Liyaquat Khan
President

3rd Oct., 2011

Submission to IRDA

Comments on 'Exposure Draft on Pension Products' issued by IRDA, dated 1st August, 2011

This note provides the comments from the Advisory Group on Life Insurance of the Institute of Actuaries of India and does not constitute views of the Council of the Institute.

We welcome the steps proposed by IRDA to foster pensions business. As noted by IRDA, the requirement on unit linked pension products to ensure a return to the policyholder at a rate of 4.5%pa, which was also indexed to the Reverse Repo Rate of the RBI, did not find wide acceptance in the market. We therefore laud IRDA's decision to review the guarantee that is to be offered. However, there are certain other elements of current regulation that also, in our view, inhibit the growth of pensions business, and we suggest that IRDA also address these[1].

We welcome IRDA's intention to apprise the prospective policyholder of the risks of the deferred annuity contract and simultaneously to encourage the premium to be set at a level designed to target a desirable level of benefit. We suggest that some flexibility in product design and disclosures may be desirable in achieving these ends.

In order to communicate the risks and benefits of a pension policy efficiently, we suggest that IRDA review the format of benefit illustrations that is currently required in respect of unit linked business. The amount of data in the illustration is so great that we suspect, in many instances, it serves to intimidate rather than to inform the prospective policyholder.

The points are dealt with in our detailed comments, below.

We thank the IRDA for this opportunity to comment on the Exposure Draft.

Comments

We refer to the section numbers of the Exposure Draft in our comments below.

Introduction

---

[1] For a general discussion of the development of pension and annuity business, we refer the reader to the Report dated 28th May, 2010, submitted to IRDA by the Pension and Annuity Working Group.

302, Indian Globe Chambers,142, Fort Street, Off D N Road, Mumbai - 400 001
Tel : 67843333 Fax: 67843330. email : president@actuariesindia.org

The last paragraph states, ‘In this background, all the pension products offered shall comply with the following objectives.’

We would like to confirm whether the draft covers:

- both unit linked and non-linked
- both group and retail business
- if the guidelines apply to group, whether they apply to both defined benefit and defined contribution schemes.

Section 1

The draft states that the ‘assured benefit’ would become payable at vesting. We note that the ‘assured benefit’ may well be a lump sum, but the lump sum would not be payable at vesting, since at least $2/3^{rd}$ of it must be annuitized.

Section 2

We note that the disclosure guidelines for unit linked products are covered by IRDA Circular No. 049/IRDA/ACTL/ULIP/January-08. We suggest that the format of the disclosure be simplified so that only essential material is retained. We recommend that IRDA consult the industry and the profession specifically on this matter of disclosures.

Section 2.4

In setting a target pension, it would be important for the policyholder to understand the effect of expected future inflation. We suggest that the illustrative pension be restated in today’s terms, by allowing for inflation at a rate consistent with the assumed investment return in the projection.

We note that in the UK, the Board for Actuarial Standards in ‘Technical Memorandum 1: Statutory Money Purchase Illustrations, Version 1.4’[2], mandates that the nominal rate of accumulation may not exceed 7.0% per annum and that price inflation should be 2.5% per annum.

We also note that FSA Handbook[3] mandates the projected rates of return on the underlying assets and corresponding rates of price inflation in respect of a standardized deterministic projection of a personal pension.

	Lower rate	Intermediate rate	Higher rate
Nominal rate of return	5%	7%	9%
Price inflation	0.5%	2.5%	4.5%

We recommend that IRDA consult on the basis of any such projection.

[2] Please see http://www.frc.org.uk/bas/standards/techmemoranda.cfm
[3] Please see http://fsahandbook.info/FSA/html/handbook/COBS/13/Annex2#DES210

302, Indian Globe Chambers,142, Fort Street, Off D N Road, Mumbai - 400 001
Tel : 67843333 Fax: 67843330. email : president@actuariesindia.org

We also suggest that the illustrative pension be based on the immediate annuity rates currently offered by the insurers with a clear disclosure that the rates at the time of vesting could be different than those offered currently.

Section 4 and Section 5

We agree that liquidity should be limited on a pension contract. Any liquidity facility offered may be exploited, with the result that the policy would become a short-term investment vehicle, rather than a pension.

However, the proposed treatment of surrenders appears inappropriate for a pension product. If an annuity is payable on surrender, the result could be a trivial annuity on each surrendered policy. In aggregate, however, the liability could be significant for companies. We note that the longevity risk arising from having a large annuity liability, where the annuitants are relatively young and hence the importance of future improvements is high, would be significant. If a company were to try to price this risk, the policyholder return would suffer.

On discontinuance of premium, we suggest instead that a pension policy be made paid-up. A minimum age at vesting should be prescribed, e.g. 50 or 55. Only from that age, could the annuity commence, though it would be expected to commence from the policyholder's normal retirement age.

We note that on discontinuance of premium of a unit linked policy, under IRDA (Treatment of Discontinued Linked Insurance Policies) Regulations, 2010, Section 4, unless the policy is revived, it must be completely withdrawn. In Section 6 of the same Regulation, it is explained that this requires the insurer to refund the amount to the policyholder, except in case of pension policies, where at least 2/3 must be annuitized while the remainder may be paid as a lump sum. We recommend that this requirement of the Regulation be reviewed. A pension policy, if it is to generate value for the policyholder, must be given time. There appears little merit in compulsorily annuitizing the proceeds at an age where the policyholder may still be in employment, simply because premiums have been discontinued. Indeed, annuity rates may not even be available at a young age, should a young policyholder decide to surrender or discontinue premium payment. Nor, we suggest should there be any lump sum payment on surrender, since such a payment would not meet the essential purpose of a pension, which is to be a vehicle for long term saving for retirement.

During the period after discontinuance of premium and prior to vesting, the policyholder should not however be trapped in the contract. In the absence of a mechanism for surrender, we suggest that a transfer to another approved pension policy, the receiving scheme, of another insurance company may be allowed.

We note that if such transfers are permitted, IRDA should also disallow 1/3rd commutation. Instead, the entire policy proceeds should be required to be transferred to the receiving scheme. Otherwise, if commutation were allowed on transfer, the receiving scheme would need to be something other than a normal pension plan: it would need to be structured as a

302, Indian Globe Chambers,142, Fort Street, Off D N Road, Mumbai - 400 001
Tel : 67843333 Fax: 67843330. email : president@actuariesindia.org

contract that did not allow further commutation, and provided only an annuity from retirement.

Section 8.1

A minimum age at entry for the annuity should apply.

Section 9

An open market option would be in the policyholders' interests, as it would allow choice at the point of vesting. For the policyholder to choose an insurer in the hope that, at vesting, the annuity rate offered would be competitive, would be, at best, a gamble. For the insurer, it would provide an opportunity to exploit a trapped policyholder, since the annuity would have to be bought at a price set by the company.

Section 10

We suggest that certain aspects of the Regulation are inappropriate to pensions business. In particular, that a policy must terminate on the later of premium discontinuance and fifth policy anniversary is, for the reasons given above, inappropriate for a pension policy.

Notes

Section 1 (i) and 1(ii)

We seek clarification as to whether the proposed rates of return of 4% p.a. and 6% p.a. represent the projected internal rate of return to the policyholder, or the gross return on the backing assets. On the basis that they represent the latter, given that long term risk free rates are currently above 8%, it would appear very cautious to require a projection at 4%. While we agree that the policyholder should be made aware of the risks of future performance, the projected returns should, we suggest, be related to observed long-term yields and updated from time to time.

We note that a calculation of a target premium at 4% could discourage prospects from taking policies altogether, which would be an undesirable consequence. Alternatively, it could lead to the sale of higher levels of premium than the client can afford, which could lead to subsequent poor persistency.

Section 2 (iii)

It is not clear whether the annuity amount would be guaranteed or the annuity rate. We note that a guarantee of the annuity rate led to considerable problems at Equitable Life in the UK. A guarantee of the annuity amount is, also dangerous, both to the company and to the wider industry. We therefore recommend that neither be allowed.

Liyaquat Khan

302, Indian Globe Chambers,142, Fort Street, Off D N Road, Mumbai - 400 001
Tel : 67843333 Fax: 67843330. email : president@actuariesindia.org