# 10-Good client practice

| Contents | Syllabus learning outcomes |
|---|---|
| Learning objectives | |
| Introduction | |
| Key terms | |
| A The duties and responsibilities of an insurance agent | 10.1 |
| B Requirements of the client | 10.1 |
| C Agent remuneration and upfront disclosure methods | 10.2 |
| D Recommending suitable policies | 10.3, 10.4, 10.5 |

**E The long-term benefits of retaining policies and avoiding short-term cancellations (persistency)**
**F Clients' rights and complaints procedures**
**G Building long-term relationships with clients**
**Key points**

**Question answers**

**Self-test questions 10.6**

**10.7**

**10.6**



## Learning objectives

After studying this chapter, you should be able to:

. • discuss the duties and responsibilities of an agent;
. • describe the requirements of clients;
. • describe the methods of remuneration for agents;
. • explain why it is unethical to advise a client to switch between products or providers, unless it is clearly in their best interests to do so;

. • discuss the need for building long-term relationships with clients.

## Introduction

Insurance agents are some of the most important intermediaries for selling life insurance products. Agents have a duty to provide the best available product solutions to their clients based on the clients' needs and requirements. They also have a duty towards the insurance company to protect it from adverse selection, as they are in the best position to judge the risk profile of their own clients.

There is an increasing awareness that insurance agents must behave in a professional way towards their clients at all times. High standards of professional conduct are in the best interests of the insurance industry itself as well as in the interest of the public it serves.

The major characteristics of all professions are as follows.

Their members:

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These requirements are as essential for insurance industry professionals as they are for doctors, lawyers and accountants, and the IRDA has laid down the Code of Conduct to ensure that all agents behave in an ethical manner towards their clients. We will look at the Code in more detail in chapter 15.

In this chapter we will discuss the duties and responsibilities that an insurance agent has towards his clients and insurance company. We will also discuss the importance of building long-term relationships with clients.

**Key terms**

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| | | | |
|---|---|---|---|
| Agent's duties and ? responsibilities? | Client requirements? | Agent remuneration ? | Disclosures? |
| Recommendations ? | Acceptance and rejection ? of a policy ? | Churning ? | Switching ? |
| Persistency? | Policy servicing? | Client rights? | Long-term relationships? |
| Disclosure methods? | Prioritisation of needs? | Suitable products? | Benefit illustration ? documents? |

## A The duties and responsibilities of an insurance agent

Insurance agents are responsible for selling life insurance products to clients, and agents must obtain a licence from the IRDA. Section 42 of the **Insurance Act 1938** defines an insurance agent as:

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An insurance agent's duties and responsibilities include establishing the client's needs and identifying the most suitable products to meet those needs. However, the agent's role does not end there. The agent has to see the policy through from inception until its maturity and/or from when a claim is made until it is settled.

An insurance agent acts as an intermediary between the insurance company and the client and has the responsibility of obtaining business for his company. An agent also represents his clients, and therefore he has to make sure that he does not mislead them in any way and that he always works in their best interests. The insurance agent is the insurance company's main contact point with clients, and he has to ensure that he collects all the necessary information about them that the insurance company will need.

**The main duties and responsibilities of an insurance agent can be summarised as follows:**

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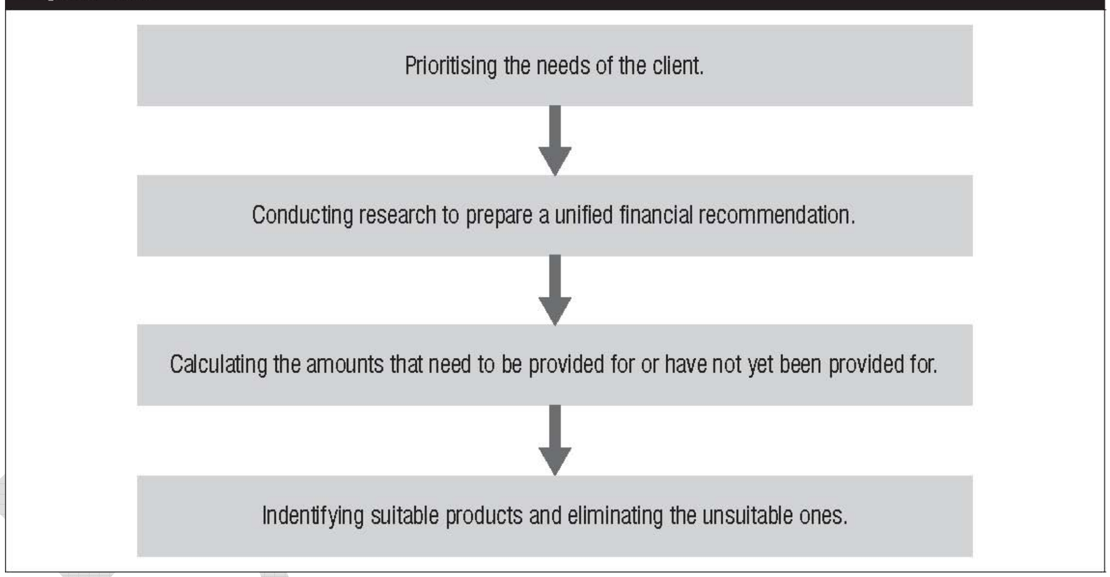
## B Requirements of the client

We have already seen in chapter 8 that the insurance agent must recommend suitable products for the client, and that before he does this he should have a clear understanding of the client's needs and requirements. The process of identifying and analysing the client's information and suggesting suitable products should be methodical and involve a series of checks. After the fact-find, the following stages are necessary:

Figure 10.1




## C Agent remuneration and upfront disclosure methods

In this section we will discuss agent remuneration and disclosure methods as recommended by the IRDA.

### C1 Remuneration methods

The remuneration of life insurance agents is governed by IRDA regulations. A life insurance agent receives his remuneration by way of commission. This commission is a certain percentage of the premium that is collected by the insurance company. The **Insurance Act 1938** stipulates the maximum amount that can be paid to an insurance agent by way of commission or any other form, the details of which are as follows:

- An insurance agent can receive a maximum of 35% of the first year's premium, 7.5% of the second and third year's renewal premium, and 5% of the subsequent years' renewal premium. (This does not apply to immediate or deferred annuities.)

. • During the first ten years of the insurer's business, an insurance agent can be paid a maximum of 40% of the first year's premium, instead of the stipulated 35%.
. • Commission on renewal premiums due to the agent must not exceed 4% in any case. The Insurance Act, section 44, states the following conditions on agents (whose agency has been terminated) for receiving commission on the renewal premium:

.– the agent should have been working with the insurer for more than five years and policies of not less than Rs. 50,000 sum insured are in force at least one year before the termination of the agency; or
.– the agent should have been working with the insurer for at least ten years and, after ceasing to act as an agent, are not directly or indirectly soliciting or procuring insurance business for any other person.

In the case of an agent's death, the commission is payable to his legal heirs.

An insurance company can make payments to its agents within the prescribed limits. Generally, commission rates for term plans are lower than those for other plans such as whole life plans. Also, polices with shorter term periods provide less commission compared to policies with longer term periods. Under single premium plans, annuity and pension plans the commission rates are lower.

## C2 Disclosures

An insurance agent must disclose the amount of remuneration and commission he receives as a result of effecting insurance for a client, on demand.

With effect from 1 July 2010 all insurers have to disclose explicitly in the benefit illustration document, the commission they pay to their agents for ULIPs. This circular was issued by the IRDA in which it was made mandatory for the agent to obtain a signed copy of the benefit illustration document together with the proposal form from the client.

The benefit illustration documents show the details of charges and growth of the fund expected over the duration of the policy as per the Life Insurance Council's assumed growth rate of 6% and 10%.

According to the IRDA, disclosure will help in increasing the transparency in the selling of life insurance products by providing clients with details regarding the exact amount of commission that is being paid to insurance agents as well as charges applicable on the policy.

**Question 10.1**

List three duties or responsibilities of an insurance agent.?

## D Recommending suitable policies

Once the insurance agent has identified suitable products for the client's respective needs, he can recommend selected policies to them. In this section we will discuss the different issues that may arise on the recommendation of suitable policies to clients with regard to:

**Figure 10.2**


### D1 Checking the client's commitment to their needs

Checking the client's commitment to their needs is an important procedure. This involves reminding the client of the needs that were agreed during the fact-finding process. The agent should go through each need and ask the client to confirm that they are still areas of concern.

If the client disagrees with the prioritised needs, the agent will have to revise the financial plan. If the client agrees with the set of needs, then the agent can go ahead with the recommendation of suitable products and policies.

## D2 Outlining the reasons for the recommendation of a particular policy

Before explaining the recommendation in detail, the agent must explain the reasons for recommending a certain policy. The reasons should be closely linked to the client's needs and concerns as expressed during the fact-find process.

The agent should ensure that the client is able to understand the key features and benefits provided by the policy. He also needs to present a chart comparing the policy with other available policies so that the client is able to compare the recommended policy against others.

Client feedback should be taken at each stage of the recommendation. Once a policy has been recommended and its features and benefits have been explained, the agent should ensure that the client agrees with it. Where the client is apprehensive or has certain concerns, they must be addressed immediately.

## D3 Acceptance or rejection of the recommendation

If the client accepts the recommendation, then the agent should ask the client to fill in the proposal form.

If the client disagrees with the recommendation, the agent must ask further questions to find out the reasons for the refusal. Recommendations can be rejected for the following reasons:

**Figure 10.3**

| | |
|---|---|
| The client does not wish to proceed with financial planning at the moment and wants to take time to consider their options before making an investment. In this case the agent can ask to contact the client at a future date. | The client is not satisfied with the recommended products. In this case, the products will have to be reviewed according to needs of the client. |

Good questioning techniques (which we looked at in chapter 8) can help agents in finding out the real reasons for why a recommendation has been rejected, and may help in resolving the issue thus leading to the recommendation being accepted. Failing this, the agent must respect the client's right to decline and should seek permission to re-approach the client at a future date.

The agent can also ask for some references from the client such as the names and contact details of any relatives, friends and acquaintances who might be interested in financial planning. These references are important selling opportunities for the insurance agent.

### D3A What should an agent do if a client accepts some but not all of their recommendations?

There can be cases where the client may tell the agent to ignore a large protection need and instead invest the money available into a savings plan; or the client may reject advice to invest capital in a low risk investment product and instruct the agent to buy a high risk investment product that is performing well at the moment (but that may not do so in the future).

In this case the agent should try to convince the client to follow his recommendation by elaborating on the reasons as to why that product has been selected. However, if the client still wishes to act against the agent's advice, the agent should express his readiness to carry out the client's instructions, although it should be made clear that the transaction is not recommended by the agent.

The client's decision to act differently from the agent's recommendations may emerge at two different stages:

- during the presentation; or
- during the fact-finding interview;

and the agent needs to address the client's apprehensions as and when they arise.

## D4 Churning and product switching

There has been increasing concern in the insurance sector about product switching, though this is now being brought under control by the proactive efforts of the Regulator (the IRDA) and with the growth of professionalism among intermediaries.

### D4A Churning

Repeatedly encouraging clients to switch policies or investments from one to another is known as churning. Insurance churning is a practice in which agents recommend that clients surrender their existing policy and use the funds to purchase a new policy, thereby allowing agents to earn a higher commission on the new policy. It is an unprofessional and unethical practice that results in clients suffering losses in the form of surrender charges and reduced long-term benefits if their policies are not kept held until maturity.

**Case study**

Sunder Singh is a 38-year-old self-employed businessman, who owns an electronics shop. His wife is a? homemaker and they have two sons. Five years ago he purchased an endowment insurance plan with a sum insured? of Rs. 10,00,000. ?

One day he is approached by an insurance agent who recommends that he should invest in the latest savings insurance ? plan that has been launched by his company, which provides a guaranteed return along with life insurance cover. Sunder ? declines the offer and tells the agent that he has already invested in an endowment insurance plan which provides him ? with insurance cover. ?

On hearing this, the agent asks for more details about Sunder's existing product. He then carries out a needs analysis ? and calculates that Sunder's need for insurance cover is higher. He tells Sunder that the product that he is offering is ? also an endowment insurance plan which will provide a sum insured of Rs. 15,00,000.?

The agent advises Sunder to surrender the existing endowment policy and to use the funds to invest in the policy that he ? has recommended as it will provide a higher sum insured. Sunder eventually agrees with the agent's recommendation ? and surrenders his existing policy to invest in the new one. ?

This is a case of insurance churning where:?

- The insurance agent did not tell Sunder that for a higher sum insured he would be paying a higher premium as well;?
- Sunder's age has increased so the premium for the same term will be higher than before; and?
- Sunder will have to bear the surrender charges for surrendering the existing policy. ?

So in order to achieve his short-term sales target, the insurance agent has not given Sunder good advice and this has ? resulted in Sunder incurring losses.?

## D4B When product switching is suitable

There will sometimes be situations where clients have been mis-sold policies that do not match their needs. There will also be times when clients are holding products that are not good value for money, and others where clients are facing financial difficulties and may desperately need to reduce expenditure or reschedule their debts. Unfortunately in these situations clients are often all too willing to cancel existing policies and they may even volunteer to do so. In such circumstances it may be acceptable, as a last resort, to advise a client to surrender a product and, possibly, take out a more appropriate one. **However, such advice should only be given where a switch is clearly in the client's best interest**. Even then, no surrender or switch should ever be recommended until the agent has explained what the client will lose as well as what the client may gain from the change.

**Case study**

Omi Shrivastava is a 31-year-old individual working for a multinational company (MNC). Omi is married and has ?
a three-year-old daughter, Deepika; his wife is a housewife. Omi and his family are staying in a rented apartment ?
although he has been planning to buy a house for some time now. He is in the process of accumulating money for the ?
down payment but has had little success so far. Omi also wants to start investing for Deepika's higher education and ?
marriage. He has been planning to do this for some time now but again has not able to make a head start on this.?

Omi is in a dilemma. He has been working since the age of 23 and in the past eight years he has been approached ?
by several insurance agents and under the pretext of saving tax he has been mis-sold several endowment, term and ?
money-back policies which he actually doesn't need. Omi has six life insurance policies for which the total annual ?
premium is Rs. 1,10,000. These six life insurance policies together give Omi a total cover of only Rs. 50 lakhs. ?
Considering Omi's age, his income protection needs and his other responsibilities (such as buying a house and saving ?
money for Deepika's education and marriage) he needs an insurance cover of at least Rs. 1 crore. Also the total annual ?
premium of Rs. 1,10,000 is putting tremendous pressure on Omi's cash flows in the following ways:?

- ?Omi doesn't have the required amount of protection cover that he actually needs even after making such a large ?
premium payment.?
- ?At the same time, the large premium payment is deterring Omi from proceeding with his other essential financial ?
goals like buying a house and investing for Deepika's education and marriage.?

One day he is approached by an insurance agent to review his current investment and protection needs and to make a ?
customised financial plan for him. Omi agrees and provides all necessary information to the agent. The insurance agent ?
does a fact-find with Omi and after a preliminary analysis concludes that the six policies that Omi has are not providing ?
him the required protection and they are also deterring him from meeting his important financial goals.?

The agent advises Omi to do the following:?

- ?Hold on to the two money-back policies which are going to mature in the next two years and to continue paying ?
premiums for them. He also advises him to use the maturity proceeds of the policies for the down payment on the ?
house. Once the policies mature the money that will be freed from premium payment can be utilised towards paying ?
the EMI for the home loan.?
- ?Continue with the term policy as normal. The agent advises him to buy one more term policy with a cover of 75 lakhs ?
so that he can have a total cover of Rs. 1 crore.?
- ?Convert the remaining three endowment policies into paid-up policies. The money that will be freed up from the ?
premium payments can be used to buy a child ULIP (unit-linked investment plan) for Deepika's education and ?
marriage. Through a ULIP Omi can get exposure and participate in the growth of the capital markets which can give ?
him good capital appreciation in the long term.?

The insurance agent presents a full illustration to Omi regarding the pros and cons of rearranging his investments. He ?
also informs him that his existing money in the three paid-up endowment plans will be locked-in until maturity but at ?
the same time he will be free from the obligation of having to pay high premiums for these three plans. The agent also ?
produces a comparative chart of the returns that Omi will receive after 15-20 years from the ULIP. The agent makes a ?
benefit illustration document as per the Life Insurance Council guidelines and presents it to Omi.?

Omi realises that he has indeed made a wrong investment choice by choosing to make tax savings over his other ?
important needs. He decides to go ahead with the new financial plan made by the insurance agent based on his ?
protection needs and financial goals.?

## E The long-term benefit of retaining policies and avoiding short-term cancellations (persistency)

Persistency refers to the amount of business that insurance companies are successful in retaining without lapse or surrender of the policy. It can be calculated as follows:

Persistency = The number of policies remaining in force at the end of the year The total number of policies in force at the beginning of the year

Agents play an important role in maintaining a high persistency ratio.

A low persistency ratio affects the whole insurance industry adversely:

. • **for the insurance company** it means that a large number of policies have lapsed or have been surrendered, resulting in a loss of profits and a reduction in the accumulation of reserves;

. • **for clients** it means fewer benefits than originally expected and a loss of insurance cover; and

. • **for agents** it means the loss of renewal commission.

## E1 Benefits of persistency

The insurance company, agent and client all benefit by retaining policies and avoiding early surrenders for the following reasons:

| | |
|---|---|
| **Helps the client in achieving goals** | Keeping the policy in force until maturity helps the client in achieving the ultimate ? goal for which the policy was bought, such as meeting children's education ? expenses or marriage expenses or building the required retirement fund. ? |
| **Increased revenues** | Higher persistency helps the insurance company in earning higher revenues and ? maintaining profitability. ? |
| **Reduction in costs** | Administrative costs and other expenses are high in the initial years of the policy ? for the insurance company. The company tries to spread this cost over the ? term of the policy. If the client surrenders a policy in the initial years, then the ? insurance company will not be able to recover its expenses. Hence maintaining ? a high persistency ratio helps the insurance company to reduce its costs.? |
| **Increased client satisfaction** | Higher persistency results in increased client satisfaction which helps to develop ? a positive brand value for the company.? |

## E2 What are the different factors that can affect persistency?

Figure 10.4


We will discuss each of these factors in turn.

- **Product design**

If the client is unsatisfied with the benefits and returns they are getting from their policy then they might decide to surrender it. Insurance companies must design products based on the real needs of their clients to avoid policy lapses and surrenders.

- **Change in the financial circumstances of the client**

There can be a change in financial circumstances of the client due to unemployment, disability or health-related issues. As a result of this they may not be in a position to pay the premiums on time and so this will result in a policy lapse.

- **Policy servicing**

Insurance agents should ensure that they maintain regular contact with clients and remind them when premium payments are due. In cases where the client is unable to pay the premium on time, then they should be asked to pay the premium within the grace period. The insurer has to ensure that the benefits that were promised are actually delivered to the client. If the insurer fails to do so, then the client can become dissatisfied with the service and can choose to surrender the policy.

- **Role of agents**

Agents play the most important role in maintaining high persistency. Insurance agents should build a good rapport with their clients and should place emphasis on recommending products that are the most suitable for their clients' needs, and not on the basis of the amount of commission they are likely to receive.

### E3 What are the different methods for maintaining high persistency?

The different methods that can be used by an insurance company for maintaining high persistency are as follows:

| | |
|---|---|
| **Flexibility in premium payment** | Clients should be provided with the choice of different premium payment methods ? such as: cheque, cash, demand draft, online transfer of funds, electronic clearing ? system (ECS), credit/debit card, collection of premiums by authorised insurance ? agents/advisers, e-seva centres etc. ? |
| **Constant reminder of due premium dates** | This is especially important in the case of an annual premium payment, as the ? client may forget due to the long gap between the payment dates. Clients should ? be reminded in advance about their premium due dates by sending them emails, ? reminder letters by post, telephone calls, SMS/text message or a combination of ? these. The insurance company can also provide a pick-up service by sending its ? representative to collect the premium cheque from the client's home or office.? |
| **Continuous contact with clients** | The agent should be in continuous contact with the clients by way of informing ? them of new products launched in the market that could be purchased to cater for ? their different needs. It is important that the agent develops a good relationship with ? the client so that high persistency can be maintained. ? |
| **Policy servicing** | Continued communication with the client should be maintained by way of policy ? servicing if the client needs any assistance, for example to make a change to ? the nominated beneficiary, changing the contact address, frequency of premium ? payments etc. ? |

**Question 10.2**

Briefly explain what churning means. ?

### F Clients' rights and complaints procedures

When a client purchases a life insurance plan, they purchase it with the intention of receiving certain benefits promised by the insurance company at the time of purchase. Where the client does not receive these benefits during the tenure of the policy or on maturity and is dissatisfied with the service, or has a query or problem which has not been addressed, they have the right to raise a grievance/complaint.

This is clearly a very important area for insurance companies and their agents, and we will look at it in detail in chapter 14 when we discuss the issue of customer protection.

**Question 10.3**

What are the benefits of high persistency?

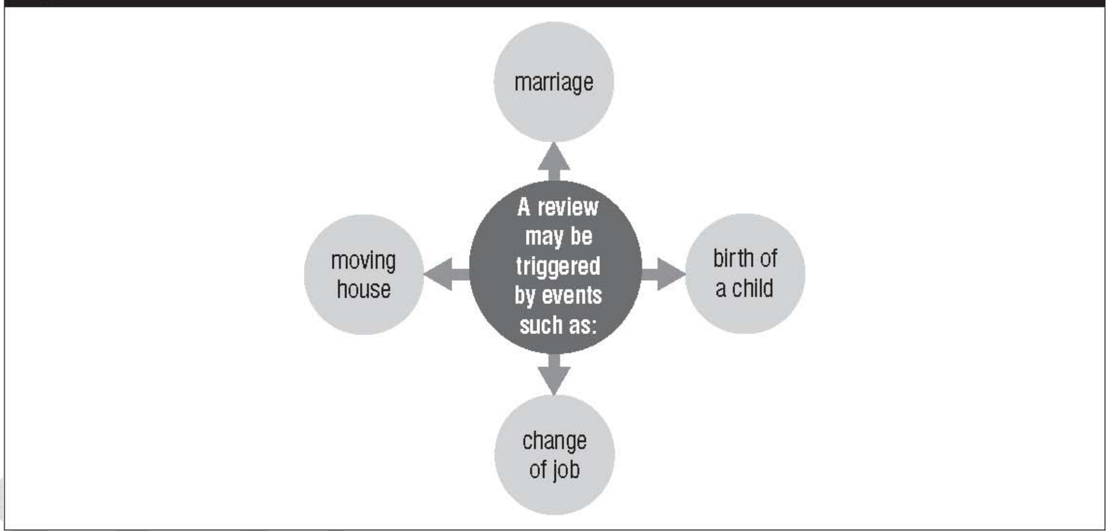
### G Building long-term relationships with clients

Insurance companies should aim to build long-term relationships with their clients instead of focusing on short-term sales. A satisfied client may be the source of other potential clients as they will speak positively about the agent and the insurance company.

Once recommendations have been made and the relevant transactions carried out, it should not be the end of the matter for an insurance agent. It is much better to have an ongoing relationship with the client that is beneficial for both parties. Thus many agents have an ongoing system to review their clients' financial needs and financial planning.

Reviews could be irregular but triggered by relevant events, such as tax or legal changes, the introduction of a new insurance product or a change in a client's circumstances.

**Figure 10.5**




These changes could lead to recommendations to:

. • take out new protection contracts;
. • increase existing levels of protection;
. • switch investments; or
. • alter existing tax saving plans.

**Consider this**

What changes in a client's circumstances may generate the need to review their financial planning? What ? recommendations can be suggested in response to these changed circumstances?

## Key points

The main ideas covered by this chapter can be summarised as follows:?

### Insurance agent's duties and responsibilities

- An insurance agent's main duties and responsibilities include establishing the client's needs and identifying the most ? suitable products to meet those needs. At the same time he should ensure that there is no adverse selection for the ? insurer.?

### Requirements of the client

- Once the fact-finding process for the client is complete, the insurance agent has to suggest suitable products to the ? client. In order to do this he should have a full understanding of the client's needs and requirements.?

### Agent remuneration and disclosure

- Remuneration of life insurance agents is governed by the Insurance Act 1938 regulations. ?
- A life insurance agent receives his remuneration in the form of commission.?
- An insurance agent must disclose the amount of remuneration/commission he receives as a result of effecting ? insurance for a client, on demand. ?
- With effect from 1 July 2010, for ULIPs, all insurers have to disclose explicitly the commission they pay to their ? agents in the benefit illustration documents.?

### Recommending suitable policies

- Before recommending policies to clients, the agent should confirm their list of needs to check that they are still areas ? of concern for the client. Once the needs are agreed upon, suitable products along with their benefits should be ? explained to the client.?
- Repeatedly encouraging a client to switch policies or investments is known as churning. This is unethical practice ? and should be avoided.?

### The long-term benefits of retaining policies and avoiding short-term cancellations (persistency)

- Persistency refers to the amount of business that insurance companies are successful in retaining without policy ? lapses and surrenders.?
- Higher persistency helps the company in maintaining profitability and reduces administrative costs. ?

### Clients' rights and complaints procedures

- Clients have the right to raise grievances/complaints about the service they have received from life insurance ? companies and their agents.?

### Building long-term relationships with clients

- Insurance companies should aim to build long-term relationships with clients instead of focusing on short-term sales.?

## Question answers

10.1 Any three from the following:

- To find prospective clients for the insurance company and to perform a needs analysis to identify their different needs.
- To have sufficient knowledge of the various insurance products offered by the insurance company and to understand the different benefits and features offered by each product.
- To suggest appropriate products to clients based on their needs and investment capacity.
- To ensure that the proposal form is correctly filled in and all the information provided by clients is correct.
- To be responsible for collecting the necessary documents such as proof of age, identity and address, medical reports and any other documentation required for underwriting.
- To disclose the scales of commission in respect of the insurance product offered for sale, if asked for by the prospective client.
- To ensure the remittance of premiums by the policyholder within the stipulated time by giving notice both orally and in writing, and to collect the premiums from clients, if they are authorised to do so by the respective insurers.
- To help underwriters in assessing the risk of the proposer by providing information about any adverse habits, income inconsistency and other material facts that are contained in the agent's confidential report.
- To help the clients in making any changes in the form such as address, nomination etc.
- To help the legal beneficiaries and nominees with the claim settlement process when a claim arises.

10.2 Repeatedly encouraging clients to switch policies or investments from one to another is known as churning. Insurance churning is a practice followed by agents, in which they suggest that clients surrender their existing policy and use the funds to purchase a new policy, thereby allowing agents to earn higher commission on the new policy. It is an unprofessional and unethical practice followed by agents with the result that the clients suffer losses in the form of surrender charges and reduced long-term benefits if their policies are not kept in force until maturity.

10.3 The insurer, agent and client all benefit from retaining policies and avoiding short-term surrenders.

- **Helps the client in achieving goals**. Keeping the policy in force until maturity helps the client to achieve the ultimate goal for which the policy was bought, such as meeting their children's education and/or marriage expenses or building the required retirement fund.
- **Increased revenues**. Higher persistency helps the insurance company in earning higher revenues and maintaining profitability.
- **Reduction in costs**. Administrative costs and other expenses are high in the initial years of a policy for the insurance company. The company tries to spread this cost over the tenure of the policy. If the client surrenders the policy in initial years, then the company will not be able to recover its expenses. Hence maintaining a high persistency ratio helps the insurance company to reduce its costs.
- **Increased client satisfaction**. Higher persistency results in increased client satisfaction which helps to develop a positive brand value for the company.

## Self-test questions

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**You will find the answers on the next page**

**10/14**

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