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Strategic Dilemmas and Opportunities for Indian life insurers

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Evolving Frontiers, Exciting Prospects

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Light touch product regulations, equity growth and distribution land grab led to high growth, some of it frothy

Product regulations

- Largely left to the Appointed Actuary for fairness and adequacy
- 2002 Distribution of Surplus regulations introduced 100:0 surplus distribution thus paving the way for unit-linked and other non-par products

Equity market growth

- Strong growth in equity markets along with strong nominal GDP growth abetted ULIP sales
- Product forms such as Highest NAV ULIPs seemed to provide upside participation along with downside protection

Distribution capacity

- Life insurers grew distribution capacity rapidly
- Focus on quantity of business, less on the quality of sales

Regulatory changes have been a constant feature during the last five years

FY 2008-09 | FY 2009-10 | FY 2010-11 | FY 2011-12 | FY 2012-13 | FY 2013-14

FY 2008-09

Q2 | Q3
Equity Market crash led to a sudden downturn

FY 2009-10

Q3
Insurers started responding to economic slowdown & drop in demand of investment products

Q4
RIY1 ULIP guidelines come into effect leading to rationalisation of commissions & cap on charges, thereby impacting margins –also saw tontine designs

FY 2010-11

Q3
RIY2 ULIP guidelines enforced. Commissions & margins on ULIPs take a hit. ULIP share in product mix started reducing

Q3
Guidelines Related to Third Party Distribution Tie-ups Impacted some corporate agency and referral arrangements

FY 2013-14

Q3
Group Product Design Guidelines : Group portfolio rejigged

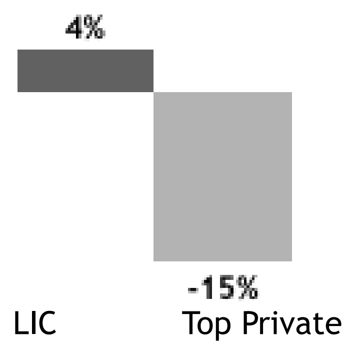
Q3
New Product Design Guidelines - Phase 1: Non par index linked and Highest NAV withdrawn

Q4
New Product Design Guidelines - Phase 2: Replacement of complete portfolio

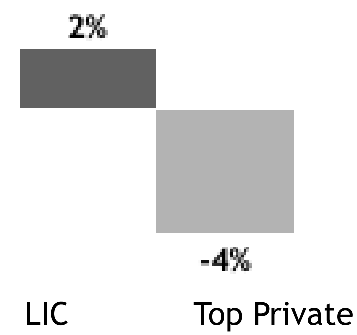
New Standard proposal form to be effective 1st Apr, 2014 – ***now deferred***

Industry has contracted significantly since its peak in FY10

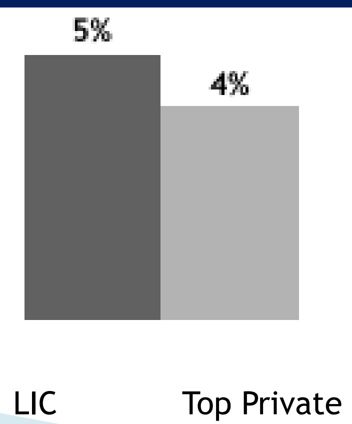
Individual Adjusted FYP (CAGR: FY10-FY13)



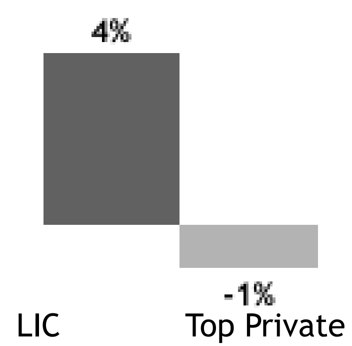
Individual + Group FYP (CAGR: FY10-FY13)



Renewal Premium (CAGR: FY10-FY13)



Gross Premium (CAGR: FY10-FY13)



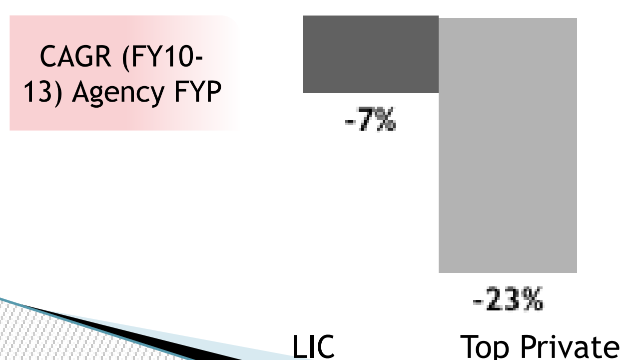
Source: IRDA, Public Disclosures of Respectiv[illegible]ers, Life Insurance Council, Market Sources

Agency and Third Party Channels have been on the decline with financial viability challenged due to regulatory changes

Decline of Agency

Agency channel struggled across players owing to:

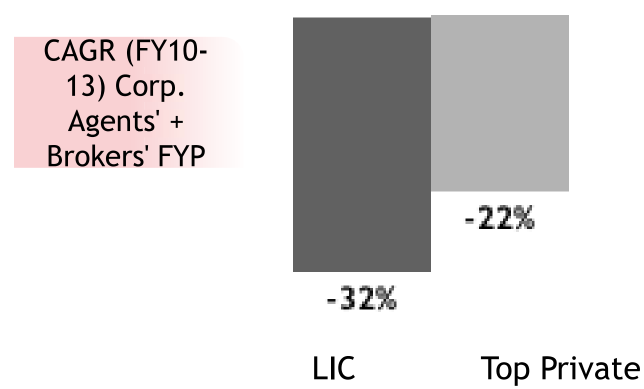
- Aggressive restructuring of mass agent distribution model (to raise productivity for covering frontline managers' costs)
- High agent and SM attrition with low activity levels
- Increasingly difficult quality recruitments owing to adverse 'give get' equation for agents



Decline of Third Party Channels

Both Corporate Agents & Brokers suffered since 2010

- Capping of expenses chargeable to policyholders under ULIPs significantly challenged channel economics
- Restrictions on referral tie-ups
- Guidelines on licensing of corporate agents



Source: IRDA, Public Disclosures of Respectiv[illegible]ers, Life Insurance Council, Market Sources

Significant decline in ULIPs after the regulatory changes; Traditional products maintained distributor value proposition

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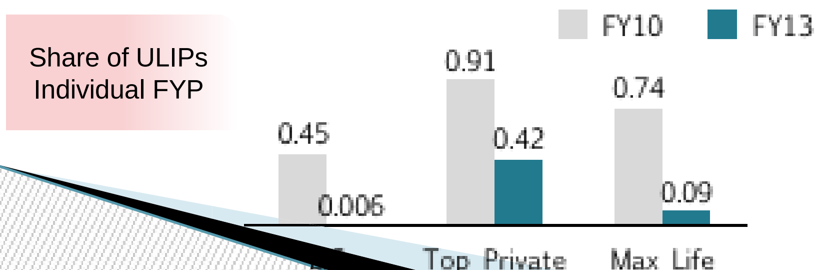
Key developments in the products space since Sep 2010

- ***Highest NAV Guaranteed ULIPs gained traction at all major players other than Max Life***
  - However, only players with strong banca pursued these ULs till Sep'13 (Reliance Life & Bajaj Allianz withdrew by 2011)
  - Product form discontinued by the IRDA from Oct 2013
- ***Rise & fall of index linked non-par products:*** With ULIP margins hit by 2010 guidelines, and par designs requiring profit sharing, index linked products provided a strong option to raise margins
  - Several players saw a high contribution from this segment in FY13
  - Product form discontinued by the IRDA from Oct 2013



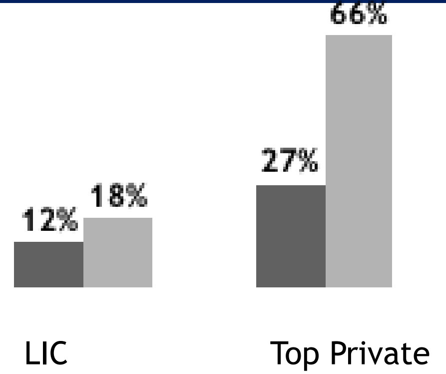
- ***Shift to limited pay products:*** To maintain distributor & customer interest, most players shifted focus to limited pay products (mostly participating) with low cover multiples
  - However, 2012's budget raised the minimum cover multiple for tax benefits to 10X thus leading to increase in both average payment terms & cover multiples
- ***Emergence of online space as a 'channel':*** Till FY10, few insurers had adopted digital as a viable channel
  - In FY14, there are 15 players in the digital space with a focus on protection solutions. Though, other segments are also being developed (e.g. annuity product by LIC, ULIPs by ICICI Pru)

PAR: Non PAR: ULIP	FY10	FY13
HDFC Life	19:1:80	34:5:62
ICICI Pru	1:1:98	5:40:55
SBI Life	5:2:93	28:30:42
Max Life	21:5:74	76:15:9

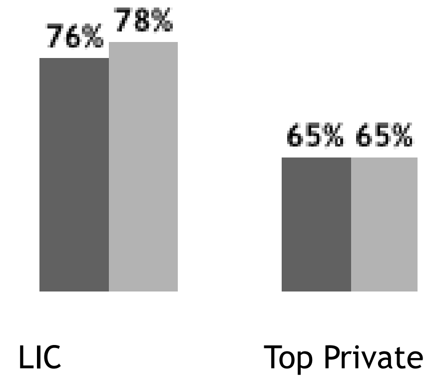
Source: Market Sources

Despite significant efforts to improve customer retention, surrenders have significantly worsened

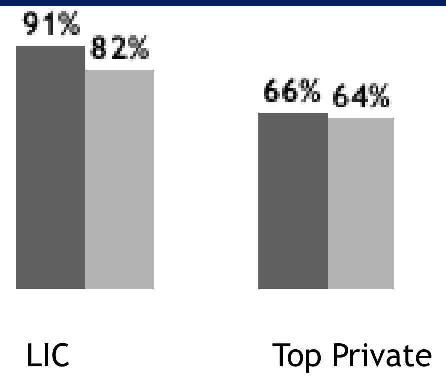
Surrenders to Gross Premium ratio (surrenders wiping out linked book for the industry), FY10 and FY13



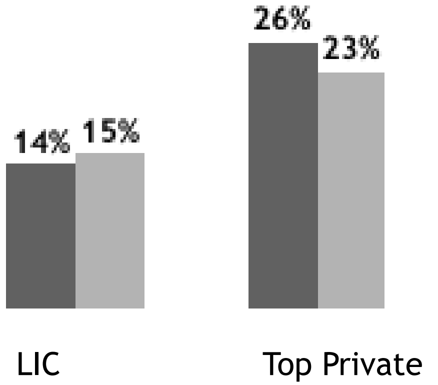
Average 13th month persistency remained flat for the industry despite significant persistency efforts



Conservation ratios dropped across the industry



Limited success in improving cost ratios



Source: Market Sources

Regulatory changes will continue to drive changes in the industry

Distribution/ Customer Acquisition

Agency:

- Minimum persistency standards
- Guidelines on opening/ closing of offices
- Multi tiered variable structure

Bancassurance:

- Open Architecture (Banks as Brokers)
- Restrictions on Compensation

Brokers/ Sub Brokers:

- Introduction of retail broking

Market Conduct:

- Standardization of proposal form
- Fact finder & customer consent

Customer Value Proposition

Product Design:

- Prescriptive guidance on product creation
- Commissions linked to premium payment tenure

Common Service Centers:

- Guidelines for utilization of CSCs to improve insurance penetration in rural markets

Changes in Illustrations:

- Customized benefit illustrations at 4% & 8% (vs. 6% & 10%) with mandatory customer signature

Governance, Risk &Compliance

Anti Money Laundering:

- Stringent KYC, AML Audits

With Profits Committee:

- With Profits Committee at Board level to review Par fund financial management

Operational Readiness:

- System & process readiness certification before product launch

Service Tax:

- Tax Audits, Litigations around payouts

Dematerialization:

- Establishment of repository for e-policies

Outsourcing Guidelines:

- Outsourcing policy to be duly approved by Board

LEGEND

- Announced/ Implemented
- Draft/ intent released

Overseas regulatory changes, changing Indian demographics will further fuel changes in the industry over time

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IFA type models

- Producer paid commissions likely to be under pressure - in particular for investment type contracts.
- Life insurers would need to focus on Protection products or differentiated investment products
- New/modified forms of distribution would need to be tested

Indian demographics

- Significant proportion of young population implies potential demand for risk and savings products. Technology could be a key differentiator to reach out to this segment
- A significant number of retired/close to retirement population along with changes in social fabric implies demand for retirement products including annuities and reverse mortgage type products

Dilemmas (1/2):

Product risks on the rise, distribution continues to become more expensive: Is the customer truly winning?

Product differentiation becoming an arms race?

- ***ALM Risks on the rise:*** Non-par guaranteed savings products being marketed with limited or no ability to hedge the interest rate risk
- ***Longevity Risk coming on balance sheets:*** Currently limited but with the withdrawal of Open Market Option, insurers are increasingly writing immediate annuity business. While bulk of this is with return of premium, as the NPS market also expands, the risk will increase. Risk transfer solutions such as reinsurance not currently available
- ***Mortality risk with term pricing:*** Term pricing particularly online term pricing places significant reliance on good quality underwriting, detecting frauds and good long term experience. Most products have rate guarantees extending beyond 30 years.

Distribution Channels becoming more expensive

- ***Agency costs not coming down*** despite significant cost cutting due to high levels of agent and SM attrition
- ***Bancassurance in a state of uncertainty***: While the focus has been on bancassurance particularly penetration of branches and productivity improvements, banks are increasingly demanding higher compensation. Regulatory changes such as the broker regulations have prevented new corporate agency agreements.
- ***Online but not disintermediated***: Is it truly the beginning of disintermediation? While there are many refreshing aspects of the rise of online business, a significant factor continues to be the involvement of agents for “assistance”, third party web aggregators fees prevent the distribution costs coming down dramatically

Source: Market Sources

Dilemmas (2/2):

Poor quality of business and flat yield curve impeding the industry from improving customer value proposition

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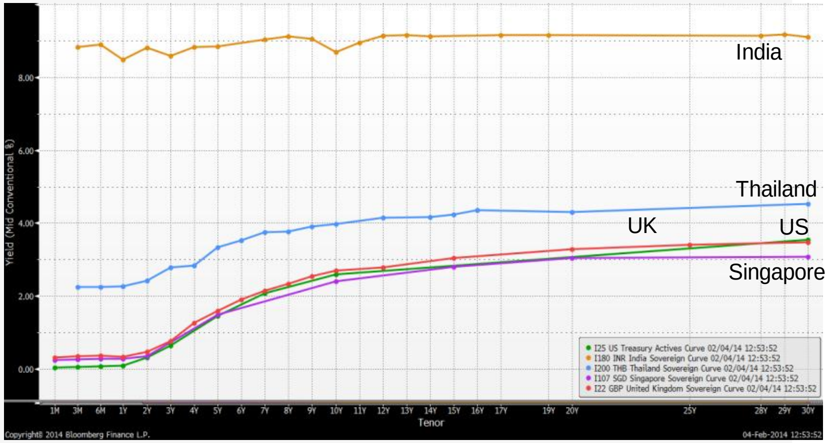
Poor persistency and high surrenders indicates a lack of trust

- ***High acquisition costs require a reasonable amortisation period:*** 20% customers continue paying premiums beyond five years, 10% beyond 10 years. Most customers are not receiving even their money back.
- ***ULIP Auto-terminations eroding trust:*** Many ULIPs sold prior to Sep 2010 had high up front charges and customers are getting their policies auto-terminated with one premium leading to low levels of trust
- ***High levels of agent attrition associated with poor persistency:*** Vicious cycle where the agents find the business tough, thus high levels leave within the first year. Most of the sales for insurers comes from agents in their first year. This leads to poor outcomes on both sides.

Flat yield curve working against long term savings

- ***Low term premium works against long term savings:*** Life insurers are at a structural disadvantage due to the flat yield curve



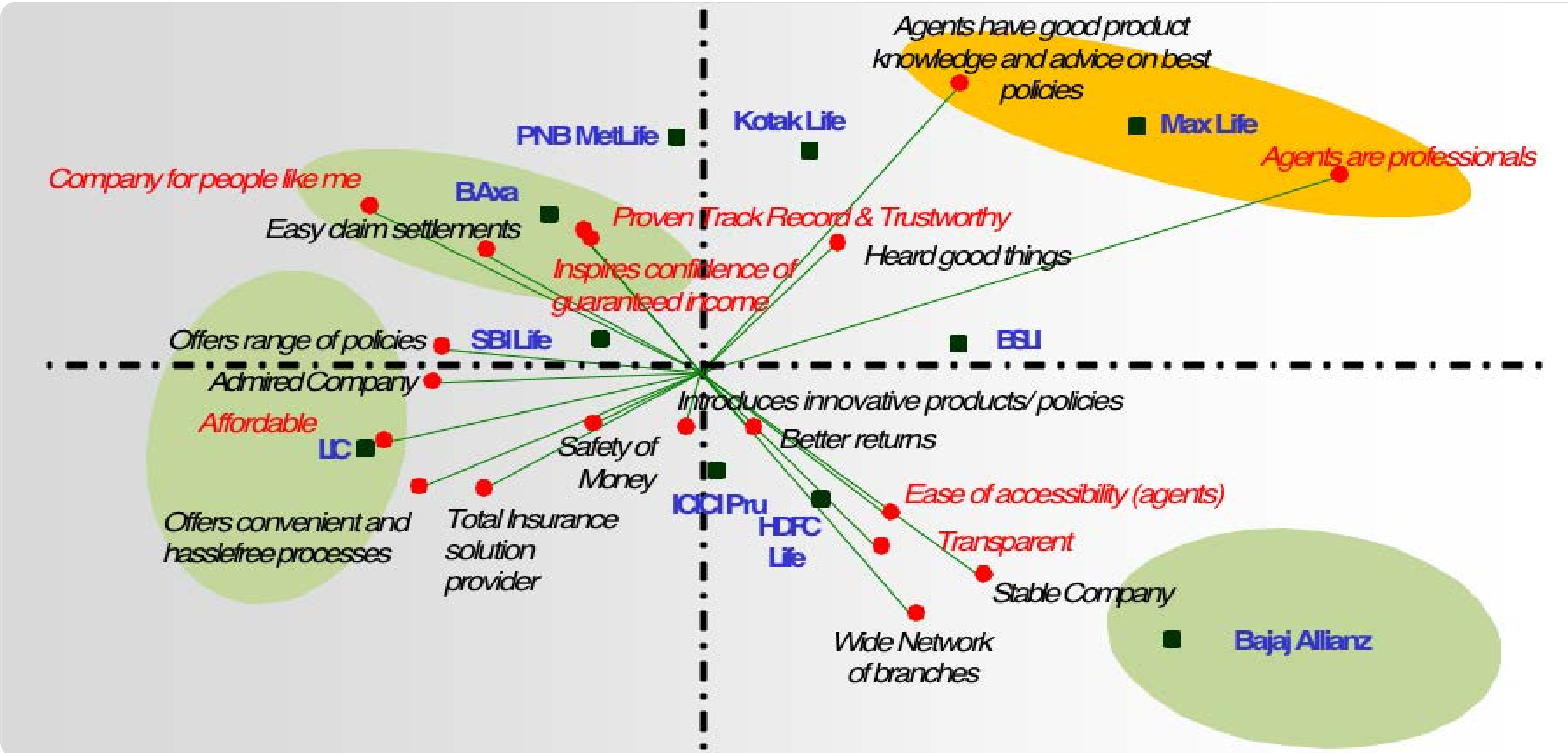
- ***Compared to many overseas markets, Indian life insurers at a structural disadvantage compared to banks operating at shorter end of the yield curve***

Source of earnings shifting to investment, mortality and expense
Life insurers need to work harder to maintain earnings or take on more risks for the same level of earnings

Source: Market Sources

Opportunities (1/4):

Early signs of brand differentiation, can we do more?



- Brand positioning chart is based on the correspondence analysis which is a perceptual mapping technique (association between different brands and imagery data)
- Correspondence analysis condenses data with several dimensions into two-dimensions - simplifying the complex relationships.
- This analysis depicts the relative position of the brands and attributes on a map

Source: Nielsen, Life insurance brand track report, July to Sep 2013, sample size 21,000

Opportunities (2/4):
No significant shifts in customer preference; Deepening opportunities exist

	Information/ Data points	What does it mean for us?
Presence of Mass affluent	• Top 20% ($4,000 per capita) of Indian households account for 40-50% of total household consumption and 50-60% of household income • Half of this group is in urban Indian and half in rural	• 70-80% of the urban mass affluent are present in the Top 150 cities
Deepening opportunity	• Sec A,B,C is over indexed with respect to Insurance penetration; Over 70% household have insurance ownership (Indicus Financial Scape 2011-12) • 'Life Insurance Owners' are 12.5 times more likely to purchase LI compared to 'Non Owners' (All Adults 24+, SEC ABC, Source TGI 2011 (IMRB), Sample size: 51445)	• Identified segments have higher affinity for sale
Awareness and service	• Awareness on financial products have significantly moved up from over last few years (Nielsen syndicated brand track) • In the MA+ segment 'Service' is quickly becoming a differentiating aspect to choose a LI company (Nielsen - affluent market study)	• Continue focusing on digitization initiatives to enhance CRM and service excellence
Insurance coverage	• Despite increase in annual incomes, current Life Insurance coverage is very low at 1.07 times of annual income (Nielsen research among SEC ABC households in 17 cities)	• Protection with cash value to become important over a long run

Source: Basis multiple MR researches and Indicus database

Opportunities (3/4):

Creation of efficient & Sustainable distribution, Extraction of Value from IF Book and Consolidation

	Information/ Data points	What does it mean for us?
Viable Distribution	• Agency Commissions have dried up making it increasingly difficult to attract and retain quality agents • Uncertainty regarding bank as Broker regulations	• Need to improve Agent Value proposition • Creation of viable Agency model – enabling a tiered Agency Model • Corporate agent/ Broker -Establish a comprehensive IFA framework - Financial planner approach. Enable parity on overall expenses • Bancassurance – Navigate Open architecture/Broker regulations
Extracting of Value from IF Book	• Value of life insurers largely driven by IF EV. Value of future new business has gone down significantly due to squeeze in margins and negative sales growth leading to VNB at current costs being negative for some insurers	• Investment income is likely to be the single most important source of surplus for many insurers. Upside risk opportunities exist in this area using optimization techniques and being on the efficient frontier • Front ended products are behind us making persistency a critical driver of value. Sharp analytics and focused execution key to manage persistency • Need to manage costs
Consolidation	• Exit of NYL, ING as Intl JV Partners • Exit of DLF as Indian JV partner • Certain others looking to exit because of reduced attractiveness of the industry	• Large scale would be key for insurers who wish to span multi distribution channels and multi product lines and derive economies of scale • Players interested in M&A may have different objectives in considering such transactions • High level of regulatory uncertainty on distribution in particular banks as brokers makes this a challenging time to execute M&A

Opportunities (4/4):

Differentiated product & service offerings, technology trends and GRC focus requires industry to up skill

	Information/ Data points	What does it mean for us?
Product Offerings	• Online Term market has been a key focus area for companies in recent times • Margins have dried up in traditional savings type products	• Health riders and Retirement products an area for future • Significant up skilling and infrastructure requirements in areas of UW, fraud management, longevity, ALM e.g. fraud bureaus, Centralised UW data repository, longevity- catastrophe bonds and reinsurance • Leadership stance on national issues – owning retirement agenda, developing corporate bond market and market for ZCBs/strips
Technology	• Technology as a tool to reduce costs and increase productivity	• Deploy Private Cloud in the Data Centre to optimize cost and get future ready • Transform Sales & Service processes by digitizing them onto a CRM framework and providing access through Mobility based solution deployment
Governance & Risk Management	• New Company Law • Development of RBC/Solvency 2 framework	• Strong financial controls and Board reporting mechanisms • Improve conduct and raise trust levels with customer. Sponsor awareness building, establishing grievance cells, customer contact centres etc for appreciation of product forms and uniqueness • Comprehensive dashboard for industry statistics not focussing overly on new business performance. Encourage EV reporting along with good disclosures • Strong Governance, Risk and Compliance frameworks and implementation

In Summary

Agency and Third Party Channels have been on the decline with financial viability challenged due to regulatory changes. Significant decline in ULIPs after regulatory changes leading to margin squeeze.

Regulatory changes likely to continue with focus on the customer and distribution models

Product risks on the rise & distribution continues to become more expensive

Poor quality of business and flat yield curve impeding the industry from improving customer value proposition on investment products

Opportunities for Insurers

1. Brand differentiation
2. Deepening opportunities at existing locations and existing customers of life insurance
3. Creation of efficient & Sustainable distribution, Extraction of Value from IF Book and Consolidation
4. Differentiated product & service offerings; use of technology and implementation of strong GRC framework and implementation
5. Treating customers fairly to bring back their trust in the industry