



# Investment-linked insurance contracts in China and Hong Kong

FINANCIAL SERVICES MARKET DEVELOPMENTS

Recent developments in the regulation of sales of investment-linked insurance in China and Hong Kong are designed to enlighten investors about the risks involved in such investments. This briefing looks at those developments and discusses what effect these may have on this market in the future.

Regulators in both China and Hong Kong have taken steps to strengthen the regulation of sales of investment-linked insurance, with the aim of ensuring that investors are aware of key risks and that products are appropriately aligned with the risk profile of individual investors. There have been concerns that retail investors may not be fully aware of, or accurately understand the risks involved with, the manner in which their contributions will ultimately be invested.

In this briefing we examine the regulatory regime for investment-linked insurance contracts in both China and Hong Kong, in light of these recent developments.

## The PRC regulatory regime

The China Insurance Regulatory Commission (CIRC) published a circular (effective 15 March 2009) that attempts to enhance risk control and strengthen the management of investment-linked insurance sales (the 2009 Circular). Key features for insurance companies and agent banks include the following:

- Agent banks may only sell investment-linked insurance products through wealth management counters (as opposed to ordinary deposit counters) and must now ensure that its sales staff meet more stringent qualification requirements. Additionally, the agent bank must allow individual policyholders more time for consultation and consideration before making their purchase.
- Sales personnel must undergo at least 40 hours of specific training, and the relevant training materials must be submitted to the CIRC.

- In addition to the existing requirement of having at least 12 months' experience of selling life insurance products, sales personnel must also pass the requisite examinations and obtain qualification certificates.
- All insurance companies must establish comprehensive risk assessment systems, which will be used to assess the appropriateness of each retail investor for the products being recommended to them. Factors to be considered during the risk assessment include an analysis of the investor's financial position, investment experience, investment purpose, awareness of relevant risks and capacity to withstand the risks. Where the risk assessment concludes that a product is not suitable for an investor, but the investor insists on purchasing the product regardless, an insurance company must now fully document its opinion (and any other matters to be clarified).
- All insurance companies must now undertake a compliance inspection and assess all the investment-linked insurance sales performed by their agent banks at least once every six months.
- Each policy issued to a new customer is now subject to a requirement for the payment of a premium of RMB30,000. This requirement reflects the CIRC's goal of limiting investment opportunities in investment-linked insurance contracts to middle and high income PRC citizens (those with stable financial background and perhaps an enhanced risk appetite).

The CIRC has been developing its regulatory strategy for investment-linked insurance contracts since 2000, when it first published a set of investment-linked

insurance regulations. These regulations set out the general qualification requirements for sales staff of insurance companies providing investment-linked insurance contracts, along with the insurance companies' disclosure and reporting obligations in relation to such products. Regulations governing the activities of agency banks when promoting investment-linked insurance contracts were published in 2003 and 2004.

Nevertheless, despite the CIRC's long-term regulatory strategy, areas of significant under-regulation in the PRC's investment-linked insurance sector have remained in relation to:

- the assessment of policyholders' suitability for investment-linked insurance contracts; and
- the level of professional expertise required for sales personnel of both insurance companies and agent banks.

This perceived under-regulation has, over time, become a major cause of concern for retail investors, who have been at risk of mis-selling by inexperienced or unscrupulous sales personnel. In response, the CIRC has previously attempted to reinvigorate its regulatory presence in the sector. An August 2007 circular reiterated insurance companies' obligations in relation to staff training and information disclosure, but did not seem to adequately address retail investors' concerns. Consequently, and in conjunction with fluctuating market conditions, retail investor appetite in the PRC has seen large-scale withdrawal from investment-linked insurance contracts.

The 2009 Circular has placed a renewed emphasis on regulation, with a greater shift towards retail investor protection. The CIRC's new regulatory strategy is designed to rebuild public confidence in these products, and has been welcomed by most PRC insurance industry participants. As such, this revised regulatory approach is likely to be strengthened in the near future, meaning that industry participants face the likely prospect of tighter regulation and stronger sanctions for non-compliance.

## The Hong Kong regulatory regime

The investment-linked insurance market in Hong Kong has been impacted by the current global economic crisis. Major insurers report that customers have moved

away, at least in the short term, from investment-linked insurance products and instead are demonstrating a more conservative investment appetite focused on non-linked insurance products.

That said, the Hong Kong financial services market has been active for some time and the regulatory approach in Hong Kong in respect of investment-linked insurance products has focused on two key areas:

- adequate and clear disclosure of key risks to ensure that investors understand the product; and
- ensuring that the product matches the risk profile and investment objectives of the investor.

The Hong Kong Securities and Futures Commission (the SFC) has released several circulars highlighting the requirement for adequate and prominent risk disclosure, and clear, fair and balanced marketing materials. Consequently, an issuer of an investment-linked assurance scheme (as investment-linked insurance contracts are known in Hong Kong) must provide sufficient information to enable retail investors to make an informed judgement of the product.

Intermediaries who advise on investment-linked assurance schemes must understand the products they recommend, and always consider the suitability of a product for an investor, so that the risk return profile of each product is matched with the personal circumstances of the investor to whom it is recommended.

The SFC has reinforced these obligations, releasing a circular on 23 February 2009, requiring that all intermediaries undertake formal self-examinations, so as to ensure that appropriate controls and procedures are in place in order to guarantee that all relevant suitability obligations are fulfilled.

There is also a renewed focus on ensuring all marketing materials and offer documents for various financial products, including investment-linked assurance schemes, present a balanced and accurate product summary. As such, an insurance company must ensure that:

- principal risks are prominently disclosed, technical jargon is excluded and risk disclosures are written in plain language;
- key product features and risks must be summarised for investors upfront, and presented prominently in a few key bullets – stating what the product is, what it does and the worst-case scenarios;

- any presentation of benefits, returns and risks of the product must be fair, balanced and proportionate; and
- investors must be encouraged to undertake a proper consideration of the product – financial or other incentives must not be used or presented in manner likely to divert or mislead investors' focus.

Insurance companies must ensure that all of their investment-linked assurance scheme marketing materials comply with the SFC's Revised Advertising Guidelines (published in June 2008) and are approved by the SFC. These guidelines impose stringent requirements regarding historical performance information, disclosure of the name of the issuer to enhance transparency and disclosure of special risks pertaining to the product.

These requirements are applicable to all issuers of investment-linked assurance schemes to the public in Hong Kong, and all new marketing materials distributed after 1 January 2009 must conform. Pre-existing marketing materials must have been conformed to the Revised Advertising Guidelines by 1 April 2009.

## Outlook

Although different approaches have been taken to regulation of investment-linked insurance contracts in the PRC and Hong Kong, it is clear that regulators are increasingly focusing on strengthening investor protection, in order to ensure that retail investors fully comprehend the complexity of these financial products, and are adequately protected.

This, in turn, is causing a shift in the manner in which insurance companies, and agent banks, must operate their businesses. The heightened focus on staff training, marketing, sales, and administration of investment-linked insurance contracts means that some industry participants may need to implement wholesale alterations to their operations. Failure to do so will result in both regulatory censure and continued investor withdrawal from the sector.

The increased regulation of the investment-linked insurance contracts sector may potentially mark a watershed in the nature of PRC financial services regulation. As global investment markets become more stable, and investors look to investment-linked insurance products once more, and as the PRC financial

services market matures, and more complex structured products are introduced, Chinese regulators have the opportunity to extend and widely implement the investor-focused approach that is becoming increasingly evident in the global regulation of investment-linked insurance contracts.

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