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INSURANCE ORDINANCE (Chapter 41)

Pursuant to section 133(1) of the Insurance Ordinance (Chapter 41), the Guideline on Establishment and Maintenance of Fund(s) in respect of Participating Business (GL34) is published by the Insurance Authority.

The Guideline shall take effect on 1 July 2024.

14 June 2024

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**GUIDELINE ON
ESTABLISHMENT AND MAINTENANCE OF
FUND(S) IN RESPECT OF
PARTICIPATING BUSINESS**

Insurance Authority

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1. Introduction

- 1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) (“the Ordinance”) and sets out the Insurance Authority’s (“IA”) expectations for sound and prudent business practices to be implemented and followed by authorized insurers in establishing and maintaining funds in respect of participating business. This Guideline also takes into account the Guideline on Underwriting Long Term Business (other than Class C Business) (GL16) issued by the IA, and the Insurance Core Principles, Standards, Guidance and Assessment Methodology (“ICP”) promulgated by the International Association of Insurance Supervisors, in particular ICP 19 which stipulates that in their conduct of insurance business, insurers should treat their customers fairly.
- 1.2 Pursuant to section 21B of the Ordinance, participating business refers to any long term business in relation to which a policy holder has a right to receive, at the discretion of the insurer, a financial benefit that is determined based on a profit-sharing mechanism as a share of the insurer’s profits in respect of the insurer’s business or a part of the insurer’s business. An authorized insurer must maintain at least 1 separate account and 1 separate sub-fund for its participating business (“participating fund”). Insurers should always uphold the principle of equitable and fair treatment of customers in managing a participating fund.
- 1.3 Whenever an authorized insurer exercises its discretion in the management of its participating business, it should pay due regard to the interests of policy holders. It should also take reasonable care to ensure the policy holders are treated fairly and the participating business is managed in a sustainable manner. It should not provide any undisclosed, or otherwise unfair, advantage to shareholders or to other stakeholders of the participating fund(s).
- 1.4 This Guideline focuses on the minimum standards and practices for governance of participating funds. An authorized insurer to which this Guideline applies should clearly document the manner in which this Guideline is complied with in its corporate policy on governance of the participating business, as approved by its Board of Directors (“Board”)

and demonstrate its adherence to such corporate policy to the IA upon request. The IA may require the insurer to appoint an independent person to assess whether the policy has been applied consistently, effectively and fairly.

- 1.5 It is the duty of the controllers (as defined in section 13A(12) of the Ordinance) of an authorized insurer to ensure the insurer observes the requirements set out in this Guideline in carrying out any participating business. Further, it is the duty of the Board to maintain adequate oversight over the implementation of measures in compliance with this Guideline and, having fully considered the advice of the actuary appointed by the insurer in relation to its long term business under section 15AAA(1)(a) or (b) of the Ordinance (“Appointed Actuary”), the Board is ultimately responsible for ensuring fair treatment of customers.
- 1.6 A failure to comply with or any circumvention of the requirements in this Guideline may adversely impact on the IA’s opinion of the continued fitness and properness of the controllers and directors of the authorized insurer in question. The IA may also take guidance from this Guideline in considering whether there has been an act or omission by an insurer that is likely to be prejudicial to the interests of policy holders or potential policy holders (albeit the IA will always take account of the full context, facts and impact of any matter before it in this respect). The IA may also take account of the standards and practices in this Guideline in considering whether grounds exist to exercise any intervention powers under the Ordinance, including the appointment of a skilled person to prepare a report pursuant to section 32A of the Ordinance.
- 1.7 Save as otherwise expressly stated –
 - (a) terms defined in the Ordinance and its subsidiary legislation shall have the same meaning when used in this Guideline; and
 - (b) authorized insurers should continue to observe GL16.

2. Scope and Application

- 2.1 This Guideline applies to authorized insurers in respect to the participating funds they maintain under section 21B of the Ordinance which comprise the participating business they carry on in Hong Kong¹ (hereinafter referred to as “*applicable participating funds*”). It does not apply to non-HK insurers which (a) have ceased accepting any new insurance business in Hong Kong (i.e. run-off non-HK insurers), and (b) have been granted by the IA a permission under section 22A or a permission for being exempted from this Guideline.
- 2.2 Without prejudice to paragraph 2.1, where an authorized insurer carries on participating business both in and outside Hong Kong, the insurer may choose whether to establish and maintain 1 participating fund or more than 1 participating funds under section 21B of the Ordinance based on the circumstances of its business and operations and taking into account its corporate policy on identifying assets to support its participating business and defining its profit-sharing mechanism.
- 2.3 An authorized insurer should apply the level of granularity that is fit for the purpose of defining its profit-sharing mechanism so long as the mechanism is incorporated in its corporate policy on governance of the participating business as approved by its Board. Such level of granularity does not necessarily need to be the same as that required to meet the requirements in section 21B of the Ordinance or that used for the purpose of determining the MA portfolios under the Insurance (Valuation and Capital) Rules (Cap. 41R).

3. Identification of Assets and Liabilities

- 3.1 For the purpose of establishing and maintaining a participating fund, an authorized insurer is required to identify the assets and liabilities attributable to the participating business.

¹ In other words, this Guideline does not apply to a participating fund which does not comprise any participating business carried on in Hong Kong.

- 3.2 An authorized insurer should have regard to the nature of each distinguishable part of its long term business when determining whether such insurance liabilities are attributable to its participating business.
- 3.3 Any riders, funds on deposit or prepaid premiums attached to a base policy of any long term business should be considered separately from the base policy. However, if according to the profit-sharing mechanism, the riders, funds on deposit or prepaid premiums are expected to have any substantive impact² on the dividend/bonus determination of the participating policies, such riders, funds on deposit or prepaid premiums should be classified as part of the participating business. In such cases, the requirements of this Guideline are applicable to such riders, funds on deposit or prepaid premiums.
- 3.4 Pursuant to section 22 of the Ordinance, an authorized insurer must maintain books of account and other records necessary to identify the assets representing each participating fund maintained under section 21B of the Ordinance and to identify the liabilities attributable to the part of its business for which the participating fund is maintained. (See section 8 of this Guideline for the physical segregation requirements.)
- 3.5 The Board, having fully considered the advice of the Appointed Actuary, should certify that the authorized insurer has on the effective date of this Guideline (“effective date”) identified the assets and liabilities attributable to the part of its business for which each applicable participating fund is maintained, having regard to the principles set out in paragraphs 3.1 to 3.4.

4. Opening Balance

- 4.1 On the effective date, an authorized insurer should ensure that the opening balance of assets in an applicable participating fund is no less than the amount of assets that is attributable to that participating business on the date immediately before the effective date, having taken into

² It should be based on the principle of substance over form, taking into consideration the occurrence and amount of the impact.

account the underlying pool of assets as reflected in the established profit-sharing mechanism for dividend/bonus determination.

- 4.2 When determining the opening balance of an applicable participating fund, any changes made by an authorized insurer since 1 January 2019 to the basis for determining the amount of assets attributable to the participating business and any one-off distributions made by an insurer since 1 January 2019 from the participating business, that serve to accelerate the release of surplus asymmetrically to shareholders prior to the effective date would be considered to be an exceptional case. The insurer should seek opinion from an external independent person about the change of basis and/or the one-off distribution in accordance with paragraph 9.10.
- 4.3 From the effective date onwards, if the amount of assets in an applicable participating fund is insufficient to cover the liabilities attributable to that participating business, having regard to the requirements under this Guideline and section 22 of the Ordinance, the authorized insurer should promptly transfer additional assets into the fund to make good the deficit. The insurer should also comply with the requirements relevant to capital support as set out in section 7 of this Guideline.
- 4.4 The Board, having fully considered the advice of the Appointed Actuary, should certify the sufficiency of the opening balance of each applicable participating fund, having regard to the principles set out in paragraphs 4.1 to 4.3.

5. Expenses and Charges

- 5.1 The allocation of any costs by an authorized insurer, whether as expenses or charges, to an applicable participating fund, as well as within an applicable participating fund, e.g. among the sub-funds or cohorts, or between in-force and new business, has to be fair, equitable and reasonable. The allocation is considered fair, equitable and reasonable if:
 - (a) the allocation is in line with the interests of the relevant policy holders;

- (b) the costs are necessary to cover the ongoing operations of the fund or sub-fund; and
- (c) the costs are justified by the expected benefit to the relevant policy holders.

5.2 An authorized insurer may only allocate to an applicable participating fund costs which are incurred for operating the fund. This may include a fair and proportionate share of overheads attributable to the management of the participating business. Having regard to the principle of substance over form, charges that are not commensurate with the costs of operating the participating business are considered as profit in nature and should be treated as allocations of distributable surplus/profits to shareholders (thus subject to the requirements set out in section 6). An insurer should perform appropriate analysis to ascertain whether the charges are commensurate with costs that are required for operating the participating fund. The cost analysis performed should be proportionate to the nature, scale and complexity of the charges³.

5.3 In the case of allocating costs arising from related party transactions, an authorized insurer should assess whether such costs are charged at arm's length. Expenses or charges that are artificially inflated are considered not commensurate with the costs of operating the participating business. Attention should also be paid to the basis of allocating intragroup expenses.

5.4 The IA expects an authorized insurer to be able to justify any costs allocated to an applicable participating fund, based on appropriate analysis with proper documentation that demonstrates the expected benefit to the relevant policy holders if incurring such costs. Disproportionate expected benefit to the shareholders versus to the relevant policy holders may cast doubt on whether such costs incurred are genuinely necessary for the policy holders and if they are attributable to the participating fund. Attention should also be paid to whether any one-off or exceptional costs should be allocated to the participating fund.

³ For instance, charges for guarantees and/or capital are considered as examples of more complex charges.

- 5.5 An authorized insurer should not allocate to an applicable participating fund any costs that comprise, directly or indirectly, any of the following:
- (a) fines or penalties imposed by the court, a regulatory authority or a law enforcement agency;
 - (b) expenses or charges incurred in relation to activities in breach of any regulatory requirements, including payments to a skilled person to produce a report required by a regulatory authority, if the report indicates that the insurer has, or may have, failed to satisfy its regulatory obligations; or
 - (c) payments of compensation or redress due to policy holders for any act or omission for which the insurer should be responsible.
- 5.6 The basis and justification for determining the allocation of expenses and charges to an applicable participating fund, as well as among the sub-funds or cohorts within an applicable participating fund, should be set out clearly in the authorized insurer's corporate policy and endorsed by its Board. Such policy should have regard to the principles set out in paragraphs 5.1 to 5.5 and map out a clear framework for assessing the nature of different types of expenses and charges.
- 5.7 The Appointed Actuary should, annually or more frequently if it is required, provide a written opinion to the Board on whether the expenses and charges are allocated to each applicable participating fund, or each sub-fund or cohort within an applicable participating fund, in a fair, equitable and reasonable manner, having regard to the principles set out in paragraphs 5.1 to 5.5.
- 5.8 An authorized insurer should demonstrate compliance with the principles set out in paragraphs 5.1 to 5.5 to the IA upon request.

6. Allocation of Distributable Surplus/Profits

- 6.1 In respect of each applicable participating fund, an authorized insurer should establish a clear framework for allocating distributable

surplus/profits based on a defined profit-sharing mechanism. The allocation of distributable surplus/profits arising from the participating business to policy holders and shareholders, as well as among different groups of policy holders, should be:

- (a) fair and equitable;
- (b) in line with the reasonable expectations of policy holders;
- (c) sustainable; and
- (d) compliant with the corporate policy on governance of the participating business as approved by the Board.

6.2 Examples of allocation of distributable surplus/profits to participating policy holders include any payment of cash dividends/bonuses, payment of terminal dividends/bonuses, and declaration of reversionary bonuses in the form of a permanent addition to policy benefits.

6.3 Any allocation of distributable surplus/profits, arising from the part of long term business for which an applicable participating fund is maintained, to shareholders should be in line with the interests of policy holders. An authorized insurer should ensure a fair balance of risk and reward⁴ between participating policy holders and shareholders, and among different groups of policy holders.

6.4 Further to the principles set out in paragraph 6.1, any distributable surplus/profits, arising from the part of long term business for which an applicable participating fund is maintained, should generally be allocated to policy holders and shareholders, as well as among different groups of policy holders, in a systematic and rational manner. An authorized insurer should strike an appropriate balance between ensuring fair payouts to exiting policy holders and the security of benefits for continuing policy holders in an applicable participating fund.

⁴ For example, it would be questionable whether it is fair to the interests of the policy holders if participating policy holders bear most of the insurance/investment risks while shareholders are expected to receive a disproportionately high portion of the distributable surplus/profits through elevated fixed or upfront profit charges.

- 6.5 An authorized insurer should not accelerate the distribution of surplus/profits from an applicable participating fund asymmetrically to shareholders⁵, unless it can be ascertained that the distributions, individually or cumulatively, are unlikely to result in any material adverse effect on the security of policy holders' contractual rights and their reasonable benefit expectations, including the prospects of non-guaranteed benefits, or the financial soundness of the fund.
- 6.6 For any prior allocation of distributable surplus/profits to shareholders that is related to declared dividends/bonuses but yet to be transferred out of an applicable participating fund, the corresponding balance and subsequent transfers out of the fund should be tracked and reported to the IA on an annual basis.
- 6.7 The basis and justification for determining an allocation of distributable surplus/profits arising from the part of long term business for which each applicable participating fund is maintained, to policy holders and shareholders, as well as among different groups of policy holders, should be set out clearly in the authorized insurer's corporate policy on governance of the participating business as approved by its Board. Such policy should have regard to the principles set out in paragraphs 6.1 to 6.5, and provide sufficient details that allow the IA and any other knowledgeable independent reviewer to assess the insurer's ongoing compliance with those principles. Such policy should also be consistently applied from year to year and not be subject to arbitrary changes.
- 6.8 The Appointed Actuary should submit a report to the Board recommending an allocation of distributable surplus/profits arising from the part of long term business for which each applicable participating fund is maintained, annually or more frequently if it is required, and the recommendations should be justified based on the principles set out in paragraphs 6.1 to 6.5.
- 6.9 An authorized insurer should demonstrate compliance with the principles set out in paragraphs 6.1 to 6.5 to the IA upon request.

⁵ Including any profit charges, referred to in paragraph 5.2, which accelerate shareholder distributions.

7. Capital Support

- 7.1 In cases where capital support is provided by shareholders to an applicable participating fund, the amount of the financial support provided, along with any terms and conditions governing its use and withdrawal, should be clearly documented with proper oversight and governance by the Board. In applying such oversight, the Board should always uphold the principle of fair treatment of customers.
- 7.2 Any capital support provided to an applicable participating fund may only be withdrawn, with the approval of the Board, having fully considered the advice of the Appointed Actuary.

8. Physical Segregation of Assets

- 8.1 Subject to paragraph 8.2, an authorized insurer is required to physically segregate assets attributable to the part of its business for which an applicable participating fund is maintained separately from its other long term business. At minimum, the physical segregation requirement applies to each of the applicable participating funds. An insurer may also, if it wishes, maintain multiple physically segregated sub-funds within one applicable participating fund, in line with its corporate policy on governance of the participating business.
- 8.2 If an authorized insurer's total amount of insurance liabilities (gross of reinsurance) of all applicable participating funds is less than HKD 1 billion as at the effective date, the insurer is exempted from the requirement to physically segregate each of its applicable participating funds from its other long term business (albeit the insurer is encouraged to physically segregate each of its applicable participating funds for the sake of proper management of the fund). If the insurer's total amount of insurance liabilities (gross of reinsurance) of all applicable participating funds increases to HKD 1 billion or above for 4 consecutive reported quarters subsequent to the effective date, the insurer is required to physically segregate each of its applicable participating funds from its other long term business within 6 months from the end of the fourth such reported quarter. Once an insurer has physically segregated its applicable

participating fund(s), the insurer should continue to maintain the physical segregation even if the amount of liabilities may subsequently fall below the HKD 1 billion threshold.

8.3 To avoid doubt, the requirements on establishing and maintaining participating funds under sections 21B to 23 of the Ordinance, together with the requirements under this Guideline (save for the requirements on physical segregation of assets) equally apply to those applicable participating funds which are exempted from the physical segregation requirements described in paragraph 8.2. Despite exemption from the physical segregation requirements, the relevant authorized insurer is still required to earmark⁶ the assets attributable to each applicable participating fund at minimum, or at a more granular level (than at the participating fund level) for the purpose of determining dividends/bonuses.⁷

8.4 For the purpose of physical segregation of assets, an authorized insurer should maintain separate custodian/bank account(s) to hold the assets for each of its applicable participating funds. The insurer should also establish policies and mechanism such that the separate custodian/bank account(s) can be distinguished for each of its applicable participating funds. For non-HK insurers (other than designated insurers and those insurers being exempted under paragraph 2.1), the custodian/bank accounts should also be identified specifically as accounts of the Hong Kong branches of these insurers. The following assets⁸ are exempted from being held in such custodian/bank accounts, but are still required to be earmarked in the name of the relevant applicable participating fund(s) and properly recorded in the insurer's books and accounts:

- land and buildings directly held by the insurer;

⁶ "Earmark" refers to assigning or designating an asset for a specific purpose. Once the asset is earmarked for the purpose of supporting participating business, it should remain designated for such purpose unless changes arise from transactions.

⁷ To avoid doubt, any MA portfolios of participating business without physical segregation are not eligible for applying the long term adjustment of the matching adjustment under rule 24 of the Insurance (Valuation and Capital) Rules (Cap. 41R).

⁸ These assets are generally considered as unable to be held under custodian/bank accounts or unable to be split into separate custodian/bank accounts from other parts of the business due to regulatory or legal restrictions.

- loans and receivables;
- bonds under Northbound Bond Connect;
- right-of-use asset; and
- deferred tax asset.

8.5 Assets held through a third party⁹ and over-the-counter derivatives entered with a third party are considered to be physically segregated where the third party establishes a separate fund account for each applicable participating fund. Where this approach is not feasible, as an alternative, the statements from the third party need to be able to demonstrate the separation of the amounts or units identified for each applicable participating fund, and there should exist sound governance procedures in respect of exchange of assets between different funds, having taken into account the controls within the authorized insurer’s operation as well as those between the insurer and the third party.

8.6 When making allocation of assets that are subject to the exemptions from the requirement for maintaining separate custodian/bank accounts as specified in paragraph 8.4, the basis and justification for the allocation should be set out clearly in the authorized insurer’s corporate policy on governance of the participating business or relevant fund management policies and procedures, and applied consistently.

8.7 An authorized insurer is required to designate an approving authority within the insurer for the transfer of assets out of an applicable participating fund (including any applicable participating fund exempted from the physical segregation requirements under paragraph 8.2). Transfer of assets includes any withdrawal of assets from the fund and exchange of assets with businesses outside of the fund¹⁰. The insurer should establish approving authority for the transfer of assets based on, for example, different nature of assets or different threshold amounts, having taken into account its controls and governance policy. As a

⁹ “Third party” refers to financial institution, fund house, asset management company, or investment vehicle.

¹⁰ Section 23 of the Ordinance states that an authorized insurer must only exchange assets at fair market value.

general principle, the larger the amount¹¹ of the transferring assets or the more complex the transaction, the more senior level the approving authority¹² should be. The insurer should also have necessary controls in place so there is a check and balance between the signatories of the custodian/bank accounts and the approving authority for the transfer of assets out of an applicable participating fund. The insurer should justify the approving authority to the IA upon request.

8.8 Where there is any interfund balance arising from an operational time gap (for example, premiums collected from policy holders in a common bank account of an authorized insurer before the monies are transferred to corresponding funds' accounts, or other kinds of intermediate steps for transfer between funds), the insurer should settle the interfund balance with financial assets swiftly, and in any event within 3 months. The shorter the operational time gap the better.

8.9 An authorized insurer should have clear operational policies and procedures on the settlement of interfund balance, including proper controls as well as frequency for the settlements, in order to ensure the interfund balances are settled swiftly and accurately.

9. Independent Report of the Establishment of Participating Fund(s) upon the Commencement of the Insurance (Amendment) Ordinance 2023

9.1 An authorized insurer is required to submit to the IA, in respect of each of its applicable participating funds, certification signed by its Board as specified in paragraphs 3.5 and 4.4 and supported by an independent report by 31 March 2025 (i.e. within 9 months of the commencement of the Insurance (Amendment) Ordinance 2023).¹³

¹¹ Authorized insurers may consider the threshold on individual basis or accumulated basis if such individual amounts should be treated as a whole in substance.

¹² For example, Appointed Actuary, senior management or Board.

¹³ As for other participating funds established under section 21B of the Ordinance which do not comprise any participating business carried on in Hong Kong, authorized insurers should ensure the establishment is appropriate with proper books and records.

9.2 The independent opinion should provide the level of granularity that is at least consistent with the applicable participating fund(s) established under the Ordinance. An authorized insurer can also opt to supply the independent report at a more granular level having regard to how the insurer manages the applicable participating fund(s).

Requirements of the person to provide the independent report

9.3 An authorized insurer should appoint an external independent person (“Independent Professional”) to provide an independent report under this section 9, who should be qualified, capable and experienced with regard to the scope of the independent report.

9.4 For the purposes of this section 9, the IA expects the Independent Professional to be –

- (a) A qualified actuary who possesses any of the overseas qualifications prescribed in the Insurance (Actuaries’ Qualifications) Regulation (Cap. 41A) or equivalent, in respect of long term business, or
- (b) A certified public accountant (practising), a CPA firm or a corporate practice as defined by section 2(1) of the Accounting and Financial Reporting Council Ordinance (Cap. 588).

9.5 There is no restriction against the Independent Professional to carry out the independent review jointly with the external auditor of the authorized insurer, provided that there is no conflict of interest¹⁴. A conflict of interest is one which creates a threat to the objectivity and independence of the Independent Professional. Matters to be considered for ascertaining the independence of an Independent Professional include whether, for example:

- the person holds a material financial interest in the insurer;

¹⁴ To avoid doubt, the Independent Professional can be the external auditor, subject to independence assessment.

- the person is a family member or has other personal relationships with the Appointed Actuary, controllers, key persons in control functions, shareholder controllers or senior management of the insurer;
- the person provides non-assurance services that directly involves the preparation of information that is related to the scope of the independent opinion;
- the person is an employee of the insurer; and
- the total fees charged by the person from the insurer represent a large proportion of the total fee income of the person.

Scope and requirements of the independent report

- 9.6 The independent report regarding the establishment of participating fund(s) should be based on the position as at the effective date and at least cover the following areas:
- (a) the identification of assets and liabilities attributable to each applicable participating fund pursuant to section 3;
 - (b) the sufficiency of the opening balance of each applicable participating fund pursuant to section 4;
 - (c) the policy on allocation of costs as expenses or charges pursuant to section 5; and
 - (d) the policy on allocation of distributable surplus/profits pursuant to section 6.
- 9.7 The independent opinion should be based on procedures performed and evidence obtained by the Independent Professional on each of the relevant areas addressed by the opinion. While the nature and extent of the procedures performed and evidence obtained could vary in order to fit the circumstances of the authorized insurer, the below lists out the IA's

minimum expectations. The Independent Professional may perform alternate procedures considered appropriate to achieve the same objective.

(a) Identification of assets and liabilities attributable to each applicable participating fund

- Review the basis and justification for identification of assets and liabilities for each applicable participating fund;
- Review the identification of assets and liabilities having regard to the nature of riders, funds on deposit and prepaid premiums;
- Review whether proper books of account and other data records are maintained to support such identification; and
- Review the assets identified as attributable to each applicable participating fund to match those physically segregated, earmarked or allocated, as the case may be.

(b) Sufficiency of the opening balance of each applicable participating fund

- Review if the opening balance of assets in each applicable participating fund is no less than the amount of assets that is attributable to that participating business on the date immediately before the effective date, according to the corporate policy on governance of the participating business;
- Review the determination of the amount of assets attributable to the participating business on the date immediately before the effective date against the corporate policy governing the management of participating business;
- Review if any changes have been made since 1 January 2019 to the basis for determining the amount of assets attributable to the participating business or any one-off distributions from the participating business since 1 January 2019 which

could constitute an acceleration in the release of surplus asymmetrically to shareholders prior to the effective date;

- Review the sustainability of each applicable participating fund having regard to the illustrated dividends/bonuses, reasonable expectations of policy holders and, assess if any additional capital support may be necessary; and
- Review if the value of assets is no less than the amount of liabilities determined on the basis of Insurance (Valuation and Capital) Rules (Cap. 41R) in respect of each applicable participating fund.

(c) Policy on allocation of costs as expenses or charges

- Review whether a clear policy is in place to provide the basis and justification for determining the allocation of expenses and charges to each applicable participating fund; and
- Review whether the policy, together with any supporting documents, contains both qualitative and quantitative (as appropriate) analysis to justify the allocation of expenses and charges, as well as to identify charges that are profit in nature.

(d) Policy on allocation of distributable surplus/profits

- Review whether a clear policy is in place to provide the basis and justification for determining the allocation of distributable surplus/profits to policy holders and shareholders, and among different groups of policy holders; and
- Review whether the policy, together with any supporting documents, illustrates how the basis and justification are in line with the principles set out in paragraphs 6.1 to 6.5, having regard to any consequential changes arising from the establishment of participating fund(s) upon the

commencement of the Insurance (Amendment) Ordinance 2023.

- 9.8 In a case where the independent opinion indicates that the identification of assets and liabilities has been inappropriate, the opening balance has been insufficient, and/or the policy on allocation of expenses/charges or the policy on allocation of distributable surplus/profits has not been clear or justifiable, the authorized insurer should rectify the situation as soon as practicable, and restore each of the applicable participating funds to the position it should be in as if such identification, opening balance or policies had been rectified since the effective date.
- 9.9 The Independent Professional should express opinion in the form of a written report on the following matters:
- (a) whether the authorized insurer has properly identified the assets and liabilities of each participating fund established under section 21B of the Ordinance which comprises participating business carried on in Hong Kong, and any findings that would cast doubt on the insurer's compliance with section 3;
 - (b) whether the insurer has maintained sufficient assets to meet the requirements on the opening balance of each applicable participating fund and any findings that would cast doubt on the insurer's compliance with section 4;
 - (c) whether the insurer has a clear policy in place on allocation of costs as expenses or charges, and any findings that would cast doubt on the insurer's compliance with section 5;
 - (d) whether the insurer has a clear policy in place on allocation of distributable surplus/profits, and any findings that would cast doubt on the insurer's compliance with section 6;
 - (e) if there are any findings in item(s) (a), (b), (c) or (d) which require rectification, details of such findings, rectification taken by the insurer and the outcome after the rectification; and

(f) any limitations and key risks of non-compliance identified.

9.10 Pursuant to paragraph 4.2, the Independent Professional should also provide additional opinion on any changes which the authorized insurer has made since 1 January 2019 to the basis for determining the amount of assets attributable to the participating business and/or any one-off distributions it made since 1 January 2019 from the participating business, that would accelerate the release of surplus asymmetrically to shareholders prior to the effective date¹⁵. The insurer should explain to the Independent Professional the reasons behind the change of basis and/or one-off distributions and justify how, despite such change of basis and/or one-off distributions, the principle of fair treatment of policy holders is maintained and that the change of basis and/or one-off distributions, individually or cumulatively, are unlikely to result in any material adverse effect on the security of policy holders' contractual rights and their reasonable benefit expectations, including prospects of non-guaranteed benefits, or the financial soundness of the applicable participating fund. The Independent Professional should provide opinion on whether such justification is reasonable. If the insurer is unable to provide such justification or the Independent Professional cannot confirm the insurer's justification is reasonable, the change of basis and/or one-off distributions have to be rectified to safeguard the interests of the participating policy holders. In such case, the independent report should provide details of such findings, rectification taken by the insurer and the outcome after the rectification.

10. Commencement

10.1 This Guideline shall come into effect on 1 July 2024.

June 2024

¹⁵ For example, acceleration of the release of surplus asymmetrically to shareholders that results in the reduction of the applicable participating fund amount leftover for further sharing between policy holders and shareholders.