

**GUIDELINE ON  
UNDERWRITING LONG TERM INSURANCE  
BUSINESS (OTHER THAN CLASS C BUSINESS)**

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## **1. Introduction**

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) (“the Ordinance”) taking into account the Insurance Core Principles, Standards, Guidance and Assessment Methodology (“ICP”) promulgated by the International Association of Insurance Supervisors (“IAIS”). Specific references are:

- (a) Section 4A of the Ordinance stipulates that the Insurance Authority (“IA”)’s function is to protect existing and potential policyholders. Section 4A(2)(c) states that the IA shall promote and encourage the adoption of proper standards of conduct, and sound and prudent business practices by authorized insurers.
- (b) ICP 19 stipulates that the conduct of the business of insurance should ensure that customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. ICP 19.0.1 further stipulates that the conduct of insurance business should help to strengthen public trust and consumer confidence in the insurance sector.

1.2 This Guideline applies to all authorized insurers underwriting long term business (other than Class C business).

## **2. Relevant Regulatory Documents**

2.1 Where appropriate, this Guideline should be read in conjunction with other relevant codes/circulars/guidelines issued by the IA or other regulatory bodies, including the following<sup>1</sup>:

- (a) Standard Illustration for Participating Policies issued by the Hong Kong Federation of Insurers (“HKFI”)
- (b) Standard Illustration for Universal Life (Non-linked) Policies issued by HKFI
- (c) AGN 5 Principles of Life Insurance Policy Illustrations issued by the Actuarial Society of Hong Kong (“ASHK”)

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<sup>1</sup> The list is not exhaustive and may be subject to changes from time to time. Authorized insurers have the responsibility to ensure compliance with all the relevant requirements with due regard to their own circumstances.

- (d) AGN on Best Estimate Assumptions issued by the ASHK
- (e) Selling of Non-linked Long Term Insurance (“NLTI”) Products issued by Hong Kong Monetary Authority

### **3. Purpose**

3.1 Both IAIS and the global insurance industry have placed increasing emphasis on fair treatment of customers. ICP 19.2.4 stipulates that fair treatment of customers encompasses:

- (a) developing and marketing products in a way that pays due regard to the interests of customers;
- (b) providing customers with clear information before, during and after the point of sale;
- (c) reducing the risk of sales which are not appropriate to customers’ needs;
- (d) ensuring that any advice given is of a high quality; and
- (e) managing the reasonable expectations of customers.

3.2 This Guideline sets out the requirements for authorized insurers underwriting long term insurance business (other than Class C business). In assessing whether the requirements have been duly followed by authorized insurers, the IA will consider the substance and nature of the matters involved. The name or form of the arrangements adopted by individual authorized insurers would be irrelevant.

### **4. Duties of the Board, the Controller and the Appointed Actuary**

4.1 It is the duty of the Controller, as specified under section 13A(12) of the Ordinance, to ensure that requirements set out in this Guideline and the relevant ICPs are observed throughout the life cycle of all long term (except Class C) insurance policies. It is also the duty of the Board to maintain general oversight over the implementation of measures in compliance with this Guideline and is ultimately responsible for ensuring fair treatment of customers.

4.2 It is a reasonable expectation for policyholders to expect to receive at least a fair proportion, if not all, of the non-guaranteed part of the illustrated

benefits. It is the duty of the Controller, the Appointed Actuary and the Board to ensure that such policyholders' reasonable expectation is met.

- 4.3 It is a continuing duty of the Appointed Actuary to advise the Board of his or her interpretation of policyholders' reasonable expectations. For instance, in the context of the provision of standard illustration, it is the duty of the Appointed Actuary to adopt reasonable assumptions, as well as to provide regular and up-to-date assessment of such assumptions to the Board for making suitable amendments. When a significant change of the underlying assumptions is likely to take place, the Appointed Actuary should take all reasonable steps to ensure that the Board appreciates the implications for the reasonable expectations of the policyholders.
- 4.4 Any attempt to circumvent the requirements prescribed in this Guideline would be regarded as acting in bad faith. In the case of Controllers, this may affect the "fit and proper" assessment under sections 8(2) and 13A(4) of the Ordinance. In the case of Appointed Actuaries, this may constitute non-compliance with professional standards under section 15C of the Ordinance, and may render the incumbent not acceptable to the IA under section 15(1)(b) of the Ordinance.

## **5. Product Design**

- 5.1 ICP 19.2.4 stipulates that insurers should develop and market products with due regard to the interests of customers. During the product design stage, the insurer should carry out a diligent review to ensure that the product meets the "fair treatment of customers" principle, including:
- (a) sustainability of the product;
  - (b) needs and affordability of the target customers;
  - (c) risks of the product; and
  - (d) distribution channels for the product.
- 5.2 When performing the diligent review mentioned above during the product design stage, authorized insurers are required to take a holistic view of all the relevant factors. For example, a product with complex features may not be suitable for distribution through the online channel, where advice to customer cannot be given during the sale process.

- 5.3 Authorized insurers are required to monitor the products after launch to ensure that they continue to meet the needs of the target customers, assess the performance of the various distribution channels with respect to sound commercial practices, and take the necessary remedial actions where appropriate.
- 5.4 In considering whether the design of a product meets the requirements of this Guideline and the “fair treatment of customers” principle, authorized insurers are required to look at all relevant factors in their totality, including the product features, insurance elements, added value/services to customers, fees/charges, surrender penalties (where applicable), remuneration structure etc.
- 5.5 Fees and charges (including charging basis, level of charges, applicable period etc.), where applicable, to be paid by the customers should be fair, commensurate with the insurance protection offered by the product concerned, and reflect the services/added value of the authorized insurer.
- 5.6 During product design, the determination of pricing assumptions should be based on the best estimate assumptions. For the guidance and considerations in setting best estimate assumptions, the Appointed Actuary should follow AGN on Best Estimate Assumptions issued by the ASHK.

## **6. Provision of Adequate and Clear Information**

- 6.1 ICP 19.2.4 stipulates that insurers should provide customers with clear information before, during and after the point of sale.
- 6.2 ICP 19.3.4 stipulates that the product development and marketing process should include the use of adequate information on customer needs.
- 6.3 ICP 19.2.4 further stipulates that insurers should manage the reasonable expectations of customers.
- 6.4 ICP 19.5.1 stipulates that an insurer should take reasonable steps to ensure that a customer is given appropriate information about a policy in good

time and in a comprehensible form so that the customer can make an informed decision about the arrangements proposed.

- 6.5 Product information (e.g. product brochure, standard illustration) should be bilingual<sup>2</sup>, clear and succinct, with the use of plain language and legible font size, and should be easily understandable by average customers. To facilitate understanding by customers, authorized insurers should avoid using technical or industry terminology.
- 6.6 Key product risks should be included in the product brochure and marketing materials and authorized insurers should communicate the relevant product risks to their potential customers. The risks are different for different products and it is the insurer's duty to identify the key product risks in the interest of customers, including the areas (where applicable) below:
- (a) Key exclusion – The insurers should disclose key exclusion of the policy in the product brochure and marketing materials alongside description of policy coverage.
  - (b) Premium adjustment – If the insurer has the right to adjust the policy premium, it should disclose the factors leading to such adjustment and also the frequency and timing of adjustment. For insurance products with premium adjustment features within premium payment term, they cannot be labeled as “level premium”.
  - (c) Premium term – The insurers should disclose the minimum premium term of the policy and the consequence of non-payment of premium within the premium term, including loss of coverage, surrender penalty, and financial loss incurred by the policyholder.
  - (d) Termination conditions – If the insurer has the right to terminate the policy before the maturity date, it should disclose the conditions of making such a decision.
  - (e) Market value adjustment – If the insurer has the right to apply market value adjustment on premium paid within cooling-off

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<sup>2</sup> For the avoidance of doubt, the English and Chinese versions of the product documents can be separated, but BOTH must be available to the customers. Authorized insurers should ensure consistency between English and Chinese versions of all the product documents (including product brochure, standard illustration, policy contract, etc.).

period, the insurer should disclose the factors for the determination of such adjustment.

- (f) Inflation risk – The insurers should alert customers, where appropriate, the adverse impact of inflation (i.e. where the actual rate of inflation is higher than expected, and the policyholder might receive less in real terms even if the insurer meets all of its contractual obligations).

- 6.7 For products with policy loan facility, authorized insurers should provide policyholders with information about the terms of the loan (including interest rate to be charged) before the loan is drawn down. For products with automatic policy loan facility, policyholders should be immediately notified that a loan has been first drawn down in accordance with the policy provisions and the interest rate being charged. Whenever there are changes to the policy loan interest rate, policyholder should be notified within a reasonable period before the new interest rate is effective. For ongoing disclosure, regular account statements to be sent to policyholders should contain information about the interest rate being charged, opening and ending loan balance as well as the interest amount charged in the period, with the relevant information highlighted to draw policyholders' attention.
- 6.8 For policies to be used as collateral assignment (e.g. for premium financing), authorized insurers should ensure that the policyholder fully understands the relevant risks and limitations (e.g. interest rate risk, rights that the assignee may exercise on the policy on behalf of the policyholder, risk of release of information to the assignee, etc.).
- 6.9 Authorized insurers have the sole responsibility of ensuring accuracy of the proposal vis-a-vis the policy provisions, with warning statements and other tools (e.g. FAQs) where appropriate to increase customers' awareness.

## **7. Suitability Assessment**

- 7.1 ICP 19.6.2 specifies that insurers should seek the information from their customers that is appropriate for assessing their insurance needs, before giving advice or concluding a contract. This information may vary, but should at least include information on the customer's:



- (a) knowledge and experience;
  - (b) needs, priorities and circumstances; and
  - (c) ability to afford the product.
- 7.2 Customers' needs should be properly assessed through the use of Financial Needs Analysis ("FNA") form where appropriate. Insurance policies should not be marketed to customers before their needs are properly analyzed.
- 7.3 Customers that have indicated their insurance needs should be presented with different insurance options that are available to meet their specific needs and financial circumstances.
- 7.4 For insurance products with long term contribution commitment or investment elements, suitability assessment should include assessing the premium payment horizon of the potential policyholder, with due regard to the financial circumstances, planned retirement age etc.
- 7.5 The suitability assessment should be carried out whenever there are relevant changes to the circumstances of the customer.
- 7.6 Authorized insurers have the duty to verify all available information and assess whether a particular product is suitable for their needs during the underwriting process.
- 7.7 Authorized insurers should endeavour to reduce the risk of sales that do not meet the needs of customers by:
- (a) strengthening training to intermediaries;
  - (b) assessing the affordability and suitability of products for policyholders during the underwriting process based on available information; and
  - (c) providing tools for intermediaries to facilitate the recommendation of suitable products to customers.

## **8. Advice to Customers**

- 8.1 ICP 19.1.1 stipulates that insurers and intermediaries should discharge their duties in a way that can reasonably be expected from a prudent person in a like position and under similar circumstances. Authorized insurers have the duty to put in place appropriate measures to ensure that their employees and agents are adequately trained to act with due skill, care and diligence.
- 8.2 ICP 19.6.1 further stipulates that where advice is given to a customer, such advice goes beyond the provision of product information and relates specifically to the provision of a recommendation on the appropriateness of a product to the disclosed needs of the customer.
- 8.3 After a customer has considered the insurance options, and is beginning to consider an insurance policy, he/she should also be properly apprised of all the product features, including the fees and charges (where applicable), surrender penalties (if any) as well as the product risks, key exclusions, 21-day cooling-off period etc.
- 8.4 The proper sales process flow is set out in the flowchart at the **Annex**. It involves completion of the FNA (if applicable), confirmation of needs, comparison of different insurance options (where FNA has been performed), and explanation of the key product features/exclusions.

## **9. Appropriate Remuneration Structure**

- 9.1 Authorized insurers have the duty to ensure that the remuneration structure for their intermediaries do not create misaligned incentives for the intermediaries to engage in mis-selling, aggressive selling, fraudulent acts or money laundering activities. The insurers are therefore required to put in place an appropriate remuneration structure to address such risks.
- 9.2 Indemnity commission, or any standing arrangement that offers advance payment of commission, is strictly prohibited. Authorized insurers should only pay commission on an earned basis.

9.3 Cases of mis-selling, aggressive selling, fraud and money-laundering often surface after the expiry of the clawback period. To deter such activities, authorized insurers should put in place a clawback mechanism to fully recover all commission paid in proven fraud / money laundering / mis-selling cases.

## **10. Ongoing Monitoring**

10.1 ICP 19.7 requires insurers and intermediaries to ensure that, where customers receive advice before concluding an insurance contract, any potential conflicts of interest are properly managed.

10.2 ICP 19.7.5 further stipulates that conflicts of interest may be managed in different ways as relevant to the circumstances, for example, through appropriate disclosure and informed consent from customers.

10.3 Authorized insurers should put in place a proper mechanism to monitor on an ongoing basis any such potential conflict of interests.

10.4 ICP 19.8 stipulates that insurers are required to:

- (a) service a policy appropriately through to the point at which all obligations under the policy have been satisfied;
- (b) disclose to the policyholder information on any contractual changes during the life of the contract; and
- (c) disclose to the policyholder further relevant information depending on the type of insurance product.

10.5 On-going communication with policyholders should be maintained at least annually as an integral part of expectation management (e.g. projections for non-guaranteed benefits in anniversary statements).

10.6 Authorized insurers should also put in place a proper mechanism to monitor the products (e.g. complaints, design flaw etc.) after launch.

## 11. Post-sale Control

- 11.1 ICP 19.2 stipulates that insurers and intermediaries should establish and implement policies and procedures on fair treatment of customers. Authorized insurers should have proper control systems in place to achieve fair treatment of customers and monitor that such policies and procedures are adhered to.
- 11.2 For the protection of vulnerable customers<sup>3</sup>, authorized insurers are required to make audio-recorded post-sale confirmation calls to all vulnerable customers procuring life insurance products (except term insurance) or products involving investment risks to ensure customers' understanding on the products and their associated risks. The post-sale confirmation calls are required to be conducted within 5 working days of the date of policy issue to reaffirm customers' understanding of the policy that they have procured, and that they are fully aware of their rights and obligations under the policy.
- (a) The insurers should appoint a separate quality assurance team to make the post-sale calls.
  - (b) The insurers should use their best endeavours to make the post-sale calls, attempting different times of the day and different days of the week.
  - (c) The insurers are encouraged to adopt additional measures such as on-site recording at the service centre or immediate "dial-in" to or from the call centre for customers who are visitors or who may be difficult to reach.
  - (d) In the event of unsuccessful calls, a confirmation letter should be sent to the customers, alongside an email/SMS alert that draws the attention of the customers to the importance of the confirmation letter.
- 11.3 Authorized insurers should collect sufficient information of the policyholder for the purpose of identification of vulnerable customers.

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<sup>3</sup> A vulnerable customer is a person (i) over 65 years of age, (ii) whose education level is "primary level" or below, or (iii) who has no regular source of income.

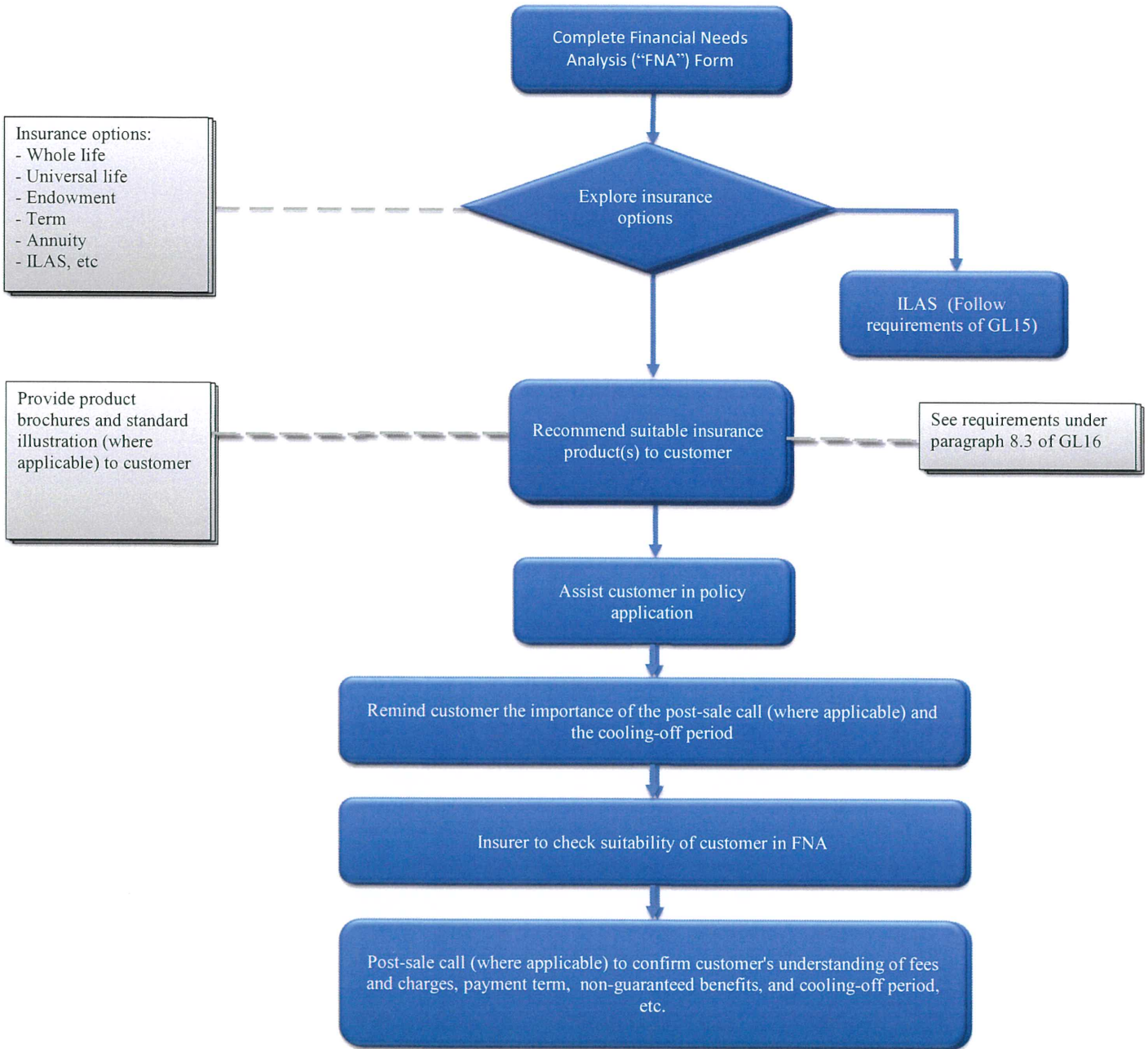
- 11.4 Authorized insurers are required to put in place an effective mechanism to identify possible cases of intermediaries abetting customers to evade the control measures, such as having high rate of unsuccessful post-sale calls.
- 11.5 Authorized insurers should have in place proper documentation systems for quality control and future monitoring. Apart from the policy documents, records of the post-sale calls, confirmation letters and the email/SMS alerts, as well as control reports in respect of above measures, should also be kept properly.

## **12. Commencement**

- 12.1 This Guideline shall take effect from 26 June 2017.

**June 2017**

**Selling Process of Non-linked Insurance Products**



**Requirements Applicable to Participating Policies**

**1. Introduction**

- 1.1 For the purpose of this Guideline, a participating (or with-profit) policy is a policy that pays non-guaranteed dividends or bonuses (including cash bonus and reversionary bonus) to the policyholder. Dividends/bonuses are generated from profits of the authorized insurer that sold the policy and are typically paid out on an annual basis over the life of the policy. Some policies also include final or terminal payments that are paid out to the policyholders upon maturity or termination of contract.

**2. Governance of Participating Policy Business**

- 2.1 To ensure appropriate governance of participating policies, an authorized insurer should have a corporate policy covering allocation of surplus/profits between shareholders and the participating pool, as well as declaration of policyholder dividends/bonuses and other discretionary benefits. This should be clearly documented, approved by the Board and made available to the Insurance Authority (“IA”) on request.

- 2.2 As a minimum, the policy should cover:

- (a) The overall philosophy in setting non-guaranteed policyholder benefits, including sharing surplus or experience, smoothing and guarantees.
- (b) The approach to sharing surplus or experience, including the items to be shared and any quantifications for these.
- (c) The charges for guarantees and/or capital if appropriate, including justifications and reasonableness etc.
- (d) The investment strategy, including ongoing management of the asset mix.

- (e) Maintenance of fairness between different products and generations.
- (f) Smoothing of payouts should be explained and justified, including whether it is expected to be on average cost-neutral to the shareholder.
- (g) How the assets are held and managed, including the segregation mechanism in case of pooling of funds for investment purpose.
- (h) The principles and practices in determining the projected non-guaranteed benefits of standard illustration at point of sales and annual inforce illustration.
- (i) Measures to manage potential conflict between its duty to policyholders and its duty to shareholders, particularly in relation to the declaration of dividends/bonuses for policyholders. The authorized insurer should provide information about the above measures either in the product brochure or in a separate leaflet to be provided to customers at the point of sale; or on its website (should also provide the relevant link to the website address in the product brochure). These may include:
  - (i) The profit sharing ratio between shareholders and participating fund;
  - (ii) Establishment of Dividend/Profit Sharing/With Profits Committee to provide independent advice on the management of participating business; or
  - (iii) Written declaration by the Chairman of the Board, an Independent Non-Executive Director and Appointed Actuary.



- 2.3 When designing products with non-guaranteed benefits, it is the Appointed Actuary's duty to ensure that there is a fair chance in achieving the non-guaranteed returns. It is thus essential for the Appointed Actuary to define the philosophy and assumptions for the determination of non-guaranteed benefits, as well as to advise the Board.
- 2.4 The Appointed Actuary should submit a report to the Board recommending policyholder dividends/bonuses and other non-guaranteed benefits annually and more frequently, if such is required. The authorized insurer's dividends/bonuses declaration mechanism will be subject to IA's regulatory review. The IA may require the authorized insurer to appoint an independent party to assess whether the policy has been applied completely, consistently and fairly. The report should also cover:
- (a) Any changes to the policy since the last report, including an explanation of why this is consistent with policyholders' reasonable expectation.
  - (b) Explanation where decisions are contractual and related to policy documents or other customer communications, and where decisions are at the discretion of the authorized insurer, taking into account the issue of equity between shareholders and policyholders.
  - (c) Consistency in the dividends/bonuses declaration mechanism needs to be maintained for the product design stage and throughout the policy life.
- 2.5 The Appointed Actuary's report should be made available to the IA upon request.
- 2.6 The Board, on the advice of the Appointed Actuary, is ultimately responsible for interpretation of the policyholders' reasonable expectation, and deciding the dividends/bonuses declaration, taking into account the principle of fair treatment of customers, and the issue of equity between shareholders and policyholders.

### **3. Provision of Standard Illustration**

- 3.1 The objective of a standard illustration is to provide a potential customer with the projected performance of a life insurance policy showing the total benefits with a breakdown for guaranteed and non-guaranteed benefits, which may reasonably be payable at each policy year should certain conditions be met. Hence, it is important for an authorized insurer to identify clearly what assumptions are made in producing the projected non-guaranteed benefits.
- 3.2 It is important for the potential customer to understand the projected benefits of the life insurance policy where he or she intends to purchase. The potential customer must sign the standard illustration to confirm his/her understanding (including understanding of the worst and extreme scenario where dividends/bonuses may be zero).
- 3.3 In the provision of standard illustrations, the authorized insurer must follow the guiding principles as laid out by the Actuarial Society of Hong Kong (“ASHK”) in AGN 5 Principles of Life Insurance Policy Illustrations, namely:
- (a) the standard illustration must not be misleading;
  - (b) where premiums and benefits are illustrated, the conditions upon which these are payable must be clearly set out;
  - (c) the use of such standard illustration in different distribution channels; and
  - (d) the standard illustration must be consistent with the regulatory requirements.
- 3.4 Additional high and low return scenarios must be provided in the standard illustration to show the variability of the ultimate results. A wider range of scenarios is expected for investment strategy with higher volatility.

- 3.5 The Appointed Actuary should have regard to Appendix A of AGN on Best Estimate Assumptions issued by the ASHK, which provides guidance and considerations for setting the standard illustration assumptions.
- 3.6 In the standard illustration, guaranteed and non-guaranteed dividends/bonuses should be separately presented with an explicit message that non-guaranteed dividends/bonuses may be zero.
- 3.7 The illustration should show the annual dividend (or reversionary bonus) and terminal dividend (or terminal bonus) separately. The policyholders need to understand the different implications on annual and terminal dividends/bonus if there are changes in, say, the assumptions (e.g. the terminal dividends/bonuses may be more volatile than annual dividends/bonuses).

#### **4. Disclosure of Non-Guaranteed Benefits**

4.1 In addition to the provision of standard illustration, an authorized insurer should adopt the following process in disclosing non-guaranteed benefits:

(a) Disclosure at the point of sale:

(i) Customers should be apprised of factors that will significantly affect the determination of policyholders' dividends/bonuses, including but not limited to the following factors:

(aa) Claims factors – The claims factors represent the experience of mortality and morbidity of the business.

(bb) Interest income factors – This may include not only interest earnings, but also outlook of interest rates, and the effects of capital gains and losses.

(cc) Market risk factors – Authorized insurers should disclose the types of market risk that would significantly affect the determination of dividends.

(dd) Expense factors – This may include direct expenses

which are specifically related to the group of policies, such as commission, underwriting and issue expenses and other maintenance expenses, such as premium collection expense. This may also include indirect expenses such as general overhead costs, which will be allocated to such group of policies.

- (ee) Persistency factors – This includes policy lapse and partial surrender experience; and the corresponding impact on investments.
  
- (ii) Non-guaranteed rate (e.g. dividend/bonus) philosophy should include investment policies and objectives and investment strategy, which will very likely result in the variation of investment returns against the long term expectation. In most circumstances, it is the key driver leading to volatility of non-guaranteed benefits.
  
- (iii) The authorized insurer should highlight the investment strategy (e.g. target asset mix / geographical allocation / currency mix, use of derivative instruments and securities lending etc.) of the underlying investment in its product brochure. The asset classes (e.g. equities, bonds, deposits) and security concentration (e.g. US Treasury, corporate bonds, high yield bonds) should also be mentioned in the investment strategy. The additional information can help customers understand the risk and volatility of returns of the underlying assets and the non-guaranteed returns.
  
- (iv) The authorized insurer should provide information on its philosophy in deciding dividends/bonuses in the product brochure (with updated information published on its website as well).
  
- (v) The authorized insurer should disclose on its company website the non-guaranteed dividends/bonuses fulfillment ratios for each product series which has new policies recently issued. Customers should be informed the website address that shows these fulfillment ratios. It

is required to disclose at least the product type and fulfillment ratios for each product series. The fulfillment ratio is calculated as the average ratio of non-guaranteed dividends/bonuses actually declared against the illustrated amounts at the point of sale. Non-guaranteed benefits may vary from product type to product type. The authorized insurer should therefore disclose:

- (aa) For dividend type traditional participating products – fulfillment ratios of the accumulated dividends (including accumulation interest and terminal/maturity dividend, if applicable).
  - (bb) For reversionary bonus type traditional participating products – fulfillment ratios of accumulated reversionary bonus and terminal bonus.
- (vi) Customers must be alerted to the fact that dividend history is not an indicator of future performance of the participating products.
- (b) Disclosure during policy life (process to ensure timely and accurate communication especially when changes to customer benefits are anticipated):
- (i) Ongoing communication must be provided to policyholders at least on an annual basis on both actual non-guaranteed benefits declared for the year and a refreshed up-to-date inforce standard illustration reflecting the latest conditions and outlook. Such communication will help manage policyholders' reasonable expectation at least once a year and minimize the gap between the original standard illustration and the actual performance.
  - (ii) Monitor the non-guaranteed benefits regularly (at least annually) and check the sustainability of the non-guaranteed benefits based on the actual experience and investment outlook.

- (iii) If there is any change to dividends/bonuses (or their philosophy), the authorized insurer should inform relevant policyholders of the change of dividend/bonus by writing separately or include the information in the annual statements with explicit reasons for the change.
- (c) In illustrating premium offset option, the authorized insurer should follow the requirements below:
- (i) Projection of the premium offset option based on different scenarios, especially the adverse situation (where the premiums are not offset due to a reduced dividend level), is required to be provided to the customer.
  - (ii) The illustration should not use the term “vanish” or “vanishing premium” or similar terminologies that suggest that the policy has been fully paid up, to describe a plan for using non-guaranteed elements to pay a portion of future premiums. The customer should be reminded that he/she has the obligation to pay premiums for the entire term. Otherwise, the benefit will be affected.
  - (iii) Clear disclosure should be made to ensure that the customers fully understand the risk involved, in particular under the scenario where the level of dividend is persistently low. In cases where future dividends are to be used to pay premiums for medical riders, the authorized insurer is required to alert customers the additional risk brought about by possible future medical cost inflation and/or reduced dividends. The authorized insurers should provide policyholders with regular update through annual statements.
  - (iv) If the product offers a range of premium payment terms, the authorized insurer should mention the shorter premium term options only as an alternative. Customers should be warned that the sustainability of premium offset depends on future dividend declaration, which is

not guaranteed. Policyholders may be obliged to resume future premiums, even if the premium offset option has been activated, in case declaration of policyholder dividends is lower than the illustrated scale. While policyholder dividends play an important part in determining the future premium offset point, customers should be reminded there are a number of other factors that should be taken into consideration. These factors include dividend withdrawals, change in dividend options and addition of optional benefits to the policy.

- (d) For the withdrawal illustration option, disclosure should be made to ensure that the customers fully understand the risk involved. For example, illustrated withdrawal amounts, which depend on non-guaranteed dividends, might not be sustainable. If withdrawal or partial surrender is used, a warning message that withdrawal or partial surrender will affect future benefits should be in place.

**Requirements Applicable to Universal Life Policies**

**1. Introduction**

- 1.1 For the purpose of this Guideline, a universal life policy is a type of life insurance with a savings element that may provide a cash value buildup. The cash value is credited with declared interest (i.e. at the declared crediting interest rate), and debited by cost of insurance charges, as well as any other policy charges and fees. The declared interest rate will vary from time to time and will be subject to a minimum if the product offers a guaranteed interest rate. It provides flexibility to policyholders in respect of premium payment and withdrawal from policy accounts (with applicable fees and charges). The death benefit, savings element and premiums can be reviewed and altered as policyholders' circumstances change.

**2. Governance of Universal Life Policy Business**

- 2.1 To ensure appropriate governance of universal life policies, authorized insurers should have internal policies covering the mechanism to determine the crediting interest rate, cost of insurance charge, other policy fees and charges, as well as other discretionary benefits. This should be clearly documented, approved by the Board and made available to the Insurance Authority upon request.
- 2.2 Authorized insurers should follow paragraphs 2.2 to 2.6 of the Appendix 1 for the purpose of this section.

**3. Provision of Standard Illustration**

- 3.1 Authorized insurers should follow paragraphs 3.1 to 3.3 of Appendix 1 for the purpose of this section.
- 3.2 Projections of policy benefits should be provided on at least two bases: (a) guaranteed or conservative basis; and (b) current assumed basis.
- 3.3 If a policy provides a minimum guaranteed interest rate and maximum policy charges, one of the projections has to be prepared based on such



guaranteed interest rate and maximum policy charges. The projection could be labeled as guaranteed basis. Otherwise, projected crediting interest rate at 0% p.a. (if minimum guaranteed interest rate is not available) or current charges (if maximum charges are not available) should be used, and this projection can only be labeled as conservative basis. The other projection has to be prepared based on a set of best estimate assumptions whereby current best estimate crediting interest rate and current charges are to be used for this purpose. Policyholders should be alerted with an explicit message that the crediting interest rate may be zero (or the minimum guaranteed interest rate where applicable).

- 3.4 It is optional for authorized insurers to provide additional high and low return scenarios in the standard illustration to show the variability of projected benefits provided that the projections are not misleading. The optional standard illustration is only applicable for products having substantial variable investment exposure.
- 3.5 The Appointed Actuary should have regard to Appendix A of AGN on Best Estimate Assumptions issued by the Actuarial Society of Hong Kong, which provides guidance and considerations on setting the standard illustration assumptions.
- 3.6 In the standard illustration, all fees and charges (current and maximum scales, if applicable) should be shown clearly, with an explicit message that the current fees and charges could be subject to change (if applicable).

#### **4. Disclosure of Non-Guaranteed Benefits**

- 4.1 Authorized insurers should follow paragraphs 4.1(a) and 4.1(b) of Appendix 1 for disclosure of non-guaranteed benefits where applicable for universal life policies, with the exception of paragraph 4.1(a)(v). For example, terminology may be modified from “dividend/bonus” to “crediting interest rate”.
- 4.2 The authorized insurer should disclose on its company website the historical crediting interest rates for each product series which has new policies recently issued. Customers should be informed the website address that shows these historical crediting interest rates. It is required to disclose at least the historical crediting interest rates for each product series.

- 4.3 In addition, key risks applicable to universal life policies (including fees and charges, lapsation risk due to zero account value etc.), and different types of crediting interest rates for different cohort of universal life product (if applicable), etc. should be disclosed.