

For information
4 July 2022

Legislative Council Panel on Financial Affairs
Regulation of Qualifying Deferred Annuity Policies

PURPOSE

This paper briefs Members on the regulatory requirements for qualifying deferred annuity policies (“QDAPs”).

BACKGROUND

2. An annuity is a long-term insurance contract¹ that allows the policy holder to turn accumulated savings into a stable stream of income over a period of time, thereby transferring the investment risk and longevity risk to the insurer. There are two major types of annuity, i.e. immediate annuity and deferred annuity.

3. A deferred annuity involves two phases, namely the accumulation phase and the annuitisation phase. During the accumulation phase, a policy holder pays premiums regularly over a specified period of time. There is usually an interim period between the payment period and the annuity period to allow the paid up sum to grow through investment by the insurer. Upon annuitisation, the policy holder will receive regular payments during the annuity period.

TAX CONCESSIONS

4. In the 2018-19 Budget Speech, the Financial Secretary suggested that tax concessions be given to encourage the development of the deferred annuity market so as to offer more options to people in making financial arrangements for retirement, and that the proposed tax concessions be applicable to Mandatory Provident Fund (MPF) tax deductible voluntary contributions as well. It was also announced in the Budget Speech that the Insurance Authority (“IA”) be tasked to issue guidelines on qualifying deferred annuities.

¹ According to the classes of long term business specified in the Insurance Ordinance (Cap. 41), annuities fall under class A “Life and annuity”.

5. The Government subsequently amended the law by enacting the Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Ordinance 2019. The Amendment Ordinance enables taxpayers to enjoy, starting from the year of assessment 2019/20, tax deductions under salaries tax and personal assessment for qualifying deferred annuity premiums and MPF tax deductible voluntary contributions paid during the year of assessment. The aggregate tax deductions a taxpayer can claim for the above two products is capped at \$60,000 for a year of assessment.

6. As at mid-May 2022, there were 23 QDAPs offered by 19 insurers in the market. Besides, for the years of assessment 2019/20 and 2020/21, as at mid-May 2022, a total deduction amount of about HK\$14.6 billion had been allowed to about 280 000 counts of taxpayers for premiums paid to qualifying deferred annuities. These figures reflect that the tax deduction arrangements have been well received by the insurance sector and the public.

REGULATION OF PRODUCTS

7. Under the Inland Revenue Ordinance (Cap. 112), a QDAP has to be certified by the IA for its compliance with the relevant guidelines published by the IA (i.e. GL19 – Guideline on Qualifying Deferred Annuity Policy (“GL19”). Before launching a QDAP, the insurer is required to submit an application to the IA with the provision of relevant documents such as a product brochure, a sample benefit illustration and a sample policy contract, so as to demonstrate that the policy has met the various requirements set out in GL19.

8. According to GL19, a policy will be certified by the IA as a QDAP only after it has satisfied a set of criteria, including:

- (a) minimum total premiums of \$180,000 and minimum payment period of five years: the minimum premiums requirement aims to ensure that the amount of premiums is sufficient to generate meaningful income payouts, whereas the requirement on minimum payment period seeks to encourage people to save a small sum regularly for a stable stream of post-retirement income;
- (b) minimum annuity period of 10 years: this requirement allows an annuity to generate income for a longer period of time and facilitates policy holders’ planning for their retirement; and
- (c) annuitisation at the age of 50 or beyond: this requirement prevents premature withdrawal of an annuity.

9. GL19 also lays down the disclosure requirements applicable to QDAPs, including –

- (a) insurers must disclose in the product brochure and benefit illustration the guaranteed portion (i.e. the guaranteed internal rate of return (“IRR”)) and total projected benefit (i.e. total IRR). IRR is a useful yardstick for clients to evaluate and compare products before making a purchase decision. The calculation formula of IRR is also set out in GL19;
- (b) insurers must clearly present in the benefit illustration the guaranteed annuity payment and, if applicable, non-guaranteed annuity payment. In this regard, GL19 sets out that the guaranteed payment should not, depending on the length of the accumulation and annuity periods, be less than 50% to 70% of the total annuity payment;
- (c) premiums of all riders such as critical illness and hospitalisation cash must be clearly separated, and the premiums of these riders are not tax deductible; and
- (d) relevant risks (e.g. the risk of significant financial loss upon early surrender by policy holders) must be clearly and prominently disclosed in the product brochure.

REGULATION ON INSURANCE INTERMEDIARIES

10. Similar to the sale of other insurance products, insurance intermediaries must, when selling QDAPs, comply with the requirements set out in the Code of Conduct for Licensed Insurance Agents issued by the IA, including acting in the best interests of clients, disclosing information and giving suitable advice. In addition, GL19 requires insurers to provide sufficient training to insurance intermediaries and ensure appropriate internal controls are in place to prevent misrepresentation and mis-selling of QDAPs.

11. To understand the selling practices of intermediaries² in respect of the two tax deductible products (i.e. QDAPs and MPF tax deductible voluntary contributions), the IA, the Mandatory Provident Fund Schemes Authority and the Hong Kong Monetary Authority commenced a joint mystery shopping programme in January 2022. The programme, carried out for the first time by the three financial regulators, aims at giving them a deeper understanding of the

² Including insurance intermediaries, MPF intermediaries, and authorised institutions as defined in section 2(1) of the Banking Ordinance.

selling practices of the intermediaries. The programme findings will be used to complement the work of the regulators and assess the extent to which relevant regulatory objectives are met. The three financial regulators will, depending on the programme findings, share with the industry any sector-wide issues and good practices identified through the programme.

PUBLIC EDUCATION

12. To help the public understand the characteristics of QDAPs, the tax deduction arrangements and how to choose a suitable QDAP, the IA³ and the Investor and Financial Education Council (“IFEC”)⁴ have both set up on their website a dedicated webpage for QDAPs where the public can download related videos and pamphlets for information. In addition, the IA organises seminars and public education talks in collaboration with the IFEC and industry associations from time to time, with a view to enhancing public understanding of QDAPs as a retirement protection product and promoting the continuous development of the market. For the ease of reference by taxpayers, the Inland Revenue Department⁵ has also uploaded Frequently Asked Questions about the tax deduction arrangements on its website.

13. Currently, a list of QDAPs and a webpage with links to QDAP products are available on the IA’s website for public information. To further help the public understand and compare these products, the IA is planning to provide more information along with the list, such as the issue age, minimum premium amount, premium payment period, annuity payment period, guaranteed IRR and supplementary benefits of the products. It is expected that the IA will start the development and design work in the second half of this year.

ADVICE SOUGHT

14. Members are invited to note the content of the paper.

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³ https://www.ia.org.hk/en/qualifying_deferred_annuity_policy/index.html

⁴ <https://www.ifec.org.hk/web/en/moneyessentials/qdap-tvc/index.page>

⁵ https://www.ird.gov.hk/eng/faq/annuity_qp.htm