Update on the latest regulatory requirements for selling of Protection Linked Plan ("PLP")

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Introduction

In order to align the regulatory requirements on investment-linked assurance scheme ("ILAS") with those of the Securities and Futures Commission ("SFC"), the Insurance Authority ("IA"), the Hong Kong Monetary Authority ("HKMA") have recently published a circular to provide guidance to authorized institutions ("AIs") on the selling of Protection Linked Plan ("PLP") to enhance customer protection.

AIs which engage in the selling of PLP are required to establish sufficient policies, procedures, controls and monitoring to ensure suitability of selling this product. AIs are also recommended by the HKMA to engage an independent party to perform pre-implementation reviews on the AI's readiness before engaging in selling of PLP.

This publication summarises the key requirements from the HKMA on the selling of PLP, from product due diligence, suitability assessment, product recommendation and disclosure, to audio recording, protection of vulnerable customers and management oversight, and outlines how our financial advisory service offerings can assist you in complying with the latest requirements.

Summary of guidance

Background

ILAS is a bundled insurance product carrying both investment and insurance features with death benefits. Traditional ILAS products, such as Pure 105, provide death benefits equals to 105 percent of the policy value, which is correlated to the performance of the underlying investments given its investment-cum-insurance feature.

In an attempt to narrow protection gap, facilitate financial inclusion and encourage early retirement planning of the underserved younger generation, the insurance industry players designed a new category of ILAS product named PLP which has specific features on death benefits, fees and charges, optional protection features and investment choices.

Given the above features and to strengthen customer protection, the HKMA sets out the requirements for selling of PLP. The key requirements of the HKMA are summarised as follows:

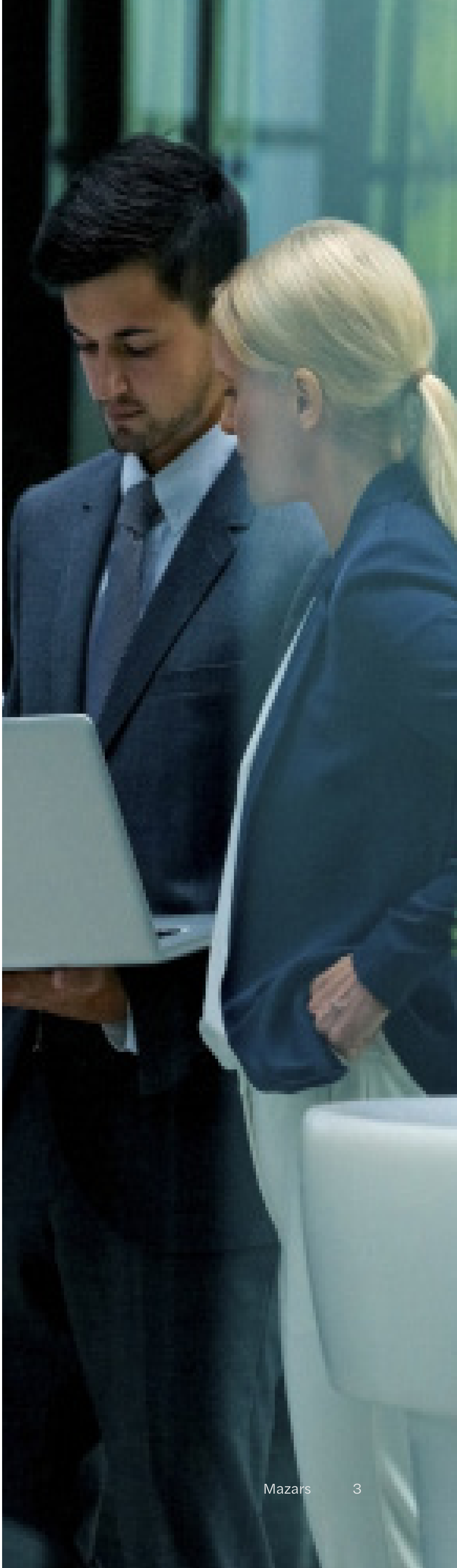
A. Product due diligence (“PDD”)

Before launching a new PLP, AIs should adequately conduct their own PDD by considering:

- natures, features and risks of the PLP and its unxderlying investment options;
- product risk ratings assigned to the underlying investment options;
- credibility and capability of the insurer;
- factors that may have an impact on the risk and benefit profile of the PLP; and
- whether the underlying investment option is linked to a derivative fund.

After identifying the target customer group for the PLP, AIs need to consider the premium payment period, surrender charge period and assessment on comparable payment to match the customers’ appropriate expected holding period of the PLP.

AIs should conduct PDD on a continuous basis with the involvement of their independent risk management functions.



B. Suitability Assessment and product recommendations

Before recommending a PLP to a new customer, AIs should seek to obtain sufficient information about the customer's circumstances and conduct suitability assessment by completing Financial Needs Analysis ("**FNA**"), the Risk Profile Questionnaire ("**RPQ**") and following other relevant regulatory requirements. AIs should also request the customer to state his/her considerations for procuring PLP in the "Statement of Purpose" paragraph of the Important Facts Statement and Applicant's Declarations ("**IFS-AD**") for assessing the suitability of the PLP for the customer.

Where conflicting answers are given by a customer in the "Statement of Purpose" paragraph of IFS-AD, FNA and/or RPQ, AIs should seek clarifications from the customer and properly document the justifications/reasons provided by the customer.

In general, PLP is considered not suitable if:

- high level of protection is not applicable to a customer at the inception and throughout the entire premium payment period of the PLP;
- the period of high level of protection offered by the PLP is shorter than the target period for high level of protection of a customer;
- the customer
  - has low insurance protection need;
  - does not have dual objective of insurance and investment;
  - is not able and willing to make own decision to choose or manage different underlying investment options under an insurance product;
  - indicate that he/she does not need and want insurance/ investment products; or
  - has a preferred investment horizon shorter than expected PLP holding period.

Furthermore, AIs should consider the customer's affordability, liquidity need, retirement plan and concentration risk in the suitability assessment.

C. Product disclosures

At the point-of-sale, AIs should provide all the relevant product documents, such as product brochure, investment choice brochure, Product Key Facts Statement , IFS-AD, illustration documents including the Supplementary Sheet of the Benefit Illustration Statement in the customer's preferred language and refer to those documents to disclose and explain the details of the PLP to the customer.

Such disclosure and explanation should include:

- product nature,
- tenor,
- investment options and risks,
- credit risk,
- premium payment and policy loan,
- fees and charges,
- insurance protection and surrender value,
- early termination risk,
- intermediaries' remuneration,
- IFS-AD, and
- pros and cons of the PLP compared with direct investment in the underlying funds and life insurance policy separately.

Summary of guidance

D. Audio recording and record maintenance

For retail banking customers, AIs should audio record the selling process of PLP and adequately maintain the audio record to illustrate that the selling process has been appropriately performed. Non-face-to-face distribution channel should not be adopted if audio recording is not practical. For non-retail banking customers, AIs should maintain proper audit trail for the same propose.

The audio record should at least cover the following:

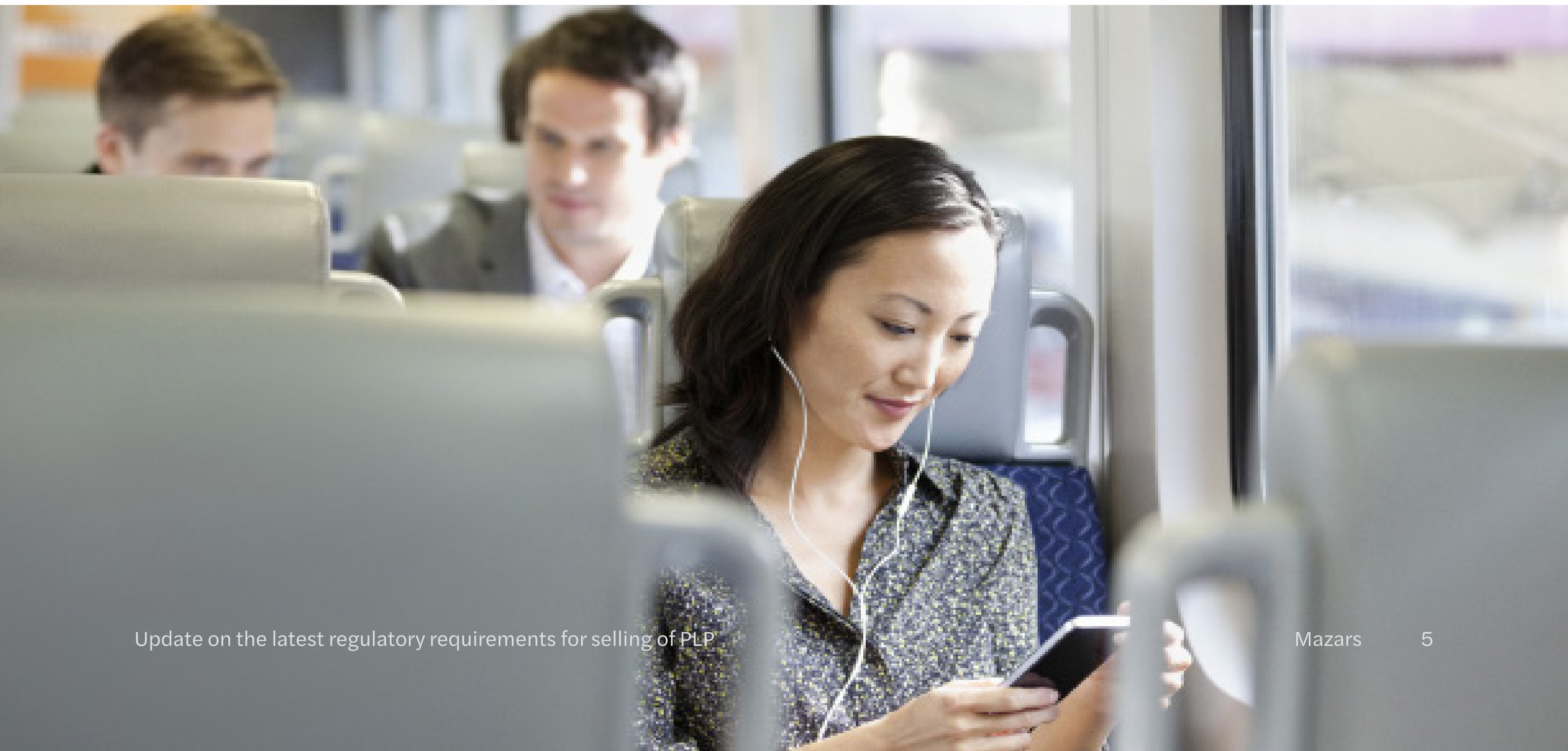
- customer risk profiling;
- suitability assessment and product recommendation;
- disclosure of product nature, features and risks;
- steps taken to ascertain whether the customer is purchasing the PLP policy as a policy replacement;
- explanation and completion of applicable important facts statements;
- comparison of PLP against direct investment in the underlying fund(s) of the underlying investment options and taking out a life insurance policy separately;
- disclosure of the maximum level of remuneration receivable by the AI if the customer directly invests in the underlying fund(s) of the underlying investment option(s) through the AI;
- switching transactions involving solicitation/recommendation; and
- transactions involving top-up investments.

E. Management oversight

The sale of PLP should be under adequate management oversight of the AIs and appropriate management information system should be established. Independent units, e.g. compliance function, of the AI should regularly monitor and review the high risk areas and exceptions of the selling practices.

F. Vulnerable customers ("VCs")

Extra care should be exercised during the selling process of PLP to VCs. Vetting of audio records of the selling process should be arranged and conducted by staff not responsible for the sale of PLP no later than the expiry of the cooling-off period. Irregularity found during the vetting process should be followed up swiftly with essential remedial actions.



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At Mazars, we have extensive experience working with the diversity of financial services players. We assist major financial institutions including brokerage houses, asset managers, investment and corporate banks, retail and private banks, central banks, and national regulators in dealing with business and regulatory issues with impacts, domestic and international.

Mazars is here to assist you in complying with the operational resilience standards and required implementation measures. Depending on the scope, coverage and specifics of your needs, our services would typically involve one or more of the following:

How can Mazars help?

A. Regulatory reviews and advice	
I.	Review and provide compliance advisory on your firm's ▪ policies and procedures, ▪ processes and controls, and/or ▪ governance and supervision.
II.	Provide observations and recommendations to assist you in complying with the regulatory requirements and expectations, as well as common industry practice.
III.	Provide pre-inspection advice or review.

B. Design and implementation of policies and procedures	
I.	Provide advice/ assistance in designing and implementing enhancements to the compliance manual, including governance framework, selling practices as well as risk disclosure procedures for PLP.

C. Training and insights	
I.	Provide training and education for staff, the board, senior management and compliance team for the regulatory requirements on the selling of PLP.
II.	Provide ongoing insights into how peer firms are dealing with the regulatory requirements of the selling of PLP and any common challenges encountered along the way.

We also take on special projects and ad-hoc mandates. We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

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