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Irda seeks to reduce churning of policies

Draft guidelines discourage frequent churning so that policyholders can avoid financial losses

Insurance companies and their agents will no longer be able to churn insurance policies, i.e., replace existing life policies with new ones, unless it is in the interest of the customers. This, too, they can do only after explaining all the benefits and consequences of the move. Add to that, insurers will also need to advise their customers against replacing their policy in the contract agreement itself. These and more are some of the measures included in the draft guidelines outlined by the Insurance Regulatory and Development Authority (Irda) on 18 June. Their aim is to protect policyholders and discourage insurance agents from churning policies by persuading customers to lapse or surrender an existing policy for a new one. Policy churn means replacing an existing life insurance policy with a new one within six months of discontinuing the old policy. The guidelines aim at ensuring complete transparency so that the buyer is aware of the financial consequences of replacing an existing policy. Insurance products are typically front-loaded, and have an exit load. Insurance products, mainly traditional plans, come with a heavy surrender penalty if you discontinue the policy midway. So, you not only bear the burden of costs and penalties in the previous policy but also saddle yourself with costs from the new policy. "In the US, policy churn is illegal and there have been class action suits. Insurers have had to compensate customers for their losses due to churning. The practice was rampant overseas until about 10 years ago, but now, more than the regulations, insurers themselves have put strong systems in place to check churn," said Kapil Mehta, managing director, SecureNow Insurance Broker Pvt. Ltd. What an agent should do The draft states that an insurance agent (intermediary) will make every reasonable effort to retain an existing policy and will be allowed to replace it only when it is in the interest of the policyholder and after all the consequences have been explained well. The agent must then take a written consent from the policyholder and notify the existing insurer 15 days before submitting the proposal form of the new policy with the new insurer. The existing insurer will then revert to the policyholder within seven days explaining the consequences of replacing the policy. The agent will also have to submit the policyholder's letter of consent to the new insurer along with the proposal form and reasons given to the policyholder for replacing the policy. There are three forms proposed for processing policy replacement: one with details of the policy and the consent of the policyholder, the second will include general disclaimer on the ills of replacing a policy, and the third will outline the reasons for replacing the policy. All these forms need to be submitted with the new insurer. "Policy churn has been hurting the industry. Whenever new products are launched, agents tend to target existing insurance customers. The guidelines, in that sense, are a welcome step. But given the amount of paperwork involved, the process will have a lot of administrative pangs. We should think about smoothening the process and allow for electronic communication as well," said P. Nandagopal, chief executive officer and managing director, IndiaFirst Life Insurance Co. Ltd. Perhaps what would also benefit the policyholder is if she is shown illustrations of what surrendering or replacing the policy will mean for her. A signed and customized illustration would help. What the insurer should do The insurance companies will also have to train their agents on these guidelines and will have to carry a clause in insurance proposal forms advising the policyholder not to surrender, lapse or make a policy paid-up (by paying premiums for a certain number of years to make the policy self-sustainable, however benefits may reduce) to buy a new policy. The proposal form will have to carry a standard note in which the harms of policy churn will be clearly laid out. The proposal will also seek information on whether the policyholder surrendered or discontinued any of the policies to buy a new one. The insurer will also need to take a declaration from the agent that these guidelines were followed. However, if a customer still decides to change a policy, the agent or the insurer is not allowed to withhold the surrender value of the existing policy. The existing insurer is expected to get back to the policyholder within seven days. If a policyholder feels the consequences of replacing the policy were not explained to her properly by the existing life insurance company, she will have the right to get the old policy restored within seven days from the date of receipt of the new life insurance policy. The restored policy will enjoy the same benefits had it continued. Upon restoration, the policyholder will be entitled to a total refund of premiums, without any recoveries, on returning the new policy and any cost of refund of the new policy will be met by the insurance agent who produced the business, or from the shareholder's account with the life insurer. Irda has sought public feedback on the draft guidelines until 20 July. Mint Money take These guidelines are directed towards discouraging policy churn, which is rampant in the insurance sector. Acknowledging the fact, former Irda chief, J. Hari Narayan had in an interview with Mint questioned the need for numerous insurance products in the industry. According to him, new batches of products are launched in quick succession to facilitate policy churn. The fact that Irda wants to discourage policy churn is a positive step, but there are still a few gaps. "The draft regulations at the very least accept the fact that there is a problem of policy churn and flags off the issue as unacceptable. Earlier, replacement was seen as "normal" business practice. But these regulations continue to put the onus on the policyholder to understand the processes. Also, the policyholder has just seven days for restitution, which is too small a time frame. This is not making the other stakeholders responsible," said Manoj Nagpal, chief executive officer, Outlook Asia Capital Ltd, a wealth management firm. "The regulations should make the insurance intermediary accountable, along with penal provisions of clawback of commissions and debarring his licence in case of repeated complaints," added Nagpal. Additionally, the regulations have not addressed instances where a policyholder is sold a new policy and subsequently asked to discontinue the old policy. "There is nothing that stops an unscrupulous agent from first selling a product and then asking the client to surrender the old policy. This guideline will not be triggered in that case," said Suresh Sadagopan, a Mumbai-based financial planner. Then there could be genuine cases for a churn. "Take the case of term plans. Churn in these plans can be good if it lowers the price that customers pay. Several clients buy new term plans that have higher sum assured or are cheaper and then discontinue the old plans. The guidelines will make this process cumbersome. Policy churn is a problem that needs to be plugged, but the focus ought to be on lapse of traditional plans. Surrenders with high charges should trigger an enquiry. Why would a customer voluntarily destroy value?" said Mehta. The biggest incentive for an intermediary to churn insurance policies is commissions, which are front-loaded. This is also an issue that Irda should address for greater compliance.

Read more at: //www.livemint.com/Money/TutvyAy8kZAtJ6geiCFDJJ/Irda-seeks-to-reduce-churning-of-policies.html?utm_source=copy

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