Insurance Intermediaries Quality Assurance Scheme

Principles and Practice of Insurance Examination

Study Notes

2004 Edition

PREFACE

These Study Notes have been prepared to correspond with the various Chapters in the Syllabus for the Principles and Practice of Insurance Examination. The Examination will be based upon these Notes. A few representative examination questions are included at the end of each Chapter to provide you with further guidance.

It should be noted, however, that these Study Notes will not make you a fully qualified underwriter or other insurance specialist. It is intended to give a preliminary introduction to the subject of Principles and Practice of Insurance, as a ***Quality Assurance*** *exercise for Insurance Intermediaries.*

We hope that the Study Notes can serve as reliable reference materials for candidates preparing for the Examination. While every care has been taken in the preparation of the Study Notes, errors or omissions may still be inevitable. You may therefore wish to make reference to the relevant legislation or seek professional advice if necessary. As further editions will be published from time to time to update and improve the contents of these Study Notes, we would appreciate your feedback, which will be taken into consideration when we prepare the next edition of the Study Notes.

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NOTE

For your study purposes, it is important to be aware of the relative "weight" of the various Chapters in relation to the Examination. All Chapters should be studied carefully, but the following table indicates areas of particular importance:

Chapter	Relative Weight
1	12%
2	16%
3	30%
4	9%
5	5%
6	21%
7	7%
Total	**100%**

1 RISK AND INSURANCE

1.1 CONCEPT OF RISK

1.1.1 Meaning of Risk

There have been many attempts to define 'risk'. Probably, to most of us, "risk" contains a suggestion of *loss* or *danger*. We may therefore define it as "**uncertainty concerning a potential loss**", a situation in which we are not sure whether there will be loss of a certain kind, or how much will be lost. It is this uncertainty and the *undesirable* element found with risk that underlie the wish and need for insurance.

The potential loss that risk presents may be:

(a) *financial*: i.e. measurable in monetary terms (e.g. loss of a camera by theft);

(b) *physical*: death or personal injury (often having financial consequences for the individual or his family); or

(c) *emotional:* feelings of grief and sorrow.

Only the first two types of risks are likely to be (commercially) **insurable risks**. Also, from a wider perspective, not every risk will be seen in the **negative** form we have just outlined (see **1.1.2a** below).

Note: Without trying to complicate matters, we should also be aware that insurers may use the word "risk" with other meanings, including:

1 the property or person at risk that they are insuring or considering insuring; and

2 the *peril* (i.e. cause of loss) insured (so, some policies may insure on an "**all risks**" basis, meaning that any loss due to any cause is covered, except where the cause is excluded from coverage).

1.1.2 Classification of Risk

To simplify a complex subject, we may classify risk under two broad headings (each having two categories) according to:

(a) its potential *financial results*; and

(b) its *cause and effect*.

1.1.2a Financial Results

Risks may be considered as being either *Pure* or *Speculative*:

(i) *Pure Risks* offer the potential of **loss** only (no gain), or, at best, no change. Such risks include fire, accident and other undesirable happenings.

(ii) *Speculative Risks* offer the potential of **gain or loss**. Such risks include gambling, business ventures and entrepreneurial activities.

The majority of the risks which are insured by commercial insurers are pure risks, and speculative risks are not normally insurable. The reason for this is that speculative risks are engaged in voluntarily for gain, and, if they were insured, the insured would have little incentive to strive to achieve that gain.

1.1.2b Cause and Effect

Risks may also be considered as being either *Particular* or *Fundamental*:

(i) *Particular Risks:* They have relatively limited consequences, and affect an individual or a fairly small number of people. The consequences may be serious, even fatal, for those involved, but are comparatively localized. Such risks include motor accidents, personal injuries and the like.

(ii) *Fundamental Risks*: Their causes are outside the control of any one individual or even a group of individual, and their outcome affects large numbers of people. Such risks include famine, war, terrorism, widespread flood and other disasters which are problems for society or mankind rather than just the "particular" individuals involved.

The majority of the risks which are insured by commercial insurers are particular risks. Fundamental risks are not normally insurable because it is considered financially infeasible for insurers to handle them commercially.

1.1.3 Risk Management

'Risk management' is a term which is used with different meanings:

(a) in the world of banking and other financial services outside insurance, it is probably used with reference to investment and other *speculative* risks (see **1.1.2a** above);

(b) insurance companies will probably use the term only in relation to *pure* risks, but they may well restrict it even further to *insured* risks only. Thus, when insurers talk about "**risk management**", they could well be referring to ways and means of reducing or improving the *insured loss potential* of the "risks" they are insuring, or being invited to insure;

(c) as a separate field of knowledge and research, risk management may be said to be that branch of management which seeks to:

(i) *identify*;

(ii) *quantify*; and

(iii) *deal with* risks (**pure** and **speculative**) that threaten an organization. Tools or measures of risk handling include:

- *risk avoidance*: elimination of the chance of loss of a certain kind by not exposing oneself to the peril (e.g. abandoning a nuclear power project so as to eliminate the risk of nuclear accidents);

- *loss prevention*: the lowering of the frequency of identified possible losses (e.g. activities promoting industrial safety);

- *loss reduction*: the lowering of the severity of identified possible losses (e.g. automatic sprinkler system);

- *risk transfer* : making another party bear the consequences of one's exposure to loss (e.g. purchase of insurance and contractual terms shifting responsibility for possible losses);

- *risk financing*: no matter how effective the loss control measures an organization takes, there will remain some risk of the organization being adversely affected by future loss occurrences. A risk financing programme is to minimize the impact of such losses on the organization. It uses tools like: insurance, risk transfer other than insurance, self-insurance, etc. (Whilst insurance is closely connected with risk management, it is only

one of the tools of risk management.)

To illustrate (i) - (iii) above, suppose a supermarket finds that it is losing goods from its shelves. It *identifies* its possible causes by observation, which could be theft by customers, theft by staff, etc. It *quantifies* the loss from frequent stocktaking compared with cash receipts (making allowance for staff errors). It may *deal with* the risk, for example, by installing closed circuit TV, or (if market conditions allow) by raising prices generally to offset such losses, or by setting up a self-insurance fund for them.

1.2 FUNCTIONS AND BENEFITS OF INSURANCE

Insurance has many functions and benefits, some of which we may describe as **primary** and others as **ancillary** or secondary, as follows:

(a) **Primary functions/benefits**: Insurance is essentially a *risk transfer mechanism*, removing, for a **premium**, the potential financial loss from the individual and placing it upon the insurer.

The primary benefit is seen in the *financial compensation* made available to insured victims of the various insured events. On the commercial side, this enables businesses to survive major fires, liabilities, etc. From a personal point of view, the money is of great help in times of tragedy (life insurance) or other times of need.

(b) **Ancillary functions/benefits:** Insurance contributes to society directly or indirectly in many different ways. These will include:

(i) *employment*: at a time when Hong Kong is gravely concerned about unemployment figures, it is worth remembering that the insurance industry is a significant factor in the local workforce;

(ii) *financial services*: since the relative decline in manufacturing in Hong Kong, financial services have assumed a much greater role in the local economy. Insurance is a major element in this sector;

(iii) *loss prevention and loss reduction* (collectively referred to as '*loss control*'): the practice of insurance includes various surveys and inspections related to **risk management** (see **1.1.3**(b) above). These are followed by requirements (conditions for acceptance of risk) and/or recommendations to improve the "risk". As a consequence, we may say that there are fewer fires, accidents and other unwanted happenings;

(iv) *savings/investments*: life insurance, particularly, offers a convenient and effective way of providing for the future. With the introduction of the Mandatory Provident Fund Schemes in 2000, the value of insurance

products in providing for the welfare of people in old age or family tragedy is very evident;

(v) *economic growth/development*: it will be obvious that few people would venture their capital on costly projects without the protection of insurance (in most cases, bank financing will just not be available without insurance cover). Thus, developments of every kind, from bridges to housing and a host of other projects, are encouraged and made possible partly because insurance is available.

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Representative Examination Questions

*The examination will consist of **75** multiple-choice questions. The majority of the questions will be very straightforward, involving a simple choice from four alternatives. These we may call **Type "A" Questions**. A selection of the questions (probably between 10% and 15%) will be slightly more complex, but again involving a choice between four alternatives. These we may call **Type "B" Questions**. Examples of each are shown below.*

Type "A" Questions

1 Risk may be described as the uncertainty concerning a potential loss. That potential loss may be:

(a) physical; .....
(b) financial; .....
(c) emotional; .....
(d) all of the above. .....

[Answer may be found in **1.1.1**]

2 A risk which offers the prospect of loss only, with no chance of gain, may be described as a:

(a) pure risk; .....
(b) particular risk; .....
(c) speculative risk; .....
(d) fundamental risk. .....

[Answer may be found in **1.1.2a**]

Type "B" Questions

3 Which of the following statements concerning risk are **true**?

(i) All risks are commercially insurable.
(ii) Not all risks are commercially insurable.
(iii) The only remedy for any kind of risk is insurance.
(iv) Insurers may mean a number of things when talking about "risk".

(a) (i) and (ii) only; .....
(b) (ii) and (iv) only; .....
(c) (i), (ii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **1.1-1.1.1**]

4 Which of the following may be considered as being among the secondary or subsidiary benefits of insurance to Hong Kong?

(i) means of savings
(ii) source of employment
(iii) encouragement of economic development
(iv) reduction in number of accidents/losses

(a) (i) and (ii) only; .....
(b) (i), (ii) and (iii) only; .....
(c) (ii), (iii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **1.2**(b)]

Note: *The answers to the above questions are for you to discover. This should be easy, from a quick reference to the relevant part of the Notes. If still required, however, you can find the answers at the end of the Study Notes.*

2 LEGAL PRINCIPLES

This and the next Chapter will concern principles of law, but the Notes will not provide a comprehensive survey of some very complex issues. The purpose of the Notes, as with the overall study, is to give an insight into the important aspects of an insurance intermediary's professional activities.

2.1 THE LAW OF CONTRACT

This is an area of law which affects every one of us, whether in our personal or business lives. As we shall see, contract is an essential element in civilized societies, so it is important to have some appreciation of this important subject.

2.1.1 Definition

The simplest definition for 'contract' is probably: a *legally enforceable agreement*. There are a large variety of agreements, but not all are intended to have legal consequences. A *social arrangement* between two persons, such as a lunch appointment for example, is an agreement, but where either of them unilaterally cancels the appointment, there is no suggestion that the disappointed party should be able to take legal action against the other party, because the agreement is not legally recognised as valid.

Contracts comprise promises or undertakings, usually given in exchange for a promise or undertaking from the other side. In a strict legal sense, contracts are something intangible. Therefore, an insurance policy in itself is not a contract; instead it is the most commonly used evidence of an insurance contract. An insured who is making a fire insurance claim will not expect the insurer to deny the claim on the grounds that the 'insurance contract' (in fact the policy) no longer exists after being destroyed in the same fire.

Contracts may concern relatively *trivial* (such as buying a newspaper or taking a tram ride) or very *important* matters (such as a major building project or employment). In any event, the contracting parties expect promises to be honoured, and can demand compensation or enforced performance if they are not honoured.

2.1.2 Types of Contracts

For our purposes, we may consider that there are two major types of contract, as follows:

(a) **Simple contracts**: Although these are described as "simple", this does not mean that they only deal with uncomplicated matters and are easy to understand. Rather, it means that they are simple or easy to form. A simple contract is one created verbally, or by writing not under seal. It can also be inferred from conduct. In short, the validity of simple contracts does not depend on special formalities.

[An example of a contract inferred from *conduct* is where someone picks up a newspaper from a street vendor and where their body language clearly indicates a purchase. Technically, a contract is formed between the seller and buyer, with the acts of handing over and accepting the money for the newspaper: no words or writing are needed.]

In fact, the great majority of insurance contracts are "simple" contracts. Technically, insurance contracts, to be valid, do not have to be evidenced in writing; but in practice, they almost always are. Nevertheless, as we shall see later, insurance contracts of a certain type are legally required to be evidenced by insurance policies.

(b) **Contracts by deeds**: A deed is a written instrument signed, sealed and delivered. (Delivery is no longer required to be physical delivery; an intention to be unconditionally bound by the deed suffices.) It must be used with certain transactions such as a transfer of land. Besides, suretyship is always issued in the form of a deed; otherwise, when a claim arises, the obligee may possibly face a defence put up by the surety that he has not a right to sue because he has provided no consideration (see **2.1.3** (c) below for the doctrine of consideration).

2.1.3 Elements or Essentials of a Contract

For the purposes of this section, we shall be talking only of *simple* contracts (see **2.1.2**(a) above), since these constitute the great majority of contracts that are met in insurance transactions.

To be a valid contract, certain criteria called ‘elements of contract’ must be met in the course of its formation. Should any of these elements be absent, the proposed contract either does not exist or is defective in another sense. There are three types of **defective contracts**, as follows:

1 *Void (or invalid) contracts*: This means that the proposed contract does not exist in law; it is entirely without legal effect. In the context of insurance, the implication is that generally all premiums which have already been paid under a void contract are returnable; so are claims paid.

2 *Voidable contracts:* This is a temporary situation, indicating that the aggrieved party may treat the contract as void as from contract conclusion, if he does it within a reasonable time after acquiring knowledge of the

availability of such a right of election. In insurance, it could arise with a breach of some types of policy provision, or the discovery that important information was omitted or wrongly given at the proposal stage (see **3.2** below);

3 *Unenforceable contracts*: This means what it says, an unenforceable contract cannot be enforced (or sued on) in a court of law. However, this is not because it is void, but because some required action has not been taken (e.g. stamp duty not paid on a lease of land, *marine* insurance policy not issued, etc.). This defect can be remedied by carrying out the required action, so that the contract becomes enforceable (e.g. by issuing a marine policy even after a loss has realised).

Turning to the **elements of contract** themselves, legal textbooks are not always agreed just exactly how many elements are found with valid contracts, but we shall consider **six** criteria here, as follows (remembering that we do not need to go into great detail):

(a) *Offer*: if no offer is made, obviously there can be no agreement between the two or more parties. In insurance, the *offeror* may be the intending insured (perhaps by completing and submitting to the insurer a proposal form (or application form)), or the insurer (perhaps as a *counter-offer* or in connection with a policy *renewal*); all depends on intention as evidenced by facts.

(b) *Acceptance:* the proposed contract cannot come into being unless the offer is accepted by the other party (the *offeree*). All terms of the offer must be accepted before a contract is concluded. If the other party intends to vary the terms of the proposed contract (requiring increased premium or policy restrictions, for example), this, upon its communication, constitutes a *counter-offer*, which will have the effect of nullifying the original offer. A counter-offer is subject to acceptance by the original *offeror* (who becomes the *offeree* with the counter offer).

(c) *Consideration*: this is the price (monetary or otherwise) a contracting party pays for the promise the other party makes to him. In a simple contract, consideration must be given by *both* parties; otherwise it is void. On the other hand, a promise contained in a deed, even if it has been given not for consideration, is enforceable at common law by the promisee. In other words, a unilateral promise not made by a deed is invalid. In insurance, the consideration is:

(i) the *promise* by the insured to pay premium; and

(ii) the *promise* by the insurer to pay or compensate as per policy terms.

Note: 1 Where an insured event occurs before the premium has been paid, the insured will still be entitled to insurance payment in accordance with the terms of the contract and the insurer will have a separate claim against him for the unpaid premium. However, some policies require actual payment of premium as consideration, which requirement will have the effect of overriding the said legal rule.

2 The insurer's consideration is the *promise* to pay, etc., rather than the actual payment. In many cases, no claim arises under the policy, but when the insured period ends the insurer is treated as having provided consideration, and so there will not be a question of the contract being void for lack of consideration leading to a return of premium.

(d) *Capacity to contract*: It means the legal ability to enter into a contract. With individuals, if they are *mentally disordered*, or are *minors*, the contracts they make are *generally* voidable at their option. With companies, they must act within their legal limitations.

(e) *Legality:* the subject of the agreement must be legal. A contract to kill or to commit any other crimes, for example, is not valid. Likewise, an insurance on smuggled goods would also not be legally recognized. However, exceptions do exist. For instance, the courts may enforce an insurance claim in favour of an insured under an insurance contract that is illegal because the insurer is not authorised to transact the kind of insurance business in question.

(f) *Intention to create legal relation*: to make a valid contract, each party to it must clearly have the intention that it is to have legal consequences. This seldom gives rise to any problem with insurance contracts because, unlike social or domestic agreements, commercial agreements are presumed to have been made with an intention to create legal relation.

2.2 THE LAW OF AGENCY

Before we commence this section, it is very important to realize that the law of agency is much wider than its application to *insurance agents* (important as that is). Therefore, in the following paragraphs, do not think only of **insurance** agents. The comments apply to every kind of **agent** (a shipping agent, an estate agent, etc.), an explanation of which immediately follows.

(a) An *agent* in this context is a person who represents a *principal*. In insurance, the position is made a little complex because insurance intermediaries may be described as **Insurance Agents** (usually representing the insurer) or as **Insurance Brokers** (usually representing the insured/proposer), as the case may be. Within the law of agency, they are both **agents**.

(b) The law of agency is deceptively simple in theory, but sometimes quite complex in practice. Essentially, this whole area of law is governed by the legal principle that *"he who acts through another is himself performing the act"*. In other words, the principal is bound (for good or ill) by the authorized actions, and sometimes even the unauthorized actions (see **2.2.2** and **2.2.3** below), of his agent. Thus, when a child (agent) buys something on credit from a grocery store at his mother's (principal) bidding, a contract of sale is created between the store and the mother so that she becomes liable to pay the price.

(c) The principal who becomes bound by the acts of his agent is exposed to *vicarious liability*, liability incurred as a result of an act or omission of another.

2.2.1 Definition

Agency is the *relationship* which exists between a *Principal* and his *Agent*. Because it is a relationship, it may arise as a matter of fact rather than as a precise agency appointment. In legal terms, an agency relationship may be *deemed* to arise in certain given circumstances.

The *law of agency* are those rules of law which govern an agency relationship. The law of contract also has to be considered as the agent often arranges an agreement with the *third party*, or performs it, on behalf of his principal. There are two contracts to consider:

(a) one between the **agent** and the **principal**; and

(b) another quite different one between the **principal** and the **third party**.

Note: an agency can exist without an agency contract. For example: a child (gratuitous agent) goes to buy a pack of sugar on behalf of his mother (principal), with authority to bind the mother in so doing, which is not granted under a contract of agency between them (remember that a domestic arrangement generally does not constitute a contract).

2.2.2 How Agency Arises

When we say that an agency relationship exists between two parties, we are, in essence, saying that the agent owes certain duties to the principal and vice versa, and the agent has some sort of authority to bind the principal in respect of

some contract or transaction to be made on the principal's behalf with another person (third party).

There are a number of ways in which an agency relationship may arise. These we consider below:

(a) *By agreement*: whether contractual or not; express, or implied from the conduct or situation of the parties.

(b) *By ratification*: Ratification means that there is *retrospective authority* for a given act, i.e. authority was not possessed at the time of the act, but the principal subsequently confirms the act, effectively **backdating** approval. It can be done in writing, verbally, or by conduct.

For example, an insurance agent who is only authorized to secure household insurances for an insurer has an opportunity to secure an attractive fire insurance risk and purports to grant cover to the client. The proposed insurance contract is technically void for it has been made without authority from the insurer. However, the insurer may subsequently accept the insurance and confirm cover so that the contract becomes valid retrospectively.

2.2.3 Authority of Agents

The issue of authority is related to, but distinct from, the issue of agency relationship. Where a certain act done by A purportedly on behalf of B will be binding on B, A is said to have B's authority to do so; but that does not mean that there must exist an agency relationship, or a full agency relationship, between them, which will, for instance, entitle A to reimbursement by B of expenses incurred on behalf of B. The various types of authority that an agent may have are considered below:

(a) *Actual authority*: The authority of an agent may be actual where it results from a manifestation of consent that he should represent or act for the principal, expressly or impliedly *made to the agent himself* by the principal. An actual authority can be an express actual authority or an implied actual authority. An *express actual authority* is an actual authority that is deliberately given, verbally or in writing. By contrast, an *implied actual authority* arises in a larger variety of circumstances; put simply, it may arise out of the conduct of the principal, from the course of dealing between the principal and the agent, or the like.

(b) *Apparent authority*: The authority of an agent may be apparent instead of actual, where it results from a manifestation of consent, *made to third parties* by the principal. The notion of apparent authority is essentially confined to the relationship between principal and third party, under which the principal may be bound by an unauthorised act of the agent of creating

a contract or entering into a transaction on behalf of the principal.

Suppose an underwriting agent has been expressly forbidden by his principal from accepting cargo risks destined for West Africa. In contravention of this prohibition, the agent has on several occasions verbally granted temporary cover to a client for such risks purportedly on behalf of the principal, each time followed by issuance of policies for them by the principal to the client. Because of such past dealings, future similar acceptance by the agent may be binding on the insurer on the basis of apparent authority to the agent.

(c) *Authority of necessity*: In urgent circumstances where the property or interests of one person (who may possibly be an existing principal) are in imminent jeopardy and where no opportunity of communicating with that person exists, so that it becomes necessary for another person (who may possibly be an existing agent) to act on behalf of the former, the latter is said to have an *authority of necessity* so to act and becomes an *agent of necessity* by so acting even though he has not acquired an express authority to do so. The implications are that: by exercising such an authority, the agent creates contracts binding and conferring rights on the principal, and becomes entitled to reimbursement and indemnity against his principal in respect of his acts. Besides, he will have a defence to any action brought against him by the principal in respect of the allegedly unauthorised acts.

For example, when a person is very ill in hospital, a neighbour and friend volunteers and gives help, by assisting with domestic arrangements at his home. This includes payment of the renewal premium for his household insurance. He will probably be unable to refuse repaying the neighbour for the premium, as the neighbour will almost certainly be considered an *agent of necessity*. Secondly, he will probably be unable to declare the insurance void and demand a return of premium from the insurer. Thirdly, it is unlikely that the insurer will be able to deny claims under the policy on the grounds that the policy was renewed without his authority.

(d) *Agency by estoppel:* Where a person, by words or conduct, represents or allows it to be represented that another person is his agent, he will not be permitted to deny the authority of the agent with respect to anyone (third party) dealing with the agent on the faith of such representation. Despite the binding effect of the acts of the agent done in such circumstances, *this doctrine agency by estoppel does not generally create an agency relationship* unless, say for example, the unauthorised act of the agent is subsequently ratified. In other words, the operation of this doctrine only concerns the relationship between principal and third party.

Note: The doctrine of apparent authority is distinct from the doctrine of estoppel. The first doctrine applies where an agent is allowed to appear to have a greater authority than that actually conferred on him, and the second

doctrine applies where the supposed agent is not authorised at all but is allowed to appear as if he was.

2.2.4 Duties Owed by Agent to Principal

These may be summarized as follows:

(a) *Obedience*: The agent must follow all lawful instructions of his principal, strictly or as best as is reasonably possible.

(b) *Personal performance*: The agent is not allowed to *delegate* his authority and responsibilities to others (sub-agents) unless he has authority to do so.

(c) *Due care and skill*: The law does not demand perfection, and an agent is normally only required to display all reasonably expected skills and diligence in performing his duties. Whilst his principal may be bound by his lack of care, the principal may in turn reclaim from the agent in respect of a loss caused by the lack of care.

(d) *Loyalty and good faith*: The agent's obligations of loyalty and good faith are governed by several strict rules of law, the no conflict rule being one of them.

(e) *Accountability*: The agent must account for all moneys or other things he receives on behalf of his principal. He must also keep adequate records relating to the agency activities.

2.2.5 Duties Owed by Principal to Agent

These may be summarized as follows:

(a) *Remuneration:* The agent is entitled to receive commission or other remuneration (such as bonus) as agreed. This the principal must pay within a reasonable time or any specified time limit, as the case may be.

(b) *Expenses, etc.*: The principal, subject to any express terms in the agency agreement, must reimburse the agent for costs and expenses properly and reasonably incurred by the agent on behalf of the principal; e.g. legal defence expenses paid by a claims settling agent.

(c) *Breach of duty:* The agent may take action against the principal for the latter's breach of obligations to him.

2.2.6 Termination of Agency

There are a number of ways in which an agency agreement can be brought to an end. These include:

(a) *Mutual Agreement*: Generally speaking, all agreements may be terminated by mutual agreement, on terms agreed between the parties.

(b) *Revocation:* Subject to any contract terms as to notice and/or compensation, either the principal or the agent may **revoke** (i.e. cancel) the agreement during its currency.

(c) *Breach:* If either the principal or the agent commits a fundamental breach of contract, the other party may treat the contract as ended (with a possible right of compensation). For example, an exclusive agent, upon discovering that the principal, in breach of a contract condition, has appointed a second agent before the expiry of the agency agreement, may terminate performance immediately and sue the principal for any loss of the profit expected from performing the agreement during the remainder period.

(d) *Death*: An agency relationship is a personal one, so the death of either the principal or the agent will end the agreement. Should either party be a corporate body (company), its liquidation will have the same effect.

(e) *Insanity:* If either the principal or the agent becomes insane so that he no longer can perform the agreement, the agreement automatically comes to an end.

(f) *Illegality*: If it happens that the agency relationship or the performance of the agreement is no longer permitted by law, this automatically ends the agreement. Suppose a British company (buying agent) has a contract with a company (principal) incorporated and domiciled in another country whereby the buying agent will purchase in the United Kingdom stuffs like wheat, steel, sulphur and other chemicals on behalf of the principal. On the outbreak of a war between the two countries, this agreement will, in the English law, automatically end for illegality.

(g) *Time:* If the agreement is for a determined period, it terminates at the end of such period.

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Representative Examination Questions

Type "A" Questions

1 A contract may be defined as:

(a) a legally enforceable agreement; .....
(b) a promise between two or more people; .....
(c) an agreement that is expressed in writing; .....
(d) any agreement between two or more parties. .....

[Answer may be found in **2.1.1**]

2 Ratification by a principal of the actions of his agent effectively means that:

(a) the agency agreement is terminated; .....
(b) the agent will not be entitled to any commission; .....
(c) the principal "back-dates" approval of the actions; .....
(d) the principal refuses to accept responsibility for those actions. .....

[Answer may be found in **2.2.2**(b)]

Type "B" Questions

3 Which **two** of the following statements regarding **simple contracts** are **true**?

(i) they must never be in writing
(ii) they are not issued under seal
(iii) they must always be in writing
(iv) they may be verbal or in writing

(a) (i) and (ii) only; .....
(b) (i) and (iii) only; .....
(c) (ii) and (iii) only; .....
(d) (ii) and (iv) only. .....

[Answer may be found in **2.1.2**(a)]

4 Which of the following are regarded as essential elements in any valid simple contract?

(i) offer
(ii) acceptance
(iii) consideration
(iv) capacity of the parties to contract

(a) (i) and (ii) only; .....
(b) (i) and (iii) only; .....
(c) (i), (ii) and (iii) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **2.1.3**]

[If still required, the answers may be found at the end of the Study Notes.]

3 PRINCIPLES OF INSURANCE

3.1 INSURABLE INTEREST

The word "interest" can have a number of meanings. In the present context, it means a *financial relationship* to something or someone. There are a number of features to be considered with "insurable interest", as below.

3.1.1 Definition

Insurable interest is a person's *legally recognized relationship* to the subject matter of insurance that gives them the right to effect insurance on it. It is important to note that the relationship must be a **legal** one. That is why a thief in possession of stolen goods does not have the right to insure them.

3.1.2 Importance of Insurable Interest

An insurance agreement is void without insurable interest. Any premiums and claims paid without knowledge of such invalidity are generally returnable.

3.1.3 Its Essential Criteria

For insurable interest to exist, the following criteria must be satisfied:

(a) there must be some *person (i.e. life, limbs, etc), property, liability* or *legal right* (e.g. the right to repayment by a debtor) capable of being insured;

(b) that person, etc. must be the *subject matter* of the insurance (that is to say, claim payment is made contingent on a mishap to such person, etc);

(c) the proposer must have the *legally recognized relationship* to the subject matter of insurance, mentioned in **3.1.1** above, so that financial loss may result to him if the insured event happens. (However, insurable interest is sometimes legally presumed without the need to show financial relationship. For example, any person is regarded as having an insurable interest in the life of their spouse.)

Note: A financial relationship alone is not sufficient to give rise to insurable interest. For instance, a creditor is legally recognised to have insurable interest in the life of his debtor, but is not allowed to insure the debtor's property despite his financial relationship to it, unless the property has been mortgaged to him.

3.1.4 How It Arises

Insurable interest arises in a variety of circumstances, which may be considered under the following headings:

(a) Insurance of the **Person:** everyone has an insurable interest in his own life, limbs, etc. One also has an insurable interest in the life of one's *spouse*. Further, one may insure the life of one's *child* or *ward* (in guardianship) who is under 18 years of age, and a policy so effected will not become invalid upon the life insured turning 18.

(b) Insurance of **Property** (physical things): the most obvious example arises in *absolute ownership*. Executors, administrators, trustees and mortgagees, who have less than absolute ownership, may respectively insure the estate, the trust property and the mortgaged property. Bailees (i.e. persons taking possession of goods with the consent of the owners or their agents, but without their intention to transfer ownership) may insure the goods bailed.

(c) Insurance of **Liability**: everyone facing potential legal liability for their own acts or omissions may effect insurance to cover this risk (sometimes insurance is *compulsory*), such liability being termed '*direct liability*' or '*primary liability*'. Insurance against *vicarious liability* (see **2.2(c)** above) is also possible, where, for example, employers insure against their liability to members of the public arising from negligence, etc. of their employees.

(d) Insurance of Legal **Rights:** anyone legally in a position of potential loss due to infringement of rights or loss of future income has a right to insure such a risk. Examples would include landlords insuring *loss of rent* following a fire.

Note: Anyone (agent) who has authority from another (principal) to effect insurance on the principal's behalf is said to have the same insurable interest to the same extent as the principal. For instance, a property management company may have obtained authority from the individual owners of a building under its management to purchase fire insurance on the building. There is no question of a fire insurance effected under such authority being void for lack of insurable interest, even if the property management company (rather than the property owners) is designated in the policy as the insured.

3.1.5 When Is It Needed?

(a) With life insurance, insurable interest is **only** needed at **policy inception**. Suppose a woman had effected a whole life policy on the life of her husband, who died some years later. When the woman presented a claim to the insurer, the latter discovered that at the time of the man's death, they

were no longer in the relationship of husband and wife. That means the woman had no insurable interest in the life of the deceased at the time of the death. Nevertheless, this lack of insurable interest will not disqualify her for the death benefit.

(b) However, with marine insurance, insurable interest is **only** needed **at the time of loss**.

(c) The above marine insurance rule is *probably* applicable to other contracts of indemnity as well.

3.1.6 Assignment

'Assignment' is a legal term that generally means a ***transfer of property***.

In insurance, there are **two types of assignment**: *assignment of the insurance contract (*or *insurance policy)* and *assignment of the right to insurance money (*or *insurance proceeds*). They are different from each other in the following manner:

(a) **Effect of an assignment of the insurance contract**: With an effective assignment of a policy (or contract) from the assignor (original policyholder) to the assignee (new policyholder), the interest of the assignor in the contract passes wholly to the assignee to the effect that when an insured event occurs afterwards, the insurer is obliged to pay the assignee for *his* loss, not that suffered by the assignor, if any.

(b) **Effect of an assignment of the right to insurance money** (sometimes simply referred to as an assignment of policy proceeds): By contrast, where the right to insurance money has been assigned, the assignor remains a contracting party and the policy remains to cover losses suffered by the assignor, not those by the assignee, although it is now the assignee (instead of the assignor) who has the right to sue the insurer for the insurance money when due.

(c) **Necessity for insurable interest:** With assignment of the insurance contract, both the assignor and the assignee need to have insurable interest in the subject matter of insurance at the time of assignment; otherwise the purported assignment will not be valid. (Taking assignment of motor policy as an illustration, the requirement of insurable interest will be satisfied by having the motor policy assigned to the purchaser contemporaneously with the transfer of property in the car.) However, with assignment of the right to insurance money, no insurable interest is needed on the part of the assignee, so that it may actually take effect as a gift to the assignee.

(d) **Necessity for insurer's consent:** An assignment of the right to insurance money requires no consent from the insurer. But the position is not that simple with assignment of the insurance contract. Different types of insurance are subject to different legal rules as to whether a purported assignment of the insurance contract will have to be agreed to, by the insurer. The matter is further complicated by the fact that very often non-marine policies include provisions that override these legal rules. Fortunately, it is sufficient for you simply to know that, in practice, unlike all other policies, life policies and marine cargo policies are assignable without the insurers' consent.

Note: 1 It is a common misunderstanding that any policy provision that claim payments shall be made to a designated person other than the insured is an assignment of the right to insurance money. In fact, the courts may construe such a provision as a mere instruction to pay, which will at most give the designated payee an expectation to be paid, rather than a right to sue the insurer, which right remains in the hands of the insured.

2 To constitute a legal assignment of either the insurance contract or the right to insurance money, a purported assignment has to be made in accordance with certain statutory provisions.

3.2 UTMOST GOOD FAITH

3.2.1 Ordinary Good Faith

At common law, most types of contracts are subject to the principle of good faith, meaning that the parties must behave with honesty and such information as they supply must be substantially true. However, it is not their responsibility to ensure that the other party obtains all vital information which may affect his decision to enter into the contract, or may affect the terms on which he would enter into the contract. For example, if only after I have boarded a double-decker and paid the fare do I find that no seats on it are vacant, I will have no grounds for complaint. In technical terms, I am not entitled, in such circumstances, to avoid my contract with the bus company for its failure to voluntarily disclose to me the fact that all the seats have been taken on the bus.

3.2.2 Utmost Good Faith

Insurance is subject to a more stringent common law principle of good faith, called the principle of utmost good faith. It means that each party is under a duty to reveal all vital information (called **material facts**) to the other party, *whether or not* that other party asks for it. For example, a proposer of fire insurance is obliged to reveal the relevant loss record to the insurer, even where

there is not a question on this in the application form.

Note: 1 Insurers sometimes *extend* the common law duty of utmost good faith by requiring the proposer to declare (or *warrant*) that all information supplied, whether relating to "material" matters or not, is totally (as opposed to substantially) true. For example, where a proposer for medical insurance enters '30' as his current age on the proposal form when he is aged 31, this is a technical breach of the above kind of warranty, if any, although this inaccuracy is unlikely to be material in the eyes of the common law principle of utmost good faith as applied to medical insurance.

2 On the other hand, a policy provision may state that an innocent or negligent (as opposed to fraudulent) breach of the duty will be waived (excused).

3.2.3 Material Fact

(a) **Statutory Definition**: 'Every circumstance which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will accept the risk'.

From this definition, it can be seen that there are three categories of material facts, by reference to the kinds of decisions likely to be affected by their disclosure. The first one only concerns the decision to accept or to reject a proposed risk (e.g. the fact that a proposed life insured has an inoperable malignant brain tumour.) The second only concerns the setting of premium (e.g. the fact that the insured person of a proposed personal accident insurance is a salesperson). And the third concerns both (e.g. where a proposed life insured is a diabetic).

You should also note that the law looks at an alleged 'material fact' in the eyes of a prudent insurer - not a particular insurer, a particular insured or a reasonable insured.

(b) **Non-material facts**: Facts which do not have to be revealed even if they will otherwise be regarded as material include:

(i) matters of *common knowledge* (e.g. the explosive character of hydrogen);

(ii) facts already *known*, or deemed to be known, to the insurer (e.g. the general conditions of storage in Nigeria that could be expected to be known to a marine cargo insurer);

(iii) facts which *improve* the risk.

[Example: A proposer for commercial fire insurance did not mention the fact that his premises were protected by an automatic sprinkler system, which fact, if disclosed, would have influenced the determination of the premium. This omission does not breach utmost good faith, as the fact (although very relevant) actually improves the risk.]

3.2.4 When to Disclose Material Facts

It may be said that utmost good faith involves a duty of disclosure by the proposer/insured. Technically, the insurer is under the same duty, but here we will concentrate on the proposer's duty. This duty has some features that we should note:

(a) *Duration* (at common law): Those material facts which do not come to the proposer's (or his agent's) knowledge until his proposal (i.e. request for insurance) is accepted by the insurer do not have to be disclosed. Suppose a proposal for a one-year medical insurance commencing on 15 January 2004 was accepted on 2 January, and the insured had a medical examination on 10 January, which revealed to him on 16 January the contraction of malaria. An important question to ask is: 'Is the insured legally obliged to disclose such finding to his insurer?' Applying the legal rule just said, the insured is not obliged to do so, assuming that the terms of insurance are silent on this point. Of course, the policy will normally contain an exclusion for pre-existing diseases, in which case the insurer may rely on this exclusion rather than a breach of utmost good faith in trying to deny a claim in respect of malaria.

(b) *Duration* (under policy terms): Some non-life policies require the disclosure of material changes in risk happening during the currency of the contract, such as a change in occupation in the case of a personal accident insurance. At common law, such a change need not be notified until renewal.

(c) *Renewal*: when the policy is being renewed, the duty of utmost good faith revives. (Note: the duty of utmost good faith does not revive when a life policy is approaching its anniversary date.)

(d) *Contract alterations*: If these are requested during the currency of the policy, the duty of utmost good faith applies in respect of these changes. Where, for example, the insured of a fire policy is requesting an extension to cover theft, he is immediately obliged to disclose all material facts relating to the theft risk, e.g. the physical protections of the insured premises and his record of theft losses, if any.

3.2.5 Types of Breach of Utmost Good Faith

A breach of utmost good faith can be in the form of either a **misrepresentation** (i.e. the giving of false information) or a **non-disclosure** (i.e. failure to give material information). Alternatively, it can be classified into a **fraudulent** breach and a **non-fraudulent** breach (i.e. a breach committed either innocently or negligently, rather than fraudulently). Both classifications combined produce a four-fold categorisation as follows:

(a) *Fraudulent Misrepresentation*: an act of fraudulently giving false material facts to the other party;

(b) *Non-fraudulent Misrepresentation*: an act of giving false material facts to the other party done either innocently or negligently;

(c) *Fraudulent Non-disclosure*: a fraudulent omission to give material facts to the other party; or

(d) *Non-fraudulent Non-disclosure*: an omission to give material facts to the other party done either innocently or negligently.

3.2.6 Remedies for Breach of Utmost Good Faith

If the duty of utmost good faith is breached (any one of the four types mentioned above), the aggrieved party (normally the insurer) may have available certain remedies against the guilty party:

(a) To *avoid* the whole contract as from policy inception, with the effect that premiums (and claims) previously paid without knowledge of the breach are generally returnable, unless it was a fraudulent breach on the part of the insured or his agent;

(b) In addition to (a) above, it is in principle possible to *sue in tort (see Glossary) for damages* if fraud is involved;

(c) To *waive* the breach, alternatively, in which case the contract becomes valid retrospectively.

Note: At law, an insurer aggrieved by a breach of utmost good faith has not the option to refuse payment of a particular claim, to treat the policy as valid for the remainder of the insurance period, and to retain part of or the whole of the premium paid. This is because the law does not recognise a right to rescind only part of a contract.

3.3 PROXIMATE CAUSE

3.3.1 Meaning and Importance of the Principle

The proximate cause of a loss is its effective or dominant cause.

Why is it important to find out which of the causes involved in an accident is the proximate cause? A loss might be the combined effect of a number of causes. For the purpose of insurance claim, one dominant cause must be singled out in each case, because not every cause of loss will be covered.

3.3.2 Types of Peril

In search of the proximate cause of a loss, we often have to analyse how the causes involved have interacted with one another throughout the whole process leading to the loss. The conclusion of such an analysis depends very much on the identification of the perils (i.e. the causes of the loss) and of their nature. All perils are classified into the following **three** kinds for the purpose of such an analysis:

(a) *Insured peril*: It is not common that a policy will cover all possible perils. Those which are covered are known as the 'insured perils' of that policy, e.g. 'fire' under a fire policy, and 'stranding' under a marine policy.

(b) *Excepted (or excluded) peril*: This is a peril that would be covered but for its removal from cover by an exclusion, e.g. fire damage caused by war is irrecoverable under a fire policy because war is an excepted peril of the policy.

(c) *Uninsured peril*: This is a peril that is neither insured nor excluded. A loss caused by an uninsured peril is irrecoverable unless it is an insured peril that has led to the happening of the uninsured peril. For example, raining and theft are among the uninsured perils of the standard fire policy.

3.3.3 Application of the Principle

The principle of proximate cause applies to all classes of insurance. Its practical applications may be very complex and sometimes controversial. For our purposes, we should note the following somewhat simplified rules:

(a) There must always be an *insured peril* involved; otherwise the loss is definitely irrecoverable.

(b) If a *single cause* is present, the rules are straightforward: if the cause is an **insured peril,** the loss is covered; if it is an **uninsured** or **excepted peril**, it is not.

(c) With more than one peril involved, the position is complex, and different rules of proximate cause are applicable, depending on whether the perils have happened as a chain of events or concurrently, and on some other considerations. Specific cases should perhaps be a matter of consultation with the insurer and/or lawyers, but the general rules are:

(i) **uninsured perils** arising directly from **insured perils:** the loss is covered, e.g. water damage (uninsured peril) proximately caused by an accidental fire (insured peril) in the case of a fire policy;

(ii) **insured perils** arising directly from **uninsured perils:** the loss from the insured peril is covered, e.g. fire (insured peril) damage proximately caused by a careless act of the insured himself or of a third party (uninsured peril) in the case of a fire policy.

(iii) the occurrence of an **excluded peril** is generally fatal to an insurance claim, subject to complicated exceptions.

(d) Other Features of the Principle

(i) Neither the first nor the last cause necessarily constitutes the proximate cause.

(ii) There may exist more than one proximate cause. For example, the dishonesty of an employee and the neglect on the part of his supervisor of a key to a company safe may both constitute proximate causes of a theft loss from the safe by the dishonest employee.

(iii) The proximate cause need not happen on the insured premises. Suppose a flat insured under a household policy is damaged by water as a result of a fire happening upstairs. The damage is recoverable under the policy, although the insured flat has never been on fire.

(iv) Where the proximate cause of a loss is found not to be an insured peril, it does not necessarily mean that the loss is irrecoverable under the policy.

[Illustration: There are four containers of cargo being carried on board a vessel and insured respectively under four marine cargo policies. The first policy solely covers the peril of collision, the second fire only, the third explosion only, and the fourth entry of

water only. During the insured voyage, because of the master's negligence, this vessel collides with another. The collision causes a fire, which then triggers an explosion. As a result, the vessel springs several leaks and all the cargo is damaged by seawater entering through the leaks. These facts show that the cargo damage was proximately caused by negligence. Bearing in mind that negligence is merely an uninsured rather than insured peril of each of the four cargo policies, an immediate and important question that has to be grappled with is: 'Is the cargo damage irrecoverable under those policies?' In search of an answer to this question, we must look at the links between the individual events of the incident. Negligence, the identified proximate cause, naturally causes a collision, which then naturally causes a fire. The fire naturally leads to an explosion, which then naturally causes an entry of water. At last, the water damages the cargo. Before us is a chain of events, happening one after another without being interrupted by other events. With respect to each policy, the water damage is regarded as a result of its sole insured peril, notwithstanding that this peril can be traced backward to an uninsured peril. Therefore, the only conclusion that we can reach is that each of the polices is liable for the water damage to the cargo it has insured. (Of course, if the proximate cause is found to be an excepted peril, the opposite conclusion will have to be made.)]

3.3.4 Policy Modification of the Principle

It is very common for insurers to adopt policy wording that has the effect of modifying the application of proximate cause rules. Two examples of such practice are given below:

(a) ***'Directly or indirectly'*:** There are a whole number of ways that an insurer can frame his policy wording for the purpose of specifying what he wants to cover or not to cover. For instance, it may use such wording as 'loss caused by …', 'loss directly caused by …' and 'loss proximately caused by …'. Well do they mean different things to you? Will any of them have the effect of modifying the rules of proximate cause? The answer is: they have been held to mean the same thing. That is to say, whether the term 'directly' or 'proximately' is adopted or left out, the legal rules to be applied are exactly the same and the same scope of cover is given or excluded. But what if the term 'indirectly' is used? A policy exclusion that says that loss *"directly or indirectly"* arising from a particular peril (excepted peril) is excluded has been construed by the courts to mean that a loss will not be recoverable even where the operation of that excepted peril has only been a *remotely* (as opposed to 'proximately') contributory factor. Read the following decided court case for illustrations:

An army officer was insured under a personal accident policy, which excluded claims "directly or indirectly caused by war". During wartime, the insured was on duty supervising the guarding of a railway station. Walking along the track in the darkness, he was struck by a train and killed. It was held that although war was only an "indirect" cause of the death, the policy wording meant that the insurer was not liable.

(b) ***'Loss proximately caused by delay, even though the delay be caused by a risk insured against'*** (an exclusion wording quoted from a marine cargo insurance clause most commonly used): Suppose an insured shipment of calendar for the year 2004, expected to arrive on 1 December 2003, does not arrive until 15 February 2004 because of a collision (insured peril) involving the carrying vessel during the insured voyage. By relying on the exclusion, the insurer can deny a 'loss of market' claim from the insured even though the loss is due to an insured peril.

Note: Remember that the principle of proximate cause is sometimes very complicated. There have been many interesting and sometimes surprising court cases which have decided its application. In particular, not too rarely are inconsistent or opposing judicial decisions in factually similar cases seen which are made on the basis of the same rule(s) of proximate cause, perhaps because the judgments of the judges vary from one case to another on how the facts of a case relate to one another. Therefore, please do not assume that knowledge of the above brief notes will make you an expert in this area.

3.4 INDEMNITY

3.4.1 Definition

Indemnity means *an exact financial compensation* for an insured loss, no more no less.

3.4.2 Implications

Indemnity cannot apply to all types of insurance. Some types of insurance deal with "losses" that cannot be measured precisely in *financial* terms. Specifically, we refer to **Life Insurance** and **Personal Accident Insurance**. Both are dealing with death of or injury to human beings, and there is no way that the loss of a finger, say for instance, can be measured precisely in money terms. Thus, *indemnity* cannot normally apply to these classes of business. (Note: medical expenses insurance, which is often included in personal accident insurance policies, is an indemnity insurance unless otherwise specified in the policies.)

Other insurances are subject to the principle of indemnity.

Note: It is sometimes said that life and personal accident insurances involve *benefit policies* rather than policies of *indemnity*. Since indemnity cannot normally apply, the policy can only provide a **benefit** in the amount specified in the policy for death or for the type of injury concerned.

3.4.3 Link with Insurable Interest

We studied insurable interest in **3.1**. That represents the financial "interest" in the subject matter, which is exactly what should be payable in a total loss situation, if the policyholder is to be completely compensated. However, life and personal accident insurances may generally be regarded as involving an *unlimited insurable interest*, and therefore indemnity cannot apply to them.

3.4.4 How Indemnity is Provided

It is common for property insurance policies to specify that the insurer may settle a loss by any one of four methods named and described below. However, both marine and non-property policies are silent on this issue so that the insurer is obliged to settle a claim by payment of cash.

(a) *Cash payment* (to the insured): This is the most convenient method, at least to the insurer.

(b) *Repair*: Payment to a repairer is the norm, for example, with motor partial loss claims.

(c) *Replacement:* With new items, or articles that suffer little or no depreciation, giving the insured a replacement item may be a very suitable method, especially if the insurer can obtain a discount from the supplier.

(d) *Reinstatement*: This is a word that has a number of meanings in insurance. As a method of providing an indemnity, it means the restoration of the insured property to the condition in which it was immediately before its destruction or damage.

Note: You are absolutely correct if you understand that the term ‘reinstatement’ overlaps in meaning with ‘repair’ and with ‘replacement’.

3.4.5 Salvage

When measuring the exact amount of loss (which indemnity is), it has to be borne in mind with certain property damage that there will sometimes be something left of the damaged *subject matter of insurance* (fire-damaged stock, the wreck of a vehicle, etc.). These remains are termed **salvage.** If the remains have any financial value, this value has to be taken into account when providing an indemnity. For example:

(a) The value of the salvage is *deducted* from the amount otherwise payable to the insured (who then keeps the salvage); or

(b) The insurer pays in full and *disposes* of the salvage for its own account.

Note: The term "salvage" in maritime law has a very different meaning, where it usually refers to saving a vessel or other maritime property from perils of the sea, pirates or enemies, for which a sum of money called 'salvage award' (or just 'salvage') is payable by the property owners to the salvor provided that the operation has been successful. The term is sometimes also used to describe property which has been salved.

3.4.6 Abandonment

This is a term mostly found in marine insurance, where it refers to the act of *surrendering* the subject matter insured to the insurers in return for a total loss payment in certain circumstances. This is quite standard in marine practice, but in other classes of property insurance policies usually specifically exclude abandonment.

The important thing to be remembered with abandonment is that the subject matter insured (or what is left of it) is *completely* handed over to the insurer, who may therefore benefit from its residual value. (This will be important with **Subrogation,** see **3.6** below).

3.4.7 Policy Provisions Preventing Indemnity

Although policies frequently promise to *indemnify* the insured, this is always within the terms of the policy. These terms may sometimes mean that something less than indemnity is payable. For example:

(a) *Average:* Most non-marine property insurances are expressly *subject to average*. This means that the insurer expects the insured property to be insured for its full value. If it is not, in the event of a loss the amount payable will be reduced in proportion to the *under-insurance*. For example, if the actual value of the affected property at the time of a loss

was $4 million and it was only insured for $1 million, we may say that the property was at the time of the loss only 25*% insured*. Therefore, by the application of **average,** only 25% of the loss is payable.

In view of this penalty for under-insurance, it is very important for insurance intermediaries to do their best to ensure that their clients will arrange full value insurance.

Note: In marine insurance, **average** has a totally different meaning. Here it means *partial loss*, a loss other than total loss. Average in marine insurance is complex and beyond the needs of this present study.

(b) *Policy excess/deductible:* An excess or deductible is a policy provision whereby the insured is not covered for losses up to the specified amount, which is always deducted from each claim.

Suppose a motor policy is comprehensive, with a $4,000 excess for damage to the insured vehicle. If an accident occurs and the repair bill for the car amounts to $14,000, the insurer is only liable for $10,000. On the other hand, with a minor accident and repairs costing $3,000, the insurer would have no liability at all.

(c) *Policy franchise*: Rarely seen today, it is similar to an excess in that it eliminates small claims. On the other hand, it is different from an excess in that if the loss exceeds or reaches the franchise – depending on the wording used - the loss is payable *in full*. Like an excess, a franchise can be expressed as a percentage, an amount of loss, or a time period.

Suppose a ship which is insured for $5,000,000 subject to a 5% franchise sustains insured damage. If repairs cost only $100,000 (2%), nothing is payable by the insurer. But if repairs cost $1,000,000 (20%), the loss is payable in full.

Example of time franchise: A particular hospitalization policy contains a 2-day franchise provision; in other words, there is a waiting period of two days. If the insured person stays in hospital for one day, no expenses are reimbursable. But if he has to stay for 5 days, the policy pays the medical expenses incurred during the whole of that 5-day period.

(d) *Policy limits*: The *sum insured* is the insurer's maximum liability, so any loss exceeding that limit will not be fully indemnified. There may also exist other types of limits within the policy terms; examples include:

(i) *Single Article Limit*: It is a limit commonly found in a household contents policy. Where such a policy covers property described in broad terms like ‘contents’ for a stated amount, there is no way the insurer can tell whether the insured contents will not, at the time of

loss, be found to include an article which is so valuable that its value already accounts for 90% of the sum insured for the whole of the contents. This is a situation the insurer will not want to see, partly because of the theft risk it represents. In fact, the insured could have declared the value of this item of contents to the insurer, requiring that it be separately subject to a sum insured representing its value. The benefit of this approach is that the insurer will be liable for an insured loss to this item of property up to its own sum insured. On the other hand, in the event that an insured has not made such an article the subject of a separate sum insured, the insurer will have to restrict the amount payable for a loss to this item to a limit specified in the policy, called the single article limit.

(ii) *Section Limit*: A policy may contain two or more sections, which take effect in relation to different subject matter of insurance (as in the case of a motor car policy), different insured perils, etc. Each of these sections is usually made subject to its own limit of liability, which operates similarly to a sum insured.

3.4.8 Policy Provisions Providing More Than Indemnity

Indemnity is very logical and technically easy to defend. However, in practice, most policyholders are ignorant of this and are confused and offended when insurers "reduce" their claims, by deducting depreciation, wear and tear, etc. As a marketing or public relations exercise, insurers sometimes offer or agree to grant property insurances which may be said to give a *commercial* rather than a *strict* indemnity. Some examples are as follows:

(a) *Reinstatement insurances* (or insurances on a reinstatement basis): This is one of the several uses of the term "reinstatement" (see **3.4.4**(d) above) and is often found with fire and commercial ‘all risks’ insurances. The meaning is that where reinstatement takes place after a loss, no deductions are made from claim payments in respect of wear and tear, depreciation, etc.

(b) *"New for Old" cover*: Again, this means that no deductions are made in respect of wear and tear, deprecation, etc. This term is more generally used with household and marine hull policies.

(c) *Agreed value policies* (or valued policies): Such policies may be used for articles of high value, where depreciation is unlikely to be a factor (e.g. works of art, jewellery, etc.) or where property valuation contains a rather subjective element. The sum insured is fixed on the basis of an expert's valuation, and agreed between the insured and the insurer as representing the value at risk of the property *throughout* the currency of the policy. In non-marine insurance, a valued policy undertakes to pay this sum in the

event of a total loss, without regard to the actual value at the time of loss, whereas in the event of a partial loss, the actual amount of loss would instead be payable without regard to the agreed value.

(d) *Marine policies*: Almost without exception, marine hull and marine cargo policies are issued on a valued basis, and the agreed value will be taken as the actual value at the time of loss for the purposes of both partial and total loss claims.

3.4.9 The Practical Problems with Indemnity

Indemnity, as mentioned above, is extremely logical. What makes more sense than to say that a person should only recover what he has lost? He should not *profit* from a loss! However, most people feel that they should receive the amount they have insured for, with a total loss. Moreover, the fact or amount of *depreciation* is an area where you, or the claims handler, may definitely expect problems with the claimant. When claims are being made, a lot of claimants will say that their property has not depreciated at all, or only marginally!

3.5 CONTRIBUTION

3.5.1 Equitable Doctrine of Contribution

This is a claims-related doctrine of equity which applies as between insurers in the event of a double insurance, a situation where two or more policies have been effected by or on behalf of the insured on the same interest or any part thereof, and the aggregate of the sums insured exceeds the indemnity legally allowed.

> [Example: Suppose a husband and wife each insure their home and contents, each thinking that the other will forget to do so. If a fire occurs and $200,000 damage is sustained, they will not receive $400,000 compensation. The respective insurers will share the $200,000 loss.]

Apart from any policy provisions, any one insurer is bound to pay to the insured the full amount for which he would be liable had other policies not existed. After making an indemnity in this manner, the insurer is entitled to call upon other insurers similarly (but not necessarily equally) liable to the same insured to share (or to contribute to) the cost of the payment.

3.5.2 Rateable Proportions

Where contribution applies, the ultimate proportion of the insured's loss that any one particular insurer is responsible for is called the 'rateable proportion' of that insurer. It is not difficult to understand that the sum of all the insurers' rateable proportions equals one, that is to say, 100% of the insured's loss.

A few methods are available for calculating rateable proportions. But as an insurance intermediary, it is not essential that you should know them well, bearing in mind that how much your clients will ultimately get paid for a loss will not depend on the basis of contribution to be employed.

3.5.3 How Arising

The criteria (or essentials) that need to be satisfied before contribution applies are:

(a) the respective policies must each be providing an *indemnity* (rather than benefit) to the loss in question (this is the reason why it is said that contribution is a corollary (i.e. a natural consequence of an established principle) of indemnity);

(b) they must each cover the *interest* (which term does not mean property, liability, etc) affected (see counter-example below);

(c) they must each cover the *peril* (cause of loss) that has given rise to the loss;

(d) they must each cover the *subject matter of insurance* (property, liability, etc.) that has been affected; and

(e) each policy must *cover* the loss (i.e. not be subject to a policy exclusion or limitation preventing contribution).

[*Counter-example of criterion (b)*: A merchant has some stock-in-trade kept in a public warehouse, and insured under a fire policy. Separately and at the same time, the warehouse operator buys fire insurance on the same property. When a fire occurs damaging the stock-in-trade, both the merchant and the warehouse operator claim under their own policies for the same damage. Immediately two basic questions come to mind. First, is the warehouse operator, not being an owner of the damaged property, entitled to claim under his own fire policy? Second, if both policyholders are entitled to claim, will there be contribution between the insurers? The answer to the first question is: the warehouse operator, being a bailee of the stock-in-trade, has insurable interest in it at the time of loss, and is thus entitled to claim under his own policy. Turning to the merchant, you probably will not conclude, or even argue, that he cannot expect to be indemnified. Now we have to wrestle with the last question. The answer to this

question hinges on that to the question of whether the two policies cover the same interest (criterion (b)). For whose benefit has the merchant bought his fire insurance? And what about the warehouse operator? In fact, each of them has bought insurance for their own benefit. In other words, the first mentioned policy covers the merchant's 'interest as owner', and the second one covers the warehouse operator's 'interest as bailee'. Is it apparent to you now that the two policies cover different interests, so that contribution will not apply as between them?

At this point, we have completely resolved the issue of contribution arising in the case. But there remains an issue of the cogency of indemnifying for the same loss with twice its amount. Now it is time for another principle of insurance – subrogation (see **3.6** below) – to play its part. The insurer of the merchant, upon indemnification, is entitled to claim, for his own benefit but in the name of the merchant, upon the warehouse operator (baliee) for the indemnity from the other insurer.]

3.5.4 How Applicable

Contribution will only apply if **indemnity** applies. Thus, if a person dies whilst insured by two or more separate *life insurance* policies, each must pay in full, because the insurances are not subject to indemnity.

3.5.5 How Amended by Policy Conditions

The position between insurers as governed by the equitable doctrine of contribution is of little or no concern to the insured, unless that has been modified by one of the following policy provisions:

(a) *Rateable Proportion Clause* (or Contribution Condition), restricting the insurer's liability to its *rateable share* of the loss. The effect is that, where there is double insurance and each of the relevant policies contains such a clause, the insured could no longer claim all of his loss from one insurer alone.

[Example: Using the example in **3.5.1** again, the standard fire policy contains a clause restricting the insurer's contribution to its "rateable share" in the event of double insurance. In the given circumstances, if Insurer A is approached first and his rateable share is, say, $50,000 (25%), he cannot be made to pay the full loss. He is liable only for $50,000 and the insured must himself go to Insurer B for B's rateable share ($150,000 or 75%).

(b) *Non-contribution clause*, to the effect that it is the other policies that will have to pay the loss.

[Example: Household policies on contents may exclude items ***"more specifically insured"***. So if a camera is separately insured under an "All Risks" policy, that policy may be regarded as more specific than the household policy, so that the latter policy is not liable for a loss of the camera from the insured premises by, say, theft.]

(c) *Partial Contribution Condition*

[Example: The so-called "Marine Clause" in the standard fire policy provides that in the event of potential contribution between a marine policy and the fire policy, the fire policy will not share the loss, except for that part of the loss which is above the marine compensation. (This may happen where, for example, some cargo, while being left in a container depot awaiting the carrying vessel, catches fire. The usual marine policy will cover the damage so caused. It is also possible that there is in place a fire policy whose coverage has been extended to cover a fire occurring in such circumstances.)]

3.6 SUBROGATION

3.6.1 Definition

Subrogation is the exercise, for one's own benefit, of rights or remedies possessed by another against third parties. As a corollary (i.e. a natural consequence of an established principle) of indemnity, subrogation allows proceeds of claim against third party be passed to insurers, to the extent of their insurance payments. At common law, an insurer's subrogation action must be conducted in the name of the insured.

Suppose, for example, that a car, covered by a comprehensive motor policy, is damaged by the negligence of a building contractor. The motor insurer must pay for the insured damage to the car. *As against the negligent contractor*, the insured's right of recovery will not be affected by the insurance claim payment. However, the motor insurer may, after indemnifying the insured, take over such right from the insured and sue the contractor for the damage in the name of the insured.

From this, it will easily be seen how subrogation seeks to protect the parent principle of **indemnity**, by ensuring that the insured does not get paid twice for the same loss.

3.6.2 How Arising

Subrogation rights arise in several manners as follows:

(a) In *tort*: This usually arises where a third party negligently causes a loss indemnifiable by a policy. For example, a fire insurer, after paying a fire loss, discovers that the fire was caused by a negligent act of a neighbour of the insured. It sues the neighbour in the name of the insured for damages recognised by the law of tort.

(b) In *contract*: This arises where the insured (perhaps a landlord) has a contractual right (perhaps under a tenancy agreement) against another person (perhaps a tenant) for an insured loss. After indemnifying the insured for the loss, the insurer may exercise such right against that other person in the name of the insured.

(c) Under *statute:* If a person is injured at work, his employer, if any, will have to pay an *employee compensation* benefit to him in accordance with the provisions of the Employees' Compensation (EC) Ordinance. The Ordinance will then grant subrogation rights to the indemnifying employer against another person who is liable to the employee for the injury. The employer must in turn pass these rights to the EC insurer.

(d) In *salvage*: This we have already considered (see **3.4.5** above). The insurer may be said to have subrogation rights in what is left of the subject-matter of insurance (salvage), arising under the circumstances already discussed.

3.6.3 How Applicable

As with contribution, **subrogation** can only apply if **indemnity** applies. Thus, if the life insured of a life policy is killed by the negligence of a motorist, the paying life insurer will not acquire subrogation rights, as this payment was not an indemnity.

3.6.4 Other Considerations

There are other features to note:

(a) In the common law, subrogation rights are only acquired *after* an indemnity has been provided. Non-marine policy conditions usually say that the insurer is entitled to such rights *even before indemnification*.

(b) Special considerations arise in respect of subrogation recoveries:

(i) The insurer cannot recover more under subrogation than he paid as an indemnity. By way of example, suppose there is an insured loss of an antique. The insurer pays, and some time later when the antique is found, its value is much higher. The insurer can only keep the amount he has paid and any balance belongs to the insured.

(ii) The above saying is not true in the event of subrogation arising after *abandonment* of the property to the insurer (see **3.4.6** above). There, **all rights** in the property belong to the insurer, of course including the right to "make a profit"!

(iii) Sharing of Subrogation Proceeds

Where the insurer has only provided a less-than indemnity on the basis of certain policy limitations, the insured may possibly be entitled to part of – sometimes even the whole of - the subrogation proceeds, depending on what limitations have been applied in the process of claims adjustments. The following are illustrations of several manners in which the sharing of subrogation proceeds between the insured and the insurer can be done:

(1) *Excess*: Suppose the insured is responsible for a loss (excess) of $10,000 before his liability insurer pays $40,000, and $20,000 is subsequently recovered from a negligent third party. The whole of $20,000 will belong to the insurer. However, if the subrogation recovery is $45,000 instead, the insured will be entitled to $5,000 and the insurer $40,000.

(2) *Limit of Liability*: Suppose an insured contractor has incurred liability to a road user in the amount of $1.5 million, of which the insured has to pay $0.5 million out of his own pocket because his policy is subject to a limit of liability of $1 million. Any recovery from a joint tortfeasor will belong to the insured, except where it amounts to more than $0.5 million in which case that part over and above the $0.5 million threshold will belong to the insurer up to the amount of the insurance payment.

(3) *Average*: Suppose a fire insurer has paid 80% of a loss where there is a 20% underinsurance. The insured is entitled to 20% of subrogation proceeds as if he was a co-insurer for 20% of the risk.

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Representative Examination Questions

Type "A" Questions

1 Insurable interest may be defined as:

(a) possession of certain goods; .....
(b) the amount always payable for insurance claims; .....
(c) a legally recognized relationship to the subject matter; .....
(d) the interest payments due if the insurance premium is paid late. .....

[Answer may be found in **3.1.1**]

2 For most types of non-life insurance, insurable interest is required:

(a) certainly at the time of the loss; .....
(b) only when the policy is first arranged; .....
(c) only at the time the first premium is paid; .....
(d) only if this is specifically mentioned in the policy. .....

[Answer may be found in **3.1.5**]

Type "B" Questions

3 Which of the following are regarded as breaches of utmost good faith?

(i) Fraudulent non-disclosure
(ii) Non-fraudulent non-disclosure
(iii) Non-fraudulent misrepresentation
(iv) Fraudulent misrepresentation

(a) (i) and (ii) only; .....
(b) (i), (ii) and (iii) only; .....
(c) (ii), (iii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **3.2.5**]

4 Which **three** of the following insurance policy provisions could mean that something **more** than indemnity is payable with claims?

(i) "New for Old" cover
(ii) Agreed value policies
(iii) Reinstatement insurances
(iv) The condition of average

(a) (i), (ii) and (iii); .....
(b) (i), (ii) and (iv); .....
(c) (i), (iii) and (iv); .....
(d) (ii), (iii) and (iv). .....

[Answer may be found in **3.4.8**]

[If still required, the answers may be found at the end of the Study Notes.]

4 CORE FUNCTIONS OF AN INSURANCE COMPANY

Whilst an insurance intermediary is unlikely to have close contact with the internal organization of insurance companies, it is good to understand something of their infrastructure and to be aware of the various departments and personnel behind the marketing process. These, in outline, are considered below. Please remember, however, that there is no single system for insurance companies to follow, so the suggested structure must be seen as representative only.

4.1 PRODUCT DEVELOPMENT

Someone once said, "Insurance is not something that is *bought*, it is something that has to be *sold*". We shall recall this when discussing marketing and promotion (**4.3** below), but to the extent that it is true the whole exercise depends upon having **something** to sell. That something may be described as an insurance *product*.

Some insurances, of course, are *compulsory* (e.g. **third party motor** and **employees' compensation**), but even with these classes the precise policy wording is not decreed by Government, so there is scope for flexibility in presentation (whilst the primary requirements of Ordinances must be respected). With other classes of insurance business, Hong Kong is an open and very *competitive* environment. Insurers must therefore be efficient and dynamic in preparing the products they "sell". As an abbreviated summary, the Product Development department/section of an insurer will be much occupied with:

(a) **Individual product development**: this is a never-ending process. With competitors eager to learn and copy (and at times being not too scrupulous in the way this is done!), it has been said that the unchallenged "lifespan" of a totally new product is very short, perhaps a matter of only a few weeks or months. After that time, the product has been copied, adapted and frequently undersold.

(b) **Product portfolio development**: increasingly, producing a "package" of covers, especially for larger clients, has become sensible, even vital, in order to retain a competitive edge.

(c) **Product research**: we may think of this in three areas:

  (i) **our own products**: nothing is perfect beyond improvement.

  (ii) **competitors' products**: we do not, and cannot, live in a vacuum. It is essential to know what is happening in our market and "what we are up against". Besides, they will have no hesitation in "borrowing" from us!

  (iii) **market trend**: the needs of the general public.

4.2 CUSTOMER SERVICING

Sometimes described as **Client Servicing**, this section has a number of functions, and with a particular insurer some of these may be carried out by other departments (such as Accounts, Claims etc.). The general scope of its responsibilities is indicated by its name. It is to provide a service to existing and potential customers/clients, and the duties are likely to include:

(a) **Correspondence:** enquiries of every imaginable kind are likely to be received, asking for guidance and information. Sometimes, the enquiries will be totally unrelated to the company's business, so a degree of perception and tact will be required. It is quite sure that the response a company gives to enquiries is very important.

(b) **Public relations:** the more formal aspects of this could be within the province of the marketing "people", but the way clients are dealt with profoundly influences a company's standing in the eyes of the public.

(c) **Documentation**: requests for duplicate policies, amendments to existing policies, copies of motor insurance certificates, etc. will probably receive at least their initial attention in this department.

(d) **Complaints**: an area that must be seen to be handled fairly and promptly. This may require considerable liaison with other colleagues/departments. It must also be remembered that complaints may reach high levels of company management and receive media and even Government attention.

4.3 MARKETING AND PROMOTION

Remembering the quotation in **4.1**, this is a very important area for the insurer. The particular areas of responsibility include:

(a) **Public Relations**: as explained, this may overlap to some extent with Customer Services, but the image of the company and its perceived standing in the eyes of the public is of great significance. This wide-ranging activity will include:

(i) the co-ordination of all *external communications*;

(ii) the co-ordination of *media enquiries and interviews*;

(iii) *press conferences*, to announce or explain things, as necessary;

(iv) preparing *press releases* and *copy* for trade and other journals.

(b) **Promotions:** organizing and co-ordinating their preparation and conduct.

(c) **Advertising**: closely interconnected with the above, this enormously important area includes:

(i) selection of external agencies (if used);

(ii) the extent to which TV or other media are to be involved;

(iii) co-ordination of advertising campaigns;

(iv) expenditure analysis and control.

Note: Advertising is an area which could involve **massive** expenditure. Great care must therefore be taken in its management and control. As one famous businessman said "Half the money I spend on advertising is wasted. Unfortunately, I do not know *which* half!"

(d) **Sponsorship**: insurers are frequently asked to sponsor industry or educational projects. Also, this is of course an important aspect of advertising, involving much time and probably a considerable budget.

(e) **Market research**: obviously, continuous monitoring of one's present and potential market is a vital element for a marketing department. This will seek to establish existing and perceived needs and demands in respect of insurance products.

4.4 INSURANCE SALES

Very closely connected with **marketing**, there may be considerable overlap of activity, if separate sections exist. The name, however, indicates the functions, which specifically will include:

(a) **Product liaison**: it is vital that the closest co-operation exists between Product Development, Marketing and Sales, for obvious reasons. Poor communication between colleagues in this area could have disastrous field results.

(b) **Sales enhancement programmes**: again requiring co-operation with other colleagues, e.g. Training and Marketing.

(c) **Monitoring**: it is important to keep abreast of results and trends. Again, much teamwork with colleagues is required.

4.5 UNDERWRITING

This may be defined as the *selection* of risks to be insured and the determination of the *terms* under which the insurance is given. With non-life insurances, it also involves a continuing process of monitoring results and individual risks, to see whether *renewals* should be offered, and on what terms. Special features to note are:

(a) **Life insurance**: for individual policies, underwriting is a *once only* exercise, since the policy cannot be cancelled by the insurer and changes are only possible with the insured's consent. Because of its crucial importance, life insurance underwriting is often centralized.

(b) **General insurance**: here the range of different covers is very wide and mistakes in underwriting are not permanent, in the sense that policies will come up for renewal and their terms be reviewed, and can even be cancelled if necessary. Therefore much less centralized underwriting is still affordable.

(c) **Guidelines**: whilst underwriting is at a "one to one" level, there is obviously a need for the preparation of underwriting manuals, rating guides and similar guidelines for staff. These involve considerable research and development, again with much attention to trends and results.

(d) **Target risks**: curiously, this term could mean highly *desirable* types of business (in Life Insurance) or highly *undesirable* types of business (in General Insurance). In the former, of course, this is business the insurance intermediaries should be encouraged to seek diligently. In the latter, the term could mean large, hazardous risks, e.g. petrochemical plants. In either context, decisions must be made as to the appropriate designations.

Each insurer will have its own ideas about what constitutes desirable or undesirable risks. Typically, however, in life insurance, healthy well qualified young professionals are likely to be desirable contacts. In theft insurance, jewelry stores in Central Hong Kong may not be favoured.

(e) **Stop-lists**: sometimes given other names, a ‘stop-list’ indicates those types of business that should not be encouraged, or should be rejected if offered. Some examples may readily come to mind, with different types of insurance, although not every insurer will have the same opinions on this subject. Nevertheless, compiling such lists involves considerable underwriting expertise, especially bearing in mind the sensitivity over *discrimination* of any kind (see **7.3** below).

4.6 POLICY ADMINISTRATION

This is another departmental description that may involve overlap with other sections or departments mentioned above or below. The general areas of concern here may be:

(a) **General or Life insurance?** : this is a most important question, since the policy document with each has a very different significance. With general insurance, technically there need not be a policy (although there almost invariably is) and it is seldom necessary to produce the original document when making a claim. With life insurance, however, the contract is non-cancellable by the insurer, and the policy documents are required to be produced at the time of a claim.

(b) **Life insurance policies**: as mentioned above, these must be produced when a claim is made. A mistake in a life policy is potentially much more serious than with General Business, especially since the policy may be *assigned* to another person and/or used as *collateral* with a loan and any assignees are expected to be relying on the veracity of the policy.

(c) **New business procedures**: especially with Life business (as noted) the process of verification and checking, both for factual accuracy and errors in document preparation, is very important. With any class of business, it is important that the policy be prepared and issued as efficiently and as impressively as possible, for reasons that are obvious.

(d) **Other procedures**: this topic embraces such matters as error handling, policy correction, endorsement preparation and renewal procedures. With life insurance, once more, the great importance of the *actual payment* of the first premium must be considered. In other classes, the contract may commence without the receipt of a premium (often a non-marine policy requires that the insured "has paid or agreed to pay the premium"). With life insurance, the usual practice is that the existence of the contract depends upon the first premium being *received*.

4.7 CLAIMS

Once more, there are significant differences between Life and General Business claims. Specifically, the implications include:

(a) **Life insurance claims**: obviously, there will only be one death claim, and this will have great importance for the claimant for reasons that are equally obvious. It is quite essential for the claims handler to check each claim with the utmost care, as all sorts of considerations are involved, such as:

(i) possible *disputes* or complications, for instance, problems may arise when the primary beneficiary cannot be traced, or more than one person lodges a claim as alleged assignees;

(ii) possible outstanding *policy loans*;

(iii) possible *assignment*, so that the claimant is not the original policyholder;

(iv) *uncertainties* over actual death or the identity of the deceased;

(v) *dividend/bonus* considerations with *participating/with-profit* policies.

For similar reasons to those pertaining to underwriting (see **4.5** above), life insurance claims handling is frequently centralized.

(b) **General insurance claims**: the range of different types of claims is much wider than with life insurance. Also, it is quite possible that the amounts involved are **enormous**. Therefore, equal care should be taken in verification, although most claims being relatively small, the work is much more likely to be decentralized, sometimes with fairly junior staff having some degree of authority in claim settlement.

[Example: Claims may be relatively trivial, such as the loss of a camera, or exceedingly complex, such as a major explosion at a large power station.]

(c) **Common features**: there are two areas that must be the subject of attention in all insurance claims. These are:

(i) **Liability**: is the insurer liable under the policy? When dealing with liability insurances, it must also be ascertained whether the insured is liable at law to the third party claimant.

(ii) **Quantum**: how much is payable with the claim? With life insurances, it is usually pre-determined, but with other classes of business, this could involve complex and sometimes bitter discussion.

The department organization and activity to deal with these two aspects can be readily understood.

(d) **Significance**: it has been said that an insurer stands or falls on the way it deals with its claims. There is truth in the remark and the insurance intermediary will want to know and feel confidence in the support he looks for in this area.

4.8 REINSURANCE

This is not an area where the insurance intermediary is likely to have a close association, but he should be aware that reinsurance is very important to the insurer. The aftermath of the September 11 terrorist attack is a testimony to this saying.

(a) **Definition**: an insurance used to transfer all or part of the risk assumed by an insurer under one or more insurance contracts to another insurer, who may be referred to as a reinsurer in relation to such a transaction.

(b) **Reasons**: The major reason for buying reinsurance is security. It is likely that an individual insurance claim is payable from the assets of the insurer, but it may be very inconvenient (and even costly) to produce large amounts of cash at short notice, since assets will mostly be in investments. A reinsurance contract may be so arranged as to entitle the reinsured to an immediate claim payment by the reinsurer in the event of a direct claim (i.e. a claim from the original insured) exceeding a pre-determined figure, even before the reinsured has actually paid the direct claim.

Another important reason for reinsurance is to increase an insurer's "underwriting capacity", which means the ability to accept proposed business with in mind all risk management considerations. Having reinsurance means that some risks may be accepted which might otherwise have to be declined in part or total.

(c) **Methods**: This is not the direct concern of insurance intermediaries, unless they handle reinsurance matters on behalf of insurers or reinsurers.

(d) **Effects for the Insured**: Reinsurance has no direct effect for the policyholder. He is not entitled to know, and probably has no need to know, that his insurance is being reinsured. That is a matter entirely between the insurer and the reinsurer(s). The insurer is always directly liable to the policyholder for the full amount payable under the contract irrespective of the financial condition of its reinsurers. Reinsurance, however, does give an added security that the insurer will be *able* to pay!

4.9 ACTUARIAL SUPPORT

An actuary may be thought of as a highly skilled mathematician. His particular expertise is not only in the collation and presentation of numerical information, but also in projecting and predicting future trends, based on available data and assumptions. It will immediately be understood, therefore, that such an expert has a very important role to play in insurance. Some specific observations:

(a) **Life insurance**: more than any other class of business, life insurance depends upon mathematical calculations (although they are very important to all classes). It is essential for the life insurer to know mathematical facts about *mortality* (death statistics) and projected *interest* earnings, for example.

Note: 1 The Insurance Companies Ordinance requires all insurers who carry on long term business to appoint a qualified actuary, acceptable to the Insurance Authority.

2 This Ordinance also requires long term insurers to carry out a *valuation* of all assets and liabilities at least once a year. This is perhaps the most important function of the actuary.

(b) **General insurance**: Their expertise, especially with *long-tail business* (insurance where claims arise and develop over a long period of time until, say, 5 years or even more after policy expiry, e.g. liability classes), is extremely valuable. This is particularly true when having to calculate *outstanding claims reserves* required. The Office of the Commissioner of Insurance requires motor and employees' compensation insurers to annually conduct actuarial review of their reserves relating to such statutory classes of business.

Note: A corresponding term, "*short-tail business"***,** refers to business where claims are mostly settled within a relatively short space of time after arising, e.g. motor (own-damage) and fire insurance.

(c) **Generally**: the application of an actuary's skills is very obvious in such areas as *premium rating*, the calculation of *reserves* and the *valuation* of liabilities.

4.10 ACCOUNTING AND INVESTMENT

The Accountant is another official with a vital role to play in the running of any business enterprise, and particularly that of an insurer. The functions of this department are fairly obvious, but for completeness we note:

(a) **Record keeping**: financial records must be accurate and reliable.

(b) **Collections**: ensuring that money receivable by the insurer is in fact paid clearly affects the very existence of the company. A satisfactory system for collecting, monitoring and reminding the company debtors is thus of high priority.

(c) **Payments**: ensuring that bills and debts are paid promptly and efficiently (and correctly) entails much routine but important work.

(d) **Investment**: if there is not a separate investment department, the care and placement of company assets may be the responsibility of the Accountant. It goes without saying that this is extremely important, from the perspectives of *security*, relative *return (or yield)* and *liquidity* (having sufficient cash-flow to meet known and anticipated monetary demands).

4.11 TRAINING AND DEVELOPMENT

Sometimes unappreciated or even slightly resented by line managers, ever conscious of targets and deadlines, the Training and Development department within a company is very important. Some observations to note:

(a) **Staff and Agents**: Training is essential for both in-house personnel and field staff. The educational and training needs of both must not be overlooked.

(b) **Relevance**: Training is not an *optional extra*, nor is it *independent*. It is part of the overall team that constitutes the insurer, and its activities must not be self-fulfilling, but relevant and effective to the continuance and enhancement of the company.

(c) **Training**: This may be seen as preparation for the actual job in hand, or the job in prospect. As such, it will involve courses, seminars and self-preparation arranged or encouraged by staff training personnel.

(d) **Education**: This may be seen as involving the quest for wider learning and professional or related qualifications. Preparations, etc. for this may be encouraged rather than provided, but having qualified staff (and insurance agents) is of great importance.

(e) **In-house or external**: Whether instruction is provided by its own staff, or arranged on behalf of staff with outside providers, this will be an important concern of company trainers.

(f) **Resources and records**: Facilities for training (library and other aids) as well as up to date records of individual training progress will clearly assist the efficient running of this section.

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Representative Examination Questions

Type "A" Questions

1 Product development for an insurer is:

(a) a never-ending process; .....
(b) not necessary for a large insurer; .....
(c) not necessary with compulsory classes of business; .....
(d) no longer necessary once policy wording has been decided. .....

[Answer may be found in **4.1**]

2 Underwriting, in the context of an insurance company's operations, means:

(a) sales activities; .....
(b) being responsible for any unsold shares; .....
(c) the assessment of risks for insurance purposes; .....
(d) the actual signing of policy and other contract documents. .....

[Answer may be found in **4.5**]

Type "B" Questions

3 Which of the following may have significance with life insurance claims?

(i) Outstanding policy loans
(ii) Complications with beneficiaries
(iii) Possible assignment of the policy to a third party
(iv) Uncertainty over the death or identity of the deceased

(a) (i) and (ii) only; .....
(b) (i), (ii) and (iii) only; .....
(c) (i), (ii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **4.7**(a)]

4 Which **two** of the following are **not** likely to be the responsibility of the Accounts department in an insurance company?

(i) Payment of outstanding bills
(ii) Collection of unpaid premiums
(iii) Determining whether a risk is insurable
(iv) Arranging for the launch of a new policy product

(a) (i) and (ii); .....
(b) (i) and (iii); .....
(c) (ii) and (iii); .....
(d) (iii) and (iv). .....

[Answer may be found in **4.10**]

[If still required, the answers may be found at the end of the Study Notes.]

5 STRUCTURE OF HONG KONG INSURANCE INDUSTRY

5.1 TYPES OF INSURANCE BUSINESS

Insurance is classified in different cross-cutting ways for different purposes. Without trying to give an exhaustive review, we may consider the topic under three headings:

(a) *Statutory*: for the purposes of Government authorization and supervision.

(b) *Practical*: for the purposes of internal company organization.

(c) *Academic*: for the purposes of professional study and training.

5.1.1 Statutory Classification of Insurance

This is found in the First Schedule of the Insurance Companies Ordinance (ICO), which specifies the various classes of business, using essentially the format used in the U.K. and the European Community. The Ordinance divides insurance into *Long Term Business* and *General Business*, with a number of sub-divisions, as follows:

(a) **Long Term Business** (predominantly Life Insurance): this is divided into nine categories, with a designated letter per class, i.e.

A	*Life and annuity*	-	life insurance and annuity (see Glossary), excluding class C below
B	*Marriage and birth*	-	insurance contracts providing benefits payable on marriage or on the birth of a child
C	*Linked long term*	-	unit-linked life insurance and unit-linked annuity (see Glossary for 'Unit-linked Business')
D	*Permanent health*	-	essentially long term policies providing benefits for incapacity from accident or for ill-health (the policy is not normally cancellable by the insurer)
E	*Tontines*	-	A tontine is an unusual contract

			on a group of persons, the accumulated contributions payable to the last survivor(s) at the end of a defined period.
F	*Capital redemption*	-	a contract to provide a capital sum at the end of a term in order to replace one's capital because, e.g. debentures will become repayable; not related to human life
G	*Retirement scheme* management category I	-	group retirement scheme contracts providing for a guaranteed capital or return
H	*Retirement scheme management category II*	-	group retirement scheme contracts not providing for a guaranteed capital or return
I	*Retirement scheme management category III*	-	group contracts providing insurance benefits under retirement schemes, but excluding classes G and H above

Note: It will be appreciated that not all the above will have equal significance in the day to day business of the Hong Kong insurance market. For instance, only a handful of companies are authorized to write class B, E or F business.

(b) **General Business**: this is divided into 17 categories, with a designated number per class, i.e.

1	*Accident*	-	this is more usually referred to by insurance practitioners as **Personal Accident (and Sickness)**, providing benefits or indemnity in the event of accident or sickness
2	*Sickness*	-	policies providing benefits or indemnity for loss due to sickness or infirmity, but excluding class D above
3	*Land vehicles*	-	property insurance mostly related to motor vehicles (not railway vehicles)

4	*Railway rolling Stock*	-	property insurance on such vehicles
5	*Aircraft*	-	property insurance on aircraft
6	*Ships*	-	property insurance on ships
7	*Goods in transit*	-	property insurance on goods in transit, including **marine cargo**
8	*Fire and natural forces*	-	property insurance covering fire and some other perils (e.g. storm and explosion)
9	*Damage to property*	-	property insurance exclusive of classes 3-8 above
10	*Motor vehicle liability*	-	third party **Motor** insurance (including compulsory motor insurance)
11	*Aircraft liability*	-	liabilities for property damage or personal injury/death arising out of the use of aircraft
12	*Liability for ships*	-	marine liabilities for property damage or personal injury/death
13	*General liability*	-	liability insurance exclusive of classes 10-12 above; employees' compensation insurance is included here
14	*Credit*	-	loss to creditors from debtors' failure to pay debts
15	*Suretyship*	-	contracts of guarantee, including fidelity guarantee, performance bonds (see Glossary for the meanings of these two terms)
16	*Miscellaneous financial loss*	-	any other classes of business (business interruption, loss of use, etc.)
17	*Legal expenses*	-	insurances to pay legal costs (whether as defendant or as claimant)

Note: Few, if any, local insurers are likely to use the above classification in their internal organization, but authorization to transact business will be granted in respect of the classes indicated.

5.1.2 Practical Classification of Insurance

For internal management and operational purposes, each insurer is free to classify his business as he sees fit. The following are typical examples of systems used by insurers in Hong Kong:

(a) **Departmental (Class of Business)**

There is no single pattern under this form of classification, but there are two main approaches:

(i) **U.K. (European) Style**: where traditionally the major classes were *Life, Marine, Fire* and *Accident* ('Accident' effectively meant anything else, such as personal accident, liability, motor, etc.).

(ii) **U.S. Style:** where there is a very clear distinction between *Life* (including annuity, medical expense and disability) and *Non-Life* business, the latter frequently being sub-divided into *Fire, Marine, Bonding* and *Casualty* (i.e. automobile, liability, theft, workers' compensation, etc.).

(b) **Source of Business**

Under this system, for control and management purposes, business is sub-divided according to how it was obtained, i.e.

(i) from **insurance agents**;

(ii) from **insurance brokers**;

(iii) **direct** from the public, no insurance intermediary being involved.

(c) **Type of Client**

Under this system, for control and management purposes, business is sub-divided according to whether it covers:

(i) **individuals** - Personal Insurance; or

(ii) **firms and organisations -** Business or Commercial Insurance.

5.1.3 Academic Classification of Insurance

For academic and professional examination purposes (especially with U.K. or Commonwealth jurisdictions), insurance is frequently sub-divided on a *Subject-Matter of Insurance* or *Functional* basis, as follows:

(a) Insurance of *the person* (which is not equivalent to 'personal insurance'), i.e. covering human beings (life, health and personal accident insurances, etc.);

(b) Insurance of *property*, i.e. covering tangible objects against loss or damage (fire, motor damage, marine cargo, etc.);

(c) Insurance of *liability*, i.e. covering legal liability for death, injury or property damage to others (employees' compensation, public liability, etc.);

(d) Insurance of *pecuniary interests:* It relates to any financial interest to be insured not covered by (a) - (c) above, including business interruption, credit and rent insurances.

Note: It must not be thought that the academic classification is only of use in studying for examinations. Thinking about insurance according to the function it performs (person, property, liability etc.) is a useful check-list when trying to help a client decide what insurances he should have.

5.1.4 Reinsurance

Reinsurers insure the insurers. This is absolutely normal, indeed essential to the well being of the industry (see **6.1.1e** below). Reinsurance is usually part of the normal activity of insurers. It can be:

(a) **Outwards reinsurance:** where the insurer insures again with other insurers/reinsurers; or

(b) **Inwards reinsurance:** where the insurer acts as a reinsurer, covering risks already insured by other insurers/reinsurers.

(Those insurers who confine their business to reinsurance are called **"Professional Reinsurers".**)

5.2 SIZE OF INDUSTRY

Insurance is a dynamic element in the financial services industry of Hong Kong, so statistics are always likely to be somewhat out of date. Nevertheless, we may usefully consider this topic under four headings:

(a) number of authorized *insurers*;

(b) number of registered or authorized *insurance intermediaries*;

(c) number of persons *employed* in the industry;

(d) premium volume.

5.2.1 Authorized Insurers

As at 31 December 2003, there were totals as follows:

(a) **"Pure" Long Term Business** (see **5.1.1** (a) above): "pure" in this context means "only" or "exclusively" (specializing) in this class. A total of 46 insurers were authorized, comprising 12 Hong Kong incorporated companies and 34 others (including 1 from the Mainland of China).

(b) **"Pure" General Business** (see **5.1.1** (b) above): 123 insurers were authorized, comprising 73 Hong Kong incorporated companies and 50 others (none from the Mainland of China).

(c) **"Composite":** the term implies carrying on both Long Term and General Business. 19 insurers were so authorized, comprising 9 Hong Kong incorporated companies and 10 others (none from the Mainland of China).

5.2.2 Registered or Authorized Insurance Intermediaries

As at 31 December 2003, there were 55,715 appointed insurance agents and authorised insurance brokers and their Responsible Officers/Chief Executives and Technical Representatives in Hong Kong (source of information: Office of the Commissioner of Insurance).

Note: An *'insurance intermediary'* is defined in the Insurance Companies Ordinance as either an *'insurance agent'* or an *'insurance broker'* (see **6.2** below). Whether the intermediary being referred to is a firm or an individual, the same set of terms are used.

5.2.3 Persons Employed

The biennial Manpower Survey Report on the Insurance Industry in Hong Kong (commissioned by the Vocational Training Council) was most recently conducted in 2003. This survey concluded that the industry in mid-2003 had a connected workforce of 45,030 people. 78% of this workforce was mainly connected with Long Term Insurance (78% of these being insurance agents) and 22% mainly with General Insurance.

5.2.4 Premium Volume

When discussing premiums, many technical considerations arise which are beyond the scope of the present study. We shall therefore confine ourselves to the broad picture. From the 2003 Annual Report of the Office of the Commissioner of Insurance, we learn that in 2002:

(a) gross premiums for Direct & Reinsurance Inward *General Business* amounted to approximately **HK$23.4 billion**, representing 1.9% of Hong Kong's Gross Domestic Product;

(b) "office premiums" (amounts paid by policyholders) for *Long Term Business* amounted to approximately **HK$49.6 billion** for Individual Life business, about **HK$1.2 billion** for Group Life business and around **HK$12.8 billion** in contributions to Retirement Scheme contracts managed by insurers, the total representing 5.2% of Hong Kong's Gross Domestic Product.

5.3 INSURANCE COMPANIES

Some statistical information about insurance companies in Hong Kong has already been considered (see **5.2.1** above). Some other features should be noted as well, as follows:

(a) **International Basis**

As is well known, Hong Kong is a major international centre for financial services. Of the 188 authorized insurers as at 31 December 2003, exactly *one half* were Hong Kong incorporated and the other half incorporated in 23 jurisdictions all over the world (including one incorporated in the Mainland of China).

(b) **Market Analysis**

The 2003 Annual Report from the Office of the Commissioner of Insurance provides information on this topic for the year 2002, including (with company names) an Analysis of Market Share of Top 10 Insurers By Major Classes of Business. This shows the following:

(i) **General Business**: the above analysis indicates the major classes of business as *Accident & Health, Motor Vehicle, Property Damage* and *Employees' Compensation*. The percentage market share of the top ten insurers (by gross premium) in relation to each of these classes is: 56.6% for Motor Vehicle, 51.3% for Property Damage, 58.6% for Employees' Compensation, and 61.3% for Accident & Health. No one company had a market share of more than 13.8% in any one of these classes.

(ii) **Long Term Business**: here the analysis reveals a very different picture, with the top ten insurers (by Office Premiums of In-Force Business) accounting for 73.5% of the 2002 market share, the top five accounting for 58.8% and the top one 18.4%.

With **142** insurers authorized to write General Business and **65** authorized to write Long Term Business, we may reasonably conclude that General Business is more evenly distributed among authorized insurers than Long Term Business.

(c) **Market Co-operation**

More will be said on this topic later (see for example **5.5** below), but it is appropriate to mention at this stage that Hong Kong insurers have a central body representing their interests, *The Hong Kong Federation of Insurers (HKFI)*. Since its formation in August 1988 the HKFI, which is recognized by the Government as the **representative body of insurers** in Hong Kong. As at 15 January 2004, the HKFI had a membership of **140**, i.e. about 74% of the total number of *authorized insurers*. Without doubt, it is a major factor in the structure of the Hong Kong Insurance Industry.

5.4 INSURANCE INTERMEDIARIES

As noted above (**5.2.2**), insurance intermediaries comprise *insurance agents* and *insurance brokers*. More detailed comments on their respective roles and legal requirements appear elsewhere in these Notes (see especially **6.2** below), but considering them under the topic of the structure of the Hong Kong Insurance Industry, we should note the following:

(a) **Registration/Authorization**: Insurance intermediaries in Hong Kong are required by the ICO to be formally registered or authorized (see **6.2.1** below).

(b) **Qualifications**: Before a person can be registered or authorized to act as an insurance intermediary, he must satisfy certain criteria. These are considered in detail later (see **Chapter 6**).

(c) **Role**: It is true that an insurance may be arranged *direct* with the insurer, i.e. without using an insurance intermediary, but this is not the norm, especially in Long Term Business. It would be relatively rare, for instance, to find life insurances being arranged in Hong Kong without an insurance intermediary being involved. Also, with complex commercial risks, it is quite normal for an insurance broker to be engaged, in view of the wide experience and independent expertise which they are generally seen to possess. It is therefore quite clear that insurance intermediaries have, and are likely to continue to have, an important role in the structure of the Hong Kong insurance industry.

(d) **Market Co-operation**: More will be said on this topic in **5.5** below, but it would probably be fair to say that the roles of *insurance agents* and *insurance brokers* are quite distinct. All, however, through their market representations and individually, have a common interest in quality service and the integrity of the market.

5.5 MARKET ASSOCIATIONS/INSURANCE TRADE ORGANIZATIONS

Some of the major market associations/insurance trade organizations in the Hong Kong insurance market are:

5.5.1 The Hong Kong Federation of Insurers (HKFI)

(a) This organization has already been mentioned (see **5.3**(c) above), but the importance of the HKFI on the local insurance scene cannot be overstated. An important objective of the HKFI is to promote and advance the common interests of **insurers** and **reinsurers** transacting business in Hong Kong. As a major influence in the **self-regulatory** process, the HKFI has numerous areas of activity.

(b) According to its Mission Statement, the HKFI exists to promote insurance to the people of Hong Kong and build **consumer confidence** in the industry, by encouraging the highest standards of **ethics** and **professionalism** amongst its members.

(c) The HKFI established the *Insurance Agents Registration Board* (**IARB**) in January 1993 to perform the dual role of **registering** insurance agents and their Responsible Officers and Technical Representatives, and of **handling complaints** against insurance agents or their Responsible Officers or Technical Representatives, pursuant to the Code of Practice for the Administration of Insurance Agents (see **6.2.2** below).

5.5.2 Approved Bodies of Insurance Brokers

The Insurance Authority has the power to approve a body of insurance brokers under Section 70 of the ICO, so that its members are deemed to be authorized insurance brokers, without the need to seek authorization from the Insurance Authority direct. There are two such approved bodies in Hong Kong:

(a) *the Hong Kong Confederation of Insurance Brokers*; and

(b) *the Professional Insurance Brokers Association Limited*.

5.5.3 Industry Organizations to Assist Claimants or Victims

Three such organizations should be noted:

(a) *The Insurance Claims Complaints Bureau* (ICCB): this is considered in more detail in **6.1.4** below.

(b) *The Motor Insurers' Bureau* (MIB)*:* funded by a surcharge on motor insurance premiums, the MIB seeks to provide compensation in respect of the death of or injury to innocent victims of motor vehicle road accidents, where the required compulsory insurance for such situations does not exist or is not effective, or the insurer concerned is in liquidation.

(c) *The Employees Compensation Insurer Insolvency Board (ECIIB)*: composed of all insurers carrying on the business of employees' compensation insurance in Hong Kong, the ECIIB runs the Employees Compensation Insurer Insolvency Scheme to assume responsibilities for liabilities under employees' compensation policies of its member insurers that have become insolvent. The Scheme is funded by a surcharge on employees' compensation insurance premiums.

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Representative Examination Questions

Type "A" Questions

1 The Insurance Companies Ordinance in Hong Kong divides insurance business into two broad categories. One is General Business and the other is:

(a) Specific Business; .....
(b) Accident Insurance; .....
(c) Long Tail Business; .....
(d) Long Term Business. .....

[Answer may be found in **5.1.1**]

2 The difference between "inwards reinsurance" and "outwards reinsurance" for a given insurance company is that:

(a) inwards reinsurance is with Hong Kong reinsurers; .....
(b) outwards reinsurance is with non-Hong Kong reinsurers; .....
(c) inwards reinsurance is where the company acts as reinsurer; .....
(d) outwards reinsurance is where the company acts as reinsurer. .....

[Answer may be found in **5.1.4**]

Type "B" Questions

3 Which **two** of the following are classes of Long Term Business?

(i) Aircraft liability
(ii) Life and Annuity
(iii) Permanent Health
(iv) Damage to property

(a) (i) and (ii); .....
(b) (ii) and (iii); .....
(c) (ii) and (iv); .....
(d) (iii) and (iv). .....

[Answer may be found in **5.1.1**(a)]

4 Which of the following statements are **true** in the Hong Kong situation, based upon available data?

(i) Relatively few insurers dominate General Business
(ii) Relatively few insurers dominate Long Term Business
(iii) General Business is shared more evenly among insurers
(iv) Long Term Business is shared more evenly among insurers

(a) (i) and (ii) only; .....
(b) (i) and (iii) only; .....
(c) (ii) and (iii) only; .....
(d) (iii) and (iv) only. .....

[Answer may be found in **5.3**]

[If still required, the answers may be found at the end of the Study Notes.]

6 REGULATORY FRAMEWORK OF INSURANCE INDUSTRY

All civilized societies recognize that a financial service as important as insurance must be subjected to some form of supervision or control. This is a sensitive area, since on the one hand it is not good for society to "strangle" any kind of worthwhile business activity with excessive controls. On the other hand, left totally unsupervised, the huge amounts of money involved with insurance have over the centuries proved irresistible to fraudsters and irresponsible people, to the great harm and detriment of the societies affected.

A measure of balance is therefore to be sought. That balance, to some extent, is achieved by a judicious mixture of *statutory* (Government) *regulation* and *self-regulation*, where representatives of the industry itself exercise discipline and oversight. Below, we shall examine both these aspects of the Hong Kong insurance industry regulatory framework.

6.1 REGULATION OF INSURANCE COMPANIES IN HONG KONG

This is a combination of statutory and/or persuasive influence by Government, coupled with various self-regulating functions on the part of the industry itself. These we shall consider in some detail.

6.1.1 Insurance Companies Ordinance (ICO)

This very important piece of legislation, with its amending statutes, provides the framework for the prudential supervision of the insurance industry of Hong Kong. In fact, it covers not only the supervision and regulation of *insurers*, but also that of *insurance intermediaries*. The ICO came into effect in June 1983 and the *Commissioner of Insurance* is appointed as the **Insurance Authority** (IA) for the purposes of the ICO. Some of its important provisions are outlined below.

6.1.1a Authorization of Insurers

Any ‘person’ (which may, as a legal term, mean a corporation) wishing to carry on insurance business in or from Hong Kong must be authorized by the IA. The ICO prescribes certain minimum requirements for authorization, relating to such matters as:

(a) *paid-up capital*;

(b) *solvency margin*;

(c) *directors and controllers*;

(d) *"adequate" reinsurance* arrangement.

In addition, the IA has issued *Guidelines* which seek to ensure that the applicant insurer is financially sound and otherwise suitable, not only at the time of authorization but continuing to be so in the future.

6.1.1b Capital Requirement

Minimum paid-up capital required:

(a) **HK$10 million**: if carrying on only *General* or only *Long Term* business, but not any statutory (or compulsory) insurance business;

(b) **HK$20 million:** if carrying on any *statutory* (or compulsory) insurance business, either alone or together with any other insurance business;

(c) **HK$20 million**: if carrying on *both* General *and* Long Term business;

(d) **HK$2 million** (instead of the above figures): if the insurer is a *Captive Insurer* (see Glossary).

Note: The above figures are merely **minimum** requirements. Insurers in Hong Kong almost invariably have paid-up capital well in excess of these requirements.

6.1.1c Solvency Margin Requirement

"Solvency" may be thought of as the point at which *assets* are just sufficient to meet *liabilities*. A *margin of solvency* is therefore the degree or amount by which assets *exceed* liabilities. Insurance companies must have a **solvency margin** of not less than the **"relevant amount" –** the minimum amount of solvency margin required of a particular insurer **-** as a safeguard against the risk that the insurer may not be able to meet its liabilities. The **relevant amount** is prescribed as follows:

(a) **General Business** : calculated on two different bases,

(i) *"Premium Income"* (the higher the volume of premium income, the larger the relevant amount) and

(ii) "Claims Outstanding" (the higher the amount of claims outstanding (see Glossary), the larger the relevant amount),

whichever produces the higher figure; and subject to a Minimum Amount of HK$10 million (or HK$20 million if carrying on statutory insurance business).

(b) **Long Term Business** :

Calculated in accordance with the detailed requirements of the Insurance Companies (Margin of Solvency) Regulation regarding each respective class of long term business, subject to a total of not less than **HK$2 million**.

(c) **Composite Business:**

In respect of the Long Term Business, the relevant amount is subject to a minimum of HK$2 million. In respect of the General Business, it will be calculated in the usual manner for General Business (see (a) above).

(d) **Captive Insurer**:

Either the 'premium income' basis or the 'claims outstanding' basis, whichever produces the higher figure; subject to a **minimum of HK$2 million.**

6.1.1d "Fit and Proper" Directors and Controllers

Any *Director* or *Controller* (which term is defined as including a Managing Director and a Chief Executive) of an insurer must be **fit and proper** to assume such a position. In addition, prior approval of the IA is required for an authorised insurer's appointment of a *Chief Executive, Managing Director,* or *Shareholder Controller*.

The term 'fit and proper' is explained by the Office of the Commissioner of Insurance (OCI) in the **Guidance Note on "Fit and Proper" Criteria under the Insurance Companies Ordinance** (the "Fit and Proper" Guidance Note). According to the "Fit and Proper" Guidance Note, the IA would look for high standards of competence and honesty. It specifies some of the relevant factors in considering whether a person is fit and proper as:

(a) financial status;

(b) character, reputation, integrity and reliability;

(c) qualifications or experience having regard to the nature of the functions to be performed; and

(d) ability to perform such functions efficiently, honestly and fairly.

This "Fit and Proper" Guidance Note also sets out the events and matters that are likely to give rise to concerns about the fitness and properness of a person to be appointed, or who has been appointed, as a director or controller of an authorized insurer.

Related but distinct from the concept of "fitness and properness" is that of corporate governance, which term refers to the rules and practices put in place within a corporation for the management and control of its business and affairs. The OCI has issued the **Guidance Note on the Corporate Governance of Authorized Insurers** (the 'Guidance Note on Corporate Governance'), which sets out the minimum standard of corporate governance that is expected of authorized insurers. A high standard of corporate governance established by authorized insurers is considered to be an essential step in instilling the confidence of the insuring public and encouraging more stable and long term development of the insurance market. The Guidance Note on Corporate Governance covers all levels of management, and all functions (risk management, underwriting, claims, client servicing, audit, etc.), of an authorized insurer.

6.1.1e "Adequate" Reinsurance

Reinsurance is an extremely important, in many cases **crucial**, element with the financial security of an insurer. However, its importance is much influenced by various factors, including the financial strength of the insurer, and the type and volume of business. The ICO therefore leaves the general requirement imprecise ("adequate"), but it is a vital consideration in the overall financial supervision of an insurer, both with regard to the *quantity* and the *quality* (probable **"collectability"**) of the reinsurance in force.

The OCI has issued and implemented a guidance note on the subject, the **'Guidance Note on Reinsurance with Related Companies'**. This Guidance Note applies only where an authorized insurer reinsures with a 'related reinsurer' (meaning one within the same grouping of companies, as defined in section 2(7)(b) and (c) of the ICO). The reason why this Guidance Note is important is that the prudent control that any one insurer should exercise on its reinsurance arrangements may possibly be compromised when the reinsurer is related to it. This situation, if allowed to be loosely supervised, will put the interests of the insuring public at risk.

The Guidance Note aims to promulgate how reinsurance arrangements with related companies will be considered 'adequate' by the IA in terms of financial security, and how the IA intends to address the supervisory concern if such reinsurance arrangements are not considered adequate.

6.1.1f Other Major Provisions of the ICO

Certain other features of the ICO which should be noted include:

(a) **Maintenance of Assets in Hong Kong** : An insurer carrying on General Business must maintain assets in Hong Kong in respect of its liabilities arising from its Hong Kong General Business. The amount required is to be calculated in accordance with one of two prescribed methods, one of which requires an amount *not less than* the **aggregate** of:

(i) **80%** of its **net liabilities** (i.e. after deducting those covered by reinsurance); and

(ii) the **relevant amount.**

Claims from Hong Kong general insurance policyholders have preference under Hong Kong insolvency law. Such protection is enhanced by the above requirement of the ICO to have funds available in Hong Kong.

Note: This requirement does **not** apply to *Captive Insurers* and *Professional (Specialist) Reinsurers*.

(b) **Valuation Bases for Assets and Liabilities :** Assets and liabilities must be valued for both General and Long Term Business. The way each is calculated is obviously of the greatest importance to the perceived financial position of the insurer concerned.

(i) **General Business :** Specific regulation governs the valuation of assets and liabilities. However, it does not apply to a *Captive Insurer*.

(ii) **Long Term Business :** Again, specific regulation governs the valuation of liabilities, especially concerning such matters as projected *interest earnings* and *expected yield* from investments.

(c) **Reporting Requirements :** The following reporting requirements apply:

(i) **Every insurer:** Must submit annually to the IA its *financial statements* prepared in accordance with the requirements of the ICO.

(ii) **General Business:** These insurers must, in addition to the requirement mentioned in (i) above, submit annually to the IA an audited *General Business Return* and audited *Statement of Assets and Liabilities* relating to its Hong Kong business.

The "*Guidance Note on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Business*" issued by the Office of the Commissioner of Insurance requires that insurers (including reinsurers) which carry on employees' compensation business or motor insurance business should annually commission an actuarial review of their reserves set side for future claims payments in respect of such line(s) of business. The actuarial review report and certificate prepared upon completion of the review shall be submitted to the IA within a prescribed period.

Note: The requirement to submit an audited *Statement of Assets and Liabilities* does **not** apply to *Captive Insurers* and *Professional (Specialist) Reinsurers.*

(iii) **Long Term Business:** Long Term insurers must, in addition to the requirement mentioned in (i) above, periodically – normally every 12 months - commission an actuarial investigation into its financial condition in respect of its long term business. An abstract of the *actuarial investigation* report together with a certificate made by the appointed actuary shall be submitted to the Insurance Authority within a prescribed period.

Note: 1 With the enactment of the Electronic Transactions Ordinance, insurers may submit these documents by electronic means.

2 Some people might find it difficult to distinguish between reserves and solvency margin. In simple terms, the solvency margin of an insurer represents the surplus of its assets over its liabilities. On the other hand, claims reserves

represent projected or estimated future insurance liabilities. If an insurer's claims reserves have been set up on the basis of a less than prudent projection or estimation, other things being equal, its net asset must be an overstated figure.

(d) **Transparency**: As an enhancement to market transparency, with effect from June 2000, the ICO allows the IA to disclose financial and statistical information of individual insurers and Lloyd's when it is considered in the interests of policyholders or the public to do so.

Note: The ICO, however, specifically prohibits the IA from disclosing any information relating to the affairs of individual policyholders, except under specified court proceedings.

6.1.1g Powers of Intervention

It is often said that for effective supervision, insurance regulators must not only have "eyes", but must also have "teeth". The statutory provisions therefore outline various actions the regulators may take for protecting the interests of policyholders and potential policyholders. These actions include:

(a) **Limitation of premium income**: if, for example, it is deemed that an insurer is growing too fast or may otherwise be facing potential difficulties with the inevitable liabilities that new business might produce.

(b) **Restrictions on investments**: on the type and/or location of investments.

(c) **Restrictions on New Business**: on the capacity to effect or vary contracts of insurance of a specified description.

(d) **Custody of assets by an approved Trustee**: for additional security.

(e) **Special actuarial investigation**: probably when there is cause for concern on a particular insurer's ability to meet liabilities.

(f) **Assumption of control by a Manager appointed by the IA**: in serious cases.

(g) **Winding up** (liquidating) **the insurer**: in extreme cases; by presenting a petition to the courts.

6.1.2 Code of Conduct for Insurers

This Code was implemented by the Hong Kong Federation of Insurers (HKFI) in May 1999. It applies to insurances effected in Hong Kong by **individual** (not company) policyholders resident in Hong Kong, insured in their *private capacity* only.

6.1.2a Objectives

These set out the expected standards of **good insurance practice** relating to such matters as

(a) underwriting and claims;

(b) product understanding;

(c) customers' rights and obligations under insurance contracts;

(d) customers' rights and interests generally;

(e) the industry's public image as a good corporate citizen.

Sections of the Code relevant to the activities of insurance agents are covered below.

6.1.2b Advising and Selling Practices

This Part of the Code makes specific comment on:

(a) **Sales Materials**: these should be up to date, accurate, in understandable language and not misleading to the public.

(b) **Proposal/Application Forms**: these are documents of prime importance to the formation of the contract, being the vehicle through which the intending insured supplies information to the insurer. As such, the forms should:

  (i) be in understandable language, with clear guidance as necessary;

  (ii) carefully explain the significance of *utmost good faith* requirements;

  (iii) make matters of *material significance* the subject of clear questions;

(iv) explain carefully the importance of any associated questionnaires.

(c) **Policies**: these provide visible evidence of the insurance contract terms. As such, they should be clear and as understandable as possible to the consumer. Also, any utmost good faith implications regarding material facts to be disclosed at *renewal* should be carefully explained.

(d) **Administration**: this covers such matters as *confidentiality, service standards, customer enquiries* and the fact that customers should not be the loser from *inaccuracy* on the part of the insurer's employees.

(e) **Medical Evidence**: confirmation that the *Personal Data (Privacy) Ordinance* requirements will be observed in this sensitive area.

6.1.2c Claims

Since claims, or their possibility, are at the heart of insurance, clear statements are necessary to establish good practice in this area. These include:

(a) **General Handling**: should be fair, efficient and speedily.

(b) **Denial of Claims**: This should **not** happen

(i) unreasonably, especially with *non-disclosure* of material facts and particularly where no proposal form was obtained;

(ii) with *innocent misrepresentation* of material facts (other than with **marine** or **aviation** insurance);

(iii) with a *breach of warranty* committed **without fraud**, where it has **not caused the loss**.

(c) **Claim Forms**: to be issued promptly without charge, and in understandable language.

(d) **Other Issues**: specific mention is made of other matters such as:

(i) claimants to be kept *reasonably informed* of claim progress;

(ii) *reasonable explanation* to be given, if a claim cannot be admitted;

(iii) payment made **promptly** with *valid claims*;

(iv) third parties acting for the insurer (*adjusters* etc.) should always act reasonably and should be professionally qualified.

6.1.2d Part IV: Management of Insurance Agents

Generally, insurers are to ensure that insurance agents comply with the law and all relevant HKFI Codes. Specifically, insurers should give attention to the following:

(a) **Registration**: all insurance agents must be registered under the provisions of the Insurance Companies Ordinance and governed by the *Code of Practice for the Administration of Insurance Agents* (see **6.2.2** below).

(b) **Complaints**: proper procedures should be in place to deal with complaints against insurance agents.

(c) **Adequate Support**: insurers should ensure that insurance agents have adequate support to perform their duties efficiently.

(d) **Miscellaneous**: insurers must not seek to limit their liability for the actions of their insurance agents and should ensure as far as possible that the insurance agents act fairly and honestly.

6.1.2e Inquiries, Complaints and Disputes

Insurers should handle inquiries in a fair and timely manner, have in place documented internal complaint-handling procedures for resolving complaints by policyholders, and:

(a) comply with the *Code of Practice for the Administration of Insurance Agents* (see **6.2.2** below), which provides an external mechanism for dealing with complaints against insurance agents; and

(b) participate in the *Insurance Claims Complaints Bureau* (**ICCB**) (see **6.1.4** below), which adjudicates insurance claims disputes between insurers and individual policyholders.

6.1.3 Guidelines on Complaint Handling

The HKFI has issued the 'Guidelines on Complaint Handling' to supplement the requirements stipulated in the Code of Conduct for Insurers on the handling of inquiries, complaints and disputes. The Guidelines apply to complaints about an insurer's provision of, or failure to provide, a service or

product. They are summarized as follows:

6.1.3a Recommended Internal Complaint Handling Procedures

(a) **General Principles**: The Guidelines lay down general principles for complaint handling procedures as: comprehensive coverage, transparency and accessibility to customers, ease of use, fairness, impartiality, consistent approach to provision of redress, flexibility, simplicity, promptness, efficiency, measurability of performance standards, and provision of feedback to all the relevant regulatory or public bodies.

(b) **Policies and Procedures**: Insurers should have in place appropriate and effective internal procedures for handling customer complaints, subjected to management controls. The procedures should be in writing, and should at least cover:

- receipt of complaints;
- response to complaints;
- investigation of complaints; and
- provision of redress.

(c) **Accessibility**: Insurers should ensure that customers know where and how to complain, and that complaints are courteously received. They should:

- publish their internal complaint handling procedures;
- provide access to them in each of their offices;
- supply them freely to customers upon request;
- supply them freely and automatically to complainants;
- inform new customers of the availability of the procedures.

(d) **Communications:** Complainants should be allowed to complain by any reasonable means, including verbal means. Communications with complainants should be made in clear and plain language, and in a language that the complainants desire or use.

(e) **Confidentiality:** Information relating to complaints including the complainants' identity should be treated as confidential, and access to it restricted.

(f) **Independence and Authority in Handling Complaints**

- Complaints should not be investigated by an employee who was directly involved in the matter complained about;

- Those responsible for responding to complaints must have the authority to settle them or have ready access to those who have it;

- Serious matters should be brought to the attention of senior management.

(g) **Redress**: Where a complaint is upheld, appropriate redress (e.g. apology, fair compensation, including compensation for loss of interest) should be offered.

(h) **Resources and Staff Training**

- Adequate resources should be provided to ensure the efficiency and effectiveness of the complaint management system;

- Insurers should ensure that all relevant employees and registered persons are aware of the procedures and comply with them. Staff having contact with customers should be trained in complaints handling.

(i) **Monitoring and Audit**

- Effective procedures should be set up to monitor complaints and to make regular reports for senior management's review.

- To measure the attainment of the procedures, regular audits should be conducted by competent and independent staff. Based on the results of the audits, improvements to the procedures, where necessary, should be made by competent staff.

(j) **Management Review**: Insurers should carry out periodic reviews of the ability of their complaint management systems to meet customers' expectations.

(k) **Time Limit for Dealing with Complaints:** Upon receipt of a complaint, the insurer should send a written acknowledgement advising the complainants of:

- the name or job title and contact details of the complaint handler;
- expected date of final response to the complaint; and
- the internal complaint handling procedures.

(l) **Final Response**

- Insurers are encouraged to give the complainant, no later than 30 days after receiving the complaint, (a) a final response, or (b) the reasons for not being able to make the final response yet together with the expected date of a final response.
- Insurers should consider including in the final response: (a) the outcome of the investigation, (b) whether there has been fault on the part of the insurer, (c) what redress, if any, will be made, and (d) when the redress will be made.

6.1.2b External Dispute Resolution

Insurers should inform the complainants of the existence of the following bodies/regulator to which the complaints could be referred if they are not satisfied with the insurers' response:

- Insurance Agents Registration Board;
- The Insurance Claims Complaints Bureau; and
- Office of the Commissioner of Insurance.

6.1.3c Record Keeping

Insurers should record details of complaints properly, and provide them to the relevant self-regulatory bodies/regulator upon request.

6.1.4 Insurance Claims Complaints Bureau (ICCB)

The ICCB has a membership of all authorized insurers underwriting personal insurance in Hong Kong. Its primary objective is to handle insurance claims complaints from individual policyholders, arising out of personal contracts with its members.

6.1.4a Composition and Powers

(a) The *Insurance Claims Complaints Panel* (the Panel) is appointed by the ICCB to handle complaints. It consists of a Chairman and four members and is **independent** in the sense that the incumbent Chairman is independent of the industry and is appointed with the prior consent of the Secretary for Financial Services and the Treasury.

(b) Of the four members on the Panel, two are nominated by the HKFI, and two from outside the insurance industry (one representing the legal/accounting profession and the other representing consumer interests).

(c) No fee is charged to the complainant, whether he wins his case or not.

(d) The Panel can make an award against an insurer up to **HK$600,000**, who has no right of appeal against an award. If the complainant is unsatisfied with an award, he may, however, seek legal redress.

(e) Further points on the powers of the Panel: The Articles of Association of the ICCB stipulates that the Panel, in making its ruling, "*shall have regard to and act in conformity with the terms of the relevant policy, general principles of good insurance practice, any applicable rule of law or judicial authority; and any codes and guidelines issued from time to time by the Hong Kong Federation of Insurers (HKFI) or the Bureau. In respect of the terms of the policy contract, these shall prevail unless they would, in the view of the Complaints Panel, produce a result that is unfair and unreasonable to the complainant*". The gist of these provisions is that, the Panel, in making a ruling, is given the power by the ICCB Members to look beyond the strict interpretation of policy terms.

As far as good insurance practice is concerned, the Panel relies heavily on the expected standards set out in *The Code of Conduct for Insurers*, with particular reference to 'Part III: Claims'. The first requirement of the section states, "*Insurers should seek to handle all claims efficiently, speedily and fairly".* As such, as to whether or not an insurer has acted fairly in the settlement of claims is subjected to the scrutiny of the Panel.

6.1.4b Terms of Reference

To summarize, the ICCB can only deal with a particular case if:

(a) the complaint is **claim-related**;

(b) the claim amount does not exceed **HK$600,000**;

(c) the insurer concerned is an **ICCB member**;

(d) the policy concerned is a personal insurance policy;

(e) the complaint is filed by a policyholder/beneficiary/rightful claimant (e.g. an assignee); and

(f) the complaint is filed within **6 months** from the date of notification of the insurer's final decision on the claim.

The ICCB does **not** handle

(a) disputes arising from **commercial**, **industrial** or **third party** insurance; and

(b) claims already subject to **legal proceedings** or **arbitration**.

6.2 REGULATION OF INSURANCE INTERMEDIARIES IN HONG KONG

As with insurance companies, the regulation of insurance intermediaries in Hong Kong is partly by the *Government* and partly by the *industry* itself. Obviously, this is an area of considerable personal and professional interest to all insurance intermediaries. We shall therefore comment in some detail on specific requirements. Your extra careful attention is invited to the following sections.

6.2.1 Roles and Responsibilities of Insurance Agents and Brokers

(a) **'Insurance agent':** The ICO prohibits any person from acting as an **"insurance agent"** unless he has become an '**appointed insurance agent'** in accordance with the relevant provisions of the ICO. (Remember that in law a corporation is a 'person'.)

But what is an 'insurance agent'? In the ICO, '*a person who holds himself out to advise on or arrange contracts of insurance in or from Hong Kong as an agent or sub-agent [i.e. an agent of an agent] of one or more insurers*' is termed an 'insurance agent'.

How to become an 'appointed insurance agent'? To become an 'appointed insurance agent', one must get registered with and appointed by an insurer.

(b) **'Insurance broker'**: The ICO prohibits any person from acting as an 'insurance broker' unless he has become an 'authorised insurance broker' in accordance with the relevant provisions of the ICO.

But what is an 'insurance broker' within the meaning of the ICO? '*A person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policyholder or potential policyholder or advising on matters related to insurance*' is termed an 'insurance broker' in the ICO.

How to become an 'authorised insurance broker'? To become an 'authorised insurance broker', one either has to obtain authorization from the Insurance Authority or to become a member of a body of insurance brokers that has been approved by the Insurance Authority.

(c) **No wearing of two hats**: *Any person shall not be an appointed insurance agent and an authorized insurance broker at the same time*, whether in relation to the same or different clients.

(d) **Further statutory prohibitions**:

(i) A proprietor of, or partner in, an insurance agent shall not be a proprietor or employee of, or partner in, another insurance agent or an insurance broker.

(ii) An employee of an insurance agent who provides insurance advice to a policy holder or potential policy holder shall not be a proprietor or employee of, or partner in, another insurance agent or an insurance broker.

(iii) A proprietor or employee of, or partner in, an insurance agent may be a director of another insurance agent or of an insurance broker only if he does not provide insurance advice to a policy holder or potential policy holder for the company.

(iv) Where a director of an insurance agent does provide insurance advice to a policy holder or potential policy holder, he may be a director of another insurance agent or of an insurance broker only if he does not provide insurance advice to a policy holder or potential policy holder for the other company.

(v) A proprietor of, or partner in, an insurance broker shall not be a proprietor or employee of, or partner in, an insurance agent.

(vi) An employee of an insurance broker who provides insurance advice to a policy holder or potential policy holder shall not be a proprietor or employee of, or partner in, an insurance agent.

(vii) A proprietor or employee of, or partner in, an insurance broker may be a director of an insurance agent only if he does not provide insurance advice to a policy holder or potential policy holder for the insurance agent.

(viii) Where a director of an insurance broker does provide insurance advice to a policy holder or potential policy holder, he may be a director of an insurance agent only if he does not provide insurance advice to a policy holder or potential policy holder for the insurance agent.

Note: Breach of the relevant provisions of the Ordinance is a serious **criminal offence**. For example, claiming to be an insurance broker without having obtained an authorization, could result in a fine as much as **HK$1 million** and **2 years'** imprisonment on conviction upon indictment (or up to **HK$100,000** and **6 months'** imprisonment on summary conviction).

6.2.1a Appointed Insurance Agent's Relationship with Insurer

The ICO says that an 'appointed insurance agent' (note: it does not say 'insurance agent') is the agent of the insurer when dealing with a third party for (1) the issue of a contract of insurance and (2) insurance business relating to the contract. What this provision is largely saying is that whenever someone who is an appointed insurance agent of an insurer is dealing with a client in respect of (1) or (2) above, he is treated as having authority to bind the insurer; in other words, the insurer will be vicariously liable to the client for the agent's acts or omissions in the course of such dealings.

You will recall the common law rule you have learnt in Chapter 2 that the principal is vicariously liable for the agent's conduct. But if you think that the said ICO provision is just repeating this common law rule, you are missing the essence of the ICO with respect to regulation of insurance agents.

Before the said provision was enacted, a dispute between an insured and an insurer as to for whom an insurance intermediary has acted would have to be adjudicated on the basis of the relevant common law rules. In the common law, the nub of this issue is best represented by this question: 'For whom at the material time was the insurance intermediary acting in respect of the act which is

alleged to have given rise to a contract or transaction between the insured and the insurer?' The courts would resolve this question on the particular facts of the case and might possibly hold that the insurance intermediary was an agent of the insured for the act in question, even if he was at and about the material time in the business of insurance agency rather than insurance broking. In other words, this is a question of *fact*, rather than a question of law.

Now that the said provision has come into effect, when a similar dispute arises, the insurer will be held vicariously liable for the acts of the insurance intermediary provided that he was at the material time its 'appointed insurance agent' and that the acts in question fall within the scope of (1) or (2).

6.2.2 The Code of Practice for the Administration of Insurance Agents

The Code is in six Parts (A - F) and was issued by the HKFI with the approval of the Insurance Authority (IA) in accordance with the provisions of the ICO. It is therefore of considerable legal and professional importance. The following summary of the Code should be noted carefully.

6.2.2a PART A : Interpretation

Two matters to note are:

(a) Various definitions for the purposes of the Code, and these Notes, i.e.

"HKFI"	=	The Hong Kong Federation of Insurers
"IARB"	=	the Insurance Agents Registration Board established by The Hong Kong Federation of Insurers to administer the Code pursuant to its Articles of Association
"Insurance Agency"	=	an insurance agent which is not an individual agent
"Line of Insurance Business"	=	General Business and/or Long Term Business (either including or excluding Linked Long Term Business) as defined in the ICO
"MPF Code"	=	the Code of Conduct for MPF Intermediaries issued by the

		Mandatory Provident Fund Schemes Authority ("MPFA"), as amended from time to time
"MPF Intermediary"	=	has the meaning assigned to it by the MPF Code
"Ordinance"	=	the ICO (with its amending legislation)
"Principal"	=	an insurer to whom the ICO applies or Lloyd's
"Responsible Officer"	=	a person who, alone or jointly with others, is responsible for the conduct of the insurance agency business of an insurance agency
"Technical Representative"	=	a person (not being an insurance subagent) who provides advice to a policy holder or potential policy holder on insurance matters for an insurance agent, or arranges contracts of insurance in or from Hong Kong on behalf of that insurance agent

(b) The Code must not be interpreted as being in conflict with the Ordinance. If any conflict really arises between the two documents, the Ordinance must prevail.

6.2.2b PART B: General Principles

(a) **Functions of the IARB:** the IARB is under the direction of the HKFI, from whom it derives certain powers. Specifically, these include:

(i) refer complaints concerning insurance agents, Responsible Officers or Technical Representatives to any Principal or the relevant insurance agents as appropriate, for investigation;

(ii) receive investigation reports from the Principal or relevant insurance agent on such complaints, as the case may be;

(iii) require any Principal or relevant insurance agent to take disciplinary action regarding a complaint;

(iv) confirm appointments of insurance agents, Responsible Officers and Technical Representatives or revoke such confirmations;

(v) maintain a register of appointed insurance agents and a sub-register of insurance agents' Responsible Officers and Technical Representatives;

(vi) report to the IA where an insurance agent or a Principal appears to be in breach of the Ordinance or the Code, or where the IARB considers an insurance agent, Responsible Officer or Technical Representative ceases to be "fit and proper".

(b) **Guidance Notes** may be issued by the IARB from time to time, to explain how it intends to operate. These guidance notes do **not**, however, constitute part of the Code.

(c) **Interpretation of the Code** in either its English or Chinese version is subject to the *Interpretation and General Clauses Ordinance*, but the HKFI has the power to determine the meaning of both versions of the Code. The HKFI also has the conclusive and binding right to resolve any inconsistencies between the two versions.

(d) There is an express warning that **criminal prosecution** of a Principal or an insurance agent may follow, from failure to comply with the Code or the Ordinance. (If you want to acquire a better understanding of this issue, please refer to the relevant provisions of the ICO.)

6.2.2c PART C: Rules

(a) **Confirmation of Appointment** of an insurance agent by his Principal or of a Responsible Officer or Technical Representative by his appointing insurance agent must not take place until the IARB gives confirmation.

(b) **Registration of Insurance Agents, Responsible Officers and Technical Representatives**

(i) It shall be effected by the IARB as soon as practicable after receiving the application from the Principal or from the insurance agent as the case may be.

(ii) It shall be for a specified period, **not exceeding three years.** A Principal may apply for re-registration of his insurance

agent, and an insurance agent may apply for re-registration of his Responsible Officer/Technical Representative, not earlier than **3 months** before the current registration expires. (**Note**: the appointees remain subject to the 'fit and proper' criteria (see **6.2.2e** below), including the requirement of the Continuing Professional Development Programme.)

(iii) The insurance agent, Responsible Officer and Technical Representative shall disclose their own registration numbers upon request, and identify the numbers on their business cards, if distributed.

(c) **Cancellation of Registration** must take place when the insurance agent ceases to represent the Principal or the Responsible Officer or Technical Representative ceases to represent the insurance agent. The Principal or insurance agent, as the case may be, must notify the IARB to this effect within **7 days** and provide such details as the IARB may require. The IARB shall remove the insurance agent from the register or the Responsible Officer or the Technical Representative from the sub-register **immediately**.

(d) **Notification to the IA** of registrations and their subsequent cancellations must be given by the IARB within **7 days**. The register must be available for inspection by the IA.

(e) **Representation of Principals** is subject to the following:

(i) the insurance agent may represent a **maximum** of **four** Principals, of whom not more than **two** may be Long Term insurers;

(ii) for the purposes of (i) above, a **composite** insurer constitutes **two** Principals;

(iii) for the purposes of (i) above, a **group** of companies (see Glossary) constitutes one Principal, or where the representation is in respect of both General and Long Term business, two Principals;

(iv) the insurance agent must obtain the consent of his Principal **prior** to accepting an appointment as an insurance agent for another Principal.

(v) Subject to (i)-(iii) above, if a person is registered as an agent of another insurance agent, he shall register to represent all the Principal(s) of the appointing agent and shall register to engage in all appointed Line(s) of Insurance Business of the appointing agent.

(f) **Representation of Insurance Agents by Responsible Officers and Technical Representatives**: A person shall not act as a Responsible Officer or a Technical Representative for more than one insurance agent.

(g) **Obligations of Principals** in respect of insurance agents. The Principal must ensure that the insurance agent:

(i) to the Principal's knowledge, does not represent more than the maximum number of Principals allowed;

(ii) is eligible to engage in the Line of Insurance Business in respect of which the Principal is authorized to carry on and has appointed the insurance agent to engage in;

(iii) meets the "fit and proper" criteria set out in the Code;

(iv) is confirmed and registered by the IARB;

(v) is appointed as his insurance agent **in writing** by an **agency agreement**, which must require the insurance agent to comply with Part F (Minimum Requirements of Model Agency Agreement) of the Code (see **6.2.2f** below);

(vi) disclose his registration number upon request, and identify the number on his business cards, if distributed;

(vii) complies with the Code;

(viii) has registered as an MPF intermediary with the MPFA where the insurance agent engages in selling or advising on MPF schemes or their constituent or underlying funds.

(h) **Obligations of Insurance Agents** in respect of their Responsible Officers and Technical Representatives. An insurance agent must ensure that each of its Responsible Officer(s) and Technical Representatives:

(i) to the knowledge of the insurance agent, does not act for more than one insurance agent;

(ii) meets the fit and proper criteria set out in the Code;

(iii) is eligible to engage in the Line of Insurance Business in which the insurance agent is eligible to engage;

(iv) is confirmed and registered by the IARB;

(v) discloses his registration number upon request, and identify the number on his business cards, if distributed;

(vi) complies with the Code.

(i) **Training of insurance agents** must be provided by the Principal so that a **reasonable person** receiving such training would:

(i) be familiar with the requirements of the Ordinance and the Code; and

(ii) be able to competently undertake the duties of an insurance agent, in accordance with the requirements of the Ordinance and the Code.

(j) **Training of Responsible Officers and Technical Representatives** must be provided by the insurance agent so that a **reasonable person** receiving such training would:

(i) be familiar with the requirements of the Ordinance and the Code; and

(ii) be able to competently undertake the duties of a Responsible Officer or Technical Representative, in accordance with the requirements of the Code.

6.2.2d PART D: Procedures

(a) The **IARB** shall maintain a **Register** of insurance agents, and a sub-register of Responsible Officers and Technical Representatives, whose appointments it has confirmed. It shall be as prescribed by the IA and available for public inspection during normal working hours, at the HKFI's registered office.

(b) **Applications** for confirmation of appointment and registration of insurance agents, Responsible Officers and Technical Representatives are in substance subject to the following:

(i) application to be made by the Principal for insurance agent and by the insurance agent for Responsible Officer or Technical Representative;

(ii) must be in a manner and form prescribed by the IARB;

(iii) the IARB may require additional information;

(iv) the IARB may reject an application which is incomplete or not in the prescribed form;

(v) the Principal and insurance agent must advise the IARB of any change in information, in respect of a pending application;

(vi) the proposed insurance agent, Responsible Officer or Technical Representative must satisfy the IARB that he is **fit and proper** to act as such.

(c) **Matters Relevant to Fitness and Properness of, and Complaints against, Insurance Agents.** If the IARB becomes aware of any matter which may render an insurance agent not fit and proper to act or to continue to act as such, or receives a complaint against an insurance agent:

(i) the IARB may refer the matter or the complaint to the Principal or insurance agent for investigation;

(ii) the Principal must investigate **diligently and expeditiously**, and report the progress and findings of the investigation on request by the IARB;

(iii) representations from the Principal and/or the insurance agent are allowed;

(iv) as required, the IARB may instruct the Principal to take disciplinary action;

(v) the disciplinary action may be:

(1) to issue a **reprimand** to the insurance agent;

(2) to **suspend** the insurance agent's appointment;

(3) to **terminate** the insurance agent's appointment and bar him from registration as an insurance agent, a Responsible Officer or a Technical Representative for a specified period;

(4) **other action** as the IARB sees fit.

(vi) the IARB must give notification of the requirement for disciplinary action to the Principal/insurance agent to be affected, together with the reasons for the requirement;

(vii) the IARB may impose further requirements and report to the IA should a Principal fail to comply with requirements already imposed.

(d) **Matters Relevant to Fitness and Properness of, and Complaints against, Responsible Officers and Technical Representatives.** These are handled in the same manner as stated in (c) above except that:

(i) the insurance agent or any Principal as appropriate shall diligently and expeditiously do the investigation and the subsequent reporting;

(ii) the Responsible Officer or Technical Representative, as well as the insurance agent and/or the Principal, is allowed to make representations;

(iii) it is the insurance agent and/or the Principal who may be required to take disciplinary action against the Responsible Officer or Technical Representative;

(iv) it is the insurance agent, Responsible Officer and Technical Representative who are entitled to a notification of the requirement of a disciplinary action; and

(v) it is the insurance agent and/or the Principal on whom a further requirement to take disciplinary action may be imposed.

(e) The affected persons may appeal to an **Appeals Tribunal** against the IARB's decisions, and the following apply:

(i) its decision is **final**;

(ii) its members shall be persons (not being members of the IARB) **nominated** by the HKFI and **confirmed** by the IA;

(iii) the IARB's decision **takes effect** whilst the appeal is pending;

(iv) the Tribunal may set its own procedures or follow set procedures;

(v) it may confirm, vary or reverse the IARB's decision, or substitute its own decision.

(f) **Reports to the IA** may be made on any complaint matter, and disclosures made in good faith shall not incur any liability for the IARB or its members towards any person concerned.

6.2.2e PART E: Fit and Proper Criteria

(a) **Fitness and Properness of Insurance Agents, Responsible Officers and Technical Representatives**: If this is in doubt, the IARB must allow the person concerned to make representations to it for consideration.

If still not satisfied, the IARB must give a **written report** to the IA, specifying the grounds for its opinion. The person concerned must also be given a copy of that report.

(b) **Matters relevant** to determining "fitness and properness" of insurance agents include:

(i) record of **bankruptcy** or of being a controller, a director, an officer or a senior manager of a company that has become **insolvent**;

(ii) relevant educational or other **qualifications**;

(iii) record of relevant **criminal conviction** or **professional misconduct**;

(iv) failure to comply with the **Minimum Requirements of Model Agency Agreement** as stated in the Code (see **6.2.2f** below);

(v) breach of the Code and/or HKFI rules;

(vi) failure to meet **minimum qualifications** (see (c) below);

(vii) any other matters the **IARB** considers **relevant**.

(viii) registration as an MPF intermediary with the MPFA if the proposed insurance agent engages in selling or advising on MPF schemes or their constituent or underlying funds;

(ix) breach of the MPF Code if the insurance agent is also an MPF intermediary;

(x) adequate measures to ensure that directors and employees have registered as MPF intermediaries with the MPFA and comply with the MPF Code where the directors and employees engage in selling or advising on MPF schemes or their constituent or underlying funds.

The above matters also apply, as appropriate, to Responsible Officers and Technical Representatives.

(c) **Minimum Qualifications**

(i) Minimum qualifications for a fit and proper insurance agent, Responsible Officer or Technical Representative are that:

(1) he has attained the age of **18**;

(2) he has completed **Form 5** or equivalent unless such requirement has been waived in accordance with the Code; and

(3) he has successfully passed the relevant papers of the Insurance Intermediaries Qualifying Examination recognized by the IA ("the Qualifying Examination") unless he has been exempted under the criteria specified in the Code.

(ii) A person's non-engagement in insurance-related work in the insurance industry in Hong Kong for two consecutive years after passing any of the papers will nullify the recognition of his qualification in respect of such paper(s).

(iii) Insurance agents, Responsible Officers and Technical Representatives must comply with the requirements of the Continuing Professional Development Programme in such manner and form as specified by the IA.

6.2.2f PART F: Minimum Requirements of a Model Agency Agreement

A Principal must appoint an insurance agent under a **written agency agreement** that meets the minimum requirements of the HKFI's *model agency agreement.* The agreement must at least include this **Conduct of Insurance Agents**:

(a) **Insurance Agents for General Insurance Business**

(i) Business is to be conducted at all times in **good faith** and with **integrity**.

(ii) An insurance agent must cooperate with the IARB and his Principal in the search for relevant facts if there is a complaint concerning his conduct. The complainant should be told to refer his complaint to the Principal and then, if necessary to the IARB.

(iii) The insurance agent must:

(1) before insurance discussions, properly identify himself as an insurance agent for the Principal;

(2) disclose his registration number upon request, and identify the number on his business cards, if distributed;

(3) give advice **only** where he is **competent** to do so, or seek the advice of his Principal;

(4) explain the **policy cover** recommended and ensure that the client understands what he is buying;

(5) explain the specific **differences** to which he is referring when making comparisons with other types of policies;

(6) treat all information as **confidential** and disclose it **only** to the Principal concerned;

(7) **not** make **inaccurate** or **misleading** statements about any Principal, or their policies, or other insurance intermediaries;

(8) **not** make any charge additional to the premium without full explanation **before** the policy becomes binding;

(9) **not** pay any part of commission or discount allowed to him to any partner, director or employee of the insured without the prior **written agreement** of the insured.

(iv) When assisting with the completion of a **proposal** or **application**, the insurance agent must:

(1) **not** influence the client, and make it clear that all answers and statements are the client's responsibility;

(2) **explain** to the client the consequences of fraud, non-disclosure and inaccuracies, drawing his attention to the relevant statements on the form.

(b) **Insurance Agents for Long Term Insurance Business**

Many of the requirements for Long Term Business insurance agents are identical with those indicated above. We shall not repeat these, but make appropriate reference. Take special note, however, of differences. Also please note that the sub-divisions given below may not always correspond with those in the actual Model Agreement (which should be referred to for full understanding).

(i) as with (a)(i) above;

(ii) as with (a)(ii) above;

(iii) (1) as with (a)(iii)(1) above;

(2) as with (a)(iii)(2) above;

(3) as with (a)(iii)(3) above;

(4) as with (a)(iii)(4) above;

(5) as with (a)(iii)(5) above;

(6) as with (a)(iii)(6) above;

(7) as with (a)(iii)(7) above;

(8) as with (a)(iii)(8) above;

The following are requirements exclusive to Long Term Business insurance agents:

(9) the insurance agent must make every reasonable effort to ensure that the proposed policy is suitable to the **needs and resources** of the client as disclosed to the agent;

(10) the insurance agent must **not** make inaccurate or misleading statements/comparisons to induce an insured to **replace** existing long term insurance to the insured's **disadvantage**;

(11) the insurance agent must **not** pay or offer any **rebate** of premium, commission or other incentive not specified in the policy as an **inducement** to a long term policyholder;

(12) the insurance agent must comply with the requirements as specified in the MPF Code if he is an MPF Intermediary.

(iv) as with (a)(iv)(1) and (2) above;

(v) When selling policies related to long term business, the insurance agent must:

(1) explain the **long term** nature of the contract and the consequences of early discontinuance and/or surrender;

(2) explain the difference between **guaranteed** and **projected** benefits in the case of investment-linked or participating policies;

(3) where projected benefits are **illustrated**, explain the assumptions on which illustrations are based, including bonus or dividend declaration, and that projected benefits are **not** guaranteed;

(4) explain that dividends (or bonuses) with participating (or with-profit) policies may be higher or lower than those currently quoted, and that past performance may not be a guide to future performance;

(5) explain with unit-linked business that the unit value and the value of the policyholder's benefits may fluctuate;

(6) use only sales proposals and illustrative figures supplied by the Principal unless specifically authorized by the Principal, and use the whole relevant illustration without addition or selection against the client's interests;

(7) when authorized to prepare illustrations himself, use only the assumptions authorized by the Principal.

6.2.2g Guidance Notes

(a) It is of primary importance that an insurance agent conducts business at all times in **good faith** and with **integrity**. Of the three sets of **Guidance Notes** (see **6.2.2b**(b) above) issued by the IARB, two identify certain actions or sales practice construed as **misconduct**, which will be subject to disciplinary action by the IARB. They are:

(i) **Guidelines on Misconduct**

(1) In order to protect the insuring public against potential losses arising from misrepresentation and forgery, insurance agents must not request their prospective customers and/or clients to sign blank forms or sign any documents relating to the policy before they have been duly completed and any alteration should be initialled by the customer.

(2) It is an insurance agent's duty to present each policy with complete honesty and objectivity. In the case where the client is already a policyholder, this means that full and fair disclosure of all facts regarding both the new coverage and the existing insurance is necessary. Policyholders should be made fully aware of the estimated cost of replacing an existing policy. In selling a life insurance policy, insurance agents must duly complete the Customer Protection Declaration (**CPD**) form as prescribed by the HKFI from time to time and bring its contents to the attention of the customer.

(3) Principals must establish control procedures to monitor insurance agents' compliance with the Code.

(ii) **Guidelines on Handling of Premiums**

Customers will want to pay their premiums in a variety of ways, including cash, credit card, cheque and bank transfer. It is up to the Principal to decide which methods are acceptable, but the following methods are recommended:

Cheque in favour of the **Principal**; or

Credit card/direct deposit/bank transfer from the **Customer's** account to the **Principal**.

Any other method of payment or credit facilities extended to an insurance agent should be subject to clear rules set out by the Principal designed to avoid the mixing of customers' money with insurance agents' personal funds.

(b) In order to ensure that no prospective or current insurance agents, their Responsible Officers or Technical Representatives shall hold themselves out as engaging in the insurance agency business relating to a Principal before the IARB confirms their relevant registrations, a separate set of Guidance Notes was issued by the IARB. It is:

Guidelines on the Effective Date of Registration of Insurance Agents, Responsible Officers and Technical Representatives

A prospective or current **insurance agent** must take note that it may be an offence under section 77 of the ICO to hold himself out as an insurance agent of a Principal before he is registered by the IARB. Therefore, no person shall act or hold himself out as an insurance agent for and on behalf of any prospective appointing Principal before the date specified by the IARB in the Notice of Confirmation of Registration. Any breach may render that person liable to criminal prosecution for an offence under section 77 of the ICO.

A prospective or current **Responsible Officer or Technical Representative** of an insurance agent should also take note that it may be a breach of the Code for him to hold himself out as the Responsible Officer or Technical Representative of such insurance agent before he is registered by the IARB. Therefore, no person shall be a Responsible Officer or Technical Representative of any prospective appointing insurance agent before the date specified by the IARB in the Notice of Confirmation of Registration. Any breach may affect the fitness and properness of the Responsible Officer, Technical Representative or insurance agent concerned.

6.2.3 "Minimum Requirements" Specified for Insurance Brokers

These **"Minimum Requirements"** are as specified under Part X of the ICO which brought into the regulatory regime a framework for the supervision of the **self-regulation** by the insurance industry of insurance *agents and brokers*.

It is worth repeating at this stage the statutory definition of an insurance broker:

> *"a person who carries on the business of negotiating or arranging contracts of insurance in or from Hong Kong as the agent of the policyholder or potential policyholder or advising on matters related to insurance."*

Persons falling within this definition must have either:

(a) obtained authorization from the **Insurance Authority** (IA); or

(b) become a member of a **body of insurance brokers** approved by the IA.

6.2.3a Minimum Requirements specified by the IA

There are **five** requirements to be satisfied, as follows (see also **6.2.3d)**:

(a) *qualifications and experience*;

(b) *capital and net assets*;

(c) *professional indemnity insurance*;

(d) *keeping of separate client accounts*;

(e) *keeping proper books and accounts*.

Besides the above requirements, an applicant **insurance broker** must be *fit and proper*, while the **applicant body** of insurance brokers must have rules and regulations sufficient to ensure that its members are *fit and proper*.

Note: 1 The IA publishes *Guidelines* to assist compliance with the requirements of the ICO. Failure to comply with these guidelines could result in a person or body of insurance brokers not being authorized/approved or having their authorization/approval withdrawn.

2 In certain cases an insurance product may constitute an *investment arrangement* under the *Securities and Futures Ordinance,* in which case it must be authorized by the **Securities and Futures Commission** (SFC) before it can be offered to the public in Hong Kong.

6.2.3b Authorization of Insurance Brokers

(a) The applicant can be a *sole proprietor* (individual person), a *partnership* or a *limited company*.

(b) The IA must be satisfied that the applicant satisfies all requirements.

(c) The applicant must be, or appoint a *Chief Executive* (CE) who must be, **fit and proper** and must meet other **minimum requirements**.

6.2.3c Approval of Bodies of Insurance Brokers

(a) Must satisfy the IA that it complies with all *statutory requirements*;

(b) Must maintain appropriate rules and regulations for its members to comply with the **minimum requirements**;

(c) The rules and regulations shall include eligibility of membership, membership rules, members' code of conduct and disciplinary procedures.

6.2.3d Specifics of the Minimum Requirements

(a) **Qualifications and Experience**

An insurance broker or the CE nominated by him must have a minimum education standard of Form 5 or equivalent and be aged 21 or above. All of them must also have:

(i) any of the acceptable insurance qualifications specified in the **minimum requirements** and a minimum of two years' experience in the insurance industry occupying a management position. In addition, if any of them intends to engage in the long term (including linked long term) insurance broking business, they must have passed the Investment-linked Long Term Insurance Paper of the IIQE, unless exempted under the criteria specified in the

Minimum Requirements.

(ii) if they have no acceptable insurance qualification, a minimum of five years' experience in the insurance industry of which at least 2 years is at management position and passed the relevant papers of the IIQE unless exempted under the criteria specified in the **Minimum Requirements**.

Any one Technical Representative of an insurance broker must:

(i) have attained the age of 18;

(ii) have the minimum education standard of Form 5 or equivalent unless exempted under the criteria specified in the **Minimum Requirements**; and

(iii) have passed the relevant papers of the IIQE as if he was an insurance broker unless he has an acceptable insurance qualification specified in the **Minimum Requirements** or has been exempted under the criteria specified in the **Minimum Requirements**.

A person who met the relevant requirements of qualifications by passing the relevant papers of the IIQE and became an authorized insurance broker or a registered Chief Executive or Technical Representative of an insurance broker, but who later ceased to engage in insurance-related work in the insurance industry in Hong Kong for two consecutive years, must pass the relevant papers again before being authorized/registered again, unless exempted under the criteria specified in the **Minimum Requirements**.

An insurance broker, his CE or Technical Representatives must comply with the requirements of the Continuing Professional Development Programme in such manner and form as specified by the IA.

(b) **Capital and Net Assets**

The requirements are:

(i) **Unincorporated insurance broker** must maintain in his business minimum net assets value of **HK$100,000**.

(ii) **Incorporated insurance broker** must maintain minimum net assets value of **HK$100,000** and minimum paid up share capital of **HK$100,000**.

(iii) **Determining minimum net assets** is by excluding all *intangible assets* (e.g. goodwill) and using accounting principles generally accepted in Hong Kong.

(c) **Professional Indemnity Insurance** must be maintained, whose *limits of indemnity* per **claim** and per insurance **year** must each be at least the **greater** of:

(i) **two times** the aggregate insurance brokerage income for the previous 12 months (or projected brokerage if in business for less than one year); and

(ii) **HK$3 million**.

BUT not more than **HK$75 million** is required.

Note: If the limit of indemnity is reduced as a result of a claim to an amount below that determined in (i) above, the insurance broker is required to have the cover reinstated to a level not below the minimum determined limit. On the other hand, where the limit of indemnity has been determined in accordance with (ii) above, the policy must provide for one automatic reinstatement to a limit of indemnity not less than HK$3 million.

(d) **Keeping of Separate Client Account** in accordance with the following:

(i) The *"Client account"* must be so designated and held for the client.

(ii) Client monies must **only** be used for the purposes of the client.

(iii) The "client account" means a *current or deposit* account with a financial institution duly authorized under the Banking Ordinance.

(iv) The insurance broker must have at least one "client account".

(v) Monies held on behalf of clients must be *deposited without delay*.

(e) **Keeping Proper Books and Accounts** in accordance with the following:

(i) All insurance brokers must keep accounting and other records which:

(1) sufficiently explain transactions;

(2) sufficiently reflect the financial position of the business;

(3) enable "true and fair view" financial statements to be prepared;

(4) can be conveniently and properly audited.

(ii) The records must be in writing or in a form that can readily be accessed and turned into writing, and in sufficient detail to show:

(1) all transactions between insurers/reinsurers, the insurance broker's clients and the insurance broker himself;

(2) all income and expenditure;

(3) all assets and liabilities.

(iii) The records must be retained for not less than **7 years**.

(f) **'Fit and Proper' Tests** of an insurance broker, its partners, CE, directors, controllers, and technical representatives:

(i) **Utmost Good Faith** (undefined), integrity, independence, impartiality, etc. must be observed by the insurance broker at all times, in all aspects of his business.

(ii) **Due Care and Diligence** must be exercised by the insurance broker and by his CE, Technical Representatives and employees, generally and in relation to technical and professional matters.

(iii) **Client's Interests** must be placed above those of the insurance broker, when he is providing advice or arranging insurance contracts.

(iv) **Information from Client** must be treated with total confidentiality.

(v) **Information for Client** must include an adequate and accurate disclosure of all relevant material information, especially as to any unauthorized status of an insurer or any matter which could involve a conflict of interest. He must disclose his registration number if so requested, and identify such number on his business cards if they are distributed.

(vi) **Capabilities** of the insurance broker shall include efficiency, mental soundness and freedom from relevant criminal convictions. In addition, of course he must comply with all statutory obligations.

6.2.3e Annual Financial Statements and Auditor's Report

(a) All insurance brokers (whether incorporated or unincorporated) authorized by the IA must submit to him an annual audited financial statement representing a *true and fair* picture of the business and of the profit or loss for the period then ended.

(b) All insurance brokers authorized by the IA must submit to him an *auditor's report* confirming that in the auditor's opinion the *minimum requirements* imposed upon the insurance broker mentioned in **6.2.3d**(b) through (e) above have been met.

(c) The auditor's report and audited financial statements mentioned in (a) and (b) above must be submitted to the IA *within 6 months* of the close of the relevant financial period.

(d) Any approved body of insurance brokers must include in its membership rules and regulations that each member shall submit to it, *within 6 months* following the end of the financial year of the member, an audited financial statement and auditor's report (similar to the requirements in (a) and (b) above).

(e) A body of insurance brokers must, *within 6 months* after the close of the relevant financial period, supply the IA with an auditor's report stating whether it has duly received the financial statements and auditor's reports from its members.

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Representative Examination Questions

Type "A" Questions

1 In the general rules for the authorization of insurers under the Insurance Companies Ordinance, the requirement concerning **reinsurance** is that it must be:

(a) adequate; .....
(b) sufficient to meet all liabilities; .....
(c) at least equal to the solvency margin; .....
(d) all be placed with Hong Kong reinsurers. .....

[Answer may be found in **6.1.1a**]

2 Under the Code of Practice for the Administration of Insurance Agents, which of the following boards may refer complaints against insurance agents to the relevant principals?

(a) the Insurance Claims Complaints Board; .....
(b) the Insurance Agents Registration Board; .....
(c) the board of directors of the company which is an appointed insurance agent; .....
(d) none of the above. .....

[Answer may be found in **6.2.2d**(c)(i)]

Type "B" Questions

3 Under the Code of Practice for the Administration of Insurance Agents, which of the following are permitted disciplinary actions against an insurance agent?

(i) Issue a reprimand
(ii) Suspend the agent's appointment
(iii) Terminate the agent's appointment
(iv) Other action deemed fit by the IARB

(a) (i), and (ii) only; .....
(b) (i), (ii) and (iii) only; .....
(c) (ii), (iii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **6.2.2d**(c)(v)]

4 Which of the following should be included in the Conduct of Insurance Agents for General Insurance Business?

(i) Give advice only when competent to do so
(ii) Identify himself before business discussions
(iii) Explain policy differences when making comparisons
(iv) Explain policy cover and ensure the client understands what he is buying

(a) (i) and (ii) only; .....
(b) (i), (ii) and (iii) only; .....
(c) (ii), (iii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **6.2.2f**(a)]

[If still required, the answers may be found at the end of the Study Notes.]

7 ETHICAL AND OTHER RELATED ISSUES

7.1 INSURANCE INTERMEDIARIES' DUTIES TO POLICYHOLDERS

At the outset, it must be remembered that insurance intermediaries may be either **insurance agents** or **insurance brokers**. Depending on the category involved, the duties towards policyholders may be different. Of course, there are areas which are common ground. These will include:

(a) absence of *fraud:* this is a common obligation on all;

(b) *fair and reasonable* behaviour: if not specifically covered by (a) above, then this standard must at least be expected when considering ethical issues;

(c) take *no unfair advantage of clients*: especially of physical, mental or educational deficiencies (again, this must be a matter of basic ethics);

(d) exert *no undue influence*: the role of the insurance intermediary is that of an adviser, not a persuader or enforcer;

(e) all actions must be *legal*: of course, strictly speaking illegality is much the same as fraud, but the honourable insurance intermediary will not only keep to the *letter* of the law, he will observe the *spirit* of the law and good insurance practice;

(f) where the duties are governed or required by *legislation*, it is important to know that a breach could involve **criminal** proceedings, with severe penalties.

All the above are virtually self-evident, but they are still important things to remember in the context of this Chapter. Specifically, there are other matters that should be borne in mind, according to whether the insurance intermediary is an insurance agent or an insurance broker. We shall look at them in reverse order.

7.1.1 If the Insurance Intermediary is an Insurance Broker

(a) **Relationship:** the cardinal point to remember is that the insurance broker is normally **agent of the policyholder**. All the legal obligations and duties within agency law therefore apply to the insurance broker in relation to the insured.

(b) **"Minimum Requirements":** In addition to the requirements of agency law, the "minimum requirements" discussed in **6.2.3** above have a relevance here. Without too much by way of repetition, some of the relevant points may be recalled, such as:

(i) special responsibilities regarding *client's monies* (see **6.2.3d**(d) above);

(ii) duty always to act in *utmost good faith* (**6.2.3d**(f)(i) above);

(iii) other duties under '*Fit and Proper' Tests* (also **6.2.3d**(f) above).

(c) **Insurance Broker's general responsibilities**: the insurance broker is seen to be an *expert* in insurance. He must also be *independent* of any one insurer. His client is the policyholder, who may expect *impartial advice*, with his interests **paramount**.

(d) **Professional liability**: if, as a deemed expert, the insurance broker fails to take reasonable care in his client's interests, he could well be guilty of *professional negligence*. This would give the policyholder the right to sue, with the knowledge that the insurance broker is required to be covered by a **Professional Indemnity Insurance** (see **6.2.3d**(c)).

7.1.2 If the Insurance Intermediary is an Insurance Agent

(a) **Relationship:** the relationship with the policyholder is quite different for the insurance agent. His principal is normally the *Insurer,* not the *Insured*. As such, his primary responsibilities are to the insurer, although of course he is not exempt from the legal and ethical obligations discussed in **7.1** above.

(b) **"Minimum Requirements":** as discussed, all insurance agents must be appointed *in writing* and subject therefore to an **Agency Agreement** (see **6.2.2f**). Such an agreement must include certain "minimum requirements". These will include a wide range of obligations towards both his Principal and the policyholder (or prospective policyholder). These may be reviewed in **6.2.2f**.

Note: Please **do** revise the passage suggested. We do not repeat the requirements here, but they are important and consist of knowledge that will be expected in your examination.

(c) **Professional liability:** Tortious liability on the part of an insurance intermediary may to some extent depend upon the degree of knowledge/expertise expected of him, which in turn depends upon the nature of the skills he has professed for undertaking on behalf of the claimant the activity which has allegedly led to a loss to the claimant. As the typical insurance broker will hold himself out as being an insurance expert for the client, his duty of care to the client can be said to be onerous. By contrast, if an insurance agent has not professed to his clients special skills for undertaking an activity for them, he should be at a much lower risk of being held liable to them for incompetent performance of such activity. With in mind this contrast and the statutory imposition of vicarious liability on an insurer for his appointed insurance agents' conduct in prescribed circumstances, it is understandable that unlike an insurance broker an insurance agent is not statutorily required to maintain professional indemnity insurance.

7.2 PROTECTION OF PERSONAL DATA

One of the consequences of the "computer revolution" has been the fear that the speed, efficiency and capabilities of information technology will severely affect personal privacy. This has been a worldwide concern and many jurisdictions, including Hong Kong, have passed laws to safeguard the individual in this respect.

The particular statute for Hong Kong is the *Personal Data (Privacy) Ordinance* (the "Ordinance").

7.2.1 Features of the Ordinance

(a) **Scope:** by international standards, the Hong Kong law is thorough, relating to:

(i) *automatic* and *manual* data;

(ii) *public* and *private* sectors; and

(iii) with a statutory body to oversee its application, in the *Privacy Commissioner for Personal Data*.

(b) **Definitions:** in the Ordinance, the following definitions appear:

(i) "*data*" - any representation of information (including an expression of opinion) in any document and includes a personal identifier;

(ii) "*personal data*" - any data (including expressions of opinions)

(1) relating **directly** or indirectly to a living individual (data subject);

(2) from which it is practicable for the identity of the individual to be directly or indirectly ascertained; and

(3) in a form in which access to or processing of the data is practicable.

(c) **Data Protection Principles:** the Ordinance gives due prominence to **six** internationally recognized principles in this area, as follows:

(i) **Purpose and manner of collection**: outlines the *lawful and fair* collection of personal data, also the information that the *data user* must give to the *data subject* when collecting personal data.

(ii) **Accuracy and duration of retention**: the personal data should be *accurate*, *up-to-date* and kept *no longer* than necessary.

(iii) **Use of personal data**: unless the *data subject* gives consent otherwise, the personal data should only be used for the purposes for which they were collected, or a *directly related* purpose.

(iv) **Security of personal data**: appropriate *security measures* should be applied to personal data (including data in a form in which access to or processing of it is not practicable).

(v) **Information to be generally available**: *data users* should show openness as to the kinds of personal data they hold and the *main purposes* for which personal data are used.

In this sensitive area, insurers might indicate to their clients that their personal data such as names and addresses is held, not only for the immediate class of business concerned, but also with a view to soliciting other business (e.g. householders cover offered to motor policyholders).

(vi) **Access to personal data**: *data subjects* have the rights of access to, and of correction of, their personal data.

(d) **Exemptions:** The right to privacy is **not absolute**. Clearly, criminals have no right to expect total secrecy, and the normal conduct of business and social life in a community demand that some information can be generally or specifically available to those with a legitimate right to know. Exemptions from the Ordinance include:

(i) a broad exemption for personal data held for *domestic* or *recreational* purposes;

(ii) exemptions on access by data subject for certain *employment-related* personal data held by their employers;

(iii) exemptions from the subject access and use limitation requirements where their application is likely to prejudice certain competing public or social interests, such as: security, defence and international relations; prevention or detection of crime; assessment or collection of any tax or duty; news activities; and health.

7.2.2 Insurance Applications

The above relate to society generally, of which insurance is of course a part, but specific applications have arisen or may be perceived to be relevant, as follows:

(a) **Claims investigation:** most would agree that investigating claims is a perfectly proper and legitimate activity. The Ordinance, however, had produced an unexpected result in that the police refused to release statements given to them about motor accidents or other events of relevance to insurers. Such statements were routinely obtained in the past, but now (after much discussion and negotiation) a declaration of consent for the statement to be released is to be sought when the statement is being taken by the police.

(b) **Financial data:** in the course of business enquiries, especially when dealing with life insurance or investment issues, very confidential information on the client's personal finances may be obtained. Insurance intermediaries should obviously treat such data with total security. This is one of the things to do in compliance with the respective ‘fit and proper’ criteria for insurance brokers and for insurance agents, as well as with the "Ordinance".

(c) **Medical information:** another area of great sensitivity, which is routinely the subject of enquiry with life, health and personal accident insurances. Under the provisions of the Ordinance, insurers must explain their need for gathering particular medical evidence *before* any testing is undertaken.

They must also notify any person who undergoes medical testing of his right to be informed of the *test results*.

(d) **Releasing information:** before any information is revealed by an insurer (e.g. in the course of verifying a client's claims history), the *identity* of the enquirer must be ascertained. Releasing information may also entail a specific confirmation from the person to whom the data relates that he consents to its release.

(e) **Gathering information**: the range of subjects where insurers (or insurance agents/brokers) may need personal data relating to existing or potential clients is considerable. This includes such diverse subjects as financial information in order to determine a sum insured for business interruption insurance and enquiry into the financial status and standard of living for a suspected fraudster in a fidelity guarantee claim. Explanations to justify the enquiry must be given.

7.3 ISSUES REGARDING EQUAL OPPORTUNITY

7.3.1 Legislation Addressing Discrimination

An **Equal Opportunities Commission (EOC)** has been in place to implement the following three Ordinances, which were respectively designed to eliminate discrimination on the grounds of:

(a) *sex, marital status or pregnancy* (the *Sex Discrimination Ordinance*, 1995);

(b) *disability* (the *Disability Discrimination Ordinance*, 1995); and

(c) *family status* (the *Family Status Discrimination Ordinance*, 1997).

7.3.2 "Fair" Discrimination in Insurance

The insurance industry, like every other area of our society, must respect the law regarding anti-discrimination. That said, in the practice of insurance business, insurers will in certain circumstances differentiate between proposers in ways that are legitimate, insofar as that is permitted by any of the three Ordinances mentioned above. An identical provision is contained in each of the Ordinances to the effect that the treatment of a person in relation to insurance is not outlawed where the treatment (a) was effected by reference to actuarial or other data from a reliable source, and (b) was reasonable having regard to the data and any other relevant factors. The following are instances of 'discrimination' in insurance that are generally considered to be legitimate:

(a) **Life insurance**: The premium charged for a life insurance is very much affected by the life expectancy of the life insured at the time the insurance is arranged. It is a biological fact that women, on average, live *longer* than men. From this, insurers may:

(i) charge a *lower* premium rate for *life insurances* on women than for men of the same age, health condition, etc, because on average the benefit will not be paid so soon and/or more premium payments are expected in the case of women; and

(ii) offer higher *annuity benefit payments* to men than to women of the same age, health condition, etc, because on average there are likely to be fewer payments to men.

(b) **Personal accident insurance**: A person with a disability, such as impaired eyesight or other serious medical condition, clearly represents a very different risk from a person with a normal healthy body. This difference could mean that insurers *decline* (refuse to insure) such persons, or impose various *underwriting measures* (higher premium, policy limitations, etc.).

7.3.3 Unfair Discrimination in Insurance

The examples of discrimination common throughout our society (appointing only women, unfairly denying promotion to women, not employing the physically handicapped, sexual harassment and so on) have no different application or treatment in insurance. Specific examples of unfair discrimination with insurance, however, would include the following two examples:

(a) **Motor insurance**: charging higher premiums or imposing stricter terms on women because of the widely held male prejudice to the effect that women drivers are worse than men. (Statistics of accidents and driving convictions in many countries seem to suggest that the opposite is true!)

(b) **Fire insurance**: refusing to grant household insurance to a woman on the grounds that she is divorced or a single parent.

7.4 PREVENTION OF MONEY LAUNDERING

The above is the title of a *Guidance Note* issued by the **Office of the Commissioner of Insurance** (OCI) in 1993, last revised in 2000 and supplemented in 2003, impressing upon all *insurance institutions*, by which is meant all authorized insurers, insurance agents and insurance brokers carrying on or advising on long term business (which is considered to be much more readily susceptible to this illegal activity than general business), the need to be on their guard against **money laundering**.

Insurance institutions that are financial institutions authorized by the Hong Kong Monetary Authority are subject to the Guideline on Prevention of Money Laundering issued by the Hong Kong Monetary Authority ("HKMA's Guideline"). However, to the extent that there are some insurance specific examples of suspicious transactions or money laundering cases in the Guidance Note of the OCI which may not be shown in the HKMA's Guideline, the insurance institutions that are authorized financial institutions are required to have regard to Annexes F and G to the Guidance Note in identifying suspicious transactions.

The term 'money laundering' is commonly used to represent dishonest acts to "clean" money (or to make it appear to be so) that has been obtained through criminal activities, by using various financial services, including insurance. (It is more technically and precisely defined in the Guidance Note.) The main area of insurance vulnerable to money laundering is *life insurance*, including *investment-linked insurance*.

7.4.1 Legislation on Money Laundering

There are two main Ordinances relating to this subject:

(a) the *Drug Trafficking (Recovery of Proceeds) Ordinance (DTROP)*, 1989; and

(b) the *Organized and Serious Crimes Ordinance (OSCO)*, 1994.

The latter Ordinance specifically makes **money laundering** a criminal offence. Amendments to both Ordinances have been made in order to tighten the statutory provisions regarding money laundering. These amendments have a significant bearing on the duty to report suspicious transactions. There is now a clear *statutory obligation* for all persons to disclose knowledge and suspicion of money laundering transactions to the relevant law enforcement authorities.

The Ordinances treat an employee who discloses to an appropriate person in accordance with the procedure established by his employer for the making of such disclosures as are required by the Ordinances as disclosing to the relevant law enforcement authorities. They also prevent a person making the statutorily required disclosure from being liable in damages for any loss arising out of the disclosure. However, a person is prohibited from disclosing any matter that is likely to prejudice an investigation into money laundering activities.

7.4.2 Money Laundering and Insurance

(a) **Commonest form**: this is by way of proposals for *single premium contracts*, in respect of investment bonds, annuities, life insurance, personal pensions, etc.

(b) **Stages of money laundering:** there are three regularly used stages which should alert insurers to potential criminal activity:

(i) *Placement:* the physical disposal of illegally obtained money;

(ii) *Layering*: complicated arrangements to "disguise" the sources of money, etc.;

(iii) *Integration:* reintroducing the "cleaned" money to the economy.

7.4.3 Procedures Required to be Taken Against Money Laundering

(a) **Customer identification**: proof of customers' identity must be obtained in accordance with effective policies and procedures. The Privacy Commissioner has given endorsement to the requirement that file copies of identity documents should be kept by the insurance institutions.

(b) **Record keeping**: adequate transaction records should be established and retained regarding persons, sources of funds, etc. - especially for single premium business.

(c) **Suspicious transactions**: appropriate policies and procedures should be in force to help identify suspicious transactions and to report them to the Joint Financial Intelligence Unit.

(d) **Feedback from the authorities**: whilst not required by law, the police and customs realize the importance of, and do practice, effective feedback procedures.

(e) **Staff training**: adequate measures should be taken to ensure that staff are properly trained and their education kept up to date in this important area.

7.5 COMBAT AGAINST TERRORIST FINANCING

7.5.1 Background and Application

In wake of the September 11 terrorist attacks, the United Nations Security Council passed various resolutions to require sanctions against certain designated terrorists and terrorist organizations. The Hong Kong SAR Government has in like manner enacted measures to step up the combat against terrorist activities, including the United Nations (Anti-Terrorism Measures) Ordinance ("UNATMO").

The Office of the Commissioner of Insurance has issued the 'Guideline on the Combat of Terrorist Financing' for compliance by 'insurance institutions' (i.e. authorized insurers, insurance agents and insurance brokers carrying on or advising on long term business) which are not financial institutions authorized by the Hong Kong Monetary Authority ("HKMA") under the Banking Ordinance ("authorized financial institutions"). Insurance institutions that are authorized financial institutions are subject to the relevant provisions on terrorist financing in the HKMA's Guideline on Prevention of Money Laundering.

7.5.2 Definition of Terrorist Financing and its Distinction from Money Laundering

The Guideline on the Combat of Terrorist Financing ('the Guideline') defines 'terrorist financing' as '*the carrying out of transactions involving funds that are owned by terrorists, or that have been, or are intended to be, used to assist the commission of terrorist acts*'. The terrorist financing regime is distinct from the money laundering regime in that the focus of the former is on the destination or use of funds, which may have derived from legitimate sources, but the latter is focused on the handling of criminal proceeds (that is to say, the source of funds is what that matters).

7.5.3 Substance of the Guideline

The Guideline mainly summarizes the key terrorist financing provisions of the UNATMO and requires those insurance institutions to which it applies to have in place policies and procedures for combating terrorist financing.

The UNATMO prohibits the supply or collection of funds (as defined) which will be supplied to or used by a terrorist. A list of terrorist names is published in the Gazette from time to time. According to the Guideline, an insurance institution should maintain a database of updated names and particulars of terrorist suspects. This should, in particular, include the lists published in the Gazette and those designated under the US Executive Order of 23 September 2001. The insurance institution should check the names of customers against the names in the database and report any suspicious transactions to the relevant law enforcement authorities.

The UNATMO requires a person to report his knowledge or suspicion of terrorist property to an authorized officer. Failure to do so will constitute an offence carrying a maximum penalty of a fine of HK$50,000 and 3 months' imprisonment. To encourage compliance with this requirement, the Ordinance provides that a disclosure made under it shall not be treated as a breach of any restriction upon the disclosure of information imposed by contract or by any enactment, rule of conduct or other provision, which terms may possibly be interpreted to include the Personal Data (Privacy) Ordinance.

Regarding policies and procedures, an insurance institution is required to take measures to ensure compliance with the relevant legislation on terrorist financing. In addition, the relevant legal obligations of the insurance institution and of its staff should be well understood, and adequate guidance and training provided to the latter.

7.6 PREVENTION OF CORRUPTION

Corruption is an individual's act of abusing his authority for personal gain at the expense of other people.

The Prevention of Bribery Ordinance helps the business sector maintain an environment that is conducive to efficiency and fair competition. It protects employers against employees' abuses of authority for personal gain. It states that an agent (normally an employee), when conducting his principal's business or affairs, shall not seek or accept an advantage without the permission of his principal; and the offeror of advantage also commits an offence.

The Independent Commission Against Corruption (ICAC) offers free corruption prevention services to organizations. For example, Best Practice Packages covering a wide range of topics have been developed to provide both public corporations and private sector companies with user-friendly guidelines on plugging corruption loopholes. The ICAC also provides free and confidential corruption prevention advice to individual organizations.

Insurance intermediaries are encouraged to get familiar with the substance of the Ordinance and the best practices suggested by the ICAC with a view to preventing corrupt conduct both within and outside their organisations. Other services of the ICAC should also be used as much as is necessary. Insurance intermediaries should, in dealing with clients or other third parties, actively refrain from doing anything that is among or verges on the acts proscribed by the Ordinance.

7.7 PREVENTION OF INSURANCE FRAUD

Fraud is of course "dishonesty" or "cheating" and since insurance is a process involving a high element of trust, there is ample scope for the dishonest person to take advantage.

Insurance fraud may take any of a large number of forms. Usually, we tend to associate the term with dishonest claims, from relatively "small" matters, such as having a cheap watch stolen and saying that it was an expensive one, to elaborate swindles involving arson or faked death certificates. There have even been examples of large life insurances being arranged and then having the person concerned murdered for the insurance money.

Fraud, however, may arise at other than the claims level. Obtaining insurance by the deliberate falsification of material information, or knowingly hiding bad features, is equally fraud. Of course, this is a form of breach of utmost good faith (see **3.2** above), but often it is difficult to prove such things later.

Although fraud may be committed by anyone involved with insurance (policyholder, insurance intermediary or even the insurer), we shall concentrate on the customary understanding of the proposer or insured seeking an illegal advantage against the insurer. The comments below refer specifically to the role of the insurance intermediary in this subject area.

7.7.1 The Insurance Intermediary and the Fraudulent Policyholder

The law is quite clear in this matter. Anyone who knowingly assists in fraudulent activities effectively becomes a *"partner in crime"*. Therefore, whether the insurance intermediary is an insurance agent or an insurance broker, he becomes immediately associated with the fraudster if he knowingly assists or cooperates in the fraud or attempted fraud. If fraud is proved against him, in an attempt to cheat the insurer, he will be considered to be *an accomplice of the proposer/insured* in such a situation, and may face criminal prosecution and/or civil action.

7.7.2 The Insurance Intermediary and Examples of Insurance Fraud

As stated, fraud takes many forms. We do not talk about deliberate collusion and dishonesty on the part of insurance intermediaries. The illegality and unethical nature of that is self-evident. However, specific examples where the insurance intermediary may be approached or tempted to assist in insurance fraud include:

(a) **Arranging the insurance:** it often happens that the insurance intermediary possesses or is supplied with information which could have an adverse effect upon an application or proposal for insurance. This information could even mean that the risk is uninsurable. Under no circumstances should that information be omitted or misrepresented. Doing this with the intention of misleading the insurer is **fraud**.

Remember, by law and ethics, an insurance intermediary is *bound* to exercise the duty of utmost good faith in such matters, whatever the practical consequences for the proposed insurance.

(b) **Fraudulent claims:** it is not the responsibility of the insurance intermediary to become a "detective" or a law-enforcement officer, but there is a common duty not to assist fraud and to report evidence or suspicions of it. Concerning claims, this may mean suspicious

circumstances, doubtful medical or other documentary evidence or even verbal communications which clearly indicate that all is not correct with a particular claim.

Note: A word of caution must be given. Fraud is a most serious matter and to allege it is something that must not be done lightly. It is the insurer's primary duty to investigate claims, and certainly only he can allege fraud. The insurance intermediary's role is to assist the insurer, and indeed the law, in resisting attempted fraud and in revealing fraud, but this is a matter of the greatest sensitivity, as will be readily appreciated.

7.7.3 Practical Steps in Preventing Fraud

As with all matters involving illegal activities, perhaps the most important advice in preventing fraud is firstly to be **aware** that it *can happen*. Of course, we must not become paranoid about this, but the possibility that it can arise is always a good beginning in fraud prevention. Additionally:

(a) **Vigilance**: suspicious actions, like sudden increases in sums insured with no or inadequate explanation, apparently inordinate amounts of insurance, and so on, should put the insurance intermediary on guard.

(b) **Diligence:** sometimes fraud can arise when records are inadequately kept or unnecessary delays occur. Keeping up to date with actions and record keeping is not only good business, it is an excellent fraud prevention exercise.

(c) **Communication:** whether representing the insured or the insurer, the insurance intermediary should always keep in close touch with the insurer, especially where there may be suspicious circumstances.

(d) **Integrity**: by law, contract and all recognized ethical behaviour, insurance agents and brokers must maintain the highest moral standards. Remembering this at all times will almost automatically supply all necessary guidance in this area. Insurance agent, insurance broker or insurer, we are all the enemy of fraud.

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Representative Examination Questions

Type "A" Questions

1 The Personal Data (Privacy) Ordinance for Hong Kong applies to:

(a) the public sector only; .....
(b) the private sector only; .....
(c) both the public sector and the private sector; .....
(d) neither the public sector nor the private sector. .....

[Answer may be found in **7.2.1**(a)]

2 Legislation has been enacted in Hong Kong regarding equal opportunity. Which of the following are areas where discrimination may arise have been made the subject of an appropriate Ordinance?

(a) sex; .....
(b) pregnancy; .....
(c) physical disability; .....
(d) all of the above. .....

[Answer may be found in **7.3.1**]

Type "B" Questions

3 Which of the following are among the recognized principles of Data Protection?

(i) Access to personal data
(ii) Security of personal data
(iii) Purpose and manner of collection
(iv) Information to be generally available to the data subject

(a) (i) and (ii) only; .....
(b) (i), (ii) and (iii) only; .....
(c) (i), (ii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **7.2.1**(c)]

4 Which of the following are common areas for "money laundering" in connection with insurance contracts?

(i) Fire insurance
(ii) Life insurance
(iii) Motor insurance
(iv) Investment-linked insurances

(a) (i) and (ii) only; .....
(b) (ii) and (iii) only; .....
(c) (ii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **7.4**]

[If still needed, the answers may be found at the end of the Study Notes.]

GLOSSARY

Abandonment A practice effectively restricted to marine insurance, whereby the assured surrenders all rights in the subject matter insured to the insurer, in return for a total loss settlement. **3.4.6**

Academic Classification of Insurance A method of classifying insurance business into separate groupings, often used for examination and educational purposes (insurance of the person, insurance of property, insurance of pecuniary interest and insurance of liability). **5.1.3**

Acceptance The act of assenting to an offer to make a contract. **2.1.3**(b)

Accounting and Investment Those functions of insurers which concern the receipt and payment of monies and the effective and productive use of accumulated funds. **4.10**

Actuarial Support The contribution of actuaries in insurance, in such matters as premium rating, loss reserving and valuation of liabilities. **4.9**

'Adequate' reinsurance One of the requirements under the Insurance Companies Ordinance for an insurer wishing to be authorized, or to remain to be authorized, in Hong Kong. **6.1.1e**

Administrator Put simply, he is a person appointed to manage the property of another. **3.1.4**(b)

Agency Principal and agent relationship. **2.2.1**

Agency by Estoppel An application of the doctrine of estoppel to an agency situation is where a person, by words or conduct, represents or allows it to be represented that another person is his agent, in which case he will not be permitted to deny the authority of the agent with respect to anyone (third party) dealing with the agent on the faith of such representation. **2.2.3**(d)

Agent A person acting on behalf of a principal. **2.2**(a)

Agreed Value Policy Property insurance where it is agreed at policy inception that the item(s) concerned have, throughout the currency of the contract, the value stated in the policy. Mostly used with items that tend not to depreciate, e.g. jewelry and antiques, and in marine insurance. **3.4.8**(c)

"All Risks" A form of property insurance cover where all causes of loss are insured unless specifically excluded. **1.1.1 Note** 2

Ancillary Functions of Insurance Indirect benefits, consequences and results of insurance (as opposed to its direct intentions and objectives). **1.2**(b)

Annual Financial Statements and Auditor's Report A requirement upon all insurance brokers, under Section 69 of the Insurance Companies Ordinance, is that they must submit an annual audited financial statement representing a true and fair picture of the business profit or loss for the period then ended. **6.2.3e**

Annuity A contract whereby an insurer promises to make a series of periodic payments ('annuity benefit payments') to a designated person ('payee') throughout the lifetime of a person ('annuitant') or for an agreed period, in return for a single payment or a series of payments made in advance by the annuity purchaser. Very often, the payee, the annuitant and the annuity purchaser are the same person. **5.1.1**(a)

Apparent Authority The authority of an agent may be apparent instead of actual, where it results from a manifestation of consent, *made to third parties* by the principal. This doctrine is distinct from the doctrine of estoppel in that it applies where an agent is allowed to appear to have a greater authority than that actually conferred on him, whereas the doctrine of estoppel applies where the supposed agent is not authorised at all but is allowed to appear as if he was. **2.2.3**(b)

Appeals Tribunal A body of members nominated by The Hong Kong Federation of Insurers and confirmed by the Insurance Authority, to hear appeals by insurance agents (or other affected persons) regarding proposed or implemented disciplinary action against them. The Tribunal's decision is final and it has great flexibility in making its decisions. **6.2.2d**(e)

Approved Bodies of Insurance Brokers Associations of insurance brokers approved by the Insurance Authority under Section 70 of the Insurance Companies Ordinance (at present consisting of the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association Limited). **5.5.2**

Assignment of Policy (Insurance Contract) The transfer of rights under a contract of insurance, whereby another person becomes the policyowner in respect of the same subject matter of insurance. **3.1.6**

Assignment of the Right to Insurance Money The transfer of the right to insurance money to a third party, who then acquires the right to sue the insurer under the contract. **3.1.6**

Average 1 Marine: partial (i.e. non-total) loss. **3.4.7**(a) **Note**
2 Non-Marine: a policy provision which imposes a penalty for under-insurance when a claim arises. **3.4.7**(a)

Bailee A bailee of goods is a person taking possession of the goods with their owner's consent, where there is no intention to transfer ownership. **3.5.3**

Breach Failure to fulfill an obligation, perhaps in connection with contractual terms, or related to agency relationship. **2.1.3**, **2.2.5**(c)

Capacity 1 **Capacity to Contract**: The legal ability to enter into a proposed contract, without which, the proposed contract will be defective. **2.1.3**(d)
2 **Underwriting Capacity**: The practical and financial ability of an insurer to accept proposed business, with or without the assistance of reinsurance. **4.8**(b)

Captive Insurer It primarily underwrites its founder's own risks. The founder, or parent company, may be one company, several companies, or an entire industry. (Note: a captive insurer, more strictly defined in the ICO, is subjected to less stringent statutory supervision than an ordinary insurer.) **6.1.1b**(d)

Cash Payment A method of providing an indemnity, or paying the policy benefit. **3.4.4**(a)

Claims The request by the insured for indemnity or policy benefit under his insurance. Alternatively, the claim made against the insured of a liability policy. **4.7**

Claims (Denial) A section within the Code of Conduct for Insurers relates to guidelines to be followed in the event of claims having to be denied. Broadly, these guidelines call for a fair and reasonable approach and good communication with the

claimant as to the reasons for the denial, etc. **6.1.2c**(b)

Claims Outstanding Put simply, they are claims which, as at a particular date, remain unpaid. The term is defined in much greater detail in the ICO. **6.1.1c**(a)(ii)

Classification of Risk Categorizing risks for a particular purpose. **1.1.2**

Client Account Part of the "Minimum Requirements" specified for insurance brokers is that they should maintain at least one client's account, so that client's money is kept separate from the insurance broker's money and used only for the purposes of the client. **6.2.3a**(d)

Client Servicing (see **Customer Servicing**) **4.2**

Code of Conduct for Insurers Implemented by The Hong Kong Federation of Insurers in May 1999, this code lays down recommended practices for insurers. The code only applies to insurance for personal policyholders resident in Hong Kong, effected in their private capacity only. **6.1.2**

Code of Practice for the Administration of Insurance Agents Issued by The Hong Kong Federation of Insurers with the approval of the Insurance Authority in accordance with the provisions of the Insurance Companies Ordinance, this has six parts (A to F) covering a wide range of expectations and requirements in the subject of administration of insurance agents. **6.2.2**

Collectability Whether or not arranged reinsurance is likely to prove effective (i.e. whether the reinsurers can or will pay their shares of loss). It in fact is not a technical term. **6.1.1e**

Complaints and Disputes This important topic is given guidelines and recommended practices in the Code of Conduct for Insurers, and includes such matters as the existence of appropriate structures for receiving and dealing with complaints, both internally and externally. **6.1.2e**

Composite (Insurer) Originally designating an insurer which transacted more than one type of business, the term now is likely to mean an insurer which transacts both types of insurance business as per the Insurance Companies Ordinance (i.e. Long Term Business and General Business). **5.2.1**(c)

Contract A legally enforceable agreement. **2.1.1**

Counter-Offer An offer made by the original offeree to the original offeror, proposing a contract on different terms from those originally offered by the latter (thus legally destroying the original offer). **2.1.3**(b)

Customer Servicing Also known as **Client Servicing**, this involves all aspects of communication with existing policyholders and potential policyholders, including public relations, complaints handling and correspondence. **4.2**

Deeds A deed is a written instrument signed, sealed and delivered. **2.1.2**(b)

Deemed Treated as. **2.2.1**

Defective Contracts Contracts which, for one reason or another, are void, voidable or unenforceable, as the case may be. **2.1.3**

Duties of the Agent to the Principal Responsibilities deemed to apply, or individually specified, such as obedience to legitimate orders, the exercise of due care and skill, etc. **2.2.4**

Duties of the Principal to the Agent Corresponding responsibilities deemed to apply, or individually mentioned, such as payment of agreed remuneration, etc. **2.2.5**

Electronic Transactions Ordinance Legislation which from April 2000 (amongst other things) allows electronic information submission when supplying required details required by the Insurance Authority. **6.1.1f**(c) **Note** 1

Emotional Risk An uncertainty that leads to grief and sorrow if realized. **1.1.1**(c)

Employees' Compensation Insurance Compulsory insurance in Hong Kong which relates to the statutory liability of an employer to pay specified compensation in respect of an employee's death or injury arising out of and in the course of his employment. **5.1.1**(b)

Equal Opportunity A concept that has received particular legislative attention in Hong Kong, with Ordinances passed with a view to eliminating discrimination on various grounds, such as sex, marital status, disability, etc. **7.3.1**

Equity That body of rules formulated by the courts to supplement the rules and procedure of the common law. **3.5.1**

Excepted (Excluded) Peril A cause of loss specifically excluded by the terms of the insurance (e.g. suicide under a personal accident insurance), or by statutory provisions. **3.3.2** (b)

Excess A policy provision requiring the insured to bear the first amount, up to the prescribed amount, with each and every claim; in other words, the insurance is only liable "in excess" of the prescribed amount. **3.4.7**(b)

Executor Person named in a will whom the testator wishes to administer the estate. **3.1.4**(b)

"Fair" Discrimination in Insurance Justified differential practices adopted by insurers to meet the realities of situations, e.g. charging men more premium in life insurance than women of the same age, health condition, etc. Thus, this is no breach of the relevant anti-discrimination legislation. **7.3.2**

Fidelity Guarantee An insurance guarantee to a person against the dishonesty of another person (perhaps, an employee of the first person). **5.1.1**(b)

Financial Risk An uncertainty producing a loss measurable in monetary terms if realized. **1.1.1**(a)

"Fit and proper" A common phrase in regulatory instruments, indicating that the individual occupying or wishing to occupy a certain position is suitable and acceptable from a regulatory point of view. **6.1.1d, 6.2.2.e, 6.2.3a**

Fitness and Properness of Insurance Agents A range of requirements and limitations concerning the criteria for this subject are contained in Part E of the Code of Practice for the Administration of Insurance Agents. **6.2.2e**

Franchise A rare policy provision whereby the insured is not covered for any loss not exceeding or attaining the specified franchise, but is covered in full if the loss exceeds or attains the franchise, depending on the wording used. It could be related to a time, rather than an amount, so that (for example) no hospitalization compensation or benefit is payable for less than three days' stay, but compensation for the full period is payable for longer stay. **3.4.7**(c)

Fraud (Insurance) Fraud against the insurer is possible in a number of ways. These could involve the insurance intermediary, either concerning the arrangement of the insurance or in connection with a claim. Great care and vigilance is recommended to combat insurance fraud. **7.7**

Fraudulent Misrepresentation A breach of utmost good faith, arising from the fraudulent provision of false or inaccurate material facts. **3.2.5**(a)

Fraudulent Non-Disclosure A breach of utmost good faith, arising from a fraudulent omission to provide a material fact. **3.2.5**(c)

Fundamental Risk That type of risk whose causes are outside the control of any one individual or even a group of individual, and whose outcome affects large numbers of people. **1.1.2b**(ii)

General Business One of the two major divisions of insurance classified under the Insurance Companies Ordinance (ICO). It consists of a very wide range of different types of insurance, with seventeen classes in the ICO. **5.1.1**(b)

General Insurance Another term for General Business, denoting insurance other than long term insurance. **5.1.1**(b)

Group of Companies For the purposes of clause 20(b) of the Code of Practice for the Administration of Insurance Agents, the term means that the relationship between the companies is that of 'subsidiary' and 'holding company' or they are the subsidiaries of another company. **6.2.2c**(e)(iii)

Guidelines on Handling of Premiums The Insurance Agents Registration Board has published this set of guidelines, recommending the method of payment of premiums. **6.2.2g**(a)(ii)

Guidelines on Misconduct Another set of guidelines issued by the Insurance Agents Registration Board, recommending procedures and appropriate actions to avoid potential losses arising from misrepresentation and forgery, etc. **6.2.2g**(a)(i)

Guidelines on the Effective Date of Registration of Insurance Agents, Responsible Officers and Technical Representatives These include reference to the fact that holding oneself out to be an insurance agent, Responsible Officer or Technical Representative, before being registered by the Insurance Agents Registration Board is an offence against the Insurance Companies Ordinance or a breach of the Code of Practice for the Administration of Insurance Agents. **6.2.2g**(b)

Hong Kong Confederation of Insurance Brokers One of the two approved bodies of insurance brokers in Hong Kong, whose members are deemed to be authorized insurance brokers. **5.5.2**(a)

Hong Kong Federation of Insurers (HKFI) The central market body, representing majority of the authorized insurers in Hong Kong. A major objective of the HKFI is to promote and advance the interests of insurers and reinsurers transacting business in Hong Kong, and its mission statement further states that the HKFI exists to promote insurance to the people of Hong Kong and build consumer confidence in the insurance industry. **5.5.1**

Indemnity An exact financial compensation, restoring the insured to the same financial situation he occupied immediately prior to the loss. A standard understanding of all insurances except life and personal accident (but its application or non-application may be modified by contractual terms). **3.4.1**

Indemnity (How Provided) Exact compensation to the insured may be provided by a cash payment, by repair or replacement, or by reinstatement. The non-marine practice is that this will be at the insurer's option. **3.4.4**

Insurable Interest The legal right to insure. The relationship with the subject matter of insurance giving the right to effect an insurance. **3.1.1**

Insurable Risk A threat of loss that meets the necessary criteria for feasible insurance cover. **1.1.1**

Insurance Agent An agent in an insurance contract, usually representing the insurer and remunerated by commission on the premium paid. **2.2**

Insurance Agents Registration Board (IARB) The body set up by The Hong Kong Federation of Insurers to register insurance agents and to handle complaints against insurance agents pursuant to the Code of Practice for the Administration of Insurance Agents. **5.5.1**(c)

Insurance Broker An insurance intermediary who arranges insurance on behalf of the intended or actual insured. Remunerated by commission (or brokerage) paid by the insurer. **2.2**

Insurance Claims Complaints Bureau Has a membership of all authorized insurers underwriting personal insurance in Hong Kong. Its primary function is to handle complaints from personal policyholders, in respect of claims affecting personal insurances. **6.1.4**

Insurance Claims Complaints Panel Consisting of an independent Chairman and four members, only two of which are nominated by The Hong Kong Federation of Insurers, the Panel may hear and adjudicate on claim-related complaints from personal policyholders. No fee is involved for the policyholder, win or lose. **6.1.4a**

Insurance Companies Ordinance (ICO) The primary legislation in Hong Kong for regulating the insurance industry. Despite its title, the ICO also contains provisions relating to the regulation of insurance intermediaries in Hong Kong. **6.1.1**

Insurance Intermediaries In Hong Kong these consist of insurance agents (usually representing the insurer) and insurance brokers (usually representing the insured). Separate regulatory rules and provisions apply to each group. **2.2**(a)

Insurance Intermediaries' Duties to Policyholders With this topic, there are common areas for both insurance agents and insurance brokers. In addition there will be separate requirements upon each, the former especially involving the requirements of the agency agreement. **7.1**

Insurance of Legal Rights Also called pecuniary insurance, this covers the infringement of rights or the loss of future income, e.g. fidelity guarantee and business interruption insurance. **3.1.4**(d)

Insurance of Liability Insurances where the subject matter is the legal liability of the insured for death, injury or property damage to third parties, e.g. public liability insurance and motor car (third party) insurance. **5.1.3**(c)

Insurance of Property Insurances where the subject matter is physical property, e.g. motor car (own damage) and fire insurance. **5.1.3**(b)

Insurance of the Person Insurances where the subject matter is the life, limb or health of the person insured e.g. life and personal accident insurance. **5.1.3**(a)

Insurance Sales The activity of an insurer in connection with marketing, product liaison and general monitoring of the results of product development. **4.4**

Insured Peril A cause of loss insured by the policy. An insured peril must always be involved before a valid claim can arise. **3.3.2**(a)

Intention to Create Legal Relation An important element in simple contracts, whereby the parties must have intended the agreement to have legal consequences in the event of breach. **2.1.3**(f)

Invalid contract An agreement that has no legal effect. **2.1.3**

Inwards Reinsurance Reinsurance of part or all of another insurer's risks, resulting in reinsurance premium coming "in". **5.1.4**(b)

Joint Tortfeasors Joint wrongdoers in cases of common action, agency or vicarious liability. **3.6.4**(b)(iii)(2)

Legality (contract) An essential requirement with contracts, that the proposed agreement is not contrary to any aspect of law; otherwise, the contract is generally unenforceable. **2.1.3**(e)

Life Insurance The major type of Long Term Business and forming the leading class of insurance, by premium volume, in Hong Kong. **5.1.1**(a)

Long-tail Business Classes of insurance where claims under a policy may arise and develop over a long period of time, perhaps a number of years after the expiry of the period of insurance, e.g. most liability insurances. **4.9**(b)

Long Term Business One of the two major divisions of insurance, as per the Insurance Companies Ordinance. The dominant categories within this division concern life insurance contracts. It is "long-term" because policies are normally not annual contracts, but last for a number of (sometimes many) years. **5.1.1**(a)

Loss Prevention The lowering of the frequency of identified losses. **1.1.3**(c)

Loss Reduction The lowering of the severity of identified losses. **1.1.3**(c)

Management of Insurance Agents Forming Part IV of the Code of Conduct for Insurers, this section provides guidance on various relevant issues, including registration, complaints, adequate support, etc. **6.1.2d**

Marine Clause A clause in a fire policy to the effect that any marine insurance covering the same loss should pay for the loss and the fire policy will pay towards any remaining uncompensated loss after the marine policy has responded. **3.5.5**(c)

Market Co-operation Whilst competition is strong among insurers, there is considerable inter-company co-operation, especially seen in the central representative body for insurers, The Hong Kong Federation of Insurers. **5.3**(c)

Marketing and Promotion Conscious contact with the public to maintain public relations and promote the company's interests. **4.3**

Material Fact A fact that would influence the judgement of a prudent underwriter as to the acceptance of a risk or the premium on which it is to be accepted. **3.2.3**

Minimum Requirements Specified for Insurance Brokers
"Minimum Requirements" are specified under Part X of the Insurance Companies Ordinance for compliance by persons applying to become authorized insurance brokers and by existing authorized insurance brokers. In addition to the requirements that insurance brokers be "fit and proper" and the approved bodies of insurance brokers must have rules and regulations to ensure that its members are "fit and proper", the Insurance Authority has stipulated five requirements, including qualifications and experience, capital, net assets, etc. **6.2.3**

Model Agency Agreement A principal must appoint an insurance agent under a written agency agreement, which must at least meet the minimum requirements of The Hong Kong Federation of Insurers' model agency agreement, as outlined in Part F of the Code of Practice for the Administration of Insurance Agents. **6.2.2f**

Money Laundering A matter of international concern, where illegally obtained money is "processed" through various methods in order to "cleanse" it. One method adopted was by the use of insurance contracts, and in addition to legislation covering the issue, the Office of the Commissioner of Insurance has given specific guidelines to help combat this illegal practice. **7.4**

More Specifically Insured A provision which is effectively a non-contribution clause, so that any insured item (e.g. under a household contents insurance) which has a more specific insurance (e.g. an "all risks" policy covering that item alone) is excluded from the less specific insurance. **3.5.5**(b)

Motor Insurers' Bureau An industry organization of which all authorized motor insurers in Hong Kong must be members. Funded by a levy on motor insurance premiums, it exists to implement the intentions of compulsory motor insurance, by compensating eligible victims for death or injury claims required to be covered by compulsory motor insurance, but where for some reason the insurance does not exist or is defective. **5.5.3**(b)

"New for Old" Cover Claims settlements are not subject to deduction for wear and tear, depreciation, etc. An expression found mostly with personal lines property insurance, with some items (e.g. clothing) not subject to this provision. **3.4.8**(b)

Non-Contribution Clause A provision in an indemnity policy to avoid contributing to a claim settlement in the event of a double insurance. **3.5.4**(b)

Non-fraudulent Misrepresentation A breach of utmost good faith, arising when one party innocently or negligently gives to another party an inaccurate or untrue representation of a material fact. **3.2.5**(b)

Non-fraudulent Non-Disclosure A breach of utmost good faith, arising when one party innocently or negligently fails to give to another party material facts. **3.2.5**(d)

Obligee There are three parties to a suretyship: the surety, the principal and the obligee. It is the obligee in whose favour the suretyship is issued. That is to say, when there is failure on the part of the principal to fulfill an obligation to the obligee, the surety will pay the obligee. **2.1.2**(b)

Offer (contract) An essential element in a simple contract, constituting the proposed terms of the intended contract. **2.1.3**(a)

Offeree The person to whom a contract offer is made. **2.1.3**(b)

Offeror The person making a contract offer. **2.1.3**(a)

Ordinary Good Faith The common law duty not to lie or deliberately mislead the other party in a contract. However, this duty does not require the disclosure of all facts known, but only in response to specific questions. **3.2.1**

Outwards Reinsurance Reinsurance of insurer's own business with a reinsurer, thus resulting in reinsurance premium having to be paid "out". **5.1.4**(a)

Paid-up Capital Shares for which no amount remains "on call" (i.e. all the money due for them has actually been paid to the company). **6.1.1a&b, 6.2.3d**(b)

Participating Policy Every year a life insurer will determine the amount of its divisible surplus, if any. Dividends will be paid out of the divisible surplus to holders of its participating policies. **4.7**(a)(v)

Particular Risk A risk where the consequences are potentially of *limited* application, i.e. affecting *relatively* few people or a relatively small area (although the consequences for those concerned may be fatal or very serious). **1.1.2b**(i)

Pecuniary Insurance The insurance of financial interests, not conveniently falling within the traditional categories of property insurance, liability insurance or insurance of the person. Includes fidelity guarantee and business interruption insurance. **5.1.3**(d)

Performance Bond A guarantee that a construction contract will be carried out. **5.1.1**(b)

Peril The cause of a loss. This is important in connection with the application of proximate cause. **1.1.1Note** 2, **3.3.2**

Personal Data Protection A subject of international importance, with the advances in computer technology. The specific legislation dealing with the issue in Hong Kong, which includes any applications in insurance, is the Personal Data (Privacy) Ordinance. **7.2**

Physical Risk An uncertainty resulting in death or injury if realized. **1.1.1**(b)

Policy A written/printed instrument most often issued to an insured as an evidence of the insurance contract. **2.1.1**

Policy Condition Policies often contain a collection of provisions which provide a framework for the policy explaining some of the relationships, rights and duties of the insured and the insurer. Such provisions are termed 'Policy Conditions'. **3.5.5**

Policy Limits Policy provisions which determine the maximum amount of insurance recovery, e.g. sum insured. **3.4.7**(d)

Powers of Intervention The statutory "teeth" given to the regulatory authorities to take action in appropriate circumstances. The options available range from various restrictions and limitations to the liquidation of the insurer concerned. **6.1.1g**

Practical Classification of Insurance The categorization of insurance business best suited to the internal organization of the insurer (perhaps, for example, using the source of business as the category: direct, broker produced and agent produced). **5.1.2**

Premium The consideration payable by the insured for an insurance. **4.6**(d)

Primary Functions of Insurance The direct objectives and intentions of insurance, e.g. transferring risk and compensating losses. **1.2**(a)

Principal The person for whom an agent acts. **2.2**(a)

Product Development The invention and introduction of new forms of cover, either as an individual product or as a portfolio development (package of covers). **4.1**

Product Research Monitoring and developing existing and new products to keep in line with trends and market competition. **4.1**(c)

Professional Indemnity Insurance A liability insurance covering professional people (doctors, lawyers, insurance brokers, etc.) for legal liability in respect of injury, loss or damage caused through their negligence. **6.2.3a**(c)

Professional Insurance Brokers Association Limited One of the two approved bodies of insurance brokers in Hong Kong, whose members are deemed to be authorized insurance brokers. **5.5.2**(b)

Professional Negligence A breach or failure of the expected degree of professional competence, resulting in death, injury or loss to a third party. Resulting claims may be covered by various forms of professional indemnity insurance. **7.1.1** (d)

Professional Reinsurer An insurer that only transacts reinsurance business. **5.1.4**

Proposal Form (or **Application Form)** A standard form on which a proposer of insurance is required to supply the insurer with material information. **2.1.3**(a)

Proposer A prospective insured who completes a proposal form when seeking insurance. May also be known as an applicant. **2.2**(a)

Proximate Cause The dominant or effective reason for a loss, which must be ascertained to determine whether or not that loss constitutes a valid claim under an insurance contract. **3.3.4**

"Pure" General Business A market summary term referring to authorized insurers in Hong Kong transacting only general (not long term) business. **5.2.1**(b)

"Pure" Long Term Business A market summary term referring to authorized insurers in Hong Kong transacting only long term (not general) business. **5.2.1**(a)

Pure Risk An uncertainty that can only result in either a loss or no change. **1.1.2a**(i)

Quantum The amount of the loss, or the amount recoverable from the insurer. **4.7**(c)(ii)

Rateable Share The proportion of a loss to be paid by the respective insurers in a contribution situation, i.e. where more than one insurer is involved with providing an indemnity to the same insured. **3.5.5**(a)

Ratification A retrospective act of adopting a contract or a transaction by someone who was not bound by it originally because it was entered into on his behalf but without his authority. **2.2.2**(b)

Register of Appointed Insurance Agents A register to be maintained by the Insurance Agents Registration Board, as prescribed by the Insurance Authority and available for public inspection at The Hong Kong Federation of Insurers' office. **6.2.2b**(a)(v)

Regulation of Insurance Intermediaries This is partly by Government and partly by the insurance industry itself, consisting of legislative requirements and various codes and other self-regulatory measures. **6.2**

Reinstatement (Property insurance) As a method of providing an indemnity, it means the restoration of the insured property to the condition in which it was immediately before its destruction or damage. **3.4.4**(d)

Reinstatement Insurance Property insurance where the settlement basis for claims is effectively "new for old" (i.e. no deduction for depreciation, etc) if the damage is reinstated (or made good). **3.4.8**(a)

Reinsurance An insurance used to transfer all or part of the risk assumed by an insurer under one or more insurance contracts to another insurer. **4.8**

Renewal The continuation of an insurance contract for a further period (legally constituting a new contract). **4.5**(b)

Replacement A method of providing an indemnity, by the insurer providing a substitute item for the one lost/damaged. **3.4.4**(c)

Reporting Requirements Under the Insurance Companies Ordinance, every insurer must submit annually to the Insurance Authority its financial statements in prescribed form. There are additional separate requirements for insurers transacting general and long term business respectively. **6.1.1f**(c)

Reserve An amount subtracted from a firm's retained earnings for either general or specific purposes. (A firm's 'retained earnings' represent its cumulative net income since it was established, less the total dividends (or drawings, in the case of unincorporated businesses) that have been paid to owners over its entire life.) **4.9**(b)

Responsible Officer More fully defined in the Code of Practice for the Administration of Insurance Agents, such a person is responsible for the conduct of an insurance agency business. **6.2.2a**(a)

Revocation The cancellation of an agency agreement by either party (which must be subject to legal and specific contractual terms). **2.2.6**(b)

Risk Uncertainty concerning a potential loss. **1.1**

Risk Avoidance Elimination of the chance of loss of a certain kind by not exposing oneself to the peril. **1.1.3**(c)

Risk Financing No matter how effective the loss control measures an organization takes, there will remain some risk of the organization being adversely affected by future loss occurrences. A risk financing programme is to minimize the impact of such losses on the organization. It uses tools like: risk assumption, risk transfer other than insurance, self-insurance, insurance, etc. **1.1.3**(c)

Risk Management (as used by insurers) Ways and means of improving the insured loss potential of risks that are insured. **1.1.3**

Risk Management (not as used by insurers) In banking and other financial service areas, the reference is to the control of speculative risks. As a separate field of knowledge and discipline, it refers to the identification, quantification and methods of dealing with all types of risk, pure and speculative. **1.1.3**

Risk Transfer Finding another party to bear the consequences of one's exposure to risk. **1.1.3**(c)

Salvage 1 Maritime law and marine insurance: (a) a reward payable to a person (salvor) who has successfully rescued ships or other maritime property from perils of the sea, pirates or enemies by the property owners, or (b) such a rescue. **3.4.5 Note**

2 Non-marine: what is left of the subject matter of insurance, following damage, e.g. the wreck of a car, which may still have some scrap value. **3.4.5**

Section Limit A policy provision limiting the amount payable under a particular section of the policy. **3.4.7**(d)(ii)

Short-tail Business Classes of insurance where claims arise and are notified in a relatively short time-scale, e.g. fire and motor (own damage) insurances. **4.9**(b) **Note**

Simple Contract It is a contract created verbally, or by writing not under seal. It can also be inferred from conduct. **2.1.2**(a)

Single Article Limit A property policy provision stipulating that the policy liability in respect of any one article shall not exceed a specified sum (single article Limit, unless separately subject to its own sum insured. **3.4.7**(d)(i)

Solvency Margin The extent to which assets exceed liability. Insurance companies in Hong Kong must have a solvency margin which does not fall below the "relevant amount" (minimum required sum) at all times. **6.1.1a**(b)

Speculative Risk A risk which offers the possibilities of gain and loss. **1.1.2a**(ii)

Statutory Classification of Insurance The categorization of insurance classes in accordance with statute (the Insurance Companies Ordinance), which broadly divides insurance into Long Term Business and General Business. **5.1.1**

Stop-Lists Risks identified by the insurer as being of a type or class not to be offered insurance cover (e.g. comprehensive motor insurance to young drivers of high-powered motor cars, having a bad accident record). **4.5**(e)

Subject Matter of Insurance The person, thing, potential liability or legal right upon which an insurance is based. **5.1.3**

Subrogation The common law principle allowing an indemnifying insurer to take and exercise for his own benefit any recovery rights the insured may possess against third parties in respect of the damage for which he is providing an indemnity. **3.6**

Subrogation - How Arising Subrogation may arise in tort, under contract, under statute or in salvage. **3.6.2**

Subrogation - Rights Limited The insurer may not retain under subrogation more than he paid as an indemnity. **3.6.4**(b)(i)

Sum Insured The limit of the insurer's liability under the policy. **3.4.7**(d)

Suretyship A suretyship contract is one whereby the surety is obliged to pay the obligee in the event of the principal's failure to fulfill an obligation to the obligee. It is the principal who pays the contract price. **2.1.2**(b), **5.1.1**(b)

Target Risks 1 General insurance: the term may be used to refer to large, hazardous risks. **4.5**(d)

2 Life insurance: risks that are especially attractive to the insurer (e.g. healthy school teachers) and therefore actively sought by insurance agents. **4.5**(d)

Technical Representative (Insurance Agent's) More fully defined in the Code of Practice for the Administration of Insurance Agents, such a person (not being an insurance subagent) provides advice to actual or potential policyholders on insurance matters for an insurance agent, or arranges contracts of insurance in or from Hong Kong on behalf of that insurance agent. **6.2.2a**(a)

Technical Representative (Insurance Broker's) More fully defined in the Minimum Requirements Specified for Insurance Brokers, such a person provides advice to actual or potential policyholders on insurance matters for an insurance broker, or negotiates or arranges contracts of insurance in or from Hong Kong on behalf of an insurance broker for actual or potential policyholders. **6.2.3d**(a)

Termination of Agency An agency relationship may be brought to an end on various grounds, including mutual consent. **2.2.6**

Third Party A person, not being the insured or the insurer, who might be involved in a claim as a claimant against the insured or a potential source of subrogation. **2.2.1**

Tontine An unusual type of Long Term Business, where the policy benefit is payable to the last survivor of a specified insured group of persons. **5.1.1**(a)

Tort The law of tort is notoriously difficult to define. In simple words, it is a kind of civil wrong (especially negligence) giving rise to a possible claim against the wrongdoer. It is the most important source of subrogation rights of insurers. **3.2.6**(b), **3.6.2**(a)

Training and Development An important area of company activity, both with inside and field staff. Especially important with insurance agents, whom the insurer is under a duty to train. **4.11**

Transparency An important word in regulatory matters, indicating that information should be freely available and the public should be able to understand procedures and implications. Specifically, for example, from June 2000 the Insurance Authority is allowed to disclose financial and statistical information of individual insurers and Lloyd's if they deem it to be in the interests of policyholders or the public. **6.1.1f**(d)

Trustee A person who is holding property on trust for another. **3.1.4**(b)

Underwriting 1 The process of determining the insurability of a risk and the terms to be applied. **4.5**

2 The area of company activity involved with the underwriting process. **4.5**

Unenforceable Contract A contract which cannot be enforced (or sued on) in a court of law. **2.1.3**

Unfair Discrimination in Insurance This relates to the application of different terms which are not justified by the technical merits of the risk, e.g. charging higher premiums for women drivers in motor insurance. **7.3.3**

Uninsured Peril A cause of loss which is not specifically excluded from policy cover, but it is not specifically included either, e.g. raining under a standard fire policy. Damage from an uninsured peril may be recoverable, if proximately caused by an insured peril, e.g. water damage caused in fighting a fire. **3.3.2**(c)

Unit-linked Business (or Linked Business) The policyowner's contributions (after deductions for expenses and premiums) are used to buy 'units' in an investment fund, so that the value of the product is linked to the value of the units. **5.1.1**(a)

Utmost Good Faith The strict common law duty upon both parties in an insurance contract to reveal all material information to the other party, whether or not such information has been specifically requested. **3.2**

Valued Policy A valued policy – a policy effected on a valued basis – is commonly issued in marine insurance. A sum called 'agreed value' is specified in the policy, which will be taken as the value of the subject matter insured throughout the currency of the policy. **3.4.8**(c)

Vicarious Liability The liability at law for the acts and omissions of another, without personal fault, e.g. the principal, in respect of his agent's actions. **2.2**(c)

Void contract An agreement devoid of any legal effect. **2.1.3**

Voidable contract Although it has full legal effect, a voidable contract may be declared void as from inception, at the option of the aggrieved party. A temporary situation demanding selection by that party within a reasonable time, failing which the contract will become valid. **2.1.3**

Waive (a breach) Effectively an "act of forgiveness", where a breach of policy condition or other contractual requirement is disregarded – actively or passively - by the aggrieved party, so that the contract remains unaffected by the breach.
3.2.2 Note 2, **3.2.6**(c)

Warrant To make a formal declaration as to the truth and accuracy of information supplied. **3.2.2 Note** 1

Warranty An absolute undertaking by the insured to do, or to refrain from doing, some specified thing(s), or an absolute affirmation as to the truth and completeness of information supplied. **3.2.2 Note** 1, **6.1.2c**(b)(iii)

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Representative Examination Questions

Answers

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2	(a)	(c)	(d)	(d)
3	(c)	(a)	(d)	(a)
4	(a)	(c)	(d)	(d)
5	(d)	(c)	(b)	(c)
6	(a)	(b)	(d)	(d)
7	(c)	(d)	(d)	(c)

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