



HONG KONG MONETARY AUTHORITY  
香港金融管理局



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

11 October 2021

## Circular to intermediaries

### Distribution of insurance-linked securities and related products

1. The Hong Kong Monetary Authority (**HKMA**) and the Securities and Futures Commission (**SFC**) remind intermediaries to observe the requirements governing selling practices, including the suitability obligations and requirements for complex products, under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**)<sup>1</sup> when they distribute insurance-linked securities (**ILS**)<sup>2</sup> and related products<sup>3</sup>. This circular has been prepared in consultation with the Insurance Authority (**IA**).
2. ILS are mechanisms by which insurers or reinsurers can transfer insurance risks to the capital markets by way of securitisation. The structure and valuation of ILS can be complicated as they are generally subject to limited market liquidity. Investors may risk a total loss of their capital upon the occurrence of predefined trigger events, eg, natural disasters or other catastrophes. Thus, target investors should have sufficient knowledge and sophistication to understand the associated risks. ILS mainly target and are sold to institutional investors such as insurance companies, banks and hedge funds.
3. The Insurance Ordinance (Cap. 41) was amended on 29 March 2021<sup>4</sup> to include a regulatory framework for the issuance of ILS in Hong Kong, whilst the Insurance (Special Purpose Business) Rules (Cap. 41P) (**SPB Rules**) restrict the sale of ILS only to certain types of investors<sup>5</sup> (**eligible ILS investors**) with a minimum investment size of US\$250,000 or equivalent. The IA's Guideline on Application for Authorization to Carry on Special Purpose Business (GL33) provides that these restrictions on offering or selling ILS also apply to any financial products backed by ILS issued in Hong Kong (ie, repackaged products) or those which derive their value from ILS issued in Hong Kong as underlying assets (ie, derivatives). The IA also specified in its Consultation Conclusions on Draft Insurance (Special Purpose Business) Rules that funds targeting the general public (such as Mandatory Provident Fund schemes or their constituent funds, occupational retirement schemes and retail funds authorised by the SFC) are not regarded as eligible ILS investors given that ILS are unsuitable for retail investors.

<sup>1</sup> The selling practice requirements, including the suitability obligations and requirements for complex products, are set out in paragraphs 5.2 and 5.5 of the Code of Conduct, Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons, Frequently Asked Questions on Guidelines on Online Distribution and Advisory Platforms and Paragraph 5.5 of the Code of Conduct as well as other guidance issued or updated by the SFC from time to time.

<sup>2</sup> For example, catastrophe bonds.

<sup>3</sup> For example, derivatives or structured products whose returns are linked to the performance of ILS, and collective investment schemes whose investment objective or principal investment strategy is investing in ILS (**ILS Funds**).

<sup>4</sup> Amendments made by the Insurance (Amendment) Ordinance 2020, Ord. No. 17 of 2020.

<sup>5</sup> As prescribed in Rule 3 of the SPB Rules. For example, governments, insurance companies, banks, and regulated corporations carrying on the business of provision of investment services.

4. Intermediaries are reminded to appropriately identify the target investors of ILS and related products by taking into account any selling restrictions on ILS issued in Hong Kong and outside Hong Kong as well as the structure and risks of these products. For example, the sale of ILS issued in Hong Kong (including repackaged products or derivatives of such ILS) is strictly limited only to eligible ILS investors. ILS issued outside Hong Kong may have similar structures and risks as ILS issued in Hong Kong, and as such, intermediaries are generally expected to adopt the same approach when identifying the target investors for these ILS as well as their repackaged products and derivative products. Also, ILS Funds in general are unsuitable for retail investors.
5. In addition to their high-risk factors, ILS and related products are considered as complex products, having regard to the factors set out in the notes to paragraph 5.5 of the Code of Conduct and paragraph 6.1 of the Guidelines on Online Distribution and Advisory Platforms. Intermediaries are reminded to comply with the suitability obligations and requirements for complex products<sup>6</sup> where applicable when distributing ILS and related products. Amongst other things, intermediaries should:
  - (a) conduct product due diligence, taking into account, amongst other factors, the products' nature, features, risks, any restrictions on their sale and target investors, and in what aspects they are considered suitable for clients;
  - (b) ensure that the risk return profile of the product matches the financial situation, investment objectives, investment experience, risk tolerance and other relevant circumstances specific to the client<sup>7</sup>;
  - (c) provide clients with sufficient and accurate information about the product, including its nature, features and risks<sup>8</sup>;
  - (d) provide clients with warning statements in a clear and prominent manner; and
  - (e) provide staff with adequate training on the products they distribute and how to appropriately disclose the products' nature, features and risks to clients.
6. Should you have any queries regarding the content of this circular, please contact Ms Eloise Pun at the Banking Conduct Department of the HKMA on 2878 1903, or Ms Kammy Kwok on 2231 1455 or your case officer at the Intermediaries Supervision Department, Intermediaries Division of the SFC.

Banking Conduct Department  
Hong Kong Monetary Authority

Intermediaries Supervision Department  
Intermediaries Division  
Securities and Futures Commission

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HKMA/B1/15C  
SFO/IS/025/2021

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<sup>6</sup> An intermediary is exempted from complying with some provisions of the Code of Conduct (eg, paragraphs 5.2 and 5.5) when it is dealing with Institutional Professional Investors or Corporate Professional Investors (for whom the intermediary has complied with paragraphs 15.3A and 15.3B of the Code of Conduct) as defined under paragraph 15.2 of the Code of Conduct.

<sup>7</sup> In particular, clients should have adequate and relevant knowledge or experience before investing in ILS and related products.

<sup>8</sup> For example, the risk of bearing a huge loss upon the occurrence of predefined trigger events (eg, natural disasters or other catastrophic events) which are difficult to predict.