Sanket Kawatkar
India

C3: Persistency and its impact on valuation of life insurers

Sanket Kawatkar
Practice Leader – Life Insurance, India
Milliman

Waves of Reforms…Oceans of Opportunities

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- The views and opinions expressed in this presentation are those of the author and not of the employer he represents

Why is good persistency important?

- Life insurance – long term business
- Cost structures - designed to generate policyholder value in the long run
- Adverse social implications due to poor persistency
- Poor persistency results in lower supply of “long term” funds
- Bad press / reputation – not good!

Policy lapse rates from other markets

Singapore

- First year lapse rates – approx. 1.5% - 2%
- Total lapses by policy year 5 – approx. 10%

Hong Kong

- Overall lapse rates – approx. 5% - 8%

UK

- First year lapse rates – approx. 10% - 12%
- Total lapses by policy year 3 – approx. 30%

Indonesia

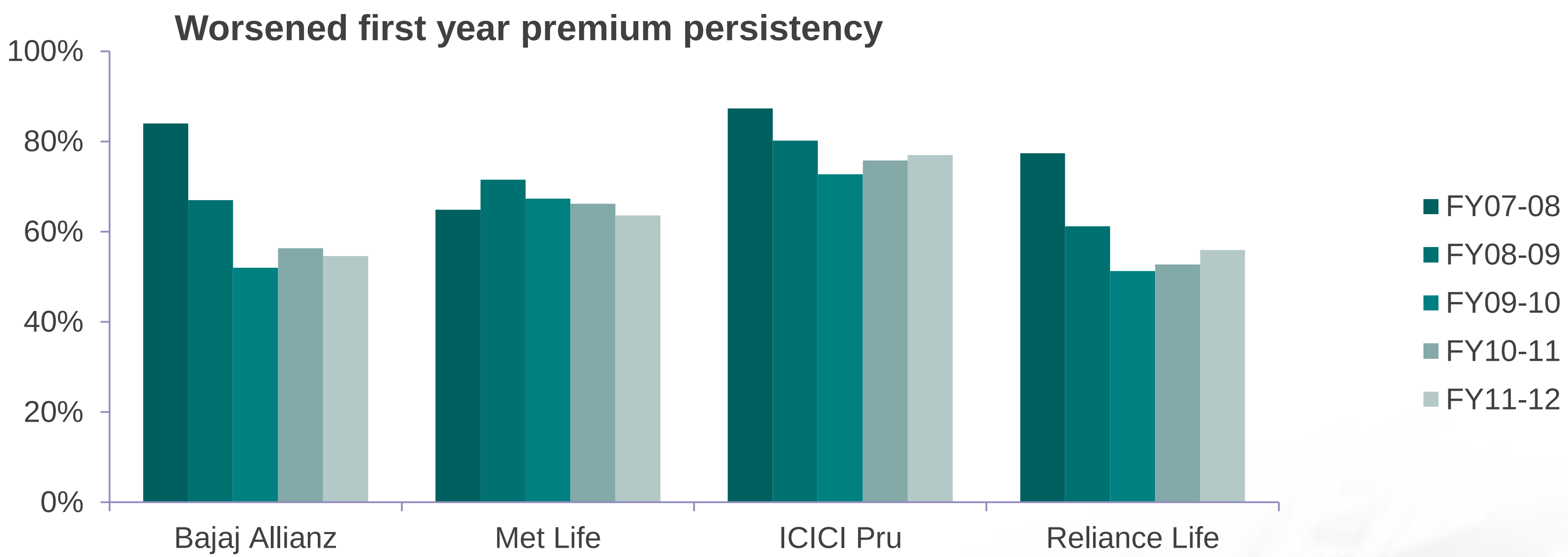
- High (e.g. 25% - 35% first year)

Sri Lanka

- High (e.g. 35% - 45% first year)

Source: MAS (Singapore); OCI (Hong Kong); FSA (UK); Authors' experience (Indonesia / Sri Lanka)

Indian experience: examples



***Source**: Company public disclosures*

Lapse rates

- High
- First year lapse rates typically around 25% - 50%
- Approx. 50% - 70% of the business is lapsed within first 3 policy years

Does anybody benefit from high lapses?

- Distributor?
  - High upfront commission vs. lost renewal commission
  - Short term gain vs. long-term loss
- Shareholder?
  - Lapse profits or expense inefficiencies?
  - High valuations? Sustainable?
  - Regulatory intervention?

How well do we know the actual lapse experience?

- Have we analysed experience in detail?
  - Policy surrender or premium discontinuity
  - Surrender of paid-up policies
  - Revival experience
  - Partial withdrawals
  - By mode of premium payment
  - By distribution channel
  - By product / product line
  - By policy size
- Do we have sufficient credible experience to analyse?
  - Pre vs. post September 2010 policies
  - Impact of changing product strategies
  - Impact of volatility in stock market performance
  - Impact due to changing distributor behaviour
  - How about policy lapse rates beyond 10 years?

Valuation of life insurers

- Several questions, but no clear answers:
  - What is the “best estimate” lapse / surrender assumption?
  - What’s the new business margin for products sold in India?
  - What is the appropriate level of valuation of life insurance businesses in India?

Example: new business margin in ULIPs

Regular premium ULIP (post September 2010)

- Policy term – 10 years
- Premium – 25,000, SA - 250,000
- Male 35
- Other projection assumptions – A set of typical assumptions seen in the market

Lapse rates – 25% / 10% / 5%+ / 15% / 5%+

- New business margins – 8%

Lapse rates – 50% of the above level

- New business margins – 12%

Lapse rates – 150% of the above level

- New business margins – 5%

Lapse rates 25% / 10% / 5%+

- New business margins – 9%

Lapse rates 20% / 10% / 5%+ / 3%+

- New business margins – 10%

How can we advise our clients?

- Do not change margins / valuations by:
  - Adopting a lower surrender value scale (e.g. in traditional products)
  - Increasing / decreasing the lapse experience
- Be truthful and frank – we don't know much about the future likely lapse / surrender experience
- Illustrate profitability margins / valuations at a range of scenarios and "educate" our client
- Educate our client on the implications of different levels of lapse / persistency rates on different products, e.g.
  - Current unit-linked products – "low" lapse rates may increase the margins
  - Current traditional products – "low" lapse rates may generally decrease the margins
- Design products that minimise the surrender / lapse profits / losses (to the extent possible!)

Thank you!