

# A Review of Life Insurance Distribution in India

## Regulatory Design of Distribution Channels and Incentive Structures

SOWMINI G PRASAD, DEEPTI GEORGE

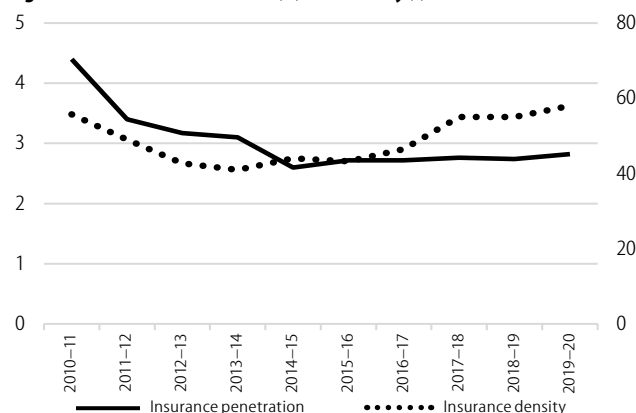
Large gaps exist in life insurance coverage in India. The paper examines this issue through a supply-side lens by examining the two key features—the distinction between the agent and the broker model and the alignment of incentive structures with product life-cycle servicing. Regulations rely on disclosures to clarify the agent–broker distinction to customers, but conflicts of interest may prevent intermediaries from making these disclosures. Without such transparency, commission-driven sales can result in mis-selling, irrespective of the intermediary being a broker or an agent. The Insurance Regulatory and Development Authority of India has sought to address the issue of mis-selling through the product disclosure and suitability guidelines. However, these measures are inadequate and might not be effective.

Life insurance penetration (the ratio of premium to gross domestic product) in India stood at 2.82% by the end of financial year (FY) 2019–20. Insurance density (premium per capita) was at \$58 for the same year. These figures are among the lowest in the world and have not seen significant growth in the past few years (Figure 1, p 51). The Insurance Regulatory and Development Authority of India's (IRDAI) data indicates that the growth in the life insurance business in terms of premium income and the number of policies in force has been subdued in the second decade (between FY 2010–11 and FY 2019–20) as compared to the first decade (between FY 2000–01 and FY 2009–10), post liberalisation of the insurance sector. While the premium income of life insurers grew at 12.7% in FY 2019–20 from ₹5.08 trillion to ₹5.73 trillion, there was no overall growth observed in the total number of policies in force for the same year when compared to the previous year (Figure 2, p 51). As of March 2021, this number stood at 333.2 million policies.

Further, life insurance in India covers only 1.2% of what may be required to protect a family after the death of an earning member. This is much lower than the insurance coverage adequacy of other countries such as Japan (20.6%), Australia (18.8%), and South Korea (16.6%) (SwissRe Institute 2020). It indicates that a large section of the population in India remains either uninsured or underinsured for life risks. Demand for life insurance in India is determined by demographic characteristics, wealth levels, and awareness about financial vulnerability and consequent savings behaviour (Kakar and Shukla 2010; Reserve Bank of India [RBI] 2017). On the supply side, while the presence of insurance companies offering a range of products that customers can choose from is important, this by itself cannot ensure insurance uptake. Indeed, factors such as relatable products, distribution channels employed, and trust in financial institutions have also been found to influence the level of participation in life insurance products (RBI 2017).

In this paper, we look at the low levels of life insurance coverage in India through a supply-side lens and focus on two components of the insurance distribution system that drive the supply—the insurance distribution channels and the incentive structures that determine the commissions payable to intermediaries for the sale of life insurance products. The objective is to review the current regulatory framework around the life insurance distribution system in India and identify regulatory

Sowmini G Prasad ([sowmini.prasad@dvara.com](mailto:sowmini.prasad@dvara.com)) and Deepti George ([deepti.george@dvara.com](mailto:deepti.george@dvara.com)) are with Dvara Research.

**Figure 1: Insurance Penetration (%) and Density (\$)**

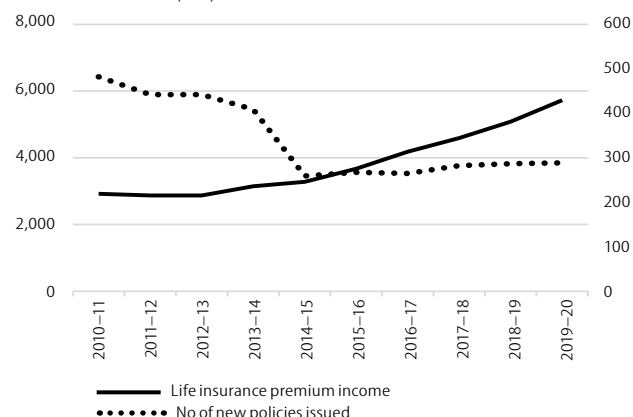
Source: IRDAI (2015a: 3, 2021a: 9).

design issues which are potentially acting as supply-side barriers to uptake of life insurance.

### Regulatory Design of Life Insurance Distribution System in India

#### Key regulatory design features of distribution channels:

At present, IRDAI's regulatory framework allows for the sale of insurance products through nine different intermediary<sup>1</sup>

**Figure 2: Life Insurance Premium Income (₹ billion) and Number of New Policies Issued (lakh)**

channels. Additionally, IRDAI has issued guidelines to regulate the operations of referral companies. We classify the licences or certificates of registration issued by IRDAI broadly into four categories based on certain key features that they share (Table 1) (George et al 2020: 22–23).

The insurance agent model includes intermediaries who represent the insurer(s) in a sale transaction (IRDAI nd). Limits have been placed on the maximum number of insurers whose product agents can sell (under life, general, and health). This

**Table 1: Life Insurance Distribution Channels in India and Their Key Features**

Insurance Intermediary	Represents Insurer/Customer	Business Restriction <sup>2</sup>	Remarks
<b>A Insurance agent model</b>			
Insurance agents	Insurer	1 in each category	Individuals intending to act as insurance agents are required to apply to the insurer.
Corporate agents	Insurer	3 in each category	Entities intending to act as corporate agents are required to apply to IRDAI and once registered, enter into arrangements with insurers for distribution of their products. Eligible applicants include banks, NBFCs, non-governmental organisations (NGOs), and microfinance institutions (MFIs).
Micro-insurance agents	Insurer	1 in each category <sup>3</sup>	Micro-insurance agents are appointed by insurers through a deed of agreement and can sell only micro-insurance products. Eligible entities include self-help groups, NGOs, and MFIs. This category of products and intermediaries was introduced to make simple and affordable products available to the poor.
Point of sales person—life insurance (POSP-LI) <sup>4</sup>	Insurer	As applicable to the appointing intermediary	This intermediary category was introduced by IRDAI to enhance ease of access to life insurance products. POSP-LI are individuals who can sell only POS-LI and micro-insurance products. The former are “simple plain vanilla” products where benefits are predefined and very simple to understand.
<b>B Insurance broker model</b>			
Insurance brokers	Customer	None	Companies, cooperative societies, and firms are eligible to register as insurance brokers with IRDAI. It needs noting that NBFCs are not permitted to act as insurance brokers.
Banks as insurance brokers	Customer	None	This license specifically allows scheduled banks, that is, scheduled commercial banks and scheduled cooperative banks to act as insurance brokers.
IMFs	Customer	2 in each category <sup>5</sup>	This intermediary category was introduced by IRDAI to help increase insurance penetration. IMFs are allowed to sell other financial products as well and have lower net worth requirements compared to other channels. For insurance, they are required to employ insurance sales persons (ISPs) who are residents of the same areas where they intend to sell. <sup>6</sup>
CPSCs	Customer	None	This intermediary category was issued by IRDAI with the intent to facilitate insurers to reach rural India utilising the network of CPSC-special purpose vehicles (SPVs) set up by the Government of India. CPSC-SPVs are allowed to sell micro-insurance products and products allowed to be distributed by POSP-LIs.
POSP-LI	Customer	As applicable to the appointing intermediary	Same as under category A—insurance agent model.
<b>C Marketplace distribution model</b>			
Insurance web aggregators		None	This channel was introduced by IRDAI to increase penetration of insurance through e-commerce.
<b>D Others</b>			
Referral companies		1 in each category	Companies registered under the Companies Act, 2013 are eligible to act as referral companies. However, companies in the business of extending loans and advances, accepting deposits, and trading in securities, such as banks and NBFCs, are not eligible.
Insurance web aggregators		None	Web aggregators can also transmit leads to insurers.

Source: Compiled from IRDAI (2010–19).

varies depending on the category of the applicant. The insurance broker model has intermediaries who arrange insurance contracts with insurers on behalf of their clients. They have to obtain a written mandate from the client stating the representation. This requirement does not apply to common public service centres (CPSCs). Insurance brokers, except insurance marketing firms (IMFs), do not have limits on the number of insurers' products they can sell. Despite this exception, IMFs still have to comply with the mandate requirement. In the marketplace distribution model, the insurance web aggregators maintain a website for providing an interface to customers for price comparison and information on products of different insurers. They can sell insurance products of those insurers who have entered into agreements with them. Then there are others with referral companies and insurance web aggregators from whom the insurers can obtain databases of customers for the generation of leads. Given that they enter into agreements with insurance companies and there is no customer interface involved in these transactions, they have been categorised under "Others" to differentiate them from the previous models.

**Table 2: Maximum Commission/Remuneration Payable to Insurance Agents and Intermediaries**

Category of Life Insurance Product or Policy	Maximum Commission/Remuneration Payable as a Percentage of Premium	
	Single/First Year Premium	Renewal Premiums
Payable to insurance agents and intermediaries for sale of non-micro insurance, micro-insurance, and POSP-LI and payable to POSP-LI for sale of micro-insurance and point of sales products—life insurance		
Individual pure risk products—single premium	7.5%	Not applicable
Individual other than pure risk—single premium	2%	Not applicable
Group pure risk—single premium	5%	Not applicable
Group savings variable life Insurance—single premium	2%	Not applicable
Individual pure risk products—regular premium	40%	10%
Individual other than pure risk—regular premium with premium terms ranging from 5 to 12 years or more	Ranging from 15% to a maximum of 35%	7.5%
Group pure risk and group savings variable life	7.5% (only on pure risk premium)	7.5%
Payable to micro-insurance agents for sale of micro-insurance products		
Individual and group products—single premium	10%	Not applicable
Individual and group products—regular premium	20%	20%

Source: IRDAI (2015b: 16–17, 2016a: 14–15).

**Key regulatory design features of incentive structures:** IRDAI prescribes the maximum commission and remuneration payable to individual agents and other intermediaries respectively. These are determined as a percentage of the premium of life insurance products. The current incentive structure is characterised by three key features. First, the maximum commissions payable for the sale of life insurance products are uniform across agent, broker, and marketplace distribution models. Micro-insurance agents are an exception to this. Second, the maximum commissions payable for the sale of life insurance products vary at the product level depending on whether the product is a micro-/non-micro-insurance product, single/regular premium<sup>7</sup> product, individual/group product, and pure risk/other than pure risk product. Third, regular premium products are characterised by high upfront commissions in the first year followed by low trail commissions in the second and subsequent years. However, in the case of both micro and non-micro products, the maximum commission payable is comparatively lower for single premium products (Table 2). In the case of following insurance intermediaries, the conditions for payment of incentive or reward varies from the rest and have been captured in Table 3.

### Issues with the Regulatory Design of the Insurance Distribution System

Life insurance, when added to the financial portfolio after a careful needs and risk analysis, can help protect households from the loss of human capital in the event of death of an earning member (Ibbotson et al 2007). For an insurance system to be able to deliver on this objective, the financial well-being of the customer should be at the centre of its product design, product delivery, and distribution channel design. The distribution channel should be able to provide access to insurance products and services in a convenient, flexible, reliable, and continuous manner (Murdoch and Rutherford 2003).<sup>8</sup> Such a well-designed distribution channel that employs both people and technology can help induce "state-of-mind effects"—the ability to create the feeling of being completely included, among both customers and non-customers (Rai et al 2013). An ideal set-up such as this can help enhance the uptake of life insurance, ensure its continued usage, and help individuals and households realise the benefits of engaging with an insurance product.

To create such a set-up, the regulatory framework should enable the participation of several intermediaries on a level

**Table 3: Maximum Remuneration/Reward Payable to Insurance Web Aggregators and Referral Companies**

Insurance Intermediary	Maximum Commission/ Remuneration Payable	
	Single/First Year Premium and Other Remuneration	Renewal Premiums
Insurance web aggregator	Only leads which are converted into sale of insurance policies will entitle the web aggregator to earn remuneration. Additionally, a flat fee of not exceeding ₹50,000 per year towards each product displayed.	Fee or remuneration not payable on any type of renewal premium/policy from the second and subsequent years.
Referral companies	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/first year premium instalment of the first policy sold based on the lead obtained from the referral company.	Fee or remuneration not payable on any type of renewal premium/policy from the second and subsequent years or for the sale of a new policy to the existing customer of the insurers.

Source: IRDAI (2010a: 14–15, 2017a: 71).

playing field, competing on the suitability of products they sell as well as the quality of service. This would require commissions offered to the intermediaries to be aligned with delivering customer-centric life insurance products and services (Rai et al 2013), with minimum opportunities for regulatory arbitrage.

### **Breakdown of the Agent–Broker Distinction at the Point of Sale**

Data from IRDAI's annual reports indicate that individual life insurance distribution (non-group) is dominated by agent channels while brokers continue to play a very limited role. In FY 2019–20, while 60.1% of the new individual business premium was acquired through individual agents and 29% through corporate agents, the share of brokers was at 1.8%. While Life Insurance Corporation of India (LIC) acquired 94.7% of its new individual business through individual agents, private life insurers acquired a majority of their new business through corporate agents (at 55.7%) (IRDAI 2011e: 63, 2021b: 103).

As mentioned earlier, two key factors distinguish an agent from a broker—who they represent and the business restrictions applicable. While an agent represents an insurer, a broker acts on behalf of the customer and represents their interests to the insurer. On the feature of business restrictions, IRDAI currently follows both the tied agency model as well as the open architecture model. Individual insurance agents fall under the former category as they can represent only one life insurer. Brokers and corporate agents fall under the latter category as they are permitted to have tie-ups with more than one life insurer (Bhaskaran 2017; IRDAI 2015c: 49). There are no upper limits placed on brokers except for IMFs who can represent up to two life insurers (Table 1). The tied agency model in the case of agents relates directly to the principal–agent relationship that they have with the insurers. The reach of nationwide entities such as banks, with their network of branches, along with the erstwhile model allowing tie-ups with only one life insurer, led to underutilised potential. This prompted IRDAI's Committee on Bancassurance to propose relaxation on the restrictions on banks. Accordingly, from 2015 onwards, corporate agents, including banks, were permitted to have tie-ups with multiple insurers with an upper limit of three life insurers (IRDAI 2011a).

Therefore, to ensure that a customer is aware of the implications of who they are buying their insurance from, that is, whether the intermediary represents the interests of the insurer or the customer and whether the customer has access to a range of products from different insurers, it becomes important that intermediaries are transparent with customers and make certain disclosures which can bring to light these differences. Such disclosures can help customers make an informed choice on the intermediary type they wish to be serviced by as well as the final product choice (International Association of Insurance Supervisors 2016).

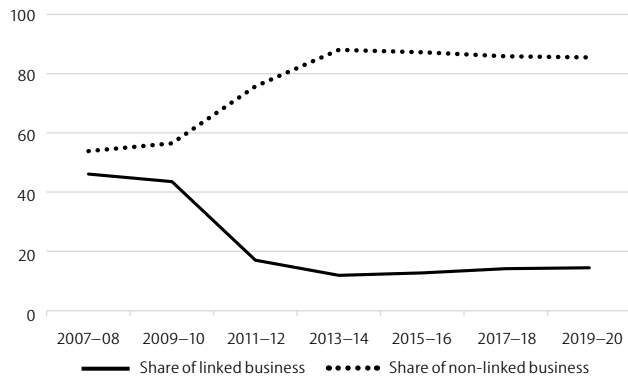
On the first aspect, IRDAI's Codes of Conduct require both agents and brokers to identify themselves to the customer and ensure that the customer understands on whose behalf they

are acting. With respect to product choice, IRDAI's Codes of Conduct requires a broker to “as soon as possible disclose the degree of choice in the products on offer” and “provide comparisons in terms of price, cover, or service” (although no such disclosure requirement has been prescribed for IMFs). Corporate agents are also required to conduct themselves in a manner similar to that of brokers as they are required to disclose to the customer “the list of insurers, with whom they have arrangements to distribute the products and provide them with the details such as scope of coverage, term of policy, premium payable, premium terms and any other information which the customer seeks on all products available with them” (IRDAI 2013, 2015b, 2015c, 2015d, 2016b, 2017a, 2018a, 2019a: 5, 2019b).

However, whether an intermediary would make these disclosures to customers is dependent on the relationship they have with the insurer whose products they sell. While, by definition, brokers represent the interests of the customers, this might not necessarily hold true at the point of sale as brokers, similar to agents, are paid commissions by insurers. The choice between a tied agency model and an open architecture model can further exacerbate the potential for conflicts for interests. In a tied agency model, conflicts of interests are restricted to the differences in commissions, if any, that can be earned across different product categories of one insurer. With an open architecture model, in addition to this, intermediaries could potentially choose to sell products of those insurers which can generate maximum commissions for them against products that are suitable to the customer's needs.

To address the issue of conflicts of interest, IRDAI's Codes of Conduct require corporate agents and IMFs to “disclose” conflicts of interest. In the case of corporate agents, it is restricted to the disclosures quoted earlier regarding product choice and in the case of IMFs, the regulations do not elaborate further on how conflicts of interests are to be managed. In contrast, brokers and web aggregators are required to “avoid” conflicts of interest. It is not clear how this would manifest in the operations and sales practices of brokers. Since there is no regulatory language around how such conflicts have to be managed, and the timing of such conduct by the broker during the sale process, there appears to be an assumption that conflict of interest is not an issue in their case. More importantly, there is no requirement for a broker to disclose the source of their commissions.

Therefore, the distinction between an agent and a broker can potentially break down at the point of sale unless the intermediaries adhere to the conduct guidelines and make the necessary disclosures to the customers. However, given that both agents and brokers are compensated by insurers, conflicts of interest might come into play and intermediaries might not be incentivised to make these disclosures. In the absence of such transparency, commission-motivated intermediaries can potentially sell products that are unsuitable to the needs of the customers. While product disclosure and suitability guidelines can be mechanisms through which potential mis-selling can be addressed, in the next section, we discuss

**Figure 3: Share of Linked and Non-linked Business in Total Premium Income (%)**

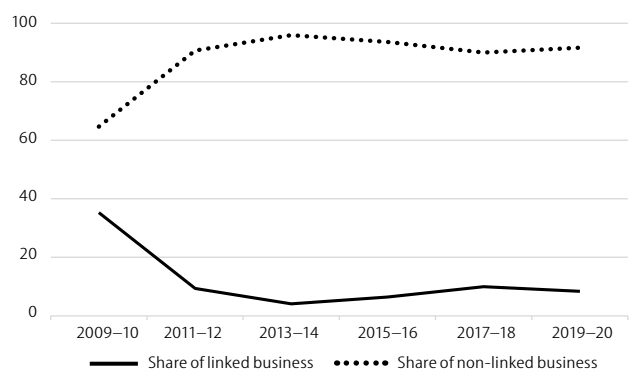
Source: IRDAI (2016c: 80–84, 2021a: 55).

why these guidelines, in their present form, may not necessarily translate into optimal outcomes for customers.

### Misalignment of Incentive Structure with Life-cycle Servicing

Incentive structures, especially in the case of regular premium products with more than one premium paying term, can determine the extent to which the design of a distribution channel is aligned with generating suitable outcomes for customers. This includes not just the point of sale at which the type of product recommended is determined, but also the incentives created for intermediaries to provide product life-cycle services to the customers. The latter should ideally culminate with successful completion of the premium paying term and/or the customer realising complete benefits from a life insurance product.

As discussed earlier, commissions for the sale of life insurance products are paid as a percentage of premium, and regular premium products are characterised by high upfront commissions and low trail commissions. Evidence from field experiments conducted by Anagol et al (2017), to study the quality of advice provided by life insurance agents, suggests that such high commissions cause agents to recommend products such as traditional endowment plans even when they are unsuitable to the needs of the customers. Such practices were found to be driven by a focus on premium size rather than the insurance cover for customers, mainly aimed at maximising agent commissions. Endowment plans are typically expensive and pure risk or term plans are generally able to provide better or similar covers at much lower premiums (Value Research Online 2020). While the maximum first-year commissions payable for pure term regular premium products are currently at 40%, this might not amount to much in terms of absolute earnings for an intermediary when compared to the 35% on first-year premiums of traditional endowment plans an agent can potentially earn.<sup>9</sup> Halan et al (2013: 1–31) estimated the impact of such mis-selling of life insurance products on customers and found that between 2004–05 and 2011–12, a period which witnessed high growth in the sale of unit linked products (ULIPs), customers incurred a loss of approximately ₹1.5 trillion.

**Figure 4: Share of Linked and Non-linked Business in Total Commission Expenses (%)**

Source: IRDAI (2016c: 88–89, 2021a: 64).

IRDAI has sought to address the issue of mis-selling at the point of sale through two approaches, product disclosure guidelines and suitability, both of which have evolved over the years as well as faced resistance from the life insurance industry.

**Product disclosures through benefit illustrations:** The first approach has been through the introduction of product disclosure guidelines. The latest directive from IRDAI on the subject, the circular on the benefit illustration and the other market conduct aspects issued in 2019, requires insurers to provide customised benefit illustrations<sup>10</sup> to prospective customers at the point of sale for all ULIPs and traditional endowment plans (non-linked participating life products and non-linked non-participating life products). This requirement does not apply to microinsurance and POSP-LI products. The circular also prescribes the benefit illustration formats to be used for each of these product categories offered by life insurers. These are required to be signed by both the customer as well as the intermediary involved in the sale process and are to form a part of the policy document. There are two key disclosure requirements of concern here—commissions payable to the intermediaries and the returns that can be expected from savings or investment embedded life insurance products.

At present, IRDAI's codes of conduct require intermediaries to disclose commissions they are likely to receive for effecting insurance. However, this is not mandatory and is required to be made upon a client's request (IRDAI 2013, 2015b, 2015c, 2015d, 2016b, 2017a, 2018a, 2019a: 5, 2019b). The benefit illustration format applicable to ULIPs brings in transparency on this front as it requires insurers to disclose the amount of commission payable each year to the intermediary involved in the sale. This was first introduced in 2011 to enhance transparency around the various charges collected from the policyholder (IRDAI 2011b). However, similar disclosure is not available in the case of non-linked products. In their field experiment, Anagol et al (2017) find that this difference in disclosure requirement had the effect of agents recommending similar but alternative products with opaque disclosures. They go on to observe that disclosure requirements need to be consistent across similar products for them to have any

effect on the advice of agents. This switch to traditional plans can also be seen in the drop in the share of ULIPs in the overall premium income as well as commission expenses of life insurers post the regulatory changes to disclosure requirements as well as the imposition of caps on expenses (Figures 3 and 4, p 54).

Differences in disclosure standards can be seen with respect to returns on these products as well, with the benefit illustration for ULIPs being comparatively more transparent than traditional endowment plans. For the latter, insurers are required to provide customised benefit illustrations showing the total benefits that would accrue to the policyholder upon surrender of the policy, maturity of the policy, and the death of the policyholder, at various stages of the policy. In the case of participating plans where there is a non-guaranteed portion to the benefits, the benefits are required to be shown at assumed returns of 4% pa and 8% pa. However, these disclosures are misleading for several reasons. At the outset, the return on premiums, net of morality charges, is lower than the stated 8% pa and 4% pa returns (Ministry of Finance 2015). Additionally, past records on traditional endowment plans indicate that the returns are very poor and range between 2% and 4% even before adjusting for inflation (Halan 2020). Hence, the 8% scenario is irrelevant and wrongly indicates that there is a possibility that 8% returns can be obtained. The Committee to Recommend Measures for Curbing Mis-selling and Rationalising Distribution Incentives in Financial Products constituted by the Ministry of Finance, Government of India (2015) (henceforth the committee) had recommended discontinuing this practice, of forecasting returns, and had instead advocated disclosing the net returns for the previous years to serve as an indicator of possible returns that can be expected from the product. Further, in the case of non-participating plans which guarantee absolute benefits upfront, the returns are shown as a percentage of the investment made. Additionally, the disclosures in both types of non-linked plans are opaque as they do not provide any information on how the premium money is allocated between the insurance and investment components of the policy.

**Suitability:** The second approach to address the issue of mis-selling has been through the introduction of guidelines on suitability. IRDAI's Codes of Conduct require each intermediary, irrespective of who they represent, to ensure the suitability of the product offered to a customer or to take into account the needs of the customer while recommending a specific plan (IRDAI 2013, 2015b, 2015c, 2015d, 2016b, 2017a, 2018a, 2019a: 5, 2019b). However, the Codes of Conduct themselves do not go into the specifics of what constitutes suitability and how the requirement needs to be adhered to. While the first attempt to operationalise suitability in life insurance sales was made in 2012, IRDAI put the same into effect only in 2019 having faced significant resistance from the industry (IRDAI 2018b; Tiwari and George 2021a).

The circular issued in 2019 requires insurers and intermediaries to collect suitability information<sup>11</sup> and make

recommendations only based on such information. Suitability has been defined as

a determination, based on information collected at the time of sale or solicitation in a format that, based upon a particular prospect's risk profile, financial situation and insurance and investment objectives, a product is suitable for that prospect. This shall include the nature of the product, mode of premium payment and tenure of policy as well as premium payment. (IRDAI 2019c: 4)

Both the customer as well as the intermediary involved in the sale process are required to sign the document containing such information and the final product recommendation (IRDAI 2019c: 1). While the impact of these guidelines on curbing mis-selling remains to be seen, it is important to note that they fail to place any direct responsibility on the insurer and the intermediary and continue with a *caveat emptor* model where the onus is placed on the customer to understand the suitability of the product recommended before agreeing to buy it (Tiwari and George 2021a, 2021b). The guidelines only require the insurer to preserve the records on the information collected and the recommendation made and make them available to IRDAI for inspection, if required. Additionally, it does not provide a clear guidance on the accountability/feedback mechanism that should be in place between an insurer and an intermediary, by which an insurer can ensure the suitability of the product recommendations. Further, the 2019 circular is not applicable for pure-risk products, including for regular-premium products (IRDAI 2019c: 1). This means that the sale of such products does not require the intermediary to assess a prospective customer's risk profile and financial situation against the nature of the product being recommended as well as the premium commitment required. Additionally, the basis for this exemption is unclear as an intermediary can decide on recommending a particular product, whether pure risk or others, only upon collecting suitability information.

A manifestation of mis-selling of life insurance products is the low persistency ratio.<sup>12</sup> While other reasons such as income disruptions can result in non-payment of renewal premiums, the ratio also indicates the ability of the distribution channel to deliver suitable products as well as a customer's level of satisfaction with the overall services offered (Dubey 2021; Ministry of Finance 2015). In addition to requiring intermediaries to make necessary product disclosures and ensure

## Economic&PoliticalWEEKLY

available at

### Skandaa Distributors

30-265/25/19, Flat No. S-1,  
Sai Enclave, Geetha Nagar,  
Near Sai Vidya Vihar,  
RK Puram Post, Malkajgiri,  
Hyderabad 500 056,  
Telangana  
9908074973

suitability of the product at the point of sale, IRDAI's Codes of Conduct also require, for instance, agents to "render necessary assistance and advice to every policyholder introduced through him/her on all policy servicing matters" (IRDAI 2015b, 2016b). IRDAI's (Protection of Policyholders' Interests) Regulations, 2017 (2017b: 17) expects the insurers to put in place board-approved policies to protect the interests of the policyholder at the point of sale as well as when providing post-sale services. It is not clear as to how policy servicing is sought to be met for single premium products as there are no tangible incentives for intermediaries to do so and no specific guidelines that separately address this issue.

However, data available with IRDAI indicates that the average persistency of life insurance policies in India continues to be on the lower side and was found to deteriorate as a policy became older. In FY 2019–20, while the average 13th month persistency, an indicator of the proportion of policies that were renewed for a second year, was at 67.6%, the average 61st month persistency was as low as 38.2%. In other words, approximately 62% of the policies were not renewed after the 5th year (IRDAI 2021a: 134). Data on complaints also present a similar picture of the quality of policy servicing. As per IRDAI's annual report for 2019–20, there were 1,65,217 complaints registered with its Integrated Grievance Management System. The highest number of complaints were in the category of policy servicing, which constituted 31% of the total complaints reported during the year, followed by 26% in the category of unfair business practices (UFBP).<sup>13</sup> Further, while UFBP complaints constituted 3.67% of the overall complaints recorded against LIC, they were much higher in the case of private insurers at 74.1%. Intermediary channel-wise complaints against private insurers show that brokers had the highest share of mis-selling complaints at 28.2%, followed by banks with corporate agent registration at 27.4%, and individual agents at 16.3%.

In 2011, taking cognisance of low persistency ratio and in an attempt to address the issue of mis-selling, IRDAI issued guidelines requiring both individual and corporate agents to satisfy a minimum persistency ratio of 75%, in terms of both number of policies as well as premium. This was reduced to 50% in the same year (to be calculated only on the number of policies) following representations from the industry. However, in 2014, IRDAI withdrew the 2011 regulatory requirement and instead required life insurers to set company-specific persistency criteria for agency renewal (IRDAI 2011c, 2011d, 2014).

The report of the Household Finance Committee constituted by the RBI (2017) had observed that the incentive structure, which provides for high commissions for the first year and far lower commissions for renewals, are misaligned, with generating optimal outcomes for households and are focused on incentivising initial uptake of policies and not adequately on renewals. For instance, for pure-term regular-premium products, while the maximum commission payable for the first year is at 40%, for the subsequent years, it is fixed at 10% (Table 2). The committee had recommended rationalising the incentive

structure and levelling them between initial sale and policy renewal. In a report published in 2020, we make a similar argument proposing a restructuring that avoids high upfront commissions and incentivises repeat contact with customers to ensure continued policy servicing (George et al 2020). The committee had also observed that "disclosures and penalties on mis-sales by themselves will not align with improved choice and increased consumer welfare" and recommended rationalising commissions along with disclosures. Specifically, it suggested continuing with upfront commissions for pure-term products given the relative difficulty in selling them as well as the mortality part of the premium in bundled products. For the investment portion of bundled products, it was in favour of phasing out upfront commissions and moving completely towards an all-trail mode which would either level or decline (Ministry of Finance 2015).

## Conclusions

The life insurance distribution system in India is defined by two key features—the agent-broker model and the front-loaded incentive structure in the case of regular premium products. Given the low levels of life insurance coverage, the paper raises questions on the effectiveness of the current regulatory design in delivering the required financial protection against life risks. Upon analysing these design features, the study conclude that the regulatory difference between an agent, a representative of the insurer, and a broker, a representative of the customer, relies on disclosures to be made by these intermediaries at the point of sale. Given that commissions in the case of both agents and brokers are payable by the insurer, we argue that intermediaries may not be incentivised to make these necessary disclosures on account of conflicts of interest. Therefore, the difference between the two models can potentially break down at the point of sale with no real benefits accruing to retail customers even if they were being served by a broker.

The current incentive structure itself, specifically for regular premium products, is not aligned with generating suitable outcomes for customers. High upfront commissions and low trail commissions have resulted in mis-selling and financial losses to customers. While IRDAI has sought to address this issue through the introduction of product disclosure guidelines, they are, however, inadequate and have not been applied uniformly across all products, resulting in arbitrage opportunities and continued mis-selling. Suitability is another policy tool through which IRDAI is attempting to address the issue of mis-selling. The guidelines in their current form may not be effective in curbing this practice as they do not place direct responsibility on insurers and intermediaries to ensure suitable sales and do not adequately address the issue of accountability between an intermediary and an insurer.

To better align supply-side design with improved choice and customer well-being, IRDAI should revisit the current distribution system and focus on improving product disclosure guidelines to bring in better transparency and fix responsibility for the suitability of products sold. These should also be

accompanied by rationalisation of incentive structure, which links intermediary commissions to the interests of the customer not just at the point of sale but also throughout the product life-cycle (Ministry of Finance 2015: 57). In carrying out such an exercise, IRDAI should avoid heavy front-loading of

commissions and should incentivise repeat contact in the form of trail commissions. While compensating intermediaries proportionately for the cost and effort they incur in making the sale as well as in servicing the policy, it should also ensure a good claims or pay-outs experience.

## NOTES

- 1 Throughout the paper, unless otherwise specified, the term intermediary has been used to refer to the whole gamut of agents, brokers, and other insurance distributors who have a direct interface with the customer.
- 2 Business restrictions refer to the restrictions on the number of insurers whose products can be sold by the insurance intermediary. The restriction applies separately to each category of insurance, that is, life, general, and health.
- 3 Micro-insurance agents can also work with Agriculture Insurance Company of India.
- 4 POSP-LI has been included under both Insurance Agent and Insurance Broker Model as POS persons can be appointed by any insurance intermediary for the sale of insurance products.
- 5 Additionally, Insurance Marketing Firms can also engage with Agriculture Insurance Company of India (AIC) and Export Credit Guarantee Corporation (ECGC).
- 6 The term area is defined as a district for which the IMF has registered itself with IRDAI. Where an IMF opts for more than one district (up to a maximum of three districts within a state), at least one of them is required to be an aspirational district.
- 7 In regular premium products, premiums are payable for more than one premium paying term and are paid at regular intervals like yearly, half yearly, quarterly, and monthly.
- 8 In their paper, Murdoch and Rutherford (2003) use these four characteristics to describe a "good microfinance" delivery model.
- 9 We studied the actual commissions paid out by life insurance companies and found them to be around the regulatorily defined limits.
- 10 Benefit illustration presents a year by year summary of costs and benefits in a savings/investment embedded life insurance policy.
- 11 Suitability information includes the prospective customer's age, income, family status, life stage, financial and family goals, investment objectives, and insurance portfolio already held.
- 12 Persistency ratio is the proportion of policyholders who continue to pay their renewal premium and measured at different stages in the life of the policy, that is, 13th, 25th, 37th, 49th, and 61st months.
- 13 In its annual report, IRDAI defines unfair business practices to include mis-selling complaints as well as complaints related to tampering records/forging signatures.

## REFERENCES

- Anagol, Santosh, Shawn Cole and Shayak Sarkar (2017): "Understanding the Advice of Commissions-Motivated Agents: Evidence from the Indian Life Insurance Market," *Review of Economics and Statistics*, Vol 99, No 1, pp 1–45.
- Bhaskaran, Deepti (2017): "Open Architecture in Insurance Sector," *Livemint*, 17 July, www.livemint.com.
- Dubey, Navneet (2021): "Why Persistency Ratio Matters in Insurance," *Livemint*, 22 February, www.livemint.com.
- George, Deepti, Sowmini Prasad, Dwijaraj Bhattacharya, Madhu Srinivas and Amulya Neelam (2020): "A Strategy for Comprehensive Financial Inclusion," *Dvara Research*, January, pp 22–32.
- Halan, Monika (2020): "Why Smart Customers Dodge the Investment-cum-insurance Policy Trap," *Livemint*, 2 September, www.livemint.com.
- Halan, Monika, Renuka Sane and Susan Thomas (2013): "Estimating Losses to Customers on Account of Mis-selling Life Insurance Policies in India," Indira Gandhi Institute of Development Research, Working Paper WP-2013-007, April, pp 1–31.
- Ibbotson, Roger G, Moshe A Milevsky, Peng Chen and Kevin X Zhu (2007): *Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance*, The CFA Institute Research Foundation, 1 April, Vol 2007, No 1.
- International Association of Insurance Supervisors (2016): "Application Paper on Approaches to Supervising the Conduct of Intermediaries," November, pp 33–34.
- IRDAI (nd): "Handbook on Insurance Intermediaries," Hyderabad, pp 6–7.
- (2010a): "IRDA (Sharing of Database for Distribution of Insurance Products) Regulations, 2010," Hyderabad, pp 10–15.
- (2011a): "Report of the Committee on Bancassurance—Reg," Hyderabad, pp 18–49.
- (2011b): "Benefit Illustrations—Payment to Distribution Channel," Hyderabad, pp 1–2.
- (2011c): "Guidelines for Individual Agents for Persistency of Life Insurance Policies," Hyderabad.
- (2011d): "Modification of Guidelines for Individual Agents for Persistency of Life Insurance Policies: IRDA Circular Ref: IRDA/CAD/GDL/AGN/016/02/2011 dated 11 February, Hyderabad.
- (2011e): "Annual Report 2010–11," Hyderabad, p 63.
- (2013): "IRDA (Licencing of Banks as Insurance Brokers) Regulations, 2013," Hyderabad, pp 41–58.
- (2014): "Guidelines for Individual Agents for Persistency of Life Insurance Policies Guidelines for Individual Agents for Persistency of Life Insurance Policies," Hyderabad.
- (2015a): "Handbook on Indian Insurance Statistics 2013–14," Hyderabad, p 3.
- (2015b): "IRDAI (Micro Insurance) Regulations, 2015," Hyderabad, pp 13–17.
- (2015c): "IRDAI (Registration of Corporate Agents) Regulations, 2015," Hyderabad, pp 48–68.
- (2015d): "IRDAI (Registration of Insurance Marketing Firm) Regulations, 2015," Hyderabad, pp 43–59.
- (2016a): "IRDAI (Payment of Commission or Remuneration or Reward to Insurance Agents and Insurance Intermediaries) Regulations, 2016," Hyderabad, pp 14–16.
- (2016b): "IRDAI (Appointment of Insurance Agents) Regulations, 2016," Hyderabad, pp 21–24.
- (2016c): "Handbook on Indian Insurance Statistics 2014–15," Hyderabad: IRDAI, pp 80–89.
- (2017a): "IRDAI (Insurance Web Aggregators) Regulations, 2017," Hyderabad, pp 71–101.
- (2017b): "IRDAI (Protection of Policyholders' Interests) Regulations, 2017," Hyderabad, p 17.
- (2018a): "IRDAI (Insurance Brokers) Regulations, 2018," Hyderabad, pp 93–135.
- (2018b): "An Exposure Draft on Repealing of IRDA (Standard Proposal form for Life Insurance) Regulations 2013," Hyderabad.
- (2019a): "Master Circular on Point of Sales Products and Persons – Life Insurance," Hyderabad, pp 4–5.
- (2019b): "IRDAI (Insurance Services by Common Public Service Centers) Regulations, 2019," Hyderabad, pp 38–43.
- (2019c): "Circular on Benefit Illustration and Other Market Conduct Aspects," Hyderabad, pp 1–4.
- (2021a): "Handbook on Indian Insurance Statistics 2019–20," Hyderabad, pp 9–134.
- (2021b): "Annual Report 2019–20," Hyderabad, p 103.
- Kakar, Preeti and Rajesh Shukla (2010): "The Determinants of Demand for Life Insurance in an Emerging Economy—India," *Margin: The Journal of Applied Economic Research*, Vol 4, No 1, pp 59–61.
- Ministry of Finance (2015): "Report of the Committee to Recommend Measures for Curbing Mis-selling and Rationalising Distribution Incentives in Financial Products," Government of India, New Delhi, pp 33–71.
- Murdoch, Jonathan and Stuart Rutherford (2003): "Microfinance: Analytical Issues for India," Background paper prepared for the World Bank, Washington, DC, pp 5–11.
- Rai, Suyash, Bindu Ananth and Nachiket Mor (2013): "Universalising Complete Access to Finance: Key Conceptual Issues," *Financial Engineering for Low-Income Households*, Bindu Ananth and Amit Shah (eds), New Delhi: Sage and Chennai: IFMR Finance Foundation.
- RBI (2017): "RBI Household Finance Committee, Indian Household Finance," Reserve Bank of India, pp 50–87.
- SwissRe Institute (2020): "Closing Asia's Mortality Protection Gap," *SwissRe*, July, pp 29–36.
- Tiwari, Anukriti and Deepti George (2021a): "Tracing the History of IRDAI's Regulations on Suitability and Its Interpretations by Market Participants – Part 1," blog, 12 October, *Dvara Research*, pp 1–7, www.dvara.com.
- (2021b): "Tracing the History of IRDAI's Regulations on Suitability and Its Interpretations by Market Participants: Part 2," *Dvara Research*, blog, 18 October, pp 1–7, www.dvara.com.
- Value Research Online (2022): "Say No to Endowment Policies and ULIPs," 29 September, pp 1–18.

## Economic&amp;PoliticalWEEKLY

available at

**Delhi Magazine Distributors  
Pvt Ltd**

110, Bangla Sahib Marg  
New Delhi 110 001  
Ph: 41561062/63