

REPORTABLE**IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION****CIVIL APPEAL No. 2568 OF 2019
(Arising out of SLP(C) No. 1689 of 2015)****Anandrao Ramchandra Salunke****...Appellant****VERSUS****Life Insurance Corporation of India & Anr.****...Respondents****J U D G M E N T****Dr Dhananjaya Y Chandrachud, J**

1 Leave granted.

2 This appeal arises from a decision of the National Consumer Disputes Redressal Commission¹ reversing a judgment of the Maharashtra Consumer Disputes Redressal Commission².

3 The appellant obtained a policy of life insurance on 11 November 1993. The sum insured was Rs 75,000. The term of the policy was twenty five years.

1 "National Commission"

2 "State Commission"

The policy envisaged the payment of a quarterly premium of Rs 775, spread over a hundred quarters during the term of the policy. The last premium was payable on 11 August 2001 and the policy was to mature on 11 November 2018. On 27 May 2001, the appellant took a loan of Rs 15,000 from the Ratnagiri Branch of the Life Insurance Corporation by pledging the policy. In August 2001, the appellant stopped paying the premium. Thereafter, he applied for the refund of the surrender value. The Corporation offered a surrender value of Rs. 2268, after deducting the loan amount and outstanding interest.

4 The appellant filed a complaint before the District Consumer Disputes Redressal Forum, Sangli³. The District Forum allowed the complaint and directed the respondent to pay an amount of Rs 29,888 together with interest at 9% p.a. with effect from 21 July 2004. The decision of the District Forum was challenged in appeal by the respondent. The State Commission affirmed the decision. In revision, the National Commission reversed the decision, relying on its earlier decision in **Branch Manager, LIC of India v A Paulraj**⁴.

5 The controversy involved in the present case turns on the interpretation of the provisions of Section 113 of the Insurance Act, 1938⁵ and Clause 7 of the policy document. Section 113 of the Act, as it stood at the material time was in the following terms:

³ "District Forum"

⁴ (1996) 2 CPJ 69. The National Commission approved the calculation of cash value of bonus payable in accordance with the surrender value factor.

⁵ "the Act"

“113. Acquisition of surrender value by policy-

(1) A policy of life insurance under which the whole of the benefits become payable either on the occurrence, or at a fixed interval or fixed intervals after the occurrence, of a contingency which is bound to happen, shall, if all premiums have been paid for at least three consecutive years in the case of a policy issued by an insurer, or five years in the case of a policy issued by a provident society defined in Part III, acquire a guaranteed surrender value, to which shall be added the surrender value of any subsisting bonus already attached to the policy, and every such policy issued by insurer shall show the guaranteed surrender value of the policy at the close of each year after the second year of its currency or at the close of each period of three years throughout the currency of the policy: Provided that the requirements of this sub-section as to the addition of the surrender value of the bonus attaching to the policy at surrender shall be deemed to have been complied with where the method of calculation of the guaranteed surrender value of the policy makes provision for the surrender value of the bonus attaching to the policy: Provided further that the requirements of this sub-section as to the showing of the guaranteed surrender value on a policy shall be deemed to have been complied with where the insurer shows on the policy the guaranteed surrender value of the policy by means of a formula accepted in this behalf by the Authority as satisfying the said requirements: Provided further that the provisions of this sub-section as to the showing of the guaranteed surrender value on a policy shall not take effect until after the expiry of six months from such date as the Authority may, by notification in the official Gazette, appoint in this behalf.

(2) Notwithstanding any contract to the contrary, a policy which has acquired a surrender value shall not lapse by reason of the non-payment of further premiums but shall be kept alive to the extent of the paid-up sum insured, and the paid-up sum insured shall for the purposes of this sub-section include in full all subsisting reversionary bonuses that have already attached to the policy, and shall, where the policy is one on which the maximum number of annual premiums payable is fixed and the premiums are of uniform amount, be before the inclusion of such bonuses not less than the amount bearing to the total sum insured by the policy exclusive of bonuses the same proportion as the total period for which premiums have already been paid bears to the maximum period for which premiums were originally payable.

(3) A policy kept alive to the extent of the paid-up sum insured under sub section (2) shall not be entitled by virtue of that sub-section to participate in any profits declared distributable after the conversion of the policy into a paid-up policy.

(4) Sub-section (2) and sub-section (3) shall not apply -

(a) where the paid-up sum insured by a policy being a policy issued by an insurer, is less than one hundred rupees inclusive of any attached bonus or takes the form of an annuity of less than twenty-five rupees, or where the paid-up sum insured by a policy, being a policy issued by a provident society as defined in Part III, is less than fifty rupees inclusive of any attached bonus or take the form of an

annuity of less than twenty-five rupees, or
 (b) where the parties after the default has occurred in the payment of the premium agree in writing to some other arrangement, or
 (c) to policies in which the surrender value is automatically applied under the terms of the contract to maintaining the policy in force after its lapse through non-payment of premium.”

Section 113 was amended on 20 March 2015, with effect from 26 December 2014.⁶

For the purposes of this case, we are concerned with the pre-amended provision.

6 Condition 7 of the policy document reads thus:

“7. Guaranteed surrender value

This policy can be surrendered for cash after the premiums have been paid for at least three years. The minimum surrender value allowable under this policy is equal to 30% of the total amount of the mentioned premiums paid excluding premiums for the first year and all extra premiums and/or additional premiums for accident benefits that may have been paid. The cash value of any existing vested bonus additions will also be allowed.” (emphasis supplied)

7 The basis on which the respondent arrived at the surrender value which was payable to the appellant is reflected in the following computation:

COMPUTATION:

6 Following the amendment, Section 113 is as follows:

“113. Acquisition of surrender value by policy-

- (1) A policy of life insurance shall acquire surrender value as per the norms specified by the regulations.
- (2) Every policy of life insurance shall contain the formula as approved by the Authority for calculation of guaranteed surrender value of the policy.
- (3) Notwithstanding any contract to the contrary, a policy of life insurance under a non-linked plan which has acquired a surrender value shall not lapse by reason of non-payment of further premiums but shall be kept in force to the extent of paid-up sum insured, calculated by means of a formula as approved by the Authority and contained in the policy and the reversionary bonuses that have already been attached to the policy:
 Provided that a policy of life insurance under a linked plan shall be kept in force in the manner as may be specified by the regulations.
- (4) The provisions of sub-section (3) shall not apply—
 - (i) where the paid-up sum insured by a policy, inclusive of attached bonuses, is less than the amount specified by the Authority or takes the form of annuity of amount less than the amount specified by the Authority; or
 - (ii) when the parties, after the default has occurred in payment of the premium, agree in writing to other arrangement.”

- Sum Assured : Rs 75,000
- Mode – Quarterly Premium : Rs 775
- Total No. of Premia Payable : 100 Quarters (i.e. 25 years)
- Date of commencement of the policy : 11.11.1993
- Premium paid upto 11.08.2001 : 31 Premia
- Duration of premium paid : 7 years 9 Months (i.e. 31 Quarters)
- Loan of Rs 15,000 taken on 27.05.2001
- Paid-Up Value : (No. of paid premia multiplied by Sum Assured)/Total No. of Premia i.e. (31 multiplied by Rs.75,000)/100 = Rs 23,250
- Vested Bonuses : Rs 42,187 (at the rate of Rs 562.5 per 1,000 as per Bonus chart for endowment policy as on 31.03.2001 (Annexure-4))
- Total paid up value : paid up value + vested bonus i.e. Rs 23,250 + 42,187 = Rs 65,437 (as per condition no. 4 as per the policy)
- Surrender Value Factor : 32.92% (as per Surrender value Table No.1A applicable to endowment policy (Annexure-5))
- Surrender Value Payable as on 14.05.2004 : total Paid-Up Value multiplied by Surrender Value Factor i.e. Rs 65,437 multiplied by 32.92% = Rs 21,542
- Outstanding Loan amount with interest : Principal + Interest i.e. Rs 15,000 + Rs 4,274 = Rs 19,274
- Net amount payable as on 14.05.2004 : Surrender Value Payable - Outstanding Loan Amount with interest i.e. Rs 21,542-19,274 = 2,268/-
- Guaranteed Surrender Value (as per condition No. 7 of the policy)- 30% of the total premium paid excluding premium paid for the first year and all extra premiums that may have been paid i.e. 30% multiplied by (Total Premium paid - 1st year premium) : 30% multiplied by(Rs 24,025-Rs 3,100)= Rs6,277
- Cash value of the vested bonus : 32.92% of the Vested Bonus i.e. 32.92% of Rs 42,187 = 13,888
- Total Guaranteed Surrender Value : Rs 20,165
- Net Amount Payable as on 14.05.2004 : Guaranteed Surrender Value Payable – Outstanding Loan amount with interest : Rs 20,165-Rs 19,274 = Rs 891/-.

8 Learned counsel appearing on behalf of the appellant submits that the appellant has a grievance in regard to the manner in which the computation of the surrender value of the bonus payable was arrived at. According to the submission, the respondent has applied a factor of 32.92% in arriving at the surrender value not

only with reference to the premia which were paid but also in regard to the bonus to which the appellant claims to be entitled. The following findings of the District Forum were relied upon during the course of arguments:

"Considering the terms and conditions in the policy and calculations by the respondent at exhibit 5/6, it is observed that the respondent has stated that 32.92% of the Premium amount and Bonus amount put together is payable. The respondent has not brought to notice any term or condition in the policy providing for 32.92% reduction in amount of Bonus. Therefore, as per calculations of the respondent at exhibit 5/6 32.92% of the premium of Rs.23250/- i.e. premium of Rs.6975/- is payable. Further, it is clear that the amount at the end of calculations against exhibit 5/6 i.e. Bonus minus loan amount of Rs.19274, is due from the respondent. Therefore, it is clear that 32.92% of the entire amount payable, plus amount of bonus payable, minus amount of outstanding loan ($6975+42187-19274=29888$) is the amount payable."

While affirming this finding, the State Commission held that the formula for the purpose of the guaranteed surrender value was required to be approved by the competent authority under Section 113. The State Commission held that no material was produced before it to indicate that the surrender value formula was approved by the competent authority.

9 Assailing the above submission, learned counsel appearing on behalf of the respondent has placed reliance on the reply which was filed by the Life Insurance Corporation in the proceedings before the District Forum to explain the basis of computing the surrender value. Learned Counsel urged that Section 113 does not speak about the payment of the full value of the subsisting bonus. On the contrary, it specifically adverts to only its surrender value. Learned counsel submitted that the first proviso to Section 113 provides that the requirements of the section shall be

deemed to have been complied with where the method of calculation for computing the guaranteed surrender value of the policy makes a provision for surrender value of the bonus attached to the policy as well. The second proviso provides that the requirement as to the showing of the guaranteed surrender value shall be deemed to have been complied with where the insurer shows on the policy the guaranteed surrender value by means of a formula accepted by the authority as specifying the requirement. The third proviso, it has been submitted, provides that the second aspect of Section 113 relating to the requirement of showing the guaranteed surrender value of the policy shall not take effect until the expiry of six months from the date of notification in the Official Gazette.

10 The rival submissions need to be analysed.

11 There are popular misconceptions about the concept of 'surrender value' in the sphere of life insurance. In a policy of fire insurance, a policy holder has no expectation of a surrender value. In contrast, a holder of a policy of life insurance may believe (as the appellant in this case does) that their surrender value will be equal to the total amount paid as premium. This expectation is misconceived. Simply put, life insurance operates on the basis of the law of averages. Premium is collected from all policy holders in order to create a common fund. Payouts from the fund are received only by those who suffer the peril which is insured. The economic loss suffered by few is divided amongst many. Premia are fixed by the insurer on the basis of expected mortality rates. Hypothetically speaking, if mortality rates of all individuals were to be equal irrespective of age and everyone paid the same

premium, the discontinuance of a policy during its term would not entitle the insured to a surrender value since the common fund would be depleted on a regular basis. In reality, the mortality rates increase with age. Actuarial tables provide a guide to the insurer. Hence, when an insurer initially collects premium from individuals of a younger age, the amount it collects is higher than the amount it pays out towards claims. The difference between them is the 'reserve'. Thus if a policy holder wishes to discontinue a policy before the end of the term, they will only be entitled to their share of the 'reserve' as a surrender value.

12 In his treatise on the subject, titled "Modern Law of Insurance in India" **K.S.N. Murthy** has elucidated on the concept of "surrender value" in life insurance policies in the following terms:

"Life insurance is based on the cooperative principle in the sense that the premiums paid by the policy holders are pooled together and after meeting the preliminary expenses of administration, etc., the balance is formed into or added to a fund which is invested in good business or which attracts an accumulated interest. On that basis when the calculations are made, and if one of the policy holders withdraws from such a cooperative enterprise, the remaining policy holders suffer a set-back and it is the duty of the seceding policy holder to make good not only the administrative expenses, etc., incurred, but something more must be deducted: but that amount also must be fair and equitable."⁷

13 Since the value of the 'reserve' is the amount which the insurer collects as premium from policy holders from which it deducts the amount of the claims it pays out, the surrender value payable to a policy holder can never be equal to the premium paid by them.

⁷ Modern Law of Insurance in India, N.M. Tripathi Private Limited, Bombay, First Edition (1978).

14 In a decision of 1913 in **Charles C. Burlingham v Charles M. Crouse**⁸, the Supreme Court of the United States was tasked with interpreting a provision of the Bankruptcy Code in relation to ownership of life insurance policies. Justice Day, who delivered the opinion of the Court, drew a distinction between insurance policies which have a surrender value and policies which do not have a surrender value:

“...Life insurance, may be given in a contract providing simply for payment of premiums on a calculated basis which accumulates no surplus for the holder. Such insurance has no surrender value. Policies, whether payable at the end of a term of years or at death, may be issued upon a basis of calculation which accumulates a net reserve in favor of the policy-holder and which forms a consequent basis for the surrender of the policy by the insured with advantage to the company upon the payment of a part of this accumulated reserve.”

The Court cited the decision of the Court of the Southern District of New York, in **In re McKinney**⁹ to elucidate on the concept of surrender value. Justice Brown had held thus:

"The first of these elements, the surrender value of the policy, arises from the fact that the fixed annual premium is much in excess of the annual risk during the earlier years of the policy, an excess made necessary in order to balance the deficiency of the same premium to meet the annual risk during the latter years of the policy. This excess in the premium paid over the annual cost of insurance, with accumulations of interest, constitutes the surrender value. Though this excess of premiums paid is legally the sole property of the company, still in practical effect, though not in law, it is moneys of the assured deposited with the company in advance to make up the deficiency in later premiums to cover the annual cost of insurance, instead of being retained by the assured and paid by him to the company in the shape of greatly increased premiums, when the risk is greatest. It is the 'net reserve' required by law to be kept by the company for the benefit of the assured, and to be maintained to the credit of the policy. So long as the policy remains in force the company has not practically any beneficial interest in it, except as its custodian, with the obligation to maintain it unimpaired and suitably invested for the benefit of the insured. This is the practical, though not

⁸ 228 U.S. 459(1913)

⁹ 15 Fed. Rep. 535, 537

the legal, relation of the company to this fund.

"Upon the surrender of the policy before the death of the assured, the company, to be relieved from all responsibility for the increased risk, which is represented by this accumulating reserve, could well afford to surrender a considerable part of it to the assured, or his representative. A return of a part in some form or other is now usually made..."

15 The issue before the Court is as to whether the provisions of Section 113 of the Act and condition 7 of the policy document were duly observed by the insurer.

Section 113(1) is in two parts:

- (i) A policy of life insurance under which the whole of the benefits become payable either on the occurrence of a contingency which is bound to happen or at fixed intervals, acquires a surrender value if all the premiums have been paid for at least three consecutive years. The surrender value of any subsisting bonus already attached to the policy is to be added to the guaranteed surrender value;
- (ii) Every such policy which is issued by an insurer must show the guaranteed surrender value of the policy at the close of each year after the second year of its currency or at the close of each period of three years throughout the currency of the policy.

16 In computing the surrender value of any subsisting bonus, reference ought to be made to the stipulations contained in Section 113. The first proviso to Section 113(1) provides that the requirement of the addition of the surrender value of the bonus attaching to the policy at surrender is deemed to have been fulfilled where the method of calculating the guaranteed surrender value makes provision for the

surrender value of the bonus attaching to the policy. The second proviso stipulates that the requirement of showing the guaranteed surrender value on a policy is deemed to have been complied with where the insurer shows on the policy the guaranteed surrender value by means of a formula which is accepted by the authority as satisfying the requirements under the third proviso. The requirement of showing the guaranteed surrender value shall not take effect until six months have expired from the date of publication of the notification in the Official Gazette.

17 In exercise of the powers conferred by Section 49(2) of the Life Insurance Corporation Act, 1956, the Central Government notified the Life Insurance Corporation Regulations 1959¹⁰. Regulation 18(2) empowers the Executive Committee to accept the surrender of any insurance or annuity and to purchase or redeem any insurance or annuity and to waive the forfeiture of any insurance on such terms as the Executive Committee may deem fit. The respondent has placed on the record a copy of the Minutes of the Seventy-seventh meeting of the Executive Committee of the Life Insurance Corporation of India held on 19 August 1959. At that meeting, the Executive Committee approved of the proposed scale of surrender values. The note on the basis of which the approval was granted has also been annexed.

18 We have considered the basis of the computation which has been placed before the Court and which has been extracted in the earlier part of this judgment. Condition 7 of the policy document specifically provides that the surrender value is equal to 30% of the total premiums paid, excluding premiums for the first year and

¹⁰ "the Regulations"

all extra premiums and/ or additional premiums for accident benefits that may have been paid. The paid up value of the policy on that basis was computed by taking into account the premiums that were paid by the insured. The paid up value of the policy worked out to Rs 23,250.

19 The real dispute in the present case arose because of the claim of the appellant that he was entitled to the entirety of the bonus and not 32.92% of the total bonus that would have accrued had the policy continued to its term of maturity. The factor of 32.92% has been duly explained on the basis of the actuarial table governing surrender values which has been placed on record. The vested bonus which accrued, stood at Rs 42,187 at the rate of Rs 562.5 per Rs 1,000, according to the bonus chart for endowment policies as on 31 March 2001. There was no error on the part of the respondent in computing the surrender value of the subsisting bonus, on the basis on which it has been computed. The surrender value of the subsisting bonus attached to the policy cannot be the bonus which would have been payable had the policy continued to its full term. In deducing the surrender value of the bonus which was payable to the appellant, the respondent applied the surrender value factor of 32.92% to the total paid up value of the policy. The total paid up value comprised of the paid up value (Rs 23,250) and the vested bonus (Rs 42,187). Hence, the total paid up value of the policy was Rs 65,437 to which the surrender value factor of 32.92% was applied. This resulted in a surrender value of Rs 21,542. What is payable to the insured was computed after deducting the loan which was taken against the policy together with the outstanding interest.

20 For the above reasons, we are of the view that the method by which the computation was carried out was in accordance with the accepted and duly approved formula. It was consistent with the provisions of Section 113 of the Act as they stood at the material time as well as condition 7 of the policy document.

21 We, therefore, do not find any merit in the appeal. The appeal is, accordingly, dismissed. There shall be no order as to costs.

.....J.
(Dr DHANANJAYA Y CHANDRACHUD)

.....J.
(HEMANT GUPTA)

NEW DELHI;
MARCH 07, 2019