Concept Paper

Proposal for Review of Unit Linked Framework and Regulatory Changes in the existing Regime for Unit Linked Business

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Table of Contents

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1. Objective:

1.1 Objective of this paper is:

(a) To provide brief snapshot of Unit Linked Business and to give overview of the currently applicable regime for unit linked business;
(b) Study of Regime for Collective Investment Schemes (CIS) in Pakistan and Unit Linked framework applicable in other jurisdictions;
(c) To identify gaps/ areas for further improvement in the existing unit linked framework, in light of best practices in the CIS regime and other jurisdictions; and
(d) To propose necessary revisions in the unit linked framework aimed at strengthening the existing regime.

2. Overview & Key Snapshot of Unit Linked Business:

2.1 Unit Linked Product: Unit Linked Insurance is a product offered by life insurance companies which, unlike a pure insurance policy, gives policyholders both insurance and investment under a single integrated plan. The investable portion of the premium is allocated to unit linked funds selected by the policyholders as per their risk appetite. The investment returns are provided to the policyholders based on the increase or decrease in the Net Asset Value of the unit.

2.2 Distinct Nature of Unit Linked Business: The nature of unit linked products is different than other types of life insurance products in many ways such as:

(i) Unlike other savings cum insurance business, investment choice is available to the policyholders;
(ii) Investment risk is borne purely by the policyholders;
(iii) Operations of unit linked funds are similar to mutual funds/ collective investment schemes, wherein units of fund selected by the policyholder at policy inception are issued against investable portion of the premium;
(iv) Generally, no guarantees are available for surrender values/ maturity benefits;
(v) Benefits for maturity and surrenders are paid to the policyholders from the respective unit linked funds selected by the policyholder, based on prevailing unit values;
(vi) Each unit linked fund is a sub-fund of the statutory fund having its own distinct investment objective and investment policy;
(vii) Policyholder's reserves are divided in two separate components i.e. unit reserves and non-unit reserves, wherein unit reserves comprises of investment related liabilities in terms of units under the contracts, while non-unit portion comprise of liabilities against the insurance component in the policies;
(viii) Unit liabilities are paid out of the available assets in the unit linked fund, which does not take in to account overall statutory funds' assets.

2.3 Key Snapshot of Unit Linked Business

Unit linked Market Share in Total Life Premium:

Unit linked business is the most popular kind of insurance business among life insurers which comprises of around 85% of the total life insurance premium underwritten by private life insurers based on 2019 figures. Major contribution in the unit linked business comes from bancassurance channel which comprises of 71% share in the total unit linked premium for the year 2019.

Below table can be referred for brief snapshot of unit linked business:

Figures in PKR'000		
Particulars	**2019**	**2018**
Total Premium – All Life insurers	**228,690,513**	**225,966,157**
Total Premium – Private Life Insurers only	**110,139,963**	**110,728,157**
Total Premium – Unit Linked only	**93,278,235**	**92,788,716**
Total Premium - Unit Linked Bancassurance only	**66,596,600**	**70,430,533**
Unit Linked Share in Total Premium – All insurers	**41%**	**41%**
Unit Linked Share in Total Premium - Private Life insurers only	**85%**	**84%**
Bancassurance share in Total Unit Linked Premium	**71%**	**76%**

Asset size of Unit Linked Funds and analysis of Surrenders under Unit Linked Business:

As on December 31, 2019, the total value of assets maintained under unit linked funds amounts to Rs. 328 Billion. The analysis shows that as on December 31, 2019, total 1.4 million + unit linked polices policies were in force. Out of unit linked policies in-force at life insurance companies during the year, 3.50% (i.e. 58,554 policies) of the policies were surrendered. Further the amount of surrenders during the year 2019 amounts to Rs. 31 bln, which makes upto 10% of the total value of assets under unit linked funds of life insurers.

3. Existing Regulatory Framework applicable on Unit Linked Business:

3.1 Dedicated Regime – Unit Linked Product and Fund Rules, 2015: Keeping in view of the considerable increase in the size of unit linked business underwritten by private life insurers, SECP Vide S.R.O 343(I)/2015 dated April 22, 2015, notified Unit Linked Product and Fund Rules, 2015, to address certain areas of the business which include:

(a) **Requirement applicable on Unit Linked Products:**

(i) Minimum Financial Protection component and Minimum Term of the Plan;
(ii) Indexation of Premium option to policyholders;
(iii) Minimum Disclosures to policyholder including provision of quarterly/ annual unit account statements to policyholders;
(iv) Insurance Need Analysis of prospective policyholders.

(b) **Requirements applicable on Unit Linked Funds:**

(i) Constitution of Investment Committee;
(ii) Development of Investment Policy and its minimum content;
(iii) Monitoring of pricing by appointed actuary;
(iv) Operations of unit linked funds including its permitted expenses and charges;
(v) Unit Pricing Methodology and Valuation of Fund's assets;
(vi) Pricing Frequency and Unit Transaction Timings;
(vii) Accounts of Unit Linked Funds and its disclosure on website.

3.2 **Other Frameworks applicable on Unit Linked Business:** Besides Unit Linked Product and Fund Rules, 2015, following are other regulatory frameworks that places certain requirements on unit linked business in addition to other kind of insurance business:

(a) **Directive for Life Insurance and Family Takaful Illustrations, 2016:** This Directive provides regulatory guidance with regards to provision of pre-sale illustrations to the policyholders for all the products having savings component, which includes:
   (i) Standardized format for illustrations in both English and Urdu language;
   (ii) Calculation methodologies for projection of illustrative values;
   (iii) Notes and disclosures in the illustration;
   (iv) Projected Growth Rate Scenarios for illustrative values in consultation with PSOA;
   (v) Requirement for showing Historical Investment Performance Report.

(b) **The Corporate Insurance Agents Regulations, 2020:** In order to strengthen the regulatory regime for distribution of insurance through corporate insurance agents, including bancassurance, SECP has notified the Corporate Insurance Agents Regulations, 2020, in order to align the long term interests of all stakeholders i.e. insurers, policyholders and banks.

These Regulations aims to strengthen the Bancassurance framework by enhancing pre-sale and post- sale disclosure requirements, improvement in after sales call back confirmation requirement by introducing minimum component of basic call script, introduction of automatic commission claw-back provision, requirement of showing audio-visual clip of insurance product to policyholders, rationalization of commission rates, and introduction of minimum premium allocation rates. The Regulations, also focuses on promotion of digitalization, encouraging suitable product mix, increased communication with the policyholders through SMS and emails during policy cycle, enhanced training requirements for bank insurance executive and specified persons etc.

4. Study of Collective Investment Scheme Regime and Regulatory Framework applicable on Unit Linked Business in other jurisdictions:

4.1 In order to review the existing unit linked framework, an analysis of Unit Linked Product and Fund Rules, 2015 with the regime applicable on Collective Investment Scheme, and unit linked regime applicable in other jurisdictions was carried out, findings of which are shared below:

(a) Review of Regime applicable on Collective Investment Scheme: The operations of unit linked funds are quite similar to collective investment schemes (CIS) offered by Asset Management Companies, wherein policyholders' money is invested in the unit linked fund(s) of their choice and accordingly, units of the respective funds are issued to the policyholders. Accordingly, a comparative study of Unit Linked Product and Fund Rules, 2015 with the regime applicable on CIS was carried out to identify the regulatory requirements applicable therein, and its relevance to unit linked business. Following are the key requirements applicable on CIS under NBFC Regulations:

   (i) Formation of Trust for management of funds;
   (ii) Registration for open ended or closed ended funds;
   (iii) Clarity on eligible investment avenues for investment from the funds.
   (iv) Investment parameters and limitations for investment from funds;
   (v) Categorization of funds and standardization of their investment policy;
   (vi) Criteria for risk categorization of funds;
   (vii) Fiduciary Responsibility with respect to management of investments;
   (viii) Criteria for trading in securities by employees engaged in investment functions;
   (ix) Prohibited activities from the funds;

(x) Unit Pricing and valuation methodology;
(xi) Procedure for revocation of funds.

(b) Review of Malaysian regime applicable on investment-linked business: In order to carry out analysis of the best practices applicable internationally, regulatory requirements applicable on investment linked business in Malaysia have been studied. Following are the salient features of Policy Document issued by Bank Negara Malaysia on Investment Linked business dated January 11, 2019 :

(i) Roles of board and senior management with respect to management of funds;
(ii) Requirements for management of funds such as clear objectives of funds, pricing and dealing aspects of units;
(iii) Product design and structure including requirements for minimum allocation rates, sustainability of coverage, minimum protection component, free look period etc.
(iv) Guidance on fees and charges of product and funds;
(v) Transparency and disclosure requirements including guidance on illustration formats and rate of return scenarios for illustrating benefits, provision of fund fact sheets, requirement for ensuring consistency between product literatures, illustrations and fund fact sheets etc.;
(vi) Annual statement of funds to policy owners;
(vii) Guidance on the formats of Fund manager reports;
(viii) Publication and circulation of fund's NAV;
(ix) Investment limits and guidance on valuation of assets and liabilities of funds.

(c) Review of IRDAI's (Unit Linked Insurance Products) Regulations, 2019: The Insurance Regulatory and Development Authority of India's (Unit Linked Insurance Products) Regulations, 2019, provides for the requirements applicable on unit linked business. The structure of unit linked product is different in India wherein a mandatory lock-in period of 5 years is applicable whereby, proceeds of the discontinued policies (either lapsed or surrendered) cannot be paid by the insurer to the policyholder during the lock-in period, except in the case of death or upon the happening of any other contingency covered.

Following are other applicable requirements in the IRDAI's regulations:

(i) Minimum insurance component in a product;
(ii) Minimum policy and premium payment term;
(iii) Guidance on discontinuation of policy within lock-in period of 5 years;
(iv) Capping on various charges under a policy such as premium allocation charges, fund management charge, guarantee charge, policy admin fee, surrender or discontinuation charges, switching charges etc.
(v) Requirement for providing customized benefit illustration to policyholders;
(vi) Computation method for NAV;
(vii) Disclosure requirements including, uploading of latest information of funds on website, and issuance of statement of accounts to policyholders.

5. Identification of Areas for improvement in the Unit Linked Framework:

In light of the review of existing regime for unit linked business and study of CIS regime and unit linked framework applicable in other jurisdictions, following key areas have been identified for further improvement and strengthening of the existing unit linked framework:

(a) Enhanced clarity on eligible and ineligible investment avenues: Further clarity or guidance may be provided on the eligible investment avenues for a unit linked fund, and the avenues that should be restricted for investment, and guidance for investment in certain instruments such as Margin Trading, Futures, etc. may be provided aimed at encouraging insurers participation in the capital markets.

(b) **Prescription of Investment Parameters and Limits for unit linked funds:** The admissibility of assets limits are prescribed under the Insurance Rules, 2017, for the purpose of calculating solvency of the insurer and the same are applicable on statutory fund level rather than individually at each unit linked fund. Further, relevancy of admissibility of assets limits for solvency purpose on unit linked business may be reconsidered which is discussed in the later part of the paper. It is considered that investment limits and parameter be specified for investment from unit linked funds.

(c) **Broad Categorization & Standardization of Unit Linked Funds:** In order to bring uniformity in the investment strategy and asset allocation of various kind of funds offered by life insurers, it is considered important that broad categories of funds such as equity funds, income funds, money market funds etc., along with standardization of their investment policies may be specified.

(d) **Guidance on Risk Categorization of Funds:** Currently risk categorization of funds is carried out by insurers based on their own analysis. However, in order to bring industry wide standardization in the risk categorization of various funds, guidance may be extended in the existing framework.

(e) **Responsibility of Insurers and its management with respect to investment:** The Code of Corporate Governance for Insurers, 2016 sets out certain requirements with respect to investment governance such as preparation of board approved policies for investments, constitution of investment committees, drawing up of an investment policy, review by board of directors etc. However, explicit guidance with regards to fiduciary responsibilities of insurers, addressing conflict of interest of employees managing investment function, fair and transparent management of funds etc. may be considered to be specified.

(f) **Strengthening of Sales process, Disclosure requirements and Communication with Policyholders:** In order to strengthen sales process, and disclosure requirements applicable on unit linked product, applicable requirements of The Corporate Insurance Agents Regulations, 2020, on sales and market conduct may be considered to be introduced in the Unit Linked Product and Fund Rules, 2015, to apply the same across all channels of distribution including agency sales force. Further, guidance with regards to formats and content of Fund Manager Reports, communication with policyholder during policy cycle etc. may also be considered to be introduced.

(g) **Improvement in the structure of Unit Linked Products:** In order to improve value under unit linked products, minimum premium allocation rates for investment in the investment accounts of policyholders, as already introduced in the Corporate Insurance Agents Regulations, 2020, may also be introduced in the unit linked rules for its application on direct distribution of products as well.

Moreover, it is being considered that reasonable surrender charges should be levied on policies to ensure that the purpose of such charges shall be to cover the expenses incurred on policies upto the date of surrender/ lapse, rather than to earn profit from the forfeiture of policyholders' cash values.

6. Proposed revisions in the Unit Linked Product and Fund Rules, 2015:

In view of the areas for improvement identified in the existing regime, it is considered important that necessary revisions be made to strengthen the existing unit linked framework, aimed at improvement in investment practices, prudent management of funds, increased transparency and disclosure requirements, and alignment with the best practices applicable in CIS regime and other jurisdictions. Accordingly, draft amendments in the Unit Linked Product and Rules, 2015 is proposed, based on following major proposals:

(i) **Specifying Investment Avenues, and Investment Policy:**

(a) Providing clarity on eligible avenues for investment from unit linked funds, including securities, margin trading, spread transactions, future contracts, etc;
(b) Specifying parameters for investment from unit linked funds and exposure limits in a particular investment instrument both in single party and in aggregate;
(c) Specifying different categories of unit linked funds based on their investment objectives and standardization of their investment policies;
(d) Providing guidance for Risk categorization of various unit linked funds based on its investment policy including risk categorization of a product.

(ii) **Investment Operations and conduct:**

(a) Specifying fiduciary responsibilities of the insurers with regards to management of unit linked funds;
(b) Prohibited activities from the funds such as pledging of funds' assets, concentration of business with single broker, transactions with connected persons without boards' approval etc.;
(c) Charging of ex-gratia payments made to policyholders for any omission, error, mis-selling etc. on part of insurers to shareholder's fund.

(iii) **Strengthening of Sales Process and Disclosure Requirements:**

(a) Alignment of sales process with the requirement introduced in the Corporate Insurance Agents Regulation, 2020, which include:

i. Provision of bilingual policy documents;
ii. Showing audio-visual clip to policyholder for guidance on product features and filling proposal forms;
iii. Strengthening of insurance need analysis requirement to include investment risk profiling and unit linked fund suitability analysis as well;
iv. Encouraging insurers to carry out Insurance Need Analysis of the policyholder through automated application/ software;
v. Requirement of minimum financial underwriting of prospective policyholders;
vi. Requirement for carrying out after sale call back confirmation from policyholders and specifying minimum components of call back scripts;
vii. Default fund from investment through a unit linked product to be low risk fund.
viii. Obtaining investment risk undertaking from policyholders in case of investment in funds other than low risk funds.

(b) Increased communication with the policyholders during the policy cycle, by introducing following requirements:

i. Acknowledgement from policyholders, on receipt of documents or policy terms, preferably through email or SMS;
ii. Welcome Message to the policyholder informing issuance of insurance policy, dispatch of insurance policy documents, and free look period clause;
iii. Specified time period for sending Renewal Notices to the policyholders and sending Follow-up SMS for collection of renewal premium;
iv. Acknowledgement on receipt of premium from policyholder;
v. Reporting to the policy holder through SMS or email on each premium payment the amount of charges deducted from the premium and net investment made in underlying funds;

vi. Interactive phone call to policyholder, in case premium not received within one month.

(c) Strengthening transparency and disclosure requirements, by introducing following additional requirements:

i. Prominent display of Free Look Period in the policy document, policy schedule, and marketing material;
ii. Requirement for appropriate naming and branding of products and funds and prohibition on using words like guaranteed or capital protection/ preserved, in the product and funds name unless an explicit guarantee is provided by the insurer;
iii. Disclosure in all sales literature that "*This is an insurance or takaful product that is linked to the performance of underlying assets under a unit linked fund, and is not a pure investment or saving product such as collective investment schemes or mutual funds or bank deposits";*
iv. Prominent display of risk category of the fund in all such documents wherever, funds description is provided in the documents;
v. Specifying minimum content of Fund Manager Report, and uploading of same on insurers along with intimation of the same to the policyholders through physical or electronic means.

(iv) **Improved Product Value:**

(a) Minimum premium allocation rates for investment in the unit linked fund as already specified under Corporate Insurance Agents Regulations, 2020, are proposed to be introduced to apply across all distribution channels;
(b) Introducing requirements for ensuring no profitability to insurance companies from the application of surrender charges.

Notification for Draft amendments to the Unit Linked Product and Fund Rules, 2015 based on aforesaid proposals are annexed to this paper as Annexure A.

7. Regulatory Changes proposed in other applicable requirements on unit linked business:

7.1 Changes in the Directive for Life Insurance and Family Takaful Illustrations, 2016 (Illustration Directive): As mentioned above, the SECP had issued Illustration Directive applicable on all life insurance products having savings component, with an aim of bringing uniformity among insurers with respect to providing policy illustrations to the policyholders. With an aim of increasing transparency and disclosure in the illustration document, and review of the illustration projection methodology, illustration directive has been reviewed and following key areas have been identified for improvement:

(i) **Disclosure of Fees/ Charges in the illustrative table:** Unit linked products are subject to various fees and charges, which includes premium allocation charges, bid offer spread, administration fee, mortality charges, investment management fee and surrender charges. Currently, the rates of these charges are disclosed in the notes to the illustration, however, it is considered that explicit disclosure of the amount of charges applicable each year may be disclosed in the illustration table for policyholder's information;

(ii) **Relevancy of Projected Growth Rate of Return Scenarios:** Currently, the projected illustrative values are based on three growth rate of return scenarios prescribed by SECP each year in consultation with Pakistan Society of Actuaries (PSOA). The PSOA recommends these rates which takes into account the yield on the latest issue of 10 year Pakistan Investment Bond as a guiding benchmark.

The aforesaid rate of returns methodology may hold relevance for those products whose investments are mainly in fixed income securities which offers stability in investment return and are not subject to major market volatility. In the case of Participating products and Universal Life products, major portion of the relevant statutory fund is invested in government securities. As per section 35(7) of the Insurance Ordinance 2000 read with Rule 16 of the Insurance Rules, 2017, 40% of the statutory fund's assets other than investment linked statutory fund, are invested in Government Securities.

However, in the case of unit linked products, different unit linked funds (such as equity fund, income fund, balanced funds) are offered to the policyholders, each having its own investment objective and strategy. Hence the aforesaid rate of returns may not hold relevance for each kind of unit linked fund.

(iii) **Reflection of historical investment performance in the illustrative values:** Currently, life insurers are required to provide a historical investment performance report of each fund showing actual performance of the fund for last five years and average return since inception of the fund. However, it may be considered to include actual performance of the fund in the projected illustrative values in the illustration table for reflecting fund performance in the illustration table.

<u>International Practices with respect to Policy Illustrations:</u>

Malaysia:

The policy document issued by Bank Negara Malaysia on Investment Linked Policy also provides guidance with respect to format and manner of illustrations. Salient features of the illustration requirements are as follows:

(i) Disclosure of years wise premium paid, amount all policy related charges to be deducted each year, projected cash values, and amount & percentage of commission paid each year with the illustrative table. The disclosure of amount of charges is segregated into allocation charge, insurance charges, fund management charges and other charges;
(ii) The projected cash values are based on two scenarios i.e. 2% and 5% for all types of funds except for equity funds. For Equity funds, projected rates are 2 % and 10 -year average historical FTSE Bursa Malaysia KLCI returns (Stock Exchange in Malaysia) for the first 20 years, and 5% thereafter;
(iii) Provision of Fund Fact Sheet to the policyholders along with policy illustrations showing details of fund, its performance benchmarks, investment strategy, fees/ charges, and historical investment performance as per format prescribed.

Web reference: pd_ILBusiness_Jan2019.pdf (bnm.gov.my)

Singapore:

The Life Insurance Association of Singapore has provided Guidelines on Policy illustrations for various kinds of insurance products including investment linked products. Key features of the illustration requirements are shared below:

(i) The illustration format requires policy year wise projected illustrative values for death benefit, and surrender values, and separate table of deductions showing effect of deductions in the surrender values. The illustration format also requires separate table for distribution cost against each premium payment.
(ii) The illustration projected rate of return are specified by LIA at 4% and 8% per annum which are subject to review by LIA.

Web reference: mu-2218-lia-guidelines-on-pi-cp-and-bpd-mu2218-sentzip.pdf

India:

Insurance Regulatory and Development Authority of India (IRDAI) circular dated September 26, 2019 provides requirements with respect to benefit illustrations of life insurance products. Feature of the illustration requirements as per IRDAI circular are as follows:

(i) The initial page of the illustration provides guidance to the policyholder on how to read and understand the illustration;
(ii) The illustrative tables are divided into two parts i.e. Part A and Part B. First part of the table requires projections of year wise premium, charges deducted, commission paid to intermediaries and surrender values and death benefit at two gross rate of return scenarios. Part B of the table requires details of amounts of charges segregated into allocation charges, mortality charges, GST, admin charges, guarantee charges, fund management charge and other charges.
(iii) The two scenarios for growth rate of returns are prescribed at 4% and 8% per annum.

Web reference: https://www.irdai.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=PageNo3909&flag=1

Proposed changes in the Illustration Directive:

In light of the issues identified above, and in order to align with the international practices, following changes are proposed in the Illustration directive:

(i) **Change in illustration format to show explicit deduction of allocation charges:** In order to increase transparency in the illustration document, it is proposed that illustrative values in the illustration should clearly and explicitly show deduction of year wise amount of allocation charges applicable on the policy next to the column containing annual premiums.

(ii) **Revision of Projected Growth Rate Scenarios for Equity based unit linked funds:** As the actual performance of equity based funds is subject to high market volatility, it is proposed that for Funds with major investment in equity instruments, prescribed rate of returns shall be linked with the performance of Pakistan Stock Exchange as benchmark rather than current basis which uses PIB rates as benchmark. The proposed three growth rate scenarios for equity based funds are as follows:

   a. 5 year average performance of KSE-100 index;
   b. 10 year average performance of KSE-100 index;
   c. 5 years average historical performance of the fund.

(iii) **Revision of Projected Growth Rate Scenarios for Participating Products:** In order to improve relevancy of the illustrative values in the participating products, it is also proposed that for participating products, the three growth rate of return scenarios shall be based on 90%, 100% and 110% of the 5-years historical average bonus rates of the relevant statutory fund.

(iv) **Provision of Fund Fact Sheet with the Illustration:** It is proposed that a key fact sheet of a unit linked fund is provided along with illustration to the policyholder enabling him to make an informed decision in selecting a suitable fund as per its risk appetite. The fund fact sheet should provide key information of the fund such as its investment objective, risk category, targeted asset allocation, performance benchmarks, fees and charges of the fund, and its historical performance.

In light of above propositions, a separate directive in partial supersession of the Directive for Life Insurance and Family Takaful Illustrations, 2016, is proposed to be issued in exercise of the powers granted under Section 40B of the SECP Act, 1997. Draft proposal is attached as **Annexure B** to this paper.

7.2 Changes required in the Solvency Requirements applicable on investment linked business: The existing solvency regime for insurance companies addresses and provides requirements on various areas covering:

(i) Admissibility of Assets limits for the purpose of calculation of solvency;
(ii) Maintenance of Net admissible assets over liabilities;
(iii) Methodology for calculation of solvency margins;
(iv) Valuation methodology for policyholders' liabilities

One major area that may needs to be addressed is the appropriateness and relevancy of admissibility of assets limits used for the purpose of calculation of solvency of a statutory fund, on unit linked statutory fund.

Summary of the admissibility of assets limits applicable at statutory fund level of a life insurer as per Rule 12 of the Insurance Rules, 2017 are as follows:

Type of Asset	Admissible Limit for solvency purpose of total investments
Any asset other than bank deposit	5% of the value of the fund
Total Bank deposits	100%
Deposits in a single bank	Greater of Rs. 25 million or 15%
Loans secured against immovable property	5%
Any one unit of immovable property	20%
Total immovable property	30%
Shares in one company or group of related companies	5%
Shares of listed companies in aggregate	50%
Shares of unlisted companies in aggregate	5%
Immovable property and shares in aggregate	60%
Loans to person	Single 1%, group of related persons 2%
TFCs / sukuk bonds issued by one issuer, not being a state owned enterprise	5%
TFCs / sukuk bonds in aggregate	30%
Units in any one open ended mutual fund	10%
Units in all open ended mutual funds managed by the same AMC	15%
Any single real estate investment trust	5%
All real estate investment trusts in aggregate	10%
All investment in shares (listed and unlisted), modaraba certificates, property, mutual funds and real estate investment trusts in aggregate but excluding mutual funds which have no direct or indirect investment in equities or property	60%
Listed modaraba certificates issued by any one company	5%
Loans to any person or group of related persons in aggregate	5%

Section 35(4) of the Insurance Ordinance 2000 read with Rule 14(4) of the Insurance Rules, 2017 requires that:

35. Net admissible assets of life insurers.-

(4) A life insurer shall, in each statutory fund maintained by it for the conduct of investment-linked business, maintain at all times a surplus of admissible assets in Pakistan over liabilities in Pakistan, other than policyholder liabilities, equal to or greater than a sum calculated in accordance with such principles as may be prescribed by the Commission.

Rule 14(4) of the Insurance Rules, 2017

14. Net admissible assets of life insurers.-

(4) For the purpose of sub-section (4) of section 35 of the Ordinance, the surplus of admissible assets in Pakistan over liabilities in Pakistan, other than policyholder liabilities, which a life insurer shall maintain at all times in each statutory fund maintained by it for the conduct of investment linked business shall be the amount of policyholder liabilities plus, unless written permission has been granted to the life insurer under Rule 14(2) to maintain the solvency margin in its shareholders' fund and statutory funds in aggregate, a solvency margin calculated in accordance with the principles set out in Annexure III.

Rule 23 of the Insurance Rules, 2017

23. Minimum valuation basis.- *For the purposes of sub-section (5) of section 50 of the Ordinance, the minimum valuation basis shall be such as is set out in Annexure V.*

Annexure V Clause 8. *Requirements for Linked Business.—(1) Reserves in respect of linked business shall consist of two components, namely, unit reserves and non-unit reserves.*

(2) Unit reserves shall be calculated in respect of the units allocated to the policies in force at the valuation date using unit values at the valuation date.

(3) Non-unit reserves shall be determined by the Appointed Actuary using generally accepted actuarial principles. These reserves shall also take into account guarantees, if any, relating to surrender values or minimum death and maturity benefits.

Possible Issues:

The limits for admissibility of assets as prescribed under Rule 12 of the Insurance Rule, 2017 read with section 32(2) of the Insurance Ordinance 2000, are applicable on all statutory funds including investment linked statutory fund under which unit linked business is underwritten by life insurers. The objective of these limits is to ensure that insurers have enough assets of adequate quality available in its statutory funds to cover its liabilities including policyholder's liabilities.

However, as mentioned above, the nature of unit linked business is different than other types of life insurance business in a way that unlike other savings cum insurance business, investment choice is available to the policyholders and investment risk is borne purely by the policyholders. Each unit linked fund is a sub-fund of the statutory fund having its own distinct investment objective and investment policy. Liabilities under unit linked business are divided in to two parts i.e. unit reserves and non-unit reserves, where unit reserve portion comprises of investment portion of the liabilities, whereas, non-unit reserves include liabilities related to insurance/ protection component. Consequently, the solvency requirement does not have the same direct disciplinary effect on the investment risks borne by the policy holder.

The above admissibility of assets limits apply on both unit reserves and non-unit reserves portion of the investment linked business, which may raise certain issues with respect to management of investments under unit linked funds:

(i) Each unit linked fund have its own investment policy, which may conflict with the limits of admissibility of assets applicable at statutory fund level, thereby compromising the investment objective of relevant unit linked fund;

(ii) Investment choice rests with the policyholder so does the investment risks, hence admissibility limits may not allow insurer to invest as per policyholder investment choice in some cases;

(iii) For companies having limited no. of unit linked funds, enough room may not be available for life insurers to take high exposures in certain investment avenues due to restrictions applicable at statutory fund level.

(iv) The proposed changes in the unit linked framework with respect to introduction of investment limits & parameters, categorization & standardization of funds etc., also requires relevant changes in the admissibility of assets limits for solvency purpose, so that unit linked funds can comply with the proposed requirements without any practical difficulty.

Proposed Way Forward:

Keeping in view of the distinct nature of unit linked business, it is proposed that limits for admissibility of assets for solvency purpose should be reviewed for investment linked statutory fund, and its applicability may be restricted to non-unit reserve portion of the statutory fund which mainly comprises of insurance liabilities.

For this purpose, it is proposed that proviso to Rule 12 of the Insurance Rules, 2017 may be added to restrict applicability of admissibility of assets limits on unit linked business to the extent of assets held against non-unit reserve portion of the investment linked business statutory fund. Notification for Draft amendments in the Insurance Rules, 2017 are annexed to this paper as **Annexure C**.

8. Recommendation for Public Consultation:

This concept paper along with notification for draft amendments to the Unit Linked Product and Fund Rules, 2015 **(attached as Annexure A),** proposed changes in the Directive for Life Insurance and Family Takaful Illustrations, 2016 **(attached as Annexure B),** and notification for draft amendments to the Insurance Rules, 2017 **(attached as Annexure C)** are shared for seeking public comments thereon, within thirty days of the date of this paper.