Institute of Actuaries of India

The Future of Life Insurance

Melanie Puri PwC, Director
Aditya Mahindroo PwC, Senior Consultant

Waves of Reforms…Oceans of Opportunities

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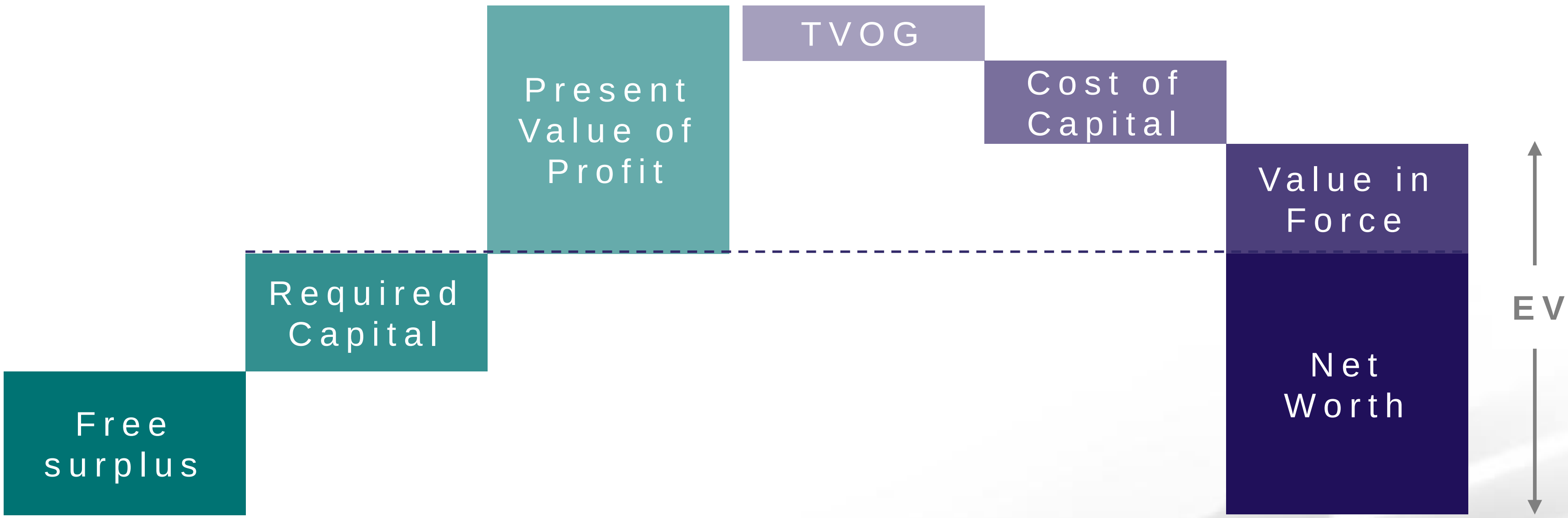
Agenda

- How do global life insurance groups make money?
- Is the same true in India?
- Which risks should insurers retain?
- What is the impact of a SII-type regime and what do investors want?
- RBC – lessons from Solvency II
- What do policyholders want?
- What next?

How do global life insurance groups make money?

- Embedded value (EV) is one measure of the value of the shareholders' interests in the business

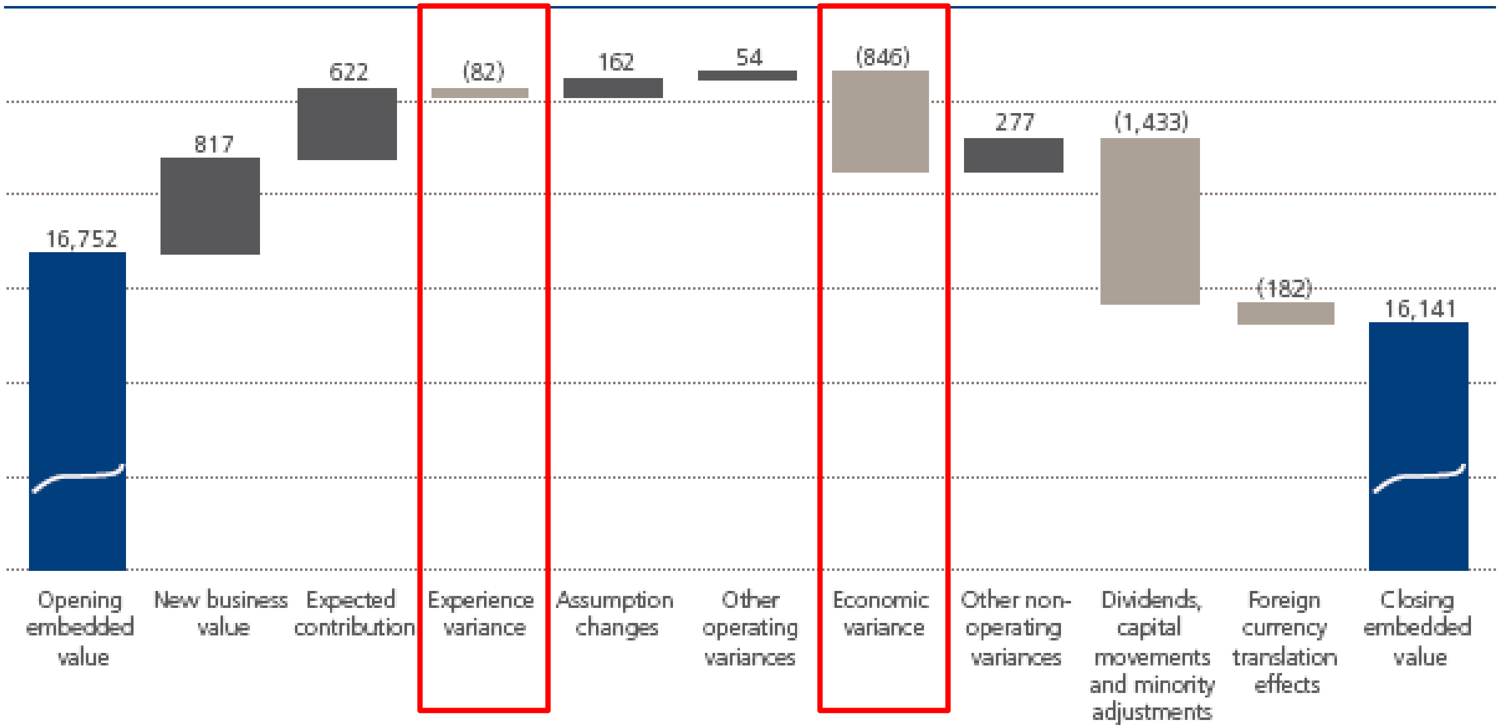


- The change in the EV – shown in the Analysis of Earnings – is one measure of 'profit'
- There are others – some look at IFRS earnings......

How do global life insurance groups make money?

Where does the change in EV come from?

- Analysis of change in the EV of a large European life insurer



- Economic variance can be highly positive or negative, depending on market performance

→ **Insurers have historically made money by taking market risk - but taking market risk in a SII world has become expensive.........**

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Is the same true in India?

- There are other factors that currently lead to Indian insurance companies losing/making money from other sources:
  - Lapse rates higher than expected
  - Distribution costs high (higher than expected??)
  - Are these short term issues that can be fixed – or more fundamental that can't?
- In the longer term taking market risk - and earning returns from doing so – is still likely to play a large part in insurance company profits
- Prescriptive 'safe' investment rules do not mean that Indian insurers do not take market risk.......

Is the same true in India?

Market risk exists in India.....

Interest Rate Risk

- Products with interest rate guarantees
- Is it possible to earn the guaranteed rates for the entire duration?

Default Risk

- Sovereign default risk on bonds?
- Reinsurance default?
- How much allowance in pricing and valuation?

Mismatch Risk

- Assets matching long term liabilities unavailable
- At time of reinvestment, interest rates may be far lower than today

Expense Risk

- For UL, many assume no market risk......
- UL profit ≈ PV(AMC's – Expenses)
- Falling market values impact future stream of AMC's

Which risks should insurers retain?

Could Europe's challenges become India's challenges?

Long-Term Risks

- Long term products
- What will interest rates be in 20, 30 years?

Low Interest Rates

- Without taking sufficient market risks, returns on capital after expenses unattractive.
- Real returns may not be achieved
- Reduced demand, high costs
- With profits business

Global Regulation

- Introduction of worldwide regulatory standards (e.g. RBC)
- Market consistent pricing already a requirement in some Indian life companies....

Which risks should insurers retain – product implications in India

Examine the shift from unit-linked to traditional products

	PREMIUM (Crores)	
	2010/11	2011/12
Non linked		
Life		
with profit	5,160	10,624
without profit	6,031	5,805
General Annuity and Pensions		
with profit	104	287
without profit	7,324	8,297
Total Non linked	**18,618**	**25,013**
Linked		
Life		
with profit	1	-
without profit	28,502	14,957
General Annuity and Pensions		
with profit	-	-
without profit	27,394	686
Total Linked	**55,897**	**15,643**

Single premium only
Source: www.irda.gov.in

- Insurers have been selling more traditional savings products over the last few years...
- .. with guarantees on death / surrender / maturity
- Issues around Asset - Liability mismatch – Are long term bonds available to match 15-20 year contracts?
- How will these products look if an RBC regime is introduced?

What is the impact of a SII type regime and what do investors want?

Investors' and Insurers' needs are tricky to align

Investor Wants	Insurer's Dilemma
Upside share price	Can come from Strategy (investing – but no cash? - divesting etc) but higher earnings potential generally equates to taking higher risk (usually market risk)
Stable (increasing) dividend stream	Post SII, 'value' is volatile if market risk is taken. Difficult to achieve stable increasing dividend stream and stable capital requirement. Can earnings come from somewhere else?
Stable capital requirement	Taking any market risk leads to significantly higher capital requirements post SII......
Understandable Financial Disclosures	Investors will invest in other sectors that are easier to understand and less volatile ...

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RBC – Lessons from Solvency II

- Recent newspaper headlines indicate that the introduction of RBC may not be far away

"IRDA plans to introduce risk-based solvency"

"IRDA mulls risk based solvency model for insurers"

"IRDA looking at risk based solvency models for insurer"

- And whilst the intention may be an RBC system similar to others in Asia rather than Solvency II – are there any lessons that can be learned?

Understand the aim of the regulation.....

Overall	To improve policyholder protection....yes but what else? How?		
Policy makers/ Regulator	To increase capital requirements? How do capital requirements look compared to other industries?	To introduce a **fully market consistent** capital regime?	To introduce a regime where capital requirements **vary** with the risks taken.....but not necessarily fully market consistent?
Policyholders	To ensure insurance companies survive and meet policy obligations	Increase **public confidence** in the life insurance sector?	
Product level	Which products are **important** in the context of wider government policy aims (e.g. Individual saving/provision for retirement rather than reliance on the state)?	Which products should still be **attractive/affordable** post the introduction of the regime?	

RBC - Lessons from Solvency II

Understand the impact on capital requirements, 'value', solvency ratios and volatility in results before agreeing the framework

Pre-2008 Financial Crisis

Market consistent regime sounded sensible in theory but **no one really understood the numbers**

Financial Crisis

Post-2008 Financial Crisis

Internal Runs (2009) and QIS 5 (2010)

Gave insight into:

- Capital requirements
- Value
- Volatility (both balance sheet and capital requirements) from period to period

Real impact understood

Back to the Solvency II drawing board

Clarity on role of insurance in wide economic context

Traditionally...

Life insurers provide long term liquidity to the wider real economy

Solvency II...

Not well thought through

Movement to shorter term assets encouraged due to capital charges

Not well thought through

Long term guaranteed business discouraged

Example

Under current proposals, infrastructure bonds would be treated as corporate bonds under Solvency II – and the capital charge would be 32.5% for a BBB-rated infrastructure bond of more than 25 years' duration.

See IMF paper published in 2011

"Possible unintended consequences of Basel III and Solvency II"

New regulations...

The role of insurance companies in the wider context of the real economy and capital markets borne in mind

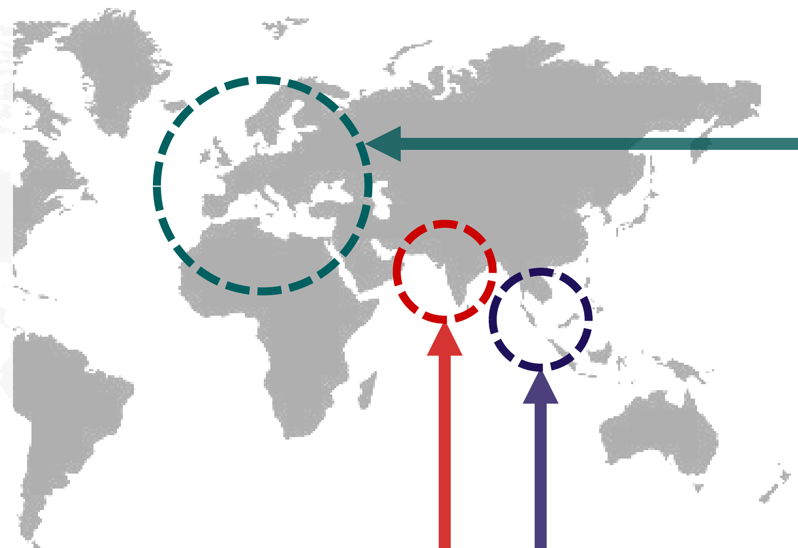
RBC – Lessons from Solvency II

Transparency of results

Consider **level** of disclosure

Consider **type** of disclosure

Introduce **RBC** regime



Solvency II

EU

Insurers required to publish ***Solvency and Financial Condition Report***

RBC

Some Asian Markets

The regime has almost been distilled down to a single number – an ***RBC solvency ratio***.

India

No public disclosures for most life insurers (e.g. annual EV disclosures).

RBC - Lessons from Solvency II

Keep the number of parties to a minimum…

- EU has a particularly cumbersome decision making mechanism

European Parliament

Council of the EU

European Commission

EIOPA

- (Too) many industry bodies – not always presenting a coherent view (got better over the years...)

CFO Forum

CRO Forum

Insurance Europe

Groupe Consultatif

- Distrust/tension between industry and the regulator(s)......

Industry felt that regulators were determined to introduce a fully market consistent regime regardless of whether that was appropriate for the industry and policyholders - and regardless of the impact on the industry

Regulators felt that industry was solely focused on reducing capital requirements

What do policyholders want?

The financial world was badly impacted by the 2008 credit crisis and the ongoing economic crises since then.......

Insurers have survived and done better than banks, but the reputation of the industry has been impacted

What do policyholders want?

Video

The video