

Interpretation Note on the Review Mechanism for Illustration Rate Caps in Benefit Illustration for Participating Policies

1. Background and objective

- 1.1 On 28 February 2025, the Insurance Authority (“IA”) issued the Practice Note on Illustration Rate Caps in Benefit Illustration for Participating Policies (“Existing Practice Note”), which articulated supervisory expectations on the application of illustration rate caps at the point of sale for participating policies.
- 1.2 Section 4 of the Existing Practice Note sets out the IA’s intention to conduct on-going reviews of the illustration rate caps, having regard to evolving economic conditions, market practices and underlying investment portfolios. The section establishes the regulatory intent for dynamic supervisory oversight and provides the foundation for further articulation of a structured review framework.
- 1.3 Since the issuance of the Existing Practice Note, market participants have continued to operate under a rapidly changing economic and financial environment, with heightened interest-rate volatility, shifts in asset allocation strategies and evolving profit-sharing practices for participating business. Against this backdrop, the IA has decided to issue this Interpretation Note to put in place a review mechanism for the illustration rate caps to ensure that they remain appropriate and aligned with prevailing market circumstances. This Interpretation Note sets out the review mechanism and the review frequency.

2. Application

- 2.1 This Interpretation Note supplements Section 4 of the Existing Practice Note and all terms therein carry the same meaning with the same applicability requirements as promulgated in the Existing Practice Note.

3. The Review Mechanism

- 3.1 The Review Mechanism is grounded in the principles adopted when the illustration rate cap was first established. The cap was originally determined with reference to prevailing economic indicators, relevant market benchmarks, and the need to ensure clarity, consistency, and comparability across products. Going forward, the Review Mechanism is set out in a more structured manner and is underpinned by three core principles:
 - (a) a formula-based adjustment anchored to prevailing asset allocation and investment outlooks;
 - (b) a smoothing rule to avoid undue volatility; and
 - (c) ongoing market monitoring to maintain competitiveness.

Formula-based adjustment

- 3.2 The formula-based adjustment combines industry-wide asset allocation insights, forward-looking market return expectations, and empirical observations from recent participating product data. By integrating these elements, the review aims to derive a

representative net return to customers, which is then used to further assess whether an adjustment to the current cap is warranted. The formula-based adjustment is derived as follows:

- (a) Asset allocation information from major participating products offered by the top authorized insurers providing participating policies is used to derive an overall allocation between fixed income and growth assets. Where an allocation range is provided, the allocation corresponding to the highest gross return is selected. Accordingly, the calculated gross return represents a modestly optimistic point estimate, which is considered acceptable for the purpose of illustration rate cap determination.
- (b) Expected returns at asset class level are sourced from published outlooks by leading investment institutions (no less than three leading investment banks and three leading asset management firms). Based on asset characteristics and the availability of published data, these returns are classified into fixed income and growth assets¹ buckets. Within each bucket, the relative composition of underlying asset classes is determined using actual asset allocation data collected through annual submission² from authorized life insurers.
- (c) Based on the asset allocation of major participating products and the expected returns derived from published outlooks, an expected gross portfolio return is estimated. A spread³ is then deducted from this gross return to derive the net return to customers.
- (d) By comparing the above calculated net return with the latest cap for products denominated in non-Hong Kong Dollar, the formula-based adjustment is arrived.

Smoothing rule

- 3.3 A smoothing rule is then applied to the formula-based adjustment to prevent undue volatility. Under this framework, an adjustment is implemented only when the calculated difference exceeds fifty basis points. Note also that adjustments, if any, will be made in increments of fifty basis points.
- 3.4 Such adjustment applies to both products denominated in Hong Kong Dollar and products denominated other than in Hong Kong Dollar; this parallel adjustment reflects the long-standing interest rate differential between Hong Kong Dollar and United States Dollar environments.

Ongoing market monitoring to maintain competitiveness

- 3.5 Trends in selected international markets are monitored to ensure that the resulting illustration rate cap remains competitive, with particular regard given to products closely aligned with the currency profile and features of participating business in Hong Kong.

¹ For this purpose, growth assets are defined to include alternatives and private assets (e.g. private credit, infrastructure debt, private equity, and venture capital).

² For example, the weights assigned to private debt, private equity and listed equity within the growth asset bucket are based on Class A business asset allocation data reported in year-end statutory returns.

³ The spread primarily reflects the difference between assumed fund earning rates and customers' IRRs, based on appropriate samples collected among the industry. A long-term duration is referenced, as it lies sufficiently beyond the amortization of upfront costs, while remaining economically meaningful and relatively stable across insurers. As the spread provides a stable and reasonable reflection of insurers' profit and expense allowances; it is subject to review only in the event of significant changes in market conditions or the broader economic environment.

4. The Review Frequency and Roadmap

- 4.1 With due regard to the need to balance stability and flexibility given the long-term nature of participating business, a regular review will be conducted on a biennial basis⁴ (i.e. once every two years).
- 4.2 Between scheduled reviews, ad hoc reviews may be conducted to facilitate timely assessment of significant changes in the economic environment or other material market developments. Such reviews may be initiated by the IA, or requested by the industry where circumstances warrant.

5. Commencement

- 5.1 This Interpretation Note shall take effect immediately.

⁴ For the avoidance of doubt, the first review will be conducted based on available data as of 1 July 2027, with results to be communicated to the industry stakeholders in Q3 2027. Stakeholder consultation will be conducted if the review results indicate that an adjustment is warranted.