Insurance Intermediaries Quality Assurance Scheme

Long Term Insurance Examination

Study Notes

2011 Edition

PREFACE

These Study Notes have been prepared to correspond with the various Chapters in the Syllabus for the Long Term Insurance Examination. The Examination will be based upon these Notes. A few representative examination questions are included at the end of each Chapter to provide you with further guidance.

Immediately following the descriptions of some aspects of the practice of long term insurance, you will find actual cases of long term insurance claims, which are there mainly to facilitate your understanding of the subject and to make your learning more interesting. The decisions you will find in those cases were based on their particular facts, including the actual wording used in the insurance policies in question. They being decided cases of the Insurance Claims Complaints Bureau (ICCB), it is worth noting that the Insurance Claims Complaints Panel of the ICCB is empowered by the Articles of Association of the ICCB to look beyond the strict interpretation of policy terms in making a ruling. In addition, as far as good insurance practice is concerned, the Insurance Claims Complaints Panel relies heavily on the expected standards set out in The Code of Conduct for Insurers, with particular reference to "Part III: Claims".

It should be noted, however, that these Study Notes will not make you a fully qualified underwriter or other insurance specialist. It is intended to give a preliminary introduction to the subject of Long Term Insurance, as a ***Quality Assurance*** *exercise for Insurance Intermediaries.*

We hope that the Study Notes can serve as reliable reference materials for candidates preparing for the Examination. While every care has been taken in the preparation of the Study Notes, errors or omissions may still be inevitable. You may therefore wish to make reference to the relevant legislation or seek professional advice if necessary. As further editions will be published from time to time to update and improve the contents of these Study Notes, we would appreciate your feedback, which will be taken into consideration when we prepare the next edition of the Study Notes.

First Edition: August 1999
Second Edition: June 2001
Third Edition: January 2005
Fourth Edition: June 2007
Fifth Edition: June 2011

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NOTE

*If you are taking this Subject in the Insurance Intermediaries Qualifying Examination, you will also be required, unless exempted, to take the Subject "**Principles and Practice of Insurance**". Whilst the examination regulations do not require you to take that Subject first, it obviously makes sense to do so. That Subject lays a foundation for further studies and many of the terms and concepts found in that Subject will be assumed knowledge with this Subject.*

For your study purposes, it is important to be aware of the relative "Weight" of the various Chapters in relation to the Examination. All Chapters should be studied carefully, but the following table indicates areas of particular importance:

Chapter	**Relative Weight**
1	10%
2	20%
3	24%
4	24%
5	22%
Total	**100%**

1 INTRODUCTION TO LIFE INSURANCE

1.1 DEFINITION OF LIFE INSURANCE

In the first of an excellent series of textbooks produced by the U.S. Life Office Management Association Inc. (**LOMA**), life insurance (or 'life assurance' in British terminology) is defined as follows:

> "*Life insurance provides a sum of money if the person who is insured dies whilst the policy is in effect.*"

Anybody who has some knowledge about life insurance will be tempted to say "Yes, **BUT**.....". In other words, surely this is too brief an explanation for a financial service that provides a very sophisticated range of savings and investment products, as well as mere compensation for death. Nevertheless, this is apt for the first chapter on life insurance for beginners.

The definition captures the original, basic intention of life insurance: i.e. to provide for one's family and perhaps others in the event of death, especially premature death (i.e. death occurring at such a time that financial hardship will likely be caused to the dependants). Originally, policies were for short periods of time, covering *temporary* risk situations, such as sea voyages. As life insurance became more established, it was realised what a useful tool it was for a number of situations, which would include:

(a) *Temporary needs/threats*: the original purpose of life insurance remains an important element in life insurance and estate planning, as things like children's education, etc. occupy responsible people's thoughts.

(b) *Savings*: providing for one's family and oneself, as a long-term exercise, becomes more and more relevant as society evolves from a tribal, clan, family orientated community to relatively affluent individual independence.

(c) *Investment*: investment is a process of exchanging current resources for expected benefits. The accumulation of wealth and safeguarding it from the ravages of inflation become realistic goals as living standards rise.

(d) *Retirement*: provision for one's own later years becomes increasingly necessary, especially in a changing cultural and social environment.

So our purpose, as we begin this study, is not so much to remember certain facts, but rather to *understand* something of the fundamentals of long term insurance, and to appreciate its role in modern society.

1.1.1 Needs for Life Insurance

Whilst **1.1** above outlines the developing appreciation of the many uses of life insurance, the modern scene tends to look upon available life insurance products from the perspective of meeting various needs. These we may think of as:

(a) *Personal needs*:

(i) dependants' living expenses;

(ii) final (end of life) expenses;

(iii) educational funds;

(iv) retirement income;

(v) mortgage repayment fund;

(vi) emergencies fund (usually needed to meet unexpected expenses);

(vii) disability income.

(b) *Business needs*:

(i) key persons;

(ii) business owners;

(iii) partnerships;

(iv) employee benefits.

1.2 PRINCIPLES OF LIFE INSURANCE

In the Core Subject for this Insurance Intermediaries Quality Assurance Scheme, **"Principles and Practice of Insurance"**, the principles of insurance were studied in detail. By way of reminder, but not detailed comment at this stage, these principles are:

(a) *Insurable Interest*: the legal right to insure;

(b) *Utmost Good Faith*: the requirement to reveal material information;

(c) *Proximate Cause*: determining the effective reason for a loss;

(d) *Indemnity*: providing an exact financial compensation;

(e) *Contribution*: insurers sharing an indemnity payment;

(f) *Subrogation*: the insurer taking over rights against third parties.

1.2.1 Insurable Interest

In simple terms, insurable interest is that relationship with the subject matter of insurance (a person's life, in the case of life insurance) which is recognised at law as giving rise to a legal right to insure that person's life. This is a legal concept that has applied for more than two centuries and is obviously based on common sense. If you have no relationship with a given person, why should you have the right to insure his life and thus *profit* from his death? Some particular points to be noted with this principle are:

(a) **Statutory requirement:** in life insurance, the legal requirement for insurable interest is *derived* from section 64B of the *Insurance Companies Ordinance (ICO).*

(b) **Effect of lack of insurable interest:** Section 64B renders a contract of life insurance void where the person for whose use or benefit or on whose account it is made has no interest.

(c) **Insurable interest in oneself and in spouse:** we all have an insurable interest in *our own lives* for an unlimited amount. In addition, a person is presumed to have an insurable interest for an unlimited amount in the life of his spouse, so that no proof of such an interest is required.

(d) **Insurable interest in others:** to have an insurable interest in other people (i.e. people other than oneself and one's spouse), the law requires some *financial* involvement which could be at risk by the other persons dying. Some examples which may be reasonably common are:

(i) *debtors*: if a person owes you money, you may insure his life for the amount of the loan, plus accrued interest;

(ii) *business partners*: especially where personal services are involved, such as performers and musicians;

(iii) *contractual relationships*: if another person's services have been engaged under contract (booking a singer for a concert, a professional sportsperson, etc.), that person's death may cause the other contracting party to suffer financially. That potential loss is insurable.

Note: This heading would include a type of life insurance known as *Key Person Life Insurance* (or *Key Employee Life Insurance*), where an employer insures the life of an important employee, in case of loss to the business from the employee's death.

(e) **Blood relationships and family members:** in some countries (e.g. in most jurisdictions of the U.S.), a family relationship (brother, sister, parent, child, grandparent, grandchild, etc) is sufficient to constitute insurable interest. This is not true in Hong Kong, where blood relationship in itself is not regarded in law as constituting an insurable interest.

(f) **Statutory extension of insurable interest:** by virtue of Section 64A of the ICO, a *parent or guardian* of a minor (i.e. a person aged under 18) is given an insurable interest in that young person. This is an important exception to the general rule in (e) above. It also means that, apart from one's spouse, only the relationships mentioned (parent/guardian of a minor) constitute insurable interest arising from blood or family connection. An insurance effected on the basis of any other blood or family relationship is technically void (see (b) above).

(g) **Sections 64C and 64D of the ICO:** these Sections have two other important provisions:

(i) the person interested in the life insured, or for whose use or *benefit* or on whose account the contract is entered into, must be *named* in the contract;

(In practice, this provision has not been construed so widely as to include all those who the policyowner intends to benefit by receiving the policy proceeds. Therefore, where a life insurance policy is payable to the executors of the policyowner, no one cares whether the names of the executors and of the persons who are intended to benefit under the will appear in the policy.)

(ii) no more than the amount of the interest the insured (i.e. policyowner) has in the life insured is recoverable under the contract [this provision is significant only where the life insurance concerned is effected on an indemnity basis, credit life insurance being an example (see **2.1.1**a(b)(i))].

(h) **When is the interest needed?:** this is a key question, and very important consequences flow from its answer. The answer is that insurable interest is **only** needed when the contract **begins**, and becomes irrelevant thereafter. What could be the (quite legal) consequences of this? Some examples are:

(i) *Divorce*: a spouse, who insures his/her spouse and then becomes divorced, can keep the policy in force and be perfectly entitled to collect the benefit in due time.

(ii) *Debts*: it is legally possible to insure your debtor, have the debt repaid, keep the policy in force, and be "paid again" in due time by the insurer.

(iii) *Assignment*: a policyowner is capable of assigning a properly arranged life insurance contract to a third party even though the latter has no insurable interest in the life insured, *provided* that this is not a premeditated act of getting round the requirement for insurable interest. The latter act will be ineffective on the grounds that it is done for the purpose of defeating the object of a statute, and the contract is indeed void as from inception because the de facto insured (i.e. the intended assignee) has not the required insurable interest. Therefore, what matters is the intention of the policyowner when he is effecting a life policy. Taking out a life policy with the general intention of assigning it is legitimate, but doing so with the intention of assigning it to a specified person who has no insurable interest in the life insured is another matter.

1.2.2 Duty of Disclosure

This concerns another important insurance principle, that of **utmost good faith**. Put simply, utmost good faith requires the disclosure of all *material facts*, whether the insurer requests them or not. A **material fact** is legally defined as ‘every circumstance which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will accept the risk’. Some points to note:

(a) **What to disclose:** clearly, the insurer wishes to know all important facts, but you **cannot** be expected to disclose what you *reasonably* cannot be expected to know. Some conditions, for example, may be easily recognisable to qualified doctors, but the average layman cannot be expected to self-diagnose and reveal such things.

Case 1 At law insurance applicants are required to disclose material facts to the insurers

Operating a trading firm in the Guangdong Province, the policyowner effected a life insurance policy. He suffered from recurrent fever three months later for over two months, and finally died of cancer. From the medical report of a hospital on the Mainland, the insurer noted that the deceased had complained of tiredness and lack of strength the year before. On the other hand, it also noted that when he was asked in the application form if he had in the past three months experienced or sustained symptoms of tiredness for more than a week, he replied "no". The insurer therefore rejected the claim on account of a material non-disclosure.

The Insurance Claims Complaints Panel (or the “Complaints Panel”) of the Insurance Claims Complaints Bureau felt that it was uncommon for an insurer to ask in an application form whether the applicant had in the past three months experienced or sustained symptoms of tiredness for more than a week. It considered that the policyowner's non-disclosure of his symptoms of "tiredness and lack of strength over a year" was not material enough for the insurer to reject the claim.

Remarks : *Apparently the Complaints Panel’s decision was based on the rules that (1) an insurance applicant is only required to disclose material facts, rather than any facts he is being asked about, and that (2) the scope of “material facts” is restricted by an objective test so that those facts which only a particular insurer deems to be material are not actually material enough to enable this insurer to rely on the principle of utmost good faith.*

Case 2 At law insurance applicants are required to actively disclose to the insurers material facts he knows or should know

The policyowner was diagnosed as suffering from carcinoma of colon nine months after he had taken out a policy. His claims for critical illness benefit and waiver of premium benefit were rejected by the insurer on the grounds that he had not disclosed on the application form the medical history of his obstructive sleep apnoea.

It was noted from the medical report that the policyowner had consulted a doctor for heavy snoring and was first diagnosed as having obstructive sleep apnoea in a sleep study 12 years before his insurance application. He had five follow-up consultations in the following year. Continuous positive airway pressure therapy was recommended which he declined. Since then he defaulted follow-up consultation. He was referred to have sleep study assessment again, one year before the insurance application. It was revealed that the symptoms of snoring and excessive daytime sleepiness had not gone away. Further sleep study was arranged but he did not return for follow up.

The policyowner admitted that he had suffered from obstructive sleep apnoea for a long time, but pointed out that such symptoms were in no way related to his colon cancer. He also emphasised that the symptoms had not affected his work as a bus driver for 20 years and he had passed the annual body check provided by the bus company.

The Complaints Panel learnt from the insurer's underwriting manual that the severity of an applicant's obstructive sleep apnoea and the co-existence of associated diseases would affect the underwriting decisions for the benefits of critical illness and waiver of premium.

As no detailed sleep study had been done to assess the severity of the policyowner's obstructive sleep apnoea, the insurer had no access to information for risk assessment. The Complaints Panel believed that had the insurer been informed of his condition at the time of the insurance application, it would have asked for more related information or arranged further medical examination of the policyowner before accepting the risk. Since the non-disclosed condition was so material as would have affected the underwriting decision of the insurer, the Complaints Panel upheld the insurer's decision to reject the claims.

Remarks: *In face of insurers' declinature of claims on grounds of non-disclosure, the claimants rather frequently argue that the losses in question had no connection with the (alleged) non-disclosures, without being aware that such a connection is not among the criteria for relying on the principle of utmost good faith.*

Case 3 At law insurance applicants are required to disclose material facts to the insurers

The life insured died of tongue carcinoma. Finding out that the deceased was a chronic drinker who consumed 10 cans of beer every day, the insurer declined the death claim on the basis of non-disclosure – to the insurer's question "Have you ever smoked tobacco or taken drugs or narcotics or alcohol as a habit?" on the application form, the deceased replied in the negative.

The deceased's son insisted that his father did not have a drinking habit and would only drink on special occasions. More importantly, there was no direct relationship between alcoholic consumption and tongue carcinoma.

The Complaints Panel's attention was drawn to the medical reports of two different hospitals indicating that the deceased had a habit of taking several cans of beer daily for 30 years and was convinced that the deceased was a chronic drinker. Since this piece of non-disclosed information would be material enough to have affected the underwriting decision of the insurer, the Complaints Panel supported the insurer's decision to reject the claim.

Remarks: *As stated before, in face of insurers' declinature of claims on grounds of non-disclosure, the claimants rather frequently argue that the losses in question had no connection with the (alleged) non-disclosures, without being aware that such a connection is not among the criteria for relying on the principle of utmost good faith.*

(b) **Non-medical application:** if the insurance is arranged without a physical examination of the applicant, the insurer will normally have great difficulty in alleging non-disclosure of a material fact not covered by questions on the application or the personal physician's form.

(c) **Medical application:** if the insurance is arranged with a physical examination of the applicant, the insurer cannot hold against the applicant negligent omissions or mis-diagnosing by the medically qualified person concerned.

Case 4 At law insurance applicants are required to actively disclose material facts to the insurers

The policyowner applied for a life policy and undertook a medical examination at the insurer's appointed clinic. The application was accepted by the insurer at an increased premium. Later, the policyowner passed away due to a ruptured aortic aneurysm and pneumonia. The insurer rescinded the policy from inception as an echocardiogram revealed that the policyowner had suffered from a tachycardia attack, ectopic heart beat and ischcaemic change two years before the insurance application.

The Complaints Panel felt that the policyowner had an onus to disclose all his medical history, even though a medical examination had been provided by the insurer, and therefore upheld the insurer's repudiation of the claim.

Remarks : *Submitting himself to a medical examination as required by the insurer may not constitute full disclosure of the applicant’s medical history and condition to the insurer, unless the nature of such medical examination is such that it will fully reveal such information.*

(d) **Medical tests:** the insurer is entitled to supplement information supplied verbally with reasonable medical examinations or tests, but great care must be taken not to breach the *Personal Data (Privacy) Ordinance*, which requires insurers to explain the need for gathering information before any testing takes place. The subject of the tests also has the right under that Ordinance to be told their results.

(e) **Breach of the duty on the part of the policyowner:** at law, a breach of utmost good faith renders the contract *voidable* by the insurer. But with most life policies in Hong Kong, regard has to be taken of the **Incontestability Provision** (see **4.2**), which means that the policy cannot be contested after it has been in force for a specified period (contestable period), unless there is proof of fraud.

1.2.3 Other Insurance Principles

(a) **Proximate cause:** this principle is concerned with the identification of the dominant, effective cause that produced the loss being claimed for under the insurance. The principle **does** apply to every class of business, but it is very likely to have rather less significance with life insurance partly because of the minimal use of exclusions. The application of proximate cause is very much concerned with different kinds of **perils** (i.e. causes of loss):

(i) *Insured Perils*: are those which **are** covered by the policy. Non-life policies may *specify* the perils which are covered, and one of those must be the **proximate cause** of the loss. In life insurance, the cause of death is not critical, unless a suicide exclusion clause operates or an accidental death benefit rider applies.

(ii) *Excepted* (or *Excluded*) *Perils*: in non-life insurance, all policies will carry some *exclusions*. If one of these operates with a claim, the insurer is not liable. Life insurance policies seldom have exclusions (but see **Note** 1 below).

(iii) *Uninsured Perils*: these are causes of loss which are neither *included* nor *excluded*, for example water damage with fire insurance. If property is damaged by water (e.g. by rain) with no other cause involved, the damage is **not** covered. But if the water damage is **proximately** caused by an insured peril (say fireman fighting a fire with water hoses), the water damage **is** covered. Such complexities are unlikely to arise with life insurance claims.

Note: 1 *Suicide* is an exception to the general statement that life policies seldom have *exclusions*, so proximate cause will be important in determining whether death arose from suicide or not. **However**, even here the principle does not have full impact, because suicide is only excluded for a limited time period (suicide exclusion period) (see **4.12**).

2 We may conclude that the principles of insurance, **especially** those concerned with **claims**, have less application in life insurance than in non-life insurance.

(b) **Indemnity:** this means an exact financial compensation for the loss sustained and is very important in most General Insurance policies. As far as life insurance is concerned, however,

(i) it is immediately obvious that the policy proceeds (or 'insurance proceeds') in no way pretend to (or can) represent an *exact* financial compensation. That is why life policies are called *benefit policies*, not indemnities;

(ii) it is impossible to *over indemnify*. The insurable interest (closely linked with indemnity) in many cases is *unlimited* (see **1.2.1**(c)).

(c) **Indemnity corollaries:** a corollary is a sub-principle and indemnity has two corollaries, *Contribution* and *Subrogation*.

(i) **Contribution:** in most General Insurance classes, if by some chance a person has more than one policy covering the loss, he does not get paid twice. Each policy *contributes to* (shares) the loss rateably. On the other hand, if he has more than one policy **not** by chance, a vigilant claims handler might well take that as an *indication* of fraud!

Life insurance policies are normally not subject to the principle of indemnity, so it is quite normal for a person to have more than one life policy and each must pay in full upon the insured event happening.

(ii) **Subrogation:** this relates to the legal right of the insurer who has provided an indemnity to take over any remedies the "policyholder" (the UK equivalent of the American term "policyowner") possesses against third parties, to seek to recover his payment to the policyholder. This does not apply to life insurance.

If, for example, a third party negligently damages a person's car (which has comprehensive cover), the person's motor insurer must pay but can attempt to recover its payment from the third party. In that same accident if an innocent victim in the car is killed, his life insurer must pay, but the life insurer has no right of recovery from the third party.

1.3 CALCULATION OF LIFE INSURANCE PREMIUM

The individual premium to insure a given life may have to take into account *individual* features which make the risk better or worse than the average for a person of that age and sex. That, however, is essentially a matter of *underwriting*, which we shall consider in more detail in **5.3**. Life insurance (premium) **rates**, which may be thought of as the normal or standard premiums applicable according to age and sex, are subject to certain common features considered below.

1.3.1 Premium

The classic criteria usually applied to life insurance premiums are that they should be:

(a) *adequate*: so that the insurer will have money to pay the benefit and meet other obligations under the contract; and

(b) *equitable* (fair): so that each policyowner is paying an amount in line with the risk and contracted benefit involved.

To achieve these criteria, a number of factors must be taken into account in the course of rating.

1.3.1a Mortality, Interest and Expenses

(a) **Mortality:** perhaps more accurately phrased as the *Rate of Mortality*, this indicates the rate at which insured lives are expected to die. Whilst this sounds very morbid, it will be immediately obvious that this is absolutely at the heart of life insurance premium calculation. To know, on average, when the life to be insured may be expected to die is a crucial factor in determining the correct premium to charge.

Of course, individual lives may live much longer or shorter than the average, but following the "*law of averages*" (which is sometimes called the "law of large numbers") reasonable predictions and calculations can be made. These are greatly facilitated by the use of **mortality tables**, which are published tables showing the expected rate of mortality at any given age.

As mentioned above, individual risks may call for special terms and consideration, but that is an *underwriting* matter. Premium rating using mortality tables merely deals with *normal* risks and normal expectations.

(b) **Interest:** in very simple terms, life insurance involves collecting money *now* and at specified intervals, to provide for a benefit at some time or upon some event in the *future*. This, by definition, means we have some **time**, and as the old saying goes "time is money"!

How much time we have, on average, largely concerns (a) above. The fact that we have some time means that we have an opportunity for **investment**. The interest earned on invested premiums and previous interest earnings is another crucial factor in determining premium rates. If the anticipated returns of investment are good, an insurer can charge lower premium rates than its competitors, and/or make more profit for its shareholders.

Note: The above two factors combined will produce what is called the *net premium* (sometimes called the **pure premium**), i.e. the money required to be collected from the policyowners just to meet death claims arising in the future under normal statistical expectations. But there is more to consider.

(c) **Expenses:** the **net premium** has to be subject to a *loading* (surcharge or additional sum) to take care of all expected and possible expenses. These will include all internal operating costs, commissions, tax and overheads to which any business is subject. With life insurance, there is also the possibility (however remote) of unusual mortality rates from some new disease or other disaster - and existing premiums **cannot** be increased later to deal with changed circumstances. Loading the net premium will include an amount to cover that kind of contingency.

Note: The **loading** added to the **net premium** produces the *gross premium*, which takes into account all three basic factors mentioned above.

1.3.1b Other Factors

As mentioned, premiums for existing policies cannot be changed. Life insurance belongs to **long term business**, and this implies that the contract not only is very likely to last several years, but also it cannot be cancelled or amended by the insurer without the consent of the policyowner. Therefore, other factors which may arise from time to time can only affect new policy premiums. Some of the influences which might have an effect on life premium rating are mentioned below:

(a) **PAR or NON-PAR:** this is extremely important. One unique feature of life insurance is that the policyowner at the commencement of the contract chooses between a "*participating*" (**PAR**) policy and a "*non-participating*" policy (**NON-PAR**). Owners of participating policies are each entitled to receive a share of (or to "participate" in) the divisible surplus, if any, of the insurer. These are in the form of *dividends*. Participating policies, naturally, are subject to higher premium rates than Non-Participating policies.

Note: 1 While U.S. insurers talk of par and non-par policies and dividends, U.K. insurers issue policies which are either **With-Profit** or **Without-Profit**, and declare bonuses. The concept is the same, although there are differences. *Bonuses* are usually *reversionary* (i.e. payable only when the policy benefit is payable), whereas **dividends** are payable upon annual declarations. Having said that, reversionary bonuses can be surrendered without terminating the policy (see **1.3.2b**(c)(i) for surrender values). Suppose a whole life policy has earned an accumulated reversionary bonus of £5,000. The policyowner is entitled to an *immediate* payment out of such value, but only at a discount. Further suppose that according to the insurer's calculation based on factors such as the current age of the life insured and the expected rates of interest, the *future* bonus value of £5,000 is equivalent to an *immediate* surrender value of £1,000. Then by surrendering, say, half of the accumulated bonus value, the policyowner will be paid £500 immediately.

2 Not all life insurance policies can be **par** or **non-par**. *Term* insurance plans (see **2.1.1**) are normally not on a participating basis.

3 For discussions on distribution of policy dividends, please see **5.2.7**.

(b) **Competition:** no insurer enjoys a monopoly position. What the market is charging cannot be ignored.

(c) **Economic changes:** extended times of affluence or recession will doubtlessly have an impact on all product prices, including insurance.

(d) **Public health:** abnormal developments in this area (e.g. the AIDS epidemic) cannot be ignored in rating.

(e) **Fiscal changes:** a lasting increase in tax levels must be reflected in higher premium rates (although this can only be for **new** clients).

(f) **Company objectives and marketing strategies:** if a company is determined to increase its market share, competitive premium rating is surely one of the possible marketing strategies.

1.3.2 Natural and Level Premium (Pricing) Systems

These systems for life insurance premium calculations might well be described as "*ancient*" and "*modern*", for reasons that will be clear shortly.

1.3.2a The Natural Premium (Pricing) System

The natural premium system (or the natural premium pricing system) was used by some life insurers in the early days of the business. It was very logical, but it was doomed to failure because of built-in features which virtually guaranteed that it could not work long-term in practice. Its features were:

(a) **Premiums:** these were not to be constant throughout the policy term, but individually calculated each year so that they reflected the *natural risk* position (age, etc.) of the life insured at each policy anniversary.

(b) **Short-term consequences:** with increasing age, there is increased mortality risk. Premiums for existing policies therefore increased every year.

(c) **Longer-term consequences:** these, in hindsight, were very predictable and included:

(i) increasing premiums with increasing age and, in later years, decreasing disposable resources or earning power of the policyowner, often presented real problems with continuation of insurance;

(ii) the system was vulnerable to *anti-selection* (also known as **selection against the insurer**), whereby the better risks - those in good health and with real prospects of a long life - dropped out of the scheme as it became more expensive, and the bad risks would normally decide to continue, for obvious reasons. This creates an *imbalance* of risks, with predictable results.

(d) **Present day:** the Natural Premium System is no longer practised, at least not for policies which are truly "long-term".

Note: We may be tempted to be scornful of a scheme which we can now see to have such obvious defects. But it is easy to live life in retrospect. Problems and shortcomings usually only appear through experience.

1.3.2b The Level Premium (Pricing) System

The level premium system (or the level premium pricing system) is now the norm and its features are described below:

(a) **Basic concept:** by the judicious use of **mortality tables** and actuarial calculations, it was realised that it was possible to quote an annual premium that would remain *level* (unchanged) for the duration of the contract, based upon the age, sex and individual underwriting features of the life to be insured. This, of course, assumes that the death benefit also remains unchanged.

Compared with the cumbersome and unsatisfactory features of the **natural premium system**, the advantages and attractiveness of such a system are obvious. It quickly superseded the old system.

(b) **Short-term consequences:** clearly, the level premium system envisages a long-term contract, where an unchanging annual premium will effectively "*average out*" over the years. In other words, the annual premium is "too much" for the risk involved in the early years, and may be "too little" for the risk involved in later years.

Of course this is a simplification, but it is not inaccurate. From this concept, it may be seen that once the initial expenses and costs of setting up the policy have been absorbed, the early "excess" premiums and interest earnings thereon start to create a fund or *reserve* against the future liability.

With other types of insurance, the premium is calculated each year and at the end of the year the premium is considered **fully earned** by the insurer. The life policy, under the **level premium system**, soon begins to build up a cash value for the policyowner.

(c) **Longer-term consequences:** some of the implications and products of (b) above will be examined in more detail in **Chapter 4**, but we may briefly mention the features that developed from the early years' "surplus" premiums found with the level premium system:

(i) **Cash value** and **surrender value:** the insurer cannot cancel a life policy, but the policyowner can. When a policy has been in force long enough to "clear" the set-up costs, part of the premiums paid – after the risk premium for the past period has been deducted – can be considered to be "not yet earned" by the insurer; it is referred to as "cash value". Therefore, when a policyowner cancels a policy with cash value, there should be a sum of money payable to him, representing a refund of premiums "unearned" by the insurer. This sum is known as "**surrender value**". Surrender value equals cash value minus surrender charge, a charge that is applicable when a policy is surrendered for its cash value or when a policy, under some plans, is adjusted to provide a lower amount of death benefit.

Note: This is not true for *Term Insurance* (see **2.1.1**), where the premium is geared only to the risk of death during a specified period of cover. Such policies have no **cash value**.

(ii) **Policy loan:** the **cash value** is excellent *collateral* security for a loan. Borrowing money from the insurer using the cash value as security is now a *right* under modern policy terms.

(iii) **Nonforfeiture:** without specific policy provisions to the contrary, the policy will *lapse* if renewal premiums are not paid. However, the **cash value** may be used voluntarily by the policyowner or sometimes automatically under policy terms, to keep the insurance in force (see **4.5**).

(iv) **Paid-up insurance:** should the policyowner decide that he cannot or does not wish to pay any further premiums, as an alternative to policy surrender he may have what is termed a *fully paid policy*. This means that he pays no more premiums and the policy stays in force exactly as before (so that it continues to be entitled to dividends if it is a participating policy), **except** that the sum insured (the *face amount*) is lower, in line with the *net cash value* and the premiums saved. This is largely possible because the premiums are not "fully earned" by the insurer in the earlier years of the policy.

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Representative Examination Questions

Type "A" Questions

1 *"Life insurance provides a sum of money if the person who is insured dies whilst the policy is in effect."* This quotation:

(a) is completely inaccurate; .....
(b) completely describes all life insurance contracts; .....
(c) does not completely describe all life insurance contracts; .....
(d) is totally misleading and contains no element of truth in it. .....

[Answer may be found in **1.1**]

2 Which of the following represents a legitimate insurable interest for life insurance?

(a) insurance of oneself; .....
(b) insurance of one's spouse; .....
(c) insurance of one's 10-year-old child; .....
(d) all the above. .....

[Answer may be found in **1.2.1**]

Type "B" Questions

3 Which **two** of the following statements are **true**?

(i) A benefit policy is the same as an indemnity policy.
(ii) Most life policies are subject to indemnity, but some are not.
(iii) Life insurance contracts are not normally subject to indemnity.
(iv) Indemnity does not normally apply to life insurance, where benefit policies are prevalent.

(a) (i) and (ii); .....
(b) (i) and (iii); .....
(c) (ii) and (iii); .....
(d) (iii) and (iv). .....

[Answer may be found in **1.2.3**]

4 Which **three** of the following are features in calculating life insurance premiums?

(i) Interest
(ii) Expenses
(iii) Mortality
(iv) Morbidity

(a) (i), (ii) ad (iii); .....
(b) (i), (ii) and (iv); .....
(c) (i), (iii) and (iv); .....
(d) (ii), (iii) and (iv). .....

[Answer may be found in **1.3.1a**]

Note: *The answers to the above questions are for you to discover. This should be easy, from a quick reference to the relative part of the Notes. If still required, however, you can find the answers at the end of the Study Notes.*

2 TYPES OF LIFE INSURANCE AND ANNUITY

To the public and perhaps inexperienced insurance intermediaries, there must seem to be a bewildering variety of life insurance contracts. Certainly, it is a sophisticated and well-developed market, but a few basic guide rules should prove helpful:

(a) **Basic functions:** it is good to distinguish the various products offered by life insurers by what the products seek to *do*. Another way of thinking about that is to ask the question: "Under what circumstances is/are the benefit(s) payable?" Some basic formats are:

(i) payment on death *only if* it occurs during a specified period;

(ii) payment on death *at any time*;

(iii) payment on a *specified date* **or** on *earlier death*.

(b) **Basic variables:** some additions/modifications to the above are:

(i) the type of policy (called the *plan*) may be *convertible*, i.e. able to be **changed** into a different **plan**, at the policyowner's option;

(ii) *renewable*, if originally for a limited time period (e.g. five years);

(iii) **Par or Non-par:** see **1.3.1b**(a);

(iv) various *Riders*, i.e. **endorsements**, may be added to the policy, either to provide *additional cover* or to make certain provisos.

(c) **Basic questions:** much heartache and misunderstanding in the whole business of life insurance selling would be avoided if insurers and insurance intermediaries clearly put the following two questions to potential policyowners (and of course acted in accordance with the answers):

(i) "What do you want the insurance to do for you?", i.e. *what is it for?*

(ii) "How much premium are you able and willing to pay?", i.e. *what can you afford?*

Note: The other basic question "How much life insurance do you need?" is of course important, but this is usually answered by the insurance intermediary rather than the applicant.

Given these important preliminaries, we may now think about specific policy types. We should just say, however, that we shall only be considering an outline of the various covers, so that you may be in a position to identify and broadly distinguish the various types of **plan** available. Professional skill and discrimination can only be obtained through experience.

2.1 TRADITIONAL TYPES OF LIFE INSURANCE

These will consist of the three basic formats mentioned in (a) above, although there are many possible variations and combinations of the different types of cover. The major traditional types we shall consider are as follows:

2.1.1 Term Insurance

Such a policy **plan** provides cover for a specified period or *term* only, and may also be described as **temporary life insurance**. The policy benefit is *only* payable if:

(a) the life insured **dies** during the specified period, or term; and

(b) the policy is **valid** (in force) at the time of death.

In the great majority of cases, term insurance plans run their course without a claim. For these reasons, it is the *cheapest* form of cover available (but, of course, its limitations must be understood).

In theory, the **term** could be for any period of time, even a few hours to cover an aircraft flight, for example. In practice, it is rare to find a term insurance for a period of less than *one year*.

2.1.1a Level/Decreasing/Increasing Term Insurance

(a) **Level term insurance:** this policy plan is perhaps the most popular term insurance. It involves a *level* **death benefit** throughout the policy period. In the event of death during the term, the **face amount** (also known as **face value**) of the policy is payable. The level of annual premium usually remains the same throughout the policy term.

Popular largely because of its simplicity, this is a useful answer to a temporary need which neither increases nor decreases to any significant extent over the period of time involved (perhaps a **loan** which is not being repaid by instalments).

(b) **Decreasing term insurance:** under this plan, the **death benefit** *decreases* annually, or at other specified times. The level of annual premium usually remains the same throughout the policy term. Because the benefit is continually decreasing and is payable only on death during the term, this is the **cheapest** form of life insurance available. It is particularly suited for a temporary need which is *reducing*. Some typical examples are:

(i) **Credit life insurance:** designed to pay the balance of a loan *direct to the lender* should the borrower die before a full repayment of loan has been made. This plan is usually sold to lending institutions on a *group basis* to cover the lives of their borrowers.

(ii) **Family income insurance:** perhaps linked with another policy plan which provides a **lump sum** payment on death, a family income plan provides a stated *monthly* death benefit payable to the beneficiaries for the remainder of a specified period (the total amount payable (i.e. monthly benefit x number of payments) is therefore **decreasing** as time goes by). Suppose a life insured under a 5-year family income plan for a monthly benefit of $1,000 dies at the end of year 4. The plan will pay the beneficiary 12 monthly payments of $1,000 each, totalling $12,000. On the other hand, a death at the end of the 50th month will mean 10 monthly payments of $1,000 each, totalling $10,000.

(iii) **Mortgage redemption (**or **'mortgage protection'**) **insurance:** a typical mortgage loan is reduced by monthly or other periodic payments. Mortgage redemption insurance is a decreasing term insurance designed to provide an amount of death benefit which *corresponds* to the decreasing balance of a mortgage loan. At any rate, the initial face amount and the subsequent reduced amounts are set at the time of purchase on the basis of the plan of repayments. Such a plan may be on a *joint-life basis* (e.g. husband and wife), the benefit being payable when the first life dies. (The major differences between mortgage redemption insurance and credit life insurance are that (a) the former insures the interests of the mortgagors (who may sometimes be required by the mortgagees to name the mortgagees as beneficiaries) whereas the latter insures the lenders' interests, and (b) the former is a benefit insurance so that claims will still be payable even if at the time of death the debt has already been paid off whereas the latter is normally an indemnity insurance.)

Note: The above form of cover must not be confused with **Mortgage Indemnity Insurance**. This is quite different, being an insurance for banks and similar lenders. It covers the possibility of non-repayment of mortgage loans, where the mortgaged property has to be sold in adverse market situations, thereby resulting in a loss to the bank, etc.

(c) **Increasing term insurance:** this plan, as the name suggests, involves a death benefit which *increases* annually or at other intervals. The increases may be at a *fixed percentage*, or in line with an agreed *index* (e.g. Consumer Price Index). The basic idea is to keep the benefit in line with the value of money, especially in case of **inflation**. The premium generally increases in line with the increases in the level of benefit.

2.1.1b Renewable/Convertible Term Insurance

(a) **Renewable term insurance:** at first sight, this seems to be a contradiction, because a **term insurance** is for a fixed period, and this extends the period. The key point, however, is that the right to *renew* the policy is *without submitting evidence* of **insurability** (health) and the **premium** for the further period is *increased* to reflect the increased age of the life insured. (The new premium is said to be based on the **attained age**.)

Because such a plan can involve **anti-selection** (see **1.3.2a**(c)(ii)), there may be some limitations applied, such as:

(i) renewals may only be for equal or *smaller* **face amounts**;

(ii) the *number* of renewals permitted may be restricted (e.g. three times);

(iii) premium rates may be *higher* than those for non-renewable policies.

Frequently, one-year term policies are made renewable, either by a basic policy provision or a **rider**. These have the obvious name *Yearly Renewable Term* (**YRT**) or *Annually Renewable Term* (**ART**) insurance.

(b) **Convertible term insurance:** such a plan includes a *conversion privilege*, which gives the policyowner the right to convert (change) the policy to a *permanent* plan without evidence of **insurability** (health). If this privilege is exercised, the premium for the wider plan must be calculated on the basis of the standard rate for such a plan based on the **attained age** of the life insured.

Because **anti-selection** is again a possibility with these plans, there may be restrictions:

(i) conversion may **not** be possible beyond a certain age (say 55 or 65);

(ii) conversion may **not** be possible after the policy has been in force for say 50% of its specified term (or a specified number of years);

(iii) the **face amount** of the new plan (**permanent insurance**) will be limited to that for the term insurance (probably less after the term policy has been in force for some specified time).

2.1.2 Endowment Insurance

An endowment plan provides for the payment of the **face amount** at the end of a specified **term** *or upon earlier death*. Should the life insured survive the term, the policy is said to **mature**. Thus, a claim may arise under such a plan either by **death** or **maturity**. As with a term insurance, the description of the policy must include reference to the number of years of the term involved, e.g. a 20-year endowment provides for payment of the face value (also known as face amount) after 20 years (on maturity) or upon earlier death. Features to be noted with this plan are:

(a) **Premiums:** are not cheap, since under normal circumstances a claim **must** arise *not later than* the specified number of years in the future; premiums are **level**, normally paid annually, although *single premium* endowments are possible;

(b) **Technically:** the plan is a **combination** of a *term insurance* and a *pure endowment* for equal amounts. (A **pure endowment** is a contract under which the benefit is *only* payable if the life insured **survives** the term);

(c) **Par or non-par:** such a plan may be on a participating (**with-profit**) or non-participating (**without-profit**) basis, at an appropriate premium;

(d) **Popularity:** because in principle such a plan provides the best of both worlds (premature death protection and personal savings for the life insured if the policy matures), these have an apparent attraction. However, probably because of the relatively high cost of premiums, such plans do not have great popularity here, or in many other markets at present.

2.1.3 Whole Life Insurance

Such a plan, quite literally, involves a policy that is designed to last *the whole of one's life* (sometimes it is called **whole of life** insurance). The fundamental feature is that the face amount is paid on *death*, whenever that occurs, and **not** before. Such policies, therefore, may be in existence for many years, even several decades. The relevant features to note are:

(a) **Premiums:** are **level**, but may be subject to different provisions, including:

(i) *payable throughout life*: in which event the policy may be called a **straight life** insurance, or a **continuous premium** whole life policy;

(ii) *payable for a limited period*: the policy may specify a number of years, after which no more premiums are payable, although the benefit is not paid until **death** takes place;

(iii) *premium subject to an age-related limitation*: instead of specifying the number of years, the policy may stipulate a certain age (say 65) after which no more premiums are required. As with (ii) above, no further premiums are payable if death occurs before the specified years/age;

(b) **Par or non-par:** either form of cover is permissible;

(c) **Variations:** many variations are possible, such as *premiums* which **increase**, or *face amounts* which **change**, at specified times during the policy's life, to cater for different needs as time goes by. One such variation is called a *graded-premium policy,* where the premium increases (against a level **face amount**) on a regular basis, say every three years, until it reaches an amount that becomes the level premium for the rest of the life of the policy.

2.2 NON-TRADITIONAL TYPES OF LIFE INSURANCE

Life insurance, more or less in its present form, has been practised for approximately 400 years. During that time, the basic policy formats have become very established and they still form a practical and useful role in providing this important form of cover. However, the pattern of economic and social life does not stand still and new products have been developed, often providing a more flexible approach to life insurance cover and associated investment. We look at two such examples.

2.2.1 Universal Life

In an attempt to provide greater consumer choice and flexibility, this product has been developed. It has been well described as a life insurance contract which:

(a) is subject to a *flexible premium*;

(b) has an *adjustable benefit*;

(c) has an "unbundled" pricing structure; and

(d) accumulates a *cash value*.

We examine these and other features of this innovative product:

(a) **Flexible premium:** subject to certain limits, the policyowner may pay *more* or *less* than the premium stated in a given year, after the first year. At his option, he can even omit premium payment for a particular year (again subject to certain conditions). Of course, the amounts of coverage and cash value depend on how much premium is paid.

(b) **Adjustable benefit:** subject to certain limits, the death benefit purchased may be *increased* or *decreased*, although proof of **insurability** may be required for an increase in benefit.

(c) **"Unbundled" pricing:** the insurer separates and individually discloses, both in the policy and in an *annual report* (see (f) below) to the policyowner, the three basic pricing factors, i.e.:

   (i) the **pure cost** of protection (covering the death risk);

   (ii) **interest**; and

   (iii) **expenses**. (The calculation of life insurance premiums includes an item for **expenses**, called *loading* (see **1.3.1a**(c)). Normally this is not disclosed to the policyowner, but with universal life insurance the expenses and other charges element is specifically disclosed to a purchaser.)

(d) **Cash value:** the intention is that the policy should acquire an increasing *cash value*. This of course is heavily influenced by the amount of premiums paid by the policyowner. After the first premium payment, additional premiums (subject to an individual limit) can be paid at any time. These, with interest earnings, are added to the cash value after the deduction of:

   (i) a specified percentage *expense charge*; and

   (ii) the *pure cost* of protection (deducted monthly).

(e) **Death benefit:** according to the plan the policyowner chooses, this may be a *face amount* plus the **cash value**, or the face amount only. For a given face amount and given premium amounts, the former option will mean a *lower* rate of accumulation of cash value because the insurer needs to be compensated for running a risk of paying out a *higher* amount of death benefit.

(f) **Annual report:** each year the policyowner receives a report which shows the *status* of the policy. The information given includes:

(i) the *death benefit option* selected (see (e) above);

(ii) the specified *amount* of insurance in force;

(iii) the *premiums paid* during the year;

(iv) the *expenses deducted* during the year;

(v) the **guaranteed** and *excess interests earned on* the cash value;

(vi) the *pure costs* of insurance deducted;

(vii) policy loan outstanding;

(viii) cash value withdrawals; and

(ix) the **cash value** *balance*.

It will be seen that this is a sophisticated product, allowing great choice to the policyowner to adjust his insurance according to his needs and financial resources as time goes by. Insurance intermediaries are advised to consult the insurers on local forms of this modern insurance plan.

2.2.2 Unit-Linked Long Term Policy

Also known as “linked long term policy” and “investment-linked long term policy”, the unit-linked long term policy is one whose value is *directly* linked to, or *directly* reflects, the performance of the investments that have been purchased with the premiums paid. This may be achieved by formally linking the policy value to **units** in a special *unitised fund* run by the insurer, or to **units** in a *unit trust*. The value of the units is directly related to the value of the underlying assets of the fund or unit trust. Because of such linkage, the policy value naturally *fluctuates* according to the overall movements of those assets.

A detailed study of this sophisticated financial product is beyond the needs of this study and is instead within the scope of the Paper 'Investment-linked Long Term Insurance'. The following features of the product suffice for your study here:

(a) **Common principle:** unit-linked policies may come in a variety of forms, but there is a common factor. All or part of the premiums will be used to purchase *units* in a fund at the price applicable at the time of purchase. The value of the policy will then fluctuate according to the value of the units allocated to it.

(b) **Types of funds:** a variety of funds may be used for linking purposes, including *equities* (ordinary shares), *fixed interest* investments and a whole range of cash and other asset funds.

(c) **Types of policy:** in theory, any kind of life insurance product may be unit-linked. The most common in practice are *whole life* and *endowments*, sometimes with a **guaranteed** minimum value, however unit prices may move.

Special care must be taken with products which are essentially investments, so that the consumer is aware that values may go up or down. This aspect is considered more in **5.2.6**.

2.3 ANNUITIES AND PENSIONS

Each refers to income or other financial provision (usually) for retirement or old age. A definition of each term is:

(a) **Annuity:** a contract whereby an insurer promises to make a series of periodic payments (called "annuity benefit payments") to a designated individual (called "payee") throughout the lifetime of a person (called "annuitant") or for an agreed period, in return for a single payment or series of payments made in advance (called "annuity considerations") by the contractholder (or "annuity purchaser"). Very often, the payee, annuitant and contractholder are the same person.

(b) **Pension:** a plan to provide for a monthly (or other periodic) income benefit to a person in retirement, until his death. It may consist of an annuity.

2.3.1 Annuities

Under a simple annuity plan, the balance of the annuity considerations paid is "lost" if the **annuitant** dies before their exhaustion. This has very little public appeal, especially in Hong Kong, so annuities are not commonly found in practice. They have their uses, particularly with elderly people with a reasonable to considerable amount of capital and no living dependants or close family. In such circumstances, a guaranteed income for life may have its attractions, especially in view of the consequent removal of the temptation to spend the capital at an excessive rate.

Some features to be noted with annuities are:

(a) **Immediate annuity:** usually purchased with a single payment, the annuity benefit payments begin one annuity period (time span between one payment and the next in the series; say, one month) immediately thereafter.

(b) **Deferred annuity:** the annuity benefit payments begin at some specified time or specified age of the annuitant.

(c) **Variations:** a number of possible variations exist. One provides for annuity benefit payments to be made for a *fixed number of years* only (whether death occurs in the meantime or not - an **annuity certain**). The **life annuity** is one that provides for periodic benefit payments for at least the lifetime of the annuitant. Being a form of life annuity, the **life income annuity with period certain** (or known as the **guaranteed annuity**) provides for payments to be made for *at least* a specified number of years, whether death occurs or not, and *for life* if the annuitant survives that period.

(d) **Underwriting:** the underlying philosophy of **annuities** is completely *opposite* to that with conventional **life insurance**. With the latter, the **premium** increases with age at inception and is **higher** for men than women of the same age. With annuities, the amount of each annuity benefit payment increases with age at payment commencement, and men receive a higher annuity benefit payment than women of the same age. Put briefly, **life insurance** is based upon the chances of *dying* and **annuities** are based upon the chances of *living*!

2.3.2 Pensions

In Hong Kong pensions are often considered to be more in the Government realm (for example for Civil Servants). More common in the private sector are **Provident Fund Schemes**, which provide for a *lump sum* benefit on retirement or other specified time, rather than an income. The Mandatory Provident Fund System, implemented since December 2000, is having a profound effect in this area.

2.4 GROUP AND INDIVIDUAL INSURANCE PLANS

The majority of the plans we have considered so far have been with applications for the insurance of *individuals*, either insuring themselves or another person. This remains a key element in the field of life insurance, but *group insurance* is playing an increasing role. This is especially so with **employee benefit plans**, where an employer provides a form of life insurance, often as an additional benefit supplementing salaries and wages. Again, this is a complex area, but certain features we may note:

(a) **Basic difference:** the most obvious difference between individual and group insurances is that the latter covers a number of people under a single policy. Sometimes this is called a *master group insurance contract.*

(b) **Contracting parties:** these are the insurer and the *group policyholder*, usually an employer, but possibly a club or other organisation insuring its members. The persons within the group who are covered may be referred to as *group insured* or sometimes *group life insured* or *persons insured*.

(c) **Different plans:** plans may be *contributory* (where the employees or other persons insured pay a share of the premium) or *non-contributory* (where individual members do not contribute towards the premium).

(d) **Eligible groups:** usually group insurance concerns a *single employer*, covering his staff members (called a 'group'), but the members of association groups (i.e. members of clubs, trade unions, sports associations, etc.) formed for a purpose other than purchase of insurance could equally be considered eligible. Besides, *multiple-employer groups* (consisting of the staff members of different companies) may participate in a single plan.

(e) **Underwriting:** doing business "in bulk" means that the high degree of underwriting attention applicable to individual insurance is neither possible nor necessary. Detailed individual information is usually not required with group plans.

(f) **Individual eligibility:** eligibility is usually decided by the **employer**, and the usual criterion for admission to group coverage is known as an *actively-at-work provision*. This requires that the individual was not only employed, but also at work (not ill or on leave) when coverage became effective.

(g) **Coverage declined:** an eligible person (particularly with **contributory** schemes) may initially decline coverage. Should that person change his mind later, evidence of *insurability* may be required (to counteract **anti-selection**).

(h) **Termination of cover:** for individual persons insured, their cover may terminate upon ceasing to be eligible (leaving the employer or group) or failing to pay any required premium. Some plans allow individuals to *convert* their previous group cover into **individual** coverage, often without proof of insurability but normally within a specified time period.

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Representative Examination Questions

Type "A" Questions

1 There are two common questions which can very usefully be asked by the honourable insurance intermediary with any enquiry about life insurance. One of these questions is "What do you want the insurance to do for you?" The other is:

(a) "How much money do you have?" .....
(b) "What is the commission rate for me?" .....
(c) "Do you really think you need this insurance?" .....
(d) "How much premium are you able and willing to pay?" .....

[Answer may be found in **2**]

2 Decreasing term insurance means that:

(a) the death benefit goes down each year; .....
(b) the premium goes down each year; .....
(c) the death benefit and the premium go down each year; .....
(d) the commission to the agent goes down each year. .....

[Answer may be found in **2.1.1a**]

Type "B" Questions

3 Anti-selection is a possibility with convertible term insurance. Which of the following are intended to discourage or counteract anti-selection?

(i) Conversion not allowed after say age 55.
(ii) The permanent insurance face amount must be for more than this policy.
(iii) Conversion not possible after the policy has been in force for some years.
(iv) The permanent insurance face amount must not be for more than this policy.

(a) (i) and (ii); .....
(b) (i), (iii) and (iv); .....
(c) (ii), (iii) and (iv); .....
(d) (i), (ii) and (iv). .....

[Answer may be found in **2.1.1b**]

4 Which **three** of the following are **not true** in relation to whole life insurance?

(i) The death benefit payable decreases each year.
(ii) The death benefit is only paid when the life insured dies.
(iii) The death benefit is only payable after a fixed number of years.
(iv) The death benefit is payable after a fixed number of years or on earlier death.

(a) (i), (ii) and (iii); .....
(b) (i), (ii) and (iv); .....
(c) (i), (iii) and (iv); .....
(d) (ii), (iii) and (iv). .....

[Answer may be found in **2.1.3**]

[If still required, the answers may be found at the end of the Study Notes.]

3 BENEFIT RIDERS AND OTHER PRODUCTS

Note: The term "policyowner-insured", as readers will come across in this chapter, refers to cases in which the life insured and the policyowner are the same person. Most life insurance policies are issued to policyowners who are also the life insured (or 'life assured' in British terminology). However, readers should also be aware that when one person purchases insurance on the life of another person (the policy being referred to as a 'third-party policy') the person who purchases the insurance is the policyowner and the person whose life is insured is the life insured.

3.1 DISABILITY BENEFITS

A **rider** is an endorsement to a policy, providing for some additional benefit or making certain stipulations. We shall consider two such riders applicable to situations where the **policyowner-insured** becomes subject to some form of *physical disability*.

3.1.1 Waiver of Premium (known as WP Benefit Rider)

A *waiver* means that some form of legal right has been given up. In this particular context it means that the insurer **waives** his right to *premiums* otherwise payable whilst the policyowner-insured is *totally disabled*. This does not mean that the policy is **suspended**. It remains in force and benefits continue to accumulate. (So, effectively, the insurer is *paying the premium*.) The WP rider may be added to virtually all types of life insurance policies.

Case 5 Definition of "total and permanent disability" for purposes of "waiver of premium" rider

The insured, who was a fireman, had been suffering from chronic low back pain and bilateral knee pain since early 1998. An x-ray photo of the lumbosacral spine revealed degenerative changes. His employment contract with the Fire Services Department was terminated in July 1999 because the Medical Board had assessed him to be unfit to continue working as a fireman. The insured believed that his condition had met the policy definition of Total and Permanent Disability and submitted a claim for waiver of premiums.

According to the policy definition, Total and Permanent Disability means "the life insured is unable to engage in any gainful occupation as a result of sickness or injury". The insurer declined his claim on the basis that a medical report had confirmed that the insured could work and walk unaided without functional limitation. Moreover, the Fire Services Department had confirmed that the insured's particulars had been circulated to other government departments in search of alternative employment.

Having noted the above, the Complaints Panel was of the view that whilst the disability had resulted in the life insured being unable to continue his old occupation as a fireman, it did not prevent him from engaging in another gainful occupation. As such, it supported the insurer's decision to decline the claim for waiver of premium.

Remarks: *the policy concerned has adopted a rather restrictive definition for "total and permanent disability" for the purposes of its "waiver of premium" rider, while more liberal definitions are available.*

There are normally some limitations, as follows:

(a) **Waiting period:** this is a time period (usually three or six months) from the time the policyowner-insured is disabled before the premiums are **waived**. The original thinking behind this probably was that most people continue to receive salaries and wages for at least short periods of disablement and so can still afford to pay premiums. But in fact some insurers will *refund* premiums paid during this waiting period if the disablement extends beyond the waiting period. (Technically, this makes it a kind of "*time franchise*". For illustrations of franchise, please read Chapter 3 of the Principles and Practice of Insurance Examination Study Notes.)

(b) **Age limitation:** waiving premiums is only permitted if the policyowner-insured is between **15** and **65** years of age (the age range varies with insurers).

(c) **Premium frequency:** differing practices exist as to what mode of premium payment is assumed when premiums are being waived. For example, if premiums are being waived on a monthly basis, the insured person who recovers, say, 25 days after a premium has been waived would have to resume premium payments the following month. On the other hand, if premiums are being waived on an annual basis, his recovery after, say, 2 months would result in a waiver of premiums for an additional 10 months while he is no longer disabled, unless some adjustments are made. In view of this, there exists a policy stipulation that an annual premium-paying mode will automatically switch to a monthly mode for the purpose of premium waiver. Alternatively changes in the frequency of premium payments during disability periods are expressly disallowed.

(d) **Exclusions:** the cover given by this rider is similar to personal accident or medical insurance, so it normally carries some similar **exclusions**, such as:

(i) *intentional* self-inflicted injuries;

(ii) injuries sustained whilst engaging in *criminal activities*;

(iii) *pre-existing* conditions;

(iv) injuries resulting from *war* while the policyowner-insured is in military service.

3.1.2 Disability Income Benefit

Whereas the WP rider gives relief from *expenditure* during **total disability**, the **Disability Income Benefit** rider (as the name suggests) provides an *income* during periods of **disability**. Again, this rider may be added to virtually all types of life insurance.

The usual provisions relating to this rider are:

(a) **Definition:** *"total disablement"* as understood by this rider could be so defined to mean that the policyowner-insured is unable to perform the **essential acts** of **his regular** occupation. A more stringent, alternative requirement could be that the policyowner-insured is unable to work at any occupation for which he is **reasonably fitted** by education, training or experience.

(b) **Income benefits:** are paid *monthly* as a stated dollar amount.

(c) **Waiting period:** similar in concept to that applicable with the WP rider, but the period varies from one to six months.

(d) **Not a loan or an advance payment:** the policy remains in full force during the disability and should **death** occur during a period of disability the full face amount is payable. (That is to say, no deductions are made in respect of **income benefits** received.)

3.2 ACCIDENT BENEFITS

Accident benefits that are commonly added to any kind of life insurance policy relate to *accidental death* and *dismemberment*. Frequently they are combined in a single rider, known (obviously) as the **Accidental Death and Dismemberment (AD&D) Rider**.

3.2.1 Accidental Death and Dismemberment

To consider these separately, although they are frequently combined:

(a) **Accidental death benefit (ADB):** this normally undertakes to pay a benefit *equal to the face amount* of the policy as an **additional** sum should death be caused by an *accident.* The customary provisions are:

(i) death must be caused **directly and independently** of all other causes, by an *accidental bodily injury*;

(ii) customary personal accident insurance *exclusions* apply, including:

(1) intentional *self-inflicted* injuries (e.g. as a result of **suicide**);

(2) *war-related* injuries;

(3) injuries during *illegal activities*;

(4) *aviation* injuries (except as a fare-paying passenger);

(iii) death must follow within a specified period of the injury, typically **3 months** or **90 days**. This is to be reasonably sure that the death was really the **result** of the accident (although obvious circumstances, such as an extended coma for an accident victim before death, would certainly meet with every sympathy and merit payment of the benefit).

Note: 1 This benefit is often called the **Double Indemnity Benefit**. We know from earlier studies (see **1.2.3**(b)) that the use of the term 'Indemnity' here is **technically inaccurate**, since life insurance is **not** subject to the principle of indemnity.

2 Also referring to previous studies (see **1.2.3**(a)), **proximate cause** becomes important with this rider. (The cause of death is in most cases irrelevant in relation to the basic life insurance plan).

(b) **Dismemberment:** literally "dismemberment" means losing one or more *members* (limbs), but the term within the **AD&D rider** relates to both the loss of limbs and the loss of *sight.* The usual provisions are:

(i) **Basic cover:** normally, a sum equal to the death benefit is payable if the life insured loses any *two limbs* or the sight in *both eyes* as a result of an accident.

(ii) **Modified cover:** often policies provide for payment of *half* the death benefit if an accident results in the loss of **one** limb or the loss of sight in **one** eye.

(iii) **Definition:** the loss of a limb may be described as the *actual* loss of limb (by physical severance at or above the wrist or ankle) or the *loss of the use* of the limb.

(iv) **Combination:** normally, the policy provides that where the same accident has resulted in both dismemberment and death, it will pay either the dismemberment benefit or the death benefit, but not both.

3.2.2 Other Accident Benefits

Different insurers may provide various forms of cover, but a typical rider giving other accident benefits has the following features:

(a) **Benefit schedule:** the cover is *accidental bodily injury* and a schedule (or list) of specified injuries is given, with a corresponding benefit against each. The list usually includes:

(i)	*Death*	- typically	**US$100,000**;
(ii)	*Loss of Two Limbs*	- typically	**US$100,000**;
(iii)	*Total Loss of Sight*	- typically	**US$100,000**;
(iv)	*1 Limb & Sight in 1 Eye*	- typically	**US$100,000**;
(v)	*Either 1 Limb or Sight in 1 Eye*	- typically	**US$ 50,000**;
(vi)	*Various specified lesser injuries*	-	see below

Lesser injuries: comprise a detailed list of possible injuries, ranging from serious impairments (e.g. loss of a thumb or index finger) to relatively minor ones (e.g. loss of a single finger joint). On the above scale, the benefits for these might range from say **US$3,000** for minor injuries to **US$25,000**.

(b) **Other benefits:** cover may include one or more of the following:

(i) *Serious Burns* - at least third degree burns, say **US$100,000**;

(ii) *Weekly Benefits* - during disability, say **US$1,000** (for 52 weeks);

(iii) *Hospital Benefit* - daily benefit of **US$100** (for 1,000 days maximum);

(iv) "*Double Indemnity*" - all benefits (**except** hospital stay) doubled, if the injury arose whilst travelling on regular public transport or in the burning of certain public places (cinemas, etc.).

(c) **Exclusions:** the normally applicable exclusions, which are commonly found with personal accident covers, include:

  (i) *Self-inflicted injuries* (including **suicide**, at any time);

  (ii) *War-related injuries*;

  (iii) *Injuries whilst involved in illegal activities*;

  (iv) *Disease or illness* (unless caused by an accident);

  (v) *Childbirth & pregnancy*;

  (vi) *Injuries resulting from hazardous sports* (as defined).

3.3 ACCELERATED DEATH BENEFITS

The meaning of this is that in certain serious situations, all or part of the death benefit under the policy may be payable to a policyowner-insured, although death has not yet occurred. Provisions for this are contained in *accelerated death benefit riders*, also known as **living benefit riders**. Common features with the different riders concerned are:

(a) **Basic reasons:** the benefits are released at times of great personal stress, under grave and life-threatening circumstances. They are to assist with related expenditure and to provide at least partial relief from the extra burden of financial worry at times which are already grief-laden.

(b) **Eligible plans:** the riders are only likely to be permitted with policies having a significant **face amount**, i.e. the larger policies, with a face amount of perhaps the equivalent of US$100,000 or more.

(c) **Beneficiaries:** since pre-death payments to the policyowner-insured will have an impact upon the expectations of named beneficiaries, the latter is usually required to sign a *release* (or *release form*), acknowledging that the death benefit stands reduced by the amount of the accelerated death benefit payment.

(d) **Assignees:** similar considerations to those in (c) above arise with any assignee, who must also sign such a release form.

(e) **Types of benefits:** we shall consider two such accelerated death benefits, namely the *critical* illness and the *long-term care* benefits.

3.3.1 Critical Illness Benefit

The basic features of this rider are:

  (a) **Meaning:** a stated portion of the death benefit is paid to the policyowner-insured when:

(i) he is diagnosed with a *specified disease*;

(ii) he is diagnosed with a *terminal illness* and has a *life expectancy* of 12 months or less; or

(iii) it is necessary for him to undergo a specified *medical procedure*.

(b) **Specified diseases:** the list of insured diseases is not identical with all insurers, but they all can be categorised into the following:

(i) cancer;

(ii) illnesses related to the heart;

(iii) disability;

(iv) illnesses related to a major organ;

(v) illnesses related to the nervous system;

(vi) illnesses related to the immune system;

(vii) others.

(c) **Medical evidence:** a statement from an attending physician is necessary, confirming the condition and, in the case of a terminal illness, the assessed *life expectancy* as well.

(d) **Amount of benefit:** this will vary between companies. Some allow the *full death benefit* to be paid. Critical illness benefit is invariably paid as a *lump sum*.

(e) **Restrictions:** again, these are not universal, but typically they may include:

(i) critical illness cover is only available up to a specified age, say, age 80;

(ii) critical illness cover is only available to standard risks;

(iii) payments may not be made for multiple/recurring events;

(iv) waiting period: the diagnosis mentioned in (a) above has to be one done when the rider has been in effect for a specified number of days, say, 90 days.

(f) **Premium waiver:** some insurers offer to *waive* all renewal premiums payable after the critical illness benefit payment.

Note: Hong Kong insurers have begun to provide the option of a package policy comprising a death cover and a critical illness cover, with both sharing the same face amount.

3.3.2 Long-Term Care (LTC)

This is not a very common product in Hong Kong at present, but the basic features of this rider are:

(a) **Meaning:** a stated portion of the death benefit is paid to a policyowner-insured who requires *constant care* for a condition.

(b) **Types of care:** these will be specified in the rider, e.g. in an *approved nursing home* or in the policyowner-insured's home by a duly *authorised* carer.

(c) **Medical evidence:** often the rider specifies that the care needs to be *medically necessary*. Confirmation of this is not always easy. Sometimes, the approval of the *policyowner-insured's physician* is acceptable, but many insurers require that the policyowner-insured be unable to perform a certain number of *activities of daily living* (**ADLs**) before the need is established. (ADLs will include basic human needs and functions, such as washing and dressing oneself, and mobility.)

(d) **Amount of benefit:** typically, this may be **2%** of the death benefit **per month** for *nursing home* care and **1%** for *home health care*. The maximum total payments may range between **50%** and **100%**.

(e) **Waiting period:** usually there is a **90-day** waiting period before **LTC** benefits are payable. Also, some insurers require the policy to have been in force for **one year** or more before qualifying for LTC benefits.

(f) **Premium waiver:** it is common for premiums to be **waived**, both for the rider benefit and the basic insurance plan, during the period that these benefits are being paid to the policyowner-insured.

3.4 MEDICAL BENEFITS

In earlier days, medical benefits would not be provided under life insurance policies. Such cover was considered to be part of the **"Accident"** (Personal Accident) portfolio. In more recent times, the boundary lines between various classes of business have become less clearly marked. It is therefore quite common for life insurers to consider medical benefits insurance part of their "insurances of the **person**" range of products. Cover may be given as a **rider** to a life insurance, or separately as a general insurance policy (for which type of insurance the insurer must of course be authorised).

A typical form of cover found in Hong Kong at present is very likely to include most of the following features:

(a) **Basic plan:** Intended to cover the expenses related to *medical treatment* and *hospitalisation*, the Basic Plan has a number of headings under which cover is given, typically as follows:

(i) **Hospital charges:** these are very likely to have three different categories, according to choice and premium paid, the usual descriptions being *Private Room, Semi-Private Room* and *Ward Bed*. Cover includes Room and Board, Miscellaneous Hospital Services and an available supplement for Intensive Care treatment.

(ii) **Private nursing:** again with three categories, this includes nursing treatment at home, in hospital by a qualified nurse or as recommended by the attending medical practitioner.

(iii) **Surgeon's, anaesthetist's** and **operating theatre fees:** maximum benefit cover is specified according to the three categories and the seriousness of the operation involved.

(iv) **In-patient physician's fees:** for non-surgical cases.

(v) **In-patient specialist's fees:** for treatment, consultations, etc.

(vi) **Out-patient follow-up care:** within 6 weeks of hospital discharge.

(vii) **Free worldwide assistance:** a number of benefits and covers to help in the event of emergency needs whilst abroad. These range from instant telephone assistance to the return of mortal remains.

(b) **Optional medical plan:** various titles may be given to this option, available at extra premium. The basic intention is to provide coverage for much increased limits under the various headings and categories of the Basic Plan.

(c) **Major exclusions:** there are limits to the time during which various benefits under the Basic and Other Plans may be paid, but these are part of the description of cover. Specific *exclusions* are very likely to include the following:

(i) **Pre-existing conditions**;

(ii) **Pregnancy and childbirth** related expenses;

(iii) **Drug or other substance abuse**, self-inflicted injury and sexually transmitted diseases;

(iv) **AIDS** or **HIV** related conditions (sometimes only excluded for say the first five years of the insurance);

(v) **Congenital abnormalities** treatment.

3.5 INSURABILITY BENEFITS

Insurability means that by normal underwriting and business standards a particular risk is acceptable for insurance. The usual feature that affects this is, of course, the **health** of the person who is to be the *life insured*. Checking whether a person is insurable is a basic element in **underwriting** (see **5.3**). Sometimes the question of insurability, however, arises for an existing client (perhaps with policy **reinstatement - see 4.7** or on other occasions). This question, however, may be avoided if the policy is made subject to the **Guaranteed Insurability (GI) Benefit**.

3.5.1 Guaranteed Insurability Option

The **GI** benefit is sometimes referred to as a *Guaranteed Insurability Option* (**GIO**). The basic features of this rider are:

(a) **Meaning:** the policyowner has the right to purchase additional insurance (of course for an additional premium) on specified *option dates*, **without** having to supply evidence of insurability.

(b) **Limitations:** the *amount* of additional cover may be limited (to the existing policy's face amount, or less). Also the right must be exercised before the life insured reaches a certain *age* (typically aged **40**).

(c) **Not automatic:** if the policyowner does not effect the extra cover on a particular *option date*, that particular right is **lost**. He may, however, exercise the right on the next option date, if any.

(d) **Option dates:** these are specified in the rider, either as particular dates or for particular *events* (such as **marriage**, or the **birth** of a child).

(e) **Temporary cover:** some insurers grant *term insurance* cover automatically to cover the policyowner-insured during the period allowed for exercising his purchase option, so that if he dies before completing the option he has the extra cover.

(f) **Policy with WP:** if the insurance also has a **Waiver of Premium** rider (see **3.1.1**) and the policyowner-insured is disabled at the time he is to exercise his option for additional cover, the additional cover is granted *automatically*. The **WP** rider also provides for **all** premiums to be *waived*, until the recovery or death of the policyowner-insured.

3.6 INFLATIONARY ADJUSTMENT

Inflation reduces the purchasing power of money. It is therefore an important element to be considered with any **long-term** insurance linked to a specific **face amount**. Bearing in mind that policies may continue for many years, perhaps many decades, before they become payable, it will be realised that what was once a significant amount may in real terms have been reduced to a small or even trivial sum, because of inflation.

Clearly, this is a problem needing serious attention to the whole of one's life insurance programme, but in the context of this Chapter on **Benefit Riders**, provision has been made in relation to disability income benefits being paid, as follows:

3.6.1 Cost of Living Adjustment (COLA)

This rider or policy provision provides for periodic increases in the disability income benefits being paid to disabled policyowner-insured. As the name suggests, the increases are linked to increases in a recognised independent index, such as a *Consumer Price Index*.

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Representative Examination Questions

Type "A" Questions

1 The "waiting period" with a Waiver of Premium (WP) rider means:

(a) a time period during which premiums are waived; .....
(b) the time allowed to a policyowner for payment of premium; .....
(c) the time period before a policy can be subject to this rider; .....
(d) a time period during disablement before premiums are waived. .....

[Answer may be found in **3.1.1**]

2 A "Double Indemnity" provision under a life policy is incorrectly named because:

(a) life policies are not subject to indemnity; .....
(b) the amount paid is not always double the face amount; .....
(c) it is only paid in the event of death through an accident; .....
(d) it is illegal for the beneficiary to be paid twice for the same event. .....

[Answer may be found in **3.2.1**]

Type "B" Questions

3 Which of the following remarks are **true** concerning the AD&D rider?

(i) Loss of a limb may mean the actual loss of a limb, or loss of its use.
(ii) A sum equal to the death benefit is paid for the loss of one limb.
(iii) A sum equal to the death benefit is paid for the loss of two limbs.
(iv) Dismemberment benefits can also be for the loss of sight in an accident.

(a) (i) and (ii) only; .....
(b) (i) and (iii) only; .....
(c) (i), (iii) and (iv); .....
(d) (ii), (iii) and (iv). .....

[Answer may be found in **3.2.1**]

4 Which **three** of the following are usually included within the insured events of the Critical Illness Benefit?

(i) Disability
(ii) Illness related to the immune system
(iii) Influenza
(iv) Cancer

(a) (i), (ii) and (iii); .....
(b) (i), (ii) and (iv); .....
(c) (i), (iii) and (iv); .....
(d) (ii), (iii) and (iv). .....

[Answer may be found in **3.3.1**]

[If still required, the answers may be found at the end of the Study Notes.]

4 EXPLAINING THE LIFE INSURANCE POLICY

It should be mentioned at the outset of this Chapter that the Hong Kong Life Insurance market tends to use policy wording commonly found in the United States and North America. The General Insurance market, on the other hand, mostly uses policy styles originating in the U.K. For the purposes of this study (the Life Insurance Policy), we shall follow the more common "U.S. style" policy provisions, making appropriate comments relating to possible variations should a local insurer be using U.K. style life insurance policy wording.

4.1 ENTIRE CONTRACT PROVISION

A Life Insurance Policy is a most important document. The contract is *Long Term*, i.e. lasting many years, perhaps decades. Unlike with most other classes of business, it is essential that the original policy document be presented when a claim is made. The "**entire contract**" provisions are therefore very important. They provide that:

(a) the **entire** contract consists of the policy and the copy of the **application** attached;

(b) **only** certain specified senior officials of the company are authorised to make changes to the contract;

(c) **no change** to the contract can be made *unless* the **policyowner** agrees.

4.2 INCONTESTABILITY PROVISION

This means that within the terms of these provisions the *validity* of the contract **cannot** be contested (challenged) by the insurer. Disputes over the validity of an insurance contract may arise with an alleged breach of **utmost good faith**, i.e. certain **material facts** have been omitted or misrepresented.

(a) The **Incontestability Provision** (or **Incontestable Clause**) states that the insurer cannot (normally - see below) dispute the validity of the contract after it has been in force for *two years*;

(b) and that minimum period of two years must be *during the lifetime* of the life insured (if the phrase '*during the lifetime* of the life insured' was omitted and the life insured died during the contestable period, the beneficiary might possibly delay making a claim until the end of this period and seek protection of the provision).

(c) Under Hong Kong law, this Clause cannot be relied upon in the event of *fraud* on the part of the claimant or the insured. Hong Kong law will not support fraud, whatever a contract may say.

[**Example:** suppose a life insurance is arranged solely on the basis of the health and other information declared by the policyowner-insured. He fails to reveal certain **material** information which, for example, would have meant that the insurer would not have insured him. The man dies after three years. Under the normal rules of **Utmost Good Faith,** the insurer could avoid the contract. Nevertheless, it cannot do that because of the overriding effect of the incontestability provision. However, if fraud is established on the part of the policyowner, the insurer may disregard the provision and avoid the contract if the applicable law is that of Hong Kong.]

Case 6 The Incontestability Provision often serves as an effective shield against an insurer's attempt to repudiate liability on the basis of breach of the duty of utmost good faith

The policyowner died of nasopharyngeal carcinoma three years after he had effected a life policy. It was revealed that he attended a medical examination by the insurer's medical officer in the morning four days after he had signed an insurance application. In the afternoon of the same day, the insured consulted a private doctor, complaining of swelling of right neck gland and blood in post-nasal drip sputum for one month. The diagnosis of nasopharyngeal carcinoma was suggested. However, the insured failed to disclose any of the above symptoms on the application form or during the medical examination. The insurer therefore refused to pay the death benefit on grounds of material non-disclosure.

The wife of the policyowner stressed that her husband consulted the private doctor just because he did not feel well that afternoon. The consultation was not a pre-scheduled appointment. As the insured often contracted flu and cold in the previous months and his symptoms were very similar to those of flu and cold, he, not being a medical expert, believed himself to be suffering from flu and cold again. Moreover, he disclosed on the application form that he had previously suffered from flu and cold and had recovered after taking medicine. This served to prove that he had fully disclosed all his medical information to the best of his knowledge at the time of the insurance application.

The Complaints Panel noted that the questions on the application form that related to the alleged non-disclosure specifically asked about "disease" suffered or treated for. Although the policyowner presented himself as a result of certain symptoms, there was no evidence suggesting that he had failed to disclose on the application form a known or diagnosed disease. Therefore the Complaints Panel was convinced that the insured had honestly completed the application.

Further, the Complaints Panel found no warning clause on the application form that had imposed on the policyowner an obligation to notify the insurer of changes in his health condition occurring after signing the application form and before issuance of the policy, which condition in this instance deteriorated soon after the application was signed.

More importantly, there is a two-year contestable period applicable to life insurance policies, beyond which a policy cannot be rescinded unless fraud is proven. The policyowner passed away more than two years after his insurance policy came in force. As no evidence had been put forward to the Complaints Panel to suggest the presence of fraud, the Complaints Panel concluded that the incontestability provision should be invoked.

Based on the above, the Complaints Panel ruled in favour of the claimant and awarded her the death benefit.

Remarks: *The claimant won her case on two alternative major grounds. Firstly, the Complaints Panel decided that the policyowner had not been in breach of the duty of utmost good faith. At law, the proposer is only required to disclose such material facts that he actually knows or ought to know. Apparently the Complaints Panel considered that the symptoms that the policyowner had at the time when he was signing the application form or undergoing the medical examination would not constitute material facts that he actually knew or ought to know. In addition, unless varied by private agreement, the duty of disclosure extinguishes as soon as the insurance contract is concluded. The Complaints Panel was apparently of the view that the subject insurance contract was concluded when the application was signed – not when the policy was issued, so that the diagnosis shortly after that critical moment, even though being material facts, would not be required to be disclosed to the insurer. Second, even if breach of the duty of utmost good faith on the part of the policyowner had been established, he should be allowed to take advantage of the Incontestability Provision unless fraud could be proved against him.*

(d) Such a clause would not have the effect of preventing the insurer from raising the question of illegality.

(e) An **Indisputable Clause** (the UK equivalent of the **Incontestability Provision**) has been held by the English courts to be incapable of preventing an insurer from avoiding liability on grounds of negligent misrepresentation on the part of the insured unless the clause expressly mentions negligence or the clause does not otherwise make sense.

4.3 GRACE PERIOD

Under U.K. style policies, this is also called **"Days of Grace"**. Essentially, this relates to a period of time after the date on which a premium is due, when cover is kept operative. But for this grace period provision, the policy would **lapse** (terminate) if the premium is not paid by the due date. So it allows for a *late payment* of premium without penalty. The features of these provisions are:

(a) the grace period is usually a minimum of **30** or **31 days**;

(b) the grace period does not apply to the initial premium for the policy;

(c) payment of premium within the grace period is deemed to be payment *on time*;

(d) this is **not** a period of *free insurance*; for example:

  (i) if the life insured dies within the grace period before payment of the premium, the claim is paid but the premium due is deducted from the death benefit payable;

  (ii) if the premium is not paid during the grace period (and subject to any other policy provisions, such as nonforfeiture, see **4.5** below) the policy will lapse from the date the premium was due.

  Note: What will be the *exact time* the policy will lapse, if the due premium has not been paid during the grace period? Under the U.K. practice, non-payment of premium during the permitted days of grace means that the policy will lapse from the *date the premium was due.* Under the U.S. system, the policy will instead lapse *at the end of the grace period*.

(e) special provisions may arise with non-traditional types of policy, e.g. *universal life*.

4.4 BENEFICIARY DESIGNATION

A **beneficiary** is a person or party to whom the policyowner of a life policy instructs the insurer to pay the death benefit when it is due. A fundamental condition for the payment is that the beneficiary must survive the life insured. In practice, there are various types of designations and beneficiaries:

(a) The beneficiary is usually *named* in the policy. But *class designations* (i.e. identification of a certain group of people as beneficiaries) can alternatively be done. Examples of class designation include "my children", and "my brothers and sisters".

(b) A *primary* (or *first*) beneficiary receives the policy proceeds, when payable (if more than one is designated, shares will be equal unless otherwise specified in the policy). *Contingent* beneficiaries may be designated in addition to primary beneficiaries, in case all the primary beneficiaries do not survive the life insured.

(c) A life policy usually allows the policyowner to change the beneficiary designation whilst the policy is in force, in which case the designated beneficiary is called a "revocable beneficiary". Alternatively, he may have a provision included in the policy making the designation irrevocable so that a change of beneficiary will require the written consent of the current beneficiary.

4.5 NONFORFEITURE BENEFITS

Most conventional life insurance plans (other than **term** insurance plans) acquire a **cash value** after an initial period in force. That cash value is important for a number of reasons, discussed elsewhere in these Study Notes, and has special relevance to the question of **nonforfeiture**. If something is "forfeited", it means that it is lost or rights to it are taken away. "Nonforfeiture" therefore means that rights are not lost under certain circumstances, in this instance the *discontinuance of premium payments*.

Without specific provisions to the contrary, the policy will **lapse** if the premium is not paid within the **grace period**. The customary nonforfeiture provision is that:

(a) the policy does **not** lapse because of non-payment of premium. Unless instructions are received to the contrary, the **cash value** of the policy is used to pay premiums for as long as the cash value lasts, keeping the policy in force for the full amount;

Note: Some insurers do not regard this as a nonforfeiture benefit, but treat it as a quite separate policy provision known as an *automatic premium loan* (**APL**) provision.

(b) the owner of a policy which has a cash value, who decides not to pay any more premiums in respect of the policy, has certain *options*. These options are:

(i) *cash surrender value* (also known as *surrender value*): the cash surrender value is paid when the policyowner terminates the policy;

(ii) *reduced paid-up insurance*: the net cash value is used as a single premium to purchase life insurance of the same plan as the original policy for a lower face amount;

(iii) *extended term insurance*: the net cash value is used as a single premium to purchase term insurance for the same amount as the original face amount, for such period as the net cash value can provide.

Note: These options arise when a conscious decision is made to discontinue premium payments. If premium payments merely **stop**, with no information from the policyowner, the **automatic** provision in (a) above, if any, will be put into operation. If the policy has no such clause, or the policyowner fails to choose any option, many policies provide that option (b)(iii) above should apply automatically.

4.6 POLICY LOAN

Another feature directly arising from the existence of a policy **cash value**, is the facility of borrowing money from the insurer, using the cash value as security. The concept arises with the **APL** feature mentioned in **4.5**(a) above, but the customary **Policy Loan** provisions are:

(a) the policyowner has a *right* to borrow money from the insurer;

(b) the loan may be for *any purpose*;

(c) the loan may be up to the policy *cash value* (less one year's loan interest);

(d) the only *security* required for the loan is the policy cash value;

(e) the loan may be repaid *at any time*, or **not**, as the policyowner decides;

(f) if not repaid, the amount of the loan together with any outstanding interest is deducted from the *policy benefit*, when payable.

4.7 REINSTATEMENT

Under U.K. life insurance practice, this is also known as **"Policy Revival"**. The concept is that a policy which has *lapsed* ("died") can be brought back to "life" under certain circumstances. Of course, this can always happen by the *mutual consent* of the insurer and the policyowner. The term "reinstatement", however, normally implies the *right* of the policyowner to have a lapsed policy brought back into force. The usual policy provisions which apply to this are:

(a) there is a time limit within which this may be demanded;

(b) that period may vary between insurers, but **5 years** is quite representative;

(c) the right normally applies only to **lapsed** (not **surrendered**) policies;

(d) the reinstatement may be subject to any of the following *conditions*:

(i) evidence of continued *insurability* (good health);

(ii) *payment* of any outstanding loan, plus interest;

(iii) payment of *back premiums*, plus interest;

(iv) payment of a reinstatement *fee*;

(v) a further *contestable period* (see **4.2**) from the reinstatement date;

(vi) a further *suicide exclusion period* (see **4.12**) from the reinstatement date.

4.8 MISSTATEMENT OF AGE OR SEX

Please note that this is a *misstatement* of age or sex. In the event of a voluntary sex change operation to an existing life insured, the advice of the insurer concerned should be obtained.

Obviously, a different age or sex from that indicated when the insurance was arranged can have a significant impact on the policy premium and/or benefit. The customary provisions in these circumstances are:

(a) *If the error is discovered after a claim has arisen*: the amount of the benefit is adjusted (up or down) to reflect the amount payable had the correct age/sex been given and the same premium paid.

Note: If the insurer follows the commonest practice in the U.K. on this issue, the benefit would only be adjusted *downwards*. If the age/sex mistake indicates that too much premium has been paid, the overpaid premium will be *refunded* (without interest). Again, this might be a point to check with any insurer using U.K. policy forms, etc.

(b) *If the error is discovered before a claim arises*: the policyowner is usually given the choice of

(i) leaving the face amount unchanged and receiving or paying the appropriate adjustment after calculating the correct premium that should have been paid; or

(ii) adjusting the face amount of the policy to the amount the premium paid would have purchased had there been no misstatement.

Note: The U.K. practice on this point will be the same.

4.9 ASSIGNMENT

A life insurance is **property** of the **policyowner**. It is said that the policyowner's interest in such property is reversionary, that is to say, even though his right in the property is unquestionably recognised, the enjoyment of the property is deferred until some date or event in the future. Therefore, the policyowner has the right *now*, as with any other property, to *assign* or **transfer** that property to another person (as a **sale -** for a payment **-** or as a **gift**). When this happens, the policyowner is termed the '*assignor*' and that other person the '*assignee*'.

Certain features of assignment that we should note, arising from policy provisions and otherwise, are as follows:

(a) **Notice of assignment:** without intending to prevent an assignment, the policy says that the insurer is **not** bound to act in accordance with an assignment until it receives **notice** of it. This should be in **writing** (the policy usually requires a "copy of any assignment").

(b) **Validity of the assignment:** the insurer disclaims responsibility for this; this implicitly is saying that the assignor should seek independent legal advice on the formalities required for a valid assignment.

(c) **Rights of assignee:** these are *subordinate* to those of the insurer regarding the **proceeds** of the policy, i.e. any *overdue premiums* and/or loans and interest must be deducted before any payment is made. The **assignee** is said to receive the *net policy proceeds*.

(d) **Limitations on the assignment:** the assignment

(i) must not violate any *vested right* of any **beneficiary** (especially of any **irrevocable beneficiary -** one that cannot be changed without his consent);

(ii) must not be for *illegal* purposes (e.g. money laundering);

(iii) may be restricted to involve *only* a **lump sum** payment to the assignee, i.e. no other settlement options.

(e) **Types of assignment:** there are two types:

(i) **absolute assignment:** the arrangement is *permanent* and the **assignee** becomes the new policyowner;

(ii) **collateral assignment:** the arrangement is *temporary*, usually where the policy is used as **collateral security** for a loan (**not** from the insurer). Here the assignee's interest is limited to the *loan plus interest*. The policyowner cannot have a **policy loan** or **surrender** the policy whilst a notified collateral assignment is in force.

4.10 DIVIDEND OPTIONS

Participating policies (known in the U.K. as *"with-profit"* policies), in due time, should qualify for dividends, which are distributed in three ways: cash dividend, reversionary bonus and terminal bonus (see **5.2.7**). **Cash dividends** become payable to the participating policyowner immediately. However, the policy normally presents some options in respect of cash dividends, so that they may be:

(a) paid in *cash* at once;

(b) applied towards *future premiums* of the policy;

(c) left with the insurer to earn *interest*;

(d) used to buy *paid-up* additional insurance;

(e) used to purchase *one-year* term insurance.

Note: If the policyowner makes no selection from the available options, most policies make provision for what is known as an *automatic dividend option* to apply. In Hong Kong, practice seems to vary, but the likely alternative applications are:

(i) option (c) above, leaving the dividends with the insurer to earn interest; or

(ii) option (d) above, the purchase of paid-up additional insurance.

Insurance intermediaries should check with the insurers.

4.11 SETTLEMENT OPTIONS

When the policy benefit becomes payable, there are different possibilities for the beneficiary and/or policyowner. These are:

(a) a *lump-sum settlement*: a single payment, to complete the whole contract;

(b) an *interest option*: the policy proceeds are left with the insurer, who pays interest annually or at agreed more frequent intervals;

(c) a *fixed period option*: the policy proceeds (and interest) are paid in instalments over an agreed period of time - effectively this is purchasing an *annuity certain* with the policy proceeds as a single premium;

(d) a *fixed amount option*: the policy proceeds (and interest) are paid in equal instalments of a stated amount for as long as the money lasts;

(e) a *life income option*: the policy proceeds (and interest) are paid in agreed instalments for the lifetime of the designated person - effectively this is purchasing a *life annuity* (see **2.3.1**(c)) with the policy proceeds as a single premium.

4.12 SUICIDE EXCLUSION

One of the features of life insurance is that the benefit may be payable even if the cause of the claim was the *deliberate act* of the life insured. This arises from the underlying reason for life insurance, which originally was primarily to make provision for dependants, rather than to benefit the life insured personally.

With a long term contract and under those circumstances, it would be unfair to penalise the family in the tragic event of the life insured taking his own life. On the other hand, certain safeguards against the effecting of life insurance with suicide in mind are perfectly reasonable. The usual provisions are:

(a) suicide is *excluded* for an initial period of the policy;

(b) that period may vary with insurers, but *1 year* is very representative;

(c) should suicide occur *after* that period, the death benefit is payable;

(d) should suicide occur *during* that period, the death benefit is not payable, but it is normal for the policy to state that premiums paid (less any outstanding loan and interest) are *refunded*.

Note: 1 Being a policy exclusion, it is for the insurer to *prove* that death was by suicide - not always an easy thing to do.

2 Bearing in mind the overall intention of the exclusion (to defeat arranging a policy when suicide was contemplated), it is not unknown for an insurer to pay for a proved suicide which can reasonably be assumed to be attributable to events arising *after* the policy commenced, and which will otherwise be caught by the exclusion. Of course, this would be *ex gratia payment* (i.e. not legally required) and the circumstances would have to be quite unusual.

3 Suicide was but is no longer criminal.

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Representative Examination Questions

Type "A" Questions

1 Under "The Entire Contract" provision, changes to the contract:

(a) cannot be made at all; .....
(b) can be done only if the policyowner agrees; .....
(c) can be done if the policyowner requests it; .....
(d) can be made if senior officials of the insurer say so. .....

[Answer may be found in **4.1**]

2 A "Grace Period" is also known as:

(a) days of grace; .....
(b) the cooling-off period; .....
(c) the nonforfeiture clause; .....
(d) the payment of benefit period. .....

[Answer may be found in **4.3**]

Type "B" Questions

3 Which of the following are nonforfeiture options?

(i) Cash surrender value
(ii) A lump-sum settlement
(iii) Extended term insurance
(iv) Reduced paid-up insurance

(a) (i) and (ii) only; .....
(b) (i), (ii) and (iii) only; .....
(c) (i), (iii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **4.5**]

4 Which of the following are dividend options?

(i) Cash payment
(ii) Left with insurer to earn interest
(iii) Used to buy paid-up additional insurance
(iv) Used to purchase one-year term insurance cover

(a) (i), (ii) and (iii) only; .....
(b) (i), (iii) and (iv) only; .....
(c) (ii), (iii) and (iv) only; .....
(d) (i), (ii), (iii) and (iv). .....

[Answer may be found in **4.10**]

[If still required, the answers may be found at the end of the Study Notes.]

5 LIFE INSURANCE PROCEDURES

5.1 COMPANY OPERATION

The way a company operates is determined by the company itself and there is no set pattern or formal structure that must be adopted. Therefore, the following comments are only *representative* of a company's operations. Before looking at the internal organisation of a typical life insurer, however, we should just mention two important types of company, according to their *constitutional* basis:

(a) **Mutual insurance companies:** a *mutual* insurance company has no **shareholders**. Legally, it is owned by its *participating policyholders* (i.e. owners of participating policies (see **1.3.1b**(a))), although in practice control is exercised by its **Board of Directors** and senior management. Being a mutual has certain advantages, especially for policyholders, who do not have to share company profits with shareholders. It has certain disadvantages as well, particularly with regard to the raising of new capital, should this be required.

Note: The fact that a company has the word "Mutual" in its title is not conclusive evidence that it **is** a "mutual", as defined above. Whilst this may well be the case, and all companies having "Mutual" in their title undoubtedly began as such a business unit, some "mutuals" world-wide have *de-mutualised*, changing their constitutional status, to become as below.

(b) **Proprietary** or **joint-stock companies:** these companies are much more common business structures, consisting of a limited liability company owned by its shareholders. "Limited liability" means that the shareholders cannot be compelled to contribute anything further towards company losses or capital requirements once their shares are *"fully paid-up"*.

5.1.1 Typical Company Operational Structure

Since company structures cover a great number of inter-related activities and there is no set pattern to follow, we shall briefly mention various departments or functions, in alphabetical order only:

(a) **Accounts department:** according to company policy and structures, an Accounts department may represent the relatively routine (but **important**) role of *bookkeeping* and *financial record* maintenance, or (more likely) it will include **Management Accounting**, with responsibilities in the key areas of *budgeting* and *investment,* etc. Standard functions of the Accounts Department include:

(i) *Receipts*: monitoring and recording all payments due to the company, by way of premiums, reinsurance, loan repayments, etc.

(ii) *Payments*: monitoring and recording all payments to be made by the company, including claims, salaries, agency commissions, purchases, etc.

(iii) *Financial returns*: every insurer must submit audited accounts each year, as required by the ICO. This is a major function and responsibility of the Accounts department.

(b) **Actuarial department:** as mentioned before, life insurance is profoundly involved with mathematical calculations and projections. The actuarial department therefore has a key role in company operations, its involvement including:

(i) *Product pricing*: probably sub-divided between the various major types of product offered, e.g. Individual Life, Group Life, Health, Personal Accident and Retirement Benefits.

(ii) *Valuation*: a **core function**, required by statute, valuation consists of the calculation of the value of **assets** and **liabilities**. The way this is done is critical to the *solvency margin* of the company and the determination of the divisible surplus, from which **dividends** or **bonuses** can be declared. (It is the Board of Directors that makes the actual decisions on declaration of dividends or bonuses.)

(iii) *Claims and reinsurance*: calculations and projections of reserves and needs in these areas are obviously of great importance.

(iv) *Management reporting*: this could be within the area of the company accounting staff, but whoever performs the function, it is a critical one. Unless top management are supplied with reliable data on reserves, surpluses and other key matters, effectively the company cannot operate (at least not efficiently, and that probably means "not for long"!).

(c) **Agency training and control:** the majority of individual life insurance contracts are sold through insurance agents. They at one and the same time represent almost the "lifeblood" of the company, and a major responsibility regarding their appointment, training and discipline. Details of requirements are given elsewhere in these and other Study Notes, but very important matters in this area include:

(i) *Training programmes*: arranging, organising and administering, with all the logistics and personnel details involved.

(ii) *Examinations*: both with regard to their being accepted as insurance intermediaries (this Insurance Intermediaries Quality Assurance Scheme, for example) and other professional qualifications.

(iii) *Resources and facilities*: the provision of suitable materials, premises and opportunities for training and career development has obvious applications.

(d) **Claims:** without claims we have no business! Perhaps a slight oversimplification, but there is truth in the remark. This important area includes:

(i) *Routine administration*: all the required enquiries, checking and general supervision to confirm all is in order.

(ii) *Various types of claim*: such as death claims, maturities and surrenders, which may require different kinds of expertise.

(iii) *Investigative work*: sometimes detailed forensic or other enquiries need to be made in verifying the validity of a claim.

(e) **Client service** (also known as **policyowner service**: see **5.5**): This involves a variety of functions, including:

(i) *Changes to policies*: these may relate to **financial** or **non-financial** changes, all of which are important to efficiency.

(ii) *Communication*: this will involve both correspondence and telephone/personal enquiries, and **complaints**.

(iii) *Documentation*: policy duplicates (with all attendant checks and enquiries) and other document requests.

(iv) *Policy renewals*: the important process relating to the **retention** of business.

(f) **Marketing**: This is a general term that can signify many things. It usually includes:

(i) *Product research*: and development of new sales products.

(ii) *Promotions/publicity*: producing the materials and physically attending to all logistic and other details involved.

(iii) *Advertising*: closely related to (ii) but with special features such as media involvement and sponsoring.

(iv) *Public relations*: news conferences, media interviews, public talks and seminars, for example.

(v) *Market research*: examining needs, demands and results.

(g) **Underwriting:** this is considered as a technical exercise in **5.3** below, but as an element in company operations this department includes:

   (i) *Risk assessment*: the technical matter of selection, rating and imposing terms, as necessary.

   (ii) *Medical requirements*: arranging and monitoring such medical examinations and related documentation as may be required.

   (iii) *Reinsurance*: the extent to which reinsurance may be required or arranged with individual risks.

Note: The above departments are representative, as previously mentioned. They do not form a comprehensive list and are not intended to represent the operational structure of any particular insurer.

5.2 APPLICATION

Some insurers might refer to an application as a *proposal*. Either term may be found in the Hong Kong market, although "application" is perhaps more widely used. Both refer to the request for insurance cover from an intending policyowner. A number of significant issues and considerations are involved with this important matter, made more important by the fact that a life insurance cannot be **cancelled** by the insurer once it becomes operative.

5.2.1 Application Procedure

Competition and the desire for efficiency have led to questions on the application being kept to the minimum. Often, questions are phrased so that a **"No"** answer means that no further enquiry needs to be made in that topic, whereas a **"Yes"** answer may need further details or enquiry.

(a) **General rules for application procedures:** the application/proposal is the main, and sometimes virtually the *only*, source of information for underwriting purposes. The insurance intermediary should therefore take great care in his advice and general assistance to the client when the form is being completed, noting the following:

   (i) All **material facts** should be given. "Yes" answers in response to enquiries on health and other matters must be accompanied by full explanations, including any relevant dates (see: **1.2.2**).

   (ii) Normally the applicant should complete the form **personally**. Sometimes the insurance intermediary is asked to assist by writing things at the client's dictation. Great care must be taken with this, to ensure that the client realises that the form is **his** statement and the answers are **his**.

(iii) **Alterations** and amendments should be avoided, if possible. If not, they must be very clear. Anything incorrect must be clearly crossed through or deleted and the alteration should be **signed and dated** by the applicant. (A replacement form may be advisable in many cases.)

(iv) **All** questions should be answered, as fully as required. Failure to observe this rule can only result in delay. Information with life insurance is too important to be waived.

(b) **Key points to be considered:** Some areas requiring special attention include:

(i) The **desired commencement date** should be clearly indicated. It is normal for insurers to allow a policy to be back-dated for a certain period (which may vary with the insurer concerned).

(ii) The **identity** of the applicant and life to be insured is important to establish. Any available **Identity Card** (or equivalent document of identification) should be inspected by the agent (some insurers require a copy to be attached to the application).

(iii) **Age next** (or sometimes **last**) **birthday** is an important element affecting the premium. Sometimes in Hong Kong this may not be easy to establish. It is not uncommon to find that only the year of birth is known. In that event, insurers are very likely to regard the birthday as being the 1st January that year.

(iv) **Other personal details**, including occupation, residential address and family medical history all have a significance which is self-explanatory.

(v) **Signature** of both the applicant and the life to be insured (if different) must be obtained. If an intended signatory cannot write, an appropriate mark or chop is acceptable, but this must be witnessed by two persons (one of whom may be the insurance intermediary).

(c) **Supplementary requirements:** these may involve a number of issues, detailed instructions about which will be supplied by the insurer. Some areas likely to be involved, however, include such matters as:

(i) **Life underwriter's report:** signed by the insurance intermediary, and including the reason for the purchase and the length of his acquaintance with the client.

(ii) **Mode of premium payment:** whether autopay facilities apply.

(iii) **Proof of insurability:** establishment of an **insurable interest**.

(iv) **Underwriting forms:** additional questionnaires for "Yes" replies relating to certain conditions, or other matters (e.g. hazardous sports).

5.2.2 Receipts and Policy Effectiveness

The fact that a life insurance policy cannot be cancelled by the insurer once it has commenced is a matter of recurring importance. In connection with **receipts** issued by insurers, for example, in Non-Life insurance a receipt is merely an acknowledgement that some money has been received. This is not inevitably connected with the *inception date* of the insurance, which could have **already** commenced some time ago, or could be intended to commence in the future. Moreover, even if the (Non-Life) policy has commenced, there is usually a policy condition allowing **cancellation** if need be. Not so with **Life Insurance**.

In life insurance, a *premium receipt* is a written acknowledgment that an insurer has received the initial premium submitted with an **application** for insurance. There are **two** types of premium receipt which are in common use:

(a) **Conditional premium receipt:** with this type of receipt, the insurer agrees that the insurance will commence *at the time of application*. **BUT** this is true only **provided** that the applicant is subsequently found to have been insurable on *standard terms* at the time of application. Two things follow from this:

(i) if the applicant is found to be insurable, but **only** for a *different* plan, premium or amount of cover, then the insurance is **not** effective from the *date of application*. Technically, we may say that the **offer** has not been **accepted** on its exact terms, so the contract does not commence until any *revised terms* have been agreed;

(ii) if the applicant, **subsequent** to the application becomes *uninsurable* or even *dies* he **is** covered provided he is found to have been insurable *at the time of application*.

(b) **Binding premium receipt:** this may be known by other names, such as a *Temporary Insurance Agreement* (TIA) or an *Unconditional Premium Receipt*. Whatever the title used, the basic features surrounding such a receipt are:

(i) this represents a **contract**, *separate from any subsequent insurance policy* that may be issued;

(ii) cover **begins** from the date the *application* was signed and the date that the *premium* was paid;

(iii) cover is **not conditional** upon the applicant subsequently proving to be, or to have been, *insurable*; **but**

(iv) cover is **limited** to a maximum specified *number of days* (say **60** or **90** days);

(v) the cover may terminate **earlier** than the final day of the period specified:

(1) from the date the insurer *returns the premium*;

(2) a specified number of days after *mailing* a notice of termination to the applicant;

(3) from the date when coverage begins under the *issued policy*.

Note: In Non-Life insurance a similar document is used to give **temporary**, unconditional but **cancellable** cover. There it is called a **Cover Note**, although it is usually only for 30 days cover and may or may not be conditional upon any premium payment.

5.2.3 Client Service - Policies and Standards

Client service has been described as the range of activities a company engages in to keep its customers satisfied.

5.2.3a The Importance of Client Service

This may have a number of considerations, including the following:

(a) *Customer loyalty*: the customer who is happy with you tends to stay with you. Continuity and the **conservation** of business are very important in life insurance, where the most of the costs and expenses are "up front" (when the policy is first arranged).

(b) *Customer "prospecting"*: "prospecting" may be described as the search for new customers. If existing customers are happy with you, they immediately become your "unpaid prospectors" with their friends and families.

(c) *Productivity/Profitability*: quality service leads to fewer mistakes and fewer complaints. That in itself means that effort can be directed to more productive activity, with its consequent impact on profitability.

5.2.3b How to Achieve Quality Client Service

There is no simple answer to this, but certainly the following will greatly assist in achieving desired goals in this area:

(a) *Corporate culture*: this should always be **customer-orientated**.

(b) *Delegation*: of adequate and appropriate **authority** and **accountability** to front-line employees.

(c) *Systems*: should be created to monitor **customer satisfaction**.

(d) *Training*: and technology appropriate to these goals should be available.

Note: The above recommendations apply primarily to the insurer, but the underlying principles are easily adapted and applicable to insurance intermediaries.

5.2.4 Cooling-Off Period

One of the popular conceptions, and certainly a popular fear in the general public, is that life insurance salesmen may be too assertive, even aggressive, in their selling. The perceived result from this could be that a person might be pressurised into purchasing a life insurance that he does not really want, or cannot really afford.

To counteract this perceived possibility, the Hong Kong Federation of Insurers (HKFI) has issued a code of practice called "Cooling-off Period" for compliance by its life insurance members (LIMs), with the following major provisions :

(a) Policyholders are given a period (called a "Cooling-off Period") during which they may reflect and if they wish *change their mind* about a life insurance policy that they have purchased or applied for.

(b) Such rights apply to purchases of new individual life insurance policies, whether linked or non-linked. To avoid possible doubt, certain transactions are stated to be beyond the scope of application, e.g. new riders added to existing life policies and conversions of life insurance plans.

(c) The Cooling-off Period is 21 days after the delivery of the policy or issue of a Notice (see (d) below) to the policyholder or the policyholder's representative, whichever is the earlier.

(d) The Notice is to inform the policyholder of the availability of the policy and the expiry date of the Cooling-off Period. It reminds the policyholder that he has the right to re-think his decision to purchase the life insurance product and to obtain a refund of the premiums paid if the policy is cancelled within the Cooling-off Period. It also reminds the policyholder to contact the Customer Service Department of the insurer directly (service hotline number should be provided) if he does not receive the policy within 9 days from the issue date of the Notice.

(e) LIMs have to keep a copy of the Notice or acknowledgement of receipt of policy delivery. In case of a reasonable complaint or dispute, they will be required to produce evidence to show that the Notice or policy has been delivered.

(f) LIMs are advised to:

(i) specify in their training materials for insurance intermediaries and internal guidelines that insurance intermediaries have to:

a. inform prospective policyholders of their Cooling-off rights and the expiry date of the Cooling-off Period when they sign their policy application forms; and

b. make all reasonable endeavour to deliver policies to the policyholders within a period of time consistent with (d) above and (f)(ii) below after the policies are issued if they are obliged to deliver policies on behalf of the insurers.

(ii) devise internal control measures which will ensure and prove that:

a. policies are delivered no later than 9 days after the policy issue date; or

b. a Notice to inform policyholders of the availability of the policies and the expiry date of the Cooling-off Period is issued no later than 9 days from the policy issue date;

and

(iii) maintain records in respect of complaints or disputes for cases where clients seek refunds outside the Cooling-off Period but are refused by the insurer and to provide these records to the HKFI upon request.

(g) Subject to the provisions below, policyholders have the rights to cancel new policies within the Cooling-off Period and obtain a refund of the premium(s) paid:

(i) For all non-linked policies other than non-linked single premium policies, the refund is 100% of the premiums paid.

(ii) For all linked policies and all non-linked single premium life insurance policies, the insurer has the right to apply a "*market value adjustment*" (MVA) to the refund of premiums.

(iii) Any such MVA has to be calculated solely with reference to the loss the insurer might make in realising the value of any assets acquired through investment of the premiums made under the life policy. It should therefore not include any allowance for expenses or commissions in connection with the issuance of the contract.

(iv) In the case of a linked policy, the insurer's right to apply an MVA has to be disclosed in the **Principal Brochure**, and the basis of calculation must be available for disclosure to the potential policyholder prior to the completion of the application form.

(v) For non-linked single premium policies, potential policyholders have to be made aware that the insurer has the right to apply an MVA before they sign the application. This may be done by letter, or within the product brochure.

(h) A statement announcing the availability of Cooling-off Rights has to be included on the application form immediately above the space for the signature.

(i) When the policy is issued, the policyholders have to be reminded of the Cooling-off Rights attaching to the policy. This may be done by way of a **letter** from the insurer, mailed **direct** to the policyholders, or a **statement** on the policy jacket or policy cover.

5.2.5 Policy Switching

With a competitive and innovative market, obviously there can be genuine and quite legitimate cases where an insurance intermediary can in all conscience recommend a client to change his present life insurance policy to one offering better terms or prospects. Such an activity will meet the approval of all unbiased people and create no problem for regulators. But that which does not comply with the above criteria is a matter of profound concern. To address this concern, the HKFI has issued the "*Code of Practice for Life Insurance Replacement*" ("the Code"), which we should study in some detail, to prevent ‘twisting’ by insurance agents, insurance brokers, and their responsible officers/chief executives and technical representatives.

(a) **"Twisting" defined:** The Code defines **twisting** as:

"*the making of inaccurate or misleading statements or comparisons to induce a policyholder to replace Existing Policy with other life insurance policy to the policyholder's disadvantage.*"

(b) **"Replacement":** Unlike 'twisting', 'replacement' is a neutral term defined in the Code in the following manner:

"Any transaction involving the purchase of life insurance is construed as a replacement if within 12 months before or after a new life insurance policy# ("New Policy") is effected:

(a) an existing life insurance policy# ("Existing Policy") or a substantial part* of the sum insured of its basic life coverage:

(i) has lapsed/will lapse; or
(ii) was/will be surrendered; or
(iii) was/will be converted to reduced paid-up or extended-term insurance under the non-forfeiture provision of the policy;

or

(b) a substantial part* of the guaranteed cash value of the Existing Policy was reduced/will be reduced including where a policy loan was/will be taken out against a substantial part* of the guaranteed cash value.

(# Life insurance policy includes all types of traditional life, annuity and other non-traditional policies.)

("a substantial part" means "50% or above".)"*

Internal replacement, i.e. both the Existing and New Policies are issued by the same insurer, is covered by the Code. The insurer concerned should devise internal controls and measures to discharge its obligations under the Code both as the selling office and the non-selling office. However, converting a term life insurance to a whole life insurance (or some forms of permanent life insurance) under policy provisions of the Existing Policy is not construed as a "replacement".

(c) **Customer Protection Declaration (CPD) Form:** This is a very important document which an insurance intermediary must help an applicant complete before the applicant agrees or makes a decision in relation to the purchase of a New Policy. Prepared in conjunction with the CPD Form, the "Explanatory Notes to Customer Protection Declaration Form" explains in detail the duties of the insurance intermediary regarding the completion of the CPD Form and how to complete it (see Appendix A).

The Code requires LIMs to provide training to help their insurance agents to get familiar with the contents of the CPD Form, of which the most important features can be found below:

(i) the form is designed to discover any replacement being recommended.

(ii) the insurance intermediary is required to explain and discuss with the applicant the full implications of his replacement, if any, in the following areas. Unless otherwise indicated, the insurance intermediary has to give reasons and/or justifications wherever required in the CPD Form in writing as fully as possible.

(1) *Financial implications*:

Estimated loss:

(a) It is stated on the CPD Form for reference only that the policy set-up cost is usually two years' premiums or 10% of single premium of the basic life insurance policy replaced or to be replaced. No reason is required if the estimated loss stated is equal to or higher than this reference. The insurance intermediary may use other reference for the estimated loss provided he could reasonably justify the estimation. In addition, if he states that the policy replacement will result in no loss, or that the estimated loss is less than two years' premiums or 10% of single premium, he must give the reason and justification in the space provided.

Annualised premiums:

(b) The insurance intermediary is required to write down whether the new policy attracts higher annualised premiums for the same sum insured and, if a negative answer is given, the reasons for that.

Guaranteed cash values:

(c) Besides, the applicant should take note that the projection of future values of the new life insurance policy may be higher than the existing life insurance policy, but the projected values in most cases depend on the insurers' performance, which may not be guaranteed. On the other hand, the insurance intermediary is required to fill in the respective guaranteed cash values of the existing life insurance policy(ies) and the new life insurance policy on the policy anniversary dates immediately after the applicant reaches age 65. But where any of the policies matures before this age , he should fill in the guaranteed cash values on the policy anniversary dates of each policy in the earliest maturity year.

(2) *Insurability implications*: the new insurer may review the life insured's current state of health, occupation, life style/habit and recreational activities. If any significant change has occurred, the insurer may deny some coverage or charge a higher premium. Such implications must be explained to the client.

(3) *Claims eligibility implications*:

Suicide clause and contestability period:

(a) The new life insurance policy may have different policy provisions and also may result in a new start of the period in the suicide clause and of the contestability period. This could result in a claim being denied that would have been paid under the existing life insurance policy. The insurance intermediary has to help the applicant fill in the respective expiry dates of the suicide exclusion period(s) and contestability period(s) of the existing life insurance policy(ies) and the new life insurance policy. He also has to obtain the expiry date(s) of the suicide exclusion period(s) and contestability period(s) of the existing life insurance policy(ies) from the applicant unless the applicant declares on the CPD Form that he does not want to disclose such information.

(b) The insurance intermediary has to explain to the applicant that if he opts for reinstatement of his existing policy following an incident of twisting (see **5.2.5**(e)(i)(4) below), it is the new insurer, rather than the existing insurer, who will be responsible for paying any claims, subject to the terms and conditions of the new policy, that will have occurred on a date when the existing policy has been surrendered or lapsed in the course of the policy replacement.

(4) *Other considerations:*

The insurance intermediary is also required to help the applicant:

(a) list those riders/supplementary benefits that are granted under the existing life insurance policy(ies) but not under the new life insurance policy. The insurance intermediary has to obtain the riders/supplementary benefits under the existing life insurance policy(ies) from the applicant unless the applicant declares on the CPD Form that he does not want to disclose such information;

(b) list the reasons why the new life insurance policy is more suitable for the applicant unless the applicant declares on the CPD Form that that is not his concern; and

(c) answer the question of whether the insurance intermediary has advised the applicant of any alternatives to replacing the existing life insurance policy.

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(iii) the original of the CPD Form shall be kept by the *selling office*, with a copy for the *client* - a Hong Kong resident or otherwise - attached to the policy, and another copy for the non-selling office (i.e. the authorised long term insurer whose policy is being replaced) within 7 business days of the issue date of the New Policy.

Note: 1 The references above to insurance intermediaries in relation to the CPD Form shall include insurance agents, insurance brokers, their responsible officer/chief executive(s) and technical representatives, as appropriate.

2 A specimen CPD Form and the explanatory notes to it can be found in **Appendix A** for reference purposes.

(d) **Identifying twisting:** This may be initiated from a number of sources:

(i) **Client initiated:** if a client complains about suspected twisting,

(1) the complaint, received by the HKFI or other party, has to be forwarded to the selling office;

(2) then the selling office has to investigate and follow the same process as if it had itself discovered a suspected or actual incident of twisting (see (ii) below). It also has to write to the client to acknowledge receipt of the complaint and commit to notify the client, within 30 days of the receipt, of its findings and any suggested arrangements .

(ii) **Selling office initiated:** if the selling office, in the course of reviewing its internal controls and the CPD Forms – which it is obligated to do under the Code – discovers cases of suspected twisting or has evidence that existing policyholders may have suffered because of twisting by its insurance agent(s) or the insurance broker(s), it has to investigate them and take action (see (e) below).

(iii) **Non-selling office initiated:** if an office has evidence that its existing or ex-policyholders have suffered because of twisting by insurance agent(s) of other office(s)/insurance broker(s), it has to investigate and take action (see (e) below);

(e) **Subsequent actions:** Once twisting is identified as likely to have occurred, the offices concerned should attempt to reach agreement. This imposes an obligation on the offices to keep the client's interest foremost. The client has to be kept informed of any material facts or arrangements which may affect his interest. Agreement must be reached speedily within a period of 30 days after the identification of the twisting and any follow up actions or arrangements affecting the interest of the policyholder has to be completed within 45 days, i.e. the next 15 days.

(i) **If it is agreed that twisting has occurred,** the **selling office** must immediately:

(1) *report* the insurance agent to the **Insurance Agents Registration Board** (IARB), or the insurance broker to the relevant broker body or the Insurance Authority (IA) as appropriate;

(2) *suspend* the insurance agent from selling any further new life insurance, or suspend accepting any further new life insurance sold by the insurance broker's chief executive/technical representative who did the twisting;

(3) *claw back* the commission paid on the case(s) in question; and

(4) *write* to the client, explaining that he may have been sold policy(ies) unprofessionally, and giving him the option to end the arrangements, request the return of all the premiums paid on the New Policy, and reinstate the Existing Policy(ies). The client will have 30 days to make a decision. He also has to be told that the selling agent has been *suspended* and has no further authority to represent the selling office to sell new life insurance, or that the selling office has suspended accepting any further new life insurance business sold by the insurance broker's chief executive/technical representative who did the twisting.

The **non-selling office** has to arrange terms for *reinstatement* of the Existing Policy(ies), if the client so wishes, to allow the client, to the maximum extent possible, to return to the same position as if the twisting had not taken place. As stated in **5.2.5**(c)(ii)(3)(b) above, where the client opts for reinstatement of the Existing Policy, it is the selling office, rather than the non-selling office, who will be responsible for paying any claims, subject to the terms and conditions of the New Policy, that may have occurred on a date when the existing policy had been surrendered or lapsed in the course of the policy replacement.

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(ii) **If it cannot be agreed** that twisting has taken place, the complaining client or office may refer the complaint to the IARB, the relevant broker body or the IA as appropriate, which will give a ruling. Where twisting is established, it will decide on the appropriate disciplinary action against the insurance agent or insurance broker and inform the client of his rights to a reinstated Existing Policy and to a return of all the premiums paid on the New Policy.

(iii) In the event that the Life Insurance Council finds that an insurer has failed to comply with the above process, it will:

(1) seek cooperation from the office(s) concerned;

(2) endeavour to mediate among all parties concerned; and /or

(3) refer the case to the IA where there is concrete evidence of non-compliance.

5.2.6 Sales Illustrations for Linked and Non-Linked Policies

5.2.6a Linked Policy Illustration Document

The Securities and Futures Commission (SFC) requires that all authorised investment-linked assurance schemes must issue to each of their prospective participants an up-to-date **Principal Brochure**, which should contain the information necessary for the participants to be able to make an informed judgment of the investment proposed to them. In addition, an 'Illustration Document' is required to be issued in accordance with the guidelines set out in the SFC's "Code on Investment-Linked Assurance Schemes". These we summarise below (a format of the Illustration Document can be found in **Appendix B**):

(a) **Minimum requirements** for the information to be included in the illustration document are:

(i) **Surrender values:** the insurance company must indicate what the policyholder would be expected to receive if he redeems at the end of each of the first **5 years** of the contract, and for every **fifth year** thereafter until maturity, after deduction of all relevant charges.

These expected surrender values should be based on at least 2 different assumptions about the **rate of return**, currently set at a **low** of not more than **5**% and a **high** of not more than **9**% p.a. respectively. (These rates may be subject to change by the SFC after consultation with the industry.)

(ii) **Prescribed statements:** the following statements should appear in the Illustration Document:

'THE ASSUMED RATES USED BELOW ARE FOR ILLUSTRATIVE PURPOSES. THEY ARE <u>NEITHER</u> GUARANTEED <u>NOR</u> BASED ON PAST PERFORMANCE. THE ACTUAL RETURN MAY BE DIFFERENT!

IMPORTANT:

THIS IS A SUMMARY ILLUSTRATION OF THE SURRENDER VALUES OF (NAME OF PRODUCT). IT IS INTENDED TO SHOW THE IMPACT OF FEES AND CHARGES ON SURRENDER VALUES BASED ON THE ASSUMPTIONS STATED BELOW AND IN NO WAY AFFECTS THE TERMS OF CONDITIONS STATED IN THE POLICY DOCUMENT.'

The following statements should be clearly disclosed before the investor's signature:

"*Warning: You should only invest in this product if you intend to pay the premium for the whole of your chosen premium payment term. Should you terminate this product early, you may suffer a significant loss.*

Declaration:

I confirm having read and understood the information provided in this illustration and received the principal brochure."

(b) **Company customisation:** subject to the approval of the SFC, the insurance company may customise the document to include additional information, provided that such additional information is not misleading and does not otherwise detract from the information disclosed in the minimum requirements.

(c) **Illustration preparation**: the insurance company has to prepare an illustration document in conjunction with each proposed investment by each prospective scheme participant, and provide the document to the latter for his review and signature prior to signing of the application form.

5.2.6b Non-Linked Policy Sales Illustration

The Life Insurance Council (LIC) of the HKFI has produced the "Standard Illustration for Non Unit-Linked Life Policies" with the purpose of ensuring that every prospective policyholder is provided with a summary illustration of the benefits of a non unit-linked life insurance (**excluding** universal life insurance), where there is some form of *return* to the policyholder other than a pure *death benefit* – so term insurance is not affected. The standard illustration sets out what **is** and what **is not** guaranteed through the comparison of the premiums payable.

The **Purpose** is clearly set out in the Illustration Document, and so are the following:

(a) **Minimum requirements:** these are set out in a sample format obtainable from the HKFI or supplied by the insurer.

The Document emphasises that:

(i) the illustration is only a summary illustration of the major benefits of the proposed policy, which does not affect the policy terms;

(ii) the illustration refers to the Basic Plan only (exclusive of any riders and additional benefits), and it assumes that all premiums are fully paid when due;

(iii) the death benefit (guaranteed and non-guaranteed) and cash value (guaranteed and non-guaranteed) need to be shown against the total premiums payable for each of the first five years and for every five years thereafter up to the age of 65 or until maturity if earlier;

(iv) the amount of total premium(s) may be slightly different from the total of the premiums payable in the policy due to rounding differences (the inclusion of this point is optional for the insurer);

(v) projected dividend values are based on the insurer's current dividend scales and are not guaranteed. The actual dividends may deviate;

(vi) projected dividends and cash payments may be left with the

Company, to earn interest at a rate which is specified but not guaranteed: the possibility of taking a cash payment regarding projected dividends is also specified;

(vii) on assumed interest and dividend rates, future Basic Plan premiums can be paid from dividends etc. after a specified policy year; this however is not guaranteed: a change in either the interest rate or projected dividend scale may require the policyholder to pay additional premiums to maintain the Basic Plan.

(b) **Company customisation:** companies are allowed to customise the Illustration Document, provided that such additional information is not misleading and does not otherwise detract from the information disclosed in the minimum requirements. It must be prepared on no more than one sheet of A4 paper, if necessary, with printing on both sides with an indication that it continues overleaf.

(c) **Rates/values:** these must be the ones currently used by the company, or if different this must be **clearly stated**. The *Appointed Actuary* must take all reasonable steps to ensure that incoming policyholders are **not misled** as to their *expectations*.

(d) **Illustration preparation:** an Illustration Document must be prepared by the Company with *each policy* to be issued. This is **very important** and subject to certain stipulations:

(i) may be provided to the prospective policyholder for review **prior** to signing the application;

(ii) if this is done, the prospective policyholder must sign a **Declaration** on the Illustration Document confirming that he understands the information supplied;

(iii) if the Declaration is not signed, the Illustration Document must be issued at policy delivery or simultaneously with the provisions of the **Cooling-Off Initiative**.

(e) **Language:** the Illustration Document must be in the same language as used by the Company in its other pre-sale literature, if the **Declaration** is signed prior to signing the application form. If not, the same language must be used as is used for other communication at the time of *policy issue*.

(f) **Complaints or disputes:** companies must keep records in respect of complaints or disputes arising from the issue of the Illustration Document. These records must be provided to the **HKFI**, upon its request.

Note: a format of the sales illustration can be found in **Appendix C**.

5.2.6c Universal Life (Non-Linked) Policy Sales Illustration

The Sales Illustration in **5.2.6b** above specifically excluded universal life products. The "Standard Illustration for Universal Life (Non-Linked) Policies" produced by the LIC, therefore, seeks to complete the picture with a very similar **Illustration Document**.

The **Purpose** is to ensure that each prospective policyholder is provided *as a minimum* with a summary illustration of the benefits of a universal life (non-linked) insurance. This is clearly set out in the Illustration Document, as are the following:

(a) **Minimum requirements:** these are set out in a sample format obtainable from the HKFI or supplied by the insurance company.

The Document emphasises that:

(i) the illustration is only a summary illustration of the major benefits of the proposed policy, which does not affect the policy terms;

(ii) the illustration refers to the Basic Plan only (i.e. exclusive of riders and additional benefits), and assumes that all premiums are duly paid without exercising the skip premium option (separate references are also made to charges, based on current scale or not);

(iii) the amount of total premium(s) may be slightly different from the total of the premiums payable in the policy due to rounding differences (the inclusion of this point is optional for the insurer);

(iv) the total cash value and total death benefits are calculated on the basis that the "Assumed Declared Rates" remain unchanged throughout the term of the policy;

(v) the total cash value and total death benefit under each of the assumed declared rates, and the guaranteed death benefit need to be shown against the total premiums payable for each of the first five years and for every five years thereafter up to the age of 65;

(vi) declared current interest rates are not guaranteed for the future.

(b) **Company customisation:** comments as per **5.2.6b**(b).

(c) **Charges/Rates of return:** comments as per **5.2.6b**(c). Also, companies should use at least two different assumptions of interest rates (net of charges) with projections, the low rate being set at no more than **5%** and the high rate at no more than **9%**. Additional illustration based on current declared rate, if appropriate, should be encouraged.

(d) **Illustration preparation:** a **very important** section, with comments as per those in **5.2.6b**(d).

(e) **Language:** comments as per **5.2.6b**(e).

(f) **Complaints or disputes:** comments as per **5.2.6b**(f).

Note: a format of the sales illustration can be found in **Appendix D**.

5.2.7 Distributions of Policy Dividends

5.2.7a Basic Principles of Dividend Distributions

Participating policies, which are discussed in other parts of the Study Notes (see **1.3.1b**(a) and **4.10**), are bought with expectations of returns in the form of policy dividends, and they normally grant guaranteed cash values as well. Generally, the amounts of dividend to be declared and distributed are directly linked to the experience of the pooled fund of the relevant participating policies. (By “pooled fund”, it means the whole of the assets which the relevant insurer has created on its balance sheet as a result of granting the participating policies and which it then manages on behalf of such policies.) The experience of the pooled fund over a given period is a function of the fund’s investment yields, expenses, claims, etc. for that period. In general, dividend amounts feel the largest impact from the pooled fund’s investment returns, which may or may not be consistent with the overall business performance of the insurer. As a matter of prudence, only when the actual experience is found to be more favourable than the actuarial and financial assumptions that the insurer has made should it declare policy dividends.

As said above, dividend amounts depend on the experience of the pooled fund. It is also worth noting that insurers normally reserve the right to determine dividend amounts. In practice, decisions on dividend amounts are based on the advice of the respective appointed actuaries and subject to the approval of the respective boards of directors. The actuaries, in making recommendations, will consider the experience of the pooled funds, the economic outlook and the equity between different classes and generations of policyholders that coexist within a single pooled fund. Besides, dividends are normally smoothed out in order to reduce large short-term fluctuations. Smoothing takes various forms and varies from one insurer to another, depending on the terms of the insurance contracts and the company policies.

5.2.7b Methods of Dividend Distributions

In Hong Kong, policy dividends are generally distributed in three ways:

(a) As a cash dividend: many policyholders choose to leave cash dividends on deposit with their insurers.

(b) As a reversionary bonus, where policy benefits are permanently increased by the declared amounts (see **1.3.1b**(a)).

(c) As a terminal bonus, such that the payout value is usually targeted to be close to the asset share of the fund (the policyholders' notional share of the participating fund), taking into account the total return of the underlying assets.

Cash dividends and reversionary bonuses are usually declared on an annual basis while terminal bonuses are usually declared at policy maturity or when the policy has been in force for a given number of years.

In Hong Kong, the majority of life insurers use method (a), with a few using method (b). Method (c) is an optional supplement to methods (a) and (b). Whilst the above is a description of the typical dividend philosophy, it is important to note that variations are possible. Member companies of the HKFI publish information about their respective dividend philosophies on their websites.

5.2.7c Advantages of Participating Policies

The main advantage of participating policies is that apart from availability of cash values and death benefits guarantees, the policyholder can participate in any favourable experience of the pooled fund in the form of dividends. A second advantage is that the risk of return to the policyholder is lower than with investment-linked policies, owing to the said guarantees. With investment-linked policies, the policyholder selects the underlying investments and will have the full upside if they perform well but also the full downside if they perform badly because such policies generally make no guarantees. The fact that returns on participating policies are generally smoothed is another advantage.

5.2.7d Transparency of Life Insurers with regard to Dividends

The practices commonly adopted by insurers in helping policyholders better understand dividend distributions under participating policies are as follows:

(a) **Point of Sale Illustrations**: At the point of sale (and later on at the request of customers), insurers provide them with an illustration of policy benefits, which separately shows benefits that are guaranteed and those that are not.

The Actuarial Society of Hong Kong, with the encouragement and support of the Insurance Authority, has issued a Guidance Note on illustrations, "AGN5: Principles of Life Insurance Policy Illustrations", which aims to provide standards and principles in preparing illustration documents.

Most insurers provide sales illustrations that assume that declared cash dividends will be left on deposit with them to earn interest at rates that are not guaranteed and that fluctuate with the market interest level. Such assumptions are explicitly mentioned in the illustrations. Furthermore, applicants are requested to sign illustrations in order to ensure that they have read the illustrations and that the illustrations have been explained to them. As a matter of good practice on sales illustrations, the HKFI recommends its members to incorporate the following notes into illustration documents:

(i) *"The projected dividends included in the above are based on the current dividend scales and are not guaranteed. The actual dividends paid may change and the actual values may be higher or lower than those illustrated." An alternative note used by at least one Company is "When experience is worse or expected to be worse than the current situation, dividends may be reduced or vice versa."*

(ii) *"As illustrated in the above, you can leave the amount of projected dividends to accumulate with the Company at an interest rate that will be reviewed and adjusted by the Company from time to time. The current interest rate used to illustrate the effect of accumulation in the above is x% p.a. This rate is not guaranteed. You can also cash all or part of the amount of projected dividends without affecting the face amount but the values shown above will be reduced accordingly."*

(iii) *"If the interest rate and assumed dividend scales remain unchanged throughout your policy term, then the future premium on the Basic Plan can be paid out of accumulated dividends (and cash payments) from policy year XX onwards. <u>This is not guaranteed: a change in either interest rate or projected dividend scale may require you to pay extra premiums to maintain the basic plan.</u>"*

(iv) A note on the front page of the illustration which states *"Dividend or bonus amounts depend on how well the fund has fared with regard to investment yield, expense, claims etc"*.

To assist potential policyholders in better understanding and assessing the impact of changing rates of investment return, some insurers illustrate projected policy benefits in sales illustrations based on an alternate dividend scale and/or accumulation interest rate that assumes different future investment earnings, while some others provide similar illustrations upon request. However, some insurers feel that it is better to give customers the best estimates of future experience on one basis, supplemented with a statement that actual dividend amounts may vary from the estimates.

(b) **Annual Statements**: In annual statements to customers, some insurers highlight any changes to policy dividends and give broad reasons for them. At the request of any of their customers, members of the HKFI will provide a revised illustration using current dividend rates after an adjustment.

(c) **Premium Offset**: Insurance plan proposals sometimes project that once premiums have been paid for a stated number of years, assuming that all projected cash dividends are left on deposit with the insurers, such dividends plus the projected interests on them will be capable of funding all future premiums so that the policyholders may then choose to stop paying premiums without affecting the validity and continuity of the policies, which practice is known as "premium offset". While this option may sound attractive to some customers, it is important to note that at any time after such an option has ever been exercised by a customer, it is possible to see unfavourable interest rate levels so that he will have to pay premiums with cash in hand again or risk policy lapse or reduced benefit amounts. As a matter of good practice, insurers should make sure that at the point of sale this situation is fully explained to the customers so that they can make an informed decision.

(d) **General Information on Dividends**: The document named "Policyholder Dividends and Disclosure for Participating Business" and issued by the LIC of the HKFI in 2009 provides general background information on participating policies. Apart from this, the HKFI requires its members to explain on their websites their respective philosophies with regard to declaration of policy dividends.

5.3 UNDERWRITING

Underwriting may be simply described as the *assessment of risks* for the purposes of insuring them or deciding what insurance terms should apply. Another way of describing the term is to say that it is determining the *insurability* of proposed risks. Since life insurance involves a **long-term** contract that **cannot** be cancelled by the insurer, we may say that normally life insurance underwriting for an individual risk can only be done **once**. It is therefore important to get it right first time.

5.3.1 Factors Considered

Underwriting is said to consist of two main stages:

(a) **Identifying the degree of risk:** from experience life insurance underwriters can identify degrees of risk with applications, usually under two headings:

(i) **Physical hazard:** this concerns largely objective factors that are likely to increase the risk of the *insured event* (death) happening. These will include obvious features such as known health dangers, including:

(1) significantly *overweight*;

(2) heavy *smoker*;

(3) *substance abuse* (alcohol, drugs etc.);

(4) very dangerous *occupation* or *leisure pursuits*;

(5) adverse inheritable family or personal *medical history*.

(ii) **Moral hazard:** this concerns rather more subjective factors surrounding the basic *honesty* or honourable intentions of the applicant/proposer. Whilst **suicide** is not a common potential problem (and is in any event covered to some extent by policy provisions - see **4.12**), there are other considerations. For example, the person may deliberately hide important information or submit false information to obtain cover. It is, of course, less easy to determine moral hazard than physical hazard.

(b) **Classifying the proposed risk:** classifying proposed risks into appropriate *categories* enables the insurer to determine an *equitable premium*. Insurers tend to have four categories of risks, as follows:

(i) **Standard risks:** these present no abnormal features, and are perfectly acceptable at the appropriate premium according to the age and sex of the applicant.

(ii) **Sub-standard risks:** because of the adverse sound of such a term, some insurers call these *special class risks*. In either case, what is implied are risks that cannot be insured under normal terms. They are *insurable*, but only subject to certain considerations, discussed in **5.3.3** below.

(iii) **Declined risks:** as the name indicates, these are risks that a particular insurer has found to be unacceptable. Insurers generally try to give cover if they reasonably can, but obviously there are some applications where health or other factors make it impossible to accept.

(iv) **Preferred risks:** not all insurers use this category, which implies an *above average* risk application that merits a discount or other favourable terms. This may include confirmed non-smokers or individuals who otherwise represent better prospects of long years before a claim is likely to arise.

Note: The above may be said to represent **technical underwriting**, involving an assessment of the intrinsic and perceived hazards presented by individual risks. We should also note what is called **Financial Underwriting**. This term relates to an assessment of the sum to be insured in relation to various matters, including:

1 the perceived ability of the policyowner to meet premium obligations;

2 the degree of risk presented (and therefore whether **reinsurance** might be advisable/available);

3 accumulation of policy plans for the same person;

4 whether it is in excess of usual levels for persons corresponding to the age and general circumstances of the applicant/proposer. We cannot say that any life insurance is *too much*, but if it is very high by customary standards this may put the insurer on enquiry.

5.3.2 Medical Reports

5.3.2a Non-medically Examined Business

Many life insurance plans are arranged on a *non-medically examined* basis. That is, the information supplied on the application and other circumstances surrounding the proposal (age, apparent health, sum to be insured, etc.) allow the underwriter to proceed without further enquiry.

5.3.2b Medically Examined Business

Sometimes, however, further information is required from qualified medical practitioners. The source of such enquiry may be an *attending physician* (by which is meant a doctor or other qualified medical person who usually supplies or has previously supplied medical care to the applicant) or an *examining physician* (by which is meant a physician who conducts a medical examination (the U.S. term commonly used is a **physical**) at the request of the insurer, who pays for this). A number of factors need to be considered with this subject:

(a) **A sensitive subject:** it is human nature to become anxious at the thought of a medical examination. This is quite illogical, as it must be for one's good to know the truth, but that is not how most of us think. Insurers are quite aware of this and only request medical information if it is deemed really necessary. In addition, great care has to be taken not to infringe any statutory provisions regarding the *protection of personal data*.

(b) **Attending Physician's Statement** (APS)**:** this is the most frequently required medical report and the usual reasons for requesting it are:

(i) specific medical disclosures on the application need further enquiry;

(ii) the amount of insurance requested is high;

(iii) the applicant is at a fairly advanced age (say, over 50).

(c) **Specialised medical questionnaire:** the examining (or attending) physician may be supplied with a separate questionnaire specifically designed to obtain information on a particular illness or condition that needs to be considered with the applicant concerned. This may relate to any of a number of conditions, ranging from blood pressure to cancer, being conditions that previously disclosed information suggests a need for further enquiry.

(d) **Confidentiality:** obviously, medical information is very private and the information obtained must be treated with the utmost confidence. However, if and when medical tests are suggested, the applicant has the right to know what tests are to be done, what the information is needed for, and (if he wants to know) the results of any tests.

5.3.3 Sub-Standard Life and Underwriting Measures

Usually for medical, but sometimes for other reasons, a particular applicant may prove to be below the required standard for acceptance at normal rates. There are a number of possible underwriting reactions to this situation, including:

(a) **Refuse to insure:** sometimes called *declinature*. This is a drastic measure that insurers prefer to avoid if at all possible. Most life applications can be accommodated, although sometimes the terms of the insurance may have to be more severe.

(b) **Load the premium:** increasing the premium is a very standard way of dealing with sub-standard risks. The extra premium, which may be quite modest or quite substantial according to circumstances, can *normalise* the abnormal, for insurance purposes.

(c) **Other options:** the above two reactions are the most common, but there is a wide range of possibilities, which might include one or more of the following:

(i) a **"debt"** on the policy, reducing each year so that it disappears on a specified date;

[A ‘debt on policy’ is one of the underwriting measures which are associated with the ‘numerical system of rating’. Under this system, the underwriter applies a mortality rating of 100 to the normal average healthy life, and then adds to it for adverse features (e.g. overweight) and subtracts from it favourable features (e.g. non-smoking). The excess of the final mortality rating over 100 is termed an ‘extra mortality’. This extra mortality will be converted into an additional premium or a debt against the sum assured.

The decreasing debt is the most commonly used type of debt. Suppose the debt is set at $190,000 at the inception of a 20-year endowment policy for a sum assured of $400,000. Should death occur in the first year of cover, the policy proceeds will be $210,000 (i.e. $400,000 minus $190,000). The debt will reduce, and so the *actual* cover will increase, at the end of each of the first 19 years of cover, by $10,000. So in the last year of the policy, the cover is $400,000.

Note: allocation of bonuses will be done on the basis of the full sum assured (i.e. the nominal cover).]

(ii) specific **exclusions**, perhaps of death from a particularly dangerous pastime or leisure pursuit (this would be very rare, since it tends to defeat the object of the cover);

(iii) offering a **different plan:** short term cover may be possible, where the medical evidence indicates that very long-term insurance is doubtful;

(iv) decline to accept **at present**, i.e. to **defer** a decision, if the applicant is severely injured or otherwise has a (hopefully) temporary adverse condition.

5.4 POLICY ISSUANCE

Once the underwriting process is complete and cover has been approved, the policy can be prepared and then delivered to the policyowner. The important fact that a policy cannot be **cancelled or amended** after its issue without the agreement of the policyowner once more needs to be mentioned. Issuing and delivering the policy in some respects may be looked upon as the "point of no return" for the insurer. Careful policy checking and confirmation is therefore needed before this happens.

5.4.1 Policy Delivery

This may be considered with policy issuance as the two are very closely connected. Using modern technology, policy documents can be produced with great speed and accuracy. The in-house system should create the client's record and verify that the first premium has been received. Policies are mostly in standard format within the class and plan concerned. Therefore, only *variations* affecting the particular client alter the routine format. All of this can be dealt with by an automated system. Some slight differences in procedure should be noted as follows:

(a) **Individual policy covers** (including *annuities*)**:** the production and delivery is straightforward, delivery normally usually being made by the **marketer**.

(b) **Group policy covers:** here the process involves enrolling individual *employees* (or other group persons). The technology system must therefore produce not only the master policy, but also a *certificate* and perhaps an *enrolment card* for each insured person. Each such person receives a certificate and completes an enrolment card, the process normally being overseen by the **insurance intermediary** or **group representative**.

5.5 AFTER SALES SERVICE

The **conservation** of existing business has been mentioned before (see **5.2.3a**(a)). This, for reasons given, is very important and the quality of after-sales service is a vital element in this area. Such service is within the responsibilities of Client Service personnel (see **5.1.1**(e)), whose department might well now be called *Policyowner Service*, or **POS**. By way of reminder, the duties of POS may include:

(a) *Correspondence*: and other communication with customers.

(b) *Documentation*: duplicate policies, surrenders, converting, etc.

(c) *Premium payments*: handling all aspects of this.

(d) *Benefit administration*: cash values, loans and dividends.

(e) *Policy changes*: see below.

5.5.1 Policy Changes

These changes may be relatively trivial, amending some administrative detail, or may have a significant effect upon contract terms. The changes usually requested include **changing** the

(a) *type of insurance cover*: obviously of considerable significance;

(b) *address*: of the policyowner or beneficiary, for example;

(c) *beneficiary*: clearly this must be a permissible change, under contract terms;

(d) *amount of cover*: after any due underwriting consideration;

(e) *owner of the policy*: another obviously important change.

Note: All changes must be carefully processed. The change requested may seem very straightforward, but there is always the possibility that it will have legal or other implications, ranging from underwriting or reinsurance matters even to potential attempted fraud (**money laundering,** etc.).

5.6 CLAIMS

With Non-Life insurance, claims are only expected under a small proportion of policies. There the cover is "in case" there is need and generally speaking neither party wishes to experience a claim situation. The latter may be true in some respects for Life insurance, but there a claim (except for **term insurance**) is inevitable if the policy is kept in force. Indeed, with many contracts having a **savings** element, the policyowner often looks forward to making a claim. Claims may be considered under three headings, as follows:

5.6.1 Maturity Claims

Mostly concerning **endowment insurance**, these involve situations where the life insured is still living and (if also beneficiary) able to collect the proceeds personally. With these, as with all procedures dealt with under this Chapter, each insurer may have its own system, but typically the following considerations arise with maturity claims:

(a) **Near the date:** a month or so in advance of the date the insurer writes to the policyowner, in order to:

 (i) *remind* him of the maturity date;

 (ii) state the *amount* payable;

(iii) list any *requirements* for payment;

(iv) enclose a relevant form of *release*.

(b) **Claim entitlement:** the insurer can only deal with the person having a right to the policy proceeds, who could be the policyowner himself, an assignee (where the policy has been assigned), or a trustee (where the policy has been placed in trust). Also, the policy will be required and, in practice, only assignments duly recorded are recognised. Regarding loss of a life policy, this is only inconvenient but not crucial, because the policy is only evidence of the insurance contract, rather than the contract itself. However, as failure to produce a policy may constitute constructive notice to the insurer (i.e. knowledge that the insurer would have acquired had it made the investigations that are usual in the circumstances) of another person's interest in it, the prudent insurer will require that a proper search for it be made. If it is still unfound, the insurer may ask the claimant to make a statutory declaration in respect of the loss, and to provide a written promise to indemnify the insurer against any losses due to its settling the claim without production of the policy.

(c) **Adjustments:** the payment may have to be subject to deductions for any outstanding items, such as loans, unpaid premiums and interest owing. Of course, any *third party interest* has to be respected and processed in an appropriate manner.

(d) **Proof of age:** if the policy is marked "*age not admitted*", this means that formal proof of age was not given at policy inception. Some insurers may not require confirmation of age if the policy has matured, but it should be requested because **misstatements of age** could have an impact on the policy benefit (see **4.8**).

(e) **Unpaid maturities:** a suitable monitoring and follow-up procedure must be in existence for any maturity claims where the policyowner does not respond to (a) above.

5.6.2 Death Claims

Maturity claims, for obvious reasons, are normally processed in a "happy" atmosphere. Death claims on the other hand inevitably have a serious and sometimes tragic background. Whilst this must not intrude unduly into the professional way in which the claim is processed, insurers and insurance intermediaries should be sensitive to the situation. The specific points needing attention with such claims are:

(a) **Claim entitlement:** people who are possibly entitled to a policy's death benefits include the surviving policyowner in the case of a third party policy, the personal representative of the policyowner-insured, an assignee and a trustee. Where a policy is expressed to be payable to a third party, named or unnamed, without creating a trust or effecting an assignment, he will normally have no right to sue under the contract and it is the policyowner's successors in title who can enforce the contract. That said, where paying the third party is an essential term of the contract, payment to him will discharge the insurer of policy liability so that whether or not the paid third party may, in certain circumstances, have to account to the policyowner's personal representative will not concern him.

For "**loss of policy**" procedure, please see **5.6.1**(b) above.

(b) **Date of death:** this must be established, as it can affect the *amount* payable, e.g. with **decreasing term** insurance, and with any **dividend/bonus** calculations. Indeed, with **term** insurance, the policy could have expired.

(c) **Proof of death:** normally, this is fairly easy to obtain, with the *death certificate* (the **original** document must be produced). Problems may arise over death certificates, however, where death arises or is alleged to have arisen overseas. This has on occasions been a particular area for *fraud*.

(d) **Cause of death:** this will be shown on the death certificate and it may be important for a number of reasons, including:

(i) *suicide*: happening within the suicide exclusion period (see **4.12**);

(ii) *accident*: the policy may be subject to an **ADB rider** (see **3.2.1**(a));

(iii) *suspicious or surprising*: death shortly after the policy was issued, or where the cause would normally develop over a longer period than that for which the policy has been in existence, will put the insurer on enquiry. **Fraud** must always be a possibility in such circumstances. Even if fraud does not apply, the policy may still be within a **contestable** period (see **4.2**);

(iv) *murder*: in most cases, this will not affect the validity of the claim, but if the murderer is proved to have been the **beneficiary**, the law (**"public policy"**) will not allow the murderer to benefit personally.

(e) **Presumption of death:** where no death certificate can be issued and it is assumed the life insured has died, this may have to be resolved by the **court**.

(f) **Proof of age:** see comments in **5.6.1**(d). Normally, proof of age is easily obtained by producing the deceased's **birth certificate**, **identity card** or **passport**.

5.6.3 Surrenders

Many of the considerations arising with **maturity claims** have relevance here, as the claimant is still living. Specifically, areas needing attention are:

(a) **Proof of title:** those who are possibly entitled to the cash value include the policyowner, an assignee and a trustee (or a trustee-in-bankruptcy). For "**loss of policy**" procedure, please see **5.6.1**(b) above.

(b) **Adjustments:** unpaid premiums, policy charges, policy loans and interests must be taken into account;

(c) **Discharge:** an appropriate release is obtained. Care must be taken to protect any **assignee** or **third party** interest in an appropriate manner;

(d) **Other enquiries:** the insurer or insurance intermediary should take special care with applications for surrender of the policy. Obviously, the policyowner has every right to discontinue cover, but it may be helpful and productive to make discreet and courteous enquiries so as to detect potential attempted fraud, e.g. money laundering.

Sometimes, the insurance meets a real need for the client, but he meets unexpected life situations and his first thought is to cancel his insurance. That may not be in his best interests and other more suitable alternatives may be available (**policy loan**, use of **nonforfeiture** provisions, etc.).

- o - o - o -

Representative Examination Questions

Type "A" Questions

1 A mutual life insurance company means that:

(a) each shareholder has limited liability; .....
(b) the company is owned by shareholders; .....
(c) all policyholders share equally in profits and dividends; .....
(d) the company is legally owned by its participating policyholders. .....

[Answer may be found in **5.1**]

2 Which of the following is **not** likely to be the responsibility of the marketing department of a life insurance company?

(a) market research; .....
(b) product research; .....
(c) settlement of claims; .....
(d) promotions and publicity work. .....

[Answer may be found in **5.1.1**(f)]

Type "B" Questions

3 Which **two** of the following statements concerning the "cooling-off period" are **true**?

(i) The period is for 14 days only.
(ii) It concerns all life insurance members of the Hong Kong Federation of Insurers.
(iii) If properly exercised, the new policy is cancelled and the premiums are returned.
(iv) The period relates to the time during which the insurer may cancel the policy.

(a) (i) and (ii); .....
(b) (i) and (iii); .....
(c) (ii) and (iii); .....
(d) (iii) and (iv). .....

[Answer may be found in **5.2.4**]

4 Which **three** of the following are matters likely to affect **physical hazard** when underwriting a life insurance application?

(i) Significant overweight
(ii) Adverse inheritable family medical history
(iii) Dishonesty of the applicant in providing information
(iv) The applicant's heavy dependency on drugs, alcohol or tobacco

(a) (i), (ii) and (iii); .....
(b) (i), (ii) and (iv); .....
(c) (i), (iii) and (iv); .....
(d) (ii), (iii) and (iv). .....

[Answers may be found in **5.3.1**]

[If still required, the answers may be found at the end of the Study Notes.]

CUSTOMER PROTECTION DECLARATION FORM

IMPORTANT DOCUMENT! PLEASE STUDY CAREFULLY BEFORE SIGNING!

This is an **IMPORTANT PART** of the Code of Practice for Life Insurance Replacement ("Code") and the Minimum Requirements as specified by the Insurance Authority under the Insurance Companies Ordinance ("Minimum Requirements") but does not form part of the application/proposal. Please refer to the Explanatory Notes before completing this Form.

Name of the Insurer of the New Life Insurance Policy : ______________________________

Application/Proposal Number : ______________________________

Name of Applicant/Proposer : ______________________________

HKID Card/Passport No. of Applicant/Proposer : ______________________________

SECTION A

1. a) **Have you replaced*** in the past 12 months any or a substantial part of your existing life insurance policy(ies) with the above application/proposal?

☐ Yes (Please go to Section B) ☐ No (Please answer question b below)

b) **Do you intend to replace** in the next 12 months any or a substantial part of your existing life insurance policy(ies) with the above application/proposal?

☐ Yes (Please go to Section B) ☐ No (Please read carefully and sign the Declaration in this Section only)

Declaration by the Applicant/Proposer :

I realize if I answer "No" to both questions above but indeed,

i) the above-mentioned application/proposal has replaced any or a substantial part of my existing life insurance policy(ies) in the past 12 months; or

ii) my current intention is to replace any or a substantial part of my existing life insurance policy(ies) within the next 12 months by the above-mentioned application/proposal,

I may jeopardize my future right of redress if I find later that I have been disadvantaged because of such replacement.

I hereby authorize the Insurer of the new life insurance policy to give the Insurance Agents Registration Board, the Hong Kong Confederation of Insurance Brokers, the Professional Insurance Brokers Association, the Insurance Authority, the Hong Kong Federation of Insurers, the insurer(s) of the life insurance policy(ies) that is/are being or has/have been replaced (if applicable) or other parties, as required for proper administration/ implementation/execution of the Code and the Minimum Requirements, a copy of this Form and any related records or information.

______________________________ ______________________________

Signature of the Applicant/Proposer Date (D / M / Y)

* Notes: Please refer to clause C of the Explanatory Notes for the definition of "Replacement".

SECTION B

Attention: A policyholder would usually suffer losses if he/she chooses to replace his/her existing life insurance policy(ies), especially within the first few years of the policy term. The intent of this Form is to ensure that the Agent/Broker has already explained to you in detail any real and potential disadvantages in replacing your existing life insurance policy(ies). You are advised to study the pamphlet titled "Life Insurance Policy Replacement – What you need to know" issued by the Insurance Authority and provided by the Agent/Broker before you complete this Form.

The Agent/Broker shall explain to you the full implications of replacing your existing life insurance policy(ies) with the new life insurance policy.

The Agent/Broker **MUST HELP YOU** complete all items below and tick where appropriate.

Please write down the life insurance policy(ies) replaced/to be replaced and complete items 2 to 6：

Name of insurer(s)： ______________________________

Policy Number(s)： ______________________________

You are strongly advised：

a) To consult the insurer(s) of your existing life insurance policy(ies) for further information **(please note that this Form will be copied to the insurer(s) of your existing life insurance policy(ies) you indicate above)**;

b) **NOT** to cancel your existing life insurance policy(ies) until the new life insurance policy is issued; and

c) To use **additional blank paper(s)** if the space provided in this Form for answer is not enough, but remember to sign and ask the Agent/Broker to sign on the additional paper(s).

2. **Financial implications** of the replacement：	
a) You could be paying the policy set-up cost **TWICE** – the set-up cost is usually two years premiums or 10% of single premium of the basic life insurance policy replaced/to be replaced (This is for reference only; the Agent/Broker should advise you of the estimated loss for this replacement).	Estimated Loss HK$： ______________ If no loss or if estimated loss is less than two years premiums or 10% of single premium of the basic life insurance policy replaced/to be replaced, please give reason and justification： ______________ ______________
b) You may have to pay **HIGHER** premiums under the new life insurance policy because you are older.	Will the annualized premiums be **HIGHER** under the new life insurance policy for the same sum insured? ☐ Yes ☐ No If no, please give reason： ______________ ______________ ______________
c) The projection of future values of the new life insurance policy may be higher than the existing life insurance policy(ies), but the projected values in most cases depend on the performance of the insurers and may **NOT** be guaranteed.	Guaranteed Cash Values on the policy anniversary dates immediately after age 65 (if one of the policies or all policies mature(s) before age 65, please fill in the Guaranteed Cash Values on the policy anniversary dates of each policy in the earliest maturity year)： On the policy anniversary date of the calendar year of__ ______________, Guaranteed Cash Value(s) of the existing life insurance policy(ies) HK$： ______________ On the policy anniversary date of the year indicated above, the Guaranteed Cash Value of the new life insurance policy HK$： ______________

3. **Insurability implications** of the replacement：	
Some coverage may be denied or a higher premium may be charged due to changes in：	Has the Agent/Broker explained to you the implication(s) of changes in each of the conditions listed on the left-hand side in this replacement?
a) health conditions;	a) ☐ Yes ☐ No
b) occupation;	b) ☐ Yes ☐ No

	c) lifestyle/habit, e.g. smoking/drinking; or d) recreational activities, e.g. hazardous sports, etc.	c) ☐ Yes ☐ No d) ☐ Yes ☐ No
4.	**Claims eligibility implications** of the replacement :	
a)	The benefits under a life insurance policy may not be payable if the life insured commits suicide within a certain period of the policy's issue date. Your new life insurance policy may restart the period in the "suicide clause".	a) Period in the "Suicide Clause" expires on : Existing life insurance policy(ies) : ____________________ (D / M / Y) New life insurance policy : ____________________ Number of months from the new policy's issue date
b)	The benefits under a life insurance policy may not be payable if information on the application was incomplete. The benefits under your existing life insurance policy(ies) will be payable, in the absence of fraud, if this incomplete information is not discovered within the "contestability period" (usually two years). Your new life insurance policy may restart the "contestability period".	b) "Contestability period" expires on : Existing life insurance policy(ies) : ____________________ (D / M / Y) New life insurance policy : ____________________ Number of months from the new policy's issue date
c)	Where replacement including twisting of life insurance policy has occurred and you opt for reinstatement of your policy by the Non-selling office, the benefits under your existing life insurance policy(ies), once surrendered or lapsed, will **NOT** be payable for any claims arising thereafter; and the benefits under the new life insurance policy will be payable subject to the terms and conditions of the new life insurance policy.	c) Has the Agent/Broker explained to you the implications of this replacement for claims payment, if any, as indicated on the left-hand side? ☐ Yes ☐ No
5.	**Other considerations** :	
a)	List riders/supplementary benefits you have under the existing life insurance policy(ies) but will not have under the new life insurance policy.	____________________ ____________________
b)	List reasons why the new life insurance policy is more suitable for your needs and objectives.	____________________ ____________________
c)	Have you been advised by the Agent/Broker of any alternatives to replacing the existing life insurance policy(ies)?	☐ Yes ☐ No

6. **Declaration by the Applicant / Proposer** :	7. **Declaration by the Agent / Broker** :
I declare that I have read and discussed the relevant item(s) of this Form with the Agent/Broker. I understand and accept the financial and other implications of changing my existing insurance arrangement as explained by the Agent/Broker. I also declare that I have received a copy of the pamphlet titled, "Life Insurance Policy Replacement – What you need to know", issued by the Insurance Authority. **I realize if I have not fully understood this Form, in signing this Declaration I may jeopardize my future rights of redress if I find later that I have been disadvantaged because of this replacement.**	I declare that I have explained fully the above listed items and the related implications of the decision of the Applicant/Proposer in regard to replacing the existing life insurance policy(ies), and have not made any inaccurate or misleading statements or comparisons nor withheld any information which may affect the decision of the Applicant/ Proposer.

I hereby authorize the Insurer of the new life insurance policy to give the Insurance Agents Registration Board, the Hong Kong Confederation of Insurance Brokers, the Professional Insurance Brokers Association, the Insurance Authority, the Hong Kong Federation of Insurers, the insurer(s) of the life insurance policy(ies) that is/are being or has/have been replaced or other parties, as required for proper administration/implementation/ execution of the Code and the Minimum Requirements, a copy of this Form and any related records or information.		Signature of the Agent/Broker Agent/Broker's name in full
Signature of the Applicant/Proposer Date (D / M / Y)	**(Warning：** **a. You must read all items carefully and check that the Agent/Broker has completed with you all the information on this Form before you sign your name here.** **b. Please do not sign a blank Form or leave any space blank.)**	Insurance Agent/Broker Reg. No. Date (D / M / Y)

(Source: HKFI, revised as at Oct 2008)

Explanatory Notes to Customer Protection Declaration Form

(A) The agent/broker must help the applicant/proposer complete a Customer Protection Declaration Form ("Form") for each new individual life insurance policy applied for/proposed by an applicant/proposer. The agent/broker must inform the applicant/proposer that according to the Code of Practice for Life Insurance Replacement ("Code") the insurer of the new life insurance policy (i) will send to the applicant/proposer a copy of the Form together with the policy when it is issued and (ii) will send a further copy to the insurer(s) of the life insurance policy(ies) which has been replaced/to be replaced. For the purpose of the Form, any reference to insurance agent/broker shall include its responsible officer/chief executive(s) and technical representatives.

To enable the insurer of the new life insurance policy to process the insurance application of the applicant/proposer, the applicant/proposer should work with the agent/broker to complete the Form which will be used for regulatory purposes as stated in the Code and the Minimum Requirements for insurance brokers as specified by the Insurance Authority under the Insurance Companies Ordinance and a copy of the Form may be transferred to the parties as stipulated in the "Declaration by the Applicant/Proposer" of the Form. Requests for access to and/or correction of the information (if appropriate) in the Form can be made to the same contact point as for the data in the insurance application.

(B) For identification purpose, the agent/broker must help the applicant/proposer fill in the full name of the Insurer issuing the new life insurance policy (the Insurer may pre-print its name on the Form), the relevant application/proposal number, the name of applicant/proposer of the new life insurance policy and the Hong Kong Identity Card/Passport number of applicant/proposer.

(C) Any transaction involving the purchase of life insurance is construed as a Replacement if (i) any existing life insurance policy(ies) or a substantial part of the sum insured of its/their basic life coverage has been/have been/will be terminated or (ii) a substantial part of the guaranteed cash value of the existing life insurance policy(ies) was reduced/will be reduced including where a policy loan was/will be taken out against a substantial part of the guaranteed cash value. Existing life insurance policy(ies) include(s) all types of traditional life, annuity and other non-traditional policies of the applicant/proposer, which has/have been terminated within 12 months before or will be terminated within 12 months after the new life insurance policy's issue date. Termination includes lapse, surrender, converted to reduced paid-up or extended-term insurance under the non-forfeiture provision of the existing life insurance policy(ies). "A substantial part" means "50% or above". However, converting term life insurance to whole life insurance (or some forms of permanent life insurance) under policy provisions of the existing life insurance policy(ies) is not construed as a Replacement.

(D) If the applicant/proposer answers "No" to both items 1(a) and 1(b) of Section A, he/she shall read carefully and simply sign the Declaration in Section A only and ignore the rest.

(E) How to complete the Form

(1) If the applicant/proposer answers "No" to both items (a) and (b), the agent/broker must explain the Declaration before he/she asks the applicant/proposer to sign in Section A. There is no need to fill in Section B.

If the applicant/proposer answers "Yes" to either item (a) or (b), the agent/broker must help the applicant/proposer complete items 2 to 5 and must explain and discuss with the applicant/proposer the full implications of replacing any or a substantial part of his/her existing life insurance policy(ies) with the new life insurance policy in relation to financial implications, insurability implications and claims eligibility implications of the replacement and other considerations. The applicant/proposer may consult the insurer(s) of his/her existing life insurance policy(ies) for further information. There is no need to sign in Section A.

(2a) The agent/broker must help the applicant/proposer fill in the estimated loss for the replacement by referencing that the set-up cost is usually two years premiums or 10% of single premium of the basic life insurance policy replaced/to be replaced. No reason is required if the estimated loss stated is equal to or higher than this reference. The agent/broker may use other reference for the estimated loss provided he/she could reasonably justify the estimation, and must give reason and the justification if there is no loss or if estimated loss is less than two years premiums or 10% of single premium.

(2b) The agent/broker must help the applicant/proposer compare the annualized premiums of the existing life insurance policy(ies) and the new life insurance policy by using the same sum insured, and give reason if the annualized premiums will not be higher under the new life insurance policy for the same sum insured.

(2c) The agent/broker must help the applicant/proposer fill in the guaranteed cash values of the existing life insurance policy(ies) and the new life insurance policy using the values on the policy anniversary dates immediately after the applicant/proposer reaches age 65, or if one of the policies or all policies mature(s) before age 65, fill in the guaranteed cash values on the policy anniversary dates of each policy in the earliest maturity year. The agent/broker has to obtain the value(s) of the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided for "Guaranteed Cash Value(s) of the existing life insurance policy(ies)" that he/she does not want to disclose such information.

(3) The agent/broker must explain the implications of the changes of health conditions, occupation, lifestyle/habit and recreational activities in this replacement to the applicant/proposer before the latter ticks the boxes.

(4a) The agent/broker must help the applicant/proposer fill in the expiry dates of the period in the "suicide clause" for both the existing life insurance policy(ies) and the new life insurance policy. The expiry date of the latter will be the number of months from its issue date. The agent/broker has to obtain the expiry date(s) of the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided for "Existing life insurance policy(ies)" that he/she does not want to disclose such information.

(4b) The agent/broker must help the applicant/proposer fill in the expiry dates of the "contestability period" for both the existing life insurance policy(ies) and the new life insurance policy. The expiry date of the latter will be the number of months from its issue date. The agent/broker has to obtain the expiry date(s) of the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided for "Existing life insurance policy(ies)" that he/she does not want to disclose such information.

(4c) The agent/broker must explain to the applicant/proposer that to the scenario where twisting of life policy has occurred and the policyholder opted for reinstatement of his policy by the Non-selling office, the insurer(s) of the existing life insurance policy(ies) will **NOT** be responsible for any payment of claims that occurred during the period that the existing life insurance policy(ies) is/are surrendered or lapsed as a result of policy replacement. The insurer of the new life insurance policy will be responsible for the claim subject to the terms and conditions of the new life insurance policy.

(5a) The agent/broker must help the applicant/proposer list out the riders/supplementary benefits under the existing life insurance policy(ies) that will not have under the new life insurance policy for the applicant/proposer. Detailed benefits under each rider/supplementary benefit are not required to be listed. The agent/broker has to obtain the riders/supplementary benefits under the existing life insurance policy(ies) from the applicant/proposer unless the applicant/proposer declares in writing in the space provided that he/she does not want to disclose such information.

(5b) The agent/broker must help the applicant/proposer list out the reasons why the new life insurance policy is more suitable for the applicant/proposer unless the applicant/proposer declares in writing in the space provided that he/she does not mind whether the new life insurance policy is more suitable or not.

(5c) The agent/broker must help the applicant/proposer answer this question.

(6) The agent/broker must explain the "Declaration by the Applicant/Proposer" to the applicant/proposer before the latter signs it.

(7) The agent/broker shall sign the "Declaration by the Agent/Broker", declaring that he/she has explained fully the related implications of the decision of the applicant/proposer in regard to replacing the existing life insurance policy(ies) and has not made any inaccurate or misleading statements or comparisons nor withheld any information which may affect the decision of the applicant/proposer.

(Notes: Additional papers may be used wherever the spaces provided in the Form are insufficient. However, both agent/broker and applicant/proposer must sign on all the papers that are used.)

~ End ~

Revised as at Oct 2008

Appendix B

Information to be disclosed in the Illustration Document

Illustration of Surrender Values for:

Name of Product: [Name of Product]
Name of Insurance Company: [Name of Insurance Company]
[Name of Applicant:] [Name of Applicant]

THE ASSUMED RATES USED BELOW ARE FOR ILLUSTRATIVE PURPOSES. THEY ARE NEITHER GUARANTEED NOR BASED ON PAST PERFORMANCE. THE ACTUAL RETURN MAY BE DIFFERENT!

IMPORTANT:

THIS IS A SUMMARY ILLUSTRATION OF THE SURRENDER VALUES OF [Name of Product]. IT IS INTENDED TO SHOW THE IMPACT OF FEES AND CHARGES ON SURRENDER VALUES BASED ON THE ASSUMPTIONS STATED BELOW AND IN NO WAY AFFECTS THE TERMS OF CONDITIONS STATED IN THE POLICY DOCUMENT.

Contract Term: [Actual Contract Term]
[Premium Payment Term:] [(if different from Actual Contract Term)]
Premium: [Actual Premium amount]
Return: Illustrated at [9%] and [5%] p.a.[i]

Projected Surrender Values for a [Regular/Single] Premium [Name of Product] with Contributions of [$ XXX] for [XXX Periods]			
Number of Years after Policy Issuance	**Total Premium Paid since Start of Policy**	**Surrender Value Assuming Rate of Return of [9%] p.a.**	**Surrender Value Assuming Rate of Return of [5%] p.a.**
1			
2			
3			
4			
5			
10			
XX			

Warning:** **You should only invest in this product if you intend to pay the premium for the whole of your chosen premium payment term. Should you terminate this product early, you may suffer a significant loss.

Declaration

I confirm having read and understood the information provided in this illustration and received the principal brochure.

Signed & dated: ______________________________
[Applicant's Full Name in Printed Form]

[i] These assumed rates of return shall comply with the guidelines issued from time to time by the Life Insurance Council of the Hong Kong Federation of Insurers.

(Source: SFC, A format of Illustration Document for ILAS)

Standard Illustration for Non Unit-linked Life Policies

X Y Z LIFE ASSURANCE COMPANY LIMITED

[A] **IMPORTANT:**
THIS IS A SUMMARY ILLUSTRATION OF THE BENEFITS OF YOUR POLICY AND IN NO WAY AFFECTS THE TERMS AND CONDITIONS STATED IN THE POLICY DOCUMENT.

[B] Proposal Summary for the **ABC** product

1.

Name :	Age :	Sex :	**[C]** Smoker / Non Smoker

2. **[D]** Basic Plan Summary (Currency :)

[E] Initial Sum Assured :	**[F]** Initial Monthly Premium :

3. Basic Plan – Illustration Summary (Currency :)

[G]	**DEATH BENEFIT**			**CASH VALUE**			**[J]**
End of Policy Year	**[H1]** Guaranteed	**[H2]** Non-Guaranteed	**[H3]** Total	**[I1]** Guaranteed	**[I2]** Non-Guaranteed	**[I3]** Total	Total Premiums
1							
2							
3							
4							
5							
10							
15							
20							
25							
30							
At age 65							

4. Benefit Summary (Currency :)

Benefit Description	**[K] Initial Protection Amount**	**[L] Initial Monthly Premium**
Basic Plan **eg. Accidental Death Benefit** **Double Indemnity** **Hospital Income**		

[M] Total Monthly Premium :

========

5. Explanation

(i) The above is only a summary illustration of the major benefits of your policy. You should refer to your agent or the Company for more information or, if appropriate, a more detailed proposal.

(ii) The Basic Plan Illustration in Section 3 relates only to your Basic Plan excluding any riders or additional benefits as shown in Section 4 (if applicable) and assumes that all premiums are paid in full when due.

[optional] (iii) The amount of total premium(s) may differ slightly from the total of the premiums payable in the policy due to rounding differences.

(iv) The projected dividend values included in the above are based on the Company's current dividend scales and are not guaranteed. The actual dividends paid may change with the values being higher or lower than those illustrated.

[N1] (v) As illustrated in the above, you can leave the amount of projected dividends and the cash payments to accumulate with the Company at a special interest rate which will change from time to time. The current interest rate used to illustrate the effect of accumulation in the above is X % pa. This rate is not guaranteed. You can also cash all or part of the amount of projected dividends and the cash payment without affecting the protection amount but the values shown above will be reduced accordingly.

[N2] (vi) If the interest rate and assumed dividend scales remain unchanged throughout your policy term, then the future premium on the Basic Plan can be paid out of accumulated dividends (and cash payments) from policy year XX onwards. This is not guaranteed; a change in either the interest rate or projected dividend scale may require you to pay additional premiums to maintain the Basic Plan.

[N3] 6. Declaration (optional)

I confirm having read and understood the information contained in this summary of illustrated benefits.

Name : ________________________ Signature:____________________ Date : _______________

(24.3.98) **[O]** PRINT DATE: DD/MM/YYYY

(Source: HKFI)

Appendix D

Standard Illustration for Universal Life (Non-Linked) Policies

THE ASSUMED RATES USED BELOW ARE FOR ILLUSTRATIVE PURPOSES ONLY. THEY ARE NEITHER GUARANTEED NOR BASED ON PAST PERFORMANCE. THE ACTUAL RETURN MAY BE DIFFERENT!

XYZ LIFE ASSURANCE COMPANY LIMITED

[A] **IMPORTANT:**
THIS IS A SUMMARY ILLUSTRATION OF THE BENEFITS OF YOUR POLICY AND IN NO WAY AFFECTS THE TERMS AND CONDITIONS STATED IN THE POLICY DOCUMENT.

[B] Proposal Summary for the **ABC** product

1.

Name:	Age:	Sex:	**[C]** Smoker/Non Smoker

2. **[D]** Basic Plan Summary (Currency:)

[E] Initial Sum Assured:	**[F]** Initial Modal Premium:

3. Basic Plan Illustration (Currency:)

End of Policy Year	Assumed Declared Rate						Total Premiums	Guaranteed Death Benefit
	X%		Current rate (optional)		Y%			
	Total Cash Value	[G] Total Death Benefit	Total Cash Value	[G] Total Death Benefit	Total Cash Value	[G] Total Death Benefit		
1								
2								
3								
4								
5								
10								
15								
20								
25								
30								
At age 65								

[H] 4. Explanation

(i) The above is only a summary illustration of the major benefits of your policy. You should refer to your agent or the Company for more information or, if appropriate, a more detailed proposal.

[If projection is based on current scale of charges] (ii) The Basic Plan Illustration in Section 3 relates to your Basic Plan excluding any riders or additional benefits. It assumes that all **[I]** modal premiums are paid in full as planned without exercising the skip premium option and the current scale of charges remain unchanged.

[If projection is not based on current scale of charges] (ii) The Basic Plan Illustration in Section 3 relates to your Basic Plan excluding any riders or additional benefits. It assumes that all **[I]** modal premiums are paid in full as planned without exercising the skip premium option and the assumed scale of charges used in this summary illustration remain unchanged. The scale of charges used are however different from that currently charged by the Company.

[optional] (iii) The amount of total premium(s) may differ slightly from the total of the premiums payable in the policy due to rounding differences.

(iv) The total cash value and total death benefits payable shown in Section 3 are calculated on the basis that the "Assumed Declared Rates" remain unchanged throughout the term of the policy.

[if current rate projection is included] (v) The current interest rate declared by the Company shall in no way be interpreted as a projection or estimation of the future return. The future declared rate may be higher or lower.

5. Declaration [optional]

I confirm having read and understood the information contained in this summary of illustrated benefits.

Name: ______________________ Signature: ______________________ Date: ____________

[J] PRINT DATE: DD/MM/YYYY

03/02 (Ver 02)

(Source: HKFI)

GLOSSARY

Absolute Assignment (絕對轉讓) A permanent assignment of all policy ownership rights to the assignee, who then becomes the new policyowner. **4.9**(e)(i)

Accelerated Death Benefits (提前支付死亡保險利益) These are life insurance death benefits which may, in prescribed circumstances (e.g. life threatening health situations), be payable in part or in full even though death has not yet occurred. **3.3**

Accident Benefits (意外保險利益) Additional benefits that may be added to a life policy by means of the Accidental Death (ADB) （意外死亡保險利益） or Accidental Death and Dismemberment (AD&D) Rider（意外死亡及喪失肢體附約）. **3.2**

Accidental Death and Dismemberment (AD&D) Rider (意外死亡及喪失肢體附約) Under this rider, the accidental death benefit is a sum equal to the face amount for the policy (providing what is termed a "double indemnity"(雙倍賠償)), and the dismemberment benefit is payable in the event of, say, loss of any two limbs or loss of sight in both eyes. **3.2**

Accidental Death Benefit (ADB) (意外死亡保險利益) An addition to a life policy, providing a double benefit should the life insured die from an accident.**3.2.1**(a)

Accounts Department (會計部) An important area of company administration, including work associated with the receipt and payment of monies and the making of required financial returns. **5.1.1**(a)

Actively-at-Work Provision (在職工作條款) A provision in group life insurance that to be admitted to the plan the employee concerned must have been present at work on the day when coverage became effective. **2.4**(f)

Activities of Daily Living (ADLs) (日常起居活動) Basic human needs and functions (washing and dressing oneself, etc.). Inability to perform these could be grounds for a payment under a **Long Term Care** rider（長期護理附約）. **3.3.2**(c)

Actuarial Department (精算部) An extremely important department for life insurers. An actuary must be appointed for life insurers, by law, and the work of this department is significant (amongst other things) in product pricing, and especially in the required valuation of the company's assets and liabilities. **5.1.1**(b)

Adequate (Premiums) (充足的(保費)) One of the classic criteria usually applied to life insurance premiums, i.e. sufficient to meet claims and other obligations under the contract. **1.3.1**(a)

After Sales Service (售後服務) The important process of maintaining good communications and relations with policyowners, to assist with the conservation of existing business. **5.5**

Age Next (Last) Birthday (下一個(前一個)生日年齡) An important detail obtained from the application, having a significant effect on the premium to be charged. **5.2.1**(b)(iii)

Age-Related Limitation (與年齡有關的限制) Whole life insurance where the premium is no longer payable after a specified age. **2.1.3**(a)(iii)

Agency Training and Control (代理人的培訓與管理) An important area of company administration, especially bearing in mind the necessity for training of an extensive field staff. The department will especially be concerned with training programmes and professional examinations. **5.1.1**(c)

Annual Report (年報) A feature of universal life insurance, whereby the policyowner receives such a report each year, outlining several headings of information, e.g. death benefit option selected, premiums received during the year, cash value balance etc. **2.2.1**(f)

Annually Renewable Term (ART) Insurance (每年可續保定期保險) An alternative title for the Yearly Renewable Term (YRT) rider. **2.1.1b**(a)

Annuitant (年金標的人) The person whose lifetime will determine – solely or otherwise - the actual length of the payout period of an annuity. **2.3**(a)

Annuity (年金) A contract whereby an insurer promises to make a series of periodic payments (called “annuity benefit payments”) to a designated individual (called “payee”) throughout the lifetime of a person (called ‘annuitant’) or for an agreed period, in return for a single payment or series of payments made in advance (called ‘annuity considerations’) by the contractholder (or “annuity purchaser”). Very often, the payee, the annuitant and the contractholder are the same person. **2.3**

Annuity Certain (確定年金) A variation of an annuity, where the benefit is paid for a fixed number of years, whether the annuitant lives or dies during that period. **2.3.1**(c)

Anti-Selection (逆選擇) Occurs where the "bad" risks tend to continue with the insurer, whilst the "better" risks tend not to. This is a real danger with the natural premium system. Also known as **Selection Against the Insurer (不利於保險人的選擇)**. **1.3.2a**(c)(ii)

Applicant (投保人) The person who is applying for a life insurance. **1.2.1**(i)

Application (投保單) The more usual term in Hong Kong life insurance for a proposal form, by means of which preliminary information is obtained regarding a proposed life insurance. **5.2.1**(a)

Approved Nursing Home (認可護理院) A nursing home as specified in the Long Term Care (LTC) rider, as a type of care acceptable to the cover provided. **3.3.2**(b)

Assignee (承讓人) The person to whom an insurance contract has been assigned. In life insurance, an assignee does not have to have insurable interest. **4.9**

Assignment (轉讓) The transfer of all rights under an insurance to a third party, either for reward or with no fee involved. **4.9**

Assignor (轉讓人) The person assigning an insurance policy to the assignee. **4.9**

Attained Age (到達年齡) The age of the life insured at the time the insurance is completed/renewed. **2.1.1b**(a)

Attending Physician's Statement (APS)(主診醫生報告) An "attending physician" is a doctor or other qualified medical person who has previously supplied medical care to the applicant. An APS may be required if information disclosed indicates that further medical information is needed, or for other abnormalities (e.g. relatively advanced age of the applicant, and relatively high amount of insurance requested). **5.3.2b**(b)

Authority (典據) Grounds for some legal proposition, e.g. judicial decisions and opinions of authors. **1.2.1**(i)

Automatic Dividend Option (自動紅利選擇) If the policyowner gives no indication of his preference regarding his dividend options, the policy provides for a particular option to be applied automatically. Often such an option means that paid-up additional insurance is purchased with the dividend or leaving the dividends with the insurer to earn interest. **4.10 Note**

Automatic Premium Loan (APL) (自動保費貸款) A policy provision to the effect that in the event of non-payment of a due premium, and in the absence of other instructions from the policyowner, the cash value of the policy, if any, is automatically used to pay the premium and keep the policy in force. **4.5**(a) **Note**

Basic Functions (基本功能) Essential formats of life insurance, e.g. benefit payable on death in a specified period, payable on death at any time, payable on a specified date or earlier death, and monthly payments in return for a lump sum "premium". **2**(a)

Basic Plan (基本計劃) Cover for the expenses of medical treatment and hospitalisation, under a medical benefits insurance. **3.4**(a)

Basic Questions (基本問題) Fundamental enquiries that should be made when arranging life insurance, i.e. "What is the insurance for?", "How much premium are you willing and able to pay?" and "How much life insurance do you need?” **2**(c)

Basic Variables (基本變數) Modifications to the basic functions of life insurance, e.g. convertibility, renewability, PAR or NON-PAR and various riders. **2**(b)

Beneficiary (受益人) The person nominated to receive the policy benefit in the event of a claim under the policy. **4.4**

Beneficiary Designation (受益人的指定) The naming of a designated beneficiary in the policy documents. **4.4**

Benefit Policies (利益保單) Policies which do not pay claims on an indemnity basis, but on a stipulated benefit basis (e.g. in life insurance policies). **1.2.3**(b)(i)

Benefit Riders (保險利益附約) Endorsements to a life insurance policies, granting various benefits, e.g. **Accidental Death Benefit (ADB)** rider (意外死亡附約). **3**

Binding Premium Receipt (立約保費收據) A premium receipt which confirms that cover applies. It therefore fulfils some of the features found with cover notes in general insurance. The cover with such receipts is temporary, with provisions which will enable the insurer to come off risk earlier than the end of the specified period, if necessary. Also known as **Unconditional Premium Receipt (不附條件保費收據)** and **Temporary Insurance Agreement (TIA) (臨時保險協議)**. **5.2.2**(b)

Bonuses (英式紅利) The approximate equivalent of dividends with participating policies, bonuses are normally reversionary amounts added to the ultimate benefit payable under the policy, and earned by with-profit policyholders. They are usually declared as a percentage, which is applied to either the sum insured or the sum of the sum insured and the accumulated bonus. **1.3.1b**(a) **Note** 1

Business Needs (業務需求) The use of life insurance contracts to meet various business situations, e.g. key person's insurance, partnerships, and employee benefits. **1.1.1**(b)

Cash Value (現金價值) It is a savings element that results when premiums during the early years of a level premium life policy exceed what is necessary to pay death claims occurring in those years. The excess payments are set aside and accumulate for the benefit of the policyowner. Cash value can be withdrawn in the form of surrender value, or used as a pledge for policy loans. **1.3.2b**(c)(i)

Cause of Death (死因) A potentially important detail with death claims, possibly affecting the validity or amount of the claim, e.g. an early suicide, and death from accident. **5.6.2**(d)

Certificate (保險憑證) See **Enrolment Card (成員登記卡)**. **5.4.1**(b)

Claims (理賠) A crucial area for life insurers. The department concerned will be involved in all aspects of claims investigation, processing and settlement. **5.1.1**(d)

Class Designation (概括式指定) A description of beneficiaries by group association rather than by name, e.g. "my children", and "my brothers and sisters". **4.4**(a)

Client Service (顧客服務) The range of activities a company engages in to keep its customers satisfied. It involves attention to the corporate culture (customer-orientated), authority being given to front-line employees and systems designed to monitor customer satisfaction. **5.2.3**

Code of Practice for Life Insurance Replacement《壽險轉保守則》 A code produced by the Hong Kong Federation of Insurers, outlining recommendations to be followed when replacing life insurance policies, in an attempt to prevent and discourage "twisting" and to provide remedies to clients who have suffered from twisting. **5.2.5**

Collateral Assignment (抵押轉讓) An assignment which is very likely to be temporary, as collateral security for a loan. The assignee's interest with such an assignment is limited to the amount of the loan plus interest. **4.9**(e)(ii)

Collateral Security (抵押品) The collateral assignment of a life policy provides collateral security for a loan given to the policyowner. **4.9**(e)(ii)

Company Customisation (按客戶需要修訂) Sales Illustration Documents are allowed to be company customised provided the basic intentions of the document are respected. **5.2.6a**(b)

Comprehensive Cover (綜合保障) The widest form of motor insurance, including both third party and "own damage" cover. The private car policy may also give other benefits, such as personal accident and/or medical expenses insurance. **1.2.3**(c)(ii)

Conditional Premium Receipt (附條件保費收據) A receipt for premium which confirms that insurance will begin from the time of the application, provided the life insured is subsequently found to have been insurable on standard terms at that time. **5.2.2**(a)

Conservation (保留) The retention of existing business, i.e. avoiding policy lapses and surrenders. **5.2.3a**(a)

Contestable Period (可異議期) The period of time specified in the **Incontestability Provision**（不可異議條款）during which the validity of the policy may be contested. **4.2**(b)

Contingent Beneficiary (次順位受益人) A beneficiary who inherits if the primary beneficiary is not living when the policy proceeds become payable. **4.4**(b)

Continuous Premium Whole Life Policy (連續繳費終身壽險單) Whole life insurance where the premiums continue to be payable throughout the lifetime of the life insured. **2.1.3**(a)(i)

Contribution (分擔) An insurance principle which means that two or more insurers covering the same insured for the same loss share that loss rateably. However, this is in providing an indemnity, to which life insurance is not subject. The existence of more than one life insurance does not affect the amount payable by the individual insurer. **1.2**(e)

Contributory (Plans) (供款（計劃）) Group life, or employee benefit, schemes where the premium is paid in part by the employees. **2.4**(c)

Convert (Conversion) (轉換) Changing a policy plan in accordance with permitted policy provisions, or by mutual consent. **2.1.1b**(b)

Convertible Term Insurance (可轉換定期壽險) A term insurance with rights to convert the policy plan into permanent cover, without evidence of insurability. **2.1.1b**(b)

Cooling-Off Initiative (冷靜期權益) An element in the self-regulation process, initiated by the Hong Kong Federation of Insurers to grant certain privileges to life insurance policyowners regarding the retroactive cancellation of arranged contracts, within a permitted period. **5.2.4**

Cooling-Off Period (冷靜期) An element in the Hong Kong Federation of Insurers' self-regulation measures, which allows a client a stipulated time period to change his mind about a completed life insurance contract during which he may cancel the policy with a full refund of premium (subject to a market value adjustment in prescribed circumstances). **5.2.4**

Cost of Living Adjustment (COLA) (生活指數調整) A rider providing for periodic increases in the disability income benefits being paid to a disabled insured. The increases are linked to a standard or recognised independent index, such as the Consumer Price Index. **3.6.1**

Cover Note (暫保單) A term from general insurance, indicating a document giving formal evidence of the temporary existence of insurance, the approximate equivalent in life insurance being the **Binding Premium Receipt**（立約保費收據）. **5.2.2**(b) **Note**

Credit Life Insurance (信用壽險) A form of decreasing term insurance normally on a group basis arranged by lending institutions to cover the outstanding balance of loans should customers die. The benefit is payable direct to the lending institution. **2.1.1a**(b)(i)

Critical Illness Benefit (危疾保險利益) A living benefit rider allowing a stated portion of the death benefit to be paid to the policyowner-insured when he is suffering from a specified disease or upon the happening of another insured event. **3.3.1**

Customer Prospecting (客戶拓展) The search for new customers for insurance, either from existing contacts or by other marketing endeavours. **5.2.3a**(b)

Customer Protection Declaration (CPD) Form 《客戶保障聲明書》 An important document that must be completed and signed before a customer agrees or makes a decision in relation to the purchase of a new life insurance policy. It is part of the concern of the insurance industry to preserve high ethical and professional standards, and to control inappropriate replacement of insurance policies instigated by insurance intermediaries. **5.2.5**(c)

Date of Death (死亡日期) An important point to be established with life insurance death claims, especially with term or decreasing term insurance, where the validity or amount of the claim may be affected. **5.6.2**(b)

Days of Grace (寬限日期) See **Grace Period (寬限期)**. **4.3**

Death Benefit (死亡保險金) The basic amount payable under the insurance in respect of the death of the life insured. This may be subject to additional factors, e.g. accidental death benefits. **2.2.1**(e)

Death Claims (死亡索償) The most common type of claim with life insurance, requiring detailed processing and verification of matters such as date of death, cause of death, proof of death, etc. **5.6.2**

"Debt" on Policy (保單負債) An underwriting measure with a sub-standard risk, whereby a "debt" is placed against the face amount, possibly reducing to extinguishment as the policy years go by without a claim. **5.3.3**(c)(i)

Declaration (聲明) The part of an application form above the signature of the prospective policyholder, confirming various statements and understandings, including the existence of a cooling-off period. A similar declaration appears on Illustration Documents, confirming understanding of the information supplied. **5.2.4**(f)

Declinature (拒保) Refusal to insure a given risk. **5.3.3**(a)

Declined Risks (拒保風險) Risks which are impaired to such an extent that they lack insurability. **5.3.1**(b)(iii)

Decreasing Term Insurance (遞減定期壽險) A term insurance where the face amount reduces each year or at specified times. The cheapest form of life cover, useful to meet a diminishing temporary need, e.g. a mortgage loan which is being repaid over a period of years. **2.1.1a**(b)

Defer Decision (延遲決定) An option for the life underwriter where a risk is uninsurable owing to a temporary condition (e.g. accident injuries). The risk is not permanently refused, but it will need reassessment at a later date. **5.3.3**(c)(iv)

Deferred Annuity (延期年金) An annuity where the payments begin at some specified future time or specified age of the annuitant. **2.3.1**(b)

De-mutualised (股份化) A mutual insurance company which has changed its mutual status, to become a proprietary company with shareholders. **5.1**(a) **Note**

Different Plan (不同的保險計劃) An underwriting option with a sub-standard risk, which proves unacceptable for the plan requested but may be insurable under another plan. **5.3.3**(c)(iii)

Disability Income Benefit (殘疾收入保險利益) A policy rider providing an income during the insured person's period of disability. **3.1.2**

Dismemberment (喪失肢體) The loss of one or more limbs, but within the AD&D Rider provisions the term also applies to loss of sight. **3.2.1**(b)

Dividend Options (紅利選擇) The choices available to the policyowner of a participating policy, for which dividends have been earned. These choices include: receiving the dividends in cash, applying them towards future premium payments, leaving them to earn interest with the insurer, etc. **4.10**

Dividends (紅利) Amounts declared to holders of participating policies on the basis of the experience of the pooled fund to which those policies are connected and which the insurer concerned manages. Usually expressed as a percentage of the premium paid. **4.10**

Divisible Surplus (可分配盈餘) That amount of an insurance company's surplus (i.e. that portion of the owners' equity which represents the excess of its assets over its liabilities and capital) which is available for distribution to the holders of its participating policies (or with-profit policies) in the form of dividends (or bonuses). **1.3.1b**(a)

Double Indemnity Benefit (雙倍賠償利益) The provision of an additional sum, equal to the policy face amount, should death occur as a result of an accident. An alternative name for **Accidental Death Benefit (意外死亡保險利益)**. **3.2.1**(a) **Note** 1

Duty of Disclosure (披露責任) The practical implications of the principle of utmost good faith, which requires the parties to a proposed insurance contract to reveal to the other all material information, whether requested or not. **1.2.2**

Employee Benefit Plans (僱員福利計劃) Group life insurance for employees within the same organisation or industry. **2.4**

Endowment Insurance (儲蓄壽險) Life insurance where the face amount is payable after a fixed period of years (at maturity) or on earlier death. **2.1.2**

Enrolment Card (and **Certificate) (成員登記卡、保險憑證)** Documents used with group life insurance, providing evidence of cover to individual insured persons. Separate from the **Master Policy (總保單)**. **5.4.1**(b)

Entire Contract Provision (完整合約條款) Part of the terms of a standard life insurance policy, making reference to the policy and application and indicating the circumstances under which changes to the policy are possible. **4.1**

Equitable (Premiums) (公平的(保費)) One of the classic criteria for life insurance premiums, i.e. each policyowner is paying an amount in line with the risk and contracted benefit involved. **1.3.1**(b)

Equities (股票) Ordinary shares in a proprietary company. As an investment vehicle, they carry more risk than some types of investment, but usually offer long-term growth prospects. Where more speculative, they offer prospect of considerable gain (or loss!). **2.2.2**(b)

Estate Planning (財產策劃) Estate Planning is a process of planning with the overall purpose of enhancing and maintaining the financial security of clients and their families. It involves the accumulation, conservation and distribution of an estate. **1.1**(a)

Ex Gratia Payment (通融賠付) A payment, usually of a claim, which is made "out of grace or favour", i.e. where there is no legal liability to make such payment. **4.12 Note** 2

Examining Physician (體檢醫生) The qualified medical professional conducting a medical examination on behalf of the insurer. **5.3.2b**

Excepted/Excluded Perils (除外危險) Cause of loss specifically excluded by the policy. Whilst there are not many such perils likely to affect a life insurance, suicide is excluded within the first year or so of the policy's existence. **1.2.3**(a)(ii)

Excess Interest (額外利息) Interest earned over and above the guaranteed interest. Must be notified in the Annual Report with universal life insurance. **2.2.1**(f)(v)

Exclusions (除外責任) Risks or causes of claims specifically removed from the cover of the policy. These are relatively rare with life insurance, but may more commonly be found with rider benefit, e.g. suicide with accidental death benefits. **5.3.3**(c)(ii)

Expenses (開支) The loading to be added to the net premium, to cover all additions necessary when calculating life premiums. **1.3.1a**(c)

Extended Term Insurance (展期保險) An option under non-forfeiture benefits, whereby the cash value is used as a single premium to purchase term insurance for the same amount as the policy amount, for such period as the amount of cash value will provide. **4.5**(b)(iii)

Face Amount (保額) An equivalent term for the sum insured under the policy. **1.3.2b**(c)(iv)

Family Income Insurance (家庭收入壽險) A variation of decreasing term insurance, usually linked with one or more lump sum benefits. The decreasing term element pays a stated monthly benefit in the event of death, for the remainder of a specified period of time. **2.1.1a**(b)(ii)

Financial Underwriting (財務性核保) Underwriting concentrating more on the implications arising from the amount of insurance requested, e.g. whether the policyowner can meet premium obligations, whether reinsurance may be required, and whether the amount seems excessive by normal criteria with such class of risks. **5.3.1Note**

First Beneficiary (第一受益人) See **Primary Beneficiary (第一順位受益人)**. **4.4**(b)

Fixed Interest Investments (固定利息投資) One type of fund that may be used for linking purposes with unit-linked insurance. **2.2.2**(b)

Fully Earned (已完全賺取的) When an amount of premium for a particular period in the past is said to be fully earned, that amount is taken as corresponding to the risk run by the insurer during that period, so it (the earned or fully earned premium) contains no "surplus" to provide for a cash value or other benefit common with the level premium system in many types of life insurance. The term also applies to general insurance and may also be said to be applicable with term life policies. **1.3.2b**(b)

Fully Paid Policy (完全清繳保單) A policy for which no more premiums have to be paid. One option under non-forfeiture provisions, where the policyowner does not wish to continue paying premiums on the original policy, in which case the face amount of the policy will be reduced to reflect the premiums saved and the cash value. Another term for **Reduced Paid-Up Insurance (減額清繳保險)** . **1.3.2b**(c)(iv)

Fully Paid-Up Shares (完全清繳的股票) Shares in a proprietary/joint stock company, for which no amount remains "on call", i.e. the full price of the shares has been paid. **5.1**(b)

Grace Period (寬限期) A period of time after a premium is due, during which the premium may be paid and cover kept continuous, without penalty. Also known as **Days of Grace (寬限日期)** . **4.3**

Graded-Premium Policy (等級保費保險) A variation of whole life insurance, where the premium increases on a regular basis, e.g. every three years, but the face amount remains unchanged. **2.1.3**(c)

Gross Premium (毛保費) The premium in life insurance after taking into account the three rating factors of mortality, interest and expenses. **1.3.1a Note**

Group Insurance (團體保險) Life insurance of a number of persons forming a recognisable group, e.g. employees of a particular employer. **2.4**

Guaranteed Annuity (保證年金) An annuity which guarantees that annuity benefits will be paid until the annuitant dies and will be paid for at least a certain period, even if he does not survive that period. Also known as Life Income With Period Certain. **2.3.1**(c)

Guaranteed Insurability Option (GIO) (保證可保選擇) Under this rider, the policyowner has the right to purchase additional insurance on specified option dates, without having to supply evidence of insurability. **3.5.1**

Immediate Annuity (即期年金) An annuity where the annuity benefit payments commence one annuity period (i.e. the time span between one payment and the next in the series) immediately following the purchase of the annuity. **2.3.1**(a)

Incontestability Provision (不可異議條款) A provision in a life policy where after an initial period, usually two years, the validity of the policy may not be contested, on grounds of breach of utmost good faith for example (except, at least in Hong Kong, where fraud is proved). **4.2**

Increasing Term Insurance (遞增定期壽險) Term insurance where the face amount increases automatically at specified intervals over the period of insurance. Increases may be linked to an agreed index (e.g. the Consumer Price Index). **2.1.1a**(c)

Indemnity (彌償) An insurable principle not normally applicable with insurances of the person. It relates to providing an exact financial compensation, which is not possible with life insurance, for example. **1.2**(d)

Indemnity Corollaries (彌償引伸) Sub-principles of the parent principle indemnity, i.e. contribution and subrogation. As with indemnity, neither is likely to have any application with life insurance policies. **1.2.3**(c)

Individual Insurance (個人保險) Life insurance arranged on the life of an individual person, as opposed to a group scheme. **2.4**

Inflation (通貨膨脹) An important economic consideration, since its effect can drastically reduce the real value of life insurance payment over an extended period. Planning a life insurance programme should therefore take this into account. **3.6**

Insurability (可保性) The physical and/or other conditions which indicate that the life to be insured is an acceptable risk for the insurance plan concerned. **3.5**

Insurability Benefits (可保權利益) A rider guaranteeing insurability under certain circumstances (see **Guaranteed Insurability Option (保證可保選擇)).** **3.5**

Insurable Interest (可保權益) The legal right to insure an individual's life. It is required at the commencement of any such insurance, although it is not needed when the insured event happens. **1.2.1**

Insurable Interest (In Oneself) (可保權益(就自己而言)) One has an unlimited insurable interest in oneself, so in theory an insurance could be effected for any amount. In practice, the amount is very likely to be governed by the ability to pay the premium and the insurer's willingness to insure very high amounts. **1.2.1**(c)

Insurable Interest (In Others) (可保權益(就其他人而言)) One has an unlimited insurable interest in one's spouse. There is also an insurable interest where a legally recognised financial relationship exists (e.g. in respect of a loan), but this is limited to the financial involvement plus reasonable interest. By statute, in Hong Kong a parent or guardian of a person under the age of 18 has an insurable interest in that person. **1.2.1**(d)

Insured Perils (受保危險) Causes of loss covered by the policy: an important consideration in establishing proximate cause. **1.2.3**(a)(i)

Interest (利息) With long term insurance, where the policies are not cancellable and the fixed periodical premium cannot be changed, the anticipated interest earnings on premiums is a critical factor in determining premium rates. **1.3.1a**(b)

Investment (投資) One aspect of certain life insurance covers, making financial provision for the future by investing in a life insurance policy, especially one which participates in the insurer's profits. **1.3.1a**(b)

Irrevocable Beneficiary (不可撤換受益人) A beneficiary who cannot be changed without his/her consent. **4.9**(d)(i)

Joint-Life Basis (聯合壽險方式) A life insurance insuring the lives of two (or more) persons, the benefit being payable upon the first death. A frequent use is with mortgage redemption insurance. **2.1.1a**(b)(iii)

Key Person Life Insurance (關鍵人物人壽保險) Insurance of an individual who represents a significant financial investment to the policyowner, e.g. an important employee and a leading professional sportsperson important to his club. **1.2.1**(d)(iii)**Note**

Language (語言) The Illustration Document must be in the same language to be used by the Company in its other pre-sale literature. If not, the same language must be used as is used for other communications at the time of policy issue. **5.2.6b**(e)

Lapse (失效) The termination of a life insurance because the premium has not been paid within the permitted time period (including the **Grace Period(寬限期)** and subject to any applicable policy provisions). **1.3.2b**(c)(iii)

Level Premium System (均衡保費制度) The normal method of life insurance pricing, whereby (for the same benefit) the annual premium is established at inception and does not vary throughout the term of the policy. **1.3.2b**

Level Term Insurance (定額定期壽險) A term insurance where the death benefit does not change during the term of the policy. **2.1.1a**(a)

Life Income Annuity With Period Certain (確定期間終身年金) See **Guaranteed Annuity (保證年金)**. **2.3.1**(c)

Life Insurance (人壽保險) An insurance contract providing a benefit payable upon the death of the life insured or upon survival to a stipulated date. **1.1**

Life Office Management Association Inc. (LOMA)(美國壽險管理學會) U.S. life insurance educational organisation, noted for its professional examinations for life insurance personnel. **1.1**

Linked Policy Sales Illustration (相連保單銷售說明書) Sales illustrations must be produced for both linked and non-linked policies. These have been produced by the Securities and Futures Commission (SFC) and the Hong Kong Federation of Insurers (HKFI) respectively. The ***illustration document for linked policies* (*相連保單銷售說明書*)**contains information on anticipated surrender values, with certain prescribed statements and other information for the protection of the investor. **5.2.6a**

Living Benefit Riders (生前支付保險利益附約) Another name for **Accelerated Death Benefit Rider(提前支付死亡保險利益附約)**. **3.3**

Loading (附加保費) The surcharge or additional sum added to life insurance net premiums to take account of expenses, commissions, etc. **1.3.1a**(c)

Long Term Business (長期業務) One of the two major divisions of insurance designated by the Insurance Companies Ordinance (the other being General Business). Consists primarily of life insurance in terms of premium volume. **1.3.1b**

Long Term Care (**LTC**) **(長期護理)** A rider allowing a stated portion of the death benefit to be paid to a policyowner-insured who requires constant care for a condition. **3.3.2**

Market Value Adjustment (**MVA**) **(市值調整)** A permitted right of insurers under the cooling-off initiative to make an adjustment with the refund of premiums, in relation to linked policies and non-linked single premium life policies. **5.2.4** (g)(ii)

Marketing (市場行銷) An important department for a life insurer, dealing with such matters as product research, and advertising and public relations. **5.1.1**(f)

Master Policy (總保單) The primary insurance document with a group life insurance plan. **5.4.1**(b)

Material Fact (重要事實) A fact that would influence the judgment of a prudent insurer in determining whether to accept a risk or at what premium to accept it. **1.2.2**

Mature (**Maturity**) **(期滿)** Relates to the situation when an endowment insurance becomes payable because the period of insurance has expired and the life insured is still living. **2.1.2**

Maturity Claims (期滿索償) Claims under endowment type insurance, where the full number of years specified have been completed and the life insured is still living. **5.6.1**

Medical Application (要體檢投保) A proposal for life insurance where a physical medical examination of the life to be insured is required. **1.2.2**(c)

Medical Benefits (醫療保險利益) Benefits traditionally (and may still be) insured under a general insurance policy, but which may be added as a rider to a life insurance. Such benefits are very likely to consist of a basic plan, with an optional medical plan and be subject to certain major exclusions. **3.4**

Medical Reports (體檢報告) Reports from qualified medical professionals in cases where this is deemed necessary, especially with insurance normally on a non-medically examined basis. **5.3.2**

Medical Tests (身體檢查) These may be needed in connection with a life insurance application. An important consideration with such tests are the provisions of the Personal Data (Privacy) Ordinance, regarding the right of the person tested to know the results and the confidentiality of those results. **1.2.2**(d)

Misstatement of Age/Sex (誤報年齡／性別) The policy provisions regarding errors of this nature. Most policies provide that in such circumstances the face amount be adjusted to reflect that which would have applied to the correct age/sex. **4.8**

Money Laundering (洗黑錢) The illegal practice of "cleansing" money obtained illegally (e.g. through drugs) by the use of business or financial instruments such as life insurance. Insurers and insurance intermediaries must take great care in trying to detect and eliminate such practices. **5.5.1Note**

Moral Hazards (道德危險) Rather more subjective features concerning human attitudes, behaviour and conduct which may have a bearing on the risk. **5.3.1**(a)(ii)

Mortality (死亡率) An important consideration in determining life insurance premium rates. It refers to the rate at which insured lives may be expected to die at a given age. The term, therefore, may more accurately be described as **Rate of Mortality(死亡比率)**. **1.3.1a**(a)

Mortality Tables (死亡表／生命表) Published statistics on mortality, indicating the expected rates of mortality at given ages. **1.3.1a**(a)

Mortgage Indemnity Insurance (按揭彌償保險) Insurance arranged by banks and other lending institutions to cover potential losses to them on mortgage loans, should the customer die or otherwise be unable to repay the loan and the property has to be sold in adverse market situations. **2.1.1a**(b)(iii) **Note**

Mortgage Redemption Insurance (抵押贖回保險) A popular form of decreasing term insurance, with the benefit linked to the outstanding balance of a mortgage loan. Often issued on a joint-life basis, payable on the first death. **2.1.1a**(b)(iii)

Multiple-Employer Groups (Insurance) (多個僱主的團體(保險)) Group life insurance where different employers participate in a single plan covering their respective employees. **2.4**(d)

Murder (謀殺) For the most part, murder of the life insured is regarded as an accident" as far as any ADB rider is concerned. However, if it is proved that the murderer was the beneficiary, **Public Policy(公共政策)** will not allow the latter to have the policy benefit. **5.6.2**(d)(iv)

Mutual Insurance Company (相互保險公司) An insurance company with no shareholders, technically owned by its participating policyholders (i.e. owners of participating policies). **5.1**(a)

Natural Premium System (自然保費制度) A system of life insurance premium pricing, whereby the premium for any one policy changes each year according to the prevailing age of the life insured and other features. This is unworkable from a practical point of view and may be considered an academic concept. **1.3.2a**

Natural Risk (自然風險) The intrinsic risk presented by the life insured at a particular point in time, related to the person's age, health and other factors. **1.3.2a**(a)

Net Cash Value (淨現金價值) The amount of cash surrender value *actually* payable to the policyowner after making adjustments for amounts such as outstanding policy loans and interests, and advance premium payments. **1.3.2b**(c)(iv)

Net Policy Proceeds (淨保單收益) The entitlement of an assignee under a life insurance policy, his interests being subordinate to those of the insurer regarding overdue premiums, loans and interest payable. **4.9**(c)

Net Premium (淨保費) Sometimes called the **Pure Premium (純保費)**, this, in the context of life insurance pricing, may be described as the basic premium to be charged exactly to cover the cost of death claims arising under normal statistical expectations, with no allowances for expenses and profit. **1.3.1a Note**

Non-Contributory (Plans) (非供款（計劃）) Group life, or employee benefit, plans where the employees do not contribute towards the premiums. **2.4**(c)

Nonforfeiture (不能作廢) A consequence of the level premium system and policies having a cash value. In the event that future premiums are not paid, the policy does not lapse (become forfeit), because the cash value may be used to keep the policy in force. **4.5**

Nonforfeiture (Options) (不能作廢（選擇權）) These are the choices available to the policyowner who does not wish to continue payment of premiums under a policy which has a cash value. These options include: taking the cash value, accepting reduced paid-up insurance and accepting extended term insurance. **4.5**(b)

Nonforfeiture Provisions (不能作廢條款) The available choices where premiums are not to be continued under a policy having a cash value. These provisions stipulate the procedure should there be no indication from the policyowner which option he chooses. **4.5**

Non-Linked Policy Sales Illustration (非相連保單銷售說明書) The purpose of this is to ensure that every policyholder is provided with a summary illustration of the benefits of his/her non unit-linked life insurance policy, where there are some forms of return to the policyholder other than a death benefit. See also **Linked Policy Sales Illustration (相連保單退保說明書)**. Separate Sales Illustrations exist for universal life (non-linked) policies. **5.2.6b**

Non-Medical Application (免體檢投保) A request for a life insurance which (subject to certain stipulations) does not have to be accompanied by a physical medical examination of the life to be insured. **1.2.2**(b)

Option Dates (備擇日期／行權日期) Dates specified under a **Guaranteed Insurability Option (保證可保選擇)** on which additional insurance may be purchased without evidence of insurability. Often such dates are linked with important life events, e.g. marriage and childbirth. **3.5.1**(d)

Optional Medical Plan (自選醫療計劃) Available cover under a medical benefits insurance, mostly consisting of increased limits for the various headings of cover under the basic plan. **3.4**(b)

Package Policy (一籃子保單) Put simply, it is a single policy containing different types of cover (e.g. personal accident and sickness policy). **3.3.1 Note**

Paid-Up Insurance (清繳保險) Insurance for a reduced amount, with no further premiums to pay but otherwise on the same terms as the original insurance. Another consequence of the level premium and cash value system, paid-up insurance is possible because the premium is not "fully earned" under the former system. **1.3.2b**(c)(iv)

PAR/NON-PAR (分紅／不分紅) The customary abbreviation for policies that are participating or non-participating. **1.3.1b**(a)

Participating/Non-Participating (分紅／不分紅) Also known as **With-Profit (有利潤)** or **Without-Profit (無利潤)**, the terms indicate whether the policies concerned share in the divisible surplus of the insurer or not. If they do, dividends or bonuses are payable. **1.3.1b**(a)

Participating Policyholders (分紅保單持有人) Those policyholders whose policies are participating (or with-profit). If the insurer is a mutual company, they are the legal owners of the company. **5.1**(a)

Pension (退休金) A monthly or other periodic payment to a person in retirement, until death. **2.3**

Permanent Insurance (永久保險) Life insurance which is effective throughout the life insured's lifetime provided premiums continue to be paid, and which contains a savings element. **2.1.1b**(b)(iii)

Personal Data (Privacy) Ordinance《個人資料(私隱)條例》 The statute giving rights to privacy over personal data. An important issue when obtaining sensitive medical information with life insurance applications. **1.2.2**(d)

Personal Needs (個人需要) An important aspect of life insurance for the individual, i.e. to make provision for various life needs (e.g. children's education, personal retirement, and provision for dependants with premature death etc). **1.1.1**(a)

Personal Representative (遺產代理人) The executor of a will of the administrator of the estate of a deceased person. **5.6.2**(a)

Physical Hazards (實質危險) The objective measurable factors that are very likely to increase the risk of the insured event happening, such as obviously known health dangers (e.g. heavy smoking and serious overweight). **5.3.1**(a)(i)

Policy Changes (更改保單) One of the duties of the POS (Policyowner Service Department), including such matters as minor amendments of address to significant issues such as change of beneficiary, and assignments. **5.5.1**

Policy Delivery (交付保單) After policy preparation, delivery of individual policy covers is normally by the marketer. Group policies involve a master policy for the employer or group concerned, with perhaps certificates and enrolment cards for each insured person, delivery being overseen by the marketer or group representative. **5.4.1**

Policy Issuance (簽發保單) The process of preparation, checking and delivery of the policy document. An important operation, since policies cannot be cancelled and may be assigned. **5.4**

Policy Loan (保單抵押貸款) Policies having a cash value usually also include rights for the policyowner to borrow money from the insurer against the security of the cash value. The loan may be for any purpose and need not be repaid until the policy benefit is due (when interest will be added and the total deducted from the claim payment).
1.3.2b(c)(ii), **4.6**

Policy Revival (保單復效) See Reinstatement. **4.7**

Policyowner-insured (受保保單所有人) Where the life insured and the policyowner are the same person, this person can be referred to as a policyowner-insured. **3 Note**

POS (Policyowner Service)(保單所有人服務部) The Client Service Department, responsible for such matters as documentation, correspondence, premium payments, etc. **5.1.1**(e), **5.5**

Pre-Existing Conditions (保險生效前已患的疾病) A common exclusion with medical benefit policies, designed to eliminate expenses relating to medical problems that existed before the insurance commenced. **3.4**(c)(i)

Preferred Risks (優良風險) Above average risks, constituting highly desirable types of business for the insurer (e.g. confirmed non-smokers in excellent health). **5.3.1**(b)(iv)

Premium (保費) The amount payable by the policyowner for (usually annual) coverage. Classic understandings of life insurance indicate that life premiums should be adequate and equitable. **1.3**

Premium Waiver (保費豁免) Contract provisions whereby premiums otherwise payable are not required by the insurer under certain circumstances, e.g. during the period when long-term care benefits are payable under a policy with an LTC Rider. **3.3.1**(g)

Prescribed Statements (規定聲明) A statements that must appear below the table of surrender values in a linked policy sales illustration document, advising the policyholder that rates of return indicated are for illustrative purposes only. Also, a statement of warning inserted before the investor's signature regarding premature termination of the investment etc. **5.2.6a**(a)(ii)

Presumption of Death (推定死亡) Where no death certificate can be issued, it may be possible to have a presumption of death by the courts (after disappearance, etc). **5.6.2**(e)

Primary Beneficiary (or **First Beneficiary**)**(第一順位受益人／第一受益人)** The designated beneficiary having priority in the payment of the policy proceeds. **4.4**(b)

Principal Brochure (主要推銷刊物) A document required with all investment-linked assurance schemes, containing the information necessary for prospective scheme participants to make an informed judgment of the investment proposed to them. **5.2.6a**

Proof of Age (年齡證明) Documentary or other evidence to satisfy the insurer as to the life insured's age. This may be provided at any time, but it is normally required before any claim under the policy can be made. **5.6.1**(d)

Proof of Death (死亡證明) Normally provided by a death certificate, this is an obvious requirement in substantiating a death claim. **5.6.2**(c)

Proof of Title (所有權證明) Title may be defined as the legal entitlement to a benefit, etc. Such title is important, for example, with a person claiming the cash value under a surrender claim. **5.6.3**(a)

Proprietary (or Joint-Stock) Company (營利(或合資股份) 公司) A company having shareholders, who have their liability towards the company's debts limited to the extent of any amounts unpaid in respect of their company shares. **5.1**(b)

Provident Fund Scheme (公積金計劃) A retirement provision, but unlike with a pension, the benefit is in the form of a lump-sum amount payable at retirement or other specified time. **2.3.2**

Proximate Cause (近因) Is the principle which seeks to establish the dominant or effective reason for a loss occurring. The cause of death may be important in life insurance, for example, especially if the policy provides additional benefits for accidental death (or if the policy is still within the contestable period or suicide exclusion period). **1.2**(c)

Public Policy (公共政策) An unwritten rule of law forbidding the enforcement of contracts or rights which are considered to be against public standards and interests, e.g. life policy proceeds must not be paid to the murderer of the life insured. **5.6.2**(d)(iv)

Pure Endowment (純生存保險) A rare form of life insurance where the benefit is only payable if death does **not** occur during the period (term) specified. **2.1.2**(b)

Pure Premium or **Pure Cost of Protection (純保費／保障的純成本)** See **Net Premium (淨保費)**. **1.3.1a Note**

Rates (Life Insurance) (費率(人壽保險)) The normal or standard premiums applicable, according to age and sex, to life insurance. **1.3**

Reduced Paid-Up Insurance (減額清繳保險) One of the non-forfeiture options, implying that the available cash value be used to purchase insurance for which no further premiums are required. The face amount will obviously be less than the original one). **4.5**(b)(ii)

Reinstatement (復效) The restoration of a lapsed policy into full force. Also known, with UK style policies, as **Policy Revival (保單復效)**. This is provided for under policy conditions, but is subject to certain limitations, e.g. a specified time period (perhaps five years for exercising the option), repayment of back premiums and interest, and perhaps other measures (e.g. the suicide exclusion clause is reinstated). **4.7**

Reinsurance (再保險) An insurance used to transfer all or part of the risk assumed by an insurer under one or more insurance contracts to another insurer. Much more commonly used in life insurance as an underwriting tool with individual risks with adverse features, e.g. extremely high face amounts and severe health problems. **5.1.1**(g)(iii)

Release (or Release Form) (棄權聲明／解除責任憑證) Documentary confirmation from a beneficiary that the policy's death benefit stands reduced by the amount of any accelerated death benefit payment. Alternatively, a discharge given by a benefit recipient, e.g. with a policy surrender and death claim. **3.3**(c), **5.6.3**(c)

Renewable Term Insurance(可續保定期壽險) A term insurance having the right of renewal for further period(s) without evidence of insurability. **2.1.1b**(a)

Renewal Premiums (續保費) Premiums paid or payable for a life insurance after payment of the initial premium. **1.3.2.b**(c)(iii)

Replacement (轉保活動) Under the Code of Practice for Life Insurance Replacement, replacement also involves any policy which has lapsed, been surrendered or converted to paid-up insurance. **5.2.5**(b)

Reserve (儲備金) An amount subtracted from a firm’s retained earnings for either general or specific purposes. **1.3.2b**(b)

Retirement (退休) One objective with life insurance, i.e., to provide for a lump sum (perhaps through an endowment policy), which may be used to purchase an annuity. **1.1**(d)

Reversionary (Interest/Bonus)(復歸或期末(權益/紅利)) A financial interest which exists now, but where full enjoyment and privileges of ownership is deferred until some future time or event, e.g. reversionary bonuses under with-profits policies. **4.9**

Rider(附約) An endorsement or addition to the policy, frequently adding further benefits to the cover (e.g. accidental death benefits). **3.1**

Sales Illustrations (銷售說明書) All linked, non-linked and universal life (non-linked) policies, must issue sales illustrations. **5.2.6**

Savings (儲蓄) One function of life insurance covers, where the policyowner is providing financially for the future, e.g. with endowment insurance. **1.1**(b)

Settlement Options (賠付選擇) The choices available to the policyowner when the policy proceeds become available. These options include: lump sum single payment, proceeds left to earn interest with the insurer and proceeds paid in instalments over a fixed period etc. **4.11**

Single-Employer Plans (單一僱主計劃) Group life insurance where all insured persons are employees of the same employer. **2.4**(d)

Single Premium Endowments (整付保費儲蓄壽險) An endowment insurance plan involving a single premium payable at policy inception, regardless of the term specified. **2.1.2**(a)

Special Class Risks (特殊風險) See **Sub-Standard Risks (次標準風險)**. **5.3.1**(b)(ii)

Standard Risks (標準風險) Risks presenting no abnormal features and insurable on normal terms. **5.3.1**(b)(i)

Straight Life Insurance (純粹壽險) Whole life insurance where the premiums continue to be payable for as long as the life insured lives. **2.1.3**(a)(i)

Subrogation (代位權) An insurance principle which allows an insurer who has provided an indemnity to take over for his own benefit rights the policyholder has against third parties. As indemnity does not apply to life insurance, so this corollary of indemnity – subrogation - does not apply to it either. **1.2**(f)

Sub-Standard Risks (次標準風險) Risks which for some adverse reason cannot be considered standard, although possibly insurable with special terms. Sometimes called **Special Class Risks.** **5.3.1(**b)(ii)

Suicide (自殺) An excluded peril for the first year or so of a life insurance policy's existence, but is a permanent exclusion in respect of any accidental death benefit addition. **1.2.3**(a) **Note** 1

Suicide Exclusion (自殺條款) This constitutes the provisions of a life policy in respect of death by suicide, which is normally excluded for the first year or so of the policy's existence, but not excluded thereafter (unless reintroduced for a further period after policy revival). **4.12**

Supplementary Requirements (補充要求) Consisting of a number of issues that an underwriter may need including life underwriter's (agent's) report, mode of premium payment and proof of insurability. **5.2.1**(c)

Surrender (退保) Termination of the insurance by the policyowner. Whilst entitled to do this, other options are very likely to be explained to the policyowner first. **5.6.3**

Surrender Value (退保價值) Surrender value equals cash value minus surrender charge, a charge that is applicable when a policy is surrendered for its cash value or when a policy, under some plans, is adjusted to provide a lower level of death benefit. Also see **Cash Value (現金價值)**. **1.3.2b**(c)(i)

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Switching (Policy Switching)(轉保) Changing an existing life policy for a replacement one. The term, however, has an undesirable implication whereby policyholders are persuaded to make the change which may be more for the benefit of the agent/insurer than the policyholder. The latter practice is known as **Twisting (誘導轉保)** (i.e. an inappropriate replacement of a life insurance policy). **5.2.5**

Technical Underwriting (技術性核保) Assessment of the intrinsic and perceived hazards of given risks, as to their insurability and terms. **5.3.1 Note**

Temporary Insurance Agreement (TIA)(臨時保險協議) See **Binding Premium Receipt (立約保費收據)**. **5.2.2**(b)

Temporary Risk Situations (暫時性風險情況) Situations where premature death might cause undue financial burdens and therefore suitable for temporary (term) life insurance, e.g. whilst a loan is outstanding or there are educational needs for children. **1.1**

Term Insurance (定期壽險) Life insurance where the benefit is payable only if the life insured dies during the period (term) specified. Also known as **Temporary Life Insurance (短期人壽保險)**. **2.1.1**

Third Degree Burns (三級燒傷或燙傷) Can be defined as full thickness skin destruction due to burns. **3.2.2**(b)(i)

Third Party Policy (第三者保單) A policy where the insurance is on the life of a person other than the applicant. **1.2.1 Note**

Total Disablement (完全殘疾) As defined under the Disability Income Benefit Rider, this means that the insured person is unable to perform the essential acts of his own occupation, or any occupation for which he is reasonably fitted by education, training or experience. **3.1.2**(a)

Twisting (誘導轉保) See **Switching (轉保)**. **5.2.5**(a)

"Unbundled" Pricing Structure (「分別列示各定價因素」定價結構) A feature of universal life insurance, whereby the insurer separately discloses the three pricing factors: mortality (or pure cost of protection), interest and expenses. **2.2.1**(c)

Unconditional Premium Receipt (不附條件保費收據) See **Binding Premium Receipt (立約保費收據)**. **5.2.2**(b)

Underwriting (核保) Concerned with the selection of risks and terms to be imposed, this department will be involved with risk assessment (for insurability and terms), medical requirements and reinsurance arrangements. **1.3.1a**(a), **5.1.1**(g), **5.3**

Uninsured Perils (不保危險) These are causes of loss neither specifically covered by a policy nor specifically excluded. An important consideration with non-life insurance and the principle of proximate cause, but unlikely to have any significant application to life insurance. **1.2.3**(a)(iii)

Unit-Linked Long Term Policy (單位相連長期保單) Also known as '**Investment-Linked Long Term Policy**' **(投資相連長期保單)**, it is an insurance policy with its policy value generally linked to the performance of its underlying investments. **2.2.2**

Universal Life Insurance (萬用壽險) A life insurance contract which is subject to a flexible premium, has an adjustable benefit and an 'unbundled' pricing structure, and accumulates a cash value. **2.2.1**

Universal Life (Non-Linked) Policy Sales Illustration (萬用壽險(非相連)保單銷售說明書) See **Non-Linked Policy Sales Illustration(非相連保單銷售說明書)**. **5.2.6c**

Utmost Good Faith (最高誠信) A common law principle with insurance contracts, whereby each party must reveal to the other all material facts, whether these are requested or not. At law, a breach of this principle makes the contract voidable. **1.2**(b)

Valuation (估值) A core function of the Actuarial Department, relating to the calculation of the value of the company's assets and liabilities. **5.1.1**(a)(ii)

Waiting Period – in relation to Critical Illness Rider (等候期——與危疾附約有關的) Where diagnosis is a defining element of an insured event of the Critical Illness Rider, the diagnosis has to be one done when the rider has already been in effect for a specified number of days. **3.3.1**(e)(iv)

Waiting Period – in relation to Waiver of Premium Rider (等候期——與豁免保費附約有關的) A qualification to the Waiver of Premium Rider, whereby premiums are not waived until the insured person has been disabled for a period of three (or six) months. Some insurers refund premiums paid during the waiting period if the disability lasts longer, so that policy premiums begin to be waived. **3.1.1**(a)

Waiver of Premium Rider (WP Benefit Rider)(豁免保費附約) An endorsement to a life policy waiving premiums otherwise payable whilst the insured person is totally disabled, keeping the insurance in full force. **3.1.1**

Whole (of) Life Insurance (終身壽險) Life insurance where the benefit is payable only on death, whenever that occurs. **2.1.3**

With-Profit (Policies) (有利潤（保單）) The equivalent term in U.K. insurance terminology of a participating insurance. **1.3.1b**(a) **Note** 1

Without-Profit (Policies) (無利潤（保單）) The equivalent term in U.K. insurance terminology of a non-participating insurance. **1.3.1b**(a) **Note** 1

Yearly Renewable Term (YRT) Insurance (每年可續保定期壽險) Policy rider indicating that the insurance is a one year term insurance with guaranteed insurability renewal provisions. Also known as **Annually Renewable Term (ART) Insurance**. **2.1.1b**(a)

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Representative Examination Questions

Answers

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4	(b)	(a)	(c)	(d)
5	(d)	(c)	(c)	(b)

ACKNOWLEDGEMENTS

Gratitude is given to the representatives of the following organisations for their contributions towards these Study Notes:

Office of the Commissioner of Insurance

The Hong Kong Federation of Insurers

The Insurance Institute of Hong Kong

Vocational Training Council

Insurance Training Board

The Hong Kong Confederation of Insurance Brokers

Professional Insurance Brokers Association

The Hong Kong General Insurance Agents Association Limited

The Life Underwriters Association of Hong Kong

General Agents & Managers Association of Hong Kong