The Case for Good Disclosures - Building A Two-Way Road Towards Suitable Insurance Sale

A simplified Customer Information Sheet that improves comprehension, enables comparison, and engenders transparency could aid suitable life insurance product sales

By Priyadarshini Ganesan

Insurance is a hard sell anywhere in the world, but more so in developing countries like India, with a population that is predominantly low-income and largely informal. Life insurance, in its current form, came to India through the Europeans (1818) and was slowly Indianized. However, it was the nationalisation of life insurance and the state backing provided to the Life Insurance Corporation of India (LIC) (1956) that propelled the industry forward to its current heights. Community-based agents appointed by LIC initially and later by other private insurers were pivotal in spreading insurance to the nooks and corners of the country. They were instrumental in increasing awareness and improving penetration. However, the history of how life insurance was popularised in India and its reliance on agent-led sales[1] has resulted in some challenges that have hindered good customer outcomes.

In this note, we discuss how the difficulty of selling life insurance led to bundling insurance with savings[2], how such bundling can be sub-optimal, and why such products are popular despite adverse customer experiences. We then make a case for providing relevant, complete, and comparable information that can aid suitable product decisions, sale, and persistence. We also offer a template for what such a Customer Information Sheet could look like.

Popularity Of Savings-Based Insurance - Ticks Many Boxes

In life insurance, unlike in other forms of insurance, the downside risk is manifested for the family and dependents after the policyholder's lifetime. This creates unique barriers to using life insurance as a form of financial risk mitigation for the household, especially given the alternative of informal social support and community solidarity strongly evident in the Indian cultural context. The agent-led model circumvented some barriers to life insurance take-up by infusing trust in the product through community members, harnessing social connections to shift preferences, and providing incentives for such sales. However, even with the agent-led intervention, the life insurance sold was mostly bundled with savings or investments, i.e., endowment life insurance. Standalone life insurance, i.e., pure life risk cover, was harder to sell owing to multiple behavioural considerations:

(i) Optimism

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[1] 52.76% of new individual business (23.08% for private sector and 96.14% for public sector) came through individual agents in 2022-23 as per IRDAI Annual Report 2022-23.

[2] Pitthan, F., & De Witte, K. (2021). Puzzles of insurance demand and its biases: A survey on the role of behavioural biases and financial literacy on insurance demand. Journal of Behavioral and Experimental Finance, 30, 100471.

People don't want to think about their own or their loved one's death, and most plans for one's financial and non-financial future are based on positive expectations. This is the psychological wiring that most of us unconsciously carry and that helps us navigate our lives positively with equanimity. However, a life insurance purchase decision, especially pure term life insurance with no embedded savings component, forces one to confront the possibility of death and its financial consequences in a very direct manner. This might be disconcerting for the customer to consider and the agent to talk about or suggest. Thus, marketing life insurance as a savings product is easier than selling pure-term life insurance. It calls to imagination a positive financial lump sum in the future that the customer can look forward to as opposed to the dismal event of death that they would rather not think about.

(ii) Lack of Salience

While the typical financial planning priority pyramid might suggest protection as the base for building other financial plans, most people do not automatically think of insurance as their first priority in allocating resources. Particularly in a developing country like India, where a substantial segment of the population still accumulates minimal surplus, protection is often not salient enough. The surplus in such a situation would rather be directed towards some specific long-term goal. Hence, endowment life insurance that provides a medium to save for the long term is often more amenable to the priorities of Indian households.

(iii) Loss Aversion

A pure life insurance product entails premium payment for life cover, which is not returned if the life risk does not materialise over the policy term. However, it is common for customers to view such premiums as wasted money. Better awareness about life insurance has not necessarily led to a fundamental understanding of how insurance products function. This lack of understanding leads to a perception of loss, making term life insurance a difficult product to sell. Bundling life insurance with savings circumvents loss aversion by ensuring some return for the customer, leading to better take-up.

Further, for the insurer, a long-term savings-cum-insurance contract could potentially solve adverse selection if customers who are willing to commit to saving for an extended period self-select into such contracts[3]. This is particularly important for nascent insurance industries to avoid early market failure.

Over time, life insurance in India (and in some other parts of the world) has come to be viewed as a long-term savings or investment product with an added life cover feature. While some specific and valid reasons exist for the popularity of endowment plans, the nature of

[3] Venezia, I. (1991). Tie-in arrangements of life insurance and savings: an economic rationale. Journal of Risk and Insurance, 383-396.

bundling makes them perform sub-optimally on insurance, savings, or both, depending on the customer to whom it is sold.

Promoted as savings and insurance, yet performs as neither completely – bundling gone amiss

Endowment life insurance typically calls for regular payment of premiums over the committed premium payment term. Apart from providing death benefits to nominees in the event of the policyholder's demise, it also offers an assured sum at the end of the policy term upon the survival of the policyholder. Due to the assured savings component, the premium per rupee of life cover is often much costlier for endowment life insurance than for term life insurance. However, it fails to provide either savings or insurance effectively.

(i) Low Life Cover

Endowment life insurance rarely offers the suggested 10x times annual income as life cover that a household typically needs to maintain its living standard despite the policyholder's death. The life cover offered by the endowment products available to the low- and middle-income segment calls for premium amounts such that those who could afford them often get only a fraction of their optimal life cover with these policies (less than 2x of annual income).

(ii) Low Return on Savings

The return on savings on endowment products is often meagre, significantly so when adjusted for inflation. This is a serious cause for concern in long-term savings instruments in a developing country like India with relatively high inflation.

(iii) High Penalty on Premature Exit

The penalty for premature exit on this policy is quite heavy, leading to a significant loss of savings for policyholders. Most endowment policies charge a 100% penalty for exit after the first year, around 70% penalty for exit after the second year of the policy[4] and so on. Considering that this is marketed as a savings cum insurance product, the loss of capital in the savings component is very high for policyholders. This is especially salient given the very low persistency rates for life insurance in India. For instance, as of February 2024, the 13th-month persistency for life insurance is 64.28% for LIC and an average of around 71.97% for all other private life insurers together[5]. This implies that around 28% to 36% of policyholders lose their life cover and the entirety of the

[4] A recent Insurance Regulatory and Development Authority of India (IRDAI) draft guidelines suggest a 70% penalty for premature exit after the first year, 65% for second year and so on for non-linked life insurance products.

[5] Handbook on Indian Insurance Statistics 2022-23. Further, the 25th-month persistency is even worse at 56.97% for LIC and an average of 60.22% for all other private life insurers together.

premium they paid in the first year of their policy by the end of the first year. Considering the country's low insurance penetration rate and high mortality protection gap, this significant loss of savings and life cover for a substantial segment of the life insurance customer base is a cause for worry[6].

Therefore, endowment life insurance products, as they are currently designed, are not an adequate insurance product or suitable savings product for most sections of the population.

The risk return matrix – unsuitable for low-income segment

In a press note, the Insurance Regulatory and Development Authority of India (IRDAI) has declared a vision of 'Insurance for All' by 2047, and one of the key focus areas is to "make available the right products to right customers"[7]. Endowment life insurance neither acts like a regular savings product that ensures the safety of capital nor does it act like a complete insurance product that provides adequate life cover. Therefore, it is not the right product for customers with:

(i) High dependencies: For example, sole breadwinners with many dependents might need much higher life cover than possible or affordable with an endowment plan.
(ii) Low surplus: Households with low savings must be directed to products that offer higher returns for similar risk than endowment products, especially since the income tax benefits offered by endowment products are irrelevant to these customers.
(iii) High-income volatility: Households that face instability of inflows might not be able to stick to the premium payment commitments and stand to lose a significant proportion of savings to exit penalty.

Endowment products are, therefore, highly unsuitable for the low-income segment. Yet, as per Centre for Monitoring Indian Economy (CMIE) Data, around 35% of households from the first five income deciles, i.e., households that earn up to around Rs. 11,000 per month, have reported using life insurance to save as of September 2023[8]. Further, as per a Dvara Research analysis of the All-India Debt and Investment Survey (AIDIS) 2019, the first five asset deciles save an average of around Rs. 7,500 per annum in endowment life insurance plans. Despite its unsuitability, what makes endowment products popular even among this segment?

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[6] Sane, R., Thomas, S., & Halan, M. (2013). Estimating losses to customers on account of mis-selling life insurance policies in India.
[7] Press Note on Insuring India by 2047 – New Landscape for Insurance Sector, IRDAI
[8] The CMIE Aspirational India dataset has a datapoint on whether the household is saving in life insurance currently.

Fig 1: Bundling makes product features fuzzy, and without good disclosures explaining these product features, information asymmetry abounds, leading to unsuitable insurance sales.

The seen and the unseen – information asymmetry

The agent-led model has been conducive to making life insurance accessible and trustworthy for customers. However, given the general level of financial literacy among the Indian population and the highly technical language used to describe life insurance product features, customers rely heavily on agents to explain and suggest suitable products for their particular needs. Customers are often unaware of the different products available in the market to ask for specific features or prod agents on product specifications to ascertain suitability by themselves. In recognition of this constraint on the part of the average customer, IRDAI has mandated suitability assessments to ensure that agents offer customers the right type of insurance. This mandate, therefore, envisions a fiduciary role for life insurers and their agents in suggesting suitable life insurance products for customers as per their circumstances, goals, and risk profile. However, a Dvara Research analysis[9] of the suitability assessment forms by various life insurers found wide variations in its implementation and gaps in its effectiveness.

Further, the commission differentials across different life insurance products skew the incentives for agents towards certain products, notably endowment life insurance. This undermines the effectiveness of the mandated suitability assessment, and customers are often shown products that work best for the agent rather than the customer[10]. Agents habituated to selling specific products also presume their universal suitability erroneously and advise customers accordingly[11]. This leaves customers bereft of choice, blind to pertinent information, and saddled with unsuitable insurance products that they either don't stick with or end up receiving suboptimal returns or coverage (or both) than would otherwise be the case.

[9] Anukriti Tiwari, Deepti George (2021). Tracing the History of IRDAI's Regulations on Suitability and its Interpretations by Market Participants – Part 2. Dvara Research.

[10] Anagol, S., Cole, S., & Sarkar, S. (2017). Understanding the advice of commissions-motivated agents: Evidence from the Indian life insurance market. Review of Economics and Statistics, 99(1), 1-15.

[11] Anagol, S., Cole, S., & Sarkar, S. (2017). Understanding the advice of commissions-motivated agents: Evidence from the Indian life insurance market. Review of Economics and Statistics, 99(1), 1-15.

IRDAI has prescribed benefit illustrations for endowment products and unit-linked products that seek to provide customers with information on policy premiums, assumed returns, death benefits, and surrender benefits in a tabular format[12]. While the table itself is comprehensive, it is often not comprehensible to customers. They again depend upon agents to explain this table to them, allowing agents to focus more on benefits and returns while glossing over surrender values. In fact, the term 'surrender benefit' could itself be misleading for most customers who do not immediately understand that it entails a penalty on their savings for any premature exit from the policy. Our field study[13] in Tamil Nadu found that customers were often not aware of any penalty for premature exit, and surrender conditions were not discussed at the time of sale.

(Amount in Rupees.)

Policy Year	Single / Annualized Premium	Guaranteed Benefits					Non-Guaranteed Benefits @ 4% p.a			Non-Guaranteed Benefits @ 8% p.a			Total Benefits including Guaranteed and Non-Guaranteed Benefits			
													Maturity Benefit		Death Benefit	
		Guaranteed Additions.	Survival Benefit	Surrender Benefit	Death Benefit	Maturity Benefit	Rever-sionary Bonus	Cash Bonus	Surrender Benefit	Rever-sionary Bonus	Cash Bonus	Surrender Benefit	Total Maturity Benefit, incl Terminal Bonus, if any @ 4% (7+8+9)	Total Maturity Benefit, incl Terminal Bonus, if any, @ 8% (7+11+12)	Total Death Benefit incl of Terminal Bonus if any, @ 4% (6+8+9)	Total Death Benefit incl of Terminal Bonus if any, @ 8% (6+11+12)
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17

Notes: Annualized Premium excludes underwriting extra premium, frequency loadings on premiums, the premiums paid towards the riders, if any, and Goods & Service Tax. . Refer Sales literature for explanation of terms used in this illustration

Fig 1: Sample illustration table mandated by IRDAI for Non-Linked Participating Life Insurance Products

Given the risk of capital loss due to premature exit, endowment insurance marketed as a savings-cum-insurance product needs disclosures to provide complete and accurate information on the downside risk to enable optimal product choice. Further, addressing this information asymmetry between customers and agents can help mitigate the misaligned influence of agents on customers' product choices.

The regulator has responded to customer complaints[14] about other product categories or other products within the same life insurance category (e.g., ULIPs) to make changes to disclosure mandates. However, the nature of endowment products makes them much less amenable to customer complaints for three reasons:

(i) **Relevant information omitted:** Unlike in the case of a relatively more complex product like ULIPs, where mis-sale happened on the back of explicitly misleading information (on returns, investment period, etc.), the mis-sale in endowment life insurance is primarily due to omission of pertinent information. The capital loss

[12] Circular on (a) Benefit illustration and (b) other market conduct aspects (IRDAI/LIFE/MISC/CIR/173/09/2019)

[13] Ganesan, P., Prasad, S., & Sharma, M. (2022). Can information disclosures influence life insurance purchase decisions for low-income households? Dvara Research.

[14] The IRDAI circular on Customer Information Sheet explicitly mentions customer complaints as the reason for the update.

owing to surrender terms is part of the policy document offered to customers at the time of insurance purchase. However, the terms were most likely not explained to customers. Community-based agents who share a reasonably good rapport with policyholders find it easy to point to the document when confronted with complaints.

(ii) **Customer base is not niche:** Mutual funds, health insurance, or ULIPs are targeted to the niche high-income segment, which typically has the means and financial acumen to raise complaints at the right forums. On the other hand, endowment life insurance is a more broad-based product offered to the low- and middle-income segments who might not have the wherewithal to raise complaints.

(iii) **Returns not benchmarked:** For relatively short-term products like health insurance, where the risk often materialises with some probability in the near term, or ULIPs, where the performance of the investment becomes apparent to the customer in the short to medium term, it is easier for customers to identify pain points or issues with suitability. In the case of long-term products like endowment life insurance, the lump sum receivable on maturity is not benchmarked against any other product, making it impossible for customers to ascertain product fit confidently. Even if they apprehend unsuitability either through the policy term or at the end of it, the sunk cost fallacy sets in, i.e., a cognitive bias that causes people to continue a course of action because of how much they have already invested in it, in this case, endowment plans, despite knowing its sup-optimal outcomes. This dissuades complaints from customers who might well be unhappy with the product.

However, the abysmal persistency rates in life insurance can be used as an indicator of adverse customer outcomes and satisfaction. The need for better disclosures should, therefore, be judged based on the life cover and savings loss incurred by customers and the impact such policy exits have on the portfolios of Indian households[15].

Better disclosures – paving a two-way path towards suitability

While mandating suitability assessment by insurance agents is a much-needed step in the right direction, arming customers with information in the most understandable format will help bridge the information asymmetry inherent in life insurance distribution. This move towards better disclosures is already evident in other product categories. For instance, SEBI has recently mandated brokers to issue a standard Most Important Terms and Conditions (MITC) document that needs to be acknowledged by clients[16]. IRDAI has also mandated an

[15] As per RBI Annual Report 2022 – 23, household sector saving was 19.6% of Gross National Disposable Income in 2021-22. Of this, 2% was in insurance funds i.e., 9.6% of household savings was with insurance funds.

[16] Circular on Most Important Terms and Conditions (MITC) (SEBI/HO/MIRSD/MIRSD – PoD – 1/P/CIR/2023/180)

updated Customer Information Sheet (CIS) that provides key information on health insurance in simple terms[17].

The literature on disclosures is inconclusive[18] about the extent to which disclosures can alter product choice. Trust in the agent is a significant deciding factor influencing product choice, and disclosure does not necessarily change product perception when presented by a trusted agent[19]. Further, the disclosure format can affect the risk perception of customers, and neither simplified disclosures nor one-size-fits-all disclosures work[20]. Similarly, mandating disclosures on agent commissions that can temper the agent's influence on customer choice can also lead to agents not suggesting products that call for such disclosures[21]. This is a crucial consideration since different products within the same life insurance category are mandated to provide different types of disclosures on commissions by IRDAI. A Dvara Research study[22] found that while accurate disclosure on endowment products alone did not lead to statistically significant differences in product choice, offering comparison to other products did lead to a significant shift in preferences. Comparability is an important feature that aids product assessment and purchase decisions. A good disclosure should, therefore, provide all pertinent details in a manner that aids easy comparison between different types of products. Despite its possible ineffectiveness in altering product perception, semi-personalised (for tenures and contributions) and simplified disclosure that aids comprehension enables comparison and highlights downside risk can enable customers to make more informed purchase decisions that, in turn, would engender trust and faith in formal finance.

Given the digitisation drive seen among many insurers, with agents now having access to customer onboarding apps, it becomes much easier to personalise disclosures to any customer based on the life cover required. Further, disclosures in online formats by InsurTechs have the potential to be even more effective. Unlike in the case of non-digital intermediation, where such a step can potentially be skipped, in digital insurance sales, it will be a necessary step that the user has to cross before buying the product. Therefore, digital disclosures that are simple, clear, and comparable could prove to be very effective.

[17] Circular on Revision of Customer Information Sheet (IRDAI/HLT/CIR/MISC/190/10/2023)
[18]See here, here and here.
[19] De Meza, D., Irlenbusch, B., & Reyniers, D. J. (2010). Disclosure, trust and persuasion in insurance markets.
[20] Linciano, N., Lucarelli, C., Gentile, M., & Soccorso, P. (2018). How financial information disclosure affects risk perception. Evidence from Italian investors' behaviour. The European Journal of Finance, 24(15), 1311-1332.
[21] Anagol, S., Cole, S. A., & Sarkar, S. (2011). Bad advice: Explaining the persistence of whole life insurance. Available at SSRN 1786624.
[22] Ganesan, P., Prasad, S., & Sharma, M. (2022). Can information disclosures influence life insurance purchase decisions for low-income households? Dvara Research.

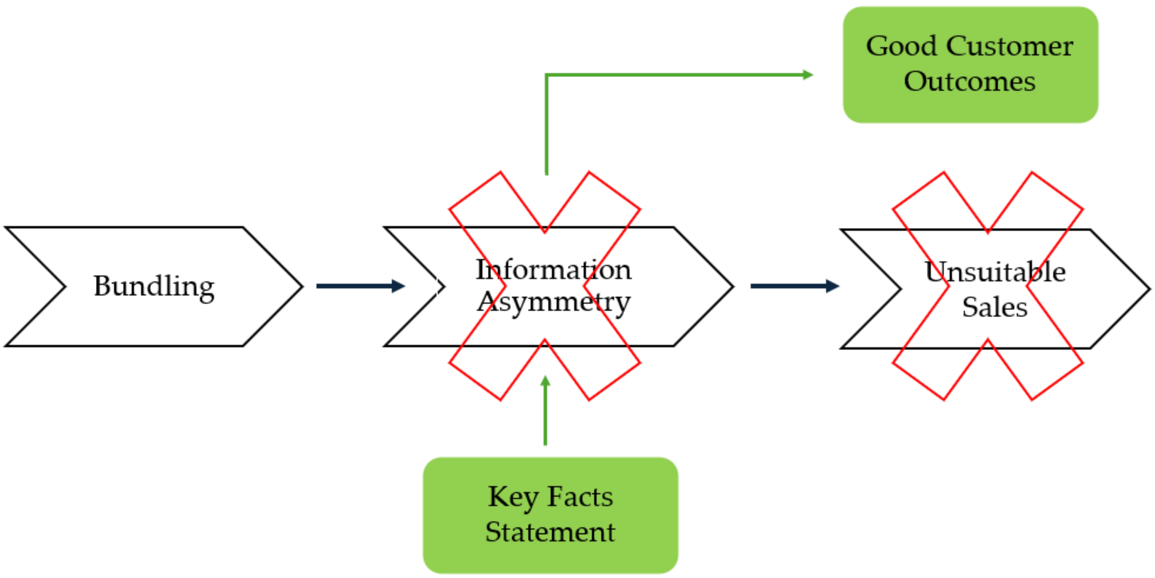

Fig 2: The information asymmetry resulting from poor disclosures needs to be tackled with a well-designed key facts statement to ensure good customer outcomes.

Simplified information sheet – the low-hanging fruit

Agents are instrumental in ensuring informed sales of insurance and are necessary to improve insurance penetration and awareness in India. They should act as fiduciaries advising the best product that is most suitable for the protection or savings needs of their customers. However, given that conflicting incentives are common in financial intermediation in India, providing customers with relevant and essential information can act as a bulwark against mis-sale. A simplified disclosure that explains product features in simple terms and provides key facts on the advised product can help customers understand and stick to the product they choose, even if it does not alter product choice, which might well remain influenced by agent persuasion.

A Dvara Research behavioural study[23] on the impact of disclosure format on insurance product choice found that disclosures do matter, and a simple and concise table that also describes the meanings of the terms and conditions works well. This is also in line with the Bose Committee recommendation that called for a one-page disclosure that is easy for the customer to understand and that could be signed by both the buyer and the seller at the point of sale. Currently, the benefits illustration, as mandated by IRDAI, is being signed by the customer. We, however, believe that a simplified information sheet can improve understanding and enable customers to make suitable product choices.

Following are some key facts that should be presented along with an explanation of the terms in simple words for a bundled insurance product:

[23] Ganesan, P., Prasad, S., & Sharma, M. (2022). Can information disclosures influence life insurance purchase decisions for low-income households? Dvara Research.

1. Sum Assured
2. Premium to be paid
3. Frequency of payment
4. Premium payment term
5. Policy term
6. Total premium payable over the policy term
7. Death benefit
8. Premium allocated towards life cover
9. Premium allocated towards savings
10. Return on savings component computed as XIRR for non-participating products and at historical return rates for participating products
11. Penalty for premature exit for each year of policy term as a percentage of premium paid

Below is an example of how such an information sheet could look like for the customer[24].

Sum Assured	Rs. 1 Lakh	Amount assured at the end of policy term
Annual Premium	Rs. 8,859	Amount to be paid for the policy every year, either annually, half-yearly, quarterly or monthly
Premium Allocated Towards Life Cover	Rs. XXX	Amount of your premium that is used to provide life cover
Premium Allocated Towards Savings	Rs. XXX	Amount of premium that is directed towards savings
Death Benefit	Rs.1 Lakh	Amount payable to family (nominee) in the event of the policyholder's death before policy term
Premium Payment Term	12 years	No. of years for which premium is payable
Total Premium Payable	Rs. 1,06,308	Total amount that has to be paid over the premium payment term
Policy term	12 years	No. of years for which policy will remain in force, giving life risk cover, after which the maturity benefit will be given to the policyholder
Maturity Benefit	Rs. 1 Lakhs + Bonus (Rs. 33,000 based on historical bonus declaration over last 10 years)	Amount receivable at the end of policy term, i.e., sum assured plus a bonus amount based on company performance
Rate of Return	3.60%	Indicative rate of return on premium paid assuming bonus of Rs. 33,000

[24] Based on LIC's New Endowment Policy (Plan 914) for Rs. 1 Lakh SA for a 30 year old

Surrender Penalty	Year - Penalty 1 - 100% 2 - 70% 3 - 65% 4 - 50% 5 - 50% 6 - 50% 7 - 50% 8 - 46.5% 9 - 35% 10 - 27.5% 11 - 10% 12 - 10%	Percentage of premium paid lost due to pre-mature exit for the policy based on year of exit. Refer to surrender benefit table for amounts that will be payable on pre-mature policy exit as per year of exit.

With the digital tools currently available to agents, such information sheets could be easily generated for each customer's specific requirement in their preferred language and customised to different sum assured, policy terms, premium payment terms, etc. Such an information sheet would facilitate understanding, enable comparison, and engender transparency in the sale of insurance products by agents.

It is critical to ensure that the path to suitability is laid from both ends - insurers and customers - to make the possibility of arriving at a suitable product choice easy and seamless. In the long run, such measures would improve the level of customer knowledge and know-how and aid in deepening and broadening the maturing insurance sector in India.

Other References

1. Brief History of Insurance
2. Tracing The History of IRDAI's Regulations on Suitability and Its Interpretations By Market Participants – Part 1