Practice Note on Remuneration Structures of Authorized Insurers for Licensed Insurance Intermediaries for Participating Policies

1. Introduction and objective

1.1 The regulatory requirements on remuneration structures for licensed insurance intermediaries in relation to participating policies are principally set out in the Guideline on Underwriting Long Term Insurance Business (other than Class C Business) ("GL16") issued by the Insurance Authority (the "IA"). Under the governing principle of "treating customers fairly", GL16 requires authorized insurers to ensure that their remuneration structures for licensed insurance intermediaries do not create misaligned incentives for the intermediaries.

1.2 The regulated activities that licensed insurance intermediaries are licensed and engaged to perform, include:

- **Pre-contract servicing** - such as sourcing potential policy holders, assessing their insurance needs and circumstances, providing advice on suitable insurance options, and arranging the insurance policies that policy holders choose to purchase; and

- **On-going servicing** - providing service to policy holders after the point of sale and throughout the policy period, such as explaining performance of non-guaranteed benefits, assisting with claims, assessing policy benefits, adding or changing beneficiaries, reviewing whether the policy continues to meet the policy holder's circumstances and advising on this.

1.3 To satisfy the requirements under GL16, authorized insurers need to ensure their remuneration structures for insurance intermediaries produce alignment between (i) policy holders' interests in receiving both pre-contract servicing and ongoing servicing; and (ii) the duty and incentive for intermediaries to provide both sets of servicing. If a remuneration structure disproportionately favours pre-contract servicing and under-rewards on-going servicing, this can lead to aggressive sales practices and neglect on-going servicing duties, resulting in unfair policy holder treatment.

1.4 The considerations in paragraph 1.3 are especially important for regular pay long term insurance policies with saving and investment elements. These policies are designed to remain in force over multiple years. The value of their non-guaranteed benefits is not fixed at the point of sale. They depend on factors like investment performance, which fluctuates throughout the policy period, and continued payment of premiums per the policy terms. On-going servicing assists policy holders to understand how their policy benefits are performing and whether their policies continue to meet their needs as their circumstances change over time. Both pre-contract and ongoing servicing are vital for ensuring that policy holders are treated fairly and their best interests are served.

1.5 Whilst GL16 requires authorized insurers to structure their intermediary remuneration to align the interests of policy holders to receive both pre-contract servicing and ongoing servicing, it is observed that pay-out of intermediary remuneration for participating policies is concentrated on pre-contract servicing and minimized for ongoing servicing. To address this issue, the IA believes it is important to establish a set of minimum expectations for how authorized insurers should structure insurance intermediary remuneration for participating policies[1].

2. Application

2.1 This Practice Note supplements the requirements applicable to authorized insurers in GL16 in relation to remuneration structures for licensed insurance intermediaries on participating policies (i.e. contracts of insurance that are "participating business" as defined in section 21B of the Insurance Ordinance (Cap. 41)).

2.2 This Practice Note applies to all participating policies with regular premium payment terms, except Qualifying Deferred Annuity Policies. For the avoidance of doubt, this Practice Note does not apply to participating policies with single premium payment terms (i.e. single pay products).

2.3 A participating policy has regular premium payment terms if, under the terms and conditions of the policy, the policy holder is obliged to make scheduled payments of premium by set due dates over a specified period. This would include a participating policy which has a prepaid premium feature, whereby the policy holder may pay premium prior to the due dates on which premium payments are required to be made under the terms and conditions of the policy. This would also include a rider to a policy where the rider is participating business with regular premium payment terms. For the avoidance of doubt, where a policy holder may (but it is not contractually obliged to) make a top up premium payment under a participating policy which is a single premium policy, this would not be a policy with regular premium payment terms.

---

[1] For the avoidance of doubt, in respect of Class C business, the IA has in the Guideline on Underwriting Class C Business (GL15) set minimum expectations for how authorized insurers should structure their intermediary remuneration to align the interests of policy holders to receive both pre-contract servicing and ongoing servicing, with the incentive for intermediaries to provide such services.

Those minimum expectations would continue to apply to Class C business, i.e. no more than 50% of the total commission payable for a Class C product with regular payment terms is to be paid upfront, with the rest to be spread evenly over a minimum of 5 years (or the premium payment term if shorter). See paragraph 5.4 of the Note on the Green Light Process for Assessment of Investment-Linked Assurance Scheme Products against Standards in GL15.

2.4 In this Practice Note, “commission” refers to monetary remuneration that:

(a) is payable by an authorized insurer to a licensed insurance intermediary for introducing a prospective policy holder, arranging and servicing a participating policy between the policy holder and the insurer;

(b) is determined as a proportion of the premium payable by the policy holder under the policy arranged; and

(c) becomes payable because the policy is entered into between the insurer and the policy holder.

2.5 For the purposes of paragraph 2.4, in considering whether remuneration payable to a licensed insurance intermediary is “commission”, a “substance-over-form” approach should be taken, irrespective of the name given to such payment or the form which such payment takes.

3. Minimum expectations on alignment of interests in remuneration structures

3.1 To satisfy the requirement not to create misalignment of interests in remuneration structures as stated in GL16, an authorized insurer must, when designing its remuneration structures for licensed insurance intermediaries, seek to align the interests of policyholders in receiving pre-contract servicing and ongoing servicing with the duty of (and incentive for) licensed insurance intermediaries to provide both types of servicing.

3.2 Subject to the exceptions in paragraph 4 below, to satisfy the requirement in paragraph 3.1 in respect of any participating policy with regular payment terms entered into by an authorized insurer and a policy holder, the commission payable by the insurer to any licensed insurance intermediary in respect of such policy must be prorated such that:

(a) no more than 70% of the total commission payable is paid upfront (i.e. the commission to be paid on the sale and arrangement of the policy and during the first policy year[2], must not exceed 70% of the total commission payable in respect of the policy); and

(b) the remaining commission payable after the first policy year must be paid at least over a minimum of 5 years (i.e. 2nd to 6th policy year) or the premium payment term, whichever is shorter, and must be spread evenly over this period (i.e. the same amount should be paid per year).

[2] First policy year means the 12-month period commencing from the policy effective date.

3.3 The spreading requirement in paragraph 3.2:

(a) in the case of licensed individual insurance agents, applies to the total commission payable by the authorized insurer in respect of the participating policy, and to all licensed individual insurance agents to whom commission is payable. However, it does not restrict how the insurer allocates the total commission payable between the individual agents to whom it is payable (e.g. between the producing agent and the agent manager(s), as those terms are defined in paragraph 4.1(a));

(b) in the case of a licensed insurance agency or licensed insurance broker company, applies to the total commission payable by the authorized insurer in respect of the participating policy, to the agency or the broker company. However, it does not restrict how the agency or broker company allocates that commission to its appointed technical representatives (agent) or technical representatives (broker); and

(c) sets the minimum expectations for the proportion of total commission payable in the early policy year versus later policy years without prescribing the overall commission level.

3.4 The spreading requirement in paragraph 3.2 sets out the IA's minimum expectation for spreading of commission in relation to any participating policy with regular payment terms. Authorized insurers may (and indeed are encouraged to) (i) pay lower than 70% of the total commission payable upfront; and (ii) spread the remaining portion of the commission beyond the 6^{th} policy year, to achieve even better alignment between the interests of policy holders to receive pre-contract servicing and ongoing servicing with the duty of (and incentive for) licensed insurance intermediaries to provide both types of servicing.

4. Situations where an authorized insurer may depart from the spreading requirement in paragraph 3.2

4.1 *Overriding commission payable to licensed individual insurance agents*

(a) The spreading requirement in paragraph 3.2 applies to commission payable to a licensed individual insurance agent who introduces, arranges and serves a participating policy ("producing agent"). It also applies to any overriding commission payable[3] to any licensed individual insurance agent(s) who is responsible for oversight and management of the producing agent ("agent manager(s)"), where those overriding commissions arise from the production, arrangement and service of the policy by the producing agent.

[3] For the purposes of this Practice Note, overriding commission is commission payable to an agent manager(s), when a producing agent under the agent manager(s)' oversight and management, produces, arranges and serves a participating policy.

(b) The spreading requirement in paragraph 3.2 will not apply to such overriding commission if, in determining its amount, the authorized insurer factors in objective non-financial performance metrics for factors that evaluate the agent manager's and the producing agent(s)' performance in complying with, and adherence to the "treating customers fairly" principle. Such metrics may include the persistency rate of the policies produced, arranged and serviced by producing agents for which the agent manager is responsible, the variety and proportion of different products in such policy portfolio, positive customer feedback, the retention rate of producing agents under management, etc.

4.2 *Volume-based bonus commission*

(a) The spreading requirement in paragraph 3.2 applies to volume-based bonus commission payable to licensed insurance agents, being a bonus that is contingent on achieving a specified sales volume target, such as a minimum volume of premium on the policies produced and arranged. For the avoidance of doubt, a bonus is considered contingent if both the eligibility to receive it and the exact amount payable remain uncertain until the specified sales volume target is achieved.

(b) However, where determination of the bonus commission is not solely based on business volume, but also incorporates objective non-financial performance metrics that evaluate the licensed insurance agents' performance in complying with, and adherence to the "treating customers fairly" principle, such bonus commission payable will not be subject to the spreading requirement in paragraph 3.2. Such metrics may include the persistency rate of the policies produced, arranged and serviced by insurance agents, the variety and proportion of different products in such policy portfolio, positive customer feedback, the retention rate of insurance agents under management, etc.

(c) For licensed insurance brokers, volume-based commissions are prohibited under the circular issued by the Office of the Commissioner of Insurance dated 10 April 2006[4] as referenced in the Practice Note supplementing Standard and Practice 7.1 of the Code of Conduct for Licensed Insurance Brokers.

4.3 *Fixed remuneration for licensed insurance agents*

The spreading requirement in paragraph 3.2 does not apply to a fixed remuneration package for a licensed insurance agent. A fixed remuneration package is one where the remuneration is contractually payable by the insurer to the insurance agent irrespective of whether an insurance policy is arranged and serviced or the volume of premium on insurance policies arranged and serviced by the insurance agent.

[4] https://www.ia.org.hk/en/legislative_framework/circulars/reg_matters/files/cir_20060410.pdf

4.4 *Commission for licensed insurance agencies who are authorized institutions*

In view of the differences in business model and operation in bancassurance channel[5], an authorized insurer may depart from the spreading requirement in paragraph 3.2 for commission payable to licensed insurance agencies that are also authorized institutions under section 2 of the Banking Ordinance (Cap. 155), provided that they continue to meet the overriding principles governing appropriate remuneration structures as stated in GL16. That said, the IA and the Hong Kong Monetary Authority will work closely together to monitor the remuneration structures in the bancassurance channel and take appropriate action if necessary.

4.5 *Policy holders who are professional investors*

An authorized insurer may depart from the spreading requirement in paragraph 3.2 for commission payable to licensed insurance intermediaries on participating policies entered into by policy holders who qualify as Professional Investors ("PI"), as defined in Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and the Securities and Futures (Professional Investor) Rules (Cap. 571D), provided that the authorized insurer:

(a) has established and implemented adequate and effective controls and processes to ascertain whether a potential policy holder qualifies as a PI during the on-boarding and know-your-client process;

(b) is satisfied that the policy holder, in accordance with such controls and processes, has been identified as a PI; and

(c) in structuring its commission payable to the license insurance intermediary introducing the policy holder, arranging and servicing the policy, is satisfied that the overriding principles governing appropriate remuneration structures as stated in GL16 is met on a continuous basis.

5. Control and Records

5.1 Authorized insurers should put in place proper controls, procedures and adequate monitoring and supervision to ensure that the regulatory expectations and standards set out in this Practice Note are met and the objective of "treating customers fairly" is achieved. Any attempt to circumvent the relevant regulatory objectives and requirements, especially any attempt to abuse the exceptions would be regarded as an act or omission likely to be prejudicial to the interests of policyholders or potential

[5] For instance, policyholders served by authorized institutions are typically sourced from their existing client base or network, and they often maintain an ongoing banking relationship with these institutions. This relationship gives authorized institutions an inherent incentive to provide quality after-sales services in insurance matters. In addition, authorized institutions commonly adopt a balanced scorecard approach to assess the appropriateness of remuneration for their technical representatives (agents).

policyholders. This may also reflect on the IA's view of the continuing fitness and properness of the authorized insurers (including their directors, controllers and key persons in relevant control functions).

5.2 An authorized insurer should maintain sufficient records and be prepared to demonstrate its compliance with the requirements stipulated in this Practice Note upon the IA's request. In particular, the design of non-financial performance metrics referenced in paragraphs 4.1(b) and 4.2(b) above must be reasonable, conducive to adherence to the "treating customers fairly" principle, and be properly justified to ensure that they effectively evaluate the performance of the licensed insurance agents against the "treating customers fairly" principle. Authorized insurers must retain documentation justifying these non-financial metrics for 7 years and provide it upon the IA's request.

6. Commencement and Review

6.1 This Practice Note shall take effect from 1 January 2026 (the "commencement date"). The spreading requirement in paragraph 3.2 is applicable to participating policies with regular payment terms issued on or after the commencement date.

6.2 The IA reserves the right to review and update this Practice Note from time to time in light of market situations.

6.3 To provide further guidance on the spreading requirement in paragraph 3.2, a list of frequently asked questions ("FAQ") is set out in Annex. These FAQs are not intended to be a comprehensive or exhaustive guide and should not be interpreted in any way that would override any provisions in this Practice Note, guidelines, interpretation notes and other regulatory instruments issued by the IA (including but not limited to GL 16 and its related interpretation notes and Questions and Answers) as well as the Insurance Ordinance (Cap. 41) and its subsidiary legislation.

Annex

Frequently Asked Questions

Q1: Can you provide examples of remuneration arrangements which do and do not satisfy the spreading requirement set out in paragraph 3.2 of the Practice Note?

A1: Below are some examples for illustration purposes. To avoid any doubt, the figures used in these examples are hypothetical and should not be interpreted as representing market levels or industry standards.

<u>Example 1</u>

An authorized insurer offers basic commission to a producing agent and overriding commission to his/her agent manager(s). Both the basic and overriding commissions become payable because of the producing agent arranging a participating policy with regular payment terms, and the commissions are determined as a proportion of the premium payable under the policy arranged:

Policy year	Premium ($)	Basic commission to producing agent ($)	Overriding commission to agent manager(s)[6] ($)	Total ($)
1	100	40	30	70
2	100	5	5	10
3	100	5	5	10
4	100	5	5	10
5	100	5	5	10
6	100	5	5	10
7	100	0	0	0
8	100	0	0	0
9	100	0	0	0
10	100	0	0	0
				120

The commission structure in Example 1 satisfies the IA's minimum expectations of the spreading requirement in paragraph 3.2 of the Practice Note:

(a) Commission payable in the first policy year is less than 70% of the total commission payable (i.e. $70/$120 = 58.3%); and

(b) Commission payable in the next 5 years (i.e. 2nd to 6th policy year) is evenly spread.

[6] This is the total amount of the overriding commission payable to all the agent manager(s) (i.e. upline managers) of the producing agent.

Example 2

An authorized insurer offers basic commission to a producing agent and overriding commission to the agent manager(s) of the producing agent. Both the basic and overriding commission become payable because of the producing agent arranging a participating policy with regular payment terms, and the commissions are determined as a proportion of the premium payable under the policy arranged:

Policy year	Premium ($)	Basic commission to producing agent ($)	Overriding commission to agent manager(s) ($)	Total ($)
1	100	35	25	60
2	100	10	0	10
3	100	10	0	10
4	100	10	0	10
5	100	10	0	10
6	100	10	0	10
7	100	5	0	5
8	100	5	0	5
9	100	0	0	0
10	100	0	0	0
				120

The commission structure in Example 2 satisfies the IA's minimum expectations of the spreading requirement in paragraph 3.2 of the Practice Note:

(a) Commission payable in the first policy year is less than 70% of the total commission payable (i.e. $60/$120 = 50%);

(b) Commission payable in the next 5 years (i.e. 2nd to 6th policy year) is the same portion of the total commission payable; and

(c) The insurer continues to pay commission to the insurance intermediaries after the 6th policy year, albeit at a lower amount. Since the commission payable in the 2nd to 6th policy year are even amount, the spreading requirement in paragraph 3.2 is satisfied, even though the amount of commission drops in the 7th and 8th policy year. Indeed, an authorized insurer is encouraged to continue to pay commission in the 7th policy year and beyond. Long term policies are (the clue is in the name) long term in nature and so is the obligation for ongoing servicing.

Example 3

An authorized insurer offers basic commission to a producing agent and overriding commission to the agent manager(s) of the producing agent. Both the basic and overriding commission become payable because of the producing agent arranging a participating policy with regular payment terms, and the commissions are determined as a proportion of the premium payable under the policy arranged:

Policy year	Premium ($)	Basic commission to producing agent ($)	Overriding commission to agent manager(s) ($)	Total ($)
1	100	65	40	105
2	100	5	0	5
3	100	5	0	5
4	100	5	0	5
5	100	5	0	5
6	100	5	0	5
7	100	5	0	5
8	100	5	0	5
9	100	0	0	0
10	100	0	0	0
		100	40	**140**

The commission structure in Example 3 does not satisfy the IA's minimum expectations of the spreading requirement in paragraph 3.2 of the Practice Note. Commission payable in the first policy year is more than 70% of the total commission payable (i.e. $105/$140 = 75%). Moreover, the commission structure breaches paragraph 9.2 of GL16 which requires that the commission should only be paid on an "earned basis" since the commission payable in the first policy year exceeds the first-year premiums received.

The authorized insurer may consider adjusting the amount of commission payable to the producing agent and/or the agent manager in the first year and spread the remaining amount over the following year(s), so that the commission payable in the first policy year is less than 70% of the total commission payable and does not exceed the first-year premium received[7].

Alternatively, the authorized insurer may consider changing the structure of the overriding commission payable to the agent manager(s) so as to include non-financial factors based on the "treating customers fairly" principle in determining the amount of overriding commission payable (such that the value of the overriding commission is not determined solely by reference to the producing and arrangement of the policy).

[7] See Q&A 6 of Questions and Answers on "Guidance Note on Underwriting Long Term Insurance Business (other than Class C Business)".

For example, if the amount of overriding commission payable was adjusted based on measures that benchmarked the performance of both the agent manager and the producing agents for which the agent manager was responsible against “treating customers fairly” factors (e.g. persistency rate across the portfolio), then the spreading requirement in paragraph 3.2 of this Practice Note would not apply to the overriding commission. Discounting the overriding commission, the commission to which the spreading requirement in 3.2 is applicable would only be the commission payable to the producing agent, being $65 in the first policy year which is less than 70% of the total commission payable (i.e. $65/$100 = 65%).

In order to ensure the requirements in paragraph 9.2 of GL16 are not breached, the authorized insurer would also have to make further adjustments to the structure of the commission payables by, for example, deferring at least payment of $5 of overriding commission from the first policy year to the second policy year, such that the total amount of basic and overriding commission paid would not exceed the total premium received in the first policy year.

<u>Example 4</u>

Further to Example 1, apart from basic commission payable to a producing agent and overriding commission payable to his/her agent manager(s), the authorized insurer also offers a year-end production bonus to the producing agent and the agent manager(s) simultaneously. The production bonus is contingent on a minimum level of business volume being reached and is determined solely based on the business volume produced by the relevant agents during the year.

As the production bonus is **<u>solely</u>** linked to business volume, it does not fall within the exception under paragraph 4.2(b) of this Practice Note and therefore, is subject to the spreading requirement. The insurer needs to allocate the total bonus amount appropriately to each policy within the business portfolio that contributed to the bonus and the amount allocated to each policy (together with the basic commission and overriding commission) needs to be spread in line with the spreading requirement.

Policy year	Premium ($)	Basic commission to producing agent ($)	Overriding commission to agent manager(s) ($)	Bonus for producing agent ($)	Bonus for agent manager(s) ($)	Total
1	150	50	40	25	25	140
2	150	5	5	0	0	10
3	150	5	5	0	0	10
4	150	5	5	0	0	10
5	150	5	5	0	0	10
6	150	5	5	0	0	10
7	150	0	0	0	0	0
8	150	0	0	0	0	0
9	150	0	0	0	0	0
10	150	0	0	0	0	0
		75	65	25	25	**190**

With the bonus allocated to the relevant policy being $25 for the producing agent and $25 for the agent manager(s), the commission structure in Example 4 does not satisfy the IA's minimum expectations of the spreading requirement in paragraph 3.2 of the Practice Note, as the commission payable in the first policy year exceeds 70% of the total commission payable (i.e. $140 / $190 = 73.7%).

The authorized insurer may either adjust the amount of the production bonus payable to the producing agent and the agent manager(s), or change its design so as to include non-financial factors based on the "treating customers fairly" principle in determining the amount of production bonus payable (such that the value of the production bonus is not determined solely by reference to the business volume produced by the relevant agents).

For example, if the amount of the production bonus payable was adjusted based on measures that benchmarked the performance of both the agent manager and the producing agent against "treating customers fairly" factors (e.g. persistency rate across the portfolio), then the spreading requirement in 3.2 of this Practice Note would not apply to the production bonus. This would result in the commission to which the spreading requirement in 3.2 is applicable, being only $90 in the first policy year which is no more than 70% of the total commission payable (i.e. ($50+$40)/($75+$65) = 64.3%)).

<u>Example 5</u>

An authorized insurer has tiered commission levels for the licensed insurance broker companies that bring it business. Under this tiering structure, all broker companies receive a basic commission, but certain broker companies allocated to higher tiers receive an additional commission. Both the basic commission and the additional commission (entitled by broker companies in higher tiers) only become payable when the broker company arranges a participating policy with regular premium payments, and both *commissions are determined as a proportion of the premium payable under the policy arranged:*

Policy year	Premium ($)	Basic commission ($)	Additional commission ($)	Total ($)
1	100	65	30	95
2	100	4	4	8
3	100	4	4	8
4	100	4	4	8
5	100	4	4	8
6	100	4	4	8
7	100	0	0	0
8	100	0	0	0
9	100	0	0	0
10	100	0	0	0
				135

Regardless of the difference in name or designation, both the basic commission and additional commission are fundamentally the same in nature. Both fall within the definition of “commission” under paragraph 2.4 of the Practice Note and are therefore subject to the spreading requirement set out in paragraph 3.2.

Accordingly, the commission structure in Example 5 does not satisfy the IA’s minimum expectations of the spreading requirement in paragraph 3.2 of the Practice Note, as commission payable in the first policy year is more than 70% of the total commission payable (i.e. $95/$135 = 70.4%).

The authorized insurer may consider adjusting the amount of basic commission and/or additional commission payable to the broker in the first year and spread the adjusted amount into the following year(s), so that the commission payable in the first policy year is less than 70% of the total commission payable.

Q2: How does the spreading requirement apply to commission and bonus arising from the riders? Does the requirement apply to the basic policy and rider collectively? Or does the requirement apply separately to the basic policy and the rider (i.e. are they treated as if they are separate policies)?

A2: The requirement applies separately to the basic policy and the rider. The insurer should ensure the commission payable and the bonus payable under the basic policy and the rider comply with the spreading requirement respectively.

Q3: What if there are two producing agents for a participating policy?

A3: The spreading requirement applies to the total commission payable in respect of the participating policy. Accordingly, when there are two producing agents, the spreading requirement applies to the total commission payable collectively to the two agents for the policy which has been produced, arranged and serviced. For example, if the two agents are from the same agency team and are subject to the oversight and management by the same agent manager, the insurer is expected to ensure that the total commission collectively payable to the two producing agents AND the agent manager satisfies the spreading requirement in paragraph 3.2 of this Practice Note.

Q4: Assume that a participating policy has an 8-year premium payment term and the original commission structure is as follows:

Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
$50	$10	$10	$10	$10	$10	$0	$0

If the policy is cancelled, lapse or is surrendered before the third-year premium is paid, leading to the first-year commission exceeding 70% of the actual total commission paid (i.e. $50 / ($50 + $10) = 83.3%), is the insurer expected to clawback the first-year commission so as to ensure the spreading requirement in paragraph 3.2 of this Practice Note is satisfied?

A4: The spreading requirement in paragraph 3.2 of this Practice Note applies to the commission structure, with the objective of prohibiting remuneration structures that pay overly high commission in the initial years of the policy term. While the IA expects authorized insurers to implement adequate controls to monitor irregularities arising from policies ending pre-maturely, it is not the IA's intention to require a clawback of the first-year commission (or any portion of it) in this situation, provided the commission structure satisfies the spreading requirement at the outset (as is the case in this example).

Q5: Paragraph 4.2(b) of the Practice Note indicates that a volume-based bonus that is contingent on a minimum business volume being reached, is not subject to the spreading requirement in paragraph 3.2 if it is also determined by additional factors that evaluate the insurance agent's performance in terms of treating customers fairly. How is this bonus payable different from the basic commission that is directly attributable to the sale of a particular participating policy (which is subject to the spreading requirement)?

A5: The objective of the spreading requirement in paragraph 3.2 is to set the IA's minimum expectations on how to ensure commission structures would not produce misalignment between (i) the interests of policy holders to receive both pre-contract servicing and ongoing servicing and (ii) the duty and incentive for insurance intermediaries to provide both sets of servicing, on participating policies with regular payment terms. The spreading requirement in paragraph 3.2 of this Practice Note aims to reduce this misalignment of interests by making a material amount of the total commission only payable in the 2nd and ensuing policy years (rather than it all being paid upfront) to incentivize ongoing servicing.

A bonus that is purely contingent on a minimum business volume (e.g. a total amount of premium on policies produced and arranged) being reached, clearly incentivizes and rewards only pre-contract servicing but not ongoing servicing. This is, however, not the only issue with these types of pure volume-based bonuses. Whereas basic commission that is payable on the arrangement of an insurance policy, rewards and incentivizes the production and arrangement of the policy, a purely volume-based bonus risks turbo-charging this incentive to such an extent that it may induce an insurance agent to sell aggressively in order to meet a sales target to trigger the bonus. It is to mitigate against this risk (which clearly arises from, among other matters, incentivizing pre-contract servicing i.e. selling, to the detriment of post-contract servicing) that such bonuses – if they are paid at all – must be made subject to the spreading requirement in paragraph 3.2 of the Practice Note.

The only exception to this would be where the bonus is determined not only based on business volume, but also on factors that evaluate the insurance agent's performance in terms of treating customers fairly and provided those additional factors are sufficient not only to mitigate the risk of aggressive selling, but also incentivize the conduct of both pre-contract servicing and post-contract servicing in line with the conduct requirements in the insurance regulatory framework. In view of its contingent nature, the IA also expects that the amount of the bonus (as a proportion of the insurance agent's overall remuneration) should not be so substantial such as to distort the insurance agent's duty to provide both pre-contract servicing and post-contract servicing.

The IA will closely scrutinize the bonuses payable which are calculated based on a portfolio of policies in its inspection and other work going forward. Authorized insurers are cautioned that any attempt to circumvent the spreading requirement (e.g. by trying to disguise a commission that should be subject to the spreading requirement as a kind of remuneration that is not subject to spreading requirement) will be viewed as non-compliant and may result in regulatory actions. Such regulatory action will not be confined to the authorized insurers themselves, but may also extend to the key person(s) responsible for intermediary management function.

Q6: Suppose an authorized insurer engages all three distribution channels (i.e. individual insurance agents, insurance agencies, and insurance broker companies) to promote its participating policies, and it is considering remunerating these intermediaries through different commission arrangements. Are there any tips to help visualize which types of commissions, under each distribution channel, are subject to the spreading requirements?

A6: The spreading requirements applicable to each distribution channel are summarized in the following table for easy reference:

Distribution Channel	Commission	Exception: Overriding Commission	Exception: Volume-based Bonus Commission
- Individual insurance agents (producing agents)	√	not applicable	⍻
- Individual insurance agents (agent mangers)	√	⍻	⍻
- Insurance agencies	√	not applicable	⍻
- Insurance broker companies	√	not applicable	not applicable

√ Subject to the spreading requirement

⍻ Subject to the spreading requirement if it is solely based on business volume without considering additional factors related to treating customers fairly. However, if such factors are taken into account, then it will not be subject to the spreading requirement