HONG KONG MONETARY AUTHORITY
香港金融管理局
Banking Conduct Department *銀行操守部*

Our Ref: B1/15C
C2/5C

8 December 2014

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Selling of Non-Linked Long Term Insurance ("NLTI") Products

During its supervisory process including on-site examinations and mystery shopping exercise as well as handling of customer complaints, the Hong Kong Monetary Authority ("HKMA") has noticed that the selling practices in respect of NLTI products[1] vary among authorized institutions ("AIs") and has identified various areas for improvement in the selling practices. In this connection, the HKMA has engaged in discussions with the Insurance Authority ("IA") and the banking industry. To enhance the selling practices with a view to ensuring appropriate protection of the interests of customers, the HKMA expects AIs to adopt the practices set out in **Annex** in their selling of NLTI products, to the extent applicable, including selling new NLTI plans as well as top up applications for existing NLTI plans. Considering the unique circumstances of banking environment and the special trust in banks by their customers, the HKMA and the IA agree that the practices set out in **Annex** would enhance protection of bank customers and ensure that appropriate NLTI products are sold to the appropriate customers.

These practices rest upon the overarching principle that AIs, as intermediaries, have the responsibility to take reasonable steps to ensure proper selling practices are adopted and that customers are treated fairly in the sales process of NLTI products. AIs should review and ensure that adequate policies, procedures and controls are implemented for adoption of the practices set out in **Annex** in the sale of NLTI products, and any necessary enhancements should be implemented as soon as practicable and not later than nine months from the date of this circular. For the avoidance of doubt, in respect of those expected practices for which

[1] Examples of NLTI products include term life insurance plans, endowment insurance plans, annuity insurance plans, whole life insurance plans and universal life insurance plans, etc. which are products under Class A of long term business specified in Part 2 of the First Schedule to the Insurance Companies Ordinance ("ICO"). For the avoidance of doubt, even if the policy term of a NLTI product is relatively short, as long as it belongs to long term business under the ICO, the selling of such a product by AIs is still subject to this circular. This circular does not cover selling of investment-linked assurance scheme products.

55th Floor, Two International Finance Centre,
8 Finance Street, Central, Hong Kong
Website: www.hkma.gov.hk

香港中環金融街8號國際金融中心2期55樓
網址：www.hkma.gov.hk

individual AI has agreed with the HKMA on the specific implementation timeline(s), the agreed timeline(s) should prevail over the above general timeline of nine months. AIs should also conduct sufficient staff training for the implementation of the practices.

As the practices set out in this circular are provided in light of the HKMA's supervisory findings, they do not cover all requirements applicable to AIs' intermediary activities in respect of NLTI products, particularly those issued by the IA and the Hong Kong Federation of Insurers ("HKFI"). AIs should ensure that they continue to comply with all applicable regulatory requirements.

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

Yours faithfully,

Carmen Chu

Executive Director (Banking Conduct)

Encl.

c.c. Insurance Authority

Annex

Practices expected of AIs in selling of NLTI products

1. Due diligence on NLTI plans

1.1 AIs should adequately assess the nature, features and risks of each NLTI plan they offer. Before marketing an insurance plan to customers, AIs should properly assess, among other things and where applicable, the insurance protection, fees and charges, lock-in period[1], circumstances under which a premium holiday can be exercised and the consequences of such exercise, arrangements and consequences of taking out a policy loan, circumstances leading to automatic early termination of the policy, the credibility and capability of the insurance company, risks from customers' perspectives, and other factors that may have a material impact on the risk and benefit profiles of NLTI plans. At the same time, AIs should identify the target customer groups to which NLTI plans may be marketed. In doing this, during the due diligence process of a NLTI plan, AIs should also determine the target customers' profile (having regard to needs/objectives and affordability of the target customers) for the NLTI plan which the sales staff should duly take into account upon matching the profile of the customer against the features and risks of the NLTI plan when the staff considers whether to recommend the NLTI plan to a customer.

1.2 The independent risk management function of the AI should be involved in the review and approval of each NLTI plan. During the due diligence process, all relevant departments of the AI such as risk control, legal and compliance should be consulted as appropriate.[2]

1.3 AIs should conduct product due diligence on NLTI plans on a continuous basis at appropriate intervals covering the nature, features and risks of the plans (such as the credibility and capability of the insurers).

1.4 Proper documentation on the due diligence work should be maintained.

---

[1] Lock-in period refers to the period during which penalties or charges will apply in the event of early encashment.

[2] HKMA's SPM Module IC-1 "General Risk Management Controls" refers.

2. Advertisements

2.1 AIs should take reasonable steps to ensure that the advertisements[3] of NLTI plans used by them in the selling process are not false, biased or misleading.

2.2 Among other things, an advertisement should display with sufficient and equal prominence the nature (e.g. a life insurance plan) and the full name of the NLTI plan and the full name of the insurance company. The contents of the advertisement should not lead to confusion that the advertised plan is something other than a NLTI plan.

2.3 Any representation relating to the benefits and returns in the advertisements should not be more prominent than, or be made without mentioning, the following warning statements or notes to the effect that (where applicable), among other things:

(i) the policyholder is subject to the credit risk of the insurance company;

(ii) if the policyholder discontinues and/or surrenders the NLTI policy in the early policy years, the amount of the benefits he/she will get back may be considerably less than the amount of the premiums he/she has paid;

(iii) a description of which specific part(s), if any, of the past, current, projected and/or potential benefits and/or returns (e.g. bonuses, dividends, interests) presented in the advertisement is/are not guaranteed and is/are for illustrative purposes only; and

(iv) (if (iii) is applicable) the actual future amounts of benefits and/or returns may be lower than or higher than the currently quoted benefits and/or returns.

2.4 Advertisements of NLTI plans should not give an impression that returns are guaranteed unless this is true. The warning statements or notes mentioned in paragraph 2.3 above should be presented in plain language.

---

[3] Advertisements include but are not limited to distribution materials (such as print media advertisements, brochures, leaflets, fact sheets, newsletters and any other regular updates, direct marketing, “fax on demand” services, etc.), display-only materials (such as posters, exhibition panels, outdoor displays, etc.) and interactive systems (such as the internet, interactive voice message systems, etc.).

3. Ensuring customer suitability

3.1 AIs should ensure that the recommended NLTI plan is suitable for the needs and resources of the customer. To achieve this, prior to recommending any NLTI plan, AIs should seek to obtain adequate information about the customer's circumstances and should assess suitability for the customer based on the nature, features and risks of the NLTI plan. Their rationale for the recommendation should be clearly documented.

Financial Needs Analysis

3.2 Having regard to the risk of inadequate financial needs analysis ("FNA") i.e. cases where all or some parts of the FNA Form are not completed by customers) rendering AIs and their sales staff unable to duly take into account customers' circumstances before recommending NLTI plans, AIs should have proper monitoring and controls to prevent and detect sales staff's abuse of the customer's option to deviate from the FNA process and take appropriate follow-up action in cases of irregularities. In particular, AIs should not accept any customer's choice to deviate from the FNA process if this would render the AI unable to comply with any regulatory requirements (e.g. proper suitability assessment). AIs should also ensure their sales staff understand that it is unacceptable to induce customers to deviate in any respect from the FNA process in any circumstance for expediency reasons.

3.3 In the mean time, as understood from the IA, the IA has been providing guidance to the HKFI on the enhancement of the requirements relating to the FNA Form with a view to disallowing opt-out of the FNA process. AIs should pay attention to the development in this regard, follow the relevant requirements and advise customers of any specific situation under which insurers will not accept applications from the customers.

Needs of customers

3.4 In general, AIs should not recommend a NLTI plan which does not match the customer's circumstances, or where the customer indicates that he or she does not need/want insurance products.

3.5 AIs should take into account adequately the customer's need(s)/objective(s), within his/her target timeframe(s), in the suitability assessment. For example, if a customer's goal is to accumulate savings in addition to life protection, the recommended NLTI plan(s) should not only meet his/her targeted savings amount, but do so within his/her expected timeframe. HKFI's requirements regarding the evaluation of total protection needs etc. in the FNA Form should also be observed. Before recommendation of a life insurance plan, AIs should take into account, among other things, whether the customer has life protection needs based on such evaluation. If a customer needs disability protection in addition to life protection, where practicable, the AI should propose plan(s) with relevant protection features or rider(s) for the customer's consideration.

3.6 Given the long-term nature of those NLTI plans with long policy terms, to the extent appropriate, AIs should have due regard to the liquidity needs of the customer in the course of suitability assessment during the selling process of NLTI plans. In this connection, among other relevant factors, AIs should also take into account the customer's retirement plan, if any, in assessing whether the NLTI plan suits the customer's circumstances before recommending the plan. AIs should exercise greater caution when dealing with elderly customers (aged 65 or above) or customers in need of liquidity, and alert such customers about the long term nature of any NLTI plan with a long policy term.

3.7 AIs should disclose to the customer the key assumption(s), if any, that they adopt in the FNA Form and/or suitability assessment for the customer (e.g. assumptions in relation to inflation rates, rates of return, etc.).

Resources of customers

3.8 Due regard should be given to the adequacy of the customer's financial resources during suitability assessment. AIs should develop and adopt proper methodologies and criteria for assessing the customer's affordability during the entire premium payment term. The factors that should be taken account of include the customer's income, liquid assets, expenses (including premiums payable for other insurance policies held by the customer), financial liabilities/commitments, source of fund for premium payment and its sustainability as considered by the customer, the impact of the customer's retirement plan on his/her affordability, the amount of funds and the period that he or she is willing and able to make premium payments, etc. Prudent thresholds should be adopted to assess the customer's capability in terms of the amount and period (e.g. taking into account the customer's intended retirement age and financial capability after retirement) to contribute the premiums.

3.9 Given the risks and consequences of exercising premium holiday, when assessing the customer's affordability of premium payments, in general AIs should not assume that the customer will exercise premium holiday or attempt to induce customers to assume that premium holiday option will be exercised in deciding whether to take up a NLTI policy (for example, by advising that the policy is affordable if the premium holiday option is exercised).

Handling of mismatches

3.10 There should be adequate control measures for transactions involving a mismatch of the NLTI plan and the customer's circumstances including needs and affordability ("mismatch"). Such measures should include that, before accepting any such transactions, the AI's staff should (i) remind the customer of the mismatch and that the plan may not be suitable for him/her; (ii) document the reasons of the customer's decision to proceed with the transaction notwithstanding the mismatch; (iii) ensure the customer's written acknowledgement of the mismatch; (iv) warn customers that insurers may not accept applications with mismatch; and (v) seek endorsement from the AI's supervisory staff and, if warranted, other risk management units. AIs should subject such mismatch cases to adequate independent monitoring to detect and avoid abuse of such control procedures by staff. Meanwhile, AIs should ensure frontline staff are adequately aware of that mismatch transactions are of higher risk, and the staff should exercise greater caution in handling such transactions.

4 Vulnerable customers

4.1 Along with the requirements set out in the HKMA circular of 3 March 2006 namely "Retail Wealth Management (RWM) Business", AIs need to exercise extra care and implement additional safeguards for vulnerable customers[4] ("VC") in the sale of NLTI plans. AIs should allow VCs to choose whether they would like to (i) bring along a companion to witness the sales process (i.e. including suitability assessment and product presentation) and/or (ii) have more than one staff member of the AI handling the sale. The VC can choose to have either, both or neither of the safeguards. AIs should adopt the choice of the VC and maintain proper audit trail of such choice. When handling elderly customers, AIs should alert them to the tenor

[4] Examples of vulnerable customers include (i) the elderly (aged 65 or above); (ii) the illiterate or those with low education level (primary or below); (iii) the visually impaired; and (iv) customers who have limited means.

(refer to paragraph 5.1 below) and the premium contribution period of the NLTI plan.

5 Product disclosure

5.1 AIs should implement adequate policies and procedures to require frontline staff to disclose and explain the nature and the key features and risks of NLTI plans to customers during the selling process, including (among other requirements) the following, to the extent applicable. This is however not a comprehensive list and some of the features and risks may not be applicable to every NLTI plan.

- Product nature – AIs should make it clear to the customer at the outset that the product is an insurance product. AIs should not (i) make any representation to the effect that the NLTI plan is equivalent or similar to any kind of deposit, or (ii) make any description that disguises the insurance element of the plan (e.g. a savings plan with complimentary insurance or life protection).

- Tenor – The timeframes for relevant features of the NLTI plan, e.g. policy term, lock-in period (if any), payment period(s) for bonus(es), dividend(s), and/or other return(s), etc. should be adequately disclosed to the customer. AIs are also reminded to explain the long term nature of the NLTI policy where relevant, and the consequences of early discontinuance and/or surrender.

- Risks – AIs should explain to the customer the key risks associated with the NLTI plan including, among others, credit risk of the insurance company, liquidity risk associated with the NLTI plan, risks relating to Renminbi NLTI products, etc.□

- Premium payment – The amount of premium, frequency of premium payment, premium contribution period and the consequences of late payment or non-payment of premium should be clearly disclosed to the customer. Where the NLTI plan allows for a premium holiday to be exercised and/or for a policy loan to be provided, AIs should specifically alert customers to the conditions, circumstances, the applicable interest and charges, as well as the possible consequences. AIs should remind customers that fees and charges will continue to be deducted during the premium holiday, and should not misrepresent the premium holiday as a risk-free option to stop/suspend premium payments.

- Fees and charges – AIs should provide disclosure, through proper explanation, in relation to fees and charges associated with NLTI plans to customers. For example, it is noted that some NLTI products (such as universal life products) have schedules of fees and charges. AIs should also disclose to customers the fact that part of the premiums will pay for the insurance and related costs. At no time may AIs represent a NLTI plan as having no fees and charges to be borne by the customer, if it is not factually correct.

- Death benefits and cash values[5] – As AIs should disclose to customers the cover afforded by each NLTI policy offered, disclosure of key exclusions and limitations should also be adequately made. As regards the illustration document, AIs should explain to customers the following, among other things[6]:
  (a) the amounts of and basis of determining the cash values and the death benefits;
  (b) where projected benefits are illustrated, (i) the assumptions on which the illustrations are based, including any future bonus/dividend declaration and future accumulation rate of the amounts of bonuses/dividends and cash payments; and (ii) which specific part(s), if any, of the projected benefits (including bonuses/dividends to be declared and the future accumulation rate) is/are not guaranteed;
  (c) where a policy offers bonus/dividend distribution or participation in profits,
    (i) the specific difference between guaranteed benefits and non-guaranteed benefits;
    (ii) where applicable, any bonuses/dividends declared in the future may be lower than or higher than those currently quoted;
    (iii) in respect of future accumulation of the amounts of bonuses/dividends and cash payments, where applicable, the actual rates at which these amounts will accumulate may be lower than or higher than those currently quoted; and
    (iv) past performance or current performance of the insurer's business may not be a guide for future performance; and
  (d) the impact of withdrawals (including but not limited to withdrawals of bonuses/dividends) on the illustrated cash values and death benefits.

---

5 For the reference to "cash values", please refer to "Standard Illustrations of Non Unit-linked Life Policies" and "Standard Illustration for Universal Life (Non-Linked) Policies" issued by the HKFI.

6 For example, where applicable, the requirements set out in clause 82 of the HKFI's "The Code of Practice for the Administration of Insurance Agents".

- <u>Specimen Warning Statement</u> – AIs should bring to the customer's attention the Specimen Warning Statement[7] applicable to the list of traditional life insurance products as required in Annex 2 to the HKMA circular of 25 March 2009.

6 Management supervision

6.1 The HKMA has required[8] AIs to establish appropriate management information system for management's supervision and regular review of the sale of NLTI products by independent units. High risk areas and exceptions should be subject to monitoring, such as transactions involving vulnerable customers, inadequate FNA, mismatch, affordability issues, policy replacement, etc. Transactions displaying such high risk areas and exceptions should also be covered in AIs' independent reviews (e.g. those by the AI's compliance function) of the selling process of NLTI products, which should include test-checks of transactions. AIs' "mystery shopping" programmes should also cover their sale of NLTI plans. AIs should promptly take appropriate follow-up actions on any irregularities discovered.

[7] The Specimen Warning Statement now reads *"[Plan name] is an insurance plan with a savings element. Part of the premium pays for the insurance and related costs. If you are not happy with your policy, you have a right to cancel it within the cooling off period and obtain a refund of any premiums paid. A written notice signed by you should be received by the insurer's Hong Kong Main Office at [address of the insurer's Hong Kong Main Office] within the cooling off period (that is, 21 days after the delivery of the policy or issue of a notice (informing you/your representative about the availability of the policy and expiry date of the cooling off period), whichever is the earlier). After the expiration of the cooling off period, if you cancel the policy before the end of the term, the projected total cash value may be less than the total premium you have paid. For non-linked single premium life insurance plans, the third sentence of the Specimen Warning Statement should be revised to "If you are not happy with your policy, you have a right to cancel it within the cooling-off period and obtain a refund of any premiums paid (less any market value adjustment which the insurer has the right to apply in the case of non-linked single premium life insurance policies)."*

[8] See the HKMA's circular of 3 March 2006 "Retail Wealth Management (RWM) Business" and Supervisory Policy Manual Module IC-1 "General Risk Management Control".