

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

**Regulation of Insurance Intermediaries and Disciplinary Actions
(New Part XI)**

INTRODUCTION

This paper sets out the policy objectives behind the key provisions in the new Part XI of the Insurance Companies Ordinance (Cap. 41) (“ICO”) to be added by Clause 84 of the Insurance Companies (Amendment) Bill 2014 (“the Bill”). The provisions are related to the conduct requirements for insurance intermediaries licensed by the independent Insurance Authority (“IA”) and disciplinary actions.

BACKGROUND

2. At present, insurance intermediaries are subject to the self-regulatory framework stipulated under Part X of the ICO, which requires them to be appointed or authorized in accordance with the relevant statutory provisions. Under the current self-regulatory regime, the three self-regulatory organizations (“SROs”) ¹ perform the supervisory role in accordance with requirements stipulated in non-statutory codes². The SROs are responsible for handling complaints against their registrants / members. They carry out investigations and take disciplinary actions on substantiated cases. However, the three SROs are not fully aligned in regard to their disciplinary procedures and level of sanctions. They also lack statutory investigation power.

3. Under our proposed licensing regime, the IA will assume all regulatory functions over insurance intermediaries. We explained the key features of the licensing scheme for insurance intermediaries in the paper titled “Licensing Regime for Insurance Intermediaries (Amendments to Part X and Other Relevant New Provisions)”. This paper covers new provisions related to the regulation of insurance intermediaries.

¹ The three SROs are the Insurance Agents Registration Board established under the Hong Kong Federation of Insurers (“HKFI”), the Hong Kong Confederation of Insurance Brokers, and the Professional Insurance Brokers Association.

² Only the Code of Practice issued by HKFI is approved by the Insurance Authority.

4. We proposed to set out the broad principles of conduct requirements for licensed insurance intermediaries in the amended ICO. If necessary, further details will be prescribed in subsidiary legislation to be made by the IIA after public consultation. The IIA will also be empowered to issue codes or guidelines on details of the conduct requirements to facilitate compliance by licensees.

5. The IIA will be vested with the power to investigate into cases of alleged misconduct of licensed insurance intermediaries³. For substantiated cases, we proposed that the IIA may impose on the licensee concerned a range of disciplinary sanctions proportionate to the nature and severity of the misconduct. Safeguards will be included to ensure that the IIA exercises its disciplinary powers in a fair, consistent and transparent manner.

POLICY OBJECTIVES AND MAJOR PROVISIONS

(a) Conduct requirements

6. The conduct of insurance intermediaries has significant impact on the development of the insurance industry. Since insurance intermediaries have face-to-face dealings with policy holders and potential policy holders, fair and credible regulation of the conduct of insurance intermediaries will enhance public confidence in insurance which will in turn be conducive to the sustainable development of the insurance industry. As pointed out by the International Association of Insurance Supervisors in Insurance Core Principle (“ICP”) 18, insurance intermediaries’ interface between consumers and insurers gives them a key role in building and justifying public trust and confidence in the insurance industry (ICP 18.0.16). The adoption of good conduct of business practices by insurance intermediaries helps ensure that customers are sufficiently informed on the insurance products before concluding an insurance contract, thereby promoting consumer protection (ICP 18.0.18). Over the past three years from 2011 to 2013, the Office of the Commissioner of Insurance (“OCI”) and the three SROs had received about 1,400 complaints annually, of which about 70% were against insurance intermediaries.

³ Details of the IIA’s investigation power are set out in the paper titled “Licensing Regime for Insurance Intermediaries (Amendments to Part X and Other Relevant New Provisions)”.

7. New section 89 added by Clause 84 of the Bill sets out the broad principles of conduct requirements on the part of a licensed insurance intermediary when carrying on a regulated activity. The principles require that a licensed insurance intermediary –

- (a) must act honestly, fairly, in the best interests⁴ 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 endeavours⁴ 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 (i.e. subsidiary legislation).

⁴ These principles have been adopted in the regulatory regime for Mandatory Provident Fund intermediaries (see section 34ZL of the Mandatory Provident Fund Schemes Ordinance (Cap. 485)), many of which are insurance intermediaries.

8. New section 92 provides that the IIA may make rules requiring licensed insurance intermediaries to comply with practices and standards in relation to the conduct of the intermediaries in carrying on regulated activities including some specified areas (see **Annex A**). These rules will be subsidiary legislation and the IIA is required under the Bill to make available drafts for public consultation before they are submitted to the Legislative Council⁵.

9. New section 93(1) provides that the IIA may publish codes of conduct for giving licensed insurance intermediaries guidance to facilitate their compliance with the conduct requirements. New sections 93(5) and (7) provide that a code of conduct is admissible in evidence before a court which must take into account any compliance or non-compliance of a provision of a code if it is relevant to a question arising in any proceeding. Nevertheless, a failure to comply with a code of conduct does not by itself render a licensed insurance intermediary liable to any judicial or other proceedings. The IIA is expected to publish codes and guidelines for licensed insurance agents and licensed insurance brokers to facilitate their compliance.

(b) Disciplinary powers

10. New section 80(1) provides that the IIA may impose disciplinary sanctions on a person if the person is or was, when being a regulated person, –

- (a) guilty of misconduct; or
- (b) not a fit and proper person⁶.

Definitions of “regulated person”, “misconduct” and “fit and proper”

11. New section 79(1) defines that “regulated person” includes a licensed insurance intermediary⁷, a responsible officer (“RO”) of a

⁵ As provided in new section 130 added by Clause 84 of the Bill.

⁶ In determining whether a regulated person is fit and proper, the IIA may consider matters including those that it must consider in determining whether a person is fit and proper for being granted a licence (new section 64ZZA, see **Annex B**), and the present or past conduct of the person.

⁷ Under the licensing regime administered by the IIA, licensed insurance intermediaries include the following types –

- (i) licensed individual insurance agent;
- (ii) licensed insurance agency;

licensed insurance agency or licensed insurance broker company, or a person concerned in the management of the regulated activities carried on by a licensed insurance agency or licensed insurance broker company. An RO has to be a licensed insurance intermediary.

12. “Misconduct” is defined as follows –

- (a) a contravention of a provision of the amended ICO;
- (b) a contravention of a term or condition of a licence granted under the amended ICO;
- (c) a contravention of any other condition imposed under a provision of the amended ICO; or
- (d) an act or omission relating to the carrying on of any regulated activity which, in the IIA’s opinion, is or is likely to be prejudicial to the interests of policy holders or potential policy holders or the public interest.

13. For the purpose of (d) above, the IIA must not form an opinion that an act or omission is or is likely to be prejudicial to the interests of policy holders or potential holders or the public interest unless it has had regard to applicable provisions set out in any code of conduct or guideline.

Disciplinary process

14. New section 80(4) provides that the IIA may impose the following disciplinary sanctions –

- (a) to revoke the licence of a licensed insurance intermediary or the approval of a person as an RO;
- (b) to suspend the licence of a licensed insurance intermediary or the approval of a person as an RO for a specified period;
- (c) to prohibit a regulated person from applying to be licensed or being appointed as an RO for a specified period;

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- (iii) licensed technical representative (“TR”) (agent);
 - (iv) licensed insurance broker company; and
 - (v) licensed TR (broker).

- (d) to reprimand a regulated person public or privately; or
- (e) to order a regulated person to pay a pecuniary penalty not exceeding the amount which is the greater of –
 - (i) \$10,000,000; or
 - (ii) three times the amount of the profit gained or loss avoided by the person as a result of the misconduct⁸.

15. New section 85 provides that if a licence or approval of a person is suspended, the person must, during the suspension period, continue to be required to comply with the provisions of the Ordinance. New section 86 provides that a revocation or suspension of a licence of a licensed insurance intermediary does not avoid or affect an agreement or transaction entered into or arranged by the person. New section 87 provides that the IIA may require a person, whose licence is revoked or suspended, to transfer to a client a copy of the records relating to the client's assets or affairs⁹.

(c) Checks and balances

16. The IIA's exercise of disciplinary powers will be subject to adequate checks and balances with a view to ensuring fairness, consistency and transparency.

Opportunity of being heard

17. New section 81 provides for the procedural requirements in respect of the IIA's exercise of disciplinary powers. The IIA must not exercise any disciplinary power without first giving the regulated person concerned a reasonable opportunity of being heard. If the IIA decides to impose a disciplinary sanction, it must inform the regulated person concerned of its decision by a written notice which must include a statement of reasons, the time when the decision is to take effect, and details of the decision.

⁸ Or any conduct of the person which leads the IIA to form the opinion that the person is / was not fit and proper.

⁹ A person who fails to comply with this requirement without reasonable excuse commits an offence and is liable to a fine of \$200,000 and to imprisonment for 2 years.

Guidelines with evidential value and proportionality

18. The IIA will issue guidelines to provide insurance intermediaries with guidance to facilitate compliance with conduct requirements. It will take into account compliance with the relevant guidelines in the disciplinary proceeding (see paragraph 13 above). The IIA's guidelines will also have evidential value in legal proceedings as specified in new section 131(5).

19. New section 82 specifically requires the IIA to publish in the Gazette a set of fining guidelines before it can exercise the power to impose disciplinary fines (i.e. paragraph 14(e) above). The IIA must have regard to the fining guidelines when imposing a fine. We envisage that the 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 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 concerned; and
- (d) a pecuniary penalty should not have the likely effect of putting the regulated person concerned in financial jeopardy.

20. A copy of the OCI's Guideline on Exercising Power to Impose Pecuniary Penalty pursuant to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) is attached at **Annex C** for Members' reference.

21. We are working closely with the three SROs under the Working Group on Transition to the IIA to prepare for the transition. We are taking stock of the SROs' existing codes and guidelines, and such information will be passed to the IIA upon its establishment.

Transparency and consistency

22. The IIA will be expected to disclose to the public details of its

disciplinary decision, including the reasons for which the decision is made, and any relevant material facts (new section 80(5)) to ensure transparency and consistency of its decisions.

Independent appellate channel

23. An aggrieved person can appeal to the Insurance Appeals Tribunal (“IAT”) against a disciplinary decision made by the IIA. The IAT is an independent quasi-judicial body chaired by a former High Court judge or a person who is eligible for appointment as a High Court judge. The chairperson will hear each appeal case with two market practitioners. The IAT may vary the IIA’s decisions or ask the IIA to review its decisions. Details of the IAT and the appellate mechanism will be discussed in a separate paper.

Process Review Panel

24. An independent Process Review Panel (“PRP”) would be established to review and advise the IIA on the adequacy of its internal procedures and operational decisions to ensure that its regulatory powers are exercised in a fair and consistent manner. It will publish regular reports on its work. This arrangement is similar to the PRPs for other financial market regulators in Hong Kong, such as the Securities and Futures Commission and the Financial Reporting Council.

**Financial Services and the Treasury Bureau
September 2014**

**Rules on Conduct Requirements for Licensed Insurance
Intermediaries**

(New Section 92 added by Clause 84 of the Bill)

(1) The independent Insurance Authority (“IIA”) may make rules requiring licensed insurance intermediaries to comply with the practices and standards, relating to the conduct of the intermediaries in carrying on regulated activities, that are specified in the rules.

(2) Without limiting (1) and without affecting new section 129 of the Bill, the IIA may in the rules –

- (a) prohibit the use of any misleading or deceptive advertisement by a licensed insurance intermediary and impose conditions on the use of advertisements;
- (b) require a licensed insurance intermediary to provide specified information to its client on entering into a policy or on the request of the client;
- (c) require a licensed insurance intermediary to take specified steps to ascertain, in relation to its client, specified matters relating to the identity, financial situation and financial and insurance needs of the client that are relevant to the services to be provided by the intermediary;
- (d) require a licensed insurance intermediary to take specified steps before providing information or advice to its client;
- (e) require a licensed insurance intermediary to take specified steps to ensure that disclosure is made to its client of the coverage, terms and conditions, and risks in relation to the policy recommended to the client;
- (f) require a licensed insurance intermediary to take specified steps to ensure that disclosure is made to its client of any commission or advantage that the intermediary receives or is to receive in relation to the policy recommended to the client;
- (g) require a licensed insurance intermediary to take specified steps to comply with the conduct requirements under new sections 89, 90 and 91 of the ICO;
- (h) require a licensed insurance intermediary not to effect a transaction in specified circumstances;

- (i) prohibit the use by a licensed insurance intermediary of information relating to the affairs of its clients except in specified circumstances and under specified conditions;
- (j) require a licensed insurance intermediary to take specified steps in cases of conflict of interest between the intermediary and its client;
- (k) prohibit the receipt by a licensed insurance intermediary of any property or services from another licensed insurance intermediary in consideration of directing business to that other licensed insurance intermediary, except in specified circumstances and under specified conditions; and
- (l) provide for any other matter in relation to the practices and standards relating to conduct in carrying on regulated activities by a licensed insurance intermediary.

Determination of Fit and Proper
(New Section 64ZZA added by Clause 71 of the Bill)

(1) In determining whether a person is a fit and proper person for the purposes of new Division 3 of Part X (i.e. Licensing), the independent Insurance Authority (“IIA”) must have regard to the following matters –

- (a) the education or other qualifications or experience of the person;
- (b) the person’s ability to carry on a regulated activity competently, honestly and fairly;
- (c) the reputation, character, reliability and integrity of the person;
- (d) the person’s financial status or solvency;
- (e) whether any disciplinary action has been taken against the person by –
 - (i) the Monetary Authority;
 - (ii) the Securities and Futures Commission;
 - (iii) the Mandatory Provident Fund Schemes Authority; or
 - (iv) any other authority or regulatory organization, whether in Hong Kong or elsewhere, which, in the IIA’s opinion, performs a function similar to those of the IIA;
- (f) if the person is a company in a group of companies, any information in the possession of the IIA, whether provided by the person or not, relating to –
 - (i) any other company in the group of companies; or
 - (ii) any controller or director of the person or of any company referred to in subparagraph (i);
- (g) the state of affairs of any other business which the person carries on or proposes to carry on.

(2) In determining whether a person is a fit and proper person for the purposes of new section 64U or 64ZA, or new section 64ZV for the renewal of a license granted under new section 64U or 64ZA, the IIA must also have regard to any information in its possession whether provided by the person or not relating to –

- (a) any other person who is or is to be employed by, or associated with the person for the purposes of carrying on regulated activities;
- (b) any other person who is or will be acting for or on behalf of the

- person in relation to carrying on regulated activities; and
- (c) the question as to whether the person has established effective internal control procedures and risk management systems to ensure its compliance with the Insurance Companies Ordinance.
- (3) The obligations imposed on the IIA under subsection (1) or (2) (or both) are in addition to those of the IIA to have regard to any other matter that the IIA considers relevant in making the determination.

G.N. 4418

Guideline on Exercising Power to Impose Pecuniary Penalty

**(For authorized insurers, reinsurers,
appointed insurance agents and
authorized insurance brokers carrying
on or advising on long term business)**

June 2012

Office of the Commissioner of Insurance

Guideline on Exercising Power to Impose Pecuniary Penalty

Introduction

This Guideline is issued by the Insurance Authority ("IA") pursuant to section 23(1) of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Chapter 615) (the "Ordinance"). Under section 21 of the Ordinance, the IA may impose a pecuniary penalty either on its own or together with other disciplinary sanctions on an authorized insurer, appointed insurance agent or authorized insurance broker carrying on or advising on long term business ("insurance institution") if the insurance institution contravenes a specified provision as defined by section 5(11) of the Ordinance.

In exercising the power to impose pecuniary penalty referred to in section 21(2)(c) of the Ordinance, the IA shall have regard to this Guideline which indicates the manner in which it proposes to exercise that power.

Considerations in exercising the IA's power to impose pecuniary penalty

1. As a matter of policy, the IA will usually publicize all his decisions to impose pecuniary penalty.
2. When considering whether to impose a pecuniary penalty and the amount of the penalty, the IA will consider all of the circumstances of the particular case, including the relevant factors described below.
3. A pecuniary penalty imposed by the IA should act as a deterrent to the insurance institution concerned from contravening a specified provision as defined by section 5(11) of the Ordinance. It should also act as a general deterrent to other insurance institutions from contravening the same or similar specified provisions.
4. Although section 21(2)(c)(ii) of the Ordinance states that one alternative maximum level of the pecuniary penalty that can be imposed is three times the amount of the profit gained, or costs avoided, the IA will not automatically link the penalty imposed in any particular case with the profit gained, or costs avoided.
5. A pecuniary penalty should not have the likely effect of putting the insurance institution concerned in financial jeopardy. In considering this

factor, the IA will take into account the size and financial resources of the insurance institution.

6. The more serious the contravention, the greater the likelihood that the IA will impose a pecuniary penalty and that the size of the penalty will be larger. In determining the seriousness of a contravention, the IA will consider all of the circumstances of the case and take into account but not limited to the factors set out below.

(a) *The nature, seriousness and impact of the contravention, including:*

- (i) whether the contravention is intentional or reckless or negligent – a contravention caused merely by negligence or conduct which only results in a technical breach is generally regarded as less serious;
- (ii) the duration and frequency of the contraventions;
- (iii) whether the contravention is potentially damaging or detrimental to the integrity and stability of the insurance industry, and/or the reputation of Hong Kong as an international financial centre;
- (iv) whether the contravention caused or potentially caused loss to, or imposed costs on, any other person;
- (v) whether the contravention was committed by the insurance institution alone or whether as part of a group and the role the insurance institution played in that group;
- (vi) whether the contravention reveals serious or systemic weaknesses of the management systems or internal controls in respect of the customer due diligence and record-keeping procedures relating to all or part of that insurance institution's business;
- (vii) whether the contravention was indicative of a pattern of contraventions;
- (viii) whether there are a number of smaller issues, which individually may not justify a pecuniary penalty, but which do so when taken collectively; and
- (ix) the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the contravention.

(b) *The conduct of the insurance institution after the contravention,*

including:

- (i) whether the insurance institution attempted to conceal its contravention;
- (ii) any remedial steps taken since the contravention or the possible contravention was identified, and any action taken by the insurance institution against those involved and any steps taken to ensure that similar contraventions will not occur in future;
- (iii) the degree of cooperation with the IA, other relevant authorities and/or law enforcement agencies during the investigation of the contravention; and
- (iv) the likelihood that the insurance institution will commit the same type of contravention in the future if no or a lighter penalty is imposed.

(c) *The previous disciplinary record and compliance history of the insurance institution, including:*

- (i) the relevant previous disciplinary record of the insurance institution, including its previous similar contraventions particularly that for which it has been disciplined before;
- (ii) whether the insurance institution has previously undertaken not to engage in that particular conduct that results in the contravention; and
- (iii) any punishment imposed or regulatory action taken or likely to be taken by other relevant authorities on the same incident.

(d) *Other factors, including:*

- (i) whether the IA has issued any guidance in relation to the conduct in question – generally the IA will not take disciplinary action against an insurance institution for conduct that is in line with the guidance which was current at the time of the conduct in question;
- (ii) what action the IA and/or other relevant authorities have taken in previous similar cases – in general similar cases should be treated consistently;
- (iii) the amount of any benefit gained or costs avoided by the insurance institution or any of its directors or employees as a result of the contravention; and
- (iv) as a mitigating factor, whether the insurance institution has promptly, effectively and completely brought the

contravention or possible contravention to the attention of the IA.

June 2012
Insurance Authority