

Insurance - India

ULIPs to senior citizens – review of SBI Life litigation

Contributed by **Tuli & Co**

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Introduction

In May 2014 the Allahabad High Court issued perhaps the sternest order ever issued against an insurer. It directed the insurance industry regulator – the Insurance Regulatory and Development Authority (IRDA) – to "critically examine each and every policy" issued by the State Bank of India (SBI) Life Insurance Company Limited and, if it finds that any policy was issued in breach of the regulations, then "it would be appropriate [for the IRDA] to direct the SBI Life to discontinue its policies and to wind up its business". The Supreme Court stayed the order on July 11 2014, but has not yet given its judgment on the case.

Facts

In 2007 a 72-year-old policyholder invested Rs50,000 in a five-year unit-linked insurance policy sold by SBI Life through its corporate agent, State Bank of India (SBI Bank). The policyholder survived the five-year policy term but, due to various deductions, received only Rs248 on maturity.

The policyholder complained to the IRDA, but was dissatisfied with the response. He therefore commenced proceedings against the government, the IRDA, the government-owned SBI Bank and SBI Life (SBI Life is a joint venture insurer formed by SBI Bank and BNP Paribas).

Decision

The Allahabad High Court gave "anxious consideration" to the case and found that, with few exceptions, the law requires that any policy sold in India first be approved by the IRDA in accordance with the 'file and use' procedure. The court found that the policy sold in this case was not approved in its entirety under the file and use procedure – particularly with respect to the mortality charges; therefore, the policy breached the file and use procedure.

The court also found that SBI Bank had not properly explained the terms and conditions to the policyholder before it sold the policy. Had an explanation been given – in particular, of the manner in which the mortality charge would be deducted – the court held that no "prudent person... would have subscribed to the policy, which in any case even if the NAV had risen, would not give any return at all".

The policy was to be terminated if the net asset value fell below Rs10,000. The court held that this "was a safeguard which was absolutely essential to protect the investment". However, SBI Life deleted the clause mid-term. This deletion led the court to hold that once the policy had commenced, it "could not have been changed unilaterally even on the advice of IRDA" and that "the IRDA completely failed in exercise of its statutory duty in allowing the unilateral amendments".

SBI Bank is majority government owned and had a 76% stake in SBI Life. Further, SBI Bank's chair and chief executive officer also served SBI Life in the same capacity. SBI Bank also had the right to nominate directors to SBI Life's board. The relevance of this finding is that SBI Life, in essence, was held to be an instrumentality of the state and therefore was bound to act reasonably and fairly in all matters. In the event, the court found that the policy was "an unconscionable contract and was thus arbitrary, illegal and void document".

Thus, the court concluded:

"we find it appropriate to issue a direction to the IRDA to critically examine each and every policy of the SBI Life. If it finds that the SBI Life, which has suffered penalties in the past, for its defaults has acted in breach of its guidelines it would be appropriate for it to direct the SBI Life to discontinue its policies and to wind up its business."

Author

Neeraj Tuli



It also called on the Serious Fraud Office to investigate the:

"unlawful gains made by the Company and its Directors including the Directors of SBI... by cheating the policyholders on the pretext that its policies are in compliance with IRDA regulations."

Comment

The case has now reached the Supreme Court, which will issue a ruling in due course and is likely to consider whether SBI Life should be seen as an instrumentality of the state. In the meantime, although the Allahabad High Court's order has been stayed, the rationale adopted by the court in reaching its judgment on issues of mis-selling and breaches of the file and use procedure may be applied by courts and consumer forums when considering similar matters.

High courts may allow writ petitions against other insurers with majority government ownership by considering them to be instrumentalities of the state on a similar basis to that in which SBI Life was considered to be an instrumentality of the state.

Given the Allahabad High Court's comments in terms of unilateral policy amendments, life insurers seeking to amend their issued policies for whatever reason will need to consider the extent to which the policyholder's consent will be required.

This case underlines the importance of complying with the file and use procedure, as well as other rules and regulations relevant to the conduct of insurance business.

For further information on this topic please contact [Neeraj Tuli](mailto:n.tuli@tuli.biz) at Tuli & Co by telephone (+91 11 2464 0906), fax (+91 2464 0904) or email (n.tuli@tuli.biz). The Tuli & Co website can be accessed at www.tuli.biz.

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