

Subject: New Requirements Relating to the Sale of ILAS Products

1 Background

As members will know, there have been substantial changes to the regulatory environment for ILAS products. These include the introduction by the Securities and Futures Commission (the "SFC") of enhanced advertising guidelines and suitability and disclosure requirements and the new requirements of the Hong Kong Monetary Authority (the "HKMA") relating to the sale of ILAS products by banks. In the light of these changes, it is necessary for the Hong Kong Federation of Insurers ("HKFI"), as a self-regulatory body, to enhance its requirements for the sale of ILAS products. The purpose of this circular is to announce these new requirements.

2 Purpose

The purpose of the new requirements is to ensure that customers purchase ILAS products that are suitable for them and consistent with their requirements and risk appetite.

3 Effective date

All member companies who sell ILAS products are required to implement these rules in two stages as follows:

- a) The enhanced Financial Needs Analysis (as per section 4.1 of this circular), Risk Profile Questionnaire (4.2), Applicant Declaration (4.3) and Suitability Check (4.4) must be implemented **no later than 16th October 2009**.
- b) The post-sale controls (section 4.5) must be implemented **no later than 31st December 2009**.

This timing allows members to make the necessary changes to their systems to implement and support the new requirements.

4 New and Enhanced Requirements

4.1 Financial Needs Analysis

Building on the HKFI's initiative on needs analysis that took effect in February 2007, every application for an ILAS product must include, or be accompanied by, a financial needs analysis form ("FNA"). The FNA must as a minimum include all the questions and multiple choice options in the suggested form of FNA shown in Appendix A. Member companies may modify the FNA to include additional questions, and may also add additional multiple choice options to the mandatory questions shown in the suggested form of FNA; however, each of the choices shown for the mandatory questions must be included in the FNA.

Neither members nor customers can opt out of the FNA. That would defeat the objective of this initiative. If the customer chooses to deviate in any respect from the FNA process they must confirm their reasons in writing. The FNA form can be designed to accommodate this – see Appendix A – but it is stressed that "tick boxes" indicating non-compliance with the FNA requirement are not permissible; the customer must set out their specific reasons.

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The FNA may be presented as either a separate form, or included as a section within another point-of-sale document such as the proposal form but whichever option is adopted, the FNA must be clearly identified: "Financial Needs Analysis" or an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by all applicants.

These new FNA requirements are in addition to the previously announced requirements of the HKFI's Initiative on Needs Analysis, which took effect in February 2007.

4.2 Risk Profile Questionnaire

Every application for an ILAS product must include, or be accompanied by a Risk Profile Questionnaire ("RPQ"). The purpose of the RPQ is to assess the customer's risk appetite and determine if a particular product and its underlying investment choices (if any) are suitable for them. The form of the RPQ should include, as a minimum, questions covering the following areas:

- 1) investment objectives
- 2) preferred investment horizon
- 3) risk tolerance
- 4) financial circumstances

However, there is no need to duplicate questions in the RPQ and the FNA. Member companies must also exercise extra care when selling ILAS products to elderly or unsophisticated customers or those who may not be able to make independent investment decisions on complex investment products, particularly products with long maturity periods or which attract heavy penalties on early redemption or withdrawal.

The treatment of customers choosing to deviate in any respect from the RPQ process is identical to the FNA requirement described in the FNA section above.

Every application for an ILAS product must include the RPQ, which may either be presented as a separate form, or included as a section within another point-of-sale document such as the proposal form but whichever option is adopted the RPQ must be clearly identified "Risk Profile Questionnaire or an appropriate set of words that clearly conveys the document's purpose and must be signed and dated by all applicants.

4.3 Applicant's Declarations

Every application for an ILAS product must include, or be accompanied by, Applicant's Declarations ("Declarations") in the exact form shown in Appendices B and C. Member companies must not modify the content of these Declarations.

The rules for the completion of the Declarations are as follows:

- 1) The applicant(s) must complete the Declarations. They cannot opt-out of this requirement.
- 2) The applicant(s) must sign the declaration of "Section I: Disclosure Declaration" to confirm they understand and accept the highlighted features of the product.
 - a) If the product has any unusual features or risks such as (without limitation) market value adjustment, foreign exchange risk, leverage, investment choices based on hedge funds, or extensive use of derivatives other than for risk management purposes, then the sales representative must explain these to the full satisfaction and understanding of the applicant(s) prior to signing. All

applicant(s) must sign and date at the bottom of "Section I: Disclosure Declaration".

- 3) The applicant(s) must then tick one of either boxes A, B or C in "Section II: Suitability Declaration".
 - a) Box A should be ticked where the sales representative and the applicant(s) agree that the product is suitable, based on the information provided by the applicant(s) as part of the FNA and RPQ.
 - b) Box B should be ticked by the applicant(s) in situations where the applicant(s) are unwilling to disclose sufficient information for suitability to be assessed, or where it is assessed that the product may not be suitable for the applicant(s) based on the information disclosed in the FNA and RPQ. In addition, whenever box B is ticked, an applicant must in his or her own handwriting provide sufficient explanation as to why he/she has determined to proceed with the application, notwithstanding that the product may not be suitable for him/her.
 - c) Box C should be ticked if the applicant(s) fails to comply with any part of the process, including but not limited to refusal to complete any or all parts of the FNA and RPQ, or the applicant(s) wishes to progress the sale on an "execution only" basis. The applicant(s) must set out their reasons and provide these in their own handwriting.
 - d) All applicant(s) must sign and date at the bottom of "Section II: Suitability Declaration".

The Declarations can either be presented as a separate form, or as a separate single page within another point-of-sale document such as the proposal form. The Declarations' document or section must be clearly titled: "Applicant's Declarations".

4.4 Suitability Check

Member companies must establish operational controls to ensure that the FNA, RPQ and Declarations are duly completed.

Further, member companies must establish a process to verify whether the ILAS product sold, and key features such as the premium amount and term are considered suitable for the applicant(s) based on the information disclosed by the applicant(s), and to deal appropriately with any exceptions (as per section 4.5 of this circular).

Special consideration is required where business is introduced by an insurance broker, including Independent Financial Advisors ("IFAs") acting in the capacity as an insurance broker. It is important that in performing the Suitability Check and any exceptions (as per Section 4.5 of this circular) that the applicant(s) fully understand that the Insurance Company is not responsible for the advice given by the insurance broker. To facilitate this differentiation, a specific Applicant Declaration (see Appendix C) has been prepared for this purpose and must be used for business introduced from this intermediary type.

4.5 Post-sale controls

Member companies will be aware that the HKMA has announced a requirement for banks to make audio recordings of ILAS sales. The HKFI's task force on the Report by HKMA on Distribution of Structured Products determined that applying this recording requirement to other sales channels, such as agents, was not practical. However, since this would create a difference between sales channels, member companies must implement the following additional post-sale controls ("Post-sale Controls") for non-bancassurance ILAS sales:

- 1) Copies of the risk disclosure statement for the relevant ILAS product and the signed Applicant's Declarations (as per Appendix B of this circular) must be sent to the customer with the policy.
- 2) A notice informing the customer that copies of the customer's FNA and RPQ are available for inspection and advising where and how the customer may access these documents must be sent with the policy to the customer. This applies to all clients irrespective of which box they tick in Section II : Suitability Declaration of either Appendix B or C.
- 3) Before the expiry of the cooling-off period, member companies must make reasonable efforts to complete and make audio recording of telephone calls with all "Vulnerable Customers" and with any customers selecting either boxes B or C of Section II of the Declarations, to confirm their consent to both the Disclosure Declaration and the Suitability Declaration (a "**Post-sales Call**").

The Post-sale Controls will not apply to bancassurance ILAS sales, as an audio recording should already have been made during the fulfillment process. However, member companies must implement the Post-Sale Controls for all other sales channels, including, without limitation, customers introduced by independent intermediaries such as brokers and IFAs acting in the capacity as an insurance broker.

To ensure compliance with the Post-sales Call requirements Member companies must prepare and follow a script for the Post-sales Call. The HKFI will shortly be indicating a minimum set of questions that should be incorporated in this script, however member companies are entitled to develop their own version provided it includes at least these questions.

In determining who is a "Vulnerable Customer" to whom a Post-sales Call must be made, account must be taken of the following matters, including but not limited to:

- Age – a customer over 65 is a Vulnerable Customer
- Level of education – a person whose education level is "primary level" or below, is a Vulnerable Customer
- Financial means – a person who has "limited means" or no regular source of income or both is a Vulnerable Customer

All member companies, including bancassurers, are required to maintain a register of policies issued to "Vulnerable Customers" or customers selecting either boxes B or C of the Declarations or both. This register must be capable of being audited and rendering appropriate data for both industry and key stakeholders' needs such as the Office of the Commissioner of Insurance.

4.6 Certification of Copies of FNA and RPQ

Insurers are permitted to accept copies of the above documents provided they are appropriately certified. In respect of banks this should be certified by the bank branch manager and bear the bank's chop. For Independent Financial Advisors ("IFA"), insurers will accept copies provided they are certified by the Responsible Officer designated by the authorized representative of the IFA.

5 Updated ILAS Information Brochure

In the interests of improved customer education, the HKFI is in the process of preparing an updated version of the ILAS Information Brochure. It is expected that this revised brochure will be made available before the end of September 2009.