# In Covid-19, the rural job plan was a big safety net

hindustantimes.com/opinion/in-covid-19-the-rural-job-plan-was-a-big-safety-net-101666445048539.html

October 22, 2022

The insurance regulator's December 12 draft on product regulations has led the life insurance industry, which had an annual premium collection of almost ₹7 lakh crore in the financial year 2021-22 to go into a huddle. It has caused the stock prices of insurance companies to fall in a rising market. However, the group that should be cheering — the prospective policyholder — is clueless about the impact of these draft regulations.

The Insurance Regulatory and Development Authority of India (IRDAI) has taken a baby step to potentially reduce the costs that a policyholder must bear in a traditional plan (money back, endowment, child plan) when she surrenders the policy earlier than the maturity period

The Insurance Regulatory and Development Authority of India (IRDAI) has taken a baby step to potentially reduce the costs that a policyholder must bear in a traditional plan (money back, endowment, child plan) when she surrenders the policy earlier than the maturity period. The biggest benefit will be for the policyholder who exited after just one premium and got nothing. If the draft goes through, she will henceforth get something back. However, the draft is weak in that it allows insurance companies a long rope to decide how much they want to return. This means the regulator is asking the industry to decide how much it will take away, instead of writing the regulation.

IPL 2024 Auction is here! Catch all the updates LIVE on HT. Join Now
The current traditional life insurance- cum-insurance product is built like a trap. Investors are hard-pressed by agents and banks that stand to gain almost the entire first-year premium as first-year commission. Agent commissions fall drastically after the first sale has been made, making them less concerned with policy renewal than with the sale of new products. In fact, investors are encouraged to close old policies and buy new ones after a few years by commission-maximising agents.

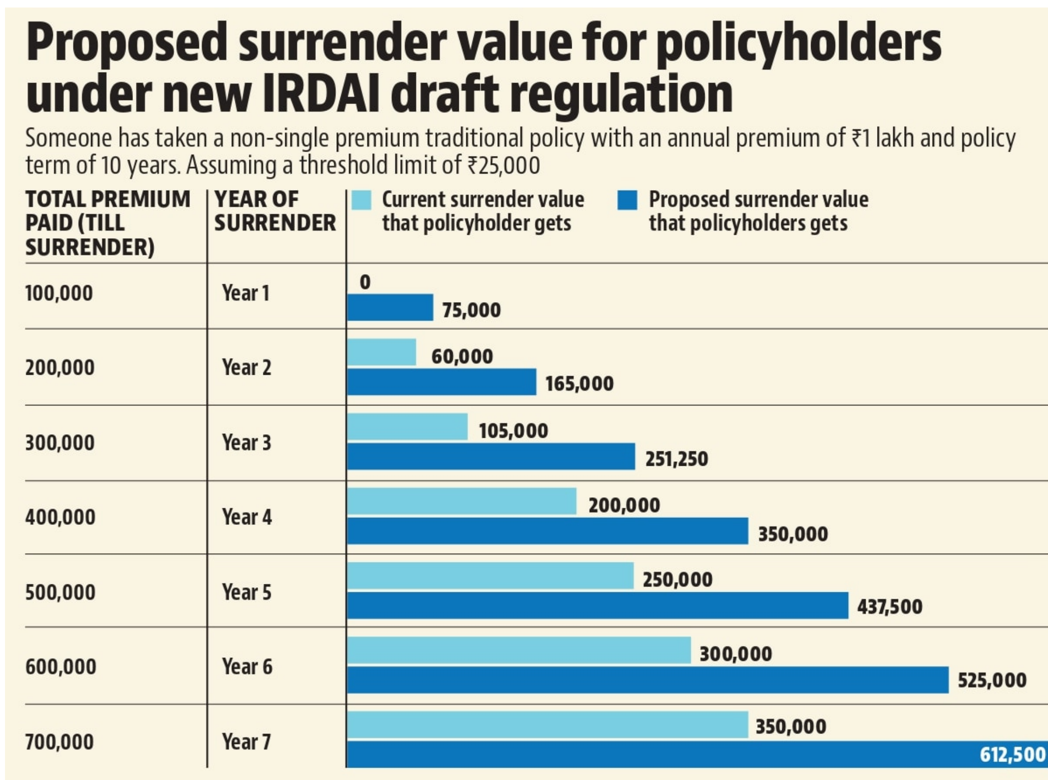
The investor, who wants to discard the policy in the subsequent years, finds huge surrender costs. These costs gouge away all the money in the first year, 70% of the premiums paid in the second and third years, half the money from the fourth year to the seventh year and then, a sliding scale of surrender costs till the maturity of the policy. These costs are never mentioned upfront at the point of sale by agents who took home annual commissions of almost ₹36,000 crore in FY22.

We only have to look at persistency numbers to see how the industry haemorrhages investor money each year. Traditional insurance is a long-term product with a tenure of 15 or more years. However, the FY 2021-22 data shows that the 61st month persistency is just about 44%. This means more than half the investors quit the policy within a five-year period after having bought a long-term product.

Given the surrender value formula, this means that over half the policyholders get less than half their capital back. Life insurance that combines investment is a long-term product that gathers a maturity value as it ages. But if more than half the policies do not even reach year six of the policy, then it should worry policymakers and regulators.

Firms in this ₹50 lakh crore assets under management industry have built this percentage of lapsation and surrender into their calculations as they benefit from the current high surrender costs. They book the surrendered premiums as profits. Insiders share that profit projections take into account persistency numbers as low as 30% to show higher profits.

These profits are nothing but the money gouged out from exiting investors. Insiders also share that the 10th, 15th and 20th-year persistency is a real cause for worry, making it uncertain as to who exactly the industry serves. The policyholder or its profits at the cost of the investor?




Proposed surrender value

IRDAI’s draft aims to dent this glaring misuse of investor money. The draft has given a new formula to the industry. The firms need to decide on a premium refund threshold — or the amount of premium that gets refunded no matter when the investor exits. Added to this is a percentage of the current guaranteed surrender value. In the illustration used in the draft, the formula for refund is 75% of total premiums paid plus 25% of the guaranteed surrender value. The illustration assumes a policy with an annual regular premium of ₹1 lakh. This policy would return nothing to the investor if he did not pay the second premium with the older rules. But the new rules say he would get ₹75,000 back, which is 75% of premiums paid. Earlier, if two premiums were paid, that is ₹2 lakh, and the third was not paid, the investor gets ₹60,000 back. Under the new rules, she gets back ₹1.65 lakh. After seven premiums, the total premiums paid are ₹7 lakh. If the 8th premium is not paid, the investor would have got back just ₹3.5 lakh, but under the new rules will get ₹6.13 lakh back as a surrender value.

There are two flaws in this. One, even in the illustration, there is still too much meat left on the bone for the industry — a 25% or so haircut just because the investor changes her mind is a cruel punishment. Two, IRDAI is leaving the decision of fixing the return percentages to the insurance company itself. This means that insurance firms can fix low return values and continue their investor gouging.

Even this baby step will see a barrage of pushback from the industry. It would be a very sad day for investors in life insurance should IRDAI retract from this small step forward. Few people have escaped the clutch of an insurance agent selling a toxic trap in the name of life insurance. This is a step too little, too late.

*Monika Halan is the author of the best-selling book Let’s Talk Money. The views expressed are personal*

Unlock a world of Benefits with HT! From insightful newsletters to real-time news alerts and a personalized news feed – it's all here, just a click away! -Login Now!