IFPHK's Response to the Insurance Authority's Consultation Paper on Draft Code of Conduct for Licensed Insurance Brokers

May 2019

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IFPHK's Profile

Background

The Institute of Financial Planners of Hong Kong ("IFPHK") was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as the premier professional body representing those financial planners that uphold the highest standards for the benefit of the public.

The IFPHK is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited ("FPSB") to grant the much-coveted and internationally-recognized CFP$^{\text{CM}}$ certification and AFP$^{\text{TM}}$ certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 6,800 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are more than 147,000 CFP certificants in 24 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,700 CFP certificants in Hong Kong.

CFP$^{\text{CM}}$, CERTIFIED FINANCIAL PLANNER$^{\text{CM}}$, CFP$^{\text{CM}}$, CERTIFIED FINANCIAL PLANNER ™, AFP$^{\text{TM}}$, ASSOCIATE FINANCIAL PLANNER$^{\text{TM}}$, AFP® and ASSOCIATE FINANCIAL PLANNER® are certification marks and/or trademarks owned outside the U.S. by Financial Planning Standards Board Limited. The IFPHK is the marks licensing authority for the CFP marks and AFP marks in Hong Kong and Macau, through agreement with FPSB.

IFPHK's interest in this consultation

The IFPHK was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as a professional body representing those financial planners that uphold the highest standards for the benefit of the public. The IFPHK is the sole licensing body in Hong Kong authorized by FPSB to grant the much-coveted and internationally-recognized CFP$^{\text{CM}}$ Certification and AFP$^{\text{TM}}$ Certification to qualified financial planning professionals in Hong Kong and Macau. In view of the growing demand for knowledge in retirement planning products, the IFPHK, in 2016, pioneered in offering a retirement-centric qualification – the Qualified Retirement Advisor ("QRA") – focusing on products and practical skills.

It is the IFPHK's mission to promote the importance of financial planning. Financial planning refers to the process of setting, planning, achieving and reviewing life goals through the proper management of finances. Insurance is considered the cornerstone of financial planning. The effective and proper use of insurance products helps spread risk, which can minimize the impact of risk on families should events take a downturn. Insurance is therefore an important part of the IFPHK's financial planning education and certification programme. Having knowledgeable insurance practitioners, proper consumer understanding of what insurance policies do, effective products, and financially sound underwriters is essential for those who seek financial planning.

In Hong Kong, financial planners work in different segments within the financial services industry. Financial planners can be insurance agents working in insurance companies, insurance brokers working in insurance brokerages, or Independent Financial Advisors ("IFAs"). At present, about 41% of the IFPHK's members work in the insurance industry and 9% work as IFAs.

As the leading professional institute representing the interests of the financial planning industry, the IFPHK has a duty to respond to any consultation paper that may impact its members and their clients. The IFPHK has previously provided feedback on the Consultation Papers "Proposed Establishment of an Independent Insurance Authority" and "Financial Services and the Treasury Bureau Consultation Paper on Key Legislative Proposals on the Establishment of an Independent Insurance Authority ("IIA")". The IFPHK has always strongly supported the establishment of an Independent Insurance Authority, which we would consider to be the most important breakthrough of Hong Kong's financial industry. We have provided our comments on to consultation papers put forward by the IA in the past few months, which include the following:

- Consultation Paper on proposed guidelines on (i) "Fit and Proper" criteria and (ii) Continuing Professional Development requirements for licensed insurance intermediaries
- Consultation Paper on Draft Insurance (Maximum Number of Authorized Insurers) Rules
- Consultation Paper on Draft Guidelines on Exercising Power to Impose Pecuniary Penalty in Respect of Regulated Persons Under the Insurance Ordinance (Cap.41)

- Consultation Paper on Draft Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules

In view of the above, the IFPHK has strong interest in this Consultation Paper.

IFPHK's representation

The IFPHK was founded by 30 members (the"Founding Members") to raise the standards of financial planners and highlight the importance of sound financial planning.

The IFPHK currently has 36 Corporate Members, including banks, financial advisors, insurance companies and securities brokerages. With our Corporate Members providing a full spectrum of client services and products, the IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

Executive Summary

On 28 March 2019, the Insurance Authority ("IA") launched a two-month public consultation on the draft Code of Conduct for Licensed Insurance Agents and the draft Code of Conduct for Licensed Insurance Brokers under the new statutory licensing regime for insurance intermediaries. The submission deadline to the IA is on or before 28 May 2019.

The IFPHK's submission to the Consultation Paper is based on the following board advocacy principles:

1. Aligning with international best practice

Because of the global contagion witnessed during the 2008 financial crisis, there have been greater calls for better coordination between regulators from different jurisdictions and for an increase in the convergence of financial regulation. Besides, the financial crisis also highlighted a number of failures around the area of consumer protection. This led to a crisis of confidence in the financial services industry, which triggered a wave of consumer protection legislation and increasing focus on "Treat Customers Fairly" principles. International organizations such as the G20 and other political and supervisory bodies continue to drive financial services sector reform – both globally and at the local level. The adoption of International Association of Insurance Supervisors ("IAIS") standards in October 2011 was a catalyst for many insurance supervisors to commence reform[1]. The Insurance Core Principles, Standard, Guidance and Assessment Methodology ("ICP") provides a globally accepted framework for the supervision of the insurance sector.

2. Advocating the six-step financial planning process

It is the IFPHK's mission to promote the importance of financial planning. For the IFPHK and other affiliates of the Financial Planning Standards Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. In 2015, global research firm GfK conducted a consumer survey jointly with the FPSB. Consumers surveyed in Hong Kong were all broadly interested in financial planning. Consumers working with a financial professional generally feel better prepared, and this pattern is even more

[1] KPMG, Evolving Insurance Regulation, Time to get ahead, February 2012.

pronounced among those working with a CFP professional.[2] At present, service providers in Hong Kong tend not to offer client-centric advisory services and independent financial plans to customers. It is the mission of the IFPHK to promote public awareness of the financial planning industry and the six-step financial planning process. As such, we welcome any policy changes that will lead to a paradigm shift of market practices to financial planning.

3. Enhancing consumer protection

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. As financial products get more complex and sophisticated, it is of utmost importance that investors/consumers are provided with proper and adequate protection under a sound and effective regulatory system. The IFPHK supports a regulatory system that would facilitate delivering better financial products and services to the benefit of members of the public, as well as protecting them. Hence, the effectiveness of consumer protection and a healthy balance of robust regulations and market development are the IFPHK's areas of focus. The IFPHK also believes that financial practitioners have a duty to protect consumers. Financial institutions that embrace transparency, redress and financial education promote financial inclusion and expand the market. Financial institutions that understand the potential of financial inclusion recognize that in the long term it is in their best interest to foster fair and equitable business practices as part of good governance and brand building, which in turn will promote good returns for the institutions and consumers[3].

4. Raising the professional standards of intermediaries

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for assurance for the benefit of the investing public. If the professional standards of financial intermediaries do not keep up with the demands of the market, even if all the protective measures proposed are implemented, Hong Kong would not be able to maintain its reputation as an international financial centre and therefore grow its financial services industry. Since its inception, the IFPHK has been striving to promote public awareness of the financial planning industry in Hong Kong and uphold the standard of CFP professionals by providing guidance notes and

[2] The Value of Financial Planning and Awareness of CFP Certification: A Global Financial Planning Survey, Hong Kong Results, FPSB & GfK.

[3] Alliance for Financial Inclusion, Policy Note Consumer Protection Leveling the playing field in financial inclusion, 2010

continuously improving the certification program[4]. In view of the growing importance of retirement planning, the IFPHK introduced the Qualified Retirement Advisor certification to uphold practitioners' knowledge in this area. The IFPHK has a long history of providing professional training to insurance practitioners. Since 2006, we have offered 1,836 courses for 4,981 hours, covering 186,518 participants. Last year, we conducted 209 CPD courses for 580 hours for 33,801 insurance practitioners.

5. Ensuring a level playing field across the financial services industry

It should be noted that the key assumption throughout this submission is that the proposed changes in legislation should be adopted consistently by all financial intermediaries servicing retail consumers operating in the IFA, banking and insurance sectors. The IFPHK believes that a failure to implement a consistent approach across the industry could result in significant negative consumer and industry consequences. The IFPHK is frequently urged by industry professionals to highlight the need for implementing a consistent approach across the industry to establish a **'level playing field'** among all financial planners/advisors in the different distribution segments, i.e. banking, insurance and financial advisors. We have already expressed our views in our responses to various consultation documents. The IFPHK strongly believes that such a consistent approach would significantly reduce any regulatory arbitrage that could potentially undermine the good intention of protecting investors. The insurance market in Hong Kong is very competitive, and it is somewhat surprising that such a small place is able to accommodate over 100,000 practitioners. The IFPHK has always stressed that a regulatory framework should deliver measurable benefits to the insurance industry in the medium to long term. It should also enable a healthy and sustainable business environment for the industry to thrive and develop. To preserve the fair competition and diversity of the market, the IA should not only be progressive and adhere to international standards when formulating its supervisory principles and details, but should have an explicit responsibility to

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[4] In 2006, with contributions from the patrons of leading industry practitioners and experts, the IFPHK published *The IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners to practice in Hong Kong. To supplement this effort, the IFPHK also launched the first *Guidance Notes, Suitability of Advice Obligations: Documenting your Financial Advice* for members. The IFPHK also participated in a global job analysis review and international studies on financial planning job skills analysis. Through this process, the IFPHK gained professional insights into core characteristics and practices vis-à-vis Hong Kong's financial planning practitioners and international CFP professionals. Based on the results of the job analysis, the IFPHK has made considerable efforts in revamping the certification programs. In June 2011, the IFPHK introduced Associate Financial Planner ("AFP") certification to attract the broader population of the financial planning industry and thus raise the overall standard of the industry.

strike a balance between regulation and market growth, keeping in mind the difference in business nature and operation model of the various market participants.

In principle, the IFPHK agrees that:

- the proposed principle-based approach of the Brokers' Code and that the General Principles and their related Standards and Practices provide a suitable framework for the conduct of licensed insurance brokers;
- "Treating clients fairly" is a very important and fundamental principle for insurance intermediaries;
- the code should address conflicts of interest by making appropriate disclosures, and
- insurance brokers, when offering advisory services to clients, should enter into client agreements.

However, the IFPHK has other comments on the proposed Code which are not covered in the questions of the Consultation Paper:

Suitability and other requirements require an enhanced competency among insurance intermediaries

Suitability is one of the General Principles in the proposed Code of Conduct. A licensed insurance intermediary 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. Before giving regulated advice, a licensed insurance broker should properly carry out a suitability assessment of the client's objectives, circumstances, needs and priorities. As aforementioned in our submission principles, for the IFPHK and other affiliates of the Financial Planning Standard Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. Whilst we agree with the suitability principles, **we are wary that by requiring intermediaries to perform suitability assessment, the intermediaries are expected to have a competency level that is beyond what is stated in the proposed Competence Guidelines.** Since the concept of suitability is the cornerstone of the financial planning industry and the core principle of the six-step financial planning process, the IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planners and advisers who have provided invaluable financial planning and investment advice to their clients. This consultation paper can be an appropriate time to elevate financial advice and financial planning, as well as the profession of being a financial planner.

In addition, given that providing insurance is a long-term service, intermediaries should be equipped with financial planning skills and knowledge that enable them to perform a proper analysis of a client's personal profile and offer advice that could meet the client's life goals and achieve their best interest. The IFPHK believes that product and basic investment knowledge alone will be insufficient to fulfill the upcoming demands of personal financial advisory and planning services. In consideration of the interest of policy holders, it is the priority of the IA to specify the body of knowledge required to perform a regulated activity. The IA should also include and increase coverage of financial and retirement planning into the core curriculum and in the examination and continuous professional education program in order to equip the intermediaries with the necessary skills and knowledge to confidently provide related advice that suits customer needs and expectations. **Consistent with our advocacy principles, we urge the IA to set up a roadmap to review and revamp the licensing examination for insurance practitioners.**

Australia requires financial advisers to undertake a “knowledge update review” every three years and new financial advisers have to be supervised for a year by a planner with at least five years’ experience. Planners are effectively forced to join a professional association. **The IFPHK considers that attachment to a professional association is a good way to ensure the standard of insurance intermediaries.**

Senior management responsibilities

We understand that management accountability has been stated in Schedule D. With the new regulatory framework, there shall be more emphasis on senior accountability, which may help revolutionize the employment structure of appointed brokers in current practice. Increased awareness of the supervision responsibilities of senior management is already visible in local and overseas regulators. In December 2016, the Securities and Futures Commission (“SFC”) issued a circular to all licensed corporations to introduce measures to heighten the accountability of the senior management of these firms and to promote awareness of senior management obligations under the current regulatory regime. The Financial Conduct Authority (“FCA”) in the UK recently implemented the Senior Manager and Certification Regime (“SM&CR”). The SM&CR is designed to make senior managers accountable for the actions of their firms. The SM&CR will apply to insurers from 10 December 2018. The applicability will be extended to include brokers on 9 December 2019. The IA may also keep track on such regulatory development. The IA may take reference to the practice of the SFC to explicitly state senior management responsibilities in the General Principles.

Care for clients with special needs

Insurance contracts are of a long-term nature. Some consumers may become vulnerable at specific times during their life. The IA may keep abreast of international development and consider strengthening standards relating to vulnerable consumers. In view of the fast-ageing population, the vulnerability of senior investors poses challenges to global regulators. Indeed, it has also been a theme advocated by the IOSCO. While there are laws, regulations and programmes in place to protect seniors from accessing certain financial services, in most cases, the laws, regulations and programs are designed to protect all investors, not just seniors. The IFPHK and the other affiliates of the FPSB believe that seniors would benefit most if regulators and professional bodies encouraged policies that support the delivery of financial advice to seniors under a client first/best interest duty. The Code could include a new section on vulnerable consumers. The section would begin with a statement acknowledging the diverse needs of vulnerable people and committing to supporting the particular needs of customers where these are identified. The MPFA may also require registered Intermediaries to provide "extra care" to clients with special needs.

TCF principles would be better achieved by practitioners attached to a professional association

Under the TCF principles is the regulators' desire to cultivate a consumer-focused business culture that goes beyond strict legal requirements. It is envisaged that TCF should be embedded in the DNA of the company. However for an insurer, the duty to the consumer is to treat them fairly, which is a far lower duty than the fiduciary duty their executives owe to the company. Members of professional associations voluntarily agree to adhere to a Code of Ethics and Professional Conduct. For instance, FPSB developed duty of care principles that require financial planners to behave like a fiduciary that places the interest of the client first, at all times acting honestly and in utmost good faith. We view the relationship between a financial planner and a client as one of trust, requiring confidence on the part of the client that the financial planner is exercising his or her discretion or expertise for the benefit of the client. The financial planner owes the client a duty of care consistent with that of a fiduciary, regardless of employment arrangement, and provides advice and product recommendations that are suitable for the client. Also, the financial planner must act in accordance with professional expectations. A financial planner needs to meet professional conduct and ethical standards, developed and enforced by his or her professional or certification body. In view of the conflicting interest of the fiduciary duty towards the company and the duty to clients, we suggest the IA encourage intermediaries to become attached to a professional association so as to ensure they adhere to certain ethical standards.

Remuneration arrangements and disclosure

The IFPHK considers that the most effective way to minimize conflicts of interest of brokers is to regulate remuneration. Remuneration arrangements are very crucial to the compliance of several of the General Principles, which include but are not limited to General Principle 2 – Acting Fairly and in Accordance with the Client's Best Interests and General Principle 7 – Conflicts of Interest. We understand there is strong resistance from the industry with respect to changing remuneration practices and disclosing remuneration and commissions. Compensation and remuneration continues to be a significant area of attention for regulators. In order to align with international practices, the IA should consider a reform with regard to the remuneration. The IFPHK thinks that the conflict of interest with regard to the remuneration practices and arrangements are the major obstacles in modernizing the regulatory regime of the insurance industry in Hong Kong. The IA can take reference from the practice of the FCA.

Written client agreement

We consider it is good practice for licensed insurance broker companies to enter into written agreements with their clients. The IFPHK's Rules of Conduct provide best practice to financial planners. It suggests the financial planning professional and the client shall mutually agree upon the services to be provided by the financial planning professional. It also suggests a financial planning professional shall disclose adequate information in writing to the client. Consistent with the scope of the engagement, a financial planning professional shall undertake a reasonable investigation of products and services to be recommended to clients. A financial planning professional may rely upon an investigation undertaken by a third party provided it is reasonable to place reliance on the quality of such investigation.

The IA Consultation

On 28 March 2019, the Insurance Authority (IA) launched a two-month public consultation on the draft Code of Conduct for Licensed Insurance Agents and the draft Code of Conduct for Licensed Insurance Brokers under the new statutory licensing regime for insurance intermediaries. The submission deadline is on or before 28 May 2019.

At present, insurance intermediaries are required to comply with conduct requirements promulgated by their respective Self-Regulatory Organisations (SROs). Under the new statutory regime, the two codes of conduct will specify fundamental conduct requirements expected of them.

The draft Codes of Conduct set out eight core General Principles, under which standards and practices are elaborated. When formulating these draft codes, the IA has taken account of conduct requirements applicable to insurance intermediaries under the existing self-regulatory regime, relevant requirements in overseas jurisdictions as well as prevailing international standards.

In recognition of the different capacities served by insurance agents (as representatives of insurers) and insurance brokers (as representatives of policy holders or potential policy holders), the IA proposes to issue two separate codes of conduct to set out respective requirements for them.

The Consultation Paper contains x questions in 2 Chapters, which are set out as below:

Chapter 1 – BACKGROUND AND INTRODUCTION TO THE BROKERS' CODE

Chapter 2 – KEY PROVISIONS OF THE BROKERS' CODE

1. Do you agree with the proposed principle-based approach of the Brokers' Code and that the General Principles and their related Standards and Practices provide a suitable framework for the conduct of licensed insurance brokers?

2. Do you agree that the objective of “treating clients fairly” is fundamental to the regulated activities of a licensed insurance broker?

3. Do you agree that providing clients with adequate disclosure so that they can make informed decisions on their insurance purchases is an important principle to include in the Brokers’ Code?

4. Do you agree that disclosure is an important mechanism for licensed insurance brokers to manage potential conflicts of interests and that standards regarding the disclosure an insurance broker should make in this respect, should be included in the Brokers’ Code?

5. Do you agree that it is good practice for licensed insurance broker companies to enter into written agreements with their clients and that the Brokers’ Code should provide for this requirement?

6. Do you agree that the Brokers’ Code should set out requirements for the governance, controls and procedures that a licensed insurance broker company should adopt (as per Part D of the Brokers’ Code)? Do you agree that licensed insurance broker companies should follow such requirements to ensure the General Principles, Standards and Practices in the Brokers’ Code are complied with by the companies and their appointed licensed technical representatives (broker)?

IFPHK's Submission

The views expressed in this submission paper are not necessarily simply summaries of the views taken from the industry. They have undergone independent and critical analysis and consideration by the IFPHK as a professional body. As a result, not all the views collected by the IFPHK are recorded in this submission paper. Nor have all the views expressed in this paper been directly endorsed by the industry representatives or members consulted.

In considering the various proposals of the Consultation Paper, the IFPHK's comments are based upon the following principles and beliefs:

IFPHK's Principles

Aligning with international best practice

Globalization and financial market integration has increased rapidly in the past decade. As an international financial centre, Hong Kong is not immune from international financial market and regulatory development. This has been illustrated by the 2008 financial crisis where problems originating in one country quickly spread across the globe. Because of the global contagion witnessed during that time, there have been greater calls for better coordination between regulators from different jurisdictions and for an increase in the convergence of financial regulation. Besides, the financial crisis also highlighted a number of failures around the area of consumer protection. This led to a crisis of confidence in the financial services industry, which triggered a wave of consumer protection legislation and increasing focus on "Treat Customers Fairly" principles.

International organizations such as the G20 and other political and supervisory bodies continue to drive financial services sector reform – both globally and at the local level. The adoption of new International Association of Insurance Supervisors ("IAIS") standards in October 2011 was a catalyst for many insurance supervisors to commence reform[5]. The Insurance Core Principles, Standard, Guidance and Assessment Methodology ("ICP") provides a globally accepted framework for the supervision of the insurance sector. It contains 26 principles that IAIS members are advised to observe and adopt.

[5] KPMG, Evolving Insurance Regulation, Time to get ahead, February 2012.

Other key international developments include but are not limited to IOSCO Standards on POS disclosure, Joint Forum Standards on POS disclosure, BCBS Consumer protection standards and the World Bank's good practices in customer protection. In consideration of the recent developments, it is necessary for the insurance industry to keep up with global standards.

Advocating the six-step financial planning process

It is the IFPHK's mission to promote the importance of financial planning. The definition of financial planning to the IFPHK and other FPSB-affiliate members is as follows:

"*a process of developing strategies to help people manage their financial affairs to meet life goals. In creating their recommendations and plans, financial planners may review all relevant aspects of a client's situation across a breadth of financial planning activities, including inter-relationships among often conflicting activities."*

For the IFPHK and other affiliates of the Financial Planning Standards Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. The process involves the following steps: 1. Establish and define the relationship with the client, 2. Collect the client's information, 3. Analyze and assess the client's financial status 4. Develop the financial planning recommendations and present them to the client, 5. Implement the financial planning recommendations, and 6. Review the client's situation.

In 2015, global research firm GfK conducted a consumer survey jointly with the FPSB. Of the 1,005 consumers surveyed in Hong Kong who were all broadly interested in financial planning, only a fifth were confident that they will reach their financial life goals. Also, only 20% felt that they are knowledgeable about financial matters. Consumers working with a financial professional generally feel better prepared, and this pattern is even more pronounced among those working with a CFP professional.[6] The provision of client-centric financial planning advisory services and independent financial plans is becoming a matter of course for a lot of financial industry operators. At present, service providers in Hong Kong tend not to offer client-centric advisory services and independent financial plans to customers. It is the mission of the IFPHK to promote public awareness of the financial planning industry and the six-step financial planning process. As such,

[6] The Value of Financial Planning and Awareness of CFP Certification: A Global Financial Planning Survey, Hong Kong Results, FPSB & GfK.

we welcome any policy changes that will lead to a paradigm shift of market practices to financial planning.

Enhancing consumer protection

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. As financial products get more complex and sophisticated, it is of utmost importance that investors/consumers are provided with proper and adequate protection under a sound and effective regulatory system. The IFPHK supports a regulatory system that would facilitate delivering better financial products and services to the benefit of members of the public, as well as protecting them. Hence, the effectiveness of consumer protection and a healthy balance of robust regulations and market development are the IFPHK's areas of focus.

The IFPHK also believes that financial practitioners have a duty to protect consumers. Financial institutions that embrace transparency, redress and financial education promote financial inclusion and expand the market. Financial institutions that understand the potential of financial inclusion recognize that in the long term it is in their best interest to foster fair and equitable business practices as part of good governance and brand building, which in turn will promote good returns for the institutions and consumers[7].

The confidence of consumers has not been restored after the crisis. In 2016, a territory-wide study by the IFPHK with GfK found that only 18% of respondents said their confidence in the markets had been fully restored after the 2008 Lehman Brothers incident.[8] According to the latest trust barometer report of Edelman, trust in financial services has been continuously declining in Hong Kong. The index has dropped from 55% to 47% this year, representing general population distrust of financial services institutions. Meanwhile, informed public trust in financial services has seen a double-digit decline, with Hong Kong's index decreasing by 15% to 48%[9]. Regulators and practitioners have to work together to restore public trust in the financial services industry.

[7] Alliance for Financial Inclusion, Policy Note Consumer Protection Leveling the playing field in financial inclusion, 2010
[8] The Value of Financial Planning and Awareness of CFP Certification: A Global Financial Planning Survey
Hong Kong Results, FPSB and GfK, 2016
[9] 2018 Edelman Trust Barometer

Raising the professional standards of intermediaries

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for assurance for the benefit of the investing public. If the professional standards of financial intermediaries do not keep up with the demands of the market, even if all the protective measures proposed are implemented, Hong Kong would not be able to maintain its reputation as an international financial centre and therefore grow its financial services industry. Since its inception, the IFPHK has been striving to promote public awareness of the financial planning industry in Hong Kong and uphold the standard of CFP professionals by providing guidance notes and continuously improving the certification program[10]. In view of the growing importance of retirement planning, the IFPHK introduced the Qualified Retirement Advisor certification to uphold practitioners' knowledge in this area.

The IFPHK regards that the reputation of the financial planning industry has been unfairly tarnished after the financial crisis due to varying standards of sales practice and professionalism. Yet there are many professional insurance practitioners in the market who have provided invaluable insurance and financial planning advice to their clients. Unfortunately in the past the standard was not uniform and quality of advice can vary significantly. Therefore, the IFPHK always aims to uplift the professional standards of the industry. The IFPHK has a long history of providing professional training to insurance practitioners. Since 2006, we have offered 1,836 courses for 4,981 hours, covering 186,518 participants. Last year, we conducted 209 CPD courses for 580 hours for 33,801 insurance practitioners.

[10] In 2006, with contributions from the patrons of leading industry practitioners and experts, the IFPHK published *The IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners to practice in Hong Kong. To supplement this effort, the IFPHK also launched the first *Guidance Notes, Suitability of Advice Obligations: Documenting your Financial Advice* for members. The IFPHK also participated in a global job analysis review and international studies on financial planning job skills analysis. Through this process, the IFPHK gained professional insights into core characteristics and practices vis-à-vis Hong Kong's financial planning practitioners and international CFP professionals. Based on the results of the job analysis, the IFPHK has made considerable efforts in revamping the certification programs. In June 2011, the IFPHK introduced Associate Financial Planner ("AFP") certification to attract the broader population of the financial planning industry and thus raise the overall standard of the industry.

Ensuring a level playing field across the financial services industry

It should be noted that the key assumption throughout this submission is that the proposed changes in legislation should be adopted consistently by all financial intermediaries servicing retail consumers operating in the IFA, banking and insurance sectors. The IFPHK believes that a failure to implement a consistent approach across the industry could result in significant negative consumer and industry consequences. The IFPHK is frequently urged by industry professionals to highlight the need for implementing a consistent approach across the industry to establish a **'level playing field'** among all financial planners/advisors in the different distribution segments, i.e. banking, insurance and financial advisors. We have already expressed our views in our responses to various consultation documents. The IFPHK strongly believes that such a consistent approach would significantly reduce any regulatory arbitrage that could potentially undermine the good intention of protecting investors.

Hong Kong ranked third in 2017 globally for insurance penetration, calculated by premiums in % of GDP[11]. As Asia's insurance hub, Hong Kong has attracted many of the world's top insurance companies. As at 31 December 2018, there were 161 authorized insurers in Hong Kong, of which 93 were pure general insurers, 49 were pure long-term insurers and the remaining 19 were composite insurers. There were 2,422 insurance agencies, 69,285 individual agents and 25,356 responsible officers/technical representatives registered with the IARB. There were 788 authorized insurance brokers as at 31 December 2018. All of them are members of the two approved bodies of insurance brokers. In addition, there were 9,560 persons registered as chief executives/technical representatives of these authorized brokers as at 31 December 2018.[12] The insurance market in Hong Kong is very competitive, and it is somewhat surprising that such a small place is able to accommodate over 100,000 practitioners. The sharp increase of buyers from mainland China has made the regulatory landscape of Hong Kong's insurance industry more complicated. In 2018, new office premiums in respect of policies issued to Mainland visitors totalled $47.6 billion, accounting for 29.4% of the total new office premiums for individual business. Among these new policies, about 96% were medical or protective in nature, such as critical illness, medical, whole life, term life and annuity products. In terms of premium payment pattern, about 99% of the policies were paid at regular intervals, i.e. non-single premiums.[13] The IFPHK has

[11] Insurance premiums represented 17.94% of GDP in 2017, of which 14.58% were in the life business and 3.36% in the non-life business.
[12] Statistics from the Insurance Authority
[13] From insurance authority website

always stressed that a regulatory framework should deliver measurable benefits to the insurance industry in the medium to long term. It should also enable a healthy and sustainable business environment for the industry to thrive and develop. To preserve the fair competition and diversity of the market, the IA should not only be progressive and adhere to international standards when formulating its supervisory principles and details, but should have an explicit responsibility to strike a balance between regulation and market growth, keeping in mind the difference in business nature and operation model of the various market participants. The Insurance Distribution Directive ("IDD") of the EU introduced minimum regulatory standards for insurance sales. The IDD will apply to both intermediaries and insurers that sell directly to their customers, which means that consumer protection should be the same regardless of the distribution channels.

Questions raised in the Consultation Paper

Chapter 2 - Principle-based approach

The Brokers' Code reflects a principle-based approach. The General Principles, Standards and Practices in the Brokers' Code do not (and cannot) serve as hard coded rules which prescribe the exact actions which a licensed insurance broker must take in every given situation. This would be neither desirable nor possible without removing from the insurance market its capacity to evolve, adapt and innovate i.e. the very dynamics which make it a market. Rather as principles of conduct, the General Principles, Standards and Practices in the Brokers' Code apply universally across every type of licensed insurance broker company (irrespective of size, scale or specialization), across the full range of channels which brokers use to interface with policy holders and potential policy holders and to new business models adopted by brokers as these evolve. This approach seeks to achieve the optimal balance between flexibility and clarity, so as to make the requirements in the Brokers' Code practical as well as substantive. As under the current self-regulatory regime, additional product specific requirements will be imposed through other regulatory instruments that apply in addition to the Brokers' Code (such as in relation to Investment-Linked Assurance Schemes ("ILAS") and Mandatory Provident Fund products).

The draft Brokers' Code sets out eight core General Principles of professional conduct, together with accompanying Standards and Practices, which licensed insurance brokers should adopt when carrying on all regulated activities. These General Principles, Standards and Practices reflect the role performed by licensed insurance broker companies as representatives of policy holders or potential policy holders and reinforce the trust and professionalism that is crucial to the dealings between licensed insurance brokers and the insurance buying public. The Brokers' Code thereby serves as an important policy holder protection measure.

The General Principles and their related Standards and Practices serve to codify in writing minimum norms which have already emerged from the day-to-day functioning of the insurance market, as generally expected minimum standards of professional conduct which every licensed insurance broker must follow. Many of these were already reflected in the self-regulatory regime (including the Minimum Requirements) as concepts which have been established through market practice as fundamental principles of conduct underlying the practice and profession of insurance broking. General Principle 1 – Honesty and Integrity, by way of example, requires that a licensed insurance broker should be trustworthy and act honestly, ethically with integrity and utmost good faith. Utmost good faith remains a sacrosanct tradition of the insurance market and for centuries has served as the foundation of trust on which the profession of insurance broking is based. General Principle 2 - Acting in the Best Interests of Clients and Treating Clients Fairly, also serves as an article of faith for insurance brokers as representatives of buyers of insurance. General Principle 3 – Exercising Care, Skill and Diligence, reflects the standard of care insurance professionals are required to meet as a matter of common law. Consistent with this is General Principle 4 – Competence to Advise. In adopting these fundamental concepts as General Principles, Standards and Practices into the Brokers' Code, the IA recognizes them as "tried and tested" fundamental principles of professional conduct for the practice of insurance broking which should be part of the new direct regulatory regime. They provide continuity with the past and licensed insurance brokers should continue to remain accountable for them as foundational policy holder protection measures.

Question 1:

Do you agree with the proposed principle-based approach of the Brokers' Code and that the General Principles and their related Standards and Practices provide a suitable framework for the conduct of licensed insurance brokers?

<u>IFPHK's Response</u>

We agree with the General Principles approach. Most Codes of Conduct, including that of the IFPHK, are based on general principles, and specific rules are then derived from these general principles. Notwithstanding our general consensus on the General Principles approach, we would like to remind the IA to be cautious of a general shift of other regulators from approaches that are pragmatic and principles-based to approaches that are more rules-based (such as Market Abuse Regulation18 and Markets in Financial Instruments Directive [MiFID II] 19).

In addition, we have some specific comments on the proposed Code of Conduct for the IA to consider:

1. Suitability assessment requirements

Suitability is one of the General Principles in the proposed Code of Conduct. A licensed insurance intermediary 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. Before giving regulated advice, a licensed insurance broker should properly carry out a suitability assessment of the client's objectives, circumstances, needs and priorities. As aforementioned in our submission principles, for the IFPHK and other affiliates of the Financial Planning Standard Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. The process involves gathering relevant financial information, setting life goals, examining a client's current financial status and coming up with a strategy or plan for how clients can meet their goals given their current situation and future plans. Whilst we agree with the suitability principles, **we are wary that by requiring intermediaries to perform suitability assessment, the intermediaries are expected to have a competency level that is beyond what is stated in the proposed Competence Guidelines.**

Since the concept of suitability is the cornerstone of the financial planning industry and the core principle of the six-step financial planning process. In 2006, with contributions from the patrons of leading industry practitioners and experts, the IFPHK published the *IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners to practise in Hong Kong. To supplement this effort, the IFPHK also launched the first Guidance Notes, *Suitability of Advice Obligations: Documenting your Financial Advice* ("Suitability Guidance Notes") for members. The IFPHK therefore is well positioned to understand the needs, concerns and aspirations of the financial planners and advisers who have provided invaluable financial planning and investment advice to their clients. This consultation paper can be an appropriate time to elevate financial advice and financial planning, as well as the profession of being a financial planner.

2. Competence of insurance intermediaries to meet the conduct requirements

Given that insurance is a long-term service, intermediaries should be equipped with financial planning skills and knowledge that enable them to perform a proper analysis of a client's personal profile and offer advice that could meet the client's life goals and achieve their best interest. The IFPHK believes that product and basic investment knowledge alone will be insufficient to fulfill the upcoming demands of personal financial advisory and planning services. With buyers from mainland China accounted for our fourth of all life insurance policies sold, practitioners also need to equip with knowledge of serving cross border clients. Bear in mind that Hong Kong-issued policies are not protected by mainland Chinese law. In consideration of the interest of policy holders, it should be the priority of the IA to specify the body of knowledge required to perform a regulated activity. The IA should also include and increase coverage of financial and retirement planning into the core curriculum and in the examination and continuous professional education program in order to equip the intermediaries with the necessary skills and knowledge to confidently provide related advice that suits customer needs and expectations.

We have provided our feedback to the IA about reforming the regulation examinations. While the regulatory examinations for insurance intermediaries cover many areas relating to the insurance industry, the requirements of suitability, having the client’s best interest and treating clients fairly lead to strong demand for insurance intermediaries to possess financial planning skills, which would also better prepare them for practising in ever so sophisticated financial markets. As early as in 2016, the IFPHK wrote a letter to the OCI captioned “Financial planning skills should be enhanced in the licensing requirements for insurance intermediaries”. We suggest that the OCI conduct a job analysis of insurance intermediaries on a regular basis and to review the licensing examination to ensure practitioners have acquired the necessary level of competence. From the IFPHK’s member sentiments survey in 2017, 67.18% of the respondents supported the proposed policy that financial planning be included in the scope of the licensing examination. **Consistent with our advocacy principles, we urge the IA to set up a roadmap to review and revamp the licensing examination for insurance practitioners.**

Regulators in overseas jurisdictions realize the importance of having qualified and competent financial planners and advisers. As such, they have introduced policy changes to raise the professional standard of the industry, and many of them have achieved it by partnering with professional organizations. The Retail Distribution Review ("RDR") in the United Kingdom has had significant impact on the industry[14]. One of the changes is to require higher minimum entry requirements for front line staff empowered with the important task of providing financial advice to consumers[15]. The Financial Services Authority ("FSA") has approved accredited bodies to help with and verify the gap-fill and provide suitable qualification measures[16]. On 20 June 2012, the Australian Senate passed the Future of Financial Advice ("FoFA") bill in which the regulator requires financial advisers to undertake a "knowledge update review" every three years and new financial advisers have to be supervised for a year by a planner with at least five years' experience. Under the reforms, planners will effectively be forced to join a professional association[17]. The wave of reform has also spread to Asia. The Monetary Authority of Singapore ("MAS") surprised the advisory industry by announcing the launch of FAIR, to strengthen investor protection. The Securities and Exchange Board of India ("SEBI") has issued the final investor adviser regulations. The SEBI requires all advisers to have a post-graduate diploma in a finance-related subject or five years industry experience. The IFPHK expects regulators in Hong Kong to propose similar requirements on becoming attached to professional organizations.

CFP certification is a world-class certification program that tests the abilities, skills and knowledge required to competently perform financial planning tasks. As the world's oldest and most recognized advanced certification program for financial planners. In order to become a CFP certificant, one must fulfill rigorous requirements in education, examination, experience and ethics. The standards and requirements for the international CFP certification programs are based on a global FPSB framework that includes empirical research of the abilities, professional skills and knowledge needed to practice financial planning. To ensure that CFP certification is continuously relevant to the needs of the practitioners, the IFPHK and its worldwide counterparts conduct surveys regularly to understand the job profiles and skills of financial planners.

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[14] Changes under RDR include but are not limited to prohibiting commission payments to intermediaries on advised sales to retail clients, facilitating adviser charging and raising minimum qualifications.

[15] It is important that advisers now press on and achieve an appropriate level 4 RDR qualification and then obtain a Statement of Professional Standing ("SPS").

[16] An affiliate member of FPSB in the UK, is one of the eight accredited bodies.

[17] As long as the associations have their codes of conduct approved by the Australia Securities and Investment Commission ("ASIC"), their members will be exempt from opt-in rules, which require advisers to obtain consent every two years from those clients who pay asset-based percentage fees and wish to remain with their adviser.

3. Responsibility of Senior Management

The SFC has a General Principle of Management Supervision in the Code of Conduct that "the senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm." We understand that management accountability has been stated in Schedule D. With the new regulatory framework, there shall be more emphasis on senior accountability, which may help revolutionize the employment structure of appointed brokers in the current practice. Increased awareness of the supervision responsibilities of senior management is already visible in local and overseas regulators. In December 2016, the Securities and Futures Commission ("SFC") issued a circular to all licensed corporations to introduce measures to heighten the accountability of the senior management of these firms and to promote awareness of senior management obligations under the current regulatory regime. "Senior managers bear primary responsibility for the effective and efficient management of their firms, and they should be well aware of the obligations currently imposed on them as well as their potential liability if they fail to discharge their responsibilities," said Mr. Ashley Alder, the SFC's Chief Executive Officer. "These measures will provide more clarity to the industry and strengthen our licensed firms' governance structures so as to better align with the present responsible officer and regulated persons regime."[18] The IA may take reference to the practice of the SFC to explicitly state senior management responsibility in the General Principles.

The Financial Conduct Authority ("FCA") in the UK recently implemented the Senior Manager and Certification Regime ("SM&CR"). The SM&CR is designed to make senior managers accountable for the actions of their firms. The SM&CR will apply to insurers from 10 December 2018. The applicability will be extended to include brokers on 9 December 2019. The IA may also keep track of such regulatory developments.

4. Care for clients with special needs

Access to financial services, including insurance, is vital for individuals and families to participate in everyday life, and can contribute to financial stability and economic growth. Financial exclusion occurs when consumers are unable or find it difficult to access appropriate financial services. They are left vulnerable to financial crises following unexpected events. The inability to manage the risk caused by the sudden death of a family member, an illness, or the loss of income or property can

[18] SFC press release on 16 December 2016

perpetuate or lead to poverty. Lower-income people often do not have social or financial buffers to help them withstand such shocks. Moreover, as insurance contracts are of a long-term nature, they are appropriate for consumers who may become vulnerable at specific times during their life. The IA may keep abreast of international developments and consider strengthening standards relating to vulnerable consumers. The Code could include a new section on vulnerable consumers. The section would begin with a statement acknowledging the diverse needs of vulnerable people and committing to supporting the particular needs of customers where these are identified.

In view of the fast-ageing population, the vulnerability of senior investors poses challenges to global regulators. Indeed, it has also been a theme advocated by the IOSCO. While there are laws, regulations and programmes in place to protect seniors from accessing certain financial services, in most cases, the laws, regulations and programs are designed to protect all investors, not just seniors. The IFPHK and the other affiliates of the FPSB believe that seniors would benefit most if regulators and professional bodies encouraged policies that support the delivery of financial advice to seniors under a client first/best interest duty. With increased access to retirement planning products like annuities, it is absolutely important that practitioners have the competencies and knowledge to explain these products to their clients, who are mostly senior investors. The current licensing examinations do not have sufficient coverage on financial planning, retirement planning and/or retirement products. To meet the demand, it is worth it to consider whether licensing examinations should be reformed.

In Hong Kong, the MPFA also requires registered intermediaries to provide "extra care" to clients with special needs ("vulnerable clients"). A vulnerable client is defined in the Guidelines as "a person who is not, or may not be able to fully understand the type of information to be provided and discussed, or may not be able to make that key decision." A key decision is defined as "one which is discretionary and could have potentially materially detrimental impacts on the client."

Chapter 2 - Principles of "treating clients fairly"

A core theme running through the entirety of the Brokers' Code is that of "treating clients fairly". This theme touches upon each General Principle, Standard and Practice in the Brokers' Code and serves as a fundamental objective which licensed insurance brokers should always meet in carrying on their regulated activities. Treating clients fairly reflects the fact that, as licensed insurance brokers serve as the representatives of their clients, it is the clients who should always be at the forefront of a licensed insurance broker's considerations.

Question 2:

Do you agree that the objective of "treating clients fairly" is fundamental to the regulated activities of a licensed insurance broker?

IFPHK's Response

The financial crisis witnessed a globally coordinated response to build a more robust and stable financial system. In the past 10-plus years, there has been a growth of principles-based approaches that emphasize governance, culture, and management supervisions in both prudential and conduct matters. With the incorporation of an independent IA, it is sensible to have a shift in regulatory focus from solvency regulation to market conduct regulation, which we believe is the right approach to advance consumer protection. We consider the "treating clients fairly" ("TCF") principle as central to an overall framework, and the general principles in the Code are all part of the ecosystem of the TCF framework. Also, treating clients fairly shall be a regulatory framework that applies consistently across the financial services industry. We urge the IA to recognize the critical role of advisors and planners in the TCF regulatory framework, as they are usually the consumer's only direct touch point with the entire financial services sector.

The UK is the pioneer in adopting the TCF framework. TCF obligations in the UK are principles-based and coupled with other conduct business rules. The FCA's conduct of business regulations is the principle that a firm must consistently pay due regard to the interest of its customers and treat them fairly. Senior management bears chief responsibility for delivering TCF outcomes and getting this wrong should subject the management to disciplinary actions. Other key TCF developments globally include the Future of Financial Advice in Australia, the Consumer Protection Framework in Canada, and the MiFID II of the EU to improve transparency and the management of conflicts of interest. In Hong Kong, the HKMA released the Treat Customers Fairly Charter in October 2013. Insurance practitioners shall also be familiar with TCF principles. The OCI released GN15 & GN16 in 2014 and 2015, which contain the principle of Treating Customers Fairly.

Under the TCF principles is the regulators' desire to cultivate a consumer-focused business culture that goes beyond strict legal requirements. It is envisaged that TCF should be embedded in the DNA of the company. To enhance ethics and compliance culture of practitioners, we suggest that the IA encourage intermediaries to become attached to a professional association. Members of professional associations voluntarily agree to adhere to a Code of Ethics and Professional Conduct, and professionals adhere to higher ethical and professional standards. For example, FPSB, of which the IFPHK is an affiliate, has developed duty of care principles to guide the activities and behavior of financial planners with clients during financial planning engagements. The principles require financial planners to behave like a fiduciary that places the interest of the client first, at all times acting honestly and in utmost good faith. We view the relationship between a financial planner and a client as one of trust, requiring confidence on the part of the client that the financial planner is exercising his or her discretion or expertise for the benefit of the client. The financial planner owes the client a duty of care consistent with that of a fiduciary, regardless of employment arrangement, and provides advice and product recommendations that are suitable for the client. Also, the financial planners must act in accordance with professional expectations. A financial planner meets professional conduct and ethical standards, developed and enforced by his or her professional or certification body. In addition to demonstrating ethical judgment, intellectual honesty and impartiality, the financial planner recognizes the public interest role of the professional and acts accordingly.[19] Hence, financial planners and more specifically CFP certificants are already required to follow high ethical standards, as well as duty of care to clients.

The first principle of IFPHK's Code of Ethics and Professional Responsibility is also Best Interest of the Client. In fact, it is suggested by FPSB, clients shall come first. FPSB suggests that placing the client's interests first is a hallmark of professionalism, requiring the financial planning professional to act honestly and not place personal gain or advantage before the client's interests.

Regulators in elsewhere increasing concerned of the conduct of insurance broker. In the press release published in April this year, the FCA warned GI firms about manufacturing, sales and distribution approaches that can lead to customers purchasing inappropriate products, paying excessive prices or receiving poor service. The recently implemented Insurance Distribution Directive requires that all firms in the GI distribution chain act in accordance with the best interests of the customer. The recently implemented Senior Manager and Certification Regime are

[19] FPSB, Financial Planner Duty of Care to Clients, 2014

designed to make Senior Managers accountable for the actions of their firms. The FCA is warning the industry that it will not hesitate to intervene with both firms and their senior managers on these bases where it sees a failure to have appropriate regard to the value their ultimate customers receive. The report highlights how the remuneration of all the parties in the distribution chain can result in customers paying significantly higher prices than the production and delivery costs of the products they are buying.[20]

<u>Chapter 2 – Disclosure requirements</u>

Several of the General Principles, Standards and Practices focus on the minimum disclosure which licensed insurance brokers should make to their clients (being policy holders and potential policy holders). Disclosure requirements are an important part of any regulatory framework as they step in to address matters which the market dynamic cannot self-correct, such as asymmetries of information and knowledge on insurance products as between licensed insurance brokers and clients.

General Principle 5 - Disclosure focuses on the disclosures which a licensed insurance broker should make to the client in relation to the brokers' identity, role and the insurance products being recommended. General Principle 6 - Suitability focuses on the suitability assessment the licensed insurance broker should carry out in order to recommend an insurance product that will meet the client's objectives, circumstances, needs and priorities. Broadly, these General Principles, Standards and Practices aim to ensure a licensed insurance broker provides sufficient information (and obtains sufficient information from the client before making a recommendation to a client) so that the client can make an informed decision on their insurance purchases and understand their obligations as a policy holder.

General Principle 7 – Conflicts of Interest requires a licensed insurance broker to avoid conflicts of interests or manage them with appropriate disclosure should they arise to ensure the client is treated fairly at all times. Licensed insurance broker companies act for policy holders and potential policy holders, but are (often) remunerated by insurers by way of commission. As under the self-regulatory regime, therefore, the Standards and Practices under General Principle 7 require a licensed insurance broker company which receives remuneration in this form, to give adequate disclosure in relation to their remuneration to its client.

[20] Financial Conduct Authority, thematic Review, General insurance distribution chain, April 2019

Question 3:

Do you agree that providing clients with adequate disclosure so that they can make informed decisions on their insurance purchases is an important principle to include in the Brokers' Code?

IFPHK's Response

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. As financial products get more complex and sophisticated, it is of utmost importance that investors/consumers are provided with proper and adequate protection under a sound and effective regulatory system.

A financial planning professional shall take all reasonable steps to ensure the client understands the financial planning recommendation(s) to allow the client to make informed decisions.

FPSB has developed Financial Planner Duty of Care to Clients, which guides the activities and behavior of financial planners with clients during financial planning engagements. The Principles include provide full and appropriate disclosure. A financial planner discloses all relevant facts to the client, initially and on an ongoing basis. Financial planners' disclosures shall include an accurate and understandable description of the compensation arrangements (further discussed in Question 4), and a summary of conflicts of interest between the client and the financial planner. The disclosures shall also include any information about the financial planner or the financial planner's employer that could reasonably be expected to materially affect the client's decision to engage the financial planner's services, and any information that the client might reasonably want to know in establishing the scope and nature of the relationship, including information about the financial planner's areas of expertise.

Question 4:

Do you agree that disclosure is an important mechanism for licensed insurance brokers to manage potential conflicts of interests and that standards regarding the disclosure an insurance broker should make in this respect, should be included in the Brokers' Code?

<u>IFPHK's Response</u>

The IFPHK considers that the most effective way to minimize conflicts of interest of brokers is to regulate remuneration, which can be in the way of disclosure or setting a cap (for example, the NYDPS has adopted new regulations to limit premium increases for in-force life insurance policies). We have certain comments on remuneration disclosure as follows:

Remuneration arrangements and disclosure

Remuneration arrangements are very crucial to the compliance of several General Principles, which include but are not limited to General Principle 2 – Acting Fairly and in Accordance with the Client's Best Interests and General Principle 7 – Conflicts of Interest. We understand that there is strong resistance from the industry with respect to changing remuneration practices and disclosing remuneration and commissions. The focus on compensation and remuneration continues to be a significant area of attention for regulators. The FSB is planning to release recommendations on how firms can enhance their capacity to consider and monitor the effectiveness of compensation tools. The FSB's recommendations are also expected to highlight mechanisms for promoting good conduct and addressing misconduct risk. In Australia, the Banking Royal Commission reviewed a number of financial services institutions and identified remuneration as one of the root causes of misconduct.[21] In order to align with international practice, the IA should consider a reform on remuneration. The IFPHK thinks that the conflict of interest in remuneration practice and arrangement are the major obstacles in modernizing the regulatory regime of the insurance industry in Hong Kong. The IA can take reference from the practice of the FCA.

The FCA Insurance: Code of Business says, "Firms are reminded of their obligations in SYSC 19F.2 to ensure remuneration arrangements do not conflict with their duty to act in the customer's best interests." The followings are extracted from FCA's Code:

[21] Deloitte, Leading in times of change, Insurance Regulatory outlook 2019, United States, December 2018

a) Remuneration disclosure

In good time, before the conclusion of a contract of insurance, an insurance undertaker must provide its customer with information on the nature of the remuneration received by its employees in relation to the contract of insurance. This information should include the nature of the remuneration received in relation to the contract of insurance, whether the contracts are on the basis of a fee or a commission or any other type of remuneration, including an economic benefit of any kind offered or given in connection with the contract. When considering what information to provide about the remuneration, a firm should include all remuneration that the insurance intermediary or the employee of an insurance undertaking receives, or may receive in relation to the distribution of the contract of insurance. This includes remuneration provided indirectly by the insurer or another firm within the distribution chain; or provided by way of a bonus (whether financial or non-financial).

b) Commission disclosure

(1) An insurance intermediary must, on a commercial customer's request, promptly disclose the commission that it and any associate receives in connection with a policy.

(2) Disclosure must be in cash terms (estimated, if necessary) and in writing or another durable medium. To the extent this is not possible, the firm must give the basis for calculation.[22]

An insurance intermediary should include all forms of remuneration from any arrangements it may have. This includes arrangements for sharing profits, for payments relating to the volume of sales, and for payments from premium finance companies in connection with arranging finance.

The IFPHK’s Rules of Conduct also provides best practice to financial planners. It suggests a financial planning professional shall disclose the following information in writing to the client: Details of the requirements

a. An accurate and understandable description of the compensation arrangements being offered. This description must include information related to costs to the client and general form and source of compensation to the financial planning professional and/or the financial planning professional’s employer; and terms under which the financial planning professional and/or the financial planning professional’s employer may receive any other sources of compensation, and if so, what the

[22] Extracted from the FCA Insurance: Code of Business

sources of these payments are and on what they are based;

Hong Kong is behind the curve in terms of disclosing and developing remuneration that minimizes conflicts of interest. We consider that a reform on remuneration arrangements and disclosure is necessary in order to modernize the regulatory framework of the insurance industry in Hong Kong.

<u>Chapter 2 – Client Agreement</u>

The Brokers' Code also sets certain basic minimum requirements on certain obvious issues which are important to the relationship between a licensed insurance broker company and its clients. For example, the Standard and Practice in 5.4 under General Principle 5 of the Brokers' Code sets a requirement for a licensed insurance broker to enter into a written agreement with each client (with the minimum requirements regarding the matters such agreement should cover). This is considered a matter of basic good practice for all licensed insurance broker companies.

Question 5

Do you agree that it is good practice for licensed insurance broker companies to enter into written agreements with their clients and that the Brokers' Code should provide for this requirement?

<u>IFPHK's Response</u>

The financial planning professional and the client shall mutually agree upon the services to be provided by the financial planning professional. The IFPHK's Rules of Conduct provides best practice to financial planners. They suggest that a financial planning professional shall disclose the following information in writing to the client: Details of the requirements extracted as follows:

b. A general summary of likely conflicts of interest between the client and the financial planning professional, the financial planning professional's employer or any affiliates or third parties, including, but not limited to, information about any familial, contractual or agency relationship of the financial planning professional or the financial planning professional's employer that has a potential to materially affect the relationship with the client;

c. Any information about the financial planning professional and the financial planning professional's employer that could reasonably be expected to materially affect the client's decision to engage with the financial planning professional;

d. Any information that the client might reasonably want to know in establishing the scope and nature of the relationship, including but not limited to information about the financial planning professional's areas of expertise; and

The Rules of Conduct of the IFPHK also state that if the services include financial planning or material elements of the financial planning process, prior to entering into an agreement, the financial planning professional shall provide written information and/or discuss with the client the following:

a. The obligations and responsibilities of each party under the agreement with respect to defining the client's objectives, needs and priorities; gathering and providing appropriate data; examining the result of the client's current course(s) of action without changes; the formulation of any recommended actions; implementation responsibilities for the financial planning recommendations; and responsibilities for reviewing the financial planning recommendations;

b. Compensation that any party to the agreement or any affiliate to a party to the agreement will or could receive under the terms of the agreements; and factors or terms that determine costs to the client, how decisions benefit the financial planning professional and the relative benefit to the financial planning professional;

c. Terms under which the financial planning professional will utilize proprietary products;

d. Terms under which the financial planning professional will use other entities/professionals to meet any of the agreement's obligations;

e. The process for terminating the relationship; and

f. Procedures for resolution of client claims and complaints against the financial planning professional. [23]

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[23] Extracted from IFPHK's Code of Ethics and Professional Responsibilities

Consistent with the scope of the engagement, a financial planning professional shall undertake a reasonable investigation of products and services to be recommended to clients. A financial planning professional may rely upon an investigation undertaken by a third party provided it is reasonable to place reliance on the quality of such investigation.

Chapter 2 - Governance

Part D of the Brokers' Code is related to new section 92(1) of the Ordinance (**SCHEDULE 1**) and is applicable to licensed insurance broker companies. Part D provides guidance on the corporate governance, controls and procedures which companies should establish and implement to ensure the General Principles, Standards and Practices in the Brokers' Code are met by the company and the licensed technical representatives (broker) appointed by the company.

In short, a licensed insurance broker company should establish and implement an organizational structure which includes adequate controls to ensure the interests of clients are not prejudiced, clear roles and lines of responsibility as well as accountability of its senior management which underpins the objective of fair treatment of the clients. The responsible officer and the senior management who oversee the regulated activities carried on by the company are accountable for ensuring such controls and procedures are in place and effective (indeed it is this level of management which sets the appropriate corporate governance culture for the company to ensure, for example, that the core principle of treating clients fairly is at the heart of company's operation). The extent of the requirements for the corporate governance framework on the company will depend on the nature, size and complexity of the business of the company as well as the medium it uses for solicitation of business and the types of insurance it arranges. The objective of good corporate governance, however, namely to ensure the interests of the clients are not prejudiced and that clients are treated fairly, remains the same across all licensed insurance broker companies.

Part D requirements are in addition to other governance requirements set out in any applicable codes and guidelines, including the "Guideline on "Fit and Proper" Criteria for Licensed Insurance Intermediaries under the Insurance Ordinance (Cap. 41)".

Question 6

Do you agree that the Brokers' Code should set out requirements for the governance, controls and procedures that a licensed insurance broker company should adopt (as per Part D of the Brokers' Code)? Do you agree that licensed insurance broker companies should follow such requirements to ensure the General Principles, Standards and Practices in the Brokers' Code are complied with by the companies and their appointed licensed technical representatives (broker)?

IFPHK's Response

Part D of the draft Code only contains three pages. It may not have the necessary details to guide the insurance intermediaries to fulfill the requirements under the Code of Conduct. Some key internal control areas are not covered in Part D, for instance, performance management, segregation of duties, risk management, information security, etc.

Joining Financial Dispute Resolution Centre

The Lehman Brothers Mini-Bond issue reflects the lack of dispute resolution services available in Hong Kong, especially one that facilitates a fast-track process to settle complaints. Regarding demands for mediation or arbitration, the Government established a Financial Dispute Resolution Centre ("FDRC") in 2012 as an alternative to costly and protracted litigation. It was established to ensure an effective process was available for resolving monetary disputes between an investor and a financial institution in a speedy, affordable, independent and impartial way. All licensed or registered persons regulated by the SFC or the HKMA are required to comply with the FDRC Scheme ("FDRS") and be bound by its processes. The primary regulatory objective remains that licensed and registered persons should seek to resolve complaints internally. If a complaint or dispute fails to be resolved internally, a licensed or registered person should inform clients of the right to make a complaint to the FDRC. Since the FDRC does not cover insurance intermediaries, consumers who seek advice on insurance products need to go through different complaint procedures depending through which distribution channels these products are sold. Such inconsistencies will be inconvenient and confusing to consumers. We understand that it is the insurance industry's preference not to join the FDRC. To better protect investors and ensure consistent consumer experiences, the IIA as the only insurance regulator might consider joining the FDRC and extending the scope of the FDRC to insurance sales and marketing activities.