Financial Services Risk and Regulation

Regulatory updates newsletter
October 2020

pwc

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Introduction

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We continue to observe developments in regulatory requirements and guidance across all Hong Kong regulators impacting all aspects of financial services regulations.

We highlight the following updates in this edition of our regulatory newsletter:

- On 30 September, the HKMA issued a report on the findings of the mystery shopping programme (MSP) on selling practices of AIs in respect of investment and insurance products. The results suggested that AIs were largely in compliance with respect to selling investment products, whereas improvements are required in the sale of insurance products.
- Owing to the increased adoption of electronic media, the SFC issued the circular on the electronic dissemination of investment product documents on 29 September. The circular sets out general principles and guidelines for transitional arrangements to issuers and intermediaries of SFC-authorised investment products.
- On 29 September, the HKMA issued a circular to announce the implementation of the "AML/CFT Surveillance Capability Enhancement Project" (AMLS Project), through which the regulator is strengthening the use of data and supervisory technology (Suptech) in its risk-based supervision.
- LIBOR updates: The HKMA has issued a circular to request AIs to take early action to adhere to the IBOR Fallbacks Protocol (the Protocol) published recently by the International Swaps and Derivatives Association (ISDA). In addition, the HKMA issued a circular to remind AIs to pay attention to the customer protection aspects relating to the reform of interest rate benchmarks.
- Having consulted the IA, the HKMA has shared its observations as well as the expected standards on the practices of AIs in relation to selling of life insurance policies. AIs should immediately review and make necessary improvements to their policies, procedures, controls and monitoring relating to policy replacement.
- Insurance Authority Regulatory Updates: Amendments to Hong Kong Financial Reporting Standard 17 Insurance Contracts; CPD Requirements under the New Regulatory Regime for Insurance Intermediaries - FAQs, Reference Lists and Reporting Requirements; and iAM Smart Pilot Sandbox Programme - Phase 2
- Other regulatory updates: SFC Circular to intermediaries – Provision of trade documents to clients by access through intermediaries' websites, and complaints against debt collection agents employed by AIs.

We hope you find our summary of these regulatory updates useful. We look forward to your feedback.

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HKMA findings of Mystery Shopping Programme (MSP) on Selling Practices for Investment and Insurance Products

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On 30 September, the HKMA issued a report on the findings of the MSP on selling practices of AIs in respect of investment and insurance products. The MSP was conducted from the second half of 2018 to 2020, to identify areas for improvement and to share with the industry perspectives to promote a good compliance culture.

Overall, the results suggested that AIs were largely in compliance with respect to selling investment products while several improvements on the sale of insurance are required.

The key findings outlined by the HKMA in this report includes:

Know-Your-Customer: Most of the bank staff invited shoppers to complete Risk Profile Questionnaire (RPQ) and had the process audio recorded. Exceptions were identified on a few samples where the sales staff briefly introduced investment products without confirming that there was a valid RPQ result for the shoppers.

The MSP revealed that some sales staff did not properly conduct Financial Needs Analysis (FNA) with the shoppers before recommending the non-investment-linked long term insurance (NLTI) plans.

Disclosure of Product Features and Risks

Some product features, risks and sales related information (such as capacity i.e. the principal/agent) in which the bank was acting, affiliation of the bank with the product issuer and the monetary benefits received by the bank from selling the respective products), of the recommended investment products were not disclosed.

While sales staff provided the shoppers with general information of the recommended NLTI plans, there was room for improvement in disclosure of product features and risks.

Suitability Assessment: Staff sales generally recommended products in line with the RPQ or FNA results, however staff should ensure due consideration to customers' circumstances. Exceptions include:

- Sales staff of both investment and insurance products recommended a mis-matched product without proper alert or justification to the shoppers; and
- Sales staff recommended mis-matched products regardless of shoppers' investment tenor and willingness to pay.

Additional Safeguards for Vulnerable Customers and other Selling Practices

Pre-Investment Cooling-off Period (PICOP) was implemented in several samples, except for certain instances such as sales staff did not offer additional safeguards (i.e. bring a companion or request for an additional frontline staff) and / or sales staff was not familiar that PICOP also applied to first-time buyers with high asset concentration.

Good Sales Practices

Sales staff refused to introduce or recommend risk-mismatched products to the shoppers. They also advised shoppers to consider carefully in purchasing a new insurance plan which involved policy replacement and not to make hasty decisions.

Key Takeaways

This report laid out common mis-selling practices that were easily overlooked by sales staff either by mistake or through aggressive selling techniques. AIs should familiarise themselves with all of the latest regulatory guidelines and expected industry practices to ensure all stakeholders involved in the selling process are in compliance. Where issues are identified, apart from reassessing internal controls, AIs should also give greater attention to their compliance culture.

Recommended Reading

Report on the Findings of the Mystery Shopping Programme on Selling Practices of Authorized Institutions in respect of Investment and Insurance Products

SFC circular on the electronic dissemination of investment product documents

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Owing to the increased adoption of electronic media, the SFC issued the circular on the electronic dissemination of investment product documents on 29 September. The circular sets out general principles and guidelines for transitional arrangements to issuers and intermediaries of SFC-authorised investment products.

Examples of electronic dissemination (e-dissemination) arrangements include:

a) providing electronic copies of documents to investors; or

b) notifying investors electronically (i) that the documents are accessible online and (ii) where the electronic documents can be accessed:

General principles include:

- E-dissemination arrangements to be in compliance with applicable laws and regulations.
- Issuers must ensure that effective measures are in place for the timely dissemination of product information to investors.
- When SFC authorised Products are held by intermediaries:
  - issuers and intermediaries must ensure that proper and effective measures are put in place to enable the intermediaries to access and be informed of product information in a timely manner, and
  - issuers should be reasonably satisfied that the intermediaries have in place proper and effective measures for the timely dissemination of product information to the end investors.
- Issuers and intermediaries should put in place systems and controls to detect and rectify any unsuccessful electronic dissemination to investors, where practicable.
- Issuers and intermediaries should maintain proper records relating to communications with investors via e-dissemination arrangements such as the date and time when a document was disseminated to investors.

Transitional arrangements for investors currently receiving paper documents are:

- Issuers must ensure that e-dissemination arrangements comply with the applicable laws and regulations governing SFC-authorised Products and their constitutive documents.
- Prior to implementing e-dissemination arrangements, intermediaries should ensure that they comply with the relevant client agreements.
- The SFC expects the transitional arrangements to include a printed notice to be sent to investors (Transition Notice) at least one month before adopting the e-dissemination arrangement.
- Also, unless an investor responds with instructions to receive product information in the form of paper documents, e-dissemination for them can proceed on the effective date.
- Investors should be entitled to receive the documents free of charge in one means of their choice (ie, an investor may choose to receive documents either in paper form or via an electronic means specified by the issuer or intermediary).
- Investors should be allowed to change the means of delivery at any time subject to reasonable prior notice.

Key Takeaways

Whilst room for discretion is given in determining the types of electronic means and dissemination arrangement, issuers and intermediaries should review their policies and controls in place to ensure timely dissemination of documents, and proper communication with investors on the latest arrangements.

Recommended Reading

Circular on the electronic dissemination of investment product documents

HKMA Circular on the Implementation of AML/CFT Surveillance Capability Enhancement Project

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On 29 September, the HKMA issued a circular to announce the implementation of the "AML/CFT Surveillance Capability Enhancement Project" (AMLS Project), through which the regulator is strengthening the use of data and supervisory technology (Suptech) in its risk-based supervision.

The AMLS Project is one of the initiatives under the HKMA's Digitalisation Programme, responding to the risks and opportunities resulting from new and emerging technologies, which are driving changes across the financial services landscape.

The AMLS Project builds on the FATF's positive assessment of the HKMA's risk-based AML/CFT supervision. It responds to the international trend of leveraging technology and data to identify and assess money laundering and terrorist financing (ML/TF) risks. It also aims to help prioritise resources of the banking sector as a key stakeholder within the broader AML/CFT ecosystem in Hong Kong.

The HKMA also issued a report titled 'AML/CFT Supervision in the Age of Digital Innovation' based on a consultancy study. This will be used to guide the HKMA's digital transformation around AML/ CFT supervision.

The HKMA in light of the rapid changes in digital technology aims to increase its engagement and data collection. This will allow better use of data to provide more forward-looking assessment of risks. At the same time, the HKMA will be using various Suptech tools to help improve and streamline work processes, increase accuracy and enhance interface with the industry.

Key Takeaways

Since the AML/CFT RegTech Forum in 2019, with COVID-19 acting as an additional accelerant, 85% of retail banks have launched or are planning remote on-boarding initiatives.

Adapting the HKMA's AML/CFT supervision to be more proactive and agile will also mean changes for AIs. AIs are encouraged to review the report issued by the HKMA and assess the implications for their ML/TF risk management systems, particularly with respect to the adoption of Regtech solutions in their AML/CFT programmes.

In view of the regulators' active promotion on the use of technology, compliance officers should adapt to rapidly innovating technologies, particularly for data-heavy areas such as customer due diligence and transaction monitoring. While there is great potential from the use of technology, institutions should remain cognisant of the need to ensure such use of technologies is well governed and managed.

Recommended Reading

HKMA Circular: Anti-Money Laundering and Counter-Financing of Terrorism (AML/CFT)

AML/CFT Supervision in the Age of Digital Innovation

LIBOR Reform Updates

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HKMA circular on reform of interest rate benchmarks

The HKMA has issued a circular to request AIs to take early action to adhere to the IBOR Fallbacks Protocol (the Protocol) published recently by the International Swaps and Derivatives Association (ISDA).

ISDA announced on 9 October 2020 that it would launch the Protocol and the IBOR Fallbacks Supplement (the Supplement) on 23 October 2020 to implement fallbacks for existing and new derivatives contracts referencing key interbank offered rates (IBORs). The Protocol and the Supplement will take effect on 25 January 2021.

The HKMA expects AIs to adhere to the Protocol before it takes effect and take proactive steps to encourage their counterparties to do the same. For existing LIBOR-linked derivatives contracts to which the Protocol is not applicable, AIs should continue to work with their counterparties to transition to ARRs. As for new derivatives contracts, all those referencing the 2006 ISDA Definitions and executed on or after 25 January 2021 will automatically incorporate fallbacks.

HKMA circular on customer protection in respect of reform of interest rate benchmarks

The HKMA issued a circular on 21 October to remind AIs to pay attention to the customer protection aspects relating to the reform of interest rate benchmarks.

The key highlights of the circular are:

- AIs are reminded to act with due skills, care and diligence in their approaches to the transition of interest rate benchmarks and when making decisions impacting customers.
- AIs are also reminded to manage the customer impact of the transition ahead of end-2021, including identifying the extent of their clients' exposures, ensuring the associated risks of their clients are assessed and managed.
- AIs are expected to develop robust customer communication programmes for consumer education and outreach. Such programmes should be introduced at an earlier stage to increase customers' awareness and understanding of the reform of interest rate benchmarks, and help them make informed decisions.
- AIs should also provide customers with appropriate and accessible channels to make enquiries and complaints, and put in place relevant handling procedures which should be proper and fair.
- It is essential for AIs to make the necessary planning and preparation in advance, for instance, gearing up resources for the relevant hotlines and/or other customer-facing channels.
- AIs should also provide sufficient training and up-to-date information to all relevant frontline staff in order to ensure their relevant staff have adequate knowledge and competence to appropriately handle communications with customers.

Key Takeaways

The HKMA has reminded AIs to make early preparations for the transitions to the ARRs, and to keep abreast of both international and local developments of the reform of interest rate benchmarks. They should take these developments into account in their preparation for the transition.

In line with the above, the HKMA has also reminded AIs to uphold customer protection principles in line with the Treat Customers Fairly Charter and other applicable requirements (e.g. Code of Banking Practice) throughout the processes of the reform and transition of interest rate benchmarks.

Recommended Reading

HKMA circular: Reform of interest rate benchmarks

Customer Protection in respect of Reform of Interest Rate Benchmarks

HKMA Shares Practices of AIs and Expected Standards on Life Insurance Policy Replacement

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Having consulted the IA, the HKMA has shared its observations on the practices of AIs in relation to selling of life insurance policies, where a customer applies to purchase a new life insurance policy, and replaces or makes certain change(s) to an existing life insurance policy previously purchased.

AIs and their sales staff are required to comply with all applicable statutory and regulatory requirements relating to life insurance policy replacement as set out in:

- the Insurance Ordinance (IO), in particular sections 90(a) and 90(d);
- "Guideline on Long Term Insurance Policy Replacement (GL27)" together with the corresponding Interpretation Notes issued by the IA; and
- Codes of Conduct issued by the IA.

The guidance provided to the AIs on standards on standards expected of them to identify, monitor, review and follow up on policy replacement so as to accord protection to customers include:

Best interests assessment and advice

Licensed insurance intermediaries including AIs and their sales staff are required to:

- assess and provide advice to the customer on whether the proposed purchase of a new life insurance policy is in the customer's best interests
- ask the customer to provide information on his/her existing life insurance policy(ies); and
- properly document the information provided by the customer during the assessment process.

Identifying policy replacement at the point of sale

AIs and their staff should take all reasonable steps to ascertain whether the customer is purchasing the life insurance policy as a policy replacement.

Monitoring policy replacement after point of sale

AIs should have proper procedures and controls in place to monitor whether any changes have been made to an existing life insurance policy of the customer after the application for the new policy. This may indicate policy replacement by making use of information available to the AI.

Internal controls and management supervision

AIs should ensure they have a framework of adequate processes, controls, reviews and oversight. This will effectively identify and monitor any changes to an existing life insurance policy which may indicate policy replacement and take appropriate actions.

Incentive systems and feedback mechanisms

AIs should properly design their incentive systems such that proper risk culture and business conduct of staff are encouraged and incentivised.

Staff training

AIs should provide sufficient training to relevant staff, including sales staff and control functions, to ensure that they have sufficient understanding of the definition of and the statutory, regulatory and internal requirements relating to policy replacement.

Key Takeaways

AIs should note that the transitional period of implementation for GL27 will end on 31 March 2021, and they are expected to implement any necessary and appropriate measures to comply with the applicable requirements.

AIs should immediately review and make necessary improvements to their policies, procedures, controls and monitoring and comply with this circular no later than 6 months after the end of the transitional period for GL27.

Recommended Reading

HKMA Circular: Life Insurance Policy Replacement

Practices of AIs and Expected Standards on Life Insurance Policy Replacement

Insurance Authority Regulatory Updates

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Amendments to Hong Kong Financial Reporting Standard 17 Insurance Contracts

The Hong Kong Institute of Certified Public Accountants ("HKICPA") has recently endorsed the Amendments to International Financial Reporting Standard 17 Insurance Contracts issued by the International Accounting Standards Board. This endorsement constitutes an adoption of equivalent Amendments to Hong Kong Financial Reporting Standard 17 Insurance Contracts (HKFRS 17).

To support the implementation of HKFRS 17, HKICPA continues the activities of the Hong Kong Insurance Implementation Support Group (HKIISG), a forum for members to raise and discuss questions on implementing HKFRS 17. The IA is encouraging authorized insurers to continue making use of the HKIISG and to ensure timely implementation of HKFRS 17.

CPD Requirements under the New Regulatory Regime for Insurance Intermediaries - FAQs, Reference Lists and Reporting Requirements

This circular sets out certain measures the IA has put in place to assist individual licensees (and their principals, i.e. their appointing authorized insurers, licensed insurance broker companies and licensed insurance agencies) in calculating the number of CPD hours they have to complete. It also provides an update on the reporting requirements for CPD compliance.

Key considerations include:

- The IA has also issued a set of Frequently Asked Questions (FAQs) to provide explanation and basic rules for calculating the minimum number of CPD hours required of individual licensees with different registration or licensing histories.
- The IA has also prepared a list for every principal indicating the number of CPD hours which each of its appointed individual licensees would have been required to complete in the First Assessment Period i.e. as at 31 July 2020, had the First and Second Assessment Periods not been merged.
- Any principal which has not yet opened a Supervisor Account in Insurance Intermediaries Connect may do so (and should do so) by submitting a signed Form A2 to the IA.
- As the First and Second CPD Assessment Periods have been merged, there is no requirement to report CPD compliance in 2020. Rather, individual licensees will be required to report their CPD compliance for the First and Second CPD Assessment Periods by 30 September 2021.

iAM Smart Pilot Sandbox Programme - Phase 2

The Pilot Sandbox will be rolling out its Phase 2 implementation for financial institutions intending to adopt iAM Smart for production use. Phase 2 will include an Integration Testing Environment (ITE) similar to the production environment to facilitate the development of their production online services.

Financial institutions interested in participating in Pilot Sandbox Phase 2 shall submit an application form with a draft user journey and implementation schedule to show the intended usage of iAM Smart APIs in the future production setup.

Recommended Reading

Amendments to Hong Kong Financial Reporting Standard 17 Insurance Contracts
CPD Requirements under the New Regulatory Regime for Insurance Intermediaries – FAQs, Reference Lists and Reporting Requirements
iAM Smart Pilot Sandbox Programme - Phase 2

Other Regulatory Updates

SFC Circular to intermediaries - Provision of trade documents to clients by access through intermediaries' websites

Subsequent to the circular "Provision of Trade Documents to Clients by Access through Intermediaries' Websites" issued on 28 July 2010, the SFC has provided updated guidance on the provision of specified documents to clients by access through intermediaries' websites (Access Service) for complying with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules on 29 September 2020.

This circular supersedes the previous circular with the following updates:

- introducing new ways in which consent to the Access Service could be obtained from new and existing clients;
- providing further guidance on the disclosure of access arrangements, which assists clients in giving informed consent;
- clarifying that other forms of effective electronic communications, in addition to email, may be used for notifying clients of the posting of trade documents on the website; and
- extending the following minimum online retrieval period for trade documents within one year:
  - Daily statement of account, contract note and receipt: three months
  - Monthly statement of account: two years.

The HKMA has also referred this circular to the AIs to encourage the provision of longer online retrieval period for post trade documents to retail banking customers, with an object to provide customer-centric services and better customer experience and convenience.

Complaints Against Debt Collection Agents Employed by AIs

The HKMA issued results of the industry survey on complaints against debt collection agents (DCAs) employed by AIs for the first half of 2020.

During the reporting period, 27 AIs used the services of DCAs and assigned 400,235 accounts to 20 DCAs. A total of 29 complaints against 9 DCAs were received by 9 AIs (compared with 13 complaints against 6 DCAs received by 6 AIs in the second half of 2019).

The incidence of complaints per 1,000 accounts assigned has increased from an average of 0.03 in the second half of 2019 to 0.07. Seven complaints were lodged by unrelated third parties, compared with 3 in the second half of 2019.

Glossary

AI	Authorised Institutions	IFRS	International Financial Reporting Standard
AML	Anti-Money Laundering	IOSCO	International Organization of Securities Commission
BC	Basel Committee	IR-1	Interest Rate Risk Management
BCBS	Basel Committee on Banking Supervision	IRR	Interest Rate Risk
CFT	Counter-Financing of Terrorism	IRRBB	Interest Rate Risk in the Banking Book
CG-1	Corporate Governance of Locally Incorporated Authorized Institutions	LC	Licensed Corporation
FATF	Financial Action Task Force	LIBOR	The London Inter-bank Offered Rate
FinTech	Financial Technology	MAS	Monetary Authority of Singapore
FMCC	Fund Manager Code of Conduct	MRF	Mutual Recognition of Funds
FI	Financial Institutions	MoU	Memorandum of Understanding
FSB	Financial Stability Board	RO	Responsible Officer
HKMA	The Hong Kong Monetary Authority	RE-1	Recovery Planning
IA	The Insurance Authority	SFC	The Securities and Futures Commission
IAF	Internal Audit Function	SFO	Securities and Futures Ordinance
IC-1	Risk Management Framework	SPM	Supervisory Policy Manual
IC-2	Internal Audit Function		
ICO	Initial Coin Offering		