01 Nov 2012

Submission to IRDA

Comments on IRDA's Exposure Draft on Linked & Non-linked Insurance Products Regulations, 2012

This note provides the comments from the Council of the Institute of Actuaries of India on the above Exposure Drafts dated 5 October 2012.

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

We appreciate the efforts taken by IRDA in collating the various regulations and guidelines governing unit-linked products and welcome the steps taken to make the customer proposition consistent across different product categories – unit-linked, participating and non-participating.

However, we have certain concerns with the details of the proposals which we outline in our comments below. The first section covers our comments on Linked products and the second section on Non-Linked products.

Comments

I. Linked Products

Section 2(g) and (o) on definitions of Death benefit and Maturity benefit: The death benefit definition requires the amount to be defined at inception of the contract. This is not appropriate for linked products where the final payout is linked to fund value or some index. We therefore suggest that the phrase "agreed at the inception of the contract" be removed from the definition. Similar comment would apply for Maturity benefit as well.

Section 3 (a) (i) on Minimum Death Benefit: The proposal to increase the minimum death benefit to Sum Assured plus Fund Value will have the consequence of making a policy expensive, particularly at older ages, in order to provide a benefit that may not even be desired. We note that typically, as people age, their dependants grow up, their debts get paid off, and hence as they approach retirement they have a lower requirement for life cover. We recommend that the minimum death benefit be redefined as the maximum of Sum Assured or Fund Value.

Section 3 (d) on VIP: We recommend the authority to provide clarity on a) the charges allowed b) the method of deduction of these charges c) the approved external indices and d) minimum guaranteed interest rate (presumably, this should be non-zero).

Section 3(d) (iii) on Variable interest rate in VIP: We recommend the Authority to provide clarity on whether the variable interest rate on VIP can be negative. For example, suppose the guaranteed return is 2% and the variable component is 80% of Sensex return. If total Sensex return is -10%, would the interest credited be 2%, or 2%-8%=-6%?

Section 3(d) (iv) (2) on Shadow policy account: We recommend the Authority to provide clarity on the purpose of running a shadow account in the case of VIP.

Section 3(d) (vi) (2) on NAV: We recommend the Authority to provide clarity on the purpose of calculating NAV in the non-unitised version.

Section 4(g) (i) (2) on Reduction of Partial Withdrawals on Death: The current rules, applicable to ULIPs, on reducing the death benefit for the partial withdrawals during the two years prior to death protect the company from anti-selection, where the death benefit is higher of the fund value and sum assured. If the death benefit were to be defined as sum of fund value and sum assured, this exclusion is not required.

Section 4(g) (iv) and (v) on Policy cancellation: In case of misrepresentation or fraud and ineligible ages that requires a policy to be cancelled, we welcome the Authority's proposal to cancel such policies. However, we would suggest that such cancellations be made immediately without the need for completion of lock-in period.

Section 4(h) on Death Benefit underpin on 105% of premiums: We note that the existing Pensions guidelines require a non-zero positive return on the premiums to be paid on Death. Increasing this underpin to 105% would make it very onerous for Pensions, and even more so for Health. We therefore recommend the Authority that this increased underpin be restricted to Life business only.

Section 5(b)(iii) on Guarantee charge on VIP: The regulation on variable linked products requires insurers to provide guarantees, which would lead to a higher capital requirement. An appropriate charge would need to be made if only to account for this requirement. Furthermore, the guarantee itself gives rise to a liability which would reduce reported profitability, all else being equal. Hence, we recommend the Authority to allow insurers to levy a guarantee charge for variable insurance products.

Section 8(a) on Commission cap: Considering that ULIPs and linked VIPs are required to adhere to the cap on reduction in yield (RIY), it is suggested that the Authority need not mandate any cap on commissions.

Section 8(d) on Discounted premium on Direct marketing: We believe a differential charge structure for direct business could lead to customer dissonance and channel conflict. Also, while commissions are not payable for direct marketing channel, there would be other costs (e.g. infrastructure) that are associated with any direct marketing sale.

In view of the above, it is proposed that companies be allowed to have the same premiums/charges across channels.

Section 12(a)(vi) on Discontinuance charges: Whilst the percentage caps on discontinuance charges are appropriate and should be maintained, we believe that the absolute rupee amount caps are inappropriate as the devaluing impact of inflation would make it progressively less effective. Therefore, we propose that the absolute rupee amount caps be removed

Section 12(c) on Discontinuance charges on top-ups: Since the company has incurred acquisition costs in Single Premium and top-ups, we believe that it is inappropriate to exclude top-ups from discontinuance charges. Incidentally, we would also like to highlight that it is administratively complex to track the unit value of top-ups separately from the base policy, making it unaffordable to implement.

Section 13(b) on Revival charges: We believe that on revival, companies should be allowed to charge for a) underwriting expenses incurred as a consequence of revival and b) a nominal fixed fee for the administrative efforts taken by the company in reviving the policy.

Section 18(b) on Minimum interest rate on Discontinued policies: Our understanding is that crediting inforce policyholders any excess returns earned over 2% on the Discontinued Policy Fund would be tantamount to adopting the Dividing Principle, which is prohibited as per Section 52 of the Insurance Act 1938. In addition, this proposal would go against the fundamental principle of unit pricing that states that interests of unit-holders not involved in a transaction should be unaffected by the transaction.

Further, it would give rise to considerable operational difficulties in making these transfers as proposed in the Draft.

We therefore suggest that this proposal be withdrawn.

Section 19(b) on conversion to Single Premium policy on discontinuance: The Authority's proposal to convert a policy that discontinues premium payment post the lock-in period into a single premium policy would disadvantage the policyholders as there would be a charge for initial acquisition expenses and commission under the new policy. Therefore, we believe conversion to a new policy is not in the interest of the policyholders. Rather, in our opinion, it would be better to simply allow the policy to continue on a paid-up basis, consistent with the treatment of non-linked policies.

We recommend the Authority to not mandate this option, but to allow a paid-up policy to exist.

Section 22(e) on Top-up in the last 5 years: We observe that there is a general propensity in consumers to save more as they approach their retirement, particularly in the last 4-5 years of their working life. Disallowing top-ups during these years may prevent companies from meeting this genuine customer need.

Section 22(f) on Caps on Top-up premiums: We recommend the Authority to remove this cap, as paying top-up premiums within an existing product could be more beneficial to customers than buying a new single premium product. Further, the life cover offered on top-up premiums and single premium products are comparable, hence customers would be indifferent to the two options on those grounds.

Section 25(c) on Cap on Riders: We submit to the Authority that a cap of 15% for rider premiums may be too low and would recommend the Authority to increase this cap. We would like to seek confirmation that the above mentioned cap on rider premiums is applicable only to Pension products and not to Life products, where the cap would continue to be 30% of the base premium. We would like to seek clarity on whether riders can be offered on a policy which has no base Sum Assured.

Ideally, we would suggest that the current limit on the rider sum assured for life business relative to that of the base policy be removed as it prevents distribution from offering meaningful amounts of cover.

Section 27(c) on Age restriction: Given increasing longevity policyholders may work longer and choose to retire later. Hence, we recommend the Authority to remove the age restriction on postponement of vesting.

In case there is a sum at risk on death, we suggest that any extension of the term be subject to the company's board-approved underwriting policy. Otherwise, companies may be open to anti-selection.

Section 31(a) on Assured Benefits for DB schemes: In DB schemes (where no individual member accounts are maintained), the reason for fund withdrawals is not normally specified and withdrawals are not assigned to individual member. Moreover, the benefits on death/retirement are set out in the Scheme Rules and not related to fund performance, as is typically the case with DC schemes.

Therefore, we recommend the Authority to remove this clause for DB schemes.

Section 32 on Annuities: In order to avoid the situation where insignificant monthly/annual payments are being made to customers offering no meaningful benefit, we recommend that the Authority mandate a minimum corpus (say, Rs. 200,000) below which the lump sum may be paid back to the customer without the need for an annuity.

Section 34 (a) on Premium Allocation Charge: We recommend the Authority to clarify if the Premium Allocation Charge may vary with the mode of premium payment (yearly, half yearly and monthly).

Section 34(c)(i) on Guarantee charges through adjustment of NAV: We recommend IRDA to permit this charge to be levied either by unit cancellation or by adjusting NAV. From an administrative perspective, unit cancellation would lead to considerable simplicity as it avoids any proliferation of pricing series.

We recommend also that the Authority consider allowing the guarantee charge to be attached to alternative carriers to just fund value. Where a guarantee becomes less onerous on the insurer over time, charging the customer a percentage of fund value may come to result in a mismatch in charges versus cost. In such an example, allowing the guarantee charge to be a percentage of the annual premium may be more appropriate.

Section 34(d) on Policy Administration Charge: We recommend the Authority to clarify if this charge could vary by the policy year in which the premium is paid, the premium size , the premium type (regular, single or top-up premium) and the mode of premium payment (yearly, half yearly and monthly).

Section 34(h) on Rider charge: We recommend the Authority to allow the flexibility for the riders to be paid for by premium payment, in addition to the proposed unit deduction method.

Section 34(h) (iii) on Rider charge: We recommend the Authority to continue with the existing practice of allowing non-Linked riders under Linked policies.

Section 37 on RIY at Maturity: Ensuring RIY at maturity is not mathematically feasible unless the benefits at maturity are arbitrarily changed, which is not allowed in UL products. As an example, if a product was designed to produce an RIY of say, 2.25% p.a. at a return of 10% p.a. for a certain model point, this may result in an RIY higher than 2.25% p.a., say 2.4% p.a. if the actual returns at maturity turn out to be 20% p.a.

We therefore recommend the Authority to consider removing this requirement.

Section 42(a) on NAV formula: With our earlier comment recommending removal of the proposal to credit excess returns earned over 2% on Discontinued Policy Fund, we suggest that the formula be suitably amended for consistency.

Section 44(b) on Asset allocation 0-100%: Where a fund, open-ended or closed-ended, has a specific investment strategy which changes over time, we believe it is appropriate to allow 0%-100% allocation definitions. We recommend that the Authority may mandate the degree to which the asset allocation can move over time.

Section 49 (a) on Series/Tranche of funds: It is seen that certain customer segments prefer insurance products that offer guarantees. A key mechanism for risk management for funds associated with guarantees is that the duration of the assets in the fund is managed in line with the guarantee. To put in place such management of guarantees, each tranche of guarantee needs a matching tranche of funds. Hence this leads to tranches of funds.

It is suggested that the Authority may mandate the insurer to illustrate to the Authority at the time of product filing the likely size of the fund, the frequency with which it intends to open/close funds, the circumstances under which this may change, and the customer benefit of doing so. Further, where an insurer has closed a fund before reaching a minimum size, the Authority may require the insurer to provide a justification for earlier closure.

Section 53 on Surrender benefits for Linked Health: We would like to bring to the Authority's notice that the requirement of extant regulations and guidelines on unit-linked business to offer a surrender value, when applied to Health business, would compromise the tax treatment of this business under Section 80D of the Income tax Act. This would obviously reduce the attractiveness of this category.

We do however agree that the guidelines on Unit Linked Insurance Plans and reduction in yield (RIY) and the IRDA (Discontinued Linked Insurance policies) Regulations, in so far as they restrict charges on the policies, should apply to unit linked health plans.

In regard to products where policyholder can access the accumulated fund only in form of health claims, we recommend that on the discontinuance of premiums or on surrender of policy, the accumulated fund should continue to be maintained with the insurer and can be claimed by the policyholder against medical expenses. The discontinuance charges would be in line with the IRDA (Discontinued Linked Insurance Policies) Regulations and any relevant clarifications issued by the Authority from time to time.

It is hence recommended to allow maintenance of the accumulated funds post the lock in period on premium discontinuance or surrender of a unit linked health product.

Section 55(g) on Statement of Consent: In order to avoid extra cost and complexity, we propose that such a requirement be included within the existing set of forms (the proposal form or illustration) rather than as an additional document.

Section 58(b) on Disclosures norms for UL: We suggest clarification from the Authority on whether the annual investment report can be made available to policyholder in soft copy where email IDs of policyholder are available.

Section 62(a) on Implementation date: Given that the last quarter of the fiscal year (Jan – Mar) is a very busy period for the industry followed by a quarter (Apr – Jun) of year-end activities and the far-reaching nature of the changes proposed that would see virtually all products (including unit-linked) being re-filed, we recommend that the implementation date be deferred to 30 September 2013 to provide sufficient time for the industry to adapt to the new environment.

Section 62(d) on Group products: The proposal of not allowing new members into existing schemes which are non-compliant with the regulations with immediate effect will deprive the Group Schemes of products to cater to their new members till the time a new product in conformity with the provisions of the new regulations is filed and approved.

We therefore propose that companies be allowed to enrol new members into the existing Group Schemes till the time the company has an alternative approved product to offer their existing clients.

Section 62(e) on Series/Tranches: In order to address the Authority's concerns we would like the Authority to please explain its concerns it has on this type of product, so that we could provide our suggestions to address its concerns. We believe that given the design of such products, the act of not allowing the opening of new tranches raises significant concerns in respect of risk management and policyholder value.

We further recommend the Authority to allow such products to have the same closing date as the other products if no new tranches are opened in the interim.

II. Non-linked Products

We would like to bring to the Authority's notice that some of the definitions relate to Unit-Linked products and would suggest that these may be revised suitably to be applicable for Non-Linked products.

Section 2(d) and (h) on definitions of Death benefit and Maturity benefit: The death benefit definition requires the amount to be defined at inception of the contract. This is not appropriate for products like Par products and Variable Non-linked Insurance products under which discretionary benefits are added during the term of policy. We therefore suggest that the wording be clarified. Similar comment would apply for Maturity benefit as well.

Section 2(k) on revival of a policy: We suggest a clarification that regulation should allow a company to offer a partial revival, whereby a reduced sum assured may be offered in return for a reduced premium on revival.

Section 5(a) prohibiting benefits linked to any index under Non par structure

The proposed benefit structure for Non-par products requires all benefits to be expressly stated at the outset and prohibits benefits that vary during the term of the policy. We, in the Actuarial Profession, believe that this definition of Non-par is quite narrow and is not conceptually supportable.

From a textbook definition perspective, any business where the policyholders participate in the surplus arising within the fund is said to be Participating business and where the policyholders do not participate in the surplus is said to be Non-Participating business. Under this definition, it is very much allowed to have benefits that vary during the term without it being expressly stated at the outset. As an example, it is common in developed markets such as the UK to have an annuity linked to an index to be classified as Non-Participating as policyholders do not participate in the surplus arising within the fund. Therefore, in our opinion, so long as a product defines at the outset how the benefits would vary during the term with no discretion on the Company and the policyholders do not participate in the surplus arising within the fund, it should be classified as Non-Participating business. We therefore recommend that the Authority should permit the existence of a non-linked non-participating conventional endowment assurance, in which benefits are linked, at least in part, to an external reference point. Without such an external reference point, such products would provide relatively poor value for money as the benefits would be guaranteed in full constraining the companies to take a rather cautious view particularly on the future investment return assumed in pricing.

Section 5(a)(iii) on bonus accruals: We recommend a clarification: would a company be allowed to declare a special one-off reversionary bonus, for example on the occasion of its twenty-fifth anniversary?

Section 5(b)(ii) on Group fund-based insurance products

This section states that under Non-Par Group fund business, the additional benefits or interest credits, if any, may be accrued in advance. We recommend clarity on whether it is the declaration of the additional benefits/interest rate that is in advance or the actual crediting of the rate.

Again, in line with our comment above, our opinion is that so long as the additional benefits/interest rate at the end of the year are based on a pre-defined formula related to the actual investment returns earned by the group funds during the year, such products should be classified as Non-Participating business.

Section 7 on Minimum Death Benefits

The minimum Basic Sum Assured is defined to be not less than 105% of all the premiums paid as on date of death. This would make the Basic Sum Assured vary over the term of the policy and would be very onerous for long-term policies, particularly Whole of Life. As mentioned earlier, this would result in making the policy expensive, particularly at older ages, in order to provide a benefit that may not even be desired. We note that typically, as people age, their dependants grow up, their debts get paid off, and hence as they approach retirement they have a lower requirement for life cover.

It may perhaps be appropriate to apply this underpin on the aggregate death benefit including bonuses/additions rather than on the Basic Sum Assured.

In addition, we recommend the Authority to provide clarity on the minimum death benefit and minimum health coverage to be offered on health products.

Under Section 4 (g) (vi) of the Exposure Draft for Linked products, there is a clause on Minor lives. However, it is not found in the Draft for Non-Linked products. We recommend the Authority to clarify if this is intentional. Similarly, Sections 4(g)(iv) and (v) of the Exposure Draft for Linked products mention that the policy be cancelled in case of fraud and misrepresentation, and ineligible ages. We recommend the Authority to clarify if these sections would apply to Non-Linked products as well.

Chapter IV – Non-Linked Variable Insurance Products

a) We recommend the Authority to provide greater clarity on:
   - The charges allowed (there is no mention of mortality charge, spread) and the method of deduction of these charges
   - The minimum floor rate to be provided. For example, presumably this must be non-negative
b) **Section 10 on Non-par VIP:** In order to remove any element of discretion under the non-participating version, we would suggest that the manner in which the additional interest rate would be related to the returns earned on the backing assets be disclosed in File & Use. Further, it may allow for the companies to smooth the returns earned. Any smoothing algorithm should be disclosed in the File & Use and demonstrated to be cost-neutral.
c) We also propose that companies be allowed to write a participating VIP in a non-par fund. Charges on the policy would accrue in the non-par fund, and all expenses except investment expenses, would be also be allocated in the same fund. The monies allocated to the account value would be transferred to the participating fund. Investment management expenses in respect of these assets would also be allocated to the participating fund. Risk benefits could be paid from either participating or non-participating fund, and any risk charges would be credited to the same fund. In practice, and for simplicity, it may be best to prescribe the

fund from which risk benefits would be paid. Such a structure is fairly common for accumulating with profits business in UK, and confers several advantages both for policyholder and company. (Please see more details in the Concept Note attached).

d) **Section 11 on Par VIP:** Since all future bonuses are reserved for in any case, we propose that flexibility be provided to the company to declare the bonuses either in advance or in arrears. Declaring bonuses in advance would also simplify the treatment of intra-year claims without the need for an interim bonus rate.

e) **Section 13 on Policy Account Value:** We recommend the Authority to provide guidance on reserving for VIPs. In particular, on whether it should be on GPV basis (as in the case of non-linked business) or Account Value plus a separate reserve in respect of charges and expenses (as in the case of unit-linked business).

f) **Section 13(b) on Shadow Policy Account:** We suggest the Authority to provide clarity on the purpose of running a shadow account in the case of VIPs, particularly since this term has not been referred to subsequently in the Draft.

g) **Section 15 on hypothecation of assets and NAV**: We believe hypothecation of assets for each product separately would become unnecessarily cumbersome with no benefit to policyholders. Instead, we suggest that the funds be available to be shared amongst several Variable Insurance Products and the interest rate credited be directly related to the interest rate earned on the backing assets.

   Further, since VIP is not a unit linked product and would fall under Controlled Fund, we suggest the Authority to clarify the relevance of NAV calculation and disclosure.

Chapter V on Administration of Insurance Products: Since section 17 (a) applies to all products, we believe the requirement under 17 (b) for 'complexly designed' products is redundant and hence this clause may be removed.

Since systems implementation is an operational matter, the responsibility for certifying systems readiness should reside with the CEO instead of Board or the delegated Risk Committee.

Developing all the system requirements at the outset, especially when some of the features may become effective only late in the contract term, may not be an optimal way to manage the IT systems that get upgraded with advancement of technology. Instead of a certificate for every new product launch, we recommend that an annual certification from the CEO to the effect that the systems requirements for all the features required over the next 12 months for day-to-day operations on all the products serviced by the company have been implemented.

Section 18 on minimum policy term: We suggest that there should be no requirement for fund-based group products to be annually renewable.

Sections 19(a) on Premium Payment Term: We presume that this section applies to Non-Linked products. Please correct the typo if this were to be the case.

Section 19(a) (iii) on alterations of premium payment term or policy term: The draft appears to be permissive in nature, in that it allows, rather than mandates, companies to offer this flexibility. However, the caveat 'wherever possible' obscures this somewhat, and so we suggest that it be deleted.

Sections 20(b), (c) and (d) on commission rates: We presume that the figures provided in these sections are maximum commission levels payable rather than what is exactly required to be payable. We recommend the Authority to modify the sections to avoid any unintended interpretation.

Further, the current rate of commission on single premium group term insurance is 2% only but with no ceiling. Proposed ceiling of Rs. 50,000 will discourage intermediaries in securing the business. We therefore suggest that the ceiling of Rs. 50,000 be removed.

Section 20(f) on differential commission rates for different channels: Regulation 20(f) requires the Appointed Actuary to demonstrate the premium rates for each distribution channel arrived at independently and altogether combined.

Premiums are not generally arrived at independently in such cases. Typically, assumptions are made to reflect the expected volume from each channel and then given the commission rates and the unit acquisition costs, a single set of premium rates to be used for all channels is calculated.

Further, since commission caps already exist that apply to all products and additional RIY caps that apply to unit-linked products and VIPs, we believe that the requirement to calculate premium rates independently for all channels would not provide any additional layer of protection but would make an additional requirement in the filing process that is already fairly cumbersome.

We note also that companies may choose to distinguish between channels by expected profitability, i.e. to accept that there may be some cross-subsidy among channels. So long as the policyholder proposition is consistent, we see no harm in this.

Section 20(g) on offering better rates to Direct Marketing customers: We believe a differential charge structure for direct business could lead to customer dissonance and channel conflict. Also, while commissions are not payable for direct marketing channel, there are other costs (e.g. infrastructure) that are associated with any direct marketing sale.

In view of the above, it is proposed that companies be allowed to have the same premiums/charges across channels.

Section 21 (a) on Group Products: Group annuities seem to have been missed out in the list of permitted products. We suggest that this product be included in the list.

Section 21 (b) on Alignment: We would like to point out that the customer profile of Group Credit and Pure Term Assurance is not comparable and hence aligning the two rates is not appropriate. Demonstrating that the expense assumptions, mortality assumptions and profit margins submitted as part of the File & Use are appropriate should address the concern that is being raised by the Authority in this section.

Section 21 (d) on Group Term: We recommend the Authority to clarify whether long-term regular premium group term that is currently offered by a few players in the industry is prohibited. We would also recommend clarity on whether both employer-employee and non employer-employee groups are covered under OYRGTA.

Section 23 (b) (iv) on Product for Micro Insurance: In our view, conventional endowment assurance is not a good product category for this segment as a) this product is tax inefficient since bonuses are paid from surplus net of tax, which is particularly harsh of the economically weaker sector b) the product does not allow for premium flexibility, which is essential where incomes can be seasonal and volatile from year to year.

We would suggest that it would be better to offer a special group unit linked contract, restricted to investment in relatively safe funds such as cash and short bonds, but without any discontinued premium fund or 5-year lock-in. This product should also offer premium flexibility and liquidity, which are vital in this segment. Further, policyholder protection on surrender and maturity could be enhanced through various limitations on charges and RIY. The details of policyholder disclosure and product design could be worked out.

We suggest also, that for regular premium products, that there should be scope to pay premiums on a seasonal basis, so that the rural population, in particular that dependent on agriculture may have access to insurance.

Section 24 on surrender of group policies: We recommend clarification why the insurer should remain responsible for providing any service if the policy has been surrendered, since this would presumably imply that coverage had been terminated.

Section 25 (a) (iii) (5) on Inspection of books of Group clients: We recommend the Authority to restrict this section to non-employer employee groups. As the employer-employee groups are in any case governed by trust rules and Income Tax Act, they should already be subject to acceptable standards of governance.

Section 25 (a) (iii) (6) on the insurer's responsibility to insured group members: In circumstances where, it would appear, the member has been the victim of a fraud perpetrated by the group, which has charged him a premium but has not remitted it to the insurer, we seek clarification why the insurer should be held responsible.

Section 25 (a) (iv) on settlement of Death claims: Since the policy contract in Group schemes is with the Master policyholder, we believe that it is legally valid to make the payment to the Master policyholder, whose responsibility is it to ensure that the benefits are in turn paid to the beneficiary. In addition, for MFI schemes, there are practical challenges of non-availability of bank accounts. We therefore propose that the current practice of making the claim payments to the Master policyholder be permitted to continue.

Section 25 (b) on payments to group policyholders: We recommend the Authority to review the costs provided in this sections as a) in the case of non-employer employee groups, the member size typically is in excess of 100,000 members where the maximum ceiling of Rs 10,000 appears inadequate; b) the proposed cost of Rs. 2 per member appears inadequate for any kind of servicing as the cost of printing and couriering would be at least Rs. 10, depending on the location.

Section 26 on Surrender Value

a) It is not advisable to offer GSV on any type of immediate annuity. If interest rates rise sufficiently, this can encourage anti-selective behaviour of lapse and re-entry. However, in view of Section 113 of the Insurance Act, 1938, we acknowledge that it may be a requirement to offer a GSV. In these circumstances, we would propose that no minimum

GSV be mandated in the regulations but instead the companies should specify the GSV in the File & Use submitted to IRDA for approval.

b) We believe that guaranteed surrender values are highly sub-optimal in providing policyholder protection. However, they can still be onerous to the company and can compromise the investment strategy, which would then be harmful to continuing policyholders' interests. We suggest that the issue of policyholder protection can be better addressed through regulation of the special surrender value, and that the GSV should not be changed from the current levels.

c) We agree that the special surrender value should be based on the asset share. However, the asset share itself is currently unregulated, while the proxy asset share requires a definition.

   We note the concept of a proxy asset share for non-participating, non-linked endowments assurances. Broadly, we believe that it should reflect the accumulation of premiums, net of allocated expenses, cost of capital, profit loadings and risk charges, at the rate of return earned on the assets hypothecated to these liabilities. However, there is a considerable amount of work in refining the detail of such a definition; for example, on the expenses to be allocated to proxy asset share.

   We also agree that this should be the basis for the payout on surrender or maturity of a non-participating non-linked endowment. We note however that it would be appropriate only where the benefits payable under the contract are variable, not where they are fixed at outset in Rupee terms.

   We consider this section in conjunction with Section 5, which requires non-participating non-linked endowments to have benefits that are either fixed in Rupee terms or to allow accruals, so long as they are not linked to an index. Since this Section 26 (i) requires the surrender benefit to be related to a 'proxy asset share' and further, Section 30 (c) requires the same of a maturity value, we understand that non-par non-linked endowments will be permitted, with indeterminate future benefits at outset, so long as the accrual of these benefits is not linked to an index.

   We presume that special surrender values would be reviewable, subject to the Authority's approval. We suggest that in case of a severe crisis in the capital markets, if asset shares, on a marked to market basis, fall sharply, it could be necessary to revise special surrender values promptly, in order to protect the fund. In these circumstances a fast-track approval of any change in special surrender value would be required.

Section 32(d) on net yield calculation: We would like to highlight that currently the net yield and the RIY calculations are based on the gross yield of 10%. For the same charges, the RIY at 6% may be less. We presume that it is not the Authority's intention to have weaker RIY for non-linked VIP than for unit linked. We recommend that the RIY calculations for non-linked products be determined using a gross yield of 10%, in line with the unit-linked requirement.

We note that reduction in yield can be a somewhat nebulous concept in participating business; in particular, it may in practice be difficult to demonstrate that participating business is being administered in the manner assumed in the illustration. This is because of features common to with profits such as smoothing and the distribution of miscellaneous surpluses.

We recognise that benefit illustrations are currently produced that make an estimate of future bonus rates on a best estimate basis, given the assumed investment return. However for the purpose of calculation of a reduction in yield, guidance would be required at least on the treatment of the cost of risk benefits.

Chapter XII on With-Profits Fund Management: This is a large topic in itself and we recommend that it be covered in its own dedicated regulations, rather than as a part of product regulation. For example, there are generally far more important decisions in a with profits fund than the nature of any reinsurance.

Section 33(a) on reinsurance arrangements in a with profits fund: Reinsurance is typically effected to protect the company, to manage its capital, to maximise its profitability, etc. The benefit for the with profits policyholder is the indirect one of participating in a soundly run fund.

Further, all insurers may not be equipped to calculate policy level asset shares. We therefore propose that aggregate asset shares calculated based on representative model points be permitted for an appropriate administration of the with-profit fund.

Section 34(d) envisages formation a With Profits Committee having an oversight on various aspects related to with profits business. We welcome the initiative to enhance the governance of With-Profit funds. However, we suggest that the Committee be comprised of CEO, Appointed Actuary, CFO and the peer reviewer, essentially replacing the independent Director by the CFO, as expense allocation in most companies falls under CFO's purview.

Section 35 (b) on Market Value Adjustment: This section permits levying an MVA for bulk exits and surrenders where there is an underlying investment guarantee. We recommend the Authority to clarify whether application of MVA is still subject to the underlying investment guarantee.

Chapter XIV on Implementation: Same comments on Implementation date and new members to existing Group Schemes outlined in Linked Sections apply here as well.

Section 40 on Review of the Guidelines: We suggest that for the ongoing health of the industry, the basis of any review of the guidelines should be extended from the sole concern of protection of policyholders' interests to include the ability of shareholders to generate appropriate profits on a risk-adjusted basis.