

**INSURANCE BOARD OF SRI LANKA**  
**GUIDELINES ON LINKED LONG TERM BUSINESS**

*The Insurance Board of Sri Lanka hereby issues Guidelines on Linked Long Term Business. The, Guidelines which cover a wide spectrum of the operations and administration of linked long term business, aim to facilitate the orderly development of linked long term business with prudential standards of corporate governance and also to maintain and improve the professionalism of insurers and their intermediaries in both the administration and sales of linked long term business, thereby ensuring fair treatment of policy holders.*

*The Guidelines shall apply to existing and new linked long-term products issued by insurers transacting long term insurance business in Sri Lanka.*

**PART I – PRELIMINARY**

**1. Introduction. -**

Linked long term business is defined in section 114(1) of the Regulation of Insurance Industry Act No: 43 of 2000, " where benefits are wholly or partially determined by reference to an index or to the value of or to the income from assets of any description".

2. The 'Guidelines on Linked Long Term Business' (Guidelines) issued will set the minimum standards for the management and administration of linked long term business, so as to achieve the following objectives: -

(a) facilitate the orderly development of the linked long term business;

(b) maintain high standard of corporate governance and professionalism in the administration of linked long-term business;

(c) maintain professional and proper conduct in the sales of linked long term policies; and

(d) product transparency and protection of policyholders interest.

**3. Coverage.-**

The Guidelines cover the administration of the business, fees and expenses, investment limits for the investment-linked funds, disclosures to policyholders, standards in product design, general marketing requirements for investment-linked products, and valuation of the assets and the liabilities of the investment-linked funds.

4. All insurers who are carrying and who wish to carry on investment-linked long-term business shall be required to comply with these Guidelines.

5. Non-compliance with the requirements of the Guidelines will compel the IBSL to initiate action against the insurer under the provisions of the Regulation of Insurance Act No: 43 of 2000.

**6. Implementation Date. –**

The Guidelines shall take effect from 01<sup>st</sup> May 2007.

**PART II - MANAGEMENT OF FUNDS**

7. In order to undertake linked long term business, an insurer is required to have adequate systems, procedures and processes to manage and administer the linked long-term funds in a proper and efficient manner. All reasonable steps shall be in place to ensure that the funds are properly valued and the investment units are appropriately priced. Transactions of the funds shall be conducted in the manner that will avoid unnecessary costs or risks to the policyholders.

**8. Objectives. -**

The objectives of an investment-linked fund shall be clear, specific and sufficiently detailed to enable a policyholder to make a proper assessment of the fund, as well as the nature of its underlying assets and potential risks.

9. The insurer must ensure that the fund is invested in accordance with its stated objectives. Where the objectives of the fund specify the fund's policy to invest in a particular security, classes of securities, economic sector or market, the insurer shall ensure that the fund is invested accordingly.

10. In the case of a new investment-linked fund, the insurer shall ensure that the fund is fully invested according to its stated objectives, immediately after its initial offer period.

11. The objectives and the allocation for the various types of investments of an investment-linked fund must be clearly and adequately disclosed in the sales materials and the policy document of that particular investment-linked policy.

12. **Linked Long Term Product:** is essentially a long term insurance product where benefits are wholly or partially determined by reference to an index or to the value of or to the income from assets of any description, as mentioned under Section 114 of the Regulation of Insurance Industry Act, 2000 (RII Act).

**13. Linked Long Term Fund:**

Every insurer who transacts linked long term business shall maintain a separate fund, which should be named as 'Linked Long Term Fund', with separate accounts, and furnish the statements of accounts required by the Board on or before such date as the Board may specify.

### PART III – DESIGN OF PRODUCT

#### 14. Design of product. —

14.1 An insurer shall design the product as mentioned in 14.2 and file with the Board for the purpose of examining whether the interest of policyholders are being adequately safeguarded before initially offering for sale in the market.

14.2 In the design of product, --

- (a) there should be two accounts, namely, unit account and non-unit account. The unit account shall contain such funds of policyholders which may be called segregated funds (names of funds to be mentioned and should not be changed during the term of the product) and such investments which are quoted in the market and for which the Net Asset Value (NAV) could be determined on a daily basis;
- (b) there should be a death benefit which shall be mentioned in absolute terms or by reference to the underlying value of assets, and the charges for this benefit shall be called 'mortality charge' which should be accounted in the non-unit account;
- (c) there should be a savings benefit which shall be the sum of net asset values of segregated funds, and the charges for this benefit shall be called 'allocation charge';
- (d) there could be any other benefit (other than death benefit and savings benefit) which shall be mentioned in absolute terms or by reference to the underlying value of assets, and the charges for this benefit shall be called 'other benefit charge';
- (e) there could also be charges, such as fund management charge, administration charge, which should be explicitly defined with examples in all the documents furnished to the policyholder;
- (f) there should be explicit mention in all the documents furnished to the policyholders of : "the savings benefits are subject to the investment risk (in view of the fluctuations in the market prices of the underlying assets) which are borne by the policyholder";
- (g) there should be explicit mention of procedures adopted in various transactions, such as annual statement of benefits, computation of net asset value of units, switches, settlement of benefits, etc., in the policy document to the policyholder; there should be explicit mention in all the documents furnished to the policyholder, for the following items:-
  - (1) annual statement [which should be furnished to the policyholder] showing the details of premium payments, all charges separately showing the amount for each charge, and NAV in respect of each segregated fund;
  - (2) computation of NAV;
  - (3) Statement (similar to #1 above) of account for each transaction of switching, any top-up premium, partial withdrawal, etc, at the time of such transaction.
- (h) 'Unit Account' shall have 'receipts' which are allocation charges (the amount of premium taken from the total premium received in respect of policies), and other items such as investment income (dividends, interest, realized gains, etc.) and 'payments' which are amounts transferred to various funds described in the policy, and expenses actually incurred for purchases/sales of investments; and the linked liability would be the net asset value which should be mentioned in

the balance sheet for the linked fund. The linked liability is built from the unit account (revenue account) and which is the policyholders' linked fund/liability;

- (i) 'Non Unit Account' shall have 'receipts' which are charges collected from the policyholders and which are described above, and also any income received from investments made in respect of monies available under non-unit account; and 'payments' are claim payments in respect of death benefit and other policy benefits, administrative expenses incurred which include increase in policy liability (other than linked liability) and transfers to shareholders; any profit/loss made in this account (revenue account) shall be mentioned as 'non-unit linked liability' in the balance sheet for the linked fund.

**14.3 Minimum Age of Policyholders.** -- To ensure that the holder of an investment-linked policy has the capacity to understand the risks involved in investing in the policy, the policyholder, who purchases the policy, shall be at least 18 years old. Nevertheless, there is no restriction on the age of the life insured.

**14.4 Surrender Value.** -- The surrender value of a policy must not be less than the value of units, based on the unit price at the time of cancellation less any insurance charges, policy fee and surrender charges, where applicable. In addition, the provisions of the RII Act on determination of surrender values shall apply to the risk portion of an investment-linked product where the risk charges are funded in advance. No surrender value is payable to any policyholder unless the policy has run consecutively for at least three years.

**14.5 Cooling-off Period / Free-look period.**-- A policyholder shall have 15 days from the date of receipt of the policy to examine its terms and conditions. A policyholder may terminate the policy within the 15-days free-look period. And if a policy is cancelled within the 15 days free-look period, the insurer shall refund:-

- (a) the unallocated premiums;
- (b) value of units that have been allocated (if any) at unit price at the next valuation date; and
- (c) any insurance charges and policy fee that have been deducted;

less medical expenses which may have been incurred.

**14.6 Pricing of Units.** - The insurer shall sell units of an investment-linked fund to policyholders at the offer price and repurchase the units from policyholders at the bid price. The bid **and** offer prices for the units shall be based on the Net Asset Value (NAV) per unit of the fund as at the next valuation date, after the request to sell/purchase units is received by the insurer. For dual pricing investment-linked funds, the offer price per unit *is* equal to the adjusted **NAV** per unit as at the valuation date divided by (1-initial charge) after the receipt of the purchase request from the policyholders. The bid price per unit is equal to the adjusted NAV per unit as at the next valuation date after receipt of the sale request from the policyholders.

14.7. The NAV per unit of an investment-linked fund is the total market value of the assets in the fund divided by the total number of units of the fund. In cases where the fund is contracting or expanding, the NAV per unit, may be adjusted, as appropriate, for an estimated transaction cost per unit, that **is** intended to reflect the average commission and brokerage expected to be incurred in respect of the investments of the investment-linked fund.

14.8. The spread between the bid and offer prices of an investment-linked fund shall not be more than 5% of the offer price.

14.9. The valuation of units and the determination of the selling and repurchase prices for the units shall be carried out daily. In cases where insurers are unable to value the units on a daily basis in

view of the nature of the investible assets, such as investment linked to derivative instrument, insurers do hereby required to obtain prior approval from the IBSL on the alternative valuation basis.

- 14.10. Insurers shall assume responsibility in cases of unit pricing error. Apart from providing adequate reserves for such occurrence, insurers shall also compensate affected policyholders for the losses incurred due to unit pricing error.
- 14.11. Information on the design of an investment-linked product and its features must be adequately disclosed in the sales literatures for the products.
- 14.12. Any compensation, corrections or ex-gratia payments made due to mis-selling or errors shall not be paid from the unit account.
- 14.13. An extension to an investment-linked product in the form of riders may be designed, and the cost of which may be funded, in the form of additional premium payment or unit deduction.
- 14.14. The insurer shall ensure the total risk charge (including unit deducting riders) as a proportion of total premium of an investment-linked product shall not be unduly high, so as not to deplete the policy owner's account value.

#### **PART IV - INVESTMENTS**

15. The investments of an investment-linked fund must be relevant and consistent with the objectives of the fund, and as disclosed in the sales literatures for the fund, and shall be those for which the market value / fair value could be determined in a transparent manner.
16. Investment Limits. -- An insurer shall comply with Section 25 of the RII Act in respect of the monies in the non-unit account, with regard to investment of monies, and comply with obligations/commitments made in the investment policy to the policyholders in respect of monies in the unit account.
17. The investments limits must be complied with at all times based on the most up-to-date value of the fund and the value of its investments. Any rebalancing of the investments necessary due to non-compliance with the limits must be done within a period of 60 days from the date of the non-compliance with the limits. Nevertheless, a 5% allowance in excess of any limit or restriction may be permitted where the limit or restriction is breached through an appreciation or depreciation of the NAV of the fund.

## **PART V - VALUATION OF ASSETS AND LIABILITIES**

- 18. Valuation of Assets.** -- The assets of an investment-linked fund shall be valued at market values daily, except for immovable property, which may be valued quarterly. However, for immovable property, the insurer needs to make appropriate adjustments should the market value of the assets change significantly during the inter-valuation period.
19. For fixed income securities, amortized value or market value wherever available shall be used.
- 20. Liabilities. –**  
The appointed actuary of the insurer shall value the liabilities of investment-linked policies at the end of each financial year of the insurer. In respect of the unit account, the policy liability shall be the NAV (net asset value) of units held in the policy at the valuation date.
21. The appointed actuary shall conduct the valuation of unit and non-unit liabilities in respect of an investment-linked policy separately.
22. The appointed actuary shall conduct a valuation of the non-unit liabilities for each investment-linked policy by a cash flow projection, at the valuation date. The liabilities in respect of the non-unit component of an investment-linked policy is valued by projecting future cash flows to ensure that all future outgoes can be met without recourse to additional finance or capital support at any future time during the duration of the investment-linked policy. The appointed actuary shall conduct the cash flow projection using actuarial principles.
23. In carrying out a projection to value the non-unit liabilities of an investment-linked policy, the appointed actuary shall use the current set of mortality and expense charges applicable as at the valuation date.
24. Where the non-unit component of an investment-linked policy is treated as an asset under the above valuation basis, the appointed actuary shall ensure that on an overall plan basis any such asset value is eliminated from the valuation by making the necessary adjustment.
25. Where the liabilities in respect of more than one investment-linked policy are to be valued, it shall not be necessary to value the policies individually so long as the overall liabilities determined can be shown to be at least as high as those produced by valuing the policies individually.
26. The appointed actuary shall ensure that the liabilities of the insurer in respect of its investment-linked policies are adequate at all times. The appointed actuary shall increase such liabilities to cover any contingencies or guarantees relating to such policies.
27. The assets needed to meet the non-unit liabilities of the insurer in respect of its investment-linked policies shall be aggregated and maintained separately in non-unit account.

## **PART VI: SOLVENCY MARGIN**

### **28. Required Solvency Margin:**

In respect of this business, every insurer transacting long term insurance business shall comply with Solvency Margin (Long Term Insurance Business) Rules, in respect of liabilities arising in the non-unit account, and also in respect of liabilities arising in the unit account where the savings benefits are guaranteed by the insurer.

## **PART VII: SALES ILLUSTRATIONS AND CUSTOMER EDUCATION.**

### **29. Sales Illustrations:**

Every insurer shall furnish a sales illustration document, which should explain the features of the product with necessary glossary.

### **30. Policyholder Education:**

Every insurer shall provide adequate and accurately information to the policyholders regarding all the features/options available to the policyholder and guide the policyholders in taking a decision with respect to exercising the options and/or buying a suitable unit linked life insurance contract.

### **31. Furnishing Statements of Accounts:**

Unit account statement shall form a part of the policy document showing the current net asset values, charges, premiums, etc., and shall make a reference to the terms and conditions applicable under the respective policy document.

### **32. Market Conduct Issues**

- (1) For better understanding of the complexities of these Products all Insurers should give a periodical in-house training to the persons involved in soliciting or procuring the business (agents, brokers, sales staff).
- (2) The curriculum for this in-house training should *inter alia* contain; the developments of the capital market, the basic knowledge of these Products, risks in investing with reference to different funds, the developments in other similar type of financial products, the concept of equity market, debt market and the overall economic scenario as affecting the capital market in general and the features of the products.
- (3) Any person involved in soliciting or procuring the business shall maintain the records pertaining to the policyholder to demonstrate that sufficient information has been collected about the potential policyholder to enable a suitable product to be recommended. These records shall form part of the proposal form and shall be made them available to the Board, whenever called for.
- (4) Further, any person involved in soliciting or procuring the business shall give the sales illustration statement with respect to the product duly indicating the specific details of the potential policyholder. This shall also indicate clearly how premium paid is appropriated towards various charges and the unit fund and the balance of the fund at the end of the first year and subsequent years. The higher upfront charges in the initial years have to be brought to the knowledge of the policyholders.

### **33. Advertisements:**

Any advertisement with regard to these products by the insurer (no other person shall make any advertisement in this regard, otherwise, the respective insurer would be liable to be prosecuted

by the Board) shall not be misleading and should contain the statement: "the savings benefits are subject to the investment risk (in view of the fluctuations in the market prices of the underlying assets) which are borne by the policyholder".

#### **34. Rating of Unit Linked Funds:**

The Board suggests the Insurers to get the evaluation of their respective unit linked funds done by an independent rating agency with an objective of providing qualitative information to the policyholder as to the assessment of performance of the various unit linked funds to enable the insuring public to choose the product in an informed manner. **This will provide the prospects a level of comfort on operational practices, fund management quality and organizational strength of insurers.**

**35. Charges.** The Board suggests the following glossary.

##### **(a) Allocation Charge and Initial Management Charge:**

**Allocation charge** means a percentage of total premiums appropriated towards charges from the premium received with the balance utilized to purchase the units of the policy. This is a charge at the time of receipt of premium.

Example: Premium = Rs. 1000; Allocation charge: 10%; Balance amount is Rs.900 and is utilized to purchase units.

Initial management charge is a percentage levied on the initial units for a specified period or throughout the term of the policy.

**(b) Annual Fund Management Charge:** means a charge levied on specific fund in respect of the underlying product shall be appropriated from the fund before calculation of NAV. This is an annual charge.

Example: Annual Fund Management charge is 1%; Fund as at 31.3.2004 is Rs.100/- Fund after this charge is Rs.99/-, which is used to calculate NAV.

**(c) Policy Administration Charge:** is a charge, which may be expressed as a fixed amount or a percentage of the premium or sum assured.

This is usually a monthly charge.

This shall be appropriated by canceling units at the beginning of each policy month.

This may be subject to inflation, preferably an x% per annum. The inflation shall be by reference to the WPI/CPI. The level of increase with respect to the index and the date of reference to the index shall be specified in all documents.

A reduced amount of this charge may be levied in case of lapsed policies, paid up policies, and fully paid up policies.

This charge shall represent the expenses other than those covered by allocation charges and the fund management expenses.

**(d) Surrender penalty:** It is levied on the value of units of the underlying unit linked life insurance policy at the time of surrender.

This charge is usually a percent of the fund.



The charge is usually in the early years of the policy and may not be levied after some policy years.

- (e) **Switching Charge:** is a charge levied by canceling the units in the fund from where the units have to be transferred to another fund.

The charge will be collected at the time of effecting switch.

The charge is usually a nominal flat amount for each switch.

- (f) **Premium redirection Charge:** is a charge levied on the premium contribution sought to be redirected (other than the fund choice opted at the inception of the policy), before allocation of the units.

The charge will be collected at the time of effecting the redirection.

The charge is usually a nominal flat amount for each redirection.

- (g) **Mortality charge:** is the cost of life insurance cover levied by cancellation of units.

This charge may be levied every month.

The method of computation shall be specified in the policy document and the mortality charge table shall form part of the policy document.

Mortality rates cannot be altered during the contract period, which are filed with the Board.

- (h) **Rider premium charge:** is the premium collected separately to cover the rider and shall be appropriated directly to the non-unit account.

- (i) **Alteration charge:** is a charge levied on each alteration of the policy, for instance, increase in sum assured, change in mode of payment of premium, reduction in policy term, etc.

The charge is usually flat amount.

**Notes:**

- 1. All the charges other than allocation charge, cost of life insurance/mortality cost and rider premium shall have an upper limit.*
- 2. The insurer cannot go beyond the upper limit. Where there are no upper limits these charges shall be guaranteed during the term of the policy.*
- 3. All the charges stated above, where relevant, may be modified within the upper limits with prior clearance from the Board.*

**36. Terminology: The Board suggests the following terminology:**

- a) **Accumulation Units:** The number of units allotted out of the premiums received after the expiry of the initial period.
- b) **Bid/sale Price:** The price at which the units are to be redeemed by the policyholder or cancelled by the Insurer.
- c) **Capital Guarantee:** Guarantee by the insurer as to the repayment of the premiums received from the insured.
- d) **Death benefit:** is the amount of benefit payable on the event of death.
- e) **Fund value:** Fund value represents the value of units at that point of time i.e. number of units multiplied by the net asset value per unit.
- f) **Fund Value:** This is the multiple of the total number of units under a policy and the NAV.
- g) **Guaranteed Surrender Value:** As defined in the provisions of RII Act.
- h) **Initial Units:** The number of the units allotted out of the premiums received during an initial period as defined in the policy terms and conditions.
- i) **Limited premium payment contract:** means that the policyholder is allowed to pay the premiums for a limited number of years, which is always less than the policy term.
- j) **Maturity benefit:** is the amount of benefit payable on the event of maturity of the insurance contract (or at the date of expiry of the contract).
- k) **Net Asset Value:**  $(\text{Market Value of investment} + \text{Current Assets (including accrued income)} - \text{Current liabilities (including accrued expenses)-provisions}) / (\text{number of units outstanding under the relevant fund})$
- l) **Offer/purchase Price:** The price at which the units are to be purchased by the policyholder or allotted by the Insurer.
- m) **Partial Withdrawals;** are amounts which could be withdrawn from the fund, partially, not wholly.
- n) **Policy Value:** Policy value is the value of units of the unit-linked policy.
- o) **Premium re-direction:** This means that the policyholder is given right to inform the insurer to redirect the amount of the premium from a specified point of time to different funds from original funds selected.
- p) **Redemption:** Encashing any number of the units at the prevailing sale price offered by the life insurer. This is applicable in case of exercising partial withdrawal or the surrender.
- q) **Regular Premium Contract:** means that the policyholder is allowed to pay premiums on specified periods of time during the period of contract, where the premium amount is fixed in advance.
- r) **Rider benefit:** is an add-on benefit to main contract.
- s) **Sales Literature:** is a document, which mentions about the features of the insurance product, and could be with illustrations.
- t) **Single premium contract:** means that the policyholder is allowed to pay the premium amount at the outset only and no further premiums are required to be paid.
- u) **Sum Assured:** Sum assured is the guaranteed amount of the benefit that is payable on death of the life assured. It should be in absolute terms, which should be a predetermined amount.
- v) **Surrender:** means cancellation of contract.
- w) **Survival benefit:** is the amount of benefit payable on the event of survival at a known point of time
- x) **Switch:** This is the facility allowing the policy holder to intervene to change the investment pattern from one fund to the other fund amongst the funds offered under the underlying policy of the life insurer.
- y) **Switches:** *Explanation:* for switches and premium re-direction, In the event the units are held in more than one investment fund account the cancellation of units shall be in proportion to the units held in respective funds, if not opted by the policyholder.

- z) **Top-up premium:** A top up premium is a premium paid at irregular intervals during the period of contract. This is an additional premium over and above the contractual premiums (including single premium) chosen at the commencement of the contract.
- aa) **Unit Linked Fund:** This is the accumulation of the premiums invested in the underlying segregated fund of unit linked life insurance policy comprising of any of the funds offered under this policy.
- bb) **Unit Value:** is the value of assets of the fund (in which units have been allocated) per unit
- cc) **Unit:** is a one-number carrying a fixed amount of face value.
- dd) **Unit:** This is a portion or a part of the underlying segregated unit linked fund.
- ee) **Valuation of funds:** The determination of the value of the underlying assets of the unit fund.
- ff) **Whole Life Contract:** means that insured amount is payable on death and where the contract terminates only on death.

## **PART VIII: MISCELLANEOUS**

### **37. Furnishing of Information to the Board.**

All the insurers shall furnish the data in respect of the following information relating to their policies to the Board in a prescribed format (The formats required for this purpose will be prescribed by the Board) every half year:

- (a) The data on switching options exercised by the policy holder
- (b) The data on premium redirections exercised by the policy holders
- (c) The data on the partial withdrawals
- (d) The data on top ups

**Lasinee Seresinhe (Mrs.)**  
**DIRECTOR GENERAL**

**STATEMENT OF NET ASSET VALUES FOR THE  
SEGREGATED FUNDS MAINTAINED BY THE INSURER  
FOR ITS LINKED BUSINESS FOR THE FINANCIAL YEAR  
ENDED 31<sup>st</sup> March, 20.**

(This form should be furnished to the IBSL within 6 months from the end of the financial year)

NAME OF INSURER:

DATE OF REGISTRATION WITH THE BOARD:

NAME OF ACTUARY:

Item No.	Description	<i>Segregated Fund 1</i>	<i>Segregated Fund 2</i>	<i>Segregated Fund 3</i>	....	<i>Total</i>
(1)	(2)	(3)	(4)	(5)	(6)	(7)
01	Opening Fund (brought forward from preceding year)					
02	Net Asset Value of units created					
03	Increase (decrease) in value of investments during the year					
04	Other income					
05	<b>Total income</b> (Sum 01 to 04)					
06	Net Asset Value of units cancelled					
07	Management charges					
08	Tax paid					
09	Other expenditure, specify					
10	Increase (decrease) in provisions					
11	<b>Total expenditure</b> (Sum 06 to 10)					
12	Closing Fund carried forward					
13	Total Number of Units:					
14	Net Asset Value per Unit					

Notes to Form LB-2:

- 1) All items must be in thousands;
- 2) Items under Col (3), Col (4), Col (5), Col (6) etc. must be brought forward from the annual accounts of the company.

## STATEMENT OF ANALYSIS OF UNITS IN SEGREGATED FUNDS AS AT 31<sup>ST</sup> MARCH, 20.

(This form should be furnished to the IBSL within 6 months from the end of the financial year)

NAME OF INSURER:

DATE OF REGISTRATION WITH THE BOARD:

NAME OF ACTUARY:

Item No.	Description (Name of Unit Linked Product)	NUMBER OF UNITS IN				
		<i>Segregated Fund 1</i>	<i>Segregated Fund 2</i>	<i>Segregated Fund 3</i>	.....	<i>Total</i>
(1)	(2)	(3)	(4)	(5)	(6)	(7)
01	a) Unit Linked Product:.....					
02	b)					
03	c)					
04						
05	Total					