LIFE INSURANCE

Toxic Plans

Where is corporate governance in all this?

A prominent Sound Bite in *Moneylife* (issue dated 19 April 2012) quotes Amitabh Chaudhry, CEO & MD, HDFC Life, as saying: "A lot more needs to be done about traditional insurance plans. The commissions are much higher, the products lack transparency, the surrender charges are too high and too much is being invested in government bonds."

I entirely agree with Mr Chaudhry, even if it is ironic that one of HDFC Life's own 'insurance products', marketed as Savings Assurance Plan, should suffer from the very maladies he is complaining about! I had highlighted this product in *Moneylife* (issue dated 1 December 2011, "No Insurance against Mis-selling"), arguing that Savings Assurance Plan sounded like an insurance-linked savings policy, but was nothing of the sort, as it had NO insurance content. For instance, for at least 60% of the life of maturity and in all probability even longer, it makes a significant dent on one's invested principal, leave alone yield any returns. But more importantly, it offers a 'death benefit' equal to the maturity value (which is less than the nominal total of the premiums paid over 10 years for a 10-year policy) plus bonuses if any, or, the premiums paid by the insurer plus 6% compounded return, whichever is lower! No insurance component. And what is worse, the product had a three-year lock-in period and one couldn't borrow against it. Wasn't one better off with a fixed deposit (FD) in a bank?

Enlightened managements committed to fair corporate governance should recall a defective product such as this one, sold under a wrong pretence, just as auto companies recall defective autos. A recall of such a product could essentially involve offering the subscribers the choice to opt out of the product in lieu of a fair fixed return. To the best of my knowledge, the product has not been recalled by HDFC Life.

A related question was why the insurance regulator even approved such products in the first place. To be fair, Insurance Regulatory and Development Authority (IRDA) did contact me stating that they are reviewing all such defective products in the industry.

However, the inherent truth in Mr Chaudhry's comments still holds. Consider this "Smart Performer: a unit-linked life insurance plan" from SBI Life. The main sales pitch of the Smart Performer was that it 'guaranteed 5% higher return than the highest guaranteed NAV (net asset value) on maturity'. The guaranteed maturity itself was based on the 'highest daily NAV during the first seven years'. It took a bit of questioning and calling for the detailed brochure, to figure out that what was being offered on maturity was a 5% premium (and not return) on the highest guaranteed NAV. A guarantee of 5% return is not quite the same as a guarantee of 5% premium on the guaranteed NAV. This can be attributed to communication gap, of course.

But, the 'detailed brochure' was silent on the extent of the applicable up-front load, except to say that the "premium contributions made by you, net of premium allocation charges are invested in the plan options… " When I specifically called for the extent of front-loaded charges, I received an email stating: "…the charges are 8.5% 1st yr, 2nd to 5th year it is 6.5% and will be levied up front and the funds remaining will be investing (sic)."

This means that if you invest Rs100 in this smart product, only Rs85 will actually be invested. Further, since only Rs85 of your money is being invested, the upfront charge of Rs15 works out to 17.6% of the amount actually invested (or about 1.76% per annum over a 10 year life of the product), while the premium of 5% on the guaranteed NAV of the invested principal of Rs85 comes to you 10 years later! Now, do your math and decide how smart a performer this product is; whether the charges are excessive; should an insurance company lop off its hefty charges upfront and not as the money is put to work; and whether such products are fair—fair to the investors, that is. ■

The author was professor at IIM-Ahmedabad, was president of ING Vysya Bank and has been working in the area of corporate social responsibility. He has written several popular books and is an adjunct professor with Bocconi University, Milan. His website is www.vraghunathan.com.