**Actuarial Practice Standard (APS) 5: Appointed Actuary and Principles Of Life Insurance Policy Illustrations**

Classification: Practice Standard

**Legislation or Authority:**

1. The Insurance Act 1938 and amendments thereto (hereinafter referred to as the Act).
2. Insurance Regulatory and Development Authority (Appointed Actuary) Regulations 2000 - (hereinafter referred to as “AA Regulations”).
3. Insurance Regulatory and Development Authority (Linked Insurance Products) Regulations, 2013, Insurance Regulatory and Development Authority (Non-Linked Insurance Products) Regulations, 2013 and subsequent clarifications dated 20 June 2013 issued in this regard (hereinafter collectively referred to as “Product Regulations 2013”)
4. Actuarial Practice Standard 1 - Appointed Actuary and Life Insurance Business , issued by the Institute of Actuaries of India, (hereinafter referred to as the APS1)
5. Life Insurance Council’s circular LC/SP/SI/VER 1.0 dated 3 February 2004 on Sales Illustrations (hereinafter referred to as “Life Council’s circular”).
6. GUIDANCE NOTE (GN) 6: Management of participating life insurance business with reference to distribution of surplus

**Application**

This Actuarial Practice Standard (APS)is applicable to an Appointed Actuary, appointed in accordance with provisions contained under AA Regulations.

The purpose of this APS is to define the framework within which the Appointed Actuary shall discharge the responsibilities as required by the “Life Council’s circular”, “Product Regulations 2013” and Para 4.3 of APS1.

**Status**

Issued under Due Process in accordance with the “Principles and Procedures for issuance of Actuarial Practice Standards (APSs) (Version. 2.00)”

This Actuarial Practice Standard shall constitute “Professional Guidance” within the meaning of Regulation 2 (1) (e) of the AA Regulations.

Version: 1.00 effective from 01 01 2004

Version: 1.01 effective from 01 07 2011

Version: 1.02 effective from dd mm yyyy

**1. The Framework**

1.1 The Framework for illustrations is set out in Sections 3 and 5 of the ”Life Council’s circular”, Section 43 of IRDA (Non-linked product) regulations 2013 and Section 40 of IRDA (linked products) regulations 2013, and the relevant portions are reproduced in the Annexure 1.

**2. Explanatory Notes to the provisions of “Life Council’s circular”, Product Regulations**

The following notes are by way of interpretation/clarification of the provisions of the Life Council’s circular:

* 1. For the purpose of this Actuarial Practice Standard “Sales Illustrations” or “Illustration at the point of Sales” would mean the document signed by an authorised official of the Life Insurer or the authorised intermediary of the Life Insurer, containing policy benefit information/illustration based on which the sale has been concluded.
  2. The requirement to review illustrations at least once a year under section 3 (e) of Life Council’s circular refers to the Life Insurance Council laying down the investment return assumptions to be used in the illustration basis, at least once every year.

The provision, in general and more so for participating business, is understood to mean that the insurer should review at least annually (and at any other time when the Life Insurance Council issues revised projection rates) the subsidiary assumptions in the illustration basis, in the context of the investment return assumptions as specified by the Life Insurance Council. Subsidiary assumptions will include bonus rates assumption, following as a consequence for conventional type participating plans, expense assumptions including inflationary increases in expenses and any other matters relevant for the illustration basis.

While reviewing the subsidiary assumptions for the purpose of benefit illustrations, the Appointed Actuary should have regard to the bases used in the asset share calculation as approved, if applicable, by the With-profits committee for the calculation of asset shares.

* 1. Section 5(1) of the Life Council’s circular requires insurers to issue official illustrations to customers directly or through licensed intermediaries. This requirement is in relation to the business written in India and shall also apply to products approved by IRDA sold overseas by an Indian insurer. However, this shall not be applicable to products not approved by IRDA that may be sold by an Indian insurer outside India, whether through an overseas subsidiary or a branch. For all products sold outside India by an Indian insurer, the Appointed Actuary shall have regard to the regulatory requirements and the territory in which such business is written. In case there is no such guidance available in the territory then the Appointed Actuary at his sole discretion may use the principles outlined herein as Guidance.
  2. Section 5 (4) of the Life Council’s circular prescribes a gross investment return assumption of 6% and 10% respectively for the lower and higher rate referred to in section 5 (3) of the said circular. However, clarification 16 to IRDA (Non-Linked Insurance Products) Regulations, 2013 mentions gross rates of “ 4% and 8% or as may be specified by IRDA or Life Insurance Council from time to time”. Since the Regulations are more recent than Life Council’s circular, the companies shall use 4% and 8% for the purpose of illustrations. These rates shall be revised as prescribed by the Regulator or Life Council as and when these are updated. The Appointed Actuary shall not use a rate which exceeds the higher rate. However, the Appointed Actuary is free to use a lower rate than the optimistic view and/or a lower rate than the conservative view, if so required in his professional judgment. The table/s, illustrating the values based on the two sets of returns should specifically state the assumed rates of investment returns.

**3. Role of Appointed Actuary**

* 1. It is a requirement under Para 4.3 of APS1, that the Appointed Actuary must take all reasonable steps to ensure that new policyholders are not misled with regard to their expectations, e.g. in connection with illustrations at the point of sales. The Appointed Actuary should be cognizant of the fact that the benefit illustrations play an important role in setting policyholders’ reasonable expectations and therefore he/she should satisfy himself/herself that the illustration is designed, subject to regulatory requirements, to create policyholders’ expectations that are supportable.
  2. Submission of a policy illustration together with the underlying assumptions is generally a requirement under the “File and Use Procedure” of the IRDA of India for product approval and as such illustrations for new products must be filed with the IRDAI in the File and Use application.
  3. In order to meet the requirements of Clause 5(2) of the Life Council’s circular, the Appointed Actuary must take steps to ensure that the illustrations are clear and fair to enable the customer make an informed decision. The procedure in each company should be that the sales illustration is issued by the Management of the Company under advice from the Appointed Actuary.

1. **Guiding Principles** 
   1. The main objective of illustrations should be to educate the potential customer about the insurance product on sale and thus assist them in developing a proper understanding of the features of the product and the flow of benefits in different circumstances, with some level of quantification.
   2. In the context of creating policyholders’ reasonable expectations, illustrations play a significant role and accordingly illustrations can have an effect on the Appointed Actuary’s assessment of the financial condition of the company. Thus the Appointed Actuary has a duty to advise on them in much the same way as he has in other areas, for example, adequacy of premium rates. This is particularly true of participating products and market linked products where illustrated benefits are a function of assumptions as to the future, in particular, the expected investment returns.
   3. Illustrations for a product should be consistent with the terms and conditions of the product as filed with the IRDAI, wording in the policy document and company practice; in some cases it may be appropriate to indicate that further information will be made available on request.
   4. Important information should not be withheld, e.g. likely conditions upon which the illustrations would not be valid.
   5. Overly complex illustrations can confuse more than explain; the Appointed Actuary needs to ensure, subject to regulatory requirements, that the content of the illustration is such that, the key messages are not lost.
   6. There is some trade-off between putting in all possible information, and keeping an illustration simple. Subject to meeting regulatory requirements, the Appointed Actuary should make a practical decision as to whether additional information serves to inform or confuse the target market. For certain target markets such as the rural markets or direct marketing a different form of illustration may be used, provided this form of illustration has also been filed with the IRDAI.
   7. It is the role of the management of the Company, to ensure that intermediaries and the employees responsible for sales receive appropriate training and are supervised and monitored with regard to the use of policy illustrations. However, if it comes to the knowledge of the Appointed Actuary that this is not the case, the Appointed Actuary shall advise the management of the company for appropriate action.
   8. Guaranteed benefits

Guaranteed benefits should be clearly distinguished from the non-guaranteed benefits. The circumstances in which the guaranteed benefits would be available and the applicable conditions, if any, should be clearly stated.

As per clarification 16 to IRDA (Non-Linked Insurance Products) Regulations, 2013, the customised benefit illustrations are not required in the case of products where all benefits are assured in absolute terms at the outset of the contract. It is clarified that if a product offers assured death and maturity benefits but offers a surrender benefit that is higher of Guaranteed Surrender Value and Special Surrender Value, which can be varied in the future, then customized benefit illustrations are required for such a product.

Further, it is clarified that this clause is not applicable for products whose benefits vary depending on future market conditions, even though the extent of such variability in benefits may have been guaranteed at the outset of the contract. For such products, the requirements of Clause 5(2) of the Life Council’s circular would apply; i.e. the benefit illustrations shall be based on two views of investment returns - higher rate and lower rate - to demonstrate the potential variability in the guaranteed benefits under different market conditions.

* 1. Non-guaranteed or variable benefits  
     1. The illustration of non-guaranteed or variable benefits shall be based on assumptions about future experience, such as investment return, taxation, mortality, morbidity, expenses , terminations by lapse or surrender and discontinuance of premiums leading to a policy becoming paid up.
     2. The assumptions for illustration should be appropriate to the product and should take into account the past experience, if available, and the Appointed Actuary’s view of the assumptions for the future. If they are different from the assumptions based on the review carried out at the start of the financial year, the Appointed Actuary must justify the same. The investment return assumption used in the illustration must be in line with section B (d) above.

In case of participating products, the Appointed Actuary should have regard to the sources of surplus in which policyholders are participating, assumptions and methods related to asset share calculations as approved by the With-profits committee.

For the purpose of illustrating discretionary benefits such as non-guaranteed surrender value, the Appointed Actuary shall have regard to the Company’s existing policy/philosophy used to set these benefits and also GN6 in the case of participating products.

* + 1. In the case of unit linked plans or Variable Insurance Plans an illustration shall include full description of all charges i.e. amounts of all types of charges debited against the policyholders’ premiums or unit account, in the case of an ongoing policy such as

- Premium Allocation Charges  
- Policy Administration Charges  
- Fund Management Charges, including Investment Guarantee Charges if any  
- Mortality and Morbidity charges

The illustration should allow for the loyalty additions, if any, in the product as well as the effect of taxation.

In the case where the company has the right to increase expense charges in line with inflation the Appointed Actuary should use for the purpose of illustrations the expense charges increased at inflation rates as appropriate to the higher rate and lower rate set by the Life Insurance Council.

* + 1. In the case of conventional type participating plans, premiums are paid to purchase guaranteed benefits (in the form of sum assured) and non- guaranteed benefits (in the form of bonuses). The assumptions underlying the values of non-guaranteed benefits illustrated should further be governed by the provisions in (b) above. The Appointed Actuary should bear in mind that bonus rates themselves can be misleading and therefore may consider providing additional information on the rate of return achieved in a suitable form, taking care that the customer is not misled or misinformed. The Appointed Actuary should determine suitable rates of bonus for each of the higher and lower rates that, in the judgment of the Appointed Actuary, are appropriate and supportable under the investment return rates used in the illustration taking into account all the relevant factors.  
         
       For the purpose of determining the appropriate and supportable bonus rates, the Appointed Actuary should also consider the determination of insurer’s asset share philosophy in particular the expenses charged to asset shares and also the level of asset share it intends to pay in different contingencies.

In the case where the company intends to increase expense charges to asset shares in line with inflation, the Appointed Actuary should use for the purpose of illustrations, the expense charges increased at inflation rates appropriate to the higher rate and lower rate, allowing for future productivity improvements if the Appointed Actuary considers it appropriate.

With a view to providing a framework for interpretation of PRE in the case of participating plans, the Appointed Actuary shall disclose in the Notes to the Benefit Illustrations the sources of surplus that are expected to be recycled to policyholders and any constraints on such distribution. This would need to be consistent with the asset share calculation methodology of the with-profit fund.

* 1. Lapses, Surrenders and non- forfeiture provisions   
     1. The Appointed Actuary should ensure that the options and benefits available in circumstances such as discontinuance of premiums before the policy acquires any value and after the policy acquires a paid up and / or surrender value, are clearly spelt out together with the applicable conditions. This is particularly important in case of discontinuance of premiums or terminations at early durations when the available benefits would be very low or nil.
     2. The Life Council’s circular provides that a Company may show illustrative surrender values. If the illustration shows surrender values, it should clearly distinguish between guaranteed and non- guaranteed surrender values. In the case of the latter, the policyholder should be told how long the current non guaranteed surrender values would be applicable and should be encouraged to check with the company the available non guaranteed surrender values thereafter.
     3. Similarly where benefits are contingent upon policyholders exercising (or not exercising) certain options, then these options should be clearly spelt out; it may be appropriate for the illustrations to reflect the differences that such options can cause.
     4. The Appointed Actuary should ensure that the calculations in the illustrations are checked and should document all the assumptions underlying the calculations along with suitable justification, wherever necessary.
     5. Whenever the IRDAI/Life Insurance Council revises the investment return rates, the Appointed Actuary shall carry out a review of and revise the assumed bases for illustrations for all types of plans and have the revised illustrations approved by the Board of the company.

Annexure 1:

**I) Extracts from Life Insurance Council’s circular LC/SP/SI/VER 1.0 dated 3 February 2004 on Sales Illustrations**

Section*3: Brochures*

*“(1) Every Insurer carrying on life insurance business shall :-   
  
(a) ensure that the brochure shall be written in simple, unambiguous and easily comprehensible language and that there is no statement, which may lead to a misunderstanding;   
  
(b) discontinue any brochure which becomes misleading following any material change of circumstances;   
  
(c) ensure that any reference to past performance in the sales illustration, if used by it, shall be appropriate to the product being illustrated and shall include a statement to the effect that past performance may not be a guide to future performance, which may be different;   
  
(d) ensure that the sales illustrations clearly distinguish between guaranteed and non-guaranteed benefits and state that the quantum of benefits in respect of non-guaranteed products may vary;   
  
(e) review the assumptions in its sales illustrations at least once in a year, and where the assumptions are no longer valid, revise the sales illustration.*

*(2) No Insurer carrying on life insurance business shall issue or use a brochure providing information on benefits where such information is inconsistent with terms and conditions as filed with the Authority.”*

Section 5: Illustrations

*“(1) Every insurer carrying on life insurance business shall provide official illustrations to customers directly or through their licensed agents and intermediaries for all products.   
  
(2) All illustrations shall be prepared in consultation with the Appointed Actuary and be authorized for use by the Board of Directors of the Company and, that the illustrations shall be clear and fair to enable a customer to make an informed decision.   
  
(3) There should be 2 views on rate of return on investments of funds (the rate) that are illustrated – a higher rate and a lower rate. The rates to be used are as set by the Life Insurance Council from time to time and all the Life Insurance Companies shall use the same rates. All charges in respect of fund management and policy charges are to be deducted from the gross investment return assumption. For the avoidance of doubt this means that illustrations based on higher and lower rates of return should show a projected fund value after all charges associated with the policy and investment of funds have been deducted. No Insurer carrying life insurance business shall issue illustrations in any other way.   
  
(4) All illustrations shall be reviewed at least once a year in the month of April. The Life Insurance Council may, if required by the IRDA, set a higher and lower projection of interest rates more frequently than annually. The initial rates to be used in projections are 10% p. a. and 6 % p. a.   
  
(5) All the insurers carrying on life insurance business shall be free to use a lower illustrative rate than that is fixed if it so desires. However, under no circumstance, higher rates than those set by the Life Insurance Council shall be used.   
  
(6) Standard common language be employed vis-à-vis statutory warning on all illustrations. The following phrase must appear on the front page of illustrations in the same font size as the rest of the text: “Some benefits are guaranteed and some benefits are variable with returns based on the future performance of your Insurer carrying on life insurance business. If your policy offers guaranteed returns then these will be clearly marked “guaranteed” in the illustration table on this page. If your policy offers variable returns then the illustrations on this page will show two different rates of assumed future investment returns. These assumed rates of return are not guaranteed and they are not the upper or lower limits of what you might get back, as the value of your policy is dependent on a number of factors including future investment performance.”   
  
(7) All policy, fund management and other policy charges payable by customers shall be included explicitly within the illustration tables.   
  
(8) Indicated within the illustration shall be the Company’s policy on surrender values. A Company may show illustrative surrender values if it wishes and should indicate whether or not guaranteed.”*

**II) Section 40(Linked Product Regulations): Customized Benefit Illustration:**

*a. The benefit illustrations shall be as shown as per the gross investment returns prescribed by the life council which are currently 4% and 8% and the corresponding yield shall be demonstrated only with respect to gross investment return of 8% p.a.*

*b. The customized benefit illustration shall include all charges as applicable, service tax and fund values including commission /brokerage payable.*

*c. The net yield and hence reduction in net yield as calculated, shall be disclosed in the benefit illustration indicating the corresponding gross yield figures.*

*d. The benefit illustration shall be as prescribed in Annexure V\_A for Unit Linked products and V\_B for Variable Linked Products.*

**III) Section 43 (Non-Linked Product Regulations): Benefit Disclosure:**

1. *All insurance products shall provide prospective policy holder a customized benefit illustration. Illustrating the guaranteed and non-guaranteed benefits at gross investment returns of 4% and 8% respectively and as specified by IRDA or Life Council from time to time.*
2. *Such benefit illustration shall be signed by both prospective policy holder & the intermediary and shall form part of the policy document.*
3. *The benefit illustration as approved under the file and use procedure shall be part of the sales literature and shall be furnished to the prospective policy holder along with sales literature before concluding the sale.*
4. *In case of non- linked variable insurance products:*
5. *The benefit illustrations shall be shown as per the gross investment returns of the 4% and 8% respectively and subsequently at the rates prescribed by the life insurance council from time to time and corresponding net yield shall be demonstrated only with respect to gross investment return of 8% p.a.*
6. *The net yield and hence reduction in net yield as calculated, shall be disclosed in the benefit illustration indicating the corresponding gross yield figures.*