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Feasibility of CDO's Suggestion to Improve Sales -

1. Addition of Terminal Bonus in Benefit Illustrations

2. Reduction in Surrender Value

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Mr. Venkatakrishna Narayana, FIAI

- Fellow of Institute of Actuaries of India (IAI)
- Overall 30 years of experience in insurance industry
- Experience of 15 years working in Actuarial field
- Worked in Bajaj Allianz Life for more than 13 years
- Was Working as a Chief Risk Office (CRO)
- Started his own consultancy in 2019

Agenda

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Introduction	• Case Study • Problem Statement
Problem Statement 1	• CEO Suggestion and it's feasibility • Approaches of bonuses in BI • Regulatory and Professional aspect • Other Alternatives
Problem Statement 2	• CDO's suggestion and it's feasibility • Actuarial, Regulatory and Professional aspect • Possible reasons for lower sales and other alternatives
Conclusion	• Conclusion of Problem statement 1 and 2

Case Study

You work as a pricing actuary in a life insurance company. The company is known for selling huge volumes of participating business and built a good portfolio of Par business over years. The company has good track record of investment performance and has passed on additional investment returns as terminal bonus to eligible policyholders. The new Chief Distribution Officer (CDO) of the company has following observations regarding the Benefit Illustrations (BI):-

- Current BI are understating the benefits payable as they are not showing terminal bonuses (TB).
- He argued that company has paid significant TB in past and BI is a great document to reflect that. If not BI, then where else will you showcase it.
- He told you to be transparent and have adequate disclaimers regarding payment of TB.

He has also identified zero or low surrender values as a reason for customer dissatisfaction. He understood the reasons for low surrender value. He opined to increase the maturity value that will act as an for policyholder to continue the policy. He suggested to keep Special surrender value (SSV) same as Guaranteed surrender value (GSV) and pass the additional money saved as TB to policyholders. These lower surrender values would reduce the early surrenders and improve persistency. As policyholders are not anyways happy with surrender value, a little more reduction may not increase the level of dissatisfaction materially.

Please evaluate the feasibility of the suggestions made by Chief Distribution Officer along with the regulatory/compliance and professional issues in implementing the same.

Problem Statements

1\. • The CDO has asked to include TB in the BI to showcase the good returns that the company has declared in the past.

2\. • The CDO has asked to reduce the SSV to keep it same as GSV and increase the TB to continuing policyholders. This would help in reducing surrenders and improving persistency.

Problem Statement 1

CDO's Observations

- Company declared Higher TB in past
- Higher TB is not reflecting in BI
- Understating benefits by not including TB

CDO's Suggestions

- Include TB in BI
- Showcase past performance of the company
- BI to be used as a tool to improve sales

Feasibility - BI Perspective

Can not showcase high past performance as:-

- BI shows expected benefits at specified investment scenarios of 4% and 8%
- Company's high past investment performance does not impact benefits in BI

Case if TB is shown in BI

- RB will be reduced to compensate for TB
- Ultimate benefit payout will be similar
- May not help increasing sales as expected by CDO

Other Considerations:-

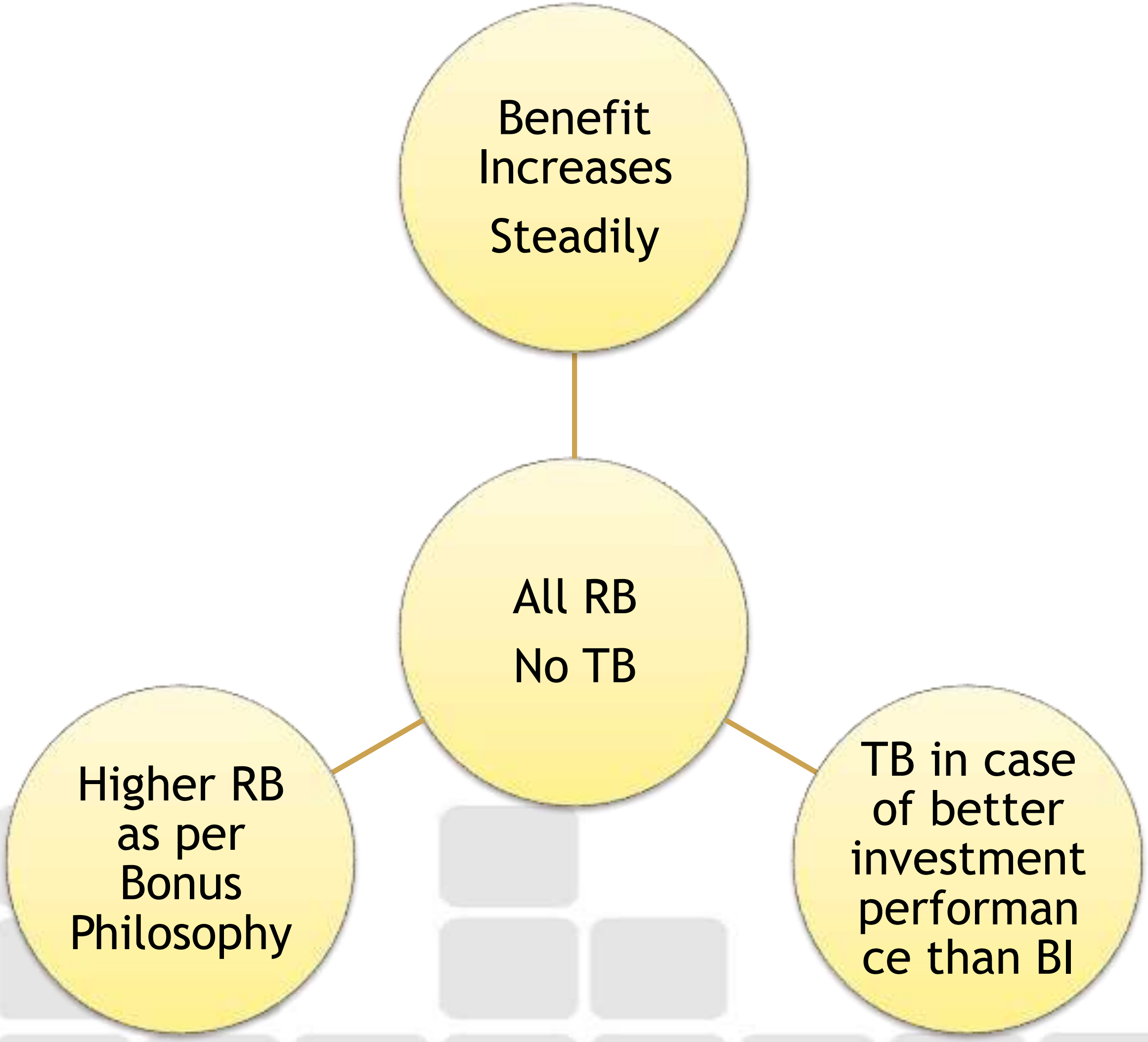
- Change in current practice of the company
- Disparity between expectation of existing customers and new customers
- Non compliance with regulation if used as a tool for competitive advantage

Objectives of Benefit Illustration (BI)

- Educate the potential customer
- Assist customer to develop an understanding of the Product features
- Understand the flow of benefits.
- For Par Products, it creates an expectation related to bonuses
- Distinction between Guaranteed and Non Guaranteed Benefits
- Understand Non Guaranteed Benefits for Par products under specified investment scenarios.
- Important information like terms and conditions related to the benefits payable.

Approaches of showing bonuses in BI

Approach 1 – All RB and No TB



Approaches of showing bonuses in BI

Approach 2 – Combination of RB and TB

Combination of RB and TB

Gradual increases in Benefits with RB

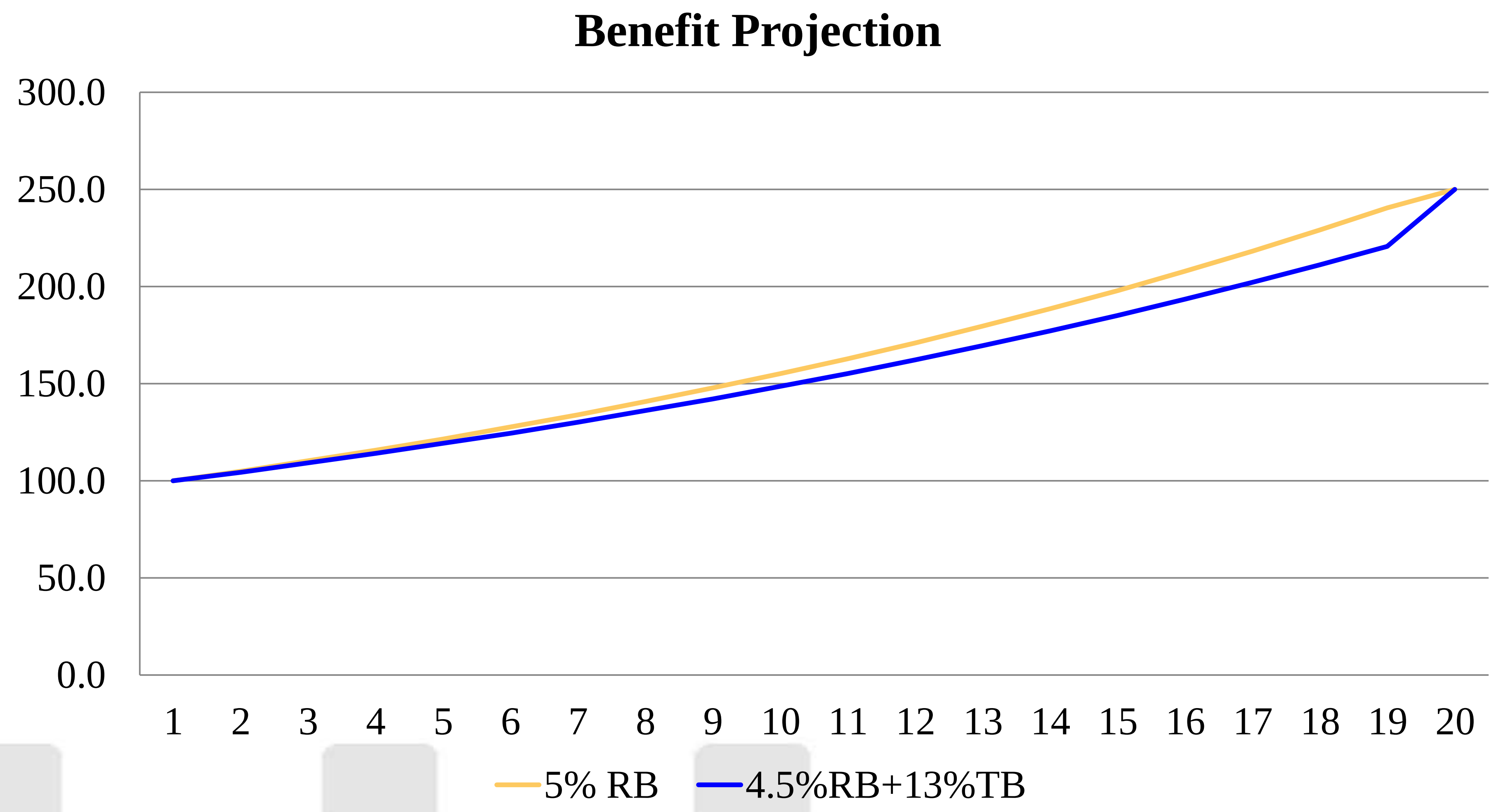
Lump sum component as TB at the end

Lower benefits up to end of Policy Term

Bonus as per Company's philosophy

Reduce TB in adverse scenario

Approach 1 Vs Approach 2



Impact of Change in Approach

- Change in current bonus philosophy of the company
- Different bonus philosophy for existing customers and new customers
- Communication of change to respective stakeholders
- Change required to be develop in system
- Change in ALM process of the company
- Change in investment strategy of the company

Regulations and Professional Standards

- APS 5: Principles of life Insurance policy Illustrations
- Non Linked Insurance Product regulations, 2019

Actuarial Professional Aspect

As per APS 5 :
“The main objective of illustrations should be to educate the potential customer about the insurance product on sale and thus assist him in developing a proper understanding of the features of the product and the flow of benefits in different circumstances, with some level of quantification. In particular, illustrations should not be used as a tool to achieve a competitive edge in the market place.”

Our view:
The CDO wishes to use the Benefit illustration to increase the sales. Professional standards guide us not to use the illustrations to achieve a competitive edge in the market place.

Actuarial Professional Aspect

As per APS 5 :
"It is expected that the company would ensure that intermediaries and the employees responsible for sales receive appropriate training and are supervised and monitored with regard to the use of policy illustrations. If it comes to the knowledge of the Appointed Actuary that this is not the case, the Appointed Actuary should take this up with the management of the company for appropriate action."

Our view:

The practice standards tells us that the intermediaries shouldn't oversell beyond what is written in the benefit illustration .
It places responsibility on the actuary to communicate to the management in case any mis-selling is identified

Actuarial Professional Aspect

As per APS 5 :

“The Appointed Actuary should determine what assumed projected rates of bonus should be used for each of the higher and lower rates, in the judgment of the Appointed Actuary, be appropriate and supportable under the investment return rates set by the Life Insurance Council taking into account all the relevant factors.”

“ Whenever the Life Insurance Council revises the investment return rates, the Appointed Actuary shall carry out a review of and revise the assumed bases for illustrations for all types of plans, have the revised illustrations approved by the management of the company and file them with the IRDA before they are used at the point of sale”

Our view:

Under the previous scenario the rates set by life insurance council were 6% and 10% to demonstrate the benefit illustrations.

However as per the new 2019 regulations, the investment returns that may be used are 4% and 8%.

The bonus assumptions as well as the ultimate payments must be revised everytime there is a change in the investment rates as per the regulations.

Regulatory Aspect

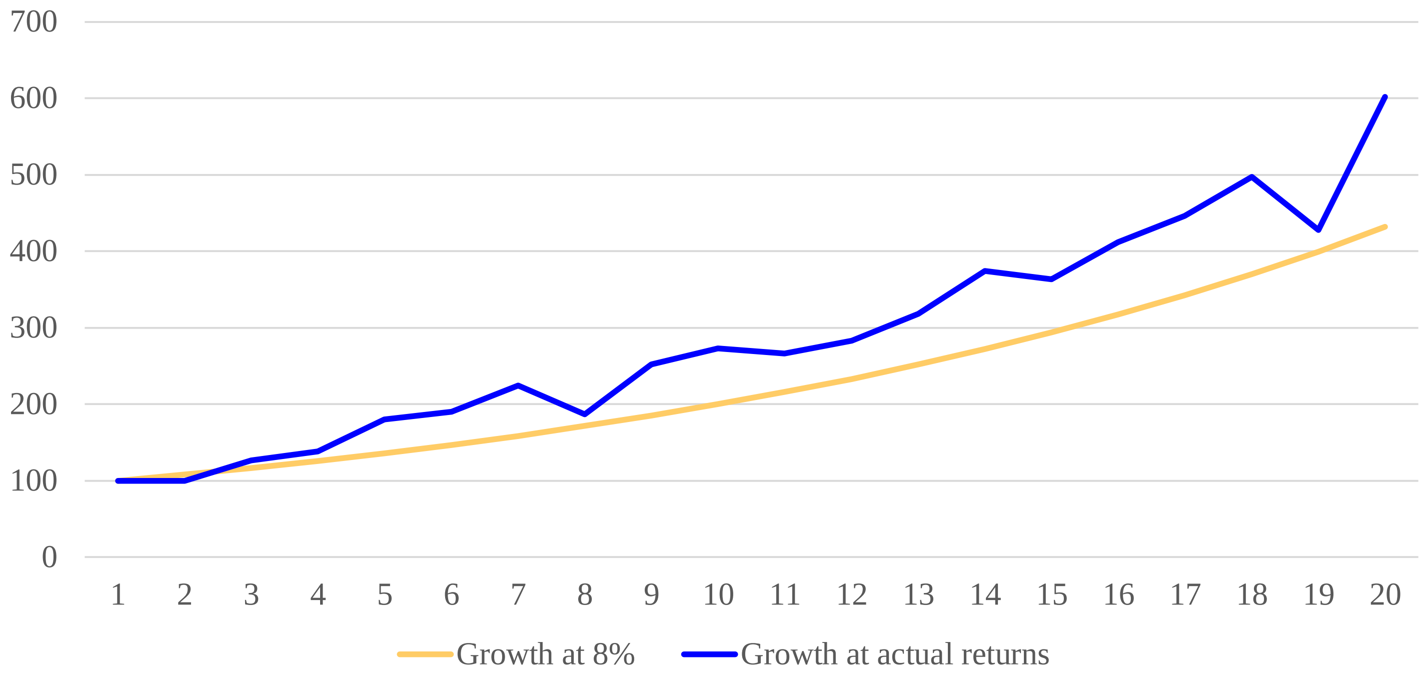
As per IRDAI Non Linked Product Regulation 2019

"Except for products where all the benefits are assured in absolute amounts at the outset of the contract, all other insurance products shall provide the prospective policyholder a customized benefit illustration at the point of sale, illustrating the guaranteed and non-guaranteed benefits at gross investment returns as stipulated by the Authority. Currently such gross investment returns are 4% p.a. and 8% p.a."

Our View

The past returns of the company could have been higher than 8% and that should not be reflected in the benefit illustration.

Actual Scenario Vs BI Investment Return Scenario



For actual returns we have assumed , that 30% will be invested in equity and 70% in 6% bonds.

For equity returns we have used Nifty Annual Growth of last 20 years.

Other alternatives

- The bonus rates should be published on the company's website.
- The past performance of the company can be advertised and marketed that may help to achieve higher sales.
- Show case past performance to existing policyholders using emails and letters. Helps in word of mouth publicity.
- Advertising about the bonus rates will help in reassurance of existing policyholders as well.

Problem Statement 2

Observations of CDO

- Customer dissatisfaction with surrender value offered during early policy years
- The above hampering reputation and sales volume
- Further reduction in surrender value may not increase the level of dissatisfaction

Suggestion from CDO

- Reduce the surrender value by making GSV and SSV same
- This will help in reducing early surrender and improve persistency
- Additional profits earned by paying lower surrender value
- Pass on the additional profit in the form of higher terminal Bonus result in increase in maturity value

Concerns around CDO’s suggestion

Concerns

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Returns on Surrender	• Capital Loss / Negative Return for the customer • Customer locked in with very low benefits for a long tenure
Treating Customer Fairly	• Over penalizing the customer • Doesn’t ensure fair treatment with the customers wanting an exit
Liquidity	• Makes it a weaker alternative, in terms of liquidity (vs other financial instruments) • Impacts marketability • Available policy loan will be inadequate
Competition	• Might make our proposition weak • Impact on sales

Concerns

Past Practice and Existing Products	• Shift from the existing practice and philosophy • Inconsistency between products
Comparison between different generation of policyholders	• Different treatment for similar policyholders
Reputation Risk	• Increased dissatisfaction / complaints • Negative publicity of the company resulting in an impact on sales
Regulatory	• Non compliance with regulations

Feasibility – Actuarial Perspective

Feasibility – Actuarial Perspective

- Being a long term contract, customers needs may change during the term of the policy resulting in surrenders

- The Surrender value must be in line with fair policy value

- Surrender Penalty must reflect
  - Loss due to early liquidation of asset
  - Loss due to high expenses

- Making GSV same as SSV will result in high penalties in later years

- This will not be in line with having fair penalties on surrender therefore breaching the principle of treating customer fairly

Feasibility – Actuarial Perspective

Impact on Profits

- The surrender profit on each surrender would increase
- It is expected that lower surrender value will result in lower surrenders (better persistency)
- Overall surrender profit might not be sufficient to provide for a higher TB at maturity

Impact on Sales

- Lowering surrender value may result in decrease in sales
- Leading to increase in per policy expenses

Regulatory / APS Perspective of CDO’s Suggestion

Governing Regulations and Guidance around Surrender Value

IRDAI Non-Linked Insurance Products Regulation, 2019

- Requires all savings product to acquire both GSV and SSV
- This regulation defines minimum Guaranteed Surrender Value to be offered

GUIDANCE NOTE (GN) 6: Management of participating life insurance business with reference to distribution of surplus

- This note provides Guidance on Asset Share calculation methodology

Actuarial Practice Standard (APS) 5: Appointed Actuary And Principles Of Life Insurance Policy Illustrations

- Disclosure of Lapses, Surrenders and non- forfeiture provisions

IRDAI Non-Linked Insurance Products Regulation, 2019

The regulation defines the Surrender Value (SV) to be:

SV = Max(Guaranteed Surrender Value (GSV) , Special Surrender Value (SSV))

GSV = Premiums Paid * SV Factor + SV of Subsisting Bonus

where,
SV Factor : Ranges from 30% to 90% depending on the policy year of surrender
SV of Subsisting Bonus : SV for the attached bonuses

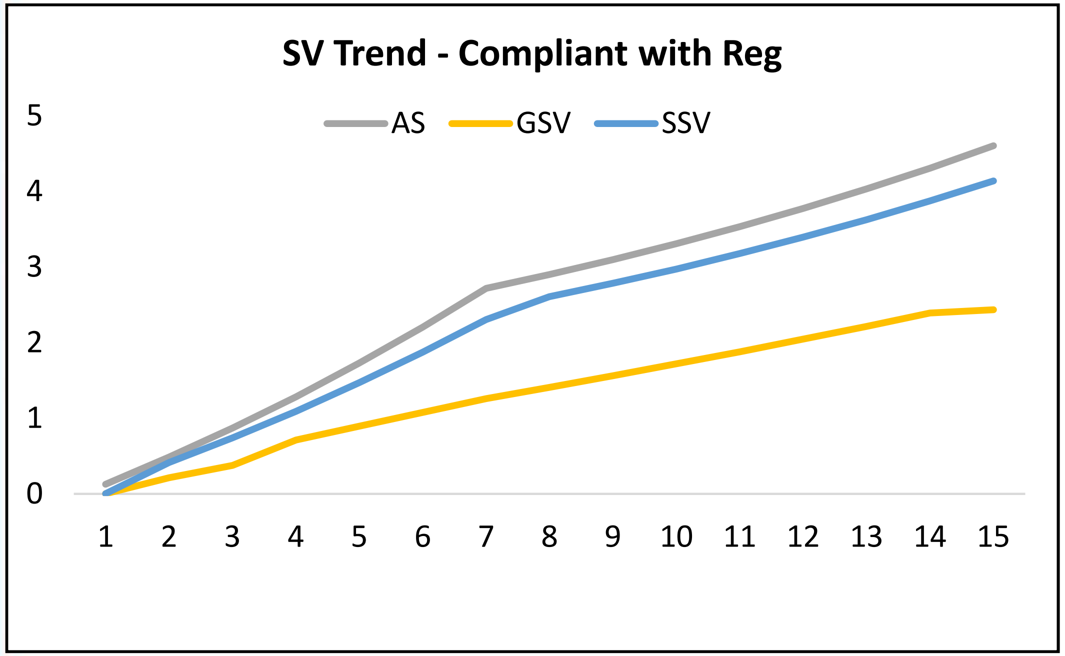
The SSV shall represent the asset share in case of par policies..

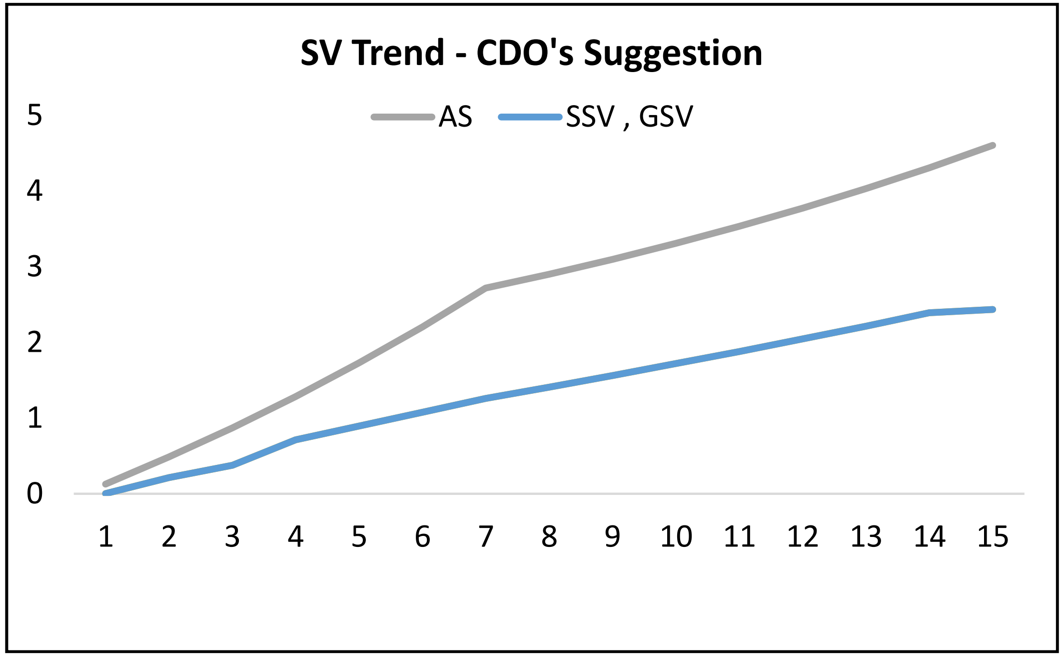
SSV = Asset Share * Target Distribution %

where,
Target Distribution % is as per company's discretion, subject to it being at least 90% post PPT (as per checklist requirement)

Our View
Regulations prescribe separate approaches for calculating GSV and SSV. Making SSV same as GSV, is not in in line with the regulatory requirement

SV Trend - Regs Compliant vs CDO's Suggestion





"The SSV shall represent the asset share in case of par policies" → *Not in Line*

GN6: Management of participating life insurance business with reference to distribution of surplus

Key points

*a) Surrender Values should have a **smooth progression**.*
*b) It should **gradually increase** with duration and be close to the maturity value towards the end of the policy term.*
c) Consideration of policyholder's reasonable expectations in respect of surrender values.

Our View:

Having SSV same as GSV,
- Doesn’t result in a smooth progression throughout
- There will be a significant difference between surrender and maturity values towards the end of policy term
- The values will be lower as compared to what a customer would reasonably expect to receive (although illustrated at sale)

APS5: Appointed Actuary And Principles Of Life Insurance Policy Illustrations

Key points

*If the illustration shows surrender values, it should clearly d**istinguish between guaranteed and non- guaranteed surrender values**.*

Our View:

- Showing same values under guaranteed and non-guaranteed only for surrender might be difficult to explain

Other Professionalism Aspect

Other Professionalism Aspect

IAI, Professional Code of Conduct

*The actuarial profession has an **obligation to serve the public interest** within the context of building and promoting confidence in the work of actuaries and in the actuarial profession.*

Our View:

- In order to better the maturity benefits, a reduction in surrender benefit is suggested
- The proposed surrender levels doesn’t ensure a fair return to the surrendering customers (especially the customers who have stayed with the company for long)
- Hence it doesn’t serve everyone’s interest

Any other reason for reduced sales?

Lower surrender value in initial years is a problem across industry. We need to investigate if there is any other problem which is contributing.

Other reasons for reduction in sales could be

- Issues with **Point of sale** and **On boarding** journey
- Concerns with customer **Policy Servicing** experience.
- **Changing needs** of the target market
- Perception of **lower claim settlement**
- Issues with **underwriting** timelines and processes

Possible solution for improving persistency and sales:

Need Based Selling

- Product Pitch as per target market

Commission Claw Back Arrangement

- Control on Miss selling

Additional Training for Distribution

- Productivity Improvement

Easy On Boarding

- Simplified process where possible
- Minimum Iterations
- Reduction in TAT between Login and Conversion

Seamless Policy Servicing

- Digital Platform
- Continuous Engagement

Conclusion

Problem Statement 1
Introduction of TB in BI

- Not possible to reflect actual superior returns in BI
- Change in approach i.e. Introduction of TB will be accompanied with a reduction in RB which brings in the other aspects related to PRE, Competition etc.
- Alternative ways of showcasing performance

Problem Statement 2
Change in SSV

- Suggested change will not be in line with Regulations and relevant Practice Standards
- Moreover, it doesn't ensure fair treatment with customers
- Also, the ultimate objective for the proposed change i.e. improving maturity benefits doesn't look achievable on an expected basis

Thank You!

Q & A