Guidelines on Universal Life crediting rate declaration by long term insurers

Introduction

1.1 The proposed guidelines underlying this note are applicable to long-term insurers only (thereafter referred as insurers).

1.2 At present, there are no established regulations, guidelines or a dedicated framework in Sri Lanka governing the oversight and management of universal life insurance business. This document sets out the proposed principles and governance framework that long-term insurers shall consider when formulating their Board-approved crediting rate policy as well as overall management of universal life business. This policy shall govern the determination of crediting rates declared at the valuation date. The principles set out in this document shall be applied consistently by the insurer while determining the future crediting rate assumptions required in insurance liability and solvency assessments as per Solvency Margin (Risk Based Capital) Rules 2015.

Governance framework

1.3 Every long-term insurer shall establish a clearly defined governance structure for the effective oversight and management of universal life business, recognizing the significant discretion involved in investment choices and crediting rate declarations.

1.4 Given this discretion, insurers must uphold strong governance standards and ensure transparency in all aspects of sales, marketing, and policyholder communications.

1.5 The governance framework under the Board approved crediting rate policy for universal life business shall include appropriate mechanisms to address conflicts of interest and to balance the interests of policyholders and shareholders.

1.6 There should be a clear definition of the roles and responsibilities of all parties involved in the crediting rate determination process:

a. **Board of Directors:** The Board of Directors retains ultimate accountability for the governance and oversight of universal life business including the final approval of the crediting rate policy and regular review of the crediting rate declaration.

b. **Senior management:** Manages day-to-day operations and advises the Board on universal life matters including recommendation of the crediting rate and ensuring compliance with regulatory requirements and internal policy.

c. **Investment function:** Oversight of the investment strategy for the universal life fund.

d. **Legal function:** Ensures crediting rate provisions in contracts are clear, enforceable, and compliant.

1.7 Insurers may assign the roles and responsibilities set out above to personnel other than those specified in paragraph 1.6, provided that each responsibility is clearly allocated to an appropriately qualified individual, function, or division. Insurers shall ensure that such person assigned to these responsibilities possess the requisite expertise, experience, and authority to discharge their duties effectively.

Notwithstanding any such delegation, the Board of Directors shall retain ultimate accountability for the governance and oversight of the insurer's universal life business. This includes, inter alia, approving the crediting rate policy and periodically reviewing crediting rate declarations to ensure that they are consistent with the approved policy and the fair treatment of policyholders.

1.8 Insurers must establish and maintain a clear, robust, and documented crediting rate policy. This policy, approved by the Board of Directors, should be guided by the following principles:

a. **Fairness and Equity:** The crediting rate policy must be fair and equitable to all policyholders within the same product groups. The crediting rate should reflect the investment performance of the underlying asset portfolio, after accounting for all relevant charges and expenses. It should not be used to cross-subsidize other product lines or to unfairly benefit shareholders at the expense of policyholders.

b. **Sustainability:** The crediting rate policy must be sustainable over the long term. It should be based on a sound investment strategy that can support the guaranteed minimum crediting rate , where applicable. while aiming to provide competitive non-guaranteed returns.

c. **Consistency:** The crediting rate policy should be applied consistently over time. While the rate itself will fluctuate, the methodology for determining the rate should be consistent, and any changes to the methodology must be well-justified, documented, and approved by the Board.

Grouping

1.9 Insurers may establish appropriate groups of universal life policies for the purpose of crediting rate determination. Groups may be based on product features, guarantee levels, policy issue dates, policy terms, difference in underlying investment principles or other relevant risk characteristics.

1.10 The grouping methodology shall ensure fairness and consistency across policyholders. No group of policyholders should be materially disadvantaged, and groupings should support risk pooling benefits only where it is appropriate and equitable to do so.

1.11 Insurers shall manage each group of universal life policies independently. Insurers shall ensure that investment returns and guarantee costs are allocated fairly within each group and shall not permit any cross-subsidization between groups.

Determination of crediting rate

1.12 In determining crediting rates for universal life policies, insurers shall give due consideration to the investment returns and other relevant aspects of managing the universal life business, ensuring that the crediting rate reflects the overall experience of the universal life fund.

1.13 The methodology to determine the crediting rate shall include a quantified assessment for investment returns, and each deduction made to the investment return to derive the declared crediting rate.

1.14 The insurers shall clearly define the limits on deductions made to the investment return to derive the crediting rate as part of this policy.

Investment return

1.15 Insurers shall maintain a well-defined and documented policy for calculating investment earnings, which forms the basis for determining crediting rates under universal life policies.

1.16 Insurers must maintain segregated assets for their universal life business in accordance with Direction 15 issued by the IRCSL. The investment returns shall be derived from the underlying assets held within the universal life fund.

1.17 The calculation of investment returns shall be based on the Time-Weighted Rate of Return (TWRR), after allowing for all cashflows into and out of the universal life fund. The TWRR so determined shall form the basis for setting the crediting rate.

1.18 The investment returns policy shall explicitly outline the methodologies used to calculate returns across all relevant asset classes held in the universal life fund, including but not limited to equities, preference shares, gold, property, fixed income instruments etc.

1.19 Insurers shall ensure that unrealized gains and losses are excluded from the calculation of investment returns used in determining the crediting rate, given that once declared, the crediting rate becomes a guaranteed benefit to the policyholder.

1.20 The insurer shall consider the following in case smoothing is applied:

a. the assumption shall reflect not only historical returns but also expected future short-term to medium-term investment returns.

b. make an appropriate allowance for market risks that may affect investment returns. These may include, but are not limited to, credit spread risk, default risk, property risk, and currency risk (where assets are denominated in foreign currencies).

1.21 If the insurer has multiple groups under the universal life fund, the insurer shall establish a mechanism to calculate investment returns separately for different groups of policies, where the underlying investment principles differ. This ensures that the crediting rate for each group appropriately reflects the corresponding investment performance.

1.22 All assumptions and methodology underlying calculation and projection of investment returns should be clearly documented.

Smoothing

1.23 Insurer can apply discretion in applying smoothing to determine the crediting rate, with appropriate quantified assessment of the extent to which smoothing is applied. They shall ensure that practices are applied consistently without prejudice to any one generation of the policyholders against another. The mechanism shall ensure fairness across policyholder cohorts and reflect the fund's actual experience.

1.24 If smoothing is applied, the insurer shall:

a. ensure no undue advantage or disadvantage to any group of policyholders;

b. maintain governance oversight and full documentation of smoothing-related decisions; and

c. establish mechanisms to manage volatility in surplus from non-investment sources when these affect dividend or crediting rate declarations.

Investment strategy

1.25 Insurers must maintain a documented investment strategy for universal life funds. This should specify investment objectives, target asset allocations, risk appetite, and alignment with the long-term nature of policyholder liabilities.

1.26 The strategy must support both the solvency of the universal life fund and that of the insurer as a whole under all reasonably foreseeable circumstances.

1.27 The investment strategy should also be compliant with any statutory limits and regulatory requirements specified as part of Determination 1.

Declaration and Review Process

1.28 Insurers shall establish and document the frequency and process for declaring and reviewing crediting rates. This shall include the timing of rate declaration and communication to policyholders, which may occur at least annually or more frequently.

Policyholders’ Reasonable Expectations (PRE) and treating customers fairly

1.29 Insurers shall ensure crediting rates are fair and consistent across different policyholder groups, and that they align with policyholders' reasonable expectations.

1.30 Policyholders’ reasonable expectations concern the policy owners’ expectations on how the non-guaranteed benefits of their universal life policies are managed and paid.

1.31 Long term insurers shall articulate sources which create PRE. PRE might be built up based on past declarations of crediting rate, past communication with the policyholders, marketing material, benefit illustrations presented at the time of sale of policy or at later stages in the lifetime of a policy, and prevailing industry practices.

1.32 In managing PRE, the long-term insurer shall:

a. Communicate clearly to policyholders the non-guaranteed nature of discretionary crediting rate and the circumstances under which such rates may be revised, reduced, or withdrawn; and

b. Ensure that all communications, whether through direct channels, intermediaries, marketing materials, or historical practices — are accurate, not misleading, and do not give rise to an impression that communicated crediting rates are fixed or guaranteed throughout the life of the policy, in order to protect the integrity of policyholder expectations.

1.33 The insurer shall ensure that the margin in the gross investment return and the crediting rate is fair and consistent with policyholders' reasonable expectations.

1.34 The insurer shall also consider the guidelines on principles on fair treatment of customers issued by IRCSL from time to time while setting up crediting rates.

Other considerations

Regular Policyholder Statements

1.35 Insurers must provide policyholders with regular statements that clearly demonstrate:

a. the policy's current fund value

b. policy fund value at end of previous statement date

c. premiums received and premiums allocated into the fund during the period

d. fee/charges deducted from the fund during the period

e. the crediting rate applied during the period

f. Key benefits payable at current statement date, including but not limited to, death benefit, surrender benefit, rider benefits.

1.36 Such statements shall be provided to policyholders at least annually. Insurers may, at their discretion, issue these statements more frequently.

1.37 The proposed format for the annual policyholder statements has been provided as part of Annexure A of this guideline.

Calculation of insurance liabilities

1.38 The future crediting rate assumption used to determine insurance liabilities shall be based on the crediting rate policy and included as part of the Annual or Quarterly Abstract submitted by insurers as per Determination 12,14 and 15, as the case may be.

1.39 The insurer shall evaluate the cost of guarantees using an appropriate and justifiable methodology. This cost shall be incorporated into the insurance liabilities for universal life business, calculated as per Solvency Margin (Risk Based Capital) Rules, 2015. The underlying assumptions, methodologies, and results shall be comprehensively documented as part of the Annual or Quarterly Abstract, as the case may be.

Documentation

1.40 The long-term insurer shall ensure that all key decisions, assessments, and actions relating to the declared crediting rate are properly documented. This documentation must demonstrate that the crediting rate determination process adheres to the principles and guidelines outlined in the Board approved crediting rate policy. Such documentation shall be made available to the Board of Directors and submitted to the Insurance Regulatory Commission of Sri Lanka (IRCSL) upon request.

1.41 Any changes to the insurer's adopted approach in managing the universal life business shall be clearly documented, including the rationale for the change from previous approach. Such change should be governed via a pre-defined approval mechanism.

1.42 At end of every financial year, for the purposes of approval of crediting rate declared for the year, a detailed report shall be prepared by the insurer and submitted to the Board of Directors, encompassing the following elements:

a. **Investment Earnings:** Annual calculation, including breakdown by policy groups.

b. **Crediting Rate Recommendation:** Proposed rates (including minimum guarantee), with supporting rationale.

c. **Financial Impact:** Assessment on liabilities and capital adequacy. Insurer may consider performing sensitivity and scenario analysis prior to recommendation of the crediting rate.

d. **Policyholder Fairness:** Explanation of how PRE and fairness principles were addressed.

e. **Undue PRE Impact:** Impact analysis of measures taken to meet undue PRE on the insurer's financial position.

f. **Monitoring and Review**: Findings of the regular review of the effectiveness of the crediting rate framework.

g. The insurer shall also consider and document any other aspect related to the management of universal life business while declaring the crediting rate.

h. A policy-by-policy analysis shall be carried out for all policies maturing during the preceding year, comparing the gross investment return earned with the actual return realized by policyholders after deduction of all applicable charges, excluding cost of insurance charge. This analysis shall be used to assess the fairness of policyholder returns, identify any groups of policies that may have been disadvantaged, and ensure continued alignment of the crediting rate policy with policyholder reasonable expectations.

i. For companies declared crediting rates more frequently than annual declaration, the requirement is to ensure that the report is produced at least annually.

Disclosure

1.43 Every insurer shall, at a minimum, disclose the following information on its website at minimum on an annual basis:

a. The insurer's crediting rate policy, presented in a manner that is understandable to policyholders. The disclosure shall, at a minimum, set out the key factors influencing the crediting rate.

b. The current and historical realized investment earnings, presented separately for each group of policies. Such a disclosure shall cover at least the preceding ten (10) years, if applicable.

c. The current and historical declared crediting rates, presented separately for each group of policies. Such disclosure shall cover at least the preceding ten (10) years, if applicable.

Compliance with the guidelines

1.44 Every insurer shall while declaring the crediting rate to the policyholders, submit a certification to the IRCSL confirming that the determination of crediting rates has been carried out in accordance with the crediting rate policy approved by the Board of Directors.

Annexure A: Sample annual policyholder statement

[Company Name] – Annual Statement
Policyholder Name:
Policy Number:
Product:
Statement Period:
Policy commencement date:
Policy term:
Premium Payment term:
Policy status:
Nominee details:

<u>Summary of Policy Benefits</u>

Particular	**Amount (LKR)**
Annual premium amount	
Basic Sum Assured[1]	
Unit fund value at the start of the period[2]	
Premiums paid during the period	
Premiums allocated during the period	
Fund management charge deducted during the period	
Mortality charges deducted during the period	
Any other charges deducted during the period	
Dividend credited to the fund during the period	
Fund value at the end of the period	

1. Basic sum assured refers to the guaranteed sum assured offered
2. Start of the period shall be the end date of previous statement shared with the policyholder. The Statement period shall not be greater than one year.

<u>Details of benefit payable</u>

Particular	**Amount (LKR)**

Death Benefit	
Surrender benefit	
Any other benefit payable, such as rider benefit	

Crediting rate declaration

Particular	Detail
Crediting rate declared (%)	
Investment yield during the period (%)	
Interim crediting rate guaranteed for next year (%)	
Historic crediting rate declared in last year (%)	

Important notes for policyholders

- The crediting rate is not guaranteed and may vary depending on the performance of the underlying fund and other factors.
- The historical crediting rate should not be taken as an indicator of future crediting rate.
- Early surrenders may result in lower benefits due to charges and market conditions.
- [Placeholder for any other note that the Company wants to include relevant from PRE / product specification perspective such as reviewability of charges]

Contact us

For questions or clarification, please contact **Actuarial Unit of IRCSL**:
📞 +94 11 2396184-9
🖂 actuarialunit@ircsl.gov.lk