

# Projected Policy Values (Case Study L2)

Group 4: Indian Fellowship Seminar  
December 2013

# Agenda

- ▶ Introduction – problem statement
- ▶ Missing charges – right thing to do?
- ▶ Missing charges – not the right thing to do – why?
  - What do regulations say?
  - Circular by Life Council
  - PCS
  - APS
  - Customer expectations, TCF
  - Other guidelines
- ▶ Next steps – Pricing Actuary
- ▶ Next steps – Actuarial Function Holder (AFH)
- ▶ Wider Issues to Consider

# Introduction – problem statement

Marketing Manager asks the Product Actuary to design a product which meets the conditions:

- Company's profit criterion
- Results in projections that are highest in the market

Product Actuary finds out that this can be achieved only if charges are not allowed for in the projections

Not allowing for charges – do not tell the whole truth – is this right?

# Missing charges – right thing to do?

- ▶ Ethical – dictionary definition – morally good or correct; moral principles that govern a person's behaviour or the conducting of an activity
- ▶ As a professional, must recognize that the views of others may be valid
  - Any other points of view to the problem?
  - Product Actuary/Marketing Manager right?
  - Any other product design possible?

# Missing charges – right thing to do?

- ▶ Assumptions made:
  - charges non-reviewable or if reviewable, need to be filed with the Regulator again
  - All other illustrations of the company normally contain projections which take account of all charges

# What do regulations say?

- ▶ IRDA (AA) Regulations 2000:
  - ...to submit the actuarial advice in the interests of the insurance industry and the policyholders
  - ...drawing the attention of the management of the insurer, to any matter on which he or she thinks action is required to be taken by the insurer to avoid (i) any contravention of the Act (ii) prejudice to the interests of the policyholders
- ▶ IRDA (Insurance Advertisements and Disclosure) Regulations 2000:
  - **Defines ...“unfair or misleading advertisement“:**

# What do regulations say?

- ▶ IRDA (Protection of Policyholder's Interest) Regulations, 2002:
  - ...requirement of **disclosure of “material information”** regarding a proposal or policy apply, to the insured.
  - *Further discussion of the Indian context is dealt with later on in the presentation*

# Circular issued by LC on Sales Illustrations Standards of Practices in Feb 2004

- ▶ All illustrations must be prepared in consultation with the AA and authorized for use by the management of the Company and should be reasonable and fair to enable a customer to make an informed decision
- ▶ All charges in respect of fund management and policy charges are to be deducted from these gross investment return assumptions i.e. illustrations based on higher and lower rates of return should show a projected fund value after all charges are deducted. No insurer shall issue illustrations in any other way.
- ▶ All policy, fund management and other policy charges payable by customers should be included explicitly within the illustrations tables



# PCS

- ▶ A member must avoid arrangements which inhibit the member's ability to conform to the standards of behaviour, integrity, competence and professional judgment which other members or the public might reasonably expect of a member (including the requirements of professional guidance)
- ▶ A member has a duty to the profession and must not act in a manner, which denigrates its reputation or impugns its integrity. Responsibility to any client must be consistent with that duty
- ▶ A material breach of the PCS or of a Guidance Note classified as Practice Standard or of the Act and Rules and Regulations made there under or Other Guidance, is of itself a ground for complaint under the disciplinary procedures and would amount to strong prima facie evidence of misconduct

# PCS (contd.)

- ▶ A breach which has not led to a materially adverse outcome may be regarded as material if a repetition of it in future could lead to a materially adverse outcome. If the member is unsure whether or not a matter is material, the member must seek guidance from the professional body
- ▶ A member found guilty of misconduct will be liable to disciplinary action

- ▶ Clients are entitled to assume that advice given by an actuary is unaffected by interests other than those of the client, taking account of *any identifiable professional or legal duty of care of the client in respect of a third party*.
- ▶ “If there is or might appear to be a *conflict of interest between two or more clients*...the actuary must **consider the nature and extent of the conflict** and whether it is such as to make it improper for the actuary to give advice to one or more of the clients involved in the conflict.”

# What do Actuarial Practice Standards say?

## ▶ APS1:

- AA must ensure,...that he/she has regard to PRE
- As a member of the IAI, every actuary has the responsibility to maintain the highest professional standards. When in doubt: seek help and advice from IAI
- Every actuary – responsible towards the Profession, his/her client and the Regulator. If any of these conflict, advise the company/client and if needed, advise the IRDA
- AA must ensure that new policyholders are not misled with regard to their expectations, e.g. in connection with illustrations at the point of sales
- For linked business, the AA must be satisfied that all discretionary elements of unit pricing and fund charges are applied consistently with PRE.

# What do Actuarial Practice Standards say?

## ▶ APS5

- The main objective of illustrations should be to educate the potential customer about the insurance product...illustrations should not be used as a tool to achieve a competitive edge in the market place
- Illustrations for a product should be consistent with the terms and conditions of the product as filed with the IRDA, wording in the policy document and company practice
- **Important information should not be withheld**

# What do Actuarial Practice Standards say?

- ▶ APS5 (contd.)
  - trade-off between putting in all possible information, and keeping an illustration simple – AA's judgment
  - **In the case of unit linked plans an illustration shall include full description of all charges**
  - AA should ensure that the illustration does not create unreasonable expectations. AA not solely responsible for contents of illustrations. The procedure in each company should be that the sales illustration is issued by the Management of the Company under advice from the AA

# Pricing Actuary – issues to consider

- ▶ Check the calculations performed
- ▶ Ask a colleague to confirm and validate the calculations
- ▶ Check whether the projections would be within the letter of the IRDA/FSA regulations but breaks the spirit of them
- ▶ Is the proposal common market practice ?

# Discuss with Marketing Manager

- ▶ Inform the marketing manager about the issues raised
- ▶ Inform him why such projections cannot be performed and the risks involved
- ▶ Can he relax the constraints/Is there any other way in which the company can achieve the marketing manager's aims
- ▶ What if the marketing manager is not convinced??



# Issues and Risks arising

- ▶ Penalty by Regulator if any act/regulation is contravened
- ▶ Increased cost of compliance
- ▶ Loss of brand name/reputation arising out of mis-selling
- ▶ Could hamper future New Business sales
- ▶ High Withdrawals from existing portfolio

# Issues and Risks arising Cond..

- ▶ Long Term Profitability may be hit
- ▶ Company may start losing market share
- ▶ Lot of customer queries
- ▶ May need to provide training to staff to deal with such queries
- ▶ Judgments by Court and Ombudsman in favor of the policyholder could further damage the company reputation

# Issues and Risks arising Cond..

- ▶ Impact on the reputation of Industry if it is a common practice
- ▶ Loss of trust in the Industry
- ▶ Customers' preference to alternate products
- ▶ Impact on the credibility of the Actuarial profession

# Documentation

- ▶ Details of the proposal by MM
- ▶ Problem with the proposal
- ▶ Risks to the Insurer
- ▶ Other arguments against the proposal
- ▶ Minutes of discussion with MM
- ▶ Pricing Actuary's comments on the proposal

# What if MM not convinced

- ▶ Discuss any alternative solution that could be applied
- ▶ Ensure that the alternative solution is in line with FSA/IRDA rules and regulations
- ▶ Ensure that the alternative solution proposed is in line not only in letter but also in spirit of the guidelines
- ▶ If still in disagreement, talk to the Appointed Actuary/Actuarial Function Holder

# Discussion with AA/AFH

- ▶ Make the AA/AFH aware of the issue
- ▶ Share the results of your calculations with the AA/AFH
- ▶ Inform him why you are not in agreement with the marketing manager
- ▶ Share any rules and regulations that could be violated by such regulation
- ▶ Also share any professional and ethical considerations on which your decisions are based

# AA/AFH issues to consider

- ▶ Is the pricing actuary correct
- ▶ If yes, call the marketing manager for a discussion
- ▶ Inform the MM that you agree with the pricing actuary
- ▶ Make the MM aware of any rules and regulations that would be violated by such a projection

# AA/AFH what next ?

- ▶ AA/AFH and MM do not agree
- ▶ The AA should Inform the company compliance cell/committee
- ▶ Hold a discussion with the senior management of the company
- ▶ Inform the senior management of the risks of following such a strategy



# AA/AFH what next ?

- ▶ Make the senior management aware if the proposed action is not in line with ethical guidelines laid down by the company
- ▶ Inform the senior management of any rules and regulations that would be violated by such a projection
- ▶ Could share any professional and ethical considerations on which your decisions are based

# AA/AFH what next ?

- ▶ AA/AFH and senior management do not agree
- ▶ Inform the institute and seek advice to find out likely course of action if the proposed projections are in line with regulations but ethically/morally not correct to do
- ▶ Inform the regulator if AA/AFH believes that insurer has contravened any rules and regulations or has engaged in conduct calculated to prevent him from discharging his/her duties effectively.

# AA/AFH & Pricing Actuary – Wider Issues to Consider

- ▶ **Professional Conduct Standards**
- Responsibility of each member to be conversant with it
- If firm takes action that could cause member to be in breach of professional guidance member must take appropriate action
- A member has a duty to the profession and must not act in a manner which denigrates its reputation

# AA/AFH & Pricing Actuary – Wider Issues to Consider Cont.

## Professional Conduct Standards Cont.

- In formulating advice a member must pay proper regard to any relevant professional guidance or other guidance and, subject to that guidance, is expected to exercise best judgment
- Your responsibility to understand the environment in which you work and apply the standards expected of you.

# AA/AFH & Pricing Actuary – Wider Issues to Consider Cont.

- ▶ **Ethical points to consider**
- To serve our investors and customers to the highest standards
- To do what we believe is right
- To live in a way that is fulfilling
- To be unbiased in terms of the personal financial gain from the decision

# AA/AFH & Pricing Actuary – Wider Issues to Consider Cont.

- ▶ To reduce the cost of compliance
- ▶ To preserve and enhance the company's and industry's reputation
- ▶ To be a company and industry where the best people want to work in
- ▶ To uphold confidence amongst public in the Integrity of the Actuarial profession

# The Indian Context – Relevant Rules and Regulations

- ▶ **Regulatory aspects**

- Section 64 J of the Insurance Act, 1938 gives the Executive committee the power of Life Insurance Council to set Standards of Practice

Sales illustrations – Life Insurance Business: Standards of Practice circular Number LC/SP/SI/VER 1.1 dated 3–2–2004 states

- **“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”.**

# The Indian Context – Relevant Rules and Regulations Cont.

- It also mentions “**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**”.



# Regulatory aspects Cont.

- IRDA (AA) Regulations 2000, Regulation 8 (e) – drawing the attention of the management of the insurer, to any matter on which he or she thinks action is required to be taken by the insurer to avoid
  - (i) – any contravention of the Act
  - (ii) – prejudice to the interests of the policyholders**
- IRDA (Insurance Advertisements and Disclosure) Regulations 2000, Regulation 2 (d) defines an – **“unfair or misleading advertisement”**

# Regulatory aspects Cont.

The proposed suggestion by MM if used in sales brochures/projections would constitute an **“unfair or misleading advertisement”**

- IRDA (Protection of Policyholder’s Interest) Regulations, 2002, Regulation 11(1) states that – The requirement of **disclosure of “material information”** regarding a proposal or policy apply, under these regulations, both to the insurer and the insured

**THANK YOU**