Asia e-Alert

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# Final guidelines for pension products in India

Following publication of an exposure draft on guidelines covering pension products in August 2011, the Insurance Regulatory and Development Authority (IRDA) has now released its final regulations.

The new rules become effective from 1 December 2011, and existing pension products that do not comply will have to be withdrawn by 1 January 2012.

The guidelines apply to unit-linked, non-linked, and variable insurance plan (VIP) type pension products, and individual as well as group products.

In India, “pension” products sold by life insurance companies include individual deferred annuity contracts (providing accumulation and annuity payouts) and group deposit administration contracts (known as superannuation), which are written in funds that offer tax benefits under section 10(23AAB) of the Income Tax Act, 1961.

## Main provisions in the guidelines

The main provisions in these guidelines include:

- All pension products shall have an explicitly defined “assured benefit” disclosed at the time of sale.
- The “assured benefit” is defined to provide at least one of the following guarantees:
    - ✓ A minimum non-zero return on all the premiums paid, which shall be disclosed at the time of purchase of the contract.
    - ✓ A guaranteed maturity benefit, death benefit, or surrender benefit in absolute terms, which shall be disclosed at the time of purchase of contract.
- Optional life insurance cover can be offered as a rider during the deferment period. However, the sum of all rider premiums shall not exceed 15% of the premiums paid for the pension policy.
- On surrender after the lock-in period (not defined in the guidelines, but interpreted to mean five years in the case of unit-linked plans and three years in the case of non-linked plans), the policyholder shall have the option to:
    - ✓ Commute one third of the surrender proceeds into a lump sum and utilise the balance to purchase an immediate annuity; or
    - ✓ Utilise the entire surrender proceeds to purchase a single premium deferred pension product. (It is unclear if such a deferred pension product is required to be offered on guaranteed annuity terms or otherwise) .
- On maturity, the policyholder shall have the option to:
    - ✓ Commute one third of the maturity proceeds into a lump sum and use the balance to purchase an immediate annuity; or
    - ✓ Utilize the entire maturity proceeds to purchase a single premium deferred pension product. (It is unclear if such a deferred pension product is required to be offered on guaranteed annuity terms or otherwise); or
    - ✓ Extend the accumulation/deferment period in the same policy, provided the policyholder is less than 55 years of age.
- On death during the deferment period, the nominee has the option to:
    - ✓ Use the entire death proceeds of the policy to purchase an immediate annuity; or
    - ✓ Withdraw the entire death proceeds of the policy.
- The annuity payout is required to be provided by the same insurer who contracted the original pension (i.e., accumulation) policy.
- All individual unit-linked pension products shall comply with the IRDA (treatment of discontinued linked insurance policies) Regulations 2010, which among other things, place restrictions on the surrender penalties that can be levied upon surrenders.

There are explicit requirements covering point-of-sale disclosures and ongoing policyholder communications. Among other things, pension providers are required to show an illustrative “target purchase price” of pension payouts at maturity (i.e., the accumulated sum at maturity) and an illustrative (non-guaranteed) “target annuity rate” at the time of vesting, based on bases specified in the guidelines (i.e., at interest rates of 4% pa and 8% pa).

## Industry reactions

The final guidelines have disappointed much of the industry.

Although IRDA has removed the requirement in the draft guidelines to offer guaranteed annuity rates, many of the other suggestions made by the industry for the revival and orderly growth of the pensions business have not been considered. In particular:

- The final guidelines do not provide an “open market option” at the time of annuitisation and instead require the policyholder to annuitise with the same company that offered the original pension contract.
- Upon surrender, the rules require either a compulsory immediate annuitisation or the purchase of a single premium deferred pension contract. The option of compulsory annuitisation may not necessarily be in the interest of the policyholder given the likely low levels of annuity payouts as a result of the low surrender values in early durations and unattractive immediate annuity rates at a young age. The deferred pension option based on guaranteed deferred annuity rates (if decided at the time of product approval), on the other hand, would involve significant risk for the insurer.
- The final guidelines do not offer a facility to make the surrender values portable across different insurers.
- It is unclear how the final regulations will be applied to group pension products, since under such products, guarantees are required to be applied to the entire policy, even though the individual member benefits are governed by the specific scheme rules.
- The disclosure requirements specified in the final guidelines do not consider the impact of inflation on policyholder benefits. Consequently, there may be a risk of policyholders purchasing inadequate pension benefits.

The IRDA has, however, removed the existing 4.5% pa investment return guarantee, with insurers now having the option to specify the level of guarantees they wish to offer in their pension products.

We now must wait to see if these final guidelines will lead insurers to reintroduce pension products to help revive the ailing pension sector.

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