

1 November 2021

Circular to Issuers of SFC-authorized investment-linked assurance schemes

Additional Guidance on Internal Product Approval Process

This circular is supplemental to the Securities and Futures Commission's (SFC) Circular¹ entitled "Guidance on Internal Product Approval Process" (PD Guidance). The purpose of this circular is to provide additional guidance to issuers of SFC-authorized investment-linked assurance schemes (ILAS) on the application of certain existing requirements under the PD Guidance to ILAS.

Background

1. ILAS is an investment-cum-life insurance product providing both life insurance protection and investment exposure from a range of funds. To maintain an effective regulatory regime for ILAS, the SFC regularly reviews and seeks disclosure and structural enhancements to the product having regard to the best interests of investors.
2. As an overarching principle, when designing an ILAS product, ILAS issuers should consider investors' interests and be generally satisfied that their ILAS are designed fairly and deliver a fair outcome to investors, taking into consideration any other alternative products for achieving the same objective and risk/return profile.
3. Having regard to the proliferation of fund platforms in the market and increasing regulatory and market focus on impact of costs on investments, the SFC has recently conducted a holistic review of ILAS with a view to formulating further product design and disclosure enhancements. We worked closely with other regulators (including the Insurance Authority) in this exercise.
4. Following the review and extensive consultation with stakeholders, the SFC issues this circular to provide additional guidance to ILAS issuers (Additional ILAS Guidance). ILAS issuers are expected to comply with the PD Guidance as supplemented by the Additional ILAS Guidance.

Additional ILAS Guidance

5. The Additional ILAS Guidance is built upon certain existing requirements under the PD Guidance, in particular, the requirements on product design and fees under paragraphs 6(d) and 6(h) as well as the requirement on accountability throughout the product life-cycle under paragraph 6(a).

¹ The PD Guidance to Product Providers of SFC-authorized unit trusts and mutual funds, SFC-authorized investment-linked assurance schemes and SFC-authorized unlisted structured investment products was first issued on 30 April 2014 and was amended on 4 March 2016.

Product design

6. ILAS issuers should be generally satisfied that their ILAS products are designed fairly and deliver a fair outcome to the target market. When conducting an assessment on the fairness of their products, ILAS issuers should take into consideration, without limitation, the following when determining the product features of the ILAS:
- (a) the level of life insurance protection (eg, whether and the extent the ILAS product provides insurance protection above the premium paid or payable similar to a term life insurance product);
 - (b) the fee charging model and structure (eg, whether policy charges are calculated based on account balance or on a transaction-by-transaction basis) and overall fees and costs borne by an investor;
 - (c) the number and variety of underlying funds and fund houses for selection;
 - (d) the premium payment structure and level (eg, whether single or regular premium payment, the premium payment amount and period); and
 - (e) product liquidity (eg, whether any surrender charges may apply in the event of early policy surrender or partial withdrawal).

Fees

7. In view of the hybrid nature of ILAS, ILAS generally have various types of fees to cover the issuers' costs for providing insurance protection (generally referred to as cost of insurance (COI)) and costs for administrating the investment platform offered and other services such as handling investment related transactions and communications with investors (generally referred to as platform fee²). Early surrender or withdrawal charge (Surrender Charge) may also be levied upon early policy surrender or partial withdrawal mainly to pay for distribution and acquisition costs.
8. When considering the level of fees of an ILAS, ILAS issuers should ensure that the fees of their ILAS are fair, proportionate and commensurate with the insurance protection offered by the ILAS (when compared with other alternative products) throughout the whole policy term. In particular:
- (a) COI – ILAS issuers should ensure that in general the COI rates of an ILAS product are not higher than those charged by comparable alternative products (eg, term life insurance products).

² Platform fees include any upfront charge and ongoing fees of ILAS other than COI.

(b) Platform fee

- Platform fee should be comparable to the corresponding alternative products over the lifetime of the ILAS policy after taking into account any bonuses (or other similar features) provided by ILAS issuers³.
- Upfront charge (if any) should be fair and not excessive. It should not significantly reduce the amount of premia available for investment and therefore lowering the surrender value as well as the death benefit of the ILAS policy in early years.

(c) Surrender Charge

- Whilst ILAS issuers may try to recoup their costs through levying a Surrender Charge under the ILAS, they should ensure that the Surrender Charge payable by investors is fair and not excessive taking into account comparable alternative products. The level and period of the Surrender Charge should be commensurate with the level of insurance protection offered by the ILAS.
- In particular, ILAS issuers should seek to lower the Surrender Charge and shorten the Surrender Charge period. In this regard:
 - (i) An ILAS that provides low or minimal insurance protection⁴ is more akin to a fund platform and should provide better liquidity to investors given its minimal insurance element. Its Surrender Charge is generally expected to be low and over a short period in view of the minimal exit charge levied by fund platforms.
 - (ii) For ILAS with high insurance protection⁴, it may charge a higher Surrender Charge or with a longer Surrender Charge period if it is commensurate with the higher insurance protection provided to investors by comparable life insurance products.
 - (iii) In addition, issuers should assess whether investors will receive a comparable payout if they surrender after holding the product for a reasonable period of time as compared to holding comparable alternative products⁵.

³ Please refer to Questions 2 and 3 under section 4 of the Frequently Asked Questions relating to Investment-Linked Assurance Schemes (ILAS FAQs) which are available on the SFC website for more guidance.

⁴ High protection ILAS generally refers to an ILAS product with death benefit of at least 150% of total premiums payable before the insured reaches age 65. An ILAS product with death benefit of less than 150% of total premium payable before the insured reaches age 65 is generally regarded as low protection ILAS.

⁵ Please refer to Question 4 under section 4 of the ILAS FAQs for more guidance.

Complex product features⁶

9. ILAS issuers should ensure that the product features are not unduly complex when designing their ILAS products. A product feature of an ILAS is considered as unduly complex where its terms and risks are not reasonably likely to be understood by investors in general. Set out below are factors to determine the complexity of a product feature:
- (a) whether any features or terms are unnecessarily complicated, are not comprehensible and provide no (or limited) additional value to investors; and
 - (b) whether multiple variables or complicated formulas are used unnecessarily to determine the return or render the financial impact on policy value or its financial return difficult for investors to understand.

Review and monitoring

10. Appropriate reviews of compliance with the Additional ILAS Guidance should be performed by the ILAS issuers as part of their ongoing monitoring obligation. This includes regular reviews as well as ad hoc reviews where appropriate. It is expected that a regular review should be conducted by the ILAS issuers (in consultation with the appointed actuary if considered appropriate) and a written confirmation of compliance should be submitted to the SFC every two years for products that are on offer to Hong Kong public.
11. Such regular review should cover the fees of the ILAS based on the latest comparable alternative products available in the market to ensure compliance with relevant requirements in the PD Guidance and this circular. ILAS issuers should also put in place policies and procedures to follow up on any review results and to implement any enhancements required following their review. ILAS issuers should maintain proper records on the above.

Enhanced disclosure requirements

12. The SFC has also enhanced the disclosure requirements relating to fees, including platform fee and Surrender Charge. Please refer to the revised ILAS product key facts statement (KFS) illustrative template posted on the SFC website.

Compliance procedures

13. Subject to the transitional arrangements as set out in paragraph 17 below, all applicants making applications for authorisation of new ILAS under section 104 of the Securities and Futures Ordinance (SFO) are required to submit a written confirmation (in the form set out in Appendix 1 to this circular) (Confirmation) to the SFC that the PD Guidance and the Additional ILAS Guidance have been and will be fully complied with. Such Confirmation⁷ should be submitted with the relevant application form and

⁶ Please refer to Question 6 under section 4 of the ILAS FAQs for examples of complex product features.

⁷ The Confirmation covers both compliance with the PD Guidance and the Additional ILAS Guidance. Submission of a separate confirmation of compliance as set out in Appendix 1 to the PD Guidance is no longer required.

other application documents (including an assessment in respect of each type of fees levied by the ILAS issuers).

14. The Confirmation must be signed by an executive director (or above) of the ILAS issuer or other person acceptable to the SFC, who has sufficient seniority with the necessary authority to sign on behalf of the applicant.
15. The SFC reserves the right to request information, records and documents from the applicants in respect of the product or the internal product approval process as the SFC deems appropriate in pursuing its regulatory objectives and performing its functions under the SFO.

Effective date and transitional arrangement

16. The Additional ILAS Guidance will take effect on 1 November 2021 (Effective Date). The Additional ILAS Guidance will apply to new ILAS for which applications for authorisation are submitted to the SFC on or after the Effective Date.
17. As for SFC-authorized ILAS in force as of the Effective Date (Existing ILAS), a transition period of 18 months from the Effective Date (expiring on 30 April 2023) will be provided to ILAS issuers to comply with the enhanced requirements under the Additional ILAS Guidance. Existing ILAS which will continue to be offered to the public in Hong Kong must comply with the requirements by the end of the transition period subject to SFC's right to grant an extension at its sole discretion on a case-by-case basis with valid justifications provided.
18. The SFC has also provided further guidance to ILAS issuers in the form of FAQs to elaborate on the enhanced requirements. Please refer to the ILAS FAQs which are available on the SFC website.
19. ILAS issuers are encouraged to start their preparation work as soon as possible and prioritise their applications (including the revamping of Existing ILAS, if any) to have an orderly submission for SFC's approval during the transition period. Issuers are welcome to contact the SFC to discuss any new ILAS product proposals.
20. To facilitate the processing of applications, we have concurrently rolled out an enhanced approval process for ILAS applications. Please refer to the Circular to Issuers of SFC-authorized ILAS entitled "Enhanced Authorisation Process for New ILAS Applications" which is available on the SFC website.
21. Should you have any questions, please contact the relevant case officers in charge.

Investment Products Division Securities and Futures Commission