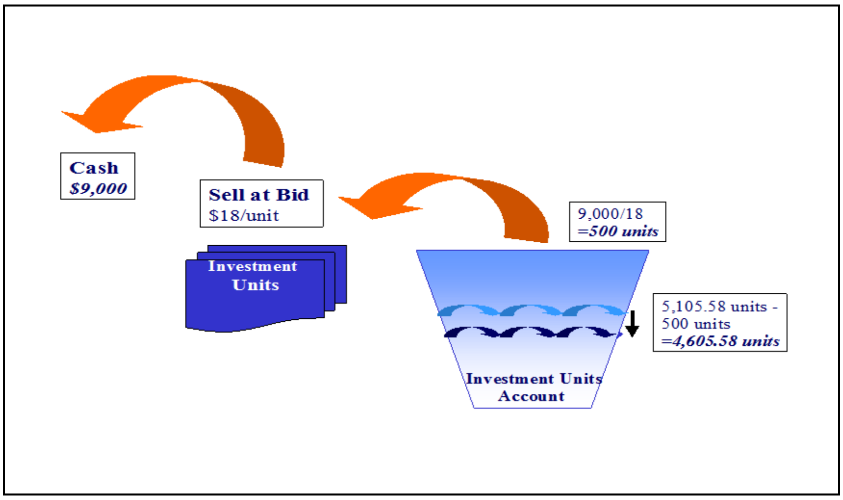


4.6.4 Partial Withdrawal (Partial Surrender) Benefit

One of the features of investment-linked policies is that the policyholder can withdraw, or surrender (subject to withdrawal/surrender charge) all or part of the units at the bid price at any time (some policies may specify minimum amount of withdraw/surrender).

If the policyholder now wishes to withdraw, say HKD9,000, at a bid price of HKD18, the number of units that has to be cancelled is 9,000/18 = 500 units

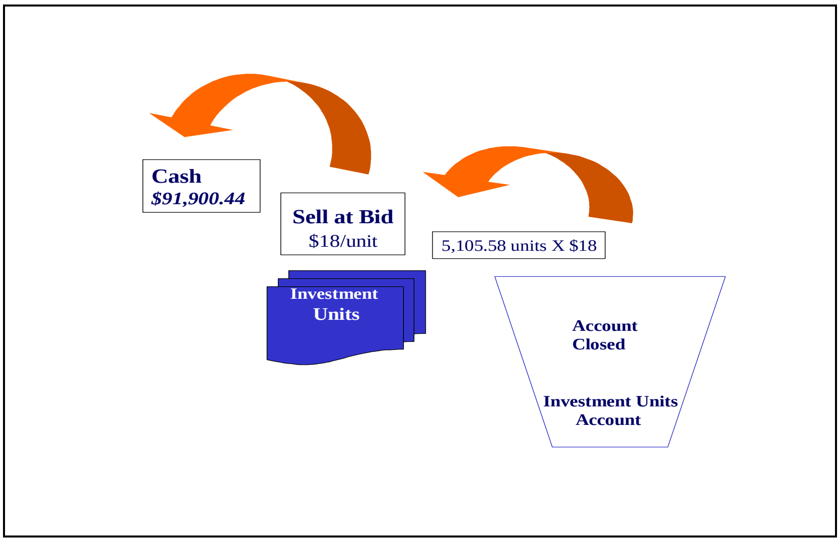
The number of remaining units = 5,105.58 - 500 = 4,605.58 units



4.6.5 Surrender Value

If, instead of a partial withdrawal, the policyholder chooses to surrender the whole policy (again at a bid price of HKD18), the surrender value will be:

HKD18 x 5,105.58 = HKD91,900.44 (less surrender charge, if any)



4.6.6 Death Benefit

Three types of death benefits options are commonly available with investment-linked policies: increasing death benefit, level death benefit, or 105 plan.

(a) Increasing Death Benefit (IDB)

The death benefit will be the value of the units accumulated in the policyholder's account, at the date of death, plus the chosen death cover. Under an increasing death benefit, and assuming the coverage is, say 150% of the single premium, the sum assured payable at death is:

Sum assured at death = **value of units (at the date of death) at bid price + 150% of HKD50,000

Based on the above example where the number of units left in the policy, after the HKD20,000 top-up and the HKD9,000 withdrawal, is 4,605.58 units, and assuming the bid price at the date of the death claim is HKD20, the sum assured is:

HKD20 x 4,605.58 + HKD50,000 x 150%
= HKD92,111.60 + HKD75,000 = HKD167,111.60

(b) Level Death Benefit (LDB)

The death benefit will be the higher of the value of units accumulated in the policyholder's account at the date of death or the chosen death cover.

Under a level death benefit, assuming that the coverage is, say 150%, the sum assured payable at death is:

Sum assured at death = **value of units (at the date of death) at bid price or 150% of HKD50,000, whichever is the higher

Again based on the above example where the number of units left in the policy, after the HKD20,000 top-up and the HKD9,000 withdrawal, is 4,605.58 units, and assuming the bid price at the date of the death claim is HKD20, the sum assured is:

The higher of HKD20 x 4,605.58 or HKD50,000 x 150%, i.e. the higher of HKD92,111.60 or HKD75,000.

The sum assured payable at death will be HKD92,111.60 since this is the higher value.

(c) 105 Plan

105 Plan generally has a smaller insurance protection element as opposed to policies with either increasing death benefit or level death benefit.

The death benefit of 105 Plan will be 105% of the value of the policy account.

Sum assured at death = **value of units (at the date of death) at bid price x 105%

** It should be noted that, for simplicity of illustration, we have used the same mortality charges for the IDB, LDB, and 105 Plan calculations, thus the three options have the same value of units at the date of death. In actual case, the mortality charges or cost of insurance will depend upon the type of death benefit option chosen and the mortality charge for IDB will always be more expensive than that of the LDB while most 105 Plans only attract minimal insurance charge. When the mortality charges are higher, the amount of premium invested in the investment funds will be smaller and thus the total number of units accumulated in the policyholder's account should also be smaller.

Based on the above example where the number of units left in the policy, after the HKD20,000 top-up and the HKD9,000 withdrawal, is 4,605.58 units, and assuming the bid price at the date of the death claim is HKD20, the sum assured is:

HKD20 x 4,605.58 x 105%
= HKD96,717.18

4.6.7 Return on Gross Premium

This is a calculation most insurance companies will use on their illustration documents to provide an estimated return for various investment related products.

The calculation takes into account the compound rate of return and is calculated as follows. Using the above example where the policyholder starts with HKD50,000 and has been allocated 3,780.75 units (after all the charges). The initial unit bid price is HKD12. In 10 years' time, HKD12 will be HKD25.91 assuming a growth rate of 8%. Thus, in 10 years' time, the value of the units will be 3,780.75 x HKD25.91 = HKD97,959.23. The return on gross premium using the same HKD50,000 as per the previous example will be calculated as follows:
(Please refer to **Appendix A** for the concept of compound rate of return.)

Let r be the rate of return on gross premium per annum.

$$
\begin{aligned}
\text{HKD}50{,}000 \times (1 + r)^{10} &= \text{HKD}97{,}959.23 \\
(1+r)^{10} &= \text{HKD}97{,}959.23/\text{HKD}50{,}000 \\
&= 1.9592 \\
(1+r) &= 1.9592^{1/10} \\
&= 1.0696 \\
r &= 1.0696 - 1 \\
&= 0.0696 \\
&= 6.96\%
\end{aligned}
$$

4.6.8 Premium Application Method Two

Another method that is sometimes used for the calculation of the number of units allocated to the policy is to deduct the policy fee, and the administrative and mortality charges from the single premium before applying the net balance to purchase the units.

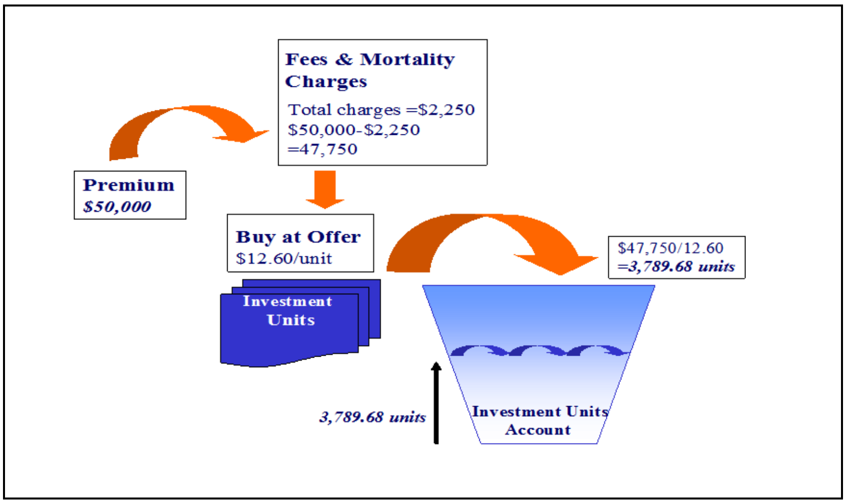
Assuming:
Single premium = HKD50,000
Policy fee = HKD1,000
Administrative and mortality charges = HKD50,000 x 2.5% = HKD1,250

Net premium for investment = HKD50,000 - HKD 1,000 - HKD 1,250
= HKD47,750

As the current NAV (bid price) is HKD12, the offer price is HKD12.60 (please refer to section **4.6.2**), the number of units purchased is therefore 47,750/12.60 = 3,789.68 units. It should be noted that the number of units that is attributable to the policyholder is slightly higher due to the fact that the policy fee and the administrative and mortality charges do not suffer the bid-offer spread.

Another method commonly used in Australia and the UK is for the policy fee, administrative and mortality charges to be deducted at regular interval, e.g. monthly, throughout the life of the policy even for the single premium policy.

The application of top-up, withdrawal, surrender, IDB, LDB, and 105 Plan will follow the same calculations as previously illustrated.



4.6.9 Basic Calculations of Regular Premium Policies

Regular premium policies operate under similar principles as single premium policies. The major difference is that the policyholder pays premiums regularly. The policyholder has the flexibility of being able to vary the level of regular premium payments and make single premium top-ups or skip premium payments for a period of time.

It should be noted that depending on each insurance company's level of commission and expense charges, during the first year, although the policyholder is assigned some units, quite an substantial part of these units might have been redeemed to pay for the "long-term" charges due to the initial distribution and policy issuance cost incurred by the insurer at the initial stage. As such, the policyholder of regular premium policies might not own any investment units for the first year of premium payments. A typical structure of premium allocation may be as follows:

Year 1	Net of initial charges, monthly administration and mortality charges 0% will be invested
Year 2	Net of initial charges, monthly administration and mortality charges 50% will be invested
Year 3 & After	Net of monthly administration and mortality charges 100% will be invested

In this example, we assume that all initial charges are amortised over two years with a more heavy allocation for year one. Through this example, we can see why it is costly for the policyholder to surrender the policy within the first few years of purchase.

It should be noted that some insurance companies do not use the above initial charge amortisation but choose to amortise it over a longer period of time. This will result in the allocation of some units in the policyholder's investment account, even during the first year. However, in doing so, the insurance company is taking the risk of not being able to recover all of its upfront expenses in the event the policy is cancelled within the first couple of years after issuance. In this situation, the insurance company may impose a surrender charge to recover the upfront expense.

4.6.10 Monthly Application of Regular Premium

Method one of deduction is the normal practice of insurance companies used in Hong Kong, that is, they will convert all monthly premiums into investment units and then cancel sufficient units to cover monthly charges.

Calculations are similar to single premium except that mortality charges for the life of the policy under single premiums are usually fully deducted at the commencement of the policy, and mortality charges for regular premium policies are calculated monthly and are deducted from the investment account.

There are different types of death benefit options, and the calculations in respect of IDB and LDB will be slightly different for regular premium versus single premium. These are separately illustrated in the following paragraphs. Since most 105 Plans only impose minimal insurance charge, no calculation will be shown here.

Example Calculations:

Assuming:
Rate of annual cost of life cover = HKD6 per thousand
Chosen death cover = HKD500,000
Number of units in the investment account = 400
Bid price = HKD12
Offer price = HKD12.60
Monthly policy fee = HKD30
Monthly premium = HKD500

1. Increasing Death Benefit (IDB)

IDB = value of account + sum assured (chosen death cover)
Value of account = 400 x HKD12 = HKD4,800
Sum assured at death = HKD4,800 + HKD500,000 = HKD504,800

<u>Deduction Calculations:</u>

Units purchased per month = 500/12.60 = 39.68 units
Amount at risk = chosen death cover = HKD500,000

Mortality charge for one month
= rate of annual cost of life cover x (1/12) x amount at risk
= HKD(6/1,000) x (1/12) x HKD500,000
= HKD250

Total charges plus policy fee = HKD250 + HKD30
= HKD280
Number of units to be cancelled = 280/12
= 23.33 units
Total number of units remaining = (400 + 39.68 – 23.33) units
= 416.35 units

2. Level Death Benefit (LDB)

LDB = the higher of value of account OR sum assured (chosen death cover)
Value of account = 400 x HKD12 = HKD4,800
Sum assured at death = HKD500,000
LDB = HKD500,000 (higher of HKD4,800 or HKD500,000)

<u>Deduction Calculations</u>:

Units purchased per month = HKD500/12.60 = 39.68 units
Amount at risk = chosen death cover less account value
= HKD500,000 - HKD4,800
= HKD495,200

Mortality charge for one month
= rate of annual cost of life cover x (1/12) x amount at risk
= HKD(6/1,000) x (1/12) x HKD495,200
= HKD247.60

Total charges plus policy fee = HKD247.60 + HKD30
= HKD277.60
Number of units to be cancelled = 277.60/12
= 23.13 units
Total number of units remaining = (400 + 39.68 – 23.13) units
= 416.55 units

As the mortality charges are calculated monthly and are deducted from the account, it is very simple for the insurance company to allow the policyholder to vary the chosen life cover over time. The increase in life cover is subject to evidence of insurability. Because of this feature, investment-linked policies enjoy a substantial advantage over traditional policies in flexibility. Monthly charges for other benefits like dread disease, total and permanent disability and accidental benefits are calculated in a similar way.

4.7 STRUCTURES OF INVESTMENT-LINKED FUNDS

Similar to the majority of investment funds, investment-linked funds are generally structured as follows:

(a) **Accumulation Units**: all profits generated from the investments are “accumulated” and reinvested back into the original fund; thus enhancing the price of the units. The number of units held will remain the same.

(b) **Distribution Units**: all profits generated from the investments are “distributed” as bonus units to the investors; thus increasing the number of units held. The price of the units will remain the same.

As the policyholder will be entitled to all the profits generated, or all the losses incurred, from the investments, he/she will therefore benefit, or suffer, either from the higher, or lower, unit price (accumulation units) or the increased, or decreased, number of units (distribution units).

4.8 TYPES OF INVESTMENT-LINKED FUNDS

In theory, an investment-linked insurance policy can be linked to any type of investment funds. There are many types of investment funds, ranging from conservative funds (money market funds) to risky funds (warrant funds). Their classification is usually based on the stated investment objectives and underlying investments of the funds.

Insurance companies usually offer a wide range of funds to the policyholder. According to the individual policyholder’s investment strategy, he/she may first select the appropriate investment funds, and then form his/her own investment portfolio by allocating weights to the funds selected. For example, he/she may select Funds A, B, C and D and allocate 40% of the investment in Fund A, 30% in Fund B, 20% in Fund C and 10% in Fund D. The contributions will be invested according to this allocation. Insurance companies usually allow the policyholder to switch funds or alter the portfolio at any time.

Fund allocation is very important to balance the risk and return of the portfolio. It is therefore desirable that insurance intermediaries understand and are able to present the benefits and disadvantages of the different type of funds for the policyholders to make their final decision.

In Hong Kong, most insurance companies categorise their funds as deposit fund and unitised funds. They will be briefly summarised in the following sections.

4.8.1 Deposit Fund

This is a notional interest bearing fund. Unit offer price of the funds is typically set at HKD1,000. Interest, in the form of units being purchased at the unit offer price, will be credited to the account.

This allows the small investors to invest in money market instruments. This is also called money market fund or money fund.

Principal objective: to invest in short-term money markets instruments in order to provide stable income with minimal capital risk

Special features: open-ended;
unit offer price remains constant (e.g. HKD1,000);
interest credited to the account as units purchased; and
participation in short-term investment instruments.

Advantages: the safest, the most stable;
higher return than bank deposits; and
asset liquidity.

Disadvantages: interest rate may fluctuate; and
relatively low return.

4.8.2 Unitised Funds

These are specific, separately managed funds, either managed by the insurance company itself or independent fund managers. Some of the commonly used types of investment funds are outlined as follow:

(a) Bond Fund

Principal objective: to provide stable income with minimal capital risk

Special features: investing in bond market;
being equivalent to a diversified bond portfolio;
debt securities issued by governments or large corporations; and
some may invest in higher yield junk bonds.

Advantages: higher return than money market fund;
fund managers can trade and take advantage of interest rate movements; and
usually can cover inflation.

Disadvantages: risk of rising interest rate; and
credit risk of issuer.

(b) Equity Fund

Principal objective: to achieve higher long-term capital appreciation

Special features: investing in equity market;
more suitable for long-term investment; and
being equivalent to a diversified shares portfolio.

Advantages: higher historical return;
good hedge against inflation; and
full utilisation of fund manager’s expertise.

Disadvantages: higher management fee may be charged;
higher risk than bond funds; and
risk of company failure.

(c) Index Fund

Principal objective:	to mirror specific index performance
Special features:	passive management; automatic investment decisions; limited number of transactions; and may also be tied to non-equity indices.
Advantages:	easy to understand; lower management fee; less risky than index futures; and hedging available.
Disadvantages:	cannot capitalise on market movements; only track market performance; cannot outperform market; and unwelcome during a bear market.

(d) Warrant Fund

Principal objective:	to achieve exceptional high return
Special features:	investing mainly in warrants; and leverage through the use of warrants.
Advantage:	possible high return
Disadvantage:	extremely high risk

(e) Global Fund

Principal objective:	to invest in stocks or bonds throughout the world
Special feature:	international investment
Advantages:	diversification; and capture overseas investment opportunities.
Disadvantages:	currency, political risks; complicated custodian arrangement; differences in accounting procedures; and lesser degree of public information.

(f) Regional/Country Fund

Principal objective:	to invest in a specific region or country
Special feature:	typically closed-end funds, could as well be open-ended funds
Advantages:	potentially high growth; and capture the opportunity of a region.

Disadvantages:	high risk; low liquidity; and lack of diversification.

(g) Specialty Fund

Principal objective:	to invest in a specific industry/sector and capitalise on the return potential
Special features:	concentration in one particular industry; and high risk, high return.
Advantages:	potentially high growth; full utilisation of fund manager's knowledge on the particular industry; and capture the opportunity of an industry.
Disadvantages:	higher risk potential; lack of diversification; and low liquidity.

(h) Income Fund

Principal objective:	to generate current income rather than to achieve growth
Special features:	dividends from preferred stocks; and coupon payments from bonds.
Advantages:	regular income; medium risk; and good liquidity.
Disadvantage:	relatively low capital appreciation

Some income funds maintain more aggressive objectives than others.

(i) Balanced Fund

Principal objective:	to achieve both income and capital appreciation and to avoid excessive risk
Special features:	investing in a combination of stocks and bonds; emphasising the growth potential of stocks; relative stability of income from bonds; and mid-way between bond and growth fund.
Advantages:	balanced risk and return; and diversification.
Disadvantages:	medium return; and may not fully capitalise on a bull market.

(j) Growth Fund

Principal objective:	to achieve maximum capital appreciation rather than a flow of dividends
Special features:	investing in growth stocks; and may invest in smaller, lesser known companies out of mainstream market which fund managers believe possess dynamic potential.
Advantages:	higher growth rate; and full utilisation of fund manager's expertise.
Disadvantages:	some fund managers may adopt highly aggressive/ speculative strategy; extremely high risk; and no consistent income/dividend flow.

(k) Guaranteed Fund

Principal objective:	to be neutral to negative market performance with a guarantee on the principal/return
Special feature:	guaranteed amount will be paid upon maturity
Advantage:	no risk of principal
Disadvantages:	application of high guarantee fee; minimum investment period applicable; special conditions may apply; and relatively lower return.

(l) Fund of Funds (Unit Portfolio Management Funds)

Principal objective:	to carry out diversified professional management
Special feature:	investing in other mutual funds
Advantage:	diversification
Disadvantage:	higher management fee may be incurred

4.8.3 Switching

Most insurance companies in Hong Kong selling investment-linked policies will offer more than one fund to its policyholders. The policyholders will be allowed to switch funds or alter their investment portfolios from time to time.

The switching facility benefits the policyholders in the implementation of an optimal investment portfolio to fit their personal investment objective or to react to changes in the financial markets. For example, as retirement age approaches, the policyholders may wish to switch their investment from a more aggressive equity fund to a more stable and liquid income fund. Alternatively, at some stage of the investment, the policyholders may wish to switch their investment from a balanced fund to a specialty fund (e.g. a technology fund) to take advantage of the growth potential in that particular industry.

4.9 BENEFITS OF INVESTING IN INVESTMENT-LINKED POLICIES

As the investment performance of an investment-linked policy is directly linked to that of the underlying investment fund, it inherits all of the benefits as well as the risks (please refer to section **3.7.4**) of an investment fund.

When compared with other types of life insurance products, the major advantage of an investment-linked policy lies in the potential return on investment and flexibility. This flexibility allows an appropriate insurance programme to be tailored to each individual policyholder. Some of the benefits are outlined as follows:

(a) **Wide Spectrum of Investment Choices**: The policyholder, in addition to the death benefit cover, will have the opportunity to devise his/her own investment portfolio based on the number of funds available to suit his/her investment objective. The policyholder can design his/her own investment strategy and invest into the different investment funds offered by the insurance company to balance his/her risk/return preference. He/she can also choose to switch between different funds to fit his/her own investment needs during different stages of his/her life cycle, or take advantage of the prevailing market condition.

(b) **Flexible Premium**: One of the most attractive features of investment-linked policies is that the policyholder has the option to vary the premium, that is, to increase or decrease the amount of regular premiums to be paid as well as to add top-ups to the policy from time to time.

Flexible premium enables the policyholder to pay higher amounts when his/her cash flow is strong. Provided that the balance in the investment account is sufficient to cover fees and related investment charges, the policyholder can also reduce, or stop altogether, payment of premium in situations where his/her cash flow is insufficient, e.g. when he/she loses his/her current job.

(c) **Variable Sum Assured**: In addition to the flexibility of varying premiums, a policyholder can vary the sum assured. In the regular premium investment-linked policies, a policyholder can choose his/her own sum assured, within certain limits, for any given premium. Subsequent to the completion of the contract, he/she can still adjust the sum assured up or down (again within certain limits) according to his/her new circumstances. Normally, such variations are subject to one change per year and underwriting requirement.

Compared to traditional whole life insurance, this is a convenient and lower cost version to increase the sum assured. The reason is that most whole life policies do not allow the increase of sum assured and thus a new policy will have to be issued for the additional amount.

(d) **Variable Death Benefit**: There are three common options of death benefit. The policyholder can choose a level death benefit option, an increasing death benefit option or only 5% of the policy account value (under the 105 Plan). Please refer to **4.6.6** for the concept of Death Benefit. It should be noted that a healthy and successful investment portfolio will increase the death benefit of the policy in the long run.

(e) **Partial Surrender/Withdrawals Allowed**: The policyholder is usually allowed to make withdrawals for a specific minimum amount provided that the remaining balance is sufficient to cover fees and related insurance charges. Such a withdrawal is achieved by cashing in the number of units necessary to give the withdrawal amount.

Compared to traditional life policies, the benefit of investment-linked policies is that the policyholder has the option of withdrawing units/cash from the policy without having to take out a policy loan where interest costs will be incurred, or to surrender the policy in return for a surrender value and thus losing the protection.

(f) **Capture the Benefits of Investing in Investment Funds**: A couple of obvious benefits derived from investing in investment funds include the access to professional fund management expertise and to a diversified portfolio through limited capital requirement.

4.10 RISKS OF INVESTING IN INVESTMENT-LINKED POLICIES

There are a number of risks associated with investing in investment-linked policies:

Market Risk: Performance of investment funds is not guaranteed and may go up and down. Since the values of investment-linked policies are directly related to the performance of their underlying investments, the poor performance of the chosen investments can potentially reduce the values of the policies. As such, while the potential yield of investment-linked policies may be higher than that of traditional policies, they can also be lower depending on the performance of their underlying investments.

Liquidity Risk: Unlike investment into direct investment funds, investment-linked policies have an additional time factor to be considered. The policies are usually established for a pre-determined period with a lifespan of at least 5 years with the initial costs to insurers heavily stacked at the beginning of the term. Thus, as discussed previously, early redemption of these policies will be subject to very high encashment charges because of the deduction of fees and charges to cover the upfront expenses of the insurers.

Other Risks, including the following**:**

- Insurers and fund managers are subject to credit and insolvency risks.
- Those with whom the client has entered into a financial contract may fail to fulfil their obligations under the contract.
- The values of the policy and the underlying funds are subject to foreign exchange risk.
- The funds put into the policy are subject to reinvestment risk should any investment be suspended or subject to a prolonged turnaround time to trade.
- If monies paid into the policy are funded by premium financing, leverage or gearing, and if the rate of return of the policy is lower than the interest rate payable for the premium financing, leverage or gearing, there is a risk of financial loss caused by such interest rate risk.
- If the policyholder ceases premium payments temporarily by virtue of a policy provision of "premium holiday", he will face the risks of reduced policy value, reduced bonuses, and even a policy lapse.
- For those risks of investing in investment-linked policies that are not mentioned above, please read section **5.2.5 (b)** and **(c)**.

4.11 COMPARISON OF INVESTMENT-LINKED LONG TERM INSURANCE POLICIES WITH GUARANTEED AND WITH-PROFITS POLICIES

4.11.1 Guaranteed Policies/Without-Profits/Non-Participating Policies

These products guarantee a fixed rate of return to policyholders in term of death benefit and cash value, if any. Examples are term insurance and non-participating whole life and endowment insurance. These policies are sold on a guaranteed cost basis, meaning that all policy elements (i.e., the premium, the face amount, and the cash values, if any) are guaranteed and will not vary with the experience of the company.

4.11.2 With-Profits/Participating Policies

Examples of such policies are with-profits (participating) whole life and endowment insurances. These policies are entitled to receive a share of (participate in) the divisible surplus (profits) of the insurance company. These are normally paid in the form of dividends which will be credited into the account. For insurance companies using UK style practice, they will use bonus systems which include reversionary bonus, performance or terminal bonuses.

4.11.3 Comparison Criteria

Basically, we should compare investment-linked long term insurance policies with other conventional life insurance policies based on the following criteria:

- Investment returns and risks;
- Investment option;
- Premium;
- Death benefit;
- Death benefit option;
- Cash value;
- Partial withdrawal; and
- Authorisation by SFC.

The comparison is summarised in the following table:

Criteria	Guaranteed Policies/ Without-Profits Policies/ Non-Participating Policies	With-Profits Policies/ Participating Policies	Investment-linked Policies
Investment Returns and Risks	Fixed amount of payment will be made on death or at maturity, therefore no investment risks for these products except the risk of insolvency of the life insurance company. However, the returns are low.	The returns are linked to the insurance company's overall investment performance. Hence it offers returns which are "smoothed" because insurance company contributes into reserves in good investment years and draws from reserves in bad years. Smoothing can also be achieved by way of offering bonuses and imposing market value reduction, where appropriate. Future bonus/dividends are never guaranteed.	The investment risk is higher and borne by the policyholders. The policy values vary according to the values of the investment funds. As such, the benefits and risks of these products accrue directly to the policyholders and no smoothing is made, unlike a with-profits policy. The risk or volatility of returns depends on the investment strategy of the fund.
Investment Option	No	No	Yes
Premium	Fixed Increasing or level during the term for term policies and usually level for non-participating whole life and endowment policies.	Fixed and usually level	Flexible. Allow to change premium payments, to take premium holidays and to add premium top-ups. Also, the insurance company may vary some of the charges made under the policy. If future experience diverges from what had been assumed when the product was priced, it may vary charges. Hence, there is an initial pricing exercise and on-going review, comparing actual experience with what has been assumed.
Death Benefit	Level/increasing/decreasing for term policies, level for non-participating whole life and endowment policies.	Generally, fixed and level	Variable, based on investment performance but there is a minimum death benefit payable upon the death of the life insured.

Criteria	Guaranteed Policies/ Without-Profits Policies/ Non-Participating Policies	With-Profits Policies/ Participating Policies	Investment-linked Policies
Death Benefit Options Available	No	No	Yes, usually three options are available. They are “Increasing death benefit”, “Level death benefit”, and “105 Plan”.
Cash Value	No cash value for term policies. Fixed and guaranteed, if any, for non-participating whole life and endowment policies.	Generally, fixed and guaranteed	Variable, based on investment performance. Not guaranteed
Partial Withdrawal Permitted	No	Generally, dividend withdrawal permitted, or in the form of Partial Surrender	Yes, usually permitted in the form of Partial Surrender which may be subject to withdrawal charges.
Authorisation by SFC	Not required	Not required (Please refer to **Note** below)	Required

Note: Depending on the features and characteristics of the policy, some with-profits policies/ participating policies may be classified as Class C business and as such constitute as collective investment schemes under the **“Securities and Futures Ordinance”** and require authorisation by the SFC. Please refer to section **1.1** for the detailed classification of Class C business.

4.12 TAXATION

Under the laws of Hong Kong, returns on investment are not subject to capital gains tax. It follows that the investment returns generated by the underlying investment funds of the investment-linked policies will normally not be taxable.

It should however be noted that overseas residents may be subject to the tax laws of their respective countries and this can be very restrictive. Prospective policyholders should be advised to obtain their own independent tax advice.

4.13 SALES PRACTICE

The industry and the regulatory authorities are equally concerned about the manner in which investment linked assurance schemes (or ILAS products) would be sold by insurance intermediaries and how they would be understood by clients.

4.13.1 Customer Protection Requirements Relating to Sale of Investment Linked Assurance Schemes (ILAS)

To better protect customers of ILAS products, the HKFI published a set of enhanced guidelines entitled "**Updated Requirements Relating to the Sale of Investment Linked Assurance Scheme ("ILAS") to Enhance Customer Protection**" (the Enhanced Requirements) in April 2013 for compliance by Life Insurance Council (LIC) member companies (Member Companies) and insurance intermediaries that sell ILAS products, which were revised in December 2014 for implementation not later than 1 January 2015 so as to be in line with the **Guidance Note on Underwriting Class C Business** (GN15) issued by the OCI (please refer to section **5.2.7**). On 14 July 2015, the HKFI issued a circular to introduce an "Initiative on Financial Needs Analysis" to supersede its "Initiative on Needs Analysis" with effect from 1 January 2016, which applies to Class C business as well as Class A business (subject to specified exceptions). Please refer to **Appendix B2** for the full version of the "Initiative on Financial Needs Analysis". The circular also revises the Enhanced Requirements for implementation not later than 1 January 2016.

The HKMA and the SFC, in close working relationship with the OCI and the HKFI, issued corresponding circulars in April 2013, May 2013 and December 2014 respectively to introduce or update enhanced requirements or measures applicable to the sale of ILAS products. The HKMA has since 2009 imposed on all its authorised institutions a mandatory requirement for audio-recording of the sales process of ILAS products. It has also requested them to produce a product key facts statement (as prescribed by the SFC; please refer to section **4.13.2 (c)** for details) for their prospective ILAS clients since 2011. The HKMA's circular issued in December 2014 also requires its authorised institutions to provide prospective clients with Important Facts Statements (as introduced by the HKFI; please refer to section **4.13.1 (e)** for details). For detailed requirements set out by the SFC, please refer to sections **4.13.2 (b)** and **(c)**, **4.13.3**, **4.15** and **5.3**.

With regard to insurance broking business involving sale of ILAS products, The Hong Kong Confederation of Insurance Brokers (CIB) and the Professional Insurance Brokers Association (PIBA) have prescribed the "**Regulations for Insurance Brokers Engaged in Advising on Linked Long Term Insurance or Arranging or Negotiating Policies of Linked Long Term Insurance**" and the "**Code of Conduct for Insurance Brokers Conducting Investment Linked Business**" respectively (please refer to **5.2.5 (b)** and **(c)**) for compliance by their own members. In addition, the CIB introduced the '**Guidance Note on Conducting "Know Your Client" Procedures for Long Term Insurance Business (Including Linked Long Term Insurance)**' and the '**Guidance Note on Product Recommendation for Long Term Insurance Business (Including Linked Long Term Insurance)**', and PIBA introduced the '**Guidance Note on Conducting Investment Linked Business**' (please refer to **5.2.5 (b)** and **(c)**).

Below is a summary of the HKFI's Enhanced Requirements. For the full version of the Requirements, please refer to **Appendix B1** to the Study Notes.

(a) Purposes

The purposes of the Enhanced Requirements are to ensure that:

(i) the suitability assessment of prospective ILAS customers has been carried out before recommendation of an ILAS product;

(ii) the product features, charges and fees, the product and investment risks have been clearly explained to the prospective customer before fulfilment;

(iii) all necessary product and marketing documents have been provided to the prospective customer before fulfilment; and

(iv) the sales process for the purchase of an ILAS product has been done in the correct order, with a financial needs analysis (FNA) and a risk profile questionnaire (RPQ) at the heart of the process. The insurance intermediary must also strictly follow the proper sales process as set out in clause 12.2 of and in the Appendix to the OCI's GN15 (please refer to section **5.2.7**), particularly in relation to the comparison of different insurance options.

(b) Proper Sales Process

ILAS insurance intermediaries must follow a proper ILAS sales process. This ensures that the key steps have been carried out to ensure the customer suitability assessment (including completion of the FNA and RPQ (see below)) of the prospective ILAS customer is conducted before the recommendation of any ILAS product. Please see Appendix A to the Enhanced Requirements for the HKFI's recommended ILAS sales process.

(c) Financial Needs Analysis

Every application for an ILAS product must be accompanied by an FNA form. The FNA form must include all the questions and multiple choice options in the suggested FNA form as set out by the HKFI. Member Companies may modify the FNA form to include additional questions and/or multiple choice options. The Initiative on Financial Needs Analysis allows Member Companies to accept FNA forms of insurance brokers and insurance agencies provided that such forms are in compliance with the requirements of the Initiative on Financial Needs Analysis.

Neither Member Companies nor customers can opt out of the FNA. If a customer, for privacy or other reasons, chooses not to disclose income/asset information under 4(a) or (b) (but not both) of the FNA form, he must confirm his reason(s) in writing. This notwithstanding, if the absence of information under either 4(a) or (b) of the FNA form would render Member Companies or the insurance intermediaries unable to comply with any of the Enhanced Requirements (e.g. assessing affordability of products recommended or comparison of different insurance options, etc.), Member Companies must reject the relevant application and should advise the customer accordingly.

The FNA form may either be presented as a separate form, or included as a section within another point-of-sale document such as an application form. Either way, it must be clearly identified as a "Financial Needs Analysis" or by using an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by the customer(s).

According to the Enhanced Requirements, the detailed requirements regarding FNA, as provided by the Initiative on Financial Needs Analysis, that should be complied with include the following:

1. The FNA form should include the following:
   - personal particulars (name, date of birth, marital status, occupation, education level, etc.);
   - financial outgoings (monthly living expenses, rent/mortgage redemption, etc.);
   - disposable assets (savings, stock/securities/bonds, etc.);
   - liabilities (mortgage loan, debts, etc.); and
   - family commitments (number of dependants, education funds, etc.).

2. Intermediaries should take into account the customers' total protection needs, total disposable assets, financial outgoings and liabilities, as well as his/her willingness and ability to pay premium (and the duration of payment) in assessing the affordability of the customers before making recommendation. The factors considered, evaluation, and reason(s) for the recommendation made by the selling intermediary should also be included in the FNA.

3. Member Companies must require the intermediaries to carry out an FNA (including comparison of different insurance options) with the customers before recommending to them any life insurance products and signing the application.

(d) Risk Profile Questionnaire

Every application for an ILAS product must include, or be accompanied by an RPQ, the purpose of which is to assess the customer's investment risk appetite and determine if a particular product and its underlying investment choices (if any) are suitable for him. The form of the RPQ should include, as a minimum, questions covering the following areas:

1. investment objectives;
2. preferred investment horizon;
3. risk tolerance; and
4. financial circumstances.

However, there is no need to duplicate FNA questions in the RPQ. Member Companies must also exercise extra care when selling ILAS products to "Vulnerable Customers", i.e. elderly customers, unsophisticated customers or those who may not be able to make independent investment decisions on complex investment products; particularly ILAS products with long maturity periods or which attract heavy penalties on early redemption or withdrawal.

Customers are not allowed to opt out or deviate in any respect from the RPQ process. Member Companies are required not to accept the application if a customer chooses to opt out or deviate from the RPQ process.

Every application for an ILAS product must include the RPQ, which may either be presented as a separate form, or included as a section within another point-of-sale document such as an application form. Either way, it must be clearly identified as a "Risk Profile Questionnaire" or by using an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by the customer(s).

For the avoidance of doubt, the FNA and RPQ are not required if they have been performed within one year (both for new and top-up applications), provided that there are no substantial changes in the customers' circumstances (in such cases Member Companies can rely on the written declarations by the customers) and that there are no mismatch (i.e. needs, or risks, affordability, etc.) identified. For the purposes of the Enhanced Requirements, "top-up" is defined to include increase in investment (single or regular premium) and RPQ is not required for top-up that includes increase in premiums for addition or variation of non-ILAS riders (e.g. term, critical illness, accidental death benefits, etc.).

(e) Important Facts Statement and Applicant's Declarations

Every application (whether new or top-up) for an ILAS product must include, or be accompanied by, an Important Facts Statement (IFS) in prescribed templates, which incorporates the Applicant's Declaration (AD).

The "General Principles" in structuring the IFS are as follows:

1. As a general principle, the template should be adopted in terms of structure, groupings and signatures. But Member Companies are allowed latitude in amending the wording to accurately reflect their specific products and their features.

2. The IFS is a document required by the IA for all ILAS sales and will be subject to its audit. It is not a marketing document and is not therefore subject to the SFC's approval.

3. The intent of the IFS charges disclosure is to simply yet comprehensively demonstrate to the customer the combined impact of all fees and charges which may be incurred.

4. Member Companies are expected to respect the principles, intention and spirit of the IFS and to be accountable for any major deviations. It is not planned that the IFS will require pre-authorisation by the IA but it will be subject to its audit at a later date.

5. 'The whole content of the IFS has to be placed in a very distinct manner and at the forefront of the AD/IFS.

6. The "Statement of Purpose" (in which the customer is required to state his reasons/considerations for procuring the ILAS policy in question) must be filled in by the customer in his own handwriting and remain in free format, without pre-set options in any circumstances.

7. Member Companies should ensure that the information contained in the IFS accurately reflects the information of the ILAS product.

8. The HKMA may direct banks being Member Companies for its specific, additional requirements in relation to the IFS.

9. For the avoidance of doubt, the IFS must be obtained for products that are open for top-up. All items must be filled except Para. 2 (Cooling-off period) and (for some very old products without principal brochure and/or key facts statements) Para. 4 (Long-term features) of the IFS.

Different Versions of IFS

1. Fundamentally, there are two versions of the IFS to reflect the complexity of the Fees and Charges of the product being sold.

2. These versions are respectively referred to as “Simple” and “Complex”. It is the responsibility of each Member Company to match the more appropriate IFS with its associated information, i.e. details of the fees and charges, to the ILAS product being sold.

3. For ILAS products with a “complex” charging structure, it is recognised that these may be tenure-specific and that a table highlighting all charges could be applied. Where an “all encompassing” table is applied showing all tenure specific charges, the insurance intermediary is required to highlight the specific charge in the table that applies to that tenure, or, as an alternative, delete the ones that do not apply.

4. The IFS will also be channel specific so as to reflect the specific requirements/modifications required by the particular distribution channel, i.e. agency, banks and brokers.

Provision of signed IFS to policyholder

The Enhanced Requirements requires Member Companies to provide the policyholder with a copy of the signed IFS together with the policy.

Remuneration Disclosure Statement

The IFS contains a statement that discloses the average remuneration payable to the insurance intermediary, and advises the potential policyholder to consult the insurance intermediary if more detail is required. Members Companies and the insurance intermediaries must disclose the remuneration, using “all-year-average” based on the calculation methodology and disclosure format stipulated by the IA. While Member Companies may decide how to provide the details upon further enquiry from the customers, they and the insurance intermediaries should bear in mind the following principles when deciding how to formulate their approach:

- disclosure must be made and should not be refused;
- the disclosure amount and/or methodology should be accurate, and not be misleading to consumers;
- it must be presented in a format that is clear and easy to understand;
- a common approach should be taken for all products and customer groups; and
- failure to apply a fair and consistent methodology could result in the "fit and proper" status of an authorised individual being called into question.

Completing the IFS

The rules for completing the IFS are as follows:

1. The applicant(s) must complete the IFS without an opt-out option.

2. The applicant(s) must sign the declaration in "Section I: Disclosure Declaration" to confirm they understand and accept the highlighted features of the product as well as to confirm that they have received a copy of the HKFI's Education Pamphlet entitled "Questions you need to ask before taking out an ILAS product". If the product has any unusual features or risks such as market value adjustment, foreign exchange risk, leverage, investment choices based on hedge funds, extensive use of derivatives other than for risk management purposes, or is for the purpose of the Capital Investment Entrant Scheme ("CIES"), then the insurance intermediary must explain these to the full satisfaction and understanding of the applicant(s) prior to signing. All applicants(s) must sign and date at the bottom of Section I.

3. The applicant(s) must then tick either box A or B in "Section III: Suitability Declaration".

   (a) Box A should be ticked where the insurance intermediary and the applicant(s) agree that the product is suitable for the applicant(s), based on the information provided by the applicant(s) as part of the FNA and RPQ.

   (b) Box B should be ticked by the applicant(s) where it is assessed that the product may not be suitable for the applicant(s) based on the information disclosed in the FNA and RPQ. In addition, whenever box B is ticked, the applicant(s) must in their own handwriting provide sufficient explanation of why they have decided to proceed with the application, notwithstanding that the product may not be suitable.

   (c) All applicant(s) must sign and date at the bottom of Section III.

Every application for an ILAS product must include the IFS, which may either be presented as a separate form, or included as a section within another point-of-sale document such as an application form. Either way, it must be clearly identified as an "Important Facts Statement" or by using an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by the applicant(s).

(f) Suitability Check

Member Companies must establish operational controls to ensure that the FNA, RPQ and IFS are duly completed.

They must also establish a process to (i) verify that the ILAS product sold and the key features such as the premium amount and term are considered suitable and affordable for the customer(s) based on the information disclosed by the customer(s), (ii) verify that the insurance intermediaries have taken due account of the reasons/considerations set out by the customer in the "Statement of Purpose" paragraph of the IFS, together with other relevant information, in assessing whether a particular ILAS product is suitable for the customer (s), and (iii) deal appropriately with any exceptions as per the section headed “Post-sale Controls”.

Special consideration is required where business is introduced by an insurance broker. It is important that in performing the Suitability Check and dealing with any exceptions as per the section headed “Post-sale Controls” the customer(s) fully understands that the insurance company is not responsible for the advice given by the insurance broker. To facilitate this differentiation, a specific set of IFS must be prepared for this purpose and must be used for business introduced from this type of intermediary. For the avoidance of doubt, however, Member Companies must still follow the requirement under clause 7.8 of the OCI’s GN15 during the underwriting process for business introduced by insurance brokers, and follow up with the insurance broker concerned in case of mismatch.

(g) Post-sale Controls

Unlike the HKMA, which requests banks to make audio recordings of ILAS sales, the LIC allows Member Companies to decide on their own to apply audio recordings in lieu of the post-sale call requirement provided these are conducted in their own offices and that the appropriate protocols and processes are observed (see “Option B” below).

Member Companies must implement the following controls for non-bancassurance ILAS sale (in accordance with either Option A or B below). Where additional control measures have been set up by Member Companies for “Vulnerable Customers”, the script should be suitably modified to reflect those measures. In determining who is a “Vulnerable Customer” to whom an appropriate Post-sale Call must be made, account must be taken of matters including but not limited to the following:

- **Age**: a customer over 65 is a Vulnerable Customer;
- **Level of education**: a person whose education level is “primary level” or below is a Vulnerable Customer; and
- **Financial means**: a person who has “limited means” or no regular source of income or both is a Vulnerable Customer.

Option A: Post-sale Controls

1. Copies of the Product Key Facts Statement (please refer to section **4.13.2(c)**) for the relevant ILAS product and the signed IFS and AD must be sent to the customer with the policy.

2. A notice (i) informing the customer that copies of the customer's FNA form and RPQ are available for inspection and (ii) advising where and how the customer may access these documents must be sent with the policy to the customer. This applies to all customers irrespective of which box (A or B) is ticked in Section III of the IFS.

3. Not later than the 5th working day after the issue date of each ILAS policy, Member Companies must make reasonable efforts to complete and make audio recordings of telephone calls with all customers to confirm their consent to the suitability assessment as set out in the FNA and RPQ sections of the Enhanced Requirements and the IFS and AD.

4. To ensure compliance with the post-sale call requirements, Member Companies must follow an approved script. The HKFI has issued a minimum set of questions which is required to be included in this script. Nonetheless, Member Companies are allowed to develop their own versions provided they at least include the questions prescribed in Appendix D to the Enhanced Requirements.

5. A flow chart, entitled "Flow chart - ILAS Post-Sale Call" (see Appendix E to the Enhanced Requirements), has been drawn to depict the necessary actions in dealing with various situations or scenarios during the course of post-sale calls.

6. The Member Company must make post-sale calls within 5 working days after the issue date of each policy. In case of any uncertain replies by a customer during a post-sale call, the Member Company must ask the relevant insurance intermediary to follow up with the customer and then report the situation to it. The Member Company must also conduct follow-up calls within 5 working days after the previous post-sale call until all the queries of the customer have been addressed. If the customer cannot be reached or the follow-up call cannot be completed properly, the Member Company must send a notification letter to the customer (alongside an email/SMS alert), citing the key areas of concern and setting out the means for him to contact the Member Company for any disagreement on the points set out. A sample notification letter is provided in Appendix F1 to the Enhanced Requirements.

7. If a post-sale call cannot reach the customer or the customer is unwilling to continue the call, the Member Company must send a notification letter to the customer (alongside an email/SMS alert), drawing the key areas to the customer's attention and setting out the means for him to contact the Member Company for any disagreement on the points set out. A sample notification letter is provided in Appendix F2 to the Enhanced Requirements.

8. At the end of each post-sale or follow-up call, the Member Company should advise the customer of the expiry date of the applicable cooling-off period.

9. As per the guidelines of the Privacy Commissioner, the recordings of the calls should be kept during the period in which the concerned person is a policyholder and for a period of 7 years from the date the

policy expires or terminates. In the event that the policy is not proceeded with, such recordings should be kept for a period of 2 years before being erased.

Option B: Point-of-sale Audio Recording

Member Companies are allowed to adopt point-of-sale audio recording (PSAR) in lieu of post-sale calls for any cases of ILAS applications provided that the following requirements are met:

1. PSAR must be conducted in the office of the Member Company.

2. An employee of the Member Company must attend, manage and witness the whole PSAR process. This employee must not have conflict of interest with the sale of the relevant ILAS policy, e.g. he will not earn, receive or be rewarded with any compensation directly due to the sale of the policy.

3. Either of the following approaches can be adopted for the PSAR:

   <u>Approach 1: PSAR to be conducted by an employee on site</u>
   Once the ILAS sales process has been completed, and all necessary forms, documents and application have been completed and signed by the applicant, the employee will activate an audio recording device to conduct a PSAR in accordance with a prescribed PSAR script (see Appendix G to the Enhanced Requirements).

   <u>Approach 2: PSAR to be conducted by call centre employee</u>
   If the ILAS sale is conducted in the Member Company's offices where no audio recording devices are available, then, on completion of the ILAS sales process all fulfilment documents should be passed to the Member Company's call centre staff, who will call the applicant and conduct a PSAR (see Appendix G to the Enhanced Requirements) over the telephone. The whole discussion will be recorded.

4. The questions to be asked must follow the prescribed PSAR script.

5. As per the guidelines of the Privacy Commissioner, the recordings of calls for policies which have been successfully issued should be kept during the respective periods of the policies and for a period of 7 years from the dates the policies expire or terminate. In the event that a policy is not taken up, the relevant recordings should be kept for a period of 2 years before being erased.

After proper completion of a PSAR, a post-sale call to the applicant will not be necessary.

(h) Certification of Copies of FNA and RPQ

Instead of receiving the original signed copies of FNA and RPQ, Member Companies are permitted to accept copies of the above documents provided they are appropriately certified for business introduced by banks and insurance brokers. In respect of business introduced by banks, the copies should be certified by the relevant bank branch manager and bear the bank's chop. For business introduced by insurance brokers, the copies should be certified by the Responsible Officer designated by the authorised representative of the insurance broker.

As the IFS is product-related, the original signed document must be returned and retained by the Member Company. In no circumstances is a certified copy from an insurance intermediary acceptable.

(i) Compliance with the OCI's GN15

Member Companies are reminded to comply with the requirements of GN15. Under no circumstances should they enter into arrangements with the intention to circumvent any of the requirements contained therein (e.g. using a side agreement to pay indemnity commission in the form of loan or advance).

With a view to improving customer education, the HKFI published a leaflet entitled "Questions you need to ask before taking out an ILAS product" in 2011, copies of which must be distributed to potential policyholders of ILAS products at the point-of-sale in accordance with the section headed "Proper Sales Process" of the Enhanced Requirements. This leaflet was later updated in June 2013.

4.13.2 Information to be Communicated in Sales Process

Several pieces of important information which should be clearly communicated to clients in the sales of investment-linked life insurance policies are:

- Investment time frame;
- Principal brochure and illustration document;
- Product Key Facts Statement;
- Product risk;
- Product features and benefits;
- Fees and charges;
- Early termination, surrender and/or withdrawal risk; and
- Premium holiday risk.

(a) Investment Time Frame

Investment-linked policies should not be used as speculative investment products. Like most insurance products, it is suitable as an investment vehicle only if the policyholder has a long-term investment horizon which is normally more than five years.

The insurance intermediary should also point out to prospective clients that since the fees and charges of an investment-linked insurance policy are heavily stacked at the beginning of the term, early redemption will be subject to very high encashment charges due to the deduction of fees and charges to cover the expenses of the insurance company as well as the load charges of the underlying investments.

(b) Principal Brochure and Illustration Document

As the policyholder of an investment-linked insurance policy bears the immediate consequences of the investment performance of the fund, the SFC is very concerned about the provision of adequate and accurate information to the policyholders. In this regard, the **"Code on Investment-linked Assurance Schemes"** (the ILAS Code) that the SFC published pursuant to section 399(1) of the **"Securities and Futures Ordinance" (Cap. 571)** imposes detailed requirements on information to be disclosed during the sales process. It specifically requires the insurance intermediary to produce three documents to the prospective clients: the principal brochure (please refer to section **4.13.3**), the illustration document (please refer to section **4.15**) and the product key facts statement (please refer to (c) below).

(c) Product Key Facts Statement

A product key facts statement (KFS) (see SFC's Circular of 3 May 2013) for ILAS is one that gives a prospective investor a concise and user friendly summary, in plain language, of the key features and risks of the product. The KFS is a part of the offering documents which require the SFC's prior approval pursuant to the ILAS Code issued by the SFC, although revisions to the KFS of existing ILAS schemes solely to reflect the enhanced disclosure requirements do not require the SFC's prior approval. Please refer to **Appendix C** for the KFS illustrative template.

(d) Product Risk

In investment terms, risk is defined as the uncertainty associated with the end of period value of investment. As a general rule, assets that produce higher prospective rates of return are generally more volatile in nature or in other words, carry higher risks. Some of the key investment considerations were described in section **2.2**.

It is appropriate for the insurance intermediary to point out to the prospective clients that the historic performance of an investment fund is not indicative of future performance.

(e) Product Features and Benefits

Investment-linked policies possess some powerful features, such as wide spectrum of investment choices and flexible premium payments. Since their product features and their comparison to traditional life products have already been covered in the previous sections, they will not be repeated here.

(f) Fees and Charges

In addition to the standard insurance charges (such as fees and charges relating to early termination, surrender and/or withdrawal), investment-linked policies may attract some additional fees and charges as a result of the investment into the underlying funds (please refer to section **4.3.2**). It is always a good practice for the insurance intermediaries to explicitly explain the relevant fees and charges to the customers in order to protect both parties.

(g) Early Termination, Surrender and/or Withdrawal Risk

While the policyholder is normally given the options of early termination, surrender and/or withdrawal, he should be alerted that he will incur a surrender or withdrawal charge and/or may even lose his entitlement to bonuses.

(h) Premium Holiday Risk

While the policy provision of "premium holiday" allows the customer to cease premium payments temporarily, he should be alerted that all relevant fees and charges will continue to be deducted from the policy value during the premium holiday, so that the policy value may be significantly reduced and his entitlement to bonuses affected.

4.13.3 Principal Brochure

As laid down in the ILAS Code, all authorised schemes must issue to each prospective scheme participant an up-to-date ***Principal Brochure*** which contains prescribed information (see below).

This should be given to all scheme participants before they submit the formal application for the policy. Since the principal brochure may consist of various parts and documents, the prospective participants should be advised to check against the list of its components in the application form to make sure that they have received all relevant documents.

The principal brochure, preferably in one single document, should contain such information as is necessary to enable prospective scheme participants to make an informed judgment of the scheme; in particular:

(a) Name and Type of Scheme

The name and description of the scheme must not be misleading to potential scheme participants and should be an accurate reflection of the type of scheme and its objectives.

(b) Parties Involved

The names and registered addresses of all parties involved in the operation of the scheme with a brief description of the insurance company.

(c) Investment Returns

Details of how the investment return of the scheme is determined should be given. Except where the scheme's investment returns are subject to a non-variable guarantee, a warning should be stated to the effect that investment involves risks. Furthermore, a statement to the effect that the unit(s) allocated to the policy is notional and is solely for the purpose of determining the value of the policy should be included. The ILAS Code imposes additional disclosure requirements for guarantee and with-profits or similar features.

If the nature of the investment policy so dictates, a warning should be given that investment in the scheme or investment option linked to a scheme is subject to abnormal risks, together with a description of the risks involved.

(d) Fees and Charges

Explanations of fees and charges may be abbreviated, but should be clearly identified to include:

(i) the level of all fees and charges payable by a scheme participant, including all charges levied on subscription, redemption and switching;

(ii) the level of all fees and charges payable by the scheme or an investment option linked to the scheme; and

(iii) details of whether charges are subject to change and the relevant notice period.

A summary of all fees and charges in tabular form should be provided to give scheme participants an overview of the fees structure at a glance. Where complex calculations are required to disclose fees and charges, illustrative examples should be given for clarity.

(e) Investment Objectives and Restrictions

A summary of the investment objective of the scheme or investment option(s) linked to a scheme including, where applicable:

(i) the types of intended investments, and their relative proportions in the portfolio;

(ii) the geographical distribution of the intended investments;

(iii) the investment and borrowing restrictions; and

(iv) if the nature of the investment policy so dictates, a warning that investment in the scheme is subject to abnormal risks, and a description of the risks involved.

(f) Borrowing Powers

The circumstances under which the scheme or investment option(s) linked to a scheme may have outstanding borrowings and the purpose for which and the extent to which such outstanding borrowings were or may be incurred.

(g) Summary of Provisions in Constitutive Documents

A summary of the provisions with respect to:

- Valuation of property and pricing;
- Characteristics of premiums/contributions;
- Benefits;
- Maturity and early surrender values; and
- Conditions of termination.

(h) Application and Surrender Procedures

A summary of the procedures for application and surrender.

(i) Warning Statements

The following warning statements should be disclosed in the principal brochure, where applicable, in a prominent manner:

(i) Investment-linked assurance schemes are insurance policies issued by the authorised insurer.

(ii) A scheme participant's investments are therefore subject to the credit risks of such authorised insurer.

(iii) Premiums paid by a scheme participant towards the insurance policy will become part of the assets of the authorised insurer. A scheme participant does not have any rights or ownership over any of those assets. The recourse of a scheme participant is against the authorised insurer only.

(iv) The scheme participant's return on investments is calculated or determined by the authorised insurer with reference to the performance of the underlying funds/assets.

(v) Where the return of the scheme is based on investment options linked to the scheme which is calculated or determined by the authorised insurer with reference to the performance of a corresponding SFC-authorised fund, a warning statement that the return of investments under the scheme shall be subject to the charges of the scheme and may be lower than the return of the corresponding SFC-authorised fund.

(vi) Early surrender or withdrawal of the policy/suspension of or reduction in premium may result in a significant loss of principal and/or bonuses awarded. Poor performance of underlying funds/assets may magnify the scheme participant's investment losses, while all charges are still deductible.

(vii) The investment options available under the scheme can have very different features and risk profiles. Some may be of high risk.

(j) Cooling-off Period

A summary of the provisions of the ILAS Code with respect to the cooling-off period (please refer to section **4.13.4**).

(k) General Information

(i) A list of constitutive documents and an address in Hong Kong where they can be inspected free of charge or purchased at a reasonable price.

(ii) A statement that the authorised insurer accepts full responsibility for the accuracy of the information contained in the offering document and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement misleading.

(iii) A statement that the SFC does not take any responsibility for the contents of the offering document, makes no representation as to its accuracy or completeness, expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of the offering document.

(iv) Where a scheme is described as having been authorised by the SFC, a prominent note should be disclosed that:

"SFC authorisation is not a recommendation or endorsement of the scheme nor does it guarantee the commercial merits of a scheme or its performance. It does not mean the scheme is suitable for all investors nor is it an endorsement of its suitability for any particular investor or class of investors."

(v) If available, website address of the scheme which contains publications of its offering document, principal brochures, circulars, notices, announcements, financial reports and the latest available offer and redemption prices or net asset value.

(l) Governing Law

The governing law of the scheme should be disclosed and an acknowledgment that the parties involved have the right to bring legal action in a Hong Kong court as well as in any court elsewhere which has a relevant connection with the scheme.

(m) Taxation

Where the likely tax benefits to be enjoyed by scheme participants are described, the principal brochure should also briefly explain the authorised insurer's understanding of the tax implications for Hong Kong scheme participants, based on expert advice received by the authorised insurer. Scheme participants should also be advised to seek professional advice regarding their own particular tax circumstances.

(n) Date of Publication of the Principal Brochure

All facts and figures in the principal brochure should be as reasonably up to date as possible.

(o) Authorisation Statement

Where a scheme is described as having been authorised by the SFC, it must be stated that authorisation does not imply official recommendation.

4.13.4 Cooling-off Period

One of the popular perceptions, and certainly a popular fear in the general public, is that life insurance intermediaries may be too assertive, even aggressive, in their selling. The perceived result from this could be that a person might be pressurised into purchasing a life insurance policy that they do not really want, or cannot really afford.

To counteract this perceived possibility, effective from July 1996 the Life Insurance Council (LIC) under the Hong Kong Federation of Insurers (HKFI) launched what was termed the "**Cooling-off Initiative**". The cooling-off period provides policyholders a chance to re-think within a reasonable period of time their decision to purchase a life insurance product which is a long-term commitment. During that period, if the policyholders wish to change their mind, they will have the rights to serve a written notice to cancel the policy and obtain a refund of the paid premium less a market value adjustment, if any.

To further enhance customer protection, the HKFI has from time to time revised this **"Cooling-off Initiative"** and a new set of documents relating to Cooling-off Period has recently been published which will be implemented not later than 1 February 2010. For full details of the document, please refer to the Life Insurance Council's circular dated 13 November 2009.

Under the latest mechanism, the **"Cooling-off Initiative"** has been further elaborated. Some of the topics which are directly related to Investment-linked Long Term Insurance Policies are summarised in the following paragraphs.

(a) Cooling-off Period

i. The Cooling-off Period is **21 days after the delivery of the policy or issue of a Notice to the policyholder or the policyholder's representative, whichever is the earlier**.

ii. The Notice should inform the policyholder of the availability of the policy, and the expiry date of the Cooling-off Period. **The Notice should remind the policyholder that he/she has the right to re-think his/her decision to purchase the life insurance product and to obtain a refund of premium paid if the policy is cancelled within the Cooling-off Period**. The Notice should also remind the policyholder to contact the Customer Service Department of the insurer ***directly*** if he/she does not receive the policy ***contract*** within ***9 days*** from the issue date of the Notice.

iii. Insurers should keep a copy of the Notice or **acknowledgement of receipt of Policy delivery.** In case of a reasonable complaint or dispute, insurers will be required to produce evidence to show that he Policy notice or Policy has been delivered.

(b) Cooling-off Rights

i. Subject to the clauses below, policyholders have the right to cancel new policies within the Cooling-off Period and obtain a refund of the premium(s) paid.

ii. For all linked policies, the insurer will have the right to apply a "**market value adjustment**" (MVA) to the refund of premiums.

iii. Any such MVA must be calculated solely with reference to the loss the insurer might make in realising the value of any assets acquired through investment of the premiums made under the life policy. It shall therefore not include any allowance for expenses or commissions in connection with the issuance of the contract.

iv. The insurer's right to apply an MVA must be disclosed in the ***Principal Brochure*** (please refer to section **4.13.3**), and the basis of calculation must be available for disclosure to the potential policyholder prior to the completion of the application form.

(c) **Announcement of Cooling-off Rights** on Application Form

i A statement as defined in "**Wording Guidelines on Announcement of Cooling-off Rights on Application Form**" (**Appendix D**) must be included on the application form immediately above the space for the signature.

ii. The size of the printing for the statement must not be smaller than the print size used for any other declarations on the form. Furthermore, the font size shall not be less than 8.

iii. It shall be communicated in the same language(s) as are used for all other sections of the application form.

(d) Advice at time of Policy Issue

i. When the policy is issued, the policyholder must be reminded of the Cooling-off rights attaching to the policy.

ii. This may be done by way of a letter from the insurer mailed direct to the policyholder, or a statement on the policy jacket or policy cover.

iii. It shall be communicated in the same language(s) as are used for other communication at the time of policy issue.

iv. The typeface shall be no smaller than font size 10.

v. For details of the Announcement, please refer to **Appendix E** "**Wording Guidelines on Announcement of Cooling-off Rights with Policy Issu*e***".

Furthermore, Life Insurance Members of the HKFI are advised to:

(a) specify in their intermediaries' training materials and internal guidelines that insurance intermediaries must:

i. inform prospective policyholders of their Cooling-off rights and the expiry date of the Cooling-off period when policyholders sign their policy application forms; and

ii. make all reasonable endeavour to deliver policies to the policyholders within a period of time consistent with the other clauses after the policies are issued if they are vested with the obligation to deliver policies on behalf of the companies.

(b) devise internal control measures which will ensure and prove that:

i. policies are delivered no later than 9 days after the policy issue date; or

ii a Notice to inform policyholders of the availability of the policies and the expiry date of the Cooling-off Period is issued ***no later than 9 days from the policy issue date***;

and

(c) maintain records in respect of complaints or disputes for cases where clients seek refunds outside the defined period but are refused by the company and to provide these records to the HKFI upon request.

4.13.5 Customer Protection Declaration

As specified under the **"Code of Practice for Life Insurance Replacement"** published by the HKFI, a **"Customer Protection Declaration"** (CPD) form must be completed before the policyholder agrees or makes a decision in relation to the purchase of a new policy. It is designed to:

(a) discover any replacement being recommended and if so;

(b) ensure that the agent/broker has explained the important consequences; and

(c) ensure that the client fully understands the important consequences.

This serves as a record that the policyholder has been informed of the consequences and disadvantages of the recommended replacement or has been given an explanation and/or justification by the agent/broker. On the other hand, the completion of the CPD Form will ensure that the policyholder has been informed of the consequences/disadvantages of the recommended replacement or has been given an explanation and/or justification by the agent/broker. The completed CPD Form creates a record of such advice.

The original of the CPD form shall be kept by the selling office and copies must be issued to:

(a) the client together with the new policy; and

(b) the insurer(s) of the existing insurance policy(ies) replaced/to be replaced (the Non-Selling Office) within 7 business days of the issue date of the new policy.

In order to perfect the system, the HKFI has released a new version of the **CPD** form revised as at 1 February 2010 which contains revised explanatory notes. The "Explanatory Notes to Customer Protection Declaration Form" explains in detail the duties of the insurance intermediary regarding the completion of the CPD form and how to complete it. Please refer to **Appendix F** for a sample of the form and the Explanatory Notes.

4.14 ETHICS

This is important for insurance intermediaries regardless of insurance products being sold. Insurance agents/their responsible officers/technical representatives are required to comply with the Code of Practice for the Administration of Insurance Agents issued by the HKFI. Insurance agents/their responsible officers/technical representatives failing to comply would be subject to de-registration. This Code of Practice will be covered in Chapter **5**.

Besides, insurance brokers/their chief executives/technical representatives should comply with the Minimum Requirements as specified under sections 69 and 70 of the ICO which will be discussed in more details in Chapter **5**.

Insurance companies and clients place their trust in their insurance intermediaries. Unethical practices will tarnish the reputation of the company one represents as well as collectively tarnish the professionalism and reputation of the Hong Kong insurance industry. In 2013, the Insurance Agents Registration Board of the HKFI received 1,388 complaints/referrals on misconduct (including re-activated cases). Among the complaints were "Conducting insurance agency business without registration", "Use of document containing inaccurate information" and "Aiding and abetting/allowing and agreeing others to conduct insurance agency business without registration". In 2014, the Hong Kong Confederation of Insurance Brokers received 51 complaints, of which 23 concerned "payment terms, policy charges and affordability" and 5 concerned "investment advice". In the same year, the Professional Insurance Brokers Association received 53 complaints, 26 of which concerned "payment terms, policy charges and affordability".

Listed below are several common unprofessional practices that should be avoided:

Misrepresentation is the practice where an insurance intermediary deliberately makes misleading statements to induce a prospect to purchase insurance. For example, it is a misrepresentation by claiming that the investment return is guaranteed when it is not etc.

Twisting is the practice where an insurance intermediary makes misleading statements, non-disclosure, misrepresentations and incomplete comparisons to induce an insured to replace existing life insurance with other life insurance resulting in a disadvantage to the insured. Please refer to the **"Code of Practice for Life Insurance Replacement"** issued by the Life Insurance Council for more details.

Rebating is the practice where an insurance agent offers a rebate of his/her commission to entice a prospect to purchase a policy. Since a client should evaluate the risks and benefits of each insurance product on its own merit, rebating may prevent him/her from making the appropriate decision. This however, may not be applicable to insurance brokers.

Fraud is the practice where an insurance intermediary deliberately makes false statements and claims, or concealing important information with the intention to deceive or cheat. For example, the intermediary deliberately conceals information concerning the current health condition of the client.

4.15 ILLUSTRATION DOCUMENTS

Since January 1997, insurance companies have been required to produce an **"Illustration Document"** in addition to the principal brochure (please refer to section **4.13.3**). The SFC provides guidelines for use of illustration documents for investment-linked policies in the ILAS Code. A sample of the document (effective no later than 1 January 2015) as provided by the SFC is reproduced in **Appendix G**. Some of the more important features are summarised below:

4.15.1 Linked Policy Illustration Documents

(a) **Illustration Document**: The insurance company, in conjunction with each proposed investment by each prospective scheme participant, must prepare a personalised illustration document (rather than a standard illustration for all customers), which should be provided to him for review and signature prior to signing of the application form.

(b) **Minimum Requirements**: For the information to be included in the illustration document are:

(i) **Surrender values**: The insurance company is required to illustrate the projected surrender values in the event that the policy is redeemed at the end of each of the first 5 years of the contract, and for every fifth year thereafter until maturity or the end of the policy whichever is applicable, after deduction of all relevant charges. In a similar

manner, the insurance company should also illustrate the projected death benefits in the event that the life insured dies on those alternative dates without the policy being redeemed.

With effect from 1 January 2015, the projected surrender values and death benefits should be based on either 4 different assumed rates of return of 0%, 3%, 6% and 9% per annum respectively (Version 1 Template) or 3 different assumed rates of return of 0%, 3% and 6% per annum respectively (Version 2 Template). For both options, other than the 0% assumed rate of return, all rates of return are maximum rates so that insurers may choose to illustrate lower rates. The illustration should be prepared so that it includes all policy level charges but not fund management charges levied by fund managers. (These rates may be subject to change by the SFC after consultation with the industry).

(ii) **Prescribed statements**: The following statements should appear in the Illustration Document as shown in **Appendix G**:

"THE ASSUMED RATES USED BELOW ARE FOR ILLUSTRATIVE PURPOSES. THEY ARE NEITHER GUARANTEED NOR BASED ON PAST PERFORMANCE. THE ACTUAL RETURN MAY BE DIFFERENT!

IMPORTANT:

THIS IS A SUMMARY ILLUSTRATION OF THE SURRENDER VALUES AND DEATH BENEFITS (VERSION 1: SHOWN ON THE FOLLOWING PAGE) OF [NAME OF PRODUCT]. IT IS INTENDED TO SHOW THE IMPACT OF FEES AND CHARGES ON SURRENDER VALUES AND DEATH BENEFITS BASED ON THE ASSUMPTIONS STATED BELOW AND IN NO WAY AFFECTS THE TERMS OF CONDITIONS STATED IN THE POLICY DOCUMENT."

The following statements should be clearly disclosed before the scheme participant's signature:

"Warning: You should only invest in this product if you intend to pay the premium for the whole of your chosen premium payment term. Should you terminate this product early or cease paying premiums early, you may suffer a significant loss.

Declaration
I confirm having read and understood the information provided in this illustration and received the principal brochure."

(c) **Company Customisation**: Subject to the approval of the SFC, the insurance company may customise the document to include additional information, provided that such additional information is not misleading and does not otherwise detract from the information disclosed in the minimum requirements.

4.16 POLICY ADMINISTRATION AND STATEMENT TO POLICYHOLDERS

Similar to the conventional life insurance policies, policy administrative activities in relation to investment-linked policies such as policy issuance, correspondence, documentation, premium collection, benefit administration and policy changes have to be performed by the insurance company.

Given that different policyholders may have varying insurance and investment needs, the insurance company will, in response to each application, issue a unique policy document for each policyholder which contains all the binding terms and conditions of his/her participation on the basis of the information submitted in his/her application form.

4.16.1 Policy Issuance

Once the underwriting process is completed and cover is approved, the policy can be prepared and then delivered to the policyholder. The important fact worth mentioning is that a policy cannot be cancelled or amended after its issuance without the agreement of the policyholder. Issuing and delivering the policy in some respects may be looked upon as the point of no return for the insurance company. Careful policy checking and confirmation are therefore needed before this happens.

4.16.2 Policy Delivery

This may be considered with policy issuance as the two are very closely connected. Using modern technology, policy documents can be produced with great speed and accuracy. The in-house system should create the policyholder's records and verify whether the first premium has been received. Therefore, only variations affecting the particular policyholder will alter the routine format. All of these can be dealt with by an automated system.

However, it is important that intermediaries should observe cooling-off period and deliver policies to the policyholders within a reasonable period of time after the policy is issued.

4.16.3 Policy Changes

Similar to other conventional life insurance policies, the policyholder of investment-linked policy can request for changes to the policy. These changes include non-financial changes such as:

- change of beneficiary;
- assignment of the policy; and
- change of address/personal particulars;

or financial changes such as:

- reinstatement;
- change of frequency of premium payment;
- change of sum assured;
- policy loan; and
- surrender.

For policyholders of investment-linked policies, they can enjoy the additional policy features which are unique and typically not available to traditional life insurance policies such as:

- change of premium amount;
- fund switching; and
- premium holidays.

4.16.4 Information to Policyholders

An insurance company typically provides two reports to each investment-linked policyholder. One is on the performance and value of his/her policy ("policy statement"). The other is on the performance of the investment-linked fund ("fund performance report").

In order to be able to carry out the administration of any investment-linked business, the use of computer is effectively mandatory. The administration of this flexible insurance product involves a large degree of calculation and record keeping which calls for the need of a powerful and flexible computer system. Besides the standard functions of any insurance administration system, the system has to handle other issues such as dealing with unit fund, allocations of units as a result of premiums received, the payment of the various types of charges (insurance charges and investment charges) by cancellation of units (please refer to section **4.6**), varying allocation rates and so on.

4.16.5 Policy Statement

The policy statement is prepared at least annually, within 30 days after the policy anniversary. Instead of basing on the policy anniversary, the insurance company may choose to prepare the statements as of a specified date in the policy year, such as December 31 of each calendar year. The statement date should be consistent from year to year.

The purpose of the policy statement is to provide the policyholder with a summary of the transactions that occurred during the statement period, and the values of his/her policy as of the statement date. As a minimum, the statement normally includes the following information:

1. Number and value of units held at the beginning of the period; bought during the period; sold during the period; and held at the end of the period;
2. Charges levied during the period;
3. Premiums received during the period;
4. The level of death benefit as of the statement date;
5. The net cash surrender value as of the statement date; and
6. The amount of outstanding loans, if any, as of the statement date.

4.16.6 Fund Performance Report

The insurance companies will also prepare their fund performance reports annually. The purpose of the fund performance report is to summarise the performance of the fund during the period and to highlight any changes in the investment policy. As a common practice, most of them include the following information:

1. A summary of the audited financial statement of the fund;
2. A comparison of the net investment return of the fund for the year with the investment returns during the preceding five or more years if available;
3. A list of investments held by the fund as of the reporting date;
4. Any charges levied against the fund during the year; and
5. A statement of any change in the investment objective and orientation of the fund, any change in investment restrictions or any change in the fund management since the last report.

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Representative Examination Questions

Type "A" Questions

1. Investment-linked business was first introduced in:

    (a) the UK;
    (b) the US;
    (c) Canada;
    (d) Australia.

[Answer may be found in **4.1**]

2. Which of the following is one of the main characteristics of an investment-linked policy?

    (a) it is used solely for investment purposes;
    (b) its cash value is usually the value of units allocated to the policy calculated at the prevailing bid price;
    (c) it has a guaranteed maturity value;
    (d) it is intended for short-term speculation purpose.

[Answer may be found in **4.2**]

3. Which one of the following funds comprises a higher proportion of equity and a lower proportion of fixed income instruments?

    (a) money market fund;
    (b) bond fund;
    (c) balanced fund;
    (d) growth fund.

[Answer may be found in **4.8**]

4. Which of the following is one of the disadvantages of an index fund?

    (a) higher risk;
    (b) higher management fee;
    (c) cannot outperform the market;
    (d) risk of company failure.

[Answer may be found in **4.8.2**]

Type "B" Questions

5. Which of the following are some of the flexibility features of investment-linked policies?

   (i) variation of premium
   (ii) variable death benefit
   (iii) flexible investment options
   (iv) flexible payment of premiums

   (a) (i) and (ii) only;
   (b) (iii) and (iv) only;
   (c) (i), (ii) and (iii) only;
   (d) all of the above.

[Answer may be found in **4.9**]

6. Which two of the following statements concerning the "cooling-off period" are true?

   (i) The period is for 14 days only.
   (ii) All Life Insurance members of the LIC subscribe to this initiative.
   (iii) If properly exercised, the policy is cancelled and premiums are returned.
   (iv) The period relates to the time during which the insurance company may cancel the policy.

   (a) (i) and (ii) only;
   (b) (i) and (iii) only;
   (c) (ii) and (iii) only;
   (d) (iii) and (iv) only.

[Answer may be found in **4.13.4**]

7. An insurance company typically provides which of the following two reports to each investment-linked policyholder annually:

   (i) policy statement
   (ii) death benefit report
   (iii) fund performance report
   (iv) top-up report

   (a) (i) and (ii) only;
   (b) (i) and (iii) only;
   (c) (ii) and (iii) only;
   (d) (iii) and (iv) only.

[Answer may be found in **4.16**]

8. The common unprofessional practices which are generally considered to be harmful to the life insurance business and must therefore be avoided include:

   (i) twisting
   (ii) misrepresentation
   (iii) rebating
   (iv) receiving commission

   (a) (i), (ii) and (iii) only;
   (b) (ii), (iii) and (iv) only;
   (c) (i), (ii) and (iv) only;
   (d) (i), (iii) and (iv) only.

[Answer may be found in **4.14**]

[*If still required, the answers may be found at the end of the Study Notes.*]

Chapter 5
REGULATORY FRAMEWORK IN HONG KONG

The **Insurance Companies Ordinance (Cap 41)** (ICO) prescribes, inter alia, the regulatory framework for insurers and insurance intermediaries in Hong Kong. The incumbent Commissioner of Insurance is customarily appointed as the Insurance Authority (IA) for the purposes of the ICO. The regulatory framework for insurance intermediaries is supported by a system of self-regulation by recognised trade bodies.

An insurance company intending to underwrite investment-linked long term insurance policies is required to be authorised by the IA under the ICO to carry on Class C of long term business. An insurance intermediary intending to sell investment-linked insurance policies should be duly authorised by the IA or registered with other self-regulatory bodies such as the Insurance Agents Registration Board set up by the Hong Kong Federation of Insurers, the Hong Kong Confederation of Insurance Brokers or the Professional Insurance Brokers Association as appropriate.

On the other hand, investment-linked long term insurance policies that are collective investment schemes are required by law to be authorised by the SFC before they can be offered to the public, unless exempted. However, it must be stressed that an SFC authorisation of an investment product does not imply an official recommendation of that product.

5.1 REGULATORY AUTHORITIES

5.1.1 Office of the Commissioner of Insurance

The Office of the Commissioner of Insurance ("OCI") was set up in June 1990 as the regulatory body for the administration of the ICO. The OCI is headed by the Commissioner of Insurance, who, as the IA, is responsible for the regulation of the insurance industry with a view to protecting the interests of existing or potential policyholders and the promotion of the general stability of the insurance industry. Unaffected by such statutory regulation, all legitimate daily operations of insurers, such as determination of the terms and conditions of insurance policies or of premium rates, are determined by market forces. What is more, the ethical and professional conducts of intermediaries are entrusted to the self-regulatory regime. The OCI is always working closely with the insurance industry to encourage the provision of better services to the insuring public and greater transparency in insurers' operations.

The duties and powers of the IA include:-

1. To authorise insurers to carry on insurance business in or from Hong Kong. The criteria for authorisation include strong financial position, proper management, viable business plan and physical presence in Hong Kong, etc.

2. To ensure the insurers conduct their business in a prudent manner so that their obligations under the insurance policies will be met. The regulation is done by way of examination of the annual audited financial statements and business returns filed by the insurers. The IA is also empowered under the ICO to intervene in the event that causes for concern are identified regarding an insurer.

3. To regulate insurance agent who is required to be properly appointed by an insurer and then registered with the Insurance Agents Registration Board; and insurance broker who may apply directly to IA to become a member of an approved body of insurance brokers.

4. To liaise with the insurance industry in promoting self-regulation by the industry. The IA would review the guidelines and regulations developed within the system regularly to ensure that they are keeping with market developments and provide adequate protection to the public.

5.1.2 Securities and Futures Commission

The Securities and Futures Commission (SFC) is an independent statutory body established by the then Securities and Futures Commission Ordinance (SFCO). The SFCO and nine other securities and futures related ordinances were consolidated into the ***Securities and Futures Ordinance (Cap 571)*** (SFO), which came into operation on 1 April 2003. The SFC continues to be responsible for regulating of the securities and futures industry and facilitating and encouraging the development of these markets. The regulated activities are:

Type 1: dealing in securities;
Type 2: dealing in futures contracts;
Type 3: leveraged foreign exchange trading;
Type 4: advising on securities;
Type 5: advising on futures contracts;
Type 6: advising on corporate finance;
Type 7: providing automated trading services;
Type 8: securities margin financing;
Type 9: asset management;
Type 10: providing credit rating services.

Insurance intermediaries engaging in promoting, offering or selling investment-linked insurance policies to the public are generally not, by virtue of such activities, required to be licensed under the SFO for the purpose of advising on securities or dealing in securities.

For the same reason, neither does an intermediary require a licence from the SFC for advising or making recommendations to policyholders concerning selection by them of the underlying funds of their investment-linked insurance policies.

Section **5.3.1** explains why an investment-linked insurance policy does not constitute a security for the purposes of the SFO.

Notwithstanding the above, if an insurance intermediary, in addition to the conduct of insurance business, engages in functions that are an integral part of a business of advising on, or dealing in, securities, he may be required to be licensed by the SFC as a consequence of the performance by him of those functions. In that event, he will fall within the regulatory regime created by the SFO and will be obliged to comply with all the relevant provisions of the SFO and such additional regulatory requirements as may be imposed on him by the SFC.

Furthermore, investment-linked long term insurance policies fall under the definition of collective investment scheme of the SFO and in certain aspects are subject to the regulation of the SFC (see section **5.3** for details). Therefore it is imperative for an insurance intermediary intending to sell investment-linked insurance policies to have a basic understanding of the regulatory framework of the SFC empowered by the SFO.

The major statutory regulatory objectives of the SFC are set out in the SFO. In carrying out its mission, the SFC would take into account of Hong Kong's continued success and development as an international financial centre. Its regulatory objectives include:-

- to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- to promote understanding by the public of the operation and functioning of the securities and futures industry;
- to provide protection for members of the public investing in or holding financial products;
- to minimise crime and misconduct in the securities and futures industry;
- to reduce systemic risks in the securities and futures industry; and
- to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

The SFC would set licensing standards to ensure that all practitioners are fit and proper. It is empowered to approve licences and maintain a public register of licensees. It develops codes and guidelines to inform the industry of its expected standard of conduct and then to monitor the licensees' financial soundness and compliance with Ordinance, codes, guidelines, rules and regulations. More importantly, the SFC may, upon receipt of complaints from investors against licensees, handle the misconduct complaints, investigate and then take action as it thinks fit.

5.2 INSURANCE LEGISLATION, CODES AND GUIDELINES

5.2.1 Insurance Companies Ordinance (ICO)

This area has been dealt with in some depth in the Study Notes for **"Principles and Practice of Insurance"** and we will not repeat the details here. However, by way of reminder, the following important regulatory aspects should be noted:

The purposes of the **ICO** are to:

1. regulate the carrying of insurance business;
2. regulate insurance intermediaries;
3. provide for the appointment of an Insurance Authority (IA);
4. confer powers of authorisation and intervention on the IA both in respect of insurers and insurance intermediaries;
5. require insurers and insurance intermediaries to furnish financial statements and other information to the IA; and
6. provide for matters incidental thereto or connected therewith.

It has certain strict requirements regarding insurance companies, which include reference to:

1. authorisation of insurers;
2. capital requirements;
3. solvency margin requirements;
4. "fit and proper" directors or controllers; and
5. "adequate" reinsurance.

These requirements are to ensure the economic and social viability of insurance companies, which in the broader sense must be related to customer service.

Under section 8 of the ICO, any company intending to carry on any class of insurance business in or from Hong Kong may apply to the Insurance Authority for authorisation. Section 8(2) provides that the IA shall not authorise a company if it appears that any person who is a director or controller of the company is not a fit and proper person to hold the position.

5.2.2 Code of Practice for the Administration of Insurance Agents

This Code is approved by the IA in accordance with the provisions of section 67 of the ICO and is referred to in Article 48 of the Amended Articles of Association of the Hong Kong Federation of Insurers. It is therefore of considerable legal and professional importance. There are 7 Parts to the Code which cover the following areas:

Part A: **Interpretation**

- Status
- Definitions
- Application of the **Ordinance**
- Conflict with the **Ordinance**

Part B: **General Principles**

- Functions of the IARB
- Guidance Notes
- Construction of this **Code** in both Official Languages

. **Part C:** **Rules**

Insurance Agents:

- Confirmation of the Appointment and Registration of Insurance Agents
- Registration of Insurance Agents: Individual Agent or Insurance Agency
- Cancellation of the Registration of Insurance Agents
- Notification to the Insurance Authority
- Representation of Principals by Insurance Agents
- Obligations of Principals in respect of Insurance Agents
- Termination of the Appointment of Insurance Agents
- Training of Insurance Agents

Responsible Officers and Technical Representatives:

- Confirmation of the Appointment and Registration of Responsible Officers and Technical Representatives
- Registration of Responsible Officers and Technical Representatives
- Cancellation of the Registration of Responsible Officers and Technical Representatives
- Notification to the Insurance Authority
- Representation of Insurance Agents by Responsible Officers and Technical Representatives
- Obligations of Insurance Agents in respect of their Responsible Officers and Technical Representatives
- Obligations of Responsible Officers
- Termination of the Appointment of Responsible Officers or Technical Representatives
- Training of Responsible Officers and Technical Representatives

Part D: **Procedures**

- The Register
- Application for the Confirmation of Appointment and Registration of Registered Persons
- Procedures for determining Fitness and Properness of Registered Persons and Complaints against Registered Persons
- Appeals
- Reports to the Insurance Authority

Part E: **Fit and Proper Criteria for Registered Persons**

- Matters Relevant to Fitness and Properness of Registered Persons
- Minimum Qualifications for Persons to be registered as Registered Persons
- Insurance Agent which is an Insurance Agency
- Additional Matters Relevant to Fitness and Properness of Responsible Officers and Technical Representatives

Part F: **Minimum Requirement of Model Agency Agreement**

Part G: **Conduct of Registered Persons**

- Conduct of Registered Persons for General Insurance Business and Restricted Scope Travel Business
- Conduct of Registered Persons for Long Term Insurance Business
- Registered Persons Not to act in connection with Insurance Brokers

The following two clauses are extracted from the Code as they are specifically relevant to investment-linked long term insurance policies, with unrelated parts being left out for the sake of simplicity. For full details, please refer to the Code.

Clause 63: Subject always that no Registered Person shall be engaged in a class of insurance business other than that his Principal or his appointing insurance agent is authorised to conduct, a Registered Person, unless exempted, is only eligible to be engaged in a Line of Insurance Business in respect of which he has passed the relevant Qualifying Examination paper(s). An individual must pass all three papers of "Principles and Practice of Insurance", "Long Term Insurance" and "Investment-linked Long Term Insurance" before he can be registered to be engaged in Long Term (including Linked Long Term) Business.

Clause 82: When selling policies related to Linked-long Term Business, a Registered Person shall:

- explain the long term nature of the policy and the consequences of early discontinuance and/or surrender;
- where a policy offers participation in profits, or is investment-linked, explain the specific difference between guaranteed and projected benefits;
- where projected benefits are illustrated, explain the assumptions on which the illustrations are based, including any future bonus or dividend declaration, and that projected benefits are not guaranteed;
- in the case of linked long term business, explain that unit value and the value of the policy holder's benefits may fluctuate;
- unless specifically authorised by a Principal or appointing insurance agent, use only such sales proposals and illustrative figures that are supplied by the Principal or appointing insurance agent and shall use the whole illustration in respect of the policy being discussed, and no other, and shall not add to it or select only the most favourable aspects of it; and
- if he is authorised by a Principal or appointing insurance agent to prepare certain illustrations himself, prepare them using only the assumptions authorised by the Principal or appointing insurance agent.

5.2.3 IARB Guidance Notes

It is of primary importance that an insurance agent conducts business at all times in good faith and with integrity. In order to clarify its intention to exercise its powers and fulfil its responsibilities under the **Code of Practice for the Administration of Insurance Agents** (please refer to **5.2.2 Part B** above), the IARB has issued the following Guidance Notes to help both insurers and insurance agents comply with the Code.

(a) Guidelines on Misconduct ('IARB – GN4')

In order to protect the insuring public against potential losses arising from misrepresentation or forgery, insurance agents must not request their prospective customers and/or clients to sign blank forms or sign any documents relating to the policy before they have been duly completed and any alteration should be initialled by the customer.

It is an insurance agent's duty to present each policy with complete honesty and objectivity. In the case where the client is already a policyholder, this means that full and fair disclosure of all facts regarding both the new coverage and the existing insurance is necessary. Policyholders should be made fully aware of the estimated cost of replacing an existing policy.

In selling a life insurance policy, insurance agents must duly complete the **Customer Protection Declaration** (CPD) form (please refer to section **4.13.5**) as prescribed by the HKFI from time to time and bring the contents to the attention of the customer. Principals must establish control procedures to monitor insurance agents' compliance with the Code.

(b) Guidelines on Handling of Premiums ('IARB – GN5')

Customers will want to pay their premiums in a variety of ways, including cash, credit card, cheque and bank transfer. It is up to the Principal to decide which methods are acceptable, but the following methods are recommended:

1. cheque in favour of the Principal; or
2. credit card/direct deposit/bank transfer from the customer's account to the Principal.

Any other method of payment or credit facilities extended to an insurance agent should be subject to clear rules set out by the Principal designed to avoid the mixing of customers' money with insurance agents' personal funds.

(c) Guidelines on the Effective Date of Registration of Insurance Agents, Responsible Officers and Technical Representatives ('IARB – GN6')

In order to ensure that no prospective or current insurance agents, their Responsible Officers or Technical Representatives, shall hold themselves out as engaging in the insurance agency business relating to a Principal before the IARB confirms their relevant registrations, a separate set of Guidance Notes was issued by the IARB.

A prospective or current insurance agent must take note that it may be an offence under section 77 of the ICO to hold him/herself out as an insurance agent of a Principal before he/she is registered by the IARB. Therefore, no person shall act or hold him/herself out as an insurance agent for and on behalf of any prospective Principal before the date specified by the IARB in the **Notice of Confirmation of Registration**. Any breach may render the person liable to criminal prosecution for an offence under section 77 of the ICO.

A prospective or current Responsible Officer or Technical Representative of an insurance agent should also take note that it may be a breach of the Code to hold him/herself out as the Responsible Officer or Technical Representative of such before he/she is registered by the IARB. Therefore, no person shall be a Responsible Officer or Technical Representative of any prospective insurance agent before the date specified by the IARB in the **Notice of Confirmation of Registration**. Any breach may affect the fitness and properness of the Responsible Officer, Technical Representative or insurance agent concerned.

5.2.4 "Minimum Requirements" Specified for Insurance Brokers

These "**minimum requirements**" are specified under Part X of the ICO, which brought into the regulatory regime a framework for the supervision of the self-regulation by the insurance industry of insurance brokers.

It is worth repeating at this stage the statutory definition of an insurance broker:

"a person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policyholder or potential policyholder or advising on matters related to insurance."

Persons falling within this definition must either:

1. obtain authorisation from the **IA**; or
2. become a member of **a body of insurance brokers** approved by the IA.

Minimum Requirements specified by the IA

Under section 69 and 70 of the ICO, the IA has the power to authorise an insurance broker, or approve a body of insurance brokers. Before such authorisation or approval is granted, there are certain requirements to be satisfied under **five** headings as follows:

1. qualifications and experience;
2. capital and net assets;
3. professional indemnity insurance;
4. keeping of separate client accounts; and
5. keeping of proper books and accounts.

Besides the above requirements, an applicant **insurance broker** must be fit and proper to be an insurance broker, while the **applicant body** of insurance brokers must have rules and regulations sufficient to ensure that its constituent members are fit and proper to be insurance brokers.

Note: 1. The IA publishes Guidelines to assist compliance with the requirements of the ICO. Failure to comply with these guidelines could result in a person or body of insurance brokers not being authorised/approved or having his/its authorisation/approval withdrawn.

2. Investment-linked long term insurance policies that fall within "Collective Investment Schemes" as defined in the **Securities and Futures Ordinance (SFO)** are required by the SFO to be authorised by the SFC before they can be offered to the public in Hong Kong.

5.2.5 Relevant Codes and Guidelines by the Self-Regulatory Bodies

(a) Hong Kong Federation of Insurers

An objective of the Hong Kong Federation of Insurers (HKFI) is to ensure that "membership of the HKFI shall be recognised as a guarantee of integrity, competence and a high standard of service".

For the purposes of promoting a self-regulatory system, the HKFI has issued the **Code of Conduct for Insurers** (the Code) for compliance by all General Insurance Members and Life Insurance Members of the HKFI. Applicable to insurances effected in Hong Kong by individual policyholders resident in Hong Kong and insured in their private capacity only, the Code consists of seven parts respectively headed as follows:

1. Introduction;
2. Advising and Selling Practices;
3. Claims;
4. Management of Insurance Agents (please refer to the **Code of Practice for the Administration of Insurance Agents** in section **5.2.2** above);
5. Management of Staff;
6. Misconduct by Insurers; and
7. Inquiries, Complaints and Disputes.

(b) Hong Kong Confederation of Insurance Brokers (CIB)

The CIB has issued a set of **Membership Regulations,** which require its members (Members) to comply with the regulations and any code of conduct the CIB promulgates from time to time.

The CIB's **Code of Conduct** serves as a guide to the Members with an objective to assist and establish a recognised standard of professional conduct. It sets out the following principles for observance by the Members:

1. The Members shall at all times conduct their business with utmost good faith and integrity.
2. The Members shall do everything possible to satisfy the insurance requirements of their clients and shall place the interests of those clients before all other considerations. Subject to these requirements and interests, the Members shall have proper regard for others.
3. Statements made by or on behalf of the Members when advertising shall not be misleading or extravagant.

The CIB has also issued a number of Guidance Notes to clarify its intention in implementing its self-regulatory regime of insurance brokers. With regard to the insurance broking business involving investment-linked long term policies, the CIB has prescribed the ***"Regulations for Insurance Brokers Engaged in Advising on Linked Long Term Insurance or Arranging or Negotiating Policies of Linked Long Term Insurance"*** (ILAS Regulations). Applicable to all the CIB members and their registrants in their carrying on of investment-linked long term insurance business, the ILAS Regulations comprise six parts and can be found in **Appendix H** in full version.

The ILAS Regulations set out specific requirements regarding internal supervision and control, information for clients, "know your client" (their identity, needs and requirements, profile and appetite, etc.) and due skill, care and diligence. As part of the "due skill, care and diligence" requirement, CIB Members should issue a Risk Disclosure Statement for and together with each recommendation for ILAS insurance whether the application is for a new policy or a top-up to an existing policy, and suggest the client to seek independent advice on the risks disclosed. As a minimum, the Risk Disclosure Statement should draw the client's attention to the following risks:

1. **Credit Risk**: in the event that the insurer or any of the fund managers of the underlying fund(s) of the policy becomes insolvent, the client may lose the capital invested.

2. **Exchange Risk**: where the policy is denominated in a foreign currency, the client will risk losing the capital through a depreciation of that currency. Also where an underlying fund of the policy is denominated in a currency other than that of the policy, there will be a similar risk.

3. **Interest Rate Risk**: where premium payments are funded by a premium finance loan, leverage or gearing, or where the policy is used as collateral, then a lower net rate of return of the policy than the rate of the finance charges may mean a financial loss to the client not limited to the value of the capital.

4. **Liquidity Risk and Reinvestment Rate Risk**: an early surrender or withdrawal of the policy may result in a significant capital loss due to the relevant charges to be imposed. Suspension of or reduction in premiums may also result in a capital loss, because all fees and charges will still be deducted at full rates from the policy value during the period of suspension or reduction. If fund switching or policy surrender or withdrawal is attempted at a time when an investment is being suspended or subject to a prolonged turnaround time to trade, this may be held up or delayed.

5. **Market Risk**: there exists a risk of capital loss due to poor performance of the underlying funds. Past performance is no guarantee of future results.

Linked to the "know your client" requirement which is contained in the ILAS Regulations is a CIB guidance note named '**Guidance Note on Conducting "Know Your Client" Procedures for Long Term Insurance Business (Including Linked Long Term Insurance)**' (CIB-GN(4)) (see **Appendix I**), and revised in response to the OCI's GN15. The major contents of CIB-GN(4) are as follows:

1. Record-keeping and Verification

   - CIB Members should keep such documentary records as are sufficient to demonstrate satisfactory compliance with the procedures of client identification, needs analysis and, if applicable, risk profile.
   - They are encouraged to use their own forms for the purposes of product recommendations.

- The records should be kept up to date using appropriate procedures.

2. Identification

- Examples of personal particulars of clients that should be recorded and verified are given in CIB-GN(4).

- Where a client is seeking insurance in the capacity of a trustee, the procedures of client identification, needs analysis and, if applicable, risk profile should be conducted on the prospective beneficial owner of the policy.

- The OCI's GN3 (see section **5.4.1**) should be followed in obtaining and verifying the particulars of corporate clients.

3. Needs Analysis

- In assessing clients' needs, CIB Members should have understanding of such circumstances of the clients as include: their existing and potential financial commitments, their income streams, and their various financial needs and priorities.

- CIB Members should ensure that the financial information of the client to be collected would enable them to assess and to advise the client on his capability to commit to any new or additional long term insurance policy.

- CIB Members should specifically ask for the details of the client's long term insurance policies that have not matured, have not lapsed or have not been surrendered.

4. Risk Profile

- CIB Members and/or their registrants should ascertain a client's risk profile before giving him advice on the underlying funds or assets of a linked long term insurance policy. However, CIB-GN(4) does not require such a procedure where the client is not going to consider any linked long term insurance, or where the client has concluded a written understanding with the Members that neither the Members nor their registrants are required to advise on any underlying funds or assets of a linked long term insurance policy, without affecting the HKFI's Enhanced Requirements of completing insurers' RPQ.

- A client's risk profile would usually include his investment objectives, investment knowledge and experience, preferred investment horizon, risk attitude and appetite, and risk tolerance or capacity. CIB Members should use risk profile questionnaires to understand and record clients' risk profiles, and update the records whenever appropriate.

- When a risk profile procedure reveals a mismatch between the risk level of a client's fund portfolio and his risk profile, CIB Members should warn him of the mismatch.

In particular, the ILAS Regulations require all CIB members to enter into a written client agreement with each client before carrying on investment-linked long term insurance business with that client. In this regard, the CIB issued the "**Guidance Note on Client Agreement for Linked Long Term Insurance Business**" (CIB-GN(9)) setting out the minimum contents of the Client Agreement (see **Appendix J**).

In response to the OCI's GN15, the CIB introduced a "**Guidance Note on Product Recommendation for Long Term Insurance Business (Including Linked Long Term Insurance)**" (CIB-GN(12)) (see **Appendix K**) to provide its members with guidelines on long term insurance product recommendations, which should be read in conjunction with CIB-GN(4). CIB-GN(12) is not applicable to General Insurance Business or indemnity-type medical insurance wrapped under long term insurance policy. Its main contents are as follows:

1. Assessment

    - No products of long term insurance (including linked long term insurance) should be recommended without the "Know Your Client" procedures having been duly conducted and the information collected properly assessed.

    - The assessment of needs should refer to such relevant information as has been disclosed in the "Know Your Client" procedures.

    - If a client is covered by an existing long term insurance policy that is in force, paid-up, suspended, under premium holiday, or under an arrangement of reduced contribution, CIB Members should give him an advice on an appropriate option under such a policy that will satisfy the identified insurance needs, prior to making an advice on a new or additional long term insurance policy.

    - In conducting the assessment, CIB Members should verify all available information and satisfy themselves that the client is financially capable of committing to options under an existing policy or to a new or additional policy.

    - The assessment should be repeated when CIB Members have been informed of changes in the client's circumstances.

2. Product Selection

    - CIB Members should put in place procedures for selecting from the market options that will satisfy clients' needs and financial circumstances, and should endeavour to reduce the risk of recommending products that will not meet their needs. Whenever an ILAS policy is recommended to a client, CIB Members should at the same time recommend a Class A product to him as one of the options, subject to two exceptions that are prescribed in the Guidance Note.

- An ILAS policy should only be recommended to clients who are willing to bear the investment risk. CIB Members should explain to such clients why the ILAS policy is more suitable than the non-ILAS option, and the basis of each recommendation.

- CIB Members are reminded that in accordance with CIB Membership Regulation 14.5, it is only when there are no suitable products offered by authorised insurers in Hong Kong or it is explicitly required by clients, that CIB Members may arrange insurance products of providers not authorised in Hong Kong.

3. Recommendation in Writing

- CIB Members should present in writing their recommendations and the bases thereof to the client, who should be asked to confirm his decisions in writing. A copy of the confirmation should be provided to the client for retention.

- In the recommendation of a regular premium policy, CIB Members should include: the ratio of the regular premiums to the client's disposable income (to be calculated in accordance with the Guidance Note), the financial commitment of the client (including the premiums for any riders) and whether the premium payment term goes beyond the client's target retirement age (and in this case the client's intended source of fund).

- Before proceeding to arrange a regular premium policy, CIB Members should obtain a declaration by the client that he is comfortable with the said ratio, consents to the financial commitment, and where applicable, confirms his ability to pay premiums beyond his target retirement age. In the case of an ILAS policy, the client should also declare that he is comfortable with the fees, charges and investment risks.

- In the recommendation of a single premium policy, CIB Members should include the premium/liquid asset ratio and the lock-up period (i.e. the period when any charge or fee will be applicable to total or partial withdrawal or surrender of policy).

- Before proceeding to arrange a single premium policy, CIB Members should obtain a declaration by the client that he is comfortable with the ratio and the lock-up period, and in the case of an ILAS policy, also with the fees, charges and investment risks.

- Where an insurance product of a provider not authorised in Hong Kong is included in the recommendation, CIB Members should explain the reasons for that.

- No policy illustration other than the policy illustration documents prepared and provided by insurers is allowed.

(c) Professional Insurance Brokers Association (PIBA)

PIBA has issued a set of Membership Regulations, covering the following topics:

1. Membership;

1A. Nominated Accounts;

2. Eligibility of Membership;
3. Code of Conduct;

3A. Remuneration Disclosure;

4. Monitoring Compliance;
5. Misconduct;
6. Power of the Membership Sub-Committee; and
7. Disciplinary Matters.

Furthermore, PIBA has prescribed the "***Code of Conduct for Insurance Brokers Conducting Investment Linked Business***" (the ILAS Code) which applies to all PIBA members who are engaged in investment linked assurance scheme (ILAS) business, and their Chief Executives and Technical Representatives. The ILAS Code, comprising 13 sections and 2 appendices, can be found in **Appendix L**.

The ILAS Code sets out specific requirements regarding registration, management and internal controls, fair treatment of clients, "know your clients" procedure, information for clients, appropriateness of advice, ILAS product replacement, investment within ILAS portfolio bond products, keeping of records, and client complaint handling and dispute resolution, and anti-money laundering and counter-terrorist financing. In particular, the ILAS Code requires all PIBA members to enter into a written agreement with client before services are provided. The client agreement should at least cover the contents stipulated in the "Minimum Content of Client Agreement" (Appendix 1 to the ILAS Code) as well as risk disclosure statements as specified in Appendix 2 to the ILAS Code (additional risk disclosure being allowed), which are summarised below:

1. **Counterparty Risk**: those with whom the client has entered into a financial contract may fail to fulfil their obligations under the contract.

2. **Credit Risk**: any policy issuer may default on payments, which risk is directly proportional to the repayment term.

3. **Currency Risk**: proceeds from policies denominated in a foreign currency are subject to exchange rate risks.

4. **Early Termination, Surrender and/or Withdrawal Risk**: if the client terminates or surrenders the policy or reduces the premium payments within a prescribed period before the expiry of the premium payment period stated in the policy, he will incur a surrender or withdrawal charge and/or may even lose his entitlement to bonuses.

5. **Fund Manager Risk**: The fund manager of a fund chosen by the client may fail to deliver the performance originally expected by the client.

6. **Liquidity Risk**: the client may fail to trade an investment or convert it into cash in a short period of time.

7. **Political/Regulatory Risk**: the client's investment may suffer losses as a result of changes in a related country's political or regulatory stability, structure or policies.

8. **Premium Holiday Risk**: if the client ceases premium payments temporarily by virtue of a policy provision of "premium holiday", he should take note that all relevant fees and charges will continue to be deducted from the policy value during the premium holiday, so that the policy value may be significantly reduced and his entitlement to bonuses affected. At a point when the policy value is too low to cover the fees and charges, the policy may lapse.

9. **Reinvestment Risk**: where proceeds or interests from an investment are to be reinvested, that may have to be done at a lower rate, particularly during a period of falling interest rates.

10. **Risk of Failure to Diversify**: with over concentration in a single investment, an investment portfolio can be expected to experience increased volatility. Failure to diversify may also increase the risk to which the portfolio is exposed. Therefore it is crucial to minimise the overall risk of the portfolio through proper diversification.

11. **Risk of Fund Prices Fluctuation**: funds' prices fluctuate, sometimes dramatically, even down to zero value.

12. **Transactions in Other Jurisdictions**: investing in a market in a jurisdiction other than Hong Kong carries the risk that the regulation there offers different or diminished investor protection.

In response to the issuance of GN15 by the OCI, PIBA issued a "**Guidance Note on Conducting Investment Linked Business**" (PIBA-GN1) (please see **Appendix M**) to set out standards of conduct and business practice in conducting ILAS business in a similar fashion to GN15. With its main contents grouped under the following headings, PIBA-GN1 should be read in conjunction with the ILAS Code and GN15:

1. Product meets the "fair treatment of customers" principle

   - PIBA Members should ensure that the ILAS product recommended to a client should meet the "fair treatment of customers" principle.

2. Provision of adequate and clear information

   - PIBA Members should provide customers with clear information before, during and after the point of sale.
   - Projections in relation to growth scenarios should not be overly optimistic.

3. Suitability assessment

   - ILAS products should only be sold to clients with both investment and insurance needs.

- PIBA Members should endeavour to reduce the risk of selling products that will not meet the client's needs.

- PIBA Members should seek appropriate information from clients for assessing their insurance needs, before giving advice or concluding a contract, which should at least include: their financial knowledge and experience; their needs, priorities and circumstances; their ability to afford the products; and their risk profiles.

- Clients' needs must first be properly assessed through the use of Financial Needs Analysis form.

- Clients should be presented with available options that will meet their specific needs and financial circumstances.

- Suitability assessment includes assessment of the investment horizon, with due regard to the financial circumstances, planned retirement age, etc.

- Suitability assessment should be done whenever there are changes to the client's circumstances.

- PIBA Members should verify all available information and assess whether a particular ILAS product is suitable for the client.

4. Advice to client

   - When a client is beginning to consider an ILAS policy after considering the insurance options, he should be informed of all the product features, particularly the fees and charges, the surrender penalties, as well as the product and investment risks.

   - When a client has decided to buy an ILAS policy, he should be fully informed of the key product features again, and his rights and obligations. He should duly sign the Important Facts Statement (IFS) / Applicant's Declaration (AD).

   - PIBA Members should put in place a mechanism to ensure full understanding of the above by the client, as evidenced by the IFS/AD.

5. Post-sale control

   - PIBA Members should establish and implement policies and procedure on fair treatment of customers, with proper control systems.

   - PIBA Members should follow the proper sales process as set out in the flowchart appended to the Guidance Note.

5.2.6 Guidance Note on the Use of Internet for Insurance Activities (GN8)

In appreciation of the role of the Internet as the prime driver of contemporary electronic commerce, the insurance industry is increasingly engaging the Internet as an alternative medium for conducting business, particularly in marketing of insurance products and servicing of clients. To provide the insurance industry with guidelines on the use of the Internet to conduct insurance activities, the OCI has published a ***Guidance Note on the Use of Internet for Insurance Activities***. It aims at better protecting the insuring public and ensuring the healthy development of the insurance industry in the new information technology era. The majority of the content appears under the following respective headings:

1. Interpretation;
2. Identity of Service Providers;
3. Authorisation Status;
4. Security;
5. Privacy of Client Information;
6. Form of Communication;
7. Sale of Insurance Products; and
8. Use of Third Party Websites.

5.2.7 Guidance Note on Underwriting Class C Business (GN15)

This Guidance Note (see **Appendix N**) was issued by the OCI pursuant to the ICO and the Insurance Core Principles, Standards, Guidance and Assessment Methodology promulgated by the International Association of Insurance Supervisors. GN15 aims to set out proper standards of conduct and business practices for authorised insurers underwriting Class C business. Where appropriate, this Guidance Note should be read in conjunction with other relevant codes/circulars/guidance notes issued by the IA or other regulatory bodies. The major areas covered by GN15 are:

- Product design;
- Provision of adequate and clear information;
- Suitability assessment;
- Advice to clients;
- Appropriate remuneration structure;
- Avoidance of conflict of interests;
- Clients' investments and assets; and
- Post-sale control.

Insurers should follow the formulation stipulated by the OCI pursuant to clause 10.2 of GN 15, which sets out (a) a clear and uniform methodology to calculate the remuneration provided to intermediaries for the sale of individual ILAS products; and (b) a clear and uniform format in the disclosure of such remuneration to clients procuring ILAS products. The objective of such remuneration disclosure is to enhance the transparency of ILAS products and allow clients to consider whether there exists any potential conflicts of interests and whether the remuneration would affect the intermediaries' recommending the ILAS product concerned. The remuneration figure disclosed must be realistic and meaningful to the client and the disclosure format must be simple and understandable by an average client.

5.3 SECURITIES LEGISLATION AND CODE OF CONDUCT

5.3.1 Securities and Futures Ordinance

The Securities and Futures Ordinance ***(Cap 571)*** (SFO) consolidates and modernises the 10 previous Ordinances that regulate the securities and futures markets in Hong Kong. The purposes of the SFO are to:

1. consolidate and amend the law relating to financial products, the securities and futures market and the securities and futures industry;
2. regulate activities and other matters connected with financial products, the securities and futures market and the securities and futures industry;
3. provide for the protection of investors and other matters incidental thereto or connected therewith, and for connected purposes.

Section 4 of the Ordinance elaborates the regulatory objectives of the SFC which have been set out in section **5.1.2** above.

The SFO regulates not only various activities concerning securities but also that of collective investment schemes. It is therefore important to learn whether investment-linked insurance policies fall into the definition of securities or collective investment schemes.

(a) Collective Investment Scheme (CIS)

The scope of CIS includes unit trusts and mutual fund corporations as previously defined in the repealed Securities Ordinance **(Cap 333)**. The detailed definition of CIS can now be found in Part 1 of Schedule 1 of the SFO. Generally, all CISs share the following common features:

- The participating persons of the CIS do not have day-to-day control over the management of the property;
- The property of the CIS is managed as a whole by or on behalf of the person operating the arrangements;
- The contributions of the participating persons and the profits or income from which payments are made to them are pooled.

Investment-linked insurance policies (see section **1.1**) fall within the definition of the term “collective investment scheme”, made in Part 1 of Schedule 1 of the SFO.

(b) Securities

Securities are defined in Part 1 of Schedule 1 of the SFO. Interests in collective investment schemes fall within paragraph (d) of the definition of securities. However, subparagraph (ii)(C) of the definition explicitly excludes a contract of insurance in relation to any class of insurance business specified in the First Schedule to the Insurance Companies Ordinance.

5.3.2 Licensing and Registration Requirements

General Requirements

Section 114(1) makes it an offence to carry on a business in regulated activities without being properly licensed or registered, a breach of which carries a maximum fine of HKD5,000,000 (plus a further fine in the case of a continuing offence) and a maximum term of imprisonment of 7 years.

Sections 116, 119, and 120 stipulate the licensing and registration requirement as a licensed corporation, registered institution, and licensed representative for carrying on regulated activities.

5.3.3 Other Relevant Codes Issued by the Securities and Futures Commission

Investment-linked policies are usually sold through insurance brokers/agents. As such, insurance intermediaries are encouraged to study and acquire knowledge of the ***Code on Unit Trusts and Mutual Funds***, which provides guidelines for authorisation of collective investment schemes in the likes of mutual fund corporations and unit trusts, and the ***Code on Investment-linked Assurance Scheme (the ILAS Code)***, which provides guidelines for authorisation of investment-linked assurance schemes. Some of the relevant issues have been discussed in section **3.7**. The ILAS Code specifically requires that an up-to-date offering document (including the principal brochure, illustration document, and **product key facts statement** (KFS)) be issued to prospective scheme participants to enable them to make an informed judgement of the proposed investment (see section **4.13.2 (b) and (c)** for details).

5.3.4 Offers of Investments

Part IV of the SFO regulates the offers of investment which includes, among others, authorisation of collective investment schemes (“CIS”) (section 104); authorisation of advertisement, invitations or document containing an invitation to invest (section 105); and criminal and civil liability for making misrepresentation in inducing others to invest (sections 107 and 108).

(a) Authorisation of Collective Investment Scheme & Advertisement

Section 103(1) makes it an offence to issue any advertisement, invitation, or documents, which to his knowledge is or contains an invitation to the public to acquire an interest in a collective investment scheme, unless authorised by the SFC, or exempted. A breach of this provision carries a maximum fine of HKD500,000 (plus a further fine in the case of a continuing offence) and a maximum term of imprisonment of 3 years. Therefore insurance intermediaries must not make use of documentation which has not been authorised by the SFC in the selling of investment-linked policies.

Section 104 empowers the SFC to authorise collective investment schemes. By virtue of section 104(1), the authorisation may be granted subject to such conditions as the SFC considers appropriate.

Section 105(1) empowers the SFC to authorise any advertisement, invitation or document and to impose any other conditions as it considers appropriate.

(b) Misrepresentation

A fraudulent misrepresentation is defined in Section 107 of the SFO as any statement when it is made, is to the knowledge of its maker false, misleading or deceptive. Reckless misrepresentation is defined in the same section as any statement which, at the time when it is made, is false, misleading or deceptive and is made recklessly. It is important to note that a misrepresentation may include promise, forecast or even omission as the case may be.

Section 107(1) of the SFO stipulates that a person commits an offence if he makes any fraudulent misrepresentation or reckless misrepresentation for the purpose of inducing another person:-

(a) to enter into or offer to enter into:–

  (i) an agreement to acquire, dispose of, subscribe for or underwrite securities; or

  (ii) a regulated investment agreement; or

(b) to acquire an interest in or participate in, or offer to acquire an interest in or participate in, a collective investment scheme.

It is worth noting that it is not an element of this offence that the accused has gained through such conduct or the other person has actually made an investment. A breach of this provision carries a maximum fine of HKD1,000,000 and a maximum term of imprisonment of 7 years.

Finally, section 108 of the SFO imposes civil liability for making fraudulent misrepresentation, reckless misrepresentation or negligent misrepresentation by which another person is induced:

(a) to enter into or offer to enter into

  (i) an agreement to acquire, dispose of, subscribe for or underwrite securities; or

  (ii) a regulated investment agreement; or

(b) to acquire an interest in or participate in, or offer to acquire an interest in or participate in, a collective investment scheme.

Negligent misrepresentation is defined in Section 108 of the SFO as any statement which is false, misleading or deceptive at the time when it is made and is made without reasonable care to ensure its accuracy. The wrongdoer may have to pay compensation by way of damages for any pecuniary loss sustained by the other party.

5.3.5 Market Misconduct

Various activities in relation to securities are prescribed as market misconducts which may lead to civil liability under Part XIII of the SFO. They include insider dealing, false trading, price rigging, stock market manipulation, disclosure of information about prohibited transactions and disclosure of false or misleading information that is likely to induce investment decisions or have a material price effect.

5.3.6 CIS Internet Guidance Notes

In April 2013, the SFC issued an updated **"Guidance Note for Persons Advertising or Offering Collective Investment Schemes (CIS) on the Internet"** (or CIS Internet Guidance Note). This clarifies the regulatory requirements concerning CIS activities on the Internet and should be read in conjunction with the "**Guidance Note on Internet Regulation**" issued in March 1999, and the OCI's ***"Guidance Note on the Use of Internet for Insurance Activities"*** (please refer to section **5.2.6**) published in January 2001.

The **CIS Internet Guidance Note** consists of eight parts headed as follows:

1. Introduction;
2. Scope of CIS Internet Guidance Note;
3. General Regulatory Approach;
4. Advertisements on the Internet;
5. Offering of CIS on the Internet;
6. Provision of Analytical Tools;
7. Communication with CIS investors via Electronic Means; and
8. Regulatory Development.

5.4 OTHER RELEVANT LEGISLATION

5.4.1 Prevention of Money Laundering and Terrorist Financing

Hong Kong is a member of the Financial Action Task Force on Money Laundering, an international organisation committed to combating money laundering ("ML") and terrorist financing ("TF"). The four main pieces of legislation in Hong Kong that are concerned with money laundering or terrorist financing are the **Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ("AMLO"), the Drug Trafficking (Recovery of Proceeds) Ordinance ("DTROP"), the Organised and Serious Crimes Ordinance ("OSCO") and the United Nations (Anti-Terrorism Measures) Ordinance ("UNATMO").** It is very important that financial institutions (FIs) and their officers and staff fully understand their respective responsibilities under the different legislation. (The term **"financial institution"** is defined in the AMLO to include: an authorised insurer, an appointed insurance agent and an authorised insurance broker.)

The OCI has issued a Guideline (GN3) on Anti-Money Laundering and Counter-Terrorist Financing ("Guideline") to give guidance on the subjects to authorised insurers, reinsurers, appointed insurance agents and authorised insurance brokers carrying on or advising on long term business. Published under section 7 of the AMLO and section 4A of the ICO and intended for use by FIs and their officers and staff, the Guideline provides guidance which is no different from those provided by other regulatory authorities (RAs) under their respective regulatory regimes.

(a) Money Laundering and Insurance

(i) Most common form of ML:

1. by way of proposals for single premium contracts in respect of investment bonds, purchased annuities, life insurances or personal pensions;
2. return premiums; and

3. overpayment of premiums.

(ii) Stages of ML: there are three common stages which should alert insurance institutions to potential criminal activities:

1. Placement: the physical disposal of cash proceeds derived from illegal activities;
2. Layering: separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the source, subvert the audit trail and provide anonymity; and
3. 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.

(b) Policies and Procedures to Combat Money Laundering and Terrorist Financing

One of the purposes of the Guideline is to 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 anti-money laundering and counter-terrorist financing statutory and regulatory requirements. Apart from the relevant legislation, FIs should study and acquire thorough knowledge of the Guideline.

The 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.

A failure by any person to comply with any provision of the 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.

In addition, a failure to comply with any provision of this Guideline by insurance intermediaries ("IIs") may reflect adversely on the fitness and properness of their directors and controllers, and may result in a disciplinary action being taken against the non-complying IIs.

(i) AML/CFT Systems

According to the Guideline, 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 ("AML/CFT systems").

The Guideline specifies various factors that FIs should take into consideration when setting up an AML/CFT system. The controls to be put in place should cover: senior management oversight; appointment of a Compliance Officer and a Money Laundering Reporting Officer; compliance and audit function; and staff screening and training.

(ii) Group AML/CFT Policy for Business Conducted Outside Hong Kong

The Guideline sets out guidance for circumstances where an FI conducts business outside Hong Kong. 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 the FI in a place outside Hong Kong have procedures in place to comply with the customer due diligence ("CDD") (see (iv) below) 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.

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.

Suspicion that any property in whole or in part directly or indirectly represents any person's 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 **Joint Financial Intelligence Unit** ("JFIU") may be required in such circumstances, but only if section 25A of OSCO/DTROP applies.

(iii) Risk-based Approach ("RBA")

The Guideline requires FIs to, in determining the extent of CDD measures and ongoing monitoring required, take a risk-based approach. 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.

(iv) Customer Due Diligence ("CDD")

The AMLO defines what CDD measures are and prescribes the circumstances in which an FI should carry out CDD. As indicated in the AMLO, FIs may also need to conduct additional measures or could conduct simplified CDD depending on specific circumstances. The Guideline sets out the expectations of the RAs in this regard and suggests ways 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.

(v) Ongoing Monitoring

The Guideline stresses that effective ongoing monitoring in an FI is vital for understanding of customers' activities and is an integral part of an effective AML/CFT system. Effective ongoing monitoring helps FIs know their customers and detect unusual or suspicious activities. The Guideline gives guidance on how to achieve effective ongoing monitoring.

(vi) Financial Sanctions

The United Nations Sanctions Ordinance ("UNSO") gives the Chief Executive the authority to make regulations to implement sanctions decided by the Security Council of the United Nations ("UNSC") and to specify or designate relevant persons and entities. 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. The RAs circulate to all FIs designations published in the government Gazette under the UNSO.

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 the 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.

The Chief Executive can, in response to an application from an FI, license exceptions to the prohibitions on making funds and economic resources available to a designated party under the UNSO.

(vii) Terrorist Financing and Proliferation Financing

The Guideline summarises the laws concerning counter-terrorist financing. To fulfil Hong Kong's obligations under the relevant international laws, the UNATMO was enacted, which gives the Secretary for Security ('S for S') powers to freeze suspected terrorist property and to 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.

It is an offence under the UNATMO 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 the 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. The S for S can, in response to an application from an FI, license 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.

Where a person is designated by a Committee of the UNSC as a terrorist and his details are subsequently published in a notice under section 4 of the UNATMO in the Government gazette, the RAs will circulate the designations to all FIs.

It is an offence under section 4 of the **Weapons of Mass Destruction (Control of Provision of Services) Ordinance** ('WMD(CPS)O'), for a person to provide any services where he believes or suspects, on reasonable grounds, that those services may be connected to WMD proliferation.

FIs may draw reference from a number of sources including relevant designation by overseas authorities. The RAs may draw FIs' attention to such designations from time to time. FIs should therefore ensure that they have an appropriate system to conduct checks against the relevant list for screening purposes and that this list is up-to-date.

(viii) Database Maintenance and Screening (Customers and Payments)

The Guideline reminds FIs to take measures to ensure compliance with the relevant regulations and legislation on TF. 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 TF. The systems and mechanisms for identification of suspicious transactions should cover TF as well as ML.

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 have access to such a database maintained by third party service providers.

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 purposes of identifying suspicious transactions.

Comprehensive ongoing screening of an FI's complete customer base is a fundamental internal control to prevent TF and sanction violations, and should be achieved in specified manners.

FIs should have some means of screening payment instructions to ensure that proposed payments to designated parties are not made, and be particularly alert to suspicious wire transfers.

Enhanced checks should be conducted before establishing a business relationship or processing a transaction, where possible, if there are circumstances giving rise to suspicion.

In order to demonstrate compliance with the above requirements for screening of customer bases, screening of payment instructions, and enhanced checks, the screening and any results should be documented, or recorded electronically.

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.

(ix) Suspicious Transaction Reports

Once knowledge or suspicion of ML/TF or terrorist property has been formed, FIs should apply the following general principles laid down in the Guideline:

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;

b. disclosures must be made as soon as is reasonably practical after the suspicion was first identified; and

c. FIs should ensure that they put in place internal controls and systems to prevent any directors, officers and employees committing the offence of tipping off customers 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.

The Guideline suggests an effective way of recognising unusual and suspicious activities, i.e. by 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.

FIs are required to ensure sufficient guidance is given to their staff (including appointed insurance agents in this context) to enable them to form suspicion or to recognise when ML/TF is taking place, and to identify and assess the information that is relevant for judging whether a transaction or instruction is suspicious in the circumstances.

Where an FI has formed a suspicion that particular transactions relate to ML/TF, it should take into account the risk of tipping off when performing the CDD process. It should ensure that their employees are aware of and sensitive to this issue when conducting CDD.

Furthermore, the Guideline gives guidance on timing and manner of suspicious transaction reports, internal reporting system, recording of internal reports and reports to the JFIU, and post reporting matters. A list of indicators of suspicious transactions and examples of ML schemes are appended to the Guideline for reference purposes.

(x) Record-keeping

The Guideline stresses the importance of record-keeping to compliance with general legal and regulatory requirements. It gives guidance on retention of records relating to customer identity and transactions, and control of intermediaries' record-keeping.

In relation to record-keeping obligations by individual insurance agents, the Guideline points out that individual insurance agents who are appointed agents of an 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 an RA.

(xi) Staff Training

According to the Guideline, the staff (including appointed insurance agents in this context) of any FI 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. FIs should implement a clear and well-articulated policy for ensuring that relevant staff receive adequate AML/CFT training. 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. Training should be provided so frequently as is sufficient to maintain the AML/CFT knowledge and competence of the staff.

Apart from what staff should be made to know, the Guideline also provides guidance on the training techniques and tools that may be used. In addition, adequate records of training should be kept and the effectiveness of the training monitored.

(xii) Wire Transfers

The Guideline provides guidance on wire transfers, which primarily applies to authorised institutions and money service operators. Other FIs should also comply with section 12 of Schedule 2 and the guidance on wire transfers if they act as an ordering institution or beneficiary institution as defined under the AMLO.

5.4.2 Personal Data (Privacy) Ordinance (PDPO)

The PDPO was enacted to protect the privacy of individuals in relation to personal data. For the purposes of the PDPO, an office has been established by the name of the Privacy Commissioner for Personal Data. A very important function of the Commissioner is to monitor and supervise compliance with the PDPO.

Personal data includes any data relating directly or indirectly to a living individual; from which it is practicable for the identity of the individual to be directly or indirectly ascertained; and in a form in which access to or processing of the data is practicable.

The PDPO provisions that data users should comply with are numerous, including the following six data protection principles, which are set out in Schedule 1 to the PDPO:

<u>Principle 1: purpose and manner of collection of personal data</u>
Personal data should not be collected unless: (i) the data are collected for a lawful purpose directly related to a function or activity of the data user who is to use the data; (ii) the collection of the data is necessary for or directly related to that purpose, and (iii) the data are adequate but not excessive in relation to that purpose. The data should be collected by lawful and fair means.

The data subject should be informed of: (i) the purpose for which the data are to be used; (ii) the classes of persons to whom the data may be transferred; and (iii) his/her rights to access and to request the correction of the data.

<u>Principle 2: accuracy and duration of retention of personal data</u>
The personal data should be accurate, up-to-date and kept no longer than is necessary. In particular, if a data user engages a data processor, whether within or outside Hong Kong, to process personal data on the data user's behalf, the data user should adopt contractual or other means to prevent any personal data that has been transferred to the data processor from being kept longer than is necessary for processing of the data. The term 'data processor' means "a person who (a) processes personal data on behalf of another person, and (b) does not process the data for any of the person's own purposes".

<u>Principle 3: use of personal data</u>
Personal data shall not, without the prescribed consent of the data subject, be used for a new purpose (i.e. any purpose other than (i) the purpose for which the data was to be used at the time of the collection of the data; or (ii) a purpose directly related to that purpose.

Principle 4: security of personal data

All practicable steps should be taken to ensure that personal data (including data in a form in which access to or processing of the data is not practicable) held by a data user and the data processor engaged by the data user are protected against unauthorised or accidental access, processing, erasure or other use.

Principle 5: information to be generally available

All practicable steps shall be taken to ensure that a person can: (i) ascertain a data user's policies and practices in relation to personal data; (ii) be informed of the kind of personal data held by a data user; and (iii) be informed of the main purposes for which personal data held by a data user are or are to be used.

Principle 6: access to personal data

A data subject shall be entitled to: (i) ascertain whether a data user holds personal data of which he/she is the data subject; (ii) request access to personal data within a reasonable time at a fee (if any) that is not excessive, in a reasonable manner and in a form that is intelligible; (iii) request correction of personal data; and (iv)be given reasons if a request referred to above is refused.

Apart from the PDPO, insurance practitioners are advised to read the guidance notes and information leaflets issued by the relevant regulatory bodies for practical guidance on collection and use of personal data, including the “Guidance on the Proper Handling of Customers’ Personal Data for the Insurance Industry” issued by the Office of the Privacy Commissioner for Personal Data.

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Representative Examination Questions

Type "A" Questions

1. Which of the following is not one of the purposes of the ***Insurance Companies Ordinance***?

   (a) to regulate the carrying of insurance business;
   (b) to provide for the appointment of an Insurance Authority (IA);
   (c) to establish a regulatory control framework for the policy wordings of investment-linked insurance policies;
   (d) to require insurers and insurance intermediaries to furnish financial statements and other information to the IA.

[Answer may be found in **5.2.1**]

2. To promote an unauthorised fund is a breach of the SFO and will be subject to:

   (a) a fine of up to HKD500,000 and imprisonment for up to 3 years;
   (b) a fine of up to HKD1,000,000 and imprisonment for up to 7 years;
   (c) imprisonment for up to 10 years;
   (d) reprimand by the SFC.

[Answer may be found in **5.3.4**]

Type "B" Questions

3. Some of the purposes of the ***Securities and Futures Ordinance*** are to:

   (i) consolidate and amend the law relating to financial products, the securities and futures market and the securities and futures industry
   (ii) regulate activities and other matters connected with financial products, the securities and futures market and the securities and futures industry
   (iii) provide for the protection of investors
   (iv) provide for other matters incidental thereto or connected therewith, and for connected purposes

   (a) (i), and (ii) only;
   (b) (ii) and (iii) only;
   (c) (ii), (iii) and (iv) only;
   (d) all of the above.

[Answer may be found in **5.3.1**]

4. Which of the following are some of the matters that the IARB will take into account in considering whether a person is fit and proper to be licensed as a technical representative?

    (i) financial status
    (ii) relevant educational or other qualifications
    (iii) relevant criminal conviction or professional misconduct
    (iv) breach of HKFI rules

    (a) (i), and (ii) only;
    (b) (ii) and (iii) only;
    (c) (ii), (iii) and (iv) only;
    (d) all of the above.

[Answer may be found in **5.2.3**]

[*If still required, the answers may be found at the end of the Study Notes.*]

Appendix A

Compound Interest Rate and Yield

Time value of money is the concept that the purchasing power of money in the future (future value) is worth more than that same amount today (present value) due to an assumed interest earning growth or implied inflation expectation.

Present value (PV) = the value of money today
Future value (FV) = the value of the same amount of money compounded at a given rate in the future

Example:

If a group of assets is valued at HKD100 today. It is assumed that this value will grow at a rate of 8% per year for two years. The future value or the value of the same HKD100 in two years would be as follows:

Year 1 HKD100 x 1.08 = HKD108
Year 2 HKD108 x 1.08 = HKD116.64

Or you can calculate it as HKD100 x 1.08^2

The concept of time value of money incorporates the concept of the compound rate of interest. Compounding is the ability of an asset (in above case the HKD100) to generate interest that is then added to previous principal plus interest (HKD108).

The formal formula is: $PV (1 + r)^n = FV$

PV = Present Value
r = the interest rate per period
n = the number of compounding periods
FV = Future Value

In the example at section **4.6.7**, we assumed a policyholder has 3,780.75 units. The unit bid price is HKD12.

In 10 years time, HKD12 will be HKD25.91 assuming a growth rate of 8%.

It is calculated as HKD12 x $(1.08)^{10}$ = HKD25.91

Thus, in 10 years time, the value of the units will be 3,780.75 x HKD25.91 = HKD97,959.23. The return on gross premium using the same HKD50,000 single premium as per the previous example will be calculated as follows:

HKD50,000$(1 + r)^{10}$ = HKD97,959.23

Let r be the rate of return on gross premium per annum.

HKD50,000 x $(1 + r)^{10}$	= HKD97,959.23
$(1+r)^{10}$	= HKD97,959.23/HKD50,000
	= 1.9592
$(1+r)$	= $1.9592^{1/10}$
	= 1.0696
r	= 1.0696-1
	= 0.0696
	= 6.96%

Updated Requirements Relating to the Sale of Investment Linked Assurance Scheme to Enhance Customer Protection

(for implementation not later than 1 January 2016)

(Source: HKFI)

Subject: Updated Requirements Relating to the Sale of Investment Linked Assurance Scheme ("ILAS") to Enhance Customer Protection

1 Background

This Circular supersedes the note issued on 25 January 2011 and the circulars issued on 22 April 2013 and 8 December 2014 respectively pertaining to the Sale of Investment Linked Assurance Scheme ("ILAS") issued by the Life Insurance Council of the Hong Kong Federation of Insurers ("HKFI"). The Insurance Authority considers it necessary for these requirements to be enhanced to protect further ILAS customers.

2 Purpose

The purpose of these updated requirements ("Requirements") is summarised below:

i. To ensure that the suitability assessment of prospective ILAS customers has been carried out before recommendation of an ILAS product;

ii. To ensure that the product features, charges and fees, the product and investment risk have been clearly explained to the prospective customer before fulfilment;

iii. To ensure that all necessary product and marketing documents have been provided to the prospective customer before fulfilment; and

iv. To ensure that the sales process for the purchase of an ILAS product has been done in the correct order, with an FNA and RPQ at the heart of the process.

3 Effective date

Member Companies which sell ILAS products are required to implement the Requirements as soon as practicable and in any event **no later than 1 January 2016**.

4 Requirements

4.1 Proper Sales Process

The intermediary must follow the proper ILAS sales process. This ensures that the key steps have been carried out to ensure the Customer Suitability Assessment, including the completion of the Financial Needs Analysis and Risk Profile Questionnaire - as set out in 4.2 and 4.3 respectively below - of the prospective ILAS customer is conducted before the recommendation of any ILAS product. The recommended ILAS sales process has been set out in Appendix A (Investment-Linked Assurance Scheme ("ILAS") Product Sales Flow (New Application)). The intermediary must also strictly follow the proper sales process as set out in 12.2 and Appendix of the Guidance Note on Underwriting Class C Business (GN15), particularly in relation to the comparison of different insurance options.

4.2 Financial Needs Analysis

Every application for an ILAS product must be accompanied by a financial needs analysis ("FNA") form. The FNA must include all the questions and multiple choice options in the suggested FNA form as set out in Appendix B. Member Companies may modify the FNA to include additional questions and/or multiple choice options as set out in Appendix B.

Neither Member Companies nor customers can opt out of the FNA. If a customer, for privacy or other reasons, chooses not to disclose income/asset information under 4(a) or (b) (but not both) of the FNA form, he/she must confirm their reason(s) in writing. This notwithstanding, if the absence of information under either 4(a) or (b) of the FNA form would render Member Companies or the intermediaries unable to comply with any of the requirements (e.g. assessing affordability of products recommended or comparison of different insurance options etc) under this (or any other) circular, Member Companies must reject the relevant application and should advise the customer accordingly.

The FNA may be either presented as a separate form, or included as a section within another point-of-sale document such as the application form; but whichever option is adopted, the FNA must be clearly identified as a "Financial Needs Analysis" or an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by the customer (s). For detailed requirements regarding FNA, please refer to the HKFI Circular "Initiative on Financial Needs Analysis".

4.3 Risk Profile Questionnaire

Every application for an ILAS product must include, or be accompanied by a Risk Profile Questionnaire ("RPQ"). The purpose of the RPQ is to assess a customer's investment risk appetite and determine if a particular product and its underlying investment choices (if any) are suitable. The form of the RPQ should include, as a minimum, questions covering the following areas:

1) investment objectives;
2) preferred investment horizon;
3) risk tolerance; and
4) financial circumstances.

However, there is no need to duplicate FNA questions in the RPQ. Member Companies must also exercise extra care when selling ILAS products to "Vulnerable Customers" i.e. the elderly or unsophisticated customers or those who may not be able to make independent investment decisions on complex investment products; particularly ILAS products with long maturity periods or which attract heavy penalties on early redemption or withdrawal.

Customers are not allowed to opt out or deviate in any respect from the RPQ process. Insurers are required not to accept the application if a customer chooses to opt out or deviate from the RPQ process.

Every application for an ILAS product must include the RPQ, which may be either presented as a separate form, or included as a section within another point-of-sale document such as the application form; but whichever option is adopted the RPQ must be clearly identified as a "Risk Profile Questionnaire" or an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by the customer(s).

For the avoidance of doubt, FNA and RPQ are not required if they have been performed within one year (both for new application or top-up), provided that there are no substantial changes in the customers' circumstances (and in such cases Member Companies can rely on the written declaration by the customers) and that there are no mismatch (i.e. needs, risks, affordability etc) identified. For the purposes of this Circular, top-up includes increase in investment (single or regular premium). RPQ is not required for top-up that includes increase in premiums for addition or variation of non-ILAS riders (e.g. term, critical illness, accidental death benefits etc).

4.4 Important Facts Statement and Applicant's Declaration

Every application (new or top-up) for an ILAS product must include, or be accompanied by, an Important Facts Statement ("IFS") in the templates shown in Appendices C1 and C2. It should be noted that the Applicant(s) Declaration which was previously contained in the Application Form should now be located in this document. There are no changes to the

Applicant Declaration and where different versions were provided for agency and broker, this practice remains unchanged.

The "General Principles" in structuring the IFS are as follows:

- The general principle is that the template should be adopted in terms of structure, groupings and signatures but companies have the latitude to amend wordings to reflect accurately their specific products and its features;
- The IFS is a document required by the Insurance Authority ("IA") for all ILAS sales and will be subject to their audit. It is not a marketing document and does not therefore require the approval of the Securities and Futures Commission ("SFC");
- The intent of the IFS charges disclosure is to simply yet comprehensively demonstrate to the customer the combined impact of all fees and charges which may be incurred;
- We expect insurers to respect the principles, intention and spirit of the IFS and being accountable for any major deviations. It is not planned that the IFS will require pre-authorisation by the IA but it will be subject to its audit at a later date;
- The whole content of the IFS has to be placed in a very distinct manner and at the forefront of the AD/IFS.
- The "Statement of Purpose" must remain free format and must be filled in by customers in their own handwriting; pre-set options will not be acceptable in any circumstances.
- Insurers have the duty to ensure that information contained in the IFS accurately reflects the information of the ILAS product in question.
- The HKMA may direct its members (banks) for its specific, additional requirements in relation to the IFS.
- For the avoidance of doubt, the IFS must be obtained for products that are open for top-up. All items must be filled except Para. 2 (Cooling-off period) and (for some very old products without principal brochure and/or key facts statements) Para. 4 (Long-term features) of the IFS.

IFS Versions

- Fundamentally, there are two versions of the IFS to reflect the complexity of the Fees & Charges of the specific product being sold;
- These versions are referred to as "Simple" and "Complex". It is the Member Company's responsibility to match the more appropriate IFS with its associated information, i.e. details of the fees and charges, to the ILAS product being sold;
- For ILAS products with "complex" charging structure, it is recognized that these may be tenure-specific and that a table highlighting all charges could be applied. Where an "all encompassing" table is applied showing all tenure specific charges, the intermediary would be required to highlight the specific charge in the table that applies to that tenure; alternatively, delete the ones that do not apply;
- The IFS will also be channel specific to reflect the specific requirements/modifications required by each channel, i.e. agency, banks and brokers.

Provision of signed IFS to policyholder

- Member Companies are required to provide policyholder with a copy of the signed IFS together with the policy.

Remuneration Disclosure Statement

- The IFS contains a statement (at paragraph 9 of Part I) that discloses the average remuneration payable to the intermediary, and advises the potential policyholder to consult the intermediary if more detail is required. Insurers must disclose the remuneration using "all-year-average" based on the calculation methodology and disclosure format set out in the "Intermediaries' Remuneration Disclosure – Guide on Calculation Methodology and Disclosure Format" issued by the IA. Insurers may decide how the details are to be provided upon further enquiry from the customers, but Member Companies and their agents should bear in mind the following principles when deciding on how to formulate their approach:
  - disclosure must be made and should not be refused;
  - the disclosure amount and / or methodology should be accurate, and not misleading to consumers;
  - it must be presented in a format that is clear and easy to understand;
  - a common approach should be taken for all products and customer groups; and
  - failure to apply a fair and consistent methodology could result in the fit and proper status of an authorised individual being called into question.

Completing the IFS

The rules for the completion of the IFS are as follows:

1) The applicant(s) must complete the IFS. They cannot opt-out of this requirement.

2) The applicant(s) must sign the declaration in "Section I: Disclosure Declaration" to confirm that they understand and accept the highlighted features of the product as well as to confirm that they have received a copy of the HKFI's Education Pamphlet entitled "Questions you need to ask before taking out an ILAS product".

   a) If the product has any unusual features or risks such as (without limitation to) market value adjustment, foreign exchange risk, leverage, investment choices based on hedge funds, extensive use of derivatives other than for risk management purposes, or is for the purpose of the Capital Investment Entrant Scheme ("CIES"), then the intermediary must explain these to the full satisfaction and understanding of the applicant(s) prior to signing. All applicant(s) must sign and date at the bottom of "Section I: Disclosure Declaration".

3) The applicant(s) must then tick one of either box A or B in "Section III: Suitability Declaration".
   a) Box A should be ticked where the intermediary and the applicant(s) agree that the product is suitable for the applicant(s), based on the information provided by the applicant(s) as part of the FNA and RPQ.

   b) Box B should be ticked by the applicant(s) in situations where it is assessed that the product may not be suitable for the applicant(s) based on the information disclosed in the FNA and RPQ. In addition, whenever box B is ticked, the applicant(s) must in their own handwriting provide sufficient explanation as to why they have decided to proceed with the application, notwithstanding that the product may not be suitable.

c) All applicant(s) must sign and date at the bottom of "Section III: Suitability Declaration".

Every application for an ILAS must include the IFS, which may be either presented as a separate form, or included as a section within another point-of-sale document such as the application form; but whichever option is adopted the IFS must be clearly identified as an "Important Facts Statement" or an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by the applicant(s).

4.5 Suitability Check

Member Companies must establish operational controls to ensure that the FNA, RPQ and IFS are duly completed.

Member Companies must also establish a process to (i) verify whether the ILAS product sold, and key features such as the premium amount and term are considered suitable and affordable for the customer(s) based on the information disclosed by the customer(s), (ii) verify whether intermediaries have taken due account of the reasons/considerations set out by the customer in the "Statement of Purpose" paragraph of the IFS, together with other relevant information, in assessing whether a particular ILAS product is suitable for the customer(s), and (iii) deal appropriately with any exceptions as per section 4.6 below.

Special consideration is required where business is introduced by an insurance broker. It is important that in performing the Suitability Check and dealing with any exceptions as per Section 4.6 below, the customer(s) fully understand that the Insurance Company is not responsible for the advice given by the insurance broker. To facilitate this differentiation, a specific set of Important Facts Statement must be prepared for this purpose and must be used for business introduced from this type of intermediary. For the avoidance of doubt, however, Member Companies must still follow the requirement under 7.8 of the GN15 during the underwriting process for business introduced by insurance brokers, and follow up with the insurance broker concerned in case of mismatch.

4.6 Post-sale Controls

The Hong Kong Monetary Authority ("HKMA") has requested banks to make audio recordings of the ILAS sale. The Life Insurance Council of the HKFI considered that applying this recording requirement to other channels, such as agents and brokers, may not be practical "in the field". However, Member Companies can apply audio recordings in lieu of the Post Sale Call Requirement provided these are conducted in the Company's premises and that the appropriate protocols and processes are observed – See "Option B" later.

In view of protecting ILAS customers, Member Companies must implement the following controls for non-bancassurance ILAS sale (either in accordance with Option A or B below). Where additional control measures have been set up by Member Companies for "Vulnerable Customers", the script should be suitably modified to reflect those measures. In determining who is a "Vulnerable Customer" to whom an appropriate Post-sale Call must be made, account must be taken of the following matters, including but not limited to:

- Age: a customer over 65 is a Vulnerable Customer;

- Level of education: a person whose education level is "primary level" or below is a Vulnerable Customer; and
- Financial means: a person who has "limited means" or no regular source of income or both is a Vulnerable Customer.

Option A: Post-sale Controls

1) Copies of the Product Key Facts Statement for the relevant ILAS product and the signed Important Facts Statement and Applicant's Declaration must be sent to the customer with the policy.

2) A notice (i) informing the customer that copies of the customer's FNA and RPQ are available for inspection and (ii) advising where and how the customer may access these documents must be sent with the policy to the customer. This applies to all customers irrespective of which box (A or B) is ticked in Section III of the Important Facts Statement.

3) Not later than the 5th working day after the issue date of relevant ILAS policy, Member Companies must make reasonable efforts to complete and make audio recording of telephone calls with all customers to confirm their consent to both the suitability assessment as set out in Section 4.2 & 4.3 and Important Facts Statement and Applicant's Declaration.

4) To ensure compliance with the Post-sale Call requirements, Member Companies must follow an approved script. The HKFI issued a minimum set of questions which is required to be included in this script. (See Appendix D) Nonetheless, Member Companies are entitled to develop their own version provided it includes at least those questions in Appendix D.

5) To guide the necessary actions in dealing with various situations or scenarios during the course of Post-sale Call conducted by the Member Companies, a flow chart "Flow chart - ILAS Post-Sale Call" has been issued by the HKFI (See Appendix E).

6) In case of any uncertain replies by the customers during the Post-sale call, the Member Company must ask the relevant intermediary to follow up with the concerned customer in such circumstances. The Member Company must conduct follow-up calls within the next 5 working days to clear the uncertain areas. In case the customer could not be reached or the follow-up call could not be completed properly, the Member Company must send a notification letter to the customer (alongside an email/SMS alert) citing the key areas of concern. Such letter should also set out the means for the customer to contact the Member Company for any disagreement on the points set out. The sample notification letter is provided in Appendix F1. For easy reading, the font size must be at least 12.

7) In case the customer could not be reached or the follow-up call could not be completed properly, the Member Company must send a notification letter (alongside an email/SMS alert) to the customer in which the key areas are drawn to their attention. Such letter should also set out the means for the customer to contact the Member Company for any disagreement on the points set out. The sample notification letter is provided in Appendix F2.

8) At the end of each Post-sale Call (including initial and any follow-up calls), the Member Company should advise the customer about the expiry date of the cooling-off period.

9) As per the guidelines of Privacy Commissioner, the recordings of calls should be kept during the period in which the concerned person is a policyholder and for a period of 7 years from the date on which the policy expires or terminates. In the event that the policy is not proceeded with, such recordings of calls should be kept for a period of 2 years before being erased.

Option B: Point-of-sale Audio Recording

Member Companies are allowed to adopt Point-of-sale Audio Recording ("PSAR") in lieu of Post-sale Call at their discretion for any cases of ILAS applications provided that the following requirements are met:

1) The PSAR must be conducted in the office of the Member Company;

2) An employee of the insurer must attend, manage and witness the whole PSAR process. Such employee should have no conflict of interest with the sales of the relevant ILAS policy, e.g. they will not earn, receive or be rewarded with any compensation directly due to the sale of the relevant ILAS policy

3) Either of the following approaches can be adopted for the PSAR:

<u>Approach 1: To be conducted by employee on site</u>
Once the ILAS sales process has been completed and all necessary forms, documents, application have been completed and signed by the applicant, the employee will activate an audio recording device to conduct the PSAR in accordance with the prescribed PSAR script – See Appendix G.

<u>Approach 2: To be conducted by call centre employee</u>

If the ILAS sale at the Member Company's offices but no audio recording devices are available, on the completion of the ILAS sales process all fulfilment documents will be passed to the Insurer's call centre staff who will call the applicant and conduct the PSAR script (see Appendix G) over the telephone. The whole discussion will be recorded.

4) The questions to be asked must follow the Point-of-sale Audio Recording Script issued by the HKFI (See Appendix G)

5) As per the guidelines of Privacy Commissioner, the recordings of calls for policies which **<u>have been successfully</u>** issued should be kept during the period in which the concerned person is a policyholder and for a period of 7 years from the date on which the policy expires or terminates. In the event that the concerned policy **<u>is not taken up</u>**, such recordings should be kept for a period of 2 years before being erased.

After proper completion of the Point-of-Sale Audio Recording, the Member Company is not required to conduct the Post-sale Call to the relevant applicant.

4.7 Certification of Copies of FNA and RPQ

Instead of receiving the original signed copies of FNA and RPQ, Member Companies are permitted to accept copies of the above documents provided they are appropriately certified for business introduced by banks and insurance brokers. In respect of business introduced by banks, the copies should be certified by the relevant bank branch manager and bear the bank's chop. For business introduced by insurance brokers, the copies should be certified by the Responsible Officer designated by the authorized representative of the insurance broker.

N.B. As the IFS is product related, the original signed document must be returned and retained by the Member Company. In no circumstances would a certified copy from an intermediary be acceptable.

5 Compliance with the GN15

Insurers are reminded to comply with the requirements of the GN15. Under no circumstances should insurers enter into arrangements with the intention to circumvent any of the requirements contained therein (e.g. using side agreement to pay indemnity commission in the form of loan or advance).

6 Updated ILAS Education Pamphlet entitled "Questions you need to ask before taking out an ILAS product"

In the interests of improving customer education, the HKFI has published an education pamphlet entitled "Questions you need to ask before taking out an ILAS product" in January 2011. This pamphlet is available from the HKFI's website at www.hkfi.org.hk. This pamphlet must be distributed to potential policyholders of ILAS products at the point-of-sale in accordance with section 4.1 above. It should be noted that this document is in the process of being updated to reflect changes arising from this Circular.

7 Summary

Member Companies must maintain robust internal procedures to ensure they strictly comply with this Circular. Member Companies (and their management, directors and controllers) who deliberately breach any aspect of the Circular may no longer satisfy the "fit and proper" requirement under the Insurance Companies Ordinance and may be liable to regulatory action.

APPENDIX A: (Investment-Linked Assurance Scheme ("ILAS") Product Sales Flow (New Application)

Investment-Linked Assurance Scheme ("ILAS") Product Sales Flow (New Application)

Step 1：Customer Suitability Assessment

↓

Assist the potential customer to complete:
1. Financial Needs Analysis
2. Risk Profile Questionnaire

↓

Step 2：Only in cases where the analysis result indicates that the potential customer has both insurance and investment needs, and that he/she is willing to bear the investment risks and make the market decision, and his/her personal and financial circumstances may be suitable for investing ILAS product(s), can the insurance intermediary propose to the potential customer to consider suitable ILAS product(s)

↓

Provide the potential customer with the *HKFI Education Pamphlet entitled "Questions you need to ask before taking out an ILAS product"*

↓

Recommend the potential customer to consider the suitable ILAS product and provide him/her with the following documents. Insurance intermediary must explain the product features and its potential risks to the potential customer. The documents must include:
1) Product Brochure
2) Product Key Facts Statement
3) Investment Choice Brochure
4) Illustration Document
If the potential customer is not interested in the recommended product, insurance intermediary may recommend potential customer to consider other suitable product

↓

Step 3：If the potential customer requests to make an application, the insurance intermediary should handle the application process.

↓

3.1 Distribute the *Illustration Document*: Explain the contents of the *Illustration Document* before assisting the potential customer to fill in the *Application Form*

↓

3.2 Explain to and assist the potential customer to complete the *Important Facts Statement and Applicant's Declaration*

↓

3.3 Assist the potential customer to complete the *application documents* as required by the insurer, including *Application Form* for relevant ILAS product and other documents deemed necessary.

After explaining the contents and relevant provisions, the potential customer must sign the *application documents* as evidence of acknowledgement.

↓

Step 4: The intermediary to inform the potential customer that there will be a post-sales call to be conducted by staff of the insurer. The objective of this call is to protect the interest of the potential customer.

↓

Attention：The above sales flow is not exhaustive and it only sets out the key steps regarding ILAS sales. For details, please refer to the latest circulars issued by HKFI, relevant regulators and the insurer. Please take note that HKFI may issue other regulatory guidance from time to time in the future. The intermediary must also strictly follow the proper sales process as set out in 12.2 and Appendix of the Guidance Note on Underwriting Class C Business (GN15), particularly the comparison of different insurance options.

APPENDIX B: Financial Needs Analysis ("FNA") Form

Please refer to the Appendix of the HKFI Circular "Initiative on Financial Needs Analysis" for the latest version of the FNA Form.

APPENDIX C1: Important Facts Statement and the Applicant's Declarations (Complex charge structure version for upfront and surrender charges - for business introduced by insurance agents)

IMPORTANT FACTS STATEMENT AND APPLICANT'S DECLARATIONS
INVESTMENT-LINKED ASSURANCE SCHEME ("ILAS") POLICY

[Name of insurer]
Name of the ILAS Policy:

PART I – IMPORTANT FACTS STATEMENT

You should carefully consider the information in this statement and the product documents (including the Principal Brochure, Product Key Facts Statement, and the Illustration Document). **If you do not understand any of the following paragraphs or do not agree to that particular paragraph or what your intermediary has told you is different from what you have read in this statement, please do not sign the confirmation and do not purchase the ILAS policy.**

You may request the Chinese version of this statement from your intermediary. 閣下可向銷售的中介人索取中文版本。

SOME IMPORTANT FACTS YOU SHOULD KNOW
(1) **Statement of Purpose:** Please set out in your own handwriting your reasons/considerations for procuring this ILAS policy. The intermediary is required to take due account of the reasons/considerations set out by you, together with other relevant information, in assessing whether a particular ILAS policy is suitable for you. ______________________________ ______________________________
(2) **Cooling-off period: You have the right to cancel this ILAS policy** and get back your original investments (subject to market value adjustment) within the cooling-off period, which is 21 days after the delivery of the policy or issue of a notice to you or your representative, whichever is the earlier. For details of how you can exercise this right, please refer to the application form.
(3) **No ownership of assets and no guarantee for investment returns: You do not have any rights to or ownership over any of the underlying/reference investment assets** of this ILAS policy. Your recourse is against *[pre-printed name of the insurer]* only. You are subject to the credit risk of *[pre-printed name of the insurer]*. Investment returns are not guaranteed. *I confirm that I have read and understood and agree to be bound by paragraphs (1), (2), and (3) above.* ____________ Applicant's Name   ____________ Applicant's Signature   ____________ Date

(4) **Long-term features (delete wherever inapplicable):**

(a) **Upfront charges:** An upfront charge will be deducted upfront from the premiums you pay as charges and will not be available for investment. **This means that the remaining amount of premiums available for investment will be lower than your premiums paid.** The upfront charge is calculated as follows:

Upfront Charge = Premiums received X Upfront Charge %

Policy year	Upfront charge %	% of premium received available for investment after upfront charge
1	A%	(100 – A)%
2	B%	(100 – B)%
3	C%	(100 – C)%
4	D%	(100 – D)%
5...	…..	…..

(b) **Early surrender / withdrawal charges:** You will be subject to an **early surrender or withdrawal charge** and **possible loss of entitlement to bonuses**, if policy termination or surrender, partial withdrawal, or suspension of or reduction in premium payment occurs within a prescribed period before the end of the policy term. The Early Termination Charge is calculated as follows:

Early Termination Charge = Account Value withdrawn/surrendered/lapsed X Early Termination Charge %

Policy year	Early Termination Charge %
1	A%
2	B%
3	C%
4	D%
5…	…..

(c) **Loyalty bonuses:** You will be entitled to a loyalty or special bonus if you meet certain conditions. For details, please refer to the product documents of this ILAS policy.

(5) **Fees and charges:** **Some fees/charges will be deducted** from the premiums you pay and/or your ILAS policy value, and will reduce the amount available for investment. Accordingly, **the return on your ILAS policy as a whole may considerably be lower than the return of the underlying/reference funds you selected.** For details, please refer to the product documents of this ILAS policy.

I confirm that I have read and understood and agree to be bound by paragraphs (4) and (5) above. I understand and accept all the fees and charges, including the upfront charges and early surrender/withdrawal charges.

Applicant's Name	Applicant's Signature	Date

(6) **<u>Switching of Investment:</u>** If you switch your investment choices, you may be subject to a charge and your risk may be increased or decreased.

(7) **<u>Premium holiday:</u>** Please check with your intermediary and the product documents whether and under what specific conditions a premium holiday (during which premium payment is suspended) may be taken. If your ILAS policy allows a premium holiday, you should note that:

(a) Premium holiday means that you may temporarily suspend your regular premium payments. It **does not mean that you are only required to make premium contribution during the initial contribution period**.

(b) As all relevant fees and charges will continue to be deducted from your ILAS policy value during the premium holiday, **the value of your ILAS policy may be significantly reduced**.

(8) **<u>Risk of early termination:</u> Your ILAS policy may be automatically early terminated and you could lose all your premiums paid and benefits accrued** if any condition of automatic early termination is triggered. This may happen if you fail to make premium contribution (for regular premium payment), or if your policy has very low or negative value (e.g. poor investment performance, exercise of premium holiday), etc.

(9) **<u>Intermediaries' Remuneration:</u> If you take up this ILAS policy, the (agent/broker firm/bank) will on average receive remuneration of $x.x per $100 of the premium that you pay.**

The remuneration is an average figure calculated on the assumption that you will pay all the premiums throughout the entire premium payment period. It covers all payments to the (agent/broker firm/bank) directly attributable to the sale of this policy (including upfront and future commissions, bonuses and other incentives).

[Note: Only print the relevant sections below]

[For remuneration structure where payments are made over a number of years and not at a flat rate] The amount of remuneration actually receivable by the (agent/broker firm/bank) may vary from year to year and is higher in the first policy year/early policy years.

[For remuneration structure which involves non-monetary benefits] Certain benefits that are immaterial, not directly attributable to the sale of this policy and not readily convertible to cash are not included from the calculation.

[For whole-life premium payment policies] As this policy involves whole-life premium payment, a 30-year period has been adopted for calculating both the total premiums and the total remuneration.

[For policies sold through bank] In this statement, "bank" refers to a licensed bank, restricted licence bank or deposit-taking company.

Please consult your (agent/broker/bank) if you wish to know more about the remuneration that he/she/they may receive in respect of this policy.

I confirm that I have read and understood and agree to be bound by paragraphs (6), (7), (8) and (9) above.

Applicant's Name	Applicant's Signature	Date

PART II – APPLICANT'S DECLARATIONS

Section I: Disclosure Declaration

- I confirm that the insurance intermediary, (insert name and registration number of the relevant insurance agent), has conducted a Financial Needs Analysis and Risk Profiling for me.
- I have received, read and understood the following documents:
  - Principal Brochure
  - Product Key Facts Statement
  - Illustration Document
  - Pamphlet "Questions you need to ask before taking out an ILAS product"
  - # Investment Choice Brochure
  - # [Other documents provided]
- # I fully understand and accept the potential loss associated with any market value adjustment, where the insurer has the right and absolute discretion under certain situations (e.g. early policy surrender) to apply a downward / negative market value adjustment to the ILAS policy.
- # I confirm that this application is for the purpose of the Capital Investment Entrant Scheme.

Applicant's Name	Applicant's Signature	Date

 # Section II: Affordability Declaration (For regular premium payment)

- I anticipate that my disposable income and/or savings is/are sufficient to pay the regular premium payments for the entire payment term of the ILAS policy; and
- I confirm that I am willing to pay the premiums for the entire payment term of the ILAS policy.

Applicant's Name	Applicant's Signature	Date

 # delete as appropriate

Section III: Suitability Declaration

I understand and agree that (tick one only):

A ☐ the features and risk level of the ILAS policy and my selected mix of underlying investment choices are suitable for me based on my disclosed current needs and risk profile as indicated in the Financial Needs Analysis and Risk Profile Questionnaire.

OR

B ☐ despite the fact that the features and/or risk level of the ILAS policy and/or my selected mix of underlying investment choices may not be suitable for me based on my disclosed current needs & risk profile as indicated in the Financial Needs Analysis and Risk Profile Questionnaire, I confirm that it is my intention and desire to proceed with my application(s) as explained below:

*(If Box B is ticked, Applicant must complete explanation in **own** handwriting in this box.)*

I acknowledge I should not purchase this ILAS policy and/or the selected mix of underlying investment choices unless I understand these and their suitability has been explained to me and that the final decision is mine.

Applicant's Name	Applicant's Signature	Date

Notes:

1. In this Statement & Declaration, the singular shall include the plural; the word "I" shall include "we"; & the word "my" shall include "our". For joint applicants, all applicants must sign all sections.

2. You are required to inform your insurance agent or us (the insurance company) if there is any substantial change of information provided in these Declarations before the policy is issued.

附件C1

重要資料聲明書及投保人聲明書
投資相連壽險計劃（投連壽險）保單

[承保人／公司]
投連壽險保單名稱:

第一部 :重要資料聲明書

閣下應細閱本聲明書及產品文件（包括主要推銷刊物、產品資料概要及退保說明文件）。**若閣下不明白、不同意以下聲明的任何一段、或此聲明內容與中介人的講述有異，請勿簽署確認或投購此投連壽險保單。**

閣下可向銷售的中介人索取英文版本。You may request the English version of this statement from your intermediary.

此乃重要資料　閣下必須細閱
(1) **目標概要**：請閣下以手寫列出投購此投連壽險保單的原因／考慮因素。中介人必須就閣下列明的原因及考慮因素，以及相關資料，一併評估此投連壽險保單是否適合閣下。 ____ ____ (2) **冷靜期：閣下有權在「冷靜期」內取消此投連壽險保單，**並取回已繳保費（但須按市值調整計算），冷靜期的時段為保單交付閣下（或閣下之代表）或通知書發出予閣下（或閣下之代表）後起計的 21 天，以較先者為準。詳情請參閱投保申請書上的「冷靜期」權益聲明。 (3) **沒有資產擁有權及沒有投資回報保證：對於此投連壽險保單的相關／參考投資資產，閣下均沒有任何權利或擁有權**。任何追討賠償，只可向*[承保人/公司]* 提出，閣下亦須承擔*[承保人/公司]* 的信貸風險。投資回報並沒有保證。 *本人現確認已閱讀及明白，並同意受以上第(1),（2）及 (3) 段約束。* ________________ 　________________ 　________________ 投保人姓名　　　　投保人簽署　　　　日期

(4) **計劃的長期性質**（如不適用可刪除）**：**

(a) **前期收費**：前期收費會於保單的已繳付保費內即時扣除，有關款項將不會用作投資。**換言之，可供投資的尚餘保費金額會低於已繳付的保費。**前期收費的計算方法如下：

前期收費 = 已繳付保費 X 前期收費%

保單年期	前期收費 %	已繳付保費在扣減前期收費後可用作投資的百分率（%）
1	A%	(100 – A)%
2	B%	(100 – B)%
3	C%	(100 – C)%
4	D%	(100 – D)%
5…	…	…

(b) **提早退保／提取保單款項的收費**：若閣下在保單期滿前的指定時限內終止保單、退保、提取部份保單款項、暫停繳交或調低供款額，均須支付**提早退保或提取保單款項的收費，並可能因此喪失獲得紅利的權利**。提前終止保單的收費計算方法如下：

提前終止保單收費 = 提取保單價值／退保價值／斷供保單價值 X 提前終止保單收費%

保單年期	提前終止保單收費%
1	A%
2	B%
3	C%
4	D%
5…	…

(c) **長期客戶獎賞：**若閣下符合指定的要求，可享有長期客戶獎賞。詳情請參閱此保單的產品計劃文件。

(5) **費用及收費：某些費用／收費將從閣下支付的保費及／或閣下所選取計劃的價值中扣減**，有關費用及收費會減少可供投資的金額。因此，**閣下投連壽險保單的整體回報有可能遠低於閣下所選取的相關／參考基金的回報。**詳情請參閱此保單的產品計劃文件。

本人現確認已閱讀及明白，並同意受以上第（4）及 (5) 段約束。本人明白及接受所有費用及收費，包括前期收費及提早退保及提取保單款項的收費。

投保人姓名	投保人簽署	日期

(6) **<u>轉換投資選項</u>**：若閣下轉換投資選項，可能需要支付相關收費，而閣下所承受的投資風險亦有可能因而增加或減少。

(7) **<u>供款假期</u>：**請向中介人查詢及參閱產品計劃文件，以確定此保單是否設有供款假期（即在此期間可暫停供款），以及可行使供款假期需符合的指定條件。若此保單設有供款假期，閣下必須注意以下事項：

(a) 供款假期指閣下可在該期間暫停供款，**但並不表示閣下只須在最初的供款期內繳付保費。**

(b) 由於在供款假期內所有費用及收費仍會繼續從閣下的投連壽險保單價值中扣除，因此，**閣下的投連壽險保單價值或會因此而大幅減少**。

(8) **<u>提早終止風險</u>**：若有任何啟動保單自動提早終止的情況出現，**閣下的保單或會被自動提早終止，而閣下亦會因此損失所有已付保費及累算權益。**可能啟動保單自動提早終止的情況包括：閣下未能定期支付保費，或閣下的保單總值處於十分低或負數的水平（例如：投資表現不理想或於行使供款假期後等）。

(9) **<u>中介人的酬勞</u>：若閣下選擇投購此投資相連壽險保單，(保險代理人/保險經紀商/銀行)將會獲取平均$xx.x 的酬勞(以閣下每繳付$100 元保費金額計)。**

中介人的酬勞是基於閣下會繳付整個供款期內所有供款的假設下計算所得的平均值。該酬勞包括所有直接因銷售此保單而向(保險代理人/保險經紀商/銀行)支付的金額（包括前期及其後的佣金、花紅及其他獎金）。

[只列印以下相關章節]

[適用於需數年繳付及非劃一酬勞率的酬勞架構](保險代理人/保險經紀商/銀行)每年實際上可獲取的酬勞金額可能不同，而酬勞金額於保單首年/早期會較高。

*[適用於涉及非金錢酬勞的酬勞架構]*一些並非直接因銷售此保單而支付的瑣碎及不易兌現的酬勞並不包括在計算當中。

*[適用於終生供款的保單]*此保單涉及終生供款，計算時總保費及總酬勞金額以三十年期作為假設計算。

*[適用於經銀行銷售的保單]*此陳述中提及的"銀行"，是指持牌銀行、有限制牌照銀行及接受存款公司。

如欲進一步了解閣下的(保險代理人/保險經紀/銀行)就此投資相連壽險保單所收取的酬勞

詳情，請向該中介人查詢。

本人現確認已閱讀及明白，並同意受以上第（6），（7），（8）及 (9) 段約束。

投保人姓名	投保人簽署	日期

*[For ILAS with **complex** charge structure for upfront and surrender charges]*

第二部 : 申請人聲明書

甲部 : 披露聲明

- 本人確認保險中介人[中介人的姓名及登記編號]已為本人進行「財務需要分析」及「風險承擔能力問卷」調查。

- 本人已收取，閱讀及明白以下文件：

  - 主要推銷刊物
  - 產品資料概要
  - 退保說明文件
  - 「購買投資相連壽險問多點知多點」小冊子
  - #「投資選擇」刊物
  - # [其他文件]

- #本人完全明白及同意承受可能因市場價格調整所引致的潛在損失，及[承保人/公司]在一些特定的情況下（例如：提早退保），本人有權及擁有絕對的酌情權對投連壽險保單的價值作出市值下調/負市值調整。

- #本人確認此申請為「資本投資者入境計劃」。

投保人姓名	投保人簽署	日期

 # 乙部 : 負擔能力聲明（適用於定期支付保費）

- 本人預計本人的可支配收入及／或儲蓄將足以支付此投連壽險保單的整段供款年期的定期保費；以及
- 本人確認本人願意支付此投連壽險保單的整段供款年期的定期保費。

投保人姓名	投保人簽署	日期

 # 如不適用請刪除

*[For ILAS with **complex** charge structure for upfront and surrender charges]*

丙部 : 適合性聲明

本人明白並同意（只可選一項）:

A ☐ 根據本人於「財務需要分析」及「風險承擔能力問卷」所披露的現時需要及投資風險概況，此產品計劃之特色及其風險級別與本人所選擇的相關投資組合均適合本人。

或

B ☐ 儘管根據本人於「財務需要分析」及「風險承擔能力問卷」所披露的現時需要及投資風險概況， 此產品計劃之特色及／ 或風險級別及／ 或本人選擇的相關投資組合可能並不適合本人，但本人確認基於下述原因，本人打算及意欲申請此投連壽險計劃：

*（如選擇「B」項，投保人必須**親筆**於此欄內提供原因。）*

本人確認，除非本人清楚了解此產品計劃和相關投資項目的選擇組合，並得悉此產品計劃如何切合本人的需要；否則，本人不應投購此產品計劃。本人擁有最終的決定權。

投保人姓名	投保人簽署	日期

註釋:

1. 就重要資料聲明書及投保人聲明書而言， 單數等同複數；「本人」包括「我們」的涵義； 及「本人的」包括「我們的」的涵義。若為聯名申請人，所有申請人必須在所有

部分內內簽署。

2. 若重要資料聲明書及投保人聲明書上填報的資料有重大改變，閣下在保單未簽發前，必須通知閣下的保險中介人或*承保人*/公司。

APPENDIX C2: Important Facts Statement and the Applicant's Declarations (Simple charge structure version for upfront and surrender charges - for business introduced by insurance agents)

IMPORTANT FACTS STATEMENT AND APPLICANT'S DECLARATIONS INVESTMENT-LINKED ASSURANCE SCHEME ("ILAS") POLICY

[Name of insurer]
Name of the ILAS Policy:

PART I – IMPORTANT FACTS STATEMENT

You should carefully consider the information in this statement and the product documents (including the Principal Brochure, Product Key Facts Statement, and the Illustration Document). **If you do not understand any of the following paragraphs or do not agree to that particular paragraph or what your intermediary has told you is different from what you have read in this statement, please do not sign the confirmation and do not purchase the ILAS policy.**

You may request the Chinese version of this statement from your intermediary. 閣下可向銷售的中介人索取中文版本。

SOME IMPORTANT FACTS YOU SHOULD KNOW
(1) <u>Statement of Purpose:</u> Please set out in your own handwriting your reasons/considerations for procuring this ILAS policy. The intermediary is required to take due account of the reasons/considerations set out by you, together with other relevant information, in assessing whether a particular ILAS policy is suitable for you. ____ ____ (2) <u>Cooling-off period:</u> **You have the right to cancel this ILAS policy** and get back your original investments (subject to market value adjustment) within the cooling-off period, which is 21 days after the delivery of the policy or issue of a notice to you or your representative, whichever is the earlier. For details of how you can exercise this right, please refer to the application form. (3) <u>No ownership of assets and no guarantee for investment returns:</u> **You do not have any rights to or ownership over any of the underlying/reference investment assets** of this ILAS policy. Your recourse is against *[pre-printed name of the insurer]* only. You are subject to the credit risk of *[pre-printed name of the insurer]*. Investment returns are not guaranteed. *I confirm that I have read and understood and agree to be bound by paragraphs (1), (2), and (3) above.* ________________ ________________ ________________ Applicant's Name Applicant's Signature Date

(4) **Long-term features (delete wherever inapplicable):**

(a) **Upfront charges:** [% Range] of the premiums you pay for the first [ ] policy years will be deducted upfront as charges and will not be available for investment. **This means that the remaining amount of premiums available for investment may be as low as [ ]% of your premiums paid in this period.**

(b) **Early surrender / withdrawal charges:** You will be subject to an **early surrender or withdrawal charge** and **possible loss of entitlement to bonuses**, if policy termination or surrender, partial withdrawal, or suspension of or reduction in premium payment occurs within the initial [ ] years of the policy term.

(c) **Loyalty bonuses:** You will be entitled to a loyalty or special bonus if you meet certain conditions. For details, please refer to the product documents of this ILAS policy.

(5) **Fees and charges:** **Some fees/charges will be deducted** from the premiums you pay and/or your ILAS policy value, and will reduce the amount available for investment. Accordingly, **the return on your ILAS policy as a whole may considerably be lower than the return of the underlying/reference funds you selected.** For details, please refer to the product documents of this ILAS policy.

(6) **Switching of Investment:** If you switch your investment choices, you may be subject to a charge and your risk may be increased or decreased.

I confirm that I have read and understood and agree to be bound by paragraphs (4), (5) and (6) above. I understand and accept all the fees and charges, including the upfront charges and early surrender/withdrawal charges.

Applicant's Name	Applicant's Signature	Date

(7) **<u>Premium holiday:</u>** Please check with your intermediary and the product documents whether and under what specific conditions a premium holiday (during which premium payment is suspended) may be taken. If your ILAS policy allows a premium holiday, you should note that:

(a) Premium holiday means that you may temporarily suspend your regular premium payments. It **does not mean that you are only required to make premium contribution during the initial contribution period**.

(b) As all relevant fees and charges will continue to be deducted from your ILAS policy value during the premium holiday, **the value of your ILAS policy may be significantly reduced**.

(8) <u>Risk of early termination:</u> **Your ILAS policy may be automatically early terminated and you could lose all your premiums paid and benefits accrued** if any condition of automatic early termination is triggered. This may happen if you fail to make premium contribution (for regular premium payment), or if your policy has very low or negative value (e.g. poor investment performance, exercise of premium holiday), etc.

(9) **<u>Intermediaries' Remuneration:</u> If you take up this ILAS policy, the (agent/broker firm/bank) will on average receive remuneration of $x.x per $100 of the premium that you pay.**

The remuneration is an average figure calculated on the assumption that you will pay all the premiums throughout the entire premium payment period. It covers all payments to the (agent/broker firm/bank) directly attributable to the sale of this policy (including upfront and future commissions, bonuses and other incentives).

[Note: Only print the relevant sections below]

[For remuneration structure where payments are made over a number of years and not at a flat rate] The amount of remuneration actually receivable by the (agent/broker firm/bank) may vary from year to year and is higher in the first policy year/early policy years.

[For remuneration structure which involves non-monetary benefits] Certain benefits that are immaterial, not directly attributable to the sale of this policy and not readily convertible to cash are not included from the calculation.

[For whole-life premium payment policies] As this policy involves whole-life premium payment, a 30-year period has been adopted for calculating both the total premiums and the total remuneration.

[For policies sold through bank] In this statement, "bank" refers to a licensed bank, restricted licence bank or deposit-taking company.

Please consult your (agent/broker/bank) if you wish to know more about the remuneration that he/she/they may receive in respect of this policy.

I confirm that I have read and understood and agree to be bound by paragraphs (7), (8) and (9) above.

Applicant's Name | Applicant's Signature | Date

PART II – APPLICANT'S DECLARATIONS

Section I: Disclosure Declaration

- I confirm that the insurance intermediary, (insert name and registration number of the relevant insurance agent), has conducted a Financial Needs Analysis and Risk Profiling for me.
- I have received, read and understood the following documents:
  - Principal Brochure
  - Product Key Facts Statement
  - Illustration Document
  - Pamphlet "Questions you need to ask before taking out an ILAS product"
  - # Investment Choice Brochure
  - # [Other documents provided]
- # I fully understand and accept the potential loss associated with any market value adjustment, where the insurer has the right and absolute discretion under certain situations (e.g. early policy surrender) to apply a downward / negative market value adjustment to the ILAS policy.
- # I confirm that this application is for the purpose of the Capital Investment Entrant Scheme.

Applicant's Name | Applicant's Signature | Date

 # Section II: Affordability Declaration (For regular premium payment)

- I anticipate that my disposable income and/or savings is/are sufficient to pay the regular premium payments for the entire payment term of the ILAS policy; and
- I confirm that I am willing to pay the premiums for the entire payment term of the ILAS policy.

Applicant's Name | Applicant's Signature | Date

 # delete as appropriate

Section III: Suitability Declaration

I understand and agree that (tick one only):

A ☐ the features and risk level of the ILAS policy and my selected mix of underlying investment choices are suitable for me based on my disclosed current needs and risk profile as indicated in the Financial Needs Analysis and Risk Profile Questionnaire.

OR

B ☐ despite the fact that the features and/or risk level of the ILAS policy and/or my selected mix of underlying investment choices may not be suitable for me based on my disclosed current needs & risk profile as indicated in the Financial Needs Analysis and Risk Profile Questionnaire, I confirm that it is my intention and desire to proceed with my application(s) as explained below:

(If Box B is ticked, Applicant must complete explanation in ***own*** *handwriting in this box.)*

I acknowledge I should not purchase this ILAS policy and/or the selected mix of underlying investment choices unless I understand these and their suitability has been explained to me and that the final decision is mine.

Applicant's Name	Applicant's Signature	Date

Notes:

1. In this Statement & Declaration, the singular shall include the plural; the word "I" shall include "we"; & the word "my" shall include "our". For joint applicants, all applicants must sign all sections.

2. You are required to inform your insurance agent or us (the insurance company) if there is any substantial change of information provided in these Declarations before the policy is issued.

附件 C2

重要資料聲明書及申請人聲明書
投資相連壽險計劃（投連壽險）保單

[承保人／公司]
投連壽險保單名稱：

第一部： 重要資料聲明書

閣下應細閱此聲明書及產品文件（包括主要推銷刊物、產品資料概要及退保說明文件）。**若閣下不明白、不同意以下聲明的任何一段、或跟此聲明內容與中介人的講述有異，請勿簽署確認或投購此投連壽險保單。**

閣下可向銷售的中介人索取英文版本。You may request the English version of this statement from your intermediary.

此乃重要資料　閣下必須細閱
(1) **目標概要：**請閣下以手寫列出投購此投連壽險保單的原因／考慮因素。中介人必須就閣下列明的原因及考慮因素，以及相關資料，一併評估此投連壽險保單是否適合閣下。 ____ ____
(2) **冷靜期：閣下有權在「冷靜期」內取消此投連壽險保單**,並取回已繳保費（但須按市值調整計算)，冷靜期的時段為保單交付閣下(或閣下之代表)或通知書發出予閣下(或閣下之代表)後起計的 21 天，以較先者為準。詳情請參閱投保申請書上的「冷靜期」權益聲明。
(3) **沒有資產擁有權及沒有投資回報保證：對於此投連壽險保單的相關／參考投資資產，閣下均沒有任何權利或擁有權**。任何追討賠償，只可向*[承保人/公司]* 提出，閣下亦須承擔*[承保人/公司]* 的信貸風險。投資回報並沒有保證。 *本人現確認已閱讀及明白，並同意受以上第(1),（2）及 (3) 段約束。* ________________ 投保人姓名　________________ 投保人簽署　________________ 日期

(4) **計劃的長期性質**（如不適用可刪除）**:**

(a) **前期收費：**保單期首[ ]年的已繳付保費中的[%比率範圍]，將會即時扣除用以支付前期收費，有關款項將不會用作投資。**換言之，可供投資的尚餘保費金額，可能低過期內已繳付保費的[ ]%。**

(b) **提早退保／提取保單款項的收費**：若閣下在保單期的首[ ]年內終止保單、退保、提取部份保單款項、暫停繳交或調低供款，均須支付**提早退保或提取保單款項的收費，並可能因此喪失獲得紅利的權利**。

(c) **長期客戶獎賞：**若閣下符合指定的要求，可享有長期客戶獎賞。詳情可參閱此此保單的產品計劃文件。

(5) **費用及收費: 某些費用／收費將從閣下支付的保費及／或閣下所選取計劃的價值中扣減，**有關費用及收費會減少可供投資的金額。因此，**閣下的投連壽險保單的整體回報有可能遠低於閣下所選取的相關／參考基金的回報。**詳情請參閱此保單的產品計劃文件。

(6) **轉換投資選項**：若閣下轉換投資選項，可能需要支付相關收費，而閣下所承受的投資風險亦可能因而增加或減少。

本人現確認已閱讀及明白，並同意受以上第（4），（5）及 (6) 段約束。本人明白及接受所有費用及收費，包括前期收費，提早退保及提取保單款項的收費。

投保人姓名	投保人簽署	日期

(7) **<u>供款假期</u>**：請向中介人查詢及參閱產品計劃文件，以確定此保單是否設有供款假期（即在此期間可暫停供款），以及可行使供款假期需符合的指定條件。若此保單設有供款假期，閣下必須注意以下事項：

(a) 供款假期指閣下可在該期間暫停供款。**但並不表示閣下只須在最初的供款期內繳付保費。**

(b) 由於在供款假期內所有費用及收費仍會繼續從閣下的投連壽險保單價值中扣除，因此，**閣下的投連壽險保單價值或會因此而大幅減少**。

(8) **<u>提早終止風險</u>**： 若有任何啟動保單自動提早終止的情況出現，**閣下的保單或會被自動提早終止，而閣下亦會損失所有已付保費及累算權益。**可能啟動保單自動提早終止的情況包括：閣下未能定期支付保費，或閣下的保單總值處於十分低或負數水平（例如：投資表現不理想或於行使供款假期後等）。

(9) **<u>中介人的酬勞</u>：若閣下選擇投購此投資相連壽險保單，(保險代理人/保險經紀商/銀行)將會獲取平均$xx.x 的酬勞(以閣下每繳付$100 元保費金額計)。**

中介人的酬勞是基於閣下會繳付整個供款期內所有供款的假設下計算所得的平均值。該酬勞包括所有直接因銷售此保單而向(保險代理人/保險經紀商/銀行)支付的金額（包括前期及其後的佣金、花紅及其他獎金）。

[只列印以下相關章節]

[適用於需數年繳付及非劃一酬勞率的酬勞架構](保險代理人/保險經紀商/銀行)每年實際上可獲取的酬勞金額可能不同，而酬勞金額於保單首年/早年會較高。

*[適用於涉及非金錢收益的酬勞架構]*一些並非直接因銷售此保單而支付的不重大及不易兌換為現金的酬勞並不包括在計算當中。

*[適用於終生供款的保單]*此保單涉及終生供款，計算時總保費及總酬勞金額以三十年期作為假設計算。

*[適用於經銀行銷售的保單]*此陳述中提及的"銀行"，是指持牌銀行、有限制牌照銀行及接受存款公司。

如欲進一步了解閣下的(保險代理人/保險經紀/銀行)就此投資相連壽險保單所收取的酬勞詳情，請向該中介人查詢。

本人現確認已閱讀及明白，並同意受以上第（7），（8）及 (9) 段約束。

投保人姓名　　投保人簽署　　日期

*[For ILAS with **simple** charge structure for upfront and surrender charges]*

第二部 : 投保人聲明書

甲部 : 披露聲明

- 本人確認保險中介人[中介人的姓名及登記編號]已為本人進行「財務需要分析」及「風險承擔能力問卷」調查。

- 本人已收取，閱讀及明白以下文件：

  - 主要推銷刊物
  - 產品資料概要
  - 退保說明文件
  - 「購買投資相連壽險問多點知多點」小冊子
  - #「投資選擇」刊物
  - # [其他文件]

- #本人完全明白及同意承受可能因市場價格調整所引致的潛在損失，及[承保人/公司]在一些特定的情況下（例如：提早退保），本人有權及擁有絕對的酌情權對投連壽險保單的價值作出市值下調/負市值調整。

- #本人確認此申請為「資本投資者入境計劃」。

投保人姓名　　投保人簽署　　日期

 # 乙部 : 負擔能力聲明（適用於定期支付保費）

- 本人預計本人的可支配收入及／或儲蓄將足以支付此投連壽險保單的整段供款年期的定期保費；以及

- 本人確認本人願意支付此投連壽險保單的整段供款年期的定期保費。

投保人姓名	投保人簽署	日期

#如不適用請刪除

[For ILAS with ***simple*** *charge structure for upfront and surrender charges]*

丙部：適合性聲明

本人明白並同意（只可選一項）：

A ☐ 根據本人於「財務需要分析」及「風險承擔能力問卷」所披露的現時需要及投資風險概況，此產品計劃之特色及其風險級別與本人所選擇的相關投資組合均適合本人。

或

B ☐ 儘管根據本人於「財務需要分析」及「風險承擔能力問卷」所披露的現時需要及投資風險概況， 此產品計劃之特色及／ 或風險級別及／ 或本人選擇的相關投資組合可能並不適合本人，但本人確認基於下述原因，本人打算及意欲申請此投連壽險計劃：

*（如選擇「B」項，投保人必須**親筆**於此欄內提供原因。）*

本人確認，除非本人清楚了解此產品計劃和相關投資項目的選擇組合，並得悉此產品計劃如何切合本人的需要；否則，本人不應投購此產品計劃。本人擁有最終的決定權。

投保人姓名	投保人簽署	日期

註釋:

1. 就重要資料聲明書及投保人聲明書而言， 單數等同複數；「本人」包括「我們」的涵義； 及「本人的」包括「我們的」的涵義。若為聯名投保人，所有投保人必須在所有部分內簽署。

2. 若重要資料聲明書及投保人聲明書上填報的資料有重大改變，閣下在保單未簽發前，必須通知閣下的保險中介人或*承保人*/公司。

APPENDIX D: Post-sale Call Content

Post–sale Call Content

售後跟進電話服務的內容

1. Opening
開始

1.1 Introduction
介紹

- The caller should introduce himself/herself by name and company;
致電者必須先報上姓名及介紹自己所屬公司的名稱；
- Explaining the purpose of the Post-sale Call and that it is a regulatory requirement that the call be made and recorded, will be a short call of only approx 10 mins;
解釋售後跟進電話服務之用意，並說明按監管要求，保險公司必須於銷售過程完成後致電客戶，並將談話內容錄音，對話大概需時十分鐘；
- Securing agreement to the call and stressing that the purpose is to ensure that the customer's rights are fully respected and protected;
確保客戶同意繼續通話，並強調致電是為了確保客戶的權益獲得充分尊重及保障；
- Verifying the customer's identity.
核實客戶的身分。

1.2 Confirming purchase of an ILAS product & Statement of Purpose
確定購買投資相連壽險產品及目標概要

Question: Can you please confirm if you have purchased an Investment Linked Assurance Scheme (ILAS) product from an agent/a broker (insert name of the relevant insurance agent/broker) of Company (insert name of the Company)?
問題：請問你是否透過xx公司（填上公司名稱）的保險代理／經紀（填上有關保險代理／經紀的姓名）購買了投資相連壽險計劃？

Can you also confirm the objective that you purchased this ILAS product is (insert the reason/ consideration stated by the applicant in the Important Facts Statement/ Applicant's Declaration)?

請你再次確認你購買這份投資壽險產計劃的目的是（重覆申請人於重要資料聲明書／申請人聲明書中所列明之原因／考慮因素)。

2. Key Questions
主要問題

2.1 Sales Process
銷售程序

Question: Did your insurance agent/broker perform a Financial Needs Analysis and Risk Profiling based on information provided by you, before recommending the ILAS product to you?

問題：你的保險代理／經紀向你推介投資相連壽險計劃前，有否根據你提供的資料進行財務需要分析及風險承擔能力評估？

Question: Did your insurance agent/broker explain and compare different insurance options based on information provided by you in the Financial Needs Analysis before recommending the ILAS product to you?

問題：你的保險代理／經紀向你推介投資相連壽險計劃前，有否根據你於財務需要分析所提供的資料向你講解及比較不同的保險產品？

2.2 Product features
產品特色

Question: Did you receive and understand the marketing literature that explains the key features of the policy, and the level of all charges and fees?

問題：你有否收到介紹保單主要特色的銷售資料？你是否明白資料的內容及所有收費與費用的詳情？

2.3 Amount of premium and premium term & implication if not fulfilling the premium payment for the chosen term

保費金額及繳付保費年期，以及不按照供款年期繳付保費，對保單可能造成的影響

Question: Can you please confirm whether the premium for the policy purchased by you is (insert the amount) and the premium term is (insert the premium payment period)? Are you aware that if you do not intend or are unable to complete the premium payment for the whole duration you have chosen, you should not acquire this policy as you may suffer a loss if you discontinue your premium payment earlier as fees and charges will be continuously deducted from your policy?

問題：請問你購買的保單保費金額是否（請填寫金額）？繳付保費年期是否（請填寫年期）？假如你在投保期間不打算或無法支付整段選定年期的保費，你就不應購買這份計劃；因為停止繳付保費，保單之費用或收費仍將繼續從你的保單中扣除，你可能因此蒙受損失。

2.4 Understanding of penalties, fees or charges
明白需要繳付的罰款、費用或收費

Question: Did your insurance agent/broker explain the types of penalties, fees or charges? Specifically, they include (1) penalties or charges for early encashment, withdrawal and temporary suspension of premium payment, and such penalties or charges can be up to (insert the highest fees and charges, and charging basis applicable); (2 if applicable) charges for switching of investment choice?

問題：你的保險代理／經紀有否解釋你需要繳付的罰款、費用或收費？特別是指：
(1) 因提早領取現金價值、提款和暫緩繳交保費，而需要繳付的罰款或收費，
而該等罰款或收費可達到（請填寫適用的最高收費及收費基礎）；(2 如適用者)
轉換投資選項之收費?

2.5 Understand Potential Risk of Investments
明白投資的潛在風險

Question: In the Product Key Facts Statement, Principal Brochure, Investment Option Brochure and the marketing literature provided to you, the risk inherent in the investment of your policy has been set out. Are you aware that investment returns are not guaranteed and each investment choice is subject to market and interest rate fluctuations, and to the risks inherent in all investments? The value of investments may go down as well as up, and past performance is not indicative of future performance. 問題：產品資料概要、主要推銷刊物、投資選項手冊及銷售資料已詳列你購買的保單的所有投資固有風險。你是否知道投資回報並非保證，而每項投資選項都會受市場及利率波動影響，亦會受投資的固有風險影響？投資價值可跌可升，過去的投資表現不能作為日後表現的指標。

Question [applicable only for ILAS product with Market Value Adjustment] 問題 [只適用於投資相連壽險產品之市值調整]

Are you aware that there may be potential loss due to Market Value Adjustment, which is determined at the sole discretion of us, under certain situation? 你是否知道若干情況下因為市值調整，保單可能會有潛在損失，而市值調整的幅度，是由本公司全權決定？

Your investment options «high_risk_fund» belongs to high risk category*. High risk investment options may be subject to higher volatility.

你選擇的投資組合«高風險基金»屬高風險類別*。高風險投資組合的表現可能會有較大波動。

2.6 Charges and changes in risk level of investment choices in switching
轉換投資選項之收費及風險水平的轉變

Question: Are you aware of the possible charges and possible changes in risk levels of the investment choices when switching? You have the right to seek professional financial advice when in doubt.

問題：你是否知道轉換投資選項可能需要支付收費，以及可能引致風險水平產生變化？如有疑問，你有權尋求專業的財務意見。

2.7 Understanding of upfront and surrender charges
明白前置及退保的收費

Question: Are you aware that an up-front fee will be charged on the premium you paid before investment (where applicable)? Are you aware that a withdrawal and / or surrender charge will be deducted from the policy benefit if you make withdrawal from and / or surrender your policy within X years (insert the number of policy years where the withdrawal and / or surrender charge is applicable) (where applicable)? 問題：你是否知道你繳交的保費在用作出投資前，部分會先用來繳付保費的前置收費 (如適用)？ 你是否知道，如果你在 x 年內提款及 / 或退保（填寫提款及 / 或退保收費適用之年期）（如適用），因為提款及 / 或退保而引申的收費，將會由你的保單利益中扣除?

3. Closing

結束

3.1 Intermediaries' Remuneration
中介人的酬勞

Are you aware that if you take up this ILAS policy, the intermediary will on average receive remuneration of $x.x per $100 of the premium that you pay? Are you aware that you can ask your intermediary further details about the remuneration that he/she may receive in respect of your ILAS policy?

你是否知道若閣下選擇投購此投資相連壽險保單，中介人將會獲取平均$xx.x的酬勞(以閣下每繳付$100元保費金額計)?你是否知道你可進一步向你的中介人查詢他／她就本投連壽險保單可收取的酬勞詳情?

3.2 Confirming suitability

確認適合性

Scenario 1: The applicant has ticked Box A in Important Facts Statement and Applicant's Declarations

情況一：申請人於重要資料聲明書 / 申請人聲明書中選擇了A項

Question: You have ticked Box A, which means the features and risk level of the product(s) and your selected mix of underlying investment choices are suitable for you. Is this consistent with your understanding?

問題：你選擇了A項，即表示產品特色和風險程度與你所選擇的相關投資組合均適合你。這說法是否與你所理解的一致？

Scenario 2: The applicant has ticked Box B in Important Facts Statement and Applicant's Declarations

情況二：申請人於重要資料聲明書 / 申請人聲明書中選擇了B項

Question: You have ticked Box B, which means that it is your intention and desire to proceed your application(s) despite the fact that the features and risk level of the product(s) and your selected mix of underlying investment choices may not be suitable for you. You explained in the Important Facts Statement and Applicant's Declarations that the reason is (insert the explanation provided in the Important Facts Statement and Applicant's Declarations). Is this consistent with your understanding?

問題：你於重要資料聲明書 / 申請人聲明書中選擇了B項，即表示產品特色和風險程度與你所選擇的相關投資組合可能並不適合你，
但你仍想繼續進行該計劃的申請，而你在重要資料聲明書/
申請人聲明書中所提供的理由是（加入在該重要資料聲明書/
申請人聲明書中填寫的理由）。這說法是否與你所理解的一致？

3.3 Important Facts Statement and Applicant's Declaration

重要資料聲明書及申請人聲明書

A copy of the Important Facts Statement and Applicant's Declaration which you have read and signed during the application will be attached to the ILAS policy contract to be delivered to you by your insurance agent/ broker. Please read it carefully once you have received it because it contained important information and facts which you should know.

你的保險代理 / 經紀將會把你的投資相連壽險合約送交給你，並會一併送上在銷售時你已經閱讀及簽署的「重要資料聲明書及申請人聲明書」副本。請你收到後小心細閱有關文件的內容，因為當中列明了你必須知道的重要資料及概要。

3.4 Cooling-off Rights
冷靜期退保權益

Provide a statement on the customer's Cooling-off Rights and also specify the expiry date of the cooling-off period if known, or otherwise describe the date in general description.
向客戶提供冷靜期退保權益概要，若知道冷靜期屆滿的確實日期，應具體指明有關日期；假如未能提供具體的屆滿日，即應簡介如何計算冷靜期的屆滿日。

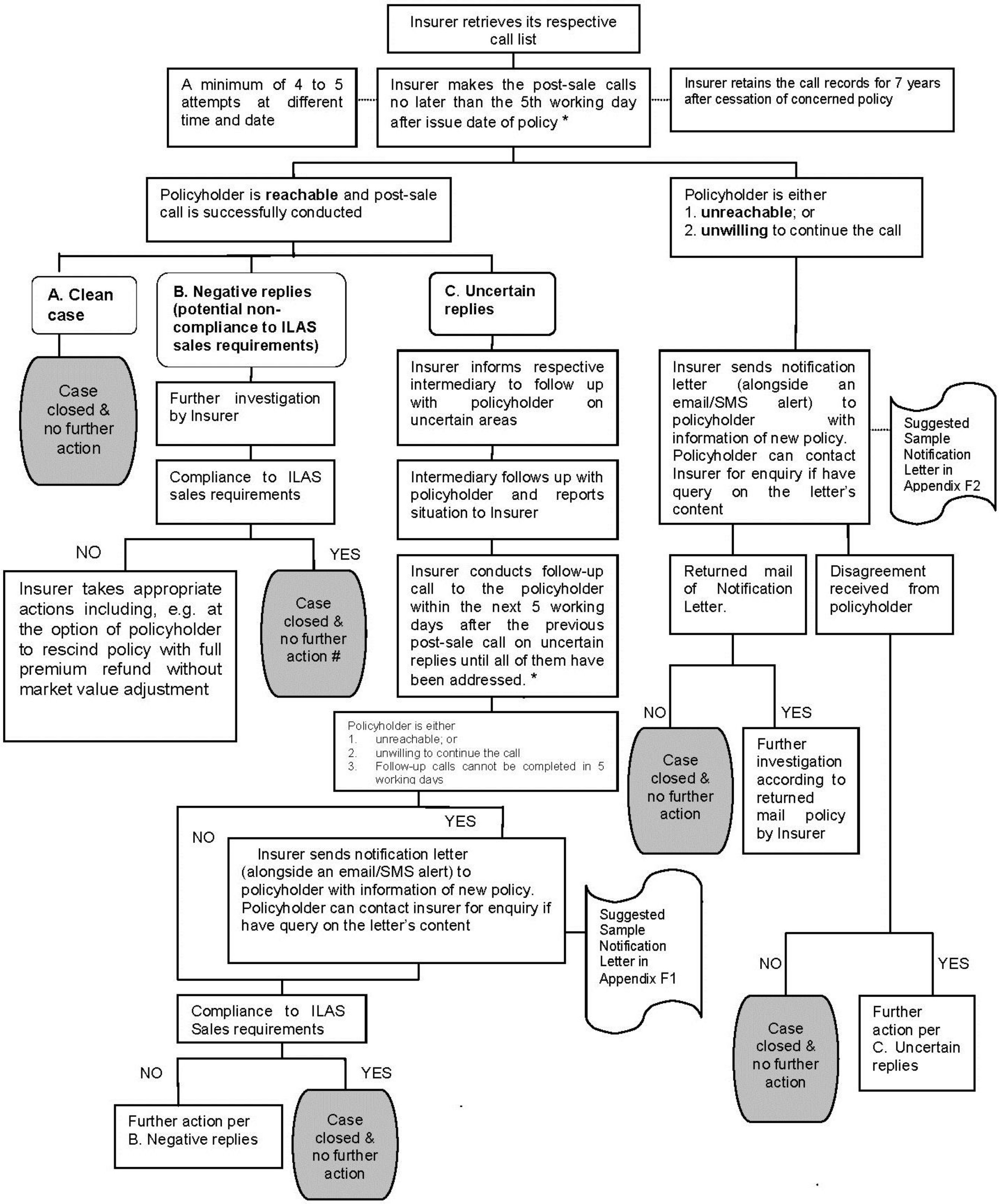
3.5 Closing Remark
結束備註

Thank the customer for their time and that you have verified all of the necessary information. Of course, if you have any queries, please feel free to either contact your broker/agent; who is keen on supporting you or contact us on xxxxx . Is there anything else that I can help you with today?
感謝客戶的寶貴時間，並說明已核實所需資料。假如客戶有任何查詢，可隨時聯絡其保險代理 / 經紀，中介人定必樂意解答有關問題，客戶亦可致電xxxxx與我們聯絡。詢請客戶是否尚有其他需要效勞的地方?

Yes – follow on 有 – 繼續跟進。

No – Bye. 沒有 – 再見。

APPENDIX E: Flow Chart – ILAS Post-sale Call



Proper follow-up actions with the policyholders need to be carried out before case closure.

* Remarks: Insurer must remind the policyholder about the expiry date of cooling-off period (provide the specific date if known, or otherwise describe the date in general description) during each follow-up call to the policyholder.

APPENDIX F1: Notification letter to the customer (customers who have given uncertain replies but could not be reached again at subsequent follow-up calls)

THIS IS AN IMPORTANT LETTER. PLEASE READ.

If you do not understand or do not agree with the contents of this letter, please contact us using any one of the following means **<u>before the expiry of cooling-off period on <<insert expiry date of cooling-off period>></u>**:

- Call our customer hotline at <<insert the hotline telephone number>>
- Write to us with attention to <<insert name of department and mailing address of company>>
- Fax to us at <<insert the fax number>>
- Send an e-mail to <<insert the e-mail address>>

«Date»

« owner_name»
«address»

<u>Re: Policy No. <« policy_no»></u>

Dear Customer,

Thank you for purchasing the above policy with <<Name of Insurer>>. As required by the Hong Kong Federation of Insurers ("HKFI") to protect your rights, we are required to conduct a post-sale call with you after the issuance of the captioned policy. As such, we have contacted you at your provided contact number(s) <<insert the all telephone number(s)>> on the policy application form. During the call, you indicated that you have queries on some of the matters related to the ILAS policy. We have therefore informed our Sales Representative to follow up with you for clarification. Subsequently, we have tried to contact you again to confirm whether your queries have been fully addressed but in vain.

A copy of the Important Facts Statement and Applicant's Declaration which you have read and signed during the application will be attached to the ILAS policy contract to be delivered to you by your insurance agent/ broker. Please read it carefully once you have received it because it contains important information and facts which you should know.

In view of the above situation and with reference to the documents you have signed to declare your understanding and acceptance of the captioned policy, we would like to inform you of the following information:

<u>Confirmation of the purchase of ILAS policy and affordability</u>

- ✓ You have purchased the above policy(ies) via the Sales Representative «name of the intermediary».
- ✓ You know the «payment_mode» premium amount for the above policy(ies) is in the sum of «premium_amount_currency» and the payment term is «payment_period».

- ✓ If you do not intend or are unable to complete the premium payment for the whole duration you have chosen, you should not acquire this policy as you may suffer a loss if you discontinue your premium payment earlier as fees and charges will be continuously deducted from your policy

Performance of Financial Needs Analysis and Risk Profiling

- ✓ The Sales Representative has performed a Financial Needs Analysis (including comparison of different insurance options) and Risk Profiling based on information provided by you before recommending the above policy to you.
- ✓ You have opted for Choice «Choice of A or B below» in the "Suitability Declaration" of "Applicant's Declaration" (Please see the attached copy of your "Applicant Declaration").

  Choice A - feature and risk level of the policy and your investment options are suitable for you based on your disclosed current needs and risk profile as indicated in the Financial Needs Analysis form and Risk Profile Questionnaire

  Choice B - it is your intention and desire to proceed with the application despite the features and risk level of the policy and your investment options may not be suitable for your disclosed current needs and risk profile as indicated in the Financial Needs Analysis form and Risk Profile Questionnaire

Investment risk disclosure

- ✓ Investment returns are not guaranteed and each investment choice is subject to market and interest rate fluctuations, and to the risks inherent in all investments. The value of investments may go down as well as up, and past performance is not indicative of future performance.
- ✓ Your investment options «high_risk_fund» belongs to high risk category*. High risk investment options may be subject to higher volatility.

Switching of investment

- ✓ Switching of investment options may involve charges (where applicable) and changes in risk level of your investment. You have right to seek professional financial advice including from the Sales Representative.

Receipt and understanding of product documents

- ✓ You have received a Product Brochure / Product Key Facts Statement / Important Facts Statement and Applicant's Declaration / other relevant supporting materials for the above policy(ies) and you have read and understood the risk disclosure statements, product features, fees and charges as stated in these documents.

Upfront and early withdrawal / surrender charges

- ✓ Upfront charges will be deducted on the premium you paid before investment (where applicable).
- ✓ Early withdrawal / surrender charges will be deducted if you make withdrawal from and / or surrender your policy within X years (insert the number of policy years where the withdrawal and / or surrender charge is applicable) (where applicable), and such penalties or charges can be up to (insert the highest fees and charges, and charging basis applicable).

- ✓ The Sales Representative has explained to you that charges apply if application for changes made after policy issuance including premium reduction, premium suspension, cash withdrawal and cooling-off cancellation (where applicable) and you understood the above.

Market Value Adjustment

- ✓ [Applicable only for ILAS with MVA] There may be potential loss due to Market Value Adjustment, which is determined at the sole discretion of us, under certain situation.

Intermediaries' Remuneration

- ✓ If you take up this ILAS policy, the intermediary will on average receive remuneration of $[x.x] per $100 of the premium that you pay. Please consult the Sales Representative if you wish to know more about the remuneration that he/she/they may receive in respect of this policy.

Cooling-off right

- ✓ Your cooling-off right

** Factsheet and risk level of each underlying fund/investment can be located at "Underlying Funds/Investments Prices" of our website* <<printed if applicable>>

Yours sincerely,
<<Name of Insurer>>

此乃重要信件，敬請細閱。

如果您不明白或不認同此信件的內容，請您在冷靜期屆滿前<<請填寫冷靜期的屆滿日期>>透過以下任何一種途徑與我們聯絡：

- 致電我們的客戶服務熱線 <<請填寫熱線電話號碼>>
- 來信通知我們 <<請填寫部門名稱及郵寄地址>>
- 傳真給我們 <<請填寫傳真號碼>>
- 寄發電子郵件給我們 <<請填寫電郵地址>>

貴客戶：

多謝您選擇於<<保險公司名稱>>投保。根據香港保險業聯會的指引，為保障您的權益，我們需要於上述保單繕發後，致電您進行售後電話跟進服務。據此，我們較早前按照您於保單申請書上所提供的聯絡電話〔註明保單上填寫的號碼〕與您聯絡。對話當中，您對上述投資相連壽險保單提出若干疑問，我們遂要求您的銷售代表與您聯絡，並釐清您的疑問。其後，我們曾嘗試再聯絡您跟進確認，惟未能成功。

您的保險代理／經紀將會把您的投資相連壽險合約送交給您，並會一併送上在銷售時您已經閱讀及簽署的「重要資料聲明書及申請人聲明書」副本。請您收到後小心細閱有關文件的內容，因為當中列明了您必須知道的重要資料及概要。

基於上述情況，以及您已簽署文件聲明您明白及接納上述保單，我們現謹提供以下資料：

<u>確認購買壽險保單及負擔能力</u>

✓ 您是經銷售代表<<中介人名稱>>投購上述保單
✓ 您清楚以上保單的«付款方式»，保費金額合共是«保費金額»，繳付保費年期則為«付款期限»
✓ 假如您在投保期間不打算或無法支付整段選定年期的保費，您便不應購買此保單。因為停止繳付保費，可能令您蒙受損失，而費用及收費會持續於您的保單價值內扣除。

<u>財務需要分析及風險承擔能力</u>

✓ 銷售代表向您推銷以上保單時，已根據您提供的資料作出財務需要分析(包括比較不同的保險產品)及風險承擔能力
✓ 您於「申請人聲明書」上的“適合性聲明”揀選選擇<<以下的選項 A 或 B>>(請參照附上的「申請人聲明書」副本)
選擇 A -
根據您填寫的「財務需要分析」及「風險承擔能力問卷」，上述保單之產品特性及風險級別與您所選擇的投資組合均適合您；

選擇 B -

儘管根據您填寫的「財務需要分析」及「風險承擔能力問卷」，上述保單之產品特性及風險級別與您所選擇的投資組合可能並不適合您，您仍然選擇投保上述保單

投資風險披露

- ✓ 投資回報並非保證，每項投資選項都會受市場及利率波動影響，亦會受投資的固有風險影響。投資價值可跌可升，過去的投資表現不能作為日後表現的指標。
- ✓ 您選擇的投資組合«高風險基金»屬高風險類別*。高風險投資組合的表現可能會有較大波動。

轉換投資選項

- ✓ 轉換投資選項可能涉及收費(如適用)以及引致風險水平產生變化。您有權尋求專業的財務意見，包括您的銷售代表。

收取產品文件

- ✓ 您已收到產品小冊子／產品資料概要／「重要資料聲明書及申請人聲明書」／其他相關資料，並已閱讀及明白這些資料內之風險披露說明、產品特性、產品費用及收費。

前期及提早退保／提取保單款項的收費

- ✓ 如果您在 X 年內提款或退保，將會被扣除相關的收費
  (填寫提取及 / 或退保的保單年期) (如適用),
  而該等罰款或收費可達到（請填寫適用的最高收費及收費基礎）
- ✓ 銷售代表有向您解釋保單生效後如中途有任何變更，包括減低保費、暫停供款、提取現金或於冷靜期內退保（如適用），您需按情況支付收費，而您亦明白有關情況。

市值調整

- ✓ [只適合於投資相連壽險有市值調整]
  因為市值調整，保單可能會有潛在損失，而市值調整的幅度，是由本公司全權決定。

中介人的酬勞

- ✓ 若閣下選擇投購此投資相連壽險保單，中介人將會獲取平均$xx.x 的酬勞(以閣下每繳付$100 元保費金額計)。如欲進一步了解閣下的銷售代表就此投資相連壽險保單所收取的酬勞詳情，請向該銷售代表查詢。

冷靜期

- ✓ 冷靜期退保權益

*您可隨時登入本公司網頁<<公司網頁>>內的「連繫基金／投資價格」，查詢各種連繫基金／投資的資料及風險級別

<<保險公司名稱>>謹啟

APPENDIX F2: Notification letter to the customer (unreachable customers at the first instance)

THIS IS AN IMPORTANT LETTER. PLEASE READ. If you do not understand or do not agree with the contents of this letter, please contact us using any one of the following means **<u>before the expiry of cooling-off period on <<insert expiry date of cooling-off period>></u>**: - Call our customer hotline at <<insert the hotline telephone number>> - Write to us with attention to <<insert name of department and mailing address of company>> - Fax to us at <<insert the fax number>> - Send an e-mail to <<insert the e-mail address>>

«Date»

« owner_name»
«address»

<u>Re: Policy No. <« policy_no»></u>

Dear Customer,

Thank you for purchasing the above policy with <<Name of Insurer>>. As required by the Hong Kong Federation of Insurers ("HKFI") to protect your rights, we are required to conduct a post-sale call with you after the issuance of the captioned policy. As such, we have tried to contact you at your provided contact number(s) <<insert the all telephone number(s)>> on the policy application form on occasion(s) but in vain.

A copy of the Important Facts Statement and Applicant's Declaration which you have read and signed during the application will be attached to the ILAS policy contract to be delivered to you by your insurance agent/ broker. Please read it carefully once you have received it because it contains important information and facts which you should know.

In view of the above situation and with reference to the documents you have signed to declare your understanding and acceptance of the captioned policy, we would like to inform you of the following information:

<u>Confirmation of the purchase of ILAS policy and affordability</u>

- ✓ You have purchased the above policy(ies) via the Sales Representative «name of the intermediary».
- ✓ You know the «payment_mode» premium amount for the above policy(ies) is in the sum of «premium_amount_currency» and the payment term is «payment_period».

- ✓ If you do not intend or are unable to complete the premium payment for the whole duration you have chosen, you should not acquire this policy as you may suffer a loss if you discontinue your premium payment earlier as fees and charges will be continuously deducted from your policy.

Performance of Financial Needs Analysis and Risk Profiling

- ✓ The Sales Representative has performed a Financial Needs Analysis (including comparison of different insurance options) and Risk Profiling based on information provided by you before recommending the above policy to you.
- ✓ You have opted for Choice «Choice of A or B below» in the "Suitability Declaration" of "Applicant's Declaration" (Please see the attached copy of your "Applicant Declaration").

  Choice A - feature and risk level of the policy and your investment options are suitable for you based on your disclosed current needs and risk profile as indicated in the Financial Needs Analysis form and Risk Profile Questionnaire

  Choice B - it is your intention and desire to proceed with the application despite the features and risk level of the policy and your investment options may not be suitable for your disclosed current needs and risk profile as indicated in the Financial Needs Analysis form and Risk Profile Questionnaire

Investment risk disclosure

- ✓ Investment returns are not guaranteed and each investment choice is subject to market and interest rate fluctuations, and to the risks inherent in all investments. The value of investments may go down as well as up, and past performance is not indicative of future performance.
- ✓ Your investment options «high_risk_fund» belongs to high risk category*. High risk investment options may be subject to higher volatility.

Switching of investment

- ✓ Switching of investment options may involve charges (where applicable) and changes in risk level of your investment. You have right to seek professional financial advice including from the Sales Representative.

Receipt and understanding of product documents

- ✓ You have received a Product Brochure / Product Key Facts Statement / Important Facts Statement and Applicant's Declaration / other relevant supporting materials for the above policy(ies) and you have read and understood the risk disclosure statements, product features, fees and charges as stated in these documents.

Upfront and early withdrawal / surrender charges

- ✓ Upfront charges will be deducted on the premium you paid before investment (where applicable).
- ✓ Early withdrawal / surrender charges will be deducted if you make withdrawal from and / or surrender your policy within X years (insert the number of policy years where the withdrawal and / or surrender charge is applicable) (where applicable), and such penalties or charges can be up to (insert the highest fees and charges, and charging basis applicable).

- ✓ The Sales Representative has explained to you that charges apply if application for changes made after policy issuance including premium reduction, premium suspension, cash withdrawal and cooling-off cancellation (where applicable) and you understood the above.

Market Value Adjustment

- ✓ [Applicable only for ILAS with MVA] There may be potential loss due to Market Value Adjustment, which is determined at the sole discretion of us, under certain situation.

Intermediaries' Remuneration

- ✓ If you take up this ILAS policy, the intermediary will on average receive remuneration of $[x.x] per $100 of the premium that you pay. Please consult the Sales Representative if you wish to know more about the remuneration that he/she/they may receive in respect of this policy.

Cooling-off right

- ✓ Your cooling-off right

** Factsheet and risk level of each underlying fund/investment can be located at "Underlying Funds/Investments Prices" of our website* <u>*<<printed if applicable>>*</u>

Yours sincerely,
<<Name of Insurer>>

此乃重要信件，敬請細閱。

如果您不明白或不認同此信件的內容，請您在冷靜期屆滿前<<請填寫冷靜期的屆滿日期>>透過以下任何一種途徑與我們聯絡：

- 致電我們的客戶服務熱線 <<請填寫熱線電話號碼>>
- 來信通知我們 <<請填寫部門名稱及郵寄地址>>
- 傳真給我們 <<請填寫傳真號碼>>
- 寄發電子郵件給我們 <<請填寫電郵地址>>

貴客戶：

多謝您選擇於<<保險公司名稱>>投保。根據香港保險業聯會的指引，為保障您的權益，我們需要於上述保單繕發後，致電您進行售後電話跟進服務。據此，我們曾按照您於保單申請書上所提供的聯絡電話〔註明保單上填寫的號碼〕嘗試與您聯絡，惟未能成功。

您的保險代理／經紀將會把您的投資相連壽險合約送交給您，並會一併送上在銷售時您已經閱讀及簽署的「重要資料聲明書及申請人聲明書」副本。請您收到後小心細閱有關文件的內容，因為當中列明了您必須知道的重要資料及概要。

基於上述情況，以及您已簽署文件聲明您明白及接納上述保單，我們現謹提供以下資料：

<u>確認購買壽險保單及負擔能力</u>

- ✓ 您是經銷售代表<<中介人名稱>>投購上述保單
- ✓ 您清楚以上保單的«付款方式»，保費金額合共是«保費金額»，繳付保費年期則為«付款期限»
- ✓ 假如您在投保期間不打算或無法支付整段選定年期的保費，您便不應購買此保單。因為停止繳付保費，可能令您蒙受損失，而費用及收費會持續於您的保單價值內扣除。

<u>財務需要分析及風險承擔能力</u>

- ✓ 銷售代表向您推銷以上保單時，已根據您提供的資料作出財務需要分析(包括比較不同的保險產品)及風險承擔能力
- ✓ 您於「申請人聲明書」上的"適合性聲明"揀選選擇<<以下的選項 A 或 B>>(請參照附上的「申請人聲明書」副本)
  選擇 A -
  根據您填寫的「財務需要分析」及「風險承擔能力問卷」，上述保單之產品特性及風險級別與您所選擇的投資組合均適合您；

選擇 B -
儘管根據您填寫的「財務需要分析」及「風險承擔能力問卷」，上述保單之產品特性及風險級別與您所選擇的投資組合可能並不適合您，您仍然選擇投保上述保單

投資風險披露
✓ 投資回報並非保證，每項投資選項都會受市場及利率波動影響，亦會受投資的固有風險影響。投資價值可跌可升，過去的投資表現不能作為日後表現的指標。
✓ 您選擇的投資組合«高風險基金»屬高風險類別*。高風險投資組合的表現可能會有較大波動。

轉換投資選項
✓ 轉換投資選項可能涉及收費(如適用)以及引致風險水平產生變化。您有權尋求專業的財務意見，包括您的銷售代表。

收取產品文件
✓ 您已收到產品小冊子／產品資料概要／「重要資料聲明書及申請人聲明書」／其他相關資料，並已閱讀及明白這些資料內之風險披露說明、產品特性、產品費用及收費。

前期及提早退保／提取保單款項的收費
✓ 你繳交的保費在用作出投資前，部分會先用來繳付保費的前置收費 (如適用) 。
✓ 如果您在 X
年內提款或退保，將會被扣除相關的收費(填寫提取及／或退保的保單年期)(如適用), 而該等罰款或收費可達到（請填寫適用的最高收費及收費基礎）。
✓ 銷售代表有向您解釋保單生效後如中途有任何變更，包括減低保費、暫停供款、提取現金或於冷靜期內退保（如適用），您需按情況支付收費，而您亦明白有關情況。

市值調整
✓ [只適合於投資相連壽險有市值調整]
因為市值調整，保單可能會有潛在損失，而市值調整的幅度，是由本公司全權決定。

中介人的酬勞
✓ 若閣下選擇投購此投資相連壽險保單，中介人將會獲取平均$xx.x 的酬勞(以閣下每繳付$100 元保費金額計)。如欲進一步了解閣下的銷售代表就此投資相連壽險保單所收取的酬勞詳情，請向該銷售代表查詢。

冷靜期
✓ 冷靜期退保權益

*您可隨時登入本公司網頁<<公司網頁>>內的「連繫基金／投資價格」，查詢各種連繫基金／投資的資料及風險級別

<<保險公司名稱>>謹啟

APPENDIX G: Point of sale Audio Recording Script

For the purpose of this script, the "Caller" refers to either the employee of insurer's call centre (電話服務員工) or the employee witnessing the PSAR process on site (銷售地點員工), who will actually conduct the PSAR script.

1. Opening
開始

1.1 Introduction
介紹

- The caller should introduce himself/herself by name and company;
致電者必須先報上姓名及介紹自己所屬公司的名稱；
- Explaining the purpose of the recorded call and that it is a regulatory requirement to verify the important points after completion of the sales process. The following discussion will be recorded and it will take about 10 mins;
解釋談話錄音之用意，並說明按監管要求，保險公司必須於銷售過程完成後跟客戶確認一些重點，以下內容將會錄音，過程大約需時十分鐘；
- Securing agreement to the call and stressing that the purpose is to ensure that the customer's rights are fully respected and protected;
確保客戶同意繼續談話，並強調致電是為了確保客戶的權益獲得充分尊重及保障；
- Ask the name of ILAS plan being applied by the customer;
詢問客戶所申請的投資連繫壽險計劃名稱；
- Verifying the customer's identity.
核實客戶的身分。

1.2 Confirming purchase of an ILAS product & Statement of Purpose
確定購買投資相連壽險產品及目標概要

Question: Can you please confirm if you have purchased an Investment Linked Assurance Scheme (ILAS) product from an agent/a broker (insert name of the relevant insurance agent/broker) of Company (insert name of the Company)?

問題：請問你是否透過xx公司（填上公司名稱）的保險代理／經紀（填上有關保險代理／經紀的姓名）購買了投資相連壽險計劃？

Can you also confirm the objective that you purchased this ILAS product is (insert the reason/ consideration stated by the applicant in the Important Facts Statement/ Applicant's Declaration)?
請你再次確認你購買這份投資壽險產計劃的目的是（請申請人讀出於重要資料聲明書／申請人聲明書中所填寫之原因／考慮因素)。

2. Key Questions
主要問題

2.1 Sales Process
銷售程序

Question: Did your insurance agent/broker perform a Financial Needs Analysis and Risk Profiling based on information provided by you, before recommending the ILAS product to you?

問題：你的保險代理 / 經紀向你推介投資相連壽險計劃前，有否根據你提供的資料進行財務需要分析及風險承擔能力評估？

Question: Did your insurance agent/broker explain and compare different insurance options based on information provided by you in the Financial Needs Analysis before recommending the ILAS product to you?

問題：你的保險代理 / 經紀向你推介投資相連壽險計劃前，有否根據你於財務需要分析所提供的資料向你講解及比較不同的保險產品？

2.2 Product features
產品特色

Question: Did you receive and understand the marketing literature that explains the key features of the policy, and the level of all charges and fees?

問題：你有否收到介紹保單主要特色的銷售資料？你是否明白資料的內容及所有收費與費用的詳情？

2.3 Amount of premium and premium term & implication if not fulfilling the premium payment for the chosen term
保費金額及繳付保費年期，以及不按照供款年期繳付保費，對保單可能造成的影響

Question: Can you please confirm whether the premium for the policy purchased by you is (insert the amount) and the premium term is (insert the premium payment period)? Are you aware that if you do not intend or are unable to complete the premium payment for the whole duration you have chosen, you should not acquire this policy as you may suffer a loss if you discontinue your premium payment earlier as fees and charges will be continuously deducted from your policy?

問題：請問你購買的保單保費金額是（請客戶讀出金額）？繳付保費年期是（請客戶讀出年期）？假如你在投保期間不打算或無法支付整段選定年期的保費，你就不應購買這份計劃；因為停止繳付保費，保單之費用或收費仍將繼續從你的保單中扣除，你可能因此蒙受損失。

2.4 Understanding of penalties, fees or charges
明白需要繳付的罰款、費用或收費

Question: Did your insurance agent/broker explain the types of penalties, fees or charges? Specifically, they include (1) penalties or charges for early encashment, withdrawal and temporary suspension of premium payment, and such penalties or charges can be up to (insert the highest fees and charges, and charging basis applicable); (2 if applicable) charges for switching of investment choice?

問題：你的保險代理 / 經紀有否解釋你需要繳付的罰款、費用或收費？特別是指：(1) 因提早領取現金價值、提款和暫緩繳交保費，而需要繳付的罰款或收費，而該等罰款或收費可達到（請填寫適用的最高收費及收費基礎）；(2 如適用者) 轉換投資選項之收費?

2.5 Understand Potential Risk of Investments
明白投資的潛在風險

Question: In the Product Key Facts Statement, Principal Brochure, Investment Option Brochure and the marketing literature provided to you, the risk inherent in the investment of your policy has been set out. Are you aware that investment returns are not guaranteed and each investment choice is subject to market and interest rate fluctuations, and to the risks inherent in all investments? The value of investments may go down as well as up, and past performance is not indicative of future performance.

問題：產品資料概要、主要推銷刊物、投資選項手冊及銷售資料已詳列你購買的保單的所有投資固有風險。你是否知道投資回報並非保證，而每項投資選項都會受市場及利率波動影響，亦會受投資的固有風險影響？投資價值可跌可升，過去的投資表現不能作為日後表現的指標。

Question [applicable only for ILAS product with Market Value Adjustment]
問題 [只適用於投資相連壽險產品之市值調整]

Are you aware that there may be potential loss due to Market Value Adjustment, which is determined at the sole discretion of us, under certain situation?

你是否知道若干情況下因為市值調整，保單可能會有潛在損失，而市值調整的幅度，是由本公司全權決定？

Your investment options «high_risk_fund» belongs to high risk category*. High risk investment options may be subject to higher volatility.

您選擇的投資組合«高風險基金»屬高風險類別*。高風險投資組合的表現可能會有較大波動。

2.6 Charges and changes in risk level of investment choices in switching
轉換投資選項之收費及風險水平的轉變

Question: Are you aware of the possible charges and possible changes in risk levels of the investment choices when switching? You have the right to seek professional financial advice when in doubt.

問題：你是否知道轉換投資選項可能需要支付收費，以及可能引致風險水平產生變化？如有疑問，你有權尋求專業的財務意見。

2.7 Understanding of upfront and surrender charges
明白前置及退保的收費

Question: Are you aware that an up-front fee will be charged on the premium you paid before investment (where applicable)? Are you aware that a withdrawal and / or surrender charge will be deducted from the policy benefit if you make withdrawal from and / or surrender your policy within X years (insert the number of policy years where the withdrawal and / or surrender charge is applicable) (where applicable), and such penalties or charges can be up to (insert the highest fees and charges, and charging basis applicable)?
問題：你是否知道你繳交的保費在用作出投資前，部分會先用來繳付保費的前置收費 (如適用)？ 你是否知道，如果你在 x 年內提款及 / 或退保 （填寫提款及 / 或退保收費適用之年期） （如適用），
而該等罰款或收費可達到（請填寫適用的最高收費及收費基礎），因為提款及 / 或退保而引申的收費，將會由你的保單利益中扣除?

3. Closing
結束

3.1 Intermediaries' Remuneration
中介人的酬勞

Are you aware that if you take up this ILAS policy, the intermediary will on average receive remuneration of $x.x per $100 of the premium that you pay? Are you aware that you can ask your intermediary further details about the remuneration that he/she may receive in respect of your ILAS policy?

你是否知道若閣下選擇投購此投資相連壽險保單，中介人將會獲取平均$xx.x的酬勞(以閣下每繳付$100元保費金額計)?你是否知道你可進一步向你的中介人查詢他／她就本投連壽險保單可收取的酬勞詳情?

3.2 Confirming suitability
確認適合性

****

If the PSAR is conducted by call centre employee, the following question should be asked by the call centre employee:

Question: Please tell me which Box in Important Facts Statement and Applicant's Declaration did you choose?

問題：請你讀出在選擇了A項或是B項？

****

<< Depends on the customer's choice on the suitability declaration, read out the respective question as follows 請根據客戶於重要資料聲明書/
申請人聲明書所作的選項而選擇以下的問題>>：

Scenario 1: The applicant has ticked Box A in Important Facts Statement and Applicant's Declarations

情況一：申請人於重要資料聲明書 / 申請人聲明書中選擇了A項

Question: You have ticked Box A, which means the features and risk level of the product(s) and your selected mix of underlying investment choices are suitable for you. Is this consistent with your understanding?

問題：你選擇了A項，即表示產品特色和風險程度與你所選擇的相關投資組合均適合你。這說法是否與你所理解的一致？

Scenario 2: The applicant has ticked Box B in Important Facts Statement and Applicant's Declarations

情況二：申請人於重要資料聲明書 / 申請人聲明書中選擇了B項

Question: You have ticked Box B, which means that it is your intention and desire to proceed your application(s) despite the fact that the features and risk level of the product(s) and your selected mix of underlying investment choices may not be suitable for you. You explained in the Important Facts Statement and Applicant's Declarations that the reason is (insert the explanation provided in the Important Facts Statement and Applicant's Declarations). Is this consistent with your understanding?

問題：你於重要資料聲明書 / 申請人聲明書中選擇了B項，即表示產品特色和風險程度與你所選擇的相關投資組合可能並不適合你，
但你仍想繼續進行該計劃的申請，而你亦在重要資料聲明書/
申請人聲明書中所提供的理由是（加入在該重要資料聲明書/
申請人聲明書中填寫的理由）。這說法是否與你所理解的一致？

3.3 Important Facts Statement and Applicant's Declaration
重要資料聲明書及申請人聲明書

A copy of the Important Facts Statement and Applicant's Declaration which you have read and signed during the application will be attached to the ILAS policy contract to be delivered to you by your insurance agent/ broker. Please read it carefully once you have received it because it contained important information and facts which you should know.
你的保險代理／經紀將會把你的投資相連壽險合約送交給你，並會一併送上在銷售時你已經閱讀及簽署的「重要資料聲明書及申請人聲明書」副本。請你收到後小心細閱有關文件的內容，因為當中列明了你必須知道的重要資料及概要。

3.4 Cooling-off Rights
冷靜期退保權益

Provide a statement on the customer's Cooling-off Rights and also specify the expiry date of the cooling-off period if known, or otherwise describe the date in general description.
向客戶提供冷靜期退保權益概要，若知道冷靜期屆滿的確實日期，應具體指明有關日期；假如未能提供具體的屆滿日，即應簡介如何計算冷靜期的屆滿日。

3.5 Closing Remark
結束備註

Thank the customer for their time and that you have verified all of the necessary information. Of course, if you have any queries, please feel free to either contact your broker/agent; who is keen on supporting you or contact us on xxxxx . Is there anything else that I can help you with today?
感謝客戶的寶貴時間，並說明已核實所需資料。假如客戶有任何查詢，可隨時聯絡其保險代理／經紀，中介人定必樂意解答有關問題，客戶亦可致電xxxxx與我們聯絡。詢請客戶是否尚有其他需要效勞的地方?

Yes – follow on　有－繼續跟進。

No – Bye.　沒有－再見。

Initiative on Financial Needs Analysis

(Source: HKFI)

Initiative on Financial Needs Analysis

Purpose:
Life insurance policies are long term policies that may lock the liquidity of customers. Accordingly, it is of paramount importance that insurance advice provided by intermediaries needs to be based upon customers' needs. It is therefore necessary to carry out financial needs analysis for the customers during the sales advisory process. This is in line with the global trend of the life assurance industry becoming more and more customer-focused. This circular supersedes the "Initiative on Needs Analysis" issued in 2007 and will **take effect on 1 January 2016**.

Requirements:

1) Every application for new life insurance policy (including rider and top-up) falling under the following types must be accompanied by a financial needs analysis ("FNA") form:

   (a) Any policies of the nature specified in Class A in Part 2 of the First Schedule to the Insurance Companies Ordinance (Cap. 41) ("ICO") except –

      (i) term insurance policies;

      (ii) refundable insurance policies providing hospital cash, medical, critical illness, or personal accident cover;

      (iii) yearly renewable insurance policies (without cash value) for critical illness/medical cover; or

      (iv) group policies.

   (b) Any policies of the nature specified in Class C in Part 2 of the First Schedule to the ICO.

2) The FNA must include all the questions and multiple choice options as set out in the Appendix. However, Member Companies may include additional questions and/or multiple choice options, if they consider that such will further enhance the suitability assessment for their own products. Member Companies may accept FNA forms of insurance brokers and insurance agencies provided that such forms are in compliance with the requirements of this circular.

3) Neither Member Companies nor customers can opt out of the FNA. A customer must respond to all the questions and multiple choice options as set out in the Appendix. If a customer, for privacy or other reasons, chooses not to disclose income/asset information under 4(a) or (b) (but not both) of the FNA, he/she must confirm their reason(s) in writing. This notwithstanding, if the absence of information under the FNA would render Member Companies or the intermediaries unable to comply with any of the requirements (e.g. assessing affordability of products recommended or comparison of different insurance options etc) under this (or any other) circular, Member Companies must reject the relevant application and should advise the customer accordingly.

4) The FNA must be clearly identified as a "Financial Needs Analysis" and must be signed and dated by the customer. The FNA form should include the following:

   - personal particulars (name, date of birth, marital status, occupation,

education level etc)
- financial outgoings (monthly living expenses, rent/mortgage redemption, etc)
- disposable assets (savings, stock/securities/bonds etc)
- liabilities (mortgage loan, debts, etc)
- family commitments (no. of dependents, education funds, etc)

5) Intermediaries should take into account the customers' total protection needs, total disposable assets, financial outgoings and liabilities, as well as his/her willingness and ability to pay premium (and the duration of payment) in assessing the affordability of customer before making recommendation. The factors considered, evaluation, and reason(s) for the recommendation made by the selling intermediary should also be included in the FNA.

6) Member Companies must require the intermediaries to carry out an FNA (including comparison of different insurance options) with the customers before recommending to them **any** life insurance products and signing the application.

Validity Period:
A signed FNA form shall have a validity period of one year, i.e. in the event that a customer purchases additional insurance coverage from the same Member Company within a year after an FNA form is signed, he/she will not necessarily have to go through another FNA provided that there are no substantial changes in the customers' circumstances (and in such cases Member Companies can rely on the declaration by the customer) and that there are no mismatch (i.e. needs, risks, affordability etc) identified.

(effective 1 January 2016)

APPENDIX: Financial Needs Analysis ("FNA") Form

The following questions form the minimum required contents of the FNA form:

Note: Please answer all questions in this form. Do <u>NOT</u> sign on this form if any questions are unanswered and have not been crossed out.

[Note: You must reply this question. Do not leave it blank. We will reject your application if you do not reply.]

1. What are your objectives of buying our product? (tick one or more)
   - a) ☐ Financial protection against adversities (e.g. death, accident, disability etc)
   - b) ☐ Preparation for health care needs (e.g. critical illness, hospitalization etc)
   - c) ☐ Providing regular income in the future (e.g. retirement income etc)
   - d) ☐ Saving up for the future (e.g. child education, retirement etc)
   - e) ☐ Investment
   - f) ☐ Others (Please specify____________________________________)

[Note: You must reply this question. Do not leave it blank. We will reject your application if you do not reply.]

2. What type(s) of insurance products you are looking for to meet your objectives above? (tick one or more)
   - a) ☐ Pure insurance product (without any savings or investment element) (e.g. term insurance)
   - b) ☐ Insurance product with savings element (with savings but without investment element) (e.g. non-participating policy)
   - c) ☐ Insurance product with investment element (Investment decisions and risks borne by insurer) (e.g. participating policy, universal life insurance)
   - d) ☐ Insurance product with investment element (Investment decisions and risks borne by policyholder) (e.g. Investment-Linked Assurance Schemes)
   - e) ☐ Others (Please specify____)

[Note: You must reply this question. Do not leave it blank. We will reject your application if you do not reply.]

3. What is your target benefit / protection period for insurance policy and/or investment plan? (tick one)

☐ < 1 year	☐ 1-5 years	☐ 6-10 years
☐ 11-20 years	☐ > 20 Years	☐ Whole of life

[Note: You must reply at least either 4(a) or (b). If you do not wish to answer either one of them, please cross it out.]

4. Your ability to pay premiums:

   a. What is your average monthly income from all sources in the past 2 years? (tick one or more)

      i. ☐ Specific amount: Not less than HK$_______________per month

      or ii. ☐ In the following range:
      - a) ☐ less than HK$10,000
      - b) ☐ HK$10,000 - HK$19,999
      - c) ☐ HK$20,000 - HK$49,999
      - d) ☐ HK$50,000 - HK$100,000
      - e) ☐ over HK$100,000.

   b. What is your approximate current accumulative amount of liquid assets? Please specify type(s) and total amount:

      Type : ☐ Cash
      ☐ Money in bank accounts

(effective 1 January 2016)

☐ Money market accounts
☐ Actively traded stocks
☐ Bonds and mutual funds
☐ US Treasury bills
☐ Others (Please specify____________________________________)

Amount : HK$ ________________

Note: Liquid assets are assets which may be easily turned into cash. Real estate, coin collection and artwork are not considered to be liquid assets.

If you choose not to disclose income/asset information under 4(a) or (b) above, you must indicate your reason(s) ***in your own handwriting*** *in the box below. Please note that we (the insurance company) will* ***reject your application*** *if you* ***choose not to respond to both 4(a) and (b)*** *above.*

(Applicant must complete explanation in ***own*** *handwriting in this box.)*

[Note: You must reply 4(c), (d) and (e) below. Do not leave any of these questions blank. We will reject your application if you do not reply.]

c. For how long are you able and willing to contribute to an insurance policy and/or investment plan? (tick one)
☐ < 1 year ☐ 1-5 years ☐ 6-10 years
☐ 11-20 years ☐ > 20 Years ☐ Whole of life

d. Approximately what percentage of your disposable income would you be able to use to pay your monthly premium for the entire term of the insurance policy/investment plan in (c) above? (tick one)
i) ☐ <10%
ii) ☐ 10% - 20%
iii) ☐ 21% - 30%
iv) ☐ 31% - 40%
v) ☐ 41% - 50%
vi) ☐ >50%

e. In considering your ability to make payments, what are your sources of funds? (tick one or more)
i) ☐ salary
ii) ☐ income
iii) ☐ savings
iv) ☐ investments
v) ☐ others (Please specify ___________________________)

5. Based on your answers to the questions above, the intermediary concerned has explored the following insurance options (as available to the intermediary) to meet your objective(s) and needs(s):

Objective(s) of Buying the Product(s) (Q1)	Type(s) of Insurance Product Explored (Q2)	Name of Insurance Product(s) Introduced (if any)	Product(s) Selected (if any)

Applicant's Name　　　Applicant's Signature　　　Date

WARNING: Please read and fill in this form carefully. Do not leave any questions blank. Do <u>NOT</u> sign if any questions are unanswered and have not been crossed out.

Note: You are required to inform us (the insurance company) if there is any substantial change of information provided in this form before the policy is issued.

(effective 1 January 2016)

Appendix C

Product Key Facts Statement – Illustrative Template

(Source: SFC)

PRODUCT KEY FACTS

[Product name and type, e.g. ABC ILAS Plan]

[Date]

[Issuer's name and logo e.g. ABC Insurance Company]

This statement provides you with key information about this product. This statement is a part of the offering document. You should not invest in this product based on this statement alone.

Quick facts

Name of insurance company:	[●]	**Policy currency:**	[●]
Single or regular premium:	[●]	**Min investment:**	[●]
Regular premium frequency:	[●]	**Max investment:**	[●]
Minimum premium payment term:	[●]	**Death benefit:**	[e.g. 101% of policy value OR premium paid (less prior withdrawal), whichever is higher]
Period with surrender charge:	[●]		
Governing Law of policy:	[●]		

Important

- This investment-linked assurance scheme ("ILAS policy") is a long-term investment-cum-life insurance product. It is only suitable for investors who:
  - [state if the principal will be at risk]
  - [state how long investors should be prepared to hold the investment]
  - [state other key characteristics of the product to help investors determine whether it is suitable for them]
  - have both investment and estate planning objectives as it is a packaged product that includes both investment and insurance element with death benefits payable to third party beneficiaries.
- This ILAS policy is **not** suitable for investors with short- or medium- term liquidity needs.
- **Fees and charges –**

  For ILAS policy with only one premium option: [Up to] [●] % of your premiums [(after taking into account all applicable [non-discretionary bonuses/rebates/*other similar features*])] will be paid to ABC Insurance to cover all the fees and charges at the ILAS policy level, of which [●] % is the cost of [life / insurance (*only if there is obligatory protection on top of life*)] protection, and this will reduce the amount available for investment.

  For ILAS policy with multiple premium options: The percentage of your premiums [(after taking into account all applicable [non-discretionary bonuses/rebates/*other similar features*])] paid to ABC Insurance to cover all the fees and charges at the ILAS policy level is shown in the table below. This will reduce the amount available for investment.

Premium option	Percentage of total premiums for covering the total fees and charges at the ILAS policy level
Single premium	[Up to] [●]%, of which [●]% is the cost of [life / insurance *(only if there is obligatory protection on top of life)*] protection
Regular premium	[Up to] [●]%, of which [●]% is the cost of [life / insurance *(only if there is obligatory protection on top of life)*] protection

Important (Cont.)

- **Fees and charges** (Cont.) –

  Please note that the above figure(s) are calculated based on the following assumptions: [(a) the life insured is non-smoking 40 year-old male [with a sum insured of [●]]]; (b) the payment of [single premium of [HKD1,000,000 or the minimum required single premium of the ILAS policy, whichever is higher] / regular premium of [HKD100,000 or the minimum required regular annual premium of the ILAS policy, whichever is higher] per annum]; (c) you hold your ILAS policy for [*Insert the number of years in accordance with the Relevant Period*] years; [(d) an assumed rate of return of 3% per annum throughout [●] years]; [(e) any optional supplementary benefits are not included]; and (f) there is no early withdrawal / termination of your ILAS policy.

  [*Where applicable*] : [You must understand that these ILAS level charges are on top of, and in addition to, the underlying funds# level charges]. The above figure(s) do(es) not take into account any early surrender / withdrawal charges.

  The above percentage(s) of your premiums for covering the total fees and charges are calculated based on the assumptions above for illustration purposes. The actual percentage(s) may change depending on individual circumstances of each case, and will be significantly higher if [the premium amount is lower, the sum insured is higher and/or your selected underlying investments are making losses].

- [**Long-term features –**

  Upfront charges:

  (a) [Up to [●]% of the] / [All] premiums you pay for the first [●] policy years will be deducted upfront as charges and will not be available for investment. **This means that the remaining amount of premiums available for investment may be [0]% of your premiums paid in this period.**

  As an illustration, this means that for each [HKD1,000] of premiums you pay each year, the premiums available for investment (after deduction of all upfront charges only) are as follows:

Policy Year	Premiums you pay	Premiums available for investment (after deduction of all upfront charges only)
1	[HKD1,000]	HKD[●] ([●]%)
...		

  You should note that the above illustration merely shows the impact of upfront charges on the premiums available for investment and does not reflect the impact of any other applicable fees and charges.

  Early surrender / withdrawal charges:

  (b) There will be an early surrender or withdrawal charge of up to [●]% of the [policy value / value of [●] Account / withdrawal amount] in case of [policy termination / surrender / partial withdrawal / suspension of or reduction in premium payment] within first [●] years. [You may also lose your entitlement to loyalty and [●] bonuses.]

Important (Cont.)

- **Long-term features** (Cont.) –

  Loyalty bonuses:

  (c) You will be entitled to a loyalty or special bonus of up to [●]% of the [policy value / value of [●] Account / first year premiums paid / total policy fees paid] if you keep your ILAS policy for [●] years.]

- **Intermediaries' remuneration** *[See Note 8 under "Guidance for preparing this statement"]*
  Although you may pay nothing directly to the intermediary who sells/distributes this ILAS policy to you, the intermediary will receive remuneration which, in effect, will be borne out of the charges you pay. You should ask your intermediary before taking up your ILAS policy to know more about the level or amount of the remuneration that the intermediary will receive in respect of your ILAS policy. If you ask, your intermediary should disclose the requested information to you.

"Underlying fund(s)" can be used by an Authorized Insurer in the event that it has disclosed in the offering document that it will be investing the net premium received from the scheme participants into the funds corresponding to the investment options as selected by the scheme participants for such Authorized Insurer's asset liability management. Otherwise, the Authorized Insurer should adopt the term "reference fund(s)".

What is this product and how does it work?

- This product is an investment-linked assurance scheme. It is a life insurance policy issued by ABC Insurance. This is not a fund authorized by the SFC pursuant to the Code on Unit Trusts and Mutual Funds ("UT Code").
- [The premiums you pay, after deduction of any applicable fees and charges of your ILAS policy, will be invested by ABC Insurance in the "underlying funds#" you selected (see below) and will accordingly go towards accretion of the value of your ILAS policy.] Your ILAS policy value will be calculated by ABC Insurance based on the performance of your selected underlying funds# from time to time and the ongoing fees and charges which will continue to be deducted from your ILAS policy value.
- Note, however, that all premiums you pay towards your ILAS policy, and any investments made by ABC Insurance in the underlying funds# you selected, will become and remain the assets of ABC Insurance. You do not have any rights or ownership over any of those assets. Your recourse is against ABC Insurance only.
- Due to the various fees and charges levied by ABC Insurance on your ILAS policy, the return on your ILAS policy as a whole may be lower than the return of the underlying funds# you selected. Please see page [●] for details of the fees and charges payable by you.
- "Underlying funds#" available for selection are the funds listed in the [investment option brochure]. These [may include] funds authorized by the SFC pursuant to the UT Code, [but may also include other portfolios internally managed by ABC Insurance on a discretionary basis not authorized by the SFC under the UT Code.]

What is this product and how does it work? (Cont.)

- Although your ILAS policy is a life insurance policy, because [part of] your death benefit is linked to the performance of the underlying funds# you selected from time to time, your death benefit is subject to investment risks and market fluctuations. The death benefit payable [may be significantly less than your premiums paid] and may not be sufficient for your individual needs.
- [More importantly, you should be aware of the following regarding your death benefit and the cost of insurance ("insurance charges"):
- Part of the fees and charges you pay that will be deducted from the value of your ILAS policy will be used to cover the insurance charges for the life coverage and any additional coverage you may choose.
- The insurance charges will reduce the amount that may be applied towards investment in the underlying funds# selected.
- The insurance charges may increase significantly during the term of your ILAS policy due to factors such as age and investment losses, etc. This may result in significant or even total loss of your premiums paid.
- If the value of your ILAS policy becomes insufficient to cover all the ongoing fees and charges, including the insurance charges, your ILAS policy may be terminated early and you could lose all your premiums paid and benefits.
- You should consult your intermediary for details, such as how the charges may increase and could impact the value of your ILAS policy.]

What are the key risks?

Investment involves risks. Please refer to the principal brochure for details including the risk factors.

- **Credit and insolvency risks** – This product is an insurance policy issued by ABC Insurance. Your investments are subject to the credit risks of ABC Insurance.
- The investment options available under this product can have very different features and risk profiles. Some may be of high risk. Please read the principal brochure [and the offering document of the underlying funds# involved] for details.
- **Early surrender/withdrawal penalty** – This ILAS policy is designed to be held for a long term period. Early surrender or withdrawal of the policy/suspension of or reduction in premium may result in a significant loss of principal [and/or] bonuses awarded. Poor performance of underlying funds#/assets may further magnify your investment losses, while all charges are still deductible.
- **Premium holiday** – with no premium contribution during premium holiday, the value of this ILAS policy may be significantly reduced due to fees and charges, which are still deductible during premium holiday, and your entitlement to bonuses may also be affected.
- **Market risks** – Return of this ILAS policy is contingent upon the performance of the underlying funds#/assets and therefore there is a risk of capital loss.

What are the key risks? (Cont.)

- [The life coverage of this ILAS policy [after the premium payment period/*specify other circumstances*] is only equal to [or may be less than] your ILAS policy value [due to surrender charge]. This means that the beneficiary(ies) will not receive any additional payment from ABC Insurance on top of the prevailing value of your ILAS policy upon the death of the life insured.]
- **Foreign exchange risks** – The investment returns of your ILAS policy may be subject to foreign exchange risks as some of the underlying funds# may be denominated in a currency which is different from that of your ILAS policy.
- **[Market value adjustment (MVA) –** For with-profits ILAS, your surrender value may be significantly reduced by an MVA imposed by ABC Insurance and the maximum amount deducted by MVA can be up to [100%] of the surrender value. You should ask your intermediary for the prevailing MVA rate.]
- **[INSERT ANY OTHER RISKS WHERE RELEVANT]**

Is there any guarantee?

- [This product does not have any guarantee of the repayment of principal. You may not get back the full amount of premium you pay and may suffer investment losses.]
- [State the guarantee] / [State that if the guarantee condition is not satisfied, scheme participants will not be able to get the guarantee]

Guarantee conditions

Whether this is a with-profits plan and whether there is MVA

Factors that will affect the guarantee

(Non-exhaustive suggested list of items)

[Other features]

- [e.g. Bonuses]

What are the fees and charges?

ABC Insurance reserves the right to vary the policy charges or imposes new charges with not less than [1] month prior written notice or such shorter period of notice in compliance with the relevant regulatory requirements.

What are the fees and charges? (Cont.)

Scheme level

	Annualised rate	Deduct from
Policy fee	[●]	[Policy value on the last business day of each month by redeeming units of investment options in proportionate to the premium allocation instruction]
Administration charge	[●]	
Account maintenance charge	[●]	
Insurance charge / Cost of Insurance	[Depends on the age, sex and risks associated with the life insured.] Please ask your intermediary [or refer to the illustration documents] for details.	
Early surrender/withdrawal charge	[●]	[Policy value on the date the surrender request is made]

Please refer to section ● (page ● to ●) of the principal brochure of ABC ILAS Plan for details of the charges.

Underlying funds# level

You should note that the underlying funds# of the investment options may have separate charges on management fee, performance fee, bid-offer spread and/or switching fee. You do not pay these fees directly – either (1) the fees will be deducted and such reduction will be reflected in the unit price of the underlying funds# or (2) units will be redeemed from your investment options to pay these fees. For details, please refer to the offering document of the underlying funds# and/or the principal brochure of ABC ILAS Plan, which are available from ABC Insurance upon request.

Additional Information

- [INSERT ANY OTHER ADDITIONAL IMPORTANT INFORMATION].

What if you change your mind?

– **Cooling-off period**

- Cooling-off period is a period during which life insurance policyholders may cancel their policies and get back their original investments (subject to market value adjustment) within the earlier of 21 days after the delivery of the policy or issue of a notice to you or the your representative. Such notice should inform you of the availability of the policy and expiry date of the cooling-off period. Please refer to the cooling off initiative issued by HKFI from time to time for reference.
- You have to tell your insurer by giving a written notice. Such notice must be signed by you and received directly by ABC Insurance at [Address of the insurer's Hong Kong Main Office]
- You may get back the amount you paid, or less if the value of the investment options chosen has gone down.

Insurance company's information

[Name of insurance company]	Phone: [●]
Address: [●]	Fax: [●]
	Email: [●]
	Website: [●]

Important

ABC Insurance is subject to the prudential regulation of the Insurance Authority. However, the Insurance Authority does not give approval to individual insurance products, including the ABC ILAS plan referred to in this statement.

If you are in doubt, you should seek professional advice.

The SFC takes no responsibility for the contents of this statement and makes no representation as to its accuracy or completeness.

Guidance for preparing this statement

1. If you want to include a responsibility statement in this statement, please make sure that such statement is consistent with the responsibility statement in other parts of the Principal Brochure.
2. Where a scheme is described as having been authorized by the SFC, please include a SFC non-endorsement statement in this statement pursuant to the requirements of the Code on Investment-Linked Assurance Schemes.
3. Disclosures shall be visually reader-friendly and written in plain language so that prospective scheme participants can easily read and understand them. Use of technical jargon or complex sentences shall be avoided.
4. Use of visual aids, graphs or charts is generally encouraged to illustrate the product structure and features.
   Note: For example, flowcharts may be used to assist scheme participants' understanding of the product structure.
5. Depending on the actual circumstances of the case, the contents of each statement may differ. Nevertheless, the headings set out in the template above are generally expected to be observed unless there are good reasons to do otherwise. Words inside the square brackets in the template are drafting notes. They should be construed as examples rather than suggestions, and are not meant to be exclusive or prescriptive. Issuers are responsible for what is and what is not to be included in this statements.
6. In the case where the ILAS contains any guaranteed features provided by a third party guarantor, disclosure as regards the credit risks of such guarantor, amongst others, shall be disclosed in this statement.
7. Issuers should refer to the Guidance Note on Fees and Charges Disclosure when preparing this statement.
8. The following version is effective, and must be adopted, by 1 January 2015 (or earlier, as appropriate, if and when the new point-of-sale disclosure and conduct requirements in respect of intermediaries' remuneration are in place):

   Although you may pay nothing directly to the intermediary who sells/distributes this ILAS policy to you, your intermediary will receive remuneration which, in effect, will be borne out of the charges you pay. Your intermediary should disclose to you in writing at the point-of-sale information about intermediary remuneration. The amount of remuneration actually receivable by your intermediary may vary from year to year and may be higher in the early policy years. You should ask your intermediary before taking up your ILAS policy to know more about the remuneration that your intermediary will receive in respect of your ILAS policy. If you ask, your intermediary should disclose the requested information to you.

Appendix D

Wording Guidelines on Announcement of Cooling-off Rights on Application Form

(Source: HKFI)

The ability of a policyholder to take advantage of their cancellation rights must be prominently displayed on the application form and clearly explained to him/her by the producing insurance intermediary. Guideline wordings and format as below:-

(1) <u>For All Non Linked Policies other than Non Linked Single Premium Policies</u>

"***Cancellation Rights and Refund of Premium(s)***

I understand that I have the right to cancel and obtain a refund of any premium(s) paid by giving written notice. Such notice must be signed by me and received directly by [Address of the insurer's Hong Kong Main Office] within 21 days after the delivery of the policy or issue of a Notice to the policyholder or the policyholder's representative, whichever is the earlier."

Note

(i) The address <u>must</u> be a Hong Kong address.

(2) <u>For All Linked Policies and all Non Linked Single Premium Policies</u>

"***Cancellation Rights and Refund of Premium(s)***

I understand that I have the right to cancel and obtain a refund of any premium(s) paid less any market value adjustment, by giving written notice. Such notice must be signed by me and received directly by [Address of the insurer's Hong Kong Main Office] within 21 days after the delivery of the policy or issue of a Notice to the policyholder or the policyholder's representative, whichever is the earlier."

Notes

(i) Insurers will be required to disclose their rights to apply a MVA and have available details of the basis of calculation of the MVA as part of the sales process and for disclosure before the application is signed.
(ii) For linked products the right to apply a MVA must be included in the principal brochure.
(iii) The address <u>must</u> be a Hong Kong address.

(3) <u>Format of Wording</u>

Should be prominent and no less than 8 font size, and

(a) In bold type no smaller than the main type font used on the application form,
(b) Be communicated in the same language(s) as are used for all other sections of the application form, and
(c) On the application form immediately above the place for the clients signature.

Appendix E

Wording Guidelines on Announcement of Cooling-off Rights with Policy Issue

(Source: HKFI)

An announcement must be prominently made at the time of policy issue clearly reminding the policyholders of their Cooling-off rights. Policyholders should also be advised that they have the rights to call the company direct if they wish to further understand their rights. Guideline wordings and format as below:

(1) <u>Wording</u>

"Your Right to Change Your Mind

If you are not fully satisfied with this policy, you have the right to change your mind.

We trust that this policy will satisfy your financial needs. However, if you are not completely satisfied then you should

- return the policy, and
- attach a letter, signed by you, requesting cancellation.

The policy will then be cancelled and the premium(s) paid will be refunded (*).

These cancellation rights have the following conditions :

- Your request to cancel must be signed by you and received directly by our [Address of the insurer's Hong Kong Main Office] within 21 days after the delivery of the policy or issue of a Notice to the policyholder or the policyholder's representative, whichever is the earlier and
- No refund can be made if a claim payment has been made.

Should you have any further queries you may contact [   ] and we will be happy to explain your cancellation rights further."

<u>Notes</u>

* For all linked Policies and all Non Linked Single Premium Life Policies add "less a deduction of the amount (if any) by which the value of your investment has fallen at the time when your cancellation letter is received by us."

(2) <u>Announcement Format</u>

Insurers may decide to make this announcement either by:

(a) display on policy jacket / cover, or
(b) separate notice, from the Insurer mailed direct to the client.

The announcement must be prominently displayed and no smaller than 10 font size.

Appendix F

Customer Protection Declaration Form

(Source: HKFI)

CUSTOMER PROTECTION DECLARATION FORM

The Hong Kong Federation of Insurers
香港保險業聯會

IMPORTANT DOCUMENT! PLEASE STUDY CAREFULLY BEFORE SIGNING!

This is an **IMPORTANT PART** of the Code of Practice for Life Insurance Replacement ("Code") and the Minimum Requirements as specified by the Insurance Authority under the Insurance Companies 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, the 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 policyholder 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$: ______ If no loss or if estimated loss is less than two years premiums or 10% of single premium of the basic life insurance policy replaced/to be replaced, please give reason and justification : ______ ______
b) You may have to pay **HIGHER** premiums under the new life insurance policy because you are older.	Will the annualized premiums be **HIGHER** under the new life insurance policy for the same sum insured? ☐ Yes ☐ No If no, please give reason : ______ ______ ______
c) The projection of future values of the new life insurance policy may be higher than the existing life insurance policy(ies), but the projected values in most cases depend on the performance of the insurers and may **NOT** be guaranteed.	Guaranteed Cash Values on the policy anniversary dates immediately after age 65 (if one of the policies or all policies mature(s) before age 65, please fill in the Guaranteed Cash Values on the policy anniversary dates of each policy in the earliest maturity year) : On the policy anniversary date of the calendar year of ______ , Guaranteed Cash Value(s) of the existing life insurance policy(ies) HK$: ______ On the policy anniversary date of the year indicated above, the Guaranteed Cash Value of the new life insurance policy HK$: ______

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	a) Period in the "Suicide Clause" expires on : Existing life insurance policy(ies) : ______

new life insurance policy may restart the period in the "suicide clause".	(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 :

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, the 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.)

7. Declaration by the Agent/ Broker :

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 Minimum Requirements for insurance brokers as specified by the Insurance Authority under the Insurance Companies 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 policyholder 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 ~

Appendix G

Illustration Document for Investment-linked Policies (Version 1)

(Source: SFC)

Information to be disclosed in the Illustration Document

Illustration of Surrender Values and Death Benefits for:

Name of Product: [Name of Product]

Name of Insurance Company: [Name of Insurance Company]

Name of Applicant: [Name of Applicant]

THE ASSUMED RATES USED BELOW ARE FOR ILLUSTRATIVE PURPOSES. THEY ARE NEITHER GUARANTEED NOR BASED ON PAST PERFORMANCE. THE ACTUAL RETURN MAY BE DIFFERENT!

IMPORTANT:

THIS IS A SUMMARY ILLUSTRATION OF THE SURRENDER VALUES AND DEATH BENEFITS (SHOWN ON THE FOLLOWING PAGE) OF [NAME OF PRODUCT]. IT IS INTENDED TO SHOW THE IMPACT OF FEES AND CHARGES ON SURRENDER VALUES AND DEATH BENEFITS BASED ON THE ASSUMPTIONS STATED BELOW AND IN NO WAY AFFECTS THE TERMS OF CONDITIONS STATED IN THE POLICY DOCUMENT.

Contract Term: [Actual Contract Term]

[Premium Payment Term:] [(if different from Actual Contract Term)]

Premium: [Actual Premium amount]

Assumed Rate of Return: Illustrated at 0%, [3%], [6%] and [9%] p.a.[i]

Projected Surrender Values for a [Regular/Single] Premium [Name of Product] with Contributions of [$ XXX] for [XXX Periods]					
Number of Years after Policy Issuance	Total Premium Paid since Start of Policy	Assuming Net Rate of Return of 0% p.a.*	Assuming Net Rate of Return of [3%] p.a.*	Assuming Net Rate of Return of [6%] p.a.*	Assuming Net Rate of Return of [9%] p.a.*
1					
2					
3					
4					
5					
10					
XX					

Declaration
I confirm having read and understood the information provided in this illustration and received the principal brochure.
Signed & dated:______________________________
[Applicant's Full Name in Printed Form]

[i] These assumed rates of return shall comply with the guidelines issued from time to time by the Life Insurance Council of the Hong Kong Federation of Insurers.

Projected Death Benefits for a [Regular/Single] Premium [Name of Product] with Contributions of [$ XXX] for [XXX Periods]					
Number of Years after Policy Issuance	Total Premium Paid since Start of Policy	Assuming Net Rate of Return of 0% p.a.*	Assuming Net Rate of Return of [3%] p.a.*	Assuming Net Rate of Return of [6%] p.a.*	Assuming Net Rate of Return of [9%] p.a.*
1					
2					
3					
4					
5					
10					
XX					

* The Surrender Value and Death Benefit shown in above Summary Illustration have been calculated based on the net rates of return. The net rates of return are net of fund charges levied by fund houses which vary with different funds. Assuming the fund charges are [1.50%] p.a., the gross rates of return on the underlying assets of the funds used in this Summary Illustration are therefore [1.50%] p.a., [4.50%] p.a., [7.50%] p.a. and [10.50%] p.a. respectively. For details of fund charges please refer to the offering documents of the funds. Please note that this illustration might not be relevant should you subsequently switch funds. Please kindly refer to your advisor for the further details. If you select a money market fund or a fixed income fund, then above returns in the growth scenarios would be considered high in many cases and unlikely to be achieved if low interest rate environment persists. You are strongly encouraged to speak to your financial adviser who could provide further information on these funds - both for your initial fund selection and subsequently.

[Under the assumed rate of return at 0% [and b%] p.a., your policy will remain in force up to an attained age of x [and y] of the individual insured respectively. The policy will terminate afterwards. Your policy may also terminate under other adverse investment scenarios. If the actual investment return is below the above assumed rate of return, the policy may terminate earlier than above attained age(s). You could lose all your premiums paid and benefits accrued if any condition of automatic early termination is triggered.]

Warning: ***You should only invest in this product if you intend to pay the premium for the whole of your chosen premium payment term. Should you terminate this product early or cease paying premiums early, you may suffer a significant loss.***

Declaration
I confirm having read and understood the information provided in this illustration and received the principal brochure.
Signed & dated:____________________________
[Applicant's Full Name in Printed Form]

i These assumed rates of return shall comply with the guidelines issued from time to time by the Life Insurance Council of the Hong Kong Federation of Insurers.

Illustration Document for Investment-linked Policies (Version 2)

(Source: SFC)

Information to be disclosed in the Illustration Document

Illustration of Surrender Values and Death Benefits for:
Name of Product: [Name of Product]
Name of Insurance Company: [Name of Insurance Company]
Name of Applicant: [Name of Applicant]

THE ASSUMED RATES USED BELOW ARE FOR ILLUSTRATIVE PURPOSES. THEY ARE NEITHER GUARANTEED NOR BASED ON PAST PERFORMANCE. THE ACTUAL RETURN MAY BE DIFFERENT!

IMPORTANT:

THIS IS A SUMMARY ILLUSTRATION OF THE SURRENDER VALUES AND DEATH BENEFITS OF [NAME OF PRODUCT]. IT IS INTENDED TO SHOW THE IMPACT OF FEES AND CHARGES ON SURRENDER VALUES AND DEATH BENEFITS BASED ON THE ASSUMPTIONS STATED BELOW AND IN NO WAY AFFECTS THE TERMS OF CONDITIONS STATED IN THE POLICY DOCUMENT.

Contract Term: [Actual Contract Term]
[Premium Payment Term:] [(if different from Actual Contract Term)]
Premium: [Actual Premium amount]
Assumed Rate of Return: Illustrated at 0%, [3%] and [6%] p.a.[i]

Projected Surrender Values and Death Benefits for a [Regular/Single] Premium [Name of Product] with Contributions of [$ XXX] for [XXX Periods]							
Number of Years after Policy Issuance	Total Premium Paid since Start of Policy	Assuming Net Rate of Return of 0% p.a.*		Assuming Net Rate of Return of [3%] p.a.*		Assuming Net Rate of Return of [6%] p.a.*	
		Surrender Value	Death Benefit	Surrender Value	Death Benefit	Surrender Value	Death Benefit
1							
2							
3							
4							
5							
10							
XX							

* The Surrender Value and Death Benefit shown in above Summary Illustration have been calculated based on the net rates of return. The net rates of return are net of fund charges levied by fund houses which vary with different funds. Assuming the fund charges are [1.50%] p.a., the gross rates of return on the underlying assets of the funds used in this Summary Illustration are therefore [1.50%] p.a., [4.50%] p.a. and [7.50%] p.a. respectively. For details of fund charges please refer to the offering documents of the funds. Please note that this illustration might not be relevant should you subsequently switch funds. Please kindly refer to your advisor for the further details. If you select a money market fund or a fixed income fund, then above returns in the growth scenarios would be considered high in many cases and unlikely to be achieved if low interest rate environment persists. You are strongly encouraged to speak to your financial adviser who could provide further information on these funds - both for your initial fund selection and subsequently.

[Under the assumed rate of return at 0% [and b%] p.a., your policy will remain in force up to an attained age of x [and y] of the individual insured respectively. The policy will <u>terminate</u> afterwards. Your policy may also terminate under other adverse investment scenarios. If the actual investment return is below the above assumed rate of return, the policy may <u>terminate</u> earlier than above attained age(s). You could lose all your premiums paid and benefits accrued if any condition of automatic early termination is triggered.]

Warning: You should only invest in this product if you intend to pay the premium for the whole of your chosen premium payment term. Should you terminate this product early or cease paying premiums early, you may suffer a significant loss.

Declaration ***I confirm having read and understood the information provided in this illustration and received the principal brochure.*** ***Signed & dated:*** ______________________ *[Applicant's Full Name in Printed Form]*

i These assumed rates of return shall comply with the guidelines issued from time to time by the Life Insurance Council of the Hong Kong Federation of Insurers.

Regulations for Insurance Brokers Engaged in Advising on Linked Long Term Insurance or Arranging or Negotiating Policies of Linked Long Term Insurance

(Source: CIB)

Regulations for Insurance Brokers Engaged in Advising on Linked Long Term Insurance or Arranging or Negotiating Policies of Linked Long Term Insurance

(Promulgated by the General Committee on 22 July 2011)
(With effect from 1 November 2011)

1. Definitions

1.1 In these Regulations, the following expressions shall have the following meanings:-

1.1.1 "Articles" means the Articles of Association of the Confederation;

1.1.2 "Code of Conduct" or "Guidance Notes" means the Code of Conduct or Guidance Notes from time to time of the Confederation.

1.1.3 "Confederation" means The Hong Kong Confederation of Insurance Brokers;

1.1.4 "Linked Long Term Insurance" has the same meaning as "Linked Long Term" in Paragraph C Part 2 of the First Schedule to the Insurance Companies Ordinance;

1.1.5 "Linked Long Term Insurance Business" means advising on Linked Long Term Insurance or arranging or negotiating policies of Linked Long Term Insurance;

1.1.6 "Registrant" means persons registered with the Confederation as Chief Executive or Technical Representative of a Member of the Confederation.

2. Interpretation

2.1 In these Regulations:-

2.1.1 Words importing one gender only shall include the other gender;

2.1.2 Words stated in the singular may apply in the plural or vice versa;

2.1.3 Any terms not defined shall have the meaning (if any) set out in the Articles or the Membership Regulations of the Confederation;

2.2 These Regulations shall be read in conjunction with the Code of Conduct and the Guidance Notes. It does not have the force of law and should not be interpreted in a way that would override the provision of any law.

2.3 Subject to the Articles, the interpretation of these Regulations shall be determined by the General Committee whose decision shall be final. The General Committee may issue guidelines or Guidance Notes from time to time as to how Members and/or Registrants may properly fulfil their responsibilities under these Regulations.

3. Persons to which these Regulations applies

3.1 These Regulations are applicable to all Members and their Registrants and Directors, and all other Employees of such Members in their carrying on the Linked Long Term Insurance Business.

4. Effect of breach of these Regulations

4.1 A failure to comply with or a breach of any provision of these Regulations may constitute a violation of the Code of Conduct by the Members, their Registrants, their Directors or Employees involved. Any alleged failure to comply with or breach of these Regulations shall be dealt with in accordance with the Articles.

4.2 The Confederation will be guided by these Regulations in considering whether a Member or a Registrant, a Director or an Employee of any Member satisfies the Code of Conduct, whenever they are engaged in Linked Long Term Insurance Business.

5. The Regulations

5.1 Supervision and control

5.1.1 Supervision – A Member, and its Directors, should ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct Linked Long Term Insurance Business on its behalf.

5.1.2 Control, financial and operational resources – A Member should have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations and its clients from financial loss arising from error, omission, theft, fraud, or other dishonest acts, professional misconduct or omissions in the course of conducting Linked Long Term Insurance Business. The Member's Directors should ensure the enforcement of such procedures and the sustainability of such capabilities.

5.2 Information for clients

5.2.1 Information about the Member – A Member should provide clients with adequate and appropriate information about its business, including but not limited to contact details, nature of business, services available to clients and corresponding remuneration policy, and the identity and status of Registrants acting on its behalf with whom the client may have contact. Where Registrants act for more than one company within a financial services group, the Member concerned should ensure that there is no reasonable basis for confusion on the part of the client as to the company for which these Registrants are acting.

5.2.2 Disclosure and fair treatment – If required by clients to do so, a Member should disclose any association or affiliation (e.g. of the same group of companies or with common directorship) it may have with any insurers or service providers whom it is recommending in relation to Linked Long Term Insurance Business. Where a Member or Registrant has a material interest in a transaction or recommendation with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to the transaction or recommendation, it should take all reasonable steps to ensure fair treatment of the client.

5.2.3 Client agreement in writing – A Member should enter into a written agreement with each client (Client Agreement) before carrying on Linked Long Term Insurance Business with that client. The Member should provide a copy of these documents to the client. The minimum contents of the Client Agreement are specified in Guidance Notes.

5.2.4 Withdrawal from business – A Member that withdraws in whole or in part from providing any services in relation to Linked Long Term Insurance Business should ensure that affected clients are promptly notified of the action and that any business which remains outstanding is promptly completed or transferred to another authorized insurance intermediary in accordance with any instructions of the affected clients.

5.3 Know your client

5.3.1 Identification – A Member and/or a Registrant should take all reasonable steps to establish the true and full identity of each client. Identity documents of individuals should be certified by the Registrant himself or a professional person such as a certified public accountant, solicitor or notary public. In respect of clients other than individuals, Members should obtain a business registration certificate and corporate documents or other official documents (certified as above) which uniquely identify the client, its directors and its shareholders. The Member concerned should keep documentary records sufficient to demonstrate that the client identification procedures have been followed satisfactorily.

5.3.2 Needs and requirements – A Registrant should take all reasonable steps to understand and record each client's needs and requirements. The Member concerned shall adopt adequate measures to verify that the Registrant's recording of the client's needs and requirements is in line with the information collected from the client.

5.3.3 Profile and appetite – A Registrant should take all reasonable steps to understand and assess each client's financial situation, in particular whether the client has sufficient net worth and/or disposable income, investment knowledge and experience, and is of a particular type of risk profile and appetite, such that he is able and/or willing to commit to a policy for Linked Long Term Insurance and/or to assume the risks and to bear the potential losses of committing to any arrangement or transactions under the policy for Linked Long Term Insurance, particularly in case of there being any associated or related leverage/gearing/collateral arrangement. A Member should adopt all reasonable measures to record and confirm that the aforesaid duties have been duly discharged by the Registrant.

5.4 Due Skill, care and diligence

5.4.1 Accurate representations – Where a Registrant advises a client, he should ensure that any representations made and information provided to the client are accurate and up-to-date.

5.4.2 Adequate information – A Registrant should offer the client adequate information, including but not limited to charges, market value adjustment, surrender charges and alternatives, for the client to understand the nature and extent of risks involved before the client commits to a policy for Linked Long Term Insurance, as well as in respect of any underlying funds, or any top-ups to any policy for Linked Long Term Insurance.

5.4.3 Risk disclosure – A Member should issue a Risk Disclosure Statement for and together with EACH recommendation to client in relation to Linked Long Term Insurance Business, including application for a new policy, and/or top-up to an existing policy, where the Statement should:-

(a) Be legible and in a language of the client's preference;

(b) Include a declaration duly signed and dated by the client to confirm that he/she has read the full contents of the Risk Disclosure Statement in relation to the relevant recommendation and has been suggested taking another independent advice on explanation of the risk(s) disclosed, that such declaration shall be made before the execution of the recommendation.

(c) Include, where appropriate to the relevant recommendation, explanation on the following headings:-

Credit Risk, e.g.

(1) Policy of Linked Long Term Insurance, like other insurance policies, is issued by insurer. Should the insurer become insolvent, similar to all other life insurance policies, there is a risk of capital loss.

(2) Return of the policy of Linked Long Term Insurance is contingent upon the performance of the underlying funds. Should any one of the fund managers become insolvent, there is a risk of capital loss.

Exchange Risk, e.g.

(1) When the denomination used for valuating the policy of Linked Long Term Insurance is not in the currency of your place of residence (or your intended place of residence when the policy matures), there is a risk of capital loss due to depreciation of the currency used for the denomination of the policy.

(2) When the denomination used for valuating the underlying funds is different from that used for the policy of Linked Long Term Insurance itself, there is a risk of capital loss due to depreciation of the currency used for the denomination of the underlying funds.

Interest rate Risk, e.g.

Should the monies paid into the policy of Linked Long Term Insurance be funded by premium financing, leverage~~,~~ or gearing, or should the policy of Linked Long Term Insurance be used as collateral, when the rate of returns of the policy net of all charges is lower than the interest rate payable for the premium financing, leverage, gearing or the collateral arrangement. there is a risk of financial loss not limited to the capital put in the policy.

Liquidity Risk and **Reinvestment rate Risk,** e.g.

(1) Policy of Linked Long Term Insurance is designed to be held for a long term period, and for regular premium type policy it is to be paid throughout the

term of policy selected. Early surrender or withdrawal of the policy may result in a significant capital loss due to charges to be imposed. Suspension of or reduction in premium may also result in capital loss, as all fees and charges at full rates are still deductible from the value of the policy during period of premium suspension or reduction (including during period of premium holidays).

(2) Design of the policy of Linked Long Term Insurance is that while any investment made by the insurer in the underlying funds you selected become and remain the assets of the insurer, should any investment be suspended or subject to a prolonged turnaround time to trade, the insurer may not be able to liquidate those investment in time to switch fund into another investment or to pay proceeds for policy surrender or withdrawal. There is a risk of fund switching or policy surrender or withdrawal being held up or delayed.

Market Risk, e.g.

Return of the policy of Linked Long Term Insurance is contingent upon the performance of the underlying funds that may be bad or good. When the funds perform badly, there is a risk of capital loss. Past performance is no guarantee of future results.

5.4.4 Suitability – A Registrant should ensure that any advice and/or recommendation to clients is based on thorough analysis. The Member concerned should conduct research and analysis to facilitate and guide the Registrant in advising clients. A Member and a Registrant should be satisfied as to the suitability of the recommendation in relation to a policy of Linked Long Term Insurance or any underlying funds made to a client, having regard to information about the client of which the Member and the Registrant should be aware of through the exercise of "Know Your Client" procedures referred to above at the time of the making of the recommendation.

5.4.5 Prompt execution – A Member and/or a Registrant should take all reasonable steps to execute promptly clients' instructions in relation to policies for Linked Long Term Insurance.

5.4.6 Recommending other service – A Member and/or a Registrant should act in the best interests of clients and avoid any conflict of interest when recommending any affiliates, associates or third party to the clients for services relating to policies for Linked Long Term Insurance arranged or negotiated by the Member or the Registrant.

6. Regulatory Issues

6.1 Attention is drawn to the following issues which arise as a result of the blurring of the demarcation between the regulatory role of the Securities and Futures Commission as regulator and the Confederation's regulatory regime.

6.1.1 Policies of Linked Long Term Insurance are excluded from the definition of "securities" in the Securities and Futures Ordinance. The Securities and Futures

Commission takes the view that arranging policies with the predominant purpose of providing life cover does not constitute dealing in securities and advising on the choice of fund linked to policies does not amount to advising on securities. If there are slight variations in circumstances resulting in different interpretation of statutory provisions or if at some future time, the Securities and Futures Commission changes its view then arranging, negotiating or advising on policies of Linked Long Term Insurance will give rise to the need to obtain licences for type 1 regulated activity (dealing in securities) or type 4 regulated activity (advising on securities). This will need to be kept under review.

6.1.2 The Securities and Futures Ordinance continues to regulate the issue of offering documents advertisements etc. of policies of Linked Long Term Insurance and requires these to be approved by the Securities and Futures Commission. Accordingly, policies of Linked Long Term Insurance may not be arranged or negotiated by reference to documents other than approved offering documents or advertisements as that is prohibited by the Securities and Futures Ordinance.

6.1.3 In respect of negotiating or arranging policies of Linked Long Term Insurance which are not predominantly policies providing life cover, these may fall within the definition of "securities" thereby requiring a licence for advising on or dealing in securities.

6.1.4 If Members are in any doubt regarding the above-mentioned Regulatory Issues, they should take legal advice.

**** END ****

Appendix I

Guidance Note on Conducting "Know Your Client" Procedures for Long Term Insurance Business (Including Linked Long Term Insurance (CIB-GN(4))

(Source: CIB)

香港保險顧問聯會
THE HONG KONG CONFEDERATION OF INSURANCE BROKERS

CIB-GN(4)
(issued on 22 June 2007)
(revised on 8 April 2014, effective from 1 June 2014)
(further revised on 18 December 2014, effective from 1 January 2015)

Guidance Note on Conducting "Know Your Client" Procedures for Long Term Insurance Business (Including Linked Long Term Insurance)

According to Membership Regulation 3.5, the General Committee is issuing this Guidance Note on Conducting "Know Your Client" Procedures for Long Term Insurance Business (Including Linked Long Term Insurance).

Background

CIB Membership Regulation 14.7.2 requires our Members and their Chief Executives and Technical Representatives to use a suitable confidential questionnaire to conduct a "needs analysis" for prospective policyholders in the selling process of long term insurance business.

Prior to the incorporation of this requirement in the Membership Regulations on 10 October 2006, CIB promulgated this practice via General Circular back in October 2002 and provided a sample Confidential Questionnaire for adoption. The said Confidential Questionnaire was circulated again in September 2006 in response to a revision of the Needs Analysis Initiative by the Life Insurance Council of the Hong Kong Federation of Insurers. It was prescribed under this Guidance Note as a sample on 22 June 2007.

As from 1 November 2011, the CIB Regulations for Insurance Brokers Engaged in Advising on Linked Long Term Insurance or Arranging or Negotiating Policies of Linked Long Term Insurance has become effective.

Also as from 1 April 2012, the Guideline on Anti-Money Laundering and Counter-Terrorist Financing ("AML Guideline") published by the Insurance Authority under section 7 of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance has become effective.

On 22 April 2013, the Life Insurance Council of the Hong Kong Federation of Insurers updated their Requirements Relating to the Sales of Investment Linked Assurance Scheme ("HKFI ILAS Requirements") which has now been fully implemented.

This Guidance Note was revised on 8 April 2014, with effect from 1 June 2014 to align the guidelines with the aforesaid regulatory development. The revision has adopted a principles-based approach, to the effect that sample Confidential Questionnaire will no longer be provided for adoption.

On 30 July 2014, the Office of the Commissioner of Insurance issued its "Guidance Note on Underwriting Class C Business" (GN15). This GN15 is applicable to all authorized insurers underwriting Class C business, or commonly known as Investment Linked Assurance Scheme ("ILAS"). In early December 2014, the HKFI ILAS Requirements were enhanced accordingly. Whilst the spirit behind it is to ensure fair treatment of clients by the insurance industry at large, its Section 7 (Suitability Assessment) and Section 8 (Advice to Client) are of relevance to business conduct of insurance brokers.

As a result, this Guidance Note is further revised to reflect the additional requirements arising therefrom on the "Know Your Client" Procedures for Long Term Insurance Business (Including Linked Long Term Insurance). A separate and new Guidance Note is also issued to deal with the requirements on product recommendation afterwards. Members are asked to develop appropriate policies and procedures and supervise their business conduct in this regard and to provide adequate training to their registrants and staff members to ensure due observance of the revised requirements.

Record-keeping and Verification

1. Owing to the fact that insurance brokers are independent from insurers, Members should not wholly or substantially rely upon insurers in record-keeping and verification of clients' information.

2. Members should keep documentary records sufficient to demonstrate that the following procedures, i.e. the client identification (as well as the customer due diligence under the AML Guideline), the needs analysis, and if applicable the risk profile, have been followed satisfactorily.

3. Usually insurance brokers should first know the clients, then source from the market and recommend the insurance products that suit the needs of clients, that Members should develop, design and use their own forms or instruments to conduct the procedures. Members who use individual insurer's forms or instruments for this purpose instead shall expect to be asked of how they have conducted the due diligence on product recommendation.

4. If the clients are subsequently to apply for investment-linked insurance, this will inevitably result in their having to fill in similar information onto insurer's Financial Needs Analysis Form and Risk Profile Questionnaire ("RPQ") as per the HKFI ILAS Requirements, that Members should put in place appropriate control and procedures to ensure that the information in the two sets of documents is consistent with each other.

5. The forms or instruments for identification, needs analysis and/or risk profile if applicable may be either presented as separate documents or consolidated into one single document. In any case, Members should ensure that the forms or instruments should be properly completed, dated and signed by both the clients and the intermediary with his/her identity clearly disclosed.

6. Client's circumstances may change over time. Members should conduct the necessary procedures whenever appropriate to update the information on their record, in particular when the circumstances of the client are known to have changed significantly.

7. There may be cases where clients do not provide any or all parts of the information required in the forms or instruments. If a Member would continue to serve its client by arranging any contract of long term insurance, it may insert an appropriate warning statement to safeguard the Member's own interest.

Identification

8. Common personal particulars should be recorded, and whenever necessary verified, for identification purpose. They should include but not limited to: full name, date of birth, nationality, identity document type and number, residential address, and contact number(s).

9. When it is a trustee who will be the prospective applicant and/or the prospective policyholder, the identification procedures, as well as the procedures for the needs analysis (and if applicable those of the risk profile), should be conducted on the beneficiary owner.

10. In case of corporate clients, the AML Guideline asks that the following information should be obtained and verified: full name, date and place of incorporation, registration or incorporation number, registered office address and business address (if different).

Needs Analysis

11. Members should recognize the importance of the need to identify and understand the client's goals, needs, resources and priorities before they could come up with any suitable recommendations, that the Members should develop appropriate questions to find out such information of the client's circumstances.

12. In order to assess clients' needs, Members should ensure that they understand, among others, the clients':-

    12.1 existing and potential financial commitments (and liabilities) arising from his/her family and marital status, and from his/her own aspirations (or lifestyle), including but not limited to the time horizon (e.g. target retirement age) and the magnitude of those financial commitments;

    12.2 income streams from his/her occupation, business, assets or others (e.g. spouse or child support or alimony), including but not limited to the reliability and magnitude of those income streams, client's age at policy inception and ability to afford the product including ability to pay regular premiums throughout a policy payment term;

    12.3 different financial needs, priorities and circumstances or requirements, at least in terms of insurance (or protection), saving, or investment.

13. Members should ensure that the financial information of the client to be collected would allow them to assess and to advise the client on his/her capability to commit to any new or additional long term insurance policy, i.e. on whether the client could afford to pay at the premium level for the full term of a regular-premium policy to be recommended, or whether the client could afford to set aside a lump sum of liquid assets for the specified term of a single-premium policy. Special attention should be given to clients who are dependent financially on other person or with an unstable income, e.g. dividends/interest of financial assets.

14. Members should include specific questions, where appropriate, asking for details of all existing long term insurance policy(ies) taken out by the client which is/are not matured, lapsed, or surrendered. In other words, information of any life or investment-linked insurance policies owned by the client that are in-force, paid-up, suspended or under premium holiday should be solicited from the client.

Risk Profile

15. This is related to giving advice on underlying funds or assets of the Linked Long Term Insurance policy. If clients are not going to consider any Linked Long Term Insurance, or they have concluded a written understanding with the Members that neither the Members nor their registrants would be required to advise on any underlying funds or assets of Linked Long Term Insurance policy, no risk profile procedures on the client is required to be conducted under this Guidance Note. This shall not however affect the requirements of completing insurers' RPQ under the HKFI ILAS Requirements at the time of applying for Linked Long Term Insurance policy by the client.

16. Clients' risk profile would usually include their (i) investment objectives, (ii) investment knowledge and experience, (iii) preferred investment horizon, (iv) risk attitude and appetite, and (v) risk tolerance or capacity. Members should develop and use appropriate risk profile questionnaires to understand and record the clients' risk profile in this regard, and the risk profile procedures should be conducted whenever appropriate to update the record, in particular when the circumstances of a client are known to have changed significantly.

17. Over time, clients' circumstances and risk profile may change, and so may the client's funds portfolio under each Linked Long Term Insurance policy. Members may or may not be aware of the changes in the funds portfolio, as some clients may switch funds on their own initiative or directly with the insurers, without consulting or informing Members and/or their registrants. When Members and/or their registrants are not involved in the fund selection, they are not duty-bound to alert clients of any mismatch between their risk level of the portfolios and risk profiles, but when such mismatch is identified when the risk profile procedures are conducted under point 16 above, Members and their registrants should serve a health warning to the clients of the mismatch.

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Appendix J

Guidance Note on Client Agreement for Linked Long Term Insurance Business (CIB-GN(9))

(Source: CIB)

香港保險顧問聯會
THE HONG KONG CONFEDERATION OF INSURANCE BROKERS

CIB-GN(9)
(Issued on 22 July 2011)

Guidance Note on Client Agreement for Linked Long Term Insurance Business

According to Membership Regulation 3.5, the General Committee is issuing this Guidance Note on Client Agreement for Linked Long Term Insurance Business as required under the Regulations for Insurance Brokers Engaged in Advising on Linked Long Term Insurance or Arranging or Negotiating policies of Linked Long Term Insurance.

This Guidance Note is issued per the above-mentioned date. To allow sufficient time for Members to prepare the necessary documentation and supervisory system, the General Committee has resolved that this Guidance Note shall take effect as from 1 November 2011).

Definitions

"Linked Long Term Insurance Business" means advising on Linked Long Term Insurance or arranging or negotiating policies of Linked Long Term Insurance;

"Underlying funds" means those funds or assets to which value of a policy of Linked Long Term Insurance is linked.

Client Agreement in Writing

A Member, who is engaged in Linked Long Term Insurance Business, shall enter into a written agreement with that client (Client Agreement), and shall provide a copy of it to the client within 7 days, with documentary proof of his/her receipt kept in client's file.

The Client Agreement shall be in a language of the client's preference. The Member, when required, shall afford the Confederation a translation of the Agreement in either Chinese or English if it is in a language other than these two.

For new client, including new client transferring an in-force Linked Long Term Insurance policy, such agreement shall be entered before carrying on Linked Long Term Insurance Business.

For existing client, where no agreement has been entered or the agreement previously entered does not meet with the minimum contents of Client Agreement as specified here below, when that client applies via the Member for a new Linked Long Term Insurance policy, the Member shall enter into a new Client Agreement which shall meet with the minimum contents as specified here below with that client before carrying on Linked Long Term Insurance Business for that client. To avoid any doubt, Members are at liberty of whether or how to align their duties and commitments to the existing client when two sets of agreement are concurrently in place.

As the Member is acting as insurance broker in or from Hong Kong, the Client Agreement shall be specified to be governed by the jurisdiction of the Hong Kong SAR. No Client Agreement shall operate to remove, exclude or restrict any rights of a client or obligations of the Member under the Hong Kong law.

The Minimum Contents of Client Agreement

1. The full name and address of the client as verified by a retained copy of the identity card, relevant sections of the passport, business registration certificate, corporation documents, or any other official document which uniquely identifies the client;

2. The address of the client as verified by a retained copy of the documentary proof;

3. The full name and address of the Member;

4. A description of the nature of business and services of the Member, with a narrative of its corresponding remuneration policy, duties and authorities (or limitation of authority), to be provided or available to the client in the Member's capacity as an insurance broker AND in relation to Linked Long Term Insurance Business, in particular:-

   4.1 Whether advice on underlying funds is to be provided or available in the said capacity,

   4.2 Any regular reviews of the policy itself and/or the underlying funds, including the extent and frequency of such reviews;

5. To avoid any doubt, when the Member intends to include business and services other than that in its capacity as an insurance broker AND in relation to Linked Long Term Insurance Business under one single Client Agreement, those business and services shall be put under sections with proper and clear headings, separating from that as specified and required for Linked Long Term Insurance Business in this Guidance Note;

6. Provisions governing that client will be informed in writing by the Member of the full name and registration number of the Member's representative(s) whom the client may contact for service to be provided or available under the Agreement, with a narrative of that representative's duties and authorities (or limitation of authority);

7. Obligations of the Member to notify the client in writing in the event of any material change to the information as specified in paragraphs (3) to (6) above;

8. Provisions governing amendments or termination of the Client Agreement, particularly in case where the Member is going to cease to be an authorized insurance broker.

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Appendix K

Guidance Note on Product Recommendation for Long Term Insurance Business (Including Linked Long Term Insurance) (CIB-GN(12))

(Source: CIB)

香港保險顧問聯會
THE HONG KONG CONFEDERATION OF INSURANCE BROKERS

CIB-GN(12)
(issued on 18 December 2014, effective from 1 January 2015)

Guidance Note on Product Recommendation for Long Term Insurance Business (Including Linked Long Term Insurance)

According to Membership Regulation 3.5, the General Committee is issuing this Guidance Note on Product Recommendation for Long Term Insurance Business (Including Linked Long Term Insurance). To avoid any doubt or confusion, this Guidance Note is **NOT** applicable to General Insurance Business or indemnity-type medical insurance wrapped under long term insurance policy.

Background

On 30 July 2014, the Office of the Commissioner of Insurance issued its "Guidance Note on Underwriting Class C Business" (GN15). This GN15 is applicable to all authorized insurers underwriting Class C business, or commonly known as Investment Linked Assurance Scheme ("ILAS"). Whilst the spirit behind it is to ensure fair treatment of clients by the insurance industry at large, provisions in its Section 7 (Suitability Assessment) and Section 8 (Advice to Client) are of relevance to the business conduct of insurance brokers.

This CIB Guidance Note is issued to reflect the additional requirements arising therefrom on the product recommendation for Long Term Insurance Business (Including Linked Long Term Insurance).

Besides the said GN15, the CIB Code of Conduct (among other things) requires our Members and their Chief Executives and Technical Representatives to do everything possible to satisfy insurance requirements of their clients. The Minimum Requirements for insurance brokers specified by the Insurance Authority also require an insurance broker:-

(a) to exercise due care and diligence in understanding and satisfying the insurance needs and requirements of his client;

(b) not to prejudice his/her client's selection of insurers by unreasonably limiting the choice of insurers; and

(c) not to be unreasonably dependent on any particular insurer in transacting insurance broking business.

This CIB Guidance Note shall be read in conjunction with the CIB Guidance Note on Conducting "Know Your Client" Procedures for Long Term Insurance Business (Including Linked Long Term Insurance), and Members are asked to develop appropriate policies and procedures and supervise their business conduct in this regard and to provide adequate training to their registrants and staff members to ensure due observance of the additional requirements.

Assessment

1. No products of Long Term Insurance (Including Linked Long Term Insurance) should be offered or recommended without the "Know Your Client" procedures having been duly conducted and the information collected properly assessed for the clients.

2. The assessment of the client's needs should refer to the financial circumstances, needs and requirements of the clients as disclosed and duly recorded in documentation obtained by Members in conducting the "Know Your Client" procedures.

3. If the client is covered by existing long term insurance policy(ies) that is/are in force, paid-up, suspended or under premium holiday, or with contribution at a reduced amount, the Members should assess and formulate an advice to the client on the appropriate option to his/her existing insurance portfolio of the client to satisfy any insurance needs and requirements identified, prior to formulating an advice of taking out new or additional long term insurance policy.

4. In conducting the assessment, Members should verify all available information and should satisfy themselves that the client is financially capable to commit to options to his/her existing insurance portfolio or taking out a new or additional long term insurance policy, in particular consideration should be given to the stability of income, target retirement age, and liquidity of assets of the client.

5. The assessment should be carried out again when Members have been informed of changes in circumstances including when an existing policyholder requests a top up as well as when Members have conducted the "Know Your Client" procedures to update clients' information.

Product Selection

6. It is the proposition of the Insurance Authority that ILAS products should bring insurance value to clients, and all authorized insurers in Hong Kong have agreed that, as from 1 January 2015, all their ILAS products would provide a minimum death benefit of 105% of the account value.

7. Members should put in place appropriate procedures to select from the market and present to clients suitable, adequate and different options that are available to meet their specific needs and financial circumstances. Members should endeavour to reduce the risk of recommending products that do not meet client's needs. In particular, whenever an ILAS policy is recommended to clients, the Members must also include in the recommendation a product which is classified under Class A of the Long Term Business in the Insurance Companies Ordinance (see notes below) as one of the options, with the exception that:-

   (1) when the client specifies the "Capital Investment Entrant Scheme" ("CIES") to be his/her need during the "Know Your Client" procedures, Members should then select and present adequate options of the ILAS products that suit the requirement under the CIES to the client; or

   (2) When the client specifies that he/she wishes to make the investment decision and is willing to bear the investment risk, Members should then select and present adequate options of the ILAS products that suit the requirement to the client.

   (notes: Class A of the Long Term Business in the Insurance Companies Ordinance is described as "Life and Annuity" with the nature of business narrated as "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").

8. An ILAS policy should only be recommended to clients who are willing to bear the investment risk. When recommending an ILAS policy, Members should explain to the client as to why the ILAS policy is more suitable than non-ILAS policy presented. Members should also explain the basis of the recommendation of each alternative having regard to the information about the client obtained through the "Know Your Client" procedures, the fees and charges involved, features of the recommended policy and any possible disadvantages of the policy to the client as can be reasonably assessed by Members.

9. Members are reminded that in accordance with Membership Regulation 14.5, it is only when there are no suitable products offered by authorized insurers in Hong Kong or it is explicitly required by the clients, that the Member may arrange insurance products of providers not authorized in Hong Kong. In this event, Members should advise clients as per the format prescribed in Annex C to the Membership Regulations.

Recommendation in Writing

10. Members should present in writing their recommendation of the options selected together with the basis thereof to client, who should be asked to confirm in writing whether he/she would agree to proceed and with which option presented. A copy of the confirmation should be provided to the client for retention.

11. In the recommendation of a regular premium policy, Members should include, but without limitation, the following:-

11.1 the ratio of the regular premiums of the recommended product to the client's disposable income. When client's disposable income is known in the form of a range, the lowest end of the range should be used for the calculation. The figures may be annualized or presented in terms of a monthly average. The premium amount of the recommended product should use the figures as shown in the insurer's illustration document. When there are premiums for any riders to the recommended product not included in the illustration document or where the premium will change significantly over time, Members should draw this attention of the client in writing so that the client can understand the nature of the premium to income ratio taking this into account;

Notes: Client's disposable income should be worked out by taking into account the client's income stream and existing financial commitments, e.g. living expenses of client and his/her dependant, mortgage and tax payments, other insurance premium payments, as collected in the Needs Analysis.

11.2 the financial commitment of client, i.e. the total premiums payable for the full payment term of the recommended product as shown in the insurer's illustration document. When there are premiums for any riders to the recommended product not included in the illustration document or this type of premium will change significantly over time, Members should draw the attention of the client to this in writing so that the client can understand the total financial commitment; and

11.3 whether the premium payment term goes beyond the client's target retirement age, and in this case the client's intended source(s) of fund to pay thereafter.

12. Before proceeding to arrange a regular premium policy, Members should obtain a declaration by the client that he/she is comfortable with the ratio, consents to the financial commitment, and where applicable, confirms his/her capability to pay premiums beyond his/her target retirement age, and when it is an ILAS policy, also with the fees and charges and the investment risks.

13. In the recommendation of single premium policy, Members should include, but without limitation, the following:-

13.1 the premium/liquid asset ratio, where the premium is that of the recommended product and the amount of liquid asset should be that identified during the “Know Your Client” procedures;

13.2 the lock-up period (i.e. when any charge or fee applicable for total or partial withdrawal or surrender of policy)

14. Before proceeding to arrange a single premium policy, the Members should obtain a declaration by the client that he/she is comfortable with both the ratio and the lock-up period, and when it is an ILAS policy, also with the fees and charges and the investment risks.

15. When insurance product of providers not authorized in Hong Kong is included in the recommendation, the Members should give the rationale of the inclusion.

16. No other policy illustration in any form other than the policy illustration documents prepared and provided by insurers, is allowed to be prepared, used, presented and/or provided to clients.

17. If it is the case that the client does not provide any or all parts of the information required in the documentation for conducting the “Know Your Client” procedures or that the assessment and product recommendation is based on no or limited information of the client, the Member should include an appropriate disclaimer in the recommendation.

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Code of Conduct for Insurance Brokers Conducting Investment Linked Business
(Source: PIBA)

Professional Insurance Brokers Association

CODE OF CONDUCT
FOR
INSURANCE BROKERS CONDUCTING
INVESTMENT LINKED BUSINESS

1 March 2014

PROFESSIONAL INSURANCE BROKERS ASSOCIATION

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SECTION 1: INTERPRETATION AND APPLICATION

Definitions

Unless otherwise defined, following words and expressions used in this Code are defined as below:

1.1 "Chief Executive" shall have the meaning ascribed to it in the Minimum Requirements for Insurance Brokers.

1.2 "ILAS" means investment-linked assurance scheme which is an insurance policy of the "Linked long term" class as defined in Part 2 of Schedule 1 to the Ordinance, other than a policy of which the predominant purpose is life assurance and not investment.

1.3 "M&A" means the Memorandum and Articles of Association of PIBA (as amended from time to time).

1.4 "Member" shall have the meaning ascribed to it in M&A.

1.5 "Minimum Requirements for Insurance Brokers" mean the minimum requirements specified by the Insurance Authority for the purpose of, inter alia, sections 69 and 70 of the Ordinance (as amended from time to time).

1.6 "Ordinance" means the Insurance Companies Ordinance (Cap.41) (as amended from time to time).

1.7 "Relevant Person(s) of a Member" means a Chief Executive, TR, Director and/or employee of a Member (as the case may be).

1.8 "PIBA" means the Professional Insurance Brokers Association.

1.9 "Statutory and/or Governmental Requirements" means any requirements under the Ordinance, Minimum Requirements for Insurance Brokers and/or any statutes or requirement as Insurance Authority and/or any other governmental authorities may impose from time to time to which Member and/or Relevant Person(s) of a Member is/are subject in engaging in ILAS business.

1.10 "TR" means technical representative and shall have the meaning ascribed to it in the Minimum Requirements for Insurance Brokers.

1.11 In this Code, where the context permits:

(a) words and expressions importing the masculine gender shall include the feminine and neuter genders and vice versa;

(b) words and expressions importing singular shall include the plural and vice versa;

(c) words and expressions importing person(s) shall include partnership, body(ies) of person(s) and corporation(s);

(d) references to section and appendix are to be construed as reference to section of and appendix to this Code respectively; and

(e) the headings in this Code are inserted for convenience only and shall be ignored in the interpretation of this Code.

1.12 In this Code,

(a) reference to staff of Member shall include and refer to employees and TR of Member (notwithstanding a TR may not be an employee of Member); and

(b) reference to client shall refer to any client of Member

Authority

1.13 The authority of this Code is given by PIBA.

Conflicts with the Statutory and/or Governmental Requirements

1.14 This Code should not be interpreted in a way that would override the provisions of any applicable laws, codes or other regulatory requirements.

1.15 In the event of any conflict between the Statutory and/or Governmental Requirements and this Code, the Statutory and/or Governmental Requirements shall prevail and this Code shall in no way affect the operation of any of the Statutory and/or Governmental Requirements in so far as such conflict is concerned.

Interpretation

1.16 The interpretation of this Code shall be subject to the M&A and shall be determined by the Executive Committee of PIBA in case of dispute arising therefrom. Any determination made by the Executive Committee shall be final. The Executive Committee may from time to time review this Code and, if think appropriate, issue guidelines and interpretation notes to Member with respect to the application of this Code.

SECTION 2: PERSONS TO WHICH THIS CODE APPLIES

This Code applies to Members and the Relevant Person(s) of a Member who and when they are engaged in the ILAS business, and every aspect of this Code with which Member is required to comply shall, so long as the context thereof permits, also apply to and be complied with by any one of Relevant Person(s) of a Member personally.

SECTION 3: REGISTRATION REQUIREMENT

No Member or Relevant Person(s) of a Member shall engage in ILAS business unless it/he/she shall have been duly registered with PIBA for engaging in the line of Long Term (including linked long term) business.

SECTION 4: MANAGEMENT AND INTERNAL CONTROLS

Member should provide adequate supervision and effective internal controls over its staff so as to ensure full compliance of Statutory and/or Governmental Requirements and this Code in every aspect by Member and/or Relevant Person(s) of a Member, and to safeguard the interests of client. For this purpose, appropriate and adequate policies and measures should be implemented by Member, and Member should ensure that its staff (particularly its TRs and intermediary and compliance staff, if any) possess the necessary qualifications, experience and skills in performing their duties effectively and competently.

Diligent Supervision

4.1 Member is responsible for the ethical and professional conduct of its staff (in particular its TRs) in conducting ILAS business. Thus, Member must exercise diligent supervision over its staff and as such, Member should implement proper system and/or policies for, at least, timely and effective reporting, proper record keeping, due and careful verification of all new applications and subsequent change applications for ILAS products in every aspect, and regular review and follow-up with client in respect of his/her ILAS policies. Further, in order to avoid any errors, omissions, or any negligent or even fraudulent acts, Member must ensure that its staff are qualified and competent to carry out their assigned duties when conducting ILAS business.

Segregation of Duties

4.2 Member is recommended to impose segregation of duties, particularly between front office and back office functions whereby client's information and instructions would be cross checked and verified by separate and independent staff member. Establishment of internal control procedures to support the segregation is highly recommended and constant supervision is necessary. Member must monitor closely the activities of the respective functions to avoid any loophole, conflict or breach of conduct.

Handling Client's Premiums

4.3 In case where client pays premium through Member, Member should ensure that client's premium is adequately safeguarded and is properly and promptly accounted for at all times. Disbursement payable to any insurer(s) should be settled in a timely manner to avoid undue delay. If the payment is made payable directly to the insurer, Member should ensure delivery of payment in a secured manner.

Responsible for Compliance by Staff

4.4 Member is required to comply with Statutory and/or Governmental Requirements as well as this Code and accordingly, Member should establish policies and procedures for its staff to ensure compliance by them with Statutory and/or Governmental Requirements and this Code in every aspect.

4.5 For every TR who sells and promotes ILAS products, he/she should
(a) has a good understanding of the relevant regulatory framework, including the laws, regulations and associated codes;
(b) is aware of the ethical standards expected of a TR; and
(c) is knowledgeable of the ILAS products that he/she deals in or advises upon.

Familiar with Relevant Ordinances and etc.

4.6 Member must, and must ensure its staff (in particular its TR), be familiar with the following when selling ILAS products:

- Prevention of Bribery Ordinance (Cap 201)
- Personal Data (Privacy) Ordinance (Cap 486)
- Insurance Companies Ordinance (Cap 41)
- Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap 615)
- Guidance Note on Prevention of Money Laundering and Terrorist Financing prepared by the Office of the Commissioner of Insurance

SECTION 5: TREAT YOUR CLIENT FAIRLY

Member should comply with all regulatory requirements applicable to the conduct of its business activities, so as to protect the interests of client and uphold the integrity fostered by PIBA.

Inform Client of Cooling Off Right

5.1 Member should advise client of the Cooling-off period when, or before, client decides to purchase ILAS policy, and should further remind client of such right upon delivery of the policy. Member is expected to make itself acquainted with the cooling-off period guidelines as imposed by the regulatory bodies, the Hong Kong Federation of Insurers (HKFI) and/or individual insurers/financial institutions concerned from time to time.

Honesty and Fairness

5.2 Member must offer and perform services in an honest and forthright manner.

Fees and Remuneration

5.3 Member's fees and remuneration, whether initial and/or ongoing, must be fair and reasonable in the circumstances and be characterized by good faith. Member should not charge or accept any fee in such amount that is disproportionate to the service rendered to client.

5.4 The fact that Member will be paid by the insurer of the ILAS product should be disclosed to client and in this regard, Member should further make reference to paragraph 3A - Remuneration Disclosure of PIBA's Membership Rules and Regulations and any memo, circular, practice note and/or etc. issued by PIBA from time to time relating thereto.

Prompt Administrative Execution for Client

5.5 Member should ensure that client's instructions and/or orders and any changes in client's information and/or policies should be promptly executed and processed without delay.

Information about Members' Business

5.6 Member should provide client with complete information about its business, contact details, and other information beneficial to client. Any changes in contact details should also be provided to client in a timely manner.

ILAS Clients Require TR While Policy in Force

5.7 When an ILAS policy is in force, Member should ensure that there is a servicing TR appointed for such particular policy at all times. In the event a TR shall resign from Member, Member should ensure that another TR be appointed in place of such leaving TR in serving the ILAS policies previously served by the leaving TR. Preferably, the new TR should be appointed prior to the departure of the leaving TR. If it is impracticable for so doing, the replacement should be done within a reasonable time after the departure of the leaving TR but in the meantime, the Chief Executive should act as the servicing TR. Client affected should be informed of such change in writing as soon as possible.

5.8 In case Member is going to cease business or howsoever unable to continue to serve its clients of ILAS policies, Member should make appropriate arrangement in advance with the insurers of ILAS policies and/or other Members so as to ensure that, as far as practicable, there are servicing TR for all ILAS policies at all times.

Client Agreement in Writing

5.9 Member must enter into an agreement in writing with client before services are provided to client. A duplicate copy of the executed agreement should be given to client. This agreement should specify the responsibilities of the parties and confirm what future role Member will take with respect to the ILAS policy (e.g. fund switching, advice, etc.). In any event, this agreement should at least include contents as stipulated in the "Minimum Content of Client Agreement" (as provided in Appendix 1 hereto) and the Risk Disclosure Statements (as provided in Section 8.5 and Appendix 2 hereto below). A copy of the executed client agreement should be kept in the client file.

Termination of Client's Appointment of Member

5.10 Where client wishes to terminate the appointment of Member, Member should have proper regard to the client's wishes and render such assistance as client may request in a professional and responsible manner.

SECTION 6: KNOW YOUR CLIENT

Member should make reasonable efforts to verify the identity of client and institute effective procedures on obtaining and verifying client information. In the event client fails to substantiate his/her identity, Member should not conduct business with him/her.

Identity and Address of Clients

6.1 Member should take all reasonable steps to verify the identity, address and contact details of client. TR or employee of Member should personally inspect, certify and take copies of client's original HKID card or passport and address proof. If it is impracticable for so doing, any copy identity document provided by client to Member should be a certified copy by a Justice of the Peace, a notary public, a lawyer, or a certified public accountant. These copies should be kept in the client file.

Documentation & Recommendations For Client

6.2 Where applicable, Member should ensure that all documentation for client (such as Financial Questionnaire, Financial Needs Analysis, Risk Profile Questionnaire, Important Facts Statement and Applicant's Declaration, and any documents as may be required by insurers, Insurance Authority and/or any other governmental authorities from time to time) has been duly completed. After taking into account of client's wishes, Member's recommendations to client should be appropriate to the client's needs and circumstances. Member should also assure itself that client fully understands the nature of the product or recommendations given to him/her. Such understanding should be confirmed by client by signing thereon with a statement to that effect.

SECTION 7: INFORMATION FOR CLIENT

Member should clearly define and explain to client, or to prospective client, the insurance/financial services (relating to ILAS products) being or to be provided or offered, and any representations made and information provided to client should be accurate and non-misleading.

Brochures and Leaflets and Explanatory Statements

7.1 Member should provide client or prospective client with all documentation and materials furnished by insurers for client (such as Principal Brochure, Product Key Facts Statement, Fund Choice booklet and etc.) and any documents required by Insurance Authority and/or any other governmental authorities to be provided to client, and procure client to acknowledge receipt thereof in writing and such written acknowledgment should be kept in the client file. Member is also recommended to explain to client in writing the type of services being or to be provided or offered.

7.2 Member should take reasonable steps to ensure that all such documentation and materials must have been approved by the Hong Kong Securities and Futures Commission (if so required) and are up to date before despatched to client.

Comprehensive Financial Planning

7.3 If a comprehensive financial planning is provided to client, Member may follow the internationally recognized six-step financial planning process:

(1) Collect and assess all relevant data
(2) Identify the client's personal goals and translate them into financial goals
(3) Define and analyse financial problems
(4) Provide a written financial plan with recommendations
(5) Implement or coordinate the implementation of the plan
(6) Periodically review the plan

Know the Product and Disclose All Material Facts

7.4 Member should be familiar with the ILAS product provided or recommended to client, and should disclose all material facts regarding the ILAS product. In particular, Member must ensure that client's attention has been specifically drawn, before client decides to purchase an ILAS product, as to the term, any early cancellation charges, the early surrender value, and the premium holiday provisions of the ILAS product. Such disclosure should be made in writing and acknowledged receipt by client by signing and dating thereon and kept in the client file.

Client Understanding

7.5 Member should take all reasonable measures to satisfy itself that client fully understands and accepts the risks associated with the ILAS products, and such understanding should be documented in writing, signed and dated by client and kept in the client file.

Decent Presentation

7.6 Any presentation of information and/or advice to client should be done in a decent manner and environment so as to ensure a proper standard of work and accuracy of information and/or advice given to client.

SECTION 8: APPROPRIATENESS OF ADVICE

Member should ensure that it has adequately considered client's investment objectives, investment strategy and financial position before making any recommendations to client. Further, to ensure the advice relating to ILAS products is appropriate and in client's best interests, Member must have established the advice under reasonable and prudent judgment. For this purpose, Member should take into account, at least, client's background, level of sophistication, financial position and objectives. Further, Member should not rely on ILAS products of one particular insurer only in its ILAS business.

Conflicts of Interest Avoided

8.1 Conflict of interest between client and Member should be avoided. If such conflict of interest arises, client should be informed by a written notice from Member at once. In case client maintains engagement of Member's service notwithstanding the existence of such conflict, an acknowledgment to that effect from client by signing and dating on the said notice should be obtained and kept in the client file.

Reasonable Research on Products and Services

8.2 Member should ensure that reasonable product and service research have been conducted regarding the benefits and features of ILAS products and/or services before recommended or provided to client.

8.3 For off-shore ILAS insurers and products not authorized by the Hong Kong Insurance Authority and the Hong Kong Securities And Futures Commission respectively, extra care must be exercised by Member to ensure these products are suitable for client and client is aware of the off-shore nature and the associated risk. Member's attention is specifically drawn to Section (IV)(E)(b) of the Minimum Requirements for Insurance Brokers.

Reasonable Research on Investment for ILAS Products

8.4 Where advice involves investments within ILAS products, such advice should as far as practicable be supported by reasonable investment research. It is recommended that such investment research (if any) should be documented and filed. It is further recommended that research specifically conducted for a particular client should be filed in that client file.

Risk Disclosure Statements

8.5 The client agreement mentioned in Section 5.9 above should contain appropriate and applicable risk disclosure statements. The risk disclosure statements contained in Appendix 2 hereto is considered to be the minimum required, and Member may elect to provide additional risk disclosure information as appropriate.

SECTION 9: ILAS PRODUCT REPLACEMENT

Member should not induce, or attempt to induce, client to replace an his/her existing ILAS policy, unless there is sound reason for so doing (e.g. it no longer meets the client's needs).

Policy Replacement

9.1 Prior to advising client to replace an existing ILAS policy, Member should ensure that an updated analysis of client's financial needs has been done and be kept in the client file. If the ILAS policy contains life insurance component, Member should complete a Customer Protection Declaration form (as prescribed in Minimum Requirements for Insurance Brokers).

SECTION 10: INVESTMENT WITHIN ILAS PORTFOLO BOND PRODUCTS

10.1 Client of ILAS Portfolio Bond Products would usually need a more professional advice on investment. As such, it is recommended that Member who promotes or sells such products should be licensed or registered with the Hong Kong Securities And Futures Commission for the relevant types of regulated activities as defined in Schedule 5 to the Securities And Futures Ordinance, Cap 571.

10.2 In any event, prior to recommending a particular investment to client within the portfolio bond, Member must be familiar with such particular investment and must explain to client thoroughly the benefits and risks associated with such investment.

10.3 Prior to any switching among investments (i.e. sell one and invest into another) within a portfolio bond, Member should:

(a) ensure that it has complied with this Code in all aspects; and
(b) exercise due care and diligence to ensure that minimum investment switching charges be incurred by client.

SECTION 11: KEEPING OF RECORDS

It is Member's responsibility to maintain sufficient and proper records for the purposes for which this Code applies.

Form and Duration of Maintenance

11.1 Records could either be kept in physical form or in scanned electronic form (for copy documents), and should be maintained for at least 7 years. If the records are related to a particular ILAS policy of client, the 7-year period will be counted from the termination or expiry date of such policy.

Confidentiality and Misuse

11.2 Records should be kept confidential and safe guarded from misuse. In particular, Member should maintain confidentiality in respect of information relating to client. Except as required by law, Member should not disclose to a third party any information relating to client without his/her explicit permission.

Records Protection

11.3 Records should be safe guarded from loss or damage by any means.

Records of Sales Transactions

11.4 Member should maintain accurate and timely records in respect of each of sale transactions related to ILAS product.

Client Files

11.5 Member should maintain a separate client file for each ILAS policy of a client. Any documents and records as related to and/or in connection with such ILAS policy, as far as practicable, should be kept in such file. In any event, such file should contain all documents and records as required by this Code.

SECTION 12: CLIENT COMPLAINT HANDLING AND DISPUTE RESOLUTION

Member must take client complaints seriously and handle the complaints promptly, properly and in a courteous manner throughout. Member should be aware that late or improper handling of client complaint may lead to adverse publicity and damage to the Member's reputation as well as the reputation of PIBA and the insurance industry generally.

Assignment of Complaints Officer

12.1 Member should appoint at least one of its staff to be a complaints officer. If Member is a firm of small to medium size, this role should be taken up by the Chief Executive. The complaints officer should be responsible for monitoring the activities of the Member's ILAS business and maintain a thorough record for each client complaint.

Process of Handling Complaints

12.2 Upon receipt of a complaint from client, Member should promptly make record of every detail of the complaint as provided by client.

12.3 Thereafter, Member should as soon as possible send an acknowledgement to client of its receipt of his/her complaint in writing, and inform client that a full investigation is being conducted and give client a time estimate within which a substantive reply would be given to client by Member in respect of the complaint.

Response with Findings and Resolution

12.4 After the investigation, Member should inform client of the result in a fair and timely manner.

SECTION 13: ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING (FINANCIAL INSTITUTIONS) ORDINANCE (CAP. 615)

13.1 Member must be familiar with Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) and particularly, *Schedule 2 - Requirements Relating to Customer Due Diligence and Record-keeping* thereto which set out (amongst other things and not exhaustive):

- What customer due diligence measures are
- When such measures must be carried out
- Simplified customer due diligence measures
- Duty to continuously monitor business relationships
- Provision relating to pre-existing customers
- When customer is not physically present for identification purposes
- When customer is politically exposed person
- Special requirement for insurance policies (i.e. relating to identification of beneficiary)
- Special requirement for wire transfer
- Special requirement in other high risk situations
- Prohibition of anonymous accounts etc.

13.2 Member must establish and implement such procedures and measures as required by Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) and provide adequate supervision and effective internal controls over its staff so as to ensure full compliance thereof.

APPENDIX 1 – MINIMUM CONTENT OF CLIENT AGREEMENT

The Client Agreement ("Agreement") mentioned in Section 5.9 above must contain terms and condition in respect of the following :

1. Name and address of client;

2. Name and address of Member;

3. Notifications - Undertakings by client and Member respectively to notify the other of any material change in information of themselves respectively;

4. Term - The term of the Agreement, and renewal clause (if any);

5. Nature of services - A description of the nature of the services to be provided or available to the client;

6. Remuneration - A description of any remuneration to be paid by client to Member under the Agreement, if any.

7. Remuneration disclosure – for remuneration paid by insurers to Member, Member should include the Form of Disclosure as required by paragraph 3A - Remuneration Disclosure of PIBA's Membership Rules and Regulations.

8. Risk disclosure statements - Risk disclosure statements should be included in the Agreement. The risk disclosure statements contained in Appendix 2 hereto is considered to be the minimum required, and Member may elect to provide additional risk disclosure information as appropriate. The font size of these statements should be in print at least as large as other text in the Agreement.

9. Declaration by TR – the TR who provides the product or service to a particular client should ensure that the risk disclosure statements have been provided to client in a language of his/her choice (English or Chinese) and advise client to read and sign on the risk disclosure statements upon execution of the Agreement, and to make a declaration to that effect by signing and dating the said declaration.

10. Client Acknowledgement – Member should ensure that the client shall acknowledge receipt of the risk disclosure statements provided to him/her in a language of his/ her

choice (English or Chinese) and that he/she has been advised to read the risk disclosure statements by signing and dating thereon.

RISK DISCLOSURE STATEMENTS 風險披露條文

Counterparty Risk 交易對手風險

Any persons or institutions with which you have entered a financial contract – who is a counterparty to the contract – might default on their obligations and fail to fulfill their obligations under the contract.

任何個人或機構與閣下簽訂金融合約 – 即合約的另一方 – 都有可能未有履行和未能完成他們於合約內所訂明的責任。

Credit Risk 信用風險

Any financial corporation (i.e. the policy issuer) might default on its payments in the future. The longer the term to repayment, the greater the risk.

任何金融公司（即保單發行人）都有可能於未來違約而未能付款。 還款期越長，風險越大。

Currency Risk 貨幣風險

The profit or loss in transactions in foreign currency-denominated policies will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the policy to another currency.

以外幣計算的保單，進行交易時或會將保單的單位貨幣轉換爲另一種貨幣，因此交易所帶來的利潤或虧損將受匯率波動所影響。

Early Termination, Surrender and/or Withdrawal Risk

提早終止保單、退保及/或提款風險

Early policy termination or surrender, or reduction in premium payment occurred within a prescribed period before the end of the policy premium payment period will incur early surrender or withdrawal charge and/or possible loss of entitlement to bonuses.

於規定的期限內或保單繳費期完結前，提早終止保單或退保、或減少支付保費，將招致提早退保或提取費用、及/或可能令原本可獲得的保單獎賞減少。

Fund Manager Risk 基金管理人風險

Performance of fund manager of a fund chosen by you may not achieve what you have originally expected.

閣下所選擇的基金，其基金管理人的表現未必能達至閣下原先的期望。

Liquidity Risk 流通風險

A particular investment may not be traded or howsoever converted into cash in a short time.

某一投資未必能在短時間內進行買賣、或以任何方法轉換成現金。

Political/Regulatory Risk 政治／監管風險

Your investment may suffer losses when there are changes in political or regulatory stability, structure or policies of a related country.

當相關國家的政治或監管的穩定性、結構或政策改變，閣下的投資可能蒙受損失。

Premium Holiday Risk 保費供款假期風險

All relevant fees and charges will continue to be deducted from your ILAS policy value during the premium holiday (i.e. no premium contribution) and under such circumstances, the value of your ILAS policy may be significantly reduced and your entitlement to the bonuses may also be affected. It may further lead to termination of your policy if the policy value is insufficient to cover the applicable policy charges.

在保費供款假期期間（即保費暫停供款），閣下的投資相連壽險保單仍然會被扣除所有相關費用及收費；在這種情況下，閣下的投資相連壽險保單的價值可能會顯著減少，而閣下可享有的保單獎賞也可能受到影響。 如保單價值不足夠支付相關適用的保單收費，閣下的保單更可能被終止。

Reinvestment Risk 再投資風險

Proceeds or interests earned from an investment may have to be reinvested at a lower potential rate, particularly so during the period of falling interest rates

從投資所賺取的收益或利益有可能只能以較低的潛在增長率再作投資，尤其在利率下降週期。

Risk of Failure To Diversify 缺乏分散投資風險

Over concentration in a single investment can lead to increased volatility (fluctuation) in your portfolio. Failing to diversify may also increase the amount of risk that the particular portfolio is exposed to in contrast to a properly allocated portfolio. It is crucial that you properly diversify the investments so as to minimize the overall risk of the portfolio.

過於集中單一投資可能會導致閣下的投資組合的波動性增加。 相對於恰當分配的投資組合，缺乏分散投資將增加某一投資組合所面對的風險。 閣下應適當地分散投資以減少投資組合的整體風險。

Risk of Fund Prices Fluctuation 基金價格波動風險

The prices of funds fluctuate, sometimes dramatically. The price of a fund may move up or down, and may become valueless. It is a likely that losses will be incurred rather than profit made as a result of buying and selling funds.

基金價格波動，有時甚爲劇烈。 基金價格可升可跌，甚至可變成毫無價值。買賣基金亦可能引致損失而不是利潤。

Transactions in Other Jurisdictions 在其他司法管轄區的交易

Transactions on markets in jurisdictions other than Hong Kong, including markets formally linked to a domestic market, may expose you to additional risk that such markets may be subject to regulation which may offer different or diminished investor protection.

於香港以外司法地區的市場(包括與本地市場有正式連繫的市場)進行交易，由於其規例對投資者所提供的保障或與香港不同、甚或更小，因此可能令閣下面對額外的風險。

Appendix M

Guidance Note on Conducting Investment Linked Business (PIBA-GN1)

(Source: PIBA)

Annex 2

PIBA – GN 1

Professional Insurance Brokers Association

GUIDANCE NOTE ON

CONDUCTING INVESTMENT LINKED BUSINESS

1 JANUARY 2015

1. Introduction

1.1 On 30 July 2014, Office of the Commissioner of Insurance ("**OCI**") issued Guidance Note on Underwriting Class C Business (GN 15) which sets out the standards of conduct and business practice for authorized insurers underwriting Investment-Linked Assurance Schemes ("**ILAS**") business.

1.2 In response to GN 15, this Guidance Note is issued to set out such standards of conduct and business practice in so far as they are applicable to members of PIBA in conducting ILAS business.

1.3 This Guidance Note should be read in conjunction with Code of Conduct for Insurance Brokers Conducting Investment Linked Business ("**Code of Conduct for Conducting ILAS Business**") issued by PIBA as well as GN 15.

2. Product meets the "fair treatment of customers" principle

Member should ensure that ILAS product recommended to client should meet the "fair treatment of customers" principle.

3. Provision of adequate and clear information

3.1 Member should provide customers with clear information before, during and after the point of sale.

3.2 Projections in relation to the growth scenarios should not be overly optimistic.

4. Suitability Assessment

4.1 ILAS products should only be sold to client with both investment and insurance needs.

4.2 Member should endeavour to reduce the risk of sales that do not meet the needs of client.

4.3 Member should seek the information from clients 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:

- financial knowledge and experience;
- needs, priorities and circumstances;
- ability to afford the product; and
- risk profile.

4.4 Client's needs must first be properly assessed through the use of Financial Needs Analysis ("FNA") form. ILAS must not be marketed to clients before their needs are properly analyzed.

4.5 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:

- clients wanting both insurance protection and "saving up for the future" should be presented with the option of procuring an endowment policy; and

- 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.

4.6 Suitability assessment includes assessing the investment horizon of client, with due regard to the financial circumstances, planned retirement age etc.

4.6.1 Premium payment term – The client's 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.

4.6.2 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.

4.7 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.

4.8 Member has the duty to verify all available information, particularly the "Statement of Purpose" section in the Important Facts Statement / Applicant's Declaration ("IFS/AD"), the FNA and Risk Profile Questionnaire ("RPQ"), and assess whether a particular ILAS product is suitable for the client.

. **Advice to Client**

5.1 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.

5.2 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.

5.3 Member has 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.

6. Post-sale control

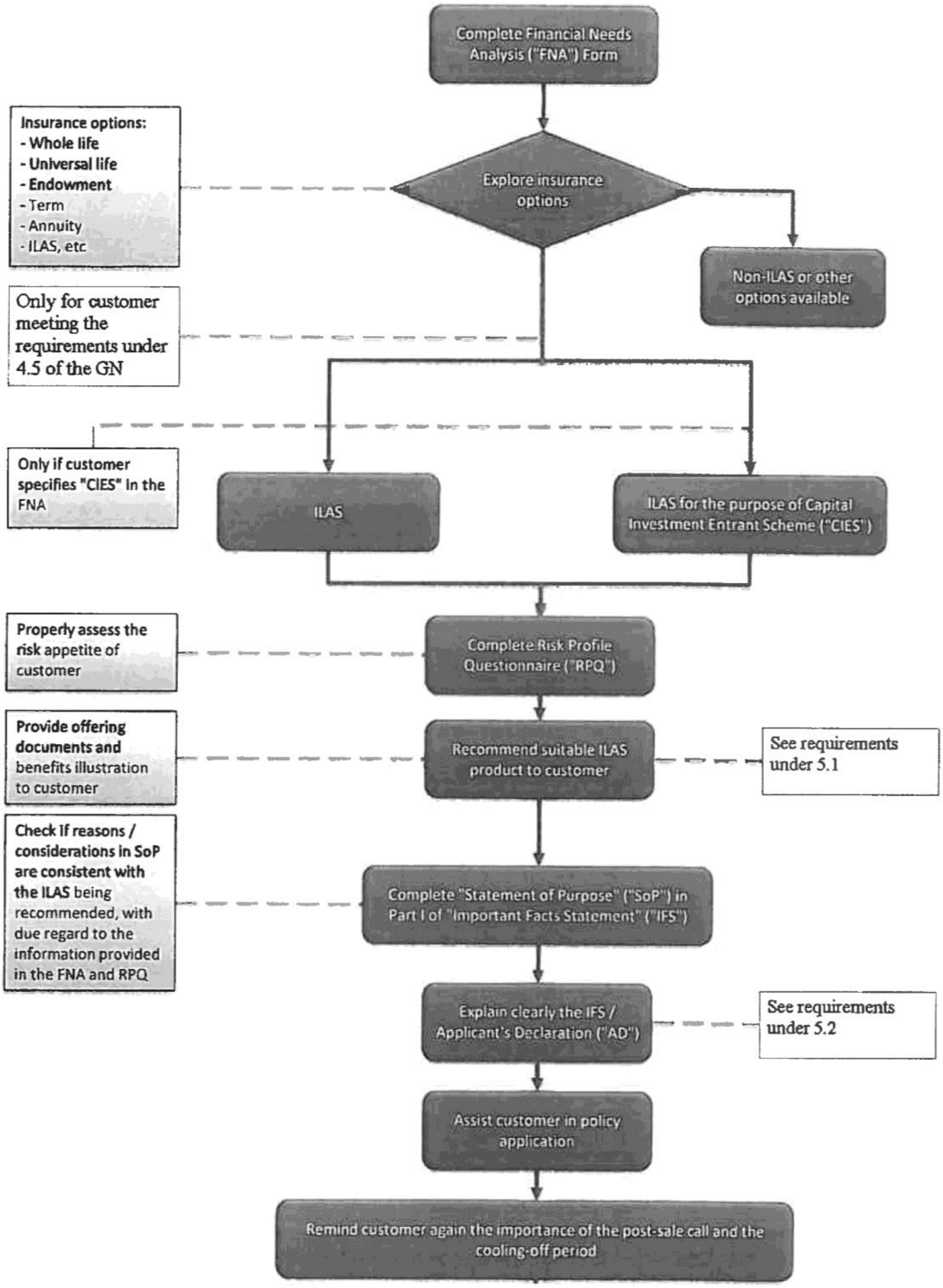
6.1 Member should establish and implement policies and procedures on fair treatment of customers. It should have proper control systems in place to achieve fair treatment of customers and monitor that such policies and procedures are adhered to.

6.2 The proper sales process flows is set out in the flowchart at the Appendix hereto. 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.

6.3 Member should remind client the post-sale confirmation call from insurer after entering into contract for ILAS product.

6.4 Member should not abet client to evade control measures implemented by the insurers.

APPENDIX –SELLING PROCESS OF ILAS PRODUCTS



Guidance Note on Underwriting Class C Business (GN15)

(Source: OCI)

GN 15

GUIDANCE NOTE ON UNDERWRITING CLASS C BUSINESS

Office of the Commissioner of Insurance
10 December 2014 (Second Edition)

GUIDANCE NOTE ON UNDERWRITING CLASS C BUSINESS

1 INTRODUCTION

1.1 This Guidance Note is issued pursuant to the Insurance Companies Ordinance (Cap. 41) ("ICO") and the Insurance Core Principles, Standards, Guidance and Assessment Methodology ("ICP") promulgated by the International Association of Insurance Supervisors ("IAIS"). Specific references are:

1.1.1 Section 4A of the ICO 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 proper standards of conduct, and sound and prudent business practices amongst insurers.

1.1.2 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 Guidance Note 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 Guidance Note should be read in conjunction with other relevant codes/circulars/guidance notes issued by the IA or other regulatory bodies, including the following[1] –

- Updated Requirements Relating to the Sale of Investment Linked Assurance Schemes to Enhance Customer Protection issued by the Hong Kong Federation of Insurers ("HKFI")
- Enhanced Regulatory Requirements on Selling of Investment-Linked Assurance Scheme Products issued by the Hong Kong Monetary Authority ("HKMA")
- Guidance on Internal Product Approval Process issued by the SFC
- 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:

- developing and marketing products in a way that pays due regard to the interests of customers;
- providing customers with clear information before, during and after the point of sale;
- reducing the risk of sales which are not appropriate to

[1] The list is not exhaustive and may be subject to changes from time to time. Insurers have the responsibility to ensure compliance with all the relevant requirements with due regard to their own circumstances.

customers' needs;

- ensuring that any advice given is of a high quality; and
- managing the reasonable expectations of customers.

3.4 This Guidance Note aims to set out the proper standards of conduct and business practices for authorized insurers underwriting Class C business.

4 DUTY OF THE BOARD AND THE CONTROLLER

4.1 It is the duty of the Controller, as specified under section 13A of the ICO, to ensure that requirements set out in this Guidance Note 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 Guidance Note.

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, particularly in the areas set out below.

5.2 Insurance Value

5.2.1 ILAS products should bring insurance value to clients.

5.2.2 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, insurers are encouraged to provide additional insurance benefits beyond this minimum level.

5.3 Fees and Charges

5.3.1 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 insurer.

5.3.2 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

5.4.1 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 GN 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 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

[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.

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 benefit illustration statement.

7 SUITABILITY ASSESSMENT

7.1 ILAS products should only be sold to clients with both investment and insurance needs.

7.2 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:

- financial knowledge and experience;
- needs, priorities and circumstances;
- ability to afford the product; and
- 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 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:

- clients wanting both insurance protection and "saving up for the future" should be presented with the option of procuring an endowment policy; and
- 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.

7.6.1 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.

7.6.2 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 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 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 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. 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. 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, 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 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 Insurers are also reminded to strictly follow the requirements under section 22, 22A and 23 of the ICO 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. They 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 flows is set out in the flowchart at the Appendix. 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, 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.

12.3.1 Insurers should appoint a separate quality assurance team to make the post-sale calls.

12.3.2 Insurers should use their best endeavours to make the post-sale calls, attempting different times of the day and different days of the week.

12.3.3 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.

12.3.4 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 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.

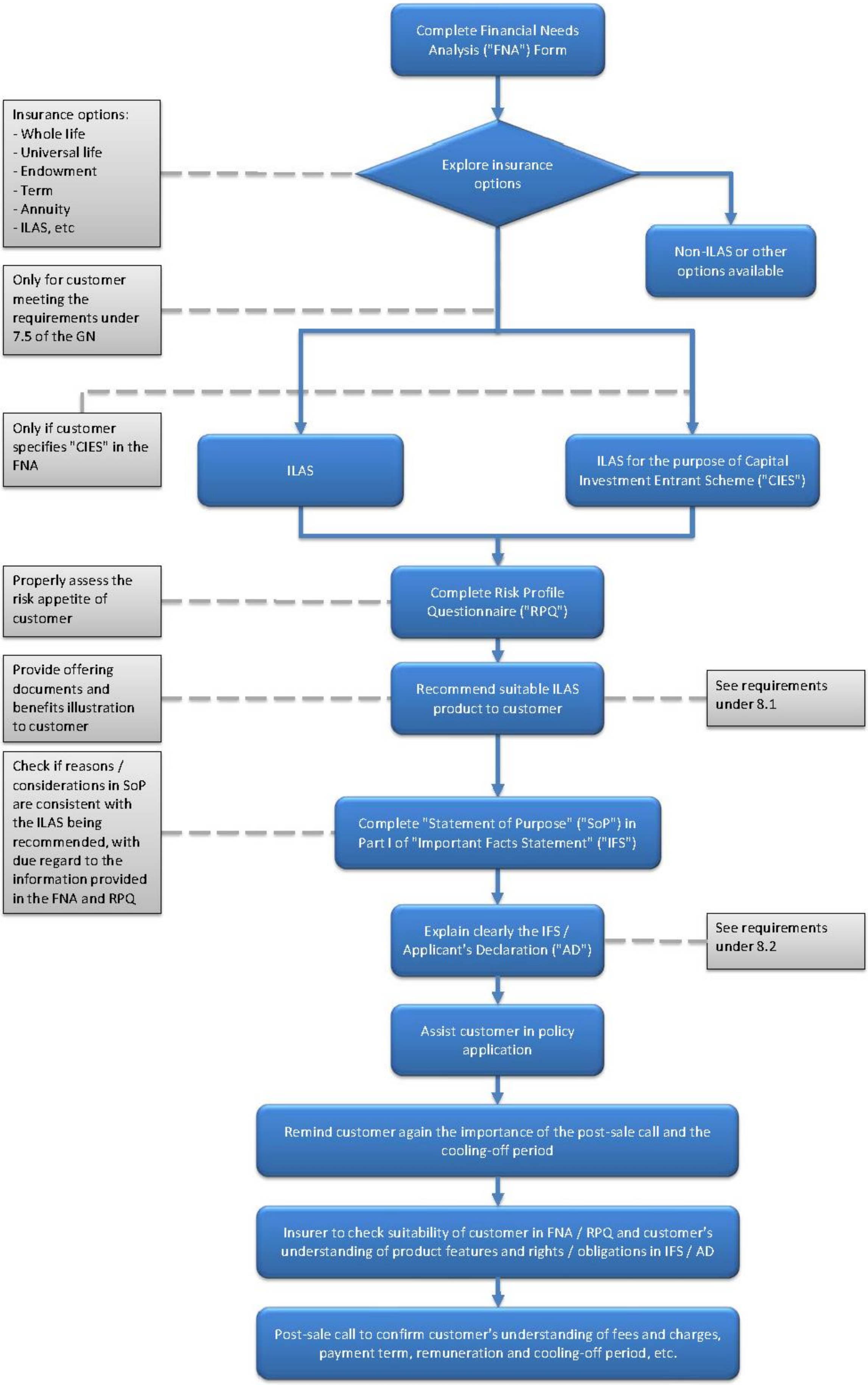
12.5 Insurers should have in place proper documentation systems for quality control and future monitoring. Apart from the policy documents and the IFS/AD, records of the post-sale calls, confirmation letters and the email/SMS alerts, as well as control reports in respect of measures in 12.4, should also be kept properly.

12.6 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 Guidance Note shall come into effect on 1 January 2015.

Selling Process of Investment-Linked Assurance Schemes ("ILAS") Products



GLOSSARY

105 Plan The death benefit of it will be 105% of the value of the policy account. **4.6.6c**

Administration Fee A fixed charge per year and/or a percentage of the premium applied to cover the insurance company's administrative expenses, also known as Maintenance Fee. **4.3.1c**

Annuitant The person entitled to receive annuity payments. **3.8.2**

Annuity A series of periodic payments to an annuitant for life or other agreed term or conditions, in return for a single payment (premium) or series of payments. **1.2**

Applicant's Declarations It must be included in every application for an investment-linked insurance policy in the exact prescribed form. **4.13.1c**

Arbitrage A simultaneous purchase and sale of same or similar assets in different markets in order to capture a risk-free profit caused by mis-pricing. **3.4.1c**

Balanced Fund An investment fund which invests in a combination of stocks and bonds with an objective of achieving both income and capital appreciation while avoiding excessive risk. **3.7**

Beneficiary The person nominated to receive the policy benefit in the event of a claim under the policy. **4.16.3**

Beta It is the measure of the change of return on a security for a 1% change in the return on the whole market. **3.3.9diii**

Bid-offer Spread The difference between the price at which the policyholder can buy units (the offer price) from the insurance company and that at which the policyholder can sell units (the bid price) to the insurance company. **4.3.2a**

Bonds Debt instruments issued by corporations, municipal governments, countries, and supra-nationals. **3.2.1**

Bond Fund An investment fund which invests in the bond market with an objective of providing stable income with minimal capital risk **4.8.2a**

Bond Ratings Alphabetical designations assigned by rating agencies to reflect the investment quality of the bond issued. **3.2.10**

Bonus The approximate equivalents of dividends on participating policies, bonuses are reversionary amounts added to the ultimate benefit payable under UK style with-profits policies. **4.11.2**

Bonus Issue The issue of shares to the existing shareholders for free as a result of capitalisation of profits. **3.3.4**

Bottom-up Approach A fundamental analysis which focuses on the financial performance of specific companies first before moving on to the industries and finally the economy. **3.3.9a**

Call Option A contract which gives the holder the right, but not the obligation, to buy the underlying assets. **3.4.3**

Callable Bond A bond which is issued with an option for the issuer to "call" (repay prematurely) before the bond's maturity date. **3.4.3**

CAMEL Rating System It is an international recognised framework for assessing capital adequacy, asset quality, management, earnings and liquidity of a bank. **2.1.6a**

Capital Asset Pricing Model It relates the expected return of a security to its risk as measured by beta. **3.3.9diii**

Cash Value It is a savings element of a permanent life insurance policy, which can be withdrawn in the form of surrender value (subject to surrender charges), or used as a pledge for policy loans. Not all policies have a cash value, e.g. term insurance. **1.2**

Certificates of Deposit Negotiable short-term time deposit certificates issued by commercial banks evidencing a deposit of a fixed maturity of less than 1 year. **3.1.2b**

CIS Internet Guidance Note Issued by the Securities & Futures Commission in May 2001, this note clarifies the regulatory requirements concerning Collective Investment Schemes activities on the Internet. **5.3.6**

Claims A crucial area for life insurers. The department concerned will be involved in all aspects of claims investigation, processing and settlement. **4.3.1a**

Closed-end Funds Type of fund which has a fixed number of shares, usually listed on a major stock exchange. Unlike open-end funds, closed-end funds do not stand ready to issue and redeem shares on a continuous basis. **3.7.2b**

Code of Conduct for Insurers Implemented by the Hong Kong Federation of Insurers in May 1999, this code lays down recommended practices for insurers. The code only applies in respect of personal policyholders resident in Hong Kong, insured in their private capacity only. **5.2.5a**

Code of Practice for the Administration of Insurance Agents Issued by the Hong Kong Federation of Insurers and approved by the Insurance Authority in accordance with the provisions of the "***Insurance Companies Ordinance***", it has six parts covering a wide range of expectations and requirements in this subject area. **5.2.2**

Code on Investment-Linked Assurance Schemes This code establishes guidelines which will be applied by the Securities and Futures Commission for the authorization of investment-linked assurance schemes. **4.13.2b**

Commercial Papers Unsecured promissory notes issued by top-rated financial and non-financial institutions with maturities of under one year. **3.1.2c**

Company Customization Illustration Documents are allowed to be company customized provided the basic intentions of the document are respected. **4.15.1b**

Company Risk Negative developments such as the loss of market share, the failure of a new product launch will have an adverse effect on a company's financial status and thus its share price. **2.1.2**

Consumption One of the components of Gross Domestic Product by the expenditure method. **2.2.3a**

Cooling-off Initiative An element in the self-regulation process, initiated by the Hong Kong Federation of Insurers, to grant certain privileges to life insurance policyholders regarding the cancellation of arranged contracts within a permitted period. **4.13.4**

Cooling-off Period A time period which provides policyholders with the time to understand carefully all the information given in relation to a policy and a policyholder may serve a written notice to cancel the policy for a refund of the paid premium less any market value adjustment. **4.13.3i**

Convertible Bonds A type of bond for which the investor may have a right to choose whether to receive the par value or the common stock of the issuer or of some other company. **3.2.3**

Corporate Bonds Medium or long-term debt obligations of private corporations. **3.2.1e**

Cost of Insurance The charge made by an insurance company to cover the mortality, annuity payment and other benefits and is mainly based on the gender, age, smoking habit, the sum assured, class of risk of the life assured and the death benefit option, also known as **mortality charges**. **4.2**

Coupon Rate The interest rate the bond issuer promises to pay the investor. **3.2.4**

Custodian An authorized institution appointed by a mutual fund corporation, responsible for taking under its control all the property of the fund in trust for the holders in accordance with the provisions of the constitutive documents such as a Custodian Agreement. **3.7.6b**

Date of Death An important point to be established with life insurance death claims, especially with term or decreasing term insurances where the validity or amount of the claim may be affected. **4.6.6a**

Death Benefit The basic amount payable under the insurance in respect of the death of the life insured. This may be subject to additional factors, e.g. accidental death benefits etc. **4.6.6**

Debt Securities see fixed income securities **3.2.1**

Demand Curve It is a graph showing the quantity of a good that buyers are willing to buy on the x-axis at each price on the y-axis. **2.2.1a**

Deposit Fund A notional interest bearing fund which invests in short-term money market instruments which provide stable income with minimal capital risk. **4.8**

Default (Credit) Risk The potential inability of a debt issuer to pay interest and repay the principal. **2.1.2**

Deferred Annuity An annuity which has the instalment payments begin at some specified time or specified age of the annuitant. **3.8.2aii**

Deflation It is negative inflation. **2.2.3f**

Derivative Warrant A warrant (option) that is issued by a third party, typically an investment house or financial institution. **3.4.3**

Direct Finance It refers to the borrowers obtaining funds directly from lenders. **2.2.2a**

Discount The bond is being sold at a price lower than the par value. **3.2.7**

Disinflation It refers to a decrease in the inflation rate. **2.2.3f**

Distribution Fee An annual fee charged by an investment fund to its investors to pay for selling the fund to new investors and providing services to existing investors. **3.7.3**

Diversification Owning different issues of the same asset class or different asset classes within a portfolio of investment, or investing in different markets, regions or countries in order to reduce the total risk of the portfolio. **2.1.4a**

Dividend Yield The current annualized dividend paid on a share, expressed as a percentage of the current market price of the corporation's common stock. **3.3.3**

Dividends (Equity) Payments made in cash to shareholders. **3.3.5**

Dividends (Insurance) A payment made in cash for participating policyholders on the divisible surplus of the insurance company. **1.2**

Dividend Discount Model A stock valuation model which states that the share price is equal to the present value of all expected future dividends discounted at the required rate of return on the share. **3.3.9di**

Dollar Cost Averaging By buying a fixed dollar amount of an asset at intervals to avoid putting all money in the market at the inappropriate time. **2.1.4a**

Domestic Bonds Bonds issued in the domestic currency by corporations domiciled in the same country. **3.2.11**

Duration It is used to measure the percentage change in bond prices with respect to change in interest rate. **2.1.5biv**

Economics It is the study of how individuals make choices under the constraint of limited resources and of the results of those choices for society. **2.2.1**

Economic Cycles It is the fluctuation of a country's economic performance as measured by the real GDP throughout history. **2.2.3b**

Economic Risk The possible impact of an overall economic slowdown. **2.1.2**

Economic Sectors They include the household sector, the business sector, the government sector, the foreign sector and the finance sector. **2.2.1b**

Endowment Insurance A life insurance contract which provides for the payment of the face amount at the end of a specified term or upon earlier death. **3.8.1aii**

Equity An ownership interest in a corporation. It provides the investor with the opportunity to participate (share) in the long-term growth of a limited company. **3.3.1a**

Equity Fund An investment fund which invests in the equity market with an objective of achieving higher long-term capital appreciation. **3.7.4c**

Equity Warrant A warrant (option) that is issued by the company issuing the underlying stock. **3.4.3**

Eurobonds Bonds denominated in US dollars or other currencies and sold to investors outside the country whose currency is used. **3.2.11**

Exchange Rate It is the amount of one currency that can be traded for the other. **2.2.3e**

Exchange (Currency) Risk A foreign financial investment denominated in a foreign currency may have to be converted into the home currency at a less favourable rate due to foreign exchange rate fluctuation. **2.1.2**

Financial Derivative A financial instrument whose value depends on or is derived from an underlying asset such as stock, bonds, interest rate, foreign currency, commodity, or stock market index. **3.4**

Financial Needs Analysis It must be included in every application for an investment-linked insurance policy to assess the financial needs of the customer. **4.13.1a**

Financial Risk The possible loss or reduction of the original sum invested. **2.1.1**

Fiscal Policy It is the decisions on the government's budget as to how much the government spends and how much tax it collects. **2.2.3.c**

Fit and Proper A common phrase in regulatory instruments, indicating that the individual occupying or wishing to occupy a certain position is suitable and acceptable from a regulatory point of view. **5.2.1**

Fitness and Properness of Insurance Agents A range of requirements and limitations concerning the criteria for this subject are contained in Part E of the "***Code of Practice for the Administration of Insurance Agents***". **5.2.2**

Fixed Income Securities A group of investment instruments that offer a fixed periodic return. **3.2.1**

Forward Contract An agreement between two parties (buyer and seller) to set a price today for an asset/good that will be delivered on a specified future date. **3.4.2**

Foreign Bonds Bonds issued in the currency of the country by foreign corporations. **3.2.11**

Fraud A non-ethical practice where the investment representative/insurance intermediary deliberately makes false statements and claims and intentionally conceals information with the intention to deceive or cheat. **4.14**

Fund Management Fee A fee charged by the investment fund manager for their services rendered to manage the fund. It is usually expressed as a specified percentage of the fund's market value and is used to support the insurance company's investment management team. **4.3.2b**

Fund of Funds An investment fund which invests in other mutual funds with an objective to carry out diversified professional management, also known as **Unit Portfolio Management Funds**. **4.8.2l**

Fund Performance Report A summary of the performance of the fund during the period which highlights any changes in the investment policy. **4.16.4**

Fund Switching Charge The fee charged to the policyholder to switch his/her investment option and allocation from time to time. **4.3.2c**

Fundamental Analysis It is the study of the economic and political factors to determine the intrinsic value of the securities. **3.3.9**

Futures Contract A standardized forward contract that is traded in an organized market called futures exchange. **3.4.2**

Global Fund An investment fund which invests in stocks or bonds throughout the world. **4.8.2e**

Government Bills Short-term debts issued by the government to finance their expenses. **3.1.2a**

Government Bonds These are financial instruments used by the government to borrow money from the public. **3.2.1b**

Gross Domestic Product (GDP) The ultimate measurement of an economy's performance is its gross domestic product. It is the market value of the final goods and services produced in a country during a given period. **2.2.3a**

Gross Premium The premium in life insurance after taking into account the three rating factors of mortality, interest and expenses. **4.6.1**

Growth Fund An investment fund which invests in growth stocks with an objective of achieving maximum capital appreciation rather than a flow of dividends. **3.7**

Guaranteed Fund An investment fund which provides a guarantee of the principal. Some funds may even guarantee a minimum return. **4.8.2k**

Guaranteed Policies These life insurance policies guarantee a fixed rate of return to policyholder in term of sum assured. They are sold on a guaranteed cost basis, meaning that all policy elements (i.e. the premium, the sum assured, and the cash values, if any) are guaranteed and will not vary with the experience of the company, also known as **non-participating/without-profit policies**. **4.11.1**

Guidance Note on Underwriting Class C Business (GN15) GN15 was issued by the OCI with an aim to set out proper standards of conduct and business practices for authorised insurers underwriting Class C business. **5.2.7**

Guidelines on Handling of Premiums The Insurance Agents Registration Board has published this Guidance Note, which includes recommendations on the method of payment of premiums. **5.2.3b**

Guidelines on Misconduct Another set of guidelines issued by the Insurance Agents Registration Board recommending procedures and appropriate actions to avoid potential losses arising from misrepresentation and forgery etc. **5.2.3a**

Guidelines on the Effective Date of Registration Another set of guidelines issued by the Insurance Agents Registration Board. These include reference to the fact that holding oneself out to be an insurance agent, Responsible Officer or Technical Representative before the Insurance Agents Registration Board confirms their relevant registrations is an offence against the "***Insurance Companies Ordinance***" or a breach of the "***Code of Practice for the Administration of Insurance Agents***". **5.2.3c**

Hedging The process to eliminate the impact of change in market price on the value or an asset or investment portfolio. **3.4.1a**

Hong Kong Confederation of Insurance Brokers An approved body of insurance brokers in Hong Kong whose members are deemed to be authorized insurance brokers. **5.2.5b**

Hong Kong Federation of Insurers The central market body, representing over 70% of authorized insurers in Hong Kong. The primary objective of the HKFI is to promote and advance the interests of insurers and reinsurers transacting business in Hong Kong, and its mission statement further states that the HKFI exists to promote insurance to the people of Hong Kong and build consumer confidence in the insurance industry. **5.2.5a**

Illustration Document A document based on two assumed rates of return that demonstrate clearly the projected surrender values over the term of the policy. **4.13.2**

Immediate Annuity An annuity purchased with a single payment, the benefits or instalments begin one annuity period (one month or six months) immediately thereafter. **3.8.2ai**

Income Fund An investment fund whose objective is to generate regular income rather than to achieve capital growth. **3.7**

Increasing Death Benefit The death benefit will be the value of the units accumulated in the policyholder's account, at the date of death, plus the chosen death cover. **4.4iii**

Index Fund An investment fund with an objective of mirroring specific index performance. **4.3.2b**

Industry Analysis A fundamental analysis which classifies an industry into four stages of life cycles. **3.3.9b**

Indirect Finance It occurs when the funds flow through the finance intermediaries from the lender to the borrower. **2.2.2a**

Inflation It is a measure of the annual percentage rate of change in the general price level. **2.2.3f**

Inflation Risk The loss of purchasing power as the return on investment does not match the inflation rate. **2.1.2**

Initial Public Offering It refers to the issue of stocks to the market for the first time when a privately owned company is to be listed on the stock market **3.3.2a**

Insurance Agent An agent in an insurance contract, usually representing the insurer and remunerated by commission on the premium paid. **5**

Insurance Agent Registration Board The body set up by the Hong Kong Federation of Insurers to register insurance agents and to handle complaints against insurance agents pursuant to the "***Code of Practice for the Administration of Insurance Agents***". **5.1.1**

Insurance Broker A person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policyholder or potential policyholder or advising on matters related to insurance. **5.2.4**

Insurance Charges Fees charged by the insurance companies for the provision of insurance policies to cover the marketing, distribution, administration, and insurance expenses. **4.3**

Insurance Companies Ordinance The primary legislation for the regulatory framework of the insurance industry in Hong Kong. Despite its title, the ICO also contains provisions relating to the regulation of insurance intermediaries in Hong Kong. **1.1**

Insurance Intermediaries In Hong Kong, these consist of insurance agents (usually representing the insurer) and insurance brokers (usually representing the insured). Separate regulatory rules and provisions apply to each group. **5**

Interest Rate It is the price of holding money which is determined by the demand and supply of money. **2.2.3d**

Interest Rate (Price) Risk The price fluctuation of certain fixed income investments prior to maturity due to current market interest rate changes. **2.1.2**

Investment To sacrifice present value for future value. **2**

Investment Advising It refers to the process of providing investment advices to the clients. **2.2.6a**

Investment Funds A form of collective investment through which a number of investors who have similar investment objectives combine their money into a large central pool. **3.7**

Investment Time Horizon This is the time period within which the investor intends to make the investment. **2.2.5b**

Investment-linked Annuity An annuity whose annuity payment is variable according to the performance of the investment funds. **4.4a**

Investment-linked Insurance Policy An insurance policy with its policy value generally linked to the performance of its underlying investments. **1**

Investment Risk The uncertainty associated with the end of period value of the investment, especially the possible loss or reduction of the original sum invested. **2.1.1**

Law of Fixed Income An inverse relationship between the yield and the price of a bond. **3.2.7**

Lead Manager It is an investment bank which has primary responsibility for organizing the marketing of the new issues of shares. **3.3.2a**

Level Death Benefit The death benefit will be the higher of the value of units accumulated in the policyholder's account at the date of death or the chosen death cover. **4.4biii**

Limit Setting The trading limits set by a financial intermediary to limit market risk exposure. **2.16bii**

Linked Long Term Business The business of effecting and carrying out 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 or by reference to fluctuations, in, or in an index of, the value or property of any description. **1.1**

Liquidity The ability of an investor to sell the asset quickly without having to make a substantial price concession. **2.2.5a**

Liquidity Risk The inability to liquidate (sell) an investment or the need to pay a substantial cost to liquidate. **2.1.2**

Load Charge A commission payable to the sales force which is based on the shares/units it sells. **3.7.3b**

Low Correlation Having little or no mutual relationship. In the process of diversification, investment is made in assets of little relationship to reduce the overall risk. **2.1.4a**

M1 The sum of legal tender notes and coins held by the public plus customers' demand deposits placed with banks. **2.2.1c**

M2 M1 plus customers' savings and time deposits with banks plus negotiable certificates of deposit (NCDs) issued by banks held outside the banking sector. **2.2.1c**

M3 M2 plus customers' deposits with restricted licence banks and deposit-taking companies plus NCDs issued by these institutions held outside the banking sector. **2.2.1c**

Management Company An institution, properly licensed or registered under Part V of the SFO to carry on the regulated activities, appointed by an investment fund responsible for investment management within the scope of the constituent documents. **3.7.6**

Management Fee A fee charged by the management company for the investment and advisory services provided by the professional fund manager. **3.7.3c**

Market Index It is the index adopted in different stock exchange markets as reference of the price level of a particular stock market. **3.3.8**

Market Risk The basic demand and supply in the market will affect the price of investment instruments. An investor will suffer a loss if he/she has to sell an asset when the price drops below his/her original purchase price. **2.1.2**

Market Value Adjustment The permitted right of an insurance company under the cooling-off initiative to adjust the refund of premiums, taking into account the loss the insurance company might suffer in realizing the value of any assets acquired through investment of the premiums made under the life policy. **4.13.4**

Marking to Market It is the process to revalue the collateral value of a client to reflect the current market value. **2.16bi**

Minimum Requirements Specified for Insurance Brokers "Minimum Requirements" are specified under Part X of the "***Insurance Companies Ordinance***". Besides the requirement that they be "fit and proper" and the body of insurance brokers concerned must have rules and regulations to ensure that its members are "fit and proper", the Insurance Authority has stipulated five requirements, including qualifications and experience, capital and net assets etc. **5.2.4**

Misrepresentation A non-ethical practice where an insurance intermediary/ licensed person deliberately makes misleading statements to induce a prospect to purchase insurance. **4.14**

Money Laundering The illegal practice of "cleansing" money obtained illegally by the use of business or financial instruments such as life insurances. Insurers must take great care in trying to detect and eliminate such practices. **5.4.1**

Money Market Instruments Short-term, highly liquid and low-risk debt instruments issued by governments, banks and large non-financial corporations. **3.1**

Monetary Policy It is the action by the government to influence the money supply in the economy so as to affect the market interest rate. **2.2.3c**

Mortality Charges See **Cost of Insurance.** **4.3.1a**

Mortality Tables Published statistics on mortality, indicating the expected rate of mortality at given ages. **4.3.1a**

Moving Average It is the calculation of the average closing prices for a specific period such as 10-day, 20-day or 250-day moving averages. **3.3.10c**

Municipal Bonds Bonds issued by states or local governments to finance their budgets. **3.2.1d**

Mutual Fund An investment fund which is set up with the objective of investing in shares of other companies. **3.7.1a**

Net Asset Value The market value of a fund calculated on the basis of the market value of the underlying assets in the portfolio after deducting liabilities and accrued expenses. **3.7.1b**

Office of the Commissioner of Insurance It is the regulatory body set up for the administration of the "***Insurance Companies Ordinance***" (ICO) (Cap. 41). The Office is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority for administering the ICO. The principal functions of the Insurance Authority are to ensure that the interests of policyholders or potential policyholders are protected and to promote the general stability of the insurance industry. **4.5**

Office Premium For policies with single mode of payment, the premiums paid by the policyholders during the financial year or, for policies with regular mode of payment, the annualized premiums of the policies as at the valuation date or the flexible premium paid by the policyholders during the financial year. **4.1**

Open-end Fund An investment fund which stands ready to purchase existing shares/units at a price based on or near the NAV of the underlying investments. **3.7.2a**

Operational Risk The risk faced by a financial institution arising from the operations of the business deal processing, deficiency of information system, ineffective internal management and control system, human errors, etc. **2.1.2**

Option A contract which gives the holder the right, but not the obligation, to buy or sell a specified amount of an underlying asset at an agreed price within or at a specified time. **3.4.3**

Option sensitivity measures The measure of the option price changes as against changes in other parameters such as time, interest rate, volatility, etc. **2.1.5biv**

Over-the-counter market It is an informal network of market participants such as brokers and dealers who negotiate sales of securities with each other. **3.2.1**

Par The bond is being sold at the same price as the par value. **3.2.7**

Par Value The amount the issuer agrees to repay the bondholder at maturity, also known as **face value**, **maturity value** or **redemption value**. **3.2.2**

Partial Withdrawal A facility which allows a policyholder to reduce the cash value in a policy by making withdrawals for a specific minimum amount provided that the remaining balance is sufficient to cover fees and related insurance charges. No penalty or debit interest will be incurred. It is also known as **partial surrender.** **4.6.4**

Participating/Non-Participating Also known as **With-Profits** or **Without-Profits**, the terms indicate whether or not the policies concerned share in the profits of the insurer. If they do, dividends or bonuses are payable. **4.11.1**

Payment Ratio The percentage of a corporation's earnings paid to shareholders in the form of cash dividends, also known as **Pay-out Ratio**. **3.3.3**

Performance Fee A fee charged by the investment company based on the actual investment gains achieved. **3.7.3c**

Policy Changes One of the duties of the Policyowner Service Department including such matters as minor amendments of address to significant issues such as change of beneficiary, assignment and change of insurance cover amount. **4.16**

Policy Delivery After policy document preparation, delivery of individual policy documents is normally done by the insurance intermediaries. **4.16.2**

Policy Fee The charge made by an insurance company to cover the distribution, marketing and policy issue expenses of setting up the policy, also known as **Initial Charges.** **4.3.1b**

Policy Issuance The process of preparation, checking and delivery of the policy document. **4.16.1**

Policy Statement A summary of the transactions that occurred during the statement period, and the values of the policy as of the statement date provided to the policyholder. **4.16.4**

Preference Share An ownership interest in a corporation which gives the investor a right to a fixed dividend provided enough profit has been made to cover it, also known as **Preferred Share**. **3.2.14**

Premium (Bond) The bond is being sold at a price higher than the par value. **3.2.7**

Premium (Option) The sum of money an option buyer pays to the seller for the option. **3.4.3**

Premium Holiday A facility which allows a policyholder of a regular premium plan to skip premium payments for a period of time provided that the policy value is sufficient to cover the mortality charges and fees. No penalty or debit interest will be incurred. **4.4bi**

Premium Payment The amount payable by the policyowner for the insurance coverage. **4.1**

Price Earnings Ratio A corporation's current stock price divided by its past 12-month earnings per share, also known as **PE Ratio**. **3.3.3**

Price Earnings Model It is to compare the PE Ratio of companies in the same industry to ascertain the relative value of an individual company. **3.3.9dii**

Primary Market It is the market in which new securities are issued for the first time. **3.3.6c**

Principal Brochure A document which contains the information necessary for prospective scheme participants to be able to make an informed decision on the proposed investment. **4.13.3**

Private Placement It takes place when the shares are issued to a specific class of investors. **3.3.2b**

Professional Insurance Brokers Association An approved body of insurance brokers in Hong Kong, whose members are deemed to be authorized insurance brokers. **5**

Put Option A contract which gives the holder the right, but not the obligation, to sell the underlying asset. **3.4.3**

Putable Bond A bond which is issued with an option for the holder to "put" (sell back to the issuer prematurely) before the bond's maturity date. **3.4.3**

Ratio Analysis It is used to ascertain a company's financial performance as compared to previous years and to an industry standard. **3.3.9c**

Regional/Country Fund An investment fund which invests in a specific region or country. **4.8.2f**

Rebating This is the practice where an insurance agent offers a rebate of his/her commission to entice a prospect to purchase a policy. **4.14**

Regular Premium Plan Investment-linked policies that are financed by regular premiums. This is more suitable for individuals who want to build up savings on a regular basis. **4.5**

Reinvestment-rate Risk The inability to reinvest interim cash flows or a mature investment at the same or higher rate of return. **2.1.2**

Relative Strength Indicator (RSI) It plots the price relationship between the closing prices of up days and down days within a specific period, the most common is 14-day RSI. RSI has a value between 0 to 100%. **3.3.10c**

Responsible Officer A person who, alone or jointly with others, is responsible for the conduct of the insurance agency business of an insurance agent. **5.2.2**

Retention Ratio The proportion of a corporation's earnings that is not paid to shareholders but is instead retained for future expansion of the corporation. **3.3.3**

Return on Equity The earnings of a corporation divided by its book value. **3.3.3**

Reversionary Bonus A financial interest which exists now, but whose full enjoyment and privileges of ownership are deferred until some future time of event. **4.11.2**

Rights Issues It refers to a listed company raising funds by inviting existing shareholders to subscribe for new shares in proportion of their existing shareholding. **3.3.2d**

Risk Tolerance The largest amount of risk that an investor is willing to take for a given increase in the expected return. **2.2.4**

Risk-averse Investor An investor who prefers an investment with less risk to one with more risk if the two investments offer the same expected return, or higher expected return to lower expected return if the two investments have the same expected risk. **2.2.4**

Risk Profile Questionnaire It must be included in every application for an investment-linked insurance policy to assess the customer's risk appetite and determine if a particular product and its underlying investment choices are suitable for them. **4.13.1b**

Samurai Bonds Japanese Yen bonds issued in Japan by corporations domiciled outside Japan. **3.2.11**

Saving Income minus spending. **2.2.1b**

Secondary Market It is the transaction between buyers and sellers of the existing issued securities **3.3.6c**

Sell Short The sale of a security that is not owned by an investor with an obligation to repay in kind by purchasing the same security in a subsequent transaction. **3.4.1**

Sharpe Ratio The return of an asset over risk free rate per unit of risk undertaken. **2.1.5biii**

Single Premium Plan Investment-linked policies that are financed by one single premium. This is more suitable for individuals who have a large capital sum at their disposal. **4.5.1**

Sovereign (Political) Risk Political instability may cause governments to take actions that are detrimental to the financial interest of financial investment instruments in that country. **2.1.2**

Specialty Fund An investment fund which invests in a specific industry or sector with an objective to capitalize on the return potential. **4.8.2g**

Sponsor It conducts due diligence to see if a company is qualified for listing and will then facilitate the company to list on the Stock Exchange of Hong Kong lodging the application and preparing all supporting documents. **3.3.2a**

Stress Test The assessment of how an investment performs when specific large moves in the market parameters occur. **2.1.5biv**

Strike Price The pre-agreed price for a call holder to buy the underlying asset or a put holder to sell the underlying asset, also known as **Exercise Price**. **3.4.3**

Suitability Check The operational controls of insurance companies to ensure that the Financial needs analysis, the Risk Profile Questionnaire, the Applicant Declarations are duly completed. **4.13.1d**

Sum Assured The amount payable upon the happening of a claim event as defined in an insurance contract, e.g. upon death. **4.3.1a**

Supply Curve It is a graph showing the quantity of a good that sellers are willing to sell on the x-axis at each price on the y-axis. **2.2.1a**

Supra-nationals These are multilateral organizations such as the World Bank, the Asian Development Bank and the International Monetary Fund (IMF). **3.2.1a**

Surrender Charge This is a charge made by the insurance company when a policyowner surrenders his/her policy through the sale of the investment fund units. **4.3.2d**

Switching A facility which allows a policyholder to make transfer of his/her investment between funds offered or to alter their investment portfolios at any time. **4.3.2c**

Technical Analysis It is a study of historical market data to predict future securities prices. **3.3.10a**

Technical Representative A person who provides advice to a policyholder or potential policyholder on insurance matters for an insurance intermediary, or arranges contracts of insurance in or from Hong Kong on behalf of that insurance intermediary. **2.2.7**

Term Life Life insurance where the benefit is payable only if the life insured dies during the period (term) specified; also known as Temporary/Term Insurance. **3.8.1ai**

Term to Maturity The number of years to the maturity of the bond. The maturity date is the date the issuer will repay the bondholder. **3.2.5**

Time Value of Money It is the relationship between the value of dollars today and that of dollars in the future. **3.2.6a**

Top-down Approach A fundamental analysis which starts with a study of the macroeconomic factors, then moves down to identify the industries and finally narrows down to the companies in the industry. **3.3.9a**

Top-up A facility which allows a policyowner to pay an additional fixed premium when the premium is due (called a regular top-up) or one-off premium at any time (called a lump sum top-up). **4.3.2e**

Top-up Fee This is the charge made by insurance companies when a policyholder chooses to top up his/her investment. **4.3.2e**

Trustee An authorized institution appointed by an investment fund to fulfil the duties imposed on them by the general law of trusts. **3.7.6b**

Twisting A non-ethical practice where an insurance intermediary makes misleading statements, non-disclosure, misrepresentations and incomplete comparisons to induce an insured to replace existing life insurance policies with other life insurance policies resulting in disadvantage to the insured. **4.14**

Underwriter It is an investment bank or a brokerage company which undertakes the risk of the new issue of share by taking up any unsold shares. **3.3.2a**

Underwriting The process of assessment and selection of risks for the purposes of insuring the insurance applicants or deciding what insurance terms should apply. It also means the process of guaranteed acceptance of an investment bank when arranging initial public offer for a stock or bond. **4.9c**

Unit Trust An investment vehicle set up under a trust. **3.7.1(b)**

Unit-linked The UK version of investment-linked insurance policy. **1.1(a)**

Unitised Funds These are specific, separately managed funds, either managed by the insurance company itself or independent fund managers. **1.2**

Universal Life A life insurance contract which is subject to a flexible premium, has an adjustable benefit and accumulated cash value. **1.1(b)**

Unemployment Rate It is the percentage of the number of unemployed divided by the labour force. **2.2.3g**

Value at Risk It is a measure of the change in value of an investment as a result of changes in market conditions at a specified confidence levels. **2.1.5biv**

Variable Life The US version of investment-linked insurance policy. **1.1(b)**

Variable Universal Life A form of life insurance which combines the premium and death benefit flexibility of universal life insurance and its feature of unbundling of the pricing factors with the investment characteristics of variable life insurance. **1.1(b)**

Volatility The annualized standard deviation of the rates of return of an asset (stock, bond or mutual fund). The term is used to describe the size and frequency of the fluctuations in price and is an important factor for option pricing. **2.1.5bii**

Warrant Fund An investment fund which invests mainly in warrants with an objective of achieving exceptional high return. **4.8**

Whole Life A life insurance contract where the benefit is payable only on death, whenever that occurs, at a level premium rate that does not increase as the insured ages. **1.1b**

With-Profits The equivalent term in UK insurance terminology of a participating insurance. **4.11.2**

Without-Profits The equivalent term in UK insurance terminology of a non-participating insurance. **4.11.1**

Yankee Bonds USD bonds issued in the US market by foreign corporations **3.2.11**

Yield The net rate of return of the bond investors taking into account of the market price, par value, coupon interest rate and time to maturity. **3.2.7**

Yield Curve It is a graphic representation of the relationship between the level of interest rate and the corresponding maturity. **3.2.8**

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Representative Examination Questions

Answers

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2	(a)	(b)	(d)	(b)	(a)
3		(a)	(a)	(d)	(d)
4		(c)	(c)	(c)	(d)
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6		(b)	(b)	(c)	
7			(c)	(b)	
8				(a)	

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