Actuarial Society of Malaysia
(ASM)

SURRENDER VALUE AND PAID-UP VALUE STANDARD FOR LIFE INSURANCE

Prepared by:

Life Insurance Sub-Committee of Actuarial Society of Malaysia

TABLE OF CONTENTS

CONTENTS **PAGE**

Section 1
OVERVIEW

1.1 Objectives

1.1.1 The Surrender Value and Paid-Up Value Standard shall set the minimum basic standards and controls for determining Surrender Value & Paid-Up Value of a life policy were it to be surrendered or be made paid-up at a date prior to its full term.

1.1.2 The Standard shall apply to all policies, including but not limited to individual life, group life, medical and health products, issued by life insurance companies in Malaysia.

1.1.3 The Standard is intended to act as a source of reference to actuaries practicing in Malaysia on the general principles as well as the methodology for determination of Surrender Value and Paid-Up Value.

1.1.4 When applicable Malaysian law, regulation, or other binding authority conflicts with this Standard, complying with such law, regulation, or other binding authority shall not be deemed as deviation from this Standard.

1.1.5 The Standard aims to ensure fair treatment of policyholders, particularly to:

i) Protect the interest of surrendering policyholders by ensuring that they get fair value; and

ii) Protect the interest of remaining policyholders such that the termination cost is not unfairly passed on to them.

1.2 Implementation

1.2.1 The Standard is implemented in two ways, through:

i) Guidance Notes
ii) Practice Notes

1.2.2 The Guidance Notes detail the binding principles that must be complied with strictly by the Appointed Actuary for determination of Surrender Value and Paid-Up Value.

1.2.3 The Practice Notes detail the methodologies that can be adopted for forming the Surrender Value and Paid-Up Value. The Practice Notes is not mandatory nor the sole guide for methodology that can be adopted, but should act as a source of reference to the most appropriate methodology to be adopted.

1.2.4 Other than the binding principles in the Guidance Notes, the Appointed Actuary may choose to adopt acceptable actuarially sound methodologies which are most suitable to their individual company's circumstances.

Section 2
GUIDANCE NOTES – PRINCIPLES

2.1 Compliance to Guidance Notes

2.1.1 The Guidance Notes must be complied with strictly.

2.1.2 The Guidance Notes detail the principles for determination of Surrender Value and Paid-Up Value.

2.2 Determining the Surrender Value

2.2.1 The Surrender Value of a policy must be set on a basis of fairness to the owner of the policy being surrendered, while not disadvantaging the interests of the remaining policyholders as well as risk mitigation to shareholders. The profit from a surrendered policy should not be equal to the profit that would have been obtained if the policy is not surrendered.

2.2.2 Application of charges whilst determining the Surrender Value must be consistent with the pricing structure of the policy and the disclosures in the policy documentation as well as promotional material.

2.2.3 A surrender charge should be for the purpose of mitigating risk in relation to expenses incurred covering policies, in addition to other administrative expenses, and other adverse financial impacts to the insurer. Hence, charging a surrender charge to policyholders who surrender early is not by itself non-equitable provided that the surrender charge is fair. The Appointed Actuary is responsible to determine the equitable surrender charge.

2.2.4 Should an adopted methodology result in negative, zero or very small Surrender Value, the Surrender Value may be set to zero. The rationale for not providing surrender value must be documented and justified, with consideration made with regards to Treating Customers Fairly principles.

2.2.5 Equity should be considered when deriving Paid-Up Value from Surrender Value. Should a policyholder choose to stop paying premiums and maintain the same term coverage, then it is a calculation that the Surrender Value given would purchase a single premium term/endowment/whole life of a Paid-Up Value amount that can last for the remaining term.

Section 3
PRACTICE NOTES – METHODOLOGIES

3.1 Concurrence to Practice Notes

3.1.1 Concurrence to the Practice Notes is strongly recommended.

3.1.2 The Practice Notes detail the methodologies that are recommended for adoption by the different major group of policy types.

3.1.3 Different methodologies are discussed for the major different policy types, as follows:

- i) Pure Protection products
- ii) Ordinary Life Insurance products
- iii) Unbundled Investment products
- iv) Fixed term and income stream products

3.1.4 Within each of these major group of policy types, the methodology recognises the different nature of:

- i) Regular premium term and single premium term
- ii) Participating and non-participating features

3.1.5 ASM recognises that every life insurer has its unique business practices, product profiles, business and marketing distribution etc. and hence accepts that there is no one standard Surrender Value and Paid-Up Value methodology that can be applied to all companies.

It is the responsibility of the Appointed Actuary to ensure that the methodology and assumptions adopted are suitable to his/her company's circumstances (e.g. bonus philosophy, solvency position, market positioning) as well as adhering to principles of the Standard, the product features set in the pricing of the product and ensuring fair treatment of policyholders.

3.2 Pure Protection Products

3.2.1 Unearned Premium Reserve Method

This method can be considered for yearly renewable term pure protection-type products, for example term insurance, critical illness insurance, personal accident insurance and health insurance as the savings element tends to be very small or zero. This method shall be applicable to yearly renewable term riders as well.

This method refunds the policyholder any amount of unearned premium paid in advance less any applicable surrender charge.
The methodology follows the formula:

[(n-t) / n * Premium Paid] less applicable surrender charge

where

n	is the term of the policy i.e. n=1
t	is the current duration in force of the policy

3.3 **Ordinary Life Insurance Products**

The Appointed Actuary should exercise professional judgement in adopting the appropriate methodology. This includes the adoption of a single methodology, or where appropriate, a blend of methodologies using the retrospective and prospective approaches.

3.3.1 Gross Premium Valuation

This method can be considered for single premium or regular premium ordinary life products with non-participating features. Examples of these products include non-participating whole life insurance, non-participating endowment, mortgage reducing term assurance and single and regular fixed premium riders.

This method follows the reserve formula as set in the Risk Based Capital framework. Reasonable assumptions shall be used in the Gross Premium Valuation method. A reasonable assumption is one that is expected to appropriately model the contingency being measured, adjusted to manage the risk of anti-selection.

3.3.2 Net Premium Valuation

This method can be considered for single premium or regular premium ordinary life products with non-participating features. Examples of these products include non-participating whole life insurance, non-participating endowment, mortgage reducing term assurance and single and regular fixed premium riders.

The net premium is determined by assuming that the policy provides for only such premium as is sufficient to provide for the risk assumed by the licensed life insurer in issuing the policy without providing for bonuses, office expenses or other charges.

If further adjustment is required, the net premium can be adjusted by:

i) assuming that the policy was issued 1 year after the actual date of its issue but without postponing the time when the premium ceases to be payable or policy moneys become payable, if that time is fixed by reference to the date of issue and to calculate the premium as above,

ii) adding to the premium an addition as would have the capitalised value at the date of issue of the policy equal to 3% of the sum insured,

where premium is payable for a whole life policy or endowment policy, with or without other benefits, or for a term policy where a surrender value is required to be paid.

3.3.3 Asset Share Method

This method can be considered for ordinary life products with participating features. Examples of these products include participating whole life insurance and participating endowment.

Asset Share shall be used as a basis for determining the surrender value. The Appointed Actuary shall refer to the following documents:

i) JPI 29/2004 Appointed Actuary's Report to the Board on Recommendation for a Reduction in Bonus Rate for Participating Life Products issued by Bank Negara Malaysia

ii) Practice Note: Asset Share Study issued by Actuarial Society of Malaysia

3.4 Unbundled Investment Products

3.4.1 Cash Value

This method can be considered for unbundled investment products such as universal life and investment-linked policies.

The surrender value is the cash value accumulated in the insurance policy less any insurance charges, policy fees, surrender charges, market value adjustments, and outstanding policy loans accumulated with interest.

Where the cost of insurance charges and/or other charges are funded in advance, the surrender values for the charges shall be determined in accordance with generally accepted actuarial principles and in a manner consistent with Treating Customers Fairly principles.

3.5 Fixed Term and Income Stream Products

3.5.1 Exchange for Lump Sum

During the accumulation or deferment period of these products, the surrender value of a policy is the cash value accumulated in the policy less any insurance charges, policy fees, surrender charges and outstanding policy loans accumulated with interest.

During the payment period of these products, where the income stream is payable for a fixed term, or if there is some form of guarantee on the income stream, the surrender value is the remaining income stream converted to a lump sum at the pricing interest rate plus a reasonable margin deemed appropriate by the Appointed Actuary. A reasonable margin is one that is expected to appropriately cover the cost of surrender and mitigate anti-selection.

During the payment period of these products, where the income stream is not payable for a fixed term, there is no recommended minimum surrender values.

Appendix 1

Comparison of Surrender Values using Gross Premium Valuation (GPV) and Net Premium Valuation (NPV) Methodology

The comparison is based on a non-participating Whole of Life plan. The plan has features such as ICP of 5% of Sum Assured payable every 3 years and benefit amounts which differ by age.

The Surrender Value illustration below is for a policyholder with the following parameters:

Sex	:	Male
Age	:	30 years old
Policy Term	:	58 years
Benefits Covered	:	Death, Total and Permanent Disability (TPD), Accidental Death (ADB), Accidental Total and Permanent Disability (ATPD)
Sum Assured (SA)	:	RM 51,100
Monthly Premium	:	RM 200

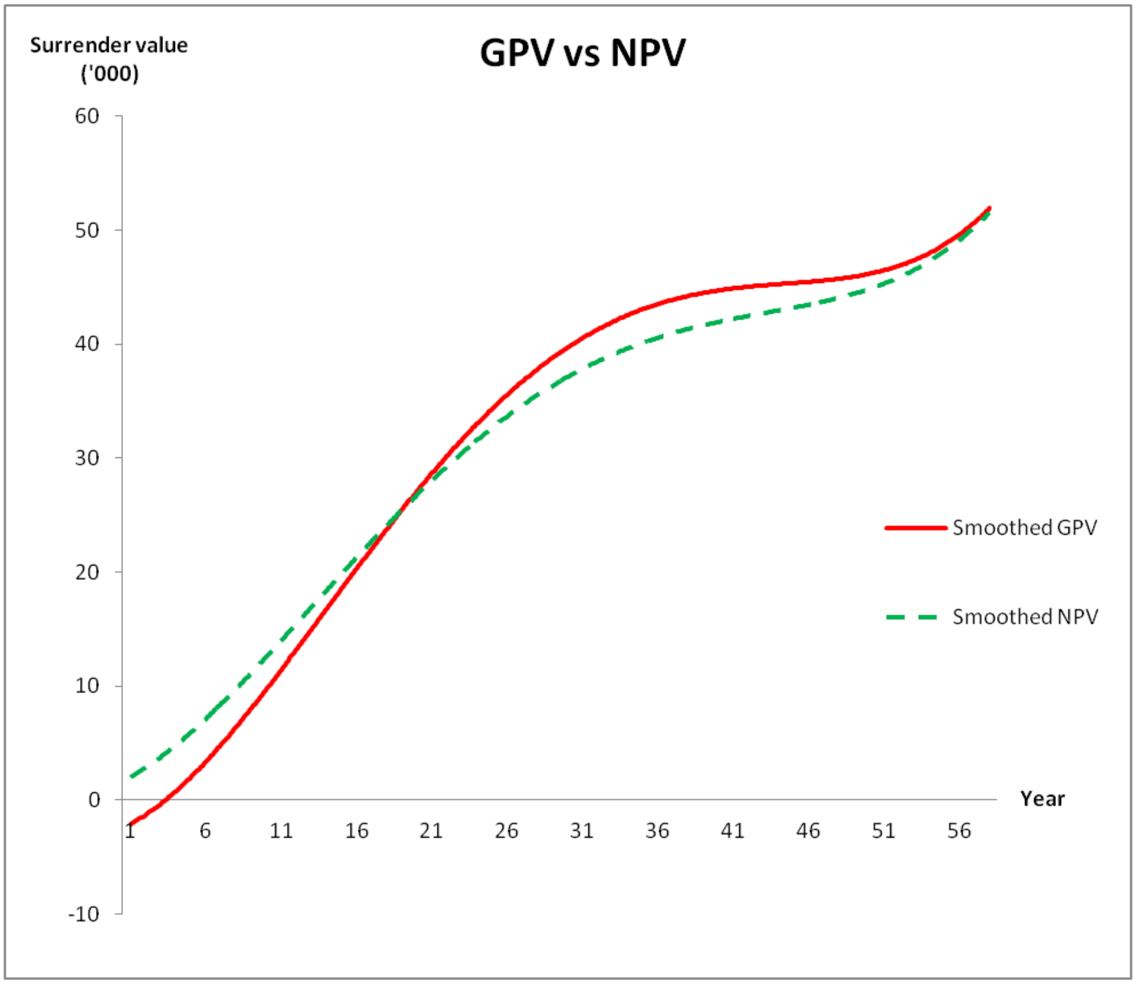
The key assumptions used for GPV are as follows:

Mortality and morbidity	:	121% of M8388 for Death and TPD 0.495 per 1,000 SA for ADB and ATPD
Expenses	:	Acquisition - 12% of premium plus RM 160 per policy Maintenance - 3% of premium plus RM 40 per policy
Interest rate	:	4%
Lapse rate	:	3%
Other assumptions	:	No surrender penalties or other factors to be applied to the Surrender Value

The key assumptions used for NPV are as follows:

Mortality and morbidity	:	121% of M8388 for Death and TPD 0.495 per 1,000 SA for ADB and ATPD
Interest rate	:	4%
Premium Adjustments	:	No adjustments applied
Other assumptions	:	No lapses, surrender penalties or other factors to be applied to the Surrender Value

Appendix 1 (Cont.)



As illustrated, GPV methodology will result in a lower surrender value in the initial years when compared to the NPV methodology. However, in the later term of the policy, GPV methodology will result in a higher surrender value compared to the NPV methodology.