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Submission to IRDA

Note on Variable Insurance Products – Exposure Draft issued by IRDA vide circular dt. 21 10 2010

IRDA has issued an exposure draft vide circular No: IRDA/ ACT/ CIR/ VIP/ 171/ 10/ 2010 dated 21-10-2010 inviting comments from stakeholders. This note provides the comments from the Advisory Group on Life Insurance of the Institute of Actuaries of India.

There are many powerful principles introduced through this document, which will guide the industry. However, there are also many areas where the document appears a little unclear and potentially may create restrictions.

1. It is mentioned that "Premium shall be shown separately as Risk premium, Expense premium, Commission Premium and Savings Component Premium". It is not clear whether the component wise break up is to be shown in the benefit illustration only or there will be four separate premium tables and the gross premium will be the sum of these four types of premiums. It is not clear whether one or more of the premium components can allow for the profit loading, cost of solvency margin, cost of guarantees, to quote a few elements of pricing.

2. There is no mention of Group traditional products including Group Gratuity, Group Superannuation, Group Leave encashment and similar other employer schemes, which could be construed as Variable Insurance Products (VIP). Therefore, it would be useful in our view to more definitively set out the scope of the contracts covered.

3. The commission proposal appears to prevent higher commission on savings/investment component of the gross premium, by giving higher commission on the risk premium. However, clarification on certain aspects should be helpful:
   i. Will the risk premium be based on entry age (level premium) or on attained age each year? If on attained age, then given that there is a uniform 5% cap on risk premium commission from the 3rd year onwards there could be an

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increasing commission to the intermediary which would not be in line with current market practice.

ii. Will the risk premium be calculated with the same frequency as premium payments? If not, will it be calculated monthly in all cases? If risk premium is calculated monthly for an annual premium policy, the intermediary will find his commission unnecessarily delayed. If risk premium is calculated at the same frequency as the basic plan, the administration system will need to be changed (currently mortality is charged monthly).

iii. The commission system will become significantly more complex, as a result of differential commission rates for 2 parts of the same premium.

4. The flexibility of sum assured is mentioned, but it is not clear what flexibility will apply to the premiums. Internationally, there is usually significant freedom for the client to reduce or increase his/her premiums.

5. Similarly, it is stated that a single premium is not allowed, but there is no mention of whether limited premium paying terms are permitted (benefit term is a minimum of 5 years). All other product lines permit the limited premium payment facilities to meet the needs of various segments of customers. There is no apparent reason for this restriction in Variable Insurance Products.

6. Mention is made of par and non-par versions of the product. The implication is that both must be offered, but it seems likely that the intention is to permit either form. It should be made clear that VIP contracts can be either par or non par. To make it less complex for the customers, a combined product with both the par and non par should not be offered i.e. a VIP policy can be either par or non par.

7. The concept of guaranteed rate is not clear, as “it must be declared and published on the website at the beginning of each financial year”, but “… is guaranteed for the whole term”. If the intent of IRDA is to offer a fixed investment guarantee for the entire policy term, it would not remain a variable insurance product and there would be onerous investment guarantee on the part of life insurers as the policyholders’ behaviour can affect the cost of guarantee.
   Further a flexibility of offering interest credit more frequently than annual might be permitted so that it benefits and is fair to the customers.

8. The basis for withdrawals in the first 3 years is not clear, because reference is made to the balance in the savings account at the start of the year of termination

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(during the 2nd and 3rd year), which means that premiums paid during the year are ignored, as are charges deducted during the year.

9. Surrender Value (SV): It is mentioned that “All VIP contracts acquire surrender value from first policy year”. The intent of IRDA appears to allow surrender value in all contracts irrespective of how many premiums have been paid. Following comments are offered on SV rule:
    a. If a policyholder surrenders the policy before the acquisition cost is recovered, there is a loss to the insurer to the extent of the unrecovered acquisition expenses.
    b. In profit testing a product any such unrecovered loss, including a part of the loss of profit to the insurer, is passed on to the continuation customers which may be inequitable to the continuing contracts.
    c. It is suggested that this restriction should be relaxed to address the above issues.
    d. Given that such products are intended to be classified as 'non-linked', the investment valuation norms will be those applicable to 'non-linked' business (i.e. fixed interest securities on HTM basis). Given this, unless there is a mechanism to reflect market value adjustments upon surrenders, it may create significant mismatching risks

Further, SV rules state that “…for surrenders in second and third policy year, the amount available in his/ her savings account at the beginning of second/ third year, is payable at the end of the lock in period”. In cases where the policyholder pays premiums after commencement of the policy year (e.g. in grace period) and the policy lapses later during the policy year, this rule does not allow the savings component to be part of the acquired surrender value which is not fair to the surrendering customers. The draft circular is also not clear on the minimum surrender value after three policy years e.g. whether interest amount pertaining to the period from the commencement of the policy year till the date of surrender is payable or left to the product designing by the insurer. ; Whether surrender penalty can be charged after three policy years.

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