



HONG KONG MONETARY AUTHORITY  
香港金融管理局

Our Ref: B1/15C  
C2/5C  
G16/1C

22 April 2013

The Chief Executive  
All Authorized Institutions

Dear Sir/ Madam,

**Selling of investment-linked assurance scheme (ILAS) products**

This circular introduces enhanced regulatory measures applicable to the sale of ILAS products by authorized institutions (AIs) and provides further guidance in respect of certain common issues identified during our recent thematic on-site examinations of a number of AIs selling such products.

**(A) Enhanced disclosure**

Typically, ILAS is a long-term investment-cum-insurance product which has a relatively complicated structure and features, e.g. complex fees and charges and long lock-in period (the period during which penalties or charges will apply in the event of early policy termination or early encashment). This gives rise to concerns that the features and risks of ILAS products may not be easily understood by customers, and may not be properly disclosed and explained to customers during the selling process. Indeed in the course of its supervision, the Hong Kong Monetary Authority (HKMA) has identified issues that need to be addressed in the sale of ILAS products by AIs. Some common issues identified are set out below. In addition, drawing on our supervisory experience and having regard to the unique features of ILAS products, for better protection of the interests of customers, the HKMA has been working closely with the Office of the Commissioner of Insurance, the Securities and Futures Commission, and the Hong Kong Federation of Insurers (HKFI) to introduce measures to enhance disclosure relating to the sale of ILAS products.

***Important Facts Statement (IFS)***

As a result of these efforts, the HKFI has introduced an IFS that will be implemented by all insurance intermediaries distributing ILAS products in Hong Kong. The IFS will become

Part I of the “Important Facts Statement and the Applicant’s Declarations” form for ILAS products (IFS-AD), to highlight to the customer some important facts about the ILAS product including the intermediary’s remuneration receivable.

AIs should implement the IFS requirements in co-ordination with the respective insurance companies. AIs should provide the customer with the IFS-AD in his/her preferred language (i.e. Chinese or English). Among other things, AIs should ensure that their sales staff (i) request the customer to set out his/her reasons/considerations for procuring the ILAS policy in the “Statement of Purpose” paragraph of the IFS, (ii) give due regard to the information set out by the customer in respect of (i), together with other relevant information, in assessing whether or not an ILAS product is suitable for the customer, and (iii) disclose and explain to the customer each paragraph in the IFS. These steps should be carried out in such a way during the selling process that the customer has sufficient time to consider the important facts before deciding to make an application for the ILAS product. AIs should not proceed with an ILAS application if any of the applicable confirmations in the IFS has not been properly signed by the customer.

In order to facilitate the pre-sale disclosure of benefits receivable as set out in the ensuing paragraphs, AIs are required to adopt the IFS-AD with the “Intermediaries’ Remuneration” paragraph modified as follows:

“(9) **Intermediaries’ Remuneration:** Where the intermediary receives remuneration for distributing this ILAS policy to you, the intermediary should disclose to you the level or amount of the remuneration in writing (see Annex).”

(For the Chinese version of IFS-AD, the modified Intermediaries’ Remuneration paragraph should be: “(9) **中介人的酬勞:** 若閣下的中介人就向閣下分銷此投連壽險保單收取酬勞，中介人必須向閣下以書面形式披露酬勞的水平或金額（見附件）。”）

### ***Compulsory pre-sale disclosure of monetary and non-monetary benefits receivable by AIs as corporate intermediaries***

AIs generally offer ILAS products in the course of their wealth management business. As AIs are already required to make pre-sale disclosure of monetary and non-monetary benefits in their sale of investment products other than ILAS products, the HKMA is requiring AIs to adopt a similar approach to make pre-sale disclosure in writing of monetary and non-monetary benefits receivable by an AI and/or any of its associates from the insurance company in connection with the distribution of the ILAS product to the customer. This practice will facilitate customers in making meaningful comparisons in determining whether to invest in ILAS products versus other investment products, especially direct investment in the relevant funds.

AIs that distribute ILAS products for insurance companies within their group are required to ensure that the level of remuneration they receive from their group insurance companies for the distribution of ILAS products should be determined on arm's length basis and commercially justifiable. There should not be any arrangement which may prejudice the new disclosure requirements directly or indirectly, such as transfer pricing that can have the effect of concealing or distorting the remuneration receivable from the insurance company

under the disclosure requirements.

Please refer to **Enclosure** which provides the template for the remuneration disclosure statement to be adopted by AIs, as Annex to the IFS-AD when applied to AIs. AIs should provide the customer with the remuneration disclosure statement in his/her preferred language (i.e. Chinese or English). AIs may only execute the transaction after proper disclosure has been made and the customer has signed to confirm he/she has read and understood the remuneration disclosure statement. For the avoidance of doubt, if a customer does not sign to indicate such confirmation, the AI should not execute the ILAS transaction.

### ***Implementation by AIs***

AIs are required to implement the IFS-AD and the compulsory remuneration disclosure for sale of ILAS products no later than end-June 2013.

AIs should take immediate action to carry out all necessary preparatory work in coordination with the respective insurance companies for ILAS products, and establish adequate control procedures and measures, and other relevant arrangements as well as provide sufficient guidance and training to all relevant staff members to ensure proper implementation by end-June 2013. Meanwhile, AIs should also ensure adequate records and audit trails (including audio records) are maintained to evidence that the above requirements as well as applicable requirements issued by the HKFI in relation to IFS-AD have been duly followed in the selling process. A copy of the IFS-AD and the remuneration disclosure statement both duly signed by the customer, among other documents, should be provided to the customer at the point of sale.

The HKMA will continue its cooperation with the other relevant regulators and the industry to keep under review and further enhance, as and when necessary, the requirements governing the sale of ILAS products.

### **(B) Guidance on expected standards and common issues identified**

The HKMA has stepped up its supervision of AIs' sale of ILAS products, including on-site examinations and off-site reviews. The findings revealed that whilst AIs in general had put in place policy and procedures with reference to regulatory requirements, there were some common issues identified suggesting that the controls and implementation of regulatory requirements among some AIs need to be further strengthened.

The HKMA's circular of 14 March 2011 sets out applicable standards and guidance. Further guidance is given in this circular in light of the HKMA's recent supervisory findings. AIs should review their policies and procedures, and make necessary improvements having due regard to the issues and guidance set out below.

## ***Affordability***

Affordability should be duly considered in the Financial Needs Analysis and assessment of whether an ILAS product is suitable for a customer. As revealed in the supervisory findings, some AIs did not provide adequate guidance to staff and their assessment of the customer's affordability did not appear to be satisfactory.

### *Case 1*

An ILAS product was sold to a housewife aged over 60, with a premium contribution period of up to the age of 100. The customer disclosed that her sources of funds were "savings" and "income from other investments" and she had zero income during the past 2 years. The total premium payment within the lock-in period accounted for around 96% of her disclosed total liquid assets. These facts suggest that the customer could not afford the ILAS product.

### *Case 2*

A customer was recommended an ILAS product that involved payment of a monthly premium of more than double her disclosed monthly disposable income. According to the AI's records, her sources of fund were existing liquid assets, which totalled over HK\$1 million.

The total premium payment (around HK\$5 million) exceeded 50% of the customer's net asset and appeared to amount to as much as 5 times of her total liquid assets. The AI did not address this issue in the assessment process by obtaining more precise information from the customer on her liquid assets to facilitate proper assessment of suitability.

AIs should assess the customer's affordability for the whole product tenor. The overall financial circumstances of the customer should be considered, including but not limited to the customer's other financial liabilities/commitments and the amount that the customer intends and would be able to pay towards the premium.

Where a customer indicates that his/her financial sources to support premium payments do not come from regular monthly salary/income, AIs should assess the customer's sources of other funds in detail to understand whether they are sufficient to support the regular premium payments having regard to the product tenor. AIs should not recommend an ILAS product which is reasonably expected to exceed the customer's ability to meet the premium payments for the product tenor unless they are able to demonstrate strong grounds for assessing that the product is suitable for the customer having regard to the customer's circumstances.

## ***Asset concentration***

It was noted that the methodology that some AIs adopted in assessing customer's asset concentration risk did not adequately take into account the total amount of premium payable with reference to the product tenor and regulatory requirements.

### Case 3

An AI allowed staff to use three months' premium as a basis for calculation of asset concentration, without considering the overall premium contribution given the long product tenor. The AI also did not consider some relevant factors (such as the customer's total investment profile) in the assessment of asset concentration.

In addition, it was noted that some AIs did not require sales staff to take into account, when calculating customer's asset concentration level, the customer's cumulative investments in ILAS policies and the underlying investment options having regard to the customer's total investments.

In respect of the assessment of asset concentration risk, AIs are expected to put in place robust methodology and threshold(s) with reference to the requirements set out in HKMA's circulars issued on 20 May 2010 and 5 January 2012. In measuring the amount of ILAS policy for calculating asset concentration, AIs should take into account the total amount of premium payable by the customer, as well as other relevant factors such as the lock-in period, how long the customer intends to hold the policy, and the cumulative concentration in ILAS products and the underlying investment options having regard to the customer's total investments.

### ***Product due diligence***

AIs should have a thorough understanding of the nature, features, structure and the associated risks of their ILAS products, including those of the underlying/reference funds.

### Case 4

Some of the underlying investment funds of an ILAS product were not available on the AI's investment funds selling platform. The due diligence documents indicated the AI's approving authority had concerns about approving these funds for reasons such as high price volatility, insufficient historical tracking records, and inexperienced issuer. However, the AI offered that ILAS product with such underlying funds. There was no evidence that these concerns had been properly addressed in the product due diligence process.

AIs should conduct adequate due diligence of the underlying investment options of ILAS products having regard to the regulatory requirements governing investment products. Where the underlying investment options of ILAS products are not available on the AIs' investment funds selling platform, AIs should conduct proper separate due diligence process and ensure a proper internal product approval process.

In addition, AIs should have regard to all the relevant information available (including explanation from the insurer) in their due diligence process to determine whether an underlying investment option of an ILAS product is a derivative product. Where a customer without knowledge of derivatives wishes to choose an underlying investment option with derivatives, AIs should warn the customer about the choice, and having regard to

the information about the customer, provide appropriate advice to the customer as to whether or not the choice is suitable for the customer in all the circumstances. Record of the warning and other communications with the customer in this connection should be maintained. As a related issue, AIs should ensure their sales staff do not recommend to customers any ILAS product (including the underlying investment option(s)) which gives rise to concerns about suitability.

### ***Premium holiday***

The explanation to customers of the circumstances under which a premium holiday can be exercised and its consequences was inadequate in some cases.

#### Cases 5 and 6

A customer indicated that his intended premium contribution period for ILAS product was 3 years. However, the sales staff recommended an ILAS product with a minimum premium payment period of 5 years. Although premium holiday may be exercised after 3 years' premium payment, the recommendation did not properly cover the likely effect of exposing the customer to the risks and consequences of taking premium holiday. His investment decision may have been prejudiced as a result.

In another case, despite knowing that the customer had already exercised premium holiday on three ILAS policies, the staff sold her another ILAS product. The total annual premium of the four ILAS policies exceeded 100% of her income. It was questionable why a new ILAS plan was considered suitable for the customer.

AIs should ensure the customer understands the features of premium holiday, including the risks and consequence of exercising premium holiday. In addition, AIs are expected to assess and explain to the customer, the effect of premium holiday together with other relevant information which may materially affect the customer's investment decision. For example: AIs should assess whether the customer's intended investment period is shorter than the lock-in period; the cumulative effect of invoking premium holiday having regard to other ILAS policies already held by the customer; whether the consequence of exercising premium holiday would be in conflict with the customer's investment objective; the fees and charges to be incurred; and possible significant losses if the ILAS policy is terminated as a result of failing to make premium payments as required during or after the premium holiday, etc.

### ***Assessing the customer's needs/ objectives***

AIs should not sell ILAS products to customers who do not need or want insurance or investment products. Some AIs appear not to have given due regard to the customer's needs or objectives. In some sample cases, customers did not indicate any life insurance or

protection needs and revealed that their need/objective was “investment” only. In other words, audit trails demonstrated no reasonable rationale for recommending products with insurance elements to the customers.

In general ILAS products are not suitable for customers who do not have a dual objective of investment and insurance (such as estate planning), as ILAS is a bundled product which carries both investment and insurance elements with death benefits for third party beneficiaries. AIs should ensure that customers’ indication of any need or purpose relating to life insurance element of ILAS products is documented, and that compliance with this requirement is subject to proper monitoring.

The HKMA will continue to follow up with the AIs concerned regarding the implementation of the required actions to address the concerns identified in the supervisory process.

If you have any questions on this circular, please feel free to contact Mr Kevin Sham at 2878-1594, or Ms Angel Chan at 2878-1606.

Yours faithfully,

Meena Datwani

Executive Director (Banking Conduct)

Encl.

c.c. Insurance Authority (Attn: Ms Carol Hui, Acting Assistant Commissioner of Insurance (Long-Term Business))

Securities and Futures Commission (Attn: Ms Christina Choi, Senior Director, Investment Products)

## Annex

**Product Name and Type: [e.g. ABC ILAS Policy] and Insurer: [name]**

You should carefully consider the information in this statement and the product documents (including the Principal Brochure, Product Key Facts Statement, and the Illustration Document). Although you may pay nothing to the intermediary who distributes this ILAS policy to you, the intermediary will, in effect, receive remuneration which may be borne out of the charges you pay as illustrated below. **If you do not understand the information below, please do not sign the confirmation and do not purchase the ILAS policy.**

**REMUNERATION RECEIVABLE BY [NAME OF AI]  
IN DISTRIBUTING [NAME OF ILAS PRODUCT] TO YOU**

Regular/ Single premium: [Regular/ Single] premium  
(Delete as appropriate)

Premium contribution period:  
(for regular premium plan) [•] year(s) (in terms of number of years)

(1) Monetary benefits

*(i) Specific disclosure*

[•] (Where the AI and/or any of its associates receives monetary benefits from the insurance company (directly or indirectly) for distributing this ILAS product: Disclose the monetary benefits that are receivable by it and/or any of its associates in actual amounts (unless otherwise stated) in the following manner. For the avoidance of doubt, the specific disclosure should be made on a transaction basis.)

Upfront [name of the remuneration] receivable: [Currency] [•]  
Ongoing [name of the remuneration] receivable: [Currency] [•] [or: [y] % of the [z]<sup>1</sup>] to be received [each month/year] after first policy year

Premium amount for first policy year: [Currency] [•]

If the policy is held for the full term of the policy,  
total premium amount for policy: [Currency] [•]  
(if no maturity date, assume upto age 100, which should be stated in this statement)

*(If the AI considers it would be more beneficial for the customer to understand, the AI can disclose the monetary benefits receivable by it and/or any of its associates as a percentage of the relevant amount in the following manner:*

Upfront [name of remuneration] receivable: [x] % of the premium amount for the first policy year  
Ongoing [name of remuneration] receivable: [y] % of the [z]<sup>1</sup> to be received [each month/year] after the first policy year

<sup>1</sup> AI should explain in this statement what is referred to in [z], for example, premium amount of [the first year/that year/that month], account value, etc.



Premium amount for first policy year: [Currency] [●]

If the policy is held for the full term of the policy,  
total premium amount for policy: [Currency] [●]  
(if no maturity date, assume upto age 100, which should be stated in this statement))

**(ii) Generic disclosure**

[●] (Where the monetary benefits received by the AI and/or any of its associates are not quantifiable prior to or at the point of sale: Disclose the existence and nature of such monetary benefits.)

**(2) Non-monetary benefits**

[●] (Where the AI and/or any of its associates receives from the insurance company non-monetary benefits for distributing this product: Disclose the existence and nature of such non-monetary benefits.)

(3) The insurance company of this ILAS product is:

affiliated with [Name of AI]

not affiliated with [Name of AI]

(AI should tick the appropriate box above.)

You confirm that you have read and understood all of the information above.

Signature of the applicant: \_\_\_\_\_

Name of the applicant: \_\_\_\_\_

Date: \_\_\_\_\_

**Instructions to AIs when preparing this statement:**

- **“Remuneration” refers to all monetary benefits and/or non-monetary benefits actually paid or payable by the ILAS insurance company to the AI and/or any of its associates in connection with the distribution of this ILAS product. These are benefits paid by the ILAS insurance company to intermediary in the form of monetary benefits such as commissions and other monetary/non-monetary benefits such as overrides, expense allowance, subsidies, referral fees, training subsidy, customer support subsidy, salary, other monetary/non-monetary support and services from the insurance company, etc.**
- **On specific disclosure for monetary benefits –**
  - **For the avoidance of doubt, the specific disclosure should be made on a transaction basis.**
  - **If the AI considers it would be more beneficial for the customer to understand, the AI can disclose the monetary benefits receivable as a percentage of the relevant amount as shown in the template. In that case, the percentage of the relevant amount to be disclosed should be rounded up to the nearest whole percentage point.**
- **This statement should be provided to the client before each new or top-up application for ILAS policy. The AI should not accept the ILAS policy application if this statement has not been properly signed by the client.**
- **This statement should be visually reader-friendly so that the client can easily read it. Information should be presented in a font that is easy to read and highly legible. The font size adopted should also be reasonably legible taking into account the language used.**