LIFE INSURANCE

# Will new draft improve life products?

**Draft norms aim to enforce a minimum cover, demarcate between linked and non-linked plans, limit commissions and ensure surrender benefits**

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A second round of product clean-up in the insurance industry is underway. But the regulator seems to be in a hurry. The Insurance and Regulatory Development Authority (Irda) set the wheel in motion last month by circulating the draft guidelines on product makeover—with a focus on traditional insurance-cum-investment plans—even before the committee that was entrusted with the job to deliberate on the product structure came out with its final report.

*Mint Money* spoke to two members of the committee and both confirmed that discussions are still on. The committee includes Birla Sun Life Insurance Co. Ltd, HDFC Standard Life Insurance Co. Ltd, Aegon Religare Life Insurance Co. Ltd, SBI Life Insurance Co. Ltd and Life Insurance Council, an industry body, among others. Chaired by Roy Chaudhary, member, life, Irda, the committee was supposed to discuss the draft guidelines circulated by Irda about a couple of months back, suggesting a minimum sum assured in traditional plans, among other things.

With the deadline of 30 September for products to fall in line, insurers have begun to review their products. Says Suresh Agarwal, executive vice-president and head (distribution and strategic initiatives), Kotak Life Insurance Co. Ltd: "We have not filed new products as of now but we have got the ball rolling. We are reviewing our products in view of the draft guidelines."

For you, the customer, the current set of draft guidelines aim to do four things: enforce a minimum cover, have clear demarcation between linked and non-linked policies, limit the commissions for short-term policies and ensure surrender benefits. The thought is definitely in your favour, but it may not translate into customer-friendly products. Here are some of the changes suggested and what they mean for you.

### Minimum sum assured

**What's proposed?** Even traditional plans—including endowment, money-back and wholelife plans that don't disclose costs or securities in which they invest—will have to offer a minimum death cover or sum assured. This minimum sum assured, if you are below 45 years of age, according to the draft, is higher of 10 times the annual premium or 0.5 times the annual premium multiplied by the term of the policy or 105% of the premiums paid as on the date of the policyholder's death. So if you buy an endowment plan for, say, 15 years for an annual premium of ₹1 lakh, the sum assured will have to be at least ₹10 lakh. But if the insured dies in the 12th year in the same case, the sum assured will have to be at least 105% of the premiums paid or ₹12.6 lakh.

**Does it work?** A minimum threshold of protection sounds good, but not when it comes at a cost. "Unlike Ulips, where the returns fluctuate, (returns in) traditional plans are more stable. A minimum cover is okay in Ulips but in traditional plans, the cover is guaranteed and the bonus is over and above the sum assured. So if there is a minimum threshold for death cover, the insurer will be forced to compensate the high sum assured by lowering the bonus. So in terms of returns, the policies will have a disadvantage," explains V. Viswanand, director and head (products and persistency management), Max Life Insurance Co. Ltd.

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### Product classification

The draft guidelines have given birth to another category of investment products: index-linked insurance plans. Earlier, such plans were being sold under the traditional banner in the non-participating category of products. A non-participating or non-par plan does not participate in the profits of the fund and so the insurer needs to clearly define the benefits right at the beginning. But these products didn't fit in well with the definition of non-par products. According to the regulator, the benefits were pegged to an index but the costs were not disclosed, making it difficult for customers to understand the final benefit.

**What's proposed?** Under the draft guidelines, the insurer can peg benefits to an index. But these products will need to clearly mention the mortality cost and also implicitly indicate other costs through the benefit table. This is a digression from the earlier draft which sought to make these products transparent with cost caps.

In the previous draft, the one that the committee has to deliberate upon, these products were supposed to conform to the guidelines as specified for variable insurance plans or VIPs. They were to disclose costs such as mortality costs, expenses and commissions and also adhere to cost caps. Under VIPs, the maximum an insurer can charge in year one is 27.5% of the premium. This cap, barring mortality charge, includes all other costs such as commissions and expenses. In the second and third years, this cost is capped at 7.5% and subsequently, at 5%.

**Does it work?** But the current set of guidelines doesn't make it mandatory either to disclose costs, barring the mortality cost, or conform to cost caps. According to the guidelines, the table of benefits shall clearly indicate the value of benefits in relation to the specific value of any approved index and implicitly reflect the charges that the insurer has allowed. In other words, you may still be left a little confused with regard to the final benefit—a problem these guidelines were supposed to address.

The other danger is the possibility of an index-linked product deluge where the costs are not capped. "There does not appear to be a cap on the charges. It is okay if the costs are not explicitly disclosed as long as there is some cap on costs. Ideally, there should be a cap consistent with the Ulip guidelines," says Kapil Mehta, managing director, SecureNow Insurance Brokers Pvt. Ltd.

### Commissions

The current draft has increased the cap on commissions from what was suggested in the previous draft, but broadly it is consistent with the previous draft since it aims to cap commissions for shorter tenor policies. For a policy with a term of 5-9 years, the maximum that an agent can earn from your money is 14% in the first year and 5% subsequently. For tenors up to 14 years, the commissions is capped at 28% in the first year, 7.5% in the second year and 5% in the third year. For policies that are for 15 years or above, the cap on commission is still guided by the Insurance Act. In other words, if the company is more than 10 years old, it can charge up to 35% in the first year. For younger companies, this cap is 40%.

### Surrender value

This is another area that needs more attention than what it gets currently.

**What's proposed?** The draft says that a traditional policy will be eligible for a guaranteed surrender value after two years if the policy tenor is less than 10 years and three years if the tenor is above 10 years.

**Does it work?** Insurers have been offering a guaranteed surrender value of 30-40% of the sum of all premiums paid till date minus the first-year premium. But if policies are surrendered before three years, insurers often don't return any money.

Now at least there are guidelines on when a person becomes eligible for a surrender value but it doesn't still specify how the insurers will arrive at the surrender value.

There are two kinds of surrender values: guaranteed and special surrender value. The guaranteed surrender value has been explained above. But the special surrender value is the current market value of the assets held against the policy and hence is usually higher than the guaramteed surrender value. However, usually it is the minimum guaranteed surrender value that is paid out; only a few insurers promise to pay the higher of the two guarantees. The draft guidelines are quiet on this front.

The regulator will need to address these concerns to make insurance products work for you. The good news is these guidelines are still being argued. Watch this space for updates.