

# Conduct risk developments impacting Hong Kong insurers



## What is conduct risk?

Conduct risk is defined by the Hong Kong Insurance Authority (IA) in their Enterprise Risk Management Guideline (GL21) as “The risk to customers, insurers, the insurance sector or the insurance market of financial loss or other adverse consequences that arise from insurers and/or intermediaries conducting their business in a way that does not ensure fair treatment of customers or results in harm to customers (also known as “conduct of business risk”)”. Conduct risk goes beyond what has been expected of firms in the past in relation to treating customer fairly. It focuses on the essence of a firm from product design to handling customer complaints, and it drives to the heart of the behaviours, culture, morals and ethics of people at all levels of the organisation. In recent years, conduct risk has become an area of significant regulatory focus, with an increasing onus on firms to define and manage conduct risk explicitly as part of their risk management framework.

Common examples of conduct risk include mis-selling resulting from misleading information, other unfair practices (e.g. inappropriate advice), mis-selling resulting from unsuitable products and transactions with sanctioned counterparties, fraud, etc.



## What is expected of insurers in the regulation?

The IA has published GL21 which requires an authorised insurer (AI) to put in place a conduct risk policy as part of their Enterprise Risk Management (ERM) framework to routinely identify, monitor, manage or mitigate conduct risk. The Guideline took effect on 1 January 2020, and AIs must comply with the new requirements.

GL21 also echoes the IA’s recently published Code of Conduct for Licensed Insurance Agents (the Agents’ Code) and Code of Conduct for Licensed Insurance Brokers (the Brokers’ Codes) in September 2019 to address conduct risk, generally one of the top operational risks that insurers and intermediaries are facing. The Code consolidates best practices and introduces a baseline standard of conduct that is expected of insurance intermediaries. The new Codes were effective on 23 September 2019 and the IA now regulates insurance intermediaries. At that time the statutory conduct requirements with which licensed Insurance Intermediaries must comply (in the new sections 90, 91 and 92 of the Insurance Ordinance) (Statutory Conduct Requirements), was commenced. Please refer to the Appendix for the relevant conduct requirements which insurance intermediaries should adopt when conducting regulated activities.



## What is expected of a Conduct Risk Policy?

Part 7.10 of GL21 sets out the relevant **Requirements for insurers in relation to conduct risk**, including:

- 1 Having in place a Conduct Risk Policy, as appropriate, that ensures fair treatment of customers. Sources of conduct risks are inherent in the nature of insurance business and service provision. The insurer has the responsibility for good conduct of business throughout the insurance life-cycle, and for maintaining appropriate conduct to those functions or activities that are outsourced.
- 2 The Conduct Risk Policy should:
  - Reflect processes and procedures to identify, monitor, manage or mitigate conduct risk in the provision of insurance products and services to policy holders and customers.
  - Address the approaches and controls which the insurer has in place for the following matters:
    - Dealing with potential policy holders and existing policy holders with due skills, care and diligence;
    - Conducting business, taking into account the policy holder's reasonable expectation e.g. discretionary benefits and premium rate reviews;
    - Using all reasonable means to conduct business in a way that enables policy holders to make informed decisions regarding any contracts of insurance offered by the insurer;
    - The product design and development, marketing, disclosures and distribution of insurance products and sales incentives, and reasonable expectations of its target market;
    - Timely communication to customers on policy information and the integrity of policy advice;
    - Maintaining good quality of policy servicing, including claims and complaints handling;
    - Resolving conflicts of interest supported by appropriate governance and control mechanisms;
    - Establishment of indicators to enable monitoring and reporting of conduct risk; and
    - Performing a regular review of the conduct risk management arrangements and policy.

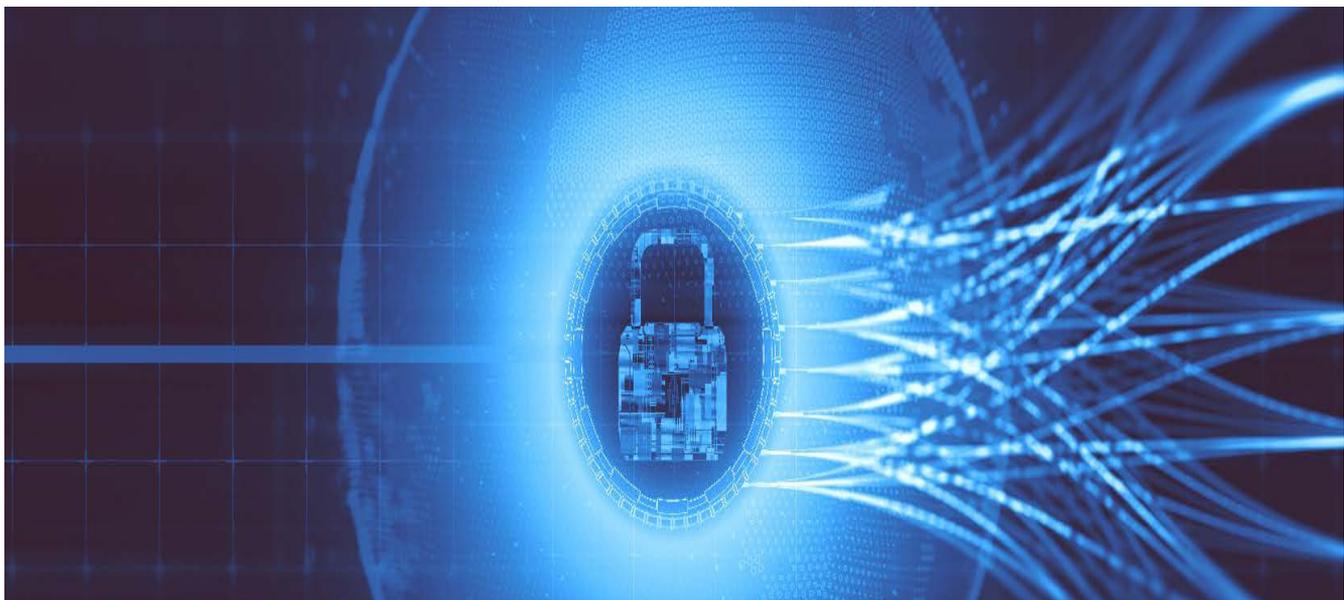




## Our view on managing Conduct Risk

Subsequent to an assessment of the current status of your conduct risk framework, it can be benchmarked against our view of best practice for managing conduct risk:

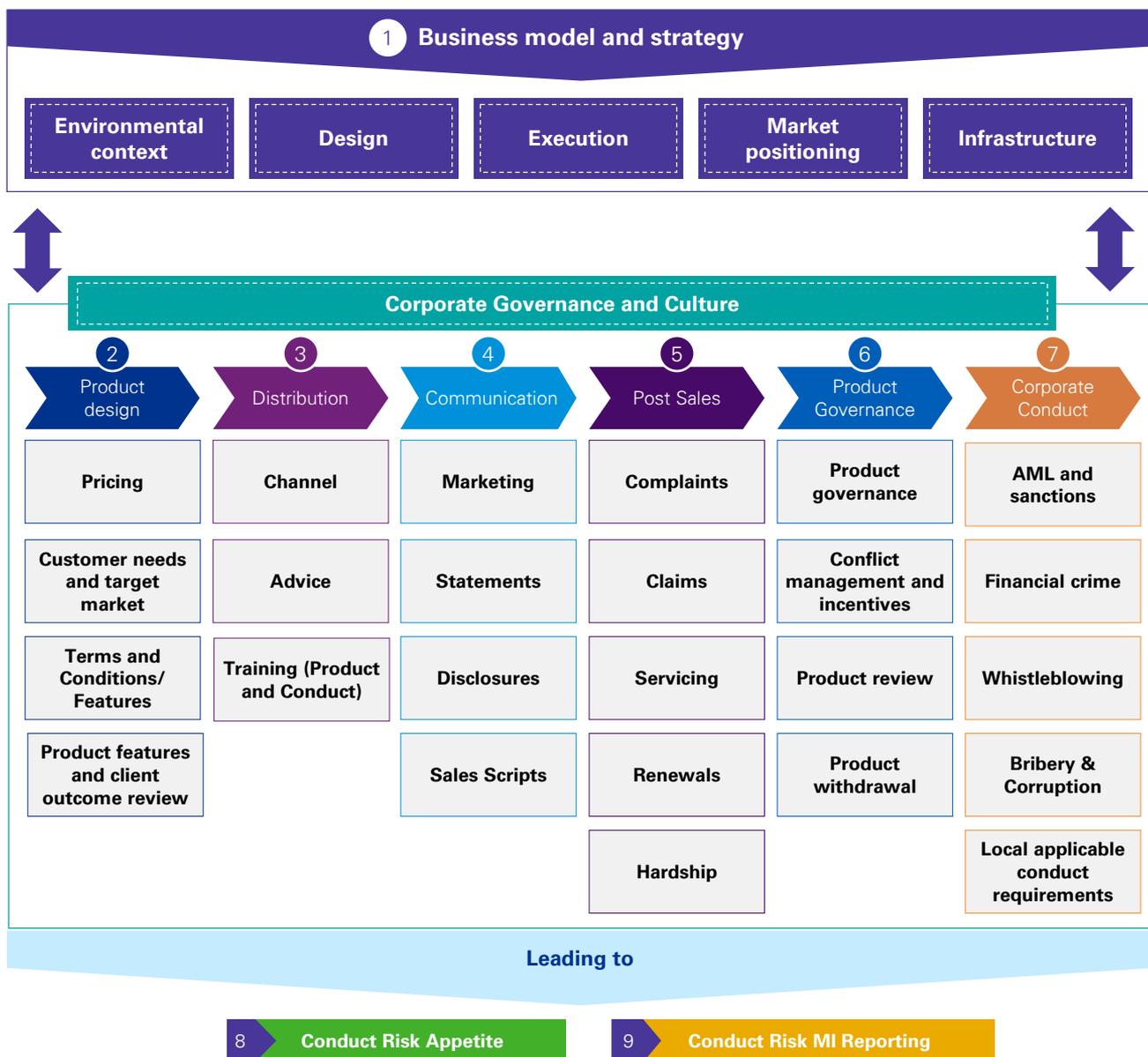
- 1 Put in place a robust system for Conduct Risk Governance** with well-defined roles and responsibilities, reporting lines and authority, in order to maintain a sound system of checks and balances.
- 2 Establish a Conduct Risk Appetite Statement** which articulates the level of risk that an insurer is willing to take to achieve its corporate objectives and business strategies. Such Risk Appetite Statements should be reviewed at least annually and approved by the Board.
- 3 Implement Conduct Risk Policy and procedures** appropriate for the nature, scale and complexity of the risk associated with the business it conducts. It should also describe the Conduct Risk Governance structure and describe how the insurer identifies, measures, monitors, reports, reviews and mitigates conduct risk. The Policy needs to be approved by the Board, and is subject to regular review.
- 4 Proactively identify and assess their conduct risk exposure** on a regular basis
- 5 Develop and enhance risk management techniques in monitoring and managing conduct risk exposure** on a regular basis. Establishment of indicators to enable monitoring and reporting of conduct risk.
- 6 Embedding conduct risk assessment and control processes in business activities:** The approaches and controls for good conduct of business put in place shall cover the following matters, i.e. dealing with policy holders with due skills, care and diligence, taking into account the policy holder's reasonable expectation, disclosure of adequate information to policy holders for informed decision making, product design, distribution of insurance products and sales incentives, communication to customers, advice to customers, policy servicing (including claims and complaints handling), resolving conflict of interest.
- 7 Feedback loop mechanism that ensures continued effectiveness of the Conduct Risk Framework**
- 8 Review the effectiveness of the Conduct Risk Framework**
- 9 Enhance independence assurance over conduct risk and organisational culture through internal audit**





# KPMG's Conduct Risk Framework Overview

The framework supports an assessment of the conduct risk profile across seven core categories. Please refer to the Appendix for an example of how this framework can be applied to a product lifecycle.





## How can we help?

Our team comprises professionals with insurance industry, regulator, operations, compliance and audit backgrounds who are able to provide a range of support from a review of your Conduct Risk arrangements and training to providing bespoke advice on specific areas of Conduct Risk such as Management Information.

We are able to adapt our approach to meet your requirements, offering timely and cost effective solutions in line with regulatory requirements and industry best practice. We have worked with a number of firms of different sizes and complexities and believe that Conduct Risk arrangements should be robust yet proportionate.

### **Our services:**

- **Conduct Risk Framework Design:** Assisting you to design and document your Conduct Risk Framework from assessing your Conduct Risk appetite and Conduct Risk Drivers to developing Conduct Risk Management Information and governance arrangements.
- **Conduct Risk Framework Review:** Undertaking bespoke reviews of some or all of your Conduct Risk Framework (including governance arrangements) to identify opportunities for improvements to processes and procedures that would minimise Conduct Risk.
- **Conduct Risk Governance:** Assessing, reviewing and/or drafting Conduct Risk governance frameworks including committee terms of reference, management information templates and senior management oversight arrangements.
- **Conduct Risk Strategy:** Enhancing your Conduct Risk strategy and arrangements to reflect the evolving Conduct Risk landscape, taking into account the key drivers of Conduct Risk.
- **Conduct Risk Exposure:** Determining the potential Conduct Risks inherent in the scale, scope and complexity of your firm's activities.
- **Drafting/reviewing Policies and Procedures:** Drafting Conduct Risk policies and procedures and/or reviewing and updating existing policies where relevant.
- **Conduct Risk Monitoring:** Assisting you to identify and implement the most effective means for monitoring Conduct Risk. Assessing the roles of the three lines of defence in monitoring and reviewing Conduct Risk and designing, implementing and/or reviewing your Conduct Risk monitoring arrangements.
- **Embedding Conduct Risk:** Assisting you with embedding Conduct Risk management within the firm, e.g. establishing internal control measures to ensure that the insurance business referred to the insurer by insurance intermediaries comply with the Insurance Ordinance requirements and the requirements imposed by the IA in any code or guideline published (see Appendix).
- **Conduct Risk Management Information:** Reviewing and assessing the firm's Conduct Risk Management Information Dashboard, Conduct Risk Key Risk Indicators (KRIs) and Key Performance Indicators (KPIs) relative to the identified Conduct Risk Drivers and wider existing Conduct Risk Framework.
- **Training on Conduct Risk Framework:** Providing customised training to all staff on the firm's Conduct Risk Framework and outlining the roles and responsibilities for all staff with respect to Conduct Risk.
- **Auditing Conduct Risk and Organisational Culture topics:** Define fit-for-purpose and tailored approaches to provide assurance over current state and progress of conduct initiatives. This would likely also include forming a view on how the broader organisational culture influences Conduct Risk.



## Contact Us



### **Michael van Vuuren**

Partner  
Actuarial & Insurance Risk  
Management  
KPMG Hong Kong  
**T:** (852) 3927 5947  
**E:** michael.vanvuuren@kpmg.com



### **Alva Lee**

Partner  
Risk Consulting  
KPMG Hong Kong  
**T:** (852) 2143 8764  
**E:** alva.lee@kpmg.com



### **Jonathon Ko**

Director  
Actuarial & Insurance Risk  
Management  
KPMG Hong Kong  
**T:** (852) 2685 7491  
**E:** jonathon.ko@kpmg.com



### **Jens Kessler**

Director  
Risk Consulting  
KPMG Hong Kong  
**T:** (852) 2143 8584  
**E:** jens.kessler@kpmg.com



### **Elliott Simpson**

Associate Director  
Risk Consulting  
KPMG Hong Kong  
**T:** (852) 3927 3028  
**E:** elliot.simpson@kpmg.com



### **Gianfran Liu**

Associate Director  
Risk Consulting  
KPMG Hong Kong  
**T:** (852) 2847 5164  
**E:** gianfran.liu@kpmg.com

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## Appendix: What is expected regarding intermediary oversight?

**Distribution models and channels** are a key aspect of how insurance products reach customers. These **may either increase or mitigate risks of consumer detriment**. How distribution models and channels are designed and selected; and the existence of adequate procedures to mitigate conduct risk arising from different distribution models are the two aspects that are relevant to an insurer.

**Section 90(a)-(h) of the Ordinance** sets out the relevant **Statutory Conduct Requirements for licensed insurance intermediaries**, and the Agent's Code and the Broker's Code sets out principles of conduct, standards and practices which agents and brokers should adopt when carrying on regulated activities, including:

1

**Honesty and integrity:** make accurate representation and presentation, comply with all laws, rules and regulations, requirements applicable to the insurance intermediaries.

2

**Acting fairly and in the client's best interests:** obtain accurate and complete information of client, and only recommend insurance products which best meet the client's interests, needs and circumstances.

3

**Exercising care, skill and diligence:** carry out the client's instructions accurately and promptly, protect the privacy and confidentiality of client's information, inform their clients about the cooling-off period and their rights to cancel the policy during the cooling-off period, and deliver the policy to client within reasonable time.

4

**Competence to advise:** possess appropriate levels of professional knowledge and experience and advise only on matters for which the agent/technical representative are competent to advise.

5

**Disclosure of information:** provide clients with accurate information to enable them to make informed decisions. Such information includes the identity and capacity of the insurance intermediaries, key features and information of insurance products recommended, policyholder's obligations and information on referral business.

6

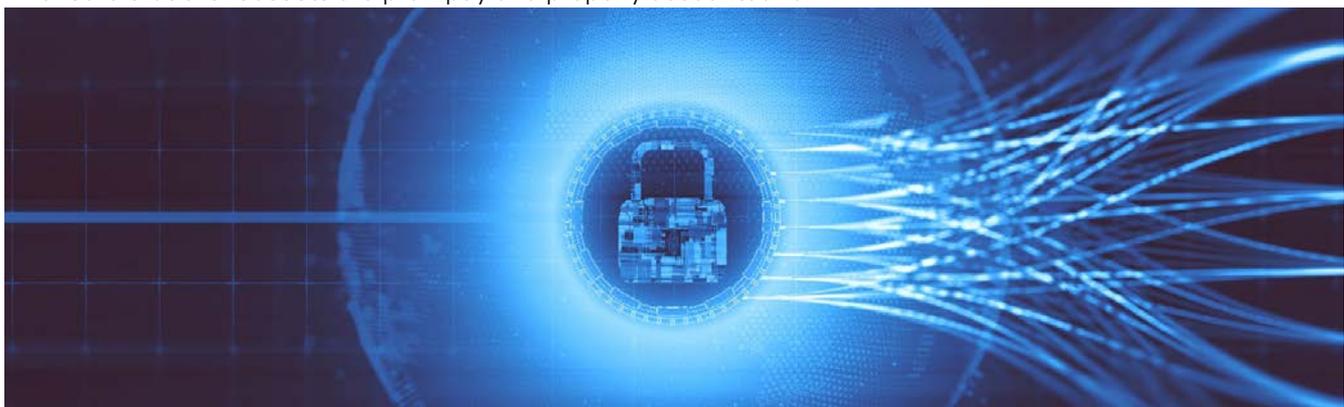
**Suitability of advice:** carry out suitability assessment of client's circumstances, explore available options and provide suitable insurance options and advice to clients. When a client insists to make a decision which, in the insurance intermediaries' opinion, is not suitable for the client, insurance intermediaries should ask the client for the reasons, explain the unsuitability of the decision, confirming that it was the client's own decision, and make proper documentation.

7

**Conflicts of interest:** make every effort to avoid conflicts of interest between the insurance intermediaries and the policyholder, and when such conflicts cannot be avoided, any conflict should be disclosed to policyholders to ensure fair treatment of customers.

8

**Client assets:** insurance intermediaries should properly safeguard premiums received from clients, and ensure that client assets are promptly and properly accounted for.





## Appendix: What is expected regarding intermediary oversight?

In addition to the provisions in the Agent's code and Broker's code, licensed intermediaries need to comply with the requirements which apply to them in the guidelines issued by the IA on Anti-Money Laundering and Counter Terrorist Financing (GL3) and (specifically relating to life insurance policies) on financial needs analysis (GL30), cooling-off period (GL29), investment-linked assurance scheme products (GL26), gifts (GL25) and policy replacement (GL27).

**Section 91 of the Ordinance** sets out the relevant **Statutory Conduct Requirements for licensed insurance agencies and their responsible officers (RO)** to establish proper controls and procedures to ensure that its licensed technical representatives (agent) comply with the conduct requirements in Section 90 and meet the General Principles, Standards and Practices set out in the Agent's Code.

**Section 92 of the Ordinance** sets out the relevant **Statutory Conduct Requirements for licensed insurance broker companies and their RO** to establish proper controls and procedures to ensure that its licensed technical representatives (broker) comply with the conduct requirements in Section 90 and meet the General Principles, Standards and Practices set out in the Broker's Code.

### Insurance Intermediaries

