MONEY GURU

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The proposed surrender charges are very low

With the current spate of regulatory guidelines, the insurance industry is looking at substantial reforms. The regulator's focus is to rein in cost and make unit-linked insurance plans (Ulips) more transparent and investor-friendly. It is perceived that these reforms will hit insurers hard. Your take.

Broadly, the reforms are very investor-friendly, but they are bound to impact the profitability of the company (insurers). The charges have been capped and have to be uniform in the first five years. Surrender charge is almost nil now. This is bound to hit the margins. In fact, in some cases the products themselves may come under threat. For instance, the guidelines ask for a guarantee of 4.5% in case of unit-linked pension plans. As an insurer, I need to guarantee this return not in the immediate future but over 20-30 years. Guaranteeing such returns is difficult. There is a possibility that pension plans don't assume focus because of guaranteed returns.

When costs reduce, agent commissions will also go down drastically. Do you foresee advent of new products or will Ulips get simpler?

I think Ulips will not have many variants. At present, insurers can add variety because costs and other features are flexible. Once the new guidelines will come into effect, it will be difficult to offer variety. Products will now look more or less similar. Plus, the suggested surrender charges are minimal. For HNIs (high networth individuals), Ulips will look like a mutual fund.

Surrender charges come into play only when the policyholder decides to quit the policy midway. But if the policyholder is staying for the long term, how do surrender charges apply? Also, when the lock-in becomes five years (as per the guidelines), how would surrender charge pose a problem?

My acquisition cost is 50-60% in the first year. I need the policyholder to stick for the tenor of the policy to make a profit. The high surrender charges earlier discouraged policy surrender. Also, it ensured that if they did surrender, I will be able to recover my cost. Having said that, I do agree surrender charges in the industry were quite high and that a correction was expected so that the insurer is able to recover only the costs. However, surrender charges, which are in percentage terms but are capped at an absolute figure, are very low. For big-ticket policies, the surrender charge would be nil. But my cost of acquisition is still high.

So is it the end of Ulips and comeback of traditional investment-cum-insurance plans?

Insurers have begun focusing on traditional plans as about 20% of the business comes from conventional plans. But for us, traditional plans are not very profitable. Hence, our focus will still be on Ulips.

The charge structure will eat into the commissions that an agent gets. Distribution in the insurance industry will be jeopardized. How do you see distribution shaping up?

Distribution will get affected badly, but distribution doesn't mean only commissions. Setting up of branches and paying financial consultants also comes under distribution, which we will have to sustain. And sustaining this business doesn't always come through the policyholder's money. It will be easier for big players to sustain distribution. However, going forward, bancassurance will assume greater importance. Irda (Insurance Regulatory and Development Authority) has strict guidelines on the skill set, which will still be capital-intensive.

What about the online medium?

The way insurance is sold, it needs a human interface. The Internet plays an important role in disseminating information, but it can't be a primary source of distribution. Insurance will still need an agent.

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