

**Bills Committee on Insurance Companies (Amendment) Bill 2014**

**The Administration's Response to Outstanding Issues  
Arising from the Discussions at Previous Meetings and Raised by the  
Industry**

**Purpose**

This paper sets out the Administration's response to outstanding issues arising from the discussions at previous Bills Committee meetings and raised by the industry. We have consulted the industry when formulating the proposed amendments. Detailed wordings of the corresponding Committee Stage Amendments ("CSAs") as mentioned in the paper will be submitted to the Bills Committee for discussion at the next meeting to be held on 26 May 2015.

**Activities performed by employees of insurers**

2. To ensure a level playing field and to prevent possible circumvention, the proposed regulatory regime is activity-based, i.e. persons who engage in "regulated activities", whether they are individual insurance agents, technical representatives of insurance agencies or insurance broker companies, or employees of insurers, should be subject to the same licensing and conduct requirements. New Schedule 1A added by Clause 86 of the Bill sets out the scope of the regulated activities, which can be summarized as any act of –

- (a) negotiating or arranging a contract of insurance;
- (b) inviting or inducing, or attempting to invite or induce, a person to enter into a contract of insurance;
- (c) inviting or inducing, or attempting to invite or induce, a person to make a material decision;
- (d) giving regulated advice.

A material decision and regulated advice refer to a decision or advice (as the case may be) in relation to any of the following matters –

- (a) the making of an application or proposal for a contract of insurance;
- (b) the issuance, continuance or renewal of a contract of insurance;
- (c) the cancellation, termination, surrender or assignment of a

- contract of insurance;
- (d) the exercise of a right under a contract of insurance;
- (e) the change in any term or condition of a contract of insurance;
- (f) the making or settlement of an insurance claim.

New section 121(2) added by Clause 84 of the Bill provides that a person acting on behalf of an insurer does not need to be licensed if he carries on a “regulated activity” that only involves the discharge of clerical or administrative duties for an insurer.

3. A Member pointed out that apart from clerical or administrative staff, some employees of insurers might give regulated advice when performing their jobs such as underwriting and claims handling. We agree to the principle that those who give regulated advice wholly incidental to the performance of their technical functions do not need to be licensed, whereas direct sales staff of insurers should be licensed. We will propose CSAs to the effect that an employee of an authorized insurer does not need to be licensed if he carries on a “regulated activity” that only involves the discharge of underwriting or claims handling duties for an insurer. Furthermore, we propose to exempt employees of authorized captive insurance companies<sup>1</sup> and authorized reinsurance companies from the licensing regime because they do not distribute insurance products to the general public.

### **Restrictions in relation to personnel of licensed insurance agencies and licensed insurance broker companies**

4. Insurance agents act on behalf of insurance companies whereas insurance brokers act on behalf of policy holders or potential policy holders. A conflict of interest will arise if a person acts as an insurance agent and an insurance broker concurrently. At present, section 65 of the Insurance Companies Ordinance (“ICO”)(Cap.41) –

- (a) stipulates that a person shall not act as an insurance agent and an insurance broker concurrently;
- (b) provides that the Insurance Authority may set the maximum number of insurers for which an insurance agent may act at any one time (currently, the maximum number of insurers

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<sup>1</sup> Captive insurance companies are insurance companies established by a parent group or groups with the specific objective of covering the risks to which the parent is exposed.

that an insurance agent may act for at the same time is four); and

- (c) imposes restrictions on personnel of insurance agencies and insurance broker companies so as to prevent circumvention of (a) and (b) above. For example, if a person is a director of an insurance agency and gives advice to policyholders or potential policyholders on insurance matters, the person may be a director of another insurance agency or insurance broker company only if he will not provide advice to policyholders or potential policyholders on insurance matters for the other company.

5. In the Bill, we intend to retain the restrictions in the existing section 65 and make necessary updates in wording by replacing “giving advice” by “deal with any matter that relates to a regulated activity” because under the new licensing regime for insurance intermediaries, giving advice on insurance matters in the course of business or employment is a regulated activity.

6. The insurance industry considers that the changes in wording will unnecessarily widen the scope of the restrictions and could hinder normal investment activities. To better reflect our policy intent and to avoid over-regulation, we will propose CSAs to provide that the restrictions on personnel apply to a person who “manages or controls any matter relating to a regulated activity” of another insurance intermediary company.

### **Insurance agents’ relationship with insurers**

7. The revised section 68 added by Clause 73 of the Bill seeks to maintain the existing requirement under the ICO regarding the liability of an insurer for the acts of its appointed insurance agent under the ICO. Specifically, the existing section 68(2) provides that an insurer is not able to exclude or limit its liability for the actions of its appointed insurance agent in the dealings for the issue of a contract of insurance and insurance business relating to the contract.

8. New section 68(1) to (4C) seeks to modernize the drafting of the existing section 68(1) to (4). The industry considers that the revised section 68 would override the recently established common law position<sup>2</sup>

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<sup>2</sup> Thanakharn Kasikorn Thai Chamkat v Akai Holdings Ltd (2010) 13 HKCFAR 479.

and that an insurer would not have to be responsible for the acts of its appointed insurance agent if the relevant policy holder knows that the insurance agent's acts are outside the latter's authority. We propose to model on the relevant provisions under the Corporations Act 2001 of Australia and move CSAs to make it clear that an insurer is not liable for the act of an insurance agent if (i) the act is not within the scope of the insurance agent's authority; and (ii) that the insurance agent has disclosed that fact to the client before the client relied on the act. The general rule that the burden of proof lies on the party who asserts the affirmative of the issue or question in dispute applies, i.e. the onus of proof lies with the insurer.

### **Award of legal costs by the Insurance Appeals Tribunal ("IAT")**

9. According to new section 104 added by Clause 84 of the Bill, IAT may, in relation to a review, by order award legal costs to a party to the review. The industry has suggested that the costs to be awarded by IAT be capped at a certain level. As we have explained to Members, the award of costs and the taxation of any costs awarded will be subject to Order 62 of the Rules of the High Court (Cap. 4 sub. leg. A). The rationale behind the arrangement is to discourage abuse of the appeal process to delay a disciplinary action or making unreasonable claims. The same arrangement is adopted by other appeals tribunals including the Securities and Futures Ordinance (Cap. 571) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap 615). We see no strong justifications to deviate from this practice. In response to a Member's suggestion, we will propose CSAs to include specific provisions that with the consent of both parties to the review, IAT may make a determination on the basis of written submissions only. We believe that this will provide potential appellants with an alternative which may involve lower legal costs.

### **Disciplinary proceedings**

#### *Consultation with the proposed expert panel*

10. The industry has raised concerns on whether IIA would act impartially and separate its functions of carrying out investigation and making disciplinary decisions. It has proposed that IIA should be mandated to consult the proposed expert panel before making major disciplinary decisions like those involving the revocation of licences. We maintain our view that the function of the proposed expert panel is to fill IIA's knowledge gap if necessary. Consultation with the expert panel

should not be a pre-requisite to disciplinary decisions by IIA. As we have explained at previous meetings, IIA will put in place a Chinese wall to ensure that its investigative staff will not be involved in the disciplinary process and the determination of disciplinary sanctions.

*Reasonableness of pecuniary penalty on insurance intermediaries*

11. On the industry's concern about IIA's power to impose a pecuniary penalty, new section 82 added by Clause 84 specifically requires IIA to publish in the Gazette a set of fining guidelines before it can exercise the power. IIA must have regard to the fining guidelines when imposing a fine. We envisage that IIA would make reference to similar fining guidelines currently adopted in other financial regulatory regimes which in general include the following factors that should be taken into account when determining the quantum of a pecuniary penalty –

- (a) the nature, seriousness and impact of a contravention;
- (b) the conduct of the regulated person / entity concerned after the contravention (i.e. whether it has taken any remedial steps or attempted to conceal);
- (c) previous disciplinary record and compliance history of the regulated person / entity concerned; and
- (d) a pecuniary penalty should not have the likely effect of putting the regulated person / entity concerned in financial jeopardy.

*Access to information, oral hearing and cross-examination*

12. The industry has requested that, during IIA's disciplinary proceedings, a defendant should be given an express right to oral hearing and cross-examination. New section 81(1) added by Clause 84 of the Bill states that IIA "must not exercise a power under section 80 (i.e. disciplinary powers on insurance intermediaries) without first giving the person in respect of whom the power is to be exercised a reasonable opportunity of being heard". We will propose CSAs to clarify that a reference to "an opportunity of being heard" is a reference to an opportunity to "make written or oral representations". We envisage that IIA will consider whether it is appropriate to conduct oral hearing and allow cross-examination on a case by case basis.

13. On the industry's demand for the right of a defendant to have access to all of the information and evidence supporting the charges

against him, as a matter of policy, we have no objection that a defendant may request access to relevant information and evidence supporting the charges against him.

14. Further to paragraphs 12 and 13 above, IIA will set out procedural details of its disciplinary proceedings (pursuant to new section 131 added by Clause 84 of the Bill) in the relevant regulatory handbook, including the arrangements that IIA will consider conducting oral hearing and allowing cross-examination if such is justified.

### **“Neglect or omission” by senior management in relation to offences by bodies corporate**

15. The expression “neglect or omission” is commonly used in recently enacted legislation. “Omission” generally means a failure to take action, where a person has a duty to initiate positive action.

16. The existing ICO and legislative proposals under the Bill impose statutory duties on an authorized insurer and licensed corporate insurance intermediaries (such as maintenance of assets and filing regulatory notifications to the regulator). We maintain that if a body corporate commits an offence, an individual should not be allowed to hide behind the corporate veil if it is proved that the offence was attributable to any neglect or omission of the individual. However, we agree that the existing wording defining the individual who could be liable in new section 122 as follows is too wide –

“a controller of the body corporate; a director, manager, company secretary or other person concerned in the management of the body corporate (officer) or an individual purporting to act as the officer or as agent of the body corporate;”

17. We will propose CSAs to state clearly that an individual who could be liable for an offence committed by a body corporate is “a controller, director, key person in control functions, or responsible officer”. All of them have statutory duties under the Bill.

### **“Best interests requirement” on licensed insurance intermediaries**

18. The ensuing paragraphs set out the Administration’s position on the proposed conduct requirement that licensed insurance intermediaries “must act honestly, fairly, in the best interests of the policy

holder concerned or the potential policy holder concerned, and with integrity” (“best interests requirement”).

### Background

19. The “best interests requirement” is one of the eight specific conduct requirements under new section 89 added by Clause 84 of the Bill (extract at **Annex A**). These conduct requirements are applicable to both insurance brokers and insurance agents.

20. An insurance broker acts on behalf of the client, i.e., an insurance broker acts as an agent of the client. Insurance brokers are obliged to act in the best interests of their clients because they owe a fiduciary duty to their clients under agency law. Insurance brokers therefore do not dispute the “best interests requirement”.

21. An insurance agent acts on behalf of an insurance company in selling insurance products. Currently, an insurance agent in Hong Kong may act on behalf of a maximum of four insurance companies, not more than two of which are life insurance companies.

### Concerns of the industry

22. Insurance companies and insurance agents contend that they do not dispute the “best interests requirement” if it is set out in the non-statutory code of conduct (pursuant to new section 93 added by Clause 84 of the Bill), but they are concerned that making the requirement statutory without qualifications may create a new statutory cause of action, rendering them susceptible to legal actions by clients.

23. Insurance agents are also concerned that having the same “best interests requirement” for insurance brokers and insurance agents could create difficulties for them as they also need to act in the interests of their appointing insurance companies, and that they do not have access to products offered by other insurance companies.

### Administration’s response

#### (a) New statutory cause of action

24. On paragraph 22, it must be noted that the consequences of a breach of the conduct requirements in new section 89 will be disciplinary sanctions by the IIA. It is not our intention to introduce a new statutory

cause of action. In fact, case law<sup>3</sup> has suggested that where the statute or regulation is silent on the issue of a cause of action, a breach of its provision does not by itself give rise to a cause of action for breach of a statutory duty.

25. Nevertheless, for the sake of clarity, we accept the industry's suggestion of inserting a provision under new section 89 to clarify that a breach of the conduct requirements would not on its own render any insurance intermediary or insurance company liable to judicial proceedings. We will propose a CSA to include the aforesaid clarification. The amendment will not disturb an aggrieved person's right to take civil action against an insurance intermediary or an insurance company on other grounds under common law. To facilitate compliance with the conduct requirement by the industry, IIA will include in the code of conduct for insurance intermediaries further details on what constitutes "best interests".

(b) Different roles of insurance agents and brokers

26. On paragraph 23, we wish to reiterate that the introduction of the "best interests requirement" will not change the difference between the two categories of insurance intermediaries, and the very fundamental difference that an insurance agent acts on behalf of his appointing insurance company whereas an insurance broker acts on behalf of his client will remain. In fact, it is a statutory licensing requirement that a licensed insurance agent must be appointed by at least one insurance company (see new section 64U(5)(b) for grant of agency licence and new 64W(3)(b) for grant of individual agent licence). In drawing up the code of conduct to further elaborate on what constitutes "best interests" (paragraph 25 above refers), IIA will take into account the different roles of insurance agents and brokers. New section 93(7) stipulates that the code of conduct will be admissible in evidence in any proceedings under the Ordinance before a court, and that "if a provision in the code appears to the court to be relevant to a question arising in the proceedings, the court must, in determining the question, take into account any compliance or non-compliance of the provision". This should address the concern of the trade that the "best interests requirement" for insurance agents should be different from those for insurance brokers.

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<sup>3</sup> R v Deputy Governor of Parkhurst Prison, ex p Hague [1992] 1AC 58.

### *Overseas experience*

27. Different jurisdictions specify conduct requirements, including the “best interests requirement”, by different means. For example –

- (a) Singapore: The “best interests requirement” is a key element in the licensing regime for insurance intermediaries, and it is stated in the statute that the regulatory body may revoke the licence of an insurance intermediary if it considers the latter not able to act in the best interests of its client.
- (b) The United Kingdom: It is stated in the non-statutory regulatory handbook of the Financial Conduct Authority that an insurance intermediary must act in accordance with the best interests of its client.
- (c) Australia: It is stated in the statute that an insurance intermediary must act in the best interests of the client. The legislation also stipulates the actions to be taken for different types of products/services to meet this requirement.

A table setting out detailed references of practices adopted by overseas jurisdictions is at **Annex B**.

**Financial Services and the Treasury Bureau**  
**May 2015**

**Conduct Requirements for Licensed Insurance Intermediaries  
(New Section 89 added by Clause 84 of the Bill)**

When carrying on a regulated activity, a licensed insurance intermediary –

- (a) must act honestly, fairly, in the best interests of the policy holder concerned or the potential policy holder concerned, and with integrity;
- (b) must exercise a level of care, skill and diligence that may reasonably be expected of a prudent person who is carrying on the regulated activity;
- (c) may advise only on matters for which the intermediary is competent to advise;
- (d) must have regard to the particular circumstances of the policy holder or the potential policy holder that are necessary for ensuring that the regulated activity is appropriate to the policy holder or the potential policy holder;
- (e) must make the disclosure of information to the policy holder or the potential policy holder that is necessary for the policy holder or the potential policy holder to be sufficiently informed for the purpose of making any material decision;
- (f) must use its best endeavours to avoid a conflict between the interests of the intermediary and the interests of the policy holder or the potential policy holder;
- (g) must disclose any conflict mentioned in paragraph (f) to the policy holder or the potential policy holder;
- (h) must ensure that the policy holder's assets are promptly and properly accounted for; and
- (i) must comply with other requirements that are prescribed by rules made under sections 92 and 127 (both added by Clause 84 of the Bill).

**Insurance Companies (Amendment) Bill 2014**  
**“Best Interests Requirement” – Overseas Experience**

| <b>Authority /Jurisdiction</b> | <b>Reference</b>  | <b>Remarks</b>   |
|--------------------------------|---|--|
| EU                             | <p><b><u>Revised Directive on Insurance Mediation (“IMD 2”)</u></b></p> <p><i>“Member States shall require that, when carrying out insurance mediation with or for customers, an insurance intermediary or insurance undertaking acts honestly, fairly and professionally in accordance with the best interests of its customers.” (Article 15)</i></p>   | <p>IMD2 is under the scrutiny of the European Parliament.</p> <p>A “directive” is a legislative act that sets out a goal that all EU countries must achieve. However, it is up to the individual countries to decide how to do so. The Member States must then adopt national measures to give effect to the terms of the Directive within a time frame set in the directive, usually two years.</p> |
| UK                             | <p><b><u>Financial Conduct Authority (“FCA”) Handbook</u></b></p> <p><i>“A firm must act honestly, fairly and professionally in accordance with the best interests of its client.” (Conduct of Business Sourcebook (“COBS”) 2.1.1)</i></p> <p>COBS further provides examples of client’s best interests rule in relation to charging structure, remuneration, assessment of the suitability of the products, the communication / disclosure of information to clients and conflict of interests.</p> <p><u>Note:</u> COBS 2.1.1 applies in relation to designated investment business carried on for a retail client. Designated investment</p> | <p>The “best interest” requirement is not in the Financial Services and Markets Act but set out in FCA’s Handbook. The said provision on best interests (COBS 2.1.1) is an administrative rule made by the FCA under the Act.</p>  |

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|           | <p>business includes assisting in the administration and performance of a life policy or a personal pension scheme.</p> <p>A firm means a person which covers a body corporate, partnership or natural person, etc.</p>  |  |
| Australia | <p><b><u>Corporations Act 2001</u></b></p> <ul style="list-style-type: none"> <li>➤ <i>“The provider must act in the best interests of the client in relation to the advice.”</i> (section 961B(1))</li> <li>➤ Section 961B(2) stipulates the statutory steps to be taken to meet the best interests requirement, for example, - <ul style="list-style-type: none"> <li>■ identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;</li> <li>■ based all judgements in advising the client on the client’s relevant circumstances; and</li> <li>■ taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client’s relevant circumstances.</li> </ul> </li> </ul> |  |
| Singapore | <p><b><u>Financial Advisers Act</u></b></p> <p><i>“..... the Authority may refuse to enter the name and other particulars of an individual in the public register of representatives, ....., or revoke the</i></p>   |  |

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|  | <p><i>status of an individual as an appointed or provisional representative if ....., the Authority has reason to believe that he has not acted / may not be able to act in the best interests of the clients of his principal;... ”</i><br/>(section 23J(1)(h)(iv) and 23J(1)(i))</p> |  |
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