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# REGULATORY NEWSLETTER

2024 Vol.6



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As the Dragon Boat Festival is celebrated across the land with young and old, may you all enjoy a safe and auspicious occasion, and may you live long and prosperous lives.

In this issue, we reflect on the financial industry's significant developments over the past month, with a focus on the evolving landscape facing risk management and compliance professionals. We hope you enjoy our regulatory newsletter for June.

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## REGULATORY UPDATES

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### **Action against (and correction of) non-compliant business models that incentivize unlicensed selling of long term insurance policies to Mainland China Visitors**

**22 May 2024**

As an international finance centre, Hong Kong serves clients from across the globe who look to the financial services sector here for quality financial products and reliable services and advice. Hong Kong's life insurance industry (on which this circular focuses) plays an important part in this, offering a market where individuals from other jurisdictions, particularly Mainland China, can come to source a full range of diverse insurance policies to meet their insurance needs

The Insurance Ordinance (Cap. 41) ("IO") seeks to reinforce trust and confidence in the Hong Kong insurance market by only permitting persons who are licensed by the Insurance Authority ("IA") as licensed insurance intermediaries to carry on regulated activities (i.e. to sell insurance, give advice on insurance matters and arrange insurance policies). To obtain a licence, a person must be fit and proper (in terms of character, educational level and insurance qualifications). Once licensed, the person must adhere to the conduct requirements in the IO and related rules, codes of conduct and guidelines, when carrying on regulated activities to serve each client's insurance needs and best interests.

The licensing requirement is underpinned by section 64G of the IO. This makes it a criminal offence for a person to carry on regulated activities without the requisite licence (unless an exemption applies). Such is the importance of this requirement that, in the event it is breached, it comes with punishment of a fine and possible imprisonment for up to two years

### **Non-compliant broker referral models**

As the IA's circulars of 30 November 2022 and 5 January 2023 warned, the IA has no tolerance for contraventions of the licensing requirement which serves as a vital policy holder protection. Equally, the IA has no tolerance for licensed insurance intermediaries who renege on their responsibilities as licensees by not performing regulated activities themselves, but who instead rely on or have arrangements with unlicensed persons to do the regulated activities for them. This seriously prejudices the interests of policy holders and exposes the insurance buying public to the risk of mis-selling.

Despite these unequivocal warnings, the IA's inspections, intelligence received and mystery shopping have continued to reveal business models adopted by certain licensed insurance broker companies that appear obviously to rely on unlicensed persons to perform regulated activities (with the broker company and its technical representatives failing to perform the substantive regulated activities themselves). These business models are characterized by the following features:

- Engagement of referrers without the requisite licence to carry on regulated activities on behalf of the broker company, to source clients usually from Mainland China to buy long-term insurance policies with savings and investment elements;
- Payment of inordinately high referral fees to referrers as reward for inducing clients to buy long-term insurance policies from Hong Kong authorized insurers via the broker company, with the referral fees being directly tied to successful sales (e.g. 90%+ of the commission received by the broker company for the insurance policy sold);
- The use by referrers of prohibited rebates to clients to induce them to buy long-term insurance policies;
- Inadequacies in the broker company's operation to fulfill its own duties to carry on regulated activities with clients. Technical representatives of the broker company do not have sufficient time or resources (with most of the commission being paid to the referrers) to perform anything other than a "cosmetic" form-filling exercise with the clients (at times with the referrers present) to make it seem like the broker company (rather than the referrers) has performed all the selling in Hong Kong. Essentially, this business model turns technical representatives into nothing more than rubber-stamps (or "signing TRs") who spend limited time with clients and provide no post-sales ongoing servicing; and
- Clients being required by the broker company to sign statements asserting that all regulated activities were carried out by the broker company in Hong Kong (when this was not the case) and also being actively prompted by the technical representatives to state this to the insurer in any post-sales call received (thereby circumventing the insurer's controls).

The IA and the Independent Commission Against Corruption have conducted a joint operation against these non-compliant business models. The investigation is ongoing. The IA is also following up with other broker companies suspected of using this type of business model and also with the authorized insurers that have had long-term insurance policies sold using this business model (to ascertain the adequacy of their controls to prevent unlicensed selling).

The persistence of these non-compliant business models despite the previous warnings given, means that the following messages need to be reinforced to licensed insurance broker companies and authorized insurers that focus on offering long-term insurance policies with savings and investment elements, to Mainland China Visitors ("MCV").

### **I. Referral business must not breach requirements under the IO or other applicable laws**

Whilst there is no prohibition on licensed insurance broker companies accepting introductions of clients (i.e. referrals) from persons who are not licensed, it is imperative that in sourcing, dealing with and referring clients to broker companies, there is no breach of the licensing requirement and the broker company (and its technical representatives) provides clients with proper advice and services in accordance with the IO, the rules, the codes, the guidelines and circulars issued by the IA (collectively "Insurance Regulatory Framework").

A licensed insurance broker company that seeks to rely on referrers (without the requisite licence) to refer prospective clients to the broker company, must ensure that any referral model adopted is consistent with the following three self-evident principles:

Principle 1 – Unlicensed referrers must not give any regulated advice to clients and must not carry on any regulated activities or sales activities

Principle 2 – The broker company (and its technical representatives) must give all regulated

advice to the client and carry on all regulated activities needed to arrange insurance policies for the client to the minimum standards required in the Insurance Regulatory Framework.

Principle 3 – If any payments are to be offered to referrers by the broker company for introducing clients, such payments should be calibrated to be consistent with (i) the referrers not carrying on regulated activities (and not being incentivized to do so); and (ii) the broker company being properly resourced to provide regulated advice and perform regulated activities for the clients being introduced.

To ensure its referral business model operates in line with the above three principles, a broker company must design, implement and practically and substantively carry out its referral model in line with these three principles. It must also reinforce this with adequate controls, processes and risk management.

The IA has given general guidance on this in its circular of 30 November 2022 and the Explanatory Notes it has issued on the subject of regulated activities. We also provide further guidance on the three principles in the Annex to this circular. However, we emphasize that the adequacy of any controls and processes implemented will always be judged on a “substance over form” approach.

The IA will be short on tolerance for any broker company that just seeks to put in place cosmetic controls and processes, whilst in substance relying on, turning a blind eye to, or encouraging unlicensed referrers to carry on regulated activities to source clients (while the broker company fails to perform the regulated activities itself). Broker companies that do this can, at the very least, expect to have their licence revoked and may also find themselves the target of criminal investigation and proceedings.

## **II. Responsibilities of the Intermediary Management Control Function of Insurers in respect of Licensed Insurance Broker Companies that rely on referral business**

Authorized insurers are also reminded that their intermediary management control function is not only there to monitor their appointed licensed insurance agents. Such function must also ensure the arrangements by the licensed insurance intermediaries (including licensed insurance broker companies) for insurance business referred to the insurer, comply with the requirements of the Insurance Regulatory Framework. This includes compliance with the licensing requirement in section 64G of the IO.

In the training sessions we have carried out for Key Persons in the Intermediary Management Control Function and Directors of authorized insurers (provided through The Hong Kong Federation of Insurers), we have already provided guidance on the type of controls and processes an intermediary management function of an insurer may consider implementing in respect of the licensed insurance broker companies which place insurance policies with the insurer. These training sessions emphasized the need for enhanced due diligence and enhanced controls on licensed insurance broker companies that rely on referrals to offer long term insurance products to MCV clients. We supplement this further in the Annex in the context of the three principles and will continue to assess the effectiveness of controls and processes of insurers using a “substance over form” approach in our conduct inspections of insurers.

## **III. Rebates**

Authorized insurers and licensed insurance intermediaries are also reminded of the prohibition on rebates of premium and commission on long term insurance products within the scope of the IA’s GL 25 - Guideline on Offering of Gifts, with the exception of rebates recorded in the insurance policy, the policy schedule, the quotation, offer letter or promotional material (the terms of which are incorporated by reference into the insurance policy).

Where unchecked and undocumented rebates are used purely as an inducement in the sales process, it risks diverting the client’s attention away from considering whether the insurance policy being purchased is suitable for the client’s circumstances. These types of undocumented rebates thereby serve as a tool for mis-selling and can risk poor policy holder outcomes. Unchecked rebating can also result in discrimination between clients, with rebates only being provided to some but not others without any basis for such differentiation. This is the reason for the prohibition on unchecked rebates on long term insurance policies within the scope of GL25.

The fact that the non-compliant business model identified in this circular has been enabling unchecked

rebates to be offered through referrers (as part of their unlicensed sales practices), demonstrates the correlation between prohibited rebates, unlicensed selling and potential erosion of standards of insurance advice (which is detrimental to confidence and trust in the Hong Kong insurance market).

If a licensed insurance broker company is aware of, turning a blind eye to, or doing nothing to prevent its referrers from offering such rebates to clients (from the referral fees the broker company pays to the referrer), then this amounts to a breach of GL25 and disciplinary action can be expected.

As GL25 states, if rebates are to be offered on long term insurance policies falling within the scope of GL25, they must be offered by authorized insurers as a formal part of the insurance policy documentation, so the rebate is part of the overall terms and conditions of the insurance policy being considered and therefore offered in a transparent, non-discriminatory manner (see further comments in section IV below).

#### **IV. Commission and the 'treating customers fairly' principle**

Authorized insurers are also reminded of their duties, as stated in the IA's GL 15 – Guideline on Underwriting Class C Business and GL 16 – Guideline on Underwriting Long Term Business (other than Class C Business), to ensure that the remuneration structures on long-term insurance products do not create misaligned incentives for intermediaries to engage in mis-selling and aggressive selling.

Given that the remuneration being offered to the licensed insurance broker companies running the non-compliant business model cited in this circular, has resulted in inordinately high referral fees (incentivizing unlicensed selling) and indirect undocumented rebates being offered to clients, insurers should consider whether, based on the "treating customers fairly" principle, their commission structures are aligned with the cited principles in GL15 and GL16 and the objective of positive policy holder outcomes and satisfaction.

The IA will be giving increasing focus to this in its inspections and supervision of insurers going forward (in respect of remuneration structures for all licensed insurance intermediaries) and ensuring insurers are held accountable to the regulatory standards (including through disciplinary action). Further comment on this issue is also included in the [Annex](#).

#### **V. Responsibilities of senior management and controllers**

Finally, we remind all licensed insurance broker companies and authorized insurers that the responsibility lies with your senior management to implement controls and processes to ensure compliance with the Insurance Regulatory Framework. Under section 124 of the IO, controllers directors, responsible officers and key persons in control functions may themselves be personally guilty of a criminal offence, if an offence is committed under the IO by the companies for which they work. Aside from this, disciplinary action may be taken by the IA resulting in, among other penalties, public reprimands which name and shame the individual controllers or members of senior management of the company for their failures to discharge their responsibilities.

It is therefore imperative that persons holding these positions take seriously their responsibilities to implement adequate controls and processes to prevent non-compliances with the Insurance Regulatory Framework and, in particular, to ensure the prevention of the non-compliant business models and other matters highlighted in this circular.

The Hong Kong insurance market has a collective duty to ensure that any client who comes to buy insurance here is provided with quality, suitable, impartial and objective advice based on the client's insurance needs and best interests. Clients must be put in a position to make informed decisions on the insurance protections they are considering. Licensed insurance intermediaries and authorized insurers must work together to ensure this so that the insurance market in Hong Kong is underpinned with trust, confidence and a deserved reputation for treating policy holders fairly.

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# ENFORCEMENT NEWS

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## **Insurance Authority bans former insurance agent for 14 years for misappropriating premium**

**20 May 2024**

The IA has banned a former insurance agent (Agent) of Prudential Hong Kong Limited (Prudential) from applying for a licence for 14 years for misappropriation of premiums from 4 policy holders.

Between March 2017 and March 2019, the Agent advised the policy holders to remit the relevant premium payments into his personal bank account. As a result, the policy holders paid him a total of RMB 2,346,237 in premium. The Agent claimed that he would forward the premium onto Prudential. At the time, however, he only forwarded on RMB 87,151.

As a consequence, unbeknownst to the policy holders, 10 of their insurance policies lapsed due to non-payment.

Whilst the Agent has since returned RMB 657,073 to Prudential, which has resulted in Prudential reinstating 5 of the lapsed insurance policies, the Agent permanently deprived the policy holders of the balance of RMB 1,602,013. After following up from the IA, Prudential is contacting the policy holders of the remaining 5 policies to provide the necessary assistance or compensation.

The reprehensible nature of the Agent's misconduct in this case was aggravated by his attempts to mask discovery of his misappropriation by delaying in assisting one of the policy holders in applying for her login details which would have enabled her to check the true status of her insurance policies directly through Prudential's online portal. Furthermore, during both Prudential's and then the IA's investigation the Agent asserted that he had relied on his "cousin", whom allegedly he had hired as his assistant, to handle the premium payments. The Agent's inability to produce any evidence of the existence of such "cousin", however, revealed it for what it was: a poor attempt to shift responsibility and mask the fact of the Agent's own obvious, serious and significant misappropriations.

The IA decided this case through its Disciplinary Panel which was constrained to apply the applicable rules of the self-regulatory regime that were in place at the relevant time. Nevertheless, within the parameters of its discretion, so disgraceful did the Disciplinary Panel find the Agent's misconduct, that it unanimously decided to elevate the penalty to a 14-year prohibition to reinforce the message of intolerance which must be sent. To quote the Disciplinary Panel "bearing in mind that one bad apple spoils the barrel, we need to send a strong deterrent message to all our practitioners and the industry".

Had the current regulatory regime applied to this case, it would have been open to the IA to impose a life-time ban to reflect its abhorrence and zero-tolerance for the level of serious misconduct on display. Referrals of such matters to other law enforcement bodies are also being made as a matter course under the network Memorandum of Understandings the IA has set in place. This case, therefore, serves as fair warning of the IA's approach to ensuring such acts of misconduct, which risk bringing the insurance industry into disrepute, are penalized to the fullest extent the law allows.

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## **Bans imposed on two former insurance agents for using false academic certificates under the former self-regulatory regime**

**31 May 2024**

The IA has taken disciplinary actions against two former insurance agents for using false academic certificates to establish that they met the minimum education requirements when registering with the former self-regulatory organization.

In the first case, the former agent admitted to submitting false information to the Insurance Agents Registration Board (IARB) during the registration process on two separate occasions (in 2013 when she first registered as an insurance agent and in 2019 during her second renewal of her registration). A 36-month ban has been imposed to reflect the seriousness of the wrongdoing.

In the second case, the former agent admitted to submitting false information to the IARB during the registration process in 2016. A ban of 23 months has been imposed which takes account of the seriousness of the wrongdoing and the former agent's admission and unconditional agreement to the disciplinary action at an early stage of the disciplinary process.

The actions of the two individuals had subjected policy holders to the risk of being advised by persons who did not have the minimum education requirements to serve as insurance agents and whose ethics had been compromised from the outset of their careers, in having deliberately submitted false academic certificates to become registered as agents in the first place. Both individuals are deserving of being prohibited from playing any part in the insurance market until such time as they are able to demonstrate such a complete reformation of character as to be trusted again, a process that must be underpinned with the acceptance and admission of the wrongdoing.

These cases emanate from the period before the IA took over the regulation of licensed insurance intermediaries on 23 September 2019 and have been handled in accordance with the relevant requirements in place at the time and the disciplinary approach followed by the IARB.

Under the current regulation of licensed insurance intermediaries, it is a criminal offence to provide false information to the IA in connection with an application for a licence or an approval under the Insurance Ordinance (Cap. 41)2. An individual who commits such offence, if found guilty, will be liable to a fine at level 53 and to imprisonment for 6 months. The IA will have no hesitation in prosecuting any individual who seeks to submit a false academic certificate to the IA as part of the licensing process under the current regime.

The IA reminds insurers (and their intermediary management control functions) that they also have an important role to play in ensuring that, as part of their recruitment and on-boarding processes, adequate checks are carried out to verify the accuracy of the information being submitted to the IA in licensing applications made by their prospective new insurance agents. Through its inspection of insurers and ongoing conduct supervision work, the IA will continue to assess the adequacy of insurers' controls and processes on this issue and hold them accountable for this.

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