Table 4: Key Regulatory design features of Annuity Options available to the low-income customer			
	Life Insurers	**NPS**	**APY**
Minimum Monthly Pension Benefit	Rs. 1000 per month or a gross amount of Rs. 5000 (lumpsum)	No minimum specified. However, since these are life insurers regulated by IRDAI the minimum benefit applicable to other life insurers would also be applicable to them	Rs. 1000 per month
Annuity options	Can purchase the annuity from the same or different insurer	Can purchase the annuity from 1 among 5 life insurers	No option given
Annuitisation	No mandatory commutation if purchased from same insurer (up to 100% and at least 40% must be annuitized). 50% annuitisation if purchased from different insurer	No mandatory commutation, with the stipulation that at least 40% of the accumulated pension wealth be converted into an annuity	100% annuitisation
Exposure to Debt and Equity Capital Markets	Central Govt. Securities – not less than 20%; Central and State Govt. Securities – not less than 40%; Approved Investments – not exceeding 60%[132]	Depends on the NPS scheme, customer can choose to invest up to 75% in Equity (under Active Choice), with tapering off of the Equity allocation after the age of 50[133]	Govt. Securities and related investments – up to 55%; Debt instruments and related investments – up to 45%; Equity and related investments – up to 15%; Asset Backed Securities – up to 5%; Short term debt – up to 10%

<u>Adequacy of pension receipts under Atal Pension Yojana</u>

An internal analysis[134] of pension benefits of APY found that an 18-year old who contributes Rs. 42 per month will result in a real monthly pension of Rs. 129 for the household. Assuming that the 18-year old's income falls within the first income quintile, the defined benefit will cover 10.3% of her monthly expenditure. The primary driver for the insufficiency of corpus is the current investment mix which allows for exposure to equity instruments to not more than 15% irrespective of the life-cycle stage of the customer. The investment mix for APY can be redesigned to mirror the Moderate Life Cycle Fund Mix for NPS-Main[135].

---

132 Pg 61, IRDAI (Investment) Regulations 2016, IRDAI, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2934&flag=1;

133 PFRDA Circular on Amendment to Investment Guidelines for NPS Schemes {other than Govt Sector (CG&SG), Corporate CG, NPS-Lite and APY}, 22nd May 2018, accessible at: https://www.pfrda.org.in/myauth/admin/showimg.cshtml?ID=1365

134 "An Initial Analysis of the Atal Pension Yojana", Vishnu Prasad and Anand Sahasranaman. Dvara Blog, March 9, 2015, accessible at: https://www.dvara.com/blog/2015/03/09/an-initial-analysis-of-the-atal-pension-yojana/

135 Investment options under NPS, accessible at: https://npscra.nsdl.co.in/download/Investment-options-under-NPS.pdf

These examples of microinsurance and APY illustrate the need for checks and balances to ensure that product regulations must not lead to the creation and sale of products that are inadequate for the customer segments they are meant to serve.

6. Challenges around Product Suitability and Disclosures

A common demand-side barrier to adoption of insurance, investment and retirement products is the concern around mis-selling of products unsuitable for the low-income household. Mis-selling can take various forms, we describe in Table 5, a few examples shared by our interview respondents.

Table 5: Examples of mis-selling	
Insurance	Withholding information on important exclusions in health insurance by distribution agent at the time of sale, resulting in claim rejection for the customer Insurers have attempted to overcome this using telephonic verification calls to the customer to check for his/her understanding of the product before issuance of the certificate. However, agents now 'teach' unsuspecting customers to lie on these calls.
Endowment Products	When IRDAI clamped down on ULIP mis-selling by cutting commissions, the market, overnight, shifted to selling endowment plans. Certain endowment plans have a negative IRR, making them unsuitable for anyone availing them. However, customers do not know this because regulations do not require returns to be disclosed in percentage terms. Lapsing of policies[136] due to agent attrition has led to customers losing trust in their agents. These policies are most commonly endowment plans, and customers who have had a bad experience are doubly wary of purchasing pure term products.

Non-credit products involve payments of customer monies or a commitment by the customer to pay their monies into the future. Mis-selling in this context, has involved people being unaware that they are expected to pay lumpsum amounts into the future. Another form of mis-selling, seen with the ULIPs before it came under the regulatory radar, was the exposure that people were made to take in equity instruments despite this being unsuitable for their requirements. In the context of pure term insurance, the scope for mis-selling takes on a different form. For instance, for a term life insurance, one can expect there to be not much variation in the extent to which pricing would vary for premiums for an individual of a particular age and income bracket. However, a distributor can be swayed by rewards she/it can be eligible for from various insurers while selling or showcasing various options available to the customer. The impact of incentive and commission design in insurance and insurance-cum-investment products, in MFs and in pension products such as the APY on outcomes for the low-income customer are discussed in Sections 3.1, 3.2 and 3.3 respectively. Opaque benefit illustrations[137]

[136] A lapsed life insurance policy' is defined by IRDAI as a policy on which premium remains unpaid even after six months from the due date.

[137] "33. Benefit Disclosure: Except for products where all the benefits are assured in absolute amounts at the outset of the contract, all other insurance products shall provide the prospective policyholder a customized benefit illustration at the point of sale, illustrating the guaranteed and non-guaranteed benefits at gross investment returns as stipulated by the Authority". IRDAI (Non-Linked Insurance Products) Regulations 2019, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3850&flag=1

for non-linked products make it easier to mislead customers who do not know how to compare returns[138]. The inability of customers to make repeat contributions due to the non-availability of their agent (lapsed policies) has been such a severe industry-wide phenomenon that IRDAI intervened to place liability on insurers to reallocate lapsed policies to other agents or through their own operations in order to revive them. This has led to a further increase in costs for the insurer to offer smaller-ticket multi-year products and difficult-to-reach customer segments.

Regulatory interventions around preventing mis-selling have focussed on separating sale and advice into distinct offerings for the customer through separate licensing/registration requirements. SEBI has investment advisor registration requirements and such advisors are to act in a fiduciary capacity on behalf of clients and cannot be paid volume-based commissions. PFRDA has retirement adviser registration[139] for intermediaries interested in providing retirement advice[140] for customers. However, similar to the insurance broker license of IRDAI, and unlike SEBI's investment advisor license, the retirement advisor can charge a volume-based advisory fee of 0.02% of the AUM of the customer subject to minimum of Rs.100 and maximum of Rs.1000[141] as well as a flat fee per transaction in addition to an onboarding fee. Therefore, it can be concluded that regulators have taken the approach of separating advice and sale as offerings but the separation is not complete, with advisors being allowed to receive volume-based incentives, thereby reducing the effectiveness of such a separation for preventing mis-selling to customers. Also, such an approach assumes that customers would be willing to pay separately for advice, which many of our interview respondents stated was found to be not the current reality in serving low-income customers. More importantly, such separation has led to a prevalence of non-advisor type registration route gaining favour among providers because of the absence of a 'fiduciary' element to their responsibilities to their customers. They can, therefore, provide free incidental advice that they have no accountability for but for which they receive volume-based incentives for sales. This is problematic if these touchpoints engage in misleading, wrong, or harmful advice to maximise sales. Indeed, SEBI has acknowledged that this is a problem and its three consultation papers[142] between 2016 and 2018 proposed some steps to resolve this, though these are yet to fructify.

---

[138] "For non-participating plans that carry a guaranteed return, the return should be disclosed as a percentage of the investment made. The IRR should be a disclosure in the benefit illustration.", as recommended by Committee to recommend measures for curbing mis-selling and rationalising distribution incentives in financial products (Chair: Sumit Bose), Ministry of Finance, August 2015, accessible at: https://www.finmin.nic.in/sites/default/files/Final_Report_Committee_on_Incentive_Structure_0.pdf

[139] PFRDA (Retirement Adviser) Regulations 2016, accessible at: https://www.nism.ac.in/certification/images/pdf/PFRDA-Retirement-Advisers-Regulations-2016.pdf

[140] As part of this, the retirement adviser is required to "collect and suggest to the customer the most suitable scheme, taking into consideration the following aspects of the prospects and based on utmost good faith and fair market practices: a. Due diligence on the requirements of the prospects to suggest them the most suitable products by collecting basic information of the prospects such as information pertaining to age, marital status, dependents, current assets, liabilities, income, planned purchases, planned retirement age; plans post retirement, family history of health and longevity and the current health position". ibid.

[141] Introduction of Advisory Fee under Regulation 15 of PFRDA (Retirement Adviser) Regulations 2016, Circular dated September 22, 2016, accessible at: https://www.pfrda.org.in/writereaddata/links/circular%20-%20advisory%20fee44f66101-6c47-4d1e-98fd-008a4cbe11dc.pdf

[142] Consultation Paper on Amendments/Clarifications to the SEBI (Investment Advisers) Regulations, 2013 – First, Second, Third, published on the SEBI website on October 7, 2016, June 22, 2017 and January 2, 2018. Accessible respectively at: https://www.sebi.gov.in/reports/reports/oct-2016/consultation-paper-on-amendments-clarifications-to-the-sebi-investment-advisers-regulations-2013_33435.html; https://www.sebi.gov.in/reports/reports/jun-2017/consultation-paper-on-amendments-clarifications-to-the-sebi-

In order to remove this arbitrage, all distributors must be subject to the same standards of conduct towards their customers, irrespective of their licensing types. Universal conduct obligations[143] applied uniformly across all regulated entities is the need of the hour. As part of their obligations, all providers must ensure that customers have access to good quality, non-obfuscatory disclosures of product features. Expected returns as a percentage of the premium/invested amount, and past and expected IRR are to be clearly known upfront[144].

The various financial sector regulators must jointly agree upon a set of suitability principles that govern the relevant financial functions such as 'investment', 'risk protection' and 'retirement income' that the products under question must abide by (Annexure 3 provides brief examples of such principles) and each regulator can then lay down prescriptive guidelines around how to meet these principles. Following this, regulators need to mandate the need for completing suitability assessments within all product sale processes by regulated entities serving retail customers. Such an assessment must consider whether the product being sold is meeting the suitability principles when serving the specific customer. Supervisory processes must then monitor and track distributor channel performance on the quality of such assessments, publish the results of such supervisory audits, and take stringent actions against those distribution channels found to be selling products that are unsuitable for their customers. IRDAI has set a good beginning in this regard in September 2019[145] by introducing a requirement on insurance companies to undertake a suitability assessment for all life products except pure risk products, and this is applicable on all intermediaries and agents.

Additionally, with an intention to prevent low-income households from entering into contracts of globally unsuitable products[146], the regulator can specify a set of globally unsuitable products that cannot be offered to households or businesses below a certain income threshold or net worth or individuals above a certain age. Such products should be prescribed by each regulator and could be amended from time to time based on feedback from customers and financial services providers, including from learnings from the various regulatory sandboxes.

7. Market Infrastructure and Supporting Services

Exciting progress has been made in the creation of various elements of market infrastructure in both the insurance and investment sectors to improve outcomes for retail customers.

The Insurance Information Bureau (IIB) under IRDAI has been tasked to create a database of all insurance agents, broker qualified persons, specified persons of corporate agents, authorized verifiers for web aggregator, point of salesperson, and so on. This database is expected to help in de-duping, with the help of Aadhaar number of PAN number, of persons who may be engaged with multiple

---

investment-advisers-regulations-2013_35152.html; and https://www.sebi.gov.in/reports/reports/jan-2018/consultation-paper-on-amendments-to-the-sebi-investment-advisers-regulations-2013_37247.html

143 See Universal Conduct Obligations for Financial Services Providers Serving Retail Customers, Deepti George, Dvara Research, 2019, for a full discussion, accessible at: https://www.dvara.com/research/wp-content/uploads/2019/05/Universal-Conduct-Obligations-for-Financial-Services-Providers-Serving-Retail-Customers.pdf

144 For a full discussion on this, see report of the Committee to recommend measures for curbing mis-selling and rationalising distribution incentives in financial products (Chair: Sumit Bose), Ministry of Finance, August 2015, accessible at: https://www.finmin.nic.in/sites/default/files/Final_Report_Committee_on_Incentive_Structure_0.pdf

145 IRDAI Circular (a) Benefit Illustration, and (b) other market conduct aspects, dated September 26, 2019

146 The Report of the RBI Committee for Comprehensive Financial Services for Small Businesses and Low-Income Households (Chair: Nachiket Mor), RBI, 2014, discusses globally unsuitable products, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf

insurers although they may not be permitted to do so under their respective distributor regimes[147]. The benefits of such an effort will help to check agent performance and persistency rates, and agent churn and lead to improved market-monitoring of agent-level conduct. Insurers have begun using the database to weed out bad actors.

The IRDAI has also licensed four insurance repositories to aid in dematerialising insurance policies and to aid in the issuance of e-insurance policies (since 2011). However, market usage has been dismal with only a total of 1.6 million electronic insurance accounts being created and 1.25 million policies converted into an electronic mode[148].

In the mutual fund industry, the MF Utility (MFU)[149] launched in 2015 by AMFI, is a digital aggregator platform for the industry. Through this, distributors and individual investors can set up bank mandates and execute purchase and sale transactions through completely digital mode across all AMCs, through a Common Account Number mapped to the investor. Investors can transact in multiple schemes and make single consolidated payments.

No major infrastructural barriers were noted by our interview respondents. The developments described above are useful for customers who are comfortable transacting digitally, the barriers to digital adoption, including lack of awareness and illiteracy on the part of low-income households can continue to serve as impediments to adoption at least in the short run.

[147] IRDAI Annual Report 2017-18, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3704&flag=1

[148] ibid.

[149] MF Utility System, MF Utilities, accessible at: https://www.mfuindia.com/MFUtility

8. A Summary of Challenges

<table>
<tr><th colspan="4">Table 6: A Summary of Challenges</th></tr>
<tr><th></th><th>Traditional Mono-product Distribution Channels</th><th>Multi-product Distribution Channels</th><th>Digital-only Fintech Channels</th></tr>
<tr><td>Ease of access at a location nearby</td><td>Customers in remote locations need to go to multiple mono-product distributors in order to avail a comprehensive set of financial services. The most ubiquitous today is LIC's individual agents (LIC's predominant distribution strategy) who offer insurance products with returns embedded returns. These are losing ground to multi-product channels, especially banks who can potentially be the most efficient multi-product distributors. Besides this, insurers and AMCs sell through own branches and website - these are unlikely to be viable ways to access products for low-income households in the near future.</td><td>Multi-product distributors such as SCBs and PBs are accessible through their branches and BCs; however, the board-driven strategy has not adequately focussed on risk protection, investment retirement planning offerings for low-income households</td><td>The universe of potential customers is restricted to the 150 million customers expected to use online banking out of the 350 million internet users in the country; this excludes a vast majority of low-income individuals who need non-digital means to access products</td></tr>
<tr><td rowspan="2">Ease of on-boarding through KYC and setting up payment transactions</td><td colspan="3">Fresh KYC needed for all new purchase transactions; Significant scope for reducing cost of KYC for provider and customer; reuse of existing valid KYC not permitted (both for products under same regulator, and products under different regulators); the Central-KYC Registry has not taken off; SEBI's CVL-KYC providers not permitted to be accessed by providers regulated by RBI, PFRDA, IRDAI.</td></tr>
<tr><td colspan="3">Regional disparities in the quality of ECS infrastructure and the penalties levied on insufficient funds turn new-to-banking customers away from opting for auto-debits. One-time mandates through UPI 2.0 is not yet permitted by RBI.</td></tr>
<tr><td rowspan="2">Ease of access to reliable financial advice and suitable products from all touchpoints</td><td colspan="3">Rampant mis-selling of insurance products with embedded returns at the cost of providing adequate pure risk cover. The regulator does not recognise 'advice' in sale process; incidental advice is misleading. However, recent rules on suitability (for non-pure-risk products) seeks to improve this. Supervisory processes need to be significantly expanded to monitor this.</td></tr>
<tr><td colspan="3">Banks selling FDs, ULIPs, endowment plans, MFs are driven by conflicting incentives that cannot prevent perverse behaviour on the part of employees and BC touchpoints to avoid engaging in unfair and misleading sales practices.
While retirement/annuity products are essential for a low-income household, these are less lucrative to sell compared to ULIPs/endowment plans. Since there is no requirement on distributors to provide reliable advice, retirement planning products are</td></tr>
</table>

	rarely pitched to customers. In MF investments, differential commissions based on whether equity or debt/liquid MFs are being distributed, introduces perverse behaviour by distributors to sell equity MFs to those households for whom it would be unsuitable.		
	Certain product design regulations have inadvertently resulted in the creation of products that are inadequate for the needs of low-income households and in the targeting of these products to them.		
Ease of subsequent/repeat transactions	Lapsing of policies is rampant; very poor persistency ratios even if the metric is being tracked by regulator		
	Incentives work against ensuring small-ticket subsequent / repeat transactions as the upfronting is very steep in insurance, causing distributors to seek business away from low-income households and towards mass affluent customers. Incentives are not proportionately increasing for distributors who take more effort and incur more costs for serving difficult-to-reach customers.		
Ease of life-cycle servicing (claims/ redemptions)	A lack of awareness about the claims process, an inability to execute the process by oneself, and the lack of any responsibilities placed on the distributor (who is the touchpoint) to provide support to claimants, takes away the value that insurance is expected to provide for the household. Bad experiences from rejected claims, omission of important information by distributors during product sale, makes customers doubly wary of subsequent insurance purchase transactions. MF redemptions are seamless and did not pose any challenges for customers invested in MFs.		
	No incentives to process claims by the distributor; not in the interests of an insurer to improve claims efficiency. Cost to assess each claim especially for smaller ticket claims is prohibitive without adequate support for both the insurer and the customer		
Ease of offering comprehensive services	Individual agents and certain other traditional mono-product channels such as IMFs, microinsurance agents, MF distributors are free to sell products across various regulatory jurisdictions after meeting necessary regulatory requirements. However, the absence of a uniform regulatory regime for investment products results in perverse incentives to mis-sell investment products that have laxer rules.	All multi-product providers are best placed to offer comprehensive financial services. However, the absence of a uniform regulatory regime for investment products results in perverse incentives to mis-sell investment products that have laxer rules.	Banks are reluctant to allow FDs to be originated by digital-only and app-based investment platforms even if API-based solutions exist.
	BCs of banks form credible last-mile touchpoints for offering these products. However, banks are reluctant to allow their BCs to sell products of other banks. This therefore prevents any healthy competition at the BC's CSP level to offer products that work best for the customer.		

Very High	High	Medium	Low

9. Recommendations

In this section, we organize proposed solutions and recommendations along three broad themes, namely Distribution Channel design, Operations and Suitability, and Business Cost Reduction.

9.1 Distribution Channel Design

- ✓ All low-income households must be able to obtain a suite of financial products that will result in comprehensive financial wellbeing with minimal effort. This means that providers must be able to offer such an offering seamlessly instead of customers having to approach many different providers separately. Also, it must be ensured that any and all financial advice, whether paid for/free/incidental to the sale, must be easy to obtain, reliable and helpful in deciding what products to purchase. [Refer Section 3.4.1]

- ✓ All financial sector regulators can jointly agree upon a common set of eligibility rules that any (corporate) financial services provider must meet in order to engage in selling customised product combinations for the household. We call such a distributor a 'Financial Services intermediary'. While all banks must de facto meet all the eligibility rules, all other corporate intermediaries engaged in the sale of financial products can be required to meet these rules in a phased manner. This can be achieved by collapsing in a phased manner, the various distribution / licensing types under the Financial Services Intermediary license. [Refer Section 3.4.1]
    - A FSI must be required to commit some capital against operating risks and customer protection risks for the business that they are engaged in. While the minimum amount may be structured as a Rs. 500,000 security deposit from the Financial Services Intermediary, the amount may vary depending on the number of customers and volume of transactions.
    - The FSI must not have been subjected to any disciplinary proceedings under the rules, regulations and by-laws of a stock exchange, SEBI, RBI, IRDA, FMC, or any other regulator with respect to the business involving either organisation, partners, directors, or employees.
    - Transactions should be accounted for and reflected in the Principal's books by the end of the day or next working day. Where the transfer of money from agent to Principal happens on the next working day, there should also be a stipulation that the FSI should transfer the day's collections to a non-operative pooled collections account on the same day itself. To ensure this, the Financial Services Intermediary has to maintain the account with a bank which has online fund transfer facility with standing instructions to transfer the funds to the designated pool account at the end of each day. This ensures that the customers' funds are secure even if the Financial Services Intermediary were to close operations or go bankrupt.
    - All transactions must be initiated by the customer, either using biometrics, OTP-based 2-factor authentication, UPI-based PIN. For recurring transactions, paper-based, as well as e-ECS mandates, are permitted, so is debit and credit card-based mandates (for amounts less than Rs.2000[150]).

[150] Processing of e-mandate on cards for recurring transactions, RBI Circular, August 21, 2019, accessible at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11668&Mode=0

- The Agent should adopt the Suitability principles for the sale of financial products depending on the functions these products are expected to serve for the household. These suitability principles must be jointly agreed upon by the various financial sector regulators (Annexure 3 provides a brief examples of such principles). Each regulator can lay down prescriptive guidelines around how to meet these principles.
- The FSI must have trained staff that can communicate with the customer about the details of the products and take full responsibility for communicating with the clients.
- The FSI must have a comprehensive human resource policy, including an incentive plan for staff that not only encourages them to achieve the business objectives but more importantly prevents mis-selling by removing any incentives that conflict with their abilities to undertake suitable sales and advice. The incentives are to be structured in a manner as articulated in Section 3.4.2.
- The FSI should also have a mechanism to address queries and grievance of the customer about the services rendered by it and publicise it widely through electronic and print media. All customer grievances should be addressed within a defined time frame.

✓ The RBI can consider providing legitimacy to a 'marketplace' approach to banking where customers can pick and choose their banking products by interacting with a 'marketplace', very similar to the web aggregators under IRDAI. The business correspondent model is the natural candidate for creating such a marketplace, and this can mitigate issues with the BC model discussed previously. In order to operationalise this, the RBI can consider introducing a differentiated registration and certification mechanism for corporate BCs that have large ABC networks and are therefore already important participants in the financial system due to the large clientele of customers across geographies and their partnerships with a variety of banks. Such an approach will provide legitimacy to those CBCs that are willing to meet certain net worth criteria and have in place the technological capabilities for real-time transactions. The latter is needed to make them less expensive and safer for banks to engage with (relative to establishing own BC networks). If such a marketplace model were to gain prominence, banks can be nudged to adorn a 'seller' hat and consider designing products that are truly suited for the low-income households and businesses, and the delivery can be taken care of by such large registered BC companies who can then create a marketplace of products from a variety of banks rather than be tied down to being the delivery channel for a single bank. This can be a precursor to the evolution of a truly white-labelled BC model.

✓ The RBI in consultation with other stakeholders can consider introducing a tiered approach to grading of BC agents on the lines of the complexity of products they are capable of offering and the sophistication in business processes they can execute for offering and servicing these products. The complexity of products is to be driven by the level of complexity the product can introduce in the financial lives of low-income households and businesses. Therefore, certification examinations will also have to be across different progressive grades rather than take the form of a single examination. [Refer Section 4.2]

✓ Given that a PB's CICO points are closer to a customer to transact with in comparison to a nearest NBFC and can potentially form touchpoints with the customer for the purposes of sale of insurance, investment and retirement products, enabling the NBFC to use the PB as a BC can help bring down costs of servicing for the NBFC and open up an additional revenue stream for the PB with negligible additional costs for servicing the NBFC customer. [Refer Section 4.1.2]

9.2 Operations and Suitability

- ✓ All distributors must be subject to the same standards of conduct towards their customers, irrespective of their licensing types. Universal conduct obligations applied uniformly across all regulated entities is the need of the hour. As part of their obligations, all providers must ensure that customers have access to good quality, non-obfuscatory disclosures of product features. Expected returns as a percentage of the premium/invested amount, and past and expected IRR are to be clearly known upfront

- ✓ The various financial sector regulators must jointly agree upon a set of suitability principles that govern the relevant financial functions such as 'investment', 'risk protection' and 'retirement income' that the products under question must abide by and each regulator can then lay down prescriptive guidelines around how to meet these principles.

- ✓ Following this, regulators need to mandate the need for completing suitability assessments within all product sale processes by regulated entities serving retail customers. Such an assessment must consider whether the product being sold is meeting the suitability principles when serving the specific customer. Supervisory processes must then monitor and track distributor channel performance on the quality of such assessments, publish the results of such supervisory audits, and take stringent actions against those distribution channels found to be selling products that are unsuitable for their customers.

- ✓ Additionally, with an intention to prevent low-income households from entering into contracts of globally unsuitable products, the regulator can specify a set of globally unsuitable products that cannot be offered to households or businesses below a certain income threshold or net worth or individuals above a certain age. Such products should be prescribed by each regulator and could be amended from time to time based on feedback from customers and financial services providers, including from learnings from the various regulatory sandboxes. [Refer Section 6]

- ✓ A board-driven strategy must drive product design and sales processes targeted at low-income households. Business processes and technology must be employed to assist staff where additional training can no longer solve for their capacity limitations. [Refer Section 5]
- ✓ While all conflicted incentives work against good outcomes for the customer, volume-based incentives by themselves cannot be done away with given the current severe levels of exclusion in the country. Therefore, incentive design for these products must incentivise behaviour of distributors that is aligned with the right outcomes from these products for the low-income household. The key features in this respect are: [Refer Section 3.4.2]

    - The design of incentives must be such that the distributor who incurs more cost and effort to serve the customer gets incentivized proportionately.
    - Incentivising repeat contact with the customer in the form of trail commissions and commissions on subsequent year premiums that can cover for the cost of the distributor.
    - Heavy front-loading through the use of volume-based commissions to be avoided in order to prevent perverse behaviour resulting in lapsed policies. As a benchmark, any up-front

commissions can be a) a percentage of premium but capped at a maximum amount say Rs.10,000 such that all expenses incurred by the distributor are adequately covered within this), and b) must not be greater than 1.2 to 1.3 times the trail/subsequent year commissions that are expected to be paid out to the distributor if the customer were to stay invested through the full period. A more radical approach to consider would be to gradually increase incentives as the years progress so that the inclination to give up on a customer reduces at any point in the tenure of the product for the distributor.

- Any distributor incentives that could induce customers into churning or exiting contracts prematurely must be carefully tracked through the behaviour of distributors and their customers, and distributors who exhibit high levels of such behaviour must be blacklisted.
- Incentivising the distributor to be in contact with the customer for the purpose of ensuring benefits of these products are reaped by the customer, for instance, by initiating claims process, supporting the nominees/customers to complete a good quality claims process and documentation that reduces chances of it being rejected by the insurer. Another instance is by helping customers to understand when they are due to begin receiving annuity pay-outs (pensions) and helping them receive it in a seamless manner.

9.3 Business Cost Reduction

✓ A centralized KYC regime is needed, that can allow for the following two functionalities: a) allow an institution to reuse KYC completed for a customer for the purpose of on-boarding the customer for another product (which is overseen by a separate regulator), and b) allow an institution to rely on KYC verified by another institution for the same customer whether or not the two institutions are regulated under the same regulator).

✓ The Central KYC Registry of the CERSAI needs to be revamped on an urgent basis.

✓ All regulators can consider permitting the use of CVL-KYC completed by SEBI-regulated KRAs to be used by their regulated entities such as banks, NBFCs and insurers.

✓ Alternate KYC mechanisms to the ones which presently exist can be considered, whereunder, the need for KYC is eliminated or significantly reduced if transactions originate from a KYC verified bank account. For instance, for "opening a mutual fund account, by funding it from a KYC compliant bank account, while restricting that the folio continues to be funded from, and money refunded into that same account", or for "purchasing an insurance policy, by funding it from a KYC compliant bank account belonging to the proposer".

✓ Digital means of completing KYC, Aadhaar e-KYC and video KYC need to be permitted by all the four regulators after adequate checks and balances are put into place. [Refer Section 3.5.1]

✓ Setting up standing instructions to auto-debit one's bank account for making recurring contributions/premium payments to one's mutual fund account / insurance account reduces the cost to distributor to initiate this transaction each time a committed payment is due for the customer. However, given the severe regional variations in banking infrastructure to enable ECS debits, RBI can require banks to report the availability of these facilities across their branches and metrics for the quality of this facility on a recurring basis. Such reporting is to also cover debit card access for its banking customers.

- ✓ In order to establish parity between distributors who opt for digital transactions vis-à-vis cash transactions, there is a need to rationalise charges arising from penalties for failed ECS debit transactions (due to insufficient balance). In this regard, it may be worthwhile to explore waiver of the charges for a select number of returned transactions, say five, akin to the number of free off-US ATM transactions.

- ✓ Payments infrastructure available at present do not allow customers to electronically earmark and accumulate small-ticket amounts for funding insurance premiums or investment contribution. The One-time Mandate proposed under UPI 2.0 attempts to offer a solution where the customer can set a mandate for up to a fixed amount. [Refer Section 3.5.2]

9.4 Product Design

- ✓ Product regulations must not lead to the creation and sale of products that are inadequate for the customer segments they are meant to serve. [Refer Section 5]

A summary of these recommendations along with a high-level indicator of the modes of intervention needed and the order of prioritisation is provided below.

Table 7: Summary of Recommendations

			Mode of Intervention			
		Outcome of Interest	Regulatory	Supervisory	Market	**Prioritisation**
DISTRIBUTION CHANNEL DESIGN	Universal Distributor licenses can be issued by all 4 regulators – 'Financial Services Intermediary' (FSI) that can offer comprehensive offerings including to LIHs	Greater coverage of LIHs				
	Collapse in a phased manner, and bring under the fold of FSI, existing types of distributor regimes					
	Applying a tiered approach to grading individual distributors such as BC agents so that the more capable ones can begin to sell these more sophisticated products					
	Registration regime for white-labelling of Corporate BCs so that banks can begin to adorn the 'seller' hat and be nudged into better product design for LIHs					
	Permissions for Payments Banks to become BCs to NBFCs					
OPERATIONS & SUITABILITY	Incorporating suitability assessment within product sale process such for various financial functions these products serve such as 'investment', 'risk management' and 'retirement income'.	Delivery of suitable products to LIHs in a comprehensive manner				
	Supervisory processes to track distribution channel performance against suitability requirements, publish results, and take stringent actions for non-compliance					
	A board-driven strategy must drive product design and sales processes targeted at LIHs. Business processes assist staff there training cannot solve for capacity issues					
	Expected returns as % of the invested amount, and past and expected IRR to be clearly known upfront					
	Upfronting of incentives to be carefully reviewed and to not exceed a fixed cap, incentives for claims processing and annuitisation support to be considered for aligning these incentives with that of customer's					
	Globally unsuitable products must not be sold to LIHs					
BUSINESS COST REDUCTION	Uniform KYC regimes and centralised KYC systems enable reuse of KYC by the provider for enrolling under products that cut across 4 regulators	Cost Efficiency in business				
	Digital means of completing KYC, Aadhaar eKYC and Video KYC to be put in place with adequate checks by all 4 regulators					
	Rationalisation / waiver of penalties on ECS defaults by LIHs					
	Supervisory focus on improving banking infrastructure debit card outreach, ECS facility availability and efficiency					
PRODUCT DESIGN	Product regulations must not lead to the creation of products that are inadequate for the needs of LIHs and the targeting of the customer segments they are meant to serve.	Suitable Product Design				
			High	Medium	Low	

Annexure 1: Insurance Distribution Models

	Insurance Intermediary	Represents Customer	Represents Insurer	Insurance Intermediary as Exclusive Business[151]	Business Restrictions[152]	Remarks
			A. Insurance Agent Model			
1.	Corporate Agents		✓		3 in each category	Banks intending to act as corporate agents are required to apply for this license.
2.	Insurance Agents		✓	No specific mention	1 in each category	Applicable for individual insurance agents.
3.	Micro-insurance Agents		✓		1 in each category	Regulation of appointment of micro-insurance agents by insurers for the sale of micro-insurance products.
4.	Point of Sales Person - Life Insurance[153]	✓	✓		Engage with only 1 insurer/ intermediary	IRDAI introduced this category to expand the universe of existing individual distributors. POS persons can sell only 'simple' products such as pure Term Insurance products, non-linked/non-participatory Endowment Products and immediate Annuity Products.
5.	Point of Sales Person - Non-Life & Health Insurers[154]	✓	✓		Engage with only 1 insurer/ intermediary	Introduced with a similar objective as POS – Life insurance, POS persons in this category can sell pre-underwritten Motor

[151] Refers to the requirement to carry out the insurance intermediary business as the only business by the entity.
[152] Business restrictions refers to the restrictions on the number of insurers (includes life, general, and health) whose products can be sold by the insurance intermediary.
[153] Point of Sales Person – Life Insurance has been included under both Insurance Agent and Insurance Broking Model as POS persons can be appointed by any insurance intermediary for the sale of insurance products.
[154] Point of Sales Person - Non-Life & Health Insurers - has been included under both Insurance Agent and Insurance Broking Model as POS persons can be appointed by any insurance intermediary for the sale of insurance products.

						Comprehensive Insurance Package Policy & Third-party liability (Act only) Policy for Two-wheeler, private car and commercial vehicles, Personal Accident Policy, Travel Insurance Policy and Home Insurance Policy.
6.	Referral Company	-	-		1 in each category	Banks are not eligible to become referral companies. Exception has been provided in the case of Regional Rural Banks and Co-operative Banks satisfying certain criteria stipulated by the RBI.
			B. Insurance Broking Model			
7.	Insurance Brokers	✓		✓	None	
8.	Banks as Insurance Brokers	✓			None	
9.	Point of Sales Person - Life Insurance	✓	✓		Engage with only 1 insurer/ intermediary	IRDAI introduced this category to expand the universe of existing individual distributors. POS persons can sell only 'simple' products such as pure Term Insurance products, non-linked/non-participatory Endowment Products and immediate Annuity Products.
10.	Point of Sales Person - Non-Life & Health Insurers	✓	✓		Engage with only 1 insurer/ intermediary	Introduced with a similar objective as POS – Life insurance, POS persons in this category can sell pre-underwritten Motor Comprehensive Insurance Package Policy & Third-party liability (Act only) Policy for Two-wheeler, private car and commercial vehicles, Personal Accident

						Policy, Travel Insurance Policy and Home Insurance Policy.
11.	Insurance Marketing Firm		✓		2 in each category	This new category was introduced by IRDAI in 2015 with the stated objective of increasing insurance penetration in the country, especially in trying to get distribution presence in the Aspirational Districts[155]. In its design, it resembles the insurance broker model but with freedoms to undertake non-insurance financial services business[156] for enhancing revenue streams. It has also reduced the minimum net worth requirements (Rs.0.5 -1 million) as compared to that of a direct broker license (Rs.7.5 million capital).
C. Marketplace Distribution Models						
12.	Insurance Web Aggregators		✓	✓	None	IRDAI first introduced this model in 2011 in the form of guidelines for registration of web aggregators with the objective of facilitating online distribution of evaluation of insurance products.
13.	Insurance E-Commerce	✓	✓		As per the restrictions applicable to the licensed intermediary.	This license was introduced to promote e-commerce in insurance space in order to lower costs and bring inefficiencies. This allows an insurance company or an insurance intermediary to set up

[155] Aspirational District means a district designated as such by the NITI Aayog, Government of India or any other economically backward district, as may be recognized by IRDAI.

[156] Can also distribute other financial products as permitted by RBI, SEBI, PFRDA, and Department of Posts.

						an electronic platform to undertake e-commerce activities including issuance of e-insurance policies.
			D. Others			
14.	Insurance Repositories	-	-		-	This license was first issued in 2011, and five entities were granted the license. The objective as stated was to provide the policyholder with the facility to maintain insurance policies in electronic form. Additionally, insurers intending to issue e-insurance policies are required to enter into service level agreements with insurance repositories.

Annexure 2: Incentive Structure Design for Insurance distribution licenses/ registration models

The maximum commissions or remuneration allowed[157] by IRDAI under each insurance product category is provided below.

Key Definitions	Applicability
Commission - paid to or received by an insurance agent from an insurer.	*Applicable* to payment of commission or remuneration or reward, to insurance agents and insurance intermediaries.
Remuneration - paid to or received by an insurance intermediary	*Not applicable* to insurance products specified under IRDAI (Micro Insurance) Regulations, 2015 and IRDAI (Insurance Services by Common Service Centre) Regulations 2015 and such other insurance products as may be specified by the Authority from time to time.
Reward - an incentive paid to an insurance agent (towards benefits) or an insurance intermediary (towards services rendered)	No Insurer shall pay both commissions to an insurance agent and remuneration to an insurance intermediary on the same insurance policy.
Insurance Intermediary for the purpose of this regulation includes - (a) Corporate Agents (b) Insurance Brokers (c) Web Aggregators (d) Insurance Marketing Firm (e) Any other entity as may be notified by the Authority from time to time.	

Life Insurance: The maximum commission or remuneration as a percentage of premium that is allowed for life insurance products offered by life insurers is as under:

	Category of Life Insurance Product or Policy	Maximum Commission/ Remuneration on Single Premium payable to insurance agent/ insurance intermediary
1	**Single-Premium**	
A	All individual life products except pure risk products	2%
B	Individual Pure Risk products	7.50%
C	Individual Immediate/ Deferred Annuity	2%

[157] IRDAI (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations, 2016, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3032&flag=1

D	One year renewable group pure risk insurance	5% of premium paid during the year or Rs 1 million, whichever is less	
E	Group Pure Risk (incl Group credit)	5%	
F	Group Savings Variable Life Insurance	2%	
G	Group Fund based	0.5% of the premium paid during the year or Rs1 million, whichever is less	
2	**Regular Premium**	**First-year premium**	**Renewal premiums**
A	Individual Pure Risk	40%	10%
B	Individual Other than Pure Risk		
i)	In respect of policies with premium payment terms of		
	5 years	15%	7.5%
	6 years	18%	7.5%
	7 years	21%	7.5%
	8 years	24%	7.5%
	9 years	27%	7.5%
	10 years	30%	7.5%
	11 years	33%	7.5%
	12 years or more	35%	7.5%
C	Individual Deferred Annuity / Pension	7.5%	2%
D	Group Pure Risk (incl Group credit) and Group Savings Variable Life	7.5% (only on pure risk premium)	7.5%
E	Government Scheme-Life-Health	As per Government Notification	As per Government Notification

Health Insurance (General & Stand-alone Health Insurers): The maximum commission or remuneration as a percentage of premium that is allowed for health insurance products offered by general insurers or stand-alone health insurers is as under:

	Line of Business	**Maximum Commission/remuneration payable to insurance agents/ insurance intermediaries**
1	Health-Individual[158]	15%
2	Health-Group (Employer-Employee only) - Annual	7.5%
3	Health-Group (Non Employer-Employee groups – not formed solely for availing insurance as defined in IRDA Group Guidelines of 14th July 2005) – Annual	15%
4	Health – Group (credit linked upto 5 years)	15%
5	Health-Govt Scheme	As specified in the Government Scheme/Notification

[158] Individual includes annual premium, 3 years single premium, 3 years regular premium

General Insurance (other than the motor[159]): The maximum commission or remuneration as a percentage of premium that is allowed for general insurance (other than the motor) is as under:

	Line of Business (Other than Motor)	Maximum Commission payable to an insurance agent	Maximum remuneration payable to an insurance intermediary
1	Fire-Retail	15%	16.5%
2	Fire-Corporate (Risks with S.I. < Rs 2,500 crs)	10%	11.5%
3	Fire-Corporate (Risks with S.I. > Rs 2,500 crs)	5%	6.3%
4	Marine-Cargo	15%	16.5%
5	Marine-Hull	10%	11.5%
6	Miscellaneous – Retail	15%	16.5%
7	Miscellaneous – Commercial/ Group[160]	10%	12.5%
8	Miscellaneous – Commercial (Engineering Risks with S.I. > Rs 2,500 crs)	5%	6.3%

Rewards:

Three channels of distribution[161]	**Rewards**
Insurance agents	Maybe paid
Insurance intermediaries - insurance intermediary business forms the core. (revenues from other than insurance intermediation is 50% or less of their total revenue from all the activities)	Maybe paid
Insurance intermediaries - insurance intermediary business does not form the core (revenues from other than insurance intermediation is 50% or more of their total revenue from all the activities)	Not allowed
Rewards Payable (Overall basis and not linked to each and every policy solicited):	
Life Insurance	Not more than 20% of the 1st year commission or remuneration paid.
General Insurance including health insurance	Not more than 30% of the 1st year commission or remuneration paid.

[159] We have not covered discussion on motor insurance in this report

[160] Commission/ remuneration shall be payable as per Government notification

Important Observations

<table>
<tr><th>Insurance Intermediary</th><th>Maximum Commission/ Remuneration Payable</th><th>Remarks</th></tr>
<tr><td>Corporate Agents</td><td rowspan="6">Caps on incentives for life, general, and health insurance are similarly placed.</td><td></td></tr>
<tr><td>Insurance Agents</td><td></td></tr>
<tr><td>Insurance Brokers</td><td></td></tr>
<tr><td>Banks as Insurance Brokers</td><td></td></tr>
<tr><td>Insurance Marketing Firm</td><td>Entitled to receive fees for undertaking insurance service activities as may be mutually agreed between the IMF and the Insurance Company.</td></tr>
<tr><td>Insurance Web Aggregators</td><td>No charges shall be paid for transmission of leads, and only leads which are converted into the sale of insurance policies will entitle the Web Aggregator to earn remuneration.

Fee or remuneration on any type of renewal premium/policy not allowed.

A flat fee of not exceeding Rs. 50,000 per year towards each product displayed.

The insurer may pay reasonable service charges at mutually agreed if it outsources 'Insurance Services' in respect of policies procured through them.</td></tr>
<tr><td>Micro-insurance Agents</td><td>(a) Life Insurance Business:
Single premium - 10% of the premium.
Non-single premium - 20% of the</td><td></td></tr>
</table>

	premium for all the years of the premium paying term. (b) General Insurance - 15% of the premium. (c) Group Insurance - The limits specified in (a) and (b) would be applicable. (d) In case of registered insurance intermediaries (other than Micro-insurance agents): According to the respective applicable regulations.	
Point of Sales Person - Life Insurance		
Point of Sales Person - Non-Life & Health Insurers		
Referral Company	Only for such database that is converted into sales, which shall not exceed 25% of the commission payable or actually paid, whichever is lower, on the first-year premium of the first policy sold based on the lead obtained from the referral company.	Fee or remuneration on any type of renewal premium/policy not allowed.
Insurance Repositories	As per the agreement entered by the two parties.	

Annexure 3: Suitability Obligations

Function of credit: If the Financial Services Intermediary is dealing in a product that provides the function of credit to the retail customer, it has an obligation to ensure that it conducts, prior to making available the credit facility to the retail customer, adequate due diligence on the retail customer to ascertain the ability of the retail customer to meet his/her repayment obligations when they are expected to fall due (both unique repayment obligations as well as the total repayment obligation under the credit arrangement), out of own income and savings without having to realise security or assets. Where credit is expected to be used for increasing income-earning capacity of the retail customer's livelihood by means of self-employment, then the financial service provider must carry out adequate due diligence to ascertain, to its satisfaction, the ability of such investment in increasing the income-earning capacity of the livelihood such that it can generate cash flows that would be adequate to meet his/her repayment obligations when they are expected to fall due (both unique repayment obligations as well as the total repayment obligation under the credit arrangement). Any due diligence of the retail customer must not be based primarily or solely on the value of any security that the retail customer is willing to furnish.

Function of insurance: If the Financial Services Intermediary is dealing in a product that provides the function of insurance to the retail customer, it has an obligation to ensure that it conducts, prior to enabling a transaction in relation to insurance, adequate due diligence on the retail customer to ascertain, including through information obtained from the retail customer about his/her financial situation, that the transaction is appropriate and adequate for the customer's interests and needs, and that the customer has the ability to make payments for the premiums due.

Function of investment: If the Financial Services Intermediary is dealing in a product that provides the function of investment to the retail customer, it has an obligation to ensure that it conducts, prior to enabling a transaction in relation to investment, adequate due diligence on the retail customer to ascertain, including through information obtained from the retail customer about his/her financial situation, risk profile and capacity, that the transaction meets the customer's investment objectives. Such due diligence must ensure that the customer is able to bear any investment risks related to such transaction in line with his/her investment objectives. Such due diligence must not be based primarily or solely on the risk appetite of the retail customer for a specific product.

In demonstrating compliance with the Obligations, the Financial Services Intermediary must invest in efforts that are proportionate to the complexity that the financial product or service can introduce in the financial life of the customer. Such a demonstration of compliance should reflect the risk of harm to the customer, considering the nature of the customer, and the nature of the financial product or financial service provided.

Annexure 4: Changes in the number of individual agents and corporate agent partnerships of life insurers, 2013-2018 (Excluding LIC)

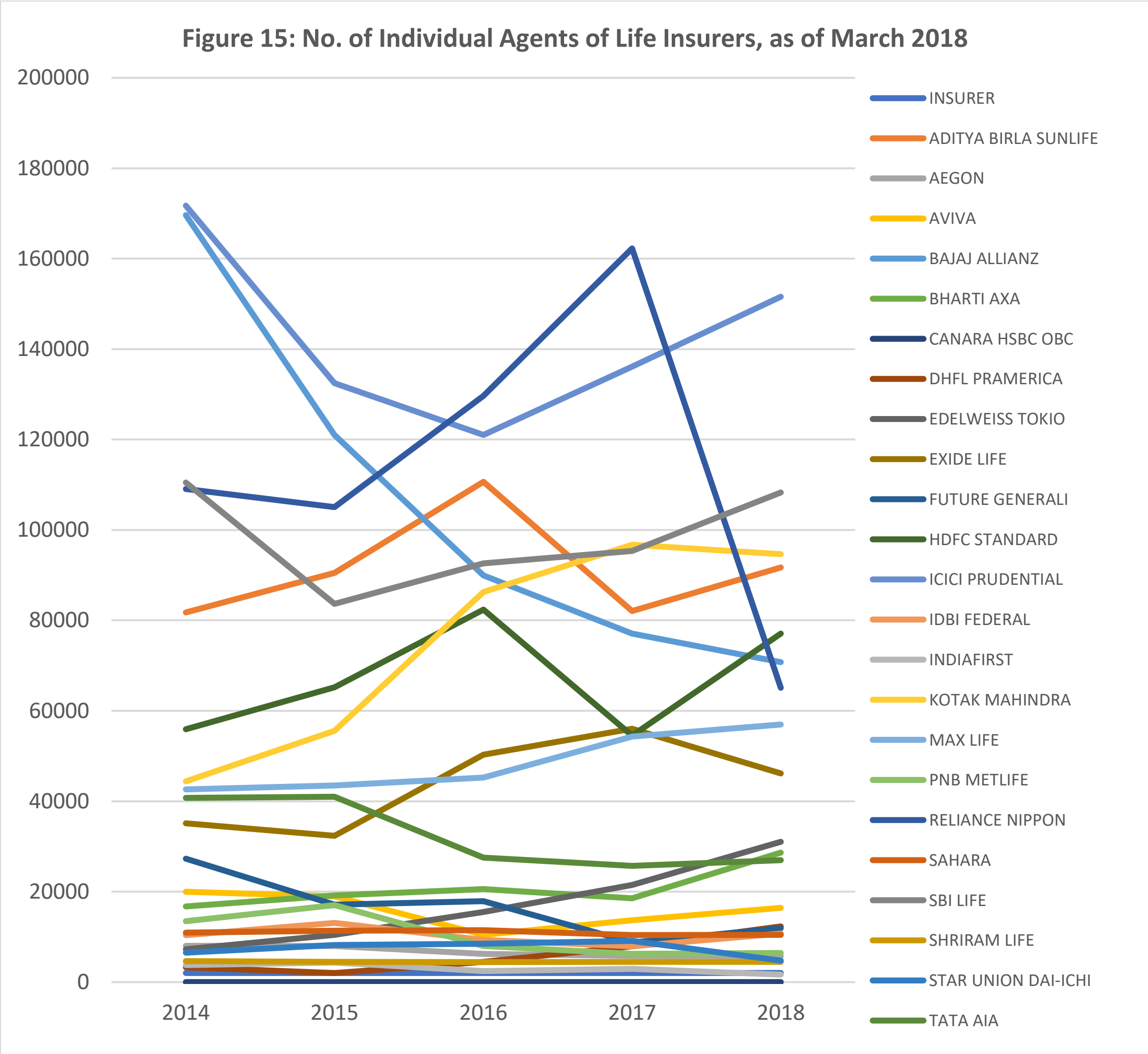
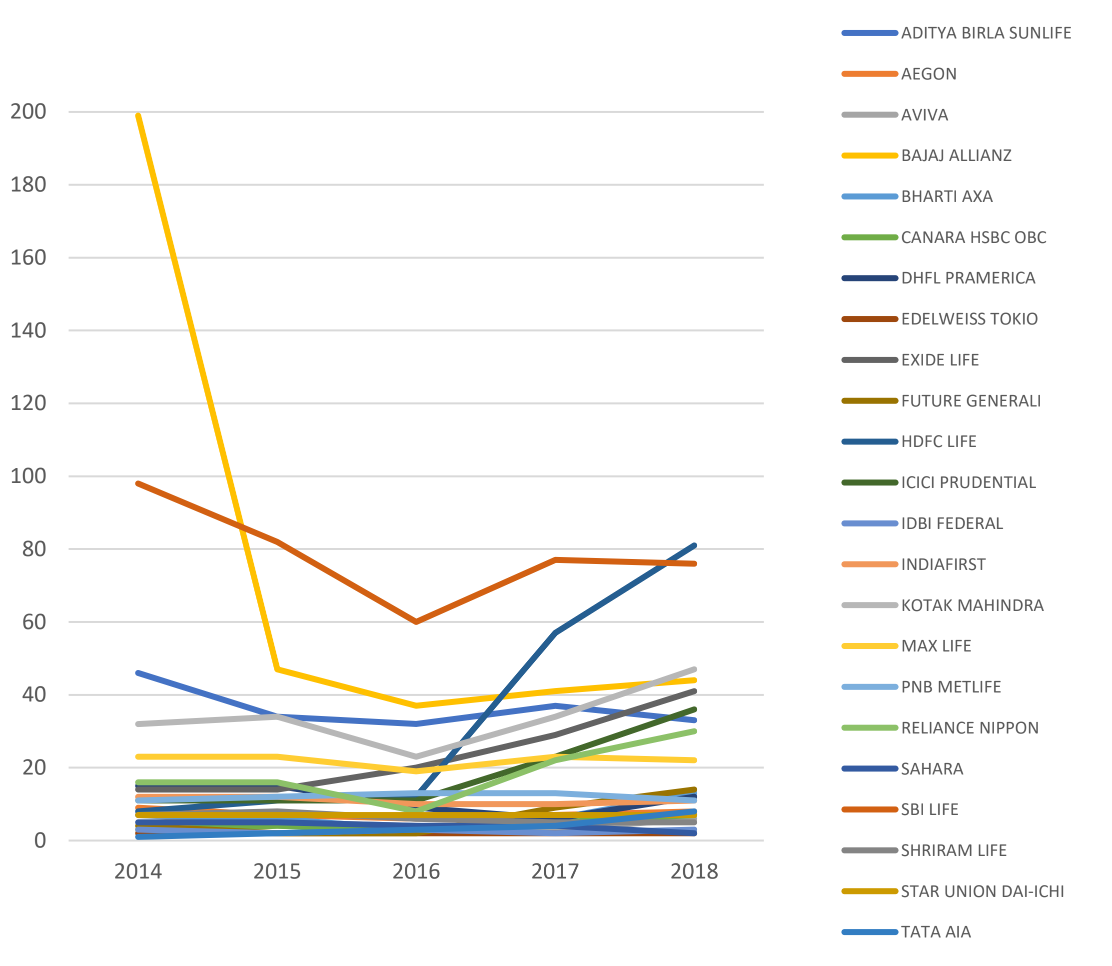


Figure 16: No. of Corporate Agents of Life insurers, as on March 2018



Annexure 5: Total Expense Ratios across AUM slabs for Mutual Funds

<table>
<tr><th colspan="5">Table 8: Base Total Expense Ratio for Mutual Funds[162]</th></tr>
<tr><td>AUM Slabs (Rs.cr)</td><td>Equity Oriented Schemes</td><td>Debt Oriented Schemes</td><td>Exchange Traded Funds (ETFs) (including Gold ETFs)/Index Funds</td><td>Fund of funds (FoF) (Both Domestic and Foreign)</td></tr>
<tr><td>Upto 100 cr</td><td>2.50%</td><td>2.25%</td><td rowspan="4">1.50%</td><td rowspan="4">Maximum of 2.5% including the TER of underlying schemes.</td></tr>
<tr><td>Next 300 cr</td><td>2.25%</td><td>2.00%</td></tr>
<tr><td>Next 300 cr</td><td>2.00%</td><td>1.75%</td></tr>
<tr><td>On balance AUM</td><td>1.75%</td><td>1.50%</td></tr>
<tr><td colspan="5">The additional expenses over and above the base TER are as under:
• Additional expenses, not exceeding 0.30 percent of daily net assets, subject to new inflows from B30 cities;
• Additional expenses, not exceeding 0.05 percent of daily net assets, due to credit of any exit load to the scheme.
• Goods & Services Tax (GST) on Management Fee is charged over and above the TER limit.</td></tr>
</table>

[162] Proposal for review of Total Expense Ratio (TER) of Mutual Fund (MF) Schemes, SEBI Board Memorandum, accessible at: https://www.sebi.gov.in/sebi_data/meetingfiles/oct-2018/1539576106009_1.pdf