CONSULTATION PAPER

P014 - 2012

June 2012

Consultation Paper on Settlement Options in Life Policies

Monetary Authority of Singapore

PREFACE

1 Some life insurers offer settlement options under their life policies. Such options allow the policy owner or beneficiary, upon the surrender, maturity or a valid claim of the policy, to leave the insurance proceeds with the insurer. These include depositing the lump sum insurance proceeds with the insurer to accrue interest, converting the lump sum to installment payments over a fixed period of time or converting the lump sum into a life annuity.

2 This consultation paper proposes to disallow the provision of settlement options under new life policies, except for the option to convert into a life annuity[1]. Existing life policies with settlement options provision, regardless of whether such options have been exercised, will be grandfathered. MAS' considerations are set out in sections 2 to 4 of this consultation paper. The proposed treatment of existing life policies that provide settlement options is set out in section 5. Section 6 covers the implementation timeline for the proposals made in this paper.

3 MAS invites interested parties to submit their views and comments on the proposals made in this paper. Electronic submission is encouraged. Please submit your written comments by 30 July 2012 to:

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Monetary Authority of Singapore
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MAS Building
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Email: settlementoptions_12@mas.gov.sg

Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

[1] For the purposes of this paper, the term "settlement options" used subsequently excludes the option of converting into a life annuity.

1 INTRODUCTION

1.1 Some life policies offer settlement options which provide policy owners or beneficiaries the choice of leaving the lump sum benefits with the insurer. This paper clarifies the regulatory position on such monies left with insurers, highlights issues which may arise for policyholders and beneficiaries who exercise this option, and consults on the treatment of settlement options in life policies.

2 COVERAGE OF SETTLEMENT OPTION MONIES UNDER THE POLICY OWNERS' PROTECTION SCHEME ("PPF SCHEME")

2.1 The PPF Scheme which came into operation on 1 September 2011[2], provides policy owners and beneficiaries certainty as to how much of their policy monies will be protected should their insurer default. The PPF Scheme covers all life policies, accident and health policies, compulsory insurance policies and selected personal lines insurance policies, subject to caps where applicable. This includes coupon deposits, advance premium payments and unclaimed monies[3] from these policies. The PPF

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[2] The Deposit Insurance and Policy Owners' Protection Schemes Act 2011 (No. 15 of 2011) came into effect on 1 May 2011. Subsequently, 1 September 2011 was appointed as the effective date for collection of PPF levies and use of the PPF.

[3] In our December 2009 consultation paper on the 'Second Consultation on Policy Owners' Protection Fund', it was stated coupon deposits, advance premium payments and unclaimed monies will be covered under the PPF0 Scheme for the following reasons:

(i) Coupon Deposits
Most life insurers offer life policies such as anticipated endowment plans, which provide a cash coupon at regular intervals. Besides claiming the cash coupons, policy owners may alternatively leave the coupons with the life insurer to earn higher interest to build up a higher payout at maturity or surrender. As such coupon deposits could make up a significant portion of policy benefits, they are covered under the PPF Scheme

(ii) Advance Premium Payments
There may be instances where life insurers receive advance premium payments from policy owners for life policies. Advance premium payments are akin to unearned premiums for general insurance policies, which contribute to the continued coverage of the insurance policies. Hence, they are covered by the PPF Scheme.

(iii) Unclaimed Monies
There may also be cases where admitted claim, maturity and surrender payments have not been sent out to the policy owners due to delays in arranging payments, or have not been collected or banked in by

Scheme does not cover policies where the insurance liability obligations of the insurer have ended and the policy owner or beneficiary has made an active decision to exercise the settlement option and leave it with the insurer.

3 PRIORITY RANKING OF SETTLEMENT OPTION MONIES

3.1 Settlement option monies are not treated as policy liabilities as the insurance coverage has ended and the life policy terminated. Settlement option monies are tracked separately from policy liabilities by the insurers, and are considered “Other Liabilities”. As such, in the event of a liquidation of an insurer, the settlement monies will be ranked after policy liabilities and equally with the unsecured liabilities of the insurer. Hence, policy owners and beneficiaries who had exercised their settlement options should be aware that in the event of default of their insurer, they may not get their monies back if the insurer’s assets have been exhausted in satisfying policy liabilities[4]. If they had deposited such monies with a bank instead, these monies would be covered by the Deposit Insurance Scheme up to a prescribed limit.

4 INTEREST PAID ON SETTLEMENT OPTION MONIES BY INSURERS

4.1 Insurers pay either guaranteed or non-guaranteed interest rates on settlement option monies depending on the specified terms in the life policy contract. For non-guaranteed interest rates, the rate paid on settlement option monies would differ from the returns earned on the insurance funds, and likely to be lower as the monies can be withdrawn anytime. While insurers do disclose the interest rates paid on settlement option monies (there are, however, differences in practices on the means and frequency in which such disclosure is made), potential disputes could arise if the actual interest paid on the settlement option monies is less than what the policy owners and

policy owners. It will not be fair to policy owners if such benefits, which they have not collected, are not protected under the PPF Scheme. Hence, they are covered under the PPF Scheme.

[4] Section 49FR of the Insurance Act (Cap. 142) sets out the priority of claims of policy owners and specified liabilities where an insurer becomes unable to meet its obligations or becomes insolvent.

beneficiaries expect when they compare the rates to the returns earned on the insurance fund.

5 PROPOSED TREATMENT OF SETTLEMENT OPTIONS

5.1 The provision of settlement options is not critical to the insurance business. Given the issues highlighted in sections 2 to 4, MAS thus proposes to disallow insurers from offering settlement options in their new business. Existing life policies with settlement options provision, regardless of whether such options have been exercised, will be grandfathered.

5.2 For participating policies with settlement options provision, we propose to require insurers to ensure that there is no cross subsidy between the settlement option monies and funds that belong to other participating policies.

Proposal 1: To disallow insurers from offering settlement options in their new business.

Proposal 2: To grandfather existing insurance policies with settlement options provision regardless of whether such options have been exercised.

Proposal 3: Insurers should ensure that there would not be any cross subsidy between the settlement option monies and funds that belong to other participating policies.

5.2 To promote transparency, we propose to require insurers to inform policy owners and beneficiaries in writing that the monies left with the insurer upon exercising their settlement option under existing life policies, will not be covered under the PPF Scheme. Similarly, for settlement options that have already been exercised, we propose to require insurers to inform the policy owners and beneficiaries of the same in writing. Insurers would also be required to inform the policy owners and beneficiaries (for both new and existing take-ups) that settlement option monies rank after policy liabilities and equally with other unsecured liabilities in the event of insolvency of the insurer.

5.3 In addition, we propose to require insurers to disclose the interest rate to be applied on the settlement option monies and state whether such interest rate is guaranteed or non-guaranteed, and the amount of settlement option monies due to the policy owners and beneficiaries. Such disclosure is to be made upon exercise of settlement options and thereafter, on at least an annual basis.

Proposal 4: To require insurers to inform policy owners and beneficiaries (upon request for new take-ups and for existing take-ups) that settlement option monies:

a) are not covered under the PPF Scheme; and
b) rank after policy liabilities and equally with the unsecured liabilities of the insurer in the event of insolvency of the insurer.

Proposal 5: To require insurers to disclose the interest rate on settlement option monies and state whether such interest rate is guaranteed or non-guaranteed, and the amount of settlement option monies to the policy owners and beneficiaries. Such disclosure is to be made upon exercise of settlement option and thereafter, on at least an annual basis.

6 IMPLEMENTATION TIMELINE

6.1 We intend to implement Proposals 1 to 5 by 1 September 2012. For avoidance of doubt, Proposals 2 to 5 will be applicable to settlement options which have been exercised in previous years.

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