# Institute of Actuaries of India

**Liyaquat Khan**
**President**

November14, 2003

**To**
**All Appointed Actuaries of Life Insurance Companies**

**Dear All,**

**Re: Actuarial Practice Standard 5 (APS5) – Appointed Actuary and Principles of Life Insurance Policy Illustrations (Ver 1.00)**

It is more than a year now that we have been engaged with issues relating to Life Insurance Policy Illustrations and the needed Actuarial Practice Standard for the same.

The Actuarial Practice Standard 5 titled “Appointed Actuary and Principles of Life Insurance Policy Illustrations (Ver 1.00)” comes in to effect now.

The APS 5 is practice standard i.e., mandatory and will be effective from 1$^{st}$ January 2004.

This APS has been issued in consultation with the IRDA and has to be seen as a resolve of IAI to strengthen the position of Appointed Actuaries so that they can fulfill their responsibilities under Para 4.3 of APS1: Appointed Actuary and Life Insurance Business.

Issuance of this APS is an important step by IAI to strengthen our resolve to “Serve the Cause of Public Interest” best.

**With regards,**

**Yours Sincerely**

**Liyaquat Khan**

1. The Framework for illustrations is set out in the SCSP, and the relevant portions are reproduced below; "*Section 2: brochures*

*Any reference to the past performance in the sales illustration, if used by an insurer, shall be appropriate to the product being illustrated and include a statement that past performance may not be a guide to future performance which may be different.*

*An insurer shall review the assumptions in its sales illustrations at least once in a year and where the assumptions are no longer valid, revise the sales illustration.*

Section 4: Illustrations

*All life insurance companies must provide official illustrations to customers directly or through their intermediaries for all products.*

*All illustrations must be prepared in consultation with the Appointed Actuary 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.*

*There should be two 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 life companies shall use the same rates. All charges in respect of fund management and policy charges are to be deducted from these gross investment return assumptions. 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 shall issue illustrations in any other way.*

*All illustrations must be reviewed at least once a year in April each year. The Life Insurance Council may, if required by the IRDA, set the higher and lower projection of interest rates more frequently than annually. The initial rates to be used in projections are 6 % p a and 10 % p a.*

*Should an insurer wish to use a lower illustrative rate then that insurer is free to do so, but under no circumstance should higher rates be used than those set by the Council.*

*There should be a standard common language statutory warning on all illustrations. The following phrase must appear on the front page of the illustrations in the same size type as the rest of the text.*

*" Some benefits are guaranteed and some benefits are variable with returns based on the future performance of your life insurance company. 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 investment returns. These assumed rates return are not guaranteed and they are not 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"*

*The process of issuing illustrations should be controlled in such a manner that customers are provided illustrations that are authorized by Appointed Actuary and approved by the Management of the Company.*

*All policy, fund management and other policy charges payable by customers should be included explicitly within the illustrations tables.*

*Indicated within the illustration should be the Company's policy on surrender values. A Company may show illustrative surrender values if it wishes and may indicate whether or not guaranteed.*

*Section 7 – Implementation*

*Section 4 "Illustrations" shall be complied with by 1 January 2004.*

**Explanatory Notes to the provisions of SCSP**

The following notes are by way of interpretation/clarification of the provisions of the SCSP:

a) 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.
b) The requirement to revise illustrations at least once a year under section 2 of SCSP 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 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, 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.

B: 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 Appoint ed Actuary should satisfy himself/herself that the illustration, which is prepared by the Insurer as required under the SCSP, does not create unreasonable expectations and that such illustrations are not prepared in any other way.
2. Submission of a policy illustration together with the underlying assumptions is a requirement under the "File and Use Procedure" of the IRDA for product approval and as such illustrations for all plans must be filed with the IRDA.
3. As the file and use compliance is the responsibility of the Appointed Actuary of the Insurer, the Appointed Actuary must ensure that the illustrations issued by the Management of the Company have been prepared taking into account his/her advice and that the advice he/she renders is within the framework of this Actuarial Practice Standard.
4. In the matter of illustrations at the point of sale under the SCSP, the role of the Appointed Actuary is as set out in the second and seventh bullet points under Section 4:Illustrations, above. However the Appointed Actuary is 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 Appointed Actuary as set out in (1) to (3) above.

**C: Guiding Principles**

1. The main objective of illustrations should be to educate the potential customer about the insurance product on sale and thus assist him in developing a proper understanding of the features of the product and the flow of benefits in different circumstances, with some level of quantification. In particular, illustrations should not be used as a tool to achieve a competitive edge in the market place.
2. In the context of creating policyholder 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 projected 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 IRDA, 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 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. 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 IRDA.
7. It is expected that the company would 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. If it comes to the knowledge of the Appointed Actuary that this is not the case, the Appointed Actuary should take this up with the management of the company for appropriate action.
8. Guaranteed benefits

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

9. Non-guaranteed or variable benefits

   a) The illustration of non-guaranteed or variable benefits shall be based on assumptions about future experience, such as, investment return, taxation mortality, morbidity, charges, expenses, terminations by lapse or surrender and discontinuance of premiums leading to a policy becoming paid up.
   b) The assumptions should be appropriate to the product which is illustrated based on past experience, if available, and the Appointed Actuary's view of the assumptions for the future. If they are different from the assumptions underlying the profit test and other analysis carried out for the filing or the most recent refiling of the product for approval by the IRDA, the Appointed Actuary must justify the same. In doing so he must have regard to the following in terms of investment return:

      The SCSP refers to two sets of investment return (gross) – a higher rate and lower rate, which will be set by the Life Insurance Council, based on which illustration projections should be made. 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.

c) In the case of unit linked plans an illustration shall include full description of expense charges i.e. amounts of all types of charges debited against the policyholders' premiums or unit account, in the case of an ongoing policy. This is to cover in some form
   - charges against premiums
   - policy fee
   - fixed amounts against premiums or against unit account
   - investment management fees based on projected size of unit account
   - buy / sell charges

   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 expense charges increased at inflation rates appropriate to the higher rate and lower rate set by the Life Insurance Council.

d) 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 projected values of non-guaranteed benefits 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 what assumed projected rates of bonus should be used for each of the higher and lower rates, in the judgment of the Appointed Actuary, be appropriate and supportable under the investment return rates set by the Life Insurance Council taking into account all the relevant factors.

10. Lapses, Surrenders and non-forfeiture provisions

a) 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.

b) The SCSP 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.

c) 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.

11. The Appointed Actuary should document all the assumptions underlying the calculations along with suitable justification, wherever necessary, and should ensure the accuracy of the calculations.

12. Whenever the 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, have the revised illustrations approved by the management of the company and file them with the IRDA before they are used at the point of sale.