

ACTUARIAL GUIDANCE NOTE**AGN 5 PRINCIPLES OF LIFE INSURANCE POLICY ILLUSTRATIONS****1. Introduction**

- 1.1 Life insurance products are by their nature complex. Policy illustrations serve a very useful purpose in promoting and explaining these products to potential and existing policyholders. Provided that illustrations are prepared responsibly and used in appropriate circumstances, the Actuarial Society of Hong Kong ("the ASHK") endorses the use of policy illustrations in the sale of life insurance products.
- 1.2 The purpose of this guideline is to raise awareness of the issues we believe should be considered when preparing and using such illustrations.
- 1.3 This guideline is categorised as a "Guidance Note", as defined under Article 1 in the ASHK's Articles of Association. Therefore members are not bound to comply with them as Professional Standards, and departure from the Guidance Note is not considered as unprofessional conduct.
- 1.4 This note is prepared principally for appointed actuaries. Nevertheless we encourage wider distribution of these notes to other members of management, both actuarial and non-actuarial, involved in preparing and approving illustrations as a means of educating and communicating the issues contained herein.
- 1.5 Should an actuary find that he is having difficulty in resolving the issues raised herein, we recommend that he discuss the matter further with one or more of the following: his senior management, the Board, the Appointed Actuary, other senior actuaries, or the ASHK.

2. Role of the Actuary in Hong Kong

- 2.1 Within the Hong Kong context actuaries currently do not have any specific statutory duty to approve policy illustrations. However, illustrations undoubtedly give rise to policyholder expectations, and the following points are of relevance.
 - 2.1.1 Under Section 26 of the Insurance Companies Ordinance, the Insurance Authority has the power of intervention should it consider that the insurer "may be unable to fulfil the reasonable expectations of policyholders or potential policyholders"
 - 2.1.2 Under the Insurance Companies (Determination of Long Term Liabilities) Regulations, regulation 5, the valuation should "have due regard to reasonable expectations of policyholders".
 - 2.1.3 Under the ASHK's PS1, it is "incumbent upon the Hong Kong Appointed Actuary to take all reasonable steps to ensure that the Company's incoming policyholders should not be misled by their expectations".

- 2.1.4 Clearly illustrations can therefore have an effect on the actuary's assessment of the financial condition of a company. Thus the Appointed Actuary has a duty to advise on them in much the same way as he has with regards to adequacy of premium rates and appropriateness of investment policy.

3. Guiding Principles

- 3.1 We have formulated five guiding principles which should be considered in preparing and using illustrations. These are listed below.
- 3.2 principles are general in nature and provide sufficient flexibility to cope with different situations. In order to assist readers of this Guidance Note, we have provided further expansion on how the principles could be applied in certain situations.
- 3.3 Illustrations should not mislead.
- 3.3.1 There should be a reasonable chance of illustrated policy benefits being realised in the future; illustrations should be based on most likely or conservative assumptions; where optimistic assumptions have been used, these should be explicitly stated and contrasted with illustrations using contrasting conservative assumptions.
- 3.3.2 Misleading language should be avoided; of particular note is the potential misuse of the word "guaranteed", e.g. if guarantees are contingent on various conditions, then these conditions should be stated.
- 3.3.3 Important information should not be withheld, eg likely conditions upon which the illustrations would not be valid.
- 3.3.4 Illustrations should be consistent with policy wording and company practice; in some cases it may be appropriate to indicate that further information (eg actual policy wording) is available on request.
- 3.3.5 Illustrations are invariably used in a competitive situation; to the extent that it is possible, illustrations should enable fair comparison between different products and companies; since it is not possible to control the basis of illustrations of other companies, illustrations should at least be able to be justified in terms of current or other explicitly stated conditions.
- 3.3.6 The power of compound interest should not be abused to present misleading results; for example long term projections should be accompanied by an illustration and /or appropriately worded statement indicating the reducing purchasing power of money due to inflation. (eg "When reviewing this illustration, please bear in mind that the cost of living in the future is likely to be higher in the future than it is today due to inflation")
- 3.3.7 Illustrations should be reviewed regularly to ensure that their contents are still relevant.

- 3.4 Illustrations should be suitable to the intended target market.
 - 3.4.1 Language should be appropriate to the specific situation of the targeted market.
 - 3.4.2 Use of technical jargon should be limited, and if used should be clearly explained.
 - 3.4.3 Overly complex illustrations can confuse more than explain; one needs to be careful that in trying to put everything into an illustration, the key messages are not lost.
 - 3.4.4 It is accepted that there is some trade-off between putting in all possible information, and keeping an illustration simple; ultimately one needs to make a practical decision as to whether additional content serves to inform or confuse the target market.
- 3.5 Where premiums and benefits are illustrated, the conditions upon which these are payable should be clearly distinguished
 - 3.5.1 Guaranteed benefits should be clearly distinguished from non guaranteed benefits. Where benefits are non-guaranteed, some indication should be given as to what could affect the actual benefits payable
 - 3.5.2 In some cases it may be appropriate to give an indication of possible variability of benefits, eg where a company is likely to vary its actual benefits in the future based on actual investment returns achieved, then it would be useful to illustrate such benefits based on the different assumed rates of investment returns.
 - 3.5.3 Policyholders may exercise their right to lapse or surrender a policy before maturity. It is usually appropriate to illustrate what the policyholder will receive or forego, when exercising such rights. This is particularly important in cases such as lapses or early surrenders where the policyholder may receive little or no cash values relative to the premiums paid to date.
 - 3.5.4 Similarly where benefits are contingent upon policyholders exercising (or not exercising) certain options, then these options should be clearly spelt out; it may be appropriate for the illustration to reflect the differences that such options can cause.
 - 3.5.5 Where premium rates are not guaranteed, or where the cessation or reduction of premiums are contingent upon other conditions (eg so called "vanishing premium" illustrations), this should be clearly stated, and the conditions when the illustration will become invalid should also be clearly stated.
- 3.6 Due consideration should be taken into the marketing or distribution channel used to sell policies, and how the illustration should and could be used within this context.

- 3.6.1 Allowance can be taken for the sales channel to supplement the illustration, provided that there are sufficient safeguards in the sales process that ensure that this is done properly; eg multiple subsequent illustrations need not have the same level of detail as new illustrations, provided that there is some process to ensure that a policyholder receives at least one full illustration.
 - 3.6.2 Companies should strive to ensure that sales representatives receive appropriate training and policing with regards to the use of policy illustrations.
 - 3.6.3 Where a sales channel cannot meet these conditions, then illustrations should be suitably modified to take account of this.
- 3.7 They should be consistent with the compliance environment.
- 3.7.1 Illustrations should be consistent with legislation, and should recognise government or industry guidance; particular care (eg by making appropriate legal or professional consultation) should be taken if there is an apparent conflict between these and this guideline.
 - 3.7.2 At the current time the following documents are of particular relevance in Hong Kong:
 - 3.7.2.1 the "Illustration Standard of Non Unit-Linked Life Insurance Products", issued by the Hong Kong Federation of Insurers (Life Insurance Council).
 - 3.7.2.2 the "Code on Investment-Linked Assurance Schemes" issued by the Hong Kong Securities and Futures Commission.
 - 3.7.2.3 the "HKFI Guidance Note on ILAS Illustration Document" issued by the Hong Kong Federation of Insurers (Life Insurance Council).
 - 3.7.3 All personnel using policy illustrations should be reminded that Section 56 of the Insurance Companies Ordinance states that "Any person who, by any statement, promise or representation, which he knows to be false, misleading or deceptive, or by making any dishonest concealment of material facts, or by the reckless making (dishonest or otherwise) of any statement, promise or representation which is false misleading or deceptive, induces another person to enter into or offer to enter into any contract of insurance commits an offence and is liable to a fine at level 6 and imprisonment for 12 months"

***** END OF ACTUARIAL GUIDANCE NOTE *****

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