19th India Fellowship Seminar

Product Designs – Impact of new regulations on the traditional products of Life Insurers

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Objective

To study the impact of new regulations on the design of traditional products of Life Insurers

To study the issues arising in Product Design

To study the challenges faced by Actuary in complying with these Regulations

Agenda

- *Legislative Requirements & Professional Guidance*
- *Product Structure*
- *Miscellaneous Provisions*
- *Impact on Product Design*
- *Summary*

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Legislative Requirements

- IRDA (Appointed Actuary) Regulations, 2000
  - To ensure that premium rates of the insurance products are fair
  - Giving actuarial advice to insurers in the areas of product design, pricing and insurance contracts wordings.
- As per "File and use" procedure, Appointed Actuary has to sign off products' terms and conditions stating that the *premiums and terms are workable and sound, assumptions are reasonable and the rates are fair*.
- Full Compliance with Products Regulations, 2013.
- Policy document issued to the policyholder should truly reflect all features of product and should be filed with "File and Use".

Role of AA is very critical for the company as well as Policyholder

Professional Guidance

APS 1- Appointed Actuary should have regard to

- The premium rates on which the company has written existing business and intends writing new business
- The nature of the contracts in force and currently being sold with particular reference to all options and guarantees
- In order to conduct business on sound financial lines, Actuary should ensure premium / charges are appropriate making the product financially viable and generate acceptable level of profitability.

APS 5 – Benefit Illustration

- To ensure new policyholders are not misled and premium / charges are in line with market price of risk covered.
- To ensure that point of sale documents assist prospective policyholder to understand features of products and flow of benefits.

Is there a need to revisit APS 5 in light of new regulations?

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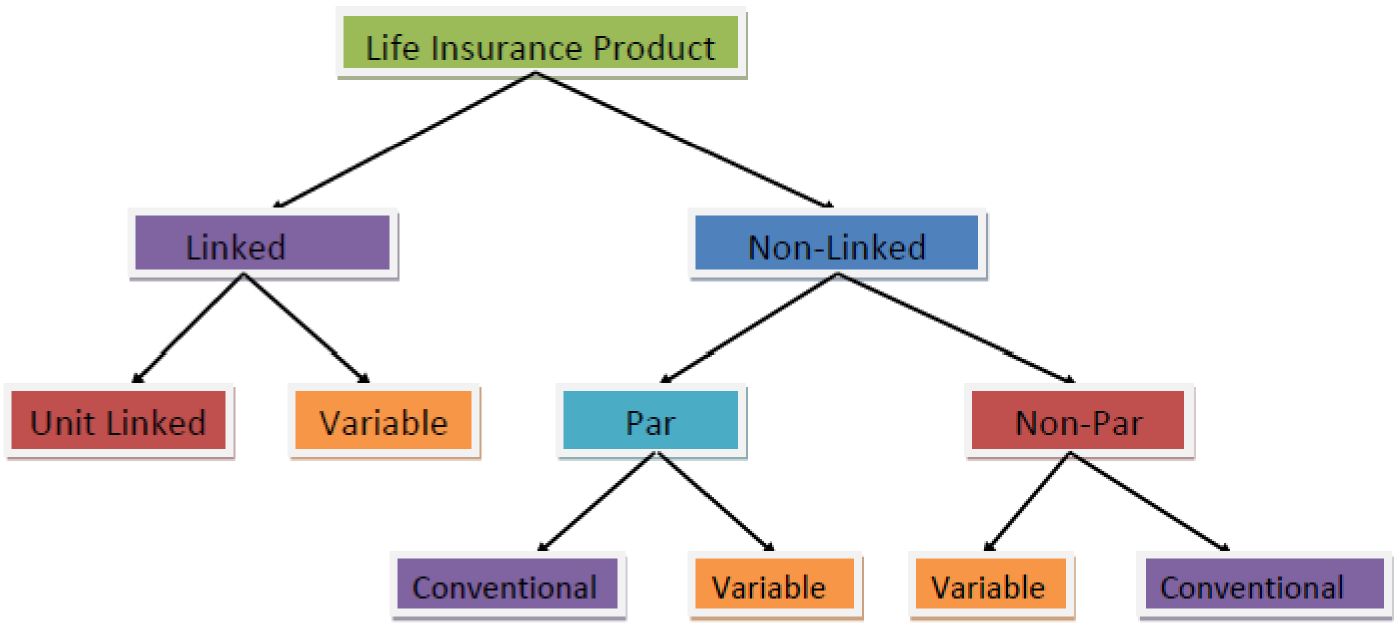
Product Structure



A new classification -Variable Linked has been introduced

Innovation will require suitable justification in regards to benefits to policyholders, market research done, etc.

Variable Par

- Death Benefit
  - Two Options
- Maturity Benefit: PAV + Terminal bonus
- Layers of additions to PAV
- Charges, SV, Discontinuance terms, Top-ups – Linked Regulations
- Shadow Policy Account, PAV - Transparency

How to allocate for bonuses in view of reduction in yield requirement? – Challenge for Actuaries.
There are some unanswered questions – Practical work would answer these

PAV: Policy Account Value

Variable Non-Par

- Death Benefit – similar to Variable Par
- Maturity Benefit : PAV
- Layers of additions to PAV
- Charges, SV, Discontinuance terms, Top-ups – Linked Regulations
- Shadow Policy Account, PAV – Transparency

Higher capital requirement and higher guarantees
To accommodate required return to policyholder – Product structure seems a little complex – especially for Fund Based group products & Group Savings VIP

PAV: Policy Account Value

Death Benefit – other than VIP

Premium Type	Age of LA<45 years	Age of LA>=45 years
Single Premium	Highest of 1.25 of SP, SAD & SAM	Highest of 1.10 of SP, SAD & SAM
Other than Single Premium	Highest of 10 times AP, 1.05 of ∑P, SAD & SAM	Highest of 7 times AP, 1.05 of ∑P, SAD & SAM

Similar to ULIPs
Additional benefits/bonuses accrued has to be paid over the minimum DB
More onerous for conventional par – in comparison to non-par
Current multiple much lower for short duration policies

Death benefit will increase with policy duration
Existing structure of Endowments with single SA for Death or Maturity - Challenge
Same multiple of premium will not be supported equally across all ages and terms

SAM: Sum Assured at Maturity SAD: Sum Assured at Death AP: Annualised Premium

Death Benefit (contd…)

For Existing Products

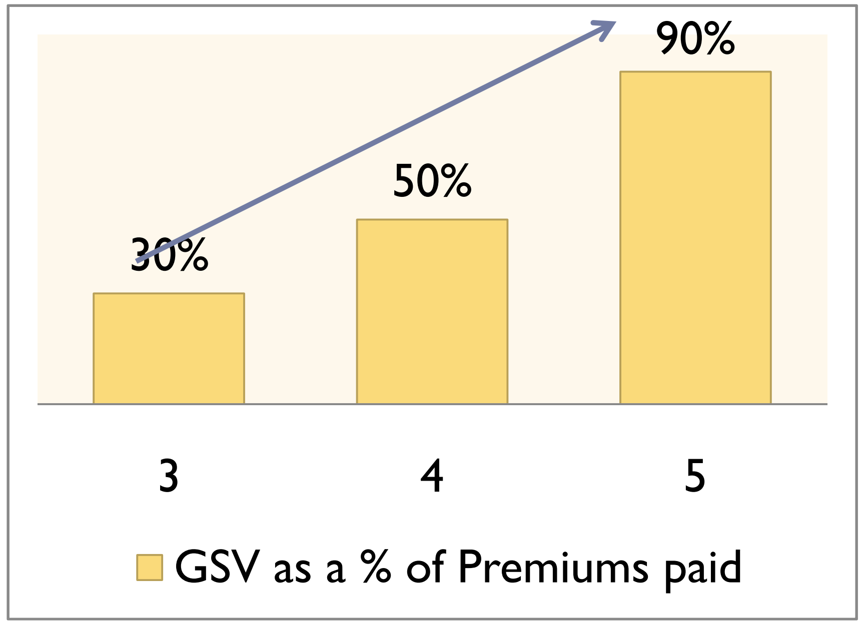
- Nearly all the participating products would be withdrawn
- Premiums need to be reworked to align with these criteria
- It would be challenging to design savings product for higher ages or shorter terms with reasonable return to policyholder

For New Products

- Protection oriented product will be favoured
- Shift from shorter terms to term of 10 years or more
- Different SA at Maturity and Death
- Product with SAD being twice the SAM
- There could be modification in proportion of RB and TB

Surrender Value

- GSV dependent on premiums paid
- Steep increase in GSV across the term
  - For a policy with term of 6 years
  - GSV in 2nd & 3rd year : 30% of Annualised Prems (AP)
  - GSV in 4th year : 50% of AP
  - GSV in 5th year : 90% of AP



In long run – Good for Policyholders as well as for Companies.
Operation of company comes under pressure as they have to manage business optimally within lower expenses.

Surrender Value (contd…)

Need to file indicative SSV – ensures insurers to think about SSV right at the time of filing.
Increase in SV - Policyholder liquidity increases

For Existing Products - GSV needs to be increased in nearly all the products

For New Products

- Increased GSV will lead to lower Equity Backing Ratio to service the high surrender guarantee
- There could be adjustment in the proportion of RB & TB to keep the guarantee low
- Shift towards minimum policy term of 10 years

Impact of high GSV – How to set Assumptions Withdrawal & Expense?

- High GSV – Good from policyholder perspective
- Policy holder behaviour? - No relevant prior experience
- Challenging to set assumptions

Impact of High GSV

High GSV → Lower Free Assets → Lower Investment freedom → Lower expected return

High GSV → ? Policy holder behaviour → Higher surrender at extreme conditions → Surrender Losses

Calculation of SSV more transparent
Impact on investment return

With Profit Fund Management

- Policy level Asset share
  - Appropriate allocation of Expenses & Investment return
  - AA responsible for determination of Asset Share
  - Determination of Asset Share as per GN / APS
  - Detailed working of Asset Shares to be approved by WPC
  - As a guide for Surrender & Maturity Benefits
  - To help the smoothing process for maturity values
  - Guide to the appropriate level of regular bonuses
  - Determining the level of payouts to with-profits policyholders and as a tool for the consideration and quantification of TCF (treating customers fairly).

More transparency
Need to revisit GN 6?

WPC: With Profit Committee

With Profit Committee – Role of Actuary

- Members of WPC – One Independent Director, CEO, AA & Independent Actuary
- To approve expense allocation to participating fund
- To approve investment return credited to participating fund
- To approve working of the Asset Share
- To treat customer fairly while deciding on discretionary benefits

WPC: With Profit Committee

Pension Products

- Assured benefit on Death & Maturity – lower Equity backing ratio
- On death - vested bonuses / accrued additional benefits need to be paid
- Non-zero positive rate of return on the premiums paid on death or maturity / vesting
- Option to extend the accumulation period if policyholder is less than 55 years – tough to allow in par product
- Option of Annuity to be provided to nominee in case of death of LA – lead to pricing of annuity from age 0
- Annuity to be provided from same company

Assured Benefits – Better for policyholders

Group Products

- Classification seems to be repeated?
  - Fund based group/ Group savings
  - Term/Credit Life/OYRT etc.
- Traditional fund based group products now move into the VIP classification
  - More regulation around the setting of interest credits?
  - Frequent interest credits have implications for asset strategy?
- Credit life premiums will need to be ‘aligned’ with pure term products
  - Group/Individual term products?
  - How do we show the alignment?

Group Products

- Market Value Adjustments now more rigorously defined
  - Further definition required?
- Reduction in surrender charges gives reduced scope for commission without an allocation charge
  - No lock-in period for groups
- Guidelines do not specifically prohibit short pays, but the IRDA may interpret this way

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Commissions

- Commission or remuneration in any form is capped
- Commission dependent on PPT
- For many group lines, maximum ceiling on commission imposed
  - Role for brokers?
- RinY requirement
- Shift towards simple products?

RinY: Reduction in Yield

Other Provisions

- Products with advance premium features would not be allowed
- Variable premiums products are not allowed
- Top-up should have corresponding insurance cover equal to single premium
- Products with misleading names are not allowed
- Each product should clearly mention its objective
- Greater importance on disclosure
- Standardised definitions in health products

Better protection to policyholders' interests

Other Provisions (contd…)

- 4% and 8% illustrations – in line with existing return to policyholders
- Regulations codify the need to have consistent features across products and insurers, and specifically mention the power to withdraw features at a later date
  - Self-regulation?
  - Consolidation of products?
- Challenging to design product in light of changes in reinsurance regulation

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Impact on Product Design

- Benefits
  - High Death benefit – Increase in Insurance benefit
  - High Surrender Value – Increase in liquidity for policyholders
  - Lower charges – Higher return to policyholders
  - Less discretion in the hands of company in benefits delivery
  - Would encourage sale of longer term policies – good for insurers
- Cost
  - Full reworking of existing products - Costly
  - Less incentive to innovate on product structure – to be justified by market research
  - Increased complexity – VIP
  - Certain products might be difficult to sell in the context of lower sales incentives – Actual situation will be clear in due course of time
  - High guarantee on products

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Summary

- Product Design
  - Similar Products – Ease of comparability for Policyholder
  - Increased Guarantees
  - More Liquidity
  - Reduction in Investment Freedom
- Pricing
  - Increased Mortality Risk
  - Increased Investment Risk
  - Increased Lapse Risk
  - Increased Expense Risk

All these risks are expected in Life insurance - Challenge for Actuaries to manage these better and hence pass more return to policyholder


Questions?
Suggestions?

Thank You