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Bills Committee on Inland Revenue (Amendment) (No. 4) Bill 2018

Background brief prepared by the Legislative Council Secretariat

Purpose

This paper provides background information on the Voluntary Health Insurance Scheme ("VHIS") and summarizes the concerns of members of the Panel on Health Services ("the Panel") on the proposed amendments to the Inland Revenue Ordinance (Cap. 112) to allow a new deduction for premiums paid in respect of hospital indemnity insurance[1] policies certified by the Secretary for Food and Health to be in compliance with VHIS ("VHIS policies").

Background

2. The Government conducted two stages of public consultation exercise on healthcare reform in 2008[2] and 2010[3] respectively to look for ways to maintain the long-term sustainability of the healthcare system. While the consultation exercise revealed strong public resistance to any supplementary healthcare

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[1] According to the Administration, hospital indemnity insurance refers to an individual hospital indemnity insurance where the insured will be reimbursed or indemnified by the insurer for his or her actual expenses incurred for medical treatments (in a hospital or an ambulatory setting).

[2] In March 2008, the Government put forth a package of healthcare service reforms and six possible supplementary healthcare financing options in the First Stage Healthcare Reform Consultation Document entitled "Your Health Your Life". The six options for addressing the long-term sustainability of healthcare financing were (a) social health insurance (i.e. mandatory contribution by the workforce); (b) out-of-pocket payments (i.e. increase user fees for public healthcare services); (c) medical savings accounts (i.e. mandatory savings for future use); (d) voluntary private health insurance; (e) mandatory private health insurance; and (f) personal healthcare reserve (i.e. mandatory savings and insurance).

[3] In October 2010, the Government published the Healthcare Reform Second Stage Public Consultation Document entitled "My Health My Choice" in which a voluntary and government-regulated private health insurance scheme was proposed for public consultation.

financing options of a mandatory nature, the public expressed support for the introduction of a voluntary and government-regulated private health insurance scheme to enhance transparency, competition and efficiency of private health insurance for the provision of an alternative to those who are willing and may afford to pay for private healthcare services.

3. Subsequently, the Government conducted another four-month public consultation exercise in December 2014 to gauge public views on the Consultation Document on Voluntary Health Insurance Scheme ("the 2014 Consultation Document") which put forth the detailed proposals for implementing VHIS to enhance the accessibility to and quality of individual indemnity hospital insurance and in turn help address the balance of the public-private healthcare sectors[4] and enhance the long-term sustainability of the healthcare system as a whole. It was proposed that all individual indemnity hospital insurance products would be required to meet or exceed a proposed set of 12 Minimum Requirements upon the implementation of VHIS. The proposed Minimum Requirements included: (a) guaranteed acceptance with premium loading capped at 200% of standard premium for all ages within the first year of implementation of VHIS, and those aged 40 or below starting from the second year of implementation of VHIS;[5] (b) portable insurance policy with no re-underwriting when changing insurers;[6] (c) guaranteed renewal without re-underwriting; (d) no "lifetime benefit limit"; (e) coverage of pre-existing conditions subject to a standard waiting period and reimbursement arrangement during the waiting period;[7] (f) coverage of hospitalization and prescribed ambulatory procedures; (g) coverage of prescribed advanced diagnostic imaging tests, subject to a 30% co-payment, and non-surgical cancer treatment up to a prescribed limit; (h) minimum benefit limits; (i) no cost-sharing (deductible or co-existence) by policy holders; (j) budgetary certainty for policy holders through Informed Financial Consent and no-gap or known gap for at least one

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[4] According to the Administration, around 88% of inpatient services (in terms of number of bed days) are provided by public hospitals.

[5] An High Risk Pool, which is the key enabler of the Minimum Requirement on guaranteed acceptance with premium loading cap for supporting VHIS's goal to improve access to individual indemnity hospital insurance, was proposed to be set up by legislation to accept policies of Standard Plan of which the premium loading is assessed to be 200% or more of the standard premium offered by the insurer. Under the proposal, the claims cost arising from the acceptance of high-risk subscribers will be met by their own premiums and Government funding for the High Risk Pool. It is estimated that the total cost to the Government for funding the operation of the High Risk Pool for a 25-year period from 2016 to 2040 would be about $4.3 billion (in 2012 constant prices).

[6] Provided that no claims were made in a certain period of time immediately before transfer of policy.

[7] It was proposed that there would be no coverage in the first policy year; 25% reimbursement in the second policy year; 50% reimbursement in the third policy year; and full coverage from the fourth policy year onwards.

procedure or test; (k) standardized policy terms and conditions; and (l) transparent information on age-banded premiums through easily accessible platform. It was proposed that, as a financial incentive for VHIS, tax reduction would be introduced for premiums paid for individual indemnity hospital insurance policies owned by taxpayers covering themselves and/or their dependants that comply with the Minimum Requirements; and premiums paid for Voluntary Supplements purchased by individuals on top of their group indemnity hospital insurance policies.

4. In January 2017, the Administration released the Consultation Report on VHIS. According to the Administration, there is broad support for the concept and policy objectives of the proposed VHIS. While there is support for most of the Minimum Requirements, there are divergent views on those relating to guaranteed acceptance with premium loading cap which have to be underpinned by a High Risk Pool, coverage of pre-existing conditions and portable insurance policy. Taking into account the aims of VHIS, its extensive impact on the insurance sector and the views collected during the public consultation exercise, the Administration decides that it will first implement a VHIS with those 10 Minimum Requirements set out in items (c) to (l) in paragraph 3 above (with refinements to some of these Minimum Requirements) through a non-legislative framework in collaboration with the Insurance Authority. There will be two types of VHIS policies, namely, Standard Plan policies which meet the minimum compliant product requirements of VHIS and Flexi Plan policies which provide enhanced benefits. In the 2018-2019 Budget Speech, the Financial Secretary proposed offering an annual tax deduction (up to $8,000 per insured person) to taxpayers who purchased VHIS policies for themselves or their dependants. On 1 March 2018, the Administration promulgated the Standard Plan Policy Template[8] and the Code of Practice for Insurance Companies under the Ambit of VHIS[9] ("the Code of Practice") for insurance companies to prepare for the implementation of VHIS.

The Bill

5. The Administration introduced the Inland Revenue (Amendment) (No. 4) Bill into the Legislative Council ("LegCo") on 23 May 2018 to introduce a new concessionary tax deduction for premiums paid under VHIS policies, and to provide for related and transitional matters. The key features of the Bill are set

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[8] The Standard Plan Policy Template can be accessed at the Administration's dedicated website for VHIS (https://www.vhis.gov.hk/doc/en/information_centre/e_standard_terms_conditions.pdf).

[9] The Code of Practice for Insurance Companies under the Ambit of VHIS can be accessed at the Administration's dedicated website for VHIS (https://www.vhis.gov.hk/doc/en/information_centre/e_cop.pdf).

out in paragraphs 3 to 15 of the LegCo Brief issued by the Food and Health Bureau ("FHB") on 16 May 2018 (File Ref: FH CR 1/3822/13).

Deliberations of the Panel

6. The Panel discussed the way forward for the implementation of VHIS, which covered the arrangements for the proposed tax deduction, and the legislative proposal at its meetings on 16 January 2017 and 19 March 2018 respectively. The deliberations and concerns of members are summarized in the following paragraphs.

Proposed tax deduction arrangement

7. Members noted that the maximum deduction for qualifying premiums paid by the taxpayer for himself or herself, the taxpayer's spouse, and each of the taxpayer's and/or his or her spouse's eligible parents, grandparents, unmarried children or siblings under VHIS policies for a year of assessment was proposed to be $8,000. They expressed concern as to whether the amount of net saving in tax, which would range from $160 to $1,360 per insured person at a marginal tax rate of 2% to 17%, could provide adequate incentive to encourage people to take up VHIS policies so as to alleviate the long-term financing pressure on the public healthcare system. There was a suggestion that the maximum deduction should be raised, say, to $10,000 per insured person. There was also a view that an option should be offered to those policy holders aged 45 or above for having the payment of the relevant premiums be covered by the accrued benefits held in their Mandatory Provident Fund account, so long as the accrued benefits so used did not exceed $5,000 per year.

8. The Administration advised that it was estimated that about one million people would purchase or migrate to VHIS policies in the first two years of implementation. According to the independent consultant commissioned by FHB, about 90% of the policy holders of Standard Plans could have their qualifying premiums fully deductible under the above proposal. The Administration stressed that VHIS was not a total solution to the challenges of the healthcare system, but one of the turning knobs for adjusting the balance of the public-private healthcare sectors. As described in the 2014 Consultation Document, the proportions of public and private inpatient (overnight and day cases) discharge in 2040 were respectively projected to be 86% and 14% under the baseline scenario (i.e. the scenario without the implementation of VHIS) and 81% and 19% under the forecast scenario (i.e. the scenario with the implementation of VHIS).

9. Since participation of the young and healthy people was essential to ensure the successful implementation of VHIS, some members were concerned about how these people would be incentivized to take out VHIS policies. They noted that many young people, who newly joined the workforce and were more likely to be healthy, might not benefit from tax deduction for VHIS policies. According to the Administration, the Minimum Requirement of guaranteed renewal of policies without re-underwriting could provide the insured young people life-long insurance cover and maintain them in an underwriting class with a lower premium even they later developed health conditions. Efforts would be made to encourage people to purchase VHIS policies at a younger age.

10. There was a concern that many elders and chronic disease patients, who accounted for the largest proportion of patients of public hospital services, were low income earners and might not benefit from tax deduction for VHIS policies, or even not be able to afford the premium of VHIS policies. The Administration advised that it was expected that after the launch of VHIS, middle-income individuals were more likely to subscribe to VHIS policies and use private healthcare services. Separately, there would be greater use of the diagnostic, elective and non-emergency therapeutic procedures of the private healthcare sector. If more people were willing to make use of private healthcare services through VHIS, resources could be released in the public sector to reduce waiting time.

Re-examination of the High Risk Pool proposal

11. Members noted that the two Minimum Requirements in relation to guaranteed acceptance with premium loading cap and portable insurance policy, as well as the proposal of establishing a High Risk Pool ("HRP") would be re-examined at a later stage taking into account, among others, the experience of actual implementation of VHIS. Some members considered that HRP, which was a key enabler of the Minimum Requirement of guaranteed acceptance, was an important feature of VHIS for relieving the pressure on the public healthcare system. A VHIS without the Minimum Requirements of guaranteed acceptance and portable insurance policy could not improve high-risk individuals' access to private hospital insurance. Some other members, however, held the view that it was a prudent approach to implement VHIS with the 10 Minimum Requirements with strong support from the community as the number of high-risk individuals who were able and willing to purchase individual indemnity hospital insurance was relatively small.

12. The Administration stressed that the 10 Minimum Requirements such as coverage of prescribed ambulatory procedures; coverage of non-surgical cancer treatments; the minimum benefit limits to provide reasonable coverage for general ward in average-priced private hospitals; and the budget certainty

requirements including Informed Financial Consent and no-gap or known-gap arrangement for at least one procedure or test could address the existing shortcomings in market practices and hence, enhance quality of insurance protection. As regards the HRP proposal, the insurance industry had expressed concern over the financial sustainability of HRP, whereas some members of the public had concerns on, among others, how far the proposal would affect the uptake of individual indemnity hospital insurance. In order not to delay the implementation of VHIS, a phased approach would be adopted by launching VHIS first in early 2019 and re-examining the HRP proposal at a later stage, taking into account, among others, the experience of actual implementation of VHIS. Time was needed to update the relevant figures for funding the operation of HRP and gauge the views of the relevant stakeholders when re-examining the proposal.

Migration arrangements

13. Members noted that an important part of the Code of Practice was related to how insurers should encourage and facilitate the migration of existing policy holders of individual indemnity hospital insurance products to switch to VHIS policies. Question was raised about whether these policy holders could migrate to VHIS policies of the same insurer, which had registered as a VHIS provider, without being re-underwritten. The Administration advised that its proposal was to allow policy holders to migrate to their insurers' VHIS policies at the same underwriting class without re-underwriting if a same plan with the incorporation of VHIS features was offered.

Regulatory agency

14. Members noted that the Insurance Authority, being the regulator of the insurance industry, would issue a Guidance Note based on the principle of fair treatment of clients and other relevant considerations to provide guidance on various aspects of underwriting individual indemnity hospital insurance business, under which insurers would be recommended to comply with the relevant guidelines on VHIS issued by FHB. Upon the implementation of VHIS, the VHIS Office under FHB might refer to the Insurance Authority those cases amounting to misconduct in the Insurance Companies Ordinance (Cap. 41). Questions were raised about whether the VHIS Office would consider the definition of cases amounting to "misconduct" and the operation of the referral mechanism.

15. According to the Administration, "misconduct" was defined in the Insurance Companies Ordinance to mean, amongst other things, an act or omission relating to the carrying on of a class of insurance business which, in Insurance Authority's opinion, was or was likely to be prejudicial to the interests

of policy holders or potential policy holders or the public interest. If the Insurance Authority considered that the failure amounted to misconduct, it could consider taking appropriate disciplinary actions for the misconduct, including the order of a pecuniary penalty, reprimand, or even revocation or suspension of the authorization of the insurer. An example of cases which the VHIS Office might refer to the Insurance Authority was where an insurer marketed a non-VHIS policies as VHIS policies and misled consumers in purchasing it.

Use of the $50 billion earmarked for healthcare reform

16. Members noted that it was announced in the 2015-2016 Budget that out of the $50 billion earmarked in the 2008-2009 Budget to support healthcare reform, funds would be injected into HRP under VHIS, and tax concession would be provided for subscribers to regulated insurance products. Members were concerned about the use of that $50 billion.

17. The Administration advised that in the face of an ageing population, an objective of the healthcare reform was to address the public-private imbalance in provision of hospital services through various measures. In this regard, $10 billion had been allocated for setting up the Hospital Authority Public-Private Partnership Fund. To help alleviate the current pressure on the public healthcare sector, a loan of $4,033 million had been offered to The Chinese University of Hong Kong for developing a non-profit-making private teaching hospital. Separately, a provision of $200 billion had been earmarked for the implementation of the 10-year public hospital development plan to ensure the development of an appropriately balanced healthcare system with capacity and capability for delivering holistic services to members of the public.

Relevant papers

18. A list of the relevant papers on the LegCo website is in the **Appendix**.

Council Business Division 2
Legislative Council Secretariat
14 June 2018

Appendix

Relevant papers on tax deduction arrangements under the Voluntary Health Insurance Scheme

Committee	Date of meeting	Paper
Panel on Health Services	16.1.2017 (Item III)	Agenda Minutes CB(2)1704/16-17(01)
	19.3.2018 (Item III)	Agenda

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