The Hong Kong Federation of Insurers' submission to Panel on Financial Affairs on Tax Concessions and Eligibility Requirements for Deferred Annuity Products

Introduction

- The Hong Kong Federation of Insurers (HKFI) is the representative body of insurance companies in Hong Kong. Established in 1988, the HKFI exists to promote insurance and help develop the industry for the benefit of the people and the economy of Hong Kong. Currently, we have 87 General Insurance Members and 48 Life Insurance Members. Together they contribute more than 90% of the gross premiums written in Hong Kong.
- HKFI and the insurance industry welcome the introduction of tax concession for deferred annuity products.
- Insurance is an innovative and dynamic business which evolves to meet the changing needs of customers. With the demographic trends pointing to an expanding pool of retirees, the industry is ready and equipped to provide a range of products and services matching the needs of the ageing population.
- Annuity products, which provides stability of income and peace of mind, are gaining popularity in Hong Kong. We believe that the new tax incentive will help raise public awareness of the role and function of annuity and attract higher take up rate. In longer term, it will be able to achieve the policy intent of encouraging people to save for the future.

Our suggestions

- The HKFI has set up a special committee to provide the necessary professional support and expert advice to the Financial Services and the Treasury Bureau and Insurance Authority (IA) to work out the details of the proposed tax concessions for the good of the HK community.
- Based on our experience and references from overseas markets, we have come up with the following suggestions which would enhance product features, reinforce transparency, strengthen consumer protection and ensure sustainability.

Issues	Proposed enhancements
Disclosure of Internal Rate of Return (IRR) for guaranteed return and best estimate IRR for non-guaranteed return	➢ Disclosure of IRR %s for guaranteed returns and best estimates for non-guaranteed returns can be included in the Product Brochures of qualifying Deferred Annuities to provide a more readily accessible summary to customers looking to understand relative returns when comparing different retirement savings vehicles. ➢ We would reiterate that under the IA's GL16 – Guideline on Underwriting Long Term Insurance Business (other than Class C Business), all HK life insurers are already obliged to disclose absolute and monetary levels of guaranteed cash value and best-estimate non-guaranteed benefits for each and every participating product upon illustration.

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<td>Minimum Guarantee as a Proportion of the total Monthly Annuity Payable</td>
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We understand the importance that the Government places on ensuring the majority of the annuity return for customers is guaranteed.
We would reiterate that the higher the minimum guarantee % of the total monthly annuity, the more difficult this makes it for insurers to provide longer-accumulation deferred annuity products that qualify for tax concessions (a function of the effects of compounding interest and diminishing principal). This would seem to run counter to the strategic rationale of the tax policy which is to encourage <u>all</u> HK residents to start preparing earlier for retirement.
As such an 70% threshold would constrain insurers to provide products with a longer accumulation period than 10 years.
We would thus propose that the minimum guarantee level be tabulated and classified according to the accumulation period of the product. As a simplified example:
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<tr><th>Years between 1st premium paid and the 1st annuity received</th><th>% of Guaranteed return</th></tr>
<tr><td>3</td><td>80%</td></tr>
<tr><td>5</td><td>75%</td></tr>
<tr><td>10</td><td>70%</td></tr>
<tr><td>15</td><td>65%</td></tr>
<tr><td>20</td><td>60%</td></tr>
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The core principle being that the minimum guarantee threshold reduces as the accumulation / deferral period increases.
In view of market development, the thresholds and qualification criteria chosen should be reviewed on a regular basis to ensure that movements in capital markets and impacts on insurers' balance sheets are fully considered in setting appropriate threshold levels, and that future evolutions in capital frameworks and product designs can also be incorporated within this tax policy in a flexible manner.

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<td>Minimum premium payment period of 5 years</td>
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We believe that the very nature of this tax policy, by virtue of being a rolling annual incentive linked to premiums paid, will incentivize residents to select longer premium periods (as they will receive tax concessions for longer).
However we also believe that we should not be excluding from this incentive residents who cannot commit to longer payment periods (such as those closer to retirement, or those with more generally pressing constraints on liquidity). These customer segments can be those with the highest gap between their current retirement savings and the income they will require in retirement.
There are also risks of bad customer outcomes if customers are overly incentivized to commit to longer payment plans that they cannot meet (i.e. early lapsation may lead to customers receiving less than premium paid).
The retirement gap is relevant for all HK residents, and thus we believe this tax policy should be as inclusive as possible. As such we would propose that the minimum payment period be set at 3 years.
We are happy to consider age or circumstance criteria to justify this shorter payment period if FSTB believes this to be worthwhile, although we do believe this has already been safeguarded by the previously agreed minimum annuitisation age (50>).

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Maximum $36,000 tax deduction per assessment year for premiums paid for eligible deferred annuities or MPF voluntary contributions	➢ The industry is very supportive of FSTB's efforts to increase this figure to a more meaningful level that will materially influence Hong Kong residents' attitudes towards saving more for living in retirement.

We look forward to helping the Administration in developing the "third-pillar" of the pension reform, which we believe will encourage people to actively cater for their retirement needs and prompt them to plan for their future.

14 May 2018