Turf Wars: Who Regulates Unit-linked Products?

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Some Indian life insurers had an interesting start to 2010 when they received formal notices from the capital markets regulator, the Securities Exchange Board of India (SEBI). On January 22 2010 SEBI wrote to a number of life insurers effectively questioning the basis on which they have been selling unit-linked insurance products (ULIPs) to the public in circumstances where they are not registered with SEBI. As far as SEBI is concerned, these life insurers are selling collective investment schemes, which are therefore investment accumulation products that require SEBI's prior approval before they can be sold to the public.

SEBI focused on products that do not also provide life cover, expressing the view that a ULIP without life cover is actually a mutual fund, thereby justifying SEBI regulation. SEBI also noted that the ULIPs in question were marketed by life insurers as an investment product and were often viewed by the public as an alternative to mutual funds.

SEBI's move came as a surprise for three main reasons:

- The products in question were on sale to the public with the approval of the insurance market regulator, the Insurance Regulatory and Development Authority (IRDA);
- The SEBI Act exempts insurance contracts from its definition of a 'collective investment scheme'; and
- The Insurance Act permits life insurers to sell annuity products based on a regular or ULIP platform.

Thus, it may be questioned why, if there is a regulatory issue, it has taken 10 years to come to the fore. As far as the third bullet point above is concerned, there has been speculation that SEBI sent the notices at the insistence of the mutual fund industry. In August 2009 SEBI barred entry fees from being charged to direct investors in mutual funds. This resulted in reduced commissions being paid to distributors and a consequent diversion of business to ULIPs, where the commission payable to the distributor is relatively high. It is estimated that almost 90% of premium collected by private sector life insurers is channelled into ULIPs.

Whatever the reason for the SEBI notices, what has been unusual is the public squaring off that has ensued between SEBI and the IRDA in circumstances where such issues would normally have been resolved behind closed doors, away from the press. Instead, the IRDA has publicly questioned the appropriateness of SEBI's conduct of writing to life insurers without first raising the question of jurisdiction with the IRDA. The IRDA is adamant that the regulation of ULIPs is within its sphere of regulation.

In its formal written response the IRDA is said to have advanced the following arguments:

- Although different jurisdictions have adopted different structures, the Indian jurisdiction is clear in its endeavour to avoid regulatory overlap and entrust the regulation of life insurers (and implicitly the products that they sell) to the IRDA, not SEBI.
- SEBI has ignored the fact that the statute by which it was formed and which demarcates its responsibilities expressly excludes the regulation of insurance contracts.
- Just because an insurance product may in some respects be similar to a mutual fund product, this does not make it the same in all respects and does not justify regulatory creep by SEBI.
- The IRDA is capable of protecting the interests of policyholders without outside assistance. The IRDA notes that the solvency requirements in the insurance industry are more stringent than those in the mutual fund industry.

As for the life insurers that received the SEBI correspondence, to some extent they are caught in the middle of this particular regulatory tussle. As far as they are concerned:

- insurance contracts are exempt from the definition of a 'collective investment scheme';
- the Insurance Act permits them to sell ULIPs; and
- the products that they have been selling for up to 10 years are being sold with the approval of the IRDA and are therefore being sold lawfully.

Beyond that, the issue is one that needs to be sorted out by and between the regulators. According to press reports, this may now be happening. SEBI has not formally responded to the IRDA's letter, but they are said to be talking to try to resolve their differences.

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