Practice Note on Illustration Rate Caps in Benefit Illustration for Participating Policies

1. Introduction and objective

1.1 Participating policies provide life cover and protection that extend over multiple years. The returns from these policies generally contain non-guaranteed elements and may be influenced by various factors during the policy period, including the insurer's investment performance and underwriting decisions. Authorized insurers are required to provide benefit illustrations at the point of sale to show potential customers the projected performance of a life insurance policy. Such illustrations play a crucial role in helping potential policy holders make informed decisions when purchasing participating policies.

1.2 The regulatory requirements on the governance of participating policies and their benefit illustration are principally set out in Guideline on Underwriting Long Term Insurance Business (other than Class C Business) ("**GL16**") and Guideline on Benefit Illustrations for Long Term Insurance Policies ("**GL28**"). Based on the principle of "treating customers fairly", GL16 requires authorized insurers to ensure that policy holders' reasonable expectations regarding the performance of their policies (including non-guaranteed returns) are met, and GL28 requires information provided by the authorized insurers in the benefit illustration documents to be adequate, accurate, clear and not misleading.

1.3 As stipulated in GL16, the objective of a benefit illustration is to provide potential customers with a projected performance overview of a life insurance policy. This illustration should clearly show the total benefits, including a breakdown of guaranteed and non-guaranteed benefits, which may reasonably be payable at each policy year, contingent upon certain conditions being met. To meet this requirement, authorized insurers must ensure there is a fair chance of achieving those illustrated returns. Relying on aggressive investment strategies to support higher non-guaranteed returns — without adequately considering associated volatility and risks — can lead to overly optimistic illustrations that may not be accurate or adequate. In addition, it is observed that some participating policies offer a very low level of guaranteed benefits, resulting in overall returns becoming volatile due to heavy reliance on non-guaranteed bonuses or dividends. Consequently, the uncertainty surrounding the likelihood of achieving these illustrated returns, particularly the non-guaranteed ones, raises concerns about whether authorized insurers are complying with the relevant requirements under GL16 and GL28, as well as the principle of "treating customers fairly".

1.4 For these reasons, the Insurance Authority ("IA") considers it necessary to articulate a set of aligned minimum expectations regarding the illustration rate caps that authorized insurers should use in benefit illustrations for participating policies at the point of sale. These illustration rate caps are designed to prevent overly aggressive investment assumptions, promote healthy competition among authorized insurers, and facilitate the sustainable development of the insurance industry. That is the purpose of this Practice Note.

2. Application

2.1 This Practice Note supplements the requirements in GL16 and GL28 in relation to benefit illustrations provided to customers at the point of sale of participating products / policies (i.e. contracts of insurance that are "participating business" as defined in section 21B of the Insurance Ordinance (Cap. 41) (the "Ordinance")).

2.2 "Participating business" is defined in section 21B of the Ordinance to mean "*any long term business in relation to which a policy holder has a right to receive, at the discretion of the insurer, a financial benefit that is determined based on a profit-sharing mechanism as a share of the insurer's profits in respect of the insurer's business or a part of the insurer's business*". For the avoidance of doubt, as overly optimistic illustrations are not commonly observed for Qualifying Deferred Annuity Policies and universal life policies, therefore, these policies are not subject to the requirements in this Practice Note.

2.3 It has been observed that authorized insurers and licensed insurance intermediaries may utilize technologies or analytical tools to enhance their sales processes for participating policies. This can include generating or comparing benefits and rates of return for various products. The IA adopts the principle of "substance over form" when determining compliance with the requirements outlined in this Practice Note. In this context, any benefit illustration of participating products generated, produced, or presented in any form of documents or tools (such as illustrations or projected policy values produced by financial needs calculators or other similar analysis tools, whether on company websites or relevant sales portals) are also subject to the requirements outlined in this Practice Note. This includes adherence to the illustration rate caps mentioned in paragraph 3.2, except for re-illustrations referenced in paragraph 3.7.

2.4 Regarding campaign and promotional offers provided by authorized insurers or licensed insurance intermediaries at the point of sale, any such offers that are not reflected in the projected policy values of a participating product— are not subject to the requirements in this Practice Note. Whilst it has been observed that authorized insurers and insurance intermediaries may sometimes present insurance products — especially through promotional platforms like social media — with seemingly higher returns that factor in the effects of various promotional campaigns or offers, these commonly observed offers may not materially uplift the projected policy values given the diminishing impacts along policy terms. Therefore, effects of campaigns or promotional offers are excluded from the requirements of this Practice Note. Authorized insurers and insurance intermediaries are reminded to adhere to applicable requirements by providing adequate, accurate, complete, and non-misleading product information, including rates of return. Review and/or tightening of the requirements will be warranted if overly aggressive or suspicious campaign/promotional offers are observed in the future.

3. Illustration rate caps in the benefit illustration for participating policies

3.1 Authorized insurers should implement illustration rate caps on customers' internal rate of returns on projected surrender value (commonly known as "Customers' IRR") in the benefit illustrations for participating policies at the point of sale.

3.2 In light of the current prevailing market and economic conditions, the IA considers the rates of **6.0% (for products denominated in Hong Kong Dollar)** and **6.5% (for products denominated other than in Hong Kong Dollar)** to be reasonable levels for the illustration rate caps on the Customers' IRR to be used in the benefit illustrations for participating products. This approach aims to maintain realistic expectations for policy holders.

3.3 The illustration rate caps apply to participating products across all payment modes, policy options[1], policy terms, and scenarios[2] (including base, optimistic, and pessimistic scenarios). For clarity, if the underlying Customers' IRR is lower than the corresponding cap, authorized insurers should continue to illustrate the benefit values of their participating products based on the Customers' IRR, ensuring that it does not exceed the rates determined under best estimation, in accordance with the requirements set out in GL28.

3.4 The illustration rate caps apply to Customers' IRRs of insurance products, as Customers' IRRs are commonly used for product comparisons and promotions in the Hong Kong insurance market when insurance intermediaries engage potential customers. While this Practice Note does not establish limits for underlying investment return assumptions or other types of best estimate assumptions for participating policies, authorized insurers and their appointed actuaries are required to adhere to the relevant requirements in the Actuarial Guidance Note 9: Best Estimate Assumptions issued by Actuarial Society of Hong Kong when setting the best estimate assumptions in benefit illustrations.

3.5 It is acknowledged that computation of policy returns involves complex processes and calculations based on various assumptions. In formulating the illustration rate caps on Customers' IRRs for benefit illustrations, due considerations are made to the following non-exhaustive matters to adhere to the principle of "treating customers fairly" and authorized insurers should also take into account those matters in determining the Customers' IRRs for their participating products (where applicable):

3.5.1 The caps and the presentation of Customers' IRRs should be straightforward and easy-to-understand; and a single cap (across payment modes, policy options, scenarios and policy years) on products denominated in the same currency is preferred to avoid overly optimistic assumptions and to ease administrative burden of authorized insurers;

3.5.2 Products with aggressive illustrated values may necessitate revisions, which could include updating benefit illustration documents, revising non-guaranteed benefits, or revamping the product. These revisions should be carried out in an orderly manner under a clear and pre-set timeline to ensure full compliance with

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[1] These refer to optional product features specified in para 2.1 (f) of GL28, which the policy holder may elect from time to time under his/her life insurance policy (such as premium holiday, partial surrender, top-up, premium offset option, policy loan etc.).

[2] For the avoidance of doubt, authorized insurers may choose to disclose in the Explanation Notes in the Standard Illustration required under GL28 that the illustrated values are subject to illustration rate caps. The disclosure can be in the form of a generic statement and/or adding specific explanation to the Explanation Notes as appropriate (e.g. "*the current assumed investment return is subject to a cap equivalent to customers' total internal rate of returns of 6.5%/6.0% p.a.* ").

relevant regulatory requirements. This approach helps maintain trust and transparency in the insurance market;

3.5.3 To foster healthy competition of authorized insurers — the caps applied in benefit illustration should provide sufficient flexibility to accommodate varying levels of illustrated returns across different scenarios, considering current market conditions. This approach ensures that products remain attractive to customers and could align with customer expectations in maintaining trust in the insurance offerings;

3.5.4 The caps and the Customers' IRRs should allow for meaningful rate differentials across economic conditions and term/risk premiums, based on the model portfolio. This flexibility helps ensure that the illustrations accurately reflect the potential variations in returns associated with different market scenarios and product characteristics, ultimately supporting better decision-making for policy holders; and

3.5.5 The caps should consider current market practices, to help maintain competitiveness while providing clarity and fairness to customers.

3.6 Policy returns of a participating policy depend on several factors, including claims, investment return, market risk, expense, persistency and non-guaranteed benefit philosophy. As a result, actual policy returns may be higher or lower than those illustrated in product materials at the point of sale. The requirements stated in this Practice Note are not intended to impose limits on targeted underwriting or investment results, nor do they affect the actual returns of participating policies issued by authorized insurers.

3.7 Benefit illustrations at the point of sale can significantly influence potential policy holders' purchasing decisions. Therefore, the adoption of illustration rate caps on Customers' IRR for new participating business is required. The IA does not anticipate that the actual policy experience or customers' actual returns on participating policies will be impacted by these illustration rate caps. Consequently, it is not necessary for authorized insurers to apply the illustration rate caps outlined in this Practice Note to re-illustrations of in-force policies. For the avoidance of doubt, authorized insurers and licensed insurance intermediaries must adhere to all relevant regulatory and conduct requirements during their solicitation and sales processes. They are required to present adequate, accurate, complete, and non-misleading benefit illustration information. Additionally, they must not use any re-illustrations (to which the illustration rate caps do not apply) to engage in aggressive or unethical selling practices.

4. On-going review

4.1 The IA reserves the right to review and update this Practice Note from time to time. The scope of review may include but not limited to the latest economic outlook in the region, evolving market practices and underlying investment portfolios. These factors will be considered in determining the prevailing applicable requirements, including the illustration rate caps for Customers' IRR of participating products used for benefit illustration purposes. This ensures that the relevant regulatory requirements remain relevant and responsive to changing market conditions.

4.2 Modified or additional measures may be considered periodically to reinforce adherence to the principle of "treating customers fairly". This could include expanding the applicability of this Practice Note to other insurance products, and updating the relevant regulatory standards. These considerations will take into account prevailing market conditions and industry practices observed during ongoing monitoring and prudential supervision. This approach ensures that the regulatory framework remains effective and aligned with the best interests of customers.

5. Controls and Records

5.1 Authorized insurers are required to implement proper controls, procedures, and adequate monitoring and supervision to ensure compliance with the requirements and expectations outlined in this Practice Note. This is essential to achieving the objective of "treating customers fairly". By establishing these measures, authorized insurers can promote transparency, accountability, and trust in their operations, ultimately enhancing customer satisfaction and protecting the interests of policy holders. Any non-compliance or attempt to circumvent the relevant regulatory objectives and requirements may be regarded as an act or omission likely to be prejudicial to the interests of policy holders or potential policy holders. This may also reflect adversely on the IA's view of the continued fitness and properness of the authorized insurers' directors, controllers and key persons in relevant control functions.

5.2 Authorized insurers must maintain proper and sufficient records related to their compliance with the requirements set forth in this Practice Note. Authorized insurers are also obligated to demonstrate their compliance upon request from the IA.

6. Commencement

6.1 This Practice Note shall take effect from 1 July 2025. The requirements and expectations outlined in this Practice Note apply to all benefit illustrations to be provided by authorized insurers and licensed insurance intermediaries at the point of sale to customers.