<u>**GL19**</u>

# GUIDELINE
# ON
# QUALIFYING DEFERRED ANNUITY POLICY

**Insurance Authority**

## Contents

## 1. Introduction

1.1 This Guideline is issued by the Insurance Authority ("IA") pursuant to section 133 of the Insurance Ordinance (Cap. 41) ("Ordinance"). The IA's principal function is to regulate and supervise the insurance industry for the protection of existing and potential policy holders and its function is to promote and encourage the adoption of proper standards of conduct by authorized insurers and licensed insurance intermediaries.

1.2 Under an annuity insurance policy, accumulated savings are turned into a stable stream of income over a period of time. A deferred annuity insurance policy is a type of annuity insurance policy which has an accumulation phase and an annuitization phase. During the accumulation phase, the policy holder pays premiums regularly over a period of time which is then (usually) followed by a deferral period to allow the paid up sum to grow through investment by the insurer. At the completion of this accumulation phase, the deferred annuity insurance policy will annuitize, the annuitization phase will begin and the annuitant will receive regular payments during the annuity period.

1.3 Pursuant to sections 26N to 26U of the Inland Revenue Ordinance (Cap. 112) ("IRO"), a certain amount of premium which is paid for a deferred annuity insurance policy will be eligible for tax deduction under salaries tax and tax under personal assessment, provided the deferred annuity insurance policy satisfies the criteria specified in a Guideline issued by the IA and has been certified by the IA for this purpose. In section 26N of the IRO, a policy meeting these requirements is a "qualifying deferred annuity policy" as therein defined and shall hereafter in this Guideline be referred to as a "QDAP".

1.4 This Guideline sets out the criteria which a deferred annuity insurance policy has to satisfy in order to obtain the necessary certification from the IA to become a QDAP, the process for obtaining that certification and the ongoing requirements which authorized insurers have to meet in respect of the promotion, arrangement and administration of QDAPs.

1.5 Unless otherwise specified, words and expressions used in this Guideline shall have the same meanings as given to them in the Ordinance and in section 26N of the IRO.

## 2. Relevant Legal and Regulatory Requirements and Status of this Guideline

2.1 This Guideline should be read in conjunction with the relevant provisions of the Ordinance, any other relevant law, rules, codes, circulars, and guidelines issued by the IA or other regulatory bodies, including but not limited to the following:

(a) IRO, in particular Part 4A, Division 7, Subdivision 1 therein;
(b) Guideline on Underwriting Long Term Insurance Business (other than Class C Business) (GL16) issued by the IA;
and
(c) Circulars/guidelines issued by the Hong Kong Monetary Authority.

2.2 This Guideline does not have the force of law and should not be interpreted in a way that would override the provision of any law. The IA may from time to time amend the whole or any part of this Guideline. A non-compliance with the provisions in this Guideline would not by itself render an authorized insurer or licensed insurance intermediary liable to judicial or other proceedings. A non-compliance may, however, reflect on the IA's view of the continued fitness and properness of the directors, controllers of authorized insurers and licensed insurance intermediaries to which this Guideline applies. The IA may also take guidance from this Guideline in considering whether there has been an act or omission likely to be prejudicial to the interests of policy holders or potential policy holders (albeit the IA will always take account of the full context, facts and impact of any matter before it in this respect).

## 3. Scope of Application

3.1 This Guideline applies to all authorized insurers carrying on long term business in respect of long term business, who are involved in developing, designing, underwriting and/or selling QDAPs.

## 4. Criteria for Certification

4.1 The IA may certify a QDAP if:

(a) the policy complies with the criteria specified in **<u>Annex A</u>**;

(b) all the required application documents have been submitted to the IA for review in accordance with **Annex B**; and

(c) the IA is satisfied with the information therein after completion of its review.

4.2 In assessing whether all the criteria in **Annex A** have been duly complied with, the IA will consider the substance and nature of the matters involved, rather than the name or form of the arrangements adopted.

4.3 The IA reserves the right to request any other information to be provided which the IA considers relevant to its consideration of any application for certification made pursuant to this Guideline or for the protection of the policy holders' interests.

## 5. Certification Process

5.1 The IA will inform the authorized insurer concerned of the result of the application for the certification in writing.

5.2 The IA will publish the list of QDAPs on its website (www.ia.org.hk). The list will be maintained and updated by the IA.

5.3 If an authorized insurer intends to make any changes to a QDAP (including, without limitation, to the policy features, guaranteed or non-guaranteed benefits, or contract terms) after the QDAP has been certified by the IA, it must obtain the IA's prior consent before such changes are effected.

5.4 The IA retains the discretion to revoke its certification of a QDAP at any time if the IA is of the view that:

(a) the policy concerned does not or will no longer comply with any of the criteria set out in **Annex A**; or

(b) the continued availability of the QDAP would adversely affect the interests of policy holders or potential policy holders.

## 6. Other Requirements

6.1 Authorized insurers should also comply with the requirements in **Annex A** which apply to the promotion, advising and arranging of QDAPs including, without limitation, those provisions relating to (i) the disclosures which need to be made when promoting, advising on or arranging QDAPs for policy holders and potential policy holders; (ii) the ongoing servicing of QDAPs (such as issuance of the Annual Summary); (iii) training; and (iv) record keeping requirements.

## 7. Commencement

7.1 This Guideline shall take effect on 1 April 2019.

**March 2019**

## Annex A – Criteria for QDAP

General

1. The policy is underwritten by an authorized insurer who is authorized to carry on long term business of a nature specified in class A in Part 2 of Schedule 1 to the Ordinance.

Policy Features

*Minimum Total Premiums Paid and Minimum Premium Payment Period*

2. Total qualifying annuity premium payable under the policy is at least HK$180,000. For policies issued in currency other than the Hong Kong Dollars, an authorized insurer must put into place suitable measures to ensure that the minimum requirement for total qualifying annuity premium payable under the policy is met at the time of policy issuance.

3. The minimum premium payment period is 5 years.

*Minimum Length of Annuity Period*

4. The length of the annuity period is at least 10 years.

5. During the annuity period, the annuity payments must be paid regularly to the annuitant(s) at least annually.

*Minimum Age of Annuitant(s) when the Annuity Period Starts*

6. The annuity period shall only start when the annuitant(s) has/have reached the age of 50 or beyond.

*Policy Currency*

7. There is no restriction on policy currency. However, the relevant risks (e.g. exchange rate risk) should be clearly disclosed to the potential policy holders in the Product Brochure ("PB"). The exchange rates adopted shall be in a consistent manner and follow the published rates on the website of the Inland Revenue Department.

*No Lapse Gain*

8. Surrender value should be set at a level where insurers do not profit from early termination (i.e. no-lapse-gain basis based on direct variable costs incurred in underwriting, administering and distributing the policy concerned) as far as possible. Insurers are required to provide supporting information to demonstrate that the level of surrender value is determined on this basis.

Disclosure Requirements

*Disclosure of Internal Rate of Return ("IRR")*

9. IRR must be disclosed[1] in the PB for the policy:
   (i) in the form of minimum to maximum IRRs for the guaranteed portion (i.e. guaranteed IRRs) and total projected benefit (i.e. total IRRs) respectively; and
   (ii) in the form of an example, i.e. a non-smoking male policy holder age 45. Insurers are required to clearly state that the example is strictly for illustration purpose and put down explicit warning that part of annuity payments is non-guaranteed (if applicable).

10. Personalized IRRs for the guaranteed IRR and total IRR should be disclosed in the Benefit Illustration ("BI") at the point of sale. (The requirement to disclose personalized IRRs in the BI pursuant to this Clause 10 is an optional requirement until 31 March 2020. Thereafter it is mandatory).

11. The insurer should use the following formula to calculate the IRR (for monthly premium contribution and monthly annuity payment):

$$\sum_{t=0}^{N}[Premium_t \times (1+IRR)^{\frac{N-t}{12}}] = \sum_{t=0}^{N}[Payment_t \times (1+IRR)^{\frac{N-t}{12}}]$$

Where
Premium $_t$ = monthly qualifying annuity premiums paid by policy holder at policy month t
Payment $_t$ = monthly annuity payment received by annuitant at policy month t
(Remarks: Payment $_t$ shall include guaranteed part only for the guaranteed IRR)
N = policy term (in months)
(Remarks: The insurer may adjust the formula to adjust for different payment frequency)

12. The Premium $_t$ and Payment $_t$ above shall take into account the effect of all the administrative charges and fees that affect the actual sum of money to be paid by the policy holder and the actual regular income to be received by the annuitant.

13. Some policies may allow the policy holders or annuitants to decide to retain the entire or part of the annuity payments at the insurer to generate additional interest income in the future. For the purpose of the calculation of the IRR, the insurer shall assume that the policy holders or annuitants always choose to receive the regular annuity payments as soon as possible according to their

[1] Any disclosure of IRR must be rounded off to at least one decimal place.

entitlements under the policy terms and conditions. For the sake of clarity, any reinvestment returns of the annuity payments payable to the annuitant shall be excluded from the calculation of the IRR.

14. For policies without a fixed policy term (e.g. life-time policy), the insurer should adopt 30 years as the annuity period in the calculation of the IRR. The relevant assumption should be clearly disclosed for the information of the potential policy holders.

*Minimum Percentage of Guaranteed Annuity Payment out of Total Projected Annuity Payment*

15. The insurer must include a clear presentation in the BI of the guaranteed annuity payment and non-guaranteed annuity payment, if applicable, where the guaranteed annuity portion should not be less than the Minimum Guaranteed Portion shown in the table below:

| | Minimum Guaranteed Portion |
|---|---|
| $x < 30$ | 70% |
| $30 \leq x < 40$ | 60% |
| $x \geq 40$ | 50% |

Where x = total number of years between
(i) the commencement of accumulation period (i.e. premium payment period plus deferral period); and
(ii) the end of the annuity period,
(For the accumulation period, there should be no overlap between the premium payment period and deferral period.)

The specific percentage of the guaranteed portion of the individual policies may vary even though those policies are grouped by the authorized insurer under the same insurance policy. The above minimum percentage of guaranteed portion shall always be observed regardless of the age and sex of the policy holder or annuitant, the amount of total premiums paid, the length of premium payment period, the length of annuity period, the age of annuitant when the annuity period starts, etc. which are allowable and possible under the policy terms and the insurer's own underwriting policy.

*Clear Separation of Premiums of All Riders*

16. Only the qualified annuity premiums paid in relation to the annuity payments can be tax deductible. Premiums paid for all riders are not tax deductible. They should be deducted from the annual summary of QDAP issued to policy holders.

17. Unbundling of premiums for embedded features (e.g. death benefits or premium waiver) can be waived if the amount is negligible and the cost of unbundling outweighs the benefits of disclosure. Insurer must provide justification to the IA with all the necessary evidence and certification by the Appointed Actuary, to obtain such waiver. The IA reserves the right to decide whether waiver will be granted at any time.

*Risk Disclosure – QDAP*

18. The insurer and licensed insurance intermediaries should ensure policy holders or potential policy holders are fully apprised of the policy features and risks associated with QDAP, and that relevant risks (e.g. the risk of significant financial loss upon early surrender by the policy holder) are clearly and prominently disclosed in the PB.

*Additional Risk Disclosure - Tax Implications of Certification*

19. On top of the usual risk disclosure applicable to all annuity policies, there must be an additional risk disclosure by insurers and licensed insurance intermediaries to remind policy holders or potential policy holders that even though a deferred annuity policy is certified by IA, it does not automatically follow that the premiums paid under that policy will be subject to tax deduction. The reason for this is that, in addition to the deferred annuity policy being certified by the IA, there may be other tax related criteria which need to be satisfied (relating to the personal circumstances of the policy holder, for example) in order for the tax deduction to be obtained. Accordingly, certification by IA only indicates that the policy complies with the criteria set out in this Guideline. Whether tax deduction is allowable for all qualifying annuity premiums paid or any portion therein is subject to the provisions of the IRO and circumstances of the policy holder (as taxpayer). The policy holder should be reminded to refer to the website of the Inland Revenue Department (IRD) or to contact the IRD directly for any tax related enquiries.

<u>Others</u>

*Issuance of Annual Summary of QDAP*

20. Insurers are required to issue separate[2] Annual Summary of QDAP in respect of each policy (either in hard copy or via electronic means) to the policy holders within 40 days after the end of the year of assessment (i.e. 31 March)

[2] For the avoidance of doubt, Annual Summary of QDAP will be required for all policies that had premium paid or refunded during the year of assessment, regardless of whether the policy has been subsequently terminated, cancelled, or transferred. In the case of change of policy holders, the original and new policy holders should each receive an Annual Summary showing the premium paid or refunded during the period when they were the policy holders.

or reasonable time after receiving a request from the policy holder to facilitate the completion of the tax returns by the policy holders as taxpayers. Template for the Annual Summary is at **Annex C**.

21. The summary must include the names of policy holder(s) and annuitant(s), the total amount of qualifying annuity premiums, full name of QDAP together with IA's reference number, premium refund(s)[3] paid or made within the relevant year of assessment.

22. If the policy includes any add-ons and/or riders, the premiums paid for such add-ons and/or riders are not qualified annuity premiums for the purpose of tax deduction. All the premiums paid for the add-ons and/or riders must be excluded from the qualifying annuity premiums in the summary.

23. The currency disclosed in the summary must either be in Hong Kong dollars or the policy currency. The exchange rates adopted shall be in a consistent manner and follow the published rates on the website of the Inland Revenue Department.

24. The language used in the annual summary must be in English or Chinese depending on the preference of the policy holder.

*Training of Insurance Intermediaries*

25. Insurers are reminded to provide sufficient training to insurance intermediaries and ensure appropriate internal controls are in place to prevent any mis-representation and mis-selling of QDAP.

*Inform IA of any Material Change of QDAP*

26. When there will be any material change in the policy feature(s) of a QDAP that may render the policy non-compliant with any of the criteria set out in this Guideline, the insurer must immediately inform the IA before any such change becomes effective.

*Record Keeping*

27. The authorized insurers shall maintain complete documentation and records to prove compliance with the requirements under this Guideline and shall make them available to the IA upon request.

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[3] For the avoidance of doubt, cash/surrender value paid to the policy holder upon surrender of the policy is not considered as premium refund.

*Name of QDAP*

28. The name of QDAP must clearly indicate that it is a deferred annuity insurance policy. The PB of the QDAP must clearly indicate that the policy is certified by the IA as QDAP.

## **Annex B – Required Application Documents for QDAP**

1. Description on how the insurer has complied with each item in the Criteria of a QDAP in **Annex A**, including any additional supporting documents as appropriate.
2. Product Brochure of the policy.
3. Sample Benefit Illustration ("BI") based on the target customer profile of the QDAP.
4. Assumptions relating to the preparation of the BI.
5. A sample of the policy contract.
6. The full name of QDAP in English and Chinese. The IA will follow this name for public disclosure.
7. The basis for declaration of dividends and bonus to policy holders or annuitants.
8. Business plan including but not limited to:
   (i) the timeline for product launch;
   (ii) total annualized premiums and number of policies of new business in the first year;
   (iii) details of distribution channels;
   (iv) details of the promotion campaign and any special offer or gift; and
   (v) any sales quota and any designated offering period.
9. A template of Annual Summary of QDAP.
10. Insurer's contacts for enquiry by the IA (name, post, direct line, and email address).

Notes:

i. For the purpose of certification by the IA, only the English version of the documents is required, unless otherwise required. It is entirely the responsibility of an insurer to ensure that the translation of the Chinese version fully reflects the meaning of the documents in English version. The insurer is accountable for any error and omission in the translation.

ii. All the supporting documents should be certified true and correct by either the Chief Executive or the Appointed Actuary of the insurer. A covering certificate will be acceptable.

## Annex C – Template for the Annual Summary of QDAP

**ANNUAL SUMMARY OF**
**QUALIFYING DEFERRED ANNUITY POLICY (QDAP)**

**FOR THE YEAR OF ASSESSMENT FROM 1 APRIL 20XX TO 31 MARCH 20XY**

Print/Issue Date:

**DETAILS OF THE QDAP**

Name of QDAP:
Reference no. of QDAP:
Name of Insurer:
Name(s) of Policy Holder(s):
Name(s) of Annuitant(s):
Policy Number:

**SUMMARY OF PREMIUMS PAID DURING THE YEAR OF ASSESSMENT**

**All amounts in Hong Kong Dollars [or policy currency]**

| | | |
|---|---|---|
| Total amount of premium due and paid during the year of assessment | | $xx,xxx |
| Less: | | |
| Riders | $x,xxx | |
| Premium refund | $x,xxx | |
| Total amount of premium **NOT** qualified for tax deduction | | ($x,xxx) |
| **Total amount of Qualifying Annuity Premiums due and paid during the year of assessment** | | **$xx,xxx** |

**Important notes:**

The Annual Summary of QDAP is to facilitate the completion of tax returns by policy holders with regard to the deduction claim of Qualifying Annuity Premiums paid under a QDAP during a year of assessment.

The amount of premium due and paid does not include levy.

In the event of refund of premiums, policy holders are required to notify the Commissioner of the Inland Revenue of such refund within 3 months after the date of refund if the policy holder has claimed tax deduction in respect of the qualifying annuity premiums paid.

For policy in currency other than the Hong Kong Dollars, policy holder may refer to the published rates on the website of the Inland Revenue Department (https://www.ird.gov.hk/eng/tax/ind_stp.htm).

For more information about QDAP, please visit our website at [insert the address to insurer’s website] or by calling our hotline at [insert insurer’s hotline no.].