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In a move that could potentially provide some relief to the Indian life insurance sector, the IRDA has released an exposure draft on pension products, proposing to withdraw the earlier requirements for these products to guarantee a minimum accumulation rate on invested premiums.

Separately, the IRDA has also issued guidelines on standardising the calculation of net asset value (NAV) for unit-linked funds and procedures for the approval of new fund offerings.

Exposure draft on pension products

In response to persistent industry lobbying, the IRDA has proposed to withdraw the earlier requirements for the pension products to have a guaranteed minimum accumulation rate (originally 4.5% p.a.) on invested premiums.

The main highlights of the exposure draft are:

- A pension product should provide a guarantee at the vesting date, in the form of either a minimum non-zero return on invested premium or a minimum maturity benefit guarantee or a guaranteed annuity rate. The quantum of such guarantee is left open (subject to IRDA's approval), but insurers will be required to disclose details of the guarantee at the point of sale.
- At the date of surrender or vesting, the policyholder should be given an option to commute up to one-third of the amount realised, and the remaining balance will be used to purchase an annuity, guaranteed for life, at the then-prevailing pension rate approved by the IRDA.
- The exposure draft states that the annuity at the time of vesting should be provided by the same insurer that offered the original pension (i.e., accumulation) policy.
- The pension products may now have only optional insurance cover throughout the deferment period or may have riders attached.
- If the policyholder dies during the deferment period, the nominee should be entitled to either withdraw the entire proceeds or use all or part of the proceeds to purchase an annuity at the then prevailing pension rate.
- In addition to complying with the existing sales literature guidelines released by the Life Insurance Council, insurers will be required to provide the following at the time of sale:
  - Target purchase price of immediate annuity at vesting (determined as the accumulated value of the premiums paid at illustrative rates of 4% and 6%), which is expected to meet the policyholder's pension needs after allowing for commutation.
  - This purchase price will be determined considering the policyholder's premium payment capacity, issue age, vesting age and expected future conditions.
  - Target pension rates at vesting (determined as the annuity that the policyholder expects to receive at vesting at illustrative rates of 4%and 6%, in return for the target purchase price).
  - Possible risks involved, if any, in meeting the targeted purchase price or the target annuity rate.
- All unit-linked pension products shall comply with the IRDA (Treatment of Discontinued Linked Insurance Policies) Regulations 2010, imposing restrictions on the surrender and other charges on such products.

Guidelines on the NAV calculations

The main aspects covered under these guidelines, which will become effective on 1 October 2011, include:

- The computation of the NAV: The IRDA has removed the requirement to use the erstwhile 'appropriation' and 'expropriation' pricing methodology to determine the NAV under unit-linked funds.

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- Other procedural matters covering:
  - The operation of segregated funds
  - The process to be followed for creating and redeeming units, including a requirement to reconcile the number of units derived from the investment accounting system and the policy administration system on a daily basis
  - The preparation of the daily cash-flow statement
  - The creation of security masters for equity and debt investments and related procedures
  - The accounting procedures for primary market deals and the accounting and authorisation procedures for secondary market deals
  - The settlement process for various trading operations and the treatment of various banking operations
  - The treatment of fund management charges and dealing costs

Fund approval procedure

The main requirements include:

- A segregated fund identification number (SFIN) has to be created for all unit-linked funds. The SFIN for existing funds has to be filed with the IRDA before 30 September 2011.

- For new products that offer existing funds, the details of investments in various asset classes have to be submitted in a format provided by the IRDA.

- For all new fund offerings post 1 August 2011, companies are required to submit the File and Use document, certifications from the Appointed Actuary, chief investment officer and chief financial officer, along with the proposed investments in various asset classes in a format provided by the IRDA.

Our observations

Most insurers had withdrawn from the unit-linked pensions market following the earlier requirements from IRDA for these products to have a guaranteed minimum accumulation rate as determined by the IRDA. Now that insurers have been given the freedom to determine the quantum and nature of the guarantees they offer on pension products, some insurers may consider re-entering this segment.

Given the proposed removal of the ‘open-market option,’ private sector insurers will now be required to compete with the LIC on the immediate annuity rates in order to present an attractive pensions savings contract. Some private sector insurers will find this a major challenge.

The removal of the requirements to use ‘appropriation’ and ‘expropriation’ pricing methodology in the calculation of the NAV under unit-linked funds will result in inequity amongst different sets of unit linked policyholders. This will also breach the earlier equity principle outlined by the IRDA in its Guidelines for Unit-linked Products 2005, which stated that “the interests of policyholders who have purchased units in that fund and not involved in a unit transaction should be unaffected by that transaction.” We understand that the suggested removal of the requirements for ‘appropriation’ and ‘expropriation’ methodology in NAV calculation is to standardise the existing different practices adopted by the insurers arising due to widespread misunderstanding of the earlier equity principle and how it was required to be implemented in practice.

The new fund approval procedure appears to be a step in the right direction in ensuring regulatory oversight over investments in unit-linked funds.

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