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Lapsation in Life Insurance Policies

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Abstract: Human life is a full of risk. The effective solution of reducing the burden of these risks and losses is to get insured. Insurance occupies an important position in the financial sector in the Indian economy. It is one of the important ingredients in the economic development of the country. The Indian's Life Insurance penetration and density is low when compared to Asian countries. In spite of rapid progress the sector is suffering with high rate of lapsation of policies. Lapsation has been biggest problem in life insurance industry. Due to the high costs incurred by the insurer, they met with huge revenue losses. In this paper an attempt has been made to understand the reasons for lapsation of life insurance policies from policyholder's perspective. The reason for the study portraits that there exists mis selling of the product, Financial burden to the policyholders and the premium rate is high.

Keywords: Lapsation, Life insurance, Indian Economy.

I. Introduction

Life Insurance selling often termed as dream selling or concept selling. After privatization significant progress has taken place in Indian insurance sector especially in life insurance business. Insurance Regulatory and Development Authority (IRDA) has been established to protect the interests of holders of insurance policy and to regulate, promote and ensure growth of the insurance industry. All these strategies are lying around the customer only. For the purpose of the study 50 sample policyholders were selected from different parts of the Coimbatore city in the state of Tamilnadu.

Based on the review of literature ten prominent reasons are identified for the lapsation of insurance policies namely high Premium rate, Mis-selling of the product, financial burden for the policyholders, Delay in Renewal Notice, Poor Customer Service is provided, Increase in complaints by existing policyholders, No transparency in the procedures, Agent force to cancel existing policy and make to purchase another new policy, Long term payment and Wrong prospecting of customers.

II. Lapsation

In India, the term "lapsation" is not directly defined in the Insurance Act 1938.It is due to non-payment of premiums on mandated due dates, the contracts cease to be in force this results in lapse of policy and consequently the policyholder's insurance protection is withdrawn. The IRDA have recommended a uniform grace period of 30 days for annual, half yearly and quarterly modes, and 15 days for monthly modes. A policy should be considered lapsed if the premium is not paid within the grace period. Policies for which premiums are paid after the grace period may be treated as reinstatements, provided the premium is paid within the revival period of 2 to 5 years, as per insurers' internal practice.

Lapse Rate is the rate at which life insurance policies terminate because of failure to pay the renewal premiums by the policyholders on stipulated dates. Once the policy is lapsed it can be treated by the insurer in either of the following ways depending on the period for which the premiums were paid.

1. **Pure lapsed policy**: The policy may be treated as a lapsed policy without any value i.e. the policy doesn't acquire any policy benefit payable to the policyholder during the period before reinstatement. Policy lapsed in this way is called a pure lapsed policy. (Reinstatement is the process of bringing a lapsed policy into force by payment of all the un-paid premiums with interest subject to certain other requirements relating to health.)

2. **Paid up policy**: The policy lapsed may not be treated as fully void but it will be treated as in-force for a reduced value during the period before reinstatement in which case the policy will be called a paid up policy.

III. Review Of Literature

N.V. Subramanian, in his study identified that wrong selling, forced selling, over selling, bogus selling, effect of competition, introduction of new plans, bad service, awareness levels of customers, non-receipt of notices, no follow-up by agents, requirement of medical check-ups, change of address, inadequate explanation of the product riders, repayment of house finance, malpractice of agents an field force are the reasons for the lapsation of policies.

Jogindra Kumar in his study titled "Lapsation of a life insurance policy" has made thorough study on impacts of lapsation. He pointed out that increase in underwriting and upfront organisation costs, sales costs and commission's leads to profit deterioration to the company.

V. Rajagopalan in his study titled "Lapsation of life insurance policies" observed that lapsation of policy affects company's earning potential.

David Chandrasekharan in his study titled "Policy lapsation in life insurance role of middle man" studied the need of the middle men in the reduction of lapsation. He studied that agency termination, like lapsation, is a curse of the life insurance industry and two are interrelated. He studied that sale of polices should be done ethically and professionally by the agent and the policy is serviced properly and assistance in given for payment of premium, chances are that the policy sold would remain in the books of the company in order to decrease the lapse rate of policies.

Dr. G. Gopalakrishnan in his study titled "conservation of life insurance business – role of the parties" has studied the lapse and revival – contractual implications. He pointed out the need for special revival schemes that can decrease the lapsing of policies in insurance sector.

IV. Statement Of The Problem

For the insurer lapsation of policies makes it difficult to construct accurate estimates. Lapsed policies have a detrimental effect on risk pooling and sharing - so, if policies start lapsing then business is sure to deteriorate. Lapsation impacts on customer retention, product performance; pricing factors, public image and workforce planning, and ultimately detrimental to the insurer's business. The insurance company suffers the loss of public image through adverse publicity. For the policyholders losing the family protection and also loses a portion of the savings - most likely accumulated with considerable effort over a period of time. The loss is disproportionately high in the initial stages because of how level premium systems work. The insured would also be losing the benefit of returns from alternate investments elsewhere. Even if the policy is surrendered, the policyholder will lose a significant amount in the way of surrender charges. Thus an attempt has been made to understand what is the reason for policy lapsation? from the policyholder's perspective.

V. Research Methodology

a) ***Data:*** Data required for the study is primary in nature. Primary data is collected by making use of interview schedule.

b) ***Sampling:*** By adopting convenient sampling, 50 policyholders residing in Coimbatore city is selected for the study.

c) ***Framework of Analysis:*** The collected data has been analysed by making use of Garrett Ranking.

d) ***Limitations:*** The data required for the study is primary in nature. Hence, all sort of limitations which is relevant to primary study is applicable to the present study too. Further, study is confined to Coimbatore city alone. Therefore, utmost care to be taken while generalizing the result.

VI. Analysis And Interpretation

Garrett's Ranking Technique has been used to analyze the factors leading to policy lapsation

$$\text{Percentage Position} = \frac{100(R_{ij} - 0.5)}{N_j}$$

Where R_{ij} = Rank given for i^{th}variable by the j^{th} respondent. N_j = Number of variables ranked by the respondents. They were asked to rank the ten factors identified for the purpose of this study as 1, 2, 3,4,5,6,7,8,9 and 10 in order to know their reasons for lapsation. The calculated total score, mean score and their positions for the ranks are given in the below Garrett's table value.

Table 1

REASONS FOR POLICY LAPSATION

Reasons for Lapsation	I (82)	II (71)	III (64)	IV (58)	V (53)	VI (48)	VII (43)	VIII (37)	IX (30)	X (19)	Total	Total Score	Mean Score	Rank
High Premium rate	8	7	5	4	4	4	4	4	4	6	50	2663	53.26	**3**
	656	497	320	232	212	192	172	148	120	114				
Mis-selling of the product	9	11	3	5	12	4	0	0	1	5	50	2954	59.08	**1**
	738	781	192	290	636	192	0	0	30	95				
Financial burden for the policyholders	5	5	3	16	4	6	9	1	0	1	50	2828	56.56	**2**
	410	355	192	928	212	288	387	37	0	19				
Delay in Renewal Notice	0	8	4	1	2	9	3	13	9	1	50	2319	46.38	**7**
	0	568	256	58	106	432	129	481	270	19				
Poor Customer Service is provided	4	1	8	6	4	2	9	6	4	6	50	2410	48.20	**6**
	328	71	512	348	212	96	387	222	120	114				
Increase in complaints by existing policyholders	5	0	17	10	2	8	1	1	6	0	50	2828	56.56	**2**
	410	0	1088	580	106	384	43	37	180	0				
No transparency in the procedures	4	8	1	4	10	6	10	0	1	6	50	2584	51.68	**4**
	328	568	64	232	530	288	430	0	30	114				
Agent force to cancel existing policy and make to purchase another new policy	8	5	0	2	0	9	5	9	7	5	50	2412	48.24	**5**
	656	355	0	116	0	432	215	333	210	95				
Long term payment	1	0	9	2	1	1	5	15	16	0	50	2125	42.50	**9**
	82	0	576	116	53	48	215	555	480	0				
Wrong prospecting of customers	6	5	0	0	11	1	4	1	2	20	50	2127	42.54	**8**
	492	355	0	0	583	48	172	37	60	380				

Source : Data collected and computed through questionnaire

Table1 highlights the Garrett total score and the mean score, which helps to know the order of reasons that leads to lapsation of life insurance policies. For factor Mis selling of the product the total score is calculated by multiplying the number of respondents ranking that factor as 1, 2, 3, 4, 5, 6, 7, 8, 9 and 10 by their respective table value given in Table 1. Mean score is calculated by dividing the total score by the number of respondents. It is seen from table 1 that according to the Garrett

Ranking, the factors which leads to policy lapsation are mis-selling of the product got first rank, Increase in complaints by existing policyholders and Financial burden of the policyholders is ranked second , High Premium rate is ranked third and followed by No transparency in the procedures, Agent force to cancel existing policy and make to purchase another new policy, Poor Customer Service is provided, Delay in Renewal Notice, Wrong prospecting of customers, and Long term payment.

VII. SUGGESTIONS

Based on the findings of the study, the following suggestions have been put forth.

» IRDA has clarified that if policy is discontinued then minimum 3.5% interest will be given on the fund. However, discontinuation charges ranging from Rs 1,000 to 6,000 will be levied during lock-in period. All these charges should be well informed to the policyholders at the time of policy commencement.

» The insurance companies will also have to train their agents on these guidelines and will have to carry a clause in insurance proposal forms advising the policyholder not to surrender, lapse or make a policy paid-up

» The policyholder should be aware of the duties and rights about the policy coverage and claims. There should be urgent n**eed to increase professionalism of agents.**

» Insurance companies should call the policy holder to ensure that they have understood all the terms of the plan and can clarify all the doubts. If in case unconvinced, they can return the policy.

» It is suggested that the whole time contract should be signed with agents so that after sale services may be provided on all financial and social aspect of policies to policyholders. There may not be allowed to agent write and do other contract. So that lapsation may be decreased.

VIII. CONCLUSION

From the study, it is found that are Mis-selling of the product, Increase in complaints by existing policyholders and financial burden of the policyholders, High Premium are the reasons that leads to policy lapsation. Policy holders have to determine their policy and premium based in their income earning potential. Similarly, insurance companies should not mis - sell their products to their ignorant policyholders.

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