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Circular Clarifying the Licensing Requirements arising out of the Promotion, Offering or Sale of Investment-Linked Assurance Schemes to the Public

This circular is published to clarify the views of the Securities and Futures Commission (“SFC”) in relation to the issue of whether insurers, corporate insurance brokers and individuals who are insurance agents or insurance brokers (such individuals collectively “insurance intermediaries”) are required to be licensed by the SFC under the provisions of the Securities and Futures Ordinance (Cap. 571) (“SFO”) where they engage in promoting, offering or selling investment-linked assurance schemes (“ILAS”) to the Hong Kong public.

Licensing requirements under the SFO

The licensing requirements imposed by the SFO revolve around the central issue of whether there is any carrying on of a business in a *regulated activity* (as defined in Part 1 of Schedule 1 of the SFO), or whether there is any holding out of the carrying on of a business in a regulated activity (see section 114 of the SFO). This circular will confine itself to the issue of whether the promotion, offering or sale of ILAS to the public constitutes the carrying on of a business in a regulated activity. It is unlikely that an insurer or corporate insurance broker that is not carrying on a business in a regulated activity will be holding itself out as doing so.

The different types of regulated activities are listed in Part 1 of Schedule 5 of the SFO and are defined in Part 2 of Schedule 5. The regulated activities that are relevant for the purposes of this circular are *advising on securities* and *dealing in securities*.

Under the SFO, only corporations may be licensed to carry on a business in a regulated activity. It necessarily follows that if an individual carries on a business in a regulated activity, he will be in breach of the SFO because he is incapable of being licensed for this purpose under the SFO.

An individual who performs any *regulated function* (as defined in section 113(1) of the SFO) in relation to a regulated activity carried on as a business by a licensed corporation must be licensed as a representative accredited to that licensed corporation (see sections 114(3) and 120 of the SFO). It follows that the licensing obligations imposed on individuals by the SFO arise, first, out of an individual being employed or otherwise engaged by a licensed corporation that is carrying on a business in a regulated activity and, secondly, out of the individual performing regulated functions in relation to the carrying on of that business by the licensed corporation.

Regulation of the Insurance Industry

Insurers, corporate insurance brokers and insurance intermediaries are principally regulated under the Insurance Companies Ordinance (Cap. 41). Those who merely promote, offer or sell insurance products to the public are neither required nor permitted to be licensed under the SFO by virtue of their carrying on those particular activities.



What are ILAS?

ILAS are life insurance contracts (policies), falling within the meaning of class C *linked long term insurance business*, as defined in Part 2 of the First Schedule of the Insurance Companies Ordinance, under which the value of such a policy is paid upon maturity or upon the death of the life assured. The premium payments that are made by ILAS policyholders are first applied in respect of fees and commissions, with the balance being paid to the insurer and notionally invested in the underlying funds selected by the policyholders. Invariably, units in these underlying funds are *securities* as defined in Part 1 of Schedule 1 of the SFO. Although it is the performance of these underlying funds that determines the value of an ILAS policy from time to time, the policyholder's premium payments are not invested in these underlying funds for or on behalf of the policyholder. If, as is normally the case, an insurer places a percentage of the premium payments received into such funds, these investments are for the account of the insurer itself. The policyholder has no interest in them whatsoever.

ILAS are issued by insurers. Members of the public acquire ILAS either through insurance agents, who are employed or otherwise engaged by insurers and who act as the insurers' agents, or through insurance brokers, who act as the agents of members of the public contemplating the acquisition of ILAS.

Regulation of the promotion, offering or sale of ILAS under the SFO

ILAS fall within the meaning of the expression *collective investment scheme*, as defined in Part 1 of Schedule 1 of the SFO. Accordingly, the issue, or the possession for the purposes of issue, of any advertisement, invitation or other document which contains an invitation to the public to acquire an interest in or participate in, or offer to acquire an interest in or participate in, ILAS must be authorized by the SFC (see section 103(1)(b) and 105(1) of the SFO).

Those promoting, offering or selling ILAS to the public must take care, when doing so, not to utilize documentation in relation to which the SFC has not given its authorization under section 105 of the SFO. This is likely to constitute a criminal offence contrary to section 103(1) of the SFO.

Units in ILAS are not securities as defined in the SFO

Although interests in collective investment schemes fall within paragraph (d) of the SFO definition of securities, an interest in a collective investment scheme, which is a contract of insurance in relation to any class of insurance business under the Insurance Companies Ordinance, is excluded from the definition of securities for the purposes of the SFO (see subparagraph (ii)(C) of the definition). Accordingly, by virtue of the fact that ILAS constitute class C insurance business within the meaning of Part 2 of the First Schedule of the Insurance Companies Ordinance, interests in ILAS cannot be regarded as securities for the purposes of the SFO.

It follows that insurers, corporate insurance brokers and insurance intermediaries engaging in promoting, offering or selling ILAS to the public, or who advise members of the public concerning ILAS, are not, by virtue of those particular activities, required to be licensed under the SFO for the purpose of advising on securities or dealing in securities.



Does giving advice or recommendations to policyholders concerning the selection by them of the underlying funds of ILAS give rise to an obligation to be licensed under the SFO?

Some insurers, corporate insurance brokers and insurance intermediaries appear to be of the view that if they advise or make recommendations to policyholders concerning the selection by them of the underlying funds of ILAS (which invariably are securities), this must constitute advising on securities and must therefore give rise to an obligation to be licensed under the SFO. The SFC does not share this view. In this context, it is necessary to consider not only the meaning of *advising on securities* under the SFO, but also the meaning of *dealing in securities*.

Advising on securities

The expression advising on securities is defined in Part 2 of Schedule 5 of the SFO. In broad terms, this expression means the giving of advice, whether oral or written, or issuing analyses or reports, on whether, which, the time at which or the terms or conditions on which securities should be acquired or disposed of. The SFC is of the view that advising or making recommendations to policyholders concerning the selection by them of the underlying funds of ILAS, does not constitute advising on securities under the SFO even if, as is usually the case, those underlying funds are securities. The reasons for this are as follows:

- Advising on securities, within the meaning of the SFO, is concerned with advice relating to the acquisition or disposal of securities by or on behalf of the person to whom the advice is given. In the case of ILAS, the underlying funds are not acquired or disposed of by or on behalf of the policyholder. If the insurer chooses to invest part of the premium income that it receives from its policyholders in the underlying funds that have been stipulated by its policyholders, such investments are for its own account.
- Any advice that might be given to a policyholder concerning the underlying securities is not, in fact, concerned with the acquisition or disposal of securities at all. Rather, such advice is concerned with the selection that the policyholder makes concerning the underlying funds whose performance will notionally be used to calculate the value of his ILAS policy from time to time.

Dealing in securities

The expression dealing in securities is also defined in Part 2 of Schedule 5 of the SFO. In broad terms, the definition, in relation to a person, is concerned with making an agreement with another person or encouraging another person to enter into an agreement -

- (a) for or with a view to acquiring, disposing of, subscribing for or underwriting securities; or
- (b) **the** purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities,

by the person.



The SFC is of the view that the process of promoting, offering or selling ILAS to the public (including giving advice to policyholders concerning their selection of the underlying funds) does not constitute dealing in securities for the following reasons:

- Units in ILAS are not securities.
- The underlying funds of ILAS are not acquired for or on behalf of policyholders.
- ILAS are first and foremost insurance policies providing the policyholder with life cover, but which have an additional investment element. Life cover, as distinct from investment, would appear to be the dominant factor motivating a policyholder to acquire an ILAS product because there are many pure investment products on the market which tend to have lower initial charges, are more negotiable than ILAS and do not give rise to the same penalties for early termination. These types of products would appear to be more suitable for, and attractive to, those who are principally concerned with investment and are unconcerned with the acquisition of life cover. Accordingly, although the value of an ILAS policy is usually determined by reference to fluctuations in the value of the underlying funds that are selected by the policyholder, it cannot be said that **the** purpose of acquiring an ILAS policy, or even the dominant purpose of doing so, is to secure a profit from fluctuations in the value of the underlying funds. The SFC therefore considers that promoting, offering or selling ILAS to the public does not constitute dealing in securities within the meaning of paragraph (b) of the SFO definition of that expression.
- Sub-paragraph (xi) of the SFO definition of dealing in securities specifically excludes a person from being regarded as dealing in securities where he *issues any advertisement, invitation or document the issue of which has been authorized by the (SFC) under section 105 of the (SFO)*. Since the issue of the documentation relating to ILAS must be authorized by the SFC under section 105 of the SFO, sub-paragraph (xi) has the effect of excluding an insurer, corporate insurance broker or insurance intermediary from being regarded as dealing in securities where it or he promotes, offers or sells ILAS to the public utilizing such documentation.

No carrying on of a business in a regulated activity when ILAS are promoted, offered or sold

The licensing obligations imposed by the SFO only arise when a business is being carried on in a regulated activity. The SFC takes the view that when ILAS are promoted, offered or sold to the public, this activity does not in itself constitute the carrying on of a business in a regulated activity within the meaning of the SFO. The reasons for this are as follows:

- Insurers, corporate insurance brokers and insurance intermediaries are primarily regulated under the provisions of the Insurance Companies Ordinance. ILAS are insurance products, which fall within the meaning of class C linked long term insurance. Promoting, offering or selling ILAS involves carrying on an insurance business, which is not a regulated activity under the SFO.
- The promotion, offering or sale of ILAS, and the giving of advice or recommendations to policyholders concerning the selection by them of the underlying funds of such



products, do not constitute advising on securities or dealing in securities. Accordingly, there can be no carrying on of a business in these regulated activities.

- Even if advising or making recommendations concerning the underlying funds of ILAS were to be regarded as advising on securities or dealing in securities, the SFC considers that there would still be no carrying on of a business in these regulated activities for the following reasons:
 - (a) Advising or making recommendations concerning the underlying funds of ILAS does not stand alone as a discrete business carried on in its own right. It is an activity that is subsumed within the insurance business that is primarily being conducted by those promoting, offering or selling ILAS to the public.
 - (b) For an activity to amount to the carrying on of a business, it must be conducted for financial gain. It does not appear that financial gain is derived from advising or making recommendations concerning the underlying funds of ILAS. It is the sale of insurance products that generates the financial gains that are enjoyed by the insurers, corporate insurance brokers and insurance intermediaries.
 - (c) Consistent repetition of an activity, as distinct from it being intermittent or irregular, is required before the activity can be regarded as constituting the carrying on of a business. Advising or making recommendations concerning the underlying funds of ILAS appears to occur haphazardly and, in the case of some insurers, appears to be a practice that is prohibited.
 - (d) For an activity to amount to the carrying on of a business, it must be conducted in circumstances that indicate the existence of an established and ongoing business principally involving that particular activity. This is not so in the case of advising or making recommendations concerning the underlying funds of ILAS.

Insurance intermediaries

As earlier stated, the SFC is of the view that, when insurers or corporate insurance brokers promote, offer or sell ILAS to the public, they are neither engaging in the regulated activities of advising on securities or dealing in securities, nor are they carrying on a business in such regulated activities. It follows, by necessary implication, that the insurance intermediaries who promote, offer or sell ILAS in association with insurers and corporate insurance brokers, cannot be regarded as performing any regulated function.

The SFC takes the view that the consequence of this is that the promotion, offering or sale of ILAS to the public by insurance intermediaries does not, in itself, fall within the meaning of section 114(3) of the SFO. Accordingly, the SFC considers that insurance intermediaries need not be licensed under section 120 of the SFO to engage in this activity. Moreover, the SFC does not regard insurance intermediaries as being in breach of section 114(1) of the SFO for the same reasons that insurers or corporate insurance brokers promoting, offering or selling ILAS to the public are not, namely, that they do not carry on a business in a regulated activity.



Concluding remarks

The contents of this circular relate only to the promotion, offering or sale of ILAS products, as described in this circular. As a general rule, the SFC considers that insurers, corporate insurance brokers and insurance intermediaries who are dealing solely in ILAS and other insurance products are neither obliged nor permitted to be licensed under the SFO. However, slight variations in circumstances can result in different interpretations of statutory provisions. Accordingly, the contents of this circular serve only to clarify the general views of the SFC and should not be taken as constituting legal advice.

In the event of an insurer, a corporate insurance broker or an insurance intermediary conducting business outside the specific scope of this circular and engaging in regulated activities within the meaning of the SFO, an obligation to be licensed under the SFO might well arise. If in doubt as to their legal obligations in this connection, these entities should seek legal advice.

**Licensing Department
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