

## REGULATION OF INSURANCE INTERMEDIARIES AND AUTHORISED INSURERS BY THE HONG KONG INSURANCE AUTHORITY – INCREASED FOCUS ON RESPONSIBLE OFFICERS AND SENIOR MANAGEMENT

On 23 September 2019, the Insurance Authority (IA) succeeded the three self-regulatory organisations in the regulation of insurance intermediaries. Insurance intermediaries will now be subject to more stringent standards and requirements regulating their day-to-day operations and conduct. Review and implementation of improved internal controls and policies, and risk management systems, are clearly a priority. There is some alignment now with the regulation of the banking and securities industries to which reference can be made. Responsible officers and senior management must take notice and gain a clear understanding of the requirements under the Insurance Ordinance (Cap 41) (the Ordinance) and the expectations of the IA.

### INTRODUCTION

On 23 September 2019, the Insurance Authority (IA) succeeded the three self-regulatory organisations in the regulation of insurance intermediaries. The three self-regulatory organisations comprise (1) the Insurance Agents Registration Board of the Hong Kong Federation of Insurers, (2) the Hong Kong Confederation of Insurance Brokers, and (3) the Professional Insurance Brokers Association (collectively, the SROs).

Insurance intermediaries will now be subject to more stringent standards and requirements regulating their day-to-day operations and conduct. Review and implementation of improved internal controls and policies, and risk management systems, are clearly a priority. There is some alignment now with the regulation of the banking and securities industries, and thus, whilst there appears to be much new regulation to consider, reference can be made to existing guidance in these segments. That said, responsible officers and senior management must take notice and gain a clear understanding of the requirements under the Insurance Ordinance and the expectations of the IA.

The stated aim of the new independent regulatory regime is to help enhance the professionalism of insurance intermediaries, promote fair and transparent regulation, and instil a robust but flexible approach in fulfilling the statutory

#### Key issues

- Insurance intermediaries carrying on regulated activities must be licensed. This includes persons actively marketing insurance services to the Hong Kong public from outside Hong Kong.
- Responsible officers and senior management should review and consider the Codes of Conduct for Brokers and Agents and the expected standards of corporate governance controls and procedures.
- Responsible officers and senior management should be aware of their potential personal liability under section 124 of the Insurance Ordinance.
- Authorised insurers must obtain the IA's prior approval for appointing or changing key persons in the Intermediary Management Function.

function of protecting policy holders. It is in the interests of all stakeholders including authorised insurers for these objectives to be achieved.

Authorised insurers are now required to obtain prior approval from the IA for key persons in the Intermediary Management Function.

## **OVERVIEW OF THE CHANGES**

Departing from the self-regulatory model, the IA serves as an independent insurance regulator with a broad scope of responsibilities and regulatory powers. Such powers include:

- Supervising and ensuring compliance with the requirements in the Ordinance by licensed insurance intermediaries and authorised insurers.
- Promoting and encouraging the adoption of proper standards of conduct and sound and prudent business practices by insurance intermediaries and authorised insurers.
- Regulating the conduct of insurance intermediaries through a statutory licensing regime.

Inspection and investigation powers in relation to insurance-related businesses of authorised institutions i.e. banks have been delegated to the Hong Kong Monetary Authority (HKMA) pursuant to a Memorandum Of Understanding signed between the HKMA and the IA. Please refer to our earlier alert for details (click [here](#)).

## **New codes and guidelines**

The IA has issued various new codes and guidelines setting out and providing guidance on, among other things, the proper standards of conduct, including in relation to the sale of long term insurance policies. Examples (which came into effect on 23 September 2019) include:

- Guideline on "Fit and Proper" Criteria under the Insurance Ordinance (Cap 41) – please refer to our earlier alert (Fit and Proper Guideline) (click [here](#)).
- Code of Conduct for Licensed Insurance Brokers.
- Code of Conduct for Licensed Insurance Agents.
- Guideline on Exercising Power to Impose Pecuniary Penalty in respect of Regulated Persons under the Insurance Ordinance (Penalty Guideline).
- Guideline on Offering of Gifts.
- Guideline on Sale of Investment-Linked Assurance Scheme (ILAS) Products.
- Guideline on Long Term Insurance Policy Replacement.
- Guideline on Benefit Illustrations for Long Term Insurance Policies.
- Guideline on Cooling-off Period.
- Guideline on Financial Needs Analysis.

## Licensing

As for the licensing of insurance intermediaries, under the new activity-based regime, a person who carries on or holds itself out as carrying on a "regulated activity" in the course of business or employment or for reward must be licensed, unless one of the statutory exemptions applies. The term "regulated activity" has broad coverage, and includes inviting or inducing, or attempting to invite or induce, a person to make a material decision, or giving regulated advice or opinions on various matters including (1) the making of an application or proposal for a contract of insurance; (2) the issuance, continuance or renewal of a contract of insurance; (3) the change in any term or condition of a contract of insurance; and (4) the making or settlement of an insurance claim. As such, a person who gives his or her personal opinion on whether a person should enter into a contract of insurance or whether an insured person should make an insurance claim, even on a voluntary basis, will be caught.

Pursuant to section 64H of the Ordinance, persons actively marketing insurance services to the Hong Kong public from a place outside Hong Kong will also be caught and required to be licensed if the insurance services marketed would constitute a regulated activity in Hong Kong. The Securities and Futures Ordinance (SFO) contains an equivalent section, namely, section 115. As discussed above, comparable regulation in the securities sector can provide guidance at this initial time. The Securities and Futures Commission (SFC) has indicated the factors it will consider in determining whether a person actively markets, including whether the marketing is conducted in a concerted manner in accordance with a detailed plan; whether the services marketed are continuing, as opposed to one-off; whether the services are packaged to target the Hong Kong public such as being written in Chinese or denominated in Hong Kong dollars. Such marketing may be by means of direct mailing, advertisements in local newspapers, broadcasting or "push" technology over the Internet, which is not passive in nature.

All insurance intermediaries who were validly registered with the SROs immediately before 23 September 2019 are deemed to be licensed insurance intermediaries registered with the IA for a period of 3 years.

## Approval for key persons

Authorised insurers must now obtain the IA's prior approval for appointing or changing key persons responsible for the Intermediary Management Function.

This applies to Hong Kong and non-Hong Kong incorporated authorised insurers which are not captive insurers. Individuals may be jointly responsible with others as key persons. The IA must be satisfied that the individual(s) to be appointed are fit and proper.

The Intermediary Management Function is defined in the Ordinance as a function to establish and maintain internal control measures for administering licensed insurance agencies and agents appointed by the insurer, and monitoring their compliance with the Ordinance and codes and guidelines including the Fit and Proper Guideline and the Code of Conduct for Agents, as well as those relating to marketing and distribution of insurance products. Whether or not to appoint a key person in the Intermediary Management Function is a decision for the board of directors and controller of the insurer after considering whether it is required as part of the insurer's corporate governance structure.

Regulation of the control function including the Intermediary Management Function is comparable to the SFC's manager in charge regime.

## **SOME KEY CHANGES FOR INSURANCE INTERMEDIARIES TO BE ALERT TO**

Some of the changes brought about by the new statutory provisions, codes and guidelines may have a significant impact and insurance intermediaries in particular should take a closer look to avoid the potential pitfalls.

### **Senior management and responsible officer**

Both the Codes of Conduct for Licensed Insurance Brokers and Licensed Insurance Agents (collectively, the Codes) inform and explain in a non-exhaustive manner the statutory conduct requirements in sections 90 to 92 of the Ordinance including honesty and integrity; care and diligence; competence to advise; sufficient disclosure; avoiding conflict of interests, and accounting for assets of policy holders. This in turn guides the IA in determining whether there has been misconduct or whether a broker or agent remains fit and proper to be licensed.

Employees/personnel of insurance intermediaries falling within the definition of senior management and responsible officers should review section IX of the Codes, which sets out the expected standards of corporate governance controls and procedures, specifically for (a) compliance; (b) insurance product and insurer due diligence; (c) handling of complaints; (d) keeping of records; and (e) reporting requirements. This will enable a better understanding of the extensive requirements imposed, as they may be held accountable for any non-compliance.

The Codes define "senior management" in relation to a licensed insurance broker company or agency to mean the persons performing the functions of managing the regulated activities carried on by the broker company or agency. Such definition will include individuals in a large broker company or agency who are responsible for oversight of a particular business line or function relating to the regulated activities carried on by the broker company or agency. In other words, the title and/or position of the individual is not conclusive, and the IA will look into the actual functions and responsibilities of the persons concerned.

Senior management should also be aware that under section 124 of the Ordinance, an offence committed by a body corporate is presumed to have been committed with the consent or connivance of, or to be attributable to neglect or omission on the part of relevant individuals. Such individuals include, among other things, a responsible officer or a "key person in control functions" concerned in the management of the body corporate. Therefore, unlike in other general cases where the regulators have the burden of proof in respect of an alleged offence, the persons concerned bear the burden of proof and have to provide sufficient evidence to rebut the presumption. In addition, the prosecution must not be able to prove the contrary beyond reasonable doubt in order for the presumption to be rebutted.

In our experience, persons falling within the definition of senior management do not always appreciate that they will be regarded as senior management by the regulators, and exposure to potential liability remains high unless clear guidance and education on the statutory requirements and expectations of the IA are provided to staff members.

## **Pecuniary penalty**

Under section 81 of the Ordinance, as a result of misconduct or where the IA forms the view that a person regulated under the Ordinance is not a fit and proper person by reason of the conduct concerned, such person may be ordered to pay a pecuniary penalty.

With a view to providing a higher degree of visibility in this regard, the IA issued the Penalty Guideline setting out qualitative factors and considerations it will take into account in imposing a pecuniary penalty.

However, the Penalty Guideline does not shed light from a quantitative perspective on the starting point of a penalty which is to be imposed, nor the extent to which the pecuniary penalty will be increased or decreased as a result of the absence or presence of qualitative elements. At this early stage, for an indication of a realistic level of pecuniary penalty, one may only be able to make reference to decisions on comparable or similar conduct made by other regulators in Hong Kong, for example, in the banking and securities sectors. The Penalty Guideline in fact provides that decisions made by other relevant authorities in respect of the conduct are relevant.

The Penalty Guideline also provides that in relation to a firm, one of the relevant factors in determining the level of penalty is whether the conduct reveals serious or systemic weaknesses of the firm's internal control procedures and risk management systems. It further provides that in relation to a responsible officer or person(s) involved in management, the extent to which such person knew or reasonably ought to have known of the conduct is relevant.

This again emphasises the importance of reviewing and ensuring strong internal control procedures and risk management systems are in place. Based on our experience, it is common in cases of regulatory investigations on regulated entities generally for such entities and/or their personnel to be unaware of the insufficiency in their internal control procedures and risk management systems until an investigation is commenced. This is something which can be avoided by engaging professional assistance in identifying and rectifying the issues at an early stage before any investigation by the IA commences.

## **CONCLUSION**

The stated aim of insurance industry regulation and in particular, the Codes, is to reinforce the bedrock of trust, which serves as the foundation for a healthy, competitive and efficient insurance industry. In particular, the change from a self-regulatory regime to a statutory licensing regime in respect of the regulation of insurance intermediaries means that all insurance intermediaries are now subject to higher levels of regulatory scrutiny. This is of course welcomed, but responsible officers and senior management need to take note of the changes taking place given the potential liabilities involved. It is now therefore important to review and consider internal control procedures and risk management systems to ensure compliance with the new requirements.

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