Why the majority of life insurance policies face early 'death'

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Skewed incentive scheme, mis-seling by agents to blame, say experts

Did you know that half the people who buy life insurance don't continue with their policies after the fifth year?

The life insurance industry has reported a persistency ratio of 47 per cent in the 61st month (completion of five years) in FY19, implying that less than half of the policies continue into the sixth year. Based on the number of policies renewed, even LIC, the insurance behemoth, doesn't have a sterling record — its 61st month persistency ratio was 51 per cent.

The persistency ratio indicates how many customers stay with their policies.

While there has been an improvement in the 61st month persistency of life policies over the past few years — thanks to the ULIP reforms, and a strong capital market boosting returns in market-linked policies — the picture is still bleak.

Many private life insurers have reported a persistency ratio of less than 40 per cent for FY19 in the 61st month, data compiled by *BusinessLine*reveal (*see table)*.

Mis-selling to blame?

One reason for the early exit could be that the policyholders were miss-sold the policies, say experts. Given that the chunk of the business for life insurers is from traditional policies (endowment plans) and the costs are front-loaded in these products, early exits mean customers don't even get their full capital back.

Traditional policies are popular today, and the insurance regulator has to keep an eye on the persistency ratio of companies to make sure that agents are not mis-selling the policies. Often, the agents lure investors by adding the 8 per cent assumed rate of return to the benefit illustration (in the policy document) as guaranteed return.

The incentives for insurance agents and distributors are designed in such a way that they make more when a customer exits his/her existing policy and buys a new one, said an agent with a private insurer who didn't want to be named.

For traditional policies, the commissions are 35-45 per cent in the first year and 4-7 per cent from the second year onwards (unlike in mutual funds, where commissions are completely trail now). So, there is an incentive for the insurance agent to make his/her customer replace his/her policy in the greed for a bulk upfront commission.

The Insurance Regulatory and Development Authority of India (IRDAI), however, doesn't buy the argument that lower persistency ratios are due to mis-selling.

"Premature surrender of policies could be due to financial exigencies or because the customer wants to take advantage of the market gains in the case of unit-linked products. It may not be entirely correct to equate policies getting lapsed to mis-sale," said an IRDAI spokesperson.

Filling insurers' kitty

Now, where does the money paid by policyholders who exit early go?

While in the first year, a significant amount of premium paid goes towards agent commission, from the second/third year onwards, there may be savings for the insurance company. After paying staff salaries and other administration costs and expenses on health check-up for the customer (if any), much of what is left goes to the insurer's kitty.

Industry insiders, however, say IRDAI doesn't approve of lapse-supported policies. When a product is filed, it gets regulatory clearance only if the company shows that the longer it stays in force, the higher the returns for the company.

Asked about the profits from lapses for insurance companies, IRDAI said: "When a new policy is issued, the insurance company experiences negative asset-share on the policy on account of high initial expenses and solvency requirements. Thus...if the policy lapses before adequate levels of reserves are built, there is nothing available under the policy to be paid back, and if the policy lapses when the reserves are sufficient, the life insurer will start recognising the paid-up value under the policy which is payable at maturity, and the surrender value will be paid if contract is terminated prematurely. Life insurers are subjected to strict statutory and regulatory provisions with regard to these matters."

life insurance **insurance**

The five-year itch

Persistency ratio (%) for 61st month (based on number of policies)

Future Generali Life	22.60
PNB MetLife	29.00
Aditya Birla Sun Life	32.00
Bajaj Allianz Life	32.40
IndiaFirst Life	33.63
Tata AIA Life	37.97
Bharti AXA Life	38.80
Aviva Life	42.00
HDFC Life	47.18
Max Life	49.00

IDBI Federal Life	49.24
Aegon Life	50.00
LIC of India	51.00
SBI Life	51.06
ICICI Prudential Life	53.30

Source: Public disclosures

COMMENTS

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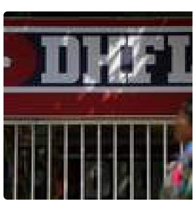

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