STUDY GUIDE

ASHK Examinations

June 2018 Edition

CORE

- *Roles and responsibilities of main regulators supervising the financial services industry*
- *Roles and responsibilities of main industry bodies*
- *Statutory reserved roles for actuaries*
- *Risk management responsibilities for actuaries*

ACTUARIAL SOCIETY of HONG KONG
香港精算學會

3.1 Core

As a major international financial centre, it is important that Hong Kong operates under an effective and transparent regulatory framework. This is to ensure that the interests of local and international investors would be safeguarded.

The Core section of the study guides introduces candidates to Hong Kong's regulatory framework and other areas of the financial services industry that are relevant to actuaries practising in Hong Kong. This study guide intends to assist candidates in preparing for the Core Examination by outlining the knowledge concerning the regulatory framework and market environment of the financial services in Hong Kong. For more details of each topic covered, candidates may refer to the reference readings listed at the syllabus.

Specific regulations and tax considerations relevant to each area of practice would be discussed in more details in the practice-specific sections of the study guides.

3.1.1 Roles and responsibilities of main statutory bodies regulating the financial services industry

The Hong Kong financial services industry comprises a network of financial institutions which offer a wide range of financial services and products to customers and investors local and abroad.

Depending on the nature of the services and products, different government authorities are responsible for their regulation and monitoring. In addition, these government authorities are responsible for improving the financial literacy of the public through financial education and encouraging the development of Hong Kong's financial services industry.

It is important that an actuary becomes familiar with these regulators. Regulatory agencies which are most relevant to an actuary's day-to-day work are introduced below:

Insurance Authority ("IA")

Prior to 26 June 2017, the Office of the Commissioner of Insurance ("OCI") was the regulator responsible for protecting the interests of policyholders and promoting the general stability of the insurance industry. The OCI's duties included the review of licence application for new insurers, insurance market supervision and insurance statistics publication.

To enhance the insurance regulatory system, the independent Insurance Authority ("IA") was established to formally take over the OCI on 26 June 2017. Under the new regulatory regime, there would be an expanded scope of regulatory oversight over insurance companies. In addition to the OCI's responsibilities, the IA would also take over the regulation of insurance intermediaries from the three existing self-regulatory organisations ("SROs") (described further in a later section), putting in place a more holistic and effective insurance regulatory system. The Government would continue to collaborate with the IA to ensure a smooth transition to the new regime.

Hong Kong Monetary Authority ("HKMA")

The Hong Kong Monetary Authority ("HKMA") is responsible for maintaining the stability of the overall economy, with duties including the maintenance of currency stability, the promotion of the safety and stability of the banking system through banking supervision, and the promotion of the efficiency, integrity and development of the financial system.

Mandatory Provident Fund Authority ("MPFA")

The Monetary Provident Fund Schemes Authority ("MPFA") is a statutory body set up to oversee the regulation and supervision of privately managed mandatory provident fund ("MPF") schemes and occupational retirement ("ORSO") schemes. The MPFA is responsible for the monitoring of legislative compliance, regulation of sales, marketing activities and advisory services, approval of qualified parties as trustees of registered schemes, MPF scheme registration, and setting rules and guidelines for the payment of mandatory contributions.

Securities & Futures Commission ("SFC")

The Securities and Futures Commission of Hong Kong ("SFC") regulates Hong Kong's securities and futures markets. It maintains and promotes the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry, and offers protection and education to the public investing in financial products.

The SFC oversees financial intermediaries in investment-related fields (e.g. brokers, fund managers), investment products, listed companies, Hong Kong Exchange and Clearing Limited ("HKEx"), automated trading service ("ATS") providers, approved share registrars, Investor Compensation Company Limited ("ICC") and other market participants.

Other useful links for this section are listed below for additional background information:

- Office of the Commissioner of Insurance (OCI) - http://www.oci.gov.hk/about/index03.html *(the OCI's website replaced by the IA's website below)*
- Insurance Authority (IA) - https://www.ia.org.hk/en/index.html
- Hong Kong Monetary Authority (HKMA) - http://www.hkma.gov.hk/eng/index.shtml
- Monetary Provident Fund Schemes Authority (MPFA) - http://www.mpfa.org.hk/tch/main/index.jsp
- Security & Futures Commission of Hong Kong (SFC) - http://www.sfc.hk/web/EN/index.html

3.1.2 Roles and responsibilities of main industry bodies

Actuarial Society Hong Kong ("ASHK")

The Actuarial Society of Hong Kong ("ASHK") is the actuarial professional body of Hong Kong and is a full member of the International Actuarial Association. While the ASHK does not currently have statutory powers, it is responsible for issuing the Code of Conduct, professional standards and actuarial guidance notes that actuaries practising in Hong Kong are expected to follow.

As the ASHK is a professional body, its members have an obligation to provide the best possible services to the public. Therefore, it is essential that the highest standards of conduct are maintained by all members. Actuaries are expected to demonstrate integrity in relationships with clients, other members of the profession and the public. The Council of the ASHK has issued a Professional Conduct Code ("PCC") to list out the principles which it expects all members to follow in spirit and letter. In the case that a member of the ASHK has allegedly acted against the PCC or performed an act of a nature that may bring discredit to the ASHK (e.g. fraud and criminal offence), the Council would take steps as it thinks fit. I deemed necessary, the Council would set in motion disciplinary procedures.

All non-retired Fellow and Associate members of the ASHK are subject to the Continuing Professional Development ("CPD") requirement on a calendar year basis. Non-compliance of the CPD requirement may result in counselling and disciplinary actions.

To maintain a high level of professionalism among members, the ASHK issues By-Laws, professional standards ("PS") and actuarial guidance notes ("AGN").

The ASHK has issued two PS for actuaries practising in different sectors of the industry. PS1 relates to the statutory duties of actuaries working in life insurance companies. In particular, it applies for actuaries appointed pursuant to Section 15 of the Insurance Ordinance of Hong Kong (appointed actuaries), as well as directors and external assessors of insurance companies. PS2 applies for actuaries in the Pension business, with a focus on the preparation of actuarial report and certificate following an actuarial review.

As for AGN, the ASHK has published AGN on life insurance policy illustrations, dynamic solvency testing, best estimate assumptions and other topics that actuaries would come across in their professional lives. They are guidelines which are generally written after consultation with the industry and represent good industry practice. The main difference between PS and AGN is that compliance with the latter is not mandatory provided there is appropriate justification.

Hong Kong Federation of Insurers ("HKFI"), Hong Kong Confederation of Insurance Brokers ("HKCIB") and Professional Insurance Brokers Association ("PIBA")

The HKFI, the HKCIB and the PIBA are the three self-regulatory organisations ("SROs") responsible for the regulation of insurance intermediaries in Hong Kong. Their regulatory power would be absorbed by the IA over a three-year transitional period from the end of 2015 (when the Provisional Insurance Authority [the IA's previous name] was established).

Pre-existing insurance intermediaries validly registered with the three SROs would be deemed as licensees upon the commencement of the new regime, until the earlier of the expiry of the three-year transitional period or a licence is granted by the IA. This is to ensure a smooth transition to the new regulatory regime. As the IA absorbs the regulatory powers of the SROs, the SROs are expected to continue to function as trade bodies responsible for representing the interests of their members.

Hong Kong Stock Exchange ("HKEx")

HKEx is a private entity operating a securities market and a derivatives market in Hong Kong. It is one of the largest financial market operators in the world. It also performs clearing house functions, such as post-trade management, position management and exercise and assignment.

In addition, HKEx acts as the front-line regulator of listed issuers (including listed companies) in Hong Kong. It strictly enforces its listing, trading and clearing house rules to maintain open, fair, transparent and efficient markets.

HKEx also provides services which mainly cover market data services, securities settlement and depository, trading of securities and derivatives providing clearing and settlement services for over-the-counter (OTC) derivative transactions. In terms of products offering, HKEx covers a wide range of securities and derivatives and the comprehensive product list can be referred to at http://www.hkex.com.hk/news/news-release?sc_lang=en(Product%20session)#.

Regulator	**Regulation scope**
IA (26 June 2017 onwards)	General insurance, long-term business and insurance intermediaries
OCI (up to 26 June 2017)	General insurance and long-term business
HKFI, HKCIB, PIBA (up to 2017-2018)	Insurance intermediaries
HKMA	Banks
MPFA	Mandatory provident fund schemes and occupational retirement schemes
SFC	Investment-related entities
ASHK	Actuaries practicing in Hong Kong
HKEx	Listed companies

Other useful links for this section are listed below for additional background information:

- Hong Kong Confederation of Insurance Brokers (HKCIB) - www.hkcib.org
- Professional Insurance Broker Association (PIBA) - www.piba.org.hk
- Hong Kong Stock Exchange (HKEx) - www.hkex.com.hk/news/news-release?sc_lang=en(Product%20session)#

3.1.3 Statutory reserved roles for actuaries

The following is a list of statutory reserved roles for actuaries in Hong Kong:

- Appointed actuary of an insurance company with long-term insurance business (for whom compliance with PS1 is compulsory)
- Providing an actuarial opinion on the transfer of liabilities of a long-term insurance business
- Preparation of actuarial report and actuarial certificate for ORSO schemes (the actuary who signs the actuarial certificate must comply with PS2)
- Preparation of annual actuarial report with respect to Employees' Compensation ("EC") and motor insurance business in accordance to GL9

In addition to the above, the Insurance Ordinance Section 13AE(12) introduces the concept of "key persons in control functions". They are individuals responsible for control functions, namely in the Actuarial, Financial Control, Internal Audit, Compliance, Risk Management and Intermediary Management (and other functions the Financial Secretary specified by notice). Appointment of such key personnel is subject to the approval of the IA, as mandated by the Ordinance. Hence, key roles in control functions are also considered as statutory roles.

3.1.4 Risk management responsibilities for actuaries

Despite the fact that there are currently no official requirements set in statute or listed within ASHK Professional Standards or Guidance Notes regarding the risk management responsibilities of actuaries, the importance of enterprise risk management is increasingly emphasised by regulators around the world. Hence, it is crucial that actuaries understand their roles in risk management.

Many of the duties performed by actuaries are closely linked to the risks of the organisations in which they are employed. Apart from various financial risks which actuaries generally focus on, operational risk and reputational risk should not be underestimated as their long-term financial impact could be very significant.

Several risk issues, often come across by actuaries practising in Hong Kong, have been specifically included in the syllabus of the Core section of the Hong Kong Practical Education Module:

- Consumers complaints or disputes
- Anti-money laundering ("AML") and counter-terrorist financing ("CTF")

- Data protection
- Outsourcing
- Anti-discrimination

3.1.4.1 Consumers complaints or disputes

Actuaries should be aware of historic complaints and be mindful of reputation risk during product design and pricing. Apart from playing a risk management role at the product development stage with regard to future disputes, actuaries are often invited to participate in the resolution of customer complaints. For instance, actuaries could be responsible for explaining certain complicated product features that have led to complaints, or estimating the fair financial compensation in the case where the insurer is deemed to have misled a customer.

Several self-regulatory bodies are responsible for handling policyholder complaints in Hong Kong:

The Insurance Claims Complaints Bureau (“ICCB”) has been set up and financed by the insurance industry to handle customer complaints for all types of personal insurance policies. For disputes related to small claims (i.e. claims involving no more than HK$50,000), policyholders could consider turning to the Small Claims Tribunal (“SCT”) for any unresolved amount.

The self-regulatory system for insurance intermediaries (e.g. insurance agents and brokers) is supported by Part X of the Insurance Companies Ordinance (Cap. 41) ("ICO"). Under section 65 of the ICO, a person is prohibited from holding himself out as an insurance agent or an insurance broker unless he is properly appointed or authorised. For complaints related to agent misconduct, policyholders could lodge their complaints to the Insurance Agents Registration Board (“IARB”) of the HKFI. If the insurance intermediary involved is a broker, depending on the affiliation of the intermediary, complaints could be made to either the Hong Kong Confederation of Insurance Brokers (“HKCIB”) or the Professional Insurance Brokers Association (“PIBA”).

The Motor Insurers’ Bureau (“MIB”) would provide assistance to victims of traffic accidents in the case where they face difficulty in claims due to absence of insurance, untraceable vehicle or insolvency of insurance company.

The Employees Compensation Insurer Insolvency Bureau (“ECIIB”) administers the Insolvency Fund Scheme to assume the responsibility for the liabilities of insurers engaging in employees’ compensation.

The Consumer Council, as a statutory body responsible for mediating consumer disputes, is an alternative for policyholders to lodge complaints against insurance services.

The Enforcement Division of the MPFA is responsible for handling consumer complaints against approved trustees. Consumers are encouraged to first contact the trustees of their retirement schemes to express any dissatisfaction and seek resolution, before filing a formal complaint with the MPFA. The Enforcement Division is also responsible for handling complaints against MPF intermediaries for non-compliance with performance requirements or for carrying out regulated activities without intermediary registration.

One of the core functions of the MPFA is to ensure employers and administrators of ORSO schemes operate their schemes in a prudent manner and in accordance with the Occupational Retirement Schemes Ordinance ("ORSO") (Cap 426), Mandatory Provident Fund Schemes (Exemption) Regulation (Cap 485 sub. leg. B). The ORSO Schemes Section of the MPFA is responsible for handling consumer complaints against employers and administrators of ORSO schemes.

Other useful links for this section are listed below for additional background information:

- Insurance Claims Complaints Bureau (ICCB) - www.iccb.org.hk
- Consumer Council - www.consumer.org.hk
- Motor Insurers' Bureau (MIB) - www.mibhk.com.hk
- Employees Compensation Insurer Insolvency Bureau (ECIIB) - www.eciib.com.hk

3.1.4.2 Anti-money laundering ("AML") & counter-terrorist financing ("CTF")

In light of the heightened scrutiny of the risks of money laundering and terrorist financing at the international level, the Financial Services and the Treasury Bureau has taken over the coordinating role for anti-money laundering ("AML") and counter-terrorist financing ("CTF") policies with effect from October 2008. The Bureau is responsible for the Hong Kong's overall compliance with the recommendations made by the Financial Action Task Force ("FATF") (known as *40+9 recommendations*).

Obligations of insurers are governed by Section 7 of the Anti-Money Laundering and Counter Terrorist Financing (Financial Institutions) Ordinance, Cap 615 ("AMLO") and Section 4A of the Insurance Ordinance.

The AMLO imposes requirements related to customer due diligence and record keeping on financial institutions (which include insurance companies). Under the AMLO, relevant authorities (namely HKMA, SFC and IA) are granted supervisory powers related to the compliance with these requirements and other requirements specified in AMLO.

The insurance industry is vulnerable to money laundering ("ML") and terrorist financing ("TF"). The inherent characteristics of insurance products give rise to ML risks that are unique to the insurance industry. For example, at policy maturity or surrender, funds become available to the policyholder or the beneficiary (i.e. an assignee, where the policy has been assigned; or a trustee, where the policy has been placed in trust). By design of insurance, the beneficiary could be changed before maturity or surrender. Such a change could be conducted right before policy maturity or surrender as a means of sending payments to the new beneficiary. This makes insurance a convenient tool for money laundering. Insurance policies could also be used as collateral to purchase other financial instruments, useful in forming a sophisticated web of complex transactions with hard-to-trace origins.

List of long-term insurance contracts that are vulnerable to money laundering or financing terrorism are:

- Unit-linked or with-profits single premium contracts
- Single premium life insurance policies with cash value
- Fixed and variable annuities
- (second-hand) endowment policies

It is therefore important for actuaries to bear in mind the risk of ML and TF when designing products. In addition, post sales, it is necessary to put in place early warning system to track suspicious customer behaviour.

3.1.4.3 Data protection

Personal data of policyholders are collected extensively in the insurance business. Thus, regulators place great importance on the proper handling of personal data.

Personal data privacy is governed by the Personal Data (Privacy) Ordinance, Cap 486. Its objective is to protect privacy rights in relation to personal data. A statutory body, Office of the Privacy Commissioner for Personal Data (“PCPD”), has been established to oversee the enforcement of the Ordinance.

Any person or organisation collecting, holding, processing or using personal data is required to comply with the six Data Protection Principles ("DPPs"), which represent the core of the Ordinance. The six DPPs cover the lifecycle of personal data, from collection to correction:

1. Data collection principle
2. Accuracy & retention principle
3. Data use principle
4. Data security principle
5. Openness principle
6. Data access and correction principle

The PCPD has issued a guidance note on the proper handling of customers’ personal data for the insurance industry. It sets out the DPPs that underpin the proper treatment of personal data and discusses the use of personal data for direct marketing purposes.

The PCPD is also responsible for prescribing the general principles adopted in medical data collection for insurance application and claim processing purposes. It is stipulated that only relevant and necessary medical data should be collected and they must be collected through a lawful and fair means.

If third parties are entrusted with the handling of customers’ personal data, insurance companies must ensure that the data are handled safely and would be erased afterwards to prohibit further use of the data. Appropriate precautionary measures to protect personal data must be adopted. For more details, the recommended practice for data handling by outsourced contractors is listed on P.21-22 of the guidance note for the insurance industry. Insurance institutions and insurance practitioners are advised to refer to the information leaflet "Outsourcing the Processing of Personal Data to Data Processors" issued by the Privacy Commissioner for engaging data processors.

Other useful link for this section are listed below for additional background information:

- Privacy Commissioner for Personal Data (PCPD) - www.pcpd.org.hk

3.1.4.4 Outsourcing

It has become increasingly common for insurance companies to outsource their business activities, both customer-related and back-office services, as a way to reduce costs. Such arrangements bring about increased risks related to the dependence on third parties. IA has issued a guidance note on outsourcing (GL14) to guide insurance companies on formulating and monitoring outsourcing arrangements. It is important to remember that outsourcing does not diminish the obligations of an insurer to comply with the relevant laws and regulations. Annex 1 of GL14 provides a list of services that, when performed by a service provider, may be regarded as outsourcing. The list is shown below for reference:

- Application processing (e.g. insurance proposals, policy loans)
- Policy administration (e.g. premium collection, invoicing, policy renewals, customer services)
- Claims processing (e.g. claims assessment, claims recoveries)
- Documents processing (e.g. cheques, bill payments)
- Investment management (e.g. portfolio management, cash management)
- Manpower management (e.g. manpower planning, staff recruitment, salaries and benefits administration, training and development)
- Marketing and research (e.g. product development, telemarketing, media relations)
- Information system management (e.g. information system, intranet and website development and maintenance, information technology security, desktop support)
- Risk management and internal control (e.g. compliance, internal audit)
- Professional services related to the business activities of the authorized insurer (e.g. accounting, actuarial)

The following are some examples of activities that would generally not be regarded as outsourcing according to GL14:

- Sale of insurance policies by agents or brokers, and ancillary services relating to those sales
- Ceding insurance business
- Independent advisory and consultancy services Loss adjusting service
- Independent audit review
- Medical examination by assigned medical and health clinics and centres
- Market information services (e.g. Standard & Poor's, Moody's)
- Purchase of goods and commodities
- Repair and maintenance of fixed assets
- Maintenance and support of licensed software
- Specialized recruitment and procurement of specialized training
- Employment of contract or temporary personnel

- Common network infrastructure (e.g. VISA, Mastercard)
- Banking services
- Printing services
- Transportation services
- Mail and courier services
- Cleaning services
- Utilities and telephone

The MPFA considers an outsourcing arrangement to an overseas service provider as a material change in respect of the retirement scheme. Trustees must ensure that the MPFA is notified of such arrangement, and provide to the MPFA information about the function, commencement date, service provider name, jurisdiction under which the outsourcing takes place and a copy of the service agreement. All existing and future outsourcing arrangements must comply with the Personal Data (Privacy) Ordinance (Cap. 486).

Other useful link for this section are listed below for additional background information:

- MPFA Circular regarding overseas outsourcing - www.mpfa.org.hk/eng/legislation_regulations/legulations_ordinance/circulars/mpf/files/tr_case.pdf

3.1.4.5 Anti-discrimination

As part of its 2014/2015 report, the Equal Opportunities Commission ("EOC") in Hong Kong has conducted an analysis of insurance policies sold by countries with similar legislation to Hong Kong, which include Australia, Canada, New Zealand, the United Kingdom and the United States. The study found that, if actuarial data and other proven information support a risk differential, discrimination based on attributes such as sex, disability and age is lawful.

Based on the study results, sex is a common discriminator in life insurance overseas, whereas the differentiation between groups in Hong Kong is mainly driven by commercial considerations. A major difference is the tendency of foreign insurers to offer greater coverage for pre-existing conditions in medical insurance. This contrasts with the popularity of coverage with exclusion of pre-existing conditions in Hong Kong. Besides, it was noted that actuarial data availability is much lower for medical insurance than for life insurance in Hong Kong, particularly because unlike other countries in the study, insurers in Hong Kong do not share medical data among themselves.

Insurers in Hong Kong are generally permitted to differentiate policyholders (offer different premium rates, policy acceptance and policy provisions) based on risk factors such as age, sex and occupation. However, according to the Anti-Discrimination Ordinances (namely Sex Discrimination Ordinance, Disability Discrimination Ordinance, Family Status Discrimination Ordinance and Race Discrimination Ordinance), these differential treatments have to be based on actuarial or other reliable statistical data. Where no such data is available, any differential treatment must be based upon reputable medical advice or opinion.

Under the Sex Discrimination Ordinance, it is unlawful to discriminate in the terms and conditions of employment or access to benefits, facilities or services, on the ground of sex, marital status or pregnancy. This applies to both existing contracts and new ones. Benefits could be in the form of fringe benefits, commissions, bonuses, allowances, pensions, health insurance plans, annual leave, merit and performance pay, or any other benefits available to employees generally. Group insurance actuaries should be mindful of any potential discrimination in product design.
Under the Disability Discrimination Ordinance, providing a less favourable term to a person on the ground of his/her disability may constitute a direct discrimination. The anti-discrimination law recognises that insurance necessarily involves the classification of risks and that premiums are tailored to reflect such risks. The EOC has developed a case study on discrimination in insurance to help the public to better understand the issue. The case involves potential discrimination against an applicant when the insurance company increases the premium for his basic life plan and refuses his application for additional coverage. The case concludes by explaining that this only constitutes as discrimination if the company fails to demonstrate that the decision is based on reasonable data from a reliable source. For more information, refer to
http://www.eoc.org.hk/eoc/graphicsfolder/inforcenter/newsletter/content.aspx?itemid=7886&mode=ce

Section 22 of the Race Discrimination Ordinance applies to commission agents, who are remunerated fully or partially through commission for work done for their principals. An insurance company (principal) should not discriminate against its insurance agents (agent) on the ground of race.

While advancing technology and underwriting techniques continue to encourage improvement in risk underwriting, the development of new insurance methodology or technology, such as genetic testing, could be hindered by concerns around privacy and discrimination. With all the hype around insurtech nowadays, there is no doubt that such concerns would be more significant.

Other useful link for this section are listed below for additional background information:

- Equal Opportunities Commission (EOC) - www.eoc.org.hk