THE LAW SOCIETY OF HONG KONG 香港律師會

INSURANCE COMPANIES (AMENDMENT) BILL 2014

SUBMISSION

Introduction

1. The *Insurance Companies (Amendment) Bill 2014* ("the Bill") was introduced into the Legislative Council in April 2014. The Bill seeks to amend *the Insurance Companies Ordinance*, Cap 41 ("ICO") to establish an Independent Insurance Authority ("IIA"), as well as a statutory licensing regime for insurance intermediaries.

2. The Law Society has the following comments on the Bill. These comments are further to those submissions the Law Society has made to the Administration on the proposed establishment of the IIA in 2010 and 2013. The Law Society asks the Administration to take into consideration the previous submissions in the course of the review of the Bill.

Comments

Conduct requirements – "best interests" requirement

3. One of the main concerns of the Law Society is the "best interests" requirement set out in the Bill. Section 89 in the Bill (p. C2115 of Legal Supplement No.3, Gazette dated 25 April 2014) provides that (with emphasis supplied)

> 89. Conduct requirements for licensed insurance intermediaries
>
> 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; ...

4. The Bill provides that IIA may make rules to require a licensed insurance intermediary (as defined in the Bill) to comply with the conduct requirements, including the above "best interests" requirement (section 92(2)(g), p. C2125 *ibid*). The conduct requirements would be applicable to both licensed insurance agency and licensed insurance broker company (sections 90(1)(a) and 91(1)(a) at respectively p. C2119 and p. C2121 *ibid*). A responsible officer (as defined) must ensure the compliance of the relevant conduct requirements under section 89 (see sections 90(2)(a) and 91(2)(a) at p. C2119 and p. C2121 *ibid*).

5. Furthermore, if there is any provision in an agreement between the insurer and its agent which affects the "best interests" obligation of the agent, that provision will be void (section 68A, p. C2073 *ibid*).

6. The proposed "best interests" conduct requirement is therefore important; yet as a matter of law, this requirement presents a conceptual impasse.

7. There is no question that appointed agents are representatives of insurers; they are the insurer's agents with respect to the issue of a contract of insurance and insurance business relating to the contract (Section 68(1), ICO). They are commonly employed by insurers or group of insurers. Their primary duties must lie to the insurers as their principals and also as employers.

8. Since the appointed agents owe their primary duties towards the insurers, when there is a conflict of interest between the insurers and the policy holders (which is not uncommon), the appointed agents simply would not be able to act in the "best interests" of the policy holders. By saddling the agents with the conduct requirement of "best interests", the agents are caught in a hopeless dilemma.

9. The above conflict issue has been relayed to the Administration by the Law Society and other stakeholders in their responses to the previous consultations. The reply of the Administration to this legitimate concern is

the introduction of a clause that any provision in the agreement which contravenes the "best duty" requirement would be void (section 68A, para 5 above).

10. The Law Society considers that the above is not a satisfactory answer as, firstly, as a matter of law, it does not resolve the conflict of the insurer and the appointed agent, and secondly, by using the word "intermediary" in its answer (viz. section 68A of the Bill), instead of distinguishing "brokers" and "agents" in the said section, the Administration muddles the roles of "brokers" and "agents".

Conflict not resolved

11. The conflict in which an appointed agent is caught is a genuine, rather than hypothetical, concern. If an agent is to act in the "best interests" of the policy holder, then can he, without breaching his duty (contractual and/or fiduciary) towards his principal, offer to the policy holders or the potential policy holders different products from different insurers on the market? If an agent cannot offer choices to the potential policy holders, and could introduce and sell to the potential policy holders only a particular product, knowing that there are other products on the market, would that be in the "best interests" of the potential policy holders?

12. "Best interests" is not defined in the Bill, but the word "best" should connote a comparative or superlative sense and such duty to act accordingly should be second to none.

13. As now being provided for under the Bill, it is unclear whether the IIA itself could have power to determine what "best interests" means. Guidelines might be issued, but the Law Society has reservation as to whether any such guideline if promulgated in this aspect would be helpful; there is the possibility that, in the context of a concept such as "best interests", the guideline could introduce more problems than it aims to solve. It is further unclear whether the insurance intermediary would be required to conduct extensive research of the insurance market and incur substantial costs in order to satisfy the "best interests" requirement.

14. It is submitted that the obligation on an insurance intermediary to "have regard to particular circumstances of the policy holder or potential policy holder that are necessary for ensuring that the regulated activity is appropriate to the policy holder or the potential policy holder" sufficiently address this concern insofar as applicable to a licensed insurance agent (see section 89(d), p. 2117, *ibid*)

15. If it is felt necessary to retain a requirement along the lines of section 89(a), the Law Society suggests that a more practical way to address the potential conflict arising therefrom is to prescribe that the agent should act "in the *reasonable interests*" of the policy holders. That would embrace and accommodate the positions of the parties, after balancing and taking into account the interest of their principals.

16. It is worth noting that in a LegCo brief issued by the Financial Services and the Treasury Bureau dated 16 April 2014, (File Ref: C2/2/50C)) the policy objective in respect of the conduct requirements is that

    "11.... In general, conduct regulation aims to ensure that insurance intermediaries act professionally, fairly and honestly, and that the licensees are fit and proper persons, e.g., they are professionally competent, financially sound and have a good track record of legal and regulatory compliance..."

    Notably, there is no requirement on acting in the "best interests" of policy holders. The current draft therefore begs the relevant question on the basis of the policy underlining the introduction of this conduct requirement of "best interests".

17. If the conduct requirements do include a requirement to act in the "best interests" of the policy holders, then, without prejudice to the above submission, it is suggested that the policy holders or the potential policy holders should be put on explicit notice that the agent is representing the interest of their principals and not representing the interests of the policy holders or the potential policy holders; In order to avoid complaints, claims or legal proceedings arising therefrom, the policy holders or the potential policy holders should additionally offer written acknowledgement on the above before they enter into any insurance contract.

18. Section 89(f) (p.C2117, *ibid*) provides as follows

> "When carrying on a regulated activity, a licensed insurance intermediary –
>
> (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".

19. The above section should only be applicable to a licensed insurance broker and not to licensed insurance agents as the interests of the licensed insurance agents are aligned with those of their principal, the insurance company, and may inevitably conflict with those of the policy holder or the potential policy holder, as discussed above. The Law Society further considers that the use of "best endeavours" is unduly burdensome and should be changed to "reasonable endeavours".

Muddling the roles

20. In addition to the above definitional problem, the Bill muddles the roles of broker and agent, insofar as their conduct requirements and obligations arising therefrom are concerned.

21. It is trite that at common law insurance brokers are acting solely as agents for an insured (see e.g. *Hobbins v Royal Skandia Life Assurance Ltd* HCCL 15/2010 Reyes J at para 69). They owe to the insured the duties under contract, tort and equity (whether imposed by common law or statute). As such, plaintiff policy holders could sue brokers for, e.g. negligence.

22. Insurance agents, on the other hand, owe their insurer principals the contractual, common law and fiduciary duties, when they act on behalf of the principals as disclosed.

23. The roles of an insurance broker and agents are different and should be delineated in the context of the conduct requirements. The current grouping together of the two definitions under the umbrella notion of "intermediaries" is unsatisfactory. It could lead to confusion as to, e.g. the consideration of how the new "best interests" duty of the "intermediaries" could interact with their existing duties to policy holders and insurers.

24. In addition, the Law Society notes 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 (section 68(2), ICO). Any attempt to exclude or limit their liability in a policy will be treated as void (section 68(3) ICO). Consequently, this new "best interests" duty imposed upon the insurance agent would translate into the same duty being imposed upon the insurance company. That seemingly is not the policy objective underlining the Bill.

Industry Advisory Committees

25. The constitution and proceedings of the Industry Advisory Committees are specified in Schedule 1C (p.C2235, ibid). Pursuant to paragraph 3 of the Schedule 1C (p.C2237, ibid), an industry advisory committee must meet at least once every 3 months to advise the IIA.

26. The Law Society suggests adequate and suitable flexibility on the arrangement of meetings of the Industry Advisory Committees in order to accommodate any necessary discussion on any relevant issues which calls for the attention of the IIA.

Responsible Officers

27. The Administration proposes that a licensed insurance agency or a licensed broker company should be required to appoint at least one responsible officer (sections 64ZE and 64ZF, p. C1979-1983, *ibid*).

28. The Law Society welcomes this proposal, as the Chief Executive Officer in many cases could serve as a liaison contact, subject to the observation that in Section 90(2) and section 91(2) (p.C2119 and C2121, *ibid*), the use of "best endeavours" will be unduly burdensome on the relevant responsible officer and should be changed to "reasonable endeavours".

Pecuniary Penalties

29. The IIA is empowered to order a penalty of HK$10,000,000 or three times the profit gained or loss avoided against the insurers or intermediaries who are guilty of misconduct or who are not fit and proper (section 41P(2)(e), p.C1877, *ibid*).

30. The Law Society takes the view that the level of fine to be imposed should be reasonable and proportionate to the offence committed.

Multiple roles of the IIA

31. The Law Society notes with concern that under the bill, the IIA is assuming multiple roles, i.e. the IIA is the regulator and rule making body (section 4A, p.C1707, *ibid*), investigator (sections 41A – 41L, p.C1843 – C1873, *ibid*), prosecutor (sections 124 - p.C2181, *ibid*) and also the judge (sections 41P – 41S, p.C1875 - p.1881, *ibid*).

32. The Law Society points out that

    (a) there may be a perception of bias where a single regulator conducts an investigation, prosecutes and disciplines regulated persons which clearly contravene the traditional separation of powers and may contravene the rule of law and natural justice; and

    (b) it is undesirable for a regulator to have a direct interest in an enforcement action.

    To ensure adequate checks and balances, the Law Society suggests that prosecutorial decisions of the IIA should be reviewed internally and/or independently by persons <u>not</u> involved in the prosecution process.

The Law Society of Hong Kong
8 July 2014